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Social Policy of the EU and National Welfare State Transformations – A Political Economy Perspective

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1 Introduction

How can we characterise the social policies promulgated by EU institutions and the effect of the EU on national social policy? For some commentators, the EU is a hyperactive regulator, forever producing new Directives which limit market freedoms by restricting working time, requiring worker consultation, extending the privileges of full-time work to part-timers and promoting the rights of women, parents and disabled people. For others, the pro-competitive orientation of the Commission and the European Court of Justice (ECJ), in particular, produces a doctrinaire insistence on the neo-liberal market model that undermines national welfare states, while monetary union imposes conservative economic policies that constrain social welfare spending.

In this paper, we show that these claims are not mutually exclusive. EU social policy is a novel combination of deregulatory and reregulatory forces, endorsing more generosity in some expenditure programmes and retrenchment in others. In both guises, it has a transformative effect which neither unambiguously undermines nor promotes national welfare states. Even so, the identifiable thrust of EU social policy is inclusion of EU citizens through employment. This corresponds to the direction of national welfare state reforms in the last decade. But some of the resulting welfare state transformations show perverse outcomes: the political exchanges necessary to bring about the reforms endorsed by the EU agenda seem to have reinforced insider-outsider divisions in labour markets. We have a closer look at this evidence since it is indicative of a political economy dilemma in EU social policy.

Hardly original but central to our interpretation of EU social policy is that there is no unitary actor pursuing a single consistent line of policy. Yet we argue that there is a logic to the way that EU social policy has developed. The Commission focuses on policies which can be presented and legitimised as technical regulatory solutions to the problems posed by market integration. Sometimes interventions are rationalised as market-making or market failure-correcting in a rather creative way, giving a distinctive tone or ‘spin’ to EU contributions to social policy debates. This spin often utilises the principles of ‘non-discrimination’ and ‘social inclusion’ (or equal opportunity) which call for both deregulation and reregulation. The principles are deregulatory in that they widen market access, but reregulatory in upholding rights to equitable access for those ‘outside’ who were previously excluded. We illustrate how this balancing act of deregulation and reregulation works in some specific cases, and also ask whether the reregulatory processes can be effective, given the lack of budgetary resources and the weakness of traditional social partnership at the EU level.

The social policy of the EU can be seen as resulting from three policy processes. First, there is the social policy implicit in the creation of the Single (or Internal) Market. This policy process works primarily through the 'Community method' of integration through law, with the Commission, in particular its Directorate General for Competition, and the ECJ playing the key roles in extending and upholding the legal framework. Second, there are the processes developed under the 'Open Method of Coordination' which promotes discussions in policy areas which remain primarily within the competence of the member states. Particularly important among these processes is the European Employment Strategy (EES), monitored by the Commission's DG for Employment, Social Affairs and Equal Opportunities¹ (DG Employment), which has a key role in the 'Lisbon Strategy' of promoting growth and employment, and which the Barroso Commission has declared its top priority and responsibility. Third, there is what we may call the 'Maastricht agenda' of sound money and sound public finance which puts pressure on the member states to curtail redistribution by fiscal means. This agenda is pursued through processes in which the member states themselves have an important role (particularly the ECOFIN Council of economics and finance ministers) along with the Commission's Directorate General of Economic and Financial Affairs (DG EcFin).

There are links between these three processes. Some make them complementary and consistent. For instance, higher employment rates might improve public finances and reduce opposition to opening markets to competition and migration. However, there are also potential inconsistencies. For instance, competition may undermine 'public service' regulation of national markets, creating pressure for compensatory government expenditure for which there is insufficient fiscal space. Furthermore, the EU is not in a position to support the necessary political exchanges to make reforms happen, given its lack of budgetary resources and the absence of strong social partnership institutions at the EU level. We will discuss with reference to the regulatory state hypothesis of Majone (1996) and the diagnosis of a negative integration bias by Scharpf (1999) how the resulting political economy of EU social policy plays itself out in theory and in the practice of member states' labour market reforms.

The article is structured as follows: The next section discusses the three elements that make up the social policy of the EU: the creation of a single market based on the 'four freedoms' of opening national markets in goods, services, capital and labour; the discursive social policy strategy of the EU to promote reforms to create 'more and better jobs'; and the commitments to the single currency and the SGP, which, in the present context, play the role of a lever for reforms to make the welfare state fiscally 'sustainable'. This is followed by a discussion of the political economy of EU social policy, examining how the weakness of traditional social partnership at the EU level and the lack of budgetary resources interact with the regulatory and ideational thrust of the EU agenda and thus may distort welfare state transformations in practice. The last section concludes.

¹ As the former DG Employment and Social Affairs is called under the Barroso Commission.

2 The social policy of the EU as a result of three policy processes

Social policy as a result of the creation of the Single European Market

The Treaty of Rome and its successors commit the member states of the EU to integrating their economies by opening their markets to competition and removing rules, standards and practices that discriminate against suppliers from other states. The Commission and the ECJ are charged with promoting and regulating the extension of market access, while member states retain competence to formulate and administer their own social policies. However, this division of competences is unstable, as market integration affects social policy and vice versa. The Commission and the ECJ impinge on national social policy as they extend market freedoms and endeavour to bestow non-nationals with rights and entitlements; this is contested by the member states which restrict market freedoms in order to uphold their social policies. Leibfried and Pierson (1995) were the first to describe the evolution of an EU social policy ‘between courts and markets’. We agree with this portrayal in analytical terms: these are the major pressures that shape the EU approach, rather than intergovernmental coordination processes. However, unlike Leibfried (2005) and notably Scharpf (1999, 2002), we do not see the creation of the single market as producing only ‘negative’, market-creating integration, but also as a process of ‘positive’ reregulation. This section traces the anatomy of this process.

Economic integration can be seen as creating a ‘market’ for social regulation in which each country ‘supplies’ a package of social measures, and mobile entrepreneurs and workers choose the package that suits them best. A key problem with the idea of a regulatory marketplace is that competition and mobility will tend to undermine redistribution by member states. People who expect to be losers from redistribution (those with high assets and incomes) will move to smaller welfare states, undermining the tax base of larger welfare states and leaving them overburdened with claimants on their redistributive systems. These problems of ‘fiscal competition’ (creating pressure to reduce taxes) and ‘social dumping’ (creating pressure to reduce benefits) will be exacerbated if capital is more mobile than labour and therefore better placed to dominate the process of regulatory competition.

In the intensive debate around social policy that accompanied the negotiation of the Treaty of Rome, the principle was established that the regulation of wages and social protection was within the competence of member states, but measures affecting particular markets or sectors could be scrutinised for their effects on competition. At the insistence of France, wage discrimination against women was prohibited on these grounds: female-dominated industries in countries which maintained discrimination would have an unfair competitive advantage (Barnard 2000: ch 1). We can see this as an early example of ‘market-correcting’ as well as ‘market creating’ social policy², given that it emphasizes competition on a level playing field *and* fairness for disadvantaged groups in the labour market.

² Or positive as well as negative integration, to use the terminology of Scharpf (1999).

Non-discrimination has subsequently developed into a fundamental principle of EU law and policy, with gender equality as its flagship. However, the principle of non-discrimination on grounds of *nationality* is the most central, invoked to ensure market access for goods and services providers domiciled in other states, to promote labour mobility and to secure access to social benefits for migrant workers. The potential of non-discrimination to affect national welfare states has emerged only slowly, with dramatic recent ECJ decisions on non-discriminatory market access in the health sector (Greer 2006). In many of these decisions, the European institutions appear to have a deregulatory effect that undermines the capacity of member states to modify market outcomes through their welfare states (Leibfried 2005: 269). However, we would suggest that the impact of Europe is reregulatory rather than just deregulatory; in particular, the European institutions are vigorous in upholding the individual social rights of European citizens.

An example which illustrates both aspects concerns the regulation of posted workers.³ A 'posted worker' is employed under a contract made in one member state (the home state) who works on the territory of another state (the host state). Short-term posting is allowed under European law, but host states can require that contractors comply with their national minimum standards on wages, working time, health and safety etc. However, host states' employment regulations are subject to rigorous scrutiny by the ECJ for possible discrimination against out-of-state providers. The Court's starting point is that compliance with host state laws interferes with cross-border transactions, and therefore must be 'justified'. An acceptable argument in justification is that such regulation upholds the individual social rights of Union citizens by protecting posted workers from exploitation relative to domiciled workers. Conversely, the argument that the regulations protect workers domiciled in the host state from competition is not an acceptable justification for interfering with free movement (Davies 2002).

This example illustrates a pattern to the ECJ's case law, which is that the Court endeavours to build a social policy for migrants, reflecting its normative orientation to market integration along with its belief that migrants are excluded from the national polity and their interests tend not to be adequately protected by national social policy institutions. In the eyes of some commentators (Leibfried 2005, Ferrera 2005), this approach tends to undermine national welfare states, which are founded on national solidarity to provide security for their own citizens. In our view, this emphasis on the 'nationalism' of the welfare state is, as a general and historical proposition, misplaced (Soysal 1994).⁴ But the Court does risk a 'hollowing out' of social rights if its decisions undermine collective institutions for social policy that back up individual claims with the means to match them. When these means are budgetary, problems arise from decisions which allow people to avoid contributing to social insurance or to make excessive claims. Where the means are regulatory, problems may arise if monopolies or regulatory restrictions are no longer tolerated although they ensured that firms have the resources to meet regulatory obligations. This is a dilemma of EU social policy to which we come back below.

³ See the most recent Communication from the Commission on this (CEC 2006) which indicates an ongoing contest between EU institutions and some member states.

⁴ Mabbett (2006) argues with reference to the treatment of migrants and non-residents in the past and present that modern social policy does not generally rely on nationalism or exclusionary nation-building.

For the political economy of EU social policy, it is important to recognize that the ECJ's institutional role and approach to adjudication precludes any explicit political 'balancing' of market access against the desirability of preserving national social policies (Davies 1995). Instead, the Court looks for principles which reconcile market openness with social objectives. Among the principles which have guided the evolution of EU law, two are of particular interest for the way that social policy in Europe has evolved. One is the concept of 'market failure', whereby unregulated markets do not operate with full economic efficiency. This concept has been used to rationalise reregulation at the European level in areas such as health and safety at work and consumer protection. Another principle is that employment relationships have a special place in the EU's regulatory regime, as 'social partnership' should be promoted rather than unregulated competition in the labour market. This concept has been formalised in the procedures for transposition of 'framework' directives, which promote the regulation of employment through collective agreements (Barnard 2000, ch 2).

The concept of market failure is highly elastic, and the Commission makes full use of this elasticity, taking a narrow view of market failure when reregulation does not seem to be viable, while widening out the concept to justify 'policy entrepreneurship' in other areas. A good example of a narrow approach to market failure can be drawn from the first phase of the creation of the single market in insurance services (Mabbett 1999). Insurance is a sector where each state has its own regulatory structure which arguably guards against market failures (notably adverse selection, unfair discrimination and commitment problems) but also serves redistributive objectives (cross-subsidisation). Indeed, it is hard to distinguish these two agendas in many regulatory regimes. For years, differences in regulatory structure prevented the development of an integrated European market in insurance services. However, in decisions in 1986⁵, the ECJ ruled that states could (only) maintain regulatory barriers to the extent necessary to protect policy-holders and insured persons. These rulings were taken up by the Commission to promote a Directive⁶ based on a narrow interpretation of insurance market failure, in which the problem that companies may not honour their commitments to pay out to policy-holders was addressed, but not other types of market failure. In particular, certain types of national regulatory measures to prevent 'cream-skimming'⁷ were deemed anticompetitive. Only with the extension of non-discrimination law and practice in the last ten years has it become apparent that the regulation of the single market in insurance had failed to grapple with these issues, to the detriment of effective social regulation at the national level. Furthermore, it has proved difficult to create a non-discrimination regime in insurance at the European level, both because member states differ in their practices in this area and because of market pressures. Discriminating insurers will tend to drive out non-discriminators through competition if the grounds for discrimination are actuarially relevant.

⁵ C-220/83, *Commission v. France*, [1986] ECR 3663 and C-205/84 *Commission v. Germany*, [1986] ECR I-3755, esp. p. 3807.

⁶ Third Non-Life Insurance Directive, 92/49/EEC

⁷ 'Cream-skimming' means the sale of insurance only to those with favourable risk characteristics. It may be prevented by anti-discrimination or 'open enrolment' regulations. It is the opposite of adverse selection, the process whereby persons with unfavourable risk characteristics tend to seek insurance more than those who are less likely to claim.

While European-level regulation of discrimination in insurance has not (yet) been achieved, the initially narrow, pro-competitive approach adopted by the Commission and the ECJ has since been modified by invoking the second principle mentioned above, concerning the special status of social partnership. In the late 1980s, the then President of the European Commission, Jacques Delors, promoted a 'social dimension' to European integration which was heavily oriented towards workers' rights and employment regulation. The products of Delors' initiative included the Community Charter (1989)⁸ and the Agreement on Social Policy in 1991.⁹ In the leading case of *Albany* (C-67/96), among others, the ECJ invoked these instruments to confirm that the promotion of social dialogue is an objective of the Community and the Member States. It went on to hold that, while collective agreements between employers and employees restricted competition and had an appreciable impact on competition and trade between member states, employers and unions are free to bargain collectively over occupational insurance and pensions as well as wages, even when, in so doing, they restrict competition between insurance and pension providers (Mabbett 1999, Hervey 2000).

The wider implication is that there are opportunities to maintain social regulation within the integrated European market. But they often involve reshaping existing national systems, and national responses may be impeded or insufficient, and welfare states may be significantly changed in the process. To return to the example of posted workers, member states have faced a number of problems in regulating their employment conditions (Menz 2003, CEC 2006). Many national systems regulated employment through collective agreements between unions and employer associations. Posted workers and their employers were not members of these organisations, and were therefore not necessarily covered by the relevant agreements. Thus governments had to regulate to ensure that wage minima (and, in some cases, wage structures) were legally binding on all workers. In a small way, systems based on social partnership thereby became more 'statist'. We can therefore see the arrival of posted workers as a threat to the way that labour markets were regulated in the host states, but also as an opportunity for governments to intervene, and possibly thereby reshape the outcomes of bargaining.

The current legal position is that employment relationships and the labour market have a special status within the Single Market Programme. They are the object of distinctive harmonisation measures, not only to combat discrimination but also to regulate the working environment and promote a better 'work-life balance'. However, preserving this special status is obviously difficult if all other markets are subject to pro-competitive reforms. Market liberalisation in goods or services must mean that labour market regulations can be evaded: states govern employment on their territory but not the goods and services that those employees might produce. In the area of services, the potential for evasion around the boundary seems considerable: when is someone a 'worker' and when a provider of services? Moreover, the historical evolution of 'social partnership' suggests that these regulatory arrangements result not only from working class power and organisation (exercised through social democratic political parties as well as through industrial mobilisation) but also from employers'

⁸ Declaration by Council of the Community Charter of Basic Social Rights for Workers (COM(89) 568 final, 19 Nov 1989).

⁹ This later became the Social Chapter of the EC Treaty (Rhodes 2005: 288-290).

desire for measures that will regulate competitive relationships between firms and mediate between sheltered and competitive sectors of the economy (Hall and Soskice 2001). The creation of the single European market changes the payoffs to these arrangements and sometimes directly undermines them.

In this section, we have argued that the regulatory social policy emanating from the Single Market Programme can be understood as being normatively ruled by the non-discrimination principle. This allows for negative and positive integration at the same time and often in the same ruling. The negative integration bias comes in when the Court interprets market failure narrowly, thereby constraining government intervention to correct it. But the practice of ECJ rulings also suggests that the special status of social partnership in employment relationships can sometimes be an effective consideration that balances the liberalising tendency of the non-discrimination principle.

Social policy through the 'Lisbon Strategy' and the 'Luxembourg process'

This section focuses on the two policy processes that have become the most prominent and characteristic instances of the EU playing a role in the multilateral surveillance of member states' redistributive policies and their reforms. They do not mark the beginning of EU involvement in member states' social policy: the Commission has had a role in the regulation of labour markets ever since the Treaty of Rome. Nor are they the first instances of the EU being concerned with redistributive policies of member states: 'combating social exclusion' has been on the agenda of summits and in EU documents ever since the late 1980s. We will briefly discuss both below. But the Lisbon Strategy and the Luxembourg process are the focus of much more sustained and overt effort than previous initiatives. They contain in a nutshell what EU social policy is trying to achieve: to exploit complementarities between economic goals (such as growth, efficiency, flexibility) and social goals (such as cohesion, inclusion, security). Obviously, each set of goals is affected by the combination with the other. Here, we will look at the processes from the point of view of their social policy objectives.

As the Single Market initiative neared its deadline for taking crucial measures in 1992, the Commission launched its White Paper on Growth, Competitiveness and Employment (CEC 1993). It sought to set the terms for the next stage of economic integration, with monetary union as its centrepiece. The White Paper took up a number of themes about labour market reform which were developed, more famously or notoriously, in the OECD Jobs Study (1994). In both studies, the problem of persistently high European unemployment was interpreted as a 'structural' (as opposed to a macroeconomic, cyclical) problem, which called for more flexibility and adaptability in the labour market. In 1997, these themes were carried further with the launching of European Employment Strategy (EES), which originated at the Intergovernmental Conference at Amsterdam. The Amsterdam Treaty saw the inclusion of an Employment title which stated that employment was a matter of common concern to the member states and called for cooperation over and 'mainstreaming' of

employment concerns. The EES was developed further at an Extraordinary European Council in Luxembourg in the same year.¹⁰

At the Lisbon summit in March 2000, the EU Heads of State agreed to make the EU, by 2010, “the most competitive and dynamic knowledge-driven economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment”. As the opening phrase makes clear, the Lisbon Agenda is dominated by comparison between the EU states and other countries, notably the USA. The agenda centres on the programme of extending competition and enhancing the integration of the European economy, but Lisbon also affirmed that the EU’s economic progress would have a ‘social face’. Much of this was reflected in the guidelines developed for the EES in its mid-term review of the same year, which centred on the four pillars of employability, adaptability, entrepreneurship and equal opportunity¹¹. In March 2005, the Barroso Commission re-launched the Lisbon Strategy, proposing to focus it even more on employment and growth and to relegate cohesion and sustainability to secondary goals. This has also led to a complete revision of the EES.¹² From July 2005 onwards, the guidelines for the employment strategy will be presented and discussed in conjunction with the macroeconomic and microeconomic guidelines for policy coordination and structural reform, to be reviewed every three years.

The EES is the leading example of the ‘Open Method of Coordination’ (OMC), which has now spawned a number of imitators, including OMCs on social inclusion, pensions and health. An OMC requires governments to agree on common targets and a timetable to achieve them, to draw up national plans that report and announce reforms intended to achieve these targets, and then undergo a peer review in the Council that will issue recommendations on how to improve performance. The Commission has only a monitoring role but not the initiating and guiding role as in the Community Method of harmonisation.¹³ The EES, like other OMCs, does not itself generate legally-binding recommendations or measures. Instead, the processes of setting targets and exchanging information about policy instruments are intended to have an effect on the ways that policy-makers frame policy problems and their assumptions and beliefs about the range of possible solutions. Perhaps the most notable contribution of the EES to ‘framing’ is that it sets targets for employment (rather than unemployment) rates, thereby highlighting not only persistent unemployment but also non-employment, particularly among women and early-retired workers. Targets were set at Lisbon for the total employment rate (persons employed as a percentage of total

¹⁰ Cf. the DG Employment website on the development of the EES [URL: http://ec.europa.eu/employment_social/employment_strategy/develop_en.htm]. A more detailed account can be found in Rhodes (2005).

¹¹ These were revised in 2003, after an impact evaluation finalized in July 2002 and a ‘Communication on streamlining the economic and employment policy co-ordination cycles’ issued in September 2002, to comprise: full employment, quality and productivity at work; and cohesion and inclusiveness in the labour market.

¹² See the Commission President’s website at URL: http://ec.europa.eu/growthandjobs/index_en.htm. It lists key documents only back to 2004, however. A search on the Commission website reveals that DG Employment is involved with the (wider) Lisbon Strategy only as far as the EES and the consultation of social partners is concerned.

¹³ A comprehensive assessment of the OMC, by leading experts both in terms of country experiences and policy areas, can be found in Zeitlin and Pochet (2005).

population) at 70%, the female employment rate at 60%, and the employment rate of older workers at 50%.

One implication of this framing is that policies to combat discrimination on grounds of age, disability or sex are also seen as having the potential to raise employment rates (Threlfall 2002). To take the flagship example of equal opportunities for women, the Lisbon Agenda and its Employment Strategy encourage the replacement of the ‘male breadwinner’ model of providing social security by what Lewis (1992) has called the ‘adult worker model’. Governments and social partners are asked to promote competitiveness and work-related inclusion by ‘employment-friendly’ tax and benefit reforms that ‘make work pay’ as well as more generous provision of family-related services and a flexibilisation of employment contracts. The adult worker model therefore has implications for all three of the policy processes we are discussing, as it links employment promotion to non-discrimination and to the redirection of government expenditure. It frames these elements as compatible, but critics point out that a ‘work-first’ approach could also mean that women enter employment on adverse and marginal terms as both users of and workers in ‘outsourced’ and ‘commodified’ care services, given that no fundamental change in the traditional gender division of labour is contemplated (Lewis and Guillari 2005). In the empirical section below, we return to the problem that a higher employment rate could be accompanied by increased inequality due to a deepening of ‘insider-outsider’ divisions between workers in primary (secure, full-time) and secondary (‘flexible’, part-time) labour markets.

The EES is very similar to the programme promoted by the OECD Jobs Study (OECD 1994), for example in advocating policies to ‘make work pay’ and reducing so-called ‘passive’ benefit expenditure for those out of employment, in favour of ‘active’ policies such as training schemes or subsidies for low-wage incomes. Yet even within a fairly economic discourse about social policy, the EES is framed in a way which is much more positive about social policy. The special status of employment relationships and social partnership within EU competition law has given DG Employment a say in what seemed to be the exclusive realm of DG Competition. In turn, DG Employment has been pressed to reconcile its traditional social policy concerns for equal opportunity and social inclusion with competitiveness. The EES in particular and the Lisbon Strategy in general emphasize that social policy can be a ‘productive factor’ that helps to increase the employment rate and enhance the productivity of workers in employment. In presenting these ideas, the US serves as a ‘contrast regime’ (Jacobsson 2004: 360) where flexibility in employment is not reconciled with security and equality in the way that the European welfare states hope to achieve. According to the Commission: “Increasingly, social protection is seen as having the potential to play an important role as a productive factor, ensuring that efficient, dynamic, modern economies are built on solid foundations and on social justice.” (CEC 2003: 3) While accepting that Europe’s problems of persistently high unemployment and low employment rates have their roots in welfare state arrangements that cause labour market ‘rigidities’, good (‘activating’) social policy can bolster employment.

The EES has also taken up the broader theme of social inclusion, which has been a concern of the Commission since the late 1980s (Silver and Miller 2003), but it translated this theme into 'labour market integration'. The goal of promoting inclusion through welfare state reforms asks governments to identify groups with low employment rates or a precarious labour market status (women with carer obligations, single parents, older workers, immigrants, youth in disadvantaged neighbourhoods) and systematically to address the obstacles to their economic integration. This can encompass neoliberal policies such as lowering of high marginal tax rates, but also protective policies requiring increased government expenditure or regulation, such as extending child care facilities or promoting the integration of immigrant communities. It can also mean subsidising employment of target groups such as longterm unemployed or providing financial incentives for firms to convert temporary wage contracts into permanent ones.

The EES is also considerably more cautious than the OECD about condemning 'restrictive' labour market regulations, notably employment protection legislation (EPL). The OECD is forthright in advocating the reduction of protection against dismissals and redundancies and the removal of restrictions on temporary employment contracts, while the EES asks governments to 'review and, where appropriate, reform overly restrictive elements in employment legislation' while 'taking account of the need for both flexibility and security' (CEC 2003: guideline 3). This is the language of fudging and compromise, but it makes some sense if an 'insider-outsider' interpretation of European labour markets is accepted. The argument is that current arrangements achieve security for 'insiders' who enjoy the protection of EPL and coverage by social insurance, while 'outsiders' face both insecure employment and inadequate social assistance. 'Flexibility and security' would mean both less segmentation in the labour market and an improvement of social safety nets.

Two main reasons can be adduced for the Commission's caution in arguing for reductions in EPL. First, the EU itself pursues an ongoing regulatory agenda for labour markets which seeks to enhance employee rights in some respects. Aside from the non-discrimination rules discussed above, there are EU directives on working time, equal rights for part-time workers, parental leave, workplace consultation, and many aspects of health and safety in the work environment. There is now a considerable body of EU law on employment-related social policy that does not simply codify the lowest common denominator of member state social policies (Falkner et al 2005: 345-349). These measures stem from the desire of DG Employment (in particular), supported by some member states or relevant parts of their governments, to develop social policy at the EU level, making use of the main instruments available, which are regulatory. However, this agenda is challenged by DG EcFin, backed by other member states or other relevant parts of national governments, which see labour market flexibility and structural adjustment as essential complements to monetary union. We return to this conflict in the next section.

Second, the EES pays a great deal of attention to the desirability of involving the social partners (employers and unions) in the policy process; an orientation which is

much less evident in the OECD's programme and processes (Casey 2004: 340).¹⁴ However, echoing a motivation for the early social inclusion agenda, the EES promotes a much broader idea of participation of non-state or 'civil society' actors in the policy process than the established corporatist arrangements. It is arguable that this emphasis on inclusion and broad participation is incompatible with the promotion of traditional social partnership, with its emphasis on earned rights to social insurance and its 'last-in, first-out' practices in regulating employment. Often, these arrangements work to the disadvantage of part-time and low-paid workers, and those with interrupted work histories. One interpretation is that the EU social policy agenda seeks to reform and 'modernise' social partnership (Martin and Ross 1999; for a critical view, see Hyman 2001). Again, this is in line with its inclusive thrust, promoting non-discrimination in a broad political sense. By encouraging poverty networks and associations that represent women's interests to participate, the Lisbon process qualifies the privileged status of traditional social partners and, predictably, they have shown little interest in promoting its agenda (de la Porte and Pochet 2005: 363-371). This is in stark contrast to the Single Market Programme and EMU where in particular representations of employer and business interests have been eager to become involved (Cowles 1994; Collignon and Schwarzer 2003).

In this section, we have argued that the welfare state reforms emanating from the explicit social policy agenda of the EU can be understood as being normatively ruled by inclusion through employment. Again we find that this allows for negative and positive integration at the same time and often in the same policy initiative. Equal opportunity of the sexes and non-discrimination of elder or younger workers can bolster reforms to shift expenditure towards welfare-to-work measures or in-work benefits and cut back on traditional non-employment transfers. In turn, promoting flexibility, eg reform of employment protection legislation to make hiring and firing easier for firms, can be justified on the ground that it improves the access of outsiders to the labour market, notably female carers, the longterm unemployed or immigrants.

Social policy as a result of coordinated fiscal consolidation efforts

Ever since the EU embarked on 'the road to Maastricht' (Dyson and Featherstone 1999), the fiscal implications of social policy have been on the European agenda. This is not to say that it required monetary union to make governments aware that social expenditure was contributing to unsustainable fiscal deficits and public debt levels; this had been apparent ever since the economic crises of the 1970s. Most OECD countries came under similar pressures, and, within the EU, Sweden and the UK embarked on radical programmes to curtail public spending even though they did not join EMU. But in heavily-indebted member states like Belgium and Italy, the commitment to join EMU was an important factor in changing the political debate in favour of 'consolidation'¹⁵. Eventually, governments agreed on a Stability and Growth Pact, the basic rules of which are extended to all EU members, even if not

¹⁴ See the website of DG Employment at URL:
http://ec.europa.eu/employment_social/social_dialogue/dates_en.htm

¹⁵ 'Fiscal consolidation' is a term of art that refers to programmes to reduce government deficits and, over time, the stock of debt through reducing expenditure or raising taxes. Note that this puts the emphasis on sound public finance while 'retrenchment' often means a retreat of government, thus favouring lower taxes along with lower expenditure.

members of the Euro area. The Broad Economic Policy Guidelines (BEPG) require EMU and non-EMU members to submit annual stability or convergence programmes, respectively, which are the same in substance, the only difference being that the non-EMU members cannot be fined under the Excessive Deficit Procedure if in breach of the stipulations. This is justified by Article 99 TEC that requires all members of the Union to conduct their economic policies ‘as a matter of common concern’.

The Maastricht Treaty stipulated that states acceding to EMU had to limit their public debt (to 60% of GDP) and fiscal deficits (to 3% of GDP). The Pact codified two fiscal rules, firstly that a deficit above 3% is ‘excessive’ under normal cyclical conditions and therefore can be sanctioned, and secondly that the deficit should be ‘close to balance or in surplus’ over the cycle. With the formulation of the SGP, DG EcFin had, for the first time, an explicit mandate to scrutinise member states’ budgetary policies. Formally, this scrutiny was confined to aggregate outcomes. States could make their own choices about whether to respond by curtailing social provision or other expenditure, or by raising taxes or social insurance contributions to cover deficits. The original Pact did not tell governments precisely when and how they had to correct an excessive deficit or how exactly to adjust to the medium-term objective of ‘close to balance or in surplus’.

While the accession period was marked by sustained fiscal consolidation, several countries went into breach of the Stability Pact (or, in the case of the UK, of the BEPG) after EMU was formed, and the SGP was revised in March 2005. The reform was widely seen as ‘softening’ the Pact, and at face value, this verdict can hardly be denied. It is very unlikely that the Excessive Deficit Procedure will ever bite: ‘other relevant factors’ such as high medium-term growth or a spell of very low growth or an overall sustainable debt position can be invoked to postpone its start; steps can be repeated if the required measures, such as a ‘minimal fiscal effort’ of reducing the deficit by 0.5% per annum, are undertaken. However, the softer conditions of the reformed SGP have now become specified in meticulous detail, and the monitoring role of the Commission has been considerably strengthened.¹⁶

In the present context, what is most relevant is that the Pact reform provides another entry point for DG Ecfin and the Ecofin Council to exercise closer monitoring of social policy reforms in member states. For instance, systemic pension reforms can postpone the onset of the Excessive Deficit Procedure, but reforms must entail “the introduction of a multi-pillar pension system that includes a mandatory, fully funded pillar.” (DG EcFin 2005: 79)¹⁷ Thus the reformed Pact directly promotes a diversification away from ‘pay-as-you go’ systems. The revised Pact rewards welfare state reforms that reduce future spending and thus gives the economic and finance ministers in the Council a potential mandate to comment on anything that is the remit of labour and social affairs ministers in most member states. The major structural reforms that a government demands to be considered must “have direct long-term

¹⁶ For the Commission’s official interpretation of the Pact reform, see DG EcFin (2005: part II). It is quite clear that the guardians of the Treaty see themselves now as even more in charge.

¹⁷ This provision has also been introduced with a view to new member states: if they apply for EMU membership, it would be taken into account that any excessive deficit is to some extent attributable to pension reforms, thus making it easier for applicants to meet the fiscal convergence criterion (DG EcFin 2005: 79).

cost-saving effects and verifiably improve fiscal sustainability over the long-term” (DG EcFin 2005: 67). Thus we can see that the softening of the Pact has increased the role of the Commission in evaluating fiscal policies and pressing for particular types of reform.

This is but the latest stage in a tendency that has been present from the very beginning of EMU, when DG EcfIn seized on the opportunity to promote certain directions of reform within the fiscal consolidation agenda. In successive reports, DG EcfIn has argued that member states should aim to improve the ‘quality’ of public expenditure by gearing the composition of expenditure towards the Lisbon goals of growth, competitiveness and employment promotion (DG EcFin 2002, 2005). DG EcfIn argues that this entails increasing expenditure on physical and human capital accumulation (public investment and education) and research and development, while spending on social protection should be oriented more towards ‘active labour market policies’ (ALMPs) such as job search assistance, training and employment subsidies that serve social inclusion of target groups. High shares of social security expenditure, particularly on pensions, are characterised as ‘unbalances’ (sic) which crowd out measures to enhance labour market efficiency and reduce poverty (DG Ecfin 2002: 91-93). The Commission developed an indicator of the composition of public spending which ranked countries according to the ‘efficiency’ of their spending. Bad performers included Belgium, Italy and Greece, which were characterised as having an excessive share of social security expenditure and low ‘productive’ expenditure (DG Ecfin 2002: ch 4).

This critical commentary was backed up by the consensus among Commission economists that monetary union would call for more labour market flexibility. This was the message of the ‘One market, one money’ report to governments (Emerson et al 1992), which made the case for monetary union. Supposedly, it had a firm grounding in economic theory, namely the by then rather outdated theory of optimum currency areas. However, Mundell (1961) had proposed that it is a *prerequisite* for an optimum currency area to have high mobility or real wage flexibility in labour markets, once the exchange rate instrument is no longer available. The idea now was to give up the exchange rate between main trading partners and make labour market regulations fit that purpose. In other words, the theory was turned on its head by recommending that a currency area be formed as a way to reform labour markets (Schelkle 2001). The initially sub-optimal currency area would put reform pressures on labour market parties; if they gave in, the currency area would develop into an optimal one over time.¹⁸ But this link between forming a monetary union and structural reforms based on what we might call the theory of ‘contrived’ optimum currency areas invited sharp criticism from independent macroeconomists (eg. Buiter et al 1993, Eichengreen and Wyplosz 1998, Goodhart and Smith 1993). They argued that governments needed more, not less fiscal flexibility in a heterogeneous union to deal with country-specific shocks, given that there is no country-specific interest rate policy any more (De Grauwe 2006: 276-277).

¹⁸ This is also different from the ‘new’ or ‘endogenous’ theory of optimum currency areas (Tavlas 1993, Frankel and Rose 1996) which stresses how, for instance, intensified trade in a monetary union can ‘optimise’ the currency area.

In light of this criticism, officials at DG EcFin turned to an overtly political case for adopting fiscal rules in order to promote reform (Buti and van den Noord 2003). The underlying ‘back against the wall’ theory of reform politics¹⁹ argues that employers in commodity markets and unions in labour markets will resist structural adjustment if they believe that the government will eventually have recourse to monetary or fiscal expansion in order to reduce unemployment. Thus, monetary union and the SGP can be seen as a set of rules for macroeconomic discipline that would make the social partners realise that structural adjustment is inevitable because monetary or fiscal expansion will not happen. Interestingly, this line of argument implies that DG EcFin endorsed the maxim ‘bad (macro)economic policy is good (reform) politics’.

The revised Pact now is consistent with a different logic of reform politics, which reflects the need for some fiscal flexibility rather than a ‘back against the wall’ rationale. Interestingly, it has been the IMF (2004a, 2004b) who reminded the Commission that conditions of fiscal austerity may impede structural reforms. The ‘need for bribes’ argument for reforming the SGP is summed up in a recent OECD paper thus (Hoeller and Giorno 2006: par.5): “The expected gains of structural reforms are usually uncertain, long-term and spread out across the economy whereas any political and budgetary costs, such as compensation schemes to offset redistributive effects, are more tangible, are felt immediately and are more concentrated.” This pattern of costs and benefits is known to create a status quo bias against reform and only if some of the opposition can be bought off, with the aid of some fiscal space, will the bias be overcome.

DG EcFin (2005) has conceded this rationale for softer fiscal rules (rather grudgingly), and has sought to establish that it implies a role for the Commission in undertaking case-by-case evaluations of member states’ fiscal stances and reform programmes. It argues that “[t]he main implication for policy is that, when taking account of economic reforms in the implementation of the Stability and Growth Pact, a mechanistic, one-size-fits-all approach [...] should be avoided. Judgment should be used on a case-by-case basis, by assessing the relevant features of the various reforms at issue.” (DG EcFin 2005: 152) Within the Commission, the revised Pact changes the weighting of scrutiny over tax and expenditure policy in favour of considerations that represent the fiscal concerns of DG EcFin relative to those that represent the social policy concerns of DG Employment.

It is arguable that this is part of a trend in the EU’s soft law processes, whereby social policy is increasingly subsumed into the economic policy objectives. The ‘streamlining’ of the EES under the BEPG that was introduced in 2003 can be read in the same vein. The BEPG are the central instrument of overall economic policy coordination; surveillance under these Guidelines has the explicit mandate to assess how member states address the ‘challenges posed by ageing populations’ for public finances and the functioning of labour and financial markets (CEC 2003: 8). Projections on the sustainability of public debt, especially insofar as debt is driven by pension obligations, is a regular and continuously refined feature of stability and convergence programmes that are assessed under the BEPG annually (DG EcFin 2005: 117).

¹⁹ The term was coined by Rodrik (1996: 26-29) who, however, is sceptical about its efficacy. So is the IMF (2004a: 113-115) but it provides a succinct review of the underlying argument.

To sum up this last section on the elements of EU social policy: the welfare state reforms emanating from the ‘Maastricht’ agenda of EMU tend to focus on fiscal sustainability. This focus is not necessarily detrimental to social policy at the member state level; it does not have to lead to cutbacks in welfare across the board. But the revision of the SGP – the stipulations of which are not confined to Euro area members but relevant for all EU members under the BEPG – has been accompanied by the advocacy of specific social policy reforms, particularly of pensions. The revised rules for fiscal surveillance now allow for exemptions to bear the upfront costs of reforms that must, however, have a demonstrable cost-saving effect in the medium to long run. The outcome will very much depend on how the Commission uses the discretionary power to assess the stability programmes of governments that it has gained under the revised rules.

3 The political economy of the EU approach to social policy

We have argued that the key norms of EU social policy – non-discrimination, work-oriented inclusion and fiscal sustainability – allow for flexible interpretations of how much deregulation and extension of rights, activation and security, retrenchment and restructuring of social expenditures are required. Crucially, it is not a unitary EU actor that is responsible for the different strands that make up EU social policy; involved are at least three Directorates (Competition, Employment and EcFin) and the Commission Presidency, the ECJ and various ministries in member states. This institutionalises the need for reconciliation between the different norms of individual rights, social security, and economic efficiency.

But can such a balancing act lead to an identifiable impact of EU social policy on welfare state transformations? Or is so much opportunism and ambiguity built into the normative foundations of EU social policy that it becomes a mere fig leaf for relentless market creation and welfare retrenchment? Our political economy perspective takes the publicly declared goals seriously in the sense that complete failure to achieve them would at least cause embarrassment. But it also requires us to look at the methods and the institutional setting of how these goals are actually pursued. The analysis above suggests that the three elements of EU social policy converge on the explicit endorsement of an EU-wide adult worker model to replace the national male breadwinner models, prioritising employment as the pathway to social inclusion and equal opportunity (Lewis and Guillari 2005, Threlfall 2002). Whether this leaves noticeable marks on observable national welfare state transformations depends, however, on the directions or biases that are introduced by what we see as the two major constraints of EU social policy compared to national social policies, namely a weaker role for social partnership and a lack of budgetary resources. We will back up our analysis with a review of recent findings in comparative research on labour market reforms.

The political economy of EU social policy

The political economy of EU social policy is distinct from that of the member states because, above all, there is neither a strong role for traditional social partnership nor a sizable EU budget for social policy. This weakens and blurs the impact of EU social policy because it is confined largely to regulatory measures and so far without a

strong political base. Our political economy perspective is based on a critical reading of Majone (1993, 2005) and Scharpf (1999, 2002). We agree with Majone that regulation is the central mode of EU governance, but challenge his construction of a distinction between regulatory and redistributive policies. We agree with much of Scharpf's characterisation of social policy developments in the EU, yet do not see an overwhelming negative integration bias.

EU social policy requires us to understand that even a primarily regulatory policy is redistributive. In Majone's (1993) analysis, the EU's regulatory activity centres on the 'allocative' function of promoting efficiency by combating market failure and by providing the public good of uniform or compatible standards. These policies can enjoy 'output-oriented legitimation' because they bring enhanced prosperity to the Community. On this account, social policy (redistribution) and social regulation (market or government failure correction) were '[a]nalytically distinct' although 'historically and institutionally related' (Majone 1993: 158). In his later work, Majone turns the analytical distinction into a normative prescription: redistributive and regulatory policies must be distinguished in practice because EU social policy requires a democratic mandate for more integration from national parliaments (Majone 2005: 166-167); by contrast, EU social regulation can be left to technocrats who are accountable for solving 'specific problems in the best possible way'.

Our account of social regulation in the Single Market has shown that this analytical distinction is a fragile artefact, built on the elision of 'regulation' with 'allocation'. For instance, a centrepiece of EU social regulation, namely non-discrimination, has both distributive and allocative effects. Discrimination against 'bad' risks in insurance or ethnic minorities in labour markets can be conceptualised as a market failure (although they do not appear on Majone's list), but this does not mean that antidiscrimination policy enjoys output-oriented legitimacy. Indeed, it draws its legitimacy partly from a critique of majoritarianism; i.e. from the limitations of input-oriented legitimation as provided by current national political systems. The EU is then a lever for specific reforms that would not be popular at home although they are based on agreed democratic principles, such as non-discrimination.

By promoting 'social policy as a productive factor', the Commission has endeavoured to bring welfare state reform under the extensive umbrella of efficiency-enhancing allocative policies. We find the language used to promote market integration 'turned' to support social reregulation, most strikingly in the development of the non-discrimination agenda, which starts with nationality and eventually reaches right through gender to disability and age. First of all, this idea acknowledges that national welfare states also depend on output-oriented legitimacy to complement their foundations in the solidarity of communities. Moreover, this 'productivist' agenda can be interpreted as the Commission having taken the message of Majone's political economy on board, in that it utilises the idea that the EU can be seen as solving allocative policy problems in a technically efficient manner. Majone (2005) criticises such ventures by the Commission in the social policy area as 'integration by stealth', while we see it as a sign of the Commission's political astuteness, based on the insight that it is an eminently political act to frame an issue as a technical-allocative problem.

However, rejecting a categorical distinction between regulation and redistribution also implies that the Commission's strategy can only go so far before running into the

rocks of distributional effects which are salient to well-organised interest groups. A particular aspect of this is the tension between the non-discrimination ‘turn’ and the promotion of social partnership. It is striking that the EU has had less success in promoting the engagement of the social partners in the EES and other OMCs than it has with other ‘representatives of civil society’ such as women’s and disability organisations. But these organisations have limited power in domestic politics; indeed sometimes they seem to have more political opportunities at EU level than domestically (de la Porte and Pochet 2005: 375-381). While they may promote the appearance of citizen involvement at the EU level in a gratifying way, this does not address the exchange problem in promoting reforms to employment relations and welfare states, a problem to which we come back.

In Scharpf’s (1999) account, the promotion of allocative efficiency and the resolution of distributive and redistributive issues are inevitably intertwined and embedded in different institutional arrangements or employment regimes. He argues that different types of welfare state can survive when borders are opened, because different welfare regimes succeed in creating different complementarities between allocative efficiency and distribution. Thus ‘national economies with different production profiles and cost structures’ can coexist in open competitive markets (Scharpf 1999: 194).²⁰ There are not two sets of policies which can be assigned, with redistribution done at home and market-correcting regulation delegated to the supranational level. Nevertheless, Scharpf sees EU-level regulation as having a negative-integrationist, market-liberalising bias which has the potential to damage these embedded systems. In his eyes, the problem is that reregulatory measures require agreement in the Council, which in turn means that exchanges between member states must be constructed which recognise the specifics of their national conditions. By contrast, the Commission and the Court are able to proceed with market-liberalising measures without the constraint of laboriously achieving Council agreement. Social policy ‘left to the judges and the markets’ (Leibfried 2005) follows a relentlessly legal logic towards competition and market integration. Enlargement has intensified this asymmetry. Scharpf (1999: 77-117) argues that deficiencies in regulatory capacity are particularly pronounced in the areas of social policy, taxation, industrial relations and macroeconomic and employment policies, due to the intensity of ideological, institutional and interest conflicts between the member states. In these areas, member states have suffered losses of national capacity which are not balanced by enhancements in European capacity.

Our argument sides with Scharpf (1999) in emphasising that regulation and redistribution are bundled together, in policies that both correct market failures and reallocate claims on resources. However, our account of the three processes for social policy-making in the EU does not support the claim that there is a dominant negative integration bias inherent in the EU’s decision-making design and problem-solving capacity. We find instances where the legal logic of the ECJ can produce social regulation as well as market integration, while the OMC explicitly addresses the problem of finding routes to reform and re-regulation in a mode which is flexible enough to allow for national differences. However, the reform of the Stability Pact,

²⁰ This resonates with the ‘varieties of capitalism’ approach, developed in Hall and Soskice (2001), but the latter looks at these complementarities from the perspective of firms and thus has a very selective perspective on the welfare state.

with its emphasis on reforms that reduce or cap welfare expenditures, may reinforce tendencies to retrenchment. It remains to be seen whether the ‘politics of permanent fiscal austerity’ (Pierson 2001) thus revived will have a sizeable effect on social expenditures – so far, it has not.

We have also suggested that the special legal status of social partnership, and the various initiatives by the Commission to promote an EU-level social dialogue between unions and employers, can be seen as attempts to create a capacity which was recognisably deficient. However, these attempts have not been notably successful. While most trade union leaderships are nowadays ‘pro-European’, exchanges at the European level remain in the realm of elite discourse, with little capacity to inspire and mobilise memberships, which remain largely hostile to European integration (Hyman 2001). The representativity of the EU-level social partners is also contested, which weakens their ability to bargain credibly (Bernard 2000).

It is not hard to see why trade unions resist any erosion of their current institutionalisation of power in exchange for the uncertain prospect of a new role. Existing industrial relations systems give trade unions key roles in collective bargaining whereas the reregulation of employment relations at the European level does not offer the same opportunities. Arguably, EU-level measures have contributed to the individualisation and legalisation of employment rights, where trade union roles are different and probably more circumscribed than under collective bargaining.²¹

The perspective of employers is slightly different. Much of ‘positive’ reregulation of employment relations undertaken by the EU restricts their flexibility in taking on, utilising and discarding labour, even though it is constructed as market-conforming and efficiency-enhancing, particularly in making fuller use of potential labour resources (e.g. the employment potential of female carers or people with disabilities). That DG Employment has succeeded in promoting these measures, largely through the traditional ‘Community Method’ of directives, is something of a puzzle if one believes in the existence of a negative integration bias. In our view, the explanation is that issues around work-life balance, the status of part-time and temporary work, and the work environment are seen as peripheral to the core political struggles over wages and social insurance which preoccupy the social partners. Employer representations, in particular of larger firms, were ready to make concessions on these secondary issues in return for negative integration and dispersion of union power overall (Falkner 1998).

Once we move into a world in which long-run positive sum policies have significant immediate distributional impacts, and where there are interest groups which notice and resist those impacts, political exchange and compromise is imperative and existing institutionalisations have to be respected. But it is evident that such exchanges are specific to conditions which vary cross-nationally, and are not really susceptible to technocratic policy-making. EU technocrats are ill-equipped to formulate and engage in these political exchanges, for three main reasons that summarize our arguments. First, the member states have different configurations of labour market-social policy

²¹ For a review of the British debate on legalisation, and some evidence, see Colling (2006).

interdependence²², so the pattern of feasible exchanges is specific to each country's institutional and political context. Second, the EU, while committed to social partnership, has little to offer unions in exchange for cooperation in reforms to promote labour market flexibility. The EU has no means to promote desirable reforms that need budgetary space; it has no authority over member states' budgetary allocations and can only look on while national governments make their own decisions. The Commission has tried to counteract its powerlessness by extending its scrutiny and commentary on states' budgetary plans, and now it has the carrot of the relaxed Pact, but it remains that the EU itself is largely confined to regulatory rather than budgetary solutions. Third, policy-making with political exchanges involves proper political negotiation rather than the dissemination of technical regulatory solutions. We find both elements side-by-side in the OMC. On the one hand, the Commission emphasises wide participation (including the involvement of the social partners) in the policy process, which can be understood as an attempt to construct political legitimacy; on the other hand, detailed benchmarking and the use of regulatory committees sustains the alternative model of technocratic policy-making.

This leaves us with a dilemma of EU social policy: political exchanges seem to be necessary for EU social policy to get off the ground, yet the EU cannot act as a partner in such exchanges, because of its weaknesses in terms of social partnership and budgetary resources. It thus falls on member states, not only to keep their commitments and reform national welfare states in line with the EU's social policy agenda, but also to strike the political deals that make this happen. This brings us to our final argument: that political exchanges at the member state level modify the EU agenda significantly while nonetheless betraying its discernible influence.

Evidence on the political economy of EU social policy

As we have seen, EU social policy endorses both flexibility and security. This means that we should not find straightforward market liberalisation or rigorous cutbacks in expenditure programmes, even if member states were reading from the EU script.²³ In any case, tracing through welfare state reforms is always complex. Fortunately, there has been an upsurge in comparative research on the reform record in mature welfare states. We draw in particular on the evidence provided by economists at the IMF, the OECD and the Fondazione Rodolfo De Benedetti (FRDB) at Bocconi University. While each source has its own limitations, none of these organisations is inclined to play up the EU's reform record. What we are looking for in these assessments is whether EU member states have been active in reforming their welfare states, say compared to OECD countries not in the EU, and whether these reforms have been broadly in line with the thrust for inclusion and flexibilisation. Finally, we will watch out for more detailed evidence on the political exchanges under fiscal constraints that may twist the intended reform paths.

²² The literature on labour market regimes and transformations is the topic of several comparative studies and of some contributions in this volume (e.g., Bertola and Boeri 2005; OECD 2006).

²³ This is not only for reasons of political exchange but also because many of the existing programmes are themselves compromises between flexibility and security etc (cf Lindert 2003).

A good starting point for the question whether there is reform activism in EU member states is the study by IMF staff on what fosters structural reforms in industrial countries, published as chapter 3 in the Economic Outlook 2004 (IMF 2004a: 113; see also IMF 2004b). It covers the period 1975-2000 in 20 industrial countries. Of particular interest in the present context is the fact that the study identifies EU membership among the statistically significant determinants of structural reforms in different areas (table 1).

Table 1: Effect of EU membership on reform activism

Reform in:	Labour Markets	Product Markets	Financial Markets	Taxes	Trade
Statistically significant effect	positive	positive	none	negative	positive

Source: IMF (2004a: table 3.3)

Since a positive effect is particularly noticeable with respect to trade liberalization and product market regulation, the authors interpret this as the effect of openness that comes with EU membership and which motivates countries to reform. The findings on the impact on social policy are more mixed. The negative effect on tax reforms is compatible with the interpretation that fiscal constraints do not allow governments to make fundamental changes to taxes. In particular they cannot lower income tax or make taxes less progressive, even though this is advocated by the Lisbon Agenda. The effect on labour market reform is supposedly positive, although the empirical basis for this claim is rather small.²⁴ Prima facie, this is in line with our hypothesis that the Internal Market Strategy exempts labour markets from regulatory reforms when the redistributive impact becomes too contentious or obvious. But before we leap to conclusions, a closer look at labour market reforms is clearly warranted.

The OECD has recently published re-assessments of labour market reforms in the wake of its Jobs Strategy, which called for a bold liberalisation of labour markets in order to tackle unemployment (OECD 2006; Duval and Elmeskov 2005; Castanheira et al 2006). These studies show that, since the OECD Jobs Strategy was launched in 1994, EU member states have been more active in reforming their labour markets than the OECD on average. Even Germany and Italy, the member states with a rather disappointing growth and employment performance, cannot be accused of lagging behind in reforms. On the contrary, after Denmark, the Netherlands and Finland, Germany and Italy have been the most intense reformers among OECD countries and above the average of EU-15 countries between 1994 and 2004 (Duval and Elmeskov 2005: figure 4). Compared to the OECD average, this relative reform activism holds even after the majority of member states joined EMU. However, EMU membership seems to have weakened the intensity of reforms compared to the EU-15 members that did not join the monetary union (DK, SW, UK). The explanation put forward by the OECD authors is that EMU member states spent their ‘political capital’ in the run-up to EMU where they felt under pressure to both deregulate and tighten fiscal policy at the same time.

²⁴ This was pointed out by Werner Roeger (DGEcfm) in his comment on Xavier Debrun (IMF) at a European Commission workshop on ‘Structural reforms and macroeconomic performance’ in November 2005.

Given this evidence from two independent sources that are not known for their enthusiastic endorsement of EU welfare arrangements, one wonders why there is still a widely held view that the EU suffers from reform inertia. Apart from an inclination for circular argumentation among liberalisers (since trend growth of the EU as a whole has not risen and caught up with the U.S., reform cannot have gone far enough), EU governments do indeed refrain from implementing straightforwardly neoliberal programmes. Table 2 summarizes the findings of Boeri (2005) which draws on the social reform database of the Fondazione RDB. It shows that reforming governments engage in a strategy of ‘two steps forward, one backwards’ with respect to non-employment benefits and even ‘one forward, one backwards’ with respect to employment protection.

Table 2: Labour market reforms in Europe over time

	Decreasing protection and generosity, increasing rewards from employment		Increasing protection and generosity, decreasing rewards from employment		Of which (in percent): Decreasing protection and generosity
	1991-1996	1997-2002	1991-1996	1997-2002	
Employment protection legislation	16	35	9	38	52.0%
Non-employment benefits	38	93	9	27	78.5%
Public pensions	10	22	32	27	39.5%

Source: Boeri (2005: table 1), own calculations

Thus, EU countries exhibit an increasing level of activism, but there is not a clear-cut direction of reform, except for a decline in the generosity of non-employment benefits (such as early retirement or social assistance). Pension reforms have made the public schemes even more generous although there is a clearly declining trend between the first and the second half of the observation period.²⁵ This makes for little net change in overall indices of labour market reforms although considerable restructuring may be going on in some systems.

One interpretation of this uneven reform record is that political exchanges take place: a slashing of transfers – in line with the stipulations of fiscal policy coordination -- is compensated by more protection for insiders in the labour market through the maintenance of EPL (Fatàs et al 2003: 38-40; Saint-Paul 2004: 13-16; Castanheira et al 2006: 12-14). The majority of OECD countries with medium to high EPL have curtailed protection, but among EU countries only Austria, Finland and Spain have reduced regulations that protect permanent workers. Instead, there have been partial reforms to EPL for temporary employment (Brandt et al 2005: 63-64; OECD 2006: 95).

²⁵ The evidence on pension reforms in the Fondazione RDB database on social reforms has to be interpreted with caution, the classification as decreasing or increasing generosity seems not consistent over time. However, Castanheira et al (2006: 13, fig.2.5) reach the same conclusion, namely that there was no discernible thrust in marginal pension reforms.

At the same time, there is clear evidence that lower unemployment may be achieved at the cost of rising inequality, as measured by wage dispersion and the incidence of poverty or low pay²⁶:

- there is an overall increase of the proportion of working poor after 1994 which has been most significant in the Netherlands and Ireland (along with the U.S.) where employment gains were also high (OECD 2006: 40);
- temporary employment has increased almost everywhere (except Ireland and Spain) which has been largely involuntary; this form of employment remains precarious in terms of employment security and benefits (OECD 2006: 40, 173);
- reforms that generated employment gains were associated with rising (gross) wage inequality (OECD 2006: 162, 165);
- the incidence of low pay, which is typically combined with adverse mobility prospects (evidence of a ‘low pay trap’), has increased, although it is accompanied in a majority of countries by lower unemployment or higher employment (OECD 2006: fig. 5.8; 176).

The significance of these findings for the social policy processes which we have identified in the EU is two-fold. First, it suggests that complementarities between higher employment and non-discrimination may not be realised. It is already well-established that higher female employment rates are correlated cross-nationally with higher occupational segregation for women (OECD 2002: ch 2). Second, the fiscal effects of higher employment are also less positive than might be expected. Social assistance costs do tend to go down, but tax revenues from labour earnings have not gone up significantly (OECD 2006: 162-164). This suggests that some of the employment gains have come from fiscally-costly measures such as tax credits and allowances for low income families.²⁷

The European Commission now attempts, in its newly established labour market reform (LABREF) database, to detect whether reforms will assist those with a more marginal relationship to the labour market (Arpaia et al 2005: 11, 17). The possibility that strong, encompassing unions might also help to prevent increased duality in the labour market has also been noted (IMF 2004b: par.113; Castanheira et al 2006: 48). In light of our analysis it is noticeable that social partnership is now invoked to realise the norms of non-discrimination and inclusion, whereas the original OECD Jobs Strategy was based on the diagnosis that social partnership was the problem rather than the solution.

Overall, these large comparative studies are compatible with – if not conclusive evidence for – the assessment that governments pursued reforms broadly in line with the agenda of the EU. They depart from the script of the OECD Jobs Strategy in two respects. First, the liberalisation of EPL has primarily been pursued at the margin, targeting temporary or time-limited contracts in order to facilitate entry into the labour market, rather than weakening employment protection for all. Second and closely

²⁶ Working poverty is measured as below 50% of median income while low pay is up to two thirds (66%) of median income.

²⁷ In the National Action Plans on Employment for 2004, almost every EU-15 government (with the exception of Portugal and Finland) announced an increase in earnings allowances or tax credits for low-income earners.

related, governments tend to go for reform packages that are fiscally neutral or even cost-saving. Thus, they have partially reregulated the labour market while lowering, or tightening eligibility for, non-employment benefits, whereas the OECD recommended the opposite bundling, namely labour market deregulation combined with fiscal compensation for prospective losers.

4 Conclusion

Political processes, involving the Commission and the ECJ in conjunction with member states both jointly (in the Council) and separately, have mediated the impact of economic integration on social policy in important ways. While the Single Market Programme has the potential to transform national welfare states through its norm of 'non-discrimination', it has been adjusted and adapted to limit its effect on member states' social policies and preserve the special status of employment and social partnership vis-à-vis other market relationships. The Lisbon Strategy in general and the Luxembourg Process in particular, with their soft, participatory coordination of labour market reforms, can be seen as an attempt to take care of this 'gap' left by the Single Market Programme and to build a consensus about the desirability of providing inclusion and equal opportunity primarily through employment. At the same time, the Maastricht Process imposed fiscal constraints which were intended to accelerate reforms to labour markets and welfare systems to make the latter fiscally sustainable. These constraints have not proved to be binding and thus the implied 'back against the wall' politics of reform can be considered to have failed; but the revised SGP makes even more explicit links between the fiscal guidelines and welfare state reforms which follows a 'need for bribes' logic of reform processes.

EU social policy exerts an impact on national welfare state transformations through regulation and surveillance of governments, not through transfers and incorporation of non-state actors. Majone's regulatory state hypothesis claims that this makes the EU a technically competent solver of market failure and collective action problems for which it enjoys output legitimacy. But its underlying distinction between regulatory and redistributive, ie. economic and political, issues is not a given; which is why it is not necessarily 'integration by stealth' if the EU transcends its regulatory-technocratic role. The bundling of regulation and redistribution does make the EU's regulatory interventions more political and contentious. This is what Scharpf's interpretation of EU governance and his diagnosis of a negative integration bias states. However, our interpretation of EU social policy finds too much market-correcting reregulation originating at the EU level to accept Scharpf's account of this bias.

Our political economy perspective has identified two major limitations in EU social policy: the weakness of social partnership at the EU level and the lack of EU budgetary resources. This means that the EU cannot be a partner who gives and takes in the political exchanges necessary to make reforms happen. It is member state governments who have to strike these deals, under conditions of fiscal austerity. This introduces potential distortions. Specifically, by trading off cuts in non-employment benefits against employment protection for the core work force, these reform-active governments (re)create insider-outsider divisions in national labour markets. This can be seen as a perverse outcome of trying to follow the EU's work-first strategy while complying with the fiscal constraints of macroeconomic policy coordination. This is not to say that governments do these reforms out of sheer obedience with EU

stipulations. Only more detailed case studies, of both EU and non-EU countries, can tell what motivates these reform packages. However, comparative studies of labour market reforms in EU and OECD countries provide some evidence for a dilemma in EU social policy: it puts pressures on governments to engage in profound welfare state transformations but does not have the political and fiscal means to facilitate them.

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