THIRD WAY REFORMS: A COMPARATIVE STUDY OF SOCIAL DEMOCRATIC WELFARE STATE REFORMS AFTER THE GOLDEN AGE

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ABSTRACT

JINGJING HUO: Third Way Reforms: A Comparative Study of Social Democratic Welfare State Reforms After the Golden Age
(Under the direction of John D. Stephens)

The dissertation examines the welfare state and labour market reforms under social democratic governments in nine OECD countries across three main types of welfare state regimes after the Golden Age. Using a “most-different-cases” comparative research design, the dissertation makes four main contributions to the literature.

First, it proposes a theoretical framework for social democratic welfare reforms. As an “activation” based approach to social justice, the core third way strategies are focused on the expansion of active labour market measures. Secondly, the dissertation contests the “new politics of the welfare state” thesis that path dependency diminishes partisan effects on welfare reforms after the Golden Age. Thirdly, the dissertation argues that focusing solely on the welfare state proper, and social expenditure in particular, is inappropriate for welfare reform studies. Lastly, with regard to theories of institutional evolution, the dissertation highlights the importance of institutional innovation based on political contestation, as opposed to institutional reproduction based on path dependency.
To my wife
To my parents
ACKNOWLEDGEMENTS

I would like to start by expressing my gratitude to John D. Stephens, my adviser and mentor. During my four years at Chapel Hill, he not only guided me through the research and revision of the dissertation and other projects, but more importantly, helped me find my own place in the field of comparative political economy. For a dissertation of this length, he tirelessly went through its several phases of major revision, page by page. By learning with him, I have gained not only deeper insights about the fundamental political dynamics of social policy reforms, but also the tacit skills, expectations, and the level of discipline or persistence required for scholarship in comparative political economy. His dedication to his students is decisive in making this dissertation possible. Similarly, I would also like to thank the rest of my dissertation committee including Evelyne Huber, Gary Marks, Liesbet Hooghe and Donald D. Searing. As accomplished scholars, they have never hesitated in offering selfless help for inexperienced students like me. Their help has made the manuscript a better scholarly work, their encouragement has made me more confident about my possibilities in the field, and their modesty has shortened for me the distance between genuine scholarship and being a graduate student.

I would also like to thank my wife, Feng Hui, and my parents, Huo Wenhuan and Liu Xiaoping. It is their devotion and love to me that make the whole endeavor worth pursuing, for now as well as for the future.
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<tr>
<td>ACTU</td>
<td>Australian Council of Trade Unions</td>
</tr>
<tr>
<td>ALMP</td>
<td>active labour market programs</td>
</tr>
<tr>
<td>ALP</td>
<td>Australian Labor Party</td>
</tr>
<tr>
<td>AMS</td>
<td>Labour Market Board in Sweden</td>
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<td>ATP</td>
<td>supplementary earnings-related pension in Sweden</td>
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<tr>
<td>BA</td>
<td>Alliance for Jobs</td>
</tr>
<tr>
<td>CDA</td>
<td>Christian Democratic Appeal</td>
</tr>
<tr>
<td>CEC</td>
<td>Consolidated Employment Contract in France</td>
</tr>
<tr>
<td>CES</td>
<td>Employment Solidarity Contract in France</td>
</tr>
<tr>
<td>CIE</td>
<td>Employment Initiative Contract in France</td>
</tr>
<tr>
<td>CTC</td>
<td>Child Tax Credit in Britain</td>
</tr>
<tr>
<td>DPTC</td>
<td>Disabled Persons Tax Credit in Britain</td>
</tr>
<tr>
<td>EPAC</td>
<td>Economic Planning Advisory Council in Australia</td>
</tr>
<tr>
<td>FAS</td>
<td>Family Allowance Supplement in Australia</td>
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<tr>
<td>GSC</td>
<td>General Social Contribution in France</td>
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<tr>
<td>JEA</td>
<td>Jobseekers’ Employment Act in the Netherlands</td>
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<tr>
<td>JET</td>
<td>Jobs, Education and Training in Australia</td>
</tr>
<tr>
<td>Job-AQTIV</td>
<td>Law for Job Activation, Qualification, Training, Investment, and Placement in Germany</td>
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LOLE………………………………Law of Orientation for the Fight against Exclusion in France
NAF/NHO…………………………………………Norwegian Employers’ Association/
Norwegian Association of Business and Industry
NCS…………………………………………National Childcare Strategy in Britain
ND50+…………………………………………New Deal for the Unemployed Aged 50 and Above
NDDP…………………………………………New Deal for Disabled People
NDLP…………………………………………New Deal for Lone Parents
NDLTU………………………………………..New Deal for Long-term Unemployed
NDP…………………………………………New Deal for Partners
NDYP…………………………………………Neal Deal for Young People
NIT…………………………………………negative income tax
OTA………………………………………..Temporary Public Sector Jobs for Older Workers in Sweden
PARE……………………………………..Plan to Help the Return to Employment in France
PPE…………………………………………Employment Premium in France
RMI…………………………………………Minimum Income Insertion in France
SAF…………………………………………Swedish Employer’s Federation
SVR…………………………………………Social Insurance Council in the Netherlands
VUT…………………………………………Early Retirement Scheme in the Netherlands
WFTC……………………………………..Working Families’ Tax Credit in Britain
WTC…………………………………………Working Taxi Credit in Britain
YEA………………………………………..Youth Employment Act in the Netherlands
CHAPTER I

INTRODUCTION

In 1983, the French Socialist government performed one of the most famous U-turns in OECD economic policy. Only a few years before, the Socialists were still in alliance with the French Communists. Then, controlling both the presidency and the National Assembly, the Socialists introduced large scale nationalization and state intervention across industries and the labour market, only to be followed by a sharp turn away from *dirigisme*, towards privatizations, relaxation of labour market regulations and dismantling of industry assistance 18 months later. At the same time, the government expanded the French welfare state and put in place measures to increase labour market participation. In the same year, the Australian Labor Party came to power. Literally days after entering office, the Australian social democrats had floated the Australian dollar, as well as started dismantling decades of government control over the banking and financial sectors. Soon to follow was further comprehensive relaxation of protection and regulation for domestic industries, plus measures to tighten social benefits and encourage people to enter employment. A year later, the Labour Party came to power in neighbouring New Zealand, and it unveiled an even more radical policy package of economic liberalization and privatization of public enterprises. Meanwhile, elements of the New Zealand welfare state underwent cautious expansion. Around the same
period, the Swedish social democrats adopted a new “third road” approach to economic policy by drawing a distance from both traditional Keynesian demand management and neoliberal monetarist approach.

Clearly, the early 1980s signaled the start of the decline for the old social democratic way of managing the economy, the welfare state, as well as the labour market. On a more general level, there is a decline in the old social democratic way of mobilizing wage earner interests and delivering social protection. This book examines a “third way”, as the common alternative strategy chosen by social democrats to represent wage and salary earner interests and deliver social protection, after the unraveling of the Golden Age. This third way centres on reforms in social security and the labour market, and it mobilizes economic policy to create a necessary macroeconomic context for these social and labour market policy changes. This new way to social protection by the state is a “third way”: it is different from the traditional social democratic practice of relying on passive income replacement in the social security system; it is also different from the centre-right alternative since the 1980s, which placed comparatively more emphasis on cost restraint and direct withdrawal of the state from social protection. The term “third way” itself has been much popularized as a frequent mantra of New Labour under Tony Blair as well as the German social democrats under Gerhard Schroeder. However, this book shows that the British and German social democrats of the late 1990s are only two of the most recent representations of the third way reforms. These reforms went back to as far as the early 1980s for social democrats in various countries, and for much of the postwar period for the Swedish social democrats in particular. Overall, the principle of social democratic third way reforms is to encourage participation in the
labour market. Social protection by the state is now pursued in a proactive manner by helping the worst off to regain their source of income. This proactive strategy is gradually replacing the Golden Age defensive strategy of compensating for the loss of income in the social security system. In other words, in the third way, social protection is integrated with making a living, rather than in lieu of it.

**Main Theoretical Propositions**

*Theorizing the Third Way to Social Protection*

As a prelude to the third way to social protection, this book outlines both the “first way” and the “second way”. The “first way” is the traditional social democratic approach to social protection during the Golden Age, and the “second way” is the neoliberal alternative, adopted to different degrees by centre-right parties since the early 1980s. As a family of parties associated with interest representation for wage earners, the social democratic parties regard the provision of generous and comprehensive social protection as a central programmatic objective. In the first way to social protection throughout the Golden Age, the social democrats tried to achieve relative wage equality between the well and worse off within the workplace, through the suppression of wage dispersion. They also tried to achieve relative equality between the worst off (those with no source of income) and the rest (in the workplace), through income replacement in the social security system. Since the early 1980s, both types of social protection through the first way became more difficult. The economy is in the process of an ongoing shift towards the service sector. Private sector service jobs such as retailing and catering are typically low wage and low productivity jobs, and it is especially
difficult to rapidly increase the level of productivity from this bottom end of the service sector. With continuing wage compression, it is difficult for the increase in productivity to outstrip the increase in wages, and as a result wage compression in the private service sector leads to further increase in unemployment. Meanwhile, income replacement in the social security system is under strain in maintaining relative equality between those with and without the source of income. Rise in unemployment resulting from manufacturing decline pushes the expenditure side of the social security budget, and fiscal restraint resulting from growing capital mobility pushes its revenue side. As both core components of the first way become less reliable, this sets in train a drastically sharpened social justice crisis. The core symptom is a significant increase in the worst off members of the society as a result of labour market exclusion, which leads to social exclusion and exposure to various new social risks (Esping-Andersen 1999; Esping-Andersen 2002; Bonoli 2005).

Responding to the gradual decline of the first way, the social democrats rejected the neoliberal second way, which was increasingly advocated to differing degrees by centre-right parties. This second way to social justice believes in the power of private market in social security and monetarist fine-tuning in the macro economy. By contrast, the social democrats adopted a third way to social protection. The third way is sharply tuned to the core characteristic of the heightened social justice crisis since the early 1980s: increase in the worst off as a result of labour market exclusion. The fundamental third way principle is to increase participation in the labour market. Compared with the first and second ways, the third way broadens the strategies for social protection. Traditionally with the first way, social protection primarily takes place within the passive apparatus (the social security system).
Here, the loss in earning power is compensated financially but the status of loss is often maintained in the process. Now with the third way, social protection increasingly takes place through the active apparatus (the labour market). Here, earning power is actually regained. *Based on this logic, the core strategies of the third way include expansion in the active apparatus of social protection on the one hand, and active redistribution or retrenchment in the passive apparatus on the other.* These core strategies serve the purpose of pulling as well as pushing the inactive population into the labour market. However, these strategies decline in their usefulness when the labour market itself is shrinking as a result of slack in demand, investment, and growth in the economy. Therefore, beyond the core strategies, third way reforms also involve the creation of a macroeconomic context for competitive economic growth. Key features of this competitive growth context include a sound public budget as well wage moderation, The search for wage moderation, in turn, leads to the creation of an appropriate corporatist institutional context. As wage compression is in increasing conflict with the employment objective of the third way, the focus of social justice inside the workplace also shifts. Now the focus is less on relative equality among all workers, but more on protection from excessively low wages for those at the bottom of the earning scale. Therefore, no matter whether it is inside the workplace or beyond, the central focus of the third way to social justice is now jobs, and reasonably paid jobs in particular.

*The Theoretical Framework of Existing Literature*

The main theoretical framework for this book is what is often known as the new politics of the welfare state or retrenchment literature (Pierson 2001b; Huber and Stephens
2001; Kitschelt et al. 1999; Scharpf and Schmidt 2000; Green-Pedersen 2002). Primarily within the context of welfare state retrenchment since the late 1970s, this body of literature has offered theoretical propositions which are very different from the literature on welfare state expansion during the Golden Age. In the literature on Golden Age social policy development, the dominant theory is the power resources theory. It argues that social democratic parties represent and mobilize wage earner interests, and capture the seat of government through the democratic electoral process. Center-left incumbency, in turn, is crucial in expanding institutionalized social protection and welfare state generosity (Stephens 1979; Korpi 1983; Esping-Andersen 1985).

By contrast, the new politics of the welfare state takes place in a very different macro context. Today’s welfare states face a set of complex but common challenges. Domestically, these challenges include persistent unemployment, low employment, escalating budget deficits, and increasing burden on the social security system. Different developments combined to pose these challenges to the domestic economy. First of all, transition to the service economy leads to a trilemma. Job creation in the public sector leads to possible budget deficits. Job creation in the private service sector leads to growing wage inequality. Pursuing wage compression and budget prudence, meanwhile, leads to further increase in unemployment (Iversen and Wren 1998). Secondly, demographic changes lead to not only an increasingly aging population but also increasing numbers of women entering the labour force. New forms of social risks affect vulnerable and often overlapping groups such as women, children, the disabled or those with low levels of education (Bonoli 2005; Esping-Andersen 1999; Esping-Andersen 2002). Thirdly, macroeconomic policy mistakes during the
1980s (such as the overheating and then crash of the real estate market in some of the Nordic countries) further increased unemployment. Challenges to the further growth and funding of the welfare state are not only domestic but also international. Capital has become increasingly mobile internationally. The increasing potential for businesses to move abroad means that it is no longer very effective to stimulate the economy with traditional tools such as lower interest rates, devaluation, or deficit spending. For many European countries, they are now under the additional constraint of the Stability and Growth Pact, the euro, and the tight monetary policy of the European Central Bank, which limits their capacity for autonomous fiscal and monetary policies (Pierson 2001c; Huber and Stephens 2001; Huber and Stephens 2005; Scharpf 2000).

Domestic or international, these common changes in demographics or the economy are not clearly reversible in the immediate future. They have in turn created a macro context for today’s welfare state development, which Pierson (2001b) aptly characterizes as “permanent austerity”. Faced with this common pressure of permanent austerity, different welfare states have responded in highly different ways. For each country, its welfare reform strategies are heavily path dependent on, and constrained by, its given institutional contexts. On a macro level, these institutional settings encompass welfare state, labour market as well as economic production regime characteristics. On a micro level, they constrain the preference distributions as well as policy assumptions, for policy makers in control of government, and for employers plus employees inside firms (Pierson 2001b; Hall and Soskice 2001; Swank 2002). In the new politics of the welfare state, the interaction between path dependency and permanent austerity has led to “diverse responses to common
challenges” (Scharpf and Schmidt 2000), and the dominant welfare reform pattern is “refracted divergence” (Myles and Quadagno 2000: 51).

The Power Resources Challenge to the Path Dependency Thesis

The retrenchment literature makes a significant theoretical contribution by highlighting the importance of path dependency in welfare state changes since the Golden Age. It, however, casts a very different light on the role of partisan government in current social policy reforms. Compared with the old politics of the welfare state, in the retrenchment literature the influence of parties and party ideology is reduced in magnitude as well as dimensionality. First of all, compared with the Golden Age era, partisan colour of government is much less relevant for current welfare reform patterns. Parties from the right are constrained in their attempt at wholesale retrenchment because of potential electoral backlash. Parties from the left are constrained in their attempt at further expansion because of fiscal pressure domestically and financial pressure internationally. Where parties continue to influence welfare reforms, they have been largely stripped of their interest mobilization functions. Now, parties are more concerned with protecting themselves from the possible electoral consequences of retrenching the welfare states. Welfare benefit programs have over the course of decades accumulated a broad constituency that often includes, crucially, the median voter. In order to capture the median voter, parties are said to be primarily strategic when it comes to retrenchment in the post Golden Age era. Parties recognize cuts as unpopular. They are only willing to implement these cuts when competition or coalition dynamics in the party system are optimal, in the sense that electoral fallout from
retrenchment is minimized (Kitschelt 2001; Green-Pedersen 2002). As the dominant theory for the old politics of the welfare state, the logic of power resources based on interest mobilization and political contestation is now clearly overshadowed by the path dependency thesis in the retrenchment literature.

This book challenges the decline of power resources. Table (1.1) summarizes the book’s main theoretical arguments, as compared with the dominant arguments in the retrenchment literature. By examining how welfare states respond to the collapse of the first way paradigm to social justice, the book identifies a strong association between significant shifts in policy paradigm on the one hand, and shift in power on the other. The initiation of the third way almost invariably follows the coming to power of social democratic parties. The initiation of the second way, similarly, is closely related to the centre-right capture of government. The partisan colour of government, in other words, continues to play the key role in determining the overall welfare reform strategies. Based on this finding, the book proposes a power resources theory to welfare state reforms since the Golden Age. Challenging the implication from the path dependency thesis, the book argues that the partisan colour of government remains absolutely crucial. Political agency continues to emerge as the fundamental momentum behind welfare state adaptation strategies, despite the heavy and sticky institutional constraints. Partisan government is the key in explaining the initiation of significant policy paradigm shifts, and it also shapes the fundamental logic and core strategies of policy paradigms. Within the framework of these policy paradigm shifts, path dependency remains important in explaining the choice of policy instruments and policy implementation. Therefore, in theorizing the new politics of the welfare state, path
dependency is a midrange causal variable that can be placed within a larger context of power resources based on political contestation. By restoring power resources to its position as a key causal variable, the book proposes a more integrated theoretical approach to welfare state development after the Golden Age. In this integrated approach, interests, ideas as well as institutions all play their full role in accounting for the complex patterns of welfare state adaptation to permanent austerity.

*The Methodology of Studying the Welfare State after the Golden Age*

In addition to its theoretical contributions, the book also examines the comparative research methodology of the welfare retrenchment literature. It proposes a more integrated methodological approach to post Golden Age welfare research. This approach involves the empirical examination of changes not only in the social security system proper but also in the labour market. The book reveals that the narrow focus on social spending or benefit entitlements tends to exaggerate the institutional constraints on political agency, especially social democratic activism in expanding social protection. In social democratic third way reforms, there is a high level of integration between expansion in the active apparatus and corresponding changes in the passive apparatus. Therefore, changes in the labour market and the social security system cannot be examined in isolation after the Golden Age. Both are now integral components for the apparatus of social protection by the state. The book suggests that different methodological approaches will offer very different predictions for the future of social protection, even in the context of permanent austerity. With narrower focus on social expenditure plus benefit entitlement, evidence indeed points towards the decline in
the overall context of stability, and therefore, that the welfare state has finally reached its limit to growth. On the other hand, if the approach to empirical data encompasses both labour market programs and the social security system, a very different prediction for welfare state future emerges: continued potential for growth, powered by social democracy. Ultimately, the choice between different methodological approaches depends on the larger theoretical framework one adopts with regard to the possibilities of social protection. As the theorizing of social protection expands from income replacement to income regaining, the methodology of studying social protection also correspondingly expands from social security proper to include labour market programs.

Contribution to Theories of Institutions

On a more general level, the power resources logic proposed in the book also contributes to the theories of institutional evolution. This literature has shifted away from the interpretation of the institutional evolutionary process as a series of long and static equilibrium, punctuated by sporadic points of radical overhaul at critical junctures. Instead, institutional changes are often ongoing as well as incremental. Theories of institutions have increasingly highlighted the integrated relationship between reproduction and innovation in this institutional evolutionary process. Theories of positive feedback and increasing returns have proposed an essentially path dependent pattern of institutional change. The existing structure and policy assumptions of institutions constitute a powerful framework for cost and benefit calculation within the short-term horizon. The cost of innovation is often too high and immediate whereas its return diffuse and long term (Pierson 1993; Skocpol 1992; Thelen
2003). However, the potential for institutional innovation increases when institutions become the subject of political contestation. During the political contestation over institutions, actors originally isolated at the margins of the institutions attempt to take the control of institutions. Once in power, they attempt to reshape the institutional agenda to address their own grievances and mobilize the core constituency interests they represent (Thelen 2004). The power resources logic can be placed in precisely this perspective, where different political parties and their interest constituencies contest the seat of government in order to shape public policy. Through its examination of social democratic third way reforms, the book affirms the politically contested nature of institutional evolution, as a process of innovation, complicated by reproduction due to path dependency.
Table (1.1) Comparative Summary of Arguments from Huo vs. the New Politics of the Welfare State Literature

<table>
<thead>
<tr>
<th>Welfare State Changes</th>
<th>New Politics of the Welfare State</th>
<th>Huo</th>
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<tbody>
<tr>
<td>Path Dependency</td>
<td></td>
<td>(1). Partisan Colour of Government (Initiation/Logic of Policy Changes)</td>
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<td></td>
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<td>(2). Path Dependency (Implementation)</td>
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<tr>
<th>Evolution of Institutions</th>
<th>Reproduction (Positive Feedback and Increasing Returns)</th>
<th>Innovation (Political Contestation)</th>
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Main Methodological Issues

This book is a comparative historical study of welfare state and labour market changes after the Golden Age. Contrary to variable-oriented quantitative strategies of comparative studies, comparative case studies focus on comparing configurations and offer causal explanations that are combinatorial in nature (Ragin 1987). This careful attention to various combinations and configurations in conditions for specific outcomes or processes is especially suitable for studies about changes associated with macro institutions that are complex as well as multidimensional, such as the welfare state and labour market regimes. The utility of case studies at the stage of theory building, where candidate theories are explored, is greatest when the subjects of analysis are macro political phenomena, and a
central objective of the comparative method is to substitute the names of variables for the names of social systems. While large-n studies approximate experiment-like rigour by focusing on variables and their statistical relationships, comparative case studies approximate such rigour by identifying comparable instances of a phenomenon and analyzing the theoretically important similarities and differences among them (Goldstone 2003; Ragin 1987; Eckstein 1975; Przeworski and Teune 1970).

Large-n studies attempt to come to conclusions about the causal relationships of variables in a large set of cases on the basis of statistical inferences made about causal relationships in a smaller subset of cases. Based on this operational rationale, large-n studies often have to rely on the assumption that certain variables have the same effect in different times and in different places, and this means that large-n studies are better suited to the examination of more homogenous social phenomena, which originate and develop in much the same way across time and space. In the framework of theories about new politics of the welfare state where a key pattern is “refracted divergence” rather than homogeneity, large-n studies can be less effective than case studies for complex causal explanations. A further advantage of comparative historical analysis is its frequent employment of the Bayesian logic to causal inference, an approach incorporated in the methodological design of this study of third way reforms. Normal statistical analysis presumes no prior knowledge about the relationship between variables. In Bayesian analysis, on the other hand, analysts begin with the advantage of some prior knowledge and seek out new data that might shift or refine established understandings of relationships between variables. The comparative historical method forces the researcher to become sufficiently familiar with the historical and
combinatorial nature of individual cases in their empirical observation as well as existing theoretical formulations, so that the subsequent methodological design has sufficient opportunities to reflect both existing theories and possibilities for revision. The challenging of prior theoretical beliefs is further enhanced through process tracing, where social phenomena are broken down into sequences in order for plausible causal links to be established between different stages of social changes (Goldstone 2003).

Taking advantage of this Bayesian logic in comparative historical research, the methodological design of this book attempts to make it suitable for not only reflecting key perspectives of existing literature in the new politics of the welfare state, but also for presenting theoretical proposals which contest the framework of this literature. As said earlier, the crucial insight from theories of the new politics of the welfare state is the pattern of path dependent “refracted divergence” in welfare state changes in the era of permanent austerity. The divergence is heavily shaped by the complementarities between different welfare state, labour market, as well as production regimes known as varieties of capitalism. In order to reflect the varieties in institutional complementarities, three country cases are examined for each of Esping-Andersen’s (1990) three main types of welfare regimes: social democratic (Sweden, Denmark, and Norway), continental (the Netherlands, France, and Germany), and liberal (Britain, Australia, and New Zealand). These nine countries represent not only different welfare state types, but also a wide variety of production and labour market institutions. They include typical manufacturing-based large coordinated market economy (Germany), large economy with significant state intervention (France), small coordinated market economies competing strongly on technological and productivity gains (Nordic
countries and the Netherlands), liberal market economy competing strongly on labour costs (Britain), or dominion economy which up till the mid-1980s relied on the squeezing of rents in the primary export sector (Australia and New Zealand). All these nine countries, meanwhile, also have relatively clear alternation between periods when the centre-left is in and out of government, making it possible to examine the changes in welfare state reform patterns as partisan control of governments shifts. In addition to the variations due to institutional differences in welfare, labour market, and production regimes, there is clearly also further room for variations due to historical and country-specific reasons. Continuous oil revenues in the Norwegian economy, for example, have influenced possible options open for Norwegian welfare state and labour market reforms. The intervention of the French state in industry and social policy arenas, similarly, can be traced to a set of strictly French reasons such as the circumstances surrounding the founding of the Fifth Republic, as well as the authority channeled to the state as a result of surge in nationalism during the French Revolution. The research design, therefore, allows for the full extent of variation not only between but also within the system of institutions.

As third way reforms took place against the background of the unraveling of the Golden Age, the overall time frame for this comparative analysis is the period since the early 1980s. Within this general time frame, periods of analytical emphasis vary among the nine country cases, focusing on periods of significant third way reforms for each country, in order to flesh out sufficient details and complexities in core third way strategies for third way theory building in the concluding chapter. As mentioned earlier, in this book a key line of argument deployed in updating the existing new politics of welfare literature is that social
democracy in government is a major causal factor in third way reforms. For this reason, in order to avoid the problem of choosing on the dependent variable, while the analytical focus for each country is on periods of third way reforms, periods of absence in third way reforms and their associated political parties are also briefly discussed as a contrast, to highlight the association between shift in power to social democracy on the one hand and shift to a third way in policy on the other.

In its approach to finding causal explanations for welfare change patterns, this book employs both “most-different-cases” and “most-similar-cases” research designs (Przeworski and Teune 1970). Combined with the logic of political agency and process tracing, the “most-different-cases” approach is used to identify partisan colour of government as a crucial factor influencing variation in welfare state change across the nine countries. In the “most-different-cases” design, causal explanations are proposed by eliminating alternative causal explanations in the form of irrelevant factors at the level of systems or institutions. In other words, differences across cases are ruled out as implausible explanations for similarities across cases, and these similarities are then causally traced back to other similarities across the cases. This process of causal tracing is then further enhanced with the logic of political agency, in other words, the logic that political actors are the source of political action that brings about political and policy changes. Therefore, the empirical observation that a political actor (parties) takes the action in putting forward a policy is utilized to enhance the plausibility of causality from the political actor to the corresponding changes in policy. Table (1.2) illustrates how this overall methodological design is adopted for the substantive purpose of this book. The common patterns of welfare state changes across the nine cases are broken
down into different aspects and outlined in detail across the remaining chapters of this book. For such cross-country commonality in welfare state changes, cross-country differences are ruled out as implausible explanations, and as Table (1.2) indicates, these differences are precisely the diverse institutional settings on which path dependency has been pinpointed as the crucial determinant in the retrenchment literature. With the elimination of these differences, common patterns in welfare state changes are causally traced back to other similarities across these nine countries, that is, the shift in power between social democrats and the centre-right parties. Table (1.3) outlines some of the main periods of governments with different partisan colours since 1980. Clearly, for all the nine countries, there are alternations between periods when the social democrats are in power (alone or in coalition) and out of power, since the ending of the Golden Age.

Table (1.2) Differences across Cases: Institutional Settings

<table>
<thead>
<tr>
<th>Social Democratic Welfare States/CMEs</th>
<th>Christian Democratic Welfare States/CMEs</th>
<th>Liberal Welfare States/LMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>The Netherlands</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>Sweden</td>
<td>France</td>
<td>Australia</td>
</tr>
<tr>
<td>Norway</td>
<td>Germany</td>
<td>New Zealand</td>
</tr>
</tbody>
</table>

CME: Coordinated Market Economy
LME: Liberal Market Economy
Table (1.3) Similarities across Cases: Power Shifts between Left and Right

<table>
<thead>
<tr>
<th></th>
<th>Social Democrats out of Government</th>
<th>Social Democrats in Government</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Denmark</strong></td>
<td>1982-1993</td>
<td>1993-</td>
</tr>
<tr>
<td><strong>Sweden</strong></td>
<td>1991-1994</td>
<td>1994-</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
<td>1979-1997</td>
<td>1997-</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
<td>1996-</td>
<td>1983-1996</td>
</tr>
<tr>
<td><strong>New Zealand</strong></td>
<td>1990-1999</td>
<td>1984-1990</td>
</tr>
</tbody>
</table>

While the main task of the book is to propose partisan colour of government as a crucial determinant of post-Golden-Age welfare state changes, it also corroborates the retrenchment literature in demonstrating the influence of path dependency on existing institutional contexts. For this purpose, the “most-similar-cases” design is adopted. Within the context of common initiation of third way reforms under a common party family in power (social democratic), many specific variations in policy instruments and implementation can be traced back to diversity in existing institutional settings known as the varieties of capitalism. Table (1.4) offers an overview of how different comparative research designs are integrated in this book for different purposes. Together, these research strategies serve to demonstrate that the “refracted and divergent” pattern of third way reforms (key
argument in the retrenchment literature) is indeed a midrange causal explanation. This midrange explanation should be nested in a larger context of power resources explanation, according to which third way reforms reflect a common social democratic principle of social protection by the state, and common core strategies of expansion, active redistribution, and retrenchment. The third way reforms are powered by social democratic governance.

Table (1.4) Comparative Research Strategies in the Book

<table>
<thead>
<tr>
<th></th>
<th>Dependent Var</th>
<th>Independent Var Eliminated</th>
<th>Independent Var Retained</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Most-Different-Cases</strong></td>
<td>Similarities</td>
<td>Differences</td>
<td>Similarities</td>
</tr>
<tr>
<td></td>
<td>(Initiation/Logic of Policy Changes)</td>
<td>(Institutional Settings)</td>
<td>(Partisan Colour)</td>
</tr>
<tr>
<td><strong>Political Agency, Process Tracing</strong></td>
<td>Differences (Implementation)</td>
<td>Similarities (Partisan Colour)</td>
<td>Differences (Institutional Settings)</td>
</tr>
<tr>
<td><strong>Most-Similar-Cases</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Main Outlines for the Book**

On the one hand, third way reforms are proposed as a social democratic response to a heightened social justice crisis in the form of labour market exclusion, which is itself primarily a result of domestic and international shifts in the economy as well as demographic changes. On the other hand, third way reforms are shown to exhibit clear patterns of path dependency as a result of existing institutional structure, policy assumption, and practice embedded in the welfare state, labour market and production regimes. To set up a basic
context for later analysis from a path dependent as well as power resources perspective, the second chapter briefly outlines the historical background in institutional characteristics and policy developments before the turn to the third way in each country. The following three chapters outline the common patterns in welfare state changes when the social democrats are in power and make comparisons with periods when centre-right parties are in power. To facilitate the discussion, core strategies of social protection by the state are broken down into active (the third chapter) and passive (the fourth chapter) apparatuses, as well as the necessary economic and corporatist context (the fifth chapter) for these core strategies.

The third chapter focuses on changes in the active apparatus of social protection. The main function of the active apparatus is to facilitate entry into the labour market for those without jobs. Active labour market policies (ALMPs), typically involving the direct offer by the state of an opportunity inside the labour market or training for labour market purposes, are the most important component of the active apparatus, and of third way strategies in general, because not only do they often involve significant increase in spending commitment by the state, they also bring the labour market right to the door of those who are excluded. In addition to ALMPs, there are two other important supplementary policy strategies in the active apparatus: in-work incentives and flexicurity measures. Neither of these supplementary strategies directly creates the opportunity for interaction between the labour market and the excluded individuals. However, flexicurity measures, as a combination of flexibility and security, increase the possibility for such interaction by decreasing the difficulty in approaching the labour market for individuals who cannot work on regular schedules or in regular conditions for family as well as health reasons. Meanwhile, the
security side of flexicurity helps to cement job security for the atypical workers entering the labour market or offer social protection for those temporarily excluded from the labour market. Furthermore, as interaction with the labour market takes place, in-work incentives in cash can increase the financial returns for such interaction; in-work incentives in kind, especially public childcare provision, can reduce the potential family related costs for such interaction. Given that ALMPs as well as the two supplementary strategies all serve to encourage entry into the labour market, the general social democratic third way reform pattern for the active apparatus is *expansion*. In other words, when the social democrats are in power, new programs in ALMPs, flexicurity, or in-work incentives are often introduced, and these new programs are often more focused on making work attractive through education, training, or financial incentives than on making welfare unattractive through simple cuts in benefit levels. On the other hand, when the centre-right parties are in power, there is less expansion in the active apparatus (and there is sometimes rollback), and for the centre-right programs in labour market activation, the emphasis is more on cutting benefits than on training and education.

The expansion of ALMPs under the social democrats are also marked by a gradual strengthening of obligations on individuals to accept the offers of activation, a trend backed up by increasing willingness of the state to apply sanctions in the case of non-compliance. At the same time, expansions in ALMPs are clearly prioritized in sequence and in their targets instead of thinly or uniformly spread across the unemployed population, and easiness as well urgency in activation are important criteria in priority setting. The phases of expansion in ALMPs usually start with the young unemployed to be followed later by the long-term
unemployed. While the general functions of ALMPs are increasingly compartmentalized depending on the nature of target populations, actual activation offers are also increasingly tailored to the specific needs and circumstances of each unemployed individual, often in the form of individual action plans drawn up between the unemployed and the labour market authorities. Expansion in in-work incentives is closely related to the third way formulation of social protection premised on the offer of jobs, and reasonably paid jobs in particular. Both legal minimum wages and negative income taxes have been used to protect individuals from inadequate financial rewards for labour market participation. Flexicurity measures directly affect the structure rather than volume of unemployment, because labour market rigidities mainly serve to create an insider/outsider divide so that existing situation of labour market exclusion tends to perpetuate itself for the individuals concerned, and in the long run flexibilization of the labour market has the potential to reduce long-term unemployment. A particularly efficient approach to flexicurity is to focus changes narrowly on the margins of the labour market, by relaxing hiring rules as well as tightening job security for atypical workers.

Reflecting the power resources logic and institutional innovation powered by political contestation, the social democrats across the country cases are distinguished from their centre-right counterparts in taking the initiative to start the expansion of the active apparatus. At the same time, the implementation of social democratic third way reforms also displays signs of path dependency, and in the context of theories of institutions, patterns of institutional reproduction based on increasing returns. The balance between rights and obligations to activation has played out in different countries as the social democrats
expanded the ALMPs. The historically greater level of public spending committed to the labour market in Scandinavian welfare regimes has provided the necessary resources for greater emphasis on the right to and quality of labour market participation than in liberal welfare regimes. For similar reasons, ALMPs in the Scandinavian context are more enabling, tailored to individual needs and capable of reaching marginal groups at the periphery of the labour market than both the continental and liberal welfare regimes. Traditional bias towards social transfers and insurance-based social contributions in continental welfare regimes has meant that the main form of in-work incentives there is reductions in social security contributions, whereas public provision of childcare is the staple in-work incentive in public service friendly Scandinavia. On the other hand, in tax-funded and residual liberal welfare states, the typical in-work incentive is negative income taxes. Introduction of labour market flexibility, furthermore, has been a much less prominent part of third way reforms in liberal welfare regimes with traditionally high labour market mobility than in continental welfare regimes with traditionally strict employment protection. All these pieces of evidence for path dependency and institutional reproduction in the expansion of active labour market measures, however, can be nested in a larger context of how social democratic parties drive forward the expansion of the active apparatus by capturing the seat of government. Across the country cases, since the early 1980s the shift of power from the centre-right to social democracy has often been associated with signs of shift in policy paradigm, from passive income replacement to proactive income regain in the expansion of active labour market measures. While the centre-right parties place more emphasis on a smaller state and free market, the social democrats have gone in the other direction by further increasing state involvement in
the labour market, not only in terms of regulatory reforms but also often in terms of direct increase in public spending to pay for the expansion of ALMPs, flexicurity measures, and in-work incentives. While increasing emphasis on the compulsion to enter the labour market, the social democrats have also adopted measures such as the minimum wage to reduce instances of working in poverty. When the social democrats were ejected from office after a period of third way reform, their centre-right successors often reversed the reform path by reducing state spending in active labour market measures and state involvement in labour market regulatory reforms. Social democratic power resources and the political contestedness of institutional innovation is a key causal factor in the expansion of the active apparatus in the third chapter.

The fourth chapter turns its focus to the other, passive, side of social protection. Mainly comprising the social security system, the passive apparatus mainly functions by replacing the lost income, while in the process maintaining the status of exclusion from, or worse, facilitating the outflow from, the labour market. With regard to unemployment benefits in particular, while they do serve the traditional social democratic purpose of protecting the worst off (those with no source of income), over time they have unintentionally taken on the extra function of preventing the worst off from regaining the source of income because of various work disincentives. Therefore, the main social democratic strategy with regard to unemployment benefits and many other social security transfers is active redistribution: on the one hand, redistribution is often intensified so that transfer payments go to those at the bottom in the greatest need; on the other hand transfer payments are adjusted in an active direction by removing their passive work disincentives. In
addition, there are various pathways towards early labour market exit in the passive apparatus, which can be either health-related (such as disability benefits), age-related (early retirement), or temporary leave schemes. These measures not only prevent entry into the labour market, they also go one step further by removing individuals who are actually inside the labour market. Virtually as measures of ALMPs in reverse, the early exit pathways have fundamental conflicts with the activation principles of third way reforms. For this reason, the main third way strategy with regard to the early exit part of the passive apparatus is retrenchment for the purpose of reducing enrollment and promoting labour market activation. Compared with changes in the active apparatus, the difference between social democrats and their centre-right counterparts in changing the passive apparatus is relatively smaller, as governments from both the left and right attempt to reduce the potential disincentives in income replacement measures and close off early exit pathways. However, differences can still be detected in the logic and design of policy changes for the passive apparatus. In contrast to the social democratic emphasis on continuing redistribution as well as removing work disincentives for the purpose of labour market activation, the centre-right strategies place more emphasis on direct cuts in benefits, for the direct purpose of cost containment, instead of labour market activation.

Under social democratic governments, changes to the passive apparatus involve cuts, and in many instances, increases as well, and none of the third way social democratic country cases see wholesale retrenchment of their welfare state. The extent of benefit cutbacks in third way reforms is often closely related to the pressure of increase in unemployment, and as unemployment starts to decline as a result of labour market activation, welfare benefits are
often promptly restored by the social democrats. Third way change to income replacement measures, in other words, is not rollback for its own sake, but a means to an end of labour market activation in the context of budget balance. Although the overall level of social expenditure is lower than before the third way reforms, for many of the most successful third way reform cases the social security system in question remains very generous and offers substantial social protection. Even where the social democrats do reduce benefit generosity, there is some distinction in the logic of the policy changes from their centre-right counterparts. Whereas the primary focus of the centre-right parties in retrenchment is often straightforward reduction in benefit levels, the social democrats have instead preferred to reduce the duration of benefits instead of levels. Unemployment replacement at a high level but for a short duration has turned out to be an especially effective strategy for the purpose of activating the labour market, because temporary but adequate unemployment benefits not only reduce long-term labour market exclusion, but also avoid pushing people prematurely into unwanted jobs and creating skill mismatches in the economy. There is a very high degree of integration of changes to the passive as well as active apparatus in third way labour market reforms, as active redistribution, retrenchment, and expansion rarely take place in isolation from one another. The highly integrated nature of the social security system and the labour market in third way reforms is a powerful demonstration of the third way logic, whereby the basis of social protection is transferred from passive replacement for loss of income to proactive regain in source of income in the labour market. This activation-oriented strategy in changing the passive apparatus, however, is often reversed once the social democrats lost office after a period of third way reforms. Upon the return of centre-right
parties to government, reductions in benefits and extent of compulsion increased again. Compared with the social democrats, the centre-right changes to the passive apparatus became more decoupled from the active apparatus. Under the centre-right, there was often decrease in state commitment to active labour market measures. Without the social democrats controlling the agenda, reform of the passive apparatus was in greater danger of reversing from the “third way” activation back to “second way” simple cost control.

Again, in addition to power resources and institutional innovation, path dependency and institutional reproduction can also be observed in the social democratic third way strategies in the passive apparatus. As evidence of path dependent “refracted divergence” and institutional reproduction, third way social democrats in insurance-based continental welfare regimes have generally found it more difficult to reform the social security system than their counterparts in liberal welfare states, where more benefits are tax-funded and cannot be subjected to proprietary claims by the employees, who in the continental welfare regimes in complementation with coordinated market economies are also often closely involved in the management of these benefits through the unions. Tightening of benefit eligibility has also been carried out in diverse patterns, in the form of targeting through means-testing applied to the bottom in Britain and applied to the top and middle income earners in Australia and New Zealand, but in the form of less generous benefit calculation formulas without direct exclusion from the contribution-based benefits in continental Europe. The presence of corporatist institutions or practice between employers and employees, on the other hand, offers room for tradeoff and compromise, which tends to soften the potential resistance to social security reform from the unions. Similarly, the extent of retrenchment in the early exit
pathways is closely related to the strength of resistance from both sides of the social partnership. Unless the institutional basis for social partner influence is completely dismantled as in the case of Netherlands, closing early exit loopholes has been more difficult in continental Europe, where there is a strong tradition of collusion between employers and employees to offload adjustment costs in the production regimes onto the social security system through early exit.

The fifth chapter turns to the macroeconomic and corporatist institutional contexts which are necessary for the core third way strategies to become effective. An increasingly clear observation across the third way country cases is that the effectiveness of active labour market measures, no matter how well they are designed and financed, is strongly related to the volume of demands in the local labour market, and to the level of investment and growth in the economy more generally. As the size of the labour market shrinks in the event of an economic decline, the encouragement of entry into the labour market through changes to either the active or passive apparatus becomes more difficult. For this reason, a larger context of competitive economic growth is essential for third way strategies. Internationally, capital mobility and hard currency constraints removed deficit spending as a key economic stimulant; domestically, sectoral shifts to low-productivity service sectors brought on increasing pressure for wage restraint in order to maintain the level of employment. Therefore, the macroeconomic context for the third way includes not only economic prudence seen in sound budgets, but also wage moderation. The achievement of persistent wage restraint, furthermore, brings the labour market back into the picture, where a corporatist institutional
framework is often essential for wage bargaining characterized by a centralized or coordinated pattern.

The third way social democratic attempt to secure the macroeconomic and corporatist institutional context has again show patterns of “refracted divergence” and institutional reproduction, nested in a larger context of power resources and institutional innovation based on political contestation. As an indication of how historical characteristics of the production regime and labour market continue to reproduce themselves in macroeconomic policy making for third way purposes, the success of the social democrats in securing corporatist relationship with unions and wage moderation is much harder in countries where the unions are weak in strength and segmented in organization, traits which can be traced back to patterns of industrialization as well as natural endowments in individual countries. Similarly, while a secular trend towards further decentralization of bargaining to the industry level can be observed across the third way country cases, wage restraint tends to be more successful where a high level of coordination in bargaining are maintained, in a pattern known as “centralized decentralization.” Third way changes in the macroeconomic context also offer evidence for the other half of the “refracted divergence” perspective in the new politics of the welfare state: the prospect of permanent austerity. Such economic constraint has forced all third way governments to turn to prudence in a sound budget as the key component towards achieving competitive economic and job growth.

Besides the path dependent institutional reproduction, third way changes in macroeconomic and wage policies also show clear evidence of institutional innovation based on the political contestation of institutions. While since the early 1980s the centre-right
governments have increasingly subscribed to the neoliberal strategy of reducing state spending and straightforwardly channeling the resulting savings in expenditure into significant cuts in taxes, the entry of social democrats has steered the direction of economic belt-tightening towards a new purpose. As soon as the fiscal position of the government is restored to balance, the social democrats have re-invested the additional revenues into public spending, not only in expansion of public services and the welfare state, but, more crucially, in expenditure on active labour market measures. As the momentum of third way reform picks up further, the social democrats also become increasingly willing to fund further expansion in ALMPs with increases in direct taxes. Similarly, on the basis of a sound budget, the social democrats are more willing than their centre-right counterparts to use demand side job creation or subsidization to stimulate growth in the labour market. Economic prudence under the third way social democrats is not an end to itself, but is prudence with a purpose (of funding social protection through labour market activation). Third way reforms in the macroeconomic and corporatist context of wage restraint and sound budget continue to involve institutional reproduction of historical labour market and production regime characteristics, but they also involve institutional innovations towards economic prudence with a social purpose when the social democrats win the political contest of institutions.

Based on the empirical analysis of core third way strategies, contexts, as well as underlying partisan influence in the previous three chapters, the sixth, and concluding, chapter proceeds to theory building, by first formulating a theory of third way to social protection and then outlining the major theoretical contributions to theories of the new politics of the welfare state as well as theories of institutional design, reproduction, and
innovation. A theory of third way to social protection is placed in the historical context of the unraveling of the first way to social protection using passive income replacement, as well as the rejection of the neoliberal second way which placed more emphasis on simple market dynamics and cost containment. The core of the third way to social protection, instead, is proactive regain of the source of income instead of passive replacement after the loss of source of income. As an updated strategy for social protection in the era of permanent austerity, the third way is the result of continuing interest mobilization for the working class by the social democratic parties when they capture the seat of government. Different from the era of the Golden Age welfare state development, changes to the labour market and the social security system are totally integrated in third way reforms, whose core strategies include expansion of the active apparatus and active redistribution/retrenchment of the passive apparatus, in the macroeconomic and corporatist institutional context of sound budget and pursuit of wage restraint. Developments in the core strategies and macro contexts for the third way show considerable evidence of path dependency due to institutional stickiness in welfare, production, and labour market regimes, offering support for the “refracted divergence” theories of welfare retrenchment literature and increasing returns in institutional reproduction in theories of institutions. However, emerging despite these intersystem differences in a “most-different-cases” comparative design is the strong association between social democracy and third way reforms both in policy initiation and design logic, and the path dependency in third way reforms should be nested in this larger context of power resources in welfare politics and innovation in institutional evolution due to political contestation.
Chapter II

HISTORICAL BACKGROUND
FOR THIRD WAY REFORMS

This chapter serves to set up a basic context for later analysis of third way reforms. For each of the nine countries examined, this chapter briefly outlines the historical background in institutional characteristics and policy developments before the turn to the third way in each country. The historical institutional characteristics help highlight the path dependent patterns evident in later third way reforms, and the history of policy developments under different governments helps highlight the power resources logic of later third way reforms.

Denmark

While maintaining a relatively strong position in the party system by international standards, the Danish social democrats have not been able to dominate the seat of government as much as their Swedish or Norwegian counterparts, especially since the 1973 shakeup of the Danish party system associated with the surge in electoral popularity for the
anti-tax Progressive Party. The Danish social democrats were excluded from office for a sustained period between 1982 and 1993, when a coalition of bourgeois parties occupied the seat of government. However, after returning to office in 1993, the social democrats stayed in power until 2001, setting in train eight years of social democratic power basis for third way reforms. This power basis was further strengthened as over time the social democrats were increasingly able to negotiate for the support of the Venstre party from the bourgeois party bloc in passing social policy reforms. There are relatively few veto points present in the unicameral and unitary characteristics of the Danish government system, and the only significant potential veto point is the high frequency of minority governments, which implies that the securing of *ad hoc* policy coalitions on specific issues, between the social democrats and the Venstre since 1993, can sometimes be an important help in passing reforms (Green-Pedersen 2001: 16-23). In addition, neither side of the social partnership maintained the type of diehard resistance to welfare state reforms typically seen in continental welfare regimes, partly because the Danish welfare state is funded more by taxation than by social security contributions, in comparison with not only continental European countries but also Sweden. With relative cooperation of the social partners on the one hand and limited veto points on the other, there is significant room for political agency in Danish welfare and labour market reforms (Goul Andersen and Jensen 2002b: 284).

Historically, the typically small and medium sized Danish firms demanded a relatively high level of flexibility in the labour market and job mobility, a characteristic which again makes Denmark distinct not only from coordinated market economies on the European continent but also neighbouring Sweden. Overall, regulation of the Danish labour
market has been characterized by a high degree of consensus as well as collective self-regulation, a pattern consolidated on the terms agreed in the “September compromise” in 1899. In this agreement, the social partners recognized each other as legitimate negotiating partners for legally binding collective bargaining, and rules for resolving industrial disputes were hammered out. In the “September compromise” recognitions were also negotiated for industrial peace, freedom of association for employers as well as employees, and the discretion for hiring and firing decisions reserved for the employers. Over time, the welfare state as well as the labour market in Denmark have evolved very much into a partnership model with a relatively high level of autonomy. Many of the issues regulated by legislation in other countries such as working time or holiday entitlements are worked out through collective agreements and developed by regional policy committees in the Danish context (Larsen and Bredgaard 2004: 11-12; Benner and Vad 2000: 410; Larsen 2004: 4-6, 17). Unemployment insurance, in particular, is negotiated according to the Ghent model (seen also in Sweden and Finland) characterized by voluntary membership in unemployment funds tied to unions as well as solidarity in professionally limited areas, and the insurance funds are also heavily subsidized by the state. Unions, therefore, maintain a strong influence over unemployment benefits management, but in a larger context of corporatist rather than adversarial working relations with the employers (Dahl et al. 2002: 9). Relatively high levels of minimum wages negotiated in a collective manner also made it easier to offer reasonably paid jobs, the core principle of action in later third way reforms. While the labour market policies presented a relatively auspicious backdrop for future reforms based on labour market activation, the Danish welfare state did register a few distinctive characteristics of passivity
by the late 1980s. On the one hand, a historically well developed public service sector as well as systems of education and training have certainly encouraged labour market participation for women as well as men, an advantage absent in most continental European countries except France. On the other hand, social security benefits characterized by very high level of replacement rates \textit{as well as} long duration have posed clear work disincentives. At the height of its generosity, for example, duration of unemployment benefits could be up to nine years, while replacement rates could exceed 90 per cent of a normal job wage for many low-skilled groups. Historically, within the circle of Scandinavian welfare states, the Danish system had been comparatively passive (Madsen 1999: 78; Benner and Vad 2000: 448; Hespanha and Moller 2001: 57). The passivity in the social security system is only aggravated by the general lack during the 1980s of measures aimed at directly offering positions in the labour market for the unemployed (that is, active labour market measures), apart from vocational training programs and general mobility enhancing measures. During the Golden Age, promotion of high employment was heavily reliant on demand management for expanding the public sector and in effect expanding the overall size of the labour market, whereas incentives for labour market entry were not emphasized, and labour market polices played a minor role. However, simple demand side job creation gradually proved less effective in sustaining high employment since the late 1970s.

At the time of the first major upset for the Danish party system in 1973, unemployment rate was only 0.9 per cent. However, by the early 1990s, there was a dramatically increased crisis of labour market exclusion, in the form of unemployment rate peaking at 12.2 per cent in 1993. Among the Nordic welfare states, Denmark had the longest
experience of unemployment crisis (Huber and Stephens 2001: 262; Ploug 2000: 4). Overall, since the late 1970s the Danish economy had suffered a persistent unemployment problem and the consequent pressure on the existing social security system. The bourgeois parties presided over much of this period of unemployment crisis. They placed less emphasis on the actual goal of reducing unemployment and comparatively more emphasis on shoring up economic competitiveness and minimizing costs in the economy. However, the bourgeois parties only made limited attempts to reduce public expenditure. Much of the cuts in benefits under the bourgeois government were dictated by short-term budgetary considerations and constrained by possible electoral backlashes, and on the whole the government only managed to slow down the speed of increase in welfare state spending instead of a rollback (Goul Andersen 2000: 72-73). At the same time, demand side measures to promote employment through job creation and enlarging the labour market were gradually abandoned. Since the 1970s, an important cause of the unemployment problems in Denmark had been the relatively low productivity of its manufacturing industries, which were traditionally characterized by small firms and orientation towards the mass instead of niche markets. Throughout the 1970s, while the technological component of Danish manufacturing industries was less dense than their Swedish counterparts, wages in level as well as rate of increase was higher, subjecting Danish industries only to more intense competitive problems in open markets. As the unemployment problems persisted and then worsened during the 1980s, the typical response of the bourgeois government to this problem of low productivity was to further lower wages (instead of raising the level of job qualifications seen under the social democrats since 1993) (Lind 1999: 195; Benner and Vad 2000: 434-435).
Although government prescription for the escalating unemployment problems in the 1980s attempted to highlight what the bourgeois parties believed to be inadequate consolidation of public expenditure, in actual policy terms the Danish state had gradually turned to measures of fiscal consolidation to sustain competitive economic growth since the mid-1970s. Tax base was broadened and rates were lowered through a series of tax reforms. The adoption of a hard currency approach in the 1970s and the pegging of the Krone to the Deutschmark in 1982 made wage restraint all the more important to sustain employment, and after wage drift in the 1970s as well as between 1983 and 1986, wage growth was contained to a level below that of both Sweden and Germany by the late 1980s (Benner and Vad 2000: 457). In other words, the tight economic policy adopted and further tightened since the late 1970s by the Danish governments, while certainly important, would not have been sufficient alone to bring on the Danish job miracle since 1993, which wrestled unemployment back to less than six per cent in five years. The important missing piece was gradually put into place in a series of active labour market reforms since the early 1990s.

Sweden

Compared with their Danish counterparts, the Swedish social democrats have maintained a much more dominant position in the party system, with an uninterrupted period of mostly single party government between 1932 and 1976. Except for a six-year interval between 1976 and 1982 and a three-year interval between 1991 and 1994, Sweden has been governed by mostly single party social democratic governments. The relative position of the
social democratic government inside the unicameral parliament, compared with the frequently minority and coalition-based situation for their Danish counterparts, is also much more consolidated, leaving even fewer veto points and stronger power basis for social democratic third way reforms. In terms of labour market regulations, formally employment protection is relatively strict, but a greater level of flexibility exists on the ground as unions and employers come to individually negotiated agreements inside the firm over this issue (interview by Stephens with the chief economist of the Swedish Confederation of Professional Employees in June 1999). As a typical example of social democratic welfare regimes, the Swedish welfare state is characterized by generous levels of benefits, universal structure of distribution, and a very high level of state spending commitment to social services. After a period of highly polarized competition across party ideological lines, the successful passage in 1959 of the supplementary earnings-related pension (ATP) reforms not only consolidated the earnings-relate and high replacement principle of Swedish social benefits but also secured the subsequent support of centrist and liberal parties for continuous welfare state expansion during the Golden Age. The emphasis on work-related benefits and replacement rates means that, in terms of financing and level of social transfers, the Swedish arrangement is not very different from the typical setup in continental welfare regimes, whereas the tax-funded social services component, on the other hand, is much more developed by comparison. Meanwhile, administration of social transfers remains fairly centralized, whereas that of social services devolved to the regional level (Hort 2002: 135; Benner and Vad 2000: 404-405; Huber and Stephens 2001: 124-125). The major exception to this pattern is unemployment insurance, which till today remains decentralized. Like in
Denmark, unions are closely involved in the administration of unemployment insurance benefits through the Ghent system based on voluntary participation and state subsidies. Unions have put up consistent resistance against attempts by the state to make unemployment benefit compulsory or state run (Hort 2002: 133).

There has also been a long tradition of corporatist relationship between unions and employers, consolidated over time through institutions such as the Labour Market Board (AMS), where both sides of the social partnership work out policies in the labour market. This high level of coordination among the social partners is also facilitated by a significant level of centralization for both the employers and employees. By the end of the 1960s, union density had reached 80 per cent for blue collar workers and 60 per cent for white collar workers, whereas the employers’ organization SAF covered companies involving 90 per cent of the total workforce in the private sector (Benner and Vad 2000: 403). The Swedish corporatist framework, however, suffered a gradual decline since the mid-1980s, as the SAF withdrew from centralized bargaining and then from the AMS itself as well. The subsequent decline of coordination in wage bargaining contributed to a bout of wage drifts during the 1980s, which in turn contributed to a sharp rise in unemployment in the 1990, but the situation for wage moderation had started to improve again into the 1990s. On the other hand, the gradual decline of corporatist framework reduced the potential room for negotiation and tradeoffs, and as the unions jealously guarded their control over unemployment benefits through the Ghent system, later third way reforms to readjust the unemployment benefit systems in Sweden had proved difficult. However, for much of the Golden Age, the passivity in the Swedish social security system in the form of potential work disincentives from
generous benefits had not significantly contributed to employment problems, because active measures targeted at the labour market were deployed simultaneously.

During the Golden Age, Sweden, and to a less extent Norway, were the only two cases where active labour market measures were widely used as a crucial strategy to promote employment. The use of active labour market measures in Sweden, in particular, had a long tradition. Swedish labour market activation can be traced back to the key policy framework guiding postwar economic policy development, the Rehn-Meidner model. Designed during the 1950s for a domestic economy dominated by high-productivity manufacturing industries and massive oligopolistic firms trying to remain competitive in the international market, the Rehn-Meidner model uses solidaristic wage polices to price low-productivity labour-intensive industries out of market. Then, through the AMS, active labour market measures kicked in to move the displaced labour into the high-productivity sector (Huber and Stephens 2001: 127-128). Structural unemployment, therefore, was for a long time kept low and the Swedish economy as a whole remained on a highly competitive growth path. On top of active labour market measures, significant expansion in the public employment sector since the 1960s not only offered massive job opportunities but also childcare places for women, which further contributed to an internationally high level of female participation in the labour market. The Rehn-Meidner logic of pricing out low-productivity industries using low wage dispersion, however, started to backfire as secular shifts from manufacturing to low-productivity service sector gathered pace since the end of the Golden Age. As the whole productivity base of the economy declined further, suppression of wage dispersion under Rehn-Meidner started to harm instead of help employment, especially in the manufacturing
sector. In this process, the expansion of the public service sector increasingly took on the challenge of continuing to sustain job growth and a high level of employment.

By the early 1980s, the social democrats had adopted a “third road” to economic growth, which departed from both traditional demand side Keynesian economic stimulants and monetarist policies in the neoliberal direction. Instead of the Rehn-Meidner emphasis on low wage dispersion, the “third road” opted for wage restraint and reductions in public spending, and a halt was placed on the growth of social expenditure. However, while on the one hand opting for increasing economic prudence, the “third road” also attempted to use two significant devaluations of the Krona (by 10 per cent in 1981 and then by 16 per cent a year later) to increase competitiveness and stimulate the economy. This strategy started to unravel since the mid-1980s as a combination of wage drift and low productivity wiped out the effect of the two devaluations. In addition, rapid deregulation of the capital market piloted since 1986 by the Finance Ministry led to a chain of events that further increased unemployment. As deregulation deepened the government continued with tax deduction for interest payments. The economy started to overheat, and there was a huge spike in real estate prices and boom in the construction and retail markets. When the real estate bubble burst, consumer retrenchment followed, with sharp increase in interest rates. These developments coincided with a shift to hard currency. The Krona was pegged to the ECU in 1990 and was in floatation by 1992. The hard currency approach ruled out further devaluations to stimulate the economy. While Sweden escaped the chronic unemployment problems besetting Denmark during the 1980s, by early 1990s the country had witnessed its worst economic recession since the 1930s. Between 1990 and 1992 employment ratio dropped from 80 to 70
per cent whereas unemployment shot up from two to eight per cent (Eitrheim and Kuhnle 2000: 48; Huber and Stephens 2001: 242; Benner and Vad 2000: 420-423, 427). The bourgeois parties in government oversaw this period of dramatically deepening recession, and similar to their Danish counterparts, the bourgeois parties made some limited attempts to reduce the size of public spending, while the generous welfare state was left largely intact due to its popularity and wide constituency. After the return of the bourgeois parties to power, supply side measures took on growing importance in the economic policy package, and new overall targets for macroeconomic policy making was set as price stability and low inflation. There was comparatively less emphasis on active labour market measures, and ALMPs requiring significant expenditure were specifically scrapped for cost reasons (Hort 2002: 140). Like in Denmark, the massively increased crisis of labour market exclusion set the scene for a renewed attempt to increase labour market activation in a third way since the early 1990s.

**Norway**

Historically the Norwegian Labour Party has also maintained a relatively dominant position in the Norwegian party system. Except for the exile period between 1940 and 1945, the party remained continuously in single party government between 1935 and 1965. For much of the 1980s when the pressure from economic slowdown and unemployment was building up, Norway was governed by a coalition led by the Conservative Party. However, upon returning to office in 1990, Labour was able to stay in power until 1997, and then in the early 2000s. Through history Labour has consistently refused to form coalition governments
with parties from the bourgeois bloc, and in case of insufficient seats to form a government alone, the party had chosen to stay in opposition instead of allying with parties from the centre-right. For this reason, Labour governments in Norway are always single-party governments, which, on top of a unicameral Storting, offers a relatively strong social democratic power base for later third way reforms in the 1990s in reaction against the unemployment crisis. On the other hand, compared with the rest of Scandinavian cases, the Norwegian welfare state also has features less helpful for labour market activation, as public provision of childcare and other policies facilitative of female employment are considerably less extensive. Female labour force participation in Norway, although high internationally, was until very recently also lower than both Sweden and Denmark (Huber and Stephens 2001: 133). Similar to Sweden, welfare benefits in the Norwegian system are generous in level and universal in distribution, and social transfers are usually insurance-based, a funding pattern similar to the continental welfare regimes.

Typical of Scandinavian labour markets, industrial relations in Norway is characterized by regular centralized bargaining as well as strongly corporatist working relationship between the employers and the unions, which was consolidated as a central policy objective in an agreement between the LO and the main employers’ organization NAF/NHO in 1966. With an internationally high level of centralization in wage bargaining, collective agreements are legally binding for the negotiating parties, and National Wage Board comprising representatives from the state as well as both sides of the social partnership is an important institutional basis for reaching consensus or compromise in wage decisions. In addition, as a result of the Basic Agreement, work councils were also established as a
platform for workplace participation, where plant management and shop stewards can cooperate on productivity issues. While bargaining was considerably decentralized in Sweden since the late 1980s due to progressive steps taken by the employers’ organization to withdraw from the relevant institutions, centralized bargaining not only remained but further strengthened in Norway. Whereas employees enjoy a relatively high level of job security, overall labour market rigidity is not high, not only because of the prevalence of flexible working time arrangements, but also due to a high level of labour market mobility as a result of the large share of small sized firms in the Norwegian economy (Dolvik et al. 1997: 70-71; 85-86; Huber and Stephens 2001: 258).

Whereas trade union density in Norway is high internationally (around 56 to 57 per cent since the 1980s), it is considerably lower than the other Scandinavian cases (Dolvik et al. 1997: 82). Compared with Sweden, both the unions in the core export-oriented industrial sector and Norwegian capital are relatively weak. On the one hand, the relatively lower union density in Norway is related to the fact that unemployment insurance, unlike Sweden or Denmark, is administered by the Norwegian state rather than through the Ghent system whereby the unions could have a significant influence based on their affiliation with insurance funds. On the other hand, the weakness of large manufacturing industrial sector is also due to relative strength of small work units based on primary economies in the periphery of the country, such as fishing. The relative dominance of the periphery in the Norwegian economy has played a role in shaping the economic policy profile of the state. Unlike the Rehn-Meidner method of pricing low-productivity industries out of existence in Sweden, highly supportive regional policy to combat employment based on intense state intervention
has been more typically adopted in Norway. The Norwegian state has played a significant role not only in reaching tripartite negotiation agreements in industrial relations, but also in an active industrial policy through low interest rates and a credit policy favourable to industries. The historical weakness of Norwegian capital has meant that employers had reconciled with, instead of putting up a spirited resistance against, either the regional policy or the active intervention of the state more generally. In addition to Sweden, Norway is the other country which had adopted a work line of active labour market measures to shore up employment well before the ending of the Golden Age, but labour market activation took a less prominent position in the government’s policy framework than in Sweden. This is partly because active state intervention, in the form of demand side job creation in declining areas, has substituted for the role in Sweden of active labour market measures in finding new job opportunities for those who were made redundant as a result of the Rehn-Meidner practice of forcing low-productivity industries to upgrade or die (Huber and Stephens 2001: 131-134).

Whereas a strong regional policy based on active state intervention prevented decline of employment in the short term, persistent shoring up of low competitiveness industries in the periphery of the country has over time contributed to relatively high costs of labour. However, on the whole this potential for structural unemployment had been restrained from having any substantial impact on employment levels, because of the relative success in continuous pursuit of wage restraint. During the 1980s, both Norway and Sweden resorted to devaluations to stimulate the economy. Whereas the Swedish strategy was later increasingly neutralized as a result of inability to maintain voluntary wage restraint in the framework of the “third road” macroeconomic approach, the higher degree of bargaining centralization in
the Norwegian context helped in shoring up wage restraint and industrial competitiveness. High level of employment up to the late 1980s was also maintained by the increasingly profitable, and prominent, position of the oil industry in the Norwegian economy. Continuous state revenues from the oil sector helped retain a budget surplus, and the Norwegian welfare state was under less pressure for retrenchment than its Swedish or Danish counterparts (Ploug 1999: 99; Eitrheim and Kuhnle 2000: 53). However, oil price started to fall since the mid-1980s, and coinciding with an international recession triggered by hard currency squeeze on the heels of an overheated credit market, a sharp increase in unemployment in Norway started since the late 1980s, reaching a peak of 8 per cent (Dolvik et al. 1997: 55). On the one hand, this unemployment crisis was more temporary, and less structural in nature than the other Scandinavian cases because of the higher level of wage restraint in Norway. On the other hand, in the context of four decades of government policy more or less successfully targeted at full employment, this sudden crisis in unemployment was unexpected, and this is the backdrop for the efforts to renew the Norwegian active labour market measures since the early 1990s.

The Netherlands

After the breakup of the fragile coalition between the Christian democrats (CDA) and the PvdA in 1981, the Dutch social democrats remained in the political wilderness for most of the 1980s, and did not return to power until 1989. However, upon re-entering government in that year, the PvdA then managed to remain in power continuously for 13 years, and more important, gradually consolidating its position in the government during this process. The
PvdA first served as a junior coalition partner with the CDA during the Lubbers administration from 1989 to 1994, and then became the major coalition partner in two historically unprecedented Purple Coalitions with a smaller Liberal Party as the junior partner. Historically, high level of pillarization in the Dutch society due to cross-cutting cleavages had contributed to the relative weakness of Dutch social democracy as compared to Christian democracy (Huber and Stephens 2001: 162). Now, with the PvdA dominating a cabinet for the first time in history and its leader Wim Kok becoming the Prime Minister, a strong power basis was laid for social democratic third way reform in the Netherlands during the 1990s. At the same time, institutional legacies from the Dutch welfare state and labour market arrangements led to developments which radically intensified the urgency for reforms to address the problem of increasing exclusion from the labour market. The most dramatic representation of this labour market exclusion crisis was an explosion in the number of disability benefit recipients, which approached 900,000 by 1990, a volume all the more perverse given the fact that, at the time of its creation in 1967, the disability benefit scheme was designed for a maximum capacity for a fourth of that volume (200,000 beneficiaries) (Hemerijck et al. 2000: 220).

The crisis of the Dutch disability benefit system was a typical representation of the cost externalization problems faced by continental welfare states after the Golden Age. On the one hand, employment levels in continental Europe suffered a clear decline, due to a combination of labour market rigidities, insufficient wage restraint or dispersion, and shift in the economy to the lower productivity service sector. On the other hand, the insurance-based continental social security system was heavily reliant on social contributions as the main
source of funding. As a result, collusions between employers and employees, made easier by the generally close networks between the two sides of the social partnership in coordinated market economies, led to the shedding of unproductive labour through a series of labour market exit schemes. The short-term costs of economic adjustment inside the firm were externalized onto the social security system. Whereas in Germany early retirement schemes were a typical tool used in cost externalization, in the Netherlands the disability and sickness benefits schemes took the limelight. Dutch employers and unions dominated corporatist institutions responsible for the administration of the two schemes, and the criteria used in granting disability benefits were especially lax. Disability benefits in the Dutch context offered protection on the basis of social risk (incapacity due to personal reasons) instead of professional risk (incapacity in the course of work). Through collective agreements, both sickness and disability benefits were often topped up to 100 per cent of previous earnings, and those on full-time disability pensions were no longer required to be available for work. As a result, at its height, between 30 to 50 per cent of the disability scheme beneficiaries were really full-time or part-time unemployed instead of being disabled. As is the case with early exit schemes often used in other continental welfare regimes, the disability and sickness benefit schemes as harsh welfare traps contributed to a high level of passivity in the Dutch welfare state (Wilthagen 2004: 23-26; van der Veen and Trommel 1999: 291; Hemerijck and Visser 2000: 239; Hemerijck et al. 2000: 219-220). For this reason, retrenchment in the passive apparatus was a particularly important component of later Dutch third way reforms. Meanwhile, the problem of passivity in the Dutch social security system was further complicated by the narrow focus on the size of, instead of entry into, the labour market
during employment policy making during the Golden Age. Active labour market measures were absent, and employment promotion policies during the 1970s relied mainly on demand side job creation in labour intensive sectors such as construction and public infrastructure. Throughout much of the 1970s and 1980s, unemployment was tackled through the use of subsidized labour to compensate for shortfalls in labour demand (de Schampheleire and van Berkel 2001: 45; Visser and Hemerijck 1997: 159).

Other features of the Dutch welfare state and labour market institutions also influenced the parameters for future third way reforms. First of all, divisions along religious lines among the unions as well as employers’ organizations, on top of a steady decline in union density, made voluntary and centralized wage bargaining increasingly difficult to reinforce, and as a result state intervention was increasingly resorted to in an attempt to reach negotiated wage agreements. As will be explained in detail in the case studies, the problems of a malfunctioning voluntary incomes policy and growing wage drift were gradually overcome only after the unions signed up to the corporatist framework of the Wassenaar agreement in the early 1980s. The central logic of the Wassenaar agreement was a tradeoff between wage restraint and public expenditure cuts on the one hand and employer commitment to employment creation on the other. The segmented organization and further decline of union strength relative to the employers played an important role in the quick incorporation of the labour movement into this corporatist framework. The strong influence of the Christian democrats in the creation and development of the Dutch welfare state over time has presented clear passivity problems for future third way reforms, for at least two reasons. First of all, the Christian democratic emphasis on generous social transfers, often
further intensified as a result of interaction with a social democratic coalition partner, led to the most generous social security benefits among continental welfare regimes (van Kersbergen 1995). The potential work disincentives in such generosity of benefits, however, are not balanced with pro-employment measures in the service side of the welfare state as in the Scandinavian cases. The Christian democratic emphasis on subsidiarity and breadwinner model of the family led to not only underdevelopment of public services, including childcare, but also bias against female employment in the unit of calculation in the household for tax purposes. Dutch female labour market participation was persistently lower than the European average. For this reason, in addition to the disability reforms, the rapid expansion in the number of women entering the workforce became another important development during later third way reforms in the 1990s.

In addition to escalating enrollments in sickness and disability schemes, the labour market exclusion crisis as the backdrop for later third way reforms also manifested itself in a straightforward rise in unemployment figures since the late 1970s, peaking in 1984 at 12 per cent based on OECD and ILO calculations. An important contributor to this loss of jobs was the discovery of North Sea gas which led to overvaluation of the Guilder and declining competitiveness of the exporting industries (Huber and Stephens 2001: 169; Hemerijck et al. 2000: 211-214). Two Lubbers administrations based on a coalition between the Christian democrats and the Liberals presided over much of this period of growing unemployment. Faced with the economic decline, the centre-right coalition emphasized the increasing public expenditure and deficit as an important cause of the problems. In an effort to downsize the state and rekindle the economy on a competitive growth path, the Lubbers “no nonsense”
administrations took the initiative by presenting the unions with the no-alternative choice of Wassenaar. Soon to follow were freezes in minimum wages, public sector wages, as well as the pegging of the Guilder to the Deutschmark in 1983. The effect of these austerity measures in fiscal consolidation was actually quite swift, as inflation was reduced to near zero by the mid-1980s and public sector deficit reduced by three per cent in three years. In the process of these changes, employment objectives was given relatively less emphasis, and in fact the deficit reduction between 1983 and 1986 was precisely achieved through a further drop in public employment (and salaries as well) (Hemerijck et al. 2000: 216-217). The growing concern with cost reduction among the centre-right was also reflected in the reforms of the Dutch social security system during the mid-1980s, which also marked the first major initiative by the Dutch state to address the disability crisis. A “price policy” was adopted for these reforms, which focused on lowering benefits and shortening durations. In 1985, benefits of all insurance schemes ranging from unemployment, disability to sickness were uniformly reduced from 80 to 70 per cent of previous earnings (Hartog 2000: 35; Hassel and Ebbinghaus 2000: 76-77; Oorschot 1998: 9). The conspicuous failure of such “price” approach to reduce the number of beneficiaries paved way for the later turn to a third way “volume policy” in the 1990s. With a focus on the ratio between the net participation in the labour market and the whole population, the “volume” approach was a more typical active labour market approach.
France

The French Socialists were one of the earlier social democratic parties to come to power against a background of the Golden Age ending. After entering government for the first time in the Fifth Republic in 1981, the party retained the French presidency until 1995, but there were more frequent alternations in cabinet control between the Socialists and the centre-right party group including mainly the Gaullists and the UDF. The presidency still maintained significant influence on policy making over domestic issues including economic as well as social policy during the early years under Mitterrand. However, as the presidential and parliamentary sides of the French executive got out of sync in periods of cohabitation since 1986, the influence of the cabinet grew steadily in domestic policies, and partisan control of the cabinet instead of the presidency became the main power basis for welfare reforms after the Golden Age. There are three main periods of social democratic cabinet control: 1981-1986, 1988-1993, and 1997-2002. While the first period was dominated by the U-turn in overall economic policy direction, it was the second and third periods of social democratic governance that saw more clear third way initiatives in the French welfare state and labour market. As a political system heavily influenced by polarized ideological battles through repeated contestations over the republican versus monarchist visions of the nation, the republican ideology has cast a long shadow over French social policy today, seen in the emphasis on the authority as well as responsibility of the state to treat issues of poverty and social protection as collective rather than individual issues. Since the 1983 U-turn, such *dirigisme* in economic policy arenas has been moderated, but as would be explained in detail in the case studies, the emphasis on the responsibility of the state continues to frame the
development of French third way activation policies in the welfare state as well as the labour market, in ways that made them distinct from other third way reform cases.

French unions as well as employers’ organizations are typically weak in strength and particularistic in organizational pattern, and the inability to enforce or coordinate agreements on either side has led to an adversarial incomes policy ineffective in securing wage restraint. Intense conflict between weak interest groups in French policy making means that there is a long tradition of state intervention in industrial relations (Vail 1999: 314; Palier 2002: 2-3; Mosley et al. 1998: 27-36; Hantrais 1996: 52). For this reason, regulatory reforms in the labour market can be easily grounded by resistance from the unions, and government efforts to reduce the level of rigidity in the French labour market saw limited results. The same problem also manifested itself in attempts to reform the French welfare state, which has over time exhibited some clear potential for passivity and labour market exclusion. Instead of a typical continental welfare regime, the French welfare state has been known as a hybrid system in which Bismarckian and Beveridgean principles co-existed (Theret and Barbier 2002: 5). Like other continental welfare states, most cash benefits in France are contributory and earnings-related, and there is a very visible linkage between payment and entitlement, making it difficult to directly cut the level of benefits. As a deficit in the social security system started to grow since the mid-1970s with the gradual rise in unemployment, the French government’s typical response was to further increase revenue by raising social security contributions instead of reducing benefits. Social security contributions stood at 44.4 per cent of payroll in 1992, compared with 17.2 per cent in 1970. Frequent use of social contribution rises also made “the social treatment of unemployment” an attractive option,
whereby retirement ages are lowered and workers removed from the labour market through massive use of early retirement schemes. Another example of Bismarckian features in the French welfare state is the breadwinner family model used in benefit design and distribution, whereby social transfers to children and women come as an extension to benefits for the male employees (Palier 2000: 116-120, 130; Clegg 2002: 209). These Bismarckian characteristics in the French welfare state presented potential for passivity typical of continental welfare states, but the republican emphasis on solidarity as well as social responsibility of the state has also put in place active measures in the service side of the French welfare state. This is seen especially in the historically extensive provision of public childcare places, which reduced the potential costs for women to enter employment. Emphasis on republican solidarity has also contributed to the Beveridgean features of the French welfare state, especially the push towards universal access through expansion of existing schemes as well as the creation of new supplementary schemes, within the overall framework of social insurance (Theret and Barbier 2002: 5, 8). This hybridized nature of the French welfare state has proved useful for later French expansion of the ALMPs, as social contributions were later combined with tax revenues into a universal contribution, used by the Socialists to pay for the government’s main active labour market measures.

Upon entering office in 1981, the Socialists embarked on large scale nationalizations and demand side subsidies in an attempt to stimulate economic growth and jobs. Minimum wages as well as social transfers were also increased. The ensuing escalating budget and trade deficits put significant pressure on the franc. In order to avoid a sharp devaluation and remain in the European Monetary System, the government was forced to abruptly reverse its
interventionist and demand side measures carried out during the first two years in office. Premised on the *franc fort* principle, the government not only pegged the franc to the Deutschmark, but also reduced industry assistance, abolished planning targets and decreased capital grants and subsidies. Whereas the bulk of the U-turn took place primarily on the economic and industrial policy front, its impact soon spread into the labour market and the welfare state, characterized by increasing unemployment and labour market exclusion, setting the scene for later third way reforms. As rapid economic austerity and liberalization reforms followed hot on the heels of equally rapid demand side stimulation, inflation was reduced from 9.6 to 2.7 per cent between 1983 and 1986, but unemployment shot up to 10.4 per cent. Average unemployment for the next ten years was 10.8 per cent, compared with an average of 3.5 per cent before the U-turn (Huber et al. 2004; Levy 2000: 324-325). In response to this crisis of unemployment, the Socialists introduced the Minimum Income Insertion (RMI) in 1988, and as will be elaborated in the case studies, this put in place a substantial expansion in French active labour market measures and set the Socialist policy strategy in a third way direction. However, this early development was cut short by the return of the Gaullists to power in 1986. As one of the earlier instances of social democrats forced to choose labour market activation to combat unemployment, the first few years of reforms under the Socialist Prime Minister Rocard were marred by contradictions. Despite expansion in the active apparatus, early retirement schemes financed by social contribution rises continued to further aggravate labour market exclusion well into the early 1990s. In addition, by 1993, power shifted back to the centre-right, and the following five years under the centre-right government saw increasing policy emphasis on deficit reduction.
In economic policy, both the Balladur (1993-1995) and Juppé (1995-1997) administrations were marked by a clear increase in the pace of liberalization. Privatization of the state sector continued, and a wide range of regressive taxes were introduced. In social and labour market policy, changes were increasingly dictated by short-term concern with cost and deficit reduction. Instead of increasing state expenditure to fund offers of active labour market opportunities, Balladur adopted a typical strategy of low-wage compulsion into employment by proposing an “insertion wage” for the youths, set at 80 per cent of the minimum wage. Employers were at the same time relieved of any responsibilities for qualifications and training. Massive protests forced the withdrawal of this measure, but the pattern of welfare state downsizing bounded by vehemence of popular protests, characterized by Levy (2000: 332-333) as “negotiation between the state and the streets”, persisted and manifested itself frequently in reforms to the welfare state under the centre-right parties. The return of the centre-right coincided with the demise of social contribution increases as the principle source of funding for further welfare state expansion, and in a reversal of direction, direct cuts in benefits followed. At the same time, however, massive early retirement continued to be encouraged in order to alleviate costs on the firms. The social security reforms under the centre-right, therefore, were clearly more oriented towards the problem of costs than the problem of passivity. The takeover of government by Juppé in 1995 intensified the attempt to downsize the social security system, and the Juppé social security proposal spread the target of benefit cuts into the civil service. The lack of consultation on top of the radical retrenchment proposals led to public anger on the streets and later through the polls in 1997. However, five years of policy making in an effort to restrain public expenditure had
not made a clear impact on economic performance. As the centre-right parties were ejected from office in 1997, unemployment stayed at 12 per cent, crowning a decade of unemployment above 10 per cent (Huber et al. 2004).

Germany

With the Red-Green coalition coming to power in 1998 after a period of 16 years in the political wilderness, the social democratic power basis for third way reforms was established in Germany later than many other country cases. In addition, typical political veto points present in the German’s federal government institutions posed further obstacles for welfare state reforms, especially the control by the opposition parties not only in the Bundesrat but also in various individual Land administrations. Mandatory active labour market policies emanating from the federal level, therefore, are difficult to implement (Clasen 2000: 104-105). Beyond simple political veto points, potential institutional obstacles for changes towards third way employment promotion also exist in the labour market. As is typical of continental welfare states, in principle there is a low level of state autonomy in industrial relations, whereas social partners not only take centre stage in negotiating incomes policies but also become closely involved in the administration of social security benefits. In the German income policies arena, the principle of Tarifautonomie is reflected in coordinated industry level bargaining free from state intervention, which usually follows the lead of the metal union. However, the organizational strength of German unions in general, and the dominance by the giant IG Metall in particular, means that piecemeal changes to pursue wage restraint or introduce regulatory reforms such as increasing flexibility in the labour
market are often impossible without in effect winning over the whole labour movement. For example, the strong attachment of IG Metall to the early retirement schemes since the 1980s has made later attempts by the Red-Green coalition to reverse this practice very difficult. For this reason, corporatism in the German context is primarily symbolic and does not have any substantial economic impact in reality, and “corporatism without state” in Germany is characterized by a lack of central concertation (Hemerijck and Manow 2001: 227; Manow and Seils 2000: 140; Lehmburch 2003: 153-154). The reluctance to abandon existing labour market practices is not limited to the unions, and there is a high level of collusion between employers and employees in shedding employees through the social security system in order to reduce the labour force in periods of demand slack. The transaction costs involved in this process, in turn, were paid through successive increases in social security contributions. Therefore, despite their public rhetoric to the contrary, in practice German employers can be as reluctant to dismantle the existing welfare state arrangement as the unions.

This problem of social partnership collusion in externalizing the cost of economic adjustment is present in all continental welfare regimes, where insurance-based social benefits are funded by contributions and where coordinated market economies premised on niche products suffer from sectoral transitions to the low-productivity service sector. However, this problem is especially serious in the German context as several potential contributing factors fed on each other in a clear vicious circle. On the one hand, the share of the low-wage sector in service employment was particularly small in Germany; on the other hand, the dominance of IG Metall in core industries meant that general downward flexibility in wages was particularly difficult to achieve. Therefore, large ranks of low-skilled workers
were continuously dismissed from the core industries due to wage as well as non-wage labour costs, but once they were out of the labour market, these workers were often unable to find low-wage low-productivity jobs and moved instead into long-term unemployment, encouraged by labour market exit schemes paid through social security contribution increases. Further rises in social security contributions, on the other, continued to add to non-wage labour costs (Manow and Seils 2000b: 296; Manow and Seils 2000: 156). Therefore, outflow from the German labour market was particularly serious, a problem further perpetuated by the dominance of the CDU in government throughout most of the 1980s and 1990s. Over an extended period of 16 years, the Christian democratic bias towards massive use of social transfers to reduce the labour force was allowed a full play. This state of affairs means that reduction in social security contributions as well as crackdown on labour market exit schemes inevitably became the centre-piece of later active labour market reforms. The potential for passivity in the German welfare state is not limited to the use of social security contributions to stimulate exclusion from the labour market. As is typical of continental welfare regimes, female employment is very low, as a result of breadwinner model of benefit calculation on the one hand and severe underdevelopment of public services on the other hand, especially childcare places.

Between 1969 and 1982, a coalition of the SPD and FDP was in government in Germany. Unemployment problems in German first started to surface after the oil shocks of 1973. During the period between 1971 and 1974, not only was the Deutschmark floated against the dollar, but the Bundesbank also formally subscribed to a monetarist policy by targeting the growth in the volume of money and maintaining a tight anti-inflationary
principle. Throughout the 1980s and 1990s a substantial revaluation in the Deutschmark followed. On top of the international recessions triggered by the oil crisis, these changes on the monetary front contributed to losses in German industrial competitiveness and economic decline. Whereas unemployment was below 1 per cent before 1973, two years later it climbed to 4 per cent, and by the early 1980s it had reached 8 per cent (Huber and Stephens 2001: 265). However, with the Bundesbank now determined to enforce a tight monetary policy, Keynesian demand side stimulants were practically ruled out in Germany by the mid-1970s, earlier than most other OECD countries, which were forced to abandon pump priming and devaluation by pegging to the Deutschmark only well into the 1980s. After the federal budget turned into a surplus by the end of the 1980s, there was clearly limited competitive leverage in further monetarist belt-tightening. Without the immediate pressure of cost control, the Christian democratic government did not rollback the welfare state, despite its rhetoric of radical change when entering office in coalition with the FDP in 1982. Instead, the Christian democratic response to the persistent unemployment problems placed more emphasis on passive removal of the denominator: labour force was continuously diminished through labour market exit schemes. Among these schemes, the removal of older workers through early retirement took on an increasingly prominent profile, especially after German unification brought the East German industries to near total collapse. A special early retirement scheme for workers over 55 years of age was created for East Germany, and between 1989 and 1997, old-age insurance contributions rose from 18.7 per cent to 20.3 per cent of payroll (Bleses and Seeleib-Kaiser 2004: 72-73). Just as the passive side of the German social and labour policy apparatus was emphasized by the Kohl government since
the 1990s, its active side was somewhat sidelined during this process, because both sides were funded from the same source. Unlike the practice in Scandinavian countries, where active labour market measures are funded through taxation, labour market measures in Germany are funded from the same social security contributions as unemployment insurance. As massive inflows from East Germany into the social security system took place, an initial burst of training and active job creation measures intended to increase East German employment was rapidly scaled back (Manow and Seils 2000b: 282-283, 293). The increasing tax and social security contribution burdens as well as total government expenditure as a result of bailing out unification were taken note of by the Bundesbank, which subsequently reacted by raising interest rates and sending Germany into a recession by 1993. By the time when the Red-Green coalition returned to power in 1998, unemployment had reached 11.6 per cent (Huber and Stephens 2001: 271). This crisis of labour market exclusion, which had progressively worsened over the previous two decades, formed the context for the later active labour market reforms.

*The United Kingdom*

Similar to the case of Germany, the coming to power of New Labour in 1997 after 18 years of continuous Conservative rule means that the power basis for third way reforms in Britain was established relatively late. A unitary system of administration in Britain and single party governments based on the first-past-the-post system, plus a weak upper house, means that there are relatively few veto points in the political institutions for government reforms. On the one hand, this smoothed the way for third way reforms under New Labour,
on the other hand, this also facilitated an extended period of radical neoliberal strategy involving cost control, austerity, and welfare state retrenchment under the previous Conservative government. The negative employment and social exclusion consequences of the Thatcherite reforms went on to form a crucial premise for the third way reforms under New Labour. As an example of liberal welfare regimes, means-tested minimum level benefits have constituted an important component of social transfers in the British welfare state. On the other hand, the tax-funded service side of the British welfare state has maintained a level of commitment to the Beveridgean ideal of universalism based on citizenship. This is seen especially in the National Health Service, which is one of the few main welfare institutions that escaped a full front assault during the Thatcher period. To some extent, Beveridgean universalism is also reflected in flat rate benefits paid to all claimants from the compulsory National Insurance, which covers not only retirement pensions and unemployment, but also sickness, maternity, and accident compensation. Although National Insurance is based on contributions, it has over time become a form of general taxation in practice. Unlike insurance-based social transfers in continental welfare states, in the British National Insurance there is no clear linkage between the amount of contributions and the amount of benefits paid back, and this characteristic has allowed governments to raise contribution rates instead of direct taxes to pay for increases in public spending, and the National Insurance in effect becomes a stealth tax. In fact, it is precisely the raising of taxes disguised as National Insurance contributions that provided an important financial resource for third way active labour market measures under New Labour. On the other hand, since entitlements to National
Insurance benefits depend on contributions, means-tested social assistance becomes an important backup for those excluded from the bulk of the social security system.

Unlike the cases of continental and social democratic welfare states, unions in Britain are rather detached from the social insurance system. This factor helped prevent the emergence of “social wage”, which, Rhodes (2000b: 24-27) argues, is an important tool for achieving nominal wage restraint. This social wage mechanism operates by offering full employment as well as expansions in social benefits and services in exchange for the willingness of unions to give up nominal wage claims. Furthermore, both the unions and employers in Britain remain fragmented in organization, and industrial relations in the British context are traditionally voluntarist as well as adversarial. A low level of coordination for multiple bargaining units and the inability of the government to directly intervene with legislation further contributed to a general state of persistent wage inflation in the British economy until well into the Thatcher period. While there was continuous failure to pursue wage restraint, the British economy was also slow in productivity and technological upgrading due to low spending on R & D and inadequacy in training, in a liberal market production regime oriented towards competition on price and reluctant to provide supply-side public goods. In addition, the economy was particularly vulnerable to financial pressure from changes in the international economy, and persistent current account deficits rapidly translated into downward pressure on the pound. In response, a series of stop-go policies followed throughout the 1950s and 1960s, further disrupting economic growth and expansion of the welfare state.
The confounding problems in incomes and economic policy came to a head after the oil hikes of 1973 induced a deep recession. The contraction of the economy coincided with a period of current account deficit between 1973 and 1977, as well as the persistent inability of the Wilson and Callaghan Labour governments to control wage and price explosions. Meanwhile, there were seriously escalating industrial conflicts over wages well into 1979, when the Conservatives returned to power under Thatcher. With regard to the stagflation problems of the late 1970s, the policy response of the British Conservatives is one of the most faithful representations of the neoliberal prescription focused on cost control and minimizing the state in order to achieve economic competitiveness. Many centre-right governments emphasized the importance of cost reduction in reversing economic decline since the early 1980s. However, in actual policy implementation, the neoliberal strategy of whole-scale and radical downsizing materialized only in the most auspicious circumstances, where there are minimum veto points in political institutions and relatively narrow constituency in welfare state benefits: Britain and New Zealand. Since the early 1980s, whereas the centre-right cuts in expenditure and the welfare state in Britain and New Zealand were radical and ideologically-driven, in most other country cases the cuts were limited in scope, driven by short-term budgetary or unemployment concerns, and often quickly reversed once budget deficit was reduced (Huber and Stephens 2001).

Under the British Conservatives, a project of radical deregulation of the labour market and de-legitimization of the unions went underway. The Trade Union Act of 1984 and the Trade Union Reform and Employment Rights Act of 1993 abolished closed shop, introduced secret balloting, severely limited the rights to industrial action, and also made
unions liable for the costs of industrial action. Trade unions were required to give seven days’ notice for strikes, and injunctions against unlawful industrial actions were allowed. The effect of these changes was significant. Between 1979 and 1994, trade union membership declined from 13 million to eight million, and most restrictions on working hours, dismissals, as well as wage standards were non-existent by the end of the Conservative period (Millar 2002: 161-162). The basically flattened field of labour relations by 1997 means that, in the third way reforms under New Labour, the securing of a macroeconomic context of wage restraint was relatively easier, and the introduction of further labour market flexibility less important, than many other third way reform cases.

Whereas the destruction of union-based potential for wage explosion does go a long way in addressing the root causes of British stagflation of the 1970s and 1980s, the merits in other parts of the Conservative economic projects are more contentious in resuscitating economic competitiveness. In particular, Conservative measures are unambiguously negative with regard to their impact on employment as well as social exclusion. Parallel with deregulation in the labour market was significant privatization in the public sector and radical liberalization in the macroeconomy, premised on a tight monetarist policy stance. Between 1979 and 1995, employment in the public sector fell from 7.5 million to 5.2 million. The high profile privatization of housing started in 1981, and by the end of the Conservative period the public share of the British housing sector had been reduced to 19 per cent (Millar 2002: 162-163; Alcock and Craig 2001: 134-135; Page 2002: 172-173). A new medium-term monetary policy was adopted, with a focus on supply of broad money, which includes cash, credit, as well as public sector borrowing. In addition, the banking and credit market was liberalized,
and rapid increase in consumption taxes went hand in hand with cuts in income taxes. The reforms aimed at reducing state expenditure also spilled into the arena of the welfare state and left a deep impact, despite the lack of clear evidence that welfare state expenditure was contributing to the competitiveness problems in the British economy. The Beveridgean universal side of the British welfare state was severely scaled back and the means-tested residual side expanded. While the number of people dependent on social assistance doubled from 4 to 8 million under the Conservatives, entitlement to National Insurance was simultaneously restricted. Quasi-markets replaced public delivery in social services, and the government actively encouraged individual private pensions, whose coverage in population grew from 1.5 to 14 million over the course of the 1980s. Despite all the retrenchment in welfare state, contraction in state expenditure and a tight monetarist policy, productivity in Britain remained the lowest among the G7 at the end of the Conservative period, and the British economy had not emerged from a low-cost low-wage trap. Meanwhile, the labour market and social consequences of the reforms were negative. Whereas unemployment stood at 5 per cent in 1979, the average unemployment for the 1980s was 10 per cent and 9 per cent for the Conservative years in the 1990s. The labour market exclusion implications are even more striking. Forty per cent of the unemployed in 1997 were long-term unemployed, and male economic inactivity stood at 3 million. As a result of these labour market exclusion problems, poverty and inequality had risen significantly by the end of the Conservative period (Millar 2002: 149; Rhodes 2000: 51; Huber et al. 2004).
Australia

Coming to power in 1983, the Australian Labor Party (ALP) was able to establish the power basis for third way reforms earlier than many other social democratic parties across the OECD countries. This power basis, meanwhile, also lasted for an extended period of 13 years, until the centre-right Coalition returned to power in 1996. The distinctive characteristics of the Australian welfare regime set down important institutional as well as policy assumption parameters for this period of reforms. Within Esping-Andersen’s (1990) liberal welfare regimes, Australia and New Zealand have often been grouped together in a unique category known as the wage earners’ welfare states. The key strategic principle of the wage earners’ welfare state arrangement is to deliver the bulk of social protection through full employment and high living wages determined through the arbitration process. In addition, arbitration also delivers various other social benefits such as sick pay or workers’ compensation. In Australia, this “basic wage” concept of social protection was solidified after the Australian Court of Arbitration passed down the Harvester Judgment in 1907 to establish the first wage fixing system in Australia and setting a weekly minimum wage determined by the cost of living. Meanwhile, in order to sustain full employment and a good living wage for the Australian core industries, massive protection for domestic industries in the form of high tariffs as well as an overtly racist White Australia immigration policy were carried on by governments both left and right until well in to the late 1970s. The informal and occupational side of the Australian welfare state has occupied a significant place in Australian social policy (Castles 1985; Castles 1988; Castles and Pierson 1996: 237-238).
The Australian labour movement and their political representatives made an important contribution to the development of the wage earners’ welfare state. The settler country context contributed to a working class radicalism particularly characterized by egalitarianism. Whilst the formal welfare state for a long time exhibited the basic liberal welfare characteristics such as means-tested benefits and minimum provision of social services, means-testing is distinctively applied from the top instead of bottom margin and implemented in a purposely un-stigmatizing way (Castles 1994). Before the establishment of Superannuation in the late 1980s, the Australian welfare state was basically non-contributory. On the one hand, there was no stigmatizing separation between social insurance and means-testing, on the other hand a high proportion of the population received means-tested benefits (Jones 2002: 25-26; Castles and Pierson 1996: 237-238). These historical and institutional legacies clearly left their mark on the later third way reforms during the 1980s and 1990s under the ALP. Third way active redistribution of the social security system, for example, characteristically involved further intensification of means-testing of the middle income earners whilst the worst off benefited. The iterative process of arbitration in delivering wages and benefits, similarly, familiarized the Australian labour movement with the concept and practice of “social wage”, which went on to become the fundamental basis for the Australian Accord, through which the ALP successfully secured the cooperation of the unions in delivering wage restraint for most of the 1980s and 1990s.

There are, however, also serious problems in the wage earners’ welfare state design, especially with regard to the large scale of protection offered to domestic industries in order to secure full employment and living wages. Together with Canada and New Zealand, the
development of the Australian political economy fits within the framework of the staples thesis (Innis 1930; Innis 1940), whereby the development of the national economy in settler countries on the periphery took place primarily during the process of exploitation of raw materials for more industrially advanced core countries. For this reason, the domestic manufacturing industries are intrinsically less competitive and efficient than the core countries in continental Europe. The arrangement of the wage earners’ welfare state leads to a situation whereby the wages and costs in low-productivity sheltered sectors are deliberately inflated through arbitration, and in the process squeeze rents out of the exposed sector based on staples production. As a result, while the productivity gap between the exposed and sheltered sectors widened, the long-term ability of the exposed sector to export profitably was also reduced (Schwartz 2000: 82-83). These underlying structural problems blew into the open when the decline of the exporting sector accelerated due to the gradual loss of the European agricultural market since the mid-1970s, especially since the entry of Britain into the EEC. After a brief period of three years in opposition, a centre-right Coalition government returned to power under Fraser in 1975. For the following eight years under the Coalition, limited reforms within the confines of the old policy framework failed to reverse the situation, and the economic, employment, as well as social fallout from this process formed the background for later reforms aimed at activating the labour market in the 1980s and 1990s.

In Australia, the centre-right parties found themselves in government during the initial stage in the unraveling of the Golden Age. During this stage, the typical response of the shell shocked governments across the OECD world was to continue pump priming and
further expansion of resources, in the last round of attempt to revitalize the economy through Keynesian demand stimulation. For this reason, austerity measures adopted by the Fraser Coalition were limited in scope. Officially, the Coalition government pursued an “anti-inflation” strategy until mid-1982. In this process, public expenditure was cut during the first few years and the welfare state scaled back, seen especially in the abolition of Medibank. However, the Coalition government was quick to reverse its measures when unemployment picked up as a result of these screw-tightening measures, and the initial Coalition stance of anti-inflation was also relaxed as well (Cass and Whiteford 1989: 280-284; Davis 1989: 70-71). More fundamentally, absent was any significant attempt to address two root problems behind the economic decline: excessive protection of domestic industries as well as growing pressure for wage inflation hidden in the arbitration system. In fact, the Coalition government publicly condemned the attempts by the previous Whitlam government to lower tariffs and committed itself to reversing what it called the “free trade” policies under Whitlam, and in 1980 the Coalition government conceded to the public sector unions wage awards well above the arbitration target. By December 1982, the government was forced to impose a wage freeze (Schwartz 2000: 108; Davis 1989: 71; Bennett and Cole 1989: 163). As will be elaborated in the case studies, the task of fundamental overhaul in the economic structure of the country, including the full liberalization of the credit and banking sector as well as dismantling of domestic protection, was left to the ALP governments in the early 1980s.

Meanwhile, the labour market and social consequences of the indecisive Fraser administration had manifested themselves fully by the time of power transition back to the left in 1983. Throughout the Coalition government period, unemployment was on a path of
monotonic and rapid increase, from 4.8 per cent in 1975 to 10 per cent in 1983. Both a collapse of resource boom and wage explosion contributed during the early 1980s to this sharp rise in unemployment. In the Australian context of occupational welfare premised on full employment, an unemployment rate of 10 per cent looked especially alarming, when compared with an average unemployment of less than 2 per cent during the late 1960s and early 1970s. The average duration of unemployment, meanwhile, was also longer than any period since the depression of the 1930s, and there were increasing numbers of people withdrawing from active job search (that is, people in joblessness). Another trend taking off during this period was significant increases in early exit from the labour market before the pension age, and the bulk of these early withdrawals from the labour market were actually involuntary. These labour market exclusion problems contributed to a significant increase in welfare dependency, as more people of working age were transferred from the wage earners’ welfare state to the means-tested and minimum formal welfare state. Therefore, despite the belt-tightening rhetoric of the Fraser government, social expenditure kept climbing through the 1970s and early 1980s. During the 1970s, the social expenditure increases were primarily a result of new programs and real increases in benefit levels. However, by the early 1980s the increasing social expenditure was simply a result of the substantial increase in unemployment. Poverty, meanwhile, also increased for all categories, especially for families with children, and for families where one or both parents were excluded from the labour market (Cass and Whiteford 1989: 275, 280-284; Jones 2002: 12-16).
As the Golden Age ended, the New Zealand social democrats entered government around the same period as their Australian counterparts, although their government tenure between 1984 and 1990 was comparatively shorter. For the incoming social democratic government (commonly known as the fourth Labour government), there was an unusual historical context of escalating but failing state intervention, which, by the time of power transition to the left in 1984, had reached record proportions in the OECD world.

The scale and failure of New Zealand state intervention by the early 1980s is a compound of common vulnerabilities shared with Australia due to the wage earners’ welfare state on the one hand, and uniquely expansionist policies under Muldoon’s National government (between 1975 and 1984). As another example of wage earners’ welfare state, historically New Zealand’s informal welfare state through basic living wage and full employment had also played a very important role in delivering the bulk of social protection. Different from the Australian Court of Arbitration, the New Zealand arbitration panels also included one representative from both the employers and employees, who over time had tended to exert dominant control over the panels and impaired their impartiality. In addition, compared with their Australian counterparts, the arbitration panels also had a lower coverage of the labour market. These institutional weakness combined, arbitration in the New Zealand context had generally had less capability to enforce discipline among the social partners and pursue wage restraint in times of economic pressure (Schwartz 2000: 78). During both the 1960s and 1970s, there was frequent upward drift in wage claims wildly beyond the target set by arbitration through a series of General Wage Orders. As another example of dominion
economy which initially expanded through the export of staples to the core industrial countries in Europe, the New Zealand economy shared an almost identical set of vulnerabilities as the Australian economy. This is especially seen in the inflation of wages and labour costs in the overprotected and low-productivity sheltered manufacturing sector and the squeezing of rents out of the exposed agricultural sector. When the core export market started to disappear with the entry of Britain into the EEC, the staples economies of both Australia and New Zealand started a similar trend towards long-term decline. However, the New Zealand economy suffered even more, because the greater inability of its arbitration system to enforce wage discipline led to serious wage inflations throughout most of the 1970s as well as the early 1980s. Similar to Australia, the absolute failure of the National government to address the fundamental problems associated with overprotection of the sheltered sector means that it was the incoming social democrats which took on the central task of deregulation as well as liberalization in the economy. However, while the Australian social democrats also increased state involvement in the labour market through active measures during this process, their New Zealand counterparts stayed firmly within the narrower confines of the economic arena. In order to explain how state activism in the labour market was decoupled from economic deregulation in New Zealand, it would be helpful to turn to the previous National government’s experience with state activism up till 1984.

After a brief period of three years out of office, the centre-right parties in Australia and New Zealand returned to power during the same year (1975) against the backdrop of ineffective and inflationary attempts by the previous social democratic governments to wrestle with the first signs of stagflation. Whilst the Coalition under Fraser in Australia
subscribed to an anti-inflationary policy, reduced public investment as well as public deficit, and removed the most significant universal component of the Australian welfare state (Medibank), the National government under Muldoon went in the completely opposite direction. Until 1975, the formal side of the New Zealand welfare state had retained the typical characteristics of a liberal welfare state such as flat-rate means-tested minimum benefits and meagre social services. However, soon after the National government returned to power in 1975, a tax-funded and universal superannuation was introduced. Available to everyone with twenty years’ residency at 65, the superannuation was far more generous than Labour’s two-tier pension schemes which it replaced (McClure 1998: 191-192; Bassett 1998: 344-345; Rice 1992: 484). By the time the Nationals left office, superannuation had become by far the largest component of government social expenditure.

In the economic sphere, the government significantly expanded credit assistance, not only to the manufacturing but also increasingly to the primary sector, which was feeling the pressure from the slack in European demands. A Supplementary Minimum Price was introduced in 1978 in order to maintain price stability for farmers, and the price assistance was paid significantly far above likely market returns. Credit to the Dairy Board, meanwhile, was continued at one per cent interest (Bassett 1998: 352-353). What took the government’s experiments in state expansion to new heights was the Nationals’ plan to stimulate economic growth by using New Zealand’s energy resources to attract energy-intensive industries (Gould 1982: 156). The government started to pump significant public expenditure into the exploration of natural gas as well as oil, not only in tax write-offs and grants, but also in direct investment in the construction of large scale power stations and processing plants.
across the country. By the time of the 1981 election campaign, these changes, in addition to the prospect of further gas exploration on South Island, had crystallized into a series of “Think Big” projects under the Nationals, who promised that these projects would create up to 410,000 new jobs during the 1980s. Government outlays ranging from superannuation, industrial and agricultural assistance, to state building in the energy sector were continuously paid through public sector borrowing, and the National government stuck to a perfect textbook Keynesian demand side stimulation right into the mid-1980s. Apparently, the full embrace of demand side economics by this centre-right government was closely related to electoral pressure, especially the efforts by the Nationals to up the ante in competition with the Labour, a type of dynamics clearly seen in the two-party competition over the generosity of superannuation. However, regardless of the causes, the large scale intervention had not been effective in reviving the New Zealand economy. The “Think Big” projects were perched on the erroneous assumption that oil prices in the international market would continue to ride on the momentum of the OPEC hikes in 1979. As oil prices started to decline during the early 1980s, the boom and bust in resources economy triggered a deep economic downturn in New Zealand as well as Australia. While unemployment was practically non-existent (0.08 per cent) the year before the entry of the Nationals into government, by 1984 it had climbed to 5.7 per cent. Overseas debt, meanwhile, shot up from 1.4 billion to 12.4 billion between 1976 and 1983, and during a similar period the proportion of government expenditure used to service debt rose from 6.5 to 17 per cent. Finally, when the Nationals were replaced by the fourth Labour government in 1984, government expenditure as a percentage of total GDP stood at 41 per cent, a level not often seen outside the Scandinavian
countries at that time. This scale of statism combined with the crisis of the economy made the neoliberal case easier for the Treasury under Douglas, who purposely stayed away from new expenditure commitments in the labour market. And, as a final parting shot, the Nationals refused to hand over power immediately after its election defeat, obstructing Labour’s attempt to devaluate the dollar and triggering a massive speculation, and the field was now open for the monetarist alternatives from the fourth Labour government (Kelsey 1995: 27; Bassett 1998: 365-366; Huber et al. 2004).
CHAPTER III

EXPANSION OF THE ACTIVE APPARATUS

As its name suggests, the active apparatus of social protection by the state primarily operates by facilitating the entry into the labour market for the unemployed and those out of the labour force. The social democrats have expanded the active apparatus primarily through introduction of new active labour market programs (ALMPs) as well as increases in the volume, scope, and financial resources for these programs. Although diverse in design, mechanism, and target population, ALMPs do share the common characteristic of making an offer to the unemployed, which could range from a temporary training scheme, education opportunity or job apprenticeship to direct placement in new jobs created in the public sector or subsidized in the private sector. In addition, all ALMPs to different extents couple the offer of activation with an obligation on the unemployed to respond actively, ranging from showing up for interviews with labour market officers or demonstrating job searching activities to compulsory acceptance of job or training placements. Apart from the ALMPs, two other important types of active measures are often used as supplements: in-work incentives and flexicurity measures. Both types offer a passage into the labour market more indirectly. On the one hand, unlike the ALMPs, they don’t directly create the physical and concrete venues where the unemployed and the labour market could interact; on the other
hand, were this interaction to occur, they should increase its financial returns, or decrease its family-related personal costs, for the working individuals. Measures serving these purposes are in-work incentives, which can encompass not only tax credits, minimum wages, reductions in social security contributions, but also the provision of adequate childcare places or individualization in taxation or benefit payment. Alternatively, some supplementary labour market measures can also increase the possibility of interaction between the labour market and individuals, especially for those individuals who cannot work in a normal condition or on regular schedules, by making necessary adjustments to the operational routine of the labour market. For those atypical workers who enter the labour market, their job security is protected, and for those temporarily excluded from the labour market, they are offered protection through the social security system. Measures serving these purposes can be called labour market flexicurity measures, a combination of flexibility and security. Regardless of whether it is ALMPs, in-work incentives or flexicurity measures, as part of the active apparatus all these policies have undergone expansion during third way activation reforms under social democratic governments. Although active and passive measures are treated separately in the book for the purposes of clearer focus, it is important to bear in mind that social democratic expansion of the active apparatus, especially ALMPs, is intrinsically linked to corresponding changes to the passive apparatus of social protection. Very often, an offer of ALMP to the unemployed remunerates the individuals for their participation in the form of increased welfare benefits; meanwhile, increasingly the conditionality of participation in activation offers is attached to entitlement to benefits.
Among the various components of the active apparatus, the ALMPs are, not surprisingly, not only the most dominant one in terms of policy volume and financial commitment, they are also the most theoretically interesting and innovative one in terms of activation strategies. This is not only because ALMPs often involve direct increases in public expenditure as the source of financing, but also because they directly offer a passage into the labour market. The ALMPs bring the labour market next to the door of the unemployed, saving them the often impossibly difficult task of reaching out on their own in search of the labour market. In addition, the making of an activation offer by the state creates the first substantial opportunity for policy makers to explicitly combine rights and duties to work and fine-tune the balance between the two, not only in actual policy implementation, but also in deeper programmatic philosophy. Therefore, it is usually in the evolutionary process of the ALMPs that social democrats reveal the most explicit evidence of philosophical or ideological shift from income replacement to income regain. In other words, the active apparatus, and the ALMPs in particular, is the place where a shift of paradigm, were it to occur, is most likely to be observed. For this reason, not only does this chapter devote a considerable amount of attention to the comparative examination of the active apparatus as policies, it also surveys, at the beginning of each country case, important shifts in overall policy paradigm, especially around the period of major power shift in government, in order to see if politics really matters in third way reforms.

As is the case with every other aspect of third way reforms, within each welfare regime type there are trendsetters who made the greatest expansion in their active apparatus, as well as laggards who made limited changes. For each regime type, we start with the
trendsetters as they are where the action is, and then the laggards are introduced as well. Similarly, for different social democratic governments, there were different emphases on which part of the active apparatus was deployed most. For this reason, this chapter also focuses on the part of the active apparatus where the greatest change has been detected, and then introduces the other parts where changes are comparatively more limited. Since the comparative focus is on the period since the early 1980s, it is important to recognize at the outset that trendsetters as well as laggards are therefore relative to this period only. Over a longer time span, what looked like a laggard by the late 1990s might be the hidden trendsetter of all. Where this shift of perspective is necessary, it will be addressed in the case studies, which now start with the Nordic welfare regimes.

The relativity in the concept of trendsetter versus laggard gets its most thorough representation in the Nordic welfare states. Since the early 1990s, the Danish social democrats have very much been the leader in its expansion in ALMPs, whereas the Swedish social democrats, while retaining their high level of ALMP expenditure, by comparison took fewer initiatives in further expansion. However, even after a decade of Danish activism, Sweden still commits more public expenditure to ALMPs than any other country in the world, as it has been doing for several decades. With this perspective in mind, we can now turn the focus to the reform experience of the third way pioneer since the 1990s, the Danish social democrats.
Denmark

Shift of Paradigm through the Shift of Power

Like most other countries which have carried out significant third way reforms, Denmark’s shift to successful labour market activation has gone through each of the three orders of changes identified by Hall (1993), ranging from minimal changes in policy setting, through limited changes in policy instruments, to fundamental changes in policy goals. During the period of bourgeois government between 1982 and 1993, there were few signs of fundamental changes towards labour market activation in policy principle, and active labour market measures remained limited in practice. The bourgeois parties were largely successful in steering the direction of economic policy from a primarily demand side strategy to one based on supply side measures. However, in terms of the social security system, the centre-right impulse to cut social expenditure or introduce private market into the delivery of services completely failed to materialize. Throughout its tenure, the bourgeois government reacted to the escalating unemployment situation by further reducing the supply of the labour force in order to alleviate the pressure on the labour market. There was only very limited retrenchment to the social security system within the overall framework of continuing generosity in social protection for those not in employment. Overall, between 1982 and 1993 the bourgeois parties slowed down the speed of expansion in the social security system and rationalized the provision of social services to a limited extent, but simultaneously they also continued to consolidate the welfare state inherited from the social democrats. Up till the end
of the bourgeois rule, the trend in Danish social security generosity continued to be steady improvement, although at a reduced speed compared with the previous social democratic era (Torfing 1999: 14; Torfing 2001: 299 Cox 1998: 11; Goul Andersen 2000: 73-75).

Throughout the bourgeois period, the Danish expenditure on labour market programs remained highest in Western Europe, but most of that expenditure was on passive measures, especially the very generous unemployment benefits, which were paid to all insured wage earners, at a level of 90 per cent of the previous wage and up to 16,000 Kroner a year, for up to seven years. Reflecting a kind of “ultimate universalism”, by the early 1990s the Danish unemployment system had become very much like a basic income system, whose overall purpose became the maintenance of the unemployed in a non-stigmatizing unemployment benefit structure. During the bourgeois period the only significant ALMP was a program which provided job offers and training support, specifically for those unemployed who were planning to start self-employment (Cox 1998: 11-12; Torfing 2001: 302; Loftager and Madsen 1997: 124; Goul Andersen 2002: 151, 154).

While efforts to activate the labour market stalled under the bourgeois parties, gradual evolution of policy beliefs was taking place among the social democrats in opposition. During the 1970s and most of the 1980s, the social and labour market policies of the social democrats were based on the traditional notion of social rights: the main aim of the party in government was to maintain people as full citizens, regardless of their labour market status. If people are unemployed, the primary task of the government would then be to maintain them in the benefit system, by avoiding the stigmatization associated with social assistance, and by maintaining equal social rights for those with and without work. Gradually into the
late 1980s and early 1990, against a background of escalating fiscal and unemployment difficulties, the policy framework of the Danish social democrats began to shift, corresponding with the developments in the Danish economy and social security system at that time. Most significantly, there was growing recognition by Danish policy makers of the structural nature of the unemployment problems plaguing the country since the late 1970s. Because of growing mismatch between the growth in wages and productivity, the main options for the Danish social democrats became either lower wage and unemployment benefit levels or stronger incentives to work (Goul Andersen 2002b: 66-67). For a labour movement, this choice was not particularly difficult to make, given that the securing of decent wages for its members was more or less its main raison d’être. Therefore, the Danish labour movement avoided lower minimum wages as well as unemployment benefits by accepting stronger incentives, either negative (obligations) or positive (rights), to work. Under the social democrats, active labour market instruments were to be deployed in order to improve skills and qualifications, so that differences in employability can be reduced to a level compatible with the traditionally small wage dispersion delivered through Danish incomes policy. This characteristically strong emphasis on skills in the social democratic activation outline can also be explained by the small and open nature of the Danish economy dominated by small businesses. For these kinds of economies, upgrading of skills and qualifications is particularly important in surviving external competition (Torfing 1999: 17-19). The gradual maturation of this new employment-centred policy outlook became substantively meaningful as the social democrats were returned to government in 1993.
On the actual policy level, the shift of paradigm first materialized in 1994, when the social democrats in government unveiled its ambitious three-phase labour market reform, which lasted until the end of the 1990s. All citizens were now expected to work or risk falling into poverty, and at the same time, state officials were correspondingly expected to be more interventionist in dealing with their clients. The new social democratic government made the first formal step in switching policy emphasis from retrenchment and reduction in labour force to restructuring the labour market, and from a policy of “welfare without work” to “work for welfare”. In a contrast to the past bourgeois practice of clearing the labour market and reducing labour supply, since 1994 the social democrats had set as its goal the increasing of labour supply by some 4 per cent over the next decade. From a virtually basic income system, the reforms under the social democrats have pushed Denmark to the level of Sweden in terms of the requirements on the duty to work. (Cox 1998: 11-12; Torfing 2001: 302; Benner and Vad 2000: 458; Goul Andersen 2002: 156). Although the duration of unemployment replacement remains higher in Denmark than in Sweden, the pressure to work as a result of strengthening ALMPs has significantly contributed to the active profile of social and labour market reforms under the Danish social democrats. Up to the early 1990s Denmark’s high expenditure on labour market measures was still completely dominated by passive measures, but since the labour market reform in 1994, passive expenditure has decreased while active expenditure kept growing rapidly. As a result, after almost ten years of reform under the social democrats, Denmark has one of the highest expenditures in active as well as passive measures in Europe, second only to Sweden. Whereas in the 1980s Denmark was relatively passive in social and labour market policy profile when compared
with other Nordic welfare states, a decade of social democratic reforms in the 1990s has made the country a front runner in labour market activation, almost on a par with Sweden (Madsen 2003: 77; Dahl et al. 2002: 14; Hespanha and Moller 2001: 57).

Changes in ALMPs

In Denmark, the very first tentative attempt to formally link rights and duties to labour market activation can be traced back to 1990, when the then bourgeois government introduced a Youth Allowances Scheme. Primarily targeted at those unemployed younger than 24 years of age, this scheme required social assistance recipients to participate in activation in order to be eligible for benefits (Rosløahl and Weise 2001: 160). However, this measure was very much the exception rather than the norm, and labour market policy in Denmark continued to be dominated by labour-force-reducing and other passive measures, until the labour market reform of 1994.

With the 1994 reform, for the unemployed individual there was now both a very explicit obligation to participate in ALMPs and the right to do so in an individualized plan drawn up between the individual and the local labour market office. Up till the early 1990s, the traditional Danish social security system offered members of the unemployment funds the privilege to receive benefits as right when unemployed, with the only condition being that they are available to the labour market on normal conditions. There was a very narrow interpretation of labour market mobility with regard to both skills and geography, and normal conditions in the context referred to the same conditions which apply for every one else on the labour market (Hespanha and Moller 2001: 58; Loftager 1998: 14). Since 1994, the
unemployed individual has to accept ALMP offers not on normal conditions but on conditions decided by the labour market authority, which can potentially imply not only lower wages and but also limit to rights previously available in a normal working contract, such as the right to wage negotiations, holidays, unemployment insurance or membership of a trade union. As well as enforcing the obligation on the unemployed, the new activation line also emphasized the responsibility of both the state and private enterprises in providing sufficient ALMP job opportunities for the unemployed (Ploug 1999: 96-98; Rosdahl and Weise 2001: 160; Loftager 1998: 14).

During the 1994 reform, the social democrats severed the connection between job training and the unemployment benefit system, so that participation in ALMPs would no longer give entitlement to unemployment benefits if the individual comes out of the training period still unemployed. This move finally reversed a long trend started under the social democrats themselves in 1979, when the party in government introduced a Job-Offer-Scheme. With the Job-Offer-Scheme, a job of at least seven months was guaranteed to all long-term unemployed. However, because of insufficient job demand in both the public and the private sector, people who were offered a temporary job were rushed out of it right after seven months in order to make way for the next eligible long-term unemployed. By the 1980s, this recycling trend had intensified, as the unemployed in general were entitled to unemployment benefit for three years, including six months of participation in a job training program, which in turn led to the entitlement for three new years of benefits. Now, the government’s reform in 1994 once and for all ended this practice of recycling the unemployed through the benefit system and ALMPs (Kvist 2000: 21; Kildal 2001: 7; Abrahamson and Oorschot 2002: 8).
Under the social democrats, the duration of unemployment benefit was split into one passive period followed by one active period. During the passive period the state offers individualized counseling to the unemployed to help them draw up an individual action plan about participation in ALMPs and reintegration into the labour market. During this phase the unemployed have a lot of discretion in choosing the preferred activation methods from the available options, and one crucial stated objective of these plans is to achieve an appropriate balance between the wishes of the individuals and the local market demands. During the active period which follows, the state is obliged to make ALMP offers based on the action plan drawn up during the passive period, and correspondingly the unemployed individuals are obliged to accept these offers. The ALMP offers from the state can encompass a very wide range of activities including specialized individual job training, pool jobs, job rotation, leave schemes, as well as training or education in the ordinary education system (Madsen 2003: 75; Bjorklund 2000: 155-156; Etherington 1998: 153-154; Dahl et al. 2002: 21; Dingeldey and Linke-Sonderegger 2004: 13). Just as the total duration of unemployment benefit was being reduced, the passive component of the benefit duration was also gradually crowded out by the active component. In 1995 the active period kicked in after four years of benefit, but by 1996 the lag was reduced to only two years and by 1999 to one, and the active period must involve activation for at least 75 per cent of the time. The reduction in the passive period was extremely steep for the young, already down to six months by 1996. For social assistance recipients, on the other hand, as of January 1994 they were required to be activated after only one year on social assistance. With these reforms, Denmark was well on
its way to implement by the end of 2000 the European Union employment guidelines calling for early activation for both young and adult unemployed persons.

With these measures for the unemployed individuals, both the rights and obligations to activation were significantly strengthened. In terms of obligations, the act severed the link between ALMPs and the right to unemployment benefit, and social assistance will now be significantly reduced if the unemployed refuses a reasonable ALMP offer. In terms of rights, for low-skilled people unable to compete in the normal labour market, the social democrats tried to create an intermediate labour market with relatively low wages, by passing in 1994 a law on wage-subsidized home service. As a whole, with its labour market reforms throughout the 1990s, the social democrats formally specified and conferred both the rights and the obligations of the unemployed, without at the same time bringing any changes to the level of benefits (Torfing 1998: 252-253; Etherington 1998: 148; Ploug 1999: 97; Kosonen 2001: 166; Goul Andersen 2002: 155). The overall development trend for Danish ALMPs is that, increasingly, activation measures are used for more people, in more situations and for longer periods, whereas the activation period kicks in increasingly earlier in the unemployment spell and the scope of activation measures continues to grow (Kvist 2000: 25-26).

In addition to intensifying the enforcement of both rights and duties to activation for the unemployed, the social democratic blueprint for ALMPs was also characterized by a very conspicuous human capital emphasis. The government used unemployment benefits of up to 100 per cent to support the participation of unemployed adults in the general education system, and since 2001 the government also introduced an apprenticeship for adults (Dingeldey and Linke-Sonderegger 2004: 15). As a result of the labour market reforms, all
the unemployed, regardless of whether they were entitled to social insurance, had the right to receive an ALMP offer of either education or job training. On the one hand, full-time ALMP participation through education or job training was made compulsory after a certain period of unemployment to reflect the general approach of the 1994 reform in emphasizing the obligation to accept activation. On the other hand, the government also emphasized the right to ALMPs by making the measures flexible and adjustable to the needs of both the specific individual and the prevailing condition in the labour market (Torfing 2001: 302-303; Bjorklund 2000: 155; Loftager and Madsen 1997: 124-125). To this end the government decentralized policy implementation to the regional level in order to facilitate the adjustment of local ALMP design to individual needs, and the most important component of this devolution process was a considerable strengthening of the power for the 14 regional labour market councils. Meanwhile, the government also introduced a system of planning guidelines and targets to insure that regional policies comply with the national goals for labour market policy. On the whole, while overall ALMP policy goals continued to be set by the Ministry of Labour and the national labour market council, detailed implementation instruments and specifications were devolved to the regional level. In addition to decentralization, the social democrats also introduced growing elements of customization in the public employment services responsible for administering the ALMP offers. The customization reforms were characterized by a strong emphasis on employer services, employers’ satisfaction, and the active recruiting of employers as customers of the employment services. With these organizational reforms, the Danish labour market has undergone a clear change from a rule-based benefit system to one based on the orientation to the needs of individuals.
The expansion and improvement in ALMPs were accompanied by very encouraging results in employment. Between 1994 and 1998 there was a massive increase in both the employment rate and decrease in unemployment rate. As the immediate objective of activating the labour market was steadily being achieved, the social democratic governments started to broaden the objective of its ALMPs to include the more marginal segments of the labour force which are more difficult to integrate. In both the second and third phase of the labour market reform in 1996 and 1999, there was growing attention to the vulnerable groups such as the long-term unemployed, low-skilled, the disabled, and other people with reduced capacity to work (Jensen 1999: 1). Correspondingly, the concept of “encompassing labour market” has taken the centre stage in the government’s activation policies. This is yet another major contrast with the practice of the previous bourgeois government. During the 1980s, the centre-right government did not make any significant effort to activate these marginalized segments of the labour market. The bourgeois government’s strategy was very much in common with its practice in other areas of social policy, including reduction in cash assistance and imposition of a waiting period for sickness benefits (Benner and Vad 2000: 448-449). By contrast, the “encompassing labour market” notion under the social democrats clearly stipulates that, on the one hand persons with reduced capacity to work should keep a job, on the other hand measures should be taken by the firm at the workplace to preserve the employee’s full capacity to work during the whole working life.

Based on the “encompassing labour market” logic, the government created flex jobs based on permanent wage subsidies for persons with permanently reduced capacity to work. The Ministry of Social Affairs launched the campaign “It Concerns Us All” to raise
awareness and exchange information on the social responsibilities of enterprises towards marginally excluded people. In 1995, the government recommended the social partners to include “social chapters” in their next round of collective agreements. These social chapters are bargained at the local level, and they serve to encourage the unions and employers to work together in facilitating ALMP and employment opportunities for individuals with reduced working capacity, health problems, or long-term exclusion from the labour market. Based on the social chapter, new types of jobs were to be created on a local level, whose wages and working conditions are suitable for people with reduced capacity (Lind 1999: 198; Madsen 2003: 105; Jensen 2004: 47) This creation of a transitional or intermediate labour market is one of the most important instruments used by the social democrats to integrate the marginalized unemployed. In addition, the government also changed the assistance to long-term unemployed from a rule-based system to a system based on the needs of both the unemployed individuals and the job requirements of the local labour market, to be reflected in an individualized ALMP action plan. For the more difficult group of low-skilled young unemployed, the government also introduced special youth measures in 1996. With this scheme, the individuals in this target group have a right and duty to ALMP on highly reduced benefits after six months of unemployment. The offers of ALMP include education and training and can last for at least 18 months (Madsen 2003: 105; Goul Andersen 2002b: 69; Madsen 1999: 76; Kildal 2001: 8; Ploug 2000: 5). The social democrats’ reforms targeted at the marginal segments of the labour market appear to have delivered some dramatic results. Five years after the labour market reform began, there had been a 61 per cent decrease in long-term unemployment and 67 per cent decrease in youth unemployment. Therefore, the
labour market programs of the social democrats have certainly served social cohesion objectives by successfully combating social exclusion for several groups traditionally marginalized from the core of labour market (Jensen 1999: 11). Since 1993, the social democrats in government have expanded childcare by some 130,000 places. Half-time daycare places have largely been converted into full-time places maintaining good quality care. This policy resulted in one of the highest employment rates of women with children within the OECD (Dingeldey and Link-Sonderegger 2004: 17; Benner and Vad 2000: 458).

On the whole, it is clear that the ALMPs under the social democrats delivered satisfactory results. Unemployment decreased over the whole decade from 1990 to 2000. There were increases in both labour market participation and employment, which then stabilized at a high level, and since 1995 both registered unemployment and hidden unemployment registered a drop. The most remarkable part of the achievement, however, is the transition from high unemployment to almost full employment without any serious inflationary consequences. Since the labour market reforms began, a dramatic shift in the Phillips curve has taken place as it is almost horizontal now, which indicates a genuine reduction in structural unemployment, as well as improvement in the general functioning of the labour market, as measured by the relationship between unemployment on the one hand and inflation or GDP on the other. If there is a country which has a comparative record to the Dutch miracle in dealing with unemployment, this country would be Denmark (Benner and Vad 2000: 451; Becker 2000: 231; Madsen 2003: 98-100; Madsen 2004: 200; Abrahamson and Oorschot 2002: 16). In addition, welfare dependency also lessened, as the proportion dependent on public support decreased from 29 to 26 per cent of all working ages between
1994 and 1998, although some of this decrease might be accounted for by the early retirement schemes in place during this period (Abrahamson and Oorschot 2002: 14).

Despite such success on a macro level, there is inevitably unevenness in performance with regard to individual programs and circumstances. Activation measures in the social insurance system seem to have better success rates than those in the municipal (social assistance) system. A similar picture can be painted about offers of job training in the private versus public sector, and regular long-term education versus short-term vocational training (Oorschot and Abrahamson 2003: 300). One key factor driving the variation in program performances seems to be the nature of the target population to be activated. The lowest employment effect for active labour market programs seems to be on groups who have been receiving assistance or excluded from the labour market for the longest period of time (Rosdahl and Weise 2001: 178-179). These, unfortunately, are probably the groups who are in the greatest need of state help in activation, because of their desperate situation of persistent exclusion. Therefore, to some extent the active labour market policies by the social democrats become least effective where they are most needed. This is not an isolated but general pattern, which also found itself in the activation reforms under New Labour as well as under the Purple Coalition in the Netherlands. Partly for this reason, partly based on what is already achieved so far, the focus of third way reforms under the Danish social democrats has gradually gone beyond straightforward activation to include non-labour-market objectives such as social integration, enhancing the quality of life, overcoming of social problems, and investment in human resources. A long-term strategy focusing on the inclusion of highly marginalized groups is occupying an increasingly important position in the social
Another example of activation reforms distinguished by a very strong element of social activation is the policies under the Jospin government in France. However, as the case study for France will show, the French approach is different in that social activation in France comes at the expense of labour market activation, rather than as a supplement to it, and for this reason the results of French activation measures are much less effective.

After the bourgeois government returned to office in 2001, it largely carried on with the activation reforms of its social democratic predecessor, with only very modest, if not symbolic changes, such as some savings in expenditures in active labour market measures. The major reform of the bourgeois government was the 2002 package “More People at Work”. In the context of the previous social democratic reforms, the biggest changes in the bourgeois package involved a condensation of individual active labour market programs into three main broad types, greater involvement of private organizations in implementing active policies, and a long-term plan to integrate social insurance and social assistance benefits. What is more significant, however, is the continuity, as “More People at Work” maintained both the administrative system for active labour market measures and the target of activating all adult unemployed after one year of unemployment (Madsen 2004: 196). The new government stressed that the basic elements of the social democrat’s employment policy have indeed been successful, and should therefore be retained. On a policy level, cross-party consensus has more or less been attained in the area of social policy and labour market activation. When the new government put forward its own reform package “More People at Work”, it was supported by all parties except those to the left of the social democrats. While
on the policy level the difference from the social democrats were small, in terms of public
discourse, the bourgeois coalition put more emphasis on incentives than on the
communitarian notion of citizenship (Goul Andersen 2002: 160; Madsen 2003: 105).
However, the new bourgeois government did signal a decline in corporatist concertation, the
institutional framework which has proved crucial in securing broad acceptance by social
partners of third way reforms of the past decade. With the introduction of interdisciplinary
national unemployment funds, the government secured an area in industrial relations where
the influence of the unions was excluded (Dahl et al. 2002: 28).

Labour Market Flexicurity Measures

In addition to the ALMPs, the success of the Danish activation reforms since the early
1990s has also been closely related to the almost unique combination between Danish social
and labour market policy arrangements known as the “golden triangle”. The three main
components of the “golden triangle” are: flexibility, social security, and active labour market
measures. The Danish employment system, therefore, is a kind of hybrid employment system
with a high level of job mobility similar to Anglo-Saxon countries but a generous
unemployment benefit system and well established ALMPs similar to other Nordic welfare
states (Madsen 2002: 245; Madsen 2004: 189). In its attempt to increase job security for
workers, the social democratic government has shunned the continental practice of stricter
hiring and firing procedures, for fear of eroding the existing flexibility and mobility of the
labour market. Instead, the government turned its attention to expanding ALMPs, especially
in qualification and training schemes, as the alternative source of employment security,
which is more sustainable for the employees from a long-term perspective because of the productivity gains it involves (Larsen and Bredgaard: 2004: 9). In addition to flexibility in moving in and out of employment, there is also a high degree of flexibility in transiting between part-time and full-time jobs, made possible by the fact that part-time work is regulated by the same legal and collective rule as full-time work (Madsen 1998: 699).

**Sweden**

*A Tradition in the Active Paradigm*

Compared with the other Nordic countries, especially Denmark, in the 1990s there had been relatively less social and active labour market policy reform under the Swedish social democrats. Apart from a development guarantee for the young unemployed on municipal social assistance, no major new ALMPs were introduced. Changes to the existing welfare state were also relatively limited, with neither dramatic structural overhaul or retrenchment (Hort 2001: 262; Merkel 2001: 67). The fundamental reason as to why there were less intense changes in the active apparatus in Sweden than in other Nordic countries in the 1990s is simply that Sweden was and is the forerunner. Compared with Sweden, the other Nordic countries were much behind at the beginning of the 1990s in the establishment and scope of ALMPs and other active measures. Almost all of the policy instruments considered crucial to today’s third way reforms had been tradition in Swedish social democracy for much of the postwar period: ALMPs, socially regulated market economy, and the importance of social partnership (Lindgren 1999: 49). What the other Nordic governments, and indeed all
other top-performing third way governments, strived to achieve was to have a set of active labour market measures as entrenched, mature, and comprehensive as the Swedes have had for decades, and today Sweden still spends more on ALMPs than any other OECD country. Indeed, despite minimal changes Sweden already fulfils all of the three quantitative demands for employment polices of the EU member states: a minimum of 20 per cent unemployed participating in ALMPs, offer of ALMPs for all young people after 6 months, and for unemployed adults after 12 months. Actually, the Swedish social democrats were so confident about active labour market reforms that they proposed an employment union within the EU to counter the emphasis on the monetary union (Boesby et al. 2002: 41; Oorschot 1999: 1; Furaker 2002: 123; Gould 2001: 147; Lodemel and Trickey 2001: 13, 67).

Changes in ALMPs

Administered by the powerful National Labour Market Board (AMS), ALMPs in the Swedish context are usually incorporated, together with a solidaristic wage structure, into the Rehn-Meidner model. Developed in the 1950s by two trade union economists Rehn and Meidner, the Rehn-Meidner model uses solidaristic wages to price low-productivity industries out of the market. Active labour market measures are then used to stimulate both the demand (through subsidies to employers) and supply (through training) of labour force. Labour displaced from low-productivity sectors are moved into the high-productivity ones through the ALMPs. Growth in the economy as a result of increasing labour force activity is then used to finance a system of universal and generous social programs. Although ostensibly a tripartite institution, the AMS is traditionally dominated by representatives from the unions.
The role of the AMS in Rehn-Meidner is primarily job creation through either demand or supply side measures, but the board also distributes subsidies to new industries, organizes training, and offers financial compensation for those moving to regions with labour shortage. Therefore, Rehn-Meidner gives the AMS an important role in both economic and employment policy (Lodemel and Trickey 2001: 13; Hort 2001: 249; Hort 2003: 249; Gould 2001: 141; Boesby et al. 2002: 19). Designed for an economy dominated by high-productivity manufacturing industries, the Rehn-Meidner practice of solidaristic wages started to have the opposite effect as secular shifts to low-productivity service sector further increased since the Golden Age. Arguably, suppression of wage dispersion now contributed to instead of removing unemployment, because while manufacturing industries shed jobs, low wage dispersion prevented expansion of private service sector employment. However, the overall impact of this change on employment was not significant, because the expansion of the public sector has increasingly become a key engine to further job growth in Sweden. Despite the historically high level of labour market activation in Sweden, the 1980s had been a less fortuitous decade for Swedish active measures when compared with the 1990s. Although ALMPs almost always dominate passive measures (unemployment insurance in particular) in the Swedish case, passive measures had peaked by the late 1980s, such as further relaxation of eligibility criteria for unemployment insurance in 1987 and the abolition of the waiting period. Corporatism, the important institutional context for active labour market reforms, was weakened with the decentralization of collective bargaining (Benner and Vad 2000: 430). When the government deregulated the credit market after 1986, the ensuing boom (and then bust) of the real estate and retail market led to an overheating economy plus
inflation, followed by economic austerity and a rapid increase in unemployment. By the early 1990s Sweden had entered a serious economic recession, with unemployment standing at eight per cent in 1992.

After coming to power in 1991, the bourgeois government attempted to control the cost of public expenditure. The government shelved the expensive ALMPs, such as skill and competence development, and invented cheaper programs instead. This strategy resulted in a serious attenuation of the ALMPs, since a growing proportion of active program participants were involved in cheaper measures. The progressive retreat from public financial commitment to ALMPs under the bourgeois government meant that by 1994, for the first time in postwar history, passive expenditure in unemployment insurance was greater than public expenditure on ALMPs. Such development was considered a major setback for the Swedish activation model (Hort 2002: 140; Hort 2003: 251).

By 1994, when the social democrats returned to power after a three-year interval, the previous government already scaled back the ALMPs. The departing bourgeois parties also handed over a combination of rapidly rising unemployment and budget deficit of 12.2 per cent of the GDP. Despite this most unfavorable condition, the social democrats managed to overturn the deficit problem in a period of two to three years. The deficit was 12.2 per cent of GDP in 1993, but by 1997 it was brought down to only 0.8 per cent, and by 2000 the budget was already in a surplus of 3.4 per cent of GDP (Anderson 2002: 14). This fiscal recovery opened new opportunities for public expenditure, and in 1996 the social democrats grabbed this chance and relaunched its active labour market reform, with new goals being set and backed up by new resources. The government put in place a new program aimed at cutting
open unemployment in half by the year 2000, and later set another goal of achieving gainful employment for at least 80 per cent of those aged between 20 to 64 by the year 2004. In relation to these targets, the government focused specifically on measures which offer training for the unemployed. In 2000, in order to reduce long-term unemployment between the ages of 55 and 64, the government further provided financial resources for an additional 40,000 job creation placements with local government, in the program Temporary Public Sector Jobs for Older Workers (OTA). During the same year the social democrats also introduced a special program called the Activity Guarantee targeted at those 20 years old or older who are in danger of becoming long-term unemployed. This measure offers a place in various types of ALMPs and offers the same level of compensation as unemployment insurance, and by refusing the offer of activation the beneficiaries will lose the right to regular unemployment benefits (Wadensjo 2002: 399; Hort 2002: 141; Dios 2002: 12; Benner and Vad 2000: 430; Gould 2001: 143).

After the social democrats returned to power in 1994, not only was there a quantitative expansion in the volume of ALMPs as compared with the previous bourgeois era, there was also a qualitative change in the principles and goals of the ALMPs. During the bourgeois period, the chief objective of the ALMPs was to keep the unemployment rate as low as possible and make sure that as few people as possible leave the labour force. With the social democrats in power, the emphasis of the active measures was focused instead on matching the unemployed to the demands of the labour market and reducing the risks of circling between active and passive measures. In other words, under the social democrats, the focus of labour market policy was on employability (Boesby et al. 2002: 41). Generally, the
Swedish social democrats have evaded the question about how low the wages should fall for low-skilled jobs and instead kept wages at relatively high levels in practice. The consensus seems to be that the state should not subsidize or encourage low wage working, and instead the state should work towards improving the qualifications of the workers so that they become more employable (Lindgren 1999: 54). Therefore, the Swedish ALMPs are a civilized version of workfare, which tries to offer empowerment to people through the right to work, and the goal of the Rehn-Meidner model has always been to improve the political resources of the unemployed. In Rehn-Meidner the carrots are usually used at the expense of the sticks, and the carrots are usually the direct offer of jobs.

In the 1990s, when there were serious deficit problems the Swedish government was forced by dwindling state resources to reinterpret the work-first principle as a bridge-over principle, so that instead of a job offer, people were offered six months of paid employment, after which they became eligible for unemployment benefits again (Hort 2002: 148; Hort 2001: 260). Obviously, this bridge-over principle has its own negative implication of recycling the unemployed between ALMPs and unemployment benefit, and it was precisely for this reason that, in Denmark, social democrats decisively broke the “bridge” by severing the linkage between unemployment benefit and participation in labour market programs. By contrast, in Sweden any attempt to separate benefits and activation was hampered by the social democrats’ move, under union pressure, to rescind the previous government’s laws making unemployment insurance mandatory. By rescinding the bourgeois laws, all rules and regulations about unemployment insurance also reverted to their pre-1994 status, including the entitlement to continuous re-qualification for benefits by participating in active measures.
(Boesby et al. 2002: 22). Nevertheless, the Swedish social democrats later did go on to make some limited changes to weaken the potential for recycling beneficiaries. Since 1996, it became no longer possible to qualify for the first period of benefits by participating in ALMPs, which could only count as work when an unemployed person was re-qualifying for the benefit (Boesby et al. 2002: 33).

As there was no dramatic increase or decrease in ALMPs overall, the general pattern of Swedish activation reforms in the 1990 is mostly shifting emphasis among existing programs. Despite these shifts in emphasis, it is important to highlight one constant feature of the Swedish approach as an overall context: historically Swedish labour market policy has followed the work-first principle, whereby a hierarchy between employment and social security was established at the central state level, so that job creation comes ahead of cash support for those on the dole. So, as the major component of the passive apparatus, unemployment insurance in Sweden has traditionally occupied a less important place than the ALMPs in the policy arrangement, especially those active measures aimed at training and retraining in order to improve skills (Hort 2002: 141; 248). When the unemployment crisis escalated during the early 1990s, the initial response of the government was to significantly intensify training and education programs in an effort to stop the potential rise of long-term unemployment. Later, ALMPs aimed at providing actual work experience became more prominent, and after the mid-1990s measures targeted at the young unemployed took the centre stage. By the end of the decade, on the other hand, both education-oriented and work-oriented programs were intensified. On a more general level, the emphasis on the obligation rather than the right to activation was made stronger in the latter half of the 1990s, when the
social democrats were in power, than during the earlier half, when the bourgeois parties ruled for most of the time. It was precisely because the social democrats enjoyed greater trust as the guarantor of the solidaristic welfare state that their attempt to introduce some more compulsion into the active apparatus was less hesitantly accepted. Similarly, when it comes to the limited retrenchments carried out over the decade, the general pattern was for the bourgeois government to propose reducing benefits or social services, only to be opposed by a united front of opposition from both the unions and the social democrats. Once in power, the social democrats actually implemented some of the cuts advocated by the bourgeois parties (Timonen 2003: 156; Gould 2001: 148).

Compared with other measures, it was the ALMPs targeted at the young that were less accommodating and carried a heavier undertone of coercion. In contrast to other ALMPs, compensation in youth programs is not linked to market wages but to replacement levels in either unemployment benefits or education programs, both of which were traditionally lower by comparison. Meanwhile, only the young unemployed had been imposed with stricter obligations to either work or continue education. For this segment of the population, the social democrats introduced a Development Guarantee Program in 1998. This program placed the young unemployed under the ultimate responsibility of the municipalities, who are required to make an offer of either municipal work or training program for up to 12 months. Meanwhile, the young unemployed themselves are obliged to accept any offer of activation or lose their benefits, even though the activation offer might involve terms inferior to the regular labour market and might not lead to entitlement to unemployment benefits. This particular attention to the young unemployed, and the adoption of comparatively harsher
measures for them, is also true of third way governments in several other countries (Timonen 2003: 100-101; Hort 2002: 141; 263; Kildal 2001: 10).

Labour Market Flexicurity Measures

By the mid-1990, the traditional corporatist practice in Sweden had ceased to function properly after the unilateral withdrawal of the employers’ organization from centralized bargaining as well as all state agencies. After substantial decentralization in bargaining, there was no longer any strong coordination of negotiating strategies on either side of the social partnership. The incapability of the social partners to reach consensual decisions based on compromises or tradeoffs was further aggravated by persistent union strength in Sweden. There was, in other words, very little immediate pressure on the unions to avoid direct confrontation with the government, and union opposition to changes they did not approve of tended to be very uncompromising. A typical example here is the social democrats’ prolonged attempt to relax employment rights in order to create the possibility for more jobs to be created, a continuation of the policy from the previous bourgeois government. After the social democrats proposed in 1995 to revise rules on employment rights, the relationship between the party and the unions deteriorated seriously, with the LO staging mass campaigns in an attempt to influence public opinion against the party. In the end there were not only significant defections within the party towards the unions, but the unions also managed to ally with the Left Party in opposition to the changes. What finally passed the parliament was a compromise solution, whereby for each employer a maximum of five individuals can be hired on a fixed contract for up to a year, by the end of which the employment could either be
terminated or renewed into permanent contracts (Gould 2001: 150-151). In addition, in 1995 the social democrats in government also abolished both of the two measures introduced by the previous bourgeois government aimed at relaxing the rules about lay-offs and probationary periods of hiring (Bjorklund 2000: 157).

These developments show that, at least in the short-term future, the social democrats have become either reluctant or simply powerless to put through any changes which can be interpreted as threatening job security for the core sectors of the labour market. Even on an European level, the Swedish social democrats have taken the somewhat unusual stance of criticizing the idea of a flexible work force because it involves less job security (Hort 2001: 261). A similar picture can be painted with regard to the party’s approach to flexible working time. When the social democrats set up a commission to investigate increasing flexibility in working time, there were serious divisions both within the party and the unions, and the final recommendation of the commission was very mild, which kept the existing working week of 40 hours but allowed a degree of flexibility in its application. There were, further more, serious disagreements between the unions and employers about the implementation or interpretation of the commission recommendations, with the employers always expecting more flexibility and the unions fearing the lost of control over their working time. Few unions had managed to negotiate an agreement with the employers over this issue, and the inability of the two sides of the social partnership to reconcile their differences led the social democrats to put on the backburner the legislation over this issue, as well as other measures concerned with increasing labour market flexibility (Gould 2001: 152-153). Despite these
difficulties in reaching agreements with the unions over flexibility issues, overall, wage bargaining to deliver wage restraint continues to be effective in Sweden.

**Norway**

*A Tradition in the Active Paradigm*

Similar to the Swedish case, in Norwegian social and labour market policy there has traditionally been a great deal of emphasis on the principle of the “work line”(*arbeidslinje*), which stipulates that waged work should be the first choice for all persons who are able to support themselves (Halvorsen 2002: 175). The “work line” also implies that there is at the same time an obligation on employers with regard to standard of working environment they offer to the workers. Employer contribution to the social insurance is differentiated by how many employees end up on disability, so employers have the incentives to offer good workplace conditions for workers. As an overall policy guideline or framework, the work line implies a strengthening of obligations on the unemployed to search for jobs as well as the rights of the unemployed to be reintegrated into the labour market, especially through training. In other words, the combined emphasis on rights and duties for both the employment services and the unemployed individuals led to a growing prominence of the contractual relationship between these two parties to the activation process. The more explicit linkage between benefits and work reflects the re-commodifying characteristic of *arbeidslinje*, but the expansion of training and qualification measures also increases productivity and potential wage return from participation in the labour market. Therefore, overall a combination of carrots and sticks are used to re-commodify labour, although the use

The *arbeidslinje* approach to labour market is not an innovation of the 1990s. Instead, it has historically been part of Norwegian labour market policy. The Norwegian government has traditionally committed large spending on ALMPs, especially those concerned with education and training, and the conditionality about willingness to accept activation offers has always been part of the eligibility criteria for social security benefits. The general trend during the 1990s was a shift towards more active measures, but often on small increments, so the active labour market reforms became an iterative process of gradual adaptation on the policy level to the spirit of *arbeidslinje*. During this period, Labour’s primary contribution to *arbeidslinje* was the translation of work conditionality into enforceable obligations that are backed up by the potential of real sanctions, in the form of restrictions on benefits (Kildal 1999: 366). The short interval of bourgeois government between late 1997 and 2000 saw some retreat from ALMPs as well as from the combination of duties and rights to activation, back to the passive labour-market-clearing measures and early exit pathways. In 1998, for example, the bourgeois government not only lowered the retirement age to 62 but also introduced a cash benefit scheme for parents with children. This benefit was not tied to the employment contract, and was targeted specifically at parents who do not use public childcare facilities. As a result, about 20 per cent of women with very young children took advantage of this scheme and reduced their labour market participation. Therefore, the bourgeois government renewed the fragmentation in arrangements about work and reproduction between men and women (Halvorsen 2002: 173, 175; Solem and Overbye
20004: 29). However, this reversal to labour-market-clearing passivity was limited, and as the bourgeois parties lost their next general election, the incoming Labour government made renewed efforts to implement arbeidslinje and introduce measures to activate the labour market.

Changes in ALMPs

During the 1990s, the first inkling for the resurgence of the arbeidslinje principle can be found in Labour’s Social Services Act of 1991, which emphasized that benefits may be conditional upon willingness to work. Admittedly very tentative, this assertion of the duty to work was later expanded by Labour to cover recipients of not only social assistance, but also benefits for unemployment, sickness, disability, old-age, and single parent families (Kildal 1999: 355). The renewed emphasis on the work line started formally with Labour’s 1992 White Paper on Rehabilitation, which focused on the increasing problems of exclusion from the labour market. The White paper clearly set out the principle of work being the first choice, and a Green Paper issued shortly afterwards presented the concept of the reservation wage as an argument for introducing cuts to unemployment benefit replacement rates. Then, in 1995, Labour in government published a further Welfare White Paper, which addressed the potential implications of arbeidslinje for the social insurance system. By formally establishing the link between the obligation and right to work and enforcing this linkage through work requirements attached to welfare benefits, the 1992 and 1995 white papers brought Norway in line with other Nordic countries with regard to their general approach to labour market policies (Dahl and Dropping 2001: 270-273, 283; Kildal 2001: 11). While this
series of conceptual developments with regard to *arbeidslinje* certainly prepared the theoretical and discourse background, on a policy level the changes in ALMPs under Labour took place slightly later.

Up to the mid-1990s, Norwegian ALMPs in the spirit of *arbeidslinje* existed alongside, rather than in lieu of, very generous passive labour market policies. This itself is not a Norwegian peculiarity, as Nordic countries in general are noted for their scale and depth of ALMPs as well as the generosity of their passive measures, especially unemployment benefits. In the Norwegian context, this characteristic is clearly reflected in a package of measures called Solidarity 2000. Launched in 1993, this was Labour’s first major offensive against unemployment on a policy level since the early 1990s. As it was designed during the period when the unemployment problem in Norway had just peaked, Solidarity 2000’s central objective was to reduce unemployment to a state of equilibrium by the year 2000, which the Ministry of Finance and Customs calculated to be 3.5 per cent. The two most important policy instruments to be deployed under Solidarity 2000 to combat unemployment were wage moderation, in the form of slower wage increase than other industrialized countries, and continuation of ALMPs. In Solidarity 2000, although the government mentioned the possibility to “reassess” welfare benefits and subsidies to private industries as a way to control cost and consolidate the budget, no substantive action was taken on these fronts, and the government was ready to continue financing the ALMPs directly through public spending.

True to a long tradition in the Norwegian approach to active labour market measures, the ALMPs introduced by Labour since the resurgence of *arbeidslinje* was marked by a
particularly strong emphasis on enabling and re-qualification. In 1998, qualifying courses alone accounted for 75 per cent of all participants in ALMPs (Harvolsen 2002: 160). As a demonstration of Labour’s serious attention to the enabling dimension, during a period of high pressure from rising unemployment the enabling active labour market programs can even be restructured into purely training programs, with the objective of job placement temporarily removed from the program remit. For example, as Norwegian unemployment started to pick up in the late 1980s, existing work training ALMPs for young and long-term unemployed became increasingly overwhelmed by the rapidly rising number of trainees. As a result, the National Employment Agency reformulated the objective of these programs. Whereas originally they were aimed at not only providing training but also eventually getting the trainees employed, now these programs only served to maintain working ability (Karlsen 1997: 153). In order to encourage life-long learning, during the 1990s the Labour government further introduced a program called “Competence Reform”, under which employees become entitled to three years of unpaid leave for educational purposes (Solem and Overbye 2004: 34). This very heavy emphasis on training and investment in human capital at the occasional expense of immediate job placement objectives almost makes a mirror image of the neoliberal workfare practice, whose preoccupation with the single objective of moving people off benefits often leads to extensive presence of low-skill low-wage jobs. The low-wage or low-benefit route to labour market activation is now clearly shunned by Northern European social democrats. However, compared to other Nordic countries, and Sweden in particular, the expansion of enabling active labour market programs
under the Labour government in Norway was relatively moderate, largely because of the comparatively less pressing unemployment problems facing Norway since the early 1990s.

Across Northern Europe, the social democratic governments have responded to growing economic recession and rising unemployment in a similar fashion, by accelerating public investment, ALMPs, and, initially, resorting to labour-market-clearing or early exit pathways. In other words, much of the expansion in active labour market measures by the Scandinavian social democrats was unemployment-driven. The expansion of active labour market measures in Norway since the late 1980s offers a very clear demonstration of this pattern. Between 1988 and 1991, participation in Norwegian active labour market measures increased by 400 per cent while unemployment rose by an unprecedented 90 per cent, albeit very temporarily. While the ALMPs cost 1.1 per cent of GDP in 1991, by 1993 it had cost about twice as much, at 2.6 per cent of GDP, and by 1999, when the country was well on its way to economic recovery, spending on the active labour market measures went back down to only 0.8 per cent of the GDP. Overall, the Norwegian active labour market measures had undergone significant fluctuations throughout the 1990s, and the government explicitly regarded this pattern as a necessary part of a “stabilization strategy”, so that the ALMPs were expanded or contracted in a countercyclical fashion with regard to the development on the labour market or in the economy more generally. In this sense, not only were the Norwegian active labour market measures unemployment-driven, they were deliberately so (Dolvik et al. 1997; Harvolsen 2002: 160; Dahl and Dropping: 281).

The unemployment problem in Norway during the early 1990s was clearly less serious than in Sweden and Denmark. Oil revenue largely shielded Norway from the external
component of the unemployment crisis gripping the rest of Scandinavia. The Norwegian government also managed to avoid some of the macroeconomic mistakes made in Sweden, such as a credit boom quickly followed by a turn to hard currency. The domestic, and structural, component of Norwegian unemployment was temporarily but swiftly reduced with labour-market-clearing measures. Given this context, there had been less pressing need for Labour to expand public resources for active labour market measures than was the case with either Sweden or Denmark. At the same time, the expansion of Norwegian ALMPs under Labour was also overshadowed by the simultaneous increase in passive expenditure, including not only early exit pathways but also increase in payments in unemployment benefits. Total public expenditure on employment measures, for example, nearly doubled between 1989 and 1993, but unemployment benefits alone accounted for 54 percent of the expenditure in 1989, and around 60 per cent by 1993 (Dolvik et al. 1997: 77).

*Labour Market Flexicurity Measures*

During its period in office during the 1990s and early 2000s, Labour had made only very limited efforts to bring more flexibility into the labour market. The most significant moves by Labour in this area include the introduction in 2000 of the right to temporary leave for up to three years for the purpose of pursuing education. At the same time, the government also encouraged the use of time accounts. However, under Labour there was no attempt to liberalize the labour law to or to make it easier to sign fixed contracts, and there was no relaxation in employment protection legislation (Halvorsen 2002: 170-172). The generally limited action by Labour in the area of labour market flexibility cannot be considered in
isolation from the fact that there was traditionally already a very high degree of flexibility in the Norwegian labour market. The already prevalent existence of part-time work, flexible working hours arrangements, leave schemes, plus an internationally very high degree of labour mobility (close to the US and Canadian level), have worked together to cancel out any serious labour market rigidity which the high degree of employee security in Norway may have introduced (Dolvik et al. 1997: 59, 69-71). Similar to the limited third way reforms by the Swedish social democrats on a more general level, the inaction by Labour with regard to labour market flexibility can be explained by the existence of a more or less satisfactory status quo.

The Netherlands

*Shift of Paradigm through the Shift of Power*

For the 1980s and early 1990s, shift of power in the Dutch context was only relative, because the Christian Democratic Appeal (CDA), the most dominant party in the Dutch party system, almost never left office, and the usual pattern in power shift was the change of coalition partners between the PvdA and the Liberals for the Christian democrats. Since the mid-1990s, this tradition has been broken as the Christian democrats were twice excluded from government, leading to what is often known as the Purple Coalitions between the PvdA and the Liberals. Ever since the PvdA replaced the Liberals as the coalition partner for the Christian democrats in 1989, the Dutch social democrats had maintained a more or less constant presence in Dutch governments, as the other two parties replaced each other as the PvdA’s coalition partner in successive elections. In this sense, the Dutch social democrats
achieved a period of unprecedented dominance in terms of government presence since the late 1980. As evidence of this growing social democratic influence, several of the governments during the 1990s were actually headed by the Labour leader Wim Kok as the Prime Minister. This sustained period of social democratic rule in the Netherlands made an important contribution to the Dutch miracle in labour market activation.

On the one hand, the consolidated presence of the social democrats in Dutch governments made possible the scope and success of the third way reforms, on the other hand the social democrats clearly built on the limited initiatives already started by previous centre-right coalition governments rather than starting from scratch. Since during each power shift only part of the government was replaced, some continuity in policy is almost inevitable, especially with regard to the overall direction of economic policy. When the PvdA entered the coalition in 1989, government outline for economic policy had already been firmly based on a prudent and anti-inflationary principle. Similarly, well before 1989, the centre-right coalition had attempted to address, though ineffectively, the mounting problem of abuse in the disability and sickness benefit systems. However, after the incorporation of the social democrats into the cabinet, a stronger emphasis on activating the labour market is gradually observed in the social and labour market policy domains. Kok as the new head of government significantly intensified the limited labour market measures installed in the 1980s by the centre-right Lubbers administrations. Whereas the previous centre-right government emphasized expenditure restraint and deficit reduction in the name of economic efficiency, the government under the PvdA started to commit more public resources to active
labour market measures. In addition, the government also comprehensively restructured the administration of sickness and disability benefits.

More fundamentally, whereas the previous centre-right governments tried to legitimize their reforms more on the grounds of cost-control and efficiency, the social democrats had increasingly attempted to legitimize these reforms by referring to the political goal of a more active society. The centre-right Lubbers administration started reforms to the social security system as early as 1987, but the centre-right perspective on combating unemployment remained primarily focused on the reduction of labour supply and redistribution of available work. The main scheme for promoting employment during the Lubbers I and II administrations was a single program *Loonsuppletie*, which offered a temporary wage supplement for all categories of unemployed on condition that they accept a job with a wage below previous wage level (Oorschot 2002: 112-114; Abrahamson and Oorschot 2002: 4-7). This reliance on low-wage low-productivity jobs as the primary solution to unemployment problems featured strongly in the centre-right government’s approach to employment promotion. The most significant failure of these earlier measures was their inability to alter the balance between active and passive instruments, and despite serious efforts at retrenchment, the volume of beneficiaries continued to increase after 1987. After the incorporation of the social democrats in government since the late 1980s, a rethinking in employment policy had gradually taken place. The reduction of labour supply was gradually replaced with efforts to expand the actual supply of labour on the job market. Policy emphasis shifted from a narrow focus on stemming unemployment to the broader issues of net participation and employment/population ratio, which kept declining despite
increasing numbers of women entering the labour market. The priority of redistributing unemployment was gradually replaced with that of increasing labour market participation, and the PvdA in government at the same time also made social cohesion a crucial component of government policy (Green-Pedersen 2002: 106-107; van Dyke et al. 2004: 19-20; Oorschot 2002: 107; Visser and Hemerjick 1997: 157; Stigter 1997: 18-19 Hoop: 2004: 69-70).

On the whole, the welfare state and labour market reforms implemented by the Lubbers I and II administrations up to the late 1980s can be characterized as primarily first and second order changes which were limited to alterations in policy settings or instruments without fundamentally innovating the policy goals (Hall 1993). Under the PvdA, the reforms gradually started to involve third order changes, as the fundamental policy objective shifted from social protection to labour market integration. The third order nature of the reforms under the PvdA is also partly the result of a changed perspective on the unit of analysis in labour activation: the breadwinner model now became discredited and replaced by the notion of individuals (van der Veen and Trommel 1999: 290; Braun and Giraud 2004: 50). As is true with many other third way reform cases studied here, the Dutch active labour market measures were closely integrated with measures aimed at wage moderation and sound public finances in a virtuous circle. Compared with previous governments, the PvdA coalitions, especially the two Purple Coalitions since 1994, had demonstrated a stronger inclination to integrate social policy, labour market, and economic reforms to serve one coherent theme of labour market activation. The rapid growth of the Dutch labour market on the demand side in the 1990s was made possible by the social partners’ support for wage and labour cost
reduction. Such support was, in turn, secured within the Wassenaar framework in exchange for social compensation, lower taxes and lower social security contribution chargers. The financial resources for these compensation measures came from improved public finances and a broader tax base, which, in turn, depends on increased labour market participation in the public as well as private sector (Hemerijck and Visser 2001: 198-199; Wilthagen 1998: 8).

Changes in ALMPs

While the Dutch government started making efforts to reduce unemployment well before the PvdA joined the coalition in 1989, the incorporation of PvdA led to further emphasis on the supply side of the labour market. The social democratic activation approach shows a growing similarity with the Scandinavian *arbetslinjen* approach, so that participation in ALMPs is now clearly required to precede income support. Benefits are paid only after all suitable active labour market possibilities have been exhausted, and Centres for Work and Income were set up to facilitate the implementation of this policy. The 1996 Law on Penalties and Measures intensified the sanctioning elements of polices, and the linkage between benefits and a person’s work record was also tightened by significantly increasing the work-related elements of entitlement criteria for benefit claimants. Entitlement to benefits for those under 21, for example, was replaced with a job entitlement through the Youth Guarantee Scheme, and single parents became subjected to work obligation once the child reaches 5 years old (Oorschot 1999: 32-33; Oorschot 2002b: 405-408).

In the PvdA coalition governments, party ideological difference with regard to strategies to activate the labour market inevitably manifested itself between the coalition
partners. In the two Purple Coalitions since 1994, for example, the Liberals as the smaller coalition partner were in line with its ideological tradition by advocating a solution to long-term unemployment based primarily on working below the minimum wage (Snels 1999: 131). By contrast, the objectives of social justice were more emphasized by the Dutch social democrats in government. However, the manner in which social justice was interpreted and delivered by the PvdA had changed significantly since the early 1980s. Now, instead of uniformly generous social protection and income equality, the PvdA in government attempted to achieve social amelioration primarily through the use of ALMPs. These active labour market measures were aimed at encouraging reintegration into the labour market, and in order to emphasize reintegration through investment in human resources and qualifications, the PvdA committed increased resources to strengthen the educational purposes of the ALMPs (Braun and Giraud 2004: 50; Levy 1999: 260-261). During the Lubbers administrations of the mid 1980s, activation used to be characterized by a generally uncompromising stance towards the supply side, and the primary policy response was rapid reduction in benefit levels and duration, based on the belief that labour market exclusion was fundamentally a problem of personal incentives deficiency. Since the entry of the PvdA into government, while the supply side remained a major focus of activation efforts, the government had adopted a much more accommodating and long-term attitude, with significant investments in labour market training and education, plus increases in the scope and level of in-work incentives. Under the PvdA, the significantly increased financial commitments to ALMPs with an enabling dimension signaled an acceptance by the state of a major responsibility for reintegration of the unemployed (Spies and van Berkel 2001: 128;
Meijers and Riele 2004: 12; Hoop 2004: 76). Instead of policy measures that rely on general subsidy schemes, the government focused on developing individual plans tailored to the specific circumstances of individuals with weak opportunities in the labour market (Pennings 2002: 304-305).

During the PvdA’s period in office, the young unemployed were the first and foremost target of the government’s third way activation reforms. In 1992, the government introduced the Youth Employment Act, under which individuals aged 18-22 who had been unemployed for more than six months would see their entitlement to a minimum income replaced with entitlement to minimum job rights. This change significantly strengthened the duties as well as rights of the young unemployed to participate in ALMPs. Based on this clearer linkage between benefits and activation, the government sponsored a wide range of ALMPs aimed at improving the skills of various types of benefit recipients as well as creating demand at the lower end of the market. A very large segment of these ALMPs offered placements in state-subsidized supplementary public sector jobs, which implies a serious commitment of financial resources to labour market activation on behalf of the social democratic government. The Youth Work Guarantee, for example, offered training or public sector jobs for young people up to 24 years of age who are not in regular education and without paid employment. On the other hand, the Banenpool-schemes were targeted at another key vulnerable group, the long-term unemployed, by offering them subsidized jobs in the healthcare or welfare sector. In addition, job pools for the low-skilled were created with funding from unemployment benefits and government subsidies. Since the early 1990s, some of the most innovative ALMP schemes aimed at job creation had included the two Melkert
job schemes named after the Minister of Social Affairs. Melkert-1 aimed to create 40,000 subsidized jobs in the most disadvantaged segment of the labour market. Under this scheme, temporary jobs were created in the public and subsidized sectors for a duration of six months to two years. These jobs were targeted at the long-term unemployed for 32 hours a week at the minimum wage or up to 20 per cent above. Melkert-2 covered both the public and the private sector by reimbursing half of the wages for up to two years for employers who hire a long-term unemployed person for a new job. Handicapped workers, on the other hand, could work in sheltered workshops and sell products at market price while collecting a wage subsidy from the government. The remit of sheltered workshops has since then been expanded as an instrument of general labour market activation, so that these workshops now also employ people who are unemployed without a handicap (Hartog 2000: 57-58; Visser 2001: 31; Beukema and Valkenburg 1999: 117-118).

In 1998, the YEA and the various other non-compulsory ALMPs for older individuals were merged into a major policy package Jobseekers’ Employment Act (JEA). The three principle measures working under the JEA are subsidized regular employment, subsidized municipal employment, and training or “social activation” (Handler 2002: 30). The integration of different labour market schemes under the JEA stopped differential treatment of different age groups, and participation in ALMPs technically became obligatory for younger as well as older job seekers. The merger of different programs under the JEA has further broadened the scope of activation measures, so that the JEA not only subsidizes regular jobs, but also offers training programs and various other unpaid activities as part of social activation. Given the integrated nature of the scheme, compulsory participation in
ALMPs means that participation in these other training and social activation programs also becomes obligatory. Along with increased obligatory requirement on job seekers, the government further committed itself to the task of offering chances of ALMPs within a one-year period for all newly unemployed and offering sufficient subsidized jobs or training opportunities. The two primary activation targets under the JEA are the two groups which top the priority list of third way activation for most social democratic governments: the young and the long-term unemployed, especially the former (van Berkel and de Schamphelaire 2001: 31; Spies and van Berkel 2001: 105, 127-128).

Although the Netherlands underwent a clear economic revival and large employment growth since the mid-1990, unemployment did not decline substantially among older unemployed, low-skilled and other disadvantaged groups vulnerable to being shut out of the labour market. There was also no significant increase in the total volume of work. For this reason activation remained on top of the government’s social and labour market policy agenda (Oorschot 1999: 32). The two Purple Coalitions since 1994 had placed a heavy emphasis on the stimulation of job creation for disadvantaged groups such as the long-term unemployed. The focus of labour market policy shifted from passively combating unemployment to an aggressive strategy of boosting labour market participation in general and increasing the participation of females, ethnic minorities and the elderly in particular, and for this purpose the government subsidized public sector jobs at the lower end of the labour market. In addition, in both 1996 and 1997 the government was able to restore net linking of minimum wages and social benefits (Visser and Hemerijck 1997: 118; Gorter 2000: 181-182). The new Social Security Act of 1996 also enabled municipalities to experiment on
activation programs targeted specifically at the long-term unemployed and their potential participation in a range of unpaid activities on a local level (van Berkel et al. 1999: 95-96). By the mid 1990s, spending on the local level as a proportion of total public expenditure was reduced to less than 25 per cent, but at the same time local taxing power was progressively updated, a move clearly aimed at compensating the drop in transfers from the central government (Fargion 2000: 72). This shift in the source of public expenditure is in alignment the governments’ general attempt to devolve the responsibilities of ALMPs to the local area so that it becomes easier to take into consideration the individual circumstance of the unemployed and design individually tailored programs. The PvdA’s decision to use increased taxation to finance labour market programs and public sector spending in general is a key characteristic that distinguishes the PvdA from the centre-right coalitions. Just as the PvdA tried to redefine social justice on the basis of employment instead of equality of social outcome, the government is committing more public expenditure to labour market policies than to social policies (Keman 2003: 129). Through the introduction of explicit activation duties and rights as well as integration of policy measures from different fields, the JEA has represented the culmination of the PvdA’s efforts to activate the labour market. The fundamental objective of social security has been transformed from protection to participation. The numerous schemes subsidizing jobs for the disadvantaged groups have in effect created a large secondary labour market (van Berkel and de Schampheleire 2001: 31; van Berkel et al. 1999: 95-96).
Labour Market Flexicurity Measures

The PvdA’s approach to increasing flexibility in the labour market is not straightforward deregulation, but the matching of flexibility with security in terms of decent levels of employment protection for part-time and temporary workers. Since they are used first and foremost as an instrument of activating the labour market, especially for those in atypical forms of employment, the primary focus of the flexicurity reforms were the legal position of employees with respect to job security, rather than the provision of social security for employees once they are ejected from the labour market (Wilthagen 2004: 1). Most of the policy changes aimed at introducing flexicurity resulted from lengthy processes of negotiations among the social partners and between them and the government. A crucial reason why the unions and employers were able to embrace the principle of flexicurity was the corporatist foundation laid years ago by the Wassenaar agreement. On the one hand, this agreement revitalized and entrenched the Dutch corporatist practice in industrial relations. On the other hand, through repeated interaction among social partners in negotiating wage restraints in exchange for working time flexibility or part-time jobs, both unions and employers came to accept the concept of flexibility as the increasingly dominant measure to create more jobs. With the continuing development of flexicurity, the original Wassenaar formula of wage restraint for reducing the working week was gradually replaced with wage restraint for part-time work, in a more or less smooth fashion.

The first major move towards flexicurity was the collective agreement for temporary workers signed by the unions and the employers in 1995. Under this agreement, temporary workers were given the right of continued employment and pension insurance after 24
months. Then, in 1997, the government took onboard most of the recommendations emerging from corporatist negotiations among the social partners and consolidated these elements into the Flexibility and Security Bill. This bill involved compromise between employers and employees as well as within unions between workers with and without stable jobs. Proposals contained in the bill included modifications to the dismissal protection enjoyed by the core labour force, abolishing of the permit system for temporary work agencies, and enhancing of the legal position of temporary workers. In 1999, the bill came into force as the Flexibility and Security Act (often known as the Flex Act). The act is the culmination of the PvdA’s efforts to introduce flexibility and security into the temporary and part-time segment of the labour market. It represents by far the most comprehensive and faithful application of the principle of flexicurity (Visser and Hemerijck 1997: 44; Hemerijck and Visser 2001: 198-199; Green-Pedersen et al. 2001: 318).

In terms of offering better security, the act clarified whether an employment agreement exists in the case of flexible labour. A temporary work agreement signed with a temporary work agency is now considered an employment agreement, and after six months all regulations regarding employment agreement fully apply. The extension and eventual conversion of temporary employment contracts into permanent contracts becomes automatic, so temporary employees are protected from dismissal unless under very special circumstance. In terms of allowing greater flexibility for employers, the act reduced the trial period in employment contract from two to one month in the case of temporary contracts. The giving of term of notice in dismissal was also made easier so that employment duration is the only factor that determines the term of notice. In addition, the procedures were shortened and
simplified for employers in requesting permission from the public employment service for dismissal. On the one hand, the act insured that a worker’s legal position would become stronger the longer he or she works on a temporary basis, on the other hand, it gave greater flexibility to the use of agency workers (Zwinkel and Peters 2001: 138-140).

Since the PvdA initiated the flexicurity reforms, there has been a massive expansion in the number and variety of flex jobs, many of which are very innovative in design. The typical flex jobs now available include not only temporary agency jobs and part-time work, but also on-call work, where workers only work when there is an actual need for additional labour, fixed-term work, and subsidized employment such as the ID jobs (“Inflow and Throughflow” jobs) which are based on a permanent contract but with the option of fixed-term one year contract for the first year of employment. Since the 1999 Flex Act, there has been an increasing number of job pools, whereby employees are rotated between different tasks depending on the various peaks in production. Or, alternatively, job pool agencies can take on for three years people who have exited from the local labour market and try to reinsert them into the labour market, while supplement wages during this period are provided by the original employer. Under the slogan “From Job Security towards Employment Security”, trade unions are actively involved in innovative experiments combining different elements of flex jobs, and the strategy of the unions reflects a considerable degree of forward looking and acceptance of the skill-based society. For example, “investments contracts” are designed, which enforce on both the employers and employees the mutual responsibility to invest in education and training. Instead of an employment offer within one job, employees are offered job opportunities within a certain job domain (Wilthagen 1998: 18-20; Wilthagen
2004: 4-6; Beukema and Valkenburg 1999: 116-117). However, the effectiveness of these measures of subsidized employment in activating the unemployed is uneven. The flow from subsidized to regular jobs decreases as the subsidy period increases, so there seems to be a lack of incentives or possibilities to move on once a client is placed in a subsidized job. These measures appear to be least successful with regard to the elderly and those with lower education, and they can potentially even be counterproductive for the disabled workers (Oorschot 2002b: 402-403).

With reforms increasingly oriented towards flexicurity, the main tool of redistributing jobs in the labour market has gradually shifted from across-the-board labour time reduction, as was the case set out in the original Wassenaar agreement, to more weight being put on part-time work (Hemerijck et al. 2000: 116-117). Nevertheless, the PvdA still took a series of measures to further relax regulations over working time. In 1996, the government introduced the new Law Governing Working Hours, under which a series of important new measure were put in place to facilitate working at irregular hours and to allow for individual variations in the length of the working week. These changes were further consolidated in July 2000, when the government introduced the Law on the Adjustment of Working Time. This new act gave workers who have worked for their current enterprise for a year the right to alter their weekly working hours either upwards or downwards, and the employer is generally obliged to comply with the request for altering working hours unless for important business or operational reasons. Since the start of 1998, an average working week of 36 hours has been extensively applied, covering 2.8 million employees (Delsen 2002: 317; Gorter 2000: 191; Plantenga and Dur 1998: 682; Beukema and Valkenburg 1991: 121).
The bulk of the flexicurity reforms, as explained earlier, focused on the legal position of atypical workers, but these core measures are also supplemented by improvements in related policy areas such as wages, training, and parental leave. As part of the omnibus 1999 Flex Act, workers on a fixed term contract and temporary agency workers have the same entitlement to leave schemes as workers on a permanent contract. Coverage for social insurance, healthcare, and additional pension schemes is now readily available for part-time workers, and the New Labour Act of 1996 also requested employers to take into consideration the caring duties of employees. By 1997, temporary work agencies had provided employment for over 200,000 person years (Green-Pedersen et al. 2001: 317; Wilthagen 2004: 22-23). With regard to wages, in 1993 the government repealed the “one-third criterion” in minimum wage and minimum holiday entitlement. This old criterion stipulated that employees working less than one-third of full-time hours are not entitled to minimum wage or holiday payments. All similar exclusionary clauses in collective agreements were removed in 1994. As a result, the legal minimum wage becomes applicable to all employees of working age. In 1996, the entitlement of part-time workers to equal treatment was extended to overtime payments, bonuses and training, and since the 2000 Working Hours Act, equal treatment of part-time workers has been extended to all areas negotiated by social partners, including not only wages and social security, but also holiday pay, subsidized care provision, and second-tier pensions. With the implementation of all these measures, the earnings difference between full-time and part-time jobs has been narrowed to 7 per cent. Then, in 2002 further provision became available for paid care leave

These series of efforts to introduce flexicurity into the Dutch labour market have produced impressive results in terms of job creation, but the downside of such instruments is also clearly emerging. Under the Kok leadership, the Dutch government was able to reach its target of creating new 350,000 jobs one year ahead of time in 1997. Value added in the total economy grew by 31 per cent between 1987 and 1996 (Visser and Hemerjick 1997: 151; Hemerijck et al. 2000c: 229). However, the largest part of the new jobs created are part-time jobs occupied mostly by women, and what is called the Dutch miracle in reality only amounts to an increase of 10 per cent in total available work. For better or worse, the fundamental nature of the Dutch miracle is the change in the structure, rather than the volume, of Dutch employment. This change in employment structure is what Oorschot (2002: 117) calls “the giant redistribution of work available,” as full-time jobs held by men in the manufacturing sector are replaced by part-time or temporary jobs by women in the service sector. For this reason, when measured in total amount of work per capita, the Dutch performance remains close to Germany, despite a much higher labour force participation rate. Although Dutch employment volume increased by 33 per cent in the sheltered sector, it dropped by 7 per cent in the exposed sector. The impressive job growth virtually happened within the low-productivity segment of the labour market. The successes of the Dutch economy since the early 1990s, therefore, has not been based on a real strengthening of the supply side, and for this reason the macroeconomic successes were very much relative. A perhaps even more serious drawback is that increasing employment in the Netherlands has
not been paralleled by the decline of non-employment. Rapid growth in employment exists alongside high level of inactivity and low level of labour participation, which is lower than the European average, particularly with regard to the elderly and women. On the one hand, the institutionalization of consistent wage moderation was a clear success, as it was one of the key contributors to the rapid growth of overall employment in the 1990. On other hand, the Dutch government did not succeed in substantially reducing long-term unemployment, one of the primary targets for activation by the government (Oorschot 1999: 32-33; Spithoven 2002: 359; Gorter 2000: 182, 204; Hemerijck et al. 2000c: 229; Goul Andersen and Jensen 2002: 32-33). In addition, because of the primary focus of government resources and energy on activating the young and the long-term unemployed, other groups with sometimes weaker labour market opportunities were not given sufficient attention, such as the older unemployed and ethnic minorities (Becker 2000: 236; Gorter 2000: 181-182).

In evaluating the overall achievements of Dutch flexicurity reforms, it is necessary to employ a perspective which proves useful for the evaluation of Dutch activation as a whole under the PvdA since the 1990s: the advantage of backwardness. In terms of the scope and speed of changes, the record since the incorporation of the PvdA into government in 1989 has been truly impressive. However, if one considers the absolute level rather than the degree of change, what the Dutch social democrats have achieved amounted primarily to dragging the Netherlands up to the Europe average. This was simply because the performance of the country had been much worse than many other European countries until well into the 1980s. For example, until 1980 Dutch labour force participation remained the lowest among OECD countries, and the social security system was firmly grounded on the breadwinner principle
The Netherlands now occupies the top position in the extent of part-time work, but it was only until the 1980s that the country overtook other countries performing strongly in this area, including Sweden, Denmark, and Britain. Although the Netherlands has above average possibilities for flex jobs as a whole, it is still below the European average on most other criteria of labour market flexibility, such as night, weekend and home work or extra hours. The scale and speed of the growth in Dutch women’s economic activity in the 1990s overtook all other European countries, but such dramatic change was only enough to transform the Netherlands from a European laggard to an average performer. In addition, the start of rapid growth in Dutch part-time jobs preceded the social democrats’ policy intervention, and the fundamental momentum behind the growing army of part-time workers was the behaviour changes in women, especially the late entry of married women into the labour force. Aggravated by the chronic lack of childcare facilities in the country, part-time work became the dominant coping solution for mothers. Nowhere else in Europe was the increasing activation of women so exclusively accounted for by developments in part-time employment within the specific sector of low-skilled service jobs (Daly 2000: 472, 481-483; Hemerijck and Visser 2000: 238; Visser 2002: 24).

*Increasing In-work Incentives*

Among the variety of financial incentives deployed by the PvdA to encourage labour market participation, a very large number were actually directed at the employers rather than employees. In generally, under the PvdA only very few activation measures were solely targeted at the unemployed individuals and did not require the immediate cooperation of
employers. For the social democrats, apparently the obstacles for those excluded from the labour market, especially the long-term unemployed, lie more in the perceptions and attitudes of employers than in the personal initiatives of these unemployed individuals. The policy premise for the PvdA was that by far the vast majority of the unemployed were very eager to find a job, but employers were especially prejudiced against hiring the long-term unemployed. Therefore, employment subsidies, especially in the form of reductions in the social security contributions paid by employers, were introduced on a large scale. (Oorschot 1999: 32-33; Oorschot 2002: 112-114; Hemerijck et al. 2000c: 226). To encourage employers to hire more low-skilled workers, the government in 1993 increased the Special Reduction in taxes for people with wages below 115 per cent of the minimum wage. In addition, two new pieces of legislation, the Law on the Use of Jobseekers and the Law on the Reintegration of Handicapped People, offered the employers subsidies to create special jobs which do not compete with regular jobs, in both the public and the private sector. Employers were also subsidized if they were willing to create jobs on an experimental basis. The general reduction in social security contributions cut wage costs by 10 percent, and in combination with reductions targeted at long-term unemployment contributions, the total cuts in wage cost can be as much as 23 per cent (Keizer 2003: 294-295; Hartog 2000: 59). Whereas in the 1970s and 1980s subsidized labour was used as part of the general unemployment policy to temporarily or permanently compensate for shortfalls in the labour market, with the PvdA in government subsidies for jobs became more flexible and tailored to the individual circumstance of the unemployed. The policy philosophy underlying these subsidies has also shifted correspondingly, from remedying unemployment to activation (de Schamphelerie and
van Berkel 2001: 51-52). Most of the various in-work incentive measures have recently been integrated under two framework laws, the Act on the Integration of Jobseekers and the Act on Reducing Contributions. The new Dutch tax system now provides new forms of tax credits and reductions to which only those employed are entitled (Hoop 2004: 69-70; Oorschot 2002: 112-114).

In addition to pure financial in-work incentives, the PvdA also improved in-work incentives by decreasing the potential family-related costs for entering the Labour market. As part of the traditional social democratic policy preference, reconciliation between work and family has been a core issue in PvdA reforms to activate the labour market. Based on this premise, the party proposed an entitlement to part-time work for parents and promised to extend maternal leave and introduce paid parental leave of six months. After becoming the dominant coalition partner in the Purple Coalition in 1994, the party proposed a “combination scenario,” which focused on the division of tasks inside households with children. The “combination scenario” recommended that each partner works for 30 to 35 hours a week and carry out caring tasks for 20 to 25 hours a week. Within this framework, it is envisaged that each employee can realize a new balance between working and caring responsibilities. In line with the “combination scenario”, an enabling Act of Labour and Care was introduced at the end of 2001. This act relaxed the conditions for various leave schemes and coordinated their implementation. A system for career interruption was also set up so that employees have the right to break off their career for a certain period of time for the purposes of taking caring responsibilities for children, family or friends (Oorschot 2004: 219; Hoop 2004: 74-75; van Dyke et al. 2004: 27-29). With the tax reform in 1990, the
government reduced the basic tax allowance for breadwinners and integrated social security with the taxation system, lowering the disincentive for second earners to work more hours. The institutionalization of statutory minimum wage helped narrow the wage differentials between men and women, as well as between part-time and full-time workers (Visser 2001: 27-28).

**France**

*Shift of Paradigm through the Shift of Power*

In France, similar to many other OECD countries, the initial response to mounting fiscal and economic problems was to increase revenue rather than reduce expenditure (Palier 2000: 118). With regard to increasing welfare dependency and social expenditure, the main policy prescription was to raise the level of social security contributions in order to make up for the increase in social expenditure, instead of direct cuts in programs and the level of benefits, for fear of its political consequences. In addition, a policy approach known as the “social treatment of unemployment” gained increasingly popularity. Typical of continental welfare regimes, this policy focused on the reduction of labour supply by removing both older and younger people from the labour market, through early retirement from the one end and education or training schemes from the other. This policy prescription also relied heavily on direct job creation schemes and job subsidization to reduce unemployment. By the early 1980s the French government was still making it progressively easier to exit the labour market early. The legal age of retirement was lowered in 1983, and unemployment benefits
were replaced with retirement pensions. Passive measures targeted at the size of the labour
supply expanded massively throughout the 1980s (Daguerre and Taylor-Gooby 2003: 629-

Faced with chronic inability to revive the French employment situation, the
traditional social democratic goal of full employment was gradually abandoned by the
Socialist cabinet, but there was as yet no clear vision for the party as to what perspective
should be deployed instead on employment. The demotion of employment objectives went
further after 1986, when a centre-right Gaullist cabinet replaced the Socialists. By the early
1990s, continuing deficit and welfare dependency had completely closed the possibility of
financing growth through yet another increase in social contribution, and unsurprisingly
labour force reduction measures did not reduce the inactivity rate, as both unemployment and
inequality continued to increase. These factors, on top of the constraint posed by the
European Single Market, shifted the Gaullist government’s attention from stasis to partial
retrenchment, partial in the sense that new benefits in unemployment insurance were
introduced alongside new rules of benefit calculation, but these changes neither altered the
Bismarckian insurance framework of French social security nor, more seriously, altered the
fundamental premise of French strategy towards combating unemployment, which remained
limited to a combination of adjustments within the social security system and measures to
further reduce labour costs, particularly at the lower end of the wage scale (Palier 2000: 114-
115; Guillemard 2001: 9; Daguerre and Taylor-Gooby 2003: 630).

Since the return of the Socialists to power in 1997, however, there have been some
signs of third order structural changes in both the social security system and the labour
market. With regard to the social security system, the Jospin government consolidated the means-tested basic income benefit as the primary source of unemployment benefit and adopted general taxation rather than social security contribution as its financing mechanism. These changes had the potential to alter the fundamental premise of French social security, as they transformed social insurance into a state-run and tax-financed Beveridge system. More importantly, under Jospin there was an important shift of policy paradigm with regard to the labour market. The Socialists rehabilitated the goal of full employment at the centre of government policy, ending almost a decade of employment policy practice which was dominated by adjusting the social security system and reducing wages. In the context of the late 1990s, this turn to full employment represented not only a break with previous centre-right governments, but also with many contemporaneous Western European social democrats who preferred the more modest or indirect goals of employability or social inclusion (Palier 2000: 114-115; 133; Palier 2002b: 12; Guillemard 2001: 9; Daguerre and Taylor-Gooby 2003: 630; Levy 2002: 8-9). Similarly, the goal of social justice was also rehabilitated, along with the willingness of the state to play a more interventionist role in both the welfare state and the labour market. The funding of the 35-hour working week out of public expenditure and the explicit delegation of deficit reduction as a second order priority in subordination to employment are all reflections of the Jospin government’s social democratic tradition.

However, despite this shift in policy paradigm regarding the labour market, it is important to mention that, unlike the situation with the Dutch or Danish social democrats, the paradigm shift has not been matched by equally significant improvements in the French labour market, and the various changes made by the Jospin government have proved
inadequate to address France’s employment problems (Malo et al. 2000: 266). Two of the most important reasons for this mismatch between policy change and policy effect will be explained in more detail later. One is the characteristically ineffective enforcement of the obligations to activation in French active labour market measures, which is itself the result of an excessively strong emphasis on the role of the state as the employer of the last resort. The treatment of unemployment and its consequence as a collective issue for the French state and society instead of an incentive issue for the unemployed individual led to an ambiguous interpretation of what activation implies, so that often general integration into activities in society, known as social activation, is regarded as sufficient. The strong emphasis on the responsibility of the French state to take care of its citizens also led to very limited changes to the unemployment benefit system in terms of both generosity and eligibility throughout the past two decades. A further obstacle to effective active labour market reforms is the lack of a corporatist structure, leading to strong union resistance to government attempts to bring greater flexibility into the labour market or close early exit pathways. Ever since the Socialists first came to power in 1981, there had been continued provision of generous unemployment compensation, increases in social spending, and extensive use of early retirement schemes. This trend was very much followed by the centre-right governments during the late 1980s and early 1990s. The fundamental structure of the labour market institutions also remained unchanged throughout the past two decades, and this lack of institutional change certainly played a role in the upsurge in unemployment and inactivity that plagued the country right up to the late 1990s (Schmidt 2001: 254; Malo et al. 2000: 249). Therefore, although the Jospin government attempted to shift the policy paradigm from
passivity to activation, the effect of the related policy changes has certainly not been maximized. Furthermore, after the return of the centre-right parties to power in 2002, there have been emerging signs that the Socialists’ activation paradigm is in danger of reversal, as the conservative cabinet not only significantly scaled down the youth activation programs but also attempted to lengthen the working week again.

Changes in ALMPs

To properly evaluate the changes in active labour market measures under the French Socialists, it is important to take into consideration the importance of the statist emphasis in French public policy in general. Traditionally, the focus of government intervention in the French economy was more in industrial than in social or labour market policy. This penchant for direct large scale intervention and steering over the development of national industries reflects the particular importance characteristically accorded to the state in French postwar public policymaking. This strong statism can be traced back to the circumstances of the founding of the Fifth Republic, as the new republic’s political system was designed with the overt purpose of increasing the strength of the executive at the expense of parties and the legislature, which were widely perceived as one of the main reasons for the failures of the Fourth Republic. For French social democracy, the regulation of capital through the active role of the state remains a very important policy instrument. The party emphasizes the centrality of the state as the guardian of both equality and solidarity, two objectives various Socialist governments attempted to achieve by adding increasing elements of tax-funded universalism to the social insurance system. The prominent presence of the French state in
the social policy arena is partly also reflected in the fact the French welfare state is one of the largest outside Scandinavia as a proportion of public expenditure (Clift 2004: 1; Sferza 2002: 137; Levy 2002: 8-14; 20, 22).

Because the state is regarded as the employer of last resort in employment, and because of the importance of social solidarity in public policy discourse, welfare-to-work programs (usually called “insertion” in the French context) which focused on the incentives of individuals were very slow to emerge in France. The ALMPs that did emerge over the years were, unsurprisingly, characterized by their strong emphasis on the broad social dimension of activation and their accommodating approach to the clients. Overall, French ALMPs emphasize the individualization of the help so that personal circumstances are dealt with on a case by case basis. The importance of local autonomy and the multidimensionality of exclusion are also central to French insertion (Farvaque 2002: 4). These features inevitably draw the French policy prescription closer to the Nordic model, especially the Danish one, with regard to the heavy use of job creation or subsidization schemes. However, despite these rather Scandinavian characteristics, the French insertion approach is limited by one crucial weakness: because of its breadth, softness, and deep concern with the social dimension of activation, there is a lack of focus on employment or adequate enforcement mechanisms. The French labour market and social policies are mixed in their objectives to such an extent that the integrity and coherence of each policy arena is compromised.

The first tentative work-based insertion program was the Collective Utility Work in 1984, but its impact remained minimal. It was only four years later that more serious efforts were made on this front with the introduction of the Minimum Income of Insertion (RMI). In
terms of its significance, if not actual effect, the RMI was crucial in explicitly establishing the principle of insertion as the main condition for receiving benefits. As a program of dual nature, the RMI is the only major social assistance benefit which is systematically integrated with special public-funded ALMPs to help recipients enter jobs or training (Barbier and Theret 2003: 150). In this sense, the RMI is almost unique in being both the major part of the passive apparatus and the major part of the active apparatus. It is precisely for this reason that RMI will feature prominently again, in the chapter about reforms of the passive apparatus, where changes in its social assistance aspects will be emphasized more. Right now, the focus is on the active aspect of the RMI, that is, the insertion requirements. In the debates and negotiations leading up to the introduction of RMI in 1988, very few unions were opposed to the attachment of the insertion requirements to the RMI. Since the insertion clauses prioritized the linkage between employment and income, it was a very welcome instrument for the unions, whose primary concern was preserving the status of earnings-related social insurance arrangements in the French social security system. Actually, the unions lobbied against the institution of an RMI minimum income based on the principle of rights for all, so the imposition of the insertion condition made it much easier for the unions to accept the RMI (Clegg 2002: 218-222).

Claimants of RMI benefits are theoretically required to sign a contract, and the contents and enforcement of the contracts vary with locality, target groups or the organizations involved, given the decentralized and devolved administration of RMI. The major set of ALMP contracts under RMI are the Employment Solidarity Contracts (CES), which are temporary, part-time, and subsidized contracts which involve 20 hours per week of
work in the nonprofit sector for a period of three months to two years. The CES contracts in
RMI was followed up in 1992 with the Consolidated Employment Contract (CEC), which are
targeted at more specific segments of the unemployed, and in 1995 with the Employment
Initiative Contracts (CIE), which are regular contracts subsidizing private sector employers.
In any of these contracts, welfare recipients can gain regular employee status with all the
corresponding rights and duties, and since the mid-1990s the integration between the social
security and employment aspects of contract objectives has been significantly strengthened
with the takeover of RMI administration by the National Employment Agency (Morel 2004:
118-119). However, on the local level, enforcement of the individual RMI contracts, and of
the insertion principle more generally, tends to be very slack, which severely limits the
effectiveness of this innovation in French employment policy. Although contracts of
insertion are technically required, all training and job activities under the RMI are voluntary
in practice, and the access to these insertion activities are legally guaranteed based on
citizenship. Since 1988, about half of the beneficiaries of RMI have constantly not signed the
contracts, and only 5 to 6 per cent of the beneficiaries have been sanctioned for
noncompliance. Even so, there is increasing pressure within the parties on the left, including
the Socialists, for transforming the RMI into an unconditional income allowance based on
citizenship and completely suppressing the RMI insertion requirements (Barbier and Theret

Overall, the conditionality of work in French social and labour market policy programs has maintained a very ambiguous profile. For the older uninsured, work-to-welfare
requirements are attached (but in name only) to the major activation measure the RMI; for
the young, these requirements supposedly exist despite RMI, because the young are not eligible for RMI benefits. However, there was no clear rule of either sanctioning or compulsion to work for the young. Technically, for example, noncompliance with job search requirements can lead to cuts in unemployment insurance benefits, but recipients of social assistance is not conditional upon participation in work-related programs (Spicker 2002: 116; Enjolras et al. 2001: 42; Daguerre 2004: 44; Gilbert 2002: 85; Barbier and Theret 2003: 150).

The dual nature of RMI as a social assistance benefit and ALMP package also has its drawbacks, because it in effect subsidies low-skilled labour with its social assistance minima and encourages the formation of a secondary labour market of unstable and low-wage jobs. As the key active labour market instrument of the Socialist government, an additional limitation of the RMI is that it was only targeted at people over the age of 25, despite the fact that the group displaying the highest unemployment rate are young women under the age of 25 (Hantrais 1996: 65; Barbier and Theret 2001: 174).

The gradual realignment of French ALMPs to the young unemployed gathered pace after the Socialists were returned to power under Jospin in 1997. Throughout its period in office, the Jospin government continued to insist on the role of the state as the guarantor of employment, and direct job creation or subsidization by the state remained a very important component of employment policy (Clift 2004: 135). In the 1997 election program of the Socialists, the two major initiatives with the highest priority were both aimed at facilitating the growth of jobs and labour market participation. One was the promotion of youth jobs in the social sector in order to reduce youth unemployment, and the other was the shortening of the working week to 35 hours (Sferza 2002: 137). The Socialist government devoted
unprecedented amount of financial resources to combat youth unemployment, and in an accurate reflection of the French *dirigisme* tradition, most of these measures involved some demand side direct job creation or subsidization, though compared with the early 1980s they now tended to incorporate clearer obligations on the unemployed. The first major program on this front was Youth Employment introduced in 1997. This program subsidizes employers to create jobs for youngsters who will be hired on a private employment contract. More than eight billion francs were allocated to the scheme to fund 50,000 jobs in 1997, and then 100,000 in 1998 (Enjolras et al. 2001: 62). The whole scheme was designed to create 350,000 jobs in the private or voluntary sector within three years, an objective that it did achieve in due course.

However, this measure is still dwarfed by the Aubry Plan, the largest scale job creation scheme to emerge under the Jospin government. Named after the Employment and Solidarity Minister, the Aubry Plan proposed the creation of 700,000 minimum-wage and largely state-financed jobs, half of which in the public sector and half in the private sector. These jobs are five-year non-renewable contracts targeted specifically at the young unemployed, and up to 80 per cent of the wage and non-wage costs would be financed by state subsidies. One year after the Socialists returned to government under Jospin, 100,000 such posts had already been identified and 60,000 filled. As the government’s major job creation instrument, the Aubry Plan is to some extent the most interventionist employment policy attempted in Europe, and it demonstrates that labour market policy goes to the very heart of policy objectives of the Socialists in government. During the whole period in office, the Jospin government increased the resources devoted to employment policy by 13 per cent,
reaching 4.5 per cent of GDP by 2000. During the 1997 to 2000 period, the French Socialists devoted considerably more public funds to subsidized employment than their German or British social democratic counterparts (Bouvet and Michel 1999: 39-40; Morel 2004: 120; Sferza 2002: 141; Clift 2003: 168; Schroter 2004: 21). By March 2001, the Aubry Plan had led to 274,900 new jobs in the public sector and 308,000 in the private sector. The number of French workers enrolled in public labour market programs had expanded two-and-a-half times, and aggregate spending on ALMPs showed a similar increase. A significant character of these job creation or subsidization plans was that their financing was openly predicted on increased public expenditure. Therefore, under the Socialists it was clear that the financial burden for supporting these measures would not fall on either the wage earners or the employers, but on the state (Levy 2002: 8-14; Clift 2003: 168).

The strong statist emphasis under the Socialists is clearly illustrated in the government’s ALMPs to reduce youth unemployment. Unlike the New Deal in Britain or the JEA in the Netherlands, the French policy instrument on this front encompassed a series of gigantic direct job creation or subsidization schemes where the obligation of activation almost fell completely on the state rather than the individual (Merkel 2001: 70). The predominant emphasis on the obligation of the state to the citizen in French public policy also goes a long way in explaining the unique characteristics of the RMI insertion clauses, where duties are compulsory for the state to offer ALMPs but there is no corresponding obligation on the individual to participate or accept the terms of the offer. The dependency on social assistance which the Socialists tried to eliminate through the RMI’s insertion clauses was merely replaced with another form of dependency, on massive use of state-sponsored job
creation or subsidization measures (Barbier and Theret 2001: 157; Farvaque 2002: 5). In addition, although the RMI includes a component of reinsertion into the labour market, in implementation it is interpreted often as general social reinsertion rather than more specific integration into the labour market. Therefore, under RMI the unemployed individual is required to demonstrate willingness to participate in society as a whole, rather than willingness to participate in the labour market or to accept a specific job offer. This characteristic of the RMI insertion clauses clearly reflects a heavy emphasis in French employment policy on the social treatment of unemployment rather than the promotion of labour market participation. This emphasis on social activation shows some similarity between the French and Scandinavian employment policies, but the Scandinavian approach emphasizes labour market integration as well as social integration. By contrast, by the mid-1990s the main French social question had become not transferring people to work but, given the lack of jobs available, the provision of welfare for those excluded from the labour market (Barbier 2001: 15; Barbier and Theret 2003: 149). French insertion and the American workfare, to some extent, occupy the two opposite ends of the spectrum in active labour market measures. Both these two policy prescriptions, however, are limited in their intended effect of moving people from welfare to employment, for almost the opposite reasons: workfare for its excessive and narrow reliance on benefit reduction; insertion for its excessively lax interpretation of the obligation of the unemployed. In other words, neither method is very effective because one relies almost entirely on compulsion while the other more or less abandons compulsion all together.
Since the Socialists came to power under Jospin, there have been gradual attempts to break free from this obsession with the principle of solidarity and the fear of compulsion. Programs such as the Employment Premium (PPE) and the Plan to Help the Return to Employment (PARE) are all policy innovations which deal more directly with the incentives of the unemployed individuals and attempt to activate them with both carrots and sticks. PARE, in particular, is a program that has the potential to set a new pattern for French employment policy, as it not only attempts to make firing and hiring easier but also significantly strengthens the linkage between work and benefits (Clasen and Oorschot 2002: 237-238). However, this program had to be heavily watered down and had its compulsory elements removed before being accepted by the trade unions. Overall, although bolder and newer concepts about activation are certainly emerging among the Socialists, the French social democratic prescription for labour market activation remains largely trapped in the solidarity framework in practice, because of the resistance from social partners. And the various labour market reforms carried out by the French social democrats to date have not been adequate to ease France’s inactivity problems.

Labour Market Flexicurity Measures

Under the Jospin government, there was one major policy initiative which had some effect in increasing flexibility in the labour market: the shortening of the working week to 35 hours. As an example of explicit state intervention to reduce working hours across industries through direct legislation, the French 35-hour week is a radical instrument of job creation of its own kind in Western Europe. Both sides of the social partnership were resolutely opposed
to this change, the unions for wage and work regulation concerns and the employers for initial fears of excessive rigidity. In order to make the reform palatable to the social partners, the Jospin government took a highly incremental approach in putting the measures in place. After the legislation was unveiled in October 1997, the actual means of reducing working time were left to the social partners to bargaining agreements at the industry or company level. The government proposed to reduce the working week from 39 to 35 hours in a gradual manner over a period of time, and this change would be coupled with an annualization of working hours in order to retain a high level of flexibility in working time (Hemerijck and Schludi 2000: 171; Sferza 2002: 142; Freyssinet 1998: 645, 652). To encourage the social partners to accept this change, the government partially funded the transition process, offering significant subsidies to companies that signed agreements with the unions in reducing time which result in either creation or preservation of jobs. To be eligible for subsidies, the companies need only forgo planned layoffs rather than having to hire new employees (Levy 2000: 339). Overall, the implementation of the 35-hour week did not further increase rigidity in the labour market, but instead introduced a considerable amount of flexibility in working patterns. To assure the employers, the government made it clear that the financial costs of transition to the 35-hour week will be shouldered by either the state or the employees, but not firms. Based on this premise, the implementation of the 35-hour was accompanied by measures to subsidize structural labour costs, especially through the reduction in social security contributions paid by the employers. These measures further contributed to the reduction of indirect labour costs. To encourage bargaining over the implementation of the working time reduction, the government created a new system of
state/company agreements, whereby state aid will be granted to companies which sign an agreement to reduce working time by at least 10 per cent. On the other hand, companies which have not reduced contractual working hours by a certain deadline will have to treat hours worked in excess of 35 as overtime and more expensive (Bouvet and Michel 1999: 40-41; Barbier 2002: 14; Schroter 2004: 21; Clift 2001: 177; Freyssinet 1998: 652-653). This Socialist success in introducing more flexibility into the labour market, however, has turned out to be the exception rather than the norm, as most other attempts by the government in this area were marred by failure. Overall, since the early 1980s, the heavy emphasis on the activist role of the state and the concept of social solidarity in the reform process has posed significant difficulties for any measures aimed at increasing flexibility or activating workers with atypical jobs, a situation aggravated by the resistance of the social partners. When the Jospin government attempted to make firing and hiring easier through the new program PARE, the plan was thwarted because of union pressure. As result of what Hall (2002: 49-50) calls the “residual impact” of the state, activation policy in France has been pushed forward in a contradictory and not wholly efficient manner. Flexibility in labour market regulation, obligation to participate, or anything else that emphasizes the obligation of the unemployed at the expense of their rights, are rejected for resembling American workfare. Therefore, in French activation, on the one hand there are indirect attempts to decrease rigidity in the labour market or reduce the influence of Bismarckian principles, on the other hand the state is firmly designated as the employer of last resort. As a result, despite some rare examples of flexibilization, such as the easing of fixed-term contract termination rules or tax breaks for
part-time contracts, the French labour market of today remains highly regulated (Barbier and Theret 2003: 155; Merkel 2001: 70).

**Increasing In-work Incentives**

Since the Jospin government came to power in 1997, the use of financial incentives to stimulate employment among disadvantaged groups has grown significantly. In order to facilitate small and medium firms in hiring new employees, especially in low-wage jobs, the government tried to reduce labour costs by reducing or exempting social security contributions for employers. Financial incentives are also targeted at the employees, with the key instrument being the Employment Premium (PPE). Introduced in 2001, the PPE is a means-tested new wage supplement funded from general taxation. It is targeted at low income earners in the form of a tax credit covering those whose wages do not exceed 1.4 times the minimum income guarantee. By compensating low-paid workers for some of their income and social security payments, the PPE increases the financial returns from work for those in low-paid jobs. In addition, the government introduced tax cuts targeted specifically at the lower end of the income scale. For example, lower salaries were progressively exempted from professional tax, and the General Social Contribution and habitation tax on lower earners were also reduced in order to remove poverty trap for people coming off the means-tested basic income benefit RMI. Income disregards for the RMI were also strengthened (Morel 2004: 120-121; Clasen and Clegg 2003: 370; Clift 2001: 176; Clift 2003: 172-173).
In addition to purely financial incentives, the Socialist government also tried to help reducing the potential family cost of entering the labour market for mothers. Different from most other continental welfare regimes but similar to the Scandinavian regimes, the model of the working mother was historically emphasized in French family policy, and for this reason public daycare was expanded rapidly throughout the 1970s (Daguerre and Bonoli 2004: 11-13; Daly 2000: 488-491). Partly due to its relatively generous provision of public childcare compared with most continental counterparts and partly due to a strong stranglehold by the social partners over policy administration, childcare policies in France show a pattern of stability and continuity. Developments in French childcare policy are incremental and based on its original principles. Along this line, the Socialist governments in the 1980s removed provisions in the family policy which discriminated in favour of particular gender or family roles. Another important change took place in 1987, when the centre-right government introduced a new child-rearing allowance (AGED). The AGED marked the turning point in French childcare policies, as it signaled the start of a trend towards greater diversification in childcare arrangements. However, while the AGED led to an increase in the number of childminders, this growth was at the expense of public daycare places. After the Socialists came to power under Jospin, the government attempted to make childcare benefit arrangement more progressive and redistributive towards the less well-off, and to align childcare policies with the general efforts by the government to activate the labour market. For these purposes, the government introduced a new benefit in 2001 to supplement childcare costs for women returning to work. The number of childcare places was also expanded. In an effort to make childcare benefit more progressive, the government excluded higher earners from the benefits
by means-testing, and it removed the tax deduction for in-home childcare. However, the Socialists were later forced to withdraw the means-testing of childcare benefits after concerted opposition from both the centre-right parties and the social partners (Daguerre and Taylor-Gooby 2003: 633-634; Levy 1999: 247-252).

Germany

Shift of Paradigm through the Shift of Power

Plans for reforming the German welfare state in the spirit of labour market activation had been in gestation within the SPD for some time while it was still in opposition. Early in the party’s 1990 election manifesto, a combination of environmentalist concern, in the face of growing threats from the Greens, and concern with unemployment, had already been the dominant themes, and this effort to address the concerns form both the old and new wings of the party was later reflected in the ecology tax introduced in 1998, which is earmarked for reimbursing pension contributions and reducing non-wage labour costs (Feigl-Heihs 2004: 170). The concern with unemployment and labour market activation grew stronger in the party’s 1994 election program, whose main feature was a ten-point plan for making employment promotion the centrepiece of a future social democratic government’s reforms. The ten-point plan evolved around a set of early active labour market plans which were rather sophisticated and advanced in design, compared with the traditional labour-market-clearing emphasis of the previous centre-right coalition. Partly because of its historical association with the contribution-based social insurance system, the Christian democrats by the mid-1990 were still attached to the habit of externalizing the cost of economic adjustment
through further increases in social contribution as well as removing older workers through early retirement. The blueprints of the social democrats, on the other hand, had started to include job creation schemes, training programs, help in relocating jobs, the promotion of part-time jobs, and the expansion of jobs in the low-skilled service sector (Lawson 1996: 48). The SPD kept the issue of combating unemployment at the top of its agenda in the 1998 election. After coming into power, especially since the start of its second term in 2002, the Schroeder government not only set up a series of important commissions to investigate strategies for active labour market reforms, but also significantly increased its public resources commitment to active labour market programs. With the latest measure the Job-AQTIV, the Schroeder government made a significant attempt to strengthen both the rights and duties to activation, within the framework of an individualized action plan negotiated between the unemployed and the labour market authorities, a strategy which is most typically adopted in the successful activation reforms by the Scandinavian social democrats. In addition, the SPD also tried to revitalize the failed efforts by the previous Christian democratic government to achieve wage moderation and job creation within the corporatist framework known as the Alliance for Jobs (BA).

However, the process of paradigm shift and its actual effect in terms of labour market achievements under the Schroeder government turn out to be similar to what happened under the French Socialists. In other words, on the one hand the shift of power in 1998 to the Red-Green coalition led to a gradual paradigm shift to labour market activation as the key policy objective, on the other hand the accompanying changes on the policy level have not been sufficient to reverse the unemployment difficulties in Germany. The resistance of both
unions and employers to reforms by the social democrats played a significant role, in Germany as well as in France, but in addition, because of the much greater contributory element of German social security than its French counterpart, a comparatively much greater proportion of German ALMPs are financed through unemployment insurance contributions rather than through general taxation. As a result, when the economy slackens, these programs automatically run into financial difficulties. Since insurance benefits and active labour market measures are financed out of the same fund, the former tends to crowd out the later whenever unemployment is on the rise. Since there is neither legal entitlement nor obligation to participation in many of these training or job programs, the labour market measures easily become a pro-cyclical instrument of cost control (Manow and Seils 2000: 149-150; Clasen 2000: 104).

Changes in ALMPs

Similar to the approach of most other third way social democrats, the first primary target of government activation reforms were the young unemployed. During the first term of the Red-Green coalition, the major ALMP to combat youth unemployment was the “Youth with a Perspective” (JUMP) introduced in 1998. Its two billion Deutsche Marks of annual budget came partly from federal subsidy and partly from the European Social Fund, and the fact that the federal government picked up the tabs for almost the entire German portion of the budget represented a significant financial commitment by the Schroeder government (Vail 2002: 11). Reflecting the general pattern of ALMPs under the SPD government, the JUMP was characterized by heavy reliance on state-subsidized employment measures such
as direct job creation or subsidization (Schroter 2004: 23). This scheme made extensive use of financial incentives, in the form of state subsidies, to encourage employers to create new jobs for the young unemployed, especially for those in the east länder. In addition, for the young unemployed the scheme also offered individual counseling, training, and apprenticeship opportunities. The scheme was originally intended to serve up to 100,000 workers under 25, but since its inception in 1998, more than 300,000 young unemployed individuals have been participants in the JUMP, and from 1999 to 2001, the JUMP subsidized between 100,000 and 140,000 jobs or training places. However, it remains unclear how many of these were actually new jobs which would not have materialized without the intervention of the JUMP (Schmidt and Picot 2001, quoted in Schroter 2004: 23; Voges et al. 2001: 98; Bispinck and Schulten 200: 205-206; Vail 2003: 50). Despite the scale and ambitions of the JUMP, the scheme was not compulsory, and although the employment service officers do have the discretion to sanction benefit claimants for not willing to accept suitable training or job opportunities, the JUMP itself relied entirely on voluntary participation by the young unemployed. This, to some extent, limited the effectiveness and breadth of coverage for the JUMP, and so far the scheme has been unable to induce a change in the administrative or the young job seekers’ behaviour (Schroter 2004: 24). In parallel with the JUMP on the national level, the SPD government also introduced a range of local job subsidization schemes called “Help Towards Work”, which subsidize either regular jobs under an employment contract or causal jobs not subject to an employment contract for a limited period (Handler 2002: 39).
Apart from these individual programs, the Schroeder government also made efforts to make its active labour market measures more systematic and efficient as a whole, and for this purpose the government increased investments in ALMP research and designs. Partly in response to the failure of the BA in securing either wage moderation or job creation, the Red-Green decided to bypass both the social partners and the parties in parliament and appointed the Hartz Commission to draft new proposals for active labour market reforms as well as correcting inaccuracies and mistakes discovered in the employment service. Ever since its inception, the Hartz Commission in its various series has become an institutionalized part of ALMP design and source of advice for the Schroeder government, touching on a wide range of issues connected to social and labour market policies. Hartz I and III revolved around the reorganization of public employment services to increase efficiency, and Hartz II highlighted the use of temporary employment as an instrument of job placement in ALMPs, through the establishment of Personnel Service Agencies. Hartz IV and V, on the other hand, pushed towards much greater enforcement of obligation on the job seekers. These two Commissions emphasized the contractual nature of the relationship between labour market institutions and ALMP clients, and they also recommended important cutbacks to the social assistance system. The proposals contained in Hartz IV and V further coincided with the objectives of the new government legislation Job-AQTIV, the key active labour market measure for the second Red-Green coalition. Along similar lines, in 2003 the Commission known as Hartz I+II also recommended measures which promote marginal part-time work for mothers by lowering the tax rate on these so called Mini-jobs. In addition to Hartz, the Red-Green coalition also appointed a separate Commission in 2002 to develop long-term sustainable

Recognizing the problem of lax enforcement in existing ALMPs, the Hartz Commission also proposed to increase demands on regional mobility, especially for younger and single unemployed, and to lengthen benefit ineligibility periods as a sanction for violating job search. In order to make sanctions in ALMPs easier to impose, the Commission suggested that ineligibility periods can be staggered over a period of time. A lot of the recommendations from Hartz, however, are yet to be put into action, and since its second term the Red-Green coalition has promised to speedily implement the recommendations and, more generally, shift even greater attention to combating unemployment (Weinkopf 2003: 251-253; Seeleib-Kaiser 2004b: 134-135). However, given the detachment of the Commissions from the direct influence or input from the social partners, the prospect remains bleak for the Schroeder government to push through fundamental reforms simply through ad hoc commissions. The Hartz Commission, for example, initially proposed cuts in wage replacement rate as well as the duration of unemployment benefits, but these recommendations had to be dropped in the face of strong opposition from the unions.

Partly based on the momentum from the series of Commissions under Hartz, there has been significant intensification and expansion of ALMPs since the start of the second term for the Red-Green coalition. The most important move on this front to date has been the introduction in 2002 of the Law for “Job-Activation, Qualification, Training, Investment, and Placement” (Job-AQTIV), which directly benefited from the recommendations in Hartz IV and V. The various initiatives contained under Job-AQTIV have worked together to further
move the government’s labour market activation strategy from benefit retrenchment typical of the previous centre-right coalition to a greater emphasis on enforcement and incentives in ALMPs. Job-AQTIV also helped to refocus the Schroeder government’s response to unemployment problems on the issue of labour market activation rather than the reduction of labour supply. Compared with previous measures, Job-AQTIV included noticeably sharpened rules about the “reasonableness of work” in job search criteria in ALMPs. Job-AQTIV also emphasized the use of intensive advice and individualized guidance for the unemployed. Making extensive use of the method of profiling, pilot projects of individualized support are carried out in a number of local settings, and Job-AQTIV explicitly stipulated that the public employment services should apply instruments of this nature. In order to expand the capacity for job placement in ALMPs and advising for employment services, Job-AQTIV also proposed to increase the involvement of third parties, such as private placement agencies or training institutions, in the active labour market measures. This development dovetailed with the earlier recommendations from the Hartz Commissions during the coalition’s first term of office, especially the plan for a one-stop-shop Job Centre which integrates the duties of various employment and social support services. Such one-step service was already implemented by the British and Australian social democrats as part of their third way active labour market strategies, and in 2000 a law was passed in Germany to similar effect so that the social assistance and unemployment placement services were merged (Weinkopf 2003: 251, 258, 266; Handler 2002: 39).

With Job-AQTIV, the Schroeder government has in effect agreed to assume a much more activist attitude with regard to labour market policy. In contrast to the Christian
democratic subsidiarity principle which treated unemployment as private (or family) misfortune, the social democrats have started to regard this issue as an area of public concern and an issue of both rights and obligations. Job-AQTIV led to restructuring of job placement services belonging to the BA, and a much more aggressive and contractual stance towards the unemployed is followed. Now, under Job-AQTIV, reinsertion plans will have to be developed as part of the ALMPs between the unemployed and the Labour Office at the local level. Based on personalized profile for each individual job seeker, the contract will clearly set out the obligations on both sides. The local authorities will be committed to offering suitable job openings plus individualized advice and counseling, and the clients committed to accepting reasonable job offers or making clear efforts to search for jobs. For clients who fail to meet their obligations, the potential sanctions are in the form of complete cutoff in benefits for up to 12 weeks. Taking over parts of the responsibilities for policy design and financing previously belonging to the Alliance for Jobs, the government has become more willing to actively apply pressure on the unemployed to accept job offers (Vail 2002: 11; Handler 2002: 39; Vail 2003: 49).

In addition to clearer conceptualization of rights and obligations, Job-AQTIV also encourages both more training elements in ALMPs and more flexibility in the labour market, through, for example, the job rotation schemes. With the recommendation of the commission Hartz I+II in 2003, training vouchers were created to increase competition between the suppliers of training measures as well as improve transparency, and state subsidies to training programs were encouraged to increase the employment chances of individuals. The government hopes that a redirection of training policy can take place so that the choice and
responsibility of the individual clients to select training programs for themselves can be improved (Dingeldey and Linke-Sonderegger 2004: 29). Despite this growing emphasis on the enabling dimension of activation, at this moment, the ALMPs of the Schroeder government still tend to focus primarily on the manipulation of pressures or incentives for the unemployed individuals while giving comparatively less attention to re-qualification, training and long-term investment in human resources, especially compared with the approach of the Scandinavian social democrats (Dingeldey and Linke-Sonderegger 2004: 37-38; Hanesch 2003b: 214-216).

Labour Market Flexicurity Measures

In an effort to reduce unemployment by increasing the flexibility of labour contracts, the Schroeder government made it legal, since January 2001, for employees to transform their full-time jobs into part-time ones without the approval of their employers. This change implemented European directives on part-time work and short-term employment contracts, and the de facto creation of a legal right to part-time employment reflects the determination of the government to intervene in the domain of wage contracts, where the principle of Tarifautonomie still dominates. Emulating the Danish leave schemes, the government introduced a job rotation scheme in 2001, in which the unemployed temporarily replace existing workers who use the time to participate in job training or education programs (Vail 2002: 15-16; Vail 2003: 52). However, beyond these measures the social democrats have so far failed to significantly improve the labour market rigidity situation in Germany.
For countries that lack a tradition in corporatist accommodation between the social partners and the government, it is difficult to produce tradeoffs and compromises that lead to agreements on labour market flexibility arrangements. The ability to produce the necessary tradeoffs appears to correlate with the strength of corporatist institutions or other consensual practices by the social partnership. In this regard, it was not very surprising that when the European Commission introduced the 1997 Green Paper proposing the balance between security and flexibility, there was a favourable response from the unions in Finland, but in Germany and France the union response was much more negative (Wilthagen 2003: 25). Similar to the case with the French Socialists, union resistance in Germany not only played a role in the Schroeder government’s limited achievements in introducing flexibility into the labour market, it also led the government to further increase job security for the core labour force as well as overall rigidity in the labour market. Under the social democrats, dismissal protection were restored for companies engaging six to ten employees, which had previously been relaxed by the centre-right coalition (Leibfried and Obinger 2003: 212). Overall, under the Red-Green coalition there has been limited progress in deregulating the labour market and introducing more flexibility. The government relies on designing different ways of work sharing as its main instrument to decrease rigidities in the labour market and promote employment. Employers are encouraged by the government to reduce working hours in exchange for greater flexibility in working practices. But on employment protection, the government has not yet made any efforts to make hiring and firing easier (Hall 2002: 48-49).
Increasing In-work Incentives

In order to promote employment, the Red-Green coalition has offered financial incentives to employers as well as employees. For employers, the government subsidizes a reduction in social contributions to the pension scheme in order to reduce non-wage labour costs and make it more financially attractive to hire new employees. For employees, the government reduces the basic rate of personal income tax and grants both income tax and social contribution exemptions below a certain wage threshold so that low income earners can get significantly greater return from work. The wage threshold for social contribution exemption was raised in 1999 with union support, and the application of these exemptions was also extended into areas of causal employment and self-employment (Schroter 2004: 25; Leibfried and Obinger 2003: 212; Seileeb-Kaiser 2004b: 128; Vail 2002: 14).

Since its reelection in 2002, the Red-Green coalition has devoted increasing resources and attention to the creation and experimentation of different financial incentives to work for employees. Based in different localities, various model projects are designed for this purpose. For example, the Einsteigsgeld and PLUSLohn models are respectively tested in Baden-Wuerttemberg and in North-Rhine Westphalia’s Duisburg employment office, the former making it easier to claim social assistance while earning a wage for 12 months and the latter offering in-work benefits for 12 months. On the national level, the Mainz model is in use, which works under the slogan “Work Must Be Worth It” and offers federal subsidies in the form of reimbursement for social security contributions or increases in child benefits to low-wage earners for up to 36 months. An important characteristic of these model projects is the very high proportion of women enrolled in them, 64.5 per cent, for example, in Mainz and 77
per cent in Einsteigsgeld. The schemes are correspondingly also friendly towards the activation of the female labour force. Both the Mainz and Einsteigsgeld models, for example, encourage greater in-work support for women with children or part-time work. For this purpose, limits to support in the model projects are related not to specific hourly rate but to the highest achievable monthly household income. Both the Mainz and Einsteigsgeld subsidies represent monetary transfers intended specifically to bring about a direct improvement in the income position of family households (Weinkopf 2003: 255-257; Vail 2003: 52; Spiess and Wagner 2003: 306).

By international standards, Germany has not only above-average unemployment rate but also low employment rate. A very important contributor to this situation is the below average female employment rate, which is itself a result of the large number of domestic and carer service jobs being performed on an unpaid basis by women outside the labour market (Weinkopf 2003: 261-262). To alleviate this problem, the Red-Green Coalition in its first term increased child allowances in several steps and substantially raised the income limits for claiming the full amount of the means-tested parental allowances. The government also proposed an expansion in child tax credits and enacted an entitlement to both parental leave provisions and part-time employment for parents until the child reaches the age of three. Shared access to parental leave, meanwhile, was made easier for both parents. There is in addition a means-tested parental benefit available for the first two years after child birth (Seeleib-Kaiser 2004: 19; Seeleib-Kaiser 2004b: 137-139). Overall, the changes under the SPD with regard to family policies have meant that the state has become increasingly willing to deliver support for the family directly through public policy, instead of letting family risks
be redistributed within the family based primarily on the situation of the main wage earners, as the past practice would be. Family policy, therefore, has undergone a process of expansion as well as adjustment in its functions, so that it is less aimed at securing the standard of living for wage earners and more at meeting the actual needs of families (Seeleib-Kaiser 2002: 34-35; Seeleib-Kaiser 2004b: 127-128; Leibfried and Obinger 2003: 212). The government also tried to better meet the needs of families with children through the 2001 pension reform. The government offered subsidies to individual private pension saving plans, and these subsidies increase proportionally with regard to the number of children. As instruments of creeping refamilization, the subsidies work to the advantage of parents and survivors with children at the expense of those not having children. Through the pension reform, the government massively extended the social function of the pension system, so that the upbringing of children is now actively promoted with a financial compensation delivered through the pension system (Lamping and Rub 2001: 22).

The employability of mothers was also emphasized in Job-AQTIV, the major activation package during the second term of the Schroeder government. The new legislation introduced equal treatment of childcare periods and contribution periods in unemployment insurance, so that mothers have entitlements to unemployment benefits as well as access to ALMPs. For families with children, the government also made available a new option to combine part-time work of up to 30 hours a week with parental leave for both parents for three years (Dingeldey and Linke-Sonderegger 2004: 30). During the second term of the Red-Green coalition, the general remit of active labour market policy has been diversified from status-equivalent re-employment of the unemployed into new areas such as atypical
employment relationship or subsidized self-employment. (Clasen 2000 and Clasen & Clegg 2003 quoted in Seeleib-Kaiser 2004: 16). After the Red-Green coalition entered its second term, the government has treated as a top priority the expansion of new childcare facilities and schools with all-day schedule. By emphasizing the role of public institutions in childcare, the social democrats have clearly distinguished themselves from the Christian democratic emphasis on the choice to buy childcare on the market. The Red-Green coalition expected that by the end of its childcare expansion reforms publicly financed childcare should be available for 20 per cent of all children under the age of three. However, as the provision of childcare facilities has been severely underdeveloped historically in German, the current efforts of the SPD government have not yet been sufficient to have a clear impact on the activity rate of women or mothers in particular (Dingeldey and Linke-Sonderegger 2004: 57-58; Seeleib-Kaiser 2004: 19-20; Seeleib-Kaiser 2004b: 139-141; Weinkopf 2003: 261-262; Backer 2003: 302). Another impediment existing in the current German system is the differential treatment of family status for tax purposes, resulting in a high marginal tax rate for a second earner, which significantly reduces the likelihood for full-time employment for married women (Dingeldey and Linke-Sonderegger 2004: 31).

United Kingdom

*Shift of Paradigm through the Shift of Power*

Since New Labour came to power in 1997, there has been a dramatic change in the ordering of political priorities for the government. Under the Conservative government, the
main emphasis in government policy was on the preservation of the private market, reduction of benefit rolls, and cost control. Therefore, employment policy under the Conservatives focused on narrow and small-scale programs. The Conservative government, for example, relied extensively for employment policy on localized pilot projects known as Project Works. In addition to the Project Works, the Job Seekers’ Allowance (JSA) was the only major welfare-to-work program under the Conservatives, which was introduced nearing the end of the government. This program significantly tightened rules for claiming benefits, but did not offer any financial resources as incentives for individual to enter the labour market. On the whole, the JSA did relatively little to protect the unemployed and only pressurized people into very low paid and low quality jobs (Peck 2001: 282-292; Cressey 1999: 176). By contrast, under New Labour, activation of the labour market entered a qualitatively new phase of large scale ALMPs, especially since the introduction of the six New Deal programs. Activation of the labour market has come to occupy the centre of New Labour’s policy outlook. There is a move away from the Conservative concern with the sheer size and cost of the welfare state, to concern about its structure. While the Conservative government under Thatcher regarded economic efficiency and growth as the solution to problems of social exclusion and poverty, New Labour regarded exclusion from the labour market as the obstacle to economic growth (Jessop 2003; Peck 2001:274-280; Judge 2001: 2). Compared with its Conservative predecessor, the extent of New Labour’s reform in labour market policy was unprecedented. Not only was the scope of the ALMPs under New Labour broader, the overall objective in labour market activation was also more coherent. New Labour also differentiated itself clearly from the Conservative practice by its willingness to commit
significantly increased public expenditure to fund the active labour market measures. Whereas the Conservative government reduced spending in active labour market measures on the grounds that they interfered with the market, by July 2000 New Labour had announced massive increases in public spending for the 2001-2004 period in order to finance its expansion in active labour market as well as social programs. The government significantly extended the coverage of its flagship New Deal programs, while fully aware that the related increase in public expenditure will potentially require increased taxation (Bauld et al. 2003: 214-215; Clasen 2000: 100).

In shifting the government’s policy paradigm from cost control to labour market integration, New Labour adopted a discourse with heavy emphasis on personal responsibility, incentives, and the threat of dependency culture (Mullard 2000: 4). By intensifying the emphasis on the behavioural aspects of causes of unemployment, there was a general attempt under New Labour to redefine rights and responsibilities, to re-interpret citizenship and social values, and to set up a new contractual relationship between the citizen and the society. While trying to activate the labour market, New Labour defined its foremost role as being on the supply side of the economy, and the main task being enforcing individual responsibilities among the unemployed. Ideologically, the Labour government tried to replace the concept of equality with inclusion, and the concept of class with community, composed of numerous individual stakeholders each expected to take up responsibilities for themselves. Politically, the clever removal of both class and equality as central policy objectives helped strengthen New Labour’s case that the party has completely disassociated itself with the ineffective radicalism of the 1980s (Page 2002: 180-181). Characterized as “tough love” (Jordan and
Jordan 2000: 24-25), this social policy philosophy emphasizes that although benefit recipients should be cared for, there should also be renewed reciprocal expectation of responsibility-taking on behalf of the benefit recipients. Activation under New Labour, in other words, is a form of top-down social engineering based on human rationality (Clasen 2000: 97; Clasen 2002: 72; Cressey 1999: 189; Jordan and Jordan 2000: 24-33). Within the framework of this new communitarian look at society and the welfare state, New Labour started to embrace non-statutory welfare, in the form of voluntary and community organizations, many of which are organized through the government’s new National Citizens Service Program (Brusdon and May 2002: 61-63). Overall, compared with the labour market activation approach by the Scandinavian or the French social democrats, New Labour’s activation strategies are characterized by a much stronger form of conditionality, moral undertone, and compulsion.

However, alongside this new social contractual rhetoric, in New Labour’s activation measures there are also similarities with traditional European social democracy, such as the concern for inequality, poverty and the standard of living for those on very low income, areas to be addressed through measures such as increasing spending by stealth and lowering the tax band for low income earners (Rhodes 2000: 180-183; Jordan and Jordan 2000: 28-33). Instead of using the term moral underclass, New Labour chooses to focus instead on the issue of social exclusion as a result of exclusion from the labour market. The attention to social exclusion is also actively promoted by the European Commission, which believes that the key to tackling exclusion is reintegration into the labour market (Annesley 2003: 156-157). In addition to the standard ALMPs which offered jobs and training opportunities through the
New Deals, the government set up a Social Exclusion Unit in the cabinet and proposed a range of measures aimed at helping the poorest children living in economically disadvantaged local areas. These measures include Sure Start, which simplifies access to childcare and early education services for families with children under four, Educational Maintenance Allowance for the 16 to 19-year-olds, and Employment Action Zones in economically depressed areas. For all these measures aimed at combating the social consequences of exclusion from the labour market, the poorest sectors of the population were the chief beneficiaries (Bauld et al. 2003: 204-207).

On the whole, the labour market activation reforms under New Labour reflect ideological influences from both the left and right. On the one hand, in New Labour’s ALMPs there are traces of influence from neoliberal workfare programs, such as the strong emphasis on individual responsibility and sanction, and relatively smaller concern with the minimum job quality. The main focus of activation reforms under New Labour has been to increase financial incentives for work and improve job placement, and the Scandinavian enabling measures such as training and childcare are comparatively on the sideline (Dingeldey and Linke-Sonderegger 2004: 24). On the other hand, compared with traditional workfare programs in the US or in Britain under Thatcher, New Labour’s active labour market measures target a much wider section of the population with potential risks of detachment from the labour market. New Labour’s approach to labour market activation is also much more interventionist than its Conservative predecessor. In addition to relying on supply side measures, the Labour government also adopted some demand side measures in order to facilitate the direct creation of jobs, and the establishment of employment zones in
local areas with chronic unemployment problems is a case in point (Jessop 2003; Ginsburg 2001: 180).

Compared with neoliberal workfare programs, there is a stronger emphasis in New Labour on investment in human resources, training, subsidies, and the amount of support that should be made available to the unemployed, especially the young. For example, in order to encourage education and training for those entering the labour market, the Blair government introduced Individual Learning Accounts specifically targeted at those in work. Further differences from the neoliberal workfare approach can be seen in the methods adopted by New Labour to encourage mothers to enter the labour market. Whereas American policy instruments such as the Temporary Assistance for Needy Families (TANF) focused on the negative incentives of very limited benefit level and duration, New Labour devoted considerably more resources to improving the provision of public childcare places. Finally, also reflective of the European social democratic influence is the overriding concern with social exclusion in New Labour’s strategies and the extensive measures the government implemented to combat exclusion and poverty (such as the National Minimum Wage and the Working Families’ Tax Credit) (Rhodes 2000b: 61-62; Annesley 2003: 154-156; Daguerre and Taylor-Gooby 2004: 29-31; Peck 2001: 322-323). These characteristics draw New Labour’s ALMPs closer to the policy preference of Northern European social democracy as well as the Working Nation program under the ALP in Australia.
Changes in ALMPs

The New Deal has undoubtedly emerged as the most ambitious and comprehensive manifestation of New Labour’s active labour market measures, and it also represents the biggest single investment in public expenditure by New Labour since it came to power. Currently, there are six different New Deal programs targeted at different groups, but they share some common characteristics. Firstly, all New Deal programs include a “Gateway Period”, during which intensive job searching help is offered to the unemployed. Secondly, if the participants remain unemployed on expiration of the Gateway Period, there are four follow-up activation options for the individual to choose from: subsidized employment, self-employment, voluntary work, and twelve months of free training. Crucially, there is “no fifth option”, so activation of some sort is theoretically required of all participants. In 2003, the Gateways for the six programs are merged into a single service called Jobcentre Plus. The merger of the six Gateways also combined the previously separated welfare and employment services, and this process contributed significantly to the unification of New Deal. Secondly, all New Deal programs are supply side programs focused on the specific needs and circumstances of different population groups to be activated. All these programs emphasize the importance of making the welfare system responsive to the individual needs of beneficiaries, in the form of Individual Action Plans. In the Individual Action Plan, individual counseling is offered to clients both as a method of enabling and control (Dingeldey and Linke-Sonderegger 2004: 18-21). Therefore, all the New Deal programs rely heavily on the one-on-one communication between New Deal targets and personal advisers familiar with the specific circumstance of the individual New Deal beneficiary. Because of
the very broad range of knowledge and skills required of these personal advisors, their growing influence through the New Deal has brought about a significant change in the institutional and cultural tradition of the British welfare state. Furthermore, the New Deal has also achieved tangible results in labour market activation. Its measures have accelerated the return to work, especially of the long-term unemployed, and these measures have also contributed to at least a small increase in general employment (Finn 2003: 125; Millar 2002b: 281; Daguerre 2004: 51).

Similar to the approaches of most other third way social democratic governments, New Labour started its active labour market reforms with the segment of the population generally expected to be most easily reintegrated into employment: the young unemployed. This group was treated by New Labour as the first priority to be activated into the labour market, and the government’s emphasis on coercion and compulsion was also primarily targeted at this group (Trickey and Walker 2001: 181; Peck 2001: 322-323). Among the six New Deal programs currently in effect, the New Deal for Young People (NDYP) is the first New Deal program introduced by the government. Initially, the government funded the NDYP through earmarked tax from private utilities, so that the starting expense of the program was front-loaded. With increased labour market participation expected, the program becomes self-funding afterwards and will not become a burden on the general taxation system (Peck 2001: 280, 301). The second New Deal program to come into effect is the New Deal for Long-term Unemployed (NDLTU), which explicitly offers employer subsidies for taking on long-term unemployed workers for a period of 6 months. These subsidies are
offered to employers as a form of reducing potential wage cost and encouraging them to create more job opportunities (Wood 2001: 58; Grover and Stewart 2000: 241).

Clearly concerned with the performance results of its programs, the government inevitably concentrated its financial resources on those most likely to be activated, and those whose exclusion from the labour market is perceived as most pressing. Other less easily activated or less urgent groups were filtered down to newer and less-well-resource New Deal programs. Overall, the NDYP and NDLTU are much better resourced financially and more clearly structured in design than the remaining four New Deal programs. NDYP, in particular, takes up the bulk of the government’s spending in New Deal programs. Out of the six New Deal programs, only these two are compulsory in participation. Partly because of better financial resources, these two New Deal programs focus on work as well as employability, so that there is a clear emphasis on human capital and job quality, matched by government investments in training and job placement services. The NDYP and NDLTU, especially the former, incorporate many of the crucial instruments of labour market activation: wage subsidies, job-search assistance, training, and direct job creation. Consequently, in terms of policy result, the NDYP is one of the most effective in activating its target population, and it is also the New Deal program with the greatest potential to become self-financing in the long term (Cressey 1999: 177; Peck 2001: 313-315; Finn 2003: 116-120; Finn 2001: 82-83).

The remaining four New Deal programs are New Deal for the Unemployed Aged 50 and Above (ND50+), New Deal for Lone Parents (NDLP), New Deal for Disabled People (NDDP), and New Deal for Partners (NDP). The gradual introduction of these programs represented the ambition of New Labour to extend its activation reforms into not only the
officially unemployed but also the economically inactive sectors of the population (Oppenheim 2001: 79-80). However, such ambition has no yet been matched by corresponding investment. For the moment, participation in all these four programs remains voluntary, although since 2002 attendance in work focused interviews has been mandatory in NDLP. With less investment from the government both in terms of attention and financial resources, these New Deal programs focus more narrowly on reducing the barriers to work, and there is also comparatively less attention to the issue of direct job creation or investment in human capital (Millar 2002b: 271-272; Dingeldey and Linke-Sonderegger 2004: 18-21). This obvious imbalance in the distribution of government investment among the six New Deal programs means that the New Deal will be most effective for those most employable, many of whom will probably enter the labour market eventually anyway, and it will be less effective for those least employable and in the greatest need of government help in order to be activated (Barbier 2001: 15). Despite this problem of uneven resource distribution, the six New Deal programs as a whole do represent a qualitative change of direction in activation policy since the Conservative government. Regardless of their financial resources, the focus of all six New Deal programs is very much on integrating participants into the labour market, rather on preventing welfare claims. Although the New Deal programs, especially the NDYP, retain some of the compulsory elements of the JSA under the Conservatives, the public funding for these programs through windfall taxes is a completely new development (Trickey and Walker 2001: 194-206). In addition, there is also increasing coordination and integration between the six New Deals and the government’s reform in the taxation system, so that reductions in marginal tax rate help further reduce the poverty trap and tax credits
help further reduce the unemployment trap. Overall, fiscal welfare together with the New Deal has significantly contributed to the removal of barriers to work. Increasing employment became New Labour’s major achievement during its first term of office (Adler 2004: 88, 97-102).

Despite an overall positive record in delivering strong employment performance, the ALMPs under New Labour also have clear vulnerabilities. Similar to the ALMPs in many other third way country cases, New Labour’s active labour market measures are no longer effective when the local economy becomes sluggish. Supply side programs such as the six New Deals have a contingent relationship with the labour market. They rely heavily on existing job opportunities in the local economy. Therefore, when the demand side in the local economy slackens, the programs are under considerable threat. The reliance of New Deal programs on the availability of jobs is an important reason behind the extensive use of subsidies to employers in the New Deal as an incentive for them to directly create more job opportunities as well as a reward to them for taking on unemployed people (Peck 2001: 313-315; 324; Trickey and Walker 2001: 194-206). Similarly, the good performance of New Labour in combating poverty, inequality, and social exclusion is closely related to economic stability, and to the government’s success in increasing labour market participation. This type of vulnerability and excessive reliance on short-term economic conditions reveal a potentially serious weakness in the government’s activation reforms. Although Labour’s focus on the supply side of the employment equation has contributed to the dramatic innovations in British labour market policy, such as the WFTC and the New Deals, the
neglect of demand side job creation sets a limit to how far the government’s activation policies can go (Hewitt 2002: 207; Peck 2001: 324, 326).

*Increasing In-work Incentives*

As part of its third way labour market activation reform, since it came to power New Labour has introduced large increases in a wide range of in-work incentives, especially for those in the lowest-paid sector. One of the most important measures in this regard is the National Minimum Wage, introduced in 1999. This represents a significant development in government strategies towards promoting employment, the first time that a national minimum wage rate has been set in Britain (Rhodes 2000: 180-183; Millar 2003: 273). In addition to the minimum wage, there are also reductions to starting tax rates, lower tax bands, and cuts in national insurance contributions for low-paid workers (Millar 2000: 342; Rhodes 2000: 181). In its efforts to increase in-work incentives, New Labour has been distinctive in its attention to the activation of lone parents and various other families on low income. With the publication of the White Paper Fairness at Work in 1998 and the Employment Relations Bill in 1999, the government formally started to actively push for family-friendly policies as part of its strategy to activate families on low income. In order to activate lone parents and low-income-earners in couple households, the government introduced a stream of measures, under the headline of “Making Work Pay”. The most important initiative under “Making Work Pay” is the introduction of “Working Families’ Tax Credit (WFTC)” in 1999. The WFTC is a form of negative income tax paid by the Inland Revenue, a form of in-cash transfer aimed at removing poverty trap and increasing disposable market income with
reference to the number of children in the household. The WFTC replaced the Family Credit introduced by the previous Conservative government. The key difference between Family Credit and WFTC is that the WFTC is paid through the wage package, so that there is a psychological effect of linking benefits to work. As a form of means-tested benefit, the WFTC is also markedly more generous than the Family Credit (Deacon 2003: 106).

As a form of negative income tax the WFTC appears as lower taxation rather than higher public spending. Since the negative income tax is counted as tax reduction rather than cash payment, the WFTC does not count as a formal part of public expenditure. This situation is consistent with Labour’s 1997 election promise not to increase income tax or public spending beyond the limits of the previous Conservative government, and tax credits have become an increasingly acceptable way of offering in-work incentives. The increasing use of the fiscal welfare as the mechanism for delivering in-work incentives, especially through the taxation systems, is a characteristic in active labour market reform shared by social democrats in other liberal welfare regimes (Rhodes 2000b: 61-62; Clasen 2002; Parry 2000: 99; Adler 2004: 97-102). With increases in financial support announced in the 2000 budget, the WFTC provided a guaranteed minimum income for one-earner families working either full-time or part-time. In 2003, there was a significant rationalization of the tax credit system, as the government introduced a single Working Tax Credit (WTC) for all working adults. Meanwhile the government also introduced a separate Child Tax Credit (CTC) for families with children, which is a major reduction in financial costs for childcare (Dingeldey and Linke-Sonderegger 2004: 24; Oppenheim 2001: 84).
With the large scale introduction of negative income tax into the wage system, income supplementation gradually became the main responsibility of the tax rather than social security system, and both the level and coverage of income supplementation increased significantly (Millar 2000: 342). By 2003, the WFTC had reduced the tax bill of about one million low-paid families by 20 pounds a week whereas the CTC amounted to a 2.5 per cent tax cut in value (Evans and Cerny 203: 38). The WFTC and CTC, along with the Disabled Persons Tax Credit (DPTC), are all work-based tax credits paid by the employer as a supplement to wages. They are paid at a higher rate than means-tested out-of-work benefits, so these tax credits offer significant in-work incentives. While the WFTC marked the first significant step in the British welfare state to integrate the previously separated tax and social security system, the 2003 merger of all tax credits into WTC marked the completion of the integration process. Crucially, this integration of the tax and social security systems went hand in hand with the integration between benefit and employment services, primarily through the Gateways services of the six New Deal programs. The linking of the New Deals with the reforms in tax credits is a major innovation of the New Labour government. With the merger of all six New Deal Gateways into one Jobcentre Plus as the single point of access, there is now an unprecedented degree of coordination and coherence in New Labour’s activation strategies in the employment, taxation, as well as social security domains (Hewitt 2002: 192-194; Adler 2004: 103-104).

Another important initiative in increasing in-work incentives is the replacement of Married Couples Allowance, which was assumed to discourage the employment of married women, with a flat rate Child Benefit. In addition, the government also expanded the scope
of its flagship New Deal programs to include a New Deal for Lone Parents (NDLP). The implementation of these programs indicates that the social policy conceptualization of the family has started to shift from the traditional breadwinner model to adult worker families (Cressey 2002: 355; Hewitt 2002: 194; Daguerre and Bonoli 2004: 8-10). On top of all these financial incentives as carrots, there was also increasingly the stick of compulsion, which is being extended to lone parents, as well as people with disabilities, so that they are required to attend work-focused interviews. Further expansion in the scope of compulsions remains very likely (Walker and Wiseman 2003: 23). There is, however, some clear weaknesses in New Labour’s attempt to promote labour market activation among families with low incomes. First of all, at the moment the government does not have a clear strategy for the activation of women. In New Labour’s ALMPs for families on low income, the policy focus is on workless households rather than workless individuals (Millar 2003: 279). The lack of individual means-testing, individual claim, and individual payment, all of which were important elements of the Working Nation package under the ALP in Australia, means that New Labour has been less successful than its Australian counterpart in encouraging labour market participation of females. Secondly, the NDLP lacks sufficient resources to introduce substantive policy initiatives. Significantly less well funded than other more established New Deal programs such as the NDYP, the NDLP has been largely limited to the offer of information and advice for lone parents, without any form of job guarantee, in-work incentives, or incentives for employers to take on lone parents (Millar 2000: 343). A more serious weakness in Labour’s activation of low-income families, however, is in the area of childcare. There was some expansion of public childcare places since 1998, with the
establishment of National Childcare Strategy (NCS), which proposed for more nurseries and after-school care. However, although the NCS marked the first attempt by a British government to formally address the issue of childcare, the NCS’s various funding schemes, known as Sure Start, focused primarily on the stimulation of private and community provision of childcare. More generally, for the moment the government clearly prefers tax credits (WFTC for example) to the expansion of public childcare as the main in-work incentives for labour market activation. Instead of offering more childcare places, the NCS uses the tax credits paid through WFTC as additional funds for parents to meet the cost of childcare (Daguerre and Bonoli 2004: 10; Daguerre and Taylor-Gooby 2003: 635; Millar 2000: 343; Dean 2002: 6). For this reason, the net impact of the NCS has been uncertain, with the number of childcare places for 8-years-old and younger continuing to decline even after the introduction of the NCS. Compared with other areas of activation, especially the creation of financial incentives for work, the money allocated to public childcare is considerably less (Lewis 2003: 86).

Australia

*Shift of Paradigm through the Shift of Power*

As is the case with most other third way reforms, the Australian Labor Party started its efforts to realign the policy paradigm towards the objective of labour market activation against a background of serious economic and unemployment problems inherited from the previous Liberal-National Coalition. The general rate and duration of unemployment had been increasing since 1974, and concomitantly there was escalating social expenditure,
which was itself a result of both new benefit schemes and increases in benefit levels needed to deal with those newly excluded from the labour market. This rapid expansion in welfare expenditure was also partly due to the Henderson Report on poverty in 1975, which formally defined a poverty line and put on the spotlight the widespread existence of poverty in Australian society. The report forced the then Coalition government to adopt an attitude of institutional acceptance of the need to tackle poverty (Jones 2002: 12-16). However, the main priority of the Coalition under Malcolm Fraser was to control inflation, and issues such as poverty, social exclusion or unemployment were very much sidelined as a result. The Coalition government’s general neglect of social and labour market policy issues only started to change during the early 1980s, when the country was clearly faced with an escalating unemployment crisis. By the time when the ALP came to power in 1983, the level of welfare dependency had increased dramatically, due to both demographic changes and the worsening economic recession. The greatest impact of this increasing welfare dependency was on families with children, trapping them outside the labour market, and there was also rapid growth in the number of single parents on welfare benefits. Labor recognized that simply increasing welfare benefits towards families with children could actually worsen their welfare trap and dependency (Gibson 1990: 182-183; Cass and Whiteford 1989: 280-284; Jones 2002: 12-16, 29-31).

As social policy solutions alone proved inadequate to address the issues of either poverty or welfare dependency, the ALP extended its strategic outlook into the labour market arena, and the party started to regard exclusion from the labour market as the fundamental cause of poverty and social exclusion. This shift in the focus of Labor’s policy strategy from
inadequacies in the social security system to inadequacies in the labour market as well as the welfare state was motivated by the traditional social democratic concern with poverty and social injustice. While the means changed from further welfare state consolidation to labour market activation, the end remained the social democratic search for social justice, so the evolution in the ALP policy paradigm took place in a incremental and logical context. This social democratic attempt to search for new ways of securing social justice in the context of new economic constraints also asserted itself as the key momentum in the paradigm shift towards the third way for other country cases, as social democratic governments link the need to activate the labour market with the fundamental objective of combating social exclusion. As will be shown later, even the New Zealand Labour Party, which charted a uniquely neoliberal reform trajectory under social democratic governance, subscribed to the importance of combating unemployment upon entering office in 1984.

The ALP believed that the major cause of unemployment was the structure of welfare support rather than the failure of economic policies. In other words, instead of economic inefficiency, the major cause of Australian unemployment was passivity, something to be re-activated through active interventions in both social and labour market policies. Under the ALP, the state started to play a distinctively important role in the creation and control of the labour market, and the government took a highly interventionist role in industrial relations (Buchanan and Nicholls 2003: 30-45; 50). The overall objective of the ALP government was to re-align both social security and labour market policy along the line of OECD’s Active Society recommendations, and the government combined the expansion of labour market programs with reforms to the social security system. In a clear departure from the previous
Coalition tradition of program design within isolated policy domains, the ALP recognized that activation required an interconnected set of different policy arenas rather than monetary or fiscal policy alone, so that social, labour market, economic, and incomes policy became highly coordinated under the overarching theme of third way activation (Gibson 1990: 184-186; Cater 1993: 266; Saunders 2002: 102; Finn 1999: 56).

The constraint of the Accord, and the strong influence of the unions inside the parliamentary ALP through the different formal factions, led the Labor government to pursue an incremental and highly consensual approach to labour market activation. The ALP’s persistent attention to both gradualism and activation led to a reform pattern where labour market participation was actively encouraged in the context of tradeoffs between wage restraint and increased social wage. Changes in the social wage made sure that targeting was tightened but aimed mainly at the better off, and greater social spending and new programs protected the most vulnerable. In addition, the heavily regulated nature of funds for occupational pension, known as Superannuation, plus the compulsory nature of contribution to Superannuation funds, all reflected a pattern of active state intervention which traditionally characterized the Australian welfare state (Pierson and Castles 2001: 8-9). Such pattern led Castles (1994: 132-133) to characterize the third way reforms under the ALP as the “refurbishment” rather than retrenchment of the traditional wage earners’ welfare state. This successful experience of refurbishing the welfare state in Australia anticipated the third way reforms in other countries a few years later. As a policy package, the third way is centred on employment, wage restraint, and a prudent economic context. On the other hand, known as the wage earners’ welfare state, the Australian welfare state is characterized by compressed
income, small state, redistribution, and, most crucially, welfare benefits derived from active participation in the labour market (that is, “welfare by other means”). In the Australian welfare state, a large part of social security is delivered through the arbitration-regulated wage system. In this process, social policy is substituted for by wages policy premised on participation in the labour market, through the concept of “fair wage” or “living wage” (Pierson 2002 16-20; Castles 1994: 124-126; 132-133; Pierson and Castles 2001: 10). When Hawke came to power in 1983, the major problems facing the country included growing exposure to international capital and very weak fiscal position for the government (Pierson 2002: 20). On top of declining labour force participation, these were similar problems that, later in history, accompanied third way reforms in other countries such as Britain, Denmark, and the Netherlands. In their 12 years of power, the Hawke and Keating governments successfully refurbished, rather than dismantled the wage earners’ welfare state, an achievement only undermined in the late 1990s when the power resources of the labour movement were drastically reduced with the coming to power of the Coalition government. Electorally, the ALP was able to juggle the balance between public versus private, skilled versus unskilled as well as sheltered versus exposed sectors till 1996 (Schwartz 2000: 120, 122). The mass defection of the labour movement was held off for more than a decade because of good employment performance delivered through active labour market reforms.

On the other hand, the Coalition government which returned to power in 1996 has maintained a more ambiguous attitude towards activating the labour market. Working Nation, the flagship active labour market measure under the ALP, was quickly abandoned by the Coalition on cost grounds. In its place was the introduction of Work for the Dole in 1997.
This new measure was a form of harsh but ineffective workfare, especially weakened by the contradiction between compulsory sanctions and minimum state involvement in the labour market. The focus of labour market policy shifted from providing work-focused ALMPs to a mandatory system of sanctions. The primary attention now becomes the number of people removed from benefits. With welfare dependency now being the centre of attention, the Coalition government emphasizes being tough on welfare cheaters, backed up by explicit appeal to public opinion (Saunders 2002: 64). With greater emphasis on cost control and efficiency, the Coalition government reduced spending on active labour market measures by 24 per cent. In order to reduce the presence of the state in employment services, the Coalition introduced Job Network, which opened contestable market into the publicly funded employment service areas. The government also introduced Centrelink, a one-stop shop for government income support (Pierson and Castles 2001: 13; Finn 1999: 65). Work for the Dole is designed not to compete with any regular form of employment, so there is little room for integrating persons with marginalized labour market opportunities. The Howard government is also especially reluctant to encourage women to enter the labour market. Still somewhat attached to the traditional breadwinner model of social security provision, the government instead introduced a scheme to make it more attractive for women to stay at home (Jones 2002: 18-25).

*Changes in ALMPs*

Under the Labor government, the most significant expansion in active labour market measures occurred during the early 1990s when Keating was the Prime Minister. In 1991,
Unemployment Benefit was replaced with two new forms of activation measures: Job Search Allowance and Newstart Allowance. Both these programs were linked to other ALMPs, required new job-searching commitments, and offered new forms of cash support for people in short or long-term unemployment to encourage job searching (Saunders 1995: 47) Then, in 1994 Keating launched the comprehensive program package Working Nation, which anticipated much of the New Deal under Blair’s New Labour. Working Nation represented a major intensification of the ALP government’s ambition and financial commitment to activating the labour market, involving a real increase in budget projections of 6.5 billion Australian dollars (Finn 1999: 58). Characterized by Pierson and Castles (2001: 10-12) as “an ideological shift”, Working Nation gave the clearest indication ever in Australia for an employment-oriented social and labour market policy strategy. Working Nation contained major reforms in both labour market and income support policies. In terms of assistance for entry into the labour market, the ALP moved on from Hawke’s earlier emphasis on the most easily activated (the young unemployed). Instead, the primary focus of Working Nation fell on the long-term unemployed (18 months or longer), with the key component of the package being a job guarantee called Job Compact, through which all the long-term unemployed were offered active assistance and reciprocally they were obliged to accept reasonable offers (Junankar and Kapuscinski 1997: 3). The government also offered wage subsidies to employers to encourage hiring the long-term unemployed, with the amount of subsidy going up as the duration of unemployment lengthens. As a whole package, Job Compact provided intensive individual case management, training, a job for 6 to 12 months, a training wage, and intensive job search assistance. Active assistance through these programs and wage
subsidies were crucial in helping the long-term unemployed leave the welfare system, with wage subsidies alone accounting for 80 percent of successful placements of the long-term unemployed.

By the time the ALP came to power in 1983, the Australian labour market had become increasingly segmented by gender, as well as by full-time versus part-time status, and such segmentation significantly contributed to the incidence of long-term unemployment (Saunders 2002: 91). In response, the ALP introduced a wide variety of activity tests characterized by their flexibility. Immediate job seeking requirements were relaxed to allow individuals to pursue a wide range of approved activities outside formal and full-time employment, such as self-employment or participation in community based cooperatives, unpaid voluntary work, or education and training courses. These reforms continued a long tradition of the ALP government in making specific efforts to activate part-time and casual unemployment, starting with the 1989 Social Security Review which formally replaced the work test with activity test, thereby acknowledging part-time as well as full-time work. Now, the ALMPs in Working Nation moved Australia much closer to participation test, rather than a simple job activity test (Finn 1999: 58, 64, 68; Marston et al. 2004: 5-6; Pierson 2001: 8). Under Working Nation, it also became easier to report earnings and quicker for income allowances to be reinstated on the termination of a casual job, so that the unemployed were encouraged to take up part-time or causal jobs (Harbridge and Bagley 2002: 180-183; Saunders 1995: 52-53; Shaver 2002: 335). The general treatment of earnings was changed so that individuals were allowed to retain a part of any casual earnings, a move which facilitated
people looking for part-time or casual job while retaining an incentive for full-time jobs (Finn 1999: 63).

However, the potential effect of Working Nation in activating the labour market was abruptly curtailed when the Coalition replaced the Labor government in 1996 and dismantled the scheme. Even within its short duration of two years, Working Nation under the ALP delivered good results in terms of labour force participation for the specific target group it set out to activate. Long-term unemployment fell by a massive 20 per cent by June 1995, only one year after Working Nation came into being (Finn 1999: 59). Overall, Working Nation left valuable lessons about how to activate the labour market in the Australian context. Evaluation of the effect of Working Nation demonstrated that employment and training programs could indeed accelerate entry into the labour market, but the overall effect was dependent on whether the program was tailored to specific context or circumstance of the individual being activated (Finn 1999).

The effectiveness of activation programs, crucially, was also dependent on the state of the economy: when there is an economic decline, it becomes much harder to activate the labour market. Therefore, supply side reforms such as Working Nation need to be linked with macro demand management measures and direct job creation (Finn 1999: 66, 69). This dependence of ALMP performance on job creation from the demand side, and on the situation of the macro economy more generally, is a finding repeated in ALMP experiences for each of the third way cases studied, and this fact points to the role of competitive economic growth, and in turn, wage moderation, as the almost indispensable economic context for successful third way reforms. Demand side job creation remained one area of
inadequacy for active labour market measures under the ALP. Because of Labor’s strong
belief in the connection between unemployment problems and deficit in person incentives,
the government’s active labour market measures were focused predominantly on the supply
side while ignoring the necessity of corresponding changes from the demand side in terms of
direct creation of jobs. Partly as a reaction against the ineffective interventionist polices of
the preceding Coalition government, Hawke abandoned Fraser’s efforts at job creation in the
public sector. This weak attention to direct job creation is one major characteristic that sets
Australian ALMP measures apart from the Scandinavian or Dutch approach (Saunders 2002:
220).

*Increasing In-work Incentives*

In order to provide in-work incentives to encourage female job searching, Working
Nation ensured that spouses of the unemployed would receive payment based on their own
job activity, and that income testing for couples was individualized. Therefore, for the first
time, the tradition of breadwinner was broken and partners were treated as separate
individuals. The Australian reform of means-testing took on all aspects of the
individualization agenda: individual claims, individualized means test, and individual
payment. Introduced since 1995, these changes in individualizing means-testing had led to a
significant transfer of payments from men to women (Millar 2003: 70). Next to females,
another major target for the ALP government’s in-work incentive measures was families on
low income or persons with caring responsibilities. On this front, the government tried to
liberalize income tests and reduce poverty traps for families working on very low incomes.
The government introduced the Family Package, a program targeted specifically at low to average income families with significantly increased level of payment. Social assistance programs were designed as a top up for the wages of those working for decreased wages. In addition to using supplementary social assistance to top up single or no-income families, for better targeting the government also transformed the universal child benefit into a means-tested family benefit called the Family Assistance Supplement (FAS). For unemployed sole parents with older children, the government introduced not only a Parenting Allowance but also Jobs, Education and Training (JET), a voluntary program involving targeted counseling, assistance with childcare, training and education. Another important measure which played a role in easing the transition from welfare to work for families was the restoration of a system of national health insurance (Medicare), which was abolished by the previous Coalition government (Hemerijck and Schludi 2000: 195-199; Schwartz 2000: 118-119; Pierson 2001: 9-10). The means-tested health benefit system under the Coalition government had created work disincentives as people were in danger of losing their health benefit when going back to work, and the re-establishment of national health insurance under ALP helped to reduce such work disincentives.

In the attempt to provide in-work incentives for part-time workers and un-paid employment more generally, the ALP government focused almost exclusively on relieving the financial burdens of dual or one-and-a-half earner families by offering incentives in cash. Apart from Medicare, the government did relatively little to directly relieve the caring burdens of these transitional families. Like the fourth Labour government in New Zealand, the ALP tried to externalize in-kind responsibilities onto the family and only remain the main
provider of cash benefits or funds. The reluctance of the Australian (and New Zealand) state to involve directly in the delivering of social services led to massive under-supply of childcare facilities and funds (Gibson 1990: 184-186; 191, 198-200; Hemerijck and Schludi 2000: 195-199). On the one hand, the individualization of spousal income and means-testing through Working Nation removed female financial dependence, on the other hand, there was little effort to remove the unpaid caring obligations within the family. As the experience in Scandinavia demonstrates, activation of women and, to a less extent, dual or one-and-a-half earners as well as part-time workers, cannot be very effective without adequate public childcare provision. The removal of barriers to female labour market participation, therefore, became a key agenda not fully addressed by the Hawke and Keating governments (Castles 1994: 140; Harbridge and Bagley 2002: 191). Also for this reason, although Working Nation had good results in lowering overall unemployment, the results in terms of labour market activation for women remained ambiguous (Junankar and Kapuscinski 1997: 27).

New Zealand

(Partial) Shift of Paradigm through the Shift of Power

In New Zealand, the shift of power from the centre-right to social democracy took place in 1984. However, unlike most other cases studied here, there was no clear shift in policy paradigm towards active labour market measures after the social democrats entered office. The replacement of the National government by Labour did signal a change of policy focus from further consolidation of the welfare state to combating unemployment as the key solution to the mounting economic and social problems confronting the New Zealand state
by the early 1980s. However, going beyond this first step, New Zealand Labour diverged from most other social democratic governments in how to proceed further. The social democrats in other country cases studied here adopted a strategy of active labour market reform as the means to combat unemployment. Admittedly some of these governments were more radical than others with regard to the extent of policy change, or more successful than others with regard to the policy effect. However, they did share a common trajectory of paradigm shift from passivity to active labour market reforms, with the state assuming a clearly interventionist role and a clear financial commitment. New Zealand Labour, on the other hand, chose a different strategy to combat unemployment. Instead of letting the state assume an activist role and relying on activation reforms in the labour market as well as the social security system, Labour opted instead to consciously avoid intervention in the labour market and used fiscal and monetary policy as the primary instrument to combat unemployment. Therefore, the shift of policy paradigm through the shift of power in New Zealand was only partial. Whereas Labour shifted government policy from combating the consequences of unemployment to combating unemployment, it stuck to a neoliberal policy prescription of monetary guidance instead of reforming the labour market and social security system as the primary strategy to reduce unemployment. In the three-order framework by Hall (1993), what happened with the shift of power to New Zealand Labour in 1984 can almost be uniquely characterized as a second-and-a-half order reform. In other words, a change in the overall policy objective (third order) was unmatched by necessary changes in policy instruments (second order). Because New Zealand Labour stopped short of active labour market reforms, it represented the only case in all the nine countries studied here
where third way reform did not happen in substance. One of the most important reasons for Labour’s preference for monetary over labour market strategies to combat unemployment was the unprecedented failure in state intervention in New Zealand by the early 1980s. The scale of state intervention as well as its failure was bigger in New Zealand than in most other OECD countries during the early 1980s, and so was the extent of discredit for the role of the state as a consequence.

When Labour came to power in 1984, the preceding National government’s heavily interventionist but increasingly ineffectual policy had plunged the country into serious economic decline and fiscal crisis. Failures in existing policy prescriptions also accelerated the changing configurations inside the parliamentary Labour Party, which paved the way for the takeover by neoliberal members based in the Treasury (Boston 1993: 126; Boston and Holland 1987: 5). By the early 1980s, the persistent government failure to deal with stagflation, deregulation, and failing primary exports, had contributed to progressive electoral realignment in New Zealand. The softening of traditional core constituencies and failures of traditional policy remedies facilitated the rise of ideologically driven neoliberal wings inside both major parties, which rapidly took advantage of New Zealand’s lack of veto points in political institutions and weakness in party-union ties, to hijack the reform process towards a radical direction (Schmidt 2000: 245-250).

In both Australia and New Zealand, economic decline and budget deficit became a clear cause of concern for the governments by the early 1980s. As dominion economies heavily reliant on exports from the primary sector, these two countries were more affected by the impact of globalization than most other OECD countries in the 1980s (Huber and
Economically, the interventionist and protectionist policies by the preceding National government had ceased to function by the early 1980s. Fumbling for a way to contain economic decline triggered by the loss of primary markets, Muldoon’s National government became increasingly radical in its attempt to up the ante in the extent of its intervention in New Zealand’s economic system. National’s increasing reliance on the traditional rural constituency of the elderly and less educated further limited its room for fundamental reform, whereas the continuing tax write-offs and heavy subsidies to these groups had serious economic costs (Kelsey 1995: 24-27). By 1984, New Zealand had become one of the most heavily regulated OECD countries, with what amounted to the only command economy in the western world (Rudd 1990: 89-93; Castles 1996: 16). Under Muldoon, there was a surge in welfare state expansion and gigantic state projects epitomized by the series of “Think Big” projects. By 1981, New Zealand had a social security system that looked like community insurance but was actually funded from general taxation. Family support, medical benefits, and, most importantly, a very generous system of superannuation, were universally open to all (Rice 1992: 484). Because of economic decline, the number of benefit recipients increased steeply by 1984, plunging the country into steeper deficits. This unprecedented urgency of economic and fiscal problems made the case for Labour’s reform and the strategies it chose much easier. In Australia, within the framework of the Accord, both labour market activation and wage restraint were aggressively encouraged by the ALP as the key strategies for employment growth. In New Zealand, by contrast, rather than taking an active labour market approach to full employment, Labour chose a monetarist approach to
employment, believing that economic competitiveness in a free market is the ultimate key to higher employment (Denemark 1990: 283; Buchanan and Nicholls 2003: 116).

With a very heavy policy input from both the Treasury and the Reserve Bank, the fourth Labour government firmly believed in the first order importance of fundamental overhaul of the economic and fiscal system of the country, towards an unregulated free-market system. With the main source of influence coming from the U.S., in particular the micro-economic theories and firm theories by Williamson, the mindset of the Treasury and the Reserve Bank was very specifically, and narrowly, focused on the undesirable level of overseas debt faced by the country (Kelsey 1995: 54; Hawke 1992: 443). Overall, Labour’s reforms between 1984 and 1989 were characterized by a strict separation between economic and social policy, with the stress very much upon the former (Shannon 1991). Contrary to the strategies of most other social democratic governments, the solution to the problem of unemployment was chosen outside both labour market and social security policy domains. Instead, it was hoped that growth in economy and employment could take place after the chronic inefficiencies in the New Zealand economic system were reduced. Social and labour market policy instruments, instead, were deployed for a completely different purpose: they were more or less used by Labour as a foil, to cushion or balance the impact of the rapid deregulatory reforms in the economic domain. The government’s preoccupation with reducing intervention in the economy meant that reform measures targeted either at the social security system or at the labour market were sidelined. With regard to these two policy domains, Labour continued with an *ad hoc* and minimalist approach with no clear outline, in contrast to its clearly established overall framework and strategic planning with respect to
economic policies. Changes to the social security system under Labour were largely limited to some tightening of access to services with the purpose of cost control (Koopman-Boyden 1990: 227, 230; O’Brien 1993: 14; Boston and Holland 1987: 7-8; Schmidt 2000: 245-250). As a general pattern, Labour went ahead with extensive reforms where the immediate political costs were low or benefits certain, but it was more cautious where the political costs were big and immediate, as in industrial relations or social policy. Labour believed that the working class votes could still be retained despite its economic fundamentalism, as long as it spared the social security system as well as industrial relations system, on top of taking a progressive stance on softer social issues such as gender and the environment, which it did (Cheyne et al. 1997: 42; Harbridge and Walsh 2002: 200-201; Huber and Stephens 2001: 293).

Although the unusual economic circumstances of 1984 allowed for the immediate takeover of government policy design by the Treasury, soon after the reforms began there were attempts inside the parliamentary party to reverse this situation. There was growing disquiet within the party over the potential social implications of the economic deregulatory reforms, and opposition to the Treasury’s strategies gradually strengthened around the Prime Minister. In the budget package of December 1987, the parliamentary Labour Party managed to remove the Treasury’s proposal for further deregulation, and during the election campaign of the same year, Lange made the promise to further extend the welfare state. By 1988, the division between the neoliberal and traditional wings of the party become public, and one year later the Treasurer was sacked by the Prime Minister and the Treasury reorganized. Therefore, well into its second term office, Labour finally managed to put a hold on the
radical turn towards economic deregulation. However, the attempt to combat unemployment by bypassing the labour market clearly did not work, as unemployment continued to rise during the period of economic reforms. Growing unemployment, aggravated by the lack of any serious attempt to reinforce the welfare state in compensation, alienated core Labour supporters, who split from the party to form the welfare-friendly New Labour Party. This new party led to vote splitting on the left and the victory of the National government in the 1990 election, which ushered in yet another era of even more extreme deregulatory reforms, this time extending into not only the industrial relations but also social security domains (Schwartz 2000: 101).

Changes in ALMPs

In the late 1970s and early 1980s, the initial response of the National government under Muldoon towards the unemployment problem was both experimental and ad hoc: there were a range of job creation schemes, cost-containment measures, and prototype welfare-to-work programs. A shift of policy paradigm took place partially with the transition of power from the Nationals to Labour in 1984, as combating unemployment became a central government objective. The importance of paid work was emphasized by Labour throughout its period in office, first in the Budget Review of 1986, and later in the budget proposals in 1990 (Mackay 2001: 76; O’Brien 1992: 158). However, although unemployment was now placed on top of the government’s agenda, actual policy instruments were completely dominated by deregulatory reforms in the economic domain rather than ALMPs. With the immediate objective being market economy efficiency, labour market and social policy
measures were applied with the narrow objective of cost control and removing persons from benefit rolls rather than transition into productive jobs. Shortly after it came to power, Labour abolished a wide range of job creation and wage subsidy schemes on the grounds that they distorted the labour market. Direct intervention in the labour market was completely ruled out. The focus shifted from the market to the unemployed as individuals. In place of the abolished ALMPs, the government installed a heavily targeted scheme called ACCESS aimed at removing behavioral barriers, backed up by substantial reduction and tightening of benefits. Based on what is called a “less eligibility” principle, a persistent income gap between benefits and wages was emphasized in the government publication Benefit Reform (Higgins 1999: 261-265; O’Brien and Wilkes 1993: 87-88; O’Brien 1992: 148-149, 158).

As a general pattern, since 1985 the government had attempted to bypass direct intervention in the labour market using a series of methods, first through restructuring individual behaviour using ACCESS, then through controlling money supply. When this policy clearly failed in 1988, the focus then moved to the control of interest rates (O’Brien and Wilkes 1993: 133-135). Activation of the labour market while bypassing the labour market ultimately turned out to be ineffective, and social and labour market measures under the fourth Labour government became a form of hard but ineffective workfare. The primacy of cost control objectives over labour force participation also created additional barriers to work for people with caring responsibilities. In the Scandinavian approach to third way activation, the labour market integration of women or persons with caring responsibilities was greatly enhanced with massive expansion of childcare facilities. By contrast, in New Zealand, deregulation under Labour as well as its National successor led to comprehensive
de-institutionalization of community care. For cost control reasons, Labour ignored the sector of unpaid community and family workers. The government also actively encouraged the externalization of welfare burdens onto the informal sector, which, consisting largely of women, was more or less confined within the limit of the family.

After ten years of hard-hitting privatization and deregulation by both major parties in the economic (and later industrial relations) domain, the non-consensual approach to reform as well as its abysmal effect in terms of economic growth and employment triggered massive discontent across the electorate. The general public’s desire to end the non-consensual approach towards policy reform ultimately led to the fundamental transformation of political institutions in New Zealand through the MMP referendum and a new electoral system. Whereas it was possible to put through reforms supported by minorities under plurality, under the mixed electoral system currently in force, the support of the median voter has to be secured. This institutional constraint, on top of public anger towards a decade of neoliberal reform, led to a gradual change of government strategy. The first post-referendum government, a National-New Zealand First coalition, became much less aggressive than its National-only predecessor. The switch to a new electoral system significantly slowed down the pace of neoliberal reform (Schwartz 2000: 121; Buchanan and Nicholls 2003: 92; Hemerijck and Schludi 2000: 193-195; Mackay 2003: 76). With the coming to power of the fifth Labour government (in coalition) in 1999, the extra step was finally taken, from the policy goal of employment to the policy instrument of active labour market measures. The emphasis on work instead of welfare, which had been highlighted by Labour in the past two decades, was continued after 1999, and Labour reaffirmed its commitment to full
employment. However, there is now a clearer departure from past practice in terms of how the work emphasis should be implemented.

Representing the first real change in policy direction since 1984, the fifth Labour government removed past workfare measures narrowly based on mandatory sanction, and put in place a broader mix of ALMPs which played a more facilitative role and offered better in-work incentives, such as the relaxation of the rate at which benefits are withdrawn and a wide range of tax credit programs to make work pay. Along the same line, Labour also committed massive increases in public spending to fund new active labour market measures (Mackay 2003: 105; Buchanan and Nicholls 2003: 105-106). The fifth Labour government no longer shied away from letting the state play a more active role in activating the labour market with increased public expenditure. Going even further than Blair’s coy approach of increasing stealth tax, the fifth Labour government explicitly pledged increase in direct taxes to pay for increased spending in active labour market reforms as well as in other areas of social spending (Schmidt 2000: 245-250; Boston et al. 1999: 313).

An Overview: Expansion of the Active Apparatus

Changes in ALMPs

In terms of macroeconomic policy, the social democrats in the cases studied either continued the budgetary discipline, anti-inflation, and cost-control principles from their centre-right predecessors, as in Britain or the Netherlands, or pioneered these principles themselves, as in Australia or New Zealand. However, in most instances, this cross-country embrace of sound budget and economic prudence had gone hand in hand with, rather than at
the expense of, increases in public expenditure devoted to active labour market programs, especially those with long-term enabling or social investment objectives (Bonoli 2004: 203). Comparing the major ALMPs covered in the case studies, several important general patterns emerge.

First of all, in designing their ALMPs, the social democrats have placed increasing emphasis on the balance between rights and obligations to accept offers of activation and shown growing willingness to use compulsion to enforce the obligations to activation. Examples of this pattern can be found in the British New Deal, Dutch JEA, ALMPs based on the Social Services Act in Norway as well as Danish ALMPs. In this respect, the Scandinavian strategy stands out in that the work conditionality in the Northern European context often emphasizes geographic and occupational mobility, as opposed to the emphasis on wage mobility in both the continental and liberal welfare regimes (Kvist 2000: 9). The RMI introduced by the French Socialists, on the other hand, is an extreme case of ALMP with obligations to participation in principle but with lax, if not non-existent, enforcement on the ground. The fact that the RMI emerges as the most integrative and accommodating ALMP is related to the traditionally statist policy framework which was itself a byproduct of the circumstances surrounding the transition from the Fourth to the Fifth Republic. Next to France in emphasizing the rights to activation are the Danish active measures. One important characteristic shared by the French and Danish ALMPs is that the social democrats in government explicitly committed planned increase in public expenditure to fund these programs, through increase in direct taxation if necessary. ALMPs in both countries, as well as the Netherlands, are noted for their strong emphasis on “social activation” rather than
activation into the labour market per se. However, the RMI uniquely has suffered from a corresponding neglect of the labour market dimension. Indeed, unemployment in France has been more effectively reduced by subsidized employment and extensive use of early exit pathways than the purportedly flagship ALMP known as the RMI (Daguerre and Taylor-Gooby 2004: 28). On the other hand, the interpretation about rights to activation is more ambiguous with regard to New Deal and the Dutch activation program the JEA, whereas such entitlement does not formally exist in the Norwegian workfare programs related to social assistance benefits.

The difference among social democratic governments in balancing rights versus obligations on the level of policy principle is easily reflected in actual emphasis in policy implementation. For example, while the Danish ALMPs have an inbuilt element of compulsion, the unemployed can choose from a wide range of activation options, and the government actively seeks to enhance the skills of the unemployed through training offers. Sanctions, while they exist, are not at the forefront of Danish ALMPs. The New Deal, by comparison, is clearly ready to impose sanctions, especially on the young. At the same time, measures in the New Deal are also much more tolerant of low wages and labour market inequalities. The linkage between fighting unemployment and skill development in the New Deal, though rapidly developing, is much more tenuous than in the Danish ALMPs (Etherington 1998: 156-159; Martin 2004: 2). On a scale from the most integrative to the most preventative ALMPs, the RMI and American workfare programs tend to occupy the polar ends (Trickey 2001: 254-256). The most effective ALMPs, however, are the ones that are somewhat in the middle, and excessive dominance by either rights (in France) or
obligations (in the US, and to a less extent the ALMPs under the Social Services Act in Norway) has not delivered very satisfactory results in terms of labour market integration. Of course, it is important to point out here that it is the social-assistance-related Norwegian programs since 1991 that are used in the comparisons made here. Other Norwegian ALMPs do have a more balanced mix between obligations and rights, especially the rights to training and re-qualification.

Secondly, under the social democrats there is clearly a hierarchy of priority with regard to the target of ALMPs. As is the case with almost every major active labour market package covered here, the young unemployed are usually the first target, bombarded with the most resources in training and job offers but also with the most coercive enforcement rules. Actually, a lot of the flagship ALMPs under the social democrats started off as programs for the young and later were expanded to become comprehensive measures (Trickey 2001: 258). Typical examples of this pattern are the New Deal in Britain and the JEA in the Netherlands, and participation in these specific programs is universal for all the young unemployed. Because of the high intensity of resources and attention, activation of the young also tends to be the most effective as compared with other target groups. Next to the young unemployed, the long-term unemployed constitute a second major activation target, especially given the close connection between this group and the increasingly salient issue of social exclusion. A typical ALMP tailored to this segment of the population is the Working Nation package under the ALP in Australia. However, compared with the measures targeted at the young, those targeted at the long-term unemployed are relatively less well resourced, and there also tends to be a less degree of compulsion. The relatively lower commitment from the social
democrats to this group probably plays an important, but by no means decisive, role in the fact that the long-term unemployed are often simultaneously the group for which active labour market measures prove least effective.

Closely related to the second pattern mentioned above, the social democrats have gradually expanded the coverage of their ALMPs to cover those segments of the labour force that are traditionally more distant from the labour market because of serious competitive or working capacity disadvantages, and the social democrats have often presented this approach as a general strategy to combat social exclusion. This pattern of expansion is very much a second stage development, dependent on the initial introduction of ALMPs into what were predominantly passive arrangements in the social security and labour market system before the social democrats came to power. For this reason, social democrats with limited reform achievements so far, such as the SPD in Germany or Socialists in France, have been less capable of reaching out to the outer margins of the labour market than their more advanced counterparts such as the Scandinavian or Dutch social democrats. In addition, as a whole there is clearly increasing attention from the social democrats to the enabling aspect of activation, and this trend is unambiguously pioneered by a very large margin by the three Scandinavian countries in this book.

*Labour Market Flexicurity Measures*

In general, measures by the social democrats have led to a higher degree of flexibility in the labour market in almost all the cases studied here, but the extent and substance of change vary greatly. Whereas Denmark, the Netherlands, and Britain clearly went down the
road of flexibilization, similar processes in Germany and France have been marred by attempts to re-regulate (Esping-Andersen and Regini 2000b: 336). One very important factor which determines the varying outcome is the role of the social partners, unions in particular, in the reform process towards greater flexibility in the labour market. Union density is the root of the problem here. With low union density, often only core workers are unionized. When unions primarily represent the interests of core employees, they are likely to oppose any policy change which has the potential to encroach upon or weaken the dominance of the core sectors in the industry in terms of job security, wage standards, and working patterns. However, where there exists an effective corporatist framework within which to build consensus and compromise with unions, the government can still pull off significant reforms despite problems presented by low density. On the other hand, in a context of ineffective (German) or recently dismantled (Swedish) corporatist structure, the acceptance of flexible arrangements was more difficult. In these cases, the pressure from unions on their respective social democratic governments not only stopped many new initiatives towards increasing labour market flexibility, but also led to the reversal of some existing flexible labour market measures introduced by the previous centre-right governments. The German case is a clear example of how a social insurance system catering to the interests of full-time males in the manufacturing sector and governed through codetermination can discourage both female and part-time working (Crouch 1999: 449). Similarly, the Jospin government, and indeed its Gaullist predecessors, has succumbed to the often very organized (and publicized) resistance from the unions. As a result, France, together with other Southern European countries, retains high levels of rigidities in the labour market framework, including strict hiring-and-firing as
well as the regulation of wages. As a matter of fact, recent changes in French collective bargaining have added further rigidities to the labour market. The other side of the coin is that deregulatory reforms are more likely when the unions are simultaneously too weak politically and too fragmented in organization to coordinate for the interest of the core segments of the labour market. For this reason, despite the general lack of a corporatist framework, New Labour in Britain was still able to bring regulatory changes in the labour market, with no serious resistance from the castrated unions (Lodovici 2000: 45; Esping-Andersen and Regini 2000b: 336; Scharpf and Schmidt 2000: 334; Wilthagen 2003: 24).

In addition to the role of social partners and the corporatist framework, the acceptance of flexibility can become easier and its practice more effective if flexibility is accompanied by decent standards of job security for the temporary workers as well as decent social protection on a more general level. Therefore, it is no wonder that the two most successful third way cases are where the combination of flexibility and security is also at its peak, seen in the “golden triangle” of Denmark and the flexicurity reforms in the Netherlands. In most other cases, the combination of flexibility and security still tends to be underdeveloped, as one of the two dimensions tends to dominate the other. For example, whereas Britain has flexible employment protection rules but ungenerous unemployment protection, Germany has generous unemployment benefit provision but relatively strict employment protection. The importance of compromises and tradeoffs is not only intrinsic to the concept of flexicurity *per se*, as a general strategy it is also important in smoothing the process of negotiations for reforms to increase labour market flexibility. For example, reducing working time without cutting wages is harder for employers to accept than instruments that blend
working time reduction with consideration for competitiveness, such as firm-level work-sharing schemes and leave schemes (Compston 1997: 204).

In addition, since most of the action will be within the company when it comes to implementing flexicurity measures, decentralization and devolution of policy responsibilities to the region or local level can also enhance the effectiveness of flexicurity reforms, as long as there is at the same time strong coordination at the central level. In this sense, the two top-performing cases of the Netherlands and Denmark in flexicurity are also where there has been the most consistent and mature development towards “centralized decentralization” in collective bargaining in recent years. By contrast, the less satisfactory progress towards flexicurity under the German social democrats is partly related to the lack of central coordination in bargaining, which is itself a legacy of the strong Tarifautonomi principle in German industrial relations. In addition, the Dutch and Danish cases also demonstrate that, by broadening the agenda for flexicurity negotiations, it becomes easier to reach agreements, based on a broader range of tradeoffs and compromises that can be designed for both sides of the social partnership (Wilthagen and Tros 2003: 29, 31).

Although the social democrats attempted to introduce greater flexibility into the labour market in a general effort to promote employment, the actual effect of greater flexibility is felt more on the structure than on the total level of unemployment, because labour market rigidities such as strict employment protection legislation mainly create an insider/outsider divide. In this sense, in the long run greater flexibility can indeed be effective in reducing long-term unemployment, but only indirectly by changing the structure of employment (Goul Andersen and Jensen 2002: 40; Goul Andersen and Jensen 2002c: 85). In
addition, employment protection starts to have a significant effect on employment only at very high levels of protection, for example in Southern Europe. By contrast, in both Norway and Sweden nominally high employment protection has not led to a severe insider/outsider divide. For both countries, employment protection can be negotiated on an individual basis on a company level, and therefore the actual level of flexibility in employment protection is quite high. Between 1980 and 2000, the average ratios between adult and youth unemployment, as an indicator of insider/outsider divide, are 2.62 and 4.00 for France and Germany respectively. By contrast, the ratios for Sweden and Norway are only 1.79 and 1.36 respectively, not very different from the liberal market economies of the United States and Britain (1.50 and 1.86 respectively). The relatively stable performance of the Swedish (and Norwegian) labour market since the mid 1990s has shown that the combination of strong work line and generous welfare state can be regarded as an effective alternative to both the classic flexicurity approach of the Netherlands and the low-wage deregulatory approach of the liberal welfare regimes (Clasen and Oorschot 2002: 236).

On a more general level, flexibility is more regulatory reform than simply deregulation, because while rules for hiring temporary workers or other workers with reduced work capacity have been relaxed, rules for retaining them (in other words, rules about their job security) have been correspondingly tightened. And the combination of regulation and deregulation in the labour market is only part of a wider effort by social democrats to carry out regulatory reforms, whose objective has shifted from redistributive fairness, industrial assistance, and democracy of the Golden Age to economic

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1 Figures are calculated from the OECD Statistical Compendium (OECD 2005).
competitiveness (Collins 2001: 301-303; Regini 2000: 14). The increasingly common strategy of regulatory reform seems to be partial deregulation targeted primarily at the outsiders while leaving the core workforce intact. This not only encourages acceptance from the social partners but is also optimally efficient because, as mentioned earlier, labour market rigidities are directly related to the structure of employment and the creation of an insider/outsider divide. For this reason, the groups most likely to be affected by labour market rigidities are the young, women, the low-skilled and various other groups traditionally disadvantaged with regard to the labour market. Flexibilization of the labour market is also more effective if the decline in wage and job security guarantee is coupled with subsidization, especially for training and education, so that there remains a good chance for the loosely attached to move to the core labour force. Fundamentally, a solution to the unemployment problem will be difficult to find in a context of low-skill equilibrium, unless at the cost of considerable income inequality, as is the case in the United States (Esping-Andersen and Regini 2000: 6; Esping-Andersen and Regini 2000b: 337-340).

**Increasing In-work Incentives**

One of the most prominent examples of in-work incentives advocated by the third way social democrats since the early 1990s has been the minimum wage, which not only implements the newer social democratic belief in labour market activation but also promotes the older social democratic belief in income equality and protection for the most vulnerable in the society. In Britain, the minimum wage was formally introduced for the first time under New Labour, whereas it had been increased on a regular basis in Australia under the Hawke
and Keating governments throughout the 1980s and early 1990s. Similarly, the indexation of legal minimum wage to price and wage developments under both the French Socialists and the PvdA has contributed to a relatively high degree of income equality. What is more, where a minimum wage is absent, high unemployment benefit replacement rates do serve as a substitute for income redistribution and social protection. High replacement rates can serve as an instrument of labour market activation, especially when there is at the same time a high degree of flexibility in the labour market and extensive active labour market programs available, as the Danish “golden triangle” indicates (Wren 2001: 254). High replacement rates do not force people into unwanted jobs, so the possibility is reduced for mismatches between workers’ skills and vacant jobs.

Another relatively innovative form of financial incentive is the negative income tax (NIT). Theoretically, the NIT promotes work incentives through two methods, either by targeting specifically at individuals who meet minimum working conditions or by saving a part of the extra income from deduction once the individuals start to earn more incomes (Bonoli and Sarfati 2002: 464). Outside the US, tax credits of this type are primarily piloted by the social democrats from the liberal welfare regimes, partly because of the predominance in these countries of means-tested benefits and the relatively greater reluctance of the Anglo-Saxon social democrats to openly increase direct taxes to fund active labour market programs, as compared with their Scandinavian counterparts. For both New Labour, the ALP, and to a less extent New Zealand Labour, NITs take up a large portion of the financial incentives to work offered by the government, in the form of British Working Families’ Tax Credit, Australian Family Assistance Supplement, and the Family Tax Credit in New Zealand.
Overall, NITs have demonstrated a decisive advantage in their positive effect on the incentive to work, especially with regard to low-wage earners. Decline in low wages is compensated in the NIT, which usually has a low withdrawal rate, leading to the result that the combined income would be higher than the basic NIT rate (Hanesch 1999: 78-79). By reducing the impact of low wages and increasing wage mobility, an important avenue is opened for activating people traditionally in a very disadvantaged position with regard to the labour market, such as the long-term unemployed, the disabled, and those with low levels of skill. As an indication of the maturity of NIT practices in liberal welfare regimes, increasingly governments in these countries (social democrats as well as the centre-right) have moved further ahead by integrating NITs for different purposes and broadening their overall scope. For example, both Australia and Canada have seen tax credits concentrated on the families with an earner transformed into common family benefit or tax credit regardless of work status. New Labour, similarly, has also replaced the WFTC with a Working Tax Credit available for all adults (Sinfield 2002: 349-350). Although practiced with the highest intensity within the liberal welfare circles, tax subsidies have left a footprint in the policies of various other social democratic governments across Europe. The Employment Premium (PPE) introduced by the French Socialists in 2001, for example, is paid by the tax authorities for those earning less than 140 per cent of the minimum wage.

While the particular popularity of NITs under New Labour, the ALP, and New Zealand Labour is related to the financing structure of the liberal welfare regimes, the same is true with the more prevalent use of reductions in social security contributions as a form of targeted wage subsidies by the Dutch, French, and to a less extent German social democrats,
simply because of the primarily contributory nature of the social security system. For these systems, the proportion of total labour cost that is accounted for by the tax wedge has become a crucial contributor to the real wage rigidities in the labour market. Partly a result of the collusion between social partners in externalizing the cost of economic adjustment, the contribution rates were by the mid-1990s unacceptably high and left ample space for restructuring. By exempting employers from social security contributions for low-skilled workers, these regressive employment subsidies achieve roughly the same purpose as NITs in reducing the tax wedge, encouraging wage mobility, and activating the traditionally disadvantaged or excluded in terms of labour market connection because of either low skills or reduced work capacity (Ferrera and Hemerijck 2003: 112; Bonoli and Sarfati 2002: 465; Lodovici 2000: 42).

Finally, in-work incentives for women, especially those with childrearing responsibilities, are more complex, as they include not only direct financial incentives but also measures to reduce the family-related personal cost of entering the labour market. In terms of financial incentives, an important factor behind the high labour force supply of women in Scandinavian countries has been the large degree of individualization in social and taxation policies in these countries. As far as the tax system is concerned, female labour supply is closely influenced by the unit of calculation for taxation purposes, the distribution of tax allowances for spouses or partners, and how these allowances alter when the second partner has an income (Kvist 2000: 12; Daly 2000: 495).

Even more significant seems to be the role of in-work incentives in kind, which can reduce the burden for childrearing for mothers entering employment. With regard to the
activation of women, the unambiguous message is that availability of childcare service is the indispensable factor, without which both low fertility and low female labour market participation will occur. Childcare service can be offered either through the public sector (as in Scandinavian countries) or through low-cost services in the private sector (as in liberal welfare regimes). Regardless of private or public, the provision of in-kind services is positively correlated with female employment rates (Lodovici 2000: 44). Despite the between-regime difference in emphasis on public versus private childcare, the third way social democrats across all welfare regimes have mostly followed their ideological preference for the public sector by making efforts to expanding public childcare places, as was the case with New Labour, PvdA, French Socialists, as well as the traditional top performers on this front, the Scandinavian social democrats. What is more, the pattern of childcare place expansion over the last two decades across these countries to some extent reflects the more general argument that politics really matters when it comes to the third way. In an extension of the power resources theory, it was the alliance between women’s movements (and childcare advocates in particular) outside the social democratic parties and those inside, after the social democrats took over the reins of government, that led to the reforms in reconciling work and family. This pattern can be seen in both the Scandinavian countries as well as Australia and New Zealand. Similarly, the policy volte-face towards the same direction in Britain in 1997 coincided with the coming to power of New Labour, which made possible for the first time the creation of a modernizing childcare coalition, now able to see its agenda institutionalized into government policy (Huber and Stephens 2001: 310; Daguerre and Bonoli 2004: 15). It is the social democrats and the affiliated interests they
represent which provide the ideological motivation towards activation and the third way, and by coming into government during the 1980s and 1990s, the power and resources of these interests were finally strong enough to make third way a reality on many dimensions.

On the one hand, across the country cases, this chapter has indeed shown rich diversities in policy instruments and implementation in changing the active apparatus, which can be explained in the path dependent logic from the retrenchment literature. On the other hand, however, the case studies show that the initiation as well as fundamental logic of policy changes for the active apparatus are heavily influenced by the partisan colour of government. In other words, while the dominant social democratic strategy in the active apparatus is expansion, with centre-right governments the emphasis is noticeably less on expansion, and there is sometimes even rollback of existing active labour market measures introduced by social democratic predecessors. As Table (3.1) demonstrates, social democratic governments place a heavy emphasis on introduction of new labour market programs, and these programs focus on education, training, as well as the direct creation of additional jobs in the public sector or subsidization of additional jobs in the private sector. On the contrary, with centre-right governments, there is noticeably less initiative in introducing new labour market programs, and the centre-right programs are focused more on cutting benefit levels and pushing people into low-wage jobs. In general, the social democratic third way strategy has focused on making work more attractive, whereas the centre-right strategy has focused on making welfare unattractive.
Table (3.1) Variation in Changes to the Active Apparatus of Social Protection

<table>
<thead>
<tr>
<th></th>
<th>Social Democrats in Power</th>
<th>Social Democrats out of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall Strategy</strong></td>
<td>Expansion</td>
<td>Less Expansion, Sometimes Rollback</td>
</tr>
<tr>
<td><strong>Fundamental Logic</strong></td>
<td>Making Work Attractive</td>
<td>Making Welfare Unattractive</td>
</tr>
<tr>
<td><strong>Evidence</strong></td>
<td>New Labour Market Programs</td>
<td>Less New Labour Programs, Rollback of Existing Programs</td>
</tr>
<tr>
<td></td>
<td>Programs Emphasize Education, Training, and Creation of Additional Jobs</td>
<td>Programs Emphasize Cuts in Benefits Levels</td>
</tr>
</tbody>
</table>

In Tables (3.2) and (3.3), expenditure priorities data for the nine countries very much corroborate the summary in Table (3.1) of findings from the case studies in this chapter. Table (3.2) compares changes in expenditure in key labour market programs and in-work incentives which serve to make work more attractive and rewarding, between periods of social democratic and centre-right governments since 1980 (the latest data available is for 2001). Table (3.3) provides zero-order correlation of expenditure in these programs with the centre-left, Christian democratic, and secular right percentages of government seats.

---

2 Expenditure figures are expressed as a percentage of GDP. Although expenditure on specific types of programs looks tiny relative to GDP as a whole, the actual money involved and its effect can still be very significant. For example, between 1980 and 2000 the average expenditure on childcare is 1.8 per cent of GDP in Denmark (OECD 2004); this is the highest among the OECD, and this is already enough to finance free and universally available childcare for the whole country.
averaged over a five-year period to take into consideration the possible lagging of policy effects across time.³

Table (3.2) Average Increase in Expenditure on Measures Making Work Attractive for the Nine Country Cases between 1980 and 2001

<table>
<thead>
<tr>
<th></th>
<th>Social Democrats in Power</th>
<th>Social Democrats out of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active Labour Market Programs as a Whole</td>
<td>.029</td>
<td>.019</td>
</tr>
<tr>
<td>Labour Market Training Programs</td>
<td>.017</td>
<td>.040</td>
</tr>
<tr>
<td>Employment Services</td>
<td>.006</td>
<td>.005</td>
</tr>
<tr>
<td>Employment Subsidies</td>
<td>.019</td>
<td>-.007</td>
</tr>
<tr>
<td>Measures for the Disabled</td>
<td>.010</td>
<td>.004</td>
</tr>
<tr>
<td>Childcare and parental benefits</td>
<td>.014</td>
<td>.003</td>
</tr>
</tbody>
</table>

*All figures are percentages of GDP.

³ Data on labour market measures, in-work incentives, and GDP (1995 price in national currency) are from the OECD Social Expenditure Database (OECD 2004), and data on partisan composition of government seats are from the Comparative Welfare State Dataset (Huber et al. 2004).
Table (3.3) Correlation of Expenditure on Measures Making Work Attractive with Five Year Average of Partisan Percentage of Government Seats between 1980 and 2001

<table>
<thead>
<tr>
<th></th>
<th>Center-Left</th>
<th>Secular Centre-Right</th>
<th>Christian Democratic</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Active Labour Market Programs as a Whole</strong></td>
<td>.16</td>
<td>-.37</td>
<td>.11</td>
<td>188</td>
</tr>
<tr>
<td><strong>Labour Market Training Programs</strong></td>
<td>.23</td>
<td>-.33</td>
<td>.02</td>
<td>183</td>
</tr>
<tr>
<td><strong>Employment Services</strong></td>
<td>.22</td>
<td>-.32</td>
<td>.15</td>
<td>188</td>
</tr>
<tr>
<td><strong>Employment Subsidies</strong></td>
<td>.02</td>
<td>-.02</td>
<td>-.01</td>
<td>183</td>
</tr>
<tr>
<td><strong>Measures for the Disabled</strong></td>
<td>.13</td>
<td>-.44</td>
<td>.30</td>
<td>177</td>
</tr>
<tr>
<td><strong>Childcare/Parental Benefits</strong></td>
<td>.23</td>
<td>-.30</td>
<td>-.13</td>
<td>194</td>
</tr>
</tbody>
</table>

With respect to not only active labour market programs as a whole but also the various categories of measures that facilitate labour market training, additional job creation, and in general serve to make working easier and more rewarding, average increase in expenditure has been larger when the social democrats are in power than when they are out of power. Actually, without social democrats in government, expenditure on measures in additional job creation is cut back. A similar picture emerges with regard to the correlations between average expenditure on these programs and partisan composition of government. Government spending on all these measures of labour market activation is positively
correlated with left composition of government. By comparison, the correlations with both the Christian democratic and secular right alternatives are almost always smaller and sometimes negative. This examination of data on spending priorities very much ties in with the chapter’s conclusion from the case studies for the nine countries: despite clear evidence of path dependency on existing institutional contexts in policy implementation and policy instruments, the initiation, scale, and fundamental logic of expansion in the active apparatus of social protection is clearly related to the coming to power of social democratic parties as opposed to their Christian democratic or secular right alternatives.
CHAPTER IV

ACTIVE REDISTRIBUTION AND RETRENCHMENT
OF THE PASSIVE APPARATUS

While the active apparatus serves to enhance the possibility of labour market integration, the passive apparatus of social protection by the state can potentially facilitate the exclusion from the labour market. Whereas the social democrats have expanded the active apparatus in their third way reforms, they have adopted two different strategies towards the passive apparatus: active redistribution in some cases and retrenchment in others. The choice between active redistribution and retrenchment is contingent on a crucial distinction between the two primary components of the passive apparatus serving substantively very different purposes. One component is most dominantly represented by unemployment benefits. The other component is a basket of different measures usually referred to as early exit pathways or labour-market-clearing-measures. These measures directly reduce the supply of the labour force and are therefore often used as an expedited instrument to reduce the unemployment rate in the short term. The most commonly used early exit pathways include age-related measures which facilitate early retirement and health-related measures such as disability and sickness benefits. Other typical early exit pathways include a wide range of leave schemes serving purposes ranging from childrearing to education. The fundamental difference
between the two components of the passive apparatus is that unemployment benefits (and other similar income replacement transfers) are mainly targeted at persons outside the labour market or unemployed, but early exit pathways are targeted at persons who are still in the labour market. This is an extremely important distinction, because it largely decides whether the social democrats choose active redistribution or retrenchment as a strategic response.

In their third way reform process, the social democrats have generally made limited retrenchments to parts of the social security system as well as limited expansion to other parts. While eligibility is almost inevitably tightened and the level or duration of benefits often reduced for unemployment benefits, the social democrats have also often used targeting, changes in welfare financing, and various other adjustment methods to not only ensure but also strengthen a basic level of protection for those at the very bottom of the income ladder. At the same time, in many cases the social democrats have also made direct increase in benefit generosity for the worst off. On the one hand, the limited retrenchment to the income replacement programs serves to reduce the disincentives for the unemployed to enter the labour market; on the other hand the increased protection for the worst off in the transfer programs implements a key traditional social democratic objective: security for those who cannot work. For this reason, even during the process of their activation third way reforms, the social democrats have never adopted an attitude of outright rejection towards income replacement as part of the passive apparatus. Instead, the social democrats continued to pursue their ideological objective of further income redistribution through the transfer programs while making necessary adjustments to these benefits, so that potential work disincentives in these programs are reduced and these programs become more aligned with
the fundamental purpose of labour market activation. Such combination of continuing redistribution as well as orientation towards labour market activation is therefore called active redistribution. This strategy of continuing redistribution is more or less also applied to parts of the welfare state which serve rather similar traditional social justice objectives but are usually not considered part of the passive apparatus because they do not have clear work disincentive impact on the unemployed, such as healthcare, family allowance, and child benefits. Though these benefits are not intrinsically passive, they are also included in the discussion in this chapter, because their reforms under the social democrats often serve the important purpose of combating social exclusion, one of the key objectives in third way reform by all social democratic governments.

For the other part of the passive apparatus, the early exit pathways, the typical social democratic strategy has been very different: straightforward retrenchment. There are two key reasons why the social democrats have generally chosen to unambiguously cut back on the early exit component of the passive apparatus as opposed to unemployment benefits. First of all, under some circumstances, income replacement transfers such as unemployment benefits do serve as a work disincentive, with the effect of creating difficulties for those excluded from the labour market to re-enter it. The early exit pathways, on the other hand, go one step further by actually moving persons who are still inside the labour market from it, so the early exit pathways serve as a double-whammy for the activation efforts of the social democrats.
Denmark

Active Redistribution of the Passive Apparatus

Until the social democrats returned to power in 1993, the Danish unemployment benefit system had been not only passive rather than active in nature, but also extremely generous, embodying the culmination of the social rights notion of citizenship long espoused by the Danish social democrats. Access to full benefits, for example, was available for the unemployed for more than nine years. The labour market reform launched in 1994 signaled the first major attempt by the social democrats to reform the major functions of the Danish social security system. Targeted specifically at recipients of unemployment benefits, the reform was carried out in three phases, respectively in 1994, 1996, and 1999. Throughout the three phases of the reform, its most conspicuous character was the growing emphasis on the obligation to accept job offers in return for the continuation of unemployment benefits, and each phase represented a significant expansion in the number and type of unemployed persons to be involved in the changes. Instead of reducing the actual level of replacement rates or creating a low wage labour market, as was the practice under the bourgeois government, the Danish social democrats followed the example of their Swedish counterparts by maintaining high replacement rates, reducing benefit periods, and meanwhile radically strengthening demands of job search (Dahl et al. 2002: 34; Lind 2000: 145). While the Danish unemployment benefit system was previous characterized by very generous replacement rates and extremely long duration compared with other European countries, the reforms under the social democrats have drawn Denmark closer to, but still above, the European average (Madsen 2003: 76). On the one hand, as a Ghent system, unemployment
funds are tied to the unions, who retain significant control over the management of these funds. On the other hand, the fact that the pre-reform Danish social security system was already close to being purely tax-financed reduced the opportunities for unions to make proprietary claims on the social security system. This forms a contrast with the insurance-dominated welfare financing pattern and the much more difficult process of reforming the income replacement programs in most continental welfare regimes (Goul Andersen 2002: 156; Goul Andersen and Jensen 2002b: 284; Kvist 2000: 32).

Under the Danish social democrats, the duration of unemployment benefits was first limited to seven years in 1995, and then to five years in 1996 and four years in 1999. These changes to the duration of benefit have been revolutionary in the Danish context, because the duration of unemployment benefits had been virtually indefinite prior to the labour market reforms. The decision in 1994 to cap the maximum duration at seven years was the first time in history when a formal limit was placed on the duration of unemployment benefits. Overall, the total duration period for passive benefits or participation in various programs had been reduced from nine years in 1993 to four years in 2000. In addition to tightening the benefit period, the social democrats also imposed working conditions on eligibility for unemployment benefits, in the form of six months of non-supported employment in 1995 and lengthened to 12 months in 1996. While the coercive part of the reforms fell primarily on the unemployed, there were also such measures targeted at the employers, such as the decision to make temporary layoff more costly by requiring employers to pay for the first two days of unemployment compensation (Stephens 1996: 55; Ploug 1999: 97; Bjorklund 2000: 155-156;
Whereas the three-phase labour market reforms primarily focused on the changes to unemployment benefits, the social democrats also made targeted efforts to readjust the social assistance system with the introduction of the 1997 social assistance reform. The government did not introduce direct institutional changes to the level or eligibility for social assistance benefits per se during the social assistance reform. Instead, the focus was on the further integration between the social assistance system and the active labour market measures. Under the reform, all recipients of social assistance were required to participate in drawing up individual action plans and accept offers of activation including job placement, job training, and education. Similar to its approach to active redistribution in other parts of the social security system, the government imposed particularly strict rules on young social assistance recipients in terms of the obligation to accept active offers. Social assistance recipients under the age of 30 were expected to be activated within the first 13 weeks of welfare, and benefit reductions of up to 20 per cent would be imposed on those who refused a fair offer of activation measures. For those over 30 years of age, activation was required within one year of unemployment. Alongside this growing emphasis on obligations of the social assistance recipients, the government meanwhile also made employment more attractive by lowering taxes and removing old work disincentives for low wage earners in particular. Local officials were now under the obligation to provide those in unemployment benefits with both a job searching plan and eventually an employed situation (Gilbert 2002: 74; Ploug 1999: 97; Benner and Vad 2000: 458; Rosdahl and Weise 2001: 169; Cox 1998: 195).
The 1997 social assistance reform was later supplemented with both a new Social Assistance Act and an Activation Act. With these two new laws, social assistance recipients who refused to accept job or training offers would have their benefit levels cut by 20 per cent, and on the contrary those who complied with the activation obligations will receive a wage protected by collective labour market agreement. The age limit of immediate activation after being placed on social assistance, meanwhile, was also raised from 25 to 30 years (Kildal 2001: 8). At the time of the first government attempt to reform the social assistance system, the ambition was modest, in the form of the Youth Allowance Scheme under the bourgeois government in the early 1990s, and the only group affected back then were the very young, between 18 and 19 years. Now, after almost a decade of labour market reform under the social democrats, the realignment of social assistance system with labour market activation had been applied to increasingly broad age bands, and with the introduction of the Activation Act, social assistance becomes compulsory paid activities for every unemployed person (Abrahamson and Oorschot 2002: 10).

In addition to changes in the unemployment benefit and social assistance components of the Danish passive apparatus, the social democrats also made corresponding adjustments in the fiscal aspect of the welfare state. The tax reform of 1994 transformed both social assistance and state old age pension from partially tax-exempted to fully taxable benefits. While the government restrained the entitlement to these benefits through the tax changes, it also raised the benefit levels at the same time to more than compensate for the retrenched entitlement. The retrenchment that was introduced through the taxation changes was aimed
not so much at cost control as at avoiding long-term passivity and increasing the work incentives of the elderly (Ploug 1999: 97; Ploug 2000: 5; Green-Pedersen 2002: 125).

With growing emphasis on the obligation of the unemployed to seek work backed up by sanctions of reduced social assistance or unemployment benefits, the active redistribution of the Danish income replacement programs under the social democrats has shown some similarities with the neoliberal workfare strategies practiced in US. However, there are fundamental differences between the Danish and the neoliberal approach to persons on unemployment benefits or social assistance. Neoliberal workfare as practiced in the U.S. or in Thatcher’s Britain is primarily a reaction against what the government perceived as growing welfare dependency and social expenditure. The primary policy objective in such a strategy is both short-term and very narrowly-focused on the removal of people from the welfare rolls and into employment, often at very low wage. The Danish approach, on the other hand, is closely modeled on the Swedish strategy, and is an offensive strategy premised on flexible labour. With this strategy, the objective to reintegrate beneficiaries of income replacement programs into the labour market takes centre stage rather than being subordinated to the objectives of cost control and retrenchment in the social security system itself. Instead of forcing benefit recipients into very low wage employment, the Danish approach pays more attention to the compatibility between individual qualification and labour market, and the flexibility of the latter in order to better accommodate the former. Because of the offensive rather than defensive approach with regard to persons on unemployment benefits or social assistance, the Danish strategy to reform the income replacement programs is also characterized by much greater attention to human capital,
Despite a growing emphasis on the obligation to work backed up by sanctions, the active redistribution reforms under the Danish social democrats do not aim primarily at punishing or coercing the unemployed. Instead, the reforms included complementary elements of social disciplining and social integration, although social disciplining was given increasing emphasis at the expense of integration over time. As unemployed individuals pass through the various stages of the government’s policy design to bring them back to work, the first stop for them would almost always be the offer of carrots: individualized counseling, planning, training and educational activities so that the unemployed are better facilitated to re-enter the job market or at least re-enter social activation. The primary objective with regard to the benefit recipients is to offer incentives to acquire qualification and be active. As part of an enabling strategy, benefit recipients are activated through skill-related initiatives rather than further cuts in the financial support they currently rely on. In dealing with the potential problem of low productivity, the social democratic qualitative approach premised on raising the level of qualifications forms a clear contrast with the neoliberal quantitative approach premised on lowering wages (Lind 1999: 195; Barbier 2001: 19; Larsen 2004: 11, 15). The sticks in the form of sanctions, in this sense, are only used as a second best option when the benefit recipients refuse to enjoy the activation services the government provides at the expense of the state coffer. In other words, the sanctions in the social security system are negotiated sanctions based on a two-way contract. Apart from reducing or removing benefits
when fair offers of activation are refused, the state rarely goes out of the way to check upon mobility, availability and job-searching activities of those on benefit.

The active redistribution reforms under the social democrats have not resulted in a break with the state as both the provider of generous benefits and the employer of last resort. On the contrary, the Danish social democratic state is taking an ever more interventionist role in the lives of those in the social security system, as evidenced by the state’s determination to commit resources to action plans which are tailored down to the specific circumstance of each unemployed individual. For this reason, the Danish active redistribution strategies are neo-statist in that the state is the main player and, most importantly, financier, in the various measures to change the behaviour of the unemployed. By contrast, in American and British Thatcherite workfare measures, the main player is very much simply the downward mobility of wage levels (Torfing 1999: 18; Barbier 2001: 19; Loftager 1998: 14). The reforms under the social democrats enabled individuals to gain control over their own life rather than pushing them towards workfare, and this is largely also the perception among those who were subjected to the impact of government reforms. Participants in labour market programs generally perceive their transition from the social security system to the labour market as a positive experience which improves their self-confidence and potential on the labour market, and the key factor in enabling the individuals to take control seems to be the individualized action plan drawn up between the individuals and labour market authorities (Jensen 1999: 14).

More generally, the structure and philosophy of the unemployment benefit system has clearly undergone a shift towards growing emphasis on the needs criteria, the duty to work,
and the communitarian notion of citizenship. The reforms by the social democrats since 1993 has gradually transformed the Danish social security system from universal, passive, and centralized to selective, active, and oriented to individual needs. In addition, whereas the traditional Danish welfare state is highly de-commodifying, the activation reforms under the social democrats have re-commodified labour to some extent (Loftager 1998: 2; Martin 2004: 1; Goul Andersen 2002b: 69, 72; Jensen 1999: 1, 3-5). Such long-term significance of the active redistribution reforms in the social security system looks only more remarkable when one considers the fact that no changes to replacement rates were introduced, which also casts doubts on previous bourgeois reforms which placed more emphasis on proposals to retrenchment benefits. Given this revelation, since the 1994 labour market reform, no substantial discussion about reducing the level of financial support had taken place till late 2003, regardless of which party headed the government (Madsen 1999: 56; Torfing 1999: 18; Jensen 1999: 5; Dingeldey and Linke-Sonderegger 2004: 13; Larsen 2004: 16).

Retrenchment of Early Exit Pathways

Initially, the expansion of various leave schemes and other early retirement measures was a crucial, and arguably the most innovative, part of the paradigm-shifting labour market reform in 1994 under the Danish social democrats. Targeted primarily at the retention of unskilled workers, the expansion of these schemes reflected the human capital emphasis of the party and its concern with the risk of social exclusion for people with disadvantaged conditions in the labour market. During the 1994 labour market reform, the government significantly improved the educational and parental leave schemes, and it also introduced a
The maximum leave period was increased to 52 weeks, and more controversially, eligibility to leave schemes was extended to include both the self-employed and the unemployed, as long as an unemployed person can be hired as a replacement during the leave period. Meanwhile, compensation worth 80 per cent of the full unemployment insurance benefits was also available for the duration of the leave schemes. In the 1994 labour market reform, the government also removed the obligation on the firms to take in substitutes and put in place the formal right to take parental leave for the employees. These changes further removed the barriers for both individuals and firms to the leave schemes. The opposition of employers, in particular, was defused by the government’s guarantee of full discretion over whether employees should be allowed to go on leave (Ploug 1999: 97; Bjorklund 2000: 155-156; Loftager and Madsen 1997: 133; Compston 1997: 200; Compston and Madsen 2001: 121).

The premise for the introduction of leave schemes was the concept of the comprehensive approach, introduced during the 1994 labour market reform. This comprehensive approach dictates that the activation of the unemployed should be combined with the effort to upgrade the skills of the workforce in general. The most explicit example of the comprehensive approach is job rotation, which is the key underlying mechanism for all the leave schemes. By linking shorter working time with an expansion in vocational training, job rotation represents a radically innovative and productive way of reducing working time (Seifert: 1998: 636; Madsen 1998: 712). In a job rotation scheme, persons going on leave will be replaced by the unemployed, who therefore get an opportunity to be reintegrated into the labour market, although employers are not obliged to hire a substitute unless in the case
of sabbatical leave. These schemes are labeled as “pull-strategies” because they create job vacancies for the unemployed instead of improving the qualification of the unemployed, as the traditional “push-strategies” would involve. Meanwhile, these leave schemes purposely use public expenditure to fund the temporary withdrawal from the labour market, and in this sense the programs hark back to the notion of citizens’ income, an idea which was slowly being replaced by the notion of communitarian citizenship through the reforms of the social democrats. In addition to the changes in leave schemes, the social democratic government also extended transitional allowance to 50-54 year olds (Etherington 1998: 148; Goul Andersen 2002: 152; Loftager and Madsen 1997: 123; Madsen 1999: 66).

However, although they were originally part of the labour market reforms under the social democrats, over time the three core schemes of parental, educational, and sabbatical leaves were all questioned with regard to their status and role in the activation of the labour market. The sabbatical leave, newly introduced by the social democrats, came under the greatest criticism, not only because of the extremely generous support it offered (up to 70 per cent of normal benefit for one year) for the leave takers, but also because of the very lax interpretation of what sabbatical activities should involve. Comparatively, the parental leave scheme was more popular with the public and the educational scheme more popular with the government because of its potential to increase labour market flexibility (Lind 1999: 197). Nevertheless, despite their somewhat forward-looking perspective on re-qualification and social exclusion, all three leave schemes, plus other early retirement measures, did have the inevitable effect of further reducing the labour force and clearing the labour market. Partly spurred on by the positive experience with pilot leave schemes under the previous bourgeois
government, the three leave schemes were rushed in by the social democrats partly as a knee-jerk reaction against the unprecedented rise in unemployment by 1993. And indeed the direct impact of the leave schemes was immediate: by 1995 the paid leave schemes had reduced registered unemployment by approximately 2 per cent of the workforce (Loftager and Madsen 1997: 135; Clasen 2000: 102-103; Compston and Madsen 2001: 118).

In spite of their short-term effect in reducing unemployment and their human capital approach, these leave schemes were nevertheless what Hall (1993) would call second order reforms. On the one hand they signaled the readiness of the state to actively intervene in combating unemployment by introducing new policy instruments, on the other hand they prescribed solutions very much within the traditional policy framework of labour force reduction. Such problems with the leave schemes began to manifest themselves clearly as unemployment declined rapidly and the Danish economy went into a boom by the mid-1990s. The schemes’ market-clearing consequences now became increasingly out of sync with the labour market situation. Famously declared as instruments to “break the curve of unemployment” by the Social Democratic Prime Minister Rasmussen, in a period of falling unemployment the leave schemes were having the opposite effect by producing bottlenecks. This bottleneck problem was further aggravated by the fact that the leave schemes were frequently abused because of their generosity and lax interpretation. In response, starting from 1995 the social democrats began a U-turn with regard to these measures. The government cancelled sabbatical leave, cut benefits for parental leave, and also imposed a more stringent requirement to replace workers who take leave. By 2002 many new leave schemes were either terminated or marked for phasing out (Cox 1998: 9; Goul Andersen
In addition to leave schemes, another major focus of the government was to stamp out various early retirement pathways. In 1999, the social democrats introduced major reforms to the early retirement schemes by merging the existing two schemes into one, so that exit from labour market can be better tailored to individual needs. The government also abolished the previous rule which excluded the unemployed above 60 from early retirement benefits if they become sick, so that they do not have to retire early for fear of losing the right to early retirement in the event of illness. Meanwhile, the benefit level in the early retirement scheme was reduced to 91 per cent of full amount for those who retired before the age of 62, in order to create disincentives for retiring early. The decision to scale down the early retirement scheme had proved politically difficult for the social democrats, because the unions have historically claimed ownership over this issue. Union opposition was somewhat softened after it emerged that white collar retirees were also increasingly exploiting this scheme, which was not originally designed in their service. For this reason, by 1999 the unions had agreed to accept stricter criteria for early retirement (Jensen 2004: 44, 54; Goul Andersen 2002b: 69; Hansen 2002: 180-181). Still, the reform to the early retirement scheme is often regarded as one of the major reasons for the electoral rout of the social democrats in the 2001 general election. This is because the party made an “early retirement guarantee” back in the 1998 election campaign, to the effect that it would not touch the existing early retirement scheme. In this context, once in office, the party’s decision to drastically restructure the early retirement scheme in 1999 was not only resented for insufficient consultation with the unions,
but also widely regarded as a clear breach of election promise (Lind 2000: 149-150). In order to correspond with the changes made to the early retirement scheme, the social democrats in government also made minor changes to the part-time pension scheme and phased out the transitional allowance for 50 to 54 years old in the 1996 Budget. In addition, the number of disability pension recipients was also declining since the late 1990s, for two possible reasons. On the one hand, the flex jobs for people with permanently reduced working capacity helped in moving some people from disability pension into employment. On the other hand, the devolution of disability pension financing to the regions since 1999 led to local authorities being more reluctant to grant disability pension entitlements (Jensen 2004: 58).

Most of the measures aimed at stopping early retirement targeted the elderly employees, but the social democrats also brought in changes which made it more difficult for employers to fire older employees with long seniority. Intervention through direct legislation, in this case, was unusual, in that there had not been a strong tradition for state intervention in direct legislation with regard to exit rules from the labour market. Instead, the more typical approach in Danish industrial relations is the principle of free collective bargaining, whereby the social partners work out corporatist agreements among themselves while the government merely plays a distant prodding role (Larsen and Bredgaard 2004: 10, 16; Lind 1999: 192). On the one hand the social democrats made early retirement progressively less attractive, on the other hand they also made it easier for the elderly to transit to employment, through a wide variety of job schemes targeted specifically at the elderly. For example, the government introduced both Job Offices and a Senior Fund to help coordinate and support projects aimed at integrating the elderly into the labour market, and firms were also offered consultations
with a maximum of 5 hours on how to design senior policies. Since 1999, the government also experimented with service jobs, which are ordinary jobs in the public service sector which require minimal level of education and training, which fit the circumstance of many elderly unemployed who are in danger of being permanently excluded from the labour market. Employers are subsidized by the state in channeling these elderly people into the service jobs (Hansen 2002: 192-194; Foden and Jepsen 2002: 451).

Sweden

Active Redistribution of the Passive Apparatus

As a general trend, since the social democrats returned to power in 1994, increases in public expenditure in active labour market measures had become a routine focus of government. However, the sustained increase in active expenditure in the 1990s was not accompanied by significant cuts in passive expenditures. Instead, since the mid-1990s expenditure on active and passive measures has gradually moved to very similar levels, and the rise in passive expenditure during this period is really the result of big rise in unemployment more than anything else (Boesby et al. 2002: 31, 45). In terms of benefit levels, the Swedish social security system did not experience any dramatic overhaul during the 1990s. Because of the serious economic and fiscal crisis at the beginning of the decade, a number of cutbacks were imposed. The timing of these cutbacks indicates that they were more likely driven by a typical social democratic concern for (especially sustained) unemployment than by a typical neoliberal concern for economic competitiveness (Stephens 1996: 44-45; Huber and Stephens 2001: 250). This argument is also supported by evidence
since the mid-1990s. While the dominant trend since the early 1990s was indeed cuts to benefit levels and tightening of eligibility conditions, during the second half of the 1990s, as the employment and fiscal position of the government improved rapidly, the social democrats went on to restore several cuts to benefit levels introduced by the previous bourgeois government, so that in the end, there was no dramatic difference in benefit generosity between the beginning and end of the decade (Hort 2003: 263; Palme et al. 2002: 341). By comparison, bigger changes took place in the pensions area instead of unemployment benefits.

In reforming the social security system, the Swedish social democrats focused more on changing its structure than its level. Instead of massively cutting replacement rates, the party used a combination of high replacement rates and tightened eligibility rules (Boesby et al. 2002: 42, 46). This method of keeping benefit generous but more demanding in eligibility or work conditionality is a strategy also adopted by the Danish social democrats in their reform of the social security system. In the Swedish context, a practical example of this strategy is the use of the Uppsala model with regard to social assistance. Named after the municipality of Uppsala, the strategy not only adopts careful means-testing but also aims at shortening the benefit period by imposing strict requirements on the unemployed to make full-time efforts looking for jobs (Hort 2001: 256). The Uppsala model reflects a more general pattern in reforms to Swedish social assistance in the 1990s. In this part of the social security system, a gradual shift in responsibility has taken place, from the public to the individuals on social assistance. Since the Social Service Act of 1998, the social democrats have made it explicit that social assistance recipients have the obligation to participate in
municipal work or training programs, and refusal to do so would lead to reduction or withdraw of benefits (Kildal 2001: 10).

Compared with the social democrats’ record in reforming the social assistance system, there had been less progress in bringing changes to the unemployment benefit system. One important reason here is that unemployment insurance benefits are restricted to members of unemployment insurance funds. Based on the Ghent system, the insurance funds are voluntary but the insurance schemes are affiliated with the unions. As other case studies in this book have shown, if social partners are deeply involved in the administration of social security benefits, downward adjustment of these benefits tends to be difficult politically (Anderson 2001: 1080). The Swedish case serves as yet another example, where resistance from the labour movement blocked any attempt by the social democrats to change the level or duration for unemployment insurance benefits. Because of the union connection, the level and duration of unemployment insurance is by tradition a politically very sensitive issue for the social democrats. Therefore, right after returning to power in 1994, the social democrats rescinded the bourgeois government’s cut of unemployment insurance duration to 60 weeks. Nevertheless, when in 1996 the party decided to propose its own version of the cut, sweetened with several compensation measures, union protests still forced the party to abandon the changes (Hort 2002: 141; Bjorklund 2000: 156; Hort 2001: 260; Anderson 2002: 18-19). In another instance, when the social democrats reduced the replacement rate for unemployment insurance from 80 to 75 per cent in the 1995 budget, again sweetened with a 12 per cent reduction to VAT on food, unions strongly opposed. Because of the pressure from unions, the party later decided to push the rate back to 80 per cent. Recently the social
democrats have further improved the arrangement by raising the benefit level for the first 100
days of unemployment (Benner and Vad 2000: 430, 432; Anderson 2002: 18-19; Olofsson
2001: 20; Boesby et al. 2002: 46). In addition to the level and duration of unemployment
insurance, the unions take even more seriously their privilege in the administration of these
benefits. Shortly after it returned to government in 1994, the social democrats reversed the
decision by the bourgeois government to make unemployment insurance compulsory and to
remove unions from the administration of unemployment insurance. The social democrats
made the reversal of these policies a big issue in their 1994 election campaign, and they duly
carried out these reversals after coming back to power, so that unemployment insurance
became voluntary again, and managed by the unions through the insurance funds (Boesby et

Compared with the limited changes to unemployment insurance, the cuts were
significantly deeper and eligibility tightened much further with regard to sickness insurance
and work injury insurance. The social democrats attempted to reform the sickness cash
benefits as part of their activation strategy. Employers were forced to pay for sickness
benefits for a limited period, and a strong incentive was created on behalf of the employers to
prevent too many workers from joining the sickness benefits. Greater action in changes in
these areas was possible partly because the unions only mounted some symbolic resistance,
as these areas are really not as vital a concern as unemployment insurance or pensions for the
labour movement. In addition, the social democrats also used retrenchments in these areas as
part of a tradeoff in negotiations with the bourgeois parties, so that areas of social security
deemed more vital both by the party and the labour movement were spared from major retrenchment (Anderson 2002: 20).

With regard to the domain of social services, the main trend since the early 1990s had been a growing element of user financing, emphasis of the market, and decentralization of service administration to the regional and local levels (Hort 2003: 264; Palme et al. 2002: 341). During the period of bourgeois government between 1991 and 1994, there was growing emphasis on introducing market competition to social service delivery. The bourgeois parties, for example, introduced vouchers equivalent to 85 per cent of the cost of education in a public school to allow families to choose between public and private schools. In health, a “house doctor” system was established to allow individuals to choose their own doctor, and the state also started financing private daycare under the same condition as public providers. After the social democrats came to power, they rescinded some of the measures by the previous government aimed at encouraging more private providers into social security, and they also extended the social rights services for the handicapped, elderly, and children. Nevertheless, the party has come to accept the option of private providers based on state regulation and financing (Swank 2002: 139; Huber and Stephens 2001: 247-248; Dios 2002: 11; Hort 2000: 151). In the administrative aspect of social security benefit delivery, there was a general consensus among the major Swedish parties that the integration of unemployment insurance and unemployment assistance would be beneficial, and the social democrats in government did succeed in joining up the administration of the two systems (Boesby et al. 2002: 29, 42).
On the whole, because of the combination of unemployment and deficit problems during the early 1990s, limited tightening in the Swedish social security system became necessary. Given the worsening fiscal position of the government, cost control was temporarily a preoccupying issue. Therefore, the general approach to the social security system under the bourgeois government was to cut benefits as well as raise the share of employees in social security contributions. The mere shifting of social contributions from employers to employees without reducing the overall level of contribution has made little impact in reducing non-wage labour costs. After the social democrats returned to power, the objective of retrenchment and economic prudence became more balanced with social amelioration and redistribution for the purpose of labour market activation. On the one hand, the social democrats maintained some of the bourgeois cuts, for example in pensions as well as sickness benefits. On the other hand, the party significantly increased spending on higher education in an attempt to reduce the pressure on the labour market. The combination of cuts in benefits, tightening of qualifying conditions (such as the retaining of a five-day waiting period for unemployment benefits), and increase in active spending, points to the traditional active labour market principle of the social democrats (Stephens 1996: 44; Jochem 2003: 125; Dios 2002: 11).

Retrenchment of Early Exit Pathways

Given the traditional dominance of active measures over passive measures in Swedish labour market as well as social policy, early exit pathways had seldom been a significant part of the overall employment policy strategy in Sweden. Instead, a very high proportion of older
workers are placed in active labour market programs (Wadensjo 2002: 381). This stability, however, was briefly disturbed in the early 1990s when there was a rapid rise in unemployment and the economy further declined. As a quick and easy knee-jerk reaction to the unemployment problems, the Swedish bourgeois government, like many other governments around that time, resorted to clearing the labour market and reducing the labour force supply in order to bring down the unemployment rate, and during this period early exit schemes underwent clear expansion in Sweden. After the social democrats returned to power in 1994, there was a renewed emphasis on active labour market measures, and more specifically, on re-qualifying the labour force instead of reducing it, and the party started to reverse the growing trend towards early exit.

Along this line, the social democrats restricted pathways of invalidity and long-term sickness benefits to only medical criteria and excluded consideration of the labour market situation. The government’s separate pension reform in 1998 also indirectly helped providing incentives for remaining in the labour market longer. Part-time pensions were abolished and eligibility criteria for disability pension tightened to include only medical reasons. The really important change, however, was the shift in ATP calculation from defined benefits to defined contribution, which significantly strengthened the linkage between benefit levels and length of contribution, and served as a major incentive for elderly workers to remain longer in employment. Changes in the pension system also helped introducing greater flexibility to the age of retirement (Mandin 2004: 10; Olofsson 2001: 19). In 2001, the social democrats introduced a new law on retirement age. This new law made it possible for an employee to work until 67, and forbade collective agreements from including rules forcing workers to
retire at 65. The government also made changes to employment protection legislation to adjust to the new retirement age of 67, by expanding the age span of employment protection. On top of these changes made specifically to remove the early exit apparatus, other programs originally designed for general labour market activation purposes have also proved very helpful in reintegrating the older unemployed. For example, the 2000 program Activity Guarantee was targeted at anyone older than 20 years of age in danger of becoming long-term unemployed, but it has benefited the over-55s most significantly, as a third of the participants in this program are within the 55-64 age band. The measures taken by the Swedish democrats to close early exit pathways might appear limited if compared with cases of more drastic reforms such as in the Netherlands or Denmark. However, the main reason for this Swedish inactivity is, as is true with many other aspects of Swedish labour market policy development since the 1990, that Sweden already has a participation rate among the elderly which is close to the general participation rate, and the dominant tradition in Swedish labour market policy has always been to include rather than exclude the elderly from the labour market (Foden and Jepsen 2002: 450).

**Norway**

*Active Redistribution of the Passive Apparatus*

When the Norwegian economy entered a period of recession during the early 1990s, the Labour Party in government did not introduce any major welfare cutbacks. Instead, during the short period between May 1992 and 1993, the party extended the duration of unemployment benefits to a maximum of 186 weeks as a result of further pressure from the
unions concerned with long-term unemployment. Unemployment benefits for a supported child were also doubled in 1992. Labour also devoted greater attention to assistance for families, especially families with children. While the government continued to expand the welfare state, it was at the same time imposing stronger obligations to work on the unemployed by changes to the social security system. The government introduced stricter qualifying conditions for unemployment insurance, so that recipients of the benefits were required to accept offers of activation programs or jobs. Meanwhile, Labour also increased the requirement on both geographical and vocational mobility in job search, so that benefit recipients were expected to move to areas where jobs were available. These requirements were later further strengthened with regard to the young. Entitlement rules to disability pensions were also changed so that only medical conditions, rather than more general social and economic problems, would be considered in eligibility decisions. The government further tightened eligibility conditions for minimum unemployment benefits in 1998, after a doubling of the minimum income requirement for receiving unemployment benefits in 1997 (Kildal 2001: 12; Kuhnle 2000: 214; Dahl and Dropping 2001: 282; Solem and Overbye: 2004). With regard to the domain of social services, Labour allowed for a greater role of private providers in health, education, and social work, but the activities of the private providers were regulated by the state with both subsidies and sanctions (Swank 2002: 152).

Under Labour, the major reform measure targeted at recipients of social assistance was the Social Services Act of 1991. With this act, recipients of means-tested social assistance became obliged to take suitable work for the municipality for benefits in the minimum safety net on terms inferior to comparable work in the regular labour market. This
obligation to work on less favourable terms was targeted specifically at the young. Meanwhile, the Labour government accompanied the strengthening of obligation to work with further improvements in the right work, in the form of individually tailored measures suitable for the personal circumstances of social assistance recipients. The Social Services Act represented the first time in sixty years that local authorities were empowered to enforce the obligation to work on the recipients of social assistance, and with this act the implementation of the arbeidslinje principle was for the first time extended to the arena of social assistance. Because of the greater autonomy granted to local authorities in enforcing work obligations, in the Social Services Act the government merely set out broad policy guidelines, while both actual policy design and implementation were devolved to the municipalities (Halvorsen 2002: 167, 172-173; Dahl and Dropping 2001: 279; Kildal 2001: 12). On a local level, the municipalities were expected to offer individually tailored packages that were limited in time and duration to the young on social assistance. However, the central government had not provided either enough financial resources or guideline specifications to accompany the devolution of policy design and implementation responsibilities to the local level. With little national oversight, on the local level a process of goal substitution had apparently taken place, whereby the local authorities designed their measures with the purpose of increasing municipal savings instead of changing the behaviour of the young recipients of social assistance. Cost-conscious local authorities often chose to design their measures with less variation with regard to individual circumstances and less resources for training and education than the government would have desired. About 59 per cent of the local authorities implemented the Social Services Act in conflict with national guidelines,
and the majority of local authorities used the arbeidslinje principle to design a much harsher and narrowly focused program, whose preoccupation, instead, tended to be the simple objective of moving the young unemployed away from social assistance. This strong compulsion to work had drawn attention to the similarities between Labour’s efforts to reform the social assistance system and American workfare programs (Lodemel 2001: 143, 153, 155; Kildal 2001: 12).

While the Norwegian social democrats responded to the unemployment crisis by focusing on active measures, it largely left its passive measures intact in terms of generosity (Karlsen 1997: 151). To different extents, this description also fits both Sweden and Denmark, but Norway went furthest in perpetuating this Scandinavian approach to the balance between active and passive measures. The first indication of change over this policy did not surface until Labour was almost near the end of its government tenure, when the party passed a bill in 1996 to limit the combined duration of unemployment benefits and active labour market policies. In the 1996 legislation, Labour raised the income threshold for unemployment benefits to 49,000 Kroner and shortened maximum duration from 186 to 150 weeks, but at the same time there was also a guarantee from the employment placement services that placement in an activation program or job should occur before the benefits run out (Dolvik et al. 1997: 76). Although not a very dramatic example of attempts to rollback the passive measures, the 1996 legislation was indeed the first time the Norwegian government decided formally to put a limit on the existing passive measure arrangements. Since the 1996 reforms, the work line has been further reflected in a strengthening of the work test, as well as in the tightening of qualifying conditions for unemployment, disability,
and insurance benefits, while at the same time benefit levels were left intact. Among the Nordic countries, Norway is the only one that has kept the replacement rate in sickness insurance stable at one to six times the basic amount in the insurance scheme, while all the other Nordic countries have reduced sickness insurance benefits considerably. At the same time, the Labour government reduced the eligibility period for benefits for lone parents from 10 to three years in order to create more incentives to look for jobs. Apart from making welfare benefits less attractive, Labour also reinforced the positive side of arbeidslinje by expanding active labour market programs for training, education, skill rehabilitation, and workers’ requalification measures. The specific goal in expanding these enabling measures was to reintegrate the long-term unemployed by training them for ordinary jobs, so that their skill mismatches can be overcome, and the danger of permanent exclusion for this segment of the labour force can be reduced (Ploug 1999: 100; Halvorsen 2002: 171; Kosonen 2001: 167; Dolvik et al. 1997: 73; Kuhnle 2000: 214).

Under Labour, although the emphasis on obligation clearly became stronger, on an absolute level the government’s approach is still noted more for its moderation and reluctance to coerce. For example, although the obligation to accept offers of activation is now enforced with the threat of benefit loss in case of refusal, the unemployed is still permitted to refuse up to three offers without any impact on their benefit (Jochem 2000: 132). In addition, unlike other Nordic countries in the 1990s, the enforcement of the obligation to work in Norway more or less bypassed any cuts in benefits or increases in waiting period. Instead, Labour attempted to scale back the passive measures primarily by either tightening eligibility rules or duration of benefits (Stephens 1996: 52). The limited extent of change in
the passive apparatus is even more conspicuous if one takes into consideration the fact that unemployment benefits in Norway are non-contributory and tax-funded, which already makes it easier for the government to bring changes to the system, since these benefits are not claimed by employees as delayed wages, as would happen in an insurance system (Karlsen 1997: 152). At the same time, the strengthening of the obligation to work for those in the social security system went hand in hand with increasing financial resources Labour committed to active labour market measures.

In social security, Norway in the 1990s is an important exception to the general pattern towards a less generous welfare state. There had been no fundamental changes to any aspect of the welfare state, and it certainly had not moved towards a more residualist direction. Rather than retrenching the welfare state, the booming oil economy gave Labour the opportunities and resources to further maintain or increase welfare benefits. In addition, Labour also strengthened the work orientation of welfare programs and increasingly used targeting to direct benefits to the most needy. All these reforms, of course, took place in the context that the basic structure of the Norwegian welfare system is preserved (Freeman 1997: 18; Eitrheim and Kuhnle 2000: 53-54; Harvolsen 2002: 172, 177). Today, in terms of economic performance, state revenues from oil production have led to a budget surplus, and unemployment remains low, so there is little economic or fiscal pressure on the government to further fine-tune, let alone retrench, the existing social security system. Therefore, Norway has become the exceptional case of economic success in the context of a more generous welfare state going hand in hand with consolidation of the egalitarian objectives typical of traditional social democracy. The country, in other words, seems to be having the best of all
worlds at this moment, and the Norwegian welfare state appears to be the one under least pressure among Nordic countries, but this situation is unlikely to remain unchallenged for Norway in the event of a consistent drop in the oil price (Freeman 1997: 18; Eitrheim and Kuhnle 2000: 54; Clasen and Oorschot 2002: 241; Ploug 1999: 99).

Retrenchment of Early Exit Pathways

In line with its traditionally strong emphasis on activation and, in particular, on the work line, Labour deliberately shunned instruments of labour force reduction or labour-market-clearing as an expedited short-term response to very high unemployment. Not only did the party fear that planned reduction in labour supply would increase non-wage labour cost and hurt competitiveness, the party also actively promoted the retention of elderly workers in order to help ease the potential problem of excessive future financial burden on the pension system. For this reason, Labour has generally taken a proactive attitude towards avoiding early exit pathways. The party shunned work sharing or reduction in overtime or standard working hours as instruments to reduce unemployment. Instead of reducing the pension age through early retirement schemes, it proposed to increase the *de facto* pension age of 60 by three years in the next 15 years. Starting from 2002, payroll taxes were also reduced for workers 62 years and above to increase the financial incentive for employers to retain older workers in employment (Halvorsen 2002: 170-172).

With regard to the various health-related early exit pathways such as disability pensions or sickness benefits, Labour adopted a combination of tighter eligibility and intensified follow-ups. In 1991, the government tightened claims to occupational and
geographical mobility for claimants of disability pensions. Geographical disability was discounted substantially whereas more stringent criteria were applied to the claims of direct causal relationship between medical condition and vocational disability. The government also increased referral trend to better utilize residual work capacity and raised the lowest age for disability pension eligibility. With regard to the employers, Labour proposed to double the employer-financed sick pay period, from two to four weeks, in an attempt to stimulate employers to take more preventive methods and improve workplace environment. This proposal was rejected by parliament, but the government succeeded in extending the sick pay period to three weeks. (Halvorsen 2002: 170-172; Solem and Overbye 2004: 30; Dropping et al. 2000: 50; Dahl and Dropping 2001: 274). In an effort to further close various early exit pathways, the government introduced a new program in 2000 based on the committee report “An Inclusive Working Life”. With this new proposal, the Labour government hoped to reduce sickness absence by 20 per cent by the end of 2005 and further enhance the labour market participation of older workers and those on disability pensions. The focus of the program’s strategy was on rehabilitation and retraining rather than compulsion, and the government’s decision to focus on the push side in improving conditions for work rather than the pull side in cutting benefits played an important role in the new program being widely accepted by the unions. In “An Inclusive Working Life”, a lot of attention was placed on policy implementation on the company level, based on the establishment of 19 Regional Centres for Inclusive Working Life at a cost of 27 million euros for 2002. Companies were encouraged to engage in active dialogue with not only the individuals on sickness or disability benefits but also the local security offices in order to design more flexible
arrangements for labour market integration on the company level. In order to make it easier to hire disabled persons, the government offered salary subsidies of up to 50 per cent for three years for companies that adjust tasks so that they can be performed by persons with reduced capacities. In order to encourage older workers to remain employed, the government also encouraged the growing use of time accounts (Solem and Overbye 2004: 34, 37).

The Netherlands

Active Redistribution of the Passive Apparatus

Before the PvdA came to power in 1989, the centre-right coalition adopted a perspective on reforming the welfare system which emphasized the importance of cost control and expenditure restraint. With regard to social security expenditure, the Lubbers I and II administrations primarily subscribed to a “price” policy by freezing and lowering the level of benefits and shortening benefit duration. In the short period between 1985 and 1987, the basic benefit-wage replacement ratio for unemployment, sickness and disability was lowered from 80 to 70 percent. The link between flat-rate benefits and the minimum wage was suspended, and the adjustment of the minimum wage to the cost of living stopped temporarily. After Lubbers’ social security reforms in 1987, the safety net function of social security became more prominent at the expense of wage-replacement. Share of above-minimum benefit recipients in social insurance programs diminished considerably. However, since these austerity reforms mainly relied on spending cuts, they did not alter the passive nature of the social security system, and they also proved ineffective in bringing down the
costs of social security, especially with regard to the most abused part of the social security system: the disability benefits. By 1990, the number of disability benefit recipients stood at 894,000, while the disability benefit scheme itself was designed only for a maximum capacity of 200,000 recipients. Despite serious efforts by the centre-right coalition to retrench the sickness and disability benefit systems, the social partners further extended their industry-wide collective schemes to finance early retirement (Hartog 2000: 35; Stigter 1997: 13-14, 17, 19; Hassel and Ebbinghaus 2000: 76-77; Hemerijck et al. 2000: 220).

After the PvdA joined the coalition, the emphasis of the government started to shift from “price” to “volume”. As a non-negotiable condition for joining the coalition, the PvdA secured the promise from the Christian democrats that the level and duration of social benefits would not be tampered with. Now, in the “volume” policy framework, the priority in reforming social security became reducing the number of benefit recipients instead of cutting benefit levels or duration. On the one hand, social security entitlement rules were tightened, on the other hand, the government undertook major institutional overhauls in the administration of social security, especially in the areas of sickness and disability benefits. By forcing the employers to take up more financial responsibility in the event of employee disability, the government introduced significant incentives for employers to restrain the use of the schemes. For the PvdA in government, what retrenchment there was to the welfare system was justified as a response to economic necessity rather than an ideological attack on the social democratic principle of solidarity (Green-Pedersen 2002: 98). On the one hand, this task was made easier by the growing economic crisis and the deepening problems in the notorious sickness and benefit schemes. On the other hand, a decade of ambiguous results in
the cost control strategies of the centre-right coalition governments further highlighted the urgency and extent of the problems in the minds of the public.

The major crucial structural changes to the social security system took place after the Christian democrats were ejected from government in the 1994 election upset and the PvdA took up the leadership of the coalition government. The focus of social security reforms under the PvdA was the dismantling of corporatist social security administrative institutions and the reduction in the discretionary power of the social partners in social security management. Correspondingly, the government increased the role of legal rules and direct supervision by the state, and meanwhile financial incentives targeted at the employers were also further improved to encourage them to create better working conditions and improve workplace environment (van der Veen and Trommel 1999; Hemerijck and Manow 2001: 227-228; Snels 1999: 133). Since the PvdA joined the government, changes to the unemployment benefit system had gradually moved it away from a demand-driven system. Instead, through the decentralization of administrative tasks, local authorities are given increasing autonomy to develop their own initiatives in unemployment benefits for the purpose of encouraging the unemployed to enter the labour market. The government progressively diminished the power and responsibilities of both the unions and the employers’ organizations over the administration of social programs, especially the sickness and disability benefits (Schmidt 2000: 286-288; Anderson 2002: 7). With the introduction of New Public Management practices, deregulation and competition becomes the key characteristics of social security administration. The Central Board of Employment Services now receives funding allocated on the basis of its performance. Emphasizing delegation of
responsibility as well as the steering function of the state, the government attempted to transform social security administration into a public service directed to clients but with a strong input from political guidance (Hemerijck and Visser 2000: 241-242; Cox 1998: 12-14; Braun and Giraud 2004: 52).

As a whole, the restructuring of social security administration under the PvdA can be characterized as a process of “managed liberalization”, where on the one hand social risks increasingly became the responsibility of individual employers, on the other hand the coordination and supervision by the state on social security administration was increasingly strengthened. The sole loser in this process of managed liberalization seemed to be the social partners (van der Veen and Trommel 1999: 290; Hemerijck and Manow 2001: 227-228). As is typical of Christian democratic welfare regimes, unions and employers have been externalizing the cost of economic adjustment through labour market exit, especially by making very liberal use of the disability benefit programs. In 1999, a new round of fundamental institutional redesign in social security further reduced the influence of social partners, as social security, social assistance, and job search support were integrated into one administrative regime through better coordination. The expected result is that every person of working age willing to work will fall under the responsibility of a particular component of this integrated regime. (Keizer 2003: 296). One important consequence of the removal of social partners from social security management is that the government now had greater leeway to restructure social security in such a way as to reassign the balance between active and passive measures without the fear of resistance from the social partners, and the unions in particular.
The changes to the social security system under the PvdA also extended into the area of social assistance. In 1995, the government introduced the New Public Assistance Act, the first major change in the social assistance system since 1963. This act introduced explicit principles of activation and emphasized the duties associated with the right to assistance. The act also allowed for the decentralization of social assistance administration, so that the municipalities achieved greater discretion in setting benefit levels. In order to activate the unemployed, the municipalities can now raise the basic allowance by up to 20 per cent or reduce the benefit by up to 15 per cent (Cox 1998: 14-15). Overall, the reforms of the PvdA in social assistance were a combination of cuts in the level of benefits, extra allowance for disadvantaged groups, plus guidance and information on job and training possibilities for job searchers. Social assistance recipients were now generally expected to actively look for work and accept a job offer. Nevertheless, despite tightened eligibility requirements, greater mandatory nature of participation, and the threat of sanction, direct imposition of penalties was actually not widely practiced. Although activation contracts were now drawn, in most cases public assistance recipients who failed to fulfill their part of the activation contract were not penalized by a direct reduction in benefits (Gilbert 2000: 85; Keizer 2001: 121; Handler 2002: 30). Similar to the organizational changes to the social insurance system, the principle agent model was applied in the management of social assistance benefits, and by devolving both administrative responsibility and a portion of the social assistance budget to the municipalities, the PvdA tried to encourage better efficiency and more flexible activation measures at the local level (van der Veen and Trommel 1999: 305-307).
Overall, the PvdA managed to achieve both economic efficiency and a certain degree of social justice, by engaging in a typical “vice into virtue” strategy. On the one hand, the government to a large extent corrected the “vice” of past policy legacy, that is, the inefficiencies epitomized by the overly generous disability pensions and the excessive labour costs introduced by frequent wage drift. On the other hand, the government used the enormous savings from the scaled-back transfer payments to fund the restructuring or modest expansion of existing social programs in order to achieve traditional social democratic goals, such as adequate benefit provision for the worst-off or the reduction of gender inequality. The overall level of benefits and entitlement definition remained largely intact, while the financing of these benefits and entitlements increasingly became the responsibility of individual employers (Trommel and de Vroom 2002: 95). While trying to suppress wage demand, the government also funded compensatory targeted tax breaks for low wage workers, and it also upgraded hourly wages and benefits of part-time and temporary workers. While the PvdA continued with the efforts of previous governments to reduce budget deficits, the party also put more emphasis on the maintenance of basic social protection level and the avoidance of working poor or social exclusion (Schmidt 2000: 286-288; Braun and Giraud 2004: 49). Whereas the Lubbers administrations in the mid 1980s emphasized the importance of expenditure and benefit reduction, company or sector wide supplementary insurance delivered through collective bargaining had kept growing under PvdA, and these individual compensation schemes went to a great extent in cushioning the effect of the initial cuts in public programs (Trommel and de Vroom 2002: 93).
As a result of the PvdA’s active redistribution reforms, the Dutch social security system has taken on a much more selective character, partly as a result of the introduction of means-testing in the basic state pension and the survivors’ scheme. Consequently, the role of social assistance in the social security system has gradually increased at the expense of insurance. Beveridge type basic benefits were introduced for people with non-existent or insufficient contribution record. The expansion of means-testing mainly served younger and marginal workers while the reciprocity contributory principle and the maintenance of adequate living standards were secured for older and core workers (Oorschot 1998: 14-15; Clasen and Oorschot 2002c: 102).

Retrenchment of Early Exit Pathways

By the early 1980s, the sickness and disability schemes had become one of the most inefficient and abused parts of the Dutch social security system. A broad definition of disability, the inclusion of labour market chances in benefit calculation, and the close relation between sickness pay and extended benefits, had all contributed to the liability of the system to excessively liberal use. Therefore, employers, unions, and the social policy administration were in de facto collusion in externalizing the costs of economic slack onto the social security system, and a sharp welfare trap was created for the disabled as a result (Hemerijck and Visser 2000: 239; Visser and Hemerijck 1997: 139).

In 1987, the Dutch government formally started to take steps to tackle the disability crisis. However, initial measures under the Lubbers administration were modest in financial resources, defensive and passive, with the primary concern being the level rather than the
structure of benefits. The main instruments of such policy included reducing the duration and level of benefits and freezing the level of social assistance and state pensions. By 1991, the central plank of the disability policy platform for the Christian democrats was still a proposed reduction of benefit level for all recipients under 50. These measures, however, proved incapable of stemming the rising number of benefit claimants, as the number of social insurance beneficiaries had increased dramatically by 1990. As a result, the PvdA coalition government decided to shift its focus from reducing the level of sickness benefits to changing the structure of benefit entitlement, distribution, and payment administration (Trommel and de Vroom 2002: 93; Hemerijck and Manow 2001: 227-228; Visser and Hemerijck 1997: 148-151; Aarts and de Jong 1996: 66; Lamping and Vergunst 2004: 19; Oorschot 2002: 110). This change in policy principle from simple cost containment to labour market activation was reflected in the overhaul of the Dutch social security system as a whole, and the primary objective had changed from social rights to incentives (Guillemard 2001: 10).

Most significantly, it was the PvdA who spearheaded the most radical elements of these reforms, such as the removal of social partners from benefit administration, which struck at the heart of the interests of the unions. As a result, the government, and the PvdA in particular, suffered the largest postwar demonstration and significant vote losses in the ensuing 1994 election. However, the social democrats weathered the storm from the unions and returned to government to become the dominant coalition partner with the Liberals. With the Christian democrats now excluded, a combination of PvdA from the left and the Liberal Party from the right politically underwrote the later third way reforms. The shift to the Purple Coalition gave the PvdA not only increased political strength but also resolve to go ahead
with its proposals. And most of the radical reforms to Dutch sickness and disability benefit schemes were carried out under the two Purple Coalitions since 1994. Traditionally, the daily administration and implementation of workers’ compensation schemes were managed jointly by the unions and employers’ organizations. However, the 1993 Parliamentary Inquiry and the Buurmeijer Committee investigating into the functioning and administration of social security put this arrangement under the spotlight. The investigations exposed gross inefficiency, and abuse, in the use of these compensation schemes, and the Buurmeijer Committee recommended that the practice of bipartite social security administration be stopped and that social security administration be monitored by a government agency operating fully independently of the social partners. The government endorsed most of the Buurmeijer recommendations and amended the Social Insurance Organization Act in 1994. This move set in train an institutional breakthrough, as the discretionary powers of the social partners were completely removed, through the progressive dismantling of corporatist institutions responsible for managing the schemes (Trommel and de Vroom 2002: 93; Hemerijck and Manow 2001: 227-228; Visser Hemerijck 1997: 148-151).

The first such major corporatist institution to go was the tripartite Social Insurance Council (SVR), whose membership was dominated by unions and employers’ associations. Traditionally the Council controlled and monitored the implementation of social security legislation, but in 1994 such responsibilities were divided up and transferred to an independent organization responsible for supervision and implementation (Ctsv). The establishment of Ctsv was an attempt to restore the primary of politics at the expense of social partnership in social security. In 1997, the temporary Ctsv was replaced by the
permanent independent organization LISV, which sets the yearly premium for different social security schemes. During the same year, market incentives were formally introduced into the implementation of social security, as all the local industrial insurance boards were dismantled and local policy administration devolved to private operators. Based on independent monitoring, the Purple Coalition introduced significant financial incentives into management of disability and sickness benefits. Firms were required to pay sick pay during the first week of an employee’s absence. A bonus malus system was introduced under which employers were entitled to a subsidy if they employed a disabled worker for at least a year. Employers either pay wages for sick employees directly, or reinsure the risk through private insurance, an option most employers ended up taking, and it is now in the employers’ interest to actively reduce sickness absenteeism (Oorschot 2002: 117; Trommel and de Vroom 2002: 93; Visser and Hemerjick 1997: 150; Ebbinghaus and Hassel 1999: 17). The status of social partners in social security administration was decisively lowered as old corporatist institutions were dismantled and replaced by independent supervisory institutions. By forcefully removing the influence of both unions and employers in the administration of social transfers, the government weakened their entrenched resistance to the change of status quo, a solution which has so far eluded both the French and German social democrats in their attempt to reform the social security system. The increased political leverage of the government, at the expense of the unions and employers’ organizations, had clearly extended rather than impeded the scope and speed of reform (Hemerijck et al. 2000: 119; Levy 1999: 260-261).
In addition to increasing the supervisory role of the state and legal rules, another major component of the government’s efforts to combat early exit was the introduction of significant financial incentives to encourage retention in employment. In 1998, the method of financing for the Disability Benefits Act was completely revised, with the result that the responsibility increased for employers to take up the cost of disability benefits. By giving employers more autonomy and responsibility for sickness and disability compensation, firms were encouraged to adopt a pre-emptive attitude towards early exit and develop proper workplace safety or sick-leave policy (van der Veen and Trommel 1999: 299; Pennings 2002: 298). In addition to changing the financing pattern for disability risks, financial incentives for the employers also came in direct cash subsidies. The general principle of the Kok government was to use favourable tax instruments and encourage employers to hire older workers. Tax credits and reductions in social security contributions were granted to employers for the long-term unemployed aged 50 (or over) earning up to 150 per cent of the minimum wage, and progressively higher credits were available for the over-58s and over-65s, respectively. In 1998, a Replacement Subsidy of up to 8,000 Guilders became available, for employers who retained disabled employees with at least one year of work history with the enterprise. Another separate set of subsidies were offered to employers who were willing to recruit disabled workers as new employees for at least six months. The government further revised the disability schemes and introduced differentiation on premiums, as well as the possibility for employers to opt out (Snels 1999: 133; Foden and Jepsen 2002: 153). In addition to employers, various financial supplements were offered to encourage the employees to stay on in employment as well. Disabled individuals, for example, were
offered additional incentives under the Reintegration Promotion Act, so that if they were willing to accept a job with wages below their healthy earnings capacity, they would receive a wage supplement for up to four years (Pennings 2002: 297).

Along with the carrots in terms of subsidies, the government also introduced some sticks by increasing the financial costs of employee disability. In 1996, for example, the compulsory wage payment by the firm for disabled workers was extended to 52 weeks. Besides employers, the government also decided to increase pressure and toughen requirements on the beneficiaries of the sickness and disability schemes. In 1993, the government decided to medically re-examine all recipients of disability benefits in an effort to decrease the number of disabled persons as well as the degree of disability of recipients. Training and re-training of the disabled became increasingly important, and the attractiveness and accessibility of disability benefits were reduced (Keizer 2003: 294-295; van der Veen and Trommel 1999: 302). Since the entry of the PvdA in government in 1989, the shift of policy focus from the level of disability benefits to the number of beneficiaries has undoubtedly had a significant impact on the incidence of sickness and benefit leaves. Compared with the failure of the 1987 reforms to contain disability claims, since 1992 the number of disability beneficiaries had started to decrease. It has become much more difficult for older workers to get a 100 per cent disability determination, and the number of new entrées into the scheme aged between 55-64 decreased from 14,300 to 10,000 between 1993 and 1995. During the same period, the total number of benefit recipients dropped from 894,000 to 862,000, the very first time that the number of beneficiaries has actually diminished since the introduction of the scheme. However, because of the unusually bad
shape of Dutch disability benefit scheme, by the end of the 1990s enrollment in disability transfer was still high by international standards (8.6 per cent of the total labour force in 1998). More seriously, since 1995 the number of recipients had started to increase again. Sickness absence percentage is also rising (Stigter 1997: 18-19; de Vroom 2004: 139; Geurts et al. 2000: 99; van der Veen and Trommel 1999: 308).

In addition to the health-related early exit pathways, the Dutch social democrats also attempted to retrench the age-related pathways, such as the early retirement benefits collectively agreed at the sectoral level and financed as a top up to unemployment benefits (Auer 2002: 91). Since 1995, a number of policy initiatives have been developed by the Dutch government to raise the awareness of age discrimination. Since 1996, the Purple Coalition has attempted to restrict voluntary unemployment through legislation on administrative penalties, and in 1999 a bill was introduced to regulate the prohibition of age discrimination, which covers not only work-related recruitment and selection, but also work-related training, education, and promotion (de Vroom 2004: 136; Auer 2002: 91). In addition to tackling age discrimination, the government also took direct measures to close age-related pathways to early labour market exit in the social security system, either by restructuring or dismantling elements of existing programs. The Early Retirement Scheme (VUT), for example, was gradually phased out, and tax support for the scheme was abolished since July 2002. The collective pay-as-you-go VUT premiums were gradually replaced with individualized savings schemes, so that the younger workers have greater incentives to save for their own early retirement. In many collective agreements, the VUT schemes are being replaced by pension schemes with a flexible retirement date, and the pension base was
changed from final pay to average pay. By 1998, nearly half of the collective agreements had already replaced the early retirement schemes with flexible pension schemes (de Vroom 2004: 139-147; Delsen 2002: 307, 319-320).

The government also took a critical look at two exceptional clauses in the general unemployment benefit system. One of them was the “elderly guideline”, which legitimized the choice of older workers as the first target group in the case of a mass dismissal, the other was the “57.5 age rule”, which released the older unemployed of 57.5 years of age or older from the obligation to find a job. Taking advantage of these two exceptional clauses, almost as many workers slipped out of the labour market via the general unemployment benefit scheme as they did via the VUT. In response, the government in 1994 replaced the elderly guideline with the rule that mass dismissal should reflect the overall age profile of the company, and it introduced an element of partial own risk for employers who dismiss older workers of 57.5 or older, by requiring them to finance part of the unemployment benefits for the dismissed. Since 1994, selective dismissal and compulsory dismissal of older workers is no longer allowed, and in 1995 the tripartite Board of Public Employment Service had removed the age criteria from all its training and placement measures. Replacing these early exit path ways, the government introduced new programs such as “flexible retirement” “pre-retirement” and “demotion”, so that there is an increased degree of flexibility in choosing between work and non-work. The government also offered direct financial incentives to attract those who retired early back to the labour market. For example, workers who return from early retirement to difficult posts to fill in the Dutch Railways or the education sector are entitled to penalty reduction in VUT, and from 2001 those returning to the healthcare
sector can work without incurring any reduction in either their VUT or pensions (de Vroom 2004: 139-147; Delsen 2002: 307, 319-320; Foden and Jepsen 2002: 446, 453).

With the various reforms to stop early exit from the labour market since the early 1990s, the PvdA has introduced a fundamental change in the basic principles underlying the design of early retirement policies. The theoretical framework for early exit shifted from social rights and the entitlements to compensation to a system offering incentives to work. Based on this new active ageing principle, the second Kok government, which came to power in 1998, has explicitly targeted a permanent increase in the employment of older people (Guillemard 2001: 10; Delsen 2002: 310-311). With regard to active labour market programs, the government also expanded the program coverage to include unemployed workers aged 45 and over, which were excluded from active labour market programs before 1995 (Foden and Jepsen 2002: 446).

France

Active Redistribution of the Passive Apparatus

Although the 1983 U-turn in economic policy meant that the Socialist government had formally switched to a prescription of economic orthodoxy and austerity, the Socialists believed that this change in economic policy had no impact on the party’s traditional goals of social justice and equality, and the government continued to regard combating social exclusion as one of its key objectives. In line with this philosophy, the Socialist government continuously expanded the French welfare state during the 1980s, despite an austere budgetary and interest rate framework constrained by the policy of *Frankfort* (Levy 2000: 263).
The Socialist government attempted to achieve the social democratic goals of redistribution and national solidarity through a partial restructuring of the French welfare state, by introducing more universalistic elements into the predominantly insurance-based French social security system. The government also sought to shift the burden of the social security system onto the more affluent. In the early 1980s, when the Socialist government had to reduce the generosity of social benefits, the tradeoff compensation was that the government shifted the burden of financing from contribution to general taxation (Palier 2002b: 13; Clift 2003: 184).

In addition to committing continued resources to the social security system, the Socialist government also increased state expenditure and involvement in active labour market programs targeted at beneficiaries of the social security system. For the Socialists in government, this task of asserting a prominent role for the state in taking care of the margins of society was made much easier by the traditional *dirigisme* that guides important areas of French public policy. Because of the centrality of the state in French policy making, problems such as unemployment, poverty, and social exclusion are generally regarded in France not as issues of individual responsibility but problems requiring a collective response from the social security system (Enjolras et al. 2001: 66). In response to the rapidly rising social costs of economic liberalization in the 1980s, the Socialist government made attempts to compensate through social as well as labour market policies. To serve these purposes, a crucial policy instrument under the Socialist government was the RMI. As explained in the chapter on expansion of the active apparatus, the RMI is unique in its dual nature as both the major locus for active labour market measures and the only major social assistance benefit in
France. In this chapter, it is the social assistance aspect, rather than the labour market activation aspect, of the RMI that will be highlighted.

Introduced by the Socialist government under Rocard in 1988, the RMI offers not only the guarantee of a means-tested minimum income, but also access to basic social rights such as healthcare, housing and work injury insurance. In addition, the RMI also offers the right to reintegration into the labour market (insertion). By the end of 1991, the RMI had been paid to almost two million individuals and their dependants (Morel 2004: 115; Hantrais 1996: 65). Since its introduction, the RMI has gradually secured its place in the French social security system as the main substitution benefit for both unemployment insurance and the main minimum income. Ninety per cent of the unemployed who receive RMI do not receive any other form of unemployment benefits, and for this reason the RMI has gradually become the “third component” of the unemployment benefit system in France (Barbier and Theret 2003: 149; Ughetto and Bouget 2002: 103). Because of its insertion requirements, the increasing dominance of RMI in the social security system also facilitated the efforts of the Socialist government to combat unemployment and activate the labour market. The RMI offers a minimum income to unemployed individuals over the age of 25 if they express willingness to participate in training programs or jobs. The most innovative feature of the RMI is simply that it is universal, so all French citizens over 25 can claim this benefit on work or training conditions. A decade after the introduction of the RMI, another Socialist government, this time under Jospin, extended the universalist principles of RMI by giving all long-term unemployed a right to personal support based on citizenship. For the young, the support involves a training program of 18 months that includes internships or education
leading to a professional qualification; for adults various original insertion-based contracts under the RMI will be expanded (Beland and Hansen 2000: 57-58).

In addition to its universalist nature, another important characteristic of the RMI is that it is financed out of general taxation, which constitutes a significant departure from the previously Bismarckian nature of French social security. The financing structure of French social security was revolutionized in 1991 when the Socialist government introduced the General Social Contribution (CSG), which started off as a 1.1 per cent tax levied on all incomes. The introduction of CSG and its financing of RMI signaled the first real shift in postwar French history from contribution to general taxation as the funding mechanism for social security. The CSG was later progressively raised by French governments from the left as well as right, and by 1998, the rate had become 7.5 per cent. With the increasing importance of the CSG, the government was able to further expand the scope of programs which were subjected to the gradual transition from contributory to tax-financing (Beland and Hansen 2000: 57-58). In this context, one of the biggest social policy achievements by the Jospin government was the establishment of a universal healthcare cover, which transformed a scheme traditionally funded disproportionately by employees’ contribution into a scheme increasingly funded by general taxation. The CSG has replaced most of the health care contribution paid by employees, and in 1999 more than 20 per cent of all social protection resources, and 35 per cent of those in the healthcare system in particular, came from the CSG.

The introduction of the CSG enabled a general shift in the financing structure of the social security system from social contribution to general taxation, and in the long run this
change should help lowering non-wage costs in the economy by reducing the level of social contributions or payroll tax. An added advantage of the CSG is that it is designed as revenue-neutral in the long run, so it introduces greater efficiency in the economy at no extra cost (Clift 2001: 174-175; Palier 2000: 130; Ferrera and Hemerijck 2003: 113). For the Socialist government, a further advantage in the growing role of the CSG is that, as the social security system becomes increasingly tax-funded instead of contributory, the leverage of the social partners and their proprietary claim to the management of social security also weakens, as does their potential resistance to future efforts by the government to reform the social security system. The control of the state in social spending and welfare standards is significantly strengthened at the expense of the committees that manage social insurance (Taylor-Gooby 2002: 16-17; Palier 2002b: 19). The introduction of RMI as the first major social assistance benefit and its financing out of general taxation indicate that an increasing element of universality is added to the Bismarckian contribution-biased system. The universal benefits are increasingly funded through general taxation, and fiscal welfare delivered through the tax system gains growing importance. The changes of the social security system under the Socialists has shifted the policy premise of French social rights away from a Christian democratic notion of reciprocity closer to a social democratic notion of national solidarity (Clift 2004: 3; Palier 2002: 3; Beland and Hansen 2000: 56).

While the Socialists in government clearly kept the goal of social justice on top of their agenda, since the late 1980s the government had tried to gradually redefine the premise of social justice, from that of equality of outcome to that of solidarity, centred on providing incentives to employment for those most affected by economic restructuring (Schmidt 2000:
The Socialists called for greater efficiency in state redistribution policies, and the type of redistribution envisaged by the Jospin government prioritizes employment objectives. Based on this premise, the Jospin government advocated growth in the economy through state-led demand expansion and redistribution of added value in favour of salaried workers in general and low income earners (the working poor) in particular. Shortly after coming to power, the Jospin government introduced a three-year plan aimed specifically at preventing social exclusion for young people with some social difficulties. Called “The Road to Employment” (TRACE), the program offered individual case management for the least employable young people, and it chiefly functioned as a coordinating and integrating mechanism by strengthening the linkages between various regular youth activation programs and the social security system (Enjolras et al. 2001: 64).

In 1998, ten years after the introduction of the RMI, the Jospin government carried further the objectives in RMI by introducing the Law of Orientation for the Fight against Exclusion (LOLE). The LOLE was an integrated approach to the promotion of fundamental social rights, and it contained an ambitious set of new schemes aimed at combating exclusion in all its possible aspects, such as employment, education, health, housing, debt, and culture. Meanwhile, the LOLE also carried further the reinsertion emphasis of the RMI and continued to promote employment-centred social justice. The new measures in LOLE included not only new job creation schemes for those under 26 but also an updated employment service program tailored to the specific needs of the unemployed individuals (Morel 2004: 93-94, 115, 120). In order to achieve employment-centred fiscal redistribution, the Jospin government called for a fundamental reform of the tax system. Socialist cuts in income and
other taxes favored people with low or no income, and the reorganization of income tax for the 2000-2003 period lightened the load at the lower brackets and made the tax more progressive (Clift 2004: 3). In order to strengthen fiscal redistribution in favour of the poor, the Jospin government raised the minimum wage by 4 per cent, and it also raised the basic income in RMI and two other types of minimum income guarantees in the social security system. The coverage of collective benefits was proposed to be extended to 100 per cent, and health insurance coverage also expanded and charges abolished for low-wage earners by the Jospin government. In addition, a new ambitious youth employment program was launched, which was expected to create 350,000 jobs, and this goal was reached within six months of the Jospin government coming into office (Hemerijck and Schludi 2000: 170; Wren 2001: 262; Clift 2001: 174-175).

Although there was growing pressure from the centre-right parties for more privatization or individualization of rights in areas such as healthcare and pensions, under the Jospin government privatization in the social security system was very limited, and opposite tendencies towards growing universalism and statism were much more visible. Throughout its tenure, the Jospin government maintained public ownership of all basic welfare services and introduced positive discrimination in their financing and pricing. A growing number of services were restructured to be more universally accessible. The Jospin government promised to allow privatization only when there is clear strategic benefit to the specific industry concerned, and even if privatization is carried out, it will be done under close state supervision (Sferza 2002: 137-139; Theret and Barber 2002: 16). The Socialists stuck to three principles with respect the social security implications of economic liberalization and
austerity reforms. First of all, if government spending must be reduced, the cuts should be targeted at the affluent. Secondly, the high income earners should bear the primary cost of structural reforms in the social security system. Thirdly, even when the government is pursuing genuine liberalization or austerity measures, these measures should be carried out along a left progressive line to the maximum extent possible. The U-turn in economic policy in 1983 and the following two decades of economic reforms have led to a retreat from *dirigisme* in economic policy, but this clearly does not mean the end of state activism. On the contrary, partly in response to the costs of economic liberalization and partly backed by a genuine desire to activate the labour market, state activism in reforming the social security system for the purposes of continuing redistribution and labour market activation had continued to grow under the Jospin government.

On the whole, the Socialist governments, especially the Jospin administration, had demonstrated that the party was able to make necessary reforms to the economy and the welfare state as well as promoting increasingly employment-centred social solidarity and egalitarianism (Schmidt 2000: 298). As an indication of the Socialists’ success in combating social exclusion, in 2001 the French programs aimed at combating exclusion were selected, together with the Dutch and Danish ones, as good examples of strategic approach to promote social cohesion by the European Commission (Morel 2004: 130). Compared with the efforts of the Socialist governments to reform the social security system both in the 1980s and 1990s, the measures introduced by the centre-right government in the early 1990s were more second order changes (Hall 1993). During the centre-right period, the main reform was the integration in 1992 of all different unemployment insurance programs under one benefit
known as the Regressive Single Allowance (AUD), whose level depended on the contribution record and decreased through time (Palier 2002b: 18).

Retrenchment of Early Exit Pathways

The measures adopted in the 1980s and early 1990s to restrict early exit focused primarily on changing the level of pension benefits and the rules for pension entitlement. As first and second order reforms which involve changes in policy setting and instruments but no policy objectives, these measures have so far proven inadequate for reversing the early exit trend (Guillemand 2001: 9). Since the early 1990s, there was increasing attention from the government on the importance of combating early exit from the labour market. French state intervention over this issue has developed through three methods: (1) the closure of pathways to early exit, (2) the measures to facilitate the retaining of older workers in employment, and (3) the reform of the pension system with the aim of postponing retirement, such as the raising of the statutory retirement age through lengthening the contribution period. In order to close off pathways towards early retirement, the government tightened control over the Special Pre-retirement Allocation program and made it more expensive for firms to dismiss wage earners older than 50. The Jospin government restricted access to the Special National Employment Fund, and contribution to the fund paid by the firm was raised in June 2001 to increase the direct cost of early exit schemes. The government also offered employers financial aid in recruitment in order to lower the labour costs. In addition, the Socialists financed training programs aimed at re-qualifying older workers with inadequate skills (de Vroom and Guillemard 2002: 194-197; Guillemard and Argoud 2004: 169, 174;
Mandin 2004: 18). Efforts to reduce working time, such as the 35-hour week, were also expected by the government to go to some extent in retaining older workers.

However, most schemes introduced so far have had very limited effects. First of all, the proposals to discourage early retirement which involved changes to the pension system were either watered down (the Balladur reforms in 1993) or completely defeated (the Juppé reforms in 1995) because of the resistance from social partners, and after the Juppé debacle the government decided to postpone all pension reforms till at least 2002. Secondly, the government devoted only a tiny proportion of public expenditure to these schemes. The nature of recent government attempts to combat early exit has been characterized by a proliferation of individual programs and a lack of coherence and financial resources. This trend is more or less followed by the centre-right government in power since 2002, which goes on to close more early exit pathways but, reflecting its greater concern with public expenditure restraint, has so far failed to come up with any specific measure about the actual reintegration of older workers. So the paradoxical situation in France today is that while the state progressively makes it impossible to retire early, it does not offer a real possibility for older workers to work longer (de Vroom and Guillemard 2002: 194-197; Guillemard and Argoud 2004: 169, 174; Mandin 2004: 18; Jolivet 2002: 245-270).

Germany

*Active Redistribution of the Passive Apparatus*

In its attempt to reform the German social security system, the Schroeder government had struggled to maintain a balance between retrenchments on the one hand and
consolidation or further expansion on the other. Motivated by a concern to control social expenditure as well as to increase the incentives for the unemployed to enter the labour market, the Red-Green coalition has primarily applied restrictions to the unemployment benefit system. At the same time, based on the traditional social democratic concern with social justice and adequate protection for those most vulnerable, the government also improved welfare benefits and social services in several other areas of social security in order to compensate for the retrenchment in the unemployment benefit system.

When the German social democrats returned to power after 16 years in the opposition, the party was very much in agreement with the centre-right parties on the economic front, with regard to the importance of a prudent anti-inflationary economic stance and the necessity to restrain public expenditure. In order to reinforce its image as a party with economic responsibility, the SPD in government introduced several cutbacks to parts of the social security system, and the Ministry of Labour alone was asked to contribute almost half of the 30 billion Deutsche Marks in total savings which the federal government was hoping to achieve in the 2000 budget. However, for fear of the potential electoral impact from its retrenchment measures, the government attempted to make cuts by stealth or at least indirectly. With regard to the pension system, for example, the social democrats bypassed direct cuts in benefit levels and chose instead to make changes to the indexation rules for pensions or the pension formula (Hering 2004: 102; Busch and Manow 2001: 185; Leibfried and Obinger 2003: 215). In addition to this concern with expenditure restraint and cost saving, the overall principle of the SPD for the functions of the social security system has gradually shifted towards the emphasis on individual responsibility, in line with the
government’s increasing efforts to encourage labour market activation. The part of the social security system that bore the brunt of the new emphasis on activation was the unemployment benefit system.

In late 2003, a comprehensive proposal for reform in the unemployment compensation system was introduced by the Red-Green coalition. Named Hartz I-IV after the head of the commission on labour market reform, the new proposals implied potentially significant cuts in benefits for the long-term unemployed by the year 2005. According to Hartz I-IV, the regular unemployment insurance payment, called Unemployment Benefit I, would be limited to 12 months, and a second tier of flat-rate and fully means-tested basic income would be instituted for workers who have exhausted their unemployment insurance payment. As a whole, this reform considerably reduced benefit levels in the insurance tier and tightened eligibility rules in the assistance tier (Seeleib-Kaiser 2004: 16). Based on the Hartz-IV recommendations, in early 2005 the government also transformed unemployment assistance and general assistance into an integrated means-tested benefit called Unemployment Benefit II, paid at the level of the lower benefit, so that minimum social assistance becomes the only benefit available for the long-term unemployed. The reform in unemployment benefits continues to rely on the narrow manipulation of incentives for individuals as the main instruments to combat unemployment problems, and only secondly does the attention fall on broader issues of integration and enabling as labour market strategies (Hanesch 2003: 160-161; Hanesch 2003b: 215; Dingeldey and Linke-Sonderegger 2004: 27). So far the SPD has not been able to establish any generally applicable mandatory activation principles into the social security system. With regard to unemployment benefits, it
is the local employment officers who have the discretion over sanctions when work conditionality is not met by the recipients of unemployment benefits. In both the Dutch and Danish case, by contrast, participation in activation is compulsory, setting in automatically after some time in unemployment. The SPD’s reforms to the unemployment system have been characterized by selective restrictions which actually tend to hit particularly hard those who are already less attached to the labour market. The government decreased the level of unemployment benefits with increasing length of unemployment, and it also restricted the suitability criteria for benefit claims, but the government has made only limited efforts to go beyond these simple measures to make employment more attractive (Hering 2004: 104; Seeleib-Kaiser 2004b: 133; Clasen 2000: 90, 103; Clasen 2000b: 97-98).

While greater limits to the unemployment benefit system were being imposed in order to control cost and encourage entry to the labour market, the Schroeder government also tried to take into consideration the traditional social democratic objectives of social justice and security for those who couldn’t work. For this reason, the social democrats also put in place a series of compensatory measures to further strengthen employment rights and welfare entitlements among the party’s core constituencies. For example, the Red-Green coalition reversed a number of marginal cost-saving measures as well as deregulatory reforms in the labour market introduced by the previous centre-right coalition. The reduction in replacement rate for old age pensions in 2001 was accompanied by the introduction of state-subsidized partial private pension arrangements. In addition, the government also reinstated the full statutory sick pay benefits and restored the replacement rate to 100 per cent. Meanwhile, statutory rules for layoffs in small enterprises were also tightened again (Schroter 2004: 24;
Leibfried and Obinger 2003: 216; Seeleib-Kaiser 2002: 32). In 1998, the government lowered co-payment for prescription drugs and waived co-payments for transportation, drugs and other associated treatment costs for those chronically ill (Leibfried and Obinger 2003: 212). Despite tightening fiscal positions and welfare budgets, the government nevertheless established a separate social insurance scheme for long-term care, which not only means a substantial expansion of resources devoted to people needing long-term care, but also a reinforcement of the contribution-based German social security system. To protect the elderly living below the poverty line within the existing pension system, the government also introduced a complementary public assistance scheme which offers flat-rate benefits financed through taxation (Leitner and Lessenich 2003: 333; 339).

Overall, the reform of the German social security system under the Schroeder government has represented a gradual process of “dual transformation”: on the one hand the preservation of status and guarantee of living standards are declining in their importance in the social security system; on the other hand policies towards the family are being increasingly taken up by public welfare. The growing liberal as well as social democratic element in German social security is connected through the communitarian principles typical of third way discourse (Seeleib-Kaiser 2004: 20). In the long run this development is in alignment with the active labour market reforms of the German social democrats, because the communitarian principle of mutual obligation is the ideological backbone for many of the social democratic governments in their third way reforms. In addition, the government is also continuing to make a conscious effort to promote left progressive and redistributive policies in the social security system. However, most of these changes are moderate alterations at the
margins, and they work firmly within the constraint of prudent economic stance. What is more important, despite the various reforms, in the German social security system the contribution-based guiding principle favouring core workforce has not been changed (Lawson 1996: 47). The general trend in changes in the German welfare state is towards cost containment and a more streamlined social insurance state, in the context of an overall very high degree of stability. Of course this is a type of stability with few signs of life, as inactivity problems in the labour market remain (Seeleib-Kaiser 2004b: 134; Leibfried and Obinger 2003: 214-216).

Retrenchment of Early Pathways

Well into the mid-1990s, German governments from both the left and right continued to frequently resort to early exit as a short-term strategy to reduce the labour force supply and the unemployment rate (Leibfried and Obinger 2003: 215; Teipen and Kohli 2004: 100). Since 1992, however, attempts have been made to raise the age limit for pension access. In order to avoid an excessive impact on the immediately eligible age groups, the reforms were planned to be phased in very gradually. With the Pension Reform Act of 1999, the Schroeder government considerably shortened the transition period to higher age limit for pension benefits. In a series of steps, the government raised the age for eligibility from 63 to 65 years of age and the age for retirement on grounds of unemployment from 60 to 65. Early retirement can still occur but will incur considerable financial loss. In 2000, the Red-Green coalition also further developed a part-time retirement law introduced by the previous centre-right coalition, so that it gives older workers the possibility to reduce working time without
incurring unacceptable levels of income loss. Both part-time employment and time accounts are increasingly adopted by the social democrats as instruments to encourage employment among the elderly. On the one hand, agreements with social partners are reached with the explicit purpose of encouraging life-long learning and work-time accounts, on the other hand the government also introduced legislation to not only allow full-time workers transit to part-time work but also to protect part-time workers from discrimination. However, the government’s measures on part-time employment have not been very effective, since workers continue to prefer to save for full-time retirement (Foden and Jepsen 2002: 447; 451-452). Beyond these measures, no major public labour market measures were designed by the social democrats with the explicit objective of reintegrating older jobseekers. This situation only began to change very recently, when the government introduced a new law on reintegration of older workers in 2003. This new law, however, has been severely weakened by the fact that it combines two policy designs serving opposite purposes. On the one hand, the proposition contains measures which make work pay for the elderly, such as subsidies from the labour office for old jobseekers who accept a job with lower wages than their previous one, or subsidies for employers willing to hire an older jobseeker. Based on negotiations in the Alliance for Jobs, the qualifying age for older worker integration subsidies was lowered to 50. On the other hand, the new law also proposed a bridging system to make it easier for older workers aged 55, especially white collar workers, to leave the labour market. Facing heavy criticism over such conflicting logic in the proposals, the government was later forced to withdraw the bridging system component of the plan (Mandin 2004: 16).
The United Kingdom

Active Redistribution of the Passive Apparatus

Like its Australian and New Zealand counterparts, when New Labour came to office it was faced with a clear increase in the number of claimants of variants benefits in the social security system. However, compared with the cases in continental welfare regimes, the overall urgency for reform in terms of social expenditure commitment, increasing welfare dependency, or fiscal crisis, was not very strong (Taylor-Gooby 2002: 618; Jordan and Jordan 2000: 24-25). Given the relatively less urgency for cost control in the social security system, over time New Labour had certain flexibility to continue pursuing traditional social ameliorative goals within the larger framework of economic prudence, which all third way social democratic governments have more or less signed on to. And New Labour in government has indeed exploited this relatively auspicious fiscal position of the government to commit increasing financial resources to social justice goals.

The Treasury, under the leadership of Gordon Brown, was particularly active in introducing some redistribution of income, not only through increased means-testing of the social security system, but also through innovative fiscal welfare measures such as the Working Families’ Tax Credit and the minimum wage. In addition, there is also a massive increase in child benefits. However, it is important to point out that the expansion in these areas of the social security system was funded more by stealth tax and windfall tax than by direct increase in income tax, which the party pledged it self to not increase. In the 2002 spending review, the Chancellor of the Exchequer committed the government to continued substantial increase in social expenditure, till at least 2006 (Pierson and Ellison 2003: 349-
Characterized by Ferrera and Hemerijck (2003: 103) as a strategy of “functional recalibration”, New Labor tried to bring changes to the structure of the social security system and eliminate welfare traps through means-testing and changes to benefit rules. At the same time, the party also tried to combat poverty and social exclusion through the introduction of minimum wage, income guarantees, new targeted programs in the social security system, and fiscal welfare such as generous tax credits. As a result of these changes to the social security as well as taxation systems, plus the minimum wage, the worst-off quintile of the population has clearly become better off, whereas the best-off quintile almost did not change their position (Jessop 2003). Most importantly, this strategy of functional recalibration in the social security system is strongly integrated with the promotion of employment and labour market participation, which goes to the heart of the activation-based third way policy of New Labour.

In its efforts to restructure welfare state distribution, New Labour continues to encourage the growing trend, started under the Conservatives, towards increasing application of the needs principle at the expense of the contribution principle. New Labour has contributed to a fundamental transformation of the British welfare state, from a social insurance model to a model combining employment, private occupational insurance (for the elderly) and fiscal welfare (tax credits for the low paid) (Adler 2004: 88, 94; 103-104; Clasen and Oorschot 2002b: 18; Clasen and Oorschot 2002c: 107). In their approach to targeting, New Labour differentiated from classic Poor Law by its emphasis on inclusion rather than exclusion. Despite increased targeting under New Labour, there is yet little sign of systematic change towards American minimalism. While on the one hand New Labour carried forward
the Conservative emphasis on tightening conditions for benefits, on the other hand there is also a renewed emphasis on including out-of-work population and on investing in human resources and training (Trikey and Walker 2001: 181; Johnson 2001: 74; Hewitt 1999: 169-170). Similar to the ALP’s asset-based egalitarianism in the Australian context, New Labour encouraged a kind of asset-based welfare, where individuals are encouraged to save for themselves and pursue asset-building as a way to fund their own future retirement. As an incentive for individual saving, the government introduced state bequests for children and donations for adults that match the amount saved. In addition to means-tested cash assistance and services in kind, New Labour is now trying to promote asset-based welfare state as a third pillar of welfare financing (Hewitt 2002: 189).

Retrenchment of Early Exit Pathways

Unemployment benefits in the continental welfare regimes are primarily funded out of social contributions and are therefore liable to being exploited as an outlet for externalizing the cost of economic adjustment. On the contrary, the tax-funded unemployment benefit arrangements common in liberal welfare regimes have generally prevented the prevalence of age-related early exit schemes seen in continental Europe. For this reason, New Labour turned its attention first to health-related early exit pathways, especially disability benefits. To discourage enrollment, the government increased the work-conditionality of insurance-based disability benefits, and in 2002 the government unified the individual gateway services of its six New Deal programs and merged services for employment (Employment Service) and benefits (Benefits Agency), to create a mega
gateway organization, Jobcentre Plus, for all benefit recipients of working age. With Jobcentre Plus, benefits become conditional upon compulsory work-focused interview, for healthy as well as disabled beneficiaries (Wright et al. 2003: 18). In order to increase the financial return from work for the disabled, the government relaxed means-testing so that earned income is disregarded when assessing the financial contribution a disabled person has to make towards the personal assistance he receives. The government introduced the National Strategy for Carers in 1999, which provided funding to local authorities over a three-year period to establish services for community care, and the Carers and Disabled Children Act of 2000 made it easier to assess the needs of community carers and offer them financial compensation. Meanwhile, the government also promoted a style of social work which focused more on the activation potential rather than the disabilities of the disabled (Morris 2003: 220-222; Jordan and Jordan 2003: 106-107). The government also devoted one of its six major New Deals to the specific purpose of combating early exit through the disability benefit path, in the form of New Deal for Disabled People.

In order to encourage older workers to remain longer in employment, New Labour further adopted measures aimed at removing age barriers and increasing incentives for work for the elderly, especially through the New Deal for 50 years and older (ND50+). The Gateway service of ND50+ assigns a personal advisor to each elderly participant, and offers advice and information about job searching through individually tailored counseling sessions. For those elderly who remain excluded from the labour market after the Gateway period, the ND50+ provides a range of follow-up measures including the offering of job or training placements and financial help such as training grants. With the ND50+, the government also
provides an employment credit of 60 pounds per week as a form of guaranteed minimum income for those unemployed for more than 6 months. Since 2003, this tax credit has been incorporated into the new Employment Tax Credit and used as a bonus for returning to work for those aged 50 and over. Promoting the idea of active ageing, the government campaigned to raise awareness about age discrimination among employers, with new legislation on age discrimination expected in 2006. The government also raised the age threshold for occupational pension, and consulted widely about introducing further flexibilities into the pension system. The main flexibility issue in the pension system is the use of full retirement as the condition for claiming any benefits. Therefore, a change of status from full-time to part-time work for the elderly will not count as retirement. This arrangement creates a barrier for work, as it makes it difficult for the elderly to remain in the labour market while drawing a partial pension, and this is the issue New Labour has promised to act upon (Mandin 2004: 13-14; Walker 2002: 421-424; Foden and Jepsen 2002: 450). After its reelection in 2001, New Labour rapidly expanded its active ageing measures. The ND50+ was expanded in scope and services, and the government introduced the Third Age Apprenticeships to retain elderly workers in sectors with skill shortages (Walker 2002: 425).

**Australia**

*Active Redistribution of the Passive Apparatus*

After coming to power in 1984, the ALP was keen to control the cost of the welfare state and reduce the large deficit left by the Fraser government. Political attention was focused strongly on rising social security expenditures, and the ALP committed itself not to
increase social expenditure. Although there was some modest increase in social expenditure between 1983 and 1985, this was followed by clear restraint. Throughout the Hawke period, social expenditure did not increase as a percentage of GDP. Significant efficiencies were achieved by the ALP in Medicare, Superannuation, higher education funding, and care for the elderly. Asset test for the age pension had massively reduced the number of aged pensioners (Graycar and Jamrozik 1993: 121; Watts 1989: 117-118; Gibson 1990: 184-186). Despite the significant cost efficiencies achieved as a result, the ALP was simultaneously able to implement its traditional objectives of social justice and social amelioration. With Medicare, childcare, family income supplements, and various other measures, the ALP achieved considerable redistribution of income during its term in office (Beilharz et al. 1992: 93). Under the Labor government the living standard and actual income of the worst off segment of the population saw clear improvements, and there was also genuine expansion in social programs and benefits for vulnerable groups. Since the overall level of social security expenditure did not increase, the party’s success in delivering these social justice objectives relied almost totally on significant redistribution of resources and services within the existing social security system. Much of this redistribution occurred as a result of increased and more precisely targeted means-testing under the Labor government. At the same time, the repeated use of the social wage in the social security system to compensate for decline in nominal wages, as part of the Accord arrangements, also greatly facilitated the general improvement in welfare provision.

The concept of the social wage was one of the most important incentives for the labour movement to sign up to the Accord. The attention to the social wage and adequate
benchmark for social provision had clearly offset the potential for growing inequality in the process of economic liberalization, a problem which accompanied the parallel reform process in New Zealand throughout the 1980s and 1990s. Based on the social security system, the social wage encompasses a wide variety of benefits, ranging from basic retirement income support (single age pension), rent assistance and working family supports to the reinstitution of Medicare. Under the Accord, the social wage, along with tax cuts, was adopted by the ALP as the primary compensation for the decline of real wages for the labour movement. During the initial period between 1983 and 1985, most increase in the social wage came from the reinstitution of Medicare, but later the government significantly increased the social wage through increased means-testing and raising benefits at the bottom, especially family benefits (Swank 2002: 240; Schwartz 1998: 269; Watts 1989: 117-118; Whiteford 1994: 242-243). While real wages declined considerably during the Hawke and Keating period, the social wage went up. These changes in the social wage cushioned the newly unemployed, facilitated the activation of women and part-time work, and facilitated the combining of family and work. The bulk of the social wage under the Accord came to fruition as a result of increased employment, which, in turn, depended on moderation in the nominal wage, and this demonstrates the close connection between labour market activation and the Accord framework in Australia (Schwartz 2000: 117). In addition, as an adjunct to the social wage component of the Accord, the ALP actively encouraged the extension of community services on a means-tested basis, and the creation of social-wage related community services is one major area of innovation under the ALP. The reduction of social expenditure went hand in hand with the development of community services, which were distributed via the social
wage, so that those benefiting could receive a subsidized service (Carter 1993: 264-266, 276-277).

The preference for changes in means-testing as the principal method of controlling social expenditure as well as redistributing social justice is a key characteristic which distinguished the practice of the Australian social democrats from that of their centre-right predecessors. The previous Coalition government under Fraser attempted to control costs mainly by directly letting the level of benefits fall across the board. By contrast, the ALP achieved most of the efficiencies not through direct cuts in benefits but through adjustments to means-testing rules. In principle the government had three options in restraining social expenditure: cutting benefits; tightening means-testing, and redefining the categories of recipients in order to reduce the number of claimants. While it made use of all three methods, the ALP relied most heavily on the third one. The previous Coalition government removed the indexation of unemployment benefits in an attempt to save costs, but after the Hawke government came to power, it not only restored the indexation of unemployment benefits but also prioritized increases in non-indexed benefits. Under Labor, the actual level of unemployment benefits in fact rose for most categories, although accompanied by increased targeting (Saunders 2002: 226; Cass and Whiteford 1989: 285-286; 294-295; Gibson 1990: 195). Unemployment benefit payment to 18-20 years olds was one of the few examples where Labor directly introduced reduction in the level of benefits to welfare dependent groups, and this particular reduction was closely connected to the Hawke government’s efforts to activate the young unemployed (Jones 2002: 22-23).
One crucial characteristic of means-testing under the ALP was that targeting did not imply restricting benefits always to the worst-off. On the contrary, targeting often meant both selective cuts and increases, accompanied by the development of new programs and expenditure. The main target of targeting was the middle and higher levels of income earners. While significantly removing its financial support for generalist and broad programs, the government clearly targeted its resources on those most in need (Gibson 1990: 195; Cass and Whiteford 1989: 285-286; Beilharz et al. 1992: 123). It was precisely on this basis that the government started to means-test child allowance, up till then the only universal cash benefit program in the country. Similarly, given the very high (80 percent) level of home ownership in Australia, the criteria in asset tests for the aged pension excluded the ownership of family home from the test. On the one hand, it is true that a vast range of means-testing was introduced; on the other hand the cut-off point for targeting remained generous. Greater targeting in unemployment benefits as well as benefits for low income families all followed this logic (Castles and Pierson 1996: 239-240; Gibson 1990: 195).

Under the ALP government, tightened restrictions on eligibility for benefits often went hand in hand with improvements in the adequacy of social provision, such as modest increases in levels of benefit payment in order to maintain a basic level of social security and protection from poverty. This process of tradeoff was clearly facilitated by the Accord framework (Cass and Whiteford 1989: 277-278; 298; Pierson 2002: 8-10; Whiteford 1994: 244-245). In order to improve social security provision, Labor met its commitment to raise the single age pension to 25 per cent of total average male weekly earnings and substantially increased the maximum level of rent assistance. Between 1983 and 1986, the government
had no significant results in combating child poverty, but after 1987, there had been
significant policy changes, especially the changes to Family Allowance. This universal
program was transformed into means-tested Family Allowance Supplement (FAS), which
involved both higher levels of payment and eligibility requirements. The government later
considerably improved the real value and relaxed the means-testing of FAS, and indexed
child payments against inflation. Hawke increased payments to sole parents substantially and
introduced Child Support Scheme. Overall, as a result of the ALP’s anti-child-poverty
strategy, there had been substantial increases in benefit payments for families with children.
Under the previous Coalition government, the real value of payments to low income families
with children declined significantly. By contrast, the ALP gave highest priority to
amelioration in this area. There was also an attempt by the government to restore women to
equal status in pay (Castles and Pierson 1996: 239-240; Whiteford 1994: 244-245; Gibson
economic (and employment) growth was not compromised, the ALP tried actively to remove
the poverty trap, with the major beneficiary being families with children in poverty. At the
same time, tightened eligibility requirements for receiving social security were imposed on
many other groups. Compared with its New Zealand counterpart, the ALP both used tighter
targeting and offered greater compensation for the worst-off groups (Hemerijck and Schludi

In financing the welfare state, Hawke tried to rely less on income tax and more on
increasing the contribution of sales tax, the rationalization of tax rates, and the widening of
the tax base to include both capital gains and fringe benefits. The changes brought by the
ALP’s tax reforms were greatest for those at the top and bottom of the income ladder, while most of the cost was borne by those in the middle (Davis 1989: 100-103; Pierson and Castles 2001: 9-10). The progressive nature of the government’s tax reforms is also demonstrated by the introduction of capital gains and fringe benefits tax, against the opposition of the Coalition parties (Castles 1994: 137). Compared with other countries, private provision is a very important part of social security for the aged in Australia, centred on homeownership and the accumulation of property assets (Castles 1997: 117). On the one hand, it is true that reductions in marginal tax rates mostly benefited higher earners, and social expenditure in general was successfully curtailed, something which the Coalition government failed to do. On the other hand, there were also taxation measures under the ALP which were clearly aimed at reducing the advantages for higher income earners, such as taxation on lump sum Superannuation payments and asset tests on pensions. From this perspective, the ALP had a stronger, and more effective, commitment than the Coalition government to both free market and social justice (Graycar and Jamrozik 1993: 121). Under the ALP, inequality increased among full-time employees, but the position of the worst-off was not very adversely affected. By the end of the 1980s, poverty had fallen substantially and living standards increased. The burden in economic and welfare restructuring was primarily born by middle income earners, and the government was successful in protecting the most vulnerable from the impact of the reforms. The restructuring of welfare distribution under the ALP was based on an idea of “asset-based egalitarianism” which was very compatible with the means-tested and small Australian welfare state where the level of homeownership is very high by international standards. Based on this principle of asset-based egalitarianism, the ALP government tackled
inequality through enhancing social capital and skills for active participation in the labour market, rather than through the redistribution of resources alone (Castles and Pierson 1996: 240; Pierson and Castles 2001: 13; Whiteford 1994: 251).

**New Zealand**

*Active Redistribution of the Passive Apparatus*

Compared with other cases of third way reforms, the process of socioeconomic reform under New Zealand Labour has been unique in that both the labour market and social security domains were very much subordinate to the deregulatory reforms taking place in the economic domain. Because of the intensity and scope of liberalization in economic policy, changes to the social security system (as well as to the labour market) were kept at a minimum in order to dampen the immediate social impact of economic reform as well as preempt any backlash from Labour’s core constituencies. As a matter of fact, members inside the parliamentary Labour Party who were concerned with the speed of deregulatory reform in the economic domain explicitly mobilized their efforts to ring fence the social security system from the Treasury’s neoliberal reform agenda, by commissioning a series of reviews devoted to social issues (O’Brien and Wilkes 1993: 35). For this reason, under New Zealand Labour, direct changes to the social security system were limited. The main changes to the New Zealand welfare state during this period were delivered as a byproduct of the economic liberalization reforms, that is, through a series of significant changes to fiscal welfare.

Because of limited ambitions to change in this area, the only clearly set out objective in Labour’s perspective on the New Zealand social security system was cost control.
However, because of pressure from inside the party as well as potential backlash from the economic changes, Labour avoided a full-scale reduction in benefits, and the guideline was instead to “do more with less”, with greater targeting as the main policy measure in achieving cost control. Under Labour, changes in social expenditure were soon superceded by changes to the title and structure of benefits. During Labour’s tenure in the 1980s, there was no significant change in the aggregate level of social spending, but there were significant changes in the functional categories to which spending were directed. The proportion devoted to welfare benefits increased, primarily at the expense of spending on industrial or producer assistance, in line with Labour’s deregulation and privatization reforms in the economy (O’Brien 1993: 14, 25-27; Castles and Pierson 1996: 241; Rudd 1990: 87-88).

In addition to greater targeting and decreasing generosity for the state pensions, the value of universal child benefits was allowed to decline, but increasing family poverty also led to new targeted benefits for families. After 1987, the government also substantially increased the levy for the insurance-based accident compensation. The area experiencing the most significant move from universal to targeting was family assistance, where between 1984 and 1991, New Zealand moved from a fully universal to fully targeted system, through the introduction of Family Support and Guaranteed Minimum Family Income (McClure 1998: 216-218; Mackay 2001: 81-83). Labour went into the 1990 election proposing a single basic rate for all benefits except superannuation. Had this new basic rate been implemented, it would have meant substantial reduction in benefits for many types of recipients (Castles and Pierson 1996: 241; O’Brien 1992: 159; O’Brien 1993: 24-25). Alongside greater targeting and reduction in benefit rates, there was a shaper growth in second-tier supplementary
assistance programs, which grew almost eight times between 1985 and 1990 (Mackay 2003: 81-83).

Overall, Labour carried out reforms on the social security system not through directly cutting social expenditure, but indirectly through widening the tax base, and the introduction of indirect consumption tax helped increase government revenue despite lower taxes on income. The indirect fine-tuning of the social security system through the fiscal welfare accelerated significantly during Labour’s second term in office, when the government formally shifted the focus of its reform from radical deregulation to an overhaul of the taxation system. Labour attempted to integrate the taxation and benefit systems, and shifted the adjustment of benefit rates from 6-monthly to annual basis (O’Brien and Wilkes 1993: 67, 77). In its second term, Labour introduced a comprehensive GST of 10 percent, sharply reduced marginal personal taxes, flattened the tax scale, and introduced taxation surcharge on superannuation. Traditionally New Zealand combined internationally low level of overall taxation with high rates of personal tax, but since the tax reforms started in 1986, the system has been radically transformed. The tax scale was reduced from a five step scale to a two step scale. The progressiveness of income tax was sharply reduced with cuts to marginal tax rates in 1988. Meanwhile, the GST was increased to 12.5 percent in 1987. The regressive nature of these reforms meant that high income earners, those in the top quintile, had a significantly greater increase in their income than lower income earners at the lowest quintile, and the most significant improvement in economic position was concentrated in the top quintile (O’Brien 1992: 152-154; Shannon 1991: 12, 17, 18; Castles 1994: 134).
As a remedy for the regressive nature of its reforms in the tax system, Labour introduced increased targeting and other minor changes in the social security system to ameliorate the impact felt on the low income earners. Increased targeting, meanwhile, also served as a way of cost control. Traditionally, social expenditure in New Zealand was heavily dominated by payments to the universal superannuation that was funded by general taxation. By the early 1990s, however, this domination was significantly lessened by sharp reduction in tax rates and the introduction of superannuation surcharge. Also important was the introduction of Family Support, an income-tested refundable tax credit, which replaced both child supplement and family care benefits. The changes to the social security system through targeting as well as fiscal welfare under the fourth Labour government clearly influenced the trajectory of social security reform under the National government in the 1990s. With greater reliance on regressive indirect taxes such as the GST and a substantially flattened direct income tax scale, it became easier for the Nationals to defend its own policy of massively increasing targeting in the social security system (Boston 1999: 9; Hawke 1992: 442-443; Rice 1992: 485-486).

In a clear contrast to Labour’s awkward balancing act between economic rationalism and social amelioration, the Nationals did not have any serious concern about retaining working class votes, and the National government extended the neoliberal reform firmly into both the social security and industrial relations systems. In a decisive break with the incrementalist style of Labour in social security, there was now rapid and radical retrenchment of the welfare state. The first priority of the incoming National government was budget consolidation, and very sharp cuts in benefits were introduced, which forced people
into employment. The primary purpose of this exercise was to control cost instead of encourage labour market activation. At the same time, the National government also massively increased the extent of means-testing and introduced market principles into the provision of social services (Hemerijck and Schludi 2000: 193-195; Schwartz 2000: 88). While there was some redistribution of benefits to the poorer, the actual spending per recipient declined for most categories. Because the Nationals’ core constituency was increasingly rural and consisted of the elderly and the less educated, the redistribution through targeting was first and foremost towards the elderly and non-earners, and only secondly towards low income earners. The group that was particularly left out was low income family households (Shannon 1991: 17).

The neglect and then decline of the social security system under New Zealand Labour (as well as the succeeding Nationals) is related the general absence of the social wage mechanism, which was used as a powerful instrument in Australia to compensate for the impacts of economic liberalization through the social security system. The absence of the social wage in New Zealand was itself a consequence of developments in the industrial relations domain, when the state in New Zealand, in a drastic contrast to the Australian Accord, retreated from wage-fixing procedures. By the time of the 1991 Employment Contracts Act, which terminated arbitration, the wage earners’ welfare state in New Zealand in effect came to an end. With any connection between social protection goals and wage fixing now severed, there was no longer any reference to the social wage. Wage fixing now strictly reflected market realities. The informal, but historically important, part of welfare state in New Zealand more or less disappeared. Social protection was now delivered through
either formal welfare or, increasingly, fiscal welfare in the form of tax credits for low-income workers. The role of fiscal welfare was expected to grow considerably, given the trend towards increased targeting and reduction in benefit levels in the social security system. Fiscal and occupational or private welfare added considerably to the volume of welfare benefits for the New Zealand population (Mackay 2003: 108; Shannon 1991: 13). Meanwhile, what limited redistribution there was in social security was overwhelmingly cancelled out in fiscal and private welfare.

**An Overview: Active Redistribution and Retrenchment of the Passive Apparatus**

*Active Redistribution of the Passive Apparatus*

None of the successful labour market activation countries examined have introduced wholesale retrenchment to the passive apparatus of their social and labour market policy package. On the contrary, some, such as the Netherlands and Denmark, still have a social security system which ranks among the most generous in delivering de-commodifying benefits in the OECD, whereas others, such as Australia, continued to expand social protection throughout the period of third way reform under the ALP. In the Nordic countries of the 1990s, the social democrats had typically tried to restrain passivity by tightening eligibility and limiting benefit duration while at the same time keeping the replacement rates very generous. In Sweden and Norway, the governments continued to increase entitlements in the social security system late into the 1980s. Meanwhile, welfare expansion increasingly served social democratic gender egalitarian purposes such as parental insurance and increase
in public sector service jobs. The pure extent of retrenchment to the social security system seems to have little association with the effectiveness of third way activation, and instead, seems to be related to unemployment. Here, the association is more in the rapidity of rise in unemployment than in the absolute level of unemployment. Since the late 1980s, within the social democratic welfare regime the rapidity of rise in unemployment was much more serious for Sweden than for Denmark and Norway. Correspondingly, larger cutbacks occurred in Sweden. However, as the fiscal and economic situation of the country started to improve, the social democrats all made efforts to restore some of the cuts, in Sweden as well as in other Scandinavian countries (Lodemel 2001b: 299; Huber and Stephens 2001: 301; Scharpf and Schmidt 2000: 335; Kuhnle 2000: 211-213).

True to traditional social democratic principles, most of the third way social democratic governments examined in this book have demonstrated clear concern about social protection and reluctance to reduce the generosity of the welfare state, unless absolutely necessary. While the social democrats increasingly share with the centre-right the belief in moving people from welfare to work, the social democrats are much more in favour of working directly through the expansion of active labour market programs, paid by the state. The centre-right parties, on the other hand, are comparatively more in favour of dismantling the passive apparatus while keeping a minimum presence of the state in the active labour market measures. For example, across different welfare regimes, countries including Britain, Norway, Sweden, and France all experienced decline in the generosity of unemployment benefits during the period of governments by the centre-right, then significant increases in generosity after social democrats took over the rein of government (Wren 2001: 254). While
New Labour still prefers to reduce minimum benefits to a level lower than the minimum wage in order to increase the incentives to work, the Scandinavian countries have combined high levels of benefits with labour market programs that have a strong emphasis on rehabilitation, and these two alterative strategies seem to have both delivered the desirable results so far in terms of labour market participation. For most countries examined, cuts to parts of the existing passive apparatus were accompanied not only by compensatory expansion in other parts of the passive apparatus but also, more importantly, by expansion of the active apparatus in an attempt to promote employment. The extent of these changes tended to fluctuate with the current unemployment situation, as the Norwegian case clearly demonstrates. These retrenchments, therefore, were primarily unemployment-driven and were applied as a strategy to promote labour market participation.

Compared with their counterparts in the liberal and Scandinavian welfare regimes, the social democrats on the continent (other than the PvdA) have been less inclined to reform the unemployment benefit system, including both the insurance and the assistance part. Even the Socialists’ introduction of RMI into the social assistance tier in France was noted more for the laxity of its reinsertion principle than for anything else. In addition, the attempt by the German SPD to reduce social security contribution for low paid workers were thwarted by resistance from unions, whose primary constituency was the normal pay core segment of the labour market. Not surprisingly, these failures are closely related to the contribution-based (and hence prone to proprietary claims by the beneficiaries) benefit structure, which, compared with the Anglo-Saxon systems, relate social security benefits much more closely to previous earnings for a much larger group of claimants. The stalled reforms in continental
welfare regimes are also closely related to the strength of the social partners, especially the unions, who are deeply involved in the management of unemployment benefits. In France, the unions are weak, but highly particularistic and fragmented, which also posed obstacles for reforming the social security system (Bonoli 2004: 203; Bonoli and Sarfati 2002: 478; Clasen et al. 2001: 208). The exception to these cases of largely failure is of course the PvdA, which was able to push forward far-reaching reforms based on the Wassenaar framework precisely because the dynamics of power balance were very much shifting away from the unions.

Increased targeting is a widely used policy instrument by the third way social democrats to reduce the passive influence of social security benefits, but in some instances the social democrats applied this instrument from the top in order to exclude the best-off, as in Australia, in other instances it is applied from the bottom in order to retain the worst-off, as in Britain under New Labour. For the third way social democrats, one of the most important ideological justification for targeting is its redistributive effect in favour of the worst off. Many of the measures involving increased targeting started off by introducing means-testing to formerly universal benefit. As a general strategy, appropriate targeting should have the potential to achieve both equity and efficiency goals, if the coverage is reasonably wide, and if stigmatizing surveillance and intrusion into personal life for the purpose of means-testing is avoided in favour of the more discrete method of delivering benefits through the tax system. The largely successful experience of increased targeting under the Hawke and Keating governments is a case in point (Esping-Andersen 1996: 262-263; Gilbert 2002: 143-144; Timonen 2003: 145, 177, 179; Cox 2004: 210; Bonoli and Palier
2000: 342). In continental countries, on the other hand, increased targeting is not immediately feasible because of the contributory base of the social security system, so the continental European social democrats chose the alternative of reducing the generosity of the original calculation formula for benefits but letting the impact of this change reach everybody (Ferrera and Rhodes 2000: 5-6). In order to somewhat cushion the worst off, a basic minimum tier was sometimes erected in the continental social security systems (such as the basic pensions in Germany and France), which was means-tested from the bottom.

Because of their original design as the last line of defense in terms of minimum income provision, the social assistance programs generally become subject to work conditionality very late, and because of its newness, the incorporation of activation principles into social assistance measures has come to represent the cutting edge of today’s third way reforms in the domain of the passive apparatus (Trickey 2001: 258; Handler 2002: 25). The exception to this is of course the RMI, which was introduced as early as 1988 and was in theory the first major attempt to combine social assistance and activation, through the principle of insertion. However, as the case study has shown, through lax enforcement the RMI has in effect served mainly half of its original objective (that of a basic income guarantee, which did not exist in France before 1988), and had very little substance as a functioning active labour market policy package. Among the social democratic governments examined, the general pattern with regard to welfare financing for the purpose of labour market activation is a gradual shift in financing burdens away from the employers, to both the state and the employees. This is achieved through social security contribution reductions for the former and corresponding increases in contribution from the latter two groups.
However, these changes are taking place in the as yet unchanged overall context of high levels of public welfare financing (Daly 2001: 94; Kautto 2001: 252-259; Kautto et al. 1999: 28). More importantly, although reducing employer contributions helps encouraging employers to hire, without a reduction in the total level of social contributions, the shuffling of contribution between employers and employees cannot effectively reduce non-wage labour costs.

Retrenchment of Early Exit Pathways

For most of the social democrats under examination, their first response to the unemployment problem of the 1980s involved an intensification of instruments to clear the labour market through various early exit pathways, a reaction somewhat understandable given the immediate (but short-term) effect on unemployment rate that can be produced by a reduction in the labour force. Precisely also because of their quick effects, these instruments of temporary labour force reduction tend to become permanent and remain in the system. This problem is most severe in continental welfare regimes because of the contributory nature of the social insurance system as well as the deep involvement in joint benefit management by social partners. Into the 1990s, these labour-market-clearing methods proved not only completely incapable of dealing with the scale of rising unemployment but also detrimental to labour force participation. Although generally ineffective in the long run, the Danish version of leave schemes with an enabling bent, such as sabbatical, educational, and parent leave schemes, did have more merits than the Dutch and German practice of straightforward and permanent labour shedding (Green-Pedersen et al. 2001: 314; Hemerijck
and Schludi 2000: 214). Nevertheless, since the early 1990, all the social democratic governments made some attempts to close off these early exit schemes.

Despite this very strong similarity in past history and principle of action, the results of the social democratic attempt to stop early exit have been high varied. This performance varies by welfare regime, but also varies massively within regime. While the Scandinavian and liberal welfare regime social democrats were generally more successful than most of their continental counterparts, the PvdA stands out as the biggest achiever of all, when the criteria is the extent of change (but not absolute level). Next to the top performing Netherlands, the second tier active ageing governments were the Danish, Swedish, and German social democrats. On the other hand, the French socialists ranked among the worst-performing governments in terms of active aging (Foden and Jepsen 2002: 454-455).

By the end of the 1990s, while both France and the Netherlands had been traditionally known for their early exit culture, the former retained that dubious reputation whereas the latter had been comparatively more successful in combating early retirement. The PvdA has, like most well-performing third way governments, successfully made the transition from the principle of collectivity and social rights to that of duties and individual incentives. Because of this emphasis on individual duties (as well as rights), the PvdA has emphasized incentives and disincentives in its attempt to close the early exit pathways and individualized the decisions about early exit. By contrast, just as the RMI under the Socialists were used mostly as a social assistance scheme with little employment consideration, the party’s efforts to close early exit pathways have been marred by the disjunction between social and labour
market policy arenas, and the strategies adopted have been limited to attempted reforms in the area of pensions (de Vroom and Guillemard 2002: 198-201).

Despite the variation in performance among different social democratic governments, their efforts to close the early exit pathways also suffer the common problem of collusion by social partners to continue these pathways in a forum which is beyond state intervention, usually in the form of supplementary schemes. With regard to early retirement schemes, intervention by social democrats to close them tends to be neutralized as collectively negotiated early retirement schemes on the company level rapidly step in to fill the void. A very similar pattern occurs with regard to disability benefits, as private employer insurance has continued to keep the option open for early exit to remove redundant workers. This process takes place despite the painstaking efforts by the social democratic governments to restructure the administration and entitlements of the benefit on top of offering various financial incentives to keep older workers in employment. In a pattern similar to the introduction of greater flexibility into the labour market, efforts to close the pathways towards early exit are most difficult where it is most needed, in continental welfare states which are saddled with both a contributory security system prone to cost externalization and an array of social partners strong in their political influence and persistent in their continuing desire to collude and offload the cost of economic adjustment onto the state. Social democratic attempts to close off early exit pathways are likely to remain largely ineffective as long as the social partners take advantage of their involvement in benefit administration and neutralize government cuts in early exit pathways by filling the void with voluntary early exit schemes (Ebbinghaus 2000: 536, 539, 547; Hassel and Ebbinghaus 2000: 80-81). In
contrast to other policy dimensions such as unemployment benefits or pensions, pathways towards early exit is one area in continental welfare regimes where there is highly consensual corporatist practice between the social partners, but for the wrong reasons. The success of the PvdA to rein in the disability benefit scheme against this unfavourable background is related to the fact that, when the old administrative institutions were dismantled to make way for independent governing bodies, both sides of the social partnership were removed from benefit administration.

All these diversities in policy instruments and implementation in reforming the passive apparatus of social protection clearly reflect the path dependency on existing institutional contexts, the key determinant factor in the new politics of the welfare state literature. However, patterns of policy changes in the passive apparatus continue to reflect the influence of partisan colour of government. Compared with the active apparatus, the difference between social democrats and the centre-right parties in reform strategies for the passive apparatus is noticeably smaller. In the context of permanent austerity, parties from both the centre-left and the centre-right have attempted to control social expenditure, retrench elements of social security (especially early exit pathways), and remove potential work disincentives in income replacement programs. On the other hand, however, differences between party families continue to manifest themselves in changing the passive apparatus, particularly in terms of differing emphases and purposes served in the policy changes. Tables (4.1) and (4.2) summarize the main findings from the case studies in this chapter in support of the power resources logic of welfare state reforms.
With regard to the part of the passive apparatus where the status of loss in earning power is sustained through income replacement (especially unemployment benefits), the primary strategy under social democratic governments has been active redistribution. This is a combination of continuing redistribution towards those in the greatest need on the one hand, and removing work disincentives to align income replacement programs with the purpose of labour market activation on the other. While the centre-right parties are similar to their social democratic counterparts in making clear attempts to reduce work disincentives in income replacement programs, the purpose is more for simple cost containment than for labour market activation. The narrow centre-right focus on cost containment also means that, compared with their social democratic counterparts, there is less emphasis on continuing redistribution in the process of reforming unemployment benefits. In evidence of this contrast in policy purposes, while the social democratic reforms of the passive apparatus have been tightly integrated with corresponding expansion in the active apparatus (as seen in the last chapter), centre-right changes to the passive apparatus have been largely decoupled from active labour market purposes, given that the active apparatus has been under noticeably less expansion, if not rollback, under centre-right governments.

This contrast in policy emphasis between activation and cost control is manifest in how the two types of governments tried to restrict unemployment benefits. While the centre-right governments have emphasized cuts in levels, their social democratic counterparts favoured cuts in duration, given that short but generous benefits actually provide additional incentives for individuals to find suitable jobs and reduce the potential for structural unemployment. Whereas mainstream economics literature emphasizes the potential
reservation wage effect and work disincentives in generous unemployment replacement, stratification research in institutional mobility regimes such as education or the welfare state (Gangl 2004; DiPrete and McManus 2000; DiPrete 2002) highlights the “scar effects” of unemployment spells on individual life courses, whereby a trigger event such as loss of a job can lead to accumulating deterioration in economic status as well as capacity to recover from career interruptions. The institutional mobility regime of welfare state transfers can reduce such scar effects, not only through short-term income compensation. More importantly, it also contributes to long-term unemployment recovery by serving as an incentive for private risk taking, so that during brief unemployment spells individuals are more likely to conduct adequate job searches and locate the jobs which match their skills. In general, unemployment replacement is an important form of social insurance for long-term investment in especially asset-specific high skills (Iversen 2005). Generous unemployment replacement can encourage labour market participation, and it is primarily the persistence in such cash transfers that has the opposite effect.

Partisan difference in reform strategies is also found in changes to early exit pathways, the passive apparatus where the status of loss in earning power is actually created during the process of income replacement. Here, both social democrats and the centre-right parties have adopted a strategy of retrenchment for these early exit pathways. However, as Table (4.2) indicates, with such retrenchment the social democratic objective is more focused on reducing enrollment and promoting labour market activation, whereas their centre-right counterpart is more on, again, cost containment. As a result, while the social democrats put more emphasis on restricting eligibility to these programs, the centre-right parties have put
relatively more emphasis on reducing expenditure in these programs. Examinations of changes to both unemployment benefits and early exit pathways lead to the same conclusion. Again, as is the case with changes in the active apparatus, the influence of political agency continues to emerge, against the path dependent institutional constraints, in the fundamental logic and purpose of reforms in the passive apparatus of social protection.

Table (4.1) Variation in Changes to Unemployment Benefits

<table>
<thead>
<tr>
<th>Fundamental Logic</th>
<th>Social Democrats in Power</th>
<th>Social Democrats out of Power</th>
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<tbody>
<tr>
<td>Evidence</td>
<td></td>
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<tr>
<td></td>
<td>Active Redistribution</td>
<td>Cost Containment</td>
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<tr>
<td></td>
<td>Aligned with Labour Market Activation</td>
<td>Decoupled from Labour Market Activation</td>
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<td></td>
<td>Emphasis on Cutting Benefit Duration</td>
<td>Emphasis on Cutting Benefit Levels</td>
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<td></td>
<td>Removing Work Disincentives</td>
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<td>Social Democrats in Power</td>
<td>Social Democrats out of Power</td>
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<tr>
<td><strong>Fundamental Logic</strong></td>
<td>Labour Market Activation</td>
<td>Cost Containment</td>
</tr>
<tr>
<td><strong>Evidence</strong></td>
<td>More Emphasis on Reducing Eligibility</td>
<td>More Emphasis on Reducing Expenditure</td>
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<td></td>
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<td>Retrenchment</td>
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Chapter V

ECONOMIC AND INSTITUTIONAL CONTEXT FOR THE THIRD WAY

Third way reforms involve expansion in the active apparatus of the social and labour market package as well as active redistribution and retrenchment in the passive apparatus. No matter whether it is expansion, active redistribution or retrenchment, all these changes more or less serve the common purpose of facilitating the entry into the labour market for the unemployed as well as non-employed. This common characteristic leads to a common vulnerability for most third way measures: apart from the measures to introduce further flexibility into the labour market as well as the subsidized or government jobs, few of the policy instruments involved in the third way are actually capable of creating more jobs from the demand side. Therefore, the effectiveness of labour market measures tends to depend very heavily on the demand situation in the job market, and on the situation of the economy more generally. As investment and economic growth slacken, third way measures become much less successful in moving people into jobs, simply because there are fewer jobs around. This is also what was demonstrated in the case studies earlier, especially with regard to the evaluation of ALMPs. Therefore, in addition to the core third way strategies of expansion, active redistribution and retrenchment, effective third way reforms usually require a robust
economic context where there is strong competitive edge, investment and growth, so that a reasonably high level of demand side job creation can be maintained to make the third way core strategies viable.

The concern to keep job creation on a high level in order to sustain the third way core strategies is the fundamental reason behind the almost uniform turn to economic prudence and anti-inflationary stance for all third way social democrats. One the one hand, since the early 1980s OECD economies have been gradually undergoing the transition to a postindustrial service structure and the concomitant decline in core manufacturing industries. On the other hand, the gradual internationalization of economy, especially finance, has made devaluation or lowering of interest rates nonviable options to stimulate the economy in the manufacturing sectors. The pressure against such traditional monetary or fiscal stimulants was particularly strong for the European countries because of the additional constraint of the Stability and Growth Pact and conservative monetarist policy of the European Central Bank. Therefore, the options for stimulating the economy and jobs were narrowed down to the practice of wage moderation within an overall economic policy framework of sound budget and anti-inflationary stance. Here, it is important to emphasize that the key external momentum is really the internationalization of finance, rather than that of production or trade, which has been very integrated internationally and historically for a lot of third way countries under examination, especially those Northern European economies (Huber and Stephens 2001). On top of this structural reason, it is also important to take into consideration the factor of credibility when examining social democratic changes in economic policy. For many of the social democrats studied, at some point or other they had gone through a galling
experience during the late 1970s and early 1980s with Keynesian demand side attempts to wrestle with stagflation, which, in retrospect, unsurprisingly ended in failure. Therefore, after a period of in some cases sustained opposition, the social democrats new in government were all the more eager to disassociate themselves from this ill reputation of economic irresponsibility.

Whatever the motive, the uniform turn to a balanced budget and wage moderation as the macro context for the third way introduces further complications for the social democrats. The maintenance of a sound budget is more or less a fiscal or monetary policy issue, which is discussed and hammered out within the more isolated circle of the treasury or the central bank. The maintenance of wage moderation, on the other hand, is an incomes policy issue in the industrial relations domain, and therefore often cannot be properly settled without heavy involvement from both sides of the social partnership: the employers and the unions. Actually in some of the countries covered in the book, especially the continental European ones, there is such a high degree of social partnership autonomy in wage awards that the state by convention does not directly intervene, such as the Tarifautonomie principle in German industrial relations. Therefore, the quest for wage moderation as an economic context for the third way leads to the quest, in most cases, for strong corporatist relationship between the social partners in wage bargaining, which, in the traditional scenario, will be collective bargaining with highly centralized coordination. However, as the case studies will show, there are other possible scenarios for a strong corporatist practice. In addition, the quest for wage moderation can also be fulfilled in some cases even with an absence of corporatist structure, on condition of a weakened and uncoordinated union presence (such as in Britain),
but this is very much the exception rather than the norm. For most third way social democrats, therefore, the macro context for third way is both economic (budget and wages) and institutional (corporatism). The role of corporatism, though most crucial in incomes policy, extends well into the domains of social and labour market policy, such as pensions or unemployment benefits. Therefore, the resistance of social partners, especially unions, to social democratic reforms can not only damage the macro context for effective third way reforms but also directly hamper core third way strategies, such as attempts to reform the unemployment benefit system or increase flexibility in the labour market. For this reason, this chapter not only outlines the economic and institutional context for the third way, where necessary it also examines the implications of corporatism for core third way strategies in both the active and passive apparatus. As the case studies in the chapter will show, in the absence of healthy corporatist institutions or practice, third way reforms by the social democrats have mostly turned out to be limited and ineffective. In addition, although the third way social democrats examined in this chapter generally stuck to economic prudence, within this cautious economic framework they also tried to cushion the effect of economic adjustment for the worst off. The increased savings in the economy as a result of prudence were channeled into new public expenditures in both social and ALMP measures, as well as being used to pay off the national debt. To borrow a phrase from one of the most prominent third way finance ministers Gordon Brown, what the third way social democrats attempted to achieve was “prudence with a purpose”.
Denmark

Prudence with a Purpose: the Economic Context

While the bourgeois government had only very limited success in reforming the Danish welfare state, it did score a major achievement in shifting Danish economic policy from demand side prescriptions of the 1970s to largely supply side measures. Since the early 1980s, the bourgeois government had followed a “norm based” economic policy in Denmark, which involved a hard currency, low inflation and a tight fiscal policy (Jochem 2003: 131; Goul Andersen 2000: 73; Torfing 2001: 299). After returning to power in 1993, the Danish social democrats continued to work within this primarily cautious policy framework. While the fiscal policy remained slightly expansive, supply side measures were largely used in preference to demand side measures, and the social democrats continued with the previous government’s strategy of sound budget, fixed exchange rate, low interest rate, and stable price and wages (Torfing 1998: 252). However, compared with their bourgeois predecessors, the social democratic strategy was towards a slightly more Keynesian direction, because the growth of employment was now promoted not only through sound budget but also through a series of active labour market measures which involved demand side job creation and other employment subsidies. In addition, the social democrats also integrated a series of tax reforms into its general economic policy strategy as an instrument to stimulate employment (Hemerijck and Schludi 2000: 182-183). On the one hand, the social democrats continued to pursue fiscal consolidation as a first priority, on the other hand it also actively used fiscal policy, especially taxation changes, to smoothen the economic cycle. Started in 1994, the reforms to the taxation system were designed to be expansionary during the first year and
revenue neutral afterwards. Faced with rapidly rising unemployment after they came to power, the social democrats first tried to kick-start the economy in 1993 with a lowering of marginal tax as well as taxes on corporate and capital income. The tax reduction was largely financed through a broadening and greening of the tax base. For this reason, the economic upswing in 1993 was a typical demand driven growth. Later the social democrats also used fiscal policy to perform a successful soft landing of the Danish economy in 1998 with lower personal income tax as well as the scaling back of interest deductions on loans and mortgages from tax income. In addition to stimulating the economy, the tax reforms also worked together with expansion in private and public labour market pensions to boost saving incentives, which further contributed to moderation on the wage front (Green-Pedersen 2001: 9; Green-Pedersen 2002: 124; Benner and Vad 2000: 447; Madsen 2004: 200).

In a break with traditional Danish mode of tax-based welfare financing, the social democrats introduced a new social security contribution earmarked to finance active labour market programs, unemployment insurance, and sickness benefits. Collected as a proportional tax on gross income from work, the new social contribution was imposed on both employees and employers. The government targeted the levy overwhelmingly at the employees. The starting contribution rate for employees was 5 per cent and by 1997 increased to 8 per cent, whereas for employers the rate was merely 0.6 per cent of the gross wage by 1998 (Benner and Vad 2000: 447).
Wage Moderation and the Institutional Context

Since the paradigm-shifting reforms to activate the labour market started in 1994, the social democratic government had tried to strengthen the cooperation between the main social partners and the government in both policy formulation and implementation. This task was to some extent made easier by the fact that labour market policy in Denmark has had a long tradition of “free collective bargaining”: bargaining is carried out with strong involvement of unions and employers’ organizations. Social partners in Denmark have autonomy in negotiating a number of issues which in other countries would have been dealt with through national legislation, such as pensions, working time, and holiday entitlements. Both at the national and the regional level, labour market councils, dominated by representatives from both sides of the social partnership, play a very influential role in the formulation of labour market policy (Madsen 1999: 55; Lind 1999: 192; Larsen and Bredgaard 2004: 12). To further consolidate this corporatist trend, the government decentralized major budget allocations and policy implementation to regional institutions run by the social partners. The strengthening in the role of social partners, especially at the local level, is an important characteristic that both the Danish and Dutch approaches to labour market activation share, going against the international trend for a decline in corporatism (Etherington 1998: 148; Dahl et al. 2002: 39).

Since the 1980s, the Danish collective bargaining system has been gradually restructured. Partly, this development was in response to the norm-based economic policy framework adopted by Danish governments during the 1980s. The government used tight fiscal policy and low inflation to strive towards a competitive growth regime, under which
the most crucial condition for continued economic growth was wage moderation. On the other hand, the changes were also accelerated by organizational changes within the Confederation of Danish Employers, which was being increasingly restructured into five components on sectoral lines. Another contributing factor was that collective agreements at the industry level had gradually become framework agreements, whose details were actually worked out on the company level. Accordingly, local actors and tripartite regional councils saw their role increase (Lind 1999: 192; Wilthagen and Tros 2003: 17).

While there was gradual decentralization in the collective bargaining system, the extent of decentralization was moderate, because the main areas of labour market policy, and the collective agreements in particular, were still bargained at the national level (Lind 2000: 139; Wilthagen and Tros 2003: 17). What is more important, this decentralization in wage bargaining was at the same time coupled with a growing degree of national coordination by peak organizations for both the unions and the employers’ organizations. In the late 1980s and early 1990s, there was major organizational restructuring among the unions. After amalgamation and reorganization of bargaining units, union bargaining was consolidated into five major cartels, and this development further helped peak union coordination in spite of decentralization in wage bargaining. In other words, decentralization in the Danish context was primarily the shift from bargaining within peak associations to bargaining within the five cartels, each of which were coordinated to a sufficient extent to enforce wage agreement on subordinate unions (Cox 2004; Jochem 2003: 134). A similar trend of better coordination at the peak level was also in evidence among employers’ organizations.
Therefore, decentralization of the Danish bargaining system was combined with internal centralization, which helped both sides of the social partnership to bind their individual member and organizations to the negotiated agreement. The pattern of “centralized decentralization” characterized the development of industrial relations in both Denmark and the Netherlands, and it has clearly helped in minimizing wage drift and securing slower wage growth. By the end of the 1990s, both sides of the Danish social partnership still remained committed to this pattern of “centralized decentralization” in wage bargaining (Benner and Vad 2000: 440; Jochem 2003: 129-132). Fundamentally, the crucial condition for maintaining such a social pact in Denmark was the unions’ continuing acceptance of the terms and conditions of the competitive growth economic regime, especially wage moderation (Lind 2000: 155). In this respect, the active labour market reforms under the social democrats had been very helpful in consolidating the social pact. Unions regarded wage moderation as a necessary evil which was expected to lead ultimately to more jobs being created, so by massively reducing unemployment and increasing employment, the Danish active labour market reforms had made it easier for the unions to remain committed to wage moderation.

The contribution of the Danish corporatist framework to the third way reform has been important. In Denmark the “golden triangle” combining flexibility and security has been achieved not through direct legislation by the state but through negotiations between social partners within the corporatist framework. The collective agreement, rather than state labour law, was the key instrument in steering Danish social and labour market policies during the third way reform period. For this reason, the Danish model of flexicurity was one
of negotiated flexibility and protection (Madsen 2002: 263; Madsen 2003: 100-103; Wilthagen and Tros 2003: 16). Over time Danish unions and employers have formed an alliance strongly supporting each of the three components of Danish golden triangle. The united opposition of unions and employers to benefit cuts has provided significant protection for the unemployment benefit system from major retrenchment. In the early 1990s, the social democrats set up several consultative commissions as well as the tripartite Zeuthren Committee. With heavy input from both unions and employers, the recommendations from these consultative processes formed the major outlines for the government’s active labour market reforms throughout the 1990s, and on a local level labour market policy was planned by the regionally developed policy communities with broad participation. The sustainability of the Danish corporatist practice directly contributed to the long-term performance of Danish flexicurity.

The Danish case indicates that the institutionalization of policy implementation can sometimes dominate the policy design in terms of its importance to the success of labour market reforms (Larsen 2004: 4, 17; Madsen 2004: 205-206; Jochem 2003: 132). This also means that direct transportation of the Danish model to other struggling third way countries is not likely to be immediately successful, because in countries where the corporatist structure is not strong enough (such has in France) or has declined (such as in Sweden), flexicurity in the Danish style is not likely to be sustainable. What is more, the viable combination of high flexibility and high security in Denmark is also made easier by the predominance of small businesses in the Danish economy, a condition not necessarily met in many other country cases (Wilthagen and Tros 2003: 13).
**Sweden**

*Prudence with a Purpose: the Economic Context*

In Sweden, the concept of mixed economy, or socially regulated market economy, is long established and uncontroversial (Lindgren 1999: 48). By the early 1980s, the Swedish social democrats had adopted a “third road” approach to economic policy, by which the party hoped to draw some distance from both Keynesian reflation and monetarist austerity. The key components of the third road approach included wage restraint, curbs on public sector spending, and incentives for corporate investments, but the instruments used to kick start the strategy was really two devaluations of the Krona (one put in by the previous bourgeois government) which led to a substantial competitive edge for Swedish industries. Meanwhile the unions agreed to accept the decline in real incomes as a result of the devaluation (Benner and Vad 2000: 422; Huber and Stephens 2001: 242; Swank 2002: 134-135). The party hoped that various pieces of the third road strategy can work together to produce balanced economic growth and full employment, and until the mid-1980s, this policy package seemed largely successful, as Sweden experienced high growth, low inflation as well as low unemployment. However, since the mid-1980s the third road approach had ceased to be effective, as the desired effect of devaluations was diluted by insufficient wage restraint and low productivity growth in the economy. Meanwhile, slow growth in the economy had also limited the government’s ability to offer compensations on the social policy front in exchange for union cooperation in delivering wage restraint. Behind the growing economic problems lies the deregulation of capital market and the ensuing boom and bust in the real estate sector. In
addition, there was decreasing ability of the government to simultaneously use trade regulations and capital control to keep the budget in shape (Stephens 1996: 46-47; Huber and Stephens 2001: 250; Benner and Vad 2000: 419).

Despite the general failure of the Swedish third road economic policy, the party did manage to significantly reform the existing tax system in an attempt to improve economic efficiency without negatively affecting the financial foundation of the welfare state. Marginal taxes were lowered, deductions reduced, and the tax base broadened. At the same time, for financing of public policy, and the Swedish welfare state in particular, the secular shift from income tax to indirect tax continued (Hort 2002: 142; Hort 2003: 246-247). Shortly after the tax reform was put in place, however, the social democrats suffered a shock exit from office during the 1991 election. During the early 1990s when the social democrats were in opposition, on the one hand the party opposed the government’s scale back in active labour market measures, on the other hand it largely aligned itself with the direction of the bourgeois parties in economic policy. The party made clear in its 1994 shadow budget that while the unemployment problem had become desperately in need of attention, the party’s first priority back in government would be to keep the inflation low, and to combat unemployment the party was prepared to help create jobs in the private rather than the public sector. The party promised in opposition that it would restore public finance by decreasing welfare benefits. Once in government, the social democrats sought to develop stronger links with industry and commerce and tried to improve the conditions in which small companies could thrive (Gould 1996: 89; Gould 2001: 48; Hart 2001: 252, 258).
After returning to power in 1994, the social democrats were very successful in their objective to turn the Swedish economy around. Public confidence in the Swedish financial market was soon reestablished and deficit turned into surplus. After the government’s fiscal situation started to clearly improve around the year 1996, the social democrats started to increasingly balance their economic austerity with a strong concern for both social amelioration and labour market activation, and in order to achieve their objectives on the social and labour market front, the social democrats did not hesitate to commit vast amounts of public expenditure. By 1997 the social democrats had achieved a projected budget surplus by 1999, so the government prioritized social expenditure rather than lower taxes, with increased spending introduced for child allowances, student grants, education, and health (Gould 2001: 48, 52; Hort 2001: 258).

Wage Moderation and the Institutional Context

Unlike the situation in Denmark, the Swedish corporatist institutional context for wage moderation has been in clear decline for the past two decades. Since the 1980s, the employers’ organization the SAF had started to question the value of centralized bargaining, and the SAF rejected any further centralized bargaining, partly in reaction to the radical labour support for more equal distribution of wage in the 1970s, which as a result hurt the international competitiveness of Swedish businesses. Then, in 1983 the Swedish Engineering Employers’ Association took the first step to abandon centralized bargaining and concluded a separate agreement with the Metal Workers’ Union. Throughout the 1980s, collective bargaining oscillated between the central and sectoral levels (Schmidt 2000: 262; Lodovici
The stability of wage bargaining was declining, and the increasing use of legislation instead of voluntary agreement to deal with income policy issues further strained the relationship between the social partners. Increasing state intervention also indicated that the corporatist framework was no longer functioning properly (Benner and Vad 2000: 416).

Since the 1990s, a series of further changes made by both the employers and the bourgeois parties in government had contributed definitively to the decline of Swedish corporatism. In 1990, the SAF decided to terminate centralized bargaining, and in 1991, it decided to withdraw its representatives from the boards of all state agencies, especially the AMS, in protest at what it believed was the excessive domination of these institutions by the interests of the unions. In 1993, the bourgeois government formally marginalized the AMS committee members by giving them only a narrow supervisory role, and the government also removed the LO from the administration of unemployment insurance, a decision which had the potential to vastly reduce the influence of the labour movement over the Swedish social security system. Over the period of a decade, centralized bargaining had declined significantly, and the current situation is one of predominantly sectoral bargaining with coordination among the sectoral organizations of employers and unions (Dios 2002: 11; Gould 2001: 142; Lodovici 2000: 50).

Segmentation of the labour market during the transition to a postindustrial economy weakened the ability of the unions to coordinate their strategy. Meanwhile the dominance of the LO in the unions, as well as the dominance of the Metall-led private sector unions relative to public sector unions, was also declining (Huber and Stephens 2001: 251-254).
These factors working together weakened the peak organization’s authority to enforce agreement, and in the long run, prevented the design of a concerted strategy to deal with increasing decentralization. This development on the union side, of course, was in parallel to a growing willingness to mount challenges from the employers’ side, and consequently labour market issues between the social partners were increasingly dealt with in a confrontational manner, overshadowed by direct state intervention. In 1994, the bourgeois government sided with the employers in reforming the “last in, first out” (LIFO) principle regulating redundancy, so that employers could exempt two employees from the rule. Unions also saw their right of veto under the Co-determination Act and right to blockade small firms removed. These latest changes brought 30,000 workers onto the street in protest, and the cooperative relationship between unions and employers further declined (Gould 2001: 149).

After it returned to power in 1994, the social democrats attempted to resuscitate the corporatist practice, and the first decision taken with this purpose in mind was the restoration of the LO back to the administration of unemployment insurance. As a *quid pro quo*, the unions accepted a cut in replacement rate from 90 per cent to 80 per cent (Dios 2002: 12). The fact that the unions were willing to suffer cuts in benefits in exchange for their role in managing the unemployment benefit system shows the importance of administration privilege in social security for the labour movement. The Swedish pattern of tradeoff where benefit cuts were exchanged for the maintenance of administration privilege proved effective in securing the consent of social partners in social security reform: given that administration privilege tends to dominate other union objectives in social security, measures to retrench or restructure social security can be made less objectionable to the unions if the corresponding
compensation is to leave union management of social security intact. Despite the efforts of
the social democrats, no new corporatist institution or consensus has emerged in Sweden to
replace the collapsed system of centralized bargaining since the late 1980s, but the current
sectoral bargaining arrangement is still effective in delivering wage restraint. On the other
hand, the lack of social partnership cooperation implies that in some areas of labour market
activation it can become more difficult to put through reforms (Merkel 2001: 66). These
potential problem areas include not only flexibility of the labour market through easier hiring
and firing rules, but also parts of the social security system where the unions are deeply
involved, such as unemployment insurance or early exit pathways. And the actual experience
of the Swedish social democrats in some of these areas did show that complete active labour
market reforms cannot be pushed forward without a sufficient degree of consent from the
labour movement (Dios 2002: 13). Partly as a result of the decline in corporatism since the
early 1980s, when the social democrats attempted to legitimize its labour market reforms in
public discourse, they have increasingly tried to communicate directly with the general
public rather than with the social partners (Schmidt 2000: 262).

**Norway**

*Prudence with a Purpose: the Economic Context*

In the early 1980s, the conservatives in government pursued extensive deregulation of
credit markets and housing, and this credit-financed private consumption led to a rapid
growth both in the economy and in employment. However, by the mid-1980s, the credit-
driven boom had gone bust as falling oil prices and external balance problems triggered
economic decline on the one hand, and excessive wages and high inflation on the other. The incoming Labour government responded with typical, and in hindsight ill-timed, hard currency policies in order to stem the inflation, which went on to further decrease competitiveness, pull the economy into decline, and drive up unemployment. Whereas unemployment was slowing rising in the early 1980s, since the hard landing of the economy around 1988 unemployment had skyrocketed to a peak of 8 per cent (Huber and Stephens 2001: 258; Dolvik et al. 1997: 55). However, it is important to mention that, similar to the situation in Sweden, this temporary sharp spike in unemployment was primarily nonstructural, since during the same period there was increasingly coordinated attempt and success in delivering wage moderation. Instead, a combination of external shocks (oil prices) and domestic bungling (policy mistakes) was behind much of this particular unemployment crisis, which, because of its nonstructural nature, actually petered out relatively quickly when revenues from oil increased again along with economic growth since the mid-1990s. In addition, the fact that the government intensified its efforts to combat unemployment, through passive labour-market-clearing strategies under the bourgeois parties as well as ALMPs under Labour, also helped, although the effect of early exit strategies were mainly temporary.

After Labour took over government from the bourgeois parties in 1986, there were both continuities with and departures from the previous government’s economic policy prescription, in the context of gradually rising unemployment. On the one hand Labour continued parts of the conservative measures by sticking to a stance of anti-inflationary economic austerity and by continuing with the liberalization of credit policies and capital
flows; on the other hand it also actively intervened to slow the economy down through changes to interest rates and adopted a fixed-exchange-rate regime. More importantly, Labour accompanied the tightening in economic outlook with a further expansion of labour market measures and financial resources for education. Into the early 1990s, Labour’s policies seemed to have worked, as the external balance went back into a favourable position. This recovery on the fiscal front gave the party greater leeway to become expansionary on the economic front, and this was the course of change the party duly charted in the early 1990s. Overall, under Labour there was no wholesale shift towards supply side measures in economic policy. The changes in economic policy under Labour led Norway to further converge with the international trend with regard to liberalization of monetary and credit policies, as well as diverge with regard to incomes policy and fiscal policy (Dolvik et al. 1997; Halvorsen 2002: 172).

This pattern of change seems to have worked well for Labour, as a combination of persistent wage moderation and the government’s active labour market programs has enabled the party to keep unemployment low during the international recession. However, in explaining this employment performance, it is difficult to disentangle the policy successes from the oil sector, whose exports have take on 16 per cent of the GDP. Clearly, this more or less uniquely oil-fuelled demand side stimulation of the economy has helped Norway avoid both a severe unemployment crisis of the Swedish or Danish type or more significant welfare rollbacks as a result (Huber and Stephens 2001: 257). After the recovery of oil revenues since the early 1990s helped the country withstand major external demand slacks, the small chunk of unemployment remaining in the Norwegian system was now primarily of the structural
kind, which the government was able to more or less sweep under the carpet through
disability benefits, early retirement, and various other early exit pathways (Harvolsen 2002:
177).

Wage Moderation and the Institutional Context

In Norway in the late 1970s, developments in incomes policy mirrored those of many
other Western countries at that time, as local wage drift gradually eroded the central
negotiations. However, after further industry-level negotiations in 1982 and 1984, collective
bargaining was recentralized in Norway in 1987. In 1993 further legislation was introduced
which allowed for the extension of collective agreements on an area- or industry-wide basis.
The unions were the main promoter of the further generalization of collective agreements,
because they were concerned about the possible social implications from the European
Economic Area agreement and the internal market. By the end of the 1990s the Norwegian
bargaining system had come to be regarded as the most centralized in the OECD area, and
meanwhile, union density in Norway, remarkably, continued to rise in the 1980s as well as
the early 1990s (Halvorsen 2002: 171; Freeman 1997: 21; Dolvik et al. 1997: 85). In addition
to growing density, a high degree of coordination persists among the unions, which are
organized largely on sectoral and industrial rather than occupational lines, and the peak
association LO enjoys substantial central authority in enforcing bargaining agreements. The
LO’s authority is also boosted by its extensive points of interest representation located inside
the Labour Party, such as membership on the party executive and joint committees as well as
weekly consultations between party leaders and the union leadership. Alongside the
continuing strength of the unions, Norwegian employers’ organizations also enjoy high density rates and centralized structure. Based on the combination of strength and coordination on both sides of the social partnership, there is a high level of mutual trust between the peak associations from both sides, and this corporatist framework has more or less persistently delivered wage moderation through a series of pay rounds since the late 1980s (Dolvik et al. 1997: 53, 82-85).

At the time of bargaining recentralization in 1987, an interim pay round was negotiated with a “no wage increase” agreement between the LO and the peak employer association NAF. Multi-tier bargaining was reintroduced in the 1990 pay round with strict control at the centre and limited decentralization at the industry level. Then, in 1991, a major breakthrough in Norwegian incomes policy took place as the social partners signed up to a five-year pact called the “Solidarity Alternative” under the auspices of the Labour government. With the explicit purpose of bringing unemployment down to 3-3.5 per cent, the key instrument of the pact was an incomes policy capable of improving cost competitiveness by 10 per cent from 1993 to 1997. Based on this premise of wage moderation, the pact also asked for public expenditure efficiency, structural change to the labour market, low-inflation economic prudence, and, crucially, active labour market policies which enhanced skill formation. In a pattern very similar to the Australian Accord operating contemporaneously, within the framework of the Solidarity Alternative the Norwegian unions consistently gave up rises in nominal wages in exchange for the social wage in the form of government guarantee to save major welfare schemes from retrenchment. In addition, the government also contributed to the bargaining process by co-financing early retirement, increasing
parental leave, and introducing time accounts for parents. Backed up by this whole set of instruments, the Solidarity Alternative delivered very satisfactory results. The pay rounds from 1991 to 1996 all maintained low wage increases, even though the 1994 round was the first one conducted at the industry level since 1986. By 1996, the Solidarity Alternative had significantly over-achieved its initial target in reducing unemployment (Dolvik et al. 1997: 92-93).

Over the past two decades, Norwegian developments in almost every key aspect of the corporatist framework, including union strength, bargaining coordination, and incomes policy, have followed a direction which is very much opposite to the Swedish case (Dolvik and Martin 2000: 279; 314-316). Together with the continuing oil revenues, this contrast in the fundamental characteristics of industrial relations helps explain the better economic performance of Norway than Sweden (and all other Nordic countries) during the 1990s. The uniquely high degree of central coordination in the Norwegian labour movement in incomes policy not only paved the way for high employment, but also made it possible for there to be close to full employment without inflationary wage demands. Wage moderation has also helped in cancelling out the potentially inflationary or anti-employment impact from any possible inflexibility in the Norwegian labour market. Wage moderation and, in turn, full employment, were particularly easy to accomplish with Labour in government, because the close connection between the labour movement and the party made concessions from both sides easier, a pattern also seen, again, in the successful record of the Accord in Australia between the ALP and ACTU. (Solem and Overbye 2004: 35-36; Dolvik et al. 1997: 95; Rodseth 1997: 182).
The Netherlands

*Prudence with a Purpose: the Economic Context*

The macroeconomic policy approach of the PvdA coalitions was very much a continuation of the previous centre-right Lubbers administrations. The government continued to pursue wage moderation as a key method of reducing unemployment, and interest rates were lowered by reducing budget deficits (Keizer 2001: 122). The government cut income taxes, from both the top and the base of the tax bracket. Whereas the cuts from the top represented a more typical centre-right supply side prescription for stimulating the economy and increasing competitiveness, the cuts from the base was much more a reflection of traditional social democratic principle of social amelioration and redistributive politics. These cuts at the lower end were aimed less at a general increase in aggregate demand than as a instrument of stimulating low-skilled service or part-time jobs for sectors of the population with the greatest disadvantage in the labour market (Merkel 2001: 63).

Although the macroeconomic policy framework of sound public finance was continued, the government under Kok has restored a redistributive dimension to Dutch economic growth (Braun and Giraud 2004: 50; Levy 1999: 260-261). One important social policy consequence of Wassenaar was that the link between contractual wages in the private sector and benefit incomes was broken in 1982. As a key negotiating condition for entering the 1989 Lubbers coalition, the PvdA requested the partial restoration of this coupling system linking wages to social security benefits, a task also made easier by the economic recovery then under way. The linkage was duly restored in 1990, but a condition was imposed that the
The coupling of benefits will be suspended if the I/A ratio, a measure of benefit recipients as a proportion of the employed, exceeds or equal 82.6 (Gorter 2000: 192). Furthermore, the close combination of sound budget, flexible labour market, wage moderation, and active labour market measures have clearly contributed to the recovery of the Dutch economy, and the job growth in the Netherlands during the past decade has clearly been impressive by international standards. However, as explained in the chapter on the active apparatus, the supply side of the economy has not been correspondingly strengthened because the new jobs are highly concentrated in the low-skill low-wage sector.

**Wage Moderation and the Institutional Context**

There are both economic and political reasons for the Dutch unions’ rapid acceptance of Wassenaar. As a whole, the process leading to Wassenaar was notable for the weakness of the unions and the strength of both the employers and the moral suasion of economic necessity (Negrelli 2000: 104). On the one hand, the persistent crisis in the Dutch economy by the early 1980s had led to a growing consensus between the state and the social partners in accepting the supply side diagnosis of the Dutch economic problems. On the other hand, partly because of economic decline and partly because of traditional union weakness, throughout the 1980s the balance of power was shifting further towards the employers. The level of union organization in the Netherlands is traditionally moderate, and by contrast the Dutch employers are very well organized, with a high degree of peak level coordination among employers’ organizations (Hemerijck et al. 2000b: 259). In this regard the union’s practical acceptance of Wassenaar can be interpreted as a pragmatic adjustment to the
changing power relations in the labour market. The crucial dynamic in this process of socioeconomic and political transformation was the soaring unemployment, which had reached a postwar record of 12 per cent by the early 1980s. Steep unemployment led directly to loss of union membership and the rapid decline of associational strength. This imminent question of survival for the unions very quickly narrowed their options in dealing with the crisis. In addition, the threat of state intervention in incomes policies by the Lubbers administration in the early 1980s further increased the incentives for both sides of the social partnership to preempt the ruling from the centre-right government, and the nearest shortcut to achieving that was to accept the offer of Wassenaar. For these reasons, the social partners, especially the unions, signed onto Wassenaar without any serious hesitation, and three years after the agreement came into effect, the practice of cost-of-living clauses in wage claims had largely been stopped (Becker 2003; Hemerijck et al. 2000: 116-117; den Butter and Mosch 2001: 22-24; Rhodes 1998: 237). The decline of union strength triggered by unemployment also paved the way for the characteristically consensual and smooth path towards flexicurity in the next decade. As their core membership was being chipped away by falling employment, the unions tried to sustain their strength by diverting attention to the more peripheral and precarious segments of their constituency. The unions willingly took onboard the major issues of concern for people in atypical jobs (Rhodes 1998: 196).

In the Wassenaar agreement, the central union and employers’ organizations agreed to give priority to the recovery of profits as a condition for investment and jobs. Long-term wage restraints and cuts in government expenditure in the public sector were exchanged for clear employment commitment from employers’ organizations. Under Wassenaar, the work-
related efforts on behalf of the employers would focus in particular on labour time reduction
and, less importantly, the creation of part-time jobs. Unions, therefore, agreed to keep wage
increases below productivity growth in exchange for a modest reduction in annual and
weekly working hours. In 1993, a major follow-up of Wassenaar was hammered out between
the social partners, in the form of the agreement “A New Course.” This new agreement
carried further the decentralization of bargaining to the company level, and the mode of
voluntary bilateral collective bargaining became more or less consolidated. An innovative
development in the “New Course” was greater involvement of social partners at the local
level. As a quid pro quo for further decentralization, the employers agreed to give up blanket
resistance to working hour reduction, and the creation of jobs, especially part-time jobs,
remained the first priority for both sides of the social partnership (Visser and Hemerijck
1997: 60, 103; Hemerijck and Visser 2000: 240; Keizer 2001: 114-115; Hemerijck and
Schludi 2000: 159; Negrelli 2000: 104-105). This Wassenaar principle of wage restraint in
exchange for employment or social compensations has entrenched itself as the key principle
in all future bipartite negotiations in the labour market.

Since Wassenaar, the Netherlands has witnessed an almost uninterrupted period of wage
restraint, and this development worked perfectly in line with the non-inflationary economic
stance of the Dutch government. Consistent wage restraint significantly improved the
competitiveness of Dutch exports. More importantly, over 40 per cent of the job creation in
the 1990s can be attributed to such prolonged wage moderation (Hemerijck and Manow 2001:
significantly for the long run, the scope and flexibility of tradeoffs from the employers in
exchange for wage moderation in the Wassenaar framework has increased in recent years. By the 1990s, an important shift in emphasis in union demands had already taken place, as wage moderation was increasingly compensated by reductions in taxes or social contributions or increases in investments in industrial reconstruction. In response, the tax reform of 1990 partially integrated social security charges and income taxes, broadened the tax base and lowered the tax rate. A tri-partite Common Policy Framework was signed between the government and social partners on the exchange of wage moderation for economic growth, more jobs, and tax relief. In a new round of agreements signed in 1997, unions accepted wage moderation in exchange for employers’ responsibility to organize and finance school activities, and to introduce a component of flexible wage. This growing attention to labour market flexibilization as a bargaining condition has the potential to set the trend for future negotiations (Gorter 2000: 205; Hemerijck et al. 2000: 116-117; Hemerijck et al. 2000b: 263; Salverda 2000).

In terms of its impact on the organization of wage bargaining, the Wassenaar agreement led Dutch corporatism into a new era of resurgence, characterized by union acceptance of “centralized decentralization” and the principle that the creation of greater business profit is both necessary and desirable (Schmidt 2000: 286-288). In 1994, tripartite consultation led to the agreement among social partners to focus wage negotiation on the lowest wage scales allowable legally, since the lowest negotiated wages were still much higher than the legal minimum wage, creating a barrier for low-skilled workers to find a job (Keizer 2001: 122). Over the long term, Wassenaar has set in train a decentralizing trend in collecting bargaining with growing numbers of sector- or firm-level agreements. At the same
time, these growing firm-level negotiations are accompanied by an increasing degree of central coordination in the wage formation process. The nature of wage bargaining shifted from central tripartite negotiations with direct state intervention to highly coordinated bipartite agreements. In the 1970s the state had to frequently intervene in order to break the stalemate in wage negotiations, but with Wassenaar, a total break with tradition has taken place as the government retreated itself from incomes policies. Since 1982, there has been no political intervention in wage setting, and the peak organizations limited themselves to the responsibility for directing negotiating parties on the sectoral level (Gorter 2000: 190; Hemerijck and Manow 2001: 224-225; Levy 1999: 259; Hemerijck 2003: 65-66). Now, the government exercises its influence in industrial relations and incomes policy in a more indirect manner. Through the “shadow of hierarchy,” the government has primarily played its role by encouraging the social partners to come to bipartite and voluntary agreements without state interference. The social democrats regard such strategies as components of a more general proposal to strengthen “cultural democracy”, to reinforce the role of the civil society and grant it more autonomy from the still prominent influence of the state (Hemerijck et al. 2000: 117; Braun and Giraud 2004: 53). As an immediate benefit of the corporatist resurgence, the traditional social amelioration objectives of the PvdA in government were more easily put into practice. Company- or sector-wide negotiations led to supplementary insurance measures which neutralized the social impact of what limited retrenchment there had been in the social security system (Trommel and de Vroom 2002: 94).

The transformation from centralized bargaining to coordinated sectoral bargaining has turned out to be very timely, because by the early 1980s the highly centralized Dutch
collective bargaining systems were already faltering as a result of increasing pressure from the decline in economic growth and productivity. This, of course, was also the circumstance confronting the Swedish social democrats at that time. However, in an instance of unintended consequences, the comparatively much greater strengths of the Swedish unions removed any significant incentive for a quick and dirty compromise between the social partners, and the missed opportunities to adjust the Swedish wage bargaining system at an early stage led to the total dismantling of centralized bargaining in Sweden by the late 1980s. On the other hand, the much more insecure position of the Dutch unions vis-à-vis the employers led to significant compromises on behalf of the labour movement in the Wassenaar agreement. However, the radical but coordinated reforms to the Dutch bargaining system since then have alleviated the rigidities of the system and secured its long time survival, so that today wage bargaining is at the industry level but highly coordinated. What is more important, over the years the consensual relationship between the social partners has delivered many more policy initiatives helpful for employment growth as well as the Dutch labour movement in general, than it originally bargained for in 1982. In continental welfare regimes with a predominantly contributory social system, the vitality of corporatist institutions and practice appears to be more or less indispensable for any far-reaching reforms in labour market activation, a lesson clearly learnt by the French and German social democrats in their incomplete attempt to push forward the third way.
France

Prudence with a Purpose: the Economic Context

The U-turn of economic policy by the Socialist government in 1983 ushered in a period of relatively coherent austerity and deregulation policies, and compared with what the Socialists had espoused in the 1970s, these changes did make a significant break from past practices. In monetary policy, since the mid-1980s the Socialist government had become unambiguously committed to the principle of *franc fort* and competitive disinflation within the constraint of the European Monetary System. Economic growth was encouraged with tax and social security contribution reductions in order to assist employment creation and boost purchasing power (Clift 2003: 158-161; Levy 2000: 340-342; Barbier and Theret 2003: 122-123). Performance-based New Public Management principle was gradually introduced into the administration of the public sector, which incidentally paved the way for the later attempts by the Gaullist governments to introduce privatization into this sector. Capital controls were lifted, and the Socialist government also reduced the scale of assistance offered to national industries and relaxed the rules for competition. Since 1983, the principle of budget discipline and deregulation in the economy has not been seriously interrupted by the changes of government, and when the Socialists returned to power under Jospin in the late 1990s, the government continued to significantly tighten fiscal policy under the pressure of the European Monetary System, so that it was able to reduce the budget deficit from 4.2 per cent of GDP in 1996 to 2.9 per cent in 1998. Indeed, it was under the Jospin government that France met the Maastricht criteria (Levy 2000: 340-341).
The Jospin government also continued with and expanded the industry privatization measures of the previous Gaullist government. Ignoring its 1997 election promise to rollback the centre-right predecessor’s privatization reforms, the Socialists in government sold off more national companies than its predecessors. In 1998, liberalization was introduced into the telecommunications sector, a time table for the privatization of Crédit Lyonnais was announced, and the government also deregulated the electricity sector, ending the monopoly of Electricité de France. Alongside privatization and deregulation in selected sectors of national industries, the Jospin government also encouraged the formation of public-private partnerships. In addition, the Socialists became increasingly selective in policies over aid to industries, shifting government help from ailing industries to the growth sectors, and direct subsidies to industries were gradually replaced with tax credits for research and development (Levy 2000: 324-326, 340-342; Bouvet and Michel 1999: 43-44).

These measures on the economic front look very much like a standard neoliberal austerity package, and they did indicate real retreat from the characteristic dirigisme in French economic policy. However, different from typical neoliberal practice, the government tried to encourage growth and employment from the demand as well as the supply side. The increased revenues from economic growth were used to fund new active labour market expenditure as well as to reduce the public deficit. Furthermore, within the prudent economic framework the Socialists were also employing a very large degree of flexibility, especially with regard to fiscal policy, to achieve some degree of income redistribution as well as social justice, in the form of improved social protection for those most vulnerable to the impact of economic liberalization.
Instead of major retrenchments to the social security system, the Socialists in government actually expanded welfare benefits for those most affected by economic liberalization. Using fiscal as well as social policy to cushion the impact of economic reforms, the Socialists had consistently let the welfare state play a critical role in its U-turn from *dirigisme* and Keynesian demand management. For example, while the government’s 1998 budget stayed firmly on course of austerity in macroeconomic prescriptions, it also redesigned income testing to exclude the affluent in social programs such as family allowance. On the one hand, cuts in income tax disproportionately favoured the low income earners and those with no income; on the other hand a new and progressive Solidarity Tax on Wealth was introduced and then strengthened in 1998, along with increases in company tax and special taxes on income from financial investments. What is more important, the government further raised the rate of the uniform taxation CSG to finance both healthcare coverage and the country’s main minimum income guarantee the RMI. As a result, income-related contributions to health insurance were almost entirely abolished (Levy 1999: 247; Clift 2003: 158-161; Merkel 2001: 69-70). The Socialist government managed to carry out most of these left progressive and demand side reforms while remaining within the economic prudence framework. Much of the redistributive reform was based on fiscal “cost shuffling” from the lower to the higher income groups without any net increase in the financial burden of the state (Clift 2003: 160). Therefore, although the Socialists carried on dismantling French *dirigisme* in economic policy, there was no shrinking of the welfare state but a redeployment of state energies and financial resources, away from economic demand management and industrial regulation, to new areas such as social protection and the labour
market. Between continuously expanding versus downsizing the French state, the Socialists chose a third option of replacing old forms of state intervention with new ones (Levy 2001: 340-345; Levy 2002: 4-7, 36). By pursuing economic prudence alongside social justice, the Jospin government had tried to establish a new alliance among the long-term unemployed, excluded, and wage-earning middle class, as the Socialists gradually came to realize that middle class support was increasingly central to their electoral success (Bouvet and Michel 2001: 212).

Wage Moderation and the Institutional Context

In the French wage bargaining process, negotiations and decisions are traditionally made between employers and employees with little interference from the government (Spicker 2002: 120-121). The discourse and practice of French social and labour market reforms traditionally take place in an adversarial manner because of the weak and particularistic organizational patterns of the unions. The entrenched position of the unions in the administration of the social security system has enabled them to exercise an influence disproportionate to their membership. For this reason, the French government, no matter from the left or the right, has rarely attacked the principle of occupational solidarity head-on (Clasen and Oorschot 2002: 237-238; Clasen and Clegg 2003: 373; Mosley et al. 1998: 27; Ebbinghaus and Hassel 1999: 19; Vail 1999: 314). Over time, the French system of wage determination has followed a gradual trend towards decentralization within the framework of collective bargaining and decreasing intervention from the state. The most important reform in the past 20 years was the Aurox Law, which assigned a more significant role to plant-level
collective agreements and sought to strengthen both union organization at the plant level and collective bargaining. However, overall there were no fundamental changes in the structure of this relatively week system of collective bargaining (Malo et al. 2000: 247, 252-253; Wren 2001: 260).

Partly because of the clear failure of the Gaullist government to push ahead welfare reforms against the widespread opposition of the unions, the Socialists in government under Jospin had adopted a more consensual and accommodating stance towards the social partners than its predecessor, for example, by extending the rights for union representatives in the codetermination procedures in wage bargaining (Schroter 2004: 25). The Socialist government adopted this strategy of corporatist concertation in order to carry out some of its most important reform measures, such as the introduction of the 35-hour week. Similarly, the corporatist nature of the pension reform process meant that the unions clearly left their imprint in the final outcome of the negotiations, so that the resulting private pension funds were administered by the social partners, rather than by private companies as the parties from the centre-right would have wanted. Corporatism under Jospin, therefore, enabled the unions to retain the most valued part of their influence in French social security, that is, the administration of insurance benefits (Schmidt 2000: 297-298).

Compared with its centre-right predecessor, the Jospin government was in general more successful in pushing through structural reforms to the social security system, because it dealt with the issues of social partners in a much more consensual manner, and it consistently tried to persuade the general public that its reform could be both economically efficient and socially ameliorative. This public discourse about the balance between
economic efficiency and social equity took on persuasive influence on the social partners after 1997, when the social democrats, with their reputation as the party traditionally espousing social justice and activist government, returned to power (Levy 2002: 256, 261). However, the entrenched position of social partners in the social security system has sometimes thwarted the government’s attempt to activate the labour market, as the Socialists bowed to pressure from the trade unions. For example, in 1999 the social partners signed a contract called the Plan to Help the Return to Employment (PARE), which pledged both the unions and employers to make serious efforts to increase employment. Under PARE, labour market institutions would do their utmost to find jobs, and the unemployed would do their utmost to accept the jobs or training offered. However, the unions believed that the distribution of obligations in the contract was not symmetrical, with no specific requirements on the behaviour of employers. Two trade unions therefore refused to sign the agreement and this led to the rejection of the initial version of PARE. This contract was later watered down so that there were no longer obligations for the unemployed to sign a PARE, which is now based on free acceptance induced by financial incentives. Although the Socialist government was able to introduce changes to labour market policy, these changes often had to occur in an implicit and incremental manner in order to placate the social partners, and changes to the social security system under the Jospin government were carried out mostly in a partial manner. For similar reasons, the Jospin government’s attempt to use a single gateway (such as ONE under New Labour or Jobcentre Plus under the ALP) to integrate benefit services for all claimants in order to strengthen the linkage between welfare and work has been largely ineffective, because for the social partners this concept of joined-up government was very
difficult to reconcile with existing and entrenched divisions of responsibility between the social partners and the state  (Ughetto and Bouget 2002: 99, 105; Clasen and Clegg 2003: 374; Handler 2002: 36).

**Germany**

*Prudence with a Purpose: the Economic Context*

Like most other third way social democrats, the Schroeder government continued with the anti-inflationary and sound budget policy stance it inherited from the previous centre-right government. In the context of Germany in the 1990s, this choice of economic strategy was more or less inevitable as well as uncontested, as the government was simultaneously at the heart of the European Monetary System and beholden to the retaliatory interest rate policies of the German Central Bank. The German government’s budgetary and fiscal stance was also closely followed by other EMS member countries, even at the expense of sometimes considerable unemployment pressure. As an added incentive, the new social democratic government also tried consciously to emphasize its competence in economic management and its new image as the party of fiscal discipline, and the government stuck to its core principle that no new deficit would be created to finance economic stimulus programs (Seeleib-Kaiser 2004b: 127). With budget consolidation becoming the central objective in the government’s fiscal policy, the system of corporate tax has been reformed with the introduction of new tax relief measures that particularly favour larger corporations and shareholders (Bispinck and Schulten 2000: 207-208).
At the same time, the Schroeder government was also keen to combat the chronic unemployment problem in the German economy through active labour market measures as well as through reduction in non-wage labour cost and increase in returns from work. In this framework, the social democrats attempted to reduce social insurance contributions as well as the general public debt in order to achieve greater efficiency as well as increased investment and growth, which in the long run also leads to higher incomes for working households. Emerging behind these employment promotion measures is a growing belief among the social democrats that economic growth is the key to reducing unemployment (Ludwig-Mayerhofer 2002: 88-89). Within the constraint of economic prudence, the Schroeder government also tried to maintain social justice objectives by introducing limited adjustments to its fiscal policy in order to aid its reforms in the social security system. One representative example in this regard was the imposition of the earmarked ecology tax, whose revenues were used for the purpose of reimbursing pension contributions in the public tier as well as reducing non-wage labour cost (Feigl-Heihs 2004: 170). This strategy not only maintained an economically sound budgetary stance but also catered well to the general preference of social democratic constituencies from both the old and new left perspectives.

Wage Moderation and the Institutional Context

In German industrial relations the principle of Tarifautonomi is traditionally upheld, which stipulates the autonomy of employers and unions from state intervention in collective bargaining, in which the metal union often takes the lead. This autonomy for social partners, however, is constrained by the German Central Bank, which strictly punishes inflationary
wage settlements with retaliatory increases in the interest rates. While German unions have not been very aggressive in wage demands, they have been unable to commit themselves to long-term wage restraint. At the insistence of the employers, the issue of long-term wage restraint was put on the agenda of the corporatist agreement the Alliance for Jobs (BA), but the unions had so far been reluctant to discuss wage developments directly with the government, or with their social partners (Bispinck and Schulten 2000: 198; Negrelli 2000: 102). This lack of incentives to accept wage restraint on behalf of the unions was closely related to the powerful and pivotal position of IG Metall, which, because of its dominance, can block reforms it doesn’t like. As the Dutch experience with Wassenaar demonstrates, concertation between social partners and the state becomes easier if the negotiations encompass a broad range of areas, so that there is more room to find possible points of compromise and tradeoffs. However, in the German case the institutional preconditions for broad package deals across different policy domains has generally been lacking. This is both because of the sectorally segmented structure of unions and their large self-regulatory competences in key policy areas, which they have come to claim in a proprietary relationship. There was, therefore, incompatibility between macro-concertation on the federal level and institutional segmentation in meso-corporatist partnership on the level of social partners. Overall, the unions had not refrained from lifting wages above the market-clearing level (Hemerijck and Schludi 2000: 152-153; Hemerijck et al. 2000: 120-122; Lamping and Vergunst 2004: 25-27, 36). So far, both the unions and employers’ confederations have been unwilling to negotiate wages in a tripartite setting. Whereas the Schroeder government is playing an increasingly activist role in labour market and social policy areas, as was
demonstrated by the government’s decision to take over employment policy funding and design responsibilities from the BA, the system of industrial relations remains dominated by the bipartite relationship between the social partners whereas the government is largely excluded (Lehmbruch 2003: 153-154; Hassel and Ebbinghaus 2000: 79-80).

The United Kingdom

Prudence with a Purpose: the Economic Context

After coming to office, New Labour accepted the policy diagnosis that the competitiveness of British economy has traditionally been compromised by the lack of policy commitment to long-term economic stability (Mullard 2000: 112). In response, the government narrowed down its general economic policy objectives to economic stability, with inflation as the key to stability. New Labour abandoned fiscal policy for the management of the short-term economy, and instead relied chiefly on monetary policy. Instead of the simultaneous concern with government borrowing, money supply, and inflation, the focus of monetary policy now is on the inflation target. The Chancellor of the Exchequer took over the overall responsibility in setting the inflation target, and the Bank of England, through the Monetary Policy Committee, becomes the key enforcer of the inflation target. In order to reduce government intervention in monetary policymaking, New Labour has committed itself to a high level of transparency, by transferring the decision on interest rates completely to the Bank of England (Mullard 2000: 122; Lund 2002: 189). In order to control public expenditure, the government stuck to its golden rule on public finance:
borrowing for investment only if there is demonstrable returns over the economic cycle (Lund 2002: 189).

Within this prudent framework of economic policy making, however, there are also measures aimed at social amelioration, which reflect a more typical social democratic concern with social justice and the activist role of the state. New Labour’s social ameliorative strategies have developed on two principal fronts: combating social exclusion and increasing financial resources for the public sector. Whereas the previous Conservative government used tax revenues almost exclusively to fund the reduction of public debts, New Labour in government channeled increasing portions of tax revenues, especially those from windfall taxes, taxation on private utilities, and release of capital receipts from council house sales, into its active labour market programs such as the New Deal as well as public services such as health and education in particular. The channeling of tax funds into public services became increasingly evident in each round of New Labour’s Comprehensive Spending Review, especially after the party was reelected in 2001 (Burchardt and Hills 1999: 46-47; Lund 2002: 190). New Labour proposed to raise health spending in Britain to the level of European average, and it increased national insurance contribution instead of general tax in order to fund such increases in health spending. This way, the link between benefits and contribution in national insurance is broken on an increasingly frequent basis, and national insurance comes to be regarded more and more by the public as a form of general taxation (Regan 2003: 278-279).

In addition to continued financial commitment to public services, New Labour has also made it a long-term strategy to tackle poverty and social exclusion, and as the chapter on
active apparatus has shown, it has increasingly tried to achieve this objective through the use of negative income taxes (Ferrera and Hemerijck 2003: 103-107; Merkel 2001: 58). The government pledged itself to the halving of child poverty by 2010 and its eradication in twenty years, and since the Comprehensive Spending Review for the 2001-2004 round, New Labour has significantly increased its spending to achieve these objectives (Bauld et al. 2003: 215). Although the government regarded the objective of cost control as an important priority and stuck to the spending limits of the Conservative government for its first term, since its reelection in 2001, there had been a significant increase in spending in the welfare state, public services, and active labour market measures. Spending on welfare programs grew almost at the same rate as the economy, and grew faster since the 2002 budget. In the 2002 budget, the government legislated for increases in national insurance contribution by employers, employees and self-employed on all earnings above the threshold, and this de facto increase in indirect tax has secured the increase in public resources the government needed while at the same time keeping its election promise of no increase in direct taxes. With its attention increasingly focused on labour market activation and the public resources needed to fund activation, New Labour has become more flexible in its budgetary stance while working within the general framework of economic prudence (Regan 2003: 271; 274-275; Bauld et al. 2003: 170). This increasing flexibility in New Labour’s interpretation of economic prudence is more or less inevitable. As the government’s spending commitments rise with the massive expansion in active labour market programs, its success in continued labour market activation is increasingly dependent on how the party solves the tension
between expenditure and the avoidance of taxation on middle or high income earners (White and Giaimo 2001: 215-219).

Wage Moderation and the Institutional Context

In industrial relations, the British wage determination system has been historically characterized by decentralized unions and weak employer organizations incapable of reinforcing wage restraint or an effective voluntary incomes policy across industries. The absence of the social wage concept as a welfare compensation for centrally enforced wage restraint and labour market activation has contributed to the weakness in both the economy and the welfare state (Hemerijck and Schludi 2000: 188; Rhodes 2000: 162; Rhodes 2000b: 54). However, two decades of radical deinstitutionalization of the unions by the Thatcher and Major governments had actually made it easier for New Labour to secure wage restraint through a non-confrontational and efficient working relationship with the unions, who are significantly weakened and unable or unwilling to mount any serious or coordinated resistance against government reforms (Ross 2000: 12).

On the one hand, compared with the previous Conservative government, New Labour adopted a more conciliatory attitude towards the unions. The government set up several reviews and proposed a relationship of partnership between the party and the labour movement as well as the public and the private sector (Hewitt 1999: 167). The introduction of the 1999 Employment Relations Act reintroduced the statutory recognition procedure for unions. This restoration of union recognition marked a small step in reversing two decades of union marginalization under the Conservative government. In addition, as part of its general
strategy to better facilitate labour market participation, New Labour also provided significant investment in funds and programs for skill upgrading, such as the Union Learning Fund (Rhodes 2000b: 60-61). On the other hand, New Labour continued to keep regulation in industrial relations at a minimum and generally shied away from formal corporatist interactions with the unions. The party made little attempt to reverse the Conservative measures aimed at deregulating industrial relations and curbing union rights. Similarly, restrictions on the right to strike and trade union government were also retained. Although the government re-institutionalized union recognition, this was limited to the workplace or company level, and the government did not reinstate multi-employer bargaining, and there was no introduction of industrial democracy for the unions. Instead, unions became part of a supply-side-based partnership project between the government and the labour movement, with the primary objective being productivity, wage restraint, and activation of the labour market (Ewing 2003: 148).

The government encouraged a huge expansion in the coverage of individual rights legislation, so that working condition and wages for most workers are regulated by legislation rather than by collective bargaining. The framework of labour law in Britain has become much more legalistic under New Labour, and the centre of gravity in industrial relations has shifted to the sole concern with employment and labour market activation, away from empowering of the unions. A comprehensive labour code has gradually taken shape under New Labour (Ferrera and Hemerijck 2003: 103-107; Cressey 1999: 171; Deakin and Reed 2000: 125; Ewing 2003: 147-151). At the same time, while industrial relations have become much more legalistic, the New Labour government did make efforts to ensure that
the regulatory acts cover issues crucial to the interest of unions and to the labour market activation of vulnerable sectors of the population. The new labour code not only includes clauses on equality of opportunity and rights at the workplace, but also reaches into areas traditionally considered to be external to industrial relations, such as the balancing between work and family, and the requirements for greater transparency from employers about the terms and conditions of employment (Ewing 2003: 150-151).

**Australia**

*Prudence with a Purpose: the Economic Context*

Overall, the direction of social democratic reform in the economic domain has shown many similarities between Australia and New Zealand. Within the overall objective of integrating the domestic economy into the world economy, for both countries there was a combination of financial deregulation, lower marginal tax rates, broader tax base, cost control, and lower industrial protection. The ALP government formally acknowledged that the Australian manufacturing industry must play a proper role, and the freeing of the manufacturing sector from excessive protection was a significant policy departure from the Coalition government (Warhurst and Stewart 1989: 160-175). Throughout the 1980s, as a consequence of the structural weaknesses of Australian industries, escalating foreign debt and balance of payment problems dominated the economic policy consideration of the ALP government, and since late 1985, Labor relied increasingly on monetary rather than fiscal policy to support the currency and constrain domestic demand (Stutchbury 1990: 58-60).
However, because of the Accord framework, the deregulatory and liberalization reforms in the economic sphere took place in Australia as a much more gradual process than in New Zealand. At the very start of the reform process the Hawke government introduced two immediate changes, floating the Australian dollar and freeing the banking and financial sectors, but since then the overall direction of government strategy became more mixed. On the one hand, the ALP tried to reduce the number of producers as well as lower industrial assistance in an effort to remove excessive protection for domestic industries; on the other hand the government shunned direct cuts in existing protection levels as well as any major dismantling of barriers to trade, until the reduction in tariff levels in 1988. The government also shied away from privatizing government enterprises such as airlines or banks. Meanwhile, subsidies were increasingly tailored to the desirable attributes of industries. As a whole, the ALP’s deregulation reform in the economic domain paralleled the government’s reform strategy in the social security domain, in that the state introduced greater selectivity, softened the blow for the victims of deregulation as well as increased assistance for those deserving state support (Davis 1989: 98, 105-106; Warhurst and Stewart 1989: 160-175; Beilharz et al. 1992: 117-119). In addition, radical reforms in the taxation area, such as the GST, were proposed, but, unlike the case in New Zealand, abandoned after meeting strong rejection from the unions (Buchanan and Nicholls 2003: 29). As the chapter on the passive apparatus has shown, while there was deregulation in the economic domain, the Labor government has made a series of efforts in reforming the social security system in order to offset the social impact of economic liberalization for the worst off. And with regard to the domain of industrial relations, the government actually further increased its involvement
under the framework of the Accord. Although there was deregulation of the financial and product markets, the deregulation of the labour market was firmly avoided (Stutchbury 1990: 75-76).

Like the fourth Labour government in New Zealand, the Hawke government kept cost control on the top of its priority list in its economic policy outlook, but the policy effect turned out to be very different between the two countries. During the 1980s and early 1990s the ALP government presided over significant increase in economic growth and employment, whereas New Zealand suffered continuous economic decline and high unemployment. Under the ALP, economic efficiency had been achieved with a lot of consideration for social amelioration. The government had combined egalitarian social policies with prudent economic policy within the framework of consensual incomes policy (Cass and Whiteford 1989: 277-278; Whiteford 1994: 253).

Wage Moderation and the Institutional Context

During the period of Labor government, the Accord had been renegotiated with the unions and updated on a periodical basis. Overall, the Accord can be said to have gone through two basic phases. The first phase focused on varying degrees of centralization in wage bargaining within the framework of wage decline, and the second phase focused on enterprise bargaining, including the formal introduction of the enterprise bargaining principle by the Australian Industrial Relations Commission. In both phases, the Accord played a fundamental role in encouraging consultation between the labour movement and the ALP and in securing support for the government’s measures from both sides of the social partnership.
In order to encourage consultation and discussion across sectors of the economy, the Accord oversaw the establishment of the Economic Planning Advisory Council (EPAC), a representative tripartite body, as well as the convening of the 1983 National Economic Summit, where the government, labour, and industry met and extensively discussed the issues of reform in the economic and labour market areas. A major achievement of the National Economic Summit was that it secured support from the business community for centralized wage fixing (Boreham 1990: 45-51; Stutchbury 1990: 54-55). Because of extensive consultation and explicit promise of improved social wage, there was a solid foundation of broad public support for the Accord. Within the framework of the Accord, the Industrial Relations Commission, and more fundamentally, the arbitration system, remained intact throughout the 1980s.

The Accord considerably strengthened the power resources of the labour movement vis-à-vis business. Because of its traditional suspicion of the unions, business was reluctant to participate in the Accord negotiations, and as a result it was the government and the unions who outlined a role for business within the Accord framework. On the whole, therefore, wages policy under the Accord became a matter of single-issue coalition between two parties, the unions and the ALP (Gardner 1990: 82-83, 85-93). The Accord became the mechanism through which the unions gained direct access to macroeconomic policy making. The prospect of widening access to government policy was a major incentive for the unions, whose sphere of influence had previously been confined to the narrow issues of wages and working conditions (Peetz 1998: 161-163; Gardner 1990: 85-93; Davis 1986: 133). There was also a great degree of asymmetry between business and labour in their ability to enforce
the Accord agreements: because of its own fragmented nature, business found it more
difficult to consistently work within the Accord framework, and Australian business was
restrained in its pursuit of labour market deregulation (Buchanan and Nicholls 2003: 47-48).

Over time, the Accord had also given the ALP a number of advantages. Overall,
concertation without business had certainly strengthened the labour movement and the ALP.
It created a stable environment for introducing reforms in areas sensitive to the labour
movement, and it also allowed decentralization of bargaining while preserving basic social
protection. Most importantly, the Accord secured the tolerance of the labour movement
towards the wide range of social and economic reforms carried out in the 1980s by the ALP
in an attempt to modernize the country’s economy, especially the pursuit of wage restraint,
the key to high labour force participation and economic growth. With the help of the Accord
framework, the task of exiting from the wage freeze legacy of the previous Coalition
government became much easier for the ALP. In both Australia and New Zealand, the
preceding centre-right government imposed extensive wage freeze as a sign of their growing
ineffectiveness in facilitating a voluntary incomes policy. After wage freeze was dismantled
in both countries, an explosion of wage claims and awards ensued in New Zealand. In
Australia, on the other hand, the development was very different. Accord Mark I was able to
deliver wage restraints in exchange for controls on prices and non-wage incomes; later
phases of the Accord then aligned wage increases with increases in productivity. Although
the ALP committed itself to the full indexation of wages to movements in the CPI, the unions
did not pursue “catch-up” claims from the wage freeze, and there was considerable
achievement in real wage reductions during the period of Accord Mark II. The unions also
accepted the fact the introduction of Medicare meant the reduction in private healthcare costs, which in turn led to a reduction of CPI by more than two per cent. Consequently, no indexation was awarded for the second half of 1984. Meanwhile, because of the strong union connection, wage restraint under the ALP was not aimed at altering the wages/profit share, and the burden of adjustment was widely spread (Stutchbury 1990: 55-58; Davis 1989: 94-97; Buchanan and Nicholls 2003: 50, 53). While the Coalition government under Fraser had been ineffective in tackling the dramatically rising rates of industrial disputes in the early 1980s, Hawke was able to reduce such disputes much more successfully, through the balanced policies within the Accord (Bennett and Cole 1989: 189-205). Indirectly, the Accord also further strengthened the government’s case for prudence in the economic sphere. After the unions delivered wage restraint, the government became obliged to deliver the social wage and tax cuts, and this significantly constrained the government’s budget outline, which led to Hawke’s famous trilogy commitment: no increase in taxes, spending, or deficit as a proportion of GDP (Davis 1989: 82-89).

The Accord also contributed to the further centralization in the organizational structure of unions in Australia. In the Accord negotiation process, the unions were represented by the one peak authority, the ACTU. During each of the eight Accord updates throughout the decade, as the difficulty of negotiation increased, so did the authority and influence of the ACTU over its local branches, making the enforcement of wage restraint much easier. In this sense, the Accord contributed to the solving of the collective action problem within the Australian labour movement. The incentives (social wage and tax credits) and coercion (the risk of unemployment) of the Accord, plus the autonomy of the state from
the incomes policy process, secured the single-issue coalition between the labour movement and the party. Arbitration, furthermore, acted as an institutional enforcer and stabilized the bargaining pattern for this single-issue coalition (Gardner 1990: 96-99). The Accord made it easier for the unions to accept a gradual introduction of enterprise bargaining. Starting from the negotiation for Accord Mark III, the decentralization of bargaining to the enterprise level became an important policy objective. Labor introduced two acts in this spirit, the 1988 Industrial Relations Act and the 1993 Industrial Relations Reform Act. The 1993 act formally introduced pattern bargaining and clearer limits on strike activities. In addition, Accord Mark VI also very extensively promoted enterprise bargaining as an alternative to central awards. However, the ALP had consistently balanced the shift to enterprise bargaining with policies to maintain basic social security and labour market standards, and with the entrenchment of the Arbitration Commission, the trend towards decentralization did not fundamentally undermine existing institutional structures (Schwartz 2000: 112-114; Buchanan and Nicholls 2003: 30-45; Castles 1994: 137). While there was significant deregulation in the economic domain, the Australian Treasury came to accept wage restraint within the Accord as the main instrument to control labour cost, so the Treasury shelved its proposal for a deregulation of the labour market. Instead, on most issues there was a strong alliance between the unions on the one hand and the Treasury on the other, two camps which were typically most opposed to each other in principle as well as in practice in many countries (Stutchbury 1990: 66-67).

After the Coalition government returned to power in 1996, the industrial relations system became massively deregulated. Following the example of New Zealand’s Employment Contracts Act, the Coalition government passed the Workplace Relations Act in
1996, which gave employers the option to avoid having to negotiate collective employment contracts. Instead, employers can now negotiate wage awards with unions on an individual basis. Although awards through the arbitration system still existed, they were now regarded as a safety net of minimum standards (Lansbury and Michelson 2003: 227-231; Buchanan and Nicholls 2003: 30-45; Harbridge and Bagley 2002: 186-189).

New Zealand

Prudence with a Purpose? The Economic Context

Under the fourth Labour government, the first, and main, thrust of economic reform was deregulation of the financial sector (removal of exchange rate controls and credit guidelines), freeing of the banking system, and deregulation of industry assistance, in particular the removal of producer subsidies. Contrary to the Keynesian tradition, fiscal policy under Labour was completely subordinate to monetary policy (Whitwell 1990: 105; Hawke 1992: 441). Indeed, during Labour’s tenure, New Zealand’s financial sector was transformed from the most to the least regulated among OECD countries. Labour refused to create money, insisting instead on fully funding any deficit. Under the fourth Labour government, the mode of regulation shifted from structural (restrictions on firms and individuals entering particular markets) to conduct regulations (measures affecting how firms and individuals behave in their chosen market) (Rudd 1990: 92-93; Hawke 1992: 441).

Another major initiative under Labour was privatization of the state sector, which involved the sale of vast swaths of state assets as well as reorganization of the civil service in line with the New Public Management principle. It is precisely in the area of privatization
and state sector reorganization that the strictest application of microeconomic theories and market principles occurred. By 1990, only two of the 14 state enterprises mentioned in the 1986 legislation on privatization looked likely to remain in public hands (O’Brien and Wilkes 1993: 26, 89; Shannon 1991; Boston 1993: 115; Williams 1990: 144). Nevertheless, the core of the state sector representing the bulk of state expenditure remained intact, because these were government departments responsible for social welfare policies. Similarly, the government was extremely cautious when it comes to the labour market, and deregulation largely bypassed this area. By contrast, non-core departments with trading or non-trading functions were all expected to commercialize their practice (Rudd 1990: 97-98; Harbridge and Walsh 2002: 199).

Ironically, despite the radical nature of the reforms carried out across sectors of the economy, New Zealand’s economic performance continued to be very poor, even compared with Australia, which underwent a much more consensual and balanced reform process in the economic domain. First of all, unemployment persisted and then worsened rapidly through the 1980s. By the end of the 1980s there was some initial sign of a turn for the better, as inflation fell and fiscal deficit narrowed. However, into the 1990s the fiscal position of the government again worsened rapidly (Boston 1993: 120-123). A crucial cause of such abysmal economic performance in New Zealand was the inability of the labour movement and the party to hammer out a voluntary incomes policy. The lack of wage restraint and frequent bouts of wage explosion in the 1980s contributed not only to excessive labour costs but also to increasing pressure on monetary policy through hikes in interest rates. The consequent economic decline, on top of large public sector redundancies, significantly
contributed to growing unemployment. Between 1987 and 1994, the country’s GDP performed about 30 per cent below the trend line, and the GDP shrank between 1985 and 1992, in contrast to continued growth in most other OECD countries. Since the lack of wage restraint led to excessive unit labour costs, tragically, despite all the harsh deregulation and privatization reforms under Labour, there was no clear-cut improvement in productivity at all. Aggregate productivity declined, and when it started to recover since 1995, it only returned to the level of pre-reform Muldoon era, which was itself characterized by excessive state intervention (Dalziel 1999: 62, 70; Kelsey 1995: 9-10).

Wage Moderation and the Institutional Context

Contrary to developments in the economic domain, the fourth Labour government had been careful to leave the labour market out of its deregulation agenda. Instead, in the industrial relations area the government continued to make limited changes which were in alignment with the interests of its core constituencies and the unions. The most significant development in industrial relations under Labour was the 1987 Labour Relations Act, whose primary objective was to enhance the flexibility of collective bargaining without sacrificing the arbitration system. While it encouraged more enterprise bargaining, the act also included awards for weaker groups, and the premise of the act continued to be industry-based rather than enterprise-based (Walsh and Brosnan 1999: 117-119). While Labour accepted the need for enterprise bargaining to grow at the expense of employment awards, the act allowed the unions to control the pace of change by retaining their right to choose between industry awards or enterprise agreements. Labour also restored compulsory unionism, which was
abolished by the previous National government. As a compensation for the unions’ acceptance of increased enterprise bargaining in the act, the government promised to expand the formal welfare state (Harbridge and Walsh 2002: 200-201; Huber and Stephens 2001: 294; Hemerijck and Schludi 2000: 193-195). Backed by the Labour Ministry, which itself made a skillful use of the connection with the labour movement, the government used the act to retain the existing framework of union rights and successfully resisted the pressure to end the blanket coverage of wage awards. In the struggles within the party leading up to the act, the Treasury’s attempt to radically deregulate the labour market was completely rejected (Walsh and Brosnan 1999: 117; Walsh 1989: 167-168).

However, Labour’s efforts to shield the industrial relations arena from total deregulation did not succeed in either securing a generally moderate wage awards pattern or a functioning corporatist working relationship with the unions, which continued to be relatively weak, segmented, and unable to coordinate or enforce bargaining agreements. Historically, the political insertion of the labour movement in New Zealand has been less successful than in Australia. By the late 19th century Australia had already developed a substantial mining sector whereas New Zealand continued to be dominated by agriculture. For this reason, unlike their Australian counterparts, for long periods trade unions in New Zealand consisted of craft or guild unions in limited sectors. The Industrial Conciliation and Arbitration Act of 1894 required that unions be formed along occupational lines, and this requirement was interpreted very strictly. These unions were highly decentralized in organization, geographically dispersed, and lacked serious political representation (Kelsey 1995: 73; Buchanan and Nicholls 2003: 92-96). Because of their decentralized structure,
peak organizations of labour as well as capital were not as effective as their counterparts in Australia in enforcing wage restraint. In the absence of a voluntary incomes policy, wages were mainly determined by direct employer-union bargaining after Muldoon’s comprehensive wage and price controls were removed in 1984. Unable to intervene formally in wages policy, the government was forced to fight inflation, very unsuccessfully, through monetarist and fiscal policies. There was a major escalation in industrial disputes in the 1985/1986 wage round over wage relativities, which ultimately triggered further decline in the economy and growing unemployment (Boston 1987: 151-154, 165-180; Oliver 1989: 40-41). In order to reform wage bargaining and break wage relativity, Labour actually proposed increases in the social wage in exchange for a tight fiscal and monetary policy, but unions (and the employer’s organizations) all remained divided and unable to come up with a coherent response to the government’s proposal. This inability to run well-institutionalized incomes policy made it impossible to create a corporatist alliance based on employment promotion, social wage and wage restraint in the fashion of the Dutch Wassenaar, Australian Accord, or Norwegian Solidarity Alternative (Boston 1993: 124; Schwartz 2000: 88-93, 98-99).

Because of the general lack of a corporatist framework, Labour had tended to introduce its deregulatory reforms with little substantive consultation or public communication. As time went on this pattern clearly contributed to the growing public discontent towards the reform process in New Zealand, which in turn triggered the total transformation of the party system through the referendum on electoral systems. Anticipating the unpopularity of deregulatory reforms with its core constituencies, Labour offered the
public very little information about the extent of its reforms. For the first few years in
government, Labour tried to create an impression that the government would adopt a
consensual and incremental approach. This impression was boosted by a series of reviews
commissioned by the government to look at income distribution and social security,
especially the 1987 Royal Commission on social security, which came about because there
was growing discontent within the party that its economic reforms ignored any potential
social implications for the population (Schmidt 2000: 245-250; O’Brien and Wilkes 1993: 25;
Easton 1987: 147). Similarly, Labour also followed the ALP in Australia by organizing a
national economic summit in 1984.

However, most of these consultation exercises lacked substantive meaning, as they
bypassed most of the submissions from welfare groups, and the initiative of the reviews was
firmly in the hands of the cabinet (Cheyne et al. 1997: 42). Although submissions to the
Royal Commission on social security emphasized heavily on income adequacy, when the
Commission reported in 1998, its recommendation was to further tighten welfare eligibility.
On the contrary, submissions within the prudent market economy framework were quickly
incorporated into government policy. Labour set up a task force in 1985 to examine the
relationship between tax and benefits, and later that year, both the GST and reduction in
marginal income tax became actual elements of the budget. Similarly, the Ministerial Task
Force on Income Security (also called Budget Review 86) was pressured by the cabinet to
make recommendations in a no cost context. Consequently the emphasis of the task force
shifted to reducing benefit levels for beneficiaries who were relatively well off. Notable in
the recommendations of the task force was the constant emphasis on work and the lack of
reference to the adequacy of benefit levels. As a whole, the government only enacted those
task force recommendations which saved money, but ignored those that required additional
spending (O’Brien 1993: 17-18, 20-23). The collective bargaining and arbitration system, the
foundation for New Zealand’s wage earners’ welfare state, was completely destroyed by the
succeeding National government through the 1991 Employment Contracts Act. With the act,
the Nationals completely replaced arbitration with purely private contracts between
individuals and firms. In a decisive break with a century of industrial relations history in New
Zealand, the mechanism of the market as the chief wage fixing tool was introduced for the
first time. After dismantling arbitration in 1991, the government went on to replace
unemployment benefits with a workfare scheme called community wage. This narrowly
targeted community wage replaced social wage, the last remnant of the wage earners’ welfare
state, and the informal welfare state in New Zealand thereby became history (Mackay 2003:
100-105, 107; Harbridge and Walsh 2002: 202).

By the time when a Labour-led coalition returned to power in 1999, deregulation had
become as discredited as state intervention was in the early 1980s. The Labour-led coalition
government made a series of attempts to reverse National’s policy legacy in the industrial
relations arena. The paradigm-shifting 1991 Employment Contracts Act was replaced by
Labour with the Employment Relations Act, which restored legal recognition to trade unions
and extended union access. Although the act shied away from a direct return to centralized or
industry/sectoral bargaining, collective bargaining at the shop level was again encouraged.
The government renewed provisions for industrial action, reinstated the special role played
by unions in industrial relations, and dismantled National’s community wage program. Some
rights were also extended to unions that should genuinely assist them in their organizing activities (Harbridge and Walsh 2002: 211-215; Buchanan and Nicholls 2003: 105-106). After bearing the brunt of National’s deregulation reforms for almost a decade, the unions whole-heartedly threw their support behind Labour’s restorative measures (de Bruin 2002: 222-223).

An Overview:
Economic and Institutional Context for the Third Way

Prudence with a Purpose: the Economic Context

With regard to the general direction of economic policy, well-performing third way social democratic governments have all subscribed to the principle of economic prudence. Fixed exchange rates, hard currency, sound public finances, and low inflation have more or less become an aspiration with bipartisan support, and supply side measures are usually adopted in preference to demand side measures to control the pace of the economy. Reforms to the tax system are frequently used to indirectly stimulate growth by removing potential inefficiencies in the economy, while reduction in income tax rate is often funded by a broadening and greening of the tax base, so there is no decline of taxation revenue overall. Meanwhile, social security contributions are often lowered in an attempt to reduce non-wage labour costs, assist employment creation, and boost purchasing power. In addition, in cases where there is either a high degree of control on the capital and finance market (as in Australia, New Zealand, Sweden and Norway) or extensive industrial assistance and protection (as in France), the social democrats have taken measures to loosen credit control.
and readjust industrial assistance from the loss-making uncompetitive to the competitive sectors of the industry. Rules of competition for industries are at the same time relaxed. In addition, the social democrats have gradually privatized national industries and introduced deregulation to the administration of the public sector, where the principle of New Public Management is being increasingly adopted. This prudent and supply side economic framework has helped in transforming the budget deficit inherited from the centre-right into budget surpluses in several instances, such as Sweden. Table (5.1) compares the social democratic and centre-right average cyclically adjusted government budget (OECD 2005) as a percentage of GDP, as well as average wage rates in the business sector (OECD 2005b), for the nine countries since 1980. In a testament to Pierson’s powerful explanation of permanent austerity, since the ending of the Golden Age both social democrats and centre-right governments have strived to achieve a balanced or surplus budget, and on average, the social democratic governments have been relatively more successful in achieving a surplus budget, in the framework of their third way reforms, than their centre-right counterparts. Similarly, the social democrats have also been relatively more successful in securing wage restraint, which helps retain a sufficient profit margin for businesses to reinvest in education and training through active labour market programs.
Table (5.1) Average Budget Balance and Change in Wage Rates for the Nine Countries between 1980 and 2001

<table>
<thead>
<tr>
<th></th>
<th>Social Democrats in Power</th>
<th>Social Democrats out of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Budget Balance</strong></td>
<td>.28</td>
<td>.04</td>
</tr>
<tr>
<td><strong>Average Percentage Change in Wage Rates in the Business Sector</strong></td>
<td>4.88</td>
<td>5.17</td>
</tr>
</tbody>
</table>

*Budget balance figures are percentages of GDP, adjusted for economic cycles.

This improved fiscal position of the government opened room for greater public expenditure, and instead of using the increased revenue to exclusively fund tax cuts or pay the national debt, the social democrats have used the increased financial leeway to pursue active labour market and social ameliorative goals as well as the reduction of deficit. In this sense, the economic prudence which the social democrats pursued in their third way reforms is indeed prudence with a purpose. Premised on increased revenues as a result of economic prudence, two sets of purposes in particular have set the social democrats apart from their centre-right counterparts: labour market activation and combating social exclusion. Instead of channeling the increased revenues heavily into further tax cuts, the social democrats have funded increased public expenditure in active labour market programs as well as improvements in the social security system and public services. As is the case with changes to both the active and passive apparatuses of social protection, political agency through the partisan colour of government continues to influence how the economic context for welfare state changes is managed in the era of permanent austerity, against constraints from existing institutional contexts. Table (5.2) summarizes the findings from the case studies in support of
this power resources logic, and Table (5.3) illustrates, in the context of permanent austerity and pressure for sound budgets, how the social democrats and their centre-right counterparts differ in how they plan to spend the increased revenues in the government coffer (OECD 2004; OECD 2004b). While government policy has focused on reducing taxes when the centre-right parties are in power, the spending priority with regard to increased revenue is very much on channeling the funds into active labour market programs, and into making work more attractive in general, when the social democrats are in power.

Table (5.2) Managing the Economic Context for Social Protection Reforms

<table>
<thead>
<tr>
<th>Differences (Purpose)</th>
<th>Social Democrats in Power</th>
<th>Social Democrats out of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use Budget Surplus to Fund Labour Market Programs</td>
<td>Use Budget Surplus to Fund Tax Cuts</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Similarities (Prudence)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget Balance/Surplus</td>
</tr>
<tr>
<td>Wage Moderation</td>
</tr>
</tbody>
</table>
Although sharing with their centre-right counterparts the general belief in a prudent and supply side economic framework, the social democrats have also distinguished themselves by a much greater degree of flexibility with which they apply fiscal policy instruments. Although marginal income taxes are reduced as a general strategy, the social democrats have not hesitated in increasing taxes on occasions in order to finance the expansion of active labour market programs as well as public services and social security, some more overtly through increases in direct taxes, as the Scandinavian and French social democrats, some more covertly through increases in indirect taxes, such as New Labour or the ALP. In addition, the social democrats have also used adjustments in their fiscal policy to help achieving its traditional redistributive goals. Marginal taxes are often reduced from the bottom as well as the top, and sometimes “wealth taxes” have also been put in place or increased, such as capital gains tax and corporate income tax. Furthermore, as the chapter on the active apparatus has shown, tax credits and other negative income taxes have also

| Table (5.3) Comparing the Purposes of Economic Prudence for the Nine Countries between 1980 and 2001 |
|---------------------------------|---------------------------------|---------------------------------|
|                                 | Social Democrats in Power | Social Democrats out of Power |
| Average Annual Change in Tax Rates on Married Couples | .34 | -.35 |
| Average Annual Change in Expenditure on Labour Market Training Programs | .002 | -.003 |

*Labour market program expenditure figures are percentages of GDP.*
contributed to the maintenance of a basic level of social protection for those most vulnerable to the impact of economic liberalization.

Finally, the social democrats have also distinguished themselves from the centre-right by their willingness to use a broader spectrum of policy tools to regulate the economy. Apart from standard strategies of tax reduction and tight monetary policy, the social democrats have also tried to stimulate employment using not only active labour market programs but also demand side job creation and various types of employment subsidies. Although the social democrats have substituted price stability for full employment as the goals of monetary policy, employment was increasingly promoted with changes primarily outside the economic sphere, through a judicious mix of expansion in the active apparatus and active redistribution in the passive apparatus of social protection (Ferrera et al. 2001: 115-116; Green-Pedersen et al. 2001: 314).

Wage Moderation and the Institutional Context

Just as all well-performing third way social democrats have maintained a prudent economic policy framework, most of these governments have also successfully pursued responsible income policies based on consensual and corporatist relationship with the social partners (Hemerijck and Schludi 2000: 208). The importance of healthy corporatist institutions go beyond the issue of wage moderation and has implications for other dimensions of the third way reform as well, including flexibility in the labour market, combating early exit pathways, as well as adjustments to the social security system. In general, third way activation reforms are more successful when the associated policy changes
are based on coordination between the government and social partners, and when these changes are presented as broad-based tradeoffs and carefully balanced concessions for one side as well as the other (Bonoli and Sarfati 2004: 454; Ferrera et al. 2001: 115-116; Hemerijck and Schludi 2000: 227; Cox 2001: 496; Esping-Andersen 1996: 266-267).

In the countries studied, social democratic third way successes take place either against the background of persistent corporatist strength (Denmark) or, more remarkably, further growth and strengthening of corporatist practice and institutions (Australia, Norway, and the Netherlands). On the other side of the coin, the French Socialists carried out limited reforms against a background of continuing dysfunction in corporatist concertation. Similarly, since the mid-1980s the Swedish social democrats have witnessed significant decline and decentralization in the corporatist structure and the breakdown of cooperative practice between the social partners. However, it is important to mention here that the limited nature of reforms in the Swedish case was related not only to the lack of social partnership cooperation, but also to the fact that Sweden had traditionally practiced active labour market policies that are very mature and advanced by international standard. A more drastic example of corporatist failure is New Zealand, although the culmination of this failure really took place after Labour had left power. Nevertheless, during the period of the fourth Labour government, declining union coordination and lack of Australian type Accord went hand in hand with very radical deregulation and liberalization reforms in the economic domain, which led to further decline both in income equality and employment. Potently, after two decades of upheavals in both the socioeconomic and political system of the country, one of
the first decisions of the new Labour coalition government in 1999 was to start rebuilding corporatism by repealing National’s 1991 Employment Contracts Act.

Looking across the cases covered in the book, the New Zealand pattern of direct decline in bargaining coordination was more the exception than the norm. The comprehensive deregulation of the bargaining system in Britain, of course, had been completed before New Labour came to power. For most other countries, the general pattern was instead limited decline in the context of overall stability when the social democrats were in government, and behind this centrifugal pressure on collective bargaining, the main explanatory factor was the growing trend towards skill and wage differentiation at the firm level (Huber and Stephens 2001: 225). Most social democratic governments have overseen a process of “centralized decentralization” which led to decentralized wage setting coupled with high level of coordination at the central level, and this trend towards “centralized decentralization” was very much pioneered by the PvdA as well as the Danish social democrats. This pattern also reflects the current bargaining arrangement in Sweden. Meanwhile, the parallel development accompanying this coordinated decentralization was usually a shift from legislated to voluntary regulation and a decrease in instances of direct state intervention (Lodovici 2000: 50-51; Ferrera et al. 2001: 132).

The advantage in this pattern of coordinated decentralization is that it goes to great lengths in facilitating the combination of macroeconomic considerations (on the coordinated macro level) and firm-level adjustment objectives (on the decentralized micro level) which are closer to the employers and employees, and the three social democratic cases most consistent in practicing “centralized decentralization” (the ALP, PvdA, and the Danish social
democrats) have all clearly benefited from this type of two-level bargaining by achieving both economic competitiveness and wage solidarity to some extent. This type of competitive corporatism and productivity-oriented social pacts represent the optimal strategy of social partnership today (Hemerijck and Schludi 2000: 207-212; Scharpf and Schmidt 2000: 318-323; Green-Pedersen et al. 2001: 318-319; Rhodes 1998: 200). On the other side of the coin, however, recentralization and further strengthening of collective bargaining under the social democrats appear as difficult to accomplish as radical deregulation, and so far only the Norwegian Labour Party has followed this path with success. On the other hand, while the PvdA and ALP substantially revitalized the corporatist institutions, they regulated rather than reversed the trend towards decline in collective and coordinated bargaining.

The juxtaposition of persistent wage moderation alongside centrally coordinated decline in wage bargaining in most third way countries indicates that wage moderation has over time become more robust, deliverable under much less ideal institutional settings than in the Golden Age. In the context of open capital market, there are no other choices for social democrats to stimulate economic growth or employment other than continuing pursuit of wage restraint. Arguably, in a reversal of the Rehn-Meidner model, solidaristic wages now have the potential to damage employment growth because they prevented the expansion of the low wage service sector while employment in the manufacturing sector declined. The credible threat of state intervention in the form of a wage freeze during the height of the crises further accelerated this process of goal adjustments towards wage moderation, as the Dutch case indicated (Hemerijck and Schludi 2000: 207-212; Ferrera et al. 2001: 117; Ebbinghaus and Hassel 1999: 21-23; Brugiavini et al. 2001: 216; Wren 2001: 244-245). The
Australian, Danish, and Swedish social democrats very much took the lead in this process of coming to terms with wage moderation since the early 1980s, motivated by the deregulation of the dominion economy for the former and the turn to a hard currency for the latter two. The innovative practice of restraint in nominal wage in exchange for the social wage, first formalized under the Australian Accord, is now increasingly being adopted by the social democrats in continental Europe. However, in the context of continental welfare regimes, organized wage restraint remains hard to achieve if the unions are too fragmented (as in France) or too dominated by a single union resistant to reform, or not confronted with an immediate shift of political balance to the other side of the social partnership (as in Germany). Union opposition to reforms is harder to overcome when there is no framework of strong, nationally coordinated and encompassing interest associations. In both the French and German cases, the recent attempts by the social democrats on the wage front have been marked mainly by failure, such as the Alliance for Jobs in Germany and Jospin’s attempt to promote a national dialogue in 1997.

The importance of social partnership and corporatist practice explains between-country variation in third way performances not only with respect to wage moderation. The contrasting experiences of the Dutch, Swedish, and German social democrats in reforming the disability or pensions systems are also cases in point (Ferrera and Hemerijck 2003: 111; Anderson 2002: 22-25; Meyer and Anderson 2004: 141-142; Visser and Hemerijck 1997: 182-183). More recently, the premises under which wage restraints are negotiated in the corporatist framework have shifted further. On the one hand, wage moderation is increasingly regarded as part of a supply-side strategy to create employment and economic
growth; on the other hand, increasingly, the social wage offered in exchange has shifted from being primarily new or expanded social benefits to more indirect or long-term objectives such as tax exemptions or work schemes. Therefore, the gains to the labour movement from the third way corporatist framework have over time become more diffuse, long-term, and more closely attached to employment and job creation (Hassel and Ebbinghaus 2000: 64-67).
A Theory of the Third Way to Social Justice

The third way, like all ways, is a means to an end. For the nine social democratic governments covered in this book, the third way is, ultimately, just a strategy, adopted in the hope of achieving their ultimate objective. In this sense, what the third way leads to is much closer to the heart of the social democrats than what the third way passes through. It is not very difficult to comprehend what this ultimate objective is, if we look back at the circumstances surrounding the birth of social democracy as political parties. Since the world’s first labour government was briefly attempted in Queensland in 1889, for more than a century the social democrats have struggled to stay loyal to the original objectives that made them parties: to better the lives of the working man who sells his labour for a living. For better or worse, this simple desire was first formed as a party ideology in the late 1880s under circumstances of genuine suffering and, sometimes, repression for the working class at the time. Creatures of the recently finished or unfinished industrial revolutions, the working class were thrust into a world where political mobilization of socioeconomic cleavages continued to manifest itself primarily as a battle between the remaining landowning class and
the bourgeois, in the form of conservative against liberal parties. The lack of political representation plus the lack of property made the workers a clearly vulnerable segment of the population, open to the risk of poverty as well as exploitation in wage and working conditions. The search for why they believed to be social justice, in the form of basic social protection for the worse off, was a key social democratic ideal then, and it still is today. Over a century, various paths have been covered by the working class in search of social justice, and on numerous occasions they have veered into tragic failures such as communism, but regardless of the paths chosen, few seriously doubt the genuineness of their initial motivation to protect the worse off from exploitation and poverty. It is this continuous search for what they believe to be social justice that led today’s social democrats towards a third way. The meaning and interpretation of social protection by the state are no longer the same, but the attainment of social justice as a fundamental social democratic objective remains. The third way, therefore, is the third way to social justice.

However, the meaning of social justice has clearly shifted during the postwar period. Although the social democrats still believe in the principle of protecting the worse off, the strategies have evolved. During much of the Golden Age, the principle strategy was to strive for relative equality of income, so that no one will be worse off. This was a two-prong strategy. On the one hand, wage equality within the workplace was attempted through low wage dispersion and solidaristic wage awards; on the other hand, income equality between those with and without work was attempted through income replacement in the social security system. With this strategy, not only the worse off (those with very low income) but also the worst off (those with no source of income at all) were protected from poverty and
exclusion. As the typical strategy adopted by most social democrats during the Golden Age, this is what we may call the “first way” (to social justice and social protection by the state).

Since the early 1980s, the first way has become increasingly unfeasible, and the fundamental dynamic behind this change was the secular shift in the structure of economy for most OECD countries from manufacturing to service industries, as well as demographic changes leading to increasing labour market exclusion and new social risks for vulnerable groups. The sectoral shift in the economy not only led to a general decline in the manufacturing sector, but also put pressure on the sustainability of solidaristic wage awards. Transition to the service industries means that low wage dispersion increasingly became de facto low wage dispersion in the context of low productivity growth, which further contributed to unit labour costs and loss in jobs. During the 1980s, this anti-employment impact of secular shift in the economic structure was further compounded by a series of policy mistakes made by governments in their attempt to adapt to changes in international economy, especially the rapid deregulation of credit markets followed by insufficient restraint in aggregate demand. At the same time, for national governments, traditional economic stimulants such as devaluation, lowering interest rates or deficit spending became infeasible as a result of increasing international mobility of capital. As a result, both components of the first way to social justice became difficult to perform. On the one hand, secular transition to low-productivity sectors means that suppression of wage dispersion in the workplace can contribute to increase in unemployment. On the other hand, rising unemployment and newly emerging social risks significantly increased the pressure on the social security system, stretching its capability to sustain income equality between those in
the social security system and those in the workplace. What is more serious for the social democrats, increasing exclusion from the labour market posed a fundamental threat to the principle of social justice, as it led to a further increase in the number of the worst off (those with zero income) relative to the worse off (those with low income). The first way is now turned on its head.

Both the “second” and the “third way” are attempts to combat unemployment, but they differ in that the former treats moving people off welfare as an end in itself, and does not take the extra step towards making work pay or rewarding. The “second way”, of course, is the way that most social democratic governments never ventured onto, with the partial exception of the fourth New Zealand Labour government. Epitomized by the neoliberal experiments under Thatcher, the second way strategy to stimulate economic and employment growth is premised on the belief in a low cost and efficient economy which minimizes state intervention in market operations. This neoliberal path towards efficiency-based economic growth involves comprehensive deregulation in the labour market and financial market, privatization, as well as considerable reliance on monetarist and supply side measures, plus retrenchment of the welfare state. While most centre-right governments started to put some increasing emphasis on cost reduction since the early 1980s, the full extent of neoliberal second way was faithfully implemented only in New Zealand under the National government and Britain under the Conservatives, where the potential political veto points for radical reforms are minimal and existing constituency for benefits most narrow. Although different centre-right governments subscribed to the second way emphasis on cost containment to different extents, this second way principle never purported to deliver social protection by the
Evolving among the social democrats, the third way to social justice is an update from the first way in the context of the changing economic and demographic conditions since the 1980s. Since structural as well as policy-induced exclusion from the labour market significantly increased the number of the worst off, the main priority of the third way is to change the status of this segment of the population by moving them back to the labour market. At the same time, since equality of income within the workplace now conflicts with the objective of combating unemployment, a larger dispersion of wage is now tolerated, as long as wages are above a decent minimum. Therefore, instead of income equality within and beyond the workplace, the third way attempts to achieve social justice by promoting work and making work pay. Since this strategy is ultimately aimed at protecting people, individuals are its ultimate target, and the third way, in this sense, “activates” the individuals. Because of its focus on the individual as the object of action, “activation” suitably describes the core principle of the third way. The third way, therefore, is an activation-based strategy towards social justice, and much of third way reforms revolve around the strategies of labour market activation. Table (6.1) summarizes the three ways to social justice and social protection by the state, their contexts, main strategies as well as main partisan advocates.
Table (6.1) Three Ways to Social Justice

<table>
<thead>
<tr>
<th></th>
<th>First Way</th>
<th>Second Way</th>
<th>Third Way</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Context</strong></td>
<td>Golden Age</td>
<td>Permanent Austerity</td>
<td>Permanent Austerity</td>
</tr>
<tr>
<td><strong>Partisan Advocates</strong></td>
<td>Social Democrats</td>
<td>Centre-Right Parties</td>
<td>Social Democrats</td>
</tr>
<tr>
<td><strong>Main Strategies</strong></td>
<td>Compress Wage</td>
<td>Minimum State Intervention</td>
<td>Making Work Pay</td>
</tr>
<tr>
<td></td>
<td>Replace Income</td>
<td></td>
<td>Making Work Pay</td>
</tr>
</tbody>
</table>

The difference between labour market activation on the one hand and income equality or deregulation-based growth on the other is the difference between the three ways at its core. This difference is reflected on almost every major policy dimension on a concrete level. On the one hand, third way social democrats differ from Golden Age social democracy on the European continent by their tolerance of supply-side measures, limited retrenchment to the welfare state, and most importantly, active labour market measures. On the other hand, they differ from the neoliberals in their positive view of the state and social partners, social investments, and aversion to social exclusion. Making innovations as well as choosing and picking from traditional social democracy and neoliberalism, the different pieces of third way come together to constitute a policy package ultimately focused on the creation of jobs, and good jobs in most cases, and this is also why no third way social democratic governments have tried to promote employment by cutting the minimum wage (Green-Pedersen et al. 2001: 24-28, 309-322). Having clarified that the third way is an activation-based way towards
social justice, this chapter now reviews the core strategies towards labour market activation in the third way.

**Expansion, Active Redistribution and Retrenchment: Core Strategies**

Because third way activation primarily involves moving persons in the social security system to the labour market, social and labour market policies are the main domains of action. In the third way, the core strategies of labour market activation include expansion, active redistribution, and retrenchment. Active redistribution, as its name suggests, involves both continuing redistribution towards those most in need and removing work disincentives for the purpose of labour market activation. Each of the three core third way strategies is tailored to specific parts of the social and labour market policy apparatus. For the purpose of clearer presentation, this book has differentiated between the active and passive apparatus of social protection, because not only do these two components serve fundamentally different purposes with regard to labour market activation, they are often treated with very different strategies by the social democrats in their third way reforms.

The active apparatus, unsurprisingly, primarily operates by facilitating the entry into the labour market, whereas the passive apparatus facilitates exclusion from the labour market. The most important component of the active apparatus belongs to active labour market programs (ALMPs). Diverse in design and operation, different ALMPs share the common characteristic of making an offer to the unemployed, either in the form of job placements or training and education. The act of making an offer is very significant, because, different from
any other social and labour market policy instrument, ALMPs move the labour market to the unemployed, as much as they move the unemployed to the labour market. In other words, the ALMPs are the primary strategy which brings the labour market to the door of the unemployed by offering direct interaction between the two parties. Compared with any other social and labour market policy instrument, the extent of state intervention and resource commitment involved in the making of an activation offer is very innovative. In the active apparatus, the ALMPs are also supplemented by two other types of strategies. Unlike the ALMPs, they do not offer the unemployed any direct interaction with the labour market. One type of supplementary strategies indirectly increase the possibility for such interaction by adjusting the structure or regulations concerning the labour market so that the labour market becomes more accessible to people who cannot work on normal schedules or conditions for family or health reasons. At the same time, job security for atypical workers and social security for those temporarily excluded from the labour market are also enhanced. Therefore, these strategies are called flexicurity measures, a combination of flexibility and security. In the event that interaction with the labour market does occur, the other type of supplementary strategies either increase the financial return or reduce the family cost from working. In this case, the supplementary strategies are called in-work incentives.

For the passive apparatus of social protection, there are two fairly different components. One targets persons outside the labour market, and the other targets those still inside the labour market. The former is most typically represented by unemployment benefits, as well as other related income replacement programs. The latter are a wide range of labour-market-clearing measures which serve the purpose of reducing the labour force. Also known
as early exit pathways, these measures can be age-related, health-related or in the form of
leave schemes. In the former two cases, exit from the labour market is permanent, whereas in
the third one it is temporary. While income replacement programs such as unemployment
benefits decrease the incentive for persons to transit from welfare to the labour market, early
exit pathways go one step further by taking people away from the labour market. In other
words, the early exit pathways are ALMPS in reverse. In addition, compared with
unemployment benefits, early exit pathways are also somewhat more ambiguous in serving
social justice objectives because they can potentially transform persons with earning
capabilities into persons without earning capabilities.

For these reasons, the active apparatus has mainly undergone expansion in third way
reforms, whereas the passive apparatus has undergone either active redistribution or
retrenchment. Given the “activation in reverse” effect of the early exit pathways, direct
retrenchment is primarily reserved for these measures. For unemployment benefits, on the
other hand, the response of the social democrats has been more sophisticated, because on the
one hand these benefits do create disincentives to enter the labour market, on the other hand
they still clearly serve social justice purposes. Therefore, cuts to parts of the income
replacement programs did occur in an attempt to remove the welfare trap, but at the same
time the cuts are limited, and frequently balanced by further redistribution towards those
most in need. For similar purposes, various other indirect adjustments have also been applied
to the passive apparatus, including changes to the taxation system as well as welfare
financing patterns. All these adjustments serve the common purpose of continuing income
redistribution for those in need while at the same time removing work disincentives for the
purpose of labour market activation. For this reason, the social democratic changes to unemployment benefits and other related income replacement programs are characterized as active redistribution. Looking at the nine social democratic governments covered in this book, the combination of expansion, active redistribution, and retrenchment reasserts itself repeatedly. Where early exit pathways are prevalent, the social democrats in each case have attempted to close them off, some less successfully than others because of resistance from the social partners. In each case of third way reform, the scope, volume, and financial resources for ALMPs expanded, along with increased in-work incentives as well as measures to increase flexibility in the labour market. None of the nine cases of third way reform, not even the unusual case of New Zealand, involved any radical retrenchment to the social security system.

A similar picture emerges when one examines expenditure in active versus passive measures. No countries which witnessed substantial increase in active labour market expenditure had substantial decrease in passive expenditure, and for the two top-performing cases of Denmark and the Netherlands, the pattern was simultaneous expansion in active and passive measures. Actually from the mid-1980s to the mid-1990s both Denmark and the Netherlands showed the highest spending on passive measures internationally (Hvinden 2003: 277; Gallie 2004: 30; Clasen and Oorschot 2002: 236; Hauser et al. 2000: 27-28). Only Sweden, the most established and consistent activation country, matches the intuitive standard of activation where active measures significantly dominate passive ones, as Sweden remains not only the country with the highest active to passive spending ratio but also the EU country with the highest spending on active measures, a fact remarkable itself because
Sweden also has one of the most generous social security systems. Although the PvdA has been catching up based on a decade of breathtaking reforms, Scandinavian social democrats are still devoting comparatively more resources to ALMPs (Daguerre 2004: 43-44; Ferrera and Hemerijck 2003: 94).

In general, in order to effectively activate the labour market, the primary policy focus must be on the expansion in the active apparatus. Adjustment to the passive apparatus is a very useful supplement, but this alone will not be sufficient to significantly increase labour market activation. On the one hand, the active apparatus, especially the ALMPs, is the primary medium through which the direct interaction between the unemployed and the labour market is actually established; on the other hand the active apparatus is where significant further growth for the future is possible, as for most countries the active apparatus started from scratch only since the mid-1980s. By comparison, the long-term potential for changes in the passive apparatus appears much more limited. The passive apparatus, intrinsically, does not directly create any opportunity for interaction between the individual and labour market, and the best possible adjustments to the passive apparatus can only make it less likely for the passive apparatus to be an obstacle to such interaction. What is more, no matter whether it is retrenchment (of early exit pathways) or active redistribution (of unemployment benefits), these strategies often involve taking away the existing financial or administrative privileges of the social partners, especially the unions, who have developed a proprietary interest in the passive apparatus. This problem is especially serious in insurance-based continental welfare regimes, where changes to unemployment insurance benefit, pension, or
existing working regulations are often fiercely opposed by the unions and aborted as a result. The limited extent of third way reform in both France and Germany is a case in point.

In addition, blanket retrenchment of the passive apparatus is clearly not the way to achieve labour market activation or ultimately the third way. On an ideological level, the passive apparatus can replace lost income and does serve the social justice purpose of protecting the vulnerable, so totally dismantling the social security system directly contradicts the social justice principle which the third way attempts to implement. On a more concrete policy level, adequate out-of-work benefits, as long as they are based on appropriate targeting, or in other words, appropriately redistributed while paying attention to labour market activation, can potentially encourage people to accept short-term jobs and increase flexibility in the labour market. Governments combining expansion in active measures with rollback in passive measures have been more successful in improving the labour market situation than those relying only on restraining passive measures. On the one hand, a substantial increase in spending on ALMPs tends to go together with improved overall labour market performance; on the other hand, reducing spending on income maintenance for those out of work does not contribute on its own to labour market performance (Hvinden et al. 2001: 195; Hvinden 2003: 280). Therefore, in their attempt to activate the labour market, the social democrats have mostly combined expansion in the active apparatus with active redistribution rather than blanket retrenchment in the passive apparatus, so that the social security system is readjusted with changes to eligibility criteria or job-search conditionality, and the social security system consequently becomes both less generous for those able to work and more so for those unable to work.
On the one hand this book has distinguished between expansion of the active apparatus and active redistribution/retrenchment of the passive apparatus, on the other hand it is important to keep in mind that, in actual third way reform, changes to these two sides of the policy apparatus are very closely related, and almost always happen simultaneously. Expansion of the active apparatus often involves corresponding changes in the passive apparatus, and retrenchments in the passive apparatus are often part of an ALMP strategy. For example, changes to the unemployment system often involve attaching the obligation to accept activation offers to unemployment benefits, and the jobs offered in ALMPs are often paid in the form of benefits in the social security system. The dual-nature French RMI, in particular, is an example of total integration between the passive and active apparatus. Nevertheless, although changes to the active and passive sides of the social protection apparatus happen simultaneously and in a related manner, they do follow distinct logics and strategies.

Expansion: ALMPs

As mentioned earlier, the ALMPs are the jewel in the crown of labour market activation strategies, not only because of their future growth potential but also because of the fact that they directly make an offer of entry into the labour market for the unemployed. ALMPs involve a greater role for the state, both in terms of intervention and public expenditure commitment, than any other policy instrument. In each of the third way cases covered in the book, the social democrats have presided over expansion in ALMPs. These programs and their development exhibit similarities as well as differences.
First and foremost, the development of ALMPs over the past two decades has been clearly marked by a gradual strengthening of the obligation on the unemployed to accept the activation offers. The strengthening of obligation is increasingly backed up by concrete sanctions in the event of failure to comply, in the form of reduction, suspension, or withdrawal of unemployment benefits the individuals are entitled to. Before the influx of ALMPs, the primary representation of obligation on the unemployed was the general principle, traditionally attached to unemployment benefits, that the unemployed should be available for work and should not refuse to work unless under reasonable conditions. In this general principle, there was neither clear specification of what availability for work should involve nor what are considered reasonable conditions. How much efforts the unemployed individuals have to make in terms of wage mobility or geographic mobility in order to be considered making themselves available for work was never spelled out concretely. With the introduction of ALMPs, the expectation about availability for work is simplified into the expectation that the unemployed accept the actual offer of activation they are presented with, be it jobs, training or education schemes. By bringing the labour market to the door of the unemployed and taking the initiative to make an offer of activation, the ALMPs have significantly sharpened the focus of the obligation that is required of the unemployed. As the obligation to be activated becomes more clearly specified, it becomes easier to enforce the obligation with sanctions. Therefore, accompanying the sharpening of obligation is the inevitable increase in the degree of compulsion for the unemployed. The making of the offer in the ALMPs, at the same time, also considerably sharpened the right of the unemployed to be activated, as the state has prepared for the individual a concrete and immediate
opportunity to interact with the labour market. The simultaneous sharpening of both right and
duty based on the making of an offer from the state is an important reason why the ALMPs
are revolutionary in their potential impact on the activation of the labour market.

Although the ALMPs in each of the third way cases have sharpened the obligation as
well as right to activation, the balance between the two have played out differently between
different countries. Compared with the other cases, both the Scandinavian and French
ALMPs have invested in the right to activation to a much greater extent. The emphasis on the
right to activation should not be very surprising for the Scandinavian cases, where such rights
are typically strengthened through the quality of the offer that is made to the individual. The
quality of the activation offer in the Scandinavian cases is particularly high because of its
enabling component. This high quality is ensured by the willingness of the state to commit
considerable investment in training, education, skill upgrading, and various other re-
qualification schemes whose cost on behalf of the government is immediate but return on
behalf of the individual is long term. By taking up an activation offer in the Scandinavian
context, therefore, an individual is much more likely to ultimately end up in a well paid and
high productivity job than in either the Anglo-Saxon or continental context. The enabling
quality of ALMP offers, therefore, has been and continues to be pioneered by the
Scandinavian social democrats. By direct contrast, the enabling aspect of the activation offer
is much less emphasized in the cases of third way reforms in liberal welfare regimes, where
the right to activation is consecrated on a lower level: instead of promising well paid and
high productivity jobs, the Anglo-Saxon ALMPs only promise the offer of decently paid jobs,
where the standard of decency is more or less upheld by the minimum wage guarantee.
The strong emphasis on the right to activation in the French ALMPs is due to more country-specific reasons, which can be traced to the birth of the Fifth Republic, if not earlier. The importance of state intervention in French public policy is partly a result of the emphasis on the executive at the expense of parties or interest groups in an attempt to correct the mistakes of the Fourth Republic. It is also partly a result of the upsurge in nationalism resulting from the French Revolution which was channeled into rapidly expanding state authority. Regardless of the causes, the habitual return to state intervention in the French context means that unemployment of the individual is not treated as an issue of individual incentives but a collective issue for the French society and the state. In other words, in the French context, the obligation and right are targeted at separate audiences. The state is expected to solve the unemployment problem for the individual, who has the right to expect such action from the state. As a direct result, in French ALMPs right of the individual to activation overwhelmingly dominates the obligation. The classic example is the major French ALMP, the RMI, whose insertion clauses are almost never enforced and sanctions nonexistent, but participation in RMI is universal and citizenship-based.

Looking across the spectrum of welfare-to-work programs, on one end there are American workfare programs where obligations dominate rights; on the other end there are French ALMPs where rights dominate obligations. Clearly, neither has worked very effectively in promoting labour market activation, and it is the ALMPs in the middle of the spectrum, where a balance between the obligation and right to activation is maintained, that are really effective in moving people from the social security system to the labour market.
In addition to the balancing act between the right and duty to be activated, another major characteristic of ALMPs is that they clearly prioritize target groups rather than treating the unemployed population as a whole. Across the nine third way cases, the first priority of the ALMPs unfailingly falls on the young unemployed. This segment of the population are the first to be subjected to activation, receive the best financed activation offers, and bear the strictest obligation to accept activation, backed up by the severest sanctions. Many of the flagship ALMP packages existing in the third way cases today started off as individual ALMPs targeted specifically at the young, such as the New Deal in Britain, the JEA in the Netherlands, and the Aubry Plan in France. The logic behind this pattern should not be difficult to see. Training and education programs are more likely to have long-term returns the younger the participants. At the same time, periods of exclusion from the labour market at the start of one’s working life often damage the labour market chances of the individual for the entire remainder of the working life, and earlier exclusion is often an easy transit to long-term exclusion from the labour market. Partly because the young unemployed are the easiest group to activate, partly because they are offered the best and strongest active labour market measures, generally ALMPs are most effective in activating the young unemployment, as compared with the activation of any other target group.

Next to the young unemployed, the second primary group subjected to the ALMPs tend to be the long-term unemployed. The young unemployed together with the long-term unemployed constitute the core target group of ALMPs, and expansion of active labour market measures to other parts of the population tend to occur only after some results have been achieved in activating the core group. Compared with ALMPs tailored to the core group,
active labour market measures are much less well financed and less strictly enforced for other typical categories in need of activation, such as the disabled, elderly, or those with lower education and skills. Whereas participation in ALMPs for the young is usually mandatory, participation in activation offers for the disabled rarely is.

Generally, the Scandinavian social democrats offer the best financed and enforced ALMPs to the marginal segments of the population, such as the flex jobs based on subsidies for people with permanently reduced work capacity in the Danish case. Public expenditure resources for ALMPs fall off as the programs move from the core to the periphery, and under this circumstance only very high level of overall spending on active measures, as seen in Scandinavian countries, can sustain the dispersion of resources to the periphery. Offers of ALMP opportunities to the most peripheral or marginalized groups in society are expensive but highly significant not only for the groups concerned but also for the labour market as whole, because, by creating points of entry to the labour market for those unable to compete in a normal labour market competition situation, the ALMPs have virtually created a whole secondary or transitional labour market for these persons. At the same time, as average work capacity or labour market competitiveness of the target population decreases, direct labour market activation also becomes more difficult, and, as an alternative, the objectives of the ALMPs for these persons often broaden to include participation in activities that are not strictly related to paid employment or to the labour market, such as community services, overcoming of social problems or simply enhancing of personal standard of life. Reintegration into the labour market, in this case, is replaced by reintegration into society in general, and this approach towards the most marginalized groups is known as social
activation. As explained earlier, because of their less direct and immediate effect in labour market activation and the high level of financial resources required, social activation is adopted primarily by the Scandinavian social democrats, whose approach to activation has traditionally been characterized by a long-term and enabling perspective.

A further characteristic of the ALMPs in the third way cases is that growing emphasis is being given to the orientation of program design to the specific circumstance of the unemployed individuals. Following this principle, personal plans of action are drawn up between the unemployed individual and the local labour market authorities. These personal plans outline the proposed details of the individual’s activities in the ALMP. Personal case managers with detailed knowledge of the specific circumstance of the unemployed individual is appointed to offer advice as well as counseling on a case-by-case basis. In the process of negotiating the plan of action, the unemployed individual is often given considerable freedom of choice with regard what elements of the active labour market measures should be included, and close reference is also made to the demand situation in the local labour market. Having drawn up the plan, the local labour market authorities are obliged to make activation offers based on the plan, but the individuals are also obliged to accept the offers. To better facilitate the customization of ALMPs, the administration of ALMPs and their payments are often devolved to the regional level.

Because of the close knowledge of the individual that is required in order to offer counseling or advice, a very high level of financial commitment from the state is needed in order to train the personal case managers. Therefore, not surprisingly, individualized ALMPs are most developed and well resourced under the Scandinavian social democrats. For
example, labour market program case managers in Denmark are not only more responsive to the social and personal circumstantial issues confronting their clients but also more autonomous in their work practice than their Australian counterparts, who instead tend to focus on the personality of the unemployed in an incentive deficiency framework. For similar purposes, the public expenditure controlled by local authorities in Scandinavian countries is considerably higher than the rest of Europe. In addition, the focus of Scandinavian activation is very predominantly on improving qualifications rather than lower benefits, and the emphasis of training is gradually shifting from training on the job to more general higher education in universities (Kvist 2002: 5-6; Jochem 2000: 129-130; Fargion 2000: 83; Marston et al. 2004: 21).

On a more general level, the process of making ALMPs adjustable to individual circumstances is a very expensive process because of the human resources and transaction costs involved. This level of investment, however, seems to be worthwhile because evaluation of ALMPs indicates that active labour market measures effective in moving people into the labour market are generally the ones which attend to the specific circumstance of the unemployed individual to a large degree. As the extent of personal orientation drops, the effectiveness of the ALMPs also drops off very quickly, so that in reality only the ALMPs tailored to the individuals prove to be programs which have a clear effect in activating the unemployed.
Expansion: In-work Incentives

In-work incentives for those entering the labour market can increase the financial return from work, and naturally in this case they are primarily incentives in cash. In-work incentives can also reduce the family-related personal cost from work, and such incentives can be either in cash or in kind. However, given the status of public childcare facilities as the dominantly effective instrument in reducing family-related cost from work, cost-reducing incentives are predominantly incentives in kind. Given the distinction between in-kind and in-cash incentives, the particular pattern of in-work incentive provision is closely related to the type of welfare regime where the third way reforms are carried out, because different regime types have traditionally preferred in-kind or in-cash benefits to different extents during the process of welfare state development.

Unsurprisingly, given the traditional bias towards cash transfers at the expense of social services in the continental welfare states (with the exception of France in terms of childcare facilities), the primary form of in-work incentives adopted by the third way social democrats in continental Europe are incentives in cash, aimed at increasing the financial return from work. Given the predominantly insurance-based social security system in these countries and a history of collusion between social partners in externalizing the cost of economic adjustment, excessively high social contributions and tax wedges have significantly contributed to non-wage labour costs and the reluctance of employees to hire new worker, especially those with marginal work capacities or records. This situation has led to the use of employment subsidies in the form of reductions in social security contribution as the primary form of in-cash in-work incentives in continental cases of third way reforms.
The one exception to this general description for the continental social democrats is the French Socialists, who oversaw continued expansion in what is already internationally high level of provision in public childcare facilities. The degree of state involvement in public childcare is, like state involvement in many other domains of French public policy, explained by the traditional emphasis on the collective rather than individual nature of social issues and the responsibility of the state or society in solving these issues. Therefore, because of the statist emphasis, in-work incentives under the French Socialists include not only in-cash employment subsidies in the form of social contribution reductions but also in-kind incentives such as public childcare facilities, which have massively reduced the potential family-related personal cost for women entering the labour market. By contrast, in both the Netherlands and Germany, both the PvdA and SPD have relied more on child benefits in cash than on the expansion of actual public childcare places to encourage female employment.

The arrangements in the social democratic welfare regimes of Scandinavia are very distinct as well. On the one hand, the jobs offered in Scandinavian ALMPs have been characteristically well paid and productive, itself a direct result of the strong enabling emphasis in the ALMPs and the corresponding willingness of the social democratic governments to make long-term investments in human resources. For this reason, extra in-work incentives in the form of financial return from work are much less of a priority in the Scandinavian context than in the Anglo-Saxon context where activation into the labour market is often accompanied by low-wage low-productivity jobs. On the other hand, a long tradition of expansion in public childcare places and parental leave schemes has been continued by the social democrats in all three cases studied, on top of the internationally
generous in-cash benefits related to the cost of caring responsibilities in the family, such as childcare benefits or family allowance. All these types of benefits, in-cash or in-kind, have clearly contributed to the traditionally high labour force participation of women. Furthermore, in terms of encouraging female employment, the role played by in-kind incentives in the form of public childcare places is much more important than in-cash family-related transfers. For this reason, in the third way reforms in Scandinavia, in-work incentives are dominated by in-kind incentives in the form of public childcare places.

On the one hand, the liberal welfare regimes share with the continental welfare regimes the characteristic that in-cash benefits dominate in-kind benefits, and as a result there is generally limited public provision of childcare places; on the other hand, compared with the continental welfare regimes, the emphasis on the breadwinner model of the family unit is relatively weaker in liberal welfare regimes, and women are much more likely to work than their continental counterpart for fear of falling below the poverty line. Therefore, as a general pattern third way social democrats in liberal welfare regimes have offered only limited in-kind in-work incentives in the form of public childcare places. Although both the ALP under Keating and New Labour had made conscious efforts to expand resources on this front, their preferred form of in-work incentives are still in-cash benefits. At the same time, because of the generally tax-funded instead of contribution-funded nature of the social security system in liberal welfare regimes, employment subsidies in the form of reductions in social security contributions are far less feasible as in-work incentives in the liberal welfare context, and unsurprisingly, the form of in-work incentives dominant in liberal welfare regimes exploit the tax-funded and means-tested nature of the benefits and often manifest themselves as
negative income taxes. Several flagship in-work incentive packages operating in the third way reforms in liberal welfare regimes are based on negative income taxes, delivered to those working poor through the fiscal system as tax credits. Prominent examples of these in-cash in-work benefits include the Working Families’ Tax Credit in Britain, Family Assistance Supplement in Australia, and Family Tax Credit in New Zealand. It is easy to see that these negative income taxes are targeted primarily at working families in low income, so these in-cash incentives in the form of negative income taxes are used as the main substitute for public childcare places as the primary policy instrument to reduce the family-related personal cost of entering the labour market. As a sign of the growing maturity of negative income taxes as a major form of in-work incentives in liberal welfare regimes, the third way social democrats in these countries have recently not only expanded the scope but also integrated the service arrangement of their negative income taxes and further integrated benefit and employment services. Under New Labour, for example, not only was the Working Families’ Tax Credit replaced by a Working Tax Credit available for all adults, but the Gateway services for all New Deals were also merged so that a high level of coordination now exists in the tax, social security, and labour market policy arrangements.

However, as said earlier, since in-cash family-related benefits such as child benefits are much less effective in encouraging female employment than the provision of adequate public childcare places, the ultimate effectiveness of negative income taxes in female labour market activation is also expected to be limited. More realistically, negative income taxes are expected to serve a simple social ameliorative objective of offering social protection for families working with low income.
As the economy continues to shift towards the low-productivity sector, long-term job growth for the future will be increasingly in conflict with traditional social democratic preference for solidaristic wage awards and low wage dispersion. Correspondingly, social democratic governments are gradually shifting away from Rehn-Meidner-type solidaristic wage arrangement as the main route to social justice. Instead, the social democrats opted for the strategy of making work pay. Because of the different levels of public expenditure resources traditionally committed to ALMPs among social democrats of different regime types, the interpretation of what “making work pay” means has turned out to be rather different. In the Scandinavian context, “making work pay” usually does mean making work pay well, as the jobs offered in ALMPs are characteristically well paid and productive. On the other hand, in both liberal and continental welfare regimes, because of traditionally lower level of government revenues committed to public expenditure, much fewer resources are devoted to the enabling dimension of activation, and, in turn, to the remuneration and productivity of jobs in the ALMPs. Therefore, for social democrats outside Scandinavia, “making work pay” generally means making sure that work does not pay too low, and for this another form of in-cash in-work incentives have gained increasing prominence in the third way reform process: minimum wages. Whereas both the French Socialists and ALP in Australia have expanded the generosity of minimum wage arrangements during the third way reform process, both New Labour and the PvdA institutionalized statutory minimum wage guarantee for the first time in their country’s history. Nevertheless, minimum income guarantee is certainly not the only option for in-work incentives that make work pay. The Scandinavian alternative of activation with an enabling edge has certainly also made work
pay, and, honestly, pay more, despite the general absence of minimum wage legislation in the Nordic context, which was not needed any way because of the high level of union coverage. The difference, ultimately, is in the proportion of government revenue that can be used as public expenditure for labour market as well as social purposes, which is itself to some extent the byproduct of welfare regime types.

Expansion: Labour Market Flexicurity Measures

As a policy instrument to increase the possibility of interaction between the labour market and the individuals who cannot work on typical labour market schedules or working conditions, increasing flexibility in the labour market has been introduced by many of the social democratic governments in their third way reforms. Generally, increasing labour market flexibility affects the structure as well as the volume of employment, because potential labour market rigidity such as very strict employment protection legislation or contract regulations mainly affects the labour market by creating an insider/outsider divide, so that those who are currently excluded from the labour market will likely remain excluded persistently. By eliminating the insider/outsider divide, flexibility in the labour market has the potential to decrease the number of long-term unemployed and activate the segment of the population which normal ALMPs sometimes have difficulty in reaching.

In third way reforms, although increasing flexibility in the labour market often involves relaxing existing regulatory rules, in general the process is less deregulation than regulatory reform, because whereas rules for labour market entry are relaxed for atypical workers who cannot work on normal schedules or in normal conditions, job security in the
labour market for this segment of the population is often tightened correspondingly. The combination of increasing flexibility of hiring atypical workers as well as increasing job security for these atypical workers is called “flexicurity.” Pioneered by the Dutch social democrats, this approach has turned out to be very effective in increasing the labour market entry of atypical workers. More than most other flexibility reforms in the cases covered, the Dutch flexicurity approach is characterized by its very sharp focus and highly efficient logic. Measures of Dutch flexicurity approach are deployed only at the marginal segments of the labour market while the core workforce is generally left intact. At the same time, these measures relate directly only to the entry into labour market as well as job security in the labour market, while more general issues of social security are left intact. Since the insider/outsider divide has implications primarily for workers already excluded from the labour market, concentrating resources on this segment of the population, and on the labour market entry of them, seems indeed to be the optimal strategy of using flexibility to increase labour market participation. Furthermore, bypassing the core workforce in terms of both deregulation and re-regulation has clearly lessened the potential resistance towards reform from the unions, who are primarily concerned with retaining the job and wage security of the core workforce only.

However, the Dutch approach to flexicurity, where measures are sharply targeted at the margins and objectives are precisely defined in terms of job security, appears to be a hard act to follow for the moment. For most other social democratic governments, the main focus is primarily on increasing toleration for temporary employment. In a few more proactive cases, the social democrats have added a further element of ALMPs to this combination
between lower job security and better social security. The most advanced practice in this tradition is the Danish “golden triangle”, a combination of generous unemployment benefits, high job mobility, modest employment protection measures, and enabling as well as comprehensive ALMPs. Although both the Danish and Dutch strategies towards increasing flexibility into the labour market have been characterized by a balanced approach to flexibility and security, as well as remarkable results in terms of labour market activation, it is important to keep in mind that the actual strategies of combining flexibility and security have followed very different logic for the two cases. Whereas the Dutch practice focuses solely on the margins of the labour market and makes changes directly related to jobs, the Danish practice not only mobilizes the whole labour market, but also the social security system, leading to changes not only related to jobs but also to welfare benefits. Since one strategy clearly mobilizes more resources than the other, whereas the two are more or less equally effective in dealing with the insider/outsider divide issue for the past decade (and arguably more effective in the Dutch case because the higher degree of rigidity pre-existing in the Dutch labour market), the Dutch variant of flexicurity is arguably the more promising strategy of increasing flexibility in the long run, not only because of its sharper focus and more efficient use of resources, but also because of an intrinsically proactive logic embedded in its design. The flexibility and security components of the Dutch flexicurity approach both aim straightforwardly at directly opening up job opportunities for the atypical workers. In other words, no outflow from the labour market is envisaged in the Dutch approach whatsoever. The Danish “golden triangle”, on the other hand, is comparatively more defensive as it first allows ejection from the labour market, then social protection in the event
of ejection, and then inflow back to the labour market with ALMPs. Clearly this kind of logic delivered results as good as the Dutch practice, but a very long detour out of the labour market and back into it has been involved, as well as mobilizing a very generous social security system, which would not have proved equally necessary in the Dutch context. In addition, both the Danish and Dutch flexicurity approaches have further insured a high degree of flexibility in transiting within the labour market: easier transition between part-time and full-time jobs in both countries have been made possible by the fact that part-time work is regulated by the same legal and collective rule as full-time work. Since this particular strategy does not involve initial outflow from the labour market, it is generally efficient.

At this moment, clearly the dominant approach to flexicurity in the third way cases covered in the book is the Danish version of “flexicurity at large”, that is, attempts to relax hiring and firing rules in the labour market while at the same time making some compensation by improvements in the social security system. Meanwhile, most other countries have not been able, or willing, to negotiate between flexibility and security in as balanced a manner as the Danish social democrats. For these other countries, one often tends to dominate the other between flexibility and security. In the liberal welfare regimes, easy hiring and firing rules in general have clearly overshadowed the means-tested and residualist social security system. In Germany, by contrast, relatively generous unemployment benefits exist against the background of relatively strict employment protection legislation. On the other hand, in Norway and Sweden, while the level of nominal employment protection is high, this has not led to a severe insider/outsider divide. For these two countries, employment
protection can often be negotiated on an individual basis between unions and employers, so there is in reality a high level of flexibility in employment protection.

For countries where strict employment protection legislation continues to persist, their limited results in terms of flexicurity reform are often closely related to the difficulty of persuading the social partners, especially the unions, given their connection to and influence on the social democrats. Up till this point in this chapter, the role of the unions in the third way reform process has been rather obscure, because the expansion of the active apparatus to move the unemployed into jobs or make their work pay does not intrinsically pose a conflict with the interests of the unions. However, as we move into areas where the job, wage, or social benefit interests of the core workforce become involved, union resistance becomes a very important factor in the success or failure of third way reforms. Therefore, in third way reforms, the role of the unions are important not only in increases in labour market flexicurity, but also in most changes involving the passive apparatus, including not only active redistribution of unemployment benefits but also retrenchment of early exit pathways. In addition, resistance of unions is often not the only reason why changes towards increasing flexicurity in the labour market are limited. In countries where the labour market was already very deregulated when the third way reform began, such as Britain, there was naturally no significant further moves towards flexibility. The moves towards greater flexibility are, like all other measures of the third way, an means to an end of eliminating the insider/outsider divide. Where this divide does not pose a clear problem for labour market activation, the justification for change is less clear. This is also the reason why increasing flexibility played
a comparatively much less prominent role in third way reforms under the social democrats in Britain, Australia, and New Zealand.

On the other hand, where the insider/outsider divide matters, getting over the union hurdle becomes an important part of the tasks in increasing flexibility in the labour market. As is the case with any other area of third way reforms where the interests of the social partners are potentially jeopardized, the existence of a corporatist framework where negotiations and tradeoffs can be hammered out with the social partners is an important condition for overcoming potential social partner resistance. The remarkable success in the flexicurity reform under the PvdA, for example, is closely related to the cooperative relationship between the government and the unions within the framework of the Wassenaar agreement. On the other hand, achievements in increasing flexibility appear much more limited where unions are too segmented to practice coordinated negotiations, such as in France, or where the state is traditionally excluded from negotiations over the labour market, such as in Germany. And in the case of France, changes under the Socialists led by Jospin have added some further rigidity to the labour market.

In addition, since many of the changes involved in increasing flexicurity need to be carried out on a firm level, decentralization of bargaining activities as well as policy implementation to the local or regional level can further enhance the effectiveness of the reforms, as long as decentralization occurs in a highly coordinated manner and remain supervised by the national authorities. Unsurprisingly, the two most successful flexicurity cases (Denmark and the Netherlands) are also where “centralized decentralization” of collective bargaining has been most advanced. Adequate resources in training and education
for the purpose of re-qualification should also be provided in the case of wage or job security decline as a result of flexicurity reforms, so that those in the margins of the labour market can have the future potential to move to the core whereas those temporarily excluded can move back to the labour market (Esping-Andersen and Regini 2000b: 337-340). For this reason, based on their very strong enabling dimension, the Danish ALMPs have been a crucial component of the Danish “golden triangle”.

Active Redistribution: Unemployment Benefits

Active redistribution, as its name suggests, involves both continuing redistribution and removal of work disincentives for the purpose of labour market activation. For unemployment benefits and related income replacement programs, historically their original focus has been to protect the worst off, those who have been ejected from the labour market and no longer have any source of income. Over the years this focus has been much diffused and income replacement measures in many cases, especially the continental welfare regimes, have spread their tentacles into the labour market by creating significant work disincentives for those who lost their original source of income to find it back. In other words, whereas the original income replacement measures served to protect the worst off, they have over the years taken on the extra functions of preventing these worst off from transforming themselves into the worse off (those with lower wages in the workplace) or well off. Active redistribution under the third way social democrats, therefore, involves shedding these extra functions and letting the social security system sharpen its focus on redistributing resources to those really in need of protection.
Not surprisingly, the re-sharpening of focus involves some cutbacks (to the extraneous areas the social security system has wandered into) as well as some improvements (to those most in need). Therefore, the most important general pattern in reforming the passive apparatus is that the third way does not involve blanket reduction in the social security system. A lot of the large cutbacks to benefits occurred less as part of the planned third way reform strategy than as an immediate reaction to the speed of increase in unemployment. Third way retrenchments to the welfare state are often unemployment-driven, and when the situation in the labour market improves, the cutbacks are often restored by the social democrats again (Huber and Stephens 2001).

When social security benefits are indeed retrenched in an attempt to decrease the work disincentive and increase labour market activation, cutbacks to the duration of benefits are often preferred to cutbacks to the level of benefits. The series of reductions in duration in unemployment benefits by the Danish social democrats serve as the most typical example of this strategy. As the unemployed remain within the social security system longer, they are more likely to lose contact with the labour market, be left behind in terms of skills and education, and the employers are also more likely to be reluctant to hire them, so that their difficulty in returning to the labour market increases further. This vicious circle can very easily lead to long-term exclusion from the labour market and push a person further to the margins of the unemployed in terms of their re-entry opportunities. Therefore, where restraints need to be placed on income replacement measures, the first and most important cut should be targeted at the duration of benefits. A high level of unemployment benefits, on the other hand, is comparatively less likely to directly prevent re-entry into the labour market,
as long as the benefits are withdrawn very swiftly after a certain period. In fact, further improvements in short-term but high-level benefits make it possible for people to search for jobs adequately. On the whole, generous unemployment replacement is a crucial form of social insurance for long-term investment in asset-specific skills (Iversen 2005). High replacement rates reduce the possibility of people being rushed into unfit jobs and creating mismatch between skills and job vacancies. High but short-term replacement benefits have the potential to enhance labour market flexibility, which in the long run leads to a reduction in long-term unemployment.

An equally effective strategy of adjustment for the purpose of labour market activation is to tighten the eligibility requirements for benefits, so that those with still good labour market opportunities can be directly released back to the labour market. In the liberal as well as Scandinavian welfare regimes, the diffused pattern of benefit distribution intrinsic to the universal and tax-funded benefit system makes it easier to sharpen the focus of the benefits by narrowing the scope of distribution and excluding those who are not worst off. Targeting, therefore, is an important strategy of eligibility tightening, especially for the Anglo-Saxon social democrats, and for these countries targeted benefits are often a result of means-testing being applied to originally universal benefits. Furthermore, means-testing tends to be applied from the top to exclude the best off in the case of Australia and New Zealand, whereas under New Labour in Britain it is applied from the bottom to retain the worst off. In the insurance-based continental social security system, on the other hand, it is more difficult to directly exclude people from the benefits, regardless of whether from the top or the bottom, since they have contributed to the funds and lay proprietary claims to them.
Therefore, the alternative strategy of eligibility tightening for the continental social democrats is usually to change the calculating formula of the benefits so that although on the one hand no one is excluded from the benefits, on the other hand each one is to some extent affected by the changes (Ferrera and Rhodes 2000: 5-6). Another strategy to tighten benefit rules without excluding any one in principle is to attach strong conditions to benefit eligibility in terms of job searching or participation in ALMPs, and this approach is adopted by social democrats across different regime types. This demonstrates the close relationship between expansion in the active apparatus and active redistribution in the passive apparatus as part of the core third way activation strategies, as changes on one side almost always involve corresponding changes on the other. Overall, as long as they are appropriately targeted, high levels of benefit or tighter benefit eligibility can be as effective as cutbacks to benefit duration in preventing work disincentive and encouraging labour market activation.

As emphasized throughout this book, the third way is a strategy towards social justice. Some parts of the social security system still serve their social justice objectives while not directly inducing any significant work disincentives, such as public healthcare, family benefits or community aged care. Therefore, these parts of the social security system were either left completely intact (as with all the three Scandinavian cases) or underwent new expansion during the third way reform process (as with the Medicare in Australia). They were not only used explicitly by the social democrats to achieve specific and direct social justice objectives (such as child benefits for combating child poverty under New Labour and the ALP), but were also retained or expanded in an attempt to prevent the potential social
fallout from relatively rapid liberalization or deregulatory reforms in the economic domain, as in the case of French Socialists or the fourth Labour government in New Zealand.

With regard to the financing of the social security system, under the third way social democrats the burden of financing is gradually shifted away from the employers through reductions in social security contribution in an attempt to reduce non-wage labour costs, increase competitiveness, and stimulate growth and employment. At the same time, the state, employees, and the private sector have all taken up a greater share of welfare financing. Here it is important to emphasize again that non-wage labour cost reduction cannot be effective if the contribution burden of the employers was merely shuffled onto the employees without a total decrease in overall social contribution. The role of the private sector, on the other hand, remains strictly regulated and supervised by the state under the social democrats, and currently the private sector is present much more in the delivery of social services than in the financing of social benefits.

Except for the case of the PvdA, efforts to reform the social security system, especially the part where the potential for work disincentives is greatest (unemployment benefits), appear to be much more limited for the continental social democrats than their Scandinavian or Anglo-Saxon counterparts. The contribution-based unemployment insurance systems and the close linkage between earnings and benefits in these countries mean that benefits are treated as deferred wages for a much larger number of the population than is the case for Anglo-Saxon countries. At the same time, the social partners, especially the unions, tend to be deeply implicated in the management of these insurance benefits. Therefore, resistance from the unions poses a considerable obstacle towards reform of the social security
system in continental welfare regimes. As is the case with efforts to increase flexibility in the labour market, resistance from the social partnership can be defused in the framework of corporatist concertation where compromises and tradeoffs can be negotiated between the government and the social partners. For this reason, despite the continental and insurance-based setting of the social security system, with the help of the Wassenaar framework the PvdA has been largely successful in carrying out adjustments to unemployment benefits in order to help activate the labour market. On the contrary, reform of the unemployment benefit system has been much less successful under the French Socialists.

*Retrenchment: Early Exit Pathways*

Early exit pathways, or labour-market-clearing strategies, are often introduced in times of acute increase in unemployment and used as an expedited short-term strategy to combat unemployment by reducing the labour supply. Although these schemes are very effective in lowering the overall unemployment rate in the short term, in the long run when the economy starts to improve and employment increases, they tend to have the opposite effect and create bottlenecks. On a more serious level, early exit pathways can be regarded as a form of “activation in reverse”, because these measures are targeted at people inside the labour market and attempt to move them out of the labour market, so what they accomplish is exactly the mirror image of ALMPs. For this reason, the early exit pathways are particularly damaging in terms of their long-term effect on labour market activation. At the same time, since the early exit pathways have the potential to virtually transform people with earning capabilities into those without earning capabilities, or, in other words, turn the worse off into
the worst off, their connection to traditional social justice objectives is comparatively less clear than unemployment benefits. Therefore, the core third way strategies with regard to early exit pathways have been relatively unambiguous retrenchment. The problem of early exit pathways is relatively less urgent in liberal welfare regimes. The means-tested and tax-funded formal welfare states in Anglo-Saxon countries have generally not been generous enough to directly attract large outflows from the labour market, and indeed in Australia it was as late as 1994 when the first early exit scheme appeared (Castles 1997: 100-101).

Two major types of early exit pathways are health-related ones such as disability and sickness benefits, and age-related ones such as various early retirement schemes. In addition, in the initial stages of the labour market reform in 1994 the Danish social democrats also introduced a wide range of early exit pathways dominated by three leave schemes: the parental, sabbatical, and educational leaves. There are some very important differences between the first two types of early exit pathways and the third one. First of all, unlike disability benefits or early retirement schemes, the leave schemes lead to temporary rather than permanent exit from the labour market. Secondly, the leave schemes do have some inbuilt long-term perspective by allowing for retraining, education or childrearing so that the worker is better prepared in both skills and family conditions to return to the labour market. Thirdly, the leave schemes do not deeply involve social partners in its management, so their closure is much less likely to be reversed by the social partners through covert agreements on the company level. Nevertheless, soon after the labour market reform began the Danish social democrats started to have concern over the bottleneck effect of these schemes, and the party managed to close them all off successfully.
Closure of the other two types of early exit pathways, on the other hand, is much more difficult, and these two types also have much greater effect in reversing activation, because of their permanent nature. Closing these schemes appears to be most difficult for social democrats in continental welfare regimes, where collusion between two sides of the social partnership to externalize the cost of economic decline onto the benefit schemes is strongest due to the contribution-based benefit structure. The negative influence of the social partners in this case not so much comes from their publicized resistance or political pressure on the social democrats as from their practice of quietly filling the void with new voluntary early exit pathways negotiated through bargaining agreements on the company level. This phenomenon of void-filling neutralizes the effect of retrenchment in early exit pathways in any welfare regime setting, so to some extent it is a problem that all third way social democrats have to confront with. However, it is in continental welfare regimes where this problem is most serious, partly because of the contribution-based benefit structure and consequently a time-honoured tradition of collusion between social partners in cost externalization, a situation also seen in the domain of unemployment insurance. Therefore, the crucial reason why the PvdA was able to pull off the biggest crackdown on disability benefits of all time, against this unfavourable continental setting, was precisely that the government started their retrenchment efforts by first of all completely dismantling the administrative bodies for disability benefits which were dominated by the social partners. Instead, the government put in place independent bodies to run the benefits, backed up by legal regulation and covert state supervision. In other words, in one swoop the role of the social partners and their almost proprietary relationship with the benefit schemes were
completely removed. Without having uprooted the social partners from the administration of early exit pathways, the prospect for the French Socialists and the German social democrats in clearing these schemes remains bleak.

Preventing age-related early exit appears to be a particularly important agenda in social and labour market policy reforms in Europe because of the demographic trend towards older populations. Strategies to promote active ageing have matured and diversified into many forms and ventured into different policy domains, including increases in retirement age, flexible pension arrangements, outlawing of age discrimination, prohibition of mass dismissal on grounds of age, as well as time accounts and financial incentives for the employers to retain older workers in the form of wage and social security contribution subsidies. Because of the importance of active ageing as a pan-European agenda, strategies towards early exit are gradually shifting from reactive to proactive, and the focus is no longer merely on preventing early exit but on making further stay in employment easier or more worthwhile for the elderly. Therefore, compared with other areas of early exit pathways, there is much greater inflow of policy instruments from the active apparatus, such as specifically targeted ALMPs for the purpose of promoting old age employment. A typical example of ALMPs helpful in promoting active ageing is the ND+50, one of the six New Deal programs under New Labour, and similarly the Swedish program Activity Guarantee has also benefited the elderly workers disproportionately.
Economic and Institutional Context for the Third Way

Regardless of whether they are applied to the active or passive apparatus, the core strategies of expansion, active redistribution, and retrenchment in the third way all aim to achieve activation-based social justice. In other words, well paid jobs are the policy objective for the third way social democrats. However, most of the core third way strategies are focused on facilitating entry into the labour market instead of significantly expanding the labour market. When the labour market shrinks, entry into the labour market declines as a result, and the main strategies of the third way are largely powerless in reversing this situation, because, apart from some of the direct job creation schemes, most third way measures aim to bring existing jobs and the unemployed together, so they cannot dramatically affect the actual size of the labour market. Labour market activation in the context of a shrinking labour market is not likely to lead to any significant improvement in the labour market opportunities of those excluded.

Job creation, of course, is technically not a labour market or social policy issue. Instead, the creation of investment, growth and employment is much more closely influenced by economic, monetary, and fiscal policies on a macro level. Therefore, for the core strategies of third way reform to be effective in the long run, a larger economic context of growth and competitiveness is needed to keep the labour market growing, or at least keep it from shrinking. The options for fueling economic growth, however, have been very much narrowed in the last two decades. Internationalization of finance, turn to a hard currency, and constraints of the Growth and Stability Pact, have all ruled out some traditional stimulants of the economy, such as competitive devaluation, large public sector borrowing, or lowering of
interest rates. The option left to stimulate growth is to pursue wage restraint as well as maintain a balanced budget and anti-inflationary policy stance. In other words, the core activation strategies of the third way need a job-growth economic context characterized by prudence and wage moderation.

Compared with wage moderation, a prudent approach to the economy appears to be easier to enforce, because the domain of economic policy is precisely where changes in the external context (Growth and Stability Pact and internationalization of finance for example) as well as domestic context (secular shift towards the service economy) are occurring. Being directly implicated by these changes, the pressure to adapt is particularly strong, and the potential for resistance for political as well as institutional reasons particularly weak. The 1983 U-turn in France is a case in point. Across the nine social democratic governments covered in the book, serious efforts were made to enforce a policy of economic prudence. Supply side measures are preferred to demand side measures, and social security contributions are cut to reduce labour costs. Where the third way reforms started off from a basis of relatively strong regulation or protection, such as in Australia and New Zealand, comprehensive deregulation and privatization in the economic domain duly followed, including not only the loosening of credit or interest rate control, but also the transfer of industrial assistance from uncompetitive to competitive industries.

For most of the third way social democrats, however, economic prudence has clearly served very specific and well-defined purposes, both in the long term and the short term. In the short term, increased revenues saved as a result of increased economic efficiency are characteristically channeled by the social democrats into increased public expenditure
devoted to the expansion of active labour market measures as well as improvements in the welfare state, especially for the purpose of combating social exclusion. The deployment of increased revenues into straightforward tax cuts, on the other hand, is much less preferred by the social democrats. In the long term, economic prudence creates the context for economic growth and expansion of the labour market, so that labour market activation as a third way towards social justice can continue to be effective. Therefore, from both a short- and long-term perspective, economic prudence serves the purpose of social justice. Compared with their centre-right counterparts, the third way social democrats have used the fiscal policy in a more flexible manner in service of their public expenditure and social justice objectives. As soon as the fiscal position of the government stabilizes into a surplus, the social democrats started to pursue fiscal policy in a slightly expansionary and redistributive manner. Marginal tax rates from the bottom of the income scale were cut back, and where the strong role of the state in redistributing incomes is traditionally emphasized, such as in Scandinavia or France, the social democrats explicitly raised direct taxes in order to finance increases in public expenditure. Where the role of the state is more residualist, such as in liberal welfare regimes, the social democrats have raised indirect or stealth taxes for the same purpose. Similarly, on condition of a healthy budget, the third way social democrats have proved much more willing than their centre-right counterparts to use demand side direct job creation as part of their efforts to expand the ALMPs in the active apparatus.

Compared with economic prudence with a social justice purpose, securing wage moderation as the other part of the economic context appears to be much more difficult, because the policy domain of incomes policy is where the social partners have historically
come into conflict to the greatest extent. Unless the social democrats can find themselves in the rare context of completely derecognized and segmented unions and comprehensive deregulation in wage bargaining, as New Labour did, a voluntary incomes policy between the social partners in the framework of corporatist concertation has become more or less indispensable for the delivery of wage moderation. Therefore, for most of the third way social democrats, an institutional context of corporatist cooperation between the social partners over incomes policy is needed in order to achieve the economic context of wage moderation with economic prudence. Furthermore, going beyond the macro contexts, corporatist concertation between the social partners and the government is needed in almost any part of the core third way strategies which could implicate the potential interests of the unions or the employers, especially with regard to changes to the passive apparatus, such as changes to the unemployment or pension system or the retrenchment of early retirement or disability schemes.

For the sustainability of continued corporatist concertation and wage moderation, the level of coordination among different branches of the social partnership appears to be more important than the level of concentration in terms of wage bargaining. Of all the nine cases studied, only the Norwegian Labour government was able to avoid decentralization of collective bargaining and indeed oversaw further centralization of bargaining in the 1990s. In every other case, decentralization to the sectoral or company level has occurred to different extents under the watch of the third way social democrats, with the exception of New Labour which came to office against the background of already individualized bargaining pattern. Where such process of decentralization is accompanied by a high level of coordination from
the peak authorities, that is, where “centralized decentralization” has occurred, a voluntary incomes policy continues to be viable and wage moderation is correspondingly delivered as a result. This pattern of “centralized decentralization” accompanies almost every third way case where wage moderation and corporatist concertation are successfully achieved, such as Denmark, the Netherlands and Australia. In addition, the proactive attitude of the government to take advantage of the high degree of coordination in the social partnership and carry out explicit corporatist institutional building has clearly helped. Both the Wassenaar agreement and the Australian Accord started as government initiatives, and both have clearly delivered long-term successes in cooperation between the two sides of the social partnership as well as the government in areas far beyond incomes policy. Where the corporatist practice is highly institutionalized, such as the Accord, the exchange of restraint in nominal wage for improvements in the social wage has been widely accepted as the routine practice. Given the flexibility and broad scope of the social wage concept, which can encompass not only any part of the social security system but also broader issues of training, education or working time regulation, its use as a form of compensation for nominal wage moderation appears be particularly elastic through time and robust against changes in the context of the labour market or economic condition. The gradual evolution of union demands for wage compensation, from direct increases in social benefits to industrial investment and then to working time agreements within the framework of Wassenaar, is a case in point. Similarly, both the restoration of Medicare and the introduction and mandating of Superannuation in Australia were delivered as part of the social wage in exchange for wage restraint through the Accord. Overall, as the scope of negotiation becomes broader, the possibilities for
compromises and tradeoffs also increase, and voluntary agreements are consequently easier to come by. The active integration of different policy domains is likely to become an increasingly dominant practice in corporatist concertation.

On the other hand, where coordination from the peak authorities has declined or remains absent, wage moderation and corporatist concertation have become more difficult to pursue, as seen in New Zealand, France as well as Germany. At the same time, the difficulty of enforcing coordination is partly a result of growing skill and wage differentiation during the transition to the service economy (such as in Sweden and Germany), or a result of historical union segmentation along occupational lines due to natural endowments and industrialization patterns (such as in New Zealand and France). Regardless of the reasons, the lack of coordination among the social partners, and unions in particular, has contributed directly to a classic collective action problem where cooperation is absent, that is, the lack of corporatist concertation. The lack of the institutional context for the third way, in turn, not only affects the immediately related policy domain of wage moderation, but also spreads its impact easily into any part of the core third way strategies where the interests of the social partners can be implicated, which includes pretty much every component of the passive apparatus, plus expansion of the active apparatus when it comes to introducing further flexibility into the labour market. Therefore, among the third way cases studied, the unevenness of third way reform performance, especially with regard to the active redistribution and retrenchment of the passive apparatus, is very closely related to the existence or absence of corporatist concertation.
Theoretical Contributions

By examining social democratic third way reforms, this book’s key argument has been that the partisan colour of government is crucial for the patterns of current welfare state transformation. In other words, the book proposes a power resources theory for welfare reforms after the Golden Age. (1). With this power resources logic, the book challenges the dominant institutionalist path dependency thesis in the new politics of the welfare state literature. Instead, it argues that, despite tight and complex institutional constraints, political agency continues to provide the fundamental momentum as well as shape the core strategies for welfare state reforms. (2). The book’s contribution also includes the methodology of comparative social policy study. Through the activation-based third way reforms, the book underlines the inadequacy of narrow focus on social expenditure or benefit entitlement in approaching empirical data. An integrated examination of the labour market plus the social security system often offers a very different perspective on the dynamics and trajectory of welfare state reforms. (3). On a more general level, the book contributes to the theories of institutions. Based on the power resources theory of welfare state changes, the book challenges the dominant logic of institutional reproduction, positive feedback and increasing returns. The book argues that institutional innovation, based on political contestation, is fundamental to the process of institutional evolution.

The Power Resources Challenge to the Path Dependency Thesis

Through the case studies, the book has shown that social democrats in power have often involved a shift of policy paradigm to an activation-based “third way” towards welfare
state reforms since the Golden Age. Depending on the time of taking office, the centre-left shift towards the third way is either from the “first way” (ALP, the Swedish social democrats, and the French Socialists in the early 1980s), a combination of the “first” and “second” way (the Scandinavian social democrats and the PvdA in the early 1990s), or the “second way” (New Labour and the French Socialists again in the late 1990s). The starting point of the shift varies according to the pre-existing policy paradigm under the centre-right parties of the time. However, the shift of paradigm to the third way through the shift of power to the left is very strong. The strong association between the two parallel shifting processes offers powerful evidence for a power resource theory of third way development: third way reform heavily depends on the left coming into government. In other words, contrary to the conventional understanding that partisan government matters less in the age of welfare retrenchment and path dependent institutional stickiness, in third way reforms partisan government matters most, despite path dependency.

In order to highlight the explanatory power of partisan government in contrast to path dependency, this book has adopted a “most-different-cases” research design. This comparative methodology removes alternative causal variables by eliminating cross-case differences as implausible explanations for cross-case similarities as the dependent variable. After eliminating alternative causal variables, the cross-case similarities are then causally traced back to other similarities across cases. The greater the cross-case differences, the more implausible they are as the right causal variable to explain cross-case common patterns. Within the framework of “most-different-cases” design, this book has attempted to accommodate cross-case institutional variation to the fullest extent possible, by examining
welfare state changes across nine countries encompassing diverse economic, labour market, and welfare state institutional settings. In turn, this high level of cross-country institutional diversity rules itself out as a credible explanation for the similar shifts towards the third way across many of the countries examined. Therefore, as the dominant logic in the new politics of the welfare state, path dependency on existing institutions becomes inadequate in accounting for the almost uniform turn towards the third way across the nine countries. Instead, the book identifies partisan government as the more credible explanation for current welfare state reforms, based on the very strong empirical association between shift in policy towards the third way on the one hand, and shift in power towards social democrats on the other. In spite of path dependent institutional constraints, therefore, political agency emerges as the source of political action that brings about policy changes.

To fully appreciate the power resources challenge in this book to welfare retrenchment theories, it is important to underline how today’s dominant retrenchment theories have substituted path dependency for partisan government as the most significant explanatory variable. Compared with the Golden Age of welfare state expansion up to the late 1970s, retrenchment theories have offered markedly different explanations for welfare state changes, aptly characterized as the “new politics of the welfare state” (Pierson 2001b). Compared with the old politics of the welfare state, the most distinctive feature of its new version is that partisan government matters much less for welfare state transformation. In the literature on welfare state expansion during the Trente Glorieuses, the power resources theory was the dominant theory. It argues that welfare state expansion during the Golden Age is a result of the political organization of wage earners. Incumbency of left parties, which is
in turn associated with the strength of the labour movement, is the most important predictor for welfare state development (Stephens 1979; Korpi 1983; Esping-Andersen 1985). Based on the logic of power resources, several further theoretical extensions have been developed over time to explain postwar welfare state development. Incumbency hegemony from the right, for example, has been identified as a major impediment to welfare state development (Castles 1978; Castles 1982; Hicks and Swank 1984) and, in the absence of strong social democratic parties, electorally dominant centrist parties can take over the role of welfare activism from the left (Hicks 1999). The original power resources logic, in combination with these theoretical extensions to the centre and centre-right, offers a coherent and clear argument that partisan ideological differences matter a great deal in welfare state development.

However, this line of argument has, up till now, suffered a clear setback in the new politics of the welfare state literature. Here, one of the most consistent arguments in explaining welfare reforms since the early 1980s has been that the clash between various partisan ideologies (often manifested in different partisan colours of government) is gradually replaced by the interaction between two other important factors. One is the existing welfare state and production regime institutions. The other is the changes in the characteristics of domestic as well as international economy. Both sides to this interactive process are macro, deeply rooted, and not easily reversible. All OECD countries are experiencing the gradual transition to a service economy. The decline of the manufacturing industry, plus the difficulty for productivity increase to outstrip wage increase in the private service sector (especially in Continental European countries where wage dispersion is
typically low) leads to increasing unemployment. Unemployment in turn increases the burden on the social security system. Meanwhile, increasing international mobility of capital has ruled out further public sector borrowing to pay for welfare state expansion. As a result, across the OECD world the social security budget is heavily constrained by a macro context of permanent austerity (Pierson 2001c). In addition to the economic context, welfare reform options are further constrained by institutional stickiness rooted in diverse welfare state, labour market, and production regimes. This interaction between the common pressure from economic changes and diversity in institutional settings has led to a dominant theoretical perspective on the new politics of welfare state. This is the thesis of path dependent “refracted divergence”, where there are “diverse responses to common challenges” (Myles and Quadagno 2000: 51; Scharpf and Schmidt 2000b; Pierson 2001c; Iversen 2005; Huber and Stephens 2001; Hicks 1999; Kitschelt et al. 1999; Swank 2002; Scharpf 2000; Green-Pedersen 2002).

In this theoretical framework, welfare state responses to internationalization of capital continue to depend on the strength of corporatist institutions plus the previous distributional history of the welfare state (Swank 1998; Swank 2002; Rhodes 2001). Macro institutional legacy of production and welfare regimes (Huber and Stephens 2001b), plus the micro incentive structures for the coalition of participants in the production process (Soskice 1999) similarly constrain welfare reform strategies. Therefore, there is no uniform welfare retrenchment across the OECD countries. According to Pierson (2001b), the retrenchment pattern is a combination of cost control and re-commodification in liberal welfare regimes, cost control and rationalization of existing social programs in social democratic welfare
regimes, and cost control and updating of existing social programs in continental welfare regimes. Along a similar line, Swank (2002) suggests that international capital mobility is either neutral or even positive for welfare state development in countries with a strong institutional basis of social interest representation, such as social corporatism and welfare benefit programs universally available. By contrast, there is much greater pressure for retrenchment where interest representation in the welfare state is fragmented and social programs are characterized by narrower constituencies.

The role of partisan government has been very much overshadowed by this dominant path dependent thesis of welfare retrenchment. In the new politics of the welfare state, the programmatic objectives of parties seem to be significantly diminished. Therefore, apparently social democrats are seriously constrained in their attempt to deliver comprehensive social protection, while the secular right parties are seriously constrained in their attempt to fundamentally remove government involvement in social protection. Instead, an instrumentalist desire to minimize the electoral impact of retrenchment becomes dominantly salient. Welfare retrenchment is limited, regardless of the government’s partisan colour. The basic logic is that the cost of cuts is immediate and concentrated, but its benefits long-term and diffused, if they materialize at all. Therefore, the electoral cost of retrenchment in offending the median voter is enormous (Pierson 2001b). Similarly, where politics still plays a role in the new politics of the welfare state, it is now premised on non-ideological dynamics in the party system. Here, electorally motivated rational strategies of vote maximization or office holding become crucial for retrenchment decisions (Kitschelt et al. 1999, Kitschelt 2001; Green-Pedersen 2002). The new politics of the welfare state, in other
words, is primarily the interaction between institutional stickiness on the one hand and permanent austerity on the other. What remains of partisan politics is the central focus on one dimensional vote maximization. In social policy reforms, parties seem to vie for the median voter rater than remain programmatic or mobilize core interest groups. The power resources theory of welfare state development was developed during the Golden Age to refute, which it effectively did, the Marxist accusation that social democracy has achieved little for wage earners. So, now the new politics of the welfare state seems to indicate that, short of the past legacy of a generous welfare state, there is little future potential for social democracy to work in the interests of wage earners. Since the Golden Age, social democrats have apparently become more pragmatic than programmatic, and have increasingly turned away from interest mobilization for wage or salary earners.

This book begs to differ. Despite the significant institutional diversities allowed in its “most-different-cases” research design, the book has identified common patterns in welfare state changes, for all but one of the nine country cases covered. Through the logic of political agency, the book traces the variation in such common patterns back to corresponding variation in the partisan colour of governments in these countries, between social democracy and their centre-right counterparts. Table (6.2) summarizes the core findings in this book, and shows how the initiation of core welfare reform strategies and their fundamental logic differ, depending on the type of parties in government. The partisan difference is greatest with regard to changes to the active apparatus of social protection. The initiation of expansion in the active apparatus strongly follows the coming to power of the social democrats. The social democratic governments not only take the initiative in introducing new labour market
programs, these new programs also strongly emphasize education, training, and incentives as opposed to cuts in benefit levels. By contrast, there is noticeably less initiative towards expansion of the active apparatus under centre-right governments, who not only tend less to introduce new measures but also sometimes roll back existing labour market programs. Furthermore, the centre-right labour market programs place more emphasis on reducing benefit levels and making welfare unattractive, in a contrast to the social democratic practice of making work more attractive or rewarding.

In comparison with the active apparatus, the partisan difference between left and right in reform strategies is smaller in the passive apparatus of social protection. For unemployment benefits, parties from both the centre-left and the centre-right have attempted to remove potential work disincentives so that people can be moved from welfare to work. For early exit pathways, governments of various partisan colours have attempted to carry out retrenchments. However, there is still clear evidence of variation in reform patterns in the passive apparatus, which can be associated with the type of parties in government. In reforming unemployment benefits, which can potentially sustain the status of loss in earning power through income replacement, the social democrats have emphasized continuing redistribution towards those most in need, in combination with removing work disincentives for the purpose of labour market activation. In other words, the social democratic strategy for unemployment benefits and related income replacement programs is active redistribution. By contrast, the centre-right governments have placed more emphasis on retrenching these income replacement measures, and there is comparatively less redistribution of resources towards the worst off. Under the centre-right governments, the retrenchment efforts are also
largely decoupled from the active apparatus, where state initiatives are much less evident than in the case of social democrats in power. Finally, for early exit pathways, the part of the passive apparatus which actually creates the loss of earning power through income replacement, both social democrats and the centre-right parties choose retrenchment. However, the former place more emphasis on reducing enrollment through tightening eligibility and linking entitlement to working history. The latter are by comparison more in favour of directly reducing expenditure related to these measures. This difference in emphasis, nevertheless, reflects a more fundamental difference in policy logic, which reverberates itself across reform strategies for each component of the social protection apparatus. This fundamental contrast in policy principle is the social democratic objective of labour market activation on the one hand and centre-right objective of cost containment on the other hand.

Table (6.2) Association between Partisan Colour and Welfare Reform Patterns

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As this book has argued, the third way is a third way to social justice, and social protection for those worse off as a traditional social democratic goal is the fundamental objective of the third way. The social democrats formulated this strategy after the collapse of the first way and rejection of the second way to social justice. Strategies have changed over the decades, but the ultimate goal of protecting the worse and worst off remains. The first way of the Golden Age attempted to protect the vulnerable through the route of equality. The worse off (those with lower wages) were protected through wage equality in the workplace approximated by wage compression. The worst off (those with no source of income) were protected through income equality inside and outside the labour market approximated by generous social security benefits. Since the late 1970s, the viability of the first way has been gradually undermined. The decline of the manufacturing sector, changes in international economy, plus macroeconomic policy mistakes during the 1980s, led to large increases in unemployment. This was in essence a large increase in the number of the worst off relative to the worse off. Simultaneously, as job growth becomes increasingly dependent on the service sector, in order to increase employment while remaining fiscally prudent, the government has to look to the private service sector and tolerate increasing wage dispersion (Iversen and Wren 1998; Iversen 2005). This means that wage compression, as the original formula for protecting the worse off, has become less feasible. Meanwhile, the original formula for protecting the worst off becomes increasingly unsustainable, as a result of large inflows into the social security system and emerging new social risks such as child poverty and social exclusion. The root of the problem is clearly the increase in the number of people excluded from the labour market. The labour market nature of this social justice crisis determined how
the social democrats reformulated their social justice strategy. The priority now is to decrease the number of the worst off, and for this purpose the focus of policy turned to the activation of those not employed. At the same time, instead of wage equality within the workplace, there is growing emphasis on a safety floor against unreasonably low wages. In other words, from the first way of social justice during the Golden Age based on income equality, the social democrats have gradually shifted to the third way based on making work pay.

The third way reforms are a clear indication that parties still remain crucial for interest representation and mobilization in welfare state reforms, even in the era of permanent austerity and path dependent institutional stickiness. In other words, power resources theory continues to play a key role in explaining welfare state changes, during the Golden Age as well as afterwards. Contrary to the Marxist assertion, social democracy continues to achieve significant social justice objectives for wage and salary earners. If anything, given that the third way social democrats across the country cases managed to mobilize a smaller welfare state to tackle a much more serious social justice crisis compared with the Golden Age, this social democratic achievement for wage and salary earners in the retrenchment era is all the bolder and more efficient. Because of its social justice objective, the third way is intrinsic to social democracy. It is social democrats who blueprinted its predecessor, the first way, during the Golden Age, and it is they who updated it into the third way during a time of economic adversity. Their centre-right counterparts, by comparison, have by and large bypassed this paradigm shift towards the third way. Before the early 1980s they largely shared with the social democrats the Keynesian consensus of demand management and reconciliation between social and economic goals. After the Keynesian consensus started to unravel since
the 1980s, the continuing concern with social protection led the social democrats to reformulate their policy paradigm from equality to making work pay. For the centre-right, ideologically more sympathetic to a free market, the natural response was different degrees of the second way, the neoliberal cost-cutting alternative for social justice since the 1980s. Characterized by its resolute rejection of the role of the state, the second way has attempted to stimulate the labour market while bypassing intervention in the labour market. Monetarist and supply side adjustments, instead, are used in the hope of kick starting the economy. However, the intrinsic contradiction between intervention and nonintervention has led to the failure of the second way to effectively induce or sustain economic growth and employment, as the experience of both Britain and New Zealand in the 1980s demonstrated.

This book has argued that the conventional new politics of the welfare state literature has exaggerated the fiscal restraint on social democratic activism under permanent austerity. However, the book does not dispute the existence of such pressure towards fiscal restraint. When New Zealand Labour came to office in 1984, the absurd scale of state intervention under the outgoing government had left behind by a large margin any other OECD country at that time. The failure of such state activism to control, if not its contribution to, unemployment, deficit or inflation, significantly discredited the role of the state. This “never again” reaction led Labour to shun increased spending in active labour market measures. Activation-based third way reforms did not emerge until the fifth Labour government came to power by the late 1990s. As the only case among the nine countries without significant expansion in active labour market programs, the fourth Labour government is indeed the exception that proves the rule. When the state is under unusually strong pressure towards
fiscal restraint, options for parties are indeed limited. However, in the conventional retrenchment literature, the threshold is significantly underestimated for such fiscal pressure to constrain social democratic activism. Across the nine country cases, the extent of crisis for state intervention in New Zealand in 1984 was very much the exception rather than the norm. For all other eight countries (and including New Zealand since the late 1990s), despite the fiscal constraint of permanent austerity, social democrats in power managed to shift their social policy paradigm towards the third way.

The Integration of Political Agency and Path Dependency

Using a “most-different-cases” research design, this book has challenged the overshadowing of power resources in the path dependency thesis of the retrenchment literature. While restoring partisan government to its proper place, the book does not dismiss the important contribution of path dependency to welfare reform patterns since the ending of the Golden Age. The book highlights the relevance of path dependency and institutional stickiness through a “most-similar-cases” research design. In contrast to the “most-different-cases” design, the “most-similar-cases” comparative strategy eliminates cross-case similarities as implausible explanations for cross-case variation as the dependent variable. After ruling out cross-case similarities, the cross-case variation is then causally traced back to other differences across cases. Based on this methodology, the book uses the activation-based social democratic third way reforms as a larger context across the country cases. Within this common context of core third way strategies (expansion, active redistribution, retrenchment), the book examines how the finer details of policy instrument and implementation vary across
countries. This variation in policy details is in turn causally traced back to path dependency on diverse existing institutional contexts, including not only welfare state regimes, but also labour market and economic production regimes. The book finds evidence for the role of institutional stickiness in complicating and enriching the common third way strategies, across each major component of the social protection apparatus.

In the active apparatus, the Scandinavian social democratic approach to ALMPs has been distinguished by the emphasis on the right to activation. Such preference can be traced back to the traditionally high state spending on human development and job skills in these countries. While the Scandinavian social democrats have been willing to raise direct taxes to pay for increases in active labour market measures, the social democrats in liberal welfare regimes have been more covert about tax implications from labour market activation. Until very recently the dominant strategy is instead to raise indirect as opposed to direct taxes. In introducing in-work incentives, reduction in social security taxes is a key social democratic strategy in continental welfare regimes. Here the collusion between social partners has led to internationally high levels of social contributions and non-wage labour costs. In Scandinavian welfare regimes, the third way in-work incentives usually come in kind, in the form of further expansion of already generous public provision of childcare. In liberal welfare regimes, the most typical in-work incentive is closely oriented towards the tax-funded and means-tested welfare distributional structure: negative income taxes such as tax credits.

In the passive apparatus of social protection, path dependency on diverse institutional contexts has also enriched the patterns of social democratic third way reforms. Social
democrats tightened eligibility requirement for unemployment benefits through different policy instruments. In continental Europe, it is difficult to take away insurance-based benefits from people who have made contributions over time and regarded them as deferred wages. Therefore, here the dominant strategy is to change the formula of benefit calculation, so that the effect of tightening is spread widely but no one is totally excluded as a result. For social democrats in liberal welfare regimes, the primary strategy adopted is instead further tightening of means-testing. By contrast, Scandinavian social democrats have placed more emphasis on tightening the link between unemployment benefit eligibility and the duty to participate in job retraining, education, or in additional jobs created by the government.

In addition to the core strategies of active and passive apparatus, path dependency also complicates the third way macroeconomic context of wage moderation. Here the key institutional constraints are the historical strength and organizational pattern of social partners and corporatist institutions. Looking across different policy areas, resistance from social partners to reforms which might harm their immediate interests is a significant institutional obstacle for third way reforms. One way to overcome this institutional hurdle is the building of corporatist institutions where differences are hammered out and tradeoffs agreed upon. Where such corporatist institutions have remained robust or further strengthened, there is clear progress in third way reforms. Such progress includes not only wage moderation, but also reforming the passive apparatus and increasing labour market flexicurity. Where such corporatist institutions have remained absent or in decline, wage drift has followed. Social democrats in this context are also largely unsuccessful in reforming the unemployment system, closing early exit pathways or introducing labour market flexibility.
Overall, through the “most-similar-cases” research design, this book has offered much evidence for the contribution from path dependency thesis to the welfare retrenchment literature. This “most-similar-cases” approach highlights how diverse institutional settings have led to the choice of different policy instruments for the common social democratic third way strategies. Therefore, the book’s power resources challenge to path dependency is not to dismiss the importance of path dependency, but to contest the overshadowing of partisan government by path dependency. By proposing the power resources logic through a “most-different-cases” strategy, the book contests the inference in the retrenchment literature that difference between the left and right is now much diminished in welfare reforms, due to the institutional constraints of path dependency. Instead, the book suggests that path dependency in third way reforms can be regarded as a midrange causal variable, within a larger context of continuing social democratic interest mobilization. In the post Golden Age era, power resources are crucial in explaining the initiation as well as fundamental logic of welfare reform policy paradigms. Within the framework of these policy paradigms, path dependency is crucial in explaining the rich diversities in policy instruments as well as policy implementation. Faced with the collapse of the first way to social protection, the coming to power of social democracy versus centre-right parties is almost always the key determinant in choosing between a third way based on activation versus a second way based on cost cutting. Social democracy not only leads to the initiation of third way policies, it also decides the fundamental components of the core third way strategies. These core strategies include first and foremost expansion in state involvement in the labour market, then supplemented with active redistribution and retrenchment in the passive apparatus of social protection, within a
larger macroeconomic context of budget balance and wage moderation. Meanwhile, institutional stickiness in different welfare state regimes has led to diverse policy instruments to expand the active apparatus or combine further redistribution with work incentives in the passive apparatus.

The book brings the attention back to the role of partisan government, interest mobilization, and political contestation in current welfare reforms. Meanwhile, it also continues to highlight the importance of path dependency on existing institutional contexts. Based on a combination of “most-different-cases” and “most-similar-cases” comparative research strategies, the book has argued for an integrated theoretical approach to the new politics of the welfare state, rather than narrower focus on any single variable as the predominant explanation. Ultimately, interests, ideas, and institutions are indispensable to each other and to a causally convincing account of the welfare reform experience in the current era of service economic trilemma plus permanent austerity for the social security budget.

*The Methodology of Studying the Welfare State after the Golden Age*

In addition to its theoretical contributions to the retrenchment literature, the book also argues for a more integrated methodological approach to the comparative welfare state literature, especially in the context of the welfare retrenchment era. In the new politics of the welfare state literature, the dominant framework of permanent austerity means that there is much focus on the fiscal constraint over social democratic governments for further welfare state expansion (Pierson 2001b; Huber and Stephens 2001; Kitschelt 1999 et al.). Through
the examination of activation-based third way reforms, the book indicates that the extent of
cost constraint on social democratic commitment to state involvement in social protection has
been exaggerated. A very important reason for this overestimation is the methodology of
comparative welfare state research. The primary focus of examination in the new politics of
the welfare state literature is often on changes within the confine of the social security system.
Here, indicators of social expenditure, though no longer dominant, continue to be regarded as
an important indicator for welfare retrenchment or expansion. In addition, data on welfare
benefit entitlement, both quantitative and qualitative, are also very much the focus of
attention. If based on this narrow analytic framework, it would indeed be a reasonable
conclusion that there is now moderate but uniform retrenchment across country cases, and
that social democratic parties are staying clear of further state expansion.

However, the social democratic third way reforms have highlighted a major weakness
in this research methodology focused tightly on the social security system proper. The third
way to social justice involves a very high degree of integration between corresponding
reforms in the social security system and the labour market. Active redistribution or
retrenchment of the passive apparatus is almost always tightly associated with expansion of
the active apparatus in terms of active labour market measures. These labour market
programs often signal a further increase in spending commitment on behalf of the social
democratic state. An activation offer in the labour market is often premised on tightening
benefit eligibility for people currently in the social security system, and meanwhile the
remuneration for participation in activation offers comes often in the form of increased
income replacement payments. For this reason, in examining third way reforms, it would
have been a serious model mis-specification to look at social security or the labour market alone. If anything, the core social democratic strategy in dealing with heightened social justice crisis is precisely to offload the main duties from the social security system to the labour market. The social democratic policy focus has shifted from defensive income replacement in social security to proactive income regaining in the labour market. For this reason, if one is to focus solely on social expenditure or benefit entitlement, the correct inference for third way social democratic activism should be a *smaller* social security system but a *bigger* state presence in the labour market, which is exactly what is found in this book.

On the one hand, tight focus on the social security system proper has led to the incorrect interpretation of declining social expenditure or benefit entitlement as a sign of retreat in social democratic activism. On the other hand, methodological focus on data within the social security system also leads to clearly incomplete observations of comparative social policy reforms. This is because the labour market half of the picture, which is precisely where there is often significant increase in public spending committed to active measures, is left out. In other words, it is not that social democratic activism diminished in the age of permanent austerity. Instead, such activism actually increased, but in a different location of the social protection apparatus. Narrow focus on the passive component of the apparatus in the research methodology clearly inflates the impression of stability and retrenchment, and under-represents the significance of expansion, because the core third way strategies are precisely expansion of the active apparatus, supplemented by changes in the social security system. Table (6.3) outlines how differing methodological approaches to welfare state research can offer very different predictions for the future of the welfare state in the context
of continuing permanent austerity. These different methodological approaches, meanwhile, can be traced back to different theoretical understandings about the role of the state in social protection.

Table (6.3) Different Predictions for Welfare Future under Permanent Austerity

<table>
<thead>
<tr>
<th>Predictions</th>
<th>Theoretical Framework</th>
<th>Policy Arena</th>
<th>Data Collection</th>
<th>Evidence</th>
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</thead>
<tbody>
<tr>
<td>Limit to Growth</td>
<td>Income Replacement</td>
<td>Social Security System</td>
<td>Social Expenditure, Benefit Entitlement,</td>
<td>Stability and Decline</td>
</tr>
<tr>
<td>Potential for Growth</td>
<td>Income Regain</td>
<td>Labour Market</td>
<td>Labour Market Programs</td>
<td>Growth under Social Democracy</td>
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When the theoretical framework for social protection is primarily income replacement within the social security system, the corresponding research methodology tends to focus on changes in either social expenditure or benefit entitlements. This methodological approach to data collection has a long tradition in comparative welfare state research. It is the conventional methodology to social policy studies, and it is reflected in influential comparative welfare state datasets (Esping-Andersen 1990; Scruggs 2005). Looking at current welfare state changes from this methodological tradition, empirical evidence indeed lends support to the conclusion that there is now clear limit to further growth for social democratic welfare activism. Across advanced industrialized countries, social expenditure or
benefit entitlement have undergone slow decline within the overall context of stability, regardless of the types of parties in power.

However, the prediction for welfare state future under permanent austerity is very different, if one adopts a different theoretical framework for social protection as well as corresponding research methodology, as is the case in this book. This book has examined social protection by including not only income replacement in the social security system, but also, more importantly, income regaining in the labour market. On an empirical level, the corresponding data examination also emphasizes labour market programs as well as traditional social security programs. Social expenditure and benefit entitlement have entered slow decline. However, state involvement in labour market programs, especially measures making work more attractive, such as education, training and in-work incentives, has undergone expansion when the social democrats are in power. In other words, there is significant advantage in adopting a more integrated methodological approach to current welfare state research, which encompasses not only social security but also the labour market. Using this approach, the book has been able to offer an interpretation of welfare reform patterns which strongly challenges the dominant path dependency thesis in the retrenchment literature. Of course, the choice of this more integrated comparative research methodology ultimately depends on the adoption of a more integrated theoretical understanding of social protection by the state, which includes not only income replacement, but also labour market activation.
Contribution to Theories of Institutions

The book’s power resources logic to third way reforms also has more general theoretical implications for institutional reproduction as well as innovation. In theories of institutional evolution, one clear line of development has been that it is inappropriate to examine institutional reproduction and change as two completely separate processes, or to associate stasis and inertia with institutional reproduction. On the contrary, the policy feedback literature has argued that institutional reproduction actually involves constant changes and adaptations in reaction to changing environments, and what is reproduced is often earlier policy assumption, preference distribution structure, behavioral constraints as well as incentives for individual actors. These constraints leave their influence on the pattern in which institutions change or adapt to developing conditions (Pierson 1993; Pierson 2004; Skocpol 1992; Thelen 2003). This path dependent argument of positive feedback or increasing returns is a major improvement in explaining institutional evolution. It rejects as unrealistic the “punctuated equilibrium” treatment of institutional evolutionary process as a long series of stasis dotted with radical changes at historically crucial moments. Instead, the logic of positive feedback offers an image of incremental but constant institutional evolution whose path is nevertheless heavily dependent on prior institutional legacies (Olson 1982; Mahoney 2000; Thelen 2004). The path dependent “refracted divergence” argument in the welfare retrenchment literature is precisely located in this framework of institutional evolution. Here, the emphasis, understandably, is on how the reproduction of distinct institutional assumptions and structures dominates the process of innovation, so that welfare
state changes in the era of retrenchment continue to follow divergent rather than common patterns.

With regard to the specific institution of the welfare state, this book has contested not the evidence for such path dependency, but how it should be interpreted and what it implies for partisan politics. Similarly, with regard to larger theories of institutional survival and change, this book does not contest the existence of path dependent increasing returns or positive feedback (in other words, acts of reproduction), but does contest whether reproduction or innovation should be the bigger component of institutional evolution. The observation of reproduction as the dominant trend in institutional evolution is inevitable if the assumption of the mechanism for change is based on a short-term calculation for actors in charge of the institutions, who are solely concerned with continuing to maintain power and control over institutions. As an institution and its practice or structure consolidate and become increasingly systematic or large scale, the transaction cost of operating on an existing platform decreases progressively. This cost often appears even smaller when compared with the transaction cost of establishing an alternative platform for institutional operation, especially when considering the possible cost, both in terms of money and popularity, associated with discarding the existing platform, making individuals vested in it redundant, and retraining them for the new platform. For this reason, comparing institutional reproduction and institutional innovation, the cost of the latter is almost always greater and more immediate. Because of the transition period involved from old to new platforms, the benefit of innovation will take time before coming into stream. The potential benefit of innovation often starts to gradually emerge some time after one or two junctures, during
which constituencies in the institutions have had an opportunity to put a verdict on the performance of institutional rulers over these innovations. Therefore, the benefit of innovation is very much long term compared with the cost, financially in terms of immediate increase in expenditure and investment, and electorally in terms of offending established constituencies. In the framework of a short horizon for institutional actors and a one-dimensional preference for maintaining control over institutions, it is a very reasonable expectation that there are often increasing returns and positive policy feedbacks from existing institutional parameters. This perspective often appears in arguments in the retrenchment literature, whereby the pressure to appease the median voter electorally and to decrease fiscal burden economically is said to have dampened the appetite for radical retrenchment as well as expansion. For this reason, parties from both the left and right continue to fall largely within existing institutional parameters.

Based on social democratic third way reforms, this book has challenged the argument in the retrenchment literature that interest mobilization declines in current welfare state reforms. The book has challenged the reduction of partisan politics to instrumentalist survival instincts, both electorally and economically, and often in the immediate short term. Similarly, with regard to theories of institutional evolution, this book challenges the assumption of short-term horizon for actors involved in institutional evolution, whose primary preference is maintaining short-term control over institutions instead of mobilizing constituency interests. Instead, the social democratic third way reforms have highlighted the inadequacy of the short-term horizon assumption for explaining institutional change. When institutional actors are programmatic instead of pragmatic, and when they are concerned with not only short-
term survival but also mobilization of long-term constituency interests, then the potential for innovation, as opposed to reproduction, is significantly greater in the overall process of institutional evolution.

Based on this line of argument, Thelen (2003; 2004) has outlined a scenario where the returns from existing institutional settings are not necessarily increasing, and where the policy feedback can be negative. The relevance of this scenario increases as the focus of analysis shifts to interest constituencies located on the periphery of the institutions, in other words, actors who do not have direct and incumbent control over institutions. When features of existing institutions start to conflict with or damage the core interests of these actors, grievances are generated from the periphery as a result. For these outsiders without control of the institutional agenda, the immediate response is to attempt to capture the institutions and become insiders, so that they can shape the agenda of the institutions to reflect their own core interests. This is what Thelen (2004: 294) calls the “political contestedness of institutions,” whereby institutions innovate instead of reproduce, as a result of the shift between the different agendas of insiders and outsiders, which are respectively tailored to their own constituency interests. In other words, in addition to reproducing existing parameters in order to maximize the immediate survival preference of central actors, institutions also innovate by accommodating different agendas whenever they are captured by newly empowered actors intending on mobilizing and representing their own core interests. In the context of welfare state theories, this is precisely the logic behind the power resources argument, whereby welfare institutions accommodate different agendas, depending on what coalition of interest constituencies and their political representatives are in executive control (in other words, in
government). For theories of institutional evolution, this book has similarly highlighted the importance of institutional innovation based on political contestation of institutions. Clearly, short-term calculation of survival exists. However, it by no means washes out interest mobilization as an important factor in welfare politics, especially when a group of interest constituencies are newly empowered and ready to reshape the institutional agenda in order to reflect their own preferences. This logic helps explain why shifts of government between the centre-left and centre-right are often associated with shifts of policy paradigms for welfare reforms. As the first way to social justice started to unravel by the early 1980s, there was a drastically sharpened social justice crisis in the form of increasing labour market exclusion (and loss in the source of income). In response, the entry of social democrats in government has often been associated with institutional innovation, in an activation-based third way to regain the source of income. In this third way reform process, path dependent institutional reproduction premised on existing institutional stickiness should also be placed in a larger context of institutional innovation, as a result of political contestation and interest mobilization by social democrats.
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