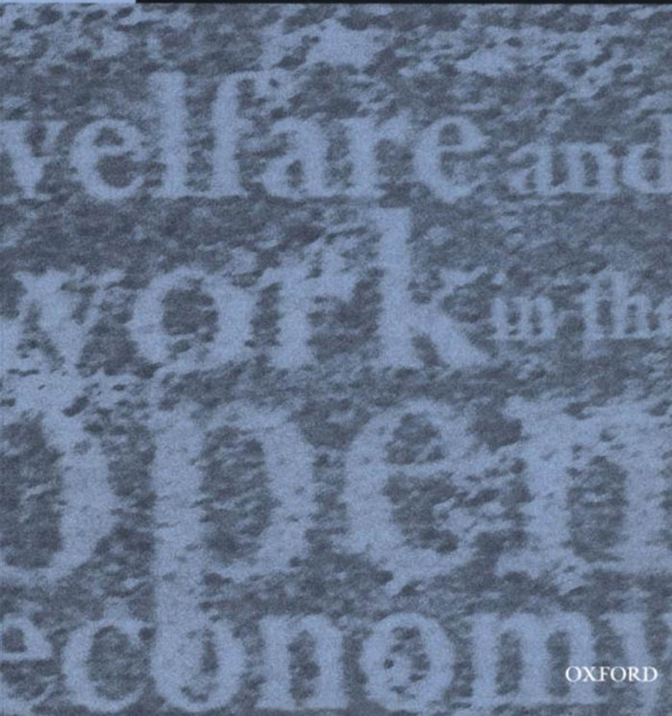
welfare and work in the open economy

VOL. II

diverse responses to common challenges

Edited by Fritz W. Scharpf and Vivien A. Schmidt



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Preface

Since the demise of the Cold War with its fear of a nuclear doomsday, 'globalization' has become the current specter of public debates in Western Europe, threatening to wipe out the achievements of advanced welfare states in providing full employment, social security, and greater social equality for their citizens. At the same time, these debates have seen an ever more rapid succession of 'model' countries that seemed to have found some miracle solution, and that were displaced by the next one when, on closer inspection, the miracle turned out to be less than perfect. Thus Japan, celebrated as the world leader in industrial productivity, was succeeded by the 'Rhine model' of social consensus and stability, which in turn was forgotten when admiration shifted first to New Zealand's radical liberalization, and then to the 'Great American Job Machine', which subsequently was overshadowed by the Dutch 'polder model', by growing attention to the Danish achievements in defending high levels of employment and social protection, and now by peak-level discussions about 'multiple Third Ways'.

When we first began to talk about the possibility of a joint project that would clarify these issues in early 1997, the academic literature was split between theoretical contributions, some warning of inexorably tightening economic constraints that were reversing postwar advances in the democratic civilization of capitalism, and others celebrating the ultimate liberation of economic dynamics from the fetters of state control. The available empirical research provided either statistical tests of hypotheses focused narrowly on a few quantifiable indicators or case studies dealing in depth with selected issues in one or a few countries. Thus, what was needed in our view was empirical and comparative research that would utilize much more information about specific problems and policy responses of advanced welfare states than was possible in statistical studies, and that would also be more comprehensive with regard to issues as well as the number of countries than had been possible in the available case studies. In a series of discussions among ourselves and with knowledgeable colleagues, we concluded that such a project would have to include at least Sweden and Denmark among the Scandinavian welfare states; Austria, Germany, the Netherlands, Belgium, France, Switzerland, and Italy in Continental Europe; and the United Kingdom, Australia, and New Zealand among the Anglo-Saxon countries. We also decided to focus on employment as well as social policy systems and to cover the period from the early 1970s to the present.

Even though our substantive research interests as well as the geographical reach of our first-hand knowledge were complementary, rather than overlapping, we never thought we could carry out a comparative study of this scope by ourselves. At the same time, the manpower requirements and costs of a project based on original empirical research covering the policy experience of a dozen countries over three decades would have been prohibitive. Instead, we decided to organize a highly structured conference project that would rely on the cooperation of colleagues who are experts on the countries to be covered, and who could draw on their background knowledge plus a limited amount of additional research for the preparation of comparable country reports that could then provide the foundation for comparative analyses. Even so, the financial needs of the project would by far exceed the resources that could be provided by the Cologne Max Planck Institute for the Study of Societies, where the project was to be located.

We count ourselves extremely lucky in obtaining the early, and in many cases enthusiastic, commitment of so many competent colleagues to what turned out to be an extremely demanding common project. At the same time, our needs for financial support were eased by a pump-priming allocation of the President of the Max Planck Society, and then met by a major grant from the Volkswagen Stiftung, a grant from the Fritz-Thyssen Stiftung for a smaller coordinated project, and by the support of the Robert Schuman Centre of the European University Institute for one of the project workshops. We are deeply grateful to all these sponsors. Their support allowed us to bring Anton Hemerijck, Rotterdam University, and Vivien Schmidt for half a year to Cologne, where the project was supported by a highly competent team including Steffen Ganghof, Martin Schludi, Eric Seils, and Torben Vad. Vad and later Ganghof acted as overall project coordinators.

In order to assure a common focus among all participants, we began the project by formulating a 50-page 'background paper' that reviewed the available literature and explicated a comprehensive set of working hypotheses on the possible first- and second-order impacts of changes in the external economic environment on the employment and social policy systems of advanced welfare states, on the likely effectiveness of possible policy responses, and on the institutional conditions favoring effective policy responses.[1] In order to allow contributors to locate their country

[1] Fritz W. Scharpf, Vivien A. Schmidt, and Torben B. P. Vad, *The Adjustment of National Employment and Social Policy to Economic Internationalization,* Background Paper (Cologne: Max Planck Institute for the Study of Societies, 1998).

studies in a quantitative context, the Cologne team also compiled a common database consisting mainly of OECD time series on the economic performance, employment, public finance, capital markets, social policy, wages and distributive outcomes for all countries, starting in the 1970s wherever possible.[2]

Both documents were made available to the participants of an 'opening conference' in Cologne, early in 1998, in which the overall design of the project, the questions to be addressed, and their goodness of fit for the countries to be covered were discussed by the future authors and several expert commentators. At the same time, it was agreed that a number of important issues needed to be addressed in special studies. First drafts, which were expected and delivered in the early Fall of 1998, were subsequently discussed in great detail in a series of smaller workshops in Cologne and Florence. Second drafts as well as first drafts of the comparative chapters were then prepared for discussion among all participants and again a number of knowledgeable commentators in a 'concluding conference', convened in February of 1999 in the snowbound isolation of the Max Planck Society's Ringberg Castle in the Bavarian Alps.

By that time, Oxford University Press had agreed in principle to publish the outcome of the project in two volumes—provided we would be able to meet its page limitations and its timetable. This implied that all authors received not only detailed comments from the editors, on themes to be elaborated and additional information to be supplied on the basis of the Ringberg discussions, but also precise instructions about how much of the text had to be cut in producing the final draft that was due at the beginning of the Summer. By the end of the Summer, a second round of comments from the editors and revisions by the authors led to 'final-final drafts' which then went to Jeremiah Riemer, our most demanding language editor, whom we cannot thank enough for his skill and diligence in translating texts from German-English, Italian-English or Danish-English into lucid and elegant American-English.

We have described the process in some detail to show that unlike many conference projects, where participants produce loosely connected papers based on ongoing work, ours did demand a great deal more of contributors, not only because of the range of issues we asked them to address but also because of the very specific guidelines we suggested they follow in writing their papers, the common hypotheses which we expected them to address, the comparative data by which we expected them to contextualize their analyses, and the numerous rounds of editing and requests for

[2] Martin Schludi, Eric Seils, and Steffen Ganghof, *Adjustment Data Base,* Paper (Cologne: Max Planck Institute for the Study of Societies, 1998).

revisions under increasingly tight deadlines with which we badgered them. We are extremely grateful for their willingness and ability to produce first-rate contributions under these very demanding conditions. Similarly, we are grateful to the expert commentators in our series of conferences and workshops who were willing to read many and very long drafts and to offer extremely helpful critiques and suggestions, both theoretical and empirical. Their input proved invaluable to the authors and to the project as a whole. Since they will not appear among the authors, we name them here in alphabetical order: Jens Alber, University of Konstanz; Peter Hall, Harvard University; Franz-Xaver Kaufmann, University of Bielefeld; Stephan Leibfried, University of Bremen; and John L. D. Stephens, University of North Carolina.

Our final thanks go to the staff of the Cologne Max Planck Institute without whose support all our efforts would have come to naught. Under the professional supervision of Christel Schommertz, Sonja Jerak and Thomas Pott worked very hard, and in the final two weeks practically around the clock, in order to have all texts, tables, and figures formatted according to Oxford rules in time to meet the ironclad publication deadline. We also thank Jürgen Lautwein and the administrative staff at the MPI for the efficient and flexible management of our complicated project finances, and Christina Glasmacher for secretarial and organizational support throughout.

Fritz W. Scharpf

Vivien A. Schmidt

Cologne and Boston

December 1999

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Abbreviations

The following abbreviations are used to indicate various countries in some of the tables and figures:

A	Austria
AUS	Australia
B	Belgium
CAN	Canada
CH	Switzerland
D	Germany
DK	Denmark
F	France
FL	Finland
I	Italy
IRL	Ireland
JAP	Japan
N	Norway
NL	Netherlands
NZ	New Zealand
S	Sweden
UK	United Kingdom
USA	United States of America

Other abbreviations used:

EC	European Community
EMU	European Monetary Union
EU	European Union
ILO	International Labour Office
IMF	International Monetary Fund
ISIC	International Standard Industrial Classification of All Economic Activities
OECD	Organisation for Economic Co-operation and Development

Notes on Contributors

MATS BENNER is Assistant Professor of Sociology at Lund University, Sweden. He has written several books and articles on comparative industrial and technology policy.

GIULIANO BONOLI is a Lecturer in the Department of Social Work and Social Policy, University of Fribourg, Switzerland. He has recently published a book entitled *The Politics of Pension Reform*: *Institutions and Policy Change in Western Europe* (Cambridge University Press, forthcoming). His current research is on comparative social and labor market policy.

MARY DALY is Professor of Sociology at Queen's University, Belfast, Northern Ireland. She formerly worked in Germany, Italy, and the Republic of Ireland. She has written widely on the topic of comparative welfare states, especially in relation to gender. Her latest book, *The Gender Division of Welfare,* is published by Cambridge University Press. Her current research interests include welfare state reform and family and labor market policies in comparative perspective.

BERNHARD EBBINGHAUS is Senior Researcher at the Max Planck Institute for the Study of Societies, Cologne (Germany) and 1999/2000 J. F. Kennedy Fellow at the Center for European Studies at Harvard University, Cambridge, Mass. (USA). He is also co-author (with Jelle Visser) of *Trade Unions in Western Europe since 1945* (London: Macmillan, 2000).

MAURIZIO FERRERA is Professor of Public Policy and Administration at the University of Pavia and directs the Center for Comparative Political Research at the Bocconi University of Milan. He has written several books in Italian on comparative social policy and on Italy's welfare state. In English he has recently edited (with M. Rhodes) a special issue of *West European Politics* on 'Recasting the European Welfare State' (2000).

STEFFEN GANGHOF is a doctoral fellow at the Max Planck Institute for the Study of Societies in Cologne. His research interests include comparative political economy, institutional analysis, and European Integration.

ELISABETTA GUALMINI is Assistant Professor at the University of Bologna, where she teaches Comparative Public Administration. Her most recent book publications include *Le rendite del neo-corporativismo* (Soveria

Mannelli: Rubbettino, 1997), *La politica del lavoro* (Bologna: Il Mulino, 1998), and *Salvati dall'Europa,* with M. Ferrera (Bologna: Il Mulino, 1999).

ANTON HEMERIJCK is Senior Lecturer in the Department of Public Administration, Leiden University, the Netherlands and visiting researcher at the Max Planck Institute of the Study of Societies in Cologne. He studied Economics at Tilburg University, and Political Science at Oxford University (Balliol College), where he wrote his dissertation, and MIT, Cambridge, Mass. He has published widely on issues of comparative social and economic policy and welfare reform. Together with Jelle Visser, he wrote *'A Dutch Miracle': Job Growth, Welfare Reform and Corporatism in the Netherlands,* which is now available in English, German, Italian, and Dutch. A Japanese edition is currently in preparation.

ADRIENNE HéRITIER is Professor of Political Science and co-director of the Max Planck Project Group on 'Common Goods: Law, Politics and Economics'. Recent publications include: *Policy Making in Europe and Diversity: Escape from Deadlock* (Cambridge: Cambridge University Press, 1999); 'Elements of Democratic Legitimation in Europe: An Alternative View', *Journal of European Public Policy,* 1999, 269–82.

JONAH D. LEVY is Associate Professor of Political Science at the University of California, Berkeley. His research focuses on economic and social policy in Western Europe, notably France. Levy's most recent publications include *Tocqueville's Revenge: State, Society, and Economy in Contemporary France* (Cambridge, Mass.: Harvard University Press, 1999) and 'Vice into Virtue? Progressive Politics and Welfare Reform in Continental Europe', *Politics and Society,* 27/2 (June 1999), 239–73.

ANDRé MACH is a teaching assistant at the Institut d'études politiques et internationales, University of Lausanne, Switzerland. He is currently completing his Ph.D. on the reform of competition policy and changes in industrial relations in the 1990s in Switzerland. He has published on organized interests and on social and economic policies.

PHILIP MANOW, political scientist, is a researcher at the Max Planck Institute for the Study of Societies in Cologne. He is the author of numerous articles on the German welfare state and has written two books on German health policy. Currently, he is co-editing a book on *Varieties of Welfare Capitalism.* Recent English articles include 'The Comparative Institutional Advantages of Welfare State Regimes and New Coalitions in Welfare State Reforms', in Paul Pierson (ed.), *The New Politics of the*

Welfare State (Oxford University Press, forthcoming); (with Anton Hemerijck and Kees van Kersbergen), 'Welfare without Work? Divergent Experiences of Reform in Germany and the Netherlands', in Stein Kuhnle (ed.), *The Survival of the European Welfare State* (Routledge, forthcoming).

MARTIN RHODES is Professor of European Public Policy at the European University Institute in Florence. His recent publications on employment and welfare issues include 'Globalization, Welfare States and Employment: Is There a European "Third Way"?', in N. Bermeo (ed.), *Unemployment in the New Europe* (Cambridge: Cambridge University Press, 2000) and 'The Political Economy of Social Pacts', in Paul Pierson (ed.), *The New Politics of the Welfare State* (Oxford University Press, 2000).

FRITZ W. SCHARPF, Professor of Political Science, is director at the Max Planck Institute for the Study of Societies, Cologne, Germany. Recent publications in English include: *Crises and Choice in European Social Democracy* (Ithaca, NY: Cornell University Press, 1991); *Games Real Actors Play: Actor-Centered Institutionalism in Policy Research* (Boulder, Colo.: Westview Press, 1997); *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999).

SUSANNE K. SCHMIDT is a research fellow at the Max Planck Institute for the Study of Societies. Recent publications include (with Raymund Werle), *Coordinating Technology* (Cambridge, Mass.: MIT Press, 1998) and *Liberalisierung in Europa. Die Rolle der Europäischen Kommission* (Frankfurt am Main: Campus, 1998).

VIVIEN A. SCHMIDT, Professor of International Relations at Boston University, has written extensively on European political economy and public policy, including *From State to Market?* (Cambridge: Cambridge University Press, 1996); *Democratizing France* (Cambridge: Cambridge University Press, 1990); and articles in journals such as *Publius, Daedalus, Comparative Politics, Current Politics* and *Economics in Europe, Government and Policy, Governance, Journal of Common Market Studies,* the *Journal of European Public Policy,* and *West European Politics.* Currently, Professor Schmidt is working on a two-volume project on the impact of European integration on national economies, institutions, and discourse in France, Britain, and Germany.

HERMAN SCHWARTZ is Associate Professor of Government and Foreign Affairs at the University of Virginia. His research interests focus on public sector restructuring in Australia, Canada, Denmark, New Zealand, and Sweden. See <http://www.people.virginia.edu/~hms2f>.

ERIC SEILS has studied political science at the Universities of Konstanz and Huddersfield. Currently he is a doctoral fellow at the Max Planck Institute for the Study of Societies in Cologne. His research interests include the welfare state and the political economy of the low-wage sector in Germany and the Netherlands.

BRIGITTE UNGER is University Professor at the Department of Economics, University of Economics and Business Administration, in Vienna, Austria. Her research topics are macroeconomics, economic policy and institutional economics, and innovation. At the moment she is revising her latest book on 'Room for Manoeuvre: Choices Left for National Policy' for publication and works on a TSER-project on National Systems of Innovations and the Idea Innovation Chain.

TORBEN BUNDGAARD VAD is a political scientist and works at Danish Commerce & Services in Copenhagen, Denmark as a political consultant with knowledge services as his main area of expertise.

JELLE VISSER (1946) is Professor of Empirical Sociology and Sociology of Labor and Organization at the University of Amsterdam, where he directs the Centre for Research of European Societies and Industrial Relations (CESAR). His most recent publications include (with Bernhard Ebbinghaus), *Trade Unions in Western Europe since 1945* (London: Macmillan, 2000; (with Anton Hemerijck), *'A Dutch Miracle': Job Growth, Welfare Reform and Corporatism in the Netherlands* (Amsterdam: Amsterdam University Press, 1997); and (with Joris van Ruysseveldt), *Industrial Relations in Europe*: *Traditions and Transitions* (London: Sage, 1996).

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1 Introduction

Fritz W. Scharpf and Vivien A. Schmidt

This book is the second of two volumes presenting the findings of a twelve-country project on the adjustment of employment and social policy systems in advanced welfare states to the challenges of economic internationalization. The first volume contains comparative analyses and attempts to draw general conclusions from the research presented here. One chapter explores how characteristic differences in the socio-economic structures, policy legacies, and policy institutions of different countries have affected their vulnerability to international economic challenges and their ability to adopt and implement effective policy responses. A second chapter compares the greater or lesser effectiveness of actual policy responses, and it attempts to identify characteristic sequences of such responses and their relationship to successful policy learning. The third chapter takes these policy responses as given and explores to what extent they violated pre-existing normative aspirations and national values and whether legitimating discourses were or were not able to gain public acceptance of policy change.

This second volume represents the core of the project and the empirical foundations for the comparative analyses in the first volume. It provides in-depth studies of the adjustment of employment and social policies to changes in the international economic environment in the period from the early 1970s to the late l990s in twelve advanced capitalist (OECD) welfare states plus special studies on women in the labor market, early retirement, the public services sector, and tax competition. The country case studies cover three countries representing the 'Anglo-Saxon' model (the United Kingdom, Australia, and New Zealand), seven varieties of the 'Continental' welfare state (Switzerland, Austria, Belgium, the Netherlands, Germany, France, and Italy), and two 'Scandinavian' welfare states (Sweden and Denmark). We left out the United States and Japan, which are generally not considered 'advanced welfare states' in the same sense as the countries included herein, and we excluded Canada, Finland, Norway, and Iceland which, though certainly advanced capitalist welfare states, appeared to represent unique cases for a variety of reasons. Ireland, Portugal, Spain, Greece, and Turkey were left out because during the period covered in our project they were confronted with external challenges that differed from those confronting more advanced economies. In the special studies, we chose to examine more closely some of the issues which are of general concern in the adjustment of the welfare state, but not likely to get sufficient attention in any one country chapter.

1.1. The Postwar Decades

In focusing on adjustments beginning in the early 1970s, we had assumed that the expansion of state responsibility for achieving full employment, assuring social security, and reducing social inequality in the early postwar decades had culminated at the end of the 'golden age' in the late 1960s, and that subsequently these solutions were challenged and increasingly constrained by changes in the international economic environment. As will be seen in the country chapters, this stylized background assumption does not apply in all cases. In some countries, welfare state solutions were exposed to severe international economic challenges long before the 1970s; and in other countries, the expansion of the welfare state continued in the 1970s and even the 1980s. Nevertheless, the specific configurations of employment and social policies of all the countries considered herein, had developed in the early postwar decades under conditions in which the direct influence of the international economic environment on domestic policy choices was very limited in comparison to conditions that had existed before World War I or in the 1920s.

After the rampant protectionism following the Great Depression and the complete breakdown of world markets in World War II, most currencies were not freely convertible, capital transfers were tightly controlled and internal financial markets strictly regulated in most countries. The restoration of international trade in product markets was a slow process. Export dependence and import penetration were still limited, and the range of economic activities that were sheltered against international competition was quite large. Services were protected along with agriculture in most countries, while manufacturing was generally more export oriented—except for Australia and New Zealand, which relied on agriculture and raw materials exports to sustain highly protected manufacturing industries. If the competitiveness of internationally exposed branches became insufficient, moreover, the Bretton-Woods system of fixed exchange rates allowed negotiated adjustments to correct structural imbalances.

While it would be wrong to speak of closed national economies in the early postwar decades, nation states were able to control their own economic boundaries and the conditions under which transnational economic transactions would take place. Behind these protective barriers, national governments and unions could more or less ignore the exit options of capital owners, taxpayers, and consumers. Government interest rate policy was able to determine, and vary, the minimal rate of return that captive capital owners could expect in the market for longer-term investment opportunities. By the same token, the level and the type of taxes that governments could impose on captive taxpayers was primarily limited by political, rather than economic, constraints. And if governments and unions were able to impose uniform regulations, taxes, and wage increases on all competing firms, the higher production costs could generally be passed on to captive consumers without endangering the profitability of capitalist production.

Under these conditions, advanced industrial democracies were able to achieve the 'Great Transformation' (Polanyi 1957) that allowed them to exploit the economic efficiency of dynamic capitalism without having to accept its recurrent crises and highly unequal distributional consequences. Since they were able to control transnational capital movements, most governments learned to dampen macroeconomic fluctuations through Keynesian demand management, and to achieve and maintain relatively high rates of economic growth and full employment. At the same time, national control over external trade gave governments and unions great freedom to shape the conditions of production and employment through regulation and collective agreements, and to redistribute incomes through cross-subsidization in the private sector as well as through transfers and public services financed through either progressive income taxes, consumption taxes, or payroll taxes. Hence, in some countries 'solidaristic' wage policy could compress wage differentials between low-skill and high-skill groups with little regard for actual differences in labor productivity; in others energy policy could require the use of expensive domestic coal in electricity generation; in Europe agricultural policy could be used to keep inefficient farms in business, whereas in Australia and New Zealand, alternatively, external protection was used to maintain full employment in import-substituting manufacturing production.

All countries in our project were capitalist in the sense that the private ownership of the means of production was accepted in principle, and all had accepted their dependence on profit-oriented private enterprise and market interactions for the creation of wealth and economic growth. At the same time, however, they all relied on the state's newly increased capacity for market-correcting action to pursue at a minimum three socially valued aspirations:

- Full employment with 'good jobs' for all (men) who were expected to work for a living;
- social insurance of workers against the risks of sickness, invalidity, unemployment, and old age;
- social assistance to prevent the poverty of those without other sources of support.

Beyond these minimum aspirations, countries differed greatly with regard to the extension of employment opportunities for women, with regard to the coverage and generosity of publicly provided social insurance, social assistance, and social services, and even more so with regard to their commitment to reduce, or prevent, the social inequalities that are continuously generated and reproduced by capitalist market economies. They also differed greatly in the policy instruments employed and the institutions created for the achievement of their market-correcting goals; and in the economic efficiency of their 'golden age' solutions, whether measured in average rates of economic growth, per capita GDP, or employment rates. These differences are explored in greater detail in the comparative chapters in Volume I. What matters here is the fact that in spite of these differences, all countries in our project were able to achieve their respective welfare-state goals without endangering the viability of their capitalist national economies in the relatively benign international economic environment of the postwar decades.

Differences in institutions and policy legacies began to matter from the early 1970s onward, when major changes in the international environment did increase the economic vulnerability of advanced welfare states. This is not meant to deny the importance of other exogenous and endogenous challenges—among them the technical changes that have revolutionized production and consumption patterns, the effects of expanding education, the aging of the population, the transformation of traditional family structures, and profound value changes—that also differed in their impact on different types of postwar welfare states. To the extent that they interacted with the external economic challenges considered here, they will be discussed in the country chapters of this volume, and also in the special study on the participation of women in the labor market (Daly, this volume). But the basic focus of our project is indeed on the responses to challenges caused by changes in the international economic environment. In the period from the early 1970s to the mid-1980s, these challenges were in the nature of macroeconomic shocks, whereas the later period and the present are characterized by intensified competition in international capital and product markets.

1.2. The Challenges

For most industrialized countries, the end of the postwar ‘golden age’ coincided with the breakdown of the Bretton-Woods system of fixed but adjustable exchange rates and with the first OPEC oil-price crisis of 1973/75. The first created an environment of floating exchange rates and accelerated the growth of ‘offshore’ capital markets that were not under the control of any of the major central banks. The second confronted oil-dependent industrial economies with the double challenges of ‘stagflation’—i.e. the simultaneous impact of cost-push inflation, caused by the fourfold increase within a few months of the price of crude oil, and of demand-gap unemployment, caused by the diversion of purchasing power to OPEC countries that could not immediately ‘recycle’ their new wealth into additional demand for industrial products. Under these conditions, governments committed to Keynesian demand management were confronted with a dilemma: if they chose to fight unemployment with monetary and fiscal demand reflation, they would generate escalating rates of inflation; but if they would instead fight inflation with restrictive fiscal and monetary policies, the result would be mass unemployment. The dilemma could only be avoided if, in addition to fiscal and monetary policy, wages could also be employed as a tool of macroeconomic policy. What was needed was a form of ‘Keynesian concertation’ where the government would prevent job losses through demand reflation while the unions would reduce inflationary cost pressures through wage restraint (Scharpf 1991).

The closest approximation to Keynesian concertation was achieved in Austria. In Germany and Switzerland, by contrast, governments were unable to reflate the economy because monetary policy was determined by an independent central bank that was unconditionally committed to the defense of price stability—in which case the bank's tight money policy would neutralize expansionary fiscal impulses. The same was true in countries like Denmark, the Netherlands, or Belgium, where the government tried to stabilize the exchange rate with the Deutschmark. Under these conditions, major job losses were unavoidable. But they could be softened if real wages were quickly adjusted downwards, which was true in Germany and Switzerland but not in the other hard-currency countries practising an imported (and perhaps less clearly understood) version of the Bundesbank's monetarism. In countries where the central bank was willing to accommodate the rise of oil prices, government deficit spending was generally able to avoid major job losses in the 1970s. But then inflation would escalate unless it was counteracted by effective wage restraint—which, in the absence of unemployment, was more than most unions would or could deliver. In most countries, therefore, inflation continued at very high, often two-digit levels. Moreover, the attempt to stabilize employment through demand reflation had left most governments with very high budget deficits at the end of the 1970s.

Thus, by the end of the decade, governments and central banks in most countries had come to define loose money policies and fiscal irresponsibility as the critical policy failures of the 1970s. This increased their willingness to switch to monetarist beliefs and hard-currency policy responses when the second oil crisis of 1979–81 seemed to replay the challenges of the 1970s—with the result that unemployment rates now also rose steeply in most of the countries that had been able to avoid major job losses in the 1970s. Most important, however, was the fact that now the monetary policy of the United States was no longer ready to accommodate oil-price inflation. As a consequence, real dollar interest rates, which had been close to zero or negative through most of the 1970s, rose steeply to very high positive levels—3.1 percent in 1981, 5.4 percent in 1982, 7.2 percent in 1983, and 8.1 percent in 1984. Since the internationalization of capital markets had progressed rapidly during the 1970s, and most countries had become heavily indebted to them, national central banks—regardless of their institutional independence and theoretical orientations—were forced to raise interest rates accordingly in order to avoid massive capital outflows. This had major distributional consequences. Since minimal profits expected from real investments have to be above the interest income from risk-free government bonds, the dramatic rise of real interest rates meant that the share of capital incomes in the national product had to rise at the expense of government and labor shares if investment and business employment were to be maintained. The only question was whether the change in distribution was realized through reduced wage claims and tax 'reforms' favoring capital incomes, or whether it was realized through disinvestment and job losses in the private sector.

On the whole, therefore, the success or failure of countries during the crises of the 1970s depended primarily on their capabilities for macroeconomic management—i.e. on the coordination between the fiscal and monetary policy choices of the state, and on the capacity and willingness of unions to practise effective wage restraint in the face of oil-induced inflation. In the early 1980s, however, the role of fighting inflation had been assumed almost everywhere by a very restrictive monetary policy. Under these conditions, the extent to which unemployment would increase depended primarily on the willingness and ability of unions to accept wage settlements that favored the rise of business profits. By and large, most countries had learned to cope with these conditions by the mid-1980s; and in the latter half of the decade, when inflation, oil prices, and dollar interest rates had come down again, the international macroeconomic environment of capitalist economies seemed once more relatively benign. At the same time, however, the protective barriers that had shielded their internal structures in the postwar decades were now rapidly disappearing.

By the early 1990s, the internationalization of markets for goods, services, and capital was again reaching levels that equaled, and then exceeded, the degree of international economic integration that had existed in the decades before World War I. Capital exchange controls, which had still protected the domestic financial markets of most countries in the early 1970s, had practically disappeared.[3] Moreover, the European Community had decided to liberalize financial services, and most countries had deregulated their domestic financial markets as well. As a consequence, financial capital is now again internationally mobile, and the minimal rate of return that investors can expect is no longer defined by reference to interest rates set by the national bank but rather by the attractiveness of competing worldwide opportunities for speculative, portfolio, or real investments. At the same time, successive rounds of GATT and WTO negotiations had progressively lowered the tariffs and quantitative restrictions protecting national markets for goods, services, and investments. In Europe, the Single Market program had also eliminated the non-tariff barriers that still impeded the full integration of product markets, and it had introduced international competition in a wide range of services and utilities—among them telecommunications, postal services, rail, air and road transport, or electricity supply—which before had been provided either by the state itself or by state-controlled monopolies and cartels. For some of the countries in our project, the completion of the internal market was followed by the commitment to create a Monetary Union which would not only remove monetary and exchange rate policy from the control of national governments and impose severe constraints on the conduct of national fiscal policy, but which also removed the last important barrier to real capital mobility: firms are now able to choose the lowest-cost location of production within the territory of the Monetary Union without having to consider either non-tariff barriers or exchange rate fluctuations that might affect their access to the home market. By the same token, it has become much easier to move mobile tax bases—in particular business profits and other forms of capital incomes—to locations offering the least burdensome tax regimes.

[3] According to an indicator of capital-exchange liberalization constructed by Dennis Quinn on the basis of IMF data (where a score of 14 marks total liberalization), in 1970 eleven of twenty OECD countries had scores below 10, and only one country (Germany) had a score of 14. By 1993, only one country (Greece) still scored below 10, and nine countries now had a score of 14.

As a consequence of these cumulative changes in the international economic and legal environment, national governments and national labor unions are now no longer able to rely on the protective barriers that facilitated the achievement of their policy goals in the postwar decades. The internationalization of capital markets had already reduced the effectiveness, and increased the budgetary costs, of Keynesian full employment policies in the 1980s, and by the 1990s the exit options of investors, taxpayers, and consumers were severely constraining the capacity to regulate processes of production and to tax the profits from production. In that sense, it is indeed plausible to conclude that 'Polanyi's Great Transformation is over' (Cerny 1994: 339).

That is not to say that countries have lost all capacity to pursue the welfare goals they had chosen in the postwar decades, but it does imply that these goals must again be pursued within the constraints of international capitalism—and it suggests that in contrast to the macroeconomic shocks of the 1970s and early 1980s, a capacity for macroeconomic management and union wage restraint is no longer sufficient for coping with the new challenges. Since governments and unions are no longer dealing with captive capital owners and captive consumers, national systems of taxation, regulation, and industrial relations have now become vulnerable to the extent that they reduce the attractiveness of the national economy to mobile capital and the competitiveness of nationally produced goods and services in international product markets. The first major impact of these new constraints is on employment in the internationally exposed sectors of the economy (including major service branches), where more intense competition puts a premium on product innovation, productivity increases, and flexibility which, on balance, have negative consequences for employment levels and the conditions of employment in the advanced industrial countries. When overall employment nevertheless increases, the gains are mainly achieved in the sheltered sectors, where services are locally produced and locally consumed. The second major impact of the new international constraints is on the financial viability of the welfare state—which is affected by international tax competition as well as by efforts to increase competitiveness in product markets through reducing the costs of production.

It is here that structural differences among financing and spending patterns have the greatest influence on the vulnerability, and on the need for policy adjustment, of different types of welfare states. These differences and their impact on the effectiveness of policy responses are examined in comparative chapters in Volume I. But comparison cannot provide new insights unless it is based on a thorough understanding of the complex interactions of challenges and responses in the countries whose experiences are to be compared. This is the task performed by the country case studies and special studies assembled in this volume.

1.3. The Country Case Studies

The overall goal of the country studies is to provide a picture of how the postwar social welfare and employment structures (as they had matured by about the early 1970s) have changed under the impact of changes in the international economic environment. Each chapter sets out the main set of problems for the country in question, examines how it went about trying to resolve its problems, and assesses the solutions. The chapters are organized in parallel fashion, to ensure the greatest ease of comparison. They are all based on the same set of cross-national data[4] (supplemented, of course, by additional country-specific data) to guarantee comparability across countries and sectors. They all address questions about how the three main types of pressures from internationalization, that is, competition for shares in the markets for goods and services, competition for investment capital, and competition for mobile tax resources, have affected different segments of national employment, including the 'exposed sector', the 'sheltered' sector, the private sector, and the public sector, and different aspects of the welfare state, including public sector revenue, welfare financing, and welfare expenditures.[5] Finally, the chapters all seek to assess: (1) the greater or lesser vulnerability of national employment structures and welfare-state institutions to the effects of international competition; (2) the greater or lesser effectiveness of the policy responses actually adopted; and (3) the greater or lesser political and institutional capacity of the national policy system to develop effective policy responses.

The country studies begin with a description of the 'golden age' or postwar model of the welfare state, by providing a snapshot of the country's economic structure and policies, industrial structure and governance system, political profile and institutions, welfare and industrial relations systems, and social policies and labor market programs. They then proceed with a chronology of the successive external economic challenges and internal

[4] The data-set consists mainly of OECD comparative time series data, starting in the 1970s, with information on such indicators as wealth, distribution, employment, unemployment, export performance, exchange rates, investment, taxation, social spending, etc. It was compiled and presented by members of the Max Planck Institute project team Martin Schludi, Steffen Ganghof, Eric Seils, and Torben Vad.

[5] These questions were all raised in a preliminary background paper (Scharpf, Schmidt, and Vad 1998) which presented an inventory of hypotheses linking international economic competition to plausible first-order and second-order effects on specific features of national employment and social-policy systems.

policy responses up until today, beginning with the oil crises of the 1970s, which some countries felt more severely than others; continuing with the 1980s, when many countries but certainly not all began the adjustment process; and following on to the 1990s, when all countries felt the need to respond. They end with a depiction of the new model or model in making, if there is one, and an assessment of what went right, and what went wrong.

The chapters focus either on a single country or on two or three countries sharing important characteristics that invite specific comparisons. Thus, for the Anglo-Saxon welfare states, Britain is considered separately, but Australia and New Zealand are paired in order to bring out the differences in countries which at the beginning of the 1970s had similar economic profiles but ended up following quite different trajectories. Similarly, for Continental welfare states, Switzerland, Germany, France, and Italy are considered separately, but Austria, the Netherlands, and Belgium are compared in a single chapter in order to highlight how countries with such seemingly similar institutional configurations could have had such different adjustment experiences. Finally, the Scandinavian welfare states are considered in a single chapter, again to illuminate the differing recent histories of countries that have traditionally been so similar in welfare-state aspirations and yet so different in economic profile and industrial structure.

1.3.1. The Anglo-Saxon Welfare States

Contrary to what many have assumed, there is no single 'Anglo-Saxon' model of welfare-state retrenchment. This is well illustrated in the chapters by Martin Rhodes on the UK and Herman Schwartz on Australia and New Zealand. Although in the postwar period prior to the 1970s, the United Kingdom, New Zealand, and Australia resembled one another in their approaches to social policy, with the 'liberal' welfare state a modest one serving as a safety net for a system based on full employment, they increasingly diverged over time. The UK, as Martin Rhodes explains, started with a comparatively meager welfare state whose expansion was constrained by economic conditions characterized by the need to defend an international reserve currency and by the inflationary pressures of a highly decentralized and conflictual wage-setting system. Neo-liberal reforms in the 1980s by a Conservative government succeeded in changing the structure of industry and breaking the power of unions, but did not fundamentally change the structure of the British welfare state. Rhodes suggests that it is only today, under a 'new' Labour government, that real reforms appear to be underway, albeit with a mix of neo-liberal individualism and social-democratic redistribution.

While the formal welfare states of New Zealand and Australia resembled the British model in the postwar period, Herman Schwartz shows that they differed from it in terms of economic policies, industrial structure, and industrial relations systems. As highly competitive exporters of agricultural products and raw materials, both had chosen to develop highly protected import-substituting industries in order to assure full employment as a complement to the welfare state. When this configuration ceased to work in the 1970s, both countries chose to liberalize their industrial sectors, attempting to achieve price competitiveness through government-controlled wage-setting procedures. Schwartz argues that since New Zealand was less successful in this, its Westminster-type governments turned to radical neo-liberal reforms in the 1980s that went beyond those enacted in Britain. Australia, by contrast, whose federal and bicameral constitution imposed greater political constraints, was able to achieve international competitiveness through corporatist concertation while maintaining and even expanding and its welfare state.

1.3.2. The Continental Welfare States

The seven Continental welfare states considered herein demonstrate as much if not more diversity in their patterns of adjustment than the Anglo-Saxon welfare states. Although all loosely resembled one another in the postwar period, with the 'Christian democratic' welfare state providing reasonably generous income replacement for the male breadwinner, they too adjusted in different ways at different times, because of differences in economic vulnerabilities and institutional capacities.

Among Continental welfare states, the country which one might assume would have had the fewest adjustment problems is Switzerland. It has had the highest per capita income and the highest employment ratios in our sample of advanced welfare states. Its export-oriented industries and services have remained highly competitive throughout the period included in our studies. And it has low tax levels, low levels of welfare expenditures, and a comparatively flexible labor market. Nevertheless, as Giuliano Bonoli and André Mach make clear, Switzerland has also felt the impact of international economic pressures, and sought to adjust. Political pressures from export-oriented business were successful in reducing the tariff and non-tariff barriers protecting the sheltered sectors of the Swiss economy, whose inefficiency was beginning to hurt the competitiveness of internationally exposed firms. However, when the demand for neo-liberal reforms touched on the benefits provided by the—not particularly generous—Swiss welfare state, Bonoli and Mach note that they were stopped not by the 'social partners' as in other consociational/

corporatist democracies, or by electoral shifts in governments, but by the direct democracy of the referendum system. As a consequence, limited retrenchment had to be combined with some important extensions of welfare coverage.

Germany, like Switzerland, has also been much less affected by international economic pressures than many of the other countries in our sample. The main question for Germany, as Philip Manow and Eric Seils see it, is: How can a country which continues to remain highly competitive internationally still suffer from serious adjustment problems, and in particular from such high unemployment? They argue that the impact of unification is only a part of the explanation, and that, ironically, Germany's very formula for success is also the key to its current problems. The manufacturing sector is still the backbone of the German economy. In spite of the job losses of the 1970s, it has been able to maintain the cooperative labor relations on which its international competitiveness depends by using the welfare state's generous exit options from the labor market for older and less productive workers. Given the prevailing mode of welfare financing, however, this required increases in social security contributions that added to the costs of labor throughout the economy. During the 1980s, employment increased again and welfare costs could be stabilized. But since the government relied on the same solution in coping with the massive employment losses in East Germany after unification, non-wage labor costs have risen to a level that can be sustained only by highly productive types of work. Under these conditions, as Manow and Seils contend, the German welfare state imposes severe constraints on the growth of the less productive domestic service sector, and thereby closes off one of the most promising solutions to the problems of unemployment and welfare-state financing.

The French welfare state, as elucidated by Jonah Levy, is financed by social security contributions to an even greater degree than is true in Germany. But unlike Germany, during the oil-price crises of the 1970s and early 1980s France tried to contain job losses by way of employment retention in its nationalized industries and subsidies to private firms. This changed with the decision to abandon *dirigisme* in industry after 1983. Thereafter, the welfare state—made more generous by the Socialist government after 1981—had to expand in order to absorb the job losses caused by industrial restructuring. As in Germany, increasing non-wage labor costs have in turn added to the difficulties of job creation in the private sector—a problem to which the government responded by shifting part of the burden to a special income tax. The purposeful expansion of the welfare state came to an end in the l990s when the pressures of European monetary integration imposed severe budgetary constraints.

However, the efforts by successive governments to cut back certain types of welfare benefits were often confronted by large-scale protest, with French citizens taking to the streets to prevent the dismantling of the traditional welfare state. The problem, Levy argues, is one of style as much as of institutional conditions. In the absence of corporatist interlocutors, French governments tend to impose their preferred solutions without negotiation, treating the intensity of protest as a test of acceptability. But it may very well be that the more communicative style of the present Jospin government has in fact hit upon a formula for more consensual and successful adjustment.

While the main problems for most countries have come from the outside, with the need to adjust to the impact of internationalization, for Italy, as Maurizio Ferrera and Elisabetta Gualmini tell us, the main problems have been on the inside, and the external pressures from internationalization have in fact acted as an impetus for internal revitalization. Italian business has consistently been able to rise to the challenge of global economic competition. Until the early 1990s, however, the clientelistic Italian state was not able to put the brakes on the spiral of wage increases that were automatically linked to price increases, and that in turn had automatic links to all sorts of public and welfare-state expenditures which—in the absence of automatic balancing requirements—led to the exponential rise in public deficits. After 1992, though, with the sea-change in Italian politics, Ferrera and Gualmini describe a seemingly miraculous new set of dynamics, as labor and business began to coordinate wage restraint and social welfare reform with the state, largely in response to the impetus of European monetary integration. The question for Italy is: Can external pressure be enough to ensure the continuation of internal reform? And what if such pressure recedes?

Although Austria, the Netherlands, and Belgium are so seemingly alike in their tightly coupled, consociational and corporatist democratic structures and in the Bismarckian origin of their welfare states, they have had radically different experiences since the 1970s. Anton Hemerijk, Jelle Visser, and Brigitte Unger show that while the Netherlands, which appeared in the 1970s and early 1980s to be afflicted with a terminal, purely 'Dutch disease', has seemingly been cured, Belgium, with a similar initial profile, has been malingering, and Austria has managed to avoid the crises from which the others are recovering. What is the possible explanation? It cannot be simply economic since the Netherlands and Belgium were initially very similar in their sectoral profiles. It also cannot be purely institutional, since Dutch institutions did not change much between the 1970s and the 1990s. What the three countries have in common is a policymaking structure with plural veto positions that can lead to perverse policy outcomes if the occupants of these positions use their power to pursue and defend narrowly defined interest positions. Under these conditions, the difference between success and failure of the political economy as a whole does depend on the ability of separate corporate actors to adopt action orientations that emphasize common, rather than separate, interests. As Hemerijk, Visser, and Unger show, the Austrian social partners have succeeded in maintaining this 'encompassing' perspective throughout; the Dutch had to relearn it after dismal failures, and in Belgium the increasing salience of linguistic cleavages added to the difficulty of achieving, and acting on, convergent perceptions and interest definitions.

1.3.3. The Scandinavian Welfare State

Among the welfare states in our sample, the Scandinavian countries have consistently been the most generous, with the 'social democratic' welfare state achieving consistently higher levels of employment and greater equality in wages and higher rates of female employment than either Anglo-Saxon or Continental welfare states. Moreover, of the two Scandinavian welfare states considered herein, Sweden has almost consistently topped Denmark in generosity and levels of employment and equality for most of the period under consideration. But very recently, the two countries seem to have changed places. This is the main puzzle that Mats Benner and Torben Vad seek to explain. Sweden, for so long respected as the most successful social democratic welfare state, capable of withstanding the pressures of internationalization through the 1970s and 1980s, fell very far in the early 1990s. At the same time, Denmark, which had struggled unsuccessfully through the 1970s and 1980s to emulate Sweden, has now emerged as the most successful and progressive of welfare states. The superficial explanations seem to emphasize major errors of judgment on the part of Swedish fiscal and monetary policy, and considerable luck in the timing of Danish macroeconomic policy choices. Beyond that, however, Benner and Vad show how Sweden is struggling to defend the previous pattern of a 'decommodifying' welfare state whereas Denmark has switched to active labor market policies that emphasize and enforce the transition from welfare to work. The question they leave us with is: Will this change in places last? Or is Sweden's fall from grace only temporary, and Denmark's rise the result of short-lived, favorable coincidences?

1.4. The Special Studies

Some very important issues cannot be adequately dealt with in the context of single-country studies because significant patterns may only become visible in comparative overviews. A few of these questions are the subject of more narrowly focused and comparative ‘special studies’ in the second part of this book. These consider: (1) the changing nature of female employment and its impact on employment in general as well as on the direction of welfare state reform; (2) the changing nature of the workforce in view of rising unemployment and early retirement; (3) the impact of liberalization in formerly protected service and infrastructure sectors (transport, telecommunications, etc.) on employment and other welfare values; and (4) the greater or lesser vulnerability of national public-revenue systems to tax competition.

One of the central causes of change in the welfare state has been the changing economic role and employment behavior of women, especially of married women. Factors related to gender, as Mary Daly argues, are the key to explaining labor market variation among the most developed countries. But that picture is a complex one, requiring fine analytic gradations among women and men in different family situations. In explaining how women's presence has transformed labor markets in the twenty-three most developed countries, Daly draws on a wide range of possible factors, including policy packages, historical trends, and cultural norms about the family and women's roles. The analysis is based on a threefold model which includes supply, demand, and country-specific contextual factors.

Another very important factor in the adjustment of the welfare state is early retirement. The main questions are: Why did early exit from work, especially among industrial blue-collar workers, become a widespread practice in many (but not all) OECD countries since the first oil crisis? What problems did it solve? And what problems has it in turn created? Bernhard Ebbinghaus reviews the strategy of early retirement as an adaptation to economic restructuration, mass unemployment, the social needs of older workers, and the employment needs of young and female job-seekers; and he shows how it was facilitated by special state-sponsored programs, employer–union bargained agreements, and (un)intended loopholes in social security systems. Ebbinghaus then goes on to discuss how, as the costs of an increasingly inactive population rose while the expected employment effects failed to materialize, reformers sought to reverse the course of ‘welfare without work’. And he explores how, besides blocking the pathways of early retirement, disability, and long-term unemployment, welfare states are now stressing new forms of part-time pension, extension and equalization of normal pension age, and shifting responsibilities and costs to the individual and firms.

The liberalization and/or privatization of formerly highly protected, monopolistic, public utilities and infrastructural services has added to the challenges of welfare-state adjustment. The move to market competition is affecting these industries' historical role not only as providers of public service goods but also as important national employers. Adrienne Héritier and Susanne K. Schmidt provide an initial stock-taking of the consequences of liberalization and privatization for the quality, cost, and availability of utilities and infrastructural services and for employment. They compare the telecommunications and railways reforms of France, Germany, and Britain, analyzing the different mechanisms that were enacted to ensure that public service goals continued to be met, and assessing the performance of the different regimes. In addition, they compare the employment effects of liberalization in the telecommunications, posts, railways, and energy sectors of a wider range of countries.

Finally, one of the factors often regarded as the cause of fiscal constraints on the welfare state is tax competition. But in fact very little is known about its real impact. How have advanced industrialized states reacted to the growing mobility of parts of their tax base? To what extent has tax competition resulted in a shift of burdens to less mobile tax bases? These are some of the questions Steffen Ganghof seeks to answer as he examines the different shape and force of tax competition in different areas of taxation in different countries, and the differing ways in which countries have responded. He concludes that while the pressures of international tax competition are real, so are countervailing economic and political pressures that work against a general 'race to the bottom' in the taxation of potentially mobile bases. And he shows that revenue-preserving strategies of policy adjustment prevented large-scale revenue losses, but partly led to a more controversial structure of taxation.

1.5. Conclusion

The contributions in this book offer a valuable set of insights into the different paths of adjustment of welfare states to international economic pressures. Most clearly, they show that there is no convergence in the welfare state, and that there is no single solution or formula for successful adaptation. Rather, each country must find its own way. And this depends upon a variety of nationally-specific factors. These include a country's economic profile and its level of vulnerability to external economic pressures; its institutional configuration and its capacity to respond effectively when necessary; the policy legacies that shape the available options; and the social learning processes that affect policy actors' awareness and willingness to respond as necessary. But while economics, institutions, and policies are the main factors considered by these chapters, they also note, where relevant, the political events, ideas, and even values and legitimating discourses which affect public reactions to policy initiatives, in order to understand the political dynamics of adjustment and not just the economic or institutional dynamics.

Thus, even though all authors collaborating in our project started from a common set of working hypotheses and a broadly standardized research design, the completed studies emphasize the diversity of national experiences, and the importance of 'historical' explanations that are responsive to the causal influence of country-specific factor constellations. These need to be taken seriously, and the country studies assembled in this volume deserve to be understood and evaluated in their own light. Nevertheless, the overall project was inspired by the expectation that the whole would be more than the sum of parts, and it is gratifying to see that this expectation was fully realized. In fact, the studies in this volume do not only provide analyses and explanations of national experiences. They also constitute a unique and immensely useful body of information for secondary, comparative analysis that permits the investigation of more complex sets of explanatory hypotheses than was previously possible. These explanatory hypotheses in turn enable us to tease out patterns that offer clues to new 'equilibrium models' of the welfare state, ones which have moved from vulnerability to competitiveness. And although our analyses yield no findings of convergence on a single model of welfare state, they do show that certain patterns of success or new 'equilibria' do emerge within each of the three clusters of welfare states (Anglo-Saxon, Continental, and Scandinavian) as well as certain cluster-specific patterns of failure or 'disequilibria'. These patterns are explored in the comparative chapters in Volume I.

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2 Restructuring the British Welfare State: Between Domestic Constraints and Global Imperatives [6]

Martin Rhodes

Britain has always been exceptional among European welfare states, and it continues to be so at the dawn of a new century. As a predominantly tax-based rather than contributions-based system, with no social partner involvement in the management of social security, the institutional and policy linkages between social policy and the economy have always been fractured and weak. This has had advantages. Unlike the Bismarckian insurance-based systems, Britain has not had a major structural problem of pension liabilities funded from social charges and payroll taxes. But unlike in its Nordic and Continental neighbors, the notion of the social wage has never been at the heart of a social consensus but instead has been the object of social conflict since mid-1940s, making a successful incomes policy impossible from the outset, not simply problematic as elsewhere in Europe with the first oil-price shock and the end of Bretton-Woods.

Britain has also been exceptional in respect of the nature and extent of its internationalization as a former imperial power and early industrializer. This was an economy which was already highly vulnerable to international economic shocks in the early postwar period, and the victim of relative economic decline and macroeconomic turmoil through its 'not so golden age'. Exposure to a turbulent external environment, exacerbated by periods of acute macroeconomic mismanagement, has conditioned the development of the British welfare state from the outset and, combined with ideological opposition to state intervention from an early stage, explains its 'liberal' nature.

[6] I would like to thank Noel Whiteside, Colin Crouch, Jonathan Zeitlin, Michael Moran, Ian Gough, Des King, Fritz W. Scharpf, and Vivien A. Schmidt for their comments on earlier drafts of this article, and the latter two for their patience and forbearance as editors. Thanks too go to Herman Schwartz for being an inspiring partner when, in an earlier incarnation, this article was part of a joint venture.

Against this background, the industrial relations—and broader economic—crisis of the 1970s should be seen as the accumulation of dysfunctions and contradictions generated by a voluntarist industrial relations system and an incapacity, primarily for organizational reasons, for implementing incomes policy. Contrary to the impression often given of a 'consensus' on economic policy priorities and the desirability of a strong welfare state, in reality 'stop–go' policies and a volatile economic cycle combined with the vicissitudes of partisan politics to produce an acute discontinuity in policymaking. The flaws of the system were fully exposed when exogenous pressures post-Bretton-Woods became more constraining, full employment became difficult to sustain, and fiscal problems made an extensive industrial policy impossible at a time of widespread crisis in traditional sectors of industry.

Thus, as presented in the first section of this chapter, until the 1980s, welfare and the economy by and large existed in separate spheres, and when and where they interacted the result was often dysfunctional. At a general level, as in all European countries, welfare could be used as part of an ensemble of public interventions to sustain demand and full employment and compensate for risks over the life cycle. But in Britain, while Keynesian policies were always problematic in practice, especially in reconciling full employment with wage demands and growth with the balance of payments and exchange rate stability, the lack of consensus on the social wage triggered industrial relations conflict that fed into the cycle of macro-mismanagement and decline. Thus, in its disjointed mix of formal social programs and labor market income delivery, both the 'accumulation function' (promoting growth) and 'legitimation function' (securing popular support for economic adjustment) of welfare were flawed.

Thatcherism, analyzed in Section 2.2 below, provided a new and rather brutal 'institutional fix' that fundamentally altered the logic of the system and established a new set of linkages between welfare—in both its formal and informal dimensions—and the economic system. It was not just policy and new legislation that reformed the system but, perhaps with even greater effect, the decade of macro-mismanagement between the early 1980s and early 1990s which accentuated the economy's vulnerability to external shocks, devastated much of an already enfeebled manufacturing sector, and via two massive labor shakeouts, completely transformed the composition of British employment. In the end, this complemented nicely the political and policy campaign against all fragile vestiges of British-style corporatism and collectivism, ending decades of futile attempts to forge incomes agreements and turning wage determination over to one of the most completely deregulated markets in the OECD.

The outcome was a welfare state much more clearly connected, indeed subjugated to, the needs of an economy increasingly polarized in terms of employment opportunities, entitlements, and incomes. The new model was one in which, as discussed in Section 2.3, a new 'functionality' was engineered between a social and employment policy system and the demands of accumulation in a liberal market economy. Low corporation taxes and social charges are vital, not just for sustaining Britain's FDI dependent manufacturing sector, but also for meeting the demands of the large low-wage, low-skill, low-productivity sector of the economy, whose employers also benefit from 'in-work' means-tested social security benefits as an effective subsidy. Demand for goods and personal services is sustained by low personal rates of income tax and a high level of credit indebtedness facilitated by a highly liberalized domestic financial sector. In these circumstances, income polarization is not just a consequence of a deregulated employment system, but a key functional component of the current economic system.

In these circumstances, any new government—not just that of Tony Blair—would find itself in a tight economic straitjacket. The potential for progressive innovation is small. The 'new functionality' between welfare and the economy must be conformed with, for on this will partly depend the growth and employment creation that might allow for more equitable policies in the long run. The major paradox—which New Labour is currently struggling to manage—is that demand for quality public services remains high while higher taxes are not just unpopular but 'dysfunctional' for the economic model it inherited. Therein lie both the force behind and the future pitfalls of the Blairite 'Third Way'.

2.1. The 'Trente Glorieuses' and the Crisis of the 1970s

2.1.1. The 'Model': The Postwar Settlement and Early Vulnerabilities

In any comparative work on the welfare state it is obligatory to begin with a discussion of British 'exceptionalism'. Britain is different in numerous respects from its European neighbors, both in terms of its welfare state and the general 'liberal' political economy in which it is embedded. Only by understanding these distinctive features can we understand the trajectory of welfare-state development and the nature of the 'adjustment problem' with which it becomes identified by the late 1970s. While many states of Continental Europe were constructed or reconstructed in a way which placed social contracts at the heart of their constitutions, in Britain, the sphere of welfare was placed at arm's length. The disarticulation of welfare from the economy has been true at least for the period until the late

1970s. From the mid-1980s onwards, it would become more central to economic regulation but in ways, once again, quite distinct from other European countries.

2.1.1.1. The Nature of the Welfare State

First, the welfare state itself. Although frequently referred to as 'liberal', the British welfare state was less the product of nineteenth-century English liberalism than of an amalgam of traditions, including in 1945 a compromise between the designs of an elitist civil service and pragmatic Labour Party 'socialism'. 1945 was far from being 'year zero' (Parry 1986). The Liberal government's introduction of old age pensions in 1908 and social insurance against unemployment and sickness in 1911 led to union involvement in running the state's insurance schemes alongside their own limited occupational regimes. The one critical change of the next thirty years was the withdrawal of the unions from social insurance management under the pressure of recession and high unemployment.

Thus, when World War II provided the stimulus for a new era of social reconstruction, bolstered by the election of the Atlee Labour government in July 1945, the unions were absent as formal participants from the feast. One of the peculiarities (at least in the European context) of the British system was the consequent divorce between the labor movement and the social insurance system (Toft 1995; Crouch 1999*a*). Combined with 'voluntarism' and organizational fragmentation in industrial relations, this helped prevent the development of the notion of the 'social wage' in Britain. As argued below, this made an important contribution to the more general problems of economic management during the postwar period.

For this reason, it makes sense to separate analytically the 'formal' social policy welfare state—the core programs, that is, of social provision—from the 'informal' welfare of employment and incomes policy and social dialogue (see Whiteside 1996). The formal programs established in the mid-1940s sought to give citizens universal rights of access to equal standards of health care, family income support, comprehensive social insurance (including pensions), public housing, and education.[7] The key elements were the National Insurance system funded by employers, employees, and the Treasury which covers unemployment, sickness, maternity and industrial injury benefits, and retirement pensions. The

[7] The major pieces of legislation were the Education Act (1944), the Family Allowance Act (1946), the National Health Service Act (1946), the Town and Country Planning Act (1947), the National Assistance Act (1948), the Children's Act (1948), and the Housing Act (1949).

National Health Service provided free treatment and has largely been tax-financed. These initiatives provided the basic architecture of the system which, in its essentials, persists today.

Their particular character can be explained by a peculiarly British combination of intellectual influence and domestic and international constraints. Like Keynes, William Beveridge (the ‘architect’ of British welfare) was a ‘reluctant collectivist’. His 1942 report on welfare maintained that ‘the State in organizing security should not stifle incentive, opportunity, responsibility’. Social insurance and assistance were to guarantee a subsistence income only (Lowe 1993: 16–19). But largely due to Treasury skepticism of National Insurance and pessimism about the economy, the system created by Labour in 1946 was even less generous than Beveridge envisaged. There was also a major reluctance to antagonize British industrialists: in 1950 they contributed the lowest proportion to welfare costs in Western Europe (15.6% compared to 39.7% in West Germany, 65.1% in France, and 70.7% in Italy) (Tomlinson 1998: 72). Though pensions eligibility was more generous under Labour than originally intended, the result overall was an austere system of social security that differed only from former private arrangements in that insurance was compulsory (Barr and Coulter 1990: 274ff.).

One of the most important aspects of social policy in the early postwar period was on the ‘informal’ side—that is the commitment to a full and stable level of employment. Beveridge's benchmark measure for full employment fixed unemployment at 3 percent—a level only exceeded as an annual average in 1947 and 1971–72 (Lowe 1993: 68–69). But there lay one of the biggest flaws in the postwar settlement. For successfully stimulating growth and full employment via demand management depended ultimately on the predictable behavior of employers and trade unions. Inflationary pressures in a seller's market for labor could only be contained if the distributional conflict was controllable (Marquand 1998: 44). Yet this assumed—wrongly as it turned out—that the unions would not endanger full employment by bargaining irresponsibly. In fact, organized labor could not be ‘encompassed’ within the system and the notion of a ‘social wage’ was neither developed nor institutionalized. This was to make economic management all the more difficult through Britain's ‘not so golden age’, with important—adverse—consequences for welfare provision.

2.1.1.2. A Vulnerable Political Economy

The British economy was highly vulnerable to external pressures from early on, and this restricted the scope for welfare expansion. A weak manufacturing sector meant that the international economy constrained the elaboration of social policy from the outset. Chronic current account deficits necessitated 'stop–go' policies to preserve the international payments position. Relatively deep, liquid (and impatient) share markets even before the 1970s meant a rapid transmission of financial pressures in the economy when internationalization accelerated. There has also been a high level of dependence on inflows of foreign capital to fund current account deficits and generate new manufacturing investment. Consequently, British governments have been especially sensitive to falling exchange rates, interest rate shocks (including credit rating downgrades), and the problematic distribution of risk between the public and private sectors.

The early postwar years found Britain at a distinct disadvantage. In 1954 it had a debt-income ratio of 175 percent (Germany had its debt written down in the late 1940s and 1950s) and the servicing costs made balance of payments crises hard to avoid (Eichengreen and Ritschl 1998). While poor economic management exacerbated that problem, the root causes of decline are to be found in the micro-foundations of the economy (Hall 1986). The financial system has been internationally oriented and poorly integrated with the domestic economy. Poor levels of investment in manufacturing have long been a serious problem. The financial system, while facilitating mergers and takeovers, has failed to provide domestic finance for regionally-based small and medium-size firms where detailed knowledge, risk assessment, and long-term investment commitments are required. The market-based credit system has kept banks, firms, and the government in different spheres, preventing the development of a state or bank-led industrial modernization strategy (see e.g. Zysman 1983). Partly in consequence, large, well-integrated, modern capitalist firms have been slow to emerge. Britain soon lost its lead in inventions, innovations, and patenting to the USA, Germany, and France in the early twentieth century. The resistance of family-run firms as well as financiers delayed the shift to the mass production paradigm (Elbaum and Lazonick 1986). Mergers from the 1950s on were frequently defensive and incomplete responses to antitrust legislation, often spurred on by financial motives such as advantageous tax treatment for debt capital.

Delayed modernization has also been attributed to an adversarial industrial relations system in which a strong but decentralized, craft-based union movement and a weakly organized employer class have impeded consensus on incomes, industrial organization, and technological change. The proliferation of British industrial relations into hundreds of bargaining units, multi-unionism, and the voluntarist rather than legal basis of industrial relations practice produced an amorphous system bedeviled by mistrust, over which governments could exercise little leverage. Ostensibly based on four pillars—legal support for union membership; legal immunities for unions in disputes and secondary actions; the acceptance of collective bargaining; and legitimate union influence in tripartite institutions—this characterization gives a greater impression of coherence than ever really existed. The tradition of 'voluntarism' has proven impossible to reform: Labour's 'In Place of Strife' initiative (1969), the Industrial Relations Act (1972), the Trade Union and Labour Relations Act (1974–76), the Employment Protection Act (1975) all fell victim to the essential 'disorganization' of the system (see Beardwell 1996).

As King and Wood (1999) argue, the more general problem was one of 'firms embedded in uncoordinated organizational contexts'. Hostile to collective organization and unable to provide supply-side public goods, they developed product market strategies that minimized reliance on such goods. Training is a major case in point. Combined with low spending on R & D, the collapse of the traditional apprenticeships, and the absence of a national training system have led to severe deficiencies in Britain's 'innovation system'. The result has been a 'low wage–low skills' equilibrium (Finegold and Soskice 1988) in which a vicious circle of low skills, low productivity, low profits, and low wages forces reliance on 'price' rather than 'non-price' competitiveness. The state has been unable to steer the economy in a different direction, despite decades of attempting to do so. The creation of various instruments of industrial planning and intervention from the 1950s onwards were all inspired by a rationalist optimism and drew heavily on Continental experience.[8] But all suffered from adversarial, 'stop–go' policymaking and the frequent antagonism of industrialists and the Treasury. Nationalized companies, meanwhile, were poorly managed, lacked clear investment and performance guidelines, and in most sectors became heavily indebted and plagued by chronic industrial relations problems.

2.1.1.3. 'Disorganized Capitalism' and British Welfare

In the British case then, 'disorganized capitalism' has long been the prevailing state of affairs. And within this general context, far from early postwar economic growth and export performance being damaged by the welfare state, it was rather the reverse. The weaknesses of the British economy and the relegation of welfare in the list of postwar priorities heavily constrained early welfare expansion, and subsequently induced a shift away from the original universal ambitions. In fact, by contrast with most

8 These include the National Economic Development Council in the early 1960s, the Department for Economic Affairs (1964), the Economic Development Councils and the National Plan (1965), the Industrial Reorganization Corporation (late 1960s), and the National Enterprise Board (1975).

of its European neighbors, this was always a rather lean—and mean—welfare state. This was partly due to some of its key characteristics: a flat-rate system of pensions payments which, while linked to wage inflation until the Conservatives broke that link, did not prevent old age poverty; under-investment in the NHS which has always had to ration its services; and a concentration on the setting of minimum standards rather than on redistribution that set an effective floor for incomes protecting the poorest in the population.

Claims that an over-generous welfare state damaged Britain's economic prospects (e.g. Bacon and Eltis 1978; Barnett 1986; Maynard 1988) have been convincingly refuted for the early postwar period by evidence that welfare spending had no detrimental impact on investment in the early years of welfare-state expansion (Tomlinson 1995: 194–219). More generally, any increase in government financed consumption comes at the expense of marketed sector consumption, not marketed sector investment, and this is a true for the 1950s as the 1970s (Crafts 1995: 253; Broadberry 1991). As Hall (1986: 31) argues, although public spending as a share of GDP grew from 32 percent in 1950 to 45 percent in 1980, with an annual PSBR (public sector borrowing requirement) of around 4 percent in the 1950s, peaking at 8 percent in the 1970s, there is no causal link between poor growth and public spending. Contending (as do Bacon and Eltis 1978) that public sector activity is unproductive ignores the contribution health policy, education, and national infrastructure make to the health of the national economy.

The informal elements of welfare—resting on incomes and employment policy—were similarly shackled by more general economic problems, and here it is possible to attribute some of the blame for Britain's economic problems. Given the parlous condition of industry, and the disorganized state of industrial relations, contradictions between full employment policy and balance of payments equilibrium made informal welfare not just a victim (as in the case of formal welfare) but also a cause (among others) of recurrent economic crisis. Full employment increased the bargaining power of trade unions—whose membership was equivalent to 43 percent of the workforce in 1950—over both wages and working conditions. In the absence of a workable incomes policy, or effective policies to bolster industrial productivity, the long-term effects could only compound Britain's economic problems.

Thus, despite bursts of growth, poor economic performance meant an insufficiency of economic resources to meet the pretensions of successive governments. GDP doubled between 1948 and 1973, but average economic growth was half that of the EEC, reducing, correspondingly, the resources to be spent on welfare. Despite its wartime defeat and widespread social and economic dislocation, by the early 1950s, Germany spent a larger proportion of GDP on welfare than Britain. By the end of that decade, Britain spent less on social security than all of its major European industrial rivals and many of the smaller ones. Social transfers in 1960 were 6.2 percent—well below the 9.3 percent European median (Crafts 1995: 247). Poor economic performance constrained British welfare. There is no convincing evidence to suggest that the reverse was the case.

2.1.2. Three Episodes of 'Crisis': U-Turns and Retreats in 'Golden Age' Social Policy

The vulnerability of the economy, poor institutional adjustment capacity, and adverse consequences of mismanagement for welfare can be illustrated briefly by considering three 'golden age' episodes of policy crisis. These episodes illustrate the institutional dynamic at the center of Britain's economic management problems during the 'golden age' and the adverse consequences for welfare:

(1) the maintenance of full employment in an uncompetitive industrial system and in the absence of an incomes policy capacity strongly contributed to the 'stop–go' cycles of the 1950s and 1960s;
(2) when demand was expanded to sustain employment, imports increased, potential exports were diverted to the home market, and a balance of payments crisis threatened (frequently also provoking a sterling crisis and higher interest rates);
(3) given that devaluation was often resisted to protect the trading and reserve roles of sterling, the response was always the same: reduce demand, increase unemployment, and create the conditions for another 'go' phase in the cycle;
(4) in turn, the tax changes used to regulate these fluctuations frequently hit formal welfare provision (Lowe 1993: 109ff.; Stewart 1977).

The consequence was a subtle interplay between the political and economic climate. Despite policy reversals under both governments, a general consensus on the desirability of welfare (or at least an inability to control it) seems to be confirmed by the fact that social spending rose faster under Conservative than Labour governments. From 1950 to 1980, the seventeen years of Conservative government saw GPD rise 2.9 percent on average and social spending by 4.1 percent. By contrast, thirteen years of Labour saw a 2.0 percent average increase in growth and 3.5 percent in spending (Parry 1986: 223). But this ignores economic constraints. Labour was able to expand spending in the 1960s when the economy grew faster, as were the

Conservatives in 1970–72. Labour is penalized, though, by poor performance in the late 1970s, while the Conservatives contained spending in the 1950s, when growth rates of both social spending and GDP were below the postwar average. In reality, as the following 'mini-crises' reveal, neither party in power was fully capable of controlling the social policy agenda nor of managing the economy in classical Keynesian fashion.

The first crisis was encountered early on. Having created the welfare state and nationalized a large part of the economy (accounting for 10% of GDP and 19% of fixed investment), the Atlee government could more easily exert moral suasion over the unions than subsequent administrations. The government also gave into joint union and employer lobbying for trade restrictions and price controls and against effective antitrust policies. Nevertheless, although a wage freeze was accepted on a temporary basis after the 1949 currency devaluation, this led to attacks by sections of the labor movement that workers were bearing the costs of making British industry more competitive.

The main problem lay in convincing skilled and semi-skilled trade union members to accept either a squeeze in wage differentials or that the expansion of welfare could be traded for real wage gains. Signs of a fragmentation of bargaining had already appeared with a powerful shop stewards movement in the car industry and unofficial dockers' strikes. As long as cost of living subsidies were in place (by 1950–51 they were more expensive than the new National Health Service), union acquiescence could be bought. But attempts to offset the impact of subsidy reductions and price increases with social spending met with union opposition (Whiteside 1996: 90ff.). When, in spring 1950, Stafford Cripps, the Chancellor of the Exchequer, offered budgetary concessions in return for wage restraint, the TUC General Secretary advised that 'he did not believe the unions would recognize the notion of the social wage' (Jones 1985: 30ff.). In the absence of such an understanding, plans put in place in the last year of the Attlee government for permanent mechanisms of wage regulation were doomed to fail—as were successive attempts of this kind under both Labour and Conservative governments (for detailed accounts, see Fishbein 1984 and Jones 1985).

In any case, there was little room for bargaining over the social wage. The 1947 sterling convertibility crisis reduced the availability of dollars for timber imports (hitting the government's housing program), while expenditure cuts after the 1949 devaluation reined in spending on health and education. Per capita health spending was virtually static between 1948 and 1954 (and actually fell as a proportion of GDP), while capital expenditure on hospitals fell to one-third of pre-war levels (Lowe 1993: 180). The first new hospital only opened at the end of the 1950s, by which time the hospital bed/population ratio was lower than in 1939 (Tomlinson 1995: 212). In May 1951, a divided government, beset by economic difficulties, introduced charges for dental and ophthalmic care—breaching the principle of a free health service and provoking the resignation of the Health Minister, Aneurin Bevan.

The second episode came against the background of ten years of Conservative mismanagement and early attempts to retrench in welfare. The Conservatives contributed to the disorganization of industrial relations, and at a time when other European countries were implementing the American 'productivity gospel', neglected the inadequacies of training and the weaknesses of management (Tiratsoo and Tomlinson 1998. For a contrasting perspective which is much less pessimistic about the success of organizational change in this period, see Zeitlin and Herrigel 2000). Britain's relative decline massively accelerated.[9] The welfare state began to suffer from its identification as a burden rather than a productive resource, for the Conservatives had already developed a 'Thatcherite' critique of welfare as reducing individual initiative and family and social responsibility and creating disincentives to work (Glennerster 1990: 16). With full employment achieved, what need was there for universal social provision? Thus, the 1954 Phillips Committee recommended the abandonment of a key principle of Beveridge—the rise of flat-rate benefits to subsistence level—and argued that pensioners would have to rely on means-tested National Assistance. In 1956–58 the Treasury attacked universal family allowances for the second child. In 1957 there was a further retreat from Beveridge when the Treasury's contribution to National Insurance was capped (Lowe 1993: 142–43).

In response, the trade unions united in their defense of free collective bargaining and against the introduction of incomes policy measures.[10] The government became caught between two contradictory policies: rising wages were used to justify the removal of universal social welfare, while the welfare state was used to justify appeals for wage restraint (Whiteside 1996: 98). The dual commitment to full employment (and thus electoral popularity) and the strength of the pound contributed to the 'stop–go' cycle of the 1950s: policy lurched between contracting the economy when a failure to achieve balances, above all in foreign payments, threatened sterling, and expanding it when unemployment threatened to rise. The

[9] Growth (per capita GDP per annum) in France, Germany, and Italy increased, respectively, by 2.0%, 2.8%, and 3.3% over that of Britain in 1951–65. This compares with increases of 0.4%, 2.0%, and 0.8% between 1924 and 1937 (Tiratsoo and Tomlinson 1998: 33–34).

[10] These included the Council on Prices, Productivity and Incomes (1959), a National Incomes Commission (1962), and the National Economic Development Council (1963–64).

excessive use of monetary and fiscal instruments to engineer deflation was highly damaging to investment—both public and private. The 1959 Plowden Committee criticized the manipulation of current and capital social expenditure as a means of regulating the economy because of its damaging effects on social provision (Lowe 1993: 109–11). Between 1952 and 1958, the growth rates of social expenditure and GDP were both below the postwar average.

The third episode—the crisis of the Labour government of Harold Wilson (1964–70)—is the most dramatic. In the last years of the Conservative government a 'tacit' alliance with the unions emerged in which wage moderation was exchanged for welfare expansion—in hospitals (where spending/GDP had fallen below the 1930s' level), higher education, and council housing. But the conditions for an enduring and explicit bargain on the social wage still did not exist—as was fully revealed under Labour. Labour planned innovations on two fronts: a state-led modernization strategy, linking planning with industrial policy; and a revival of incomes policy. But both were completely overwhelmed by economic problems. By 1965–66, the economy was overheating and inflation threatened competitiveness. After many years of current balance surplus, a large deficit was recorded in 1964 and low reserves and a weak payments position exposed sterling to crisis on three occasions between 1965 and 1967. The consequent combination of cuts and tax increases diverted nearly £1 bn (or 3% of GNP) from consumption.

International factors loomed large: greater international competition increased the import propensity of the economy and prevented producers from passing on increasing unit wage costs (Woodward 1993: 74–75); and as revealed by the financial disasters of 1965–68, the confidence of overseas bankers and speculators had become at least as important as the state of the real economy. Together speculation and British capital exports accounted for two-thirds of the total negative foreign balance of £3.6 bn in 1964–68 (Pollard 1992: 360).

In consequence, Labour's welfare ambitions had to be abandoned. A promised 'income guarantee' and upgrade in universal benefits were jettisoned. Means-tested claimants and benefits increased enormously, in conflict with both Labour Party policy and Beveridgean principles (Lowe 1993: 143). Prescription charges—which Labour had withdrawn on its return to office—were reintroduced. While Labour's proposals for reforms of pensions, local government, and the NHS foundered, in employment policy, the aims of the 1964 Industrial Training Act were undermined by the absence of consensus among firms on training delivery and a failure to override trade union control of the apprenticeship system (Vickerstaff 1985: 45–64).

There was no new consensus on the social wage. Labour was unable to use demand-management to draw the unions into a voluntary and long-term incomes policy commitment and a fractured labor movement, in any case, provided an unlikely partner in such a project. The TUC could barely influence the strategies of its more than 100 member unions. But more to the point there were by now 200,000 or more workshops, sections, or groups into which two thousand or so plants had fragmented for pay decisions. In 1965–66, wage rates and hourly earnings rose at twice the norm due to plant-level pay increases and wage drift. After devaluation, attempts to introduce a zero norm, deflationary policies, unemployment at over 2 percent and attempts by employers to recoup profitability all led to the strike and wages explosion of 1969–70 that helped bring the Conservatives back to power.

All in all, and despite improvements in social and economic conditions, this was a far from sparkling 'golden age'. The consequence for social policy was what Glennerster (1998) calls 'welfare with the lid on'—that is, a constrained welfare state in which, despite periods of spending expansion, there was little scope for building on the foundations put in place in 1945. Welfare spending grew when and as GDP grew—although the former tended to outpace the latter as time went on. Between 1952 and 1958, social spending and GDP both grew below the postwar average; between 1961 and 1968 they were both above average; in the crisis years of the 1970s both grew on average at 1 percent or less in relation to the average (Parry 1986).

2.1.3. The End of the 'Golden Age': Welfare and the Failure of Economic Management, 1970–1978

In terms of the underlying dynamic of discontinuous economic policymaking, there is no sharp break between the experiences of recurrent 'mini-crises' in the 1960s and the major crises of the 1970s. The first Wilson Labour government had become entrapped in the same vicious circle as its predecessors. The essence of the problem was the failure to maintain productive efficiency in industry, which led to export losses, an increased import propensity, balance of payments problems, and short-term, knee-jerk government responses which further damaged investment and productivity.

In this context, incomes policies in the 1960s, buttressed by the devaluation of 1967, were really attempts to bring prices into line with the weakened condition of the economy as export markets became more competitive. The competitiveness problem itself remained untackled. Wage rises were actually below those in Britain's major competitor countries

(France, West Germany, Italy and Japan) until the 1970s: the difference was that in those countries these increased costs were absorbed by productivity gains that British manufacturing could not generate (Pollard 1992: 366–67). Meanwhile, and contrary to the usual 'golden age' thesis, maintaining full employment in this context—although largely achieved before the late 1960s–early 1970s—was never unproblematic, regardless of fixed exchange rates and the absence of major external shocks (cf. Sentance 1998: 38–40).

In this respect, the 'external problem' facing the economy had been consistent from the end of the 1950s onwards, as the 'seller's market' that British manufacturers enjoyed was steadily transformed into a 'buyer's market' in which they could not compete (Woodward 1993: 74–75). Whereas in 1951 some 51 percent of British exports went to Commonwealth markets protected by Imperial Preference, this fell to 29 percent by 1970. By then, 40 percent of exports were sold on much more competitive European markets. Meanwhile imports also increased as British goods lost their price and quality advantage at home. Also consistent was the other aspect of the difficult external position: the poor ratio of reserves to short-term liabilities that lay behind perpetual sterling crises. Before 1970, gold and dollar reserves never exceeded $4 bn, compared with much higher levels of sterling balances (held mainly by foreign governments), sustained by the international role of the pound. Between 1972 and 1976, this situation became critical, with reserves only sufficient to pay for two month's imports (Burk and Cairncross 1982: 167–68; Cairncross and Eichengreen 1983).

To the extent that both the competitive and sterling reserve problems were longstanding features of the economy, 'internationalization' was not new. Moreover, short-term capital flows had always had a substantial influence over exchange rate policy and the balance of payments. What was new, however, was the importance assumed in the 1970s by the foreign exchange market in determining the exchange rate. This reflected both long-term factors such as the internationalization of capital markets and short-term factors such as the inflow and outflow of OPEC oil revenues after the mid-1970s' price hikes.

The crisis of 1975–77 was significantly worsened by large-scale capital outflows, at a time when the current account was actually improving (Burk and Cairncross 1982: 279–80). Nevertheless, this begs the question of why there was so little confidence among holders of sterling and why Britain suffered so much more than other countries facing the same perilous international economic conditions. This takes us back to the chronic failures of domestic economic management, which, ultimately, must bear full responsibility for the crisis of the British economy. New dimensions of 'internationalization' were complicating and exacerbating factors, rather than causal.

Like Harold Wilson's Labour government before him, Edward Heath's Conservatives came to power in 1970 determined to break with ‘stop–go’, innovate in labor market policy, and reform the welfare state—including an early but active ‘pre-Thatcherite’ search for alternatives to state provision in housing and income maintenance. But with unemployment increasing from 2.5 percent in late 1970 to 3.8 percent in the first quarter of 1972, and inflation at 6–7 percent, Heath made two big mistakes. The first was liberalizing credit controls (in the mistaken view that interest rates manipulation could control any consequent burst in bank lending and growth), the second his ‘dash for growth’ in the form of a reflationary budget in 1972. An unsuccessful attempt to join the European Community's currency ‘snake’ led to a decision to allow the pound to float, followed by a substantial depreciation, which, given the worldwide commodity price boom, added imported inflation to the domestic wage explosion (Jones 1985: 97). While the classic demand strategy gave the requisite kick to the economy, producing growth of 5 percent by the middle of 1973 and a fall in unemployment, the industrial relations and incomes policies were a dismal failure.

At the same time, Heath became caught in a familiar bind over the social wage. Heath's employment and welfare policies hardly endeared him to the labor movement. First, the Industrial Relations Act of 1971—which sought to bring greater coherence and responsibility to wage bargaining—was rejected outright by the unions. Most reprehensible for the latter was its attack on the closed shop. Further, like previous Conservative governments, Heath's failed to appreciate the political importance of preserving the welfare status quo. For while health and education were ring-fenced, alternatives to state provision were actively sought in housing and income maintenance. The 1972 Housing Finance Act sought to make housing aid more selective, targeting poorer tenants only; the 1973 Pensions Act sought to wind down National Insurance and introduce greater reliance on private occupational pensions (Glennerster 1990: 18–20).

Through 1972, ultimately unsuccessful negotiations saw the unions consciously raise the issue of the social wage and link their agreement to a wage accord with radical welfare concessions. The statutory pay freeze that followed the collapse of incomes policy talks held average earnings at less than 1 percent from November 1972 to March 1973 and prices stabilized, but the government's expansionary policies and falling unemployment led to competitive bidding between firms. Subsequent attempts to keep wage increases at 7 percent linked to a new system of wage indexing were bust apart by a large miner's wage claim and strike. A voluntary policy had become infeasible anyway. For there were now some 5,700 pay settlements in firms employing between 100 and 999 people alone, excluding those in the smaller firm sector (Jones 1985: 97). Wage drift was uncontrollable. And if the miners had not undermined Heath's incomes policy, rising inflation and the autumn 1973 OPEC price hike certainly would have (Jones 1985: 86–96; Brown 1994: 35–37).

Labour came back into power in 1974 hoping (against hope) that by invoking the social wage it would be able to bind the unions to government policy without surrendering its freedom to govern. In fact, that was precisely the problem: inflexibility in domestic policy at a time of unprecedented external pressures. There were thus critical differences between the response of Britain to the crisis and that of other, more successful, countries. In 1974–75, the Wilson government prioritized full employment while relying on an insubstantial incomes policy. By contrast, a tough combination of fiscal and monetary restraint in Germany and the USA was followed by a return to expansionary policies in 1975. Thus, prices and unemployment rose faster in Britain than elsewhere.

After the biggest boom in 1973, Britain went into the deepest recession in 1974–76: zero GDP growth compared with 3–5 percent in France, Italy, and Germany. Productivity growth was stagnant against 10 percent growth in France and Germany (Burk and Cairncross 1982: 221–24). In the liquidity crisis of 1974–75, industrial profitability fell to half that of France, a third that of West Germany, and to a quarter that of Japan and the USA. Labour costs doubled (Middlemas 1991: 10–12). Stagflation, combined with higher public spending and borrowing, reserves well below the liquid liabilities that had accumulated as sterling balances, and, most importantly for market confidence, four years of current account deficit from 1973 to 1976, made Britain the sickest of the sick men of Europe.

It was not meant to be that way. The social wage was at the center of Labour's 'Social Contract'—a bold attempt to bring the lessons and benefits of Scandinavian and Continental corporatism to industrial strife ridden Britain. A new incomes policy was to be based on 'real wages'—pay after tax, social security, and benefits (Middlemas 1990: 374–75). In return for wage stability, Labour promised a wealth tax, price and rent control, more protection against dismissals, a full repeal of Conservative industrial relations laws, 'economic democracy', more nationalization and full employment. Things began relatively well. The first of three budgets in 1974 was slightly deflationary but more strongly distributional, increasing pensions and food subsidies and raising corporation taxes. Labour repealed the Conservative's industrial relations laws and strengthened dismissals protection and the closed shop. The 1975 Employment Protection Act bolstered union recognition, guaranteed pay during layoffs, and extended mandatory notice periods for redundancies (Flanagan, Soskice, and Ullman 1983: 418–24). The 1975 Social Security Pensions Act sought to end massive dependency on means-tested, supplementary benefits by adding a state earnings pension (SERPS) to the basic flat-rate pension to be fully protected against inflation. The 1975 Social Security Act, replaced the Beveridge flat-rate system and introduced earnings-related contributions. This supposedly made it possible to increase benefits and make cash benefits less like actuarial insurance and more like a redistributive tax transfer system (Barr and Coulter 1990: 277–79).

These were major achievements but they were expensive—especially in a hyper-inflationary environment—and the change in philosophy short-lived. An uncontrollable wage and prices explosion, a leap in unemployment, and full recession in 1974–75 led to tax increases, cuts and cash limits on all spending programs. A growing fiscal crisis forced the government into heavy borrowing to meet increased demands for welfare as unemployment rose, undermining foreign confidence and forcing the value of sterling to historically low levels. The postwar commitment to full employment was jettisoned and in the 1978 Supplementary Benefit Review, a renewed emphasis on means-tested benefits was explicitly made (Lowe 1993: 324). This was the most acute example of institutional incapacity in British government in the postwar period. Caught between powerful domestic constraints and overwhelming global imperatives, the loss of state autonomy was complete.

In retrospect, the Social Contract was doomed from the outset. As industrial wages spiraled out of control in 1975, union leaders failed to deliver restraint: decentralized, plant-level bargaining made local shop stewards pivotal. Basic wage rates escalated to 33.1 percent in spring 1975. Phase 1 of the subsequent incomes policy was relatively successful due to a sharp fall in profitability (reducing union bargaining power) and the TUC's determination to penalize free riding (Boston 1985). Incomes policy seemed to work after all. But by spring 1977, unemployment was rising less rapidly, inflation was falling, and the pressure on the exchange rate eased after the negotiation of the $3.9 bn IMF loan which restored market confidence. The unions felt less constrained and attacked the government for abandoning full employment and for IMF induced cuts and spending limits. Phase 4 of the policy—introduced in mid-1978, with perhaps an unwisely restrictive 5 percent pay target (Hopkin 1998)—saw its collapse. Strike numbers rose from 1 million to 4.5 million (Jones 1985: 110–17; Flanagan, Soskice, and Ulman 1983: 434–436). Militant public sector workers and private sector workers joined forces and launched the 'Winter of Discontent'—the first to fight falling real incomes, the second to defend wage differentials. What they got was Margaret Thatcher.

2.2. New Times, New Politics, New Model? Employment, Welfare and Economic Adjustment Under the Conservatives: 1979–1997

2.2.1. The Model in the Late 1970s

The analysis above has presented a much less than 24-carat 'golden age' in which the formal welfare state is the victim not the cause of Britain's economic adjustment problems. The industrial relations system, by contrast, is intrinsically caught up in the special pathology of Britain's ongoing economic crises. At the heart of the matter, it has been argued, lay an institutional incapacity to link advances in welfare provision with a medium- to long-term commitment to wages and price stability. It was the absence of a clear notion of the 'social wage' as the crux of social consensus that tripped up government after government and contributed both to the failures of economic management and to the indirect effects of low growth on the expansion of welfare.

Despite its many achievements, the performance of the welfare state gave cause for critique on all sides. On the formal welfare side, the success of British welfare lay in its undeniable contribution to living standards and its eradication of abject poverty, the development of a comprehensive system of education, the creation of a National Health Service which was much more cost-effective than its insurance-based counterparts in France and Germany or the US market-led system, and the avoidance of excessive public sector deficits. The downside lay in the consequences of the process described above: thirty years of development in which neither political party was fully capable of meeting its objectives, and in which continuity was overridden by short-term policy switches and budgetary fluctuations, undermining the government's powers of raising revenue, distributing income, and meeting new needs.

This, coupled with technical and organizational inefficiencies, affected the quality of provision in all services. In health, despite higher spending, the numbers on waiting lists for treatment grew steadily from the 1960s on. In education, despite major successes in increasing the numbers passing public examinations, in the early 1980s some 10 percent of 23 year olds had literacy problems and the deficiencies of technical education were widely acknowledged. Housing policy had rehoused millions from slum areas but often in conditions even more conducive to physical degradation and the proliferation of social problems and crime. Homelessness among certain groups became a major problem from the 1960s on (Parry 1986: 202–8; Lowe 1993: 280–97).

Most seriously—and lying behind many of these problems—was the persistence of major gaps in the full coverage of social need (affecting the long-term unemployed, the low paid with inadequate income support, the disabled, single-parent households, and pensioners), alongside poverty and unemployment traps and a social security system which, by the 1980s, was struggling to deal with the consequences of an increasingly regressive tax system and the expansion of means-tested benefits. Contrary to the nostrums of the New Right, the problem was not so much one of dependency and 'voluntary unemployment'—one of the so-called 'moral hazard' consequences of welfare—but of the prevalence of low-paid jobs, the burden of taxation and National Insurance at low income levels, and the poor take-up by those in work of means-tested supplements. In the 1960s and 1970s, combined tax and benefit changes actually reduced the 'replacement ratio' of benefits to income from work which had never been especially high in the British case (Parry 1986: 196–97; Pollard 1992: 279).

Taxation became less progressive. While taxes on income and capital, including net insurance contributions rose only from 20.8 percent of GNP in 1950 to 23.8 percent of GNP in 1980, taxes on spending—which are regressive in effect—rose from 14.7 percent to 19.3 percent. Between 1945 and 1975, the standard rate of tax fell from 50 percent to 35 percent, with a similar fall in the effective rate of surtax paid by higher income earners. After 1970, due to the withdrawal of 'reduced' tax rates, those who only just passed the tax threshold were paying the standard rate: in 1949 a married man with two children would have to reach 187 percent of average earnings before paying tax at the standard rate. By 1975, this had fallen to 44.6 percent. Tax allowances (e.g. relief on mortgage interest payments) and exemptions (e.g. of company contributions to occupational pensions) all favored the more prosperous classes. Between 1949 and 1975–76, the proportion of post-tax income received by the bottom 50 percent of income earners rose hardly at all—from 25.6 percent to 27.4 percent (Lowe 1993: 282). In contrast, that of the top 10 percent fell from 27.1 percent to 22.3 percent. Evidence does show, however, that inequality was trending downwards from the early 1960s onwards, to be reversed in the period after 1978/79 (Jenkins 1996).

By the late 1970s, the middle classes had become major beneficiaries of the welfare state. Julian Le Grand calculated in the early 1980s that the top 20 percent of income earners were receiving educational and health services worth, respectively, three times and two-fifths as much as those received by the bottom 20 percent (Lowe 1993: 284–87).

In fact, it is in the operation the tax system that we can find one of the few causal links between the operation of the British welfare state, broadly conceived, and the performance of the economy. In terms of revenue sources, it should be noted that corporation tax had long been low and had fallen through the 1950s–1970s, with two effects. First, it meant a steady shift of taxation onto the average wage earner. But second, it may also have had a detrimental effect on employment and economic performance, contributing via generous tax allowance incentives, to low company profitability and a decline of employment in manufacturing industry in the 1960s and 1970s. Between 1955 and 1964, the proportion of total tax revenue raised from companies halved, and did so again between 1965 and 1974, while income tax, employee's National Insurance contributions (as the Treasury contribution fell), and indirect taxes—particularly regressive—assumed an ever greater part of the tax burden (Lowe 1993: 284). Tax allowance incentives to investment were part of government policy to promote full employment and growth. But because of rising labor costs, this led to a substitution of capital for labor within existing technologies and a longer run shift to more capital-intensive ones—and this process continued even as profit gross of tax fell (Maynard 1988: 18–19).

There is also a connection between the effects of the tax-benefit system, the issue of the social wage, and the problems of sustaining wage moderation—again with consequences, albeit indirect, for economic performance. As a result of industrial relations indiscipline and low investment levels in the 1960s and 1970s, British wages rose considerably faster in relation to prices and productivity than in comparable countries, contributing to a rapid rise in unit labor costs and the loss of markets for British goods. Trade union militancy was due in part to empowering legislation (especially that passed under Labour governments in the 1960s and 1970s), rising membership (from 9.3 million in 1950 to 13.5 million in 1979—58% of the workforce), the growth of the closed shop (covering 44% of manual workers in 1980), and the fragmentation of the bargaining system.

But it was also due to genuine frustration with the decline of freely disposable incomes. This was due to the incidence of standard tax rates at low levels of income (described above) and the rapid rise in additional costs per employee in National Insurance contributions and taxes (which rose from 21% to 47% of net earnings between 1960 and 1980). From the 1960s on, the ratio of the net amount transferred by the tax and benefit system to the total turnover of taxes and benefits (the 'churning' index) continued to fall (in 1967 the average household lost 38% of income to tax and recovered 21%, but by 1983 it lost 47.2% and gained 25.3%). As pay increases took workers from the first quintile to the third, the 'churning indicator' fell rapidly from 62 percent to 11 percent (Pollard 1992: 268–73; Parry 1986: 200–201). This reflected government policy to increase the size and range of benefits, leave taxation to pay for them and ignore the cumulative effects on final incomes.

In sum, the absence of any mechanism for regulating the social wage in Britain not only contributed to 'stop–go' and an incapacity for stable economic management. It also produced heavy distortions in the operation of the social wage, with detrimental consequences for incomes—amongst the working poor as well as higher wage earners—and contributed a further twist to the vicious circle linking poor industrial relations with the perennial problems of British economic management.

2.2.2. 'There Is No Alternative': Neo-Liberalism in the 1980s and 1990s

Keynesianism and the full-employment commitment had already been abandoned under the Labour government when forced into a strategy of fiscal and monetary conservatism in 1975. But Labour had its back against the wall; this was a party committed to full employment that had discovered, amidst inflation and currency crisis, that Keynesianism—in the form of soft currency policies and an expansionary macroeconomic stance—was no longer possible. The Conservatives, by contrast, hit the ground running in 1979, committed to a reversal of the status quo at all levels: the use of macroeconomic management to determine output and employment was to be abandoned; given the futility of incomes policy, monetarist restraint was considered the only alternative for controlling wages and inflation; and releasing the productive potential of the economy required a reduction in the role of the state—in taxation, borrowing and the public ownership of industry.

While there was no detailed blueprint for change, the enemies—Keynesian demand management, the trade unions, bureaucracy, and welfare—were clearly identified. 'Public expenditure', stated the government's first White Paper, was 'at the heart of Britain's economic difficulties' (HM Treasury 1979, cited in Hills 1998: 3). The welfare state constrained the free spirits of capitalism, sapped the individual of initiative, and created a culture of dependency. As had frequently occurred since 1945, 'corporatist collusion' could deprive the state of its capacity for purposive action; indeed, an important feature of Thatcherism was its determination to 're-empower' the state.

These ideas were not new and had been around in various forms in the Conservative Party since the 1950s. But in the 1970s they were backed by a growing 'advocacy coalition' of politicians, pundits, and think tanks, and with the crisis of the late 1970s, their time had decidedly come. Thus, legitimized by New Right thinking—and electoral victory—a combination of principled and expedient policies, linked to direct attacks on the power bases of the Labour Party and the labor movement, soon melded into what seemed to be a coherent plan to reform Britain forever.

Privatization, new restrictive industrial relations laws, the diminution of the powers of local government, the massive sell-off of public housing all simultaneously strengthened the institutional capacity of central government, sapped the electoral strength of Labour, and helped build a new pro-market social coalition. The latter, with the help of fortuitous events (e.g. the Falklands War), was to keep Labour in opposition for almost two decades and transform the political—and economic—landscape.

A key part of that transformation lay in abandoning the failed and, in retrospect, futile, attempts of governments since 1946 to forge a negotiated link between the formal and informal welfare states around the notion of the social wage. Incomes policies were abandoned (except for the public sector where statutory limits were imposed), the power of unions to influence government policy was radically reduced—indeed eliminated—and a new and instrumental linkage was forged between the social security system and the labour market, by 'activating' benefits and making welfare a tool of employment policy. Meanwhile, even if welfare spending remained at roughly the same level in 1997 as twenty years earlier, its role, as argued below, had in many respects changed fundamentally. The most important long-term results would be an often quite explicit subservience of social policy to the interests of the economy (and where possible subject to market competition), the division of welfare purchasers from welfare providers (e.g. the NHS reforms), the decentralization of responsibilities for benefit delivery (to local government and in some cases businesses), and the concentration of formal powers of control in the hands of central government—trends largely continued, and indeed reinforced under New Labour in the late 1990s (see C. Pierson 1994).

That said, change was much more radical in some areas than others, and economic performance during the Thatcher decade was far from outstanding, raising important questions regarding state capacity—often considered to be the *sine qua non* of the British case. Indeed, until the early mid-1990s it is fair to say that the failure to escape from the classic British 'stop–go' policy put the Conservatives in a similar position to their predecessors. Fundamental weaknesses in the real economy combined with economic mismanagement to frustrate success in their labor market and welfare reforms as well as in broader economic performance.

In 1990—after eleven years of Conservative government and the year Margaret Thatcher resigned as prime minister—Britain had the highest rate of inflation among the advanced economies, the highest interest rates, high and rising unemployment, large-scale bankruptcies, falling output, declining national income, and the largest current account deficit in history. As for rolling back the state, the share of national income devoted to welfare services was still roughly the same as in the late 1970s. The only consistent achievement—held to through all phases of the economic cycle—was judged at that point to be the Conservative's ‘reverse Robin Hood program’ which transferred ‘income from the poor, especially the poorest, to the rich, and especially the richest’ (Pollard 1992: 379). Yet once the deep recession of the early 1990s had passed, the more general impact of the Thatcher ‘revolution’—its successes (in its own terms) as well as its failures—would become much clearer.

2.2.2.1. Macro-Mismanagement and the Medium-Term Economic Strategy

Given the importance of the economic cycle for understanding the Thatcher–Major period—in terms of public spending, employment, and economic adjustment—a detour into the macroeconomy is indispensable. As described above, postwar governments of both stripes had frequently come to power convinced of the need (and their ability) to break the ‘stop–go’ cycle but always failed. The Conservatives after 1979 were no exception; but being Conservatives, they did so in Rolls-Royce style. The boom–bust cycle was especially impressive. The deep recession of the early 1980s was followed by a boom which, fueled by the liberalization of credit and hire-purchase controls, was the longest and most sustained episode of its kind in the post-war period—as was the bust of the late 1980s and early 1990s which followed, with all the predictable consequences in terms of bankruptcies, spending limits, and damage to investment and employment, especially in manufacturing. The opportunity of escaping from the main cause of the ‘stop–go’ cycle—the balance of payment deficits—provided by the flow of North Sea oil, was therefore squandered.

Once again, it was all meant to be very different. The new Conservative government was determined to reject short-termism and develop a medium-term economic strategy, with a focus not on the demand side but the supply side of the economy. A tight monetary policy—to be achieved by focusing on broad money M3 (cash and credit instruments) plus the public sector borrowing requirement (PSBR)—would dispense with the need for an incomes policy, since trade unions would soon realize the consequences of irresponsible wage bargaining: increasing unemployment for their members. The market would set wages, and welfare provisions would be cut, not just to reduce government spending, but to remove the floor below wage levels and allow them to fall. The rate of inflation was the most important target, while the value of the currency and the balance of payments took second place.

The problem of the Thatcher years lay in a clear contradiction between the micro policy supply-side strategy and the deflationary impact of macro policies to restrain the money supply (Pollard 1992: 376ff.). Indeed, the latter can be said to have 'overdetermined' the former. The severity of deflationary policies was intensified, in turn, by the poorly timed liberalization of credit and exchange controls in the early 1980s and impressive personal tax reductions in an already inflationary environment both at the beginning and end of the decade. Thus, the 1979 budget was deflationary but accompanied by a big shift from direct to indirect taxation: the standard rate was cut from 33 to 30 percent and top rates from 83 to 60, while value added tax (VAT) increased from 8 and 12.5 percent to 15 percent. The abolition of exchange controls in the same year led to an immediate outflow of capital. The rate of inflation rose by 4–5 percent to more than 20 percent in early 1980, stimulating higher wage claims. Interest rates consequently rose, nationalized industries were forced to raise gas and electricity charges and local authorities to raise rents (Pollard 1992; OECD 1982, 1983).

The removal of the 'corset' on bank lending in 1980 and the abolition of controls on hire-purchase in 1982 helped produce monetary growth well in excess of the target ranges (by 9% in 1980–81 and 3.5% in 1981–82) and well beyond any overshoots in 1976–80 when objectives were more or less met. High interest rates and a high exchange rate (bolstered by the flow of North Sea oil) quickly took their toll on industry and unemployment doubled to 12 percent—nearly 3 million—over 1980–82. In 1983 imports of manufactures exceeded exports for the first time since the war. Recession meant a decline in government receipts, an increase in transfer payments as unemployment rose and large PSBR overshoots in 1980–81. Inflation came down rapidly with the recession to around 5 percent and unemployment peaked at around 12 percent in the summer of 1985—during which time, however, real wages continued to rise. Monetary policy, meanwhile, remained unsuccessful, and money supply targets impossible to meet given their poor definition (and thus lack of credibility with the markets), the increasing international integration of financial markets and the simultaneous liberalization of domestic finance. Against this background, large current account deficits (with goods sucked in primarily by a massive shift from private saving to consumption) made the country increasingly vulnerable to shifts in speculative international capital.

As always, economic mismanagement played a prominent role. When in 1988 the standard rate of tax was reduced to 25 percent and all higher tax bands of 45, 50, 55, and 60 percent consolidated into single top rate tax of 40 percent, inflation was already mounting. Unemployment had fallen from 11.5 percent in 1986 to 8.5 percent, with a large increase in jobs (especially part-time and for women) in the service sector, and credit liberalization and easy mortgage finance was feeding a frenzied consumer boom. Between May and December 1988, the Chancellor raised interest rates (the only tool for controlling money supply the government permitted itself) 12 times, but inflation rose to 11 percent in October 1990. The 1990–92 recession had begun. Investment in 1990 fell by 5.4 percent, GDP growth fell to 0.5 percent (before slumping to −2.2 in 1991), while bankruptcies that year rose by 35 percent and housing repossessions soared as the housing price boom collapsed. The unemployment rate (UK claimant count) at 5.8 percent that year rose to 8.1 percent in 1991 and 10 percent in 1992 (OECD 1995). This was the second massive labor shakeout in less than a decade, with major consequences for government spending and the nature of the labor market—and arguably as important for understanding the transformation of the employment system as government legislation.

Aware that its independent monetary policy lacked credibility with the markets, the UK authorities had already been tracking the Deutschmark for several years before joining the ERM in October 1990. In choosing a central entry rate of DM 2.95 the authorities took a hard currency option to bring inflation down while putting heavy pressure in the short run on already suffering export industries. However, with protracted and deep recession in the UK and tight monetary conditions called for in Germany, tensions between internal and exchange rate objectives emerged and together with turmoil in international financial markets led to sterling's suspension from the ERM in September 1992 (OECD 1993). Poor UK economic conditions combined with the consequences of German unification made the situation unsustainable. After ERM exit the UK abandoned monetary aggregates as a nominal anchor and instead followed the New Zealand solution of explicit inflation targets set over an 18-month–two-year period. Both the target and interest rates were now set by the Chancellor of the Exchequer with the Governor of the Bank of England providing policy recommendations. By the mid-1990s policy credibility—in terms of financial market expectations and exchange rate stability—had once again been achieved.

One of the most important consequences of macro-mismanagement and the accompanying currency overvaluations of the early 1980s and the ERM period was the damage done to British manufacturing, producing bankruptcies, closures, and employment losses well in excess of the requirements of structural change and modernization. As Rowthorn (1999) argues, macroeconomic instability and exchange rate fluctuations destroyed even successful parts of the manufacturing sector with potential for long-term growth, while also discouraging new firm entry and damaging service activities dependent on manufacturing. Parts of the north, already afflicted with adjustment problems, were reduced to industrial wastelands, and a large proportion of their workers consigned to long-term unemployment.

Against this background it is unsurprising that the government failed to halt budget expansion as foreseen. In the first half of the Thatcher decade (and regardless of privatization receipts) public spending rose from 34.7 percent of GDP in 1979 to 39.1 percent, in 1982 and 42.6 percent in 1984 as well as against the average of other OECD countries, and with it went tax levels. A rising defense budget (agreed to with other NATO countries) played a part, but particularly important was the big increase in unemployment and increases in National Insurance and social benefits paid to the unemployed. The biggest real spending increases between 1979 and 1989 were in health (35%) and social security (33%). While total spending remained constant over 1980–93, a fall in government consumption and investment was offset by a rise in transfer spending. The share of social spending in GDP rose by 5 percentage points compared with an OECD average of 4.7. Compared to OECD averages, increases in UK spending were lower for pensions and unemployment benefits (areas where the government could successfully cut outlays by ending earnings indexation), close to the average for health care but much higher for disability, housing, and other social assistance benefits (all areas of spending linked to the incidence of unemployment and increases in household poverty) (OECD 1998). Other areas of spending, which were critical for long-term economic performance—most importantly education and training—suffered instead from much heavier restraint.

Again, it was all supposed to be very different. In terms of capacity for achieving broad economic objectives, it was unsurprising that at the end of the Thatcher decade Keith Middlemas (1991: 275) provided the following assessment: 'A government determined to rule by monetarist rules did so to full effect for only a brief period in 1981. What followed suggests that there existed in late-twentieth-century British conditions very serious practical limits to the thesis that parliamentary sovereignty confers effective power on governments to manage the state and control public behavior.'

2.2.2.2. Labor Market and Welfare Reforms

Assessing the situation a decade after Middlemas, it is much less obvious that over almost twenty years of government the Conservatives failed, ultimately, to 'control public behavior' or create the economy they wanted.

The first signs of success appeared in the aftermath of the recession of the early 1990s. By the spring of 1994 the UK economy attained its 1990 peak level of output two years after the start of the economic recovery. But the same level of output was now produced with 1.8 million fewer jobs and greater reliance on female and part-time workers, while modest nominal and real wage outcomes and more flexible employment practices meant that the drop in unemployment was much faster than in the previous

1980–81 recession. After a period of seven to eight years in the first part of the 1980s in which wage behavior seemed unaffected by labor market deregulation, real wages rose surprisingly little in the second half of the 1980s despite the rapid fall in unemployment. Real wages did increase during the 1990–92 recession, at a time when unemployment was rising sharply, but in 1993 wage moderation led to a fall in 'underlying' inflation despite currency depreciation and this helped to 'crowd in' jobs (OECD 1994).

Even allowing for a decline in labor force participation (especially amongst males in manufacturing) (Morgan 1996), this was a big contrast to the 1980s. The unions had been weakened (strike rates in 1993 were at their lowest since records began in 1891!), product market competition had increased, the labor market deregulated, and managerial attitudes changed (Dunn and Metcalf 1996). Productivity was up, as was investment and returns on capital, and export competitiveness, helped enormously by post-ERM sterling depreciation, had markedly improved. Public spending was back under 40 percent of GDP and the overall tax burden no higher than in 1980. The 1970s were just a bad memory. Bolstered by a credible anti-inflationary macroeconomic stance, the upturn in 1993 initiated a period of non-inflationary growth and declining unemployment rates that was to continue for the rest of the decade.

How, and to what extent, did labor market and welfare reform contribute to this change? Before presenting an answer to this question in the next section, a brief survey of the key innovations is appropriate. As discussed, the enemies—including bureaucracy, the trade unions, and the supposedly debilitating effects of welfare (for both individuals and the economy)—had been clearly identified. But the aims of reform on the informal side—industrial relations and the labor market—were much more explicit and conscientiously pursued than those on the formal side, for both practical and political reasons. Public support for radical change in industrial relations legislation and the fragility of industrial relations and labor market regulation contrasted with the popularity amongst the electorate of major welfare programs—especially health—their institutional embeddedness and the variety of client and professional vested interests defending them.

The reform mix consisted of several elements, the interaction of which has radically transformed the nature of the British welfare state, at least in terms of the delivery and composition of the social wage and the interface between the social security system and employment:

(1) trade unions were placed in a legal straitjacket which overturned the tradition of 'labor immunities';