DYNAMO

Dynamics of national employment models

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The present e-brochure gives an overview of the main findings of the DYNAMO project. It draws on the final reports written by Prof. Gerhard Bosch, Dr. Steffen Lehndorff and Prof. Jill Rubery (University of Manchester).

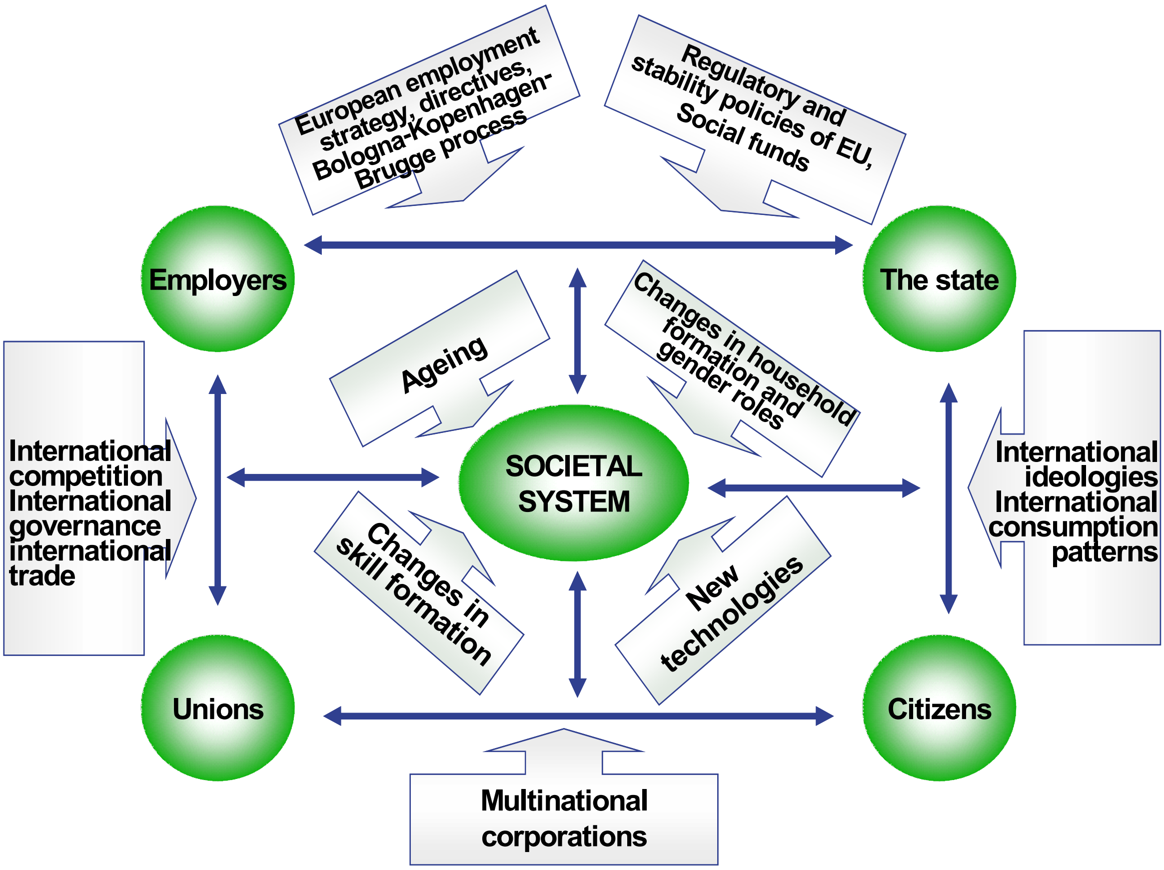
Varieties of national employment models

EU countries exhibit a wide array of distinctive institutional settings influencing the supply, utilisation and demand for labour. These are what we call national employment models. In Europe such arrangements are often called the European social model but are better referred to as European social *models*, as there are substantial differences across countries which as such are part of Europe's identity.

Their common basis has been the belief that within the constraints of capitalism there is still scope for the development and maintenance of a public space and for the protection of employees' and citizens' rights. Both these institutions and the beliefs which have been at the roots of their formation are now under challenge from both within and outside the nation states and the European Community.

Pressure to change stems from increased globalisation, the development of new technologies, new forms of governance and the dominance of the service economy, all of which are said to be undermining the comparative advantages of distinctive national models that have their origin in outmoded or nationally specific production models. These challenges to established models coincide with internal pressures to reform welfare and employment regimes in line with long-term changes in demography and social attitudes, manifest in both the ageing and feminisation of the economically active population. These pressures to change are being articulated not only at the national level by national actors but also through the various policies of the European Union and other supranational organizations (Figure 1).

Figure 1: Pressures for change on EU national employment models



Source: DYNAMO

This is the background to the DYNAMO project. Its objective was to find out whether or not, and in what respects, national employment models have continued to differ over the past few decades and possibly will continue to do so in the future. Given the overriding trend towards a predominance of market-led solutions, this process of "liberalization" may reflect a process of convergence in which national employment models are moving towards a "market model" which may call into question the concept behind the "European social model". Alternatively, it may also be the case that national distinctiveness continues to be reproduced or renewed, which in turn could be regarded as crucial for the future of a distinctive European social model, or as we would prefer to phrase it, of the different social models in Europe that contribute to the EU's distinctiveness compared to other regions in the world. Based on this analysis, DYNAMO has highlighted policy implications, particularly with respect to the European Employment Strategy (EES).

To this end, researchers from ten EU countries – Sweden, the UK, Ireland, France, Germany Austria, Hungary, Greece, Italy and Spain - analysed the dynamics of their respective national employment models from a number of different perspectives. The basic undertaking was to analyse institutional change in the national employment models over recent decades. The reference periods for comparison differed across countries as the main aim was to capture the most relevant period of institutional change in each country. This analysis was supplemented by a shift in perspective towards a life-cycle approach, i.e. to the question of employment-related institutional support given to individuals over their life course, from the phase of education and preparation for the labour market until the end of their careers and the transition into the old-age pension system. Further, a range of three *sectors* per country were analysed with respect to their interaction with the national employment model in order to identify the effects of overall changes at the sector level and, conversely, the potential impacts on the national employment model emanating from individual sectors. The criterion used to choose the sectors to be studied was that they should provide meaningful examples of the influence of particularly interesting challenges to national employment models.

Multifaceted patterns of change

The patterns of change in the ten countries analysed suggest that distinctive features of national employment models, and of features shared by groups of national models, are being reproduced amidst common trends of adaptation to liberalisation pressures.

The **UK** has long been the flagship of the “liberal market economies” in the EU. But today, the divergence between the UK and the US model is starker than in the early 1990s. There is a higher commitment to the public space, but based on a “market state”. The developments of the past decade have built upon both the strengths and the weaknesses of the UK economy.

The UK's position as a leader in the globalisation of services and in the promotion of internationalised production chains has been further strengthened.

The thrust of UK policy has been to increase the quantity rather than the quality of employment for the mass of the working population. Inequality and segmentation are still inherent features of the labour market. The UK's prosperity is based on relatively fragile conditions that might undermine its sustainability.

Sweden used to be, next to Germany, the main reference country for "coordinated market economies" and the most distinctive example of a social-democratic welfare state. After more than a decade of crisis, it has become an example of the revitalization of the original model through the adaptation of its institutions. In spite of Sweden's EU-leading employment rate (and its female participation rate in particular), tensions over an unemployment rate which is widely perceived as intolerable have grown among the Swedish public.

Germany has also been a key exemplar of the "coordinated market economy" and of "corporatist or negotiated capitalism", but at the same time, in contrast to Sweden, a prominent example of a "continental" or "conservative" welfare state. Today, the German model is still "coordinated", but increasingly fragmented. The revitalised and highly competitive manufacturing industry is no longer a flagship for the whole economy and the once effective welfare state and collective bargaining institutions geared to containing inequality are damaged. The employment model has been substantially changed under the impact of unification insofar as both social and spatial inequalities are on the rise.

France has always been an ambiguous case in the framework of major typologies: not coordinated, but state-led, with a continental welfare state which, in contrast to its German neighbour, has for decades fostered female labour market participation. Over recent decades, the French model has moved from "state-led" to "state-enhanced" capitalism. Private capital has gained a new and major role, but traditional elitist structures and fragmented industrial relations persist, giving rise to increasing incoherences within the employment model.

Austria, too, may have been regarded as an exemplar of a “state-led market economy” with a high proportion of public ownership up to the 1980s, but in stark contrast to France it was a sheltered economy with an institutionalised “social partnership“ and full coverage by collective bargaining. Over the past two decades, the Austrian model has undergone a “conversion” within the old institutional framework towards a coordinated market economy with a “free-market” orientation. Within the now open and highly competitive economy, the state is no longer a major employer in manufacturing or banking.

Ireland’s employment model is as much “liberal” as “continental”. The unique characteristics of the “Celtic Tiger” are its mixture of economic liberalism and social democratic-style consensus, combined with its strong reliance on FDI. Today, however, the shortcomings of the Irish economic model in terms of delivering non-tertiary qualifications or an efficient welfare system are becoming more obvious and the “life cycle” of a primarily US-based FDI trajectory may be coming to an end.

Hungary’s “post-transitional model” consists in fact of model-*seeking* production, employment and welfare regimes. Over the past ten years the economy has been characterised by a race to ‘catch up’, with FDI, deregulation and privatisation the main instruments deployed. This policy has resulted in growing differentiation across the various strata of society. The Hungarian employment model hovers between two conflicting sets of concepts, those associated with “social Europe”, on the one hand, and with “competitive Europe”, on the other. The low-road, FDI-driven trajectory is coming to the end of its life. Hungary today has an unregulated market economy with low inherent capacities for self-regulation but with continuing strong expectations of the welfare state.

Spain’s employment model, after four decades of a breathtaking economic catch-up race since the end of the era of dictatorship and its subsequent integration into the EU, is torn between “short-term speculative capitalism” and highly controversial social orientations. The labour market is dualised and has the highest shares of temporary employment in the whole EU but there has also been a partial expansion of social services. By and large, the family continues to be regarded as the support mechanism of last resort, despite changing family structures.

Italy used to have a “coordinated“ market economy with highly competitive “industrial districts”, on the one hand, and a Southern European “family-based” welfare regime, on the other.

After decades of substantial privatisations and labour market flexibilisation measures, the Italian labour market continues to be fragmented, with a core of well-protected workers in large manufacturing firms and the public sector, on the one hand, and a relatively unprotected periphery, on the other. These privileged sectors, with their relatively high levels of social protection, account for a declining share of economic growth and their existence within a largely liberalised environment gives rise to multiple divides: between the North and the South and between young and prime age, male and female, skilled and unskilled workers.

Greece’s employment model could be characterised, in the period after dictatorship, as state-led familial capitalism. Today, it has become an employment model in transition with an uncertain future. Its major incoherences include a drive towards liberalisation without providing for comparative advantage. On the other hand, there is no prospect of developing a coordinated market economy due to an absence of any tradition of class compromise. Any attempt to move away from a family-based welfare regime is hampered by insufficient public social expenditures, while the tax base is restricted by a large informal sector, as is the case in other Southern European countries and Hungary.

Interactions between national models and sectors

The sectors explored by the DYNAMO project were chosen with a view to providing meaningful examples of the influence of particularly interesting challenges to national employment models**: elderly care,** as an example of how national models react to the challenge of ageing societies, the **IT sector,** as an example of how national models take on the challenge of new technologies and international business models, the **construction industry,** as an example of labour migration and EU regulations impacting on national labour markets, **urban public transport,** as an example of EU free-market policy impacting on a industry traditionally sheltered and run by local public authorities, the **hotel and restaurant business,** as one of the usual suspects for high shares of low-wage labour, and the **motor industry** as arguably the most prominent example of the international re-division of labour and re-organisation of value chains and their repercussions on industrial relations.

IT services

When national employment models meet new challenges, the existing institutional setting may “fit” well with the actions required to cope with the new situation. In most cases, however, there will be tensions. Table 1 gives an overview on “fits” and tensions or conflicts between national institutions, on the one hand, and the IT industry, on the other.

Table 1: Tensions between employment conditions at sector level and the national employment system: the example of the IT industry

		Examples of 'fit' with national model		Ongoing areas of conflict/ tension?
		Partial	**Full**	
Coordinated market economies	**AT**	High use of self-employed workers	New sectoral agreement on collective bargaining Strongly developed VET	Firms less keen to hire workers with intermediate-level skills
	DE	No specific sectoral agreement on collective bargaining; patchy provision from other sector agreements	Strongly developed VET, extends also to further training	Increasing use of graduates potentially conflicts with national investment in VET Very weak enforcement of works council provisions
State-led market economy	**FR**	Flexibility exercised outside the Aubry working-time legislation	Full-time, permanent contract the norm Divided, weak trade unions	High mobility of IT workers conflicts with traditional stability of internal labour markets
Liberal market economy	**UK**	Exceptionally high use of freelancers Risk to job security posed by outsourcing and off-shoring	Limited joint regulation of wages and high use of 'market rates' and individualised bonuses Strong reliance on expanding pool of graduate job applicants Employment protection legislation applies to outsourced IT workers	Outsourcing and staff transfer brings unionisation to non-union US-owned IT firms Firms' disinterest in vocational training conflicts with national policy efforts to extend and deepen vocational programmes
State-led familial market economy	**EL**	High use of individual wage bonuses Firms avoid formal definition of working time	Minimum employment conditions covered by national collective bargaining agreements	Strong preference for graduates conflicts with investment in VET Relatively low rates of self-employment conflict with firms' use of sub-contractors Weak formalisation of IT profession

Source: DYNAMO

Tensions may be positively harnessed in order to produce institutional solutions that help countries to meet the new challenges. Alternatively, they can simply be destructive without laying the foundations for renewal or revitalisation. Thus challenges may create opportunities for some national models but risks for many others. The IT industry is arguably one of the most striking examples of the opportunity-risk mix brought about by challenges. If we take an expanding IT sector as an indicator of the potential for future growth and competitiveness, it becomes obvious that there are different institutional gateways to that future, quite in line what would be suggested from a "varieties of capitalism" perspective. At the same time, tensions and contradictions become evident under all circumstances. Even within a liberal environment, which would in theory be regarded as the best "fit" with many of the sector-specific requirements of the IT industry, there are paradoxical tensions emerging, such as the unionisation challenge to US firms that are seeking to take advantage of the outsourcing strategy in the UK public service, which in fact has given a major boost to the industry over recent years in that country. In a nutshell, changes in the production regime may cause tensions with the employment regime, and there may be contradictory repercussions emanating from the employment regime to the production regime.

Elderly care

The interaction between care regimes and national employment policies has led to very different results in terms of the quantity and quality of the labour supply and may explain the variations observed in care labour shortages and in the use of immigrant labour. Care regimes differ in their capacity to create a market for care services, whether that market be primarily formal or a mix of formal and informal provision, with the main contributions being made by family members or informal immigrant labour.

Systems relying on in-kind provision, contracting out and "tied" cash allowances (to be used to hire private carers) are the most effective in creating a formal market. Those systems relying mostly on unconditional cash allowances (monetary transfers) have slowed down the creation of a formal market for care, encouraging instead the supply from the informal market, either family carers or carers hired by the family in the market.

Thus, the interaction of the care regime with the national employment model can lead to very different results in terms of the kind of employment that is created and ultimately determines whether the increasing demand can be met internally or immigrant workers are needed in order to make good labour shortages (cf. Table 2).

Table 2: Care regimes

Predominantly formal care market	Sweden, France, UK
Important informal care market (predominantly family carers) and growing share of formal market	Germany, Austria
Predominantly informal care market (family carers and immigrant labour)	Mediterranean countries

Source: DYNAMO

The UK, Sweden and France fall within the first category, i.e. the creation of a market for care, but have different experiences in terms of the supply of domestic care labour. In the UK, care service jobs have required no formal qualifications for entry. With the increasing marketisation of services, cost pressures have further encouraged the development of a low paid and casualised workforce. Sweden's system of long-term care services, in contrast, is designed to support women in the workplace and to professionalise care-giving to older people needing help. Compared to other countries, Sweden requires the highest levels of education and pays the highest salaries. Germany and Austria share two common features: a care system based on mandatory care insurance, largely paid in the form of cash benefits with no strings attached. The combination of an unconditional money transfer, favouring informal care, with a highly regulated system of qualifications and professional degrees has produced a dualistic market. In Italy the limited amount of public funds spent on elderly care has been used in large part to compensate family carers, but they have been mostly redirected to pay migrant workers in the underground economy. Both types of allowances coexist.

The elderly care sector study adds to our knowledge on emerging contradictions between employment and welfare regimes in the face of the challenges posed by an ageing population and changing gender roles. The first lesson provides further support for the social investment strategy pursued within Nordic welfare regimes. The Nordic way entails, however, an increasing tax burden, which makes the combined challenges of social services quality and gender equity in the labour market controversial and high-priority issues in the public debate, which are, moreover, subject from time to time to considerable political pressures and consequent turmoil. Social investment is arguably the most viable way to meet the challenges discussed here, but it is also a strategy that is becoming increasingly demanding for policy makers.

Public urban transport

The opening of public local transport to competitive tendering provides an interesting example of different approaches across national employment models towards EU product market regulation. The more local transport markets are opened up and (large) private companies enter via the competitive tendering process, the greater will be the drive towards rationalisation, the application of economies of scale, outsourcing and the contract-based delivery of non-core tasks. As far as the approaches adopted in the countries covered by the DYNAMO studies of local transport are concerned, three different types of trajectories can be identified. The first, and maybe most clear-cut case is Sweden which was the European leader in competitive tendering and privatisation in this industry. In contrast to more liberal type countries, however, wages continued to be fully protected within the centralised and virtually comprehensive bargaining system. Moreover, wages have been allowed to rise against a background of widespread privatisation and comparatively high service quality.

The contrasting approach has been practised so far in Italy, Hungary, and Ireland. Though the rationale and the measures taken in each of these cases has been different, the drive towards privatisation and tendering of local transport services initiated by the EU regulation has been by and large blocked or postponed so far. In

Italy, this approach has been supported by a general guarantee for employment conditions in the sector, which has made it unattractive for private companies to bid for individual routes.
With the exception of Sweden, potential private suppliers of transport services appear not to be interested in or prepared to adopt rationalisation measures that could make services more cost-effective without affecting wages. This fits with the approach of public authorities, who do not appear willing to increase investment in public urban transport in order to improve service quality.

Germany and Austria provide examples of creeping or staggered privatisations. The continuous reduction of subsidies and the actual tendering procedures (implemented to a moderate degree in Austria) are subjecting wages in the publicly owned companies to considerable pressure and causing non-core services to be outsourced. While the high quality of integrated services based on continuous technical investment and the high degree of coordination among companies involved have not yet been significantly compromised, the impacts on collective bargaining have been crucial, since high levels of coverage have been safeguarded only at the expense of greater fragmentation within the industrial relations system and sector-wide concession bargaining.

To summarise, national or regional authorities continue to enjoy a certain degree of freedom to set quality standards for services, which influences the demand for certain qualifications and skills among the workforce. However, the provision of financial resources for transport services remains limited. Thus, the decision on the level of service required is a purely political one that determines the price to be paid by passengers and the level of public subsidy required. This establishes the framework for determining both wages and the potential profitability of the transport operations. The lower the level of public commitment is, the greater the pressure on employment conditions will be. This brings existing labour market regulations into play. The more they relied primarily on the public character of ownership in the past, the greater the strain on labour standards will be in a less regulated environment. The bottom line here is the increasing importance of more general protection of employment conditions at national level once traditional product market regulations begin to be eroded.

Construction industry

The interaction and mutual dependence between product and labour market regulations is equally important in the construction industry, even though the underlying story is different. As the DYNAMO sector studies show, two major types of employment models in construction have hitherto coexisted in European countries.

The high-road type has focused on guaranteeing professional development through a combination of training processes, division of tasks and institutions that provide employment security in a context of seasonal fluctuations, mobility of manpower and great product variability. The low-road type is based on learning on the job, strong competition between core workforces and subcontractors, which leads to poor working conditions and inadequate safety nets, only palliated in recent years by the strong growth in the countries where this model is predominant.

In recent years, the high-road trajectory has been threatened by changes such as the limitation of recognised fields of professional activity and the challenge of international subcontracting. In a certain but modest counter-move, countries on the low-road construction trajectory have adopted new regulations on products, health and safety and subcontracting, but the overriding pressures of labour migration, international outsourcing and the EU internal market strategy remain dominant. National norms, such as the German craft system or the Swedish collective agreements, continue to be effective in mitigating the worst impacts of these pressures as far as labour standards are concerned. Nevertheless, these regulations are under continuous pressure and there is growing evidence of foreign subcontractors being used to undermine labour standards and national norms (taxes, wages, etc.).

So there are clear signs that, in some countries, the deregulation of product markets has removed some of the important pillars supporting labour standards and that they have not yet been replaced by substitutes in the employment systems. As we learned from the experiences in other European countries, such substitutes could be provided by either generally extended collective agreements or very high trade union density.

The EU directives leave it to the national states to introduce new labour regulations where necessary in order to prevent negative impacts on labour standards arising out of the deregulation of product markets.

In the case of the postal services, Germany created a regulatory authority, which could require each new competitor to pay the local wage rates. However, this has not been implemented, since the state traditionally does not interfere directly in industrial relations.

Since the new competitors have not joined an employers' organisation there was no industry-wide bargaining agreement to be declared generally binding, which would have been the traditional protective mechanism in the German system of industrial relations.

New labour standards are not easy to implement in employment systems in which trade union density is low or industry-wide bargaining has been weakened or even abandoned altogether in the affected industries without a substantial change in the system of industrial relations. So national actors have choices, but some actors may no longer see the need for national compromises. Furthermore, the traditional employment system might be a constraint to non path-dependent reforms. So there are good reasons to argue that EU regulatory policies are increasing divergences between EU member states and endangering labour standards in some EU countries.

The motor industry and the hotel/restaurant business: contrasting cases for supportive state action

The interaction between industrial relations and political action taken by the nation state has been highlighted by the motor industry study within the DYNAMO project. The state can be a decisive stabilising influence on labour relations in an era of globalisation. By way of example, it was the state as an actor in the national employment pact that enabled the other actors to rebuild Italy's industrial relations system. And in Spain it is the state that guarantees the high rate of coverage by collective agreements, despite the social partners' relative weakness, by declaring them gen-

agreements, despite the social partners' relative weakness, by declaring them generally binding.
Contrasting examples are provided by the state refraining from supporting the collective agreement extension procedures in Germany, and even more so, in Hungary, where the industrial relations system could benefit from the increased stability that political support could provide.

A similar lesson, if with a very different background, can be taken from the analysis of the hotel and restaurant sector. The most prominent feature of this industry is its high share of low-wage workers and, for various reasons spelled out in the report, low-wage work in the hotel business appears to be "socially accepted" across national borders. However, as a comparison between France and Germany reveals, the actual share of low wage earners (defined as two thirds of median hourly pay) in these two countries differs substantially, with 12.7 % in France against 20.8 % in Germany. The contrast in the hotel industry is even more pronounced: in Germany, 58 % of all full timers in the hotel/restaurant business are low wage earners, in France the rate is about one quarter of all full-timers. France has a statutory minimum wage (the SMIC), whereas in Germany this is no more than a highly controversial issue for the time being and fewer and fewer collective agreements are being made generally binding by the extension procedures provided for in the Collective Bargaining Act. Thus, state action may work as a last resort where industrial relations fail to provide basic protection.

The reproduction of distinctiveness amidst common trends

The DYNAMO country cases confirm the pertinence of across-the-board institutional trends, albeit in a context of continuing institutional diversity. As Table 3 shows, there are important overlaps in institutional trends observed in all of the ten national employment models.

Table 3: Across-the-board trends in institutional change

Challenges	Production regime	Employment regime	Welfare regime
Globalisation / MNCs	International reorganisation of value-added chains -> re-division of labour		
Liberalisation / international governance	Boost of stock markets Shifting balance financial <-> real economy Privatisation of formerly state-owned banks and other mfg + service companies	Boost of non-standard employment Cut-back of unemployment compensation	Gradual shifts towards means-testing
Regulatory policies of EU	Privatisation of utilities Product market deregulations		
Ageing			Gradual shifts towards private elements in pension systems
New technologies / changing consumption patterns + skill requirements		Boost of higher education	

Source: DYNAMO

While it is true that the importance of common trends in institutional adaptation may differ across countries, the similarity of national and international actors' reactions to these challenges over the past two or three decades is evident. Since the late 1970s, "liberalisation" has become the key international ideology and has influenced the strategies adopted by national and international actors in the face of the other pressures for change. As a consequence, it is as much a trend affecting the way challenges are tackled as a challenge in its own right.

At the same time, however, the distinctiveness of national employment models has re-emerged amidst these commonalities. Both Sweden and the UK have renewed or even revitalised their national distinctiveness *through* institutional change. In corporatist systems, such as in Austria in particular, the character of the institutions geared to cooperation “rubs off” onto the outcomes, even though there has been a shift in the orientations of the major actors towards a “supply-side corporatism”. The condition for this persistence of national distinctiveness, however, is that leading actors continue to sustain the model, which is no more unanimously the case in Germany. This is why in Germany, and to a much greater extent in Hungary and the three Southern European countries, incoherences within the national employment models are on the rise. The capacities of existing national employment models to “digest” the drive towards liberalisation differs substantially across countries.

The inequality challenge

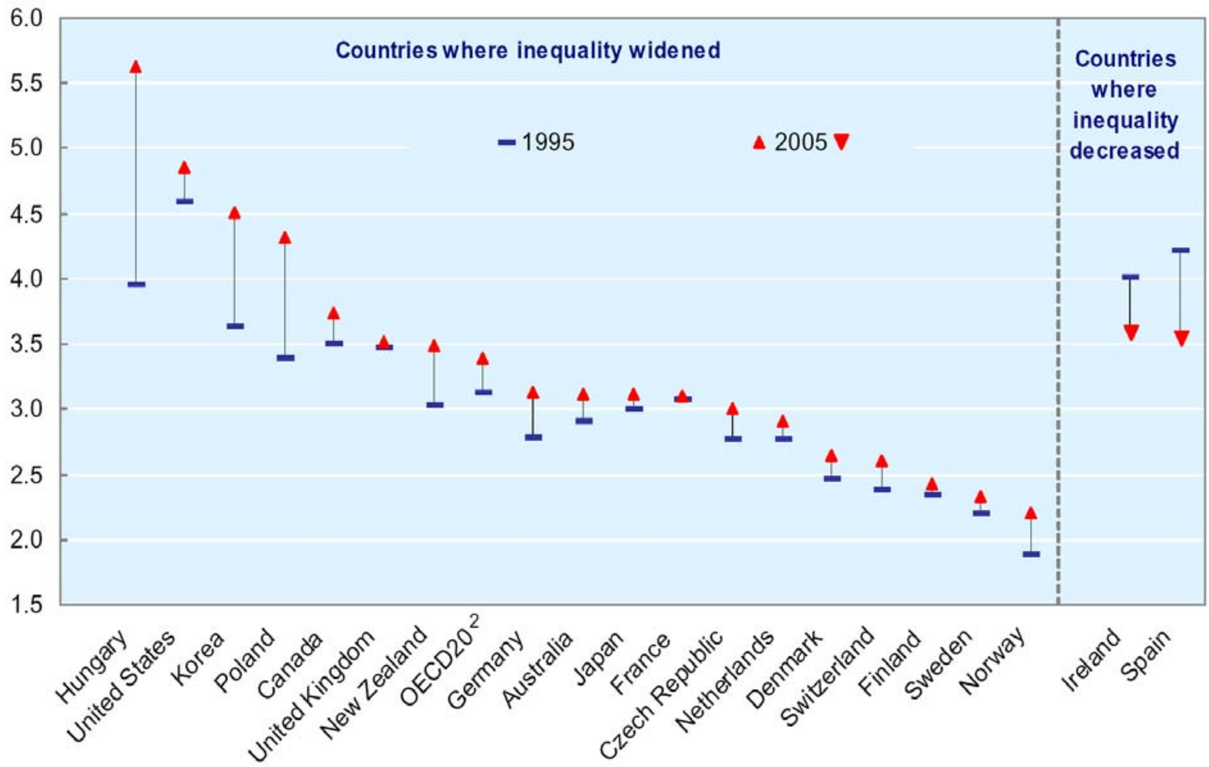
The pressures on existing national employment models are most obviously demonstrated by the rise in earnings inequality in most countries. Wages in the EU have suffered a long-term dual squeeze: the first is reflected in the share of wages relative to profits, which has been dropping continuously since the mid-1970s (OECD Employment Outlook 2007: 113). The second squeeze is *within* the wage distribution, as the earnings dispersion has widened considerably in most EU countries (cf. Figure 2).

The most dramatic rise in the earnings dispersion has occurred in Hungary (from an already high level), whereas earnings inequality at the bottom end of the distribution has almost stagnated in the UK following the introduction of the national minimum wage. It should also be noted that, according to these data, inequality soared in some of the flagship “coordinated” or “corporatist” market economies, most markedly in Germany.

While it would be misleading to interpret the data as showing convergence, the trend certainly points in the same direction in almost all countries, starting from different levels of inequality, but without narrowing substantially the gap between the countries with more and those with less earnings inequality. Both the speed of change and the level of earnings inequality continue to differ across countries.

The Nordic countries in particular, represented by Sweden in the DYNAMO project, are growing even further apart from the majority of EU countries in general, and from other CME countries in particular, with the possible exception of Austria.

Figure 2: Ratio of the 90th to the 10th earnings percentiles



Note: The figure shows that in all countries except Ireland and Spain, the earnings of the 10% best-paid workers increased more than the earnings of the 10% least-paid workers, over the 1995-2005 period (*i.e.* earnings inequality widened).

1. Full-year, full-time workers. The data shown are consistent over time, but not entirely comparable across countries owing to differences in pay reporting periods and coverage of workers.
2. Unweighted average of countries shown in the figure.

Source: OECD database on Earnings Distribution.

Source: OECD Employment Outlook 2007, p. 286

The strain exerted on welfare regimes by the inequality challenge becomes evident from data on poverty rates (Table 4). Poverty risks resulting from market earnings, i.e. before social spending, as well as poverty risks after social spending differ substantially across EU countries.

Table 4: Risk of poverty before and after social transfers (2003**)*

	Risk of poverty before social transfers (%)	Risk of poverty after social transfers (%)
HU	15	10
SE	29	11
FR	26	12
AT	24	13
DE	24	15
EU 25	*24*	*15*
UK	26	18
ES	22	19
IT	22	19
EL	24	21
IE	31	21

* Risk-of-poverty rate: the share of persons with an equivalised disposable income below 60% of the national median equivalised disposable income. This share is calculated before social transfers (original income including pensions but excluding all other social transfers) and after social transfers (total income).

** except FR, HU, SE (2002), IT, EU-25 (2001)

Source: Employment in Europe 2005, p. 123

Among the countries covered by DYNAMO, the risk of relative poverty based on market income, i.e. before social transfers, is the second highest in Sweden, whereas in the same country the poverty risk is second lowest after social transfers. Next to Sweden, poverty is least tolerated in the three countries with continental welfare regimes. Given the high market earnings dispersion in Sweden and also in France (where it is at the same level as in the UK), this constitutes an obvious and major challenge to the redistributive capacities of these welfare states.

Not surprisingly, the UK ranks above the EU-25 average in both indicators, but the reduction of the poverty risk by social transfers is almost as important as in Germany (the reduction rate is even higher in Ireland but social transfers cannot make good the market initiated poverty risk in that country).

This underscores the finding of the British DYNAMO report that the residual welfare state of the UK may function in an environment prepared to accept greater inequality than other European nations but all the same, as demonstrated over the past decade, it is increasingly being challenged to take on the poverty problem. It is true that the pressure on public spending has been eased considerably by the statutory minimum wage, which seeks to limit the indirect subsidies for bad jobs in private services. It should be noted, however, that increased anti-poverty spending, including in-work benefits, by the UK government has been made possible by high growth rates, which may not be sustained in the medium term.

The implication of the UK experience for catch-up countries like Hungary that are trying to combine an LME-type production regime with a continental welfare regime is that this approach may not be successful, since Hungary does not have the value added base in high-value services that makes the UK way feasible for the time being and a move towards high-quality manufacturing is hampered by the low level of commitment to vocational training. In addition, the growing problem of a large undeclared sector contributes to the limited capacities of the welfare state.

The three countries with Southern welfare regimes exhibit a striking commonality in that initial poverty risks are below EU average, but the contribution of social transfers to poverty reduction is minimal. As the Italian and Greek DYNAMO reports show, this largely reflects limited capacities rather than a simple circumvention of social obligations. The cushioning of social risks entailed by the extensive and ever growing precarious segments in the labour market remains to a large extent within the realm of the family as last resort. This, in turn, helps to increase the size of the large informal sector, which official statistics fail to capture. The informal sector, in turn, erodes the fiscal base and thereby reduces the room for manoeuvre in developing more comprehensive welfare systems.

The different institutional settings in EU countries continue to produce different social outcomes. However, the challenge for welfare regimes is increasing as a result of the growing trend towards inequality.

Thus it is not simply the *capacities* of employment models that count, it is also the dominant *orientations* among major actors and the public that are becoming increasingly crucial.

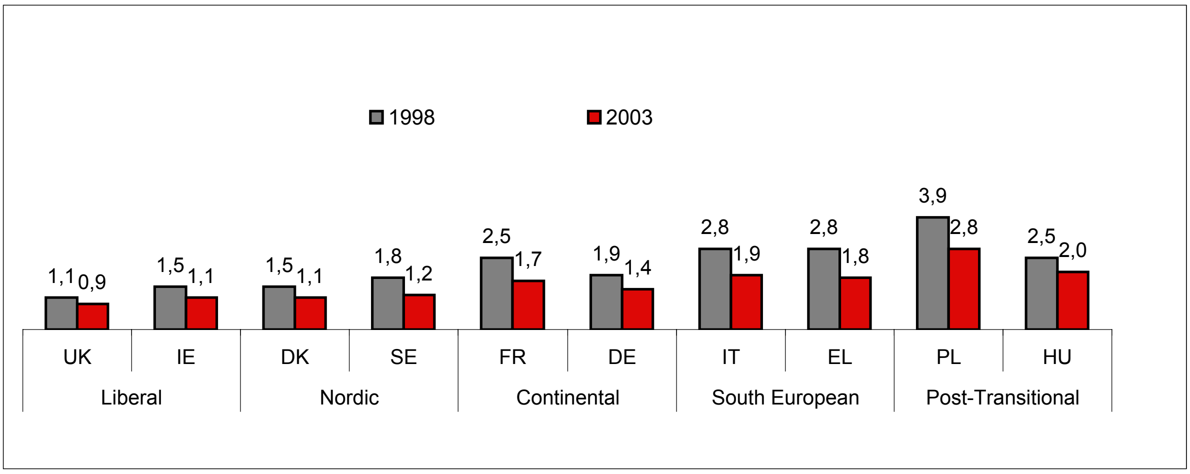
The latter is demonstrated by the narrowing gap in earnings inequality between Germany and the UK, as well as by the fact that social spending on the reduction of poverty risks in these two countries has reached very similar levels. The importance of the orientations of key actors and the public is also demonstrated by the Swedish case, whose welfare regime has to deal with an ever growing inequality challenge produced by the market.

The product market - labour market regulation nexus

Over recent decades many product market regulations have been weakened or abolished to a large extent as a result of EU competition policy but also in accordance with other international agreements, such as those of the WTO. The OECD has developed a wide range of indicators that are used to monitor changes in product market regulations. One of these indicators summarizes the extent of deregulation in energy, transport and communication, i.e. industries that have to be deregulated as a direct result of EU directives. The indicator shows that some European countries, especially the UK but also the Nordic countries, started the deregulation of these industries by privatising public enterprises, abolishing entry barriers and implementing other measures in the 1980s, before EU directives made it mandatory. Some Continental countries, such as Germany, started to implement the directives mainly from 1995 onwards, whereas France and the Southern European countries have continued to drag their feet. Figure 3 shows that, in liberal production regimes, product markets in some industries had already been deregulated in the 1980s and other industries had been only lightly regulated for a long time, so that only relatively slight adjustments have had to be made in recent years in response to EU directives.

One perhaps surprising finding is the low level of product market regulation in the Nordic countries, whose regulatory index now hovers around that of the liberal economies. The other three groups of countries are moving more slowly from a generally higher level towards the Nordic and liberal countries.

*Figure 3: Composed indicator of production market regulations, 1998-2003, selected countries**



* This indicator is calculated as weighted average of a number of lower level indicators such as size and scope of public enterprises, barriers to entrepreneurship and barriers to trade and investment.
Source: Convey / Janod / Nicoletti (2005: 59)

The question is how these substantial changes in product market regulation are affecting the different national employment models. It seems that the nexus between product market and employment regulations differs substantially across countries. In the Scandinavian countries, product market deregulation has so far not significantly influenced labour market regulations. Labour standards there are based not on product market regulations but on statutory and collectively agreed regulations with extensive spheres of application. The same standards apply equally to state and private, to domestic and foreign companies. Generally binding collective agreements with legal minimum wages have the same effects in Austria and France, and also in Italy, Spain and Greece. The privatisation of public utilities in the UK, however, led to more decentralised bargaining at the company level, accompanied by an extensive use of outsourcing, often to non-unionised firms, so that the effect was to weaken employment protection overall in the sector.

In Germany also, the lack of generally binding pay conditions gave rise in some industries, after privatisation, to an underbidding 'war' between firms bound by collective agreements and those not so bound.

This so far has not been the case in the energy industry (gas and electricity), where public monopolies were mainly replaced by private monopolies. Product market deregulation has had similar effects on labour markets in Hungary and other Central and Eastern European countries with decentralised industrial relations systems.

The bottom line here is that the ongoing Europeanisation must be accompanied by effective regulatory frameworks at national or sectoral level if cut-throat competition impacting on labour standards is to be prevented. In this regard, both collective agreements as well as statutory regulations can be useful. The interaction of product and labour market regulation used to produce potential for virtuous circle effects, i.e. the mutual reinforcement of production and employment regimes fostering high-road trajectories in certain industries (as demonstrated by the example of construction in the DYNAMO project). The more this "equilibrium" is being endangered from the production regime end, the more important the employment regime end becomes as a counterbalance. Thus the importance of the nation state and of the national or sectoral frameworks in which employment regimes are shaped is clearly on the rise.

The labour market - welfare regime nexus

The share of women of working age entering the labour market over the past decade has increased significantly in all EU countries (cf. Table 5).

Among the countries covered by DYNAMO, the increase has been most marked in Southern Europe (with Spain way ahead, with an employment rate soaring by roughly 20% within one decade). The picture is more mixed, however, once full-time equivalents (FTE) are taken into account. Here, again, increases are substantial in many countries, including Southern Europe and Ireland. Note, however, the contrast between Ireland and Spain, on the one hand, with FTE employment rates leaping forward by 12.6 and 16.0 pts. respectively (and above the EU 25 average in the case of Ireland), and Germany and Austria, on the other, where FTE employment rates have dropped by 0.9 and 3.4 pts. respectively (and even below the EU 25 average in the case of Germany).

Table 5: Female employment rates (in % of population aged 15-64 and in full-time equivalents), 1995 and 2006

	1995	2005	FTE 1995	FTE 2005	*Δ FTE*
Italy	35.4	45.3	33.8	40.3	+ *6.5*
Greece	38.1	46.1	36.9	44.5	+ *7.6*
Spain	31.7	51.2	28.9	44.9	+ *16.0*
Germany	55.1	59.6	46.1	45.2	- *0.9*
Ireland	41.6	58.3	36.4	49.0	+ *12.6*
Hungary	45.2*	51.0	44.5*	49.9	+ *5.4*
Austria	59.0	62.0	53.4	50.0	- *3.4*
France	52.1	57.6	46.2	50.8	+ *4.6*
UK	61.7	65.9	47.0	51.5	+ *4.5*
Sweden	68.8	70.4	58.5	60.8	+ *2.3*
EU 25	*51.1***	*56.3*	*n.a.*	*47.6*	*n.a.*

* 1996, ** 1997
Source: Employment in Europe 2006

The German case in particular demonstrates the impact of marginal part-time work, which continues to be subsidised within the continental welfare regime. Such employment opportunities have helped to increase the overall female employment rate, but at the same time have contributed to a drop in FTE. Given the rising average level of educational attainment amongst women, it is evident that Europe's largest economy is wasting a considerable proportion of the skills the country produces.

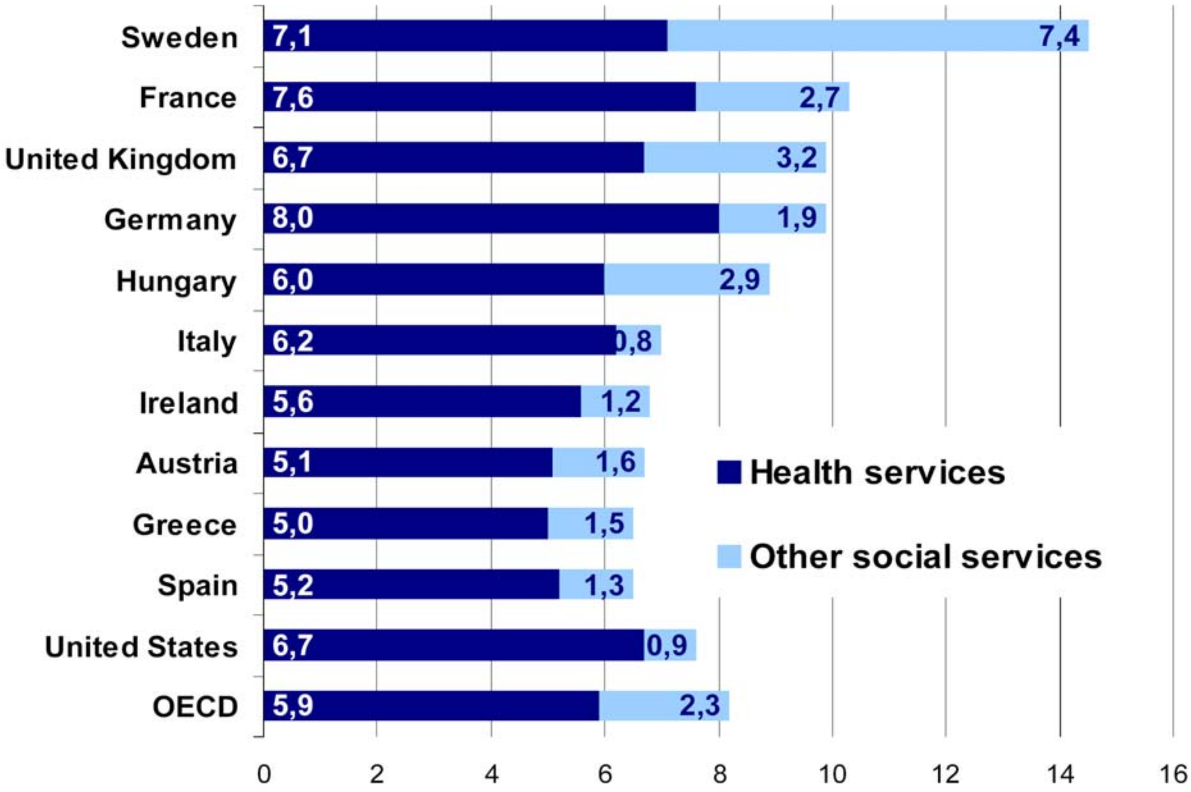
The combined effects of changing gender roles and changing age structures will influence employment models, since they can produce either a virtuous or a vicious circle. In principle, the support for female labour market participation and for greater gender equity in the labour market offered by welfare regimes can be one of the most effective answers to the strain on welfare states connected with ageing (next to economic growth, productivity increase and the redistribution of incomes). In this case, there will be a complementary relationship between the production and employment regimes, on the one hand, and the welfare regime, on the other. This relationship is ultimately driven by the multiplier effect triggered by women moving into paid employment, with its implications for social and human capital investment and for households' purchasing power.

The same logic, however, may work the other way too. Inadequate provisions for gender equity in the labour market may worsen the impacts of ageing: either women will reduce their labour market participation (reduction of working hours offered, marginal part-time, under-utilisation of educational attainment), thereby diminishing the tax base, or fertility rates will drop because the work environment is incompatible with the raising of children. In this case, the relationship between production/ employment regimes and welfare regimes will be contradictory and harmful, rather than complementary.

Thus, welfare regime strategies aimed at supporting women's employment become crucial. A rough indicator for the incidence of such strategies is provided by the OECD statistics on gross public expenditures on social services as a percentage of GDP (cf. Figure 4).

As social services may be provided by private or not-for-profit organisations rather than just by public organisations, and paid for by private households, we have extended the analysis to the weekly hours worked per capita in education, health and other social services in order to give the full picture on labour input into social services. The data on trends in labour input into social services over the past decade support the picture provided by data on social expenditures. Sweden and the UK as the high-end countries have rapidly expanded the hours worked in social services as a whole. Remarkably, the build-up of social services has been fastest in the UK of all the countries covered, but it should be noted it has taken place within the UK government's "market state" strategy, in which social services are being increasingly supported by cash benefits given to private households and service provision is being increasingly outsourced rather than being delivered within the public service.

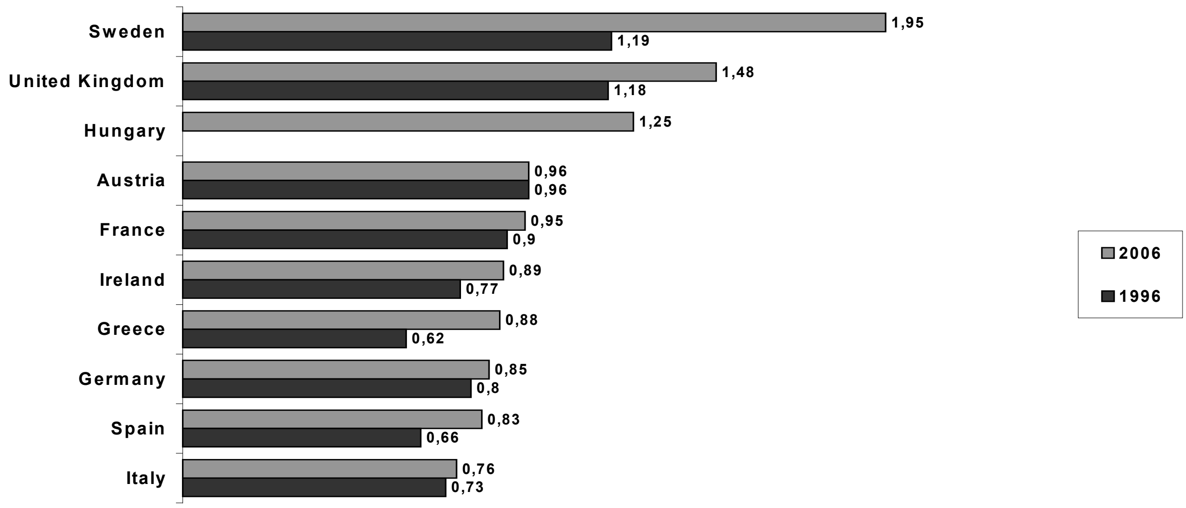
Figure 4: Gross public expenditure on social services in % of GDP



Source: OECD, portrayal by DYNAMO

Interesting additional insights include the finding that Ireland and the Southern countries, with the possible exception of Italy, are catching up much faster than the Continental welfare regimes in Austria and Germany. The division between the latter group of countries, on the one hand, and the two flagships of social democratic and liberal welfare regimes, on the other, is still as pertinent today as it used to be, as shown by the data on social expenditures (cf. Figure 5).

Figure 5: Weekly hours worked in social services per head of population (1996, 2006)*

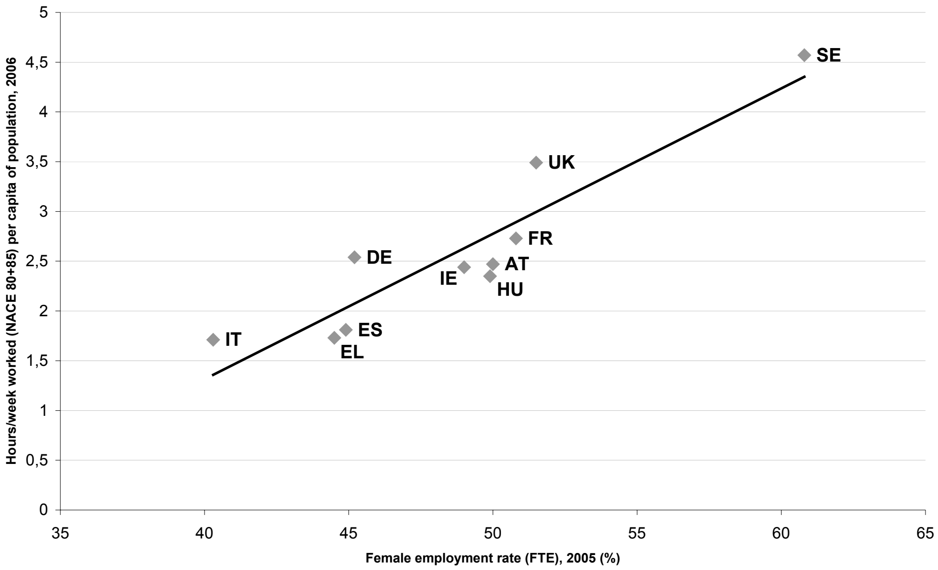


Education, health and other social services (NACE 80 + 85)
Source: ELFS, calculation and portrayal by DYNAMO

As a consequence, there is a strong correlation between labour input into social services and female FTE employment rates in the countries covered by DYNAMO. Figure 6 reflects the institutional complementarity, which appears to be a comparative advantage for some countries but a comparative *dis*advantage for countries with continental and southern welfare regimes.

However, one should not forget that female employment rates are increasing irrespective of limited social services provision. The implication in countries with continental/family-based welfare regimes is that increasing female labour market participation is accompanied by fertility rates way below EU average. In the UK, on the other hand, the potentially negative effect on fertility rates of childcare services lagging behind the rapidly increasing demand is outweighed by means-tested benefits and, most importantly, the relatively young age at which graduates start their careers, which obviously allows them to become established in their careers before starting a family.

Figure 6: Labour input into social services and female FTE employment rate***



* Total hours worked in education, health and other social services per head of population, 2006
** 2005 (Correlation: 0.92*** significant at the 0.001 level)
Source: ELFS, calculation and portrayal by DYNAMO

On the other hand, the UK approach also has its downsides, which are not reflected in the general labour market and social expenditures data. While it is true that female labour market participation is supported by the provision of social services, the "market state" approach links this to even greater cost pressures than is the case in the tax-based "social investment" approach. As a consequence, social divisions, particularly among women, are on the rise. High employment and fertility rates give rise to high levels of inequality in the labour market and poor labour standards in the expanding social services. The inequality challenge, including important shares of child poverty, may place different kinds of strain on the welfare state in the future.

Still different problems are faced by some countries (with Germany being the most prominent example here) where women continue to enter the labour market on reduced working hours, thereby not making full use of the qualifications they have acquired. As a consequence, the value added base needed to meet the demographic challenge to welfare states in the short run is being restricted, as is the potential to modify demographic trends in the longer run.

The most obvious contradiction with long-term implications is the one faced by the Southern countries and the Continental welfare regimes. While it is true that female employment rates and, to some extent, also public spending on social services in the former group of countries are catching up rapidly (with the partial exception of Italy), the gap between these countries and the most advanced group remains substantial. More importantly, this catch-up race is severely hampered by the widespread practice of tax evasion, which feeds into the vicious circle suggested at the beginning of the present section. Even though this problemat is much less relevant in the more advanced Continental welfare regimes of Germany and Austria, the lack of political support for a strategy of social investment (given the lack of public preparedness for a shift towards a clear-cut market-state approach) is causing these countries to drift into the dual trap of a constrained female labour supply (including a polarisation by educational attainment) and low fertility rates, which limits these countries' ability to meet the challenge of a changing age structure.

National employment models and the European Employment Strategy (EES)

The EU has developed a reform agenda for European social and employment models, with the vision for their future encapsulated within the guidelines and rhetoric associated with the Lisbon agenda and in particular the European Employment Strategy (EES).

The DYNAMO project has made it clear that the process of convergence in European models - to the extent that it exists - relates primarily to the orientation of policies and not to the level of social provision.

In this respect the EU may be a source of continuing divergence rather than convergence as the rules of the EMU relate public expenditure and debt limits to percentages of GDP and not to the development of public services. As such, the EU does not provide, except through the structural funds, for a catching-up or harmonisation of levels of social support. The structural funds do support infrastructure development but not social benefits. In addition, they promote policies in line with the approved orientation, such as activation and flexibility. However, promotion of orientation is hardly sufficient to bring about convergence towards a modernised welfare state, since member states do not have the scope to undertake the major investments needed to move from, for example, a domestic or family system of service provision to provision through public services.

The celebration of difference within the OMC allows the EU to hide behind the fact that, even if the EES was in part inspired by the Swedish model, the EU's regulatory approach precludes the emergence of new Scandinavian welfare states within the EU. Unless long-term processes leading towards some degree of harmonisation of the substantive systems are set in motion, the convergence of political vision may in fact reinforce the established differences in levels of social protection and decent work, since it reduces the scope for real innovative institution building in the area of employment and social policy in member states where social policy is currently underdeveloped while exposing these same member states to the rigours of competition in the areas of product markets and macro policy.

Another factor in the lack of real convergence processes is that the assessment of policy initiatives within the broad approved fields, such as activation, flexibility or gender equality, are not subject to detailed scrutiny and are certainly not assessed with respect to some form of quality threshold as to their likelihood of modernising the employment model. Interactions and contradictions between policy areas remain unexplored and unnoticed; that policies may make work pay for some groups but not for others is not highlighted by governments nor brought out by the EU assessment of policies. Flexibility policies such as the promotion of part-time work are not evaluated for their actual impact on gender equality.

For example, France has historically had a reasonably high employment rate as a result its policies that support women to stay in work. However, new policies that encourage women to stay out of the labour market when they have their second child have not been criticised at EU level for moving away from the joint employment targets of 70% overall and 60% for women, or indeed potentially undermining commitments to gender equality. This loose approach to policy evaluation may have some upsides, for example by enabling those countries with already developed social policies to retain a higher than average system of social protection . However, the downside is that there is very limited evidence that application of the EES approach is leading to the development of coherent new social models.

The tolerance of variety in approaches in fact reflects the trend away from regarding social policy as a main source of future productivity and development of the European society. When first initiated, the EES did have as one of its founding principles a belief- as expressed by the then Director-General of DG Employment - that social policy should be regarded as a productive factor. As such the development of an appropriate social policy should not only provide for social cohesion and inclusion but should also help to achieve the goals of a productive and knowledge-based society. However, the objectives of the EES became more narrowly defined after the review of the Lisbon strategy by the Kok Commission. Privatisation and the removal of obstacles to trade became the primary requirements for a productive society. Social policy is to be productivist only in the sense of creating more self-reliant individuals, able to be flexible across their working lives and to respond to market changes through a willingness to change employment and hours and to develop skills through lifelong learning. Consequently, social policy should be geared to facilitating market functions but not to creating distinctive collective capital on which the EU project as a whole can draw. It is not, however, only in social policy that the EU is weak in boosting collective capital: raising research and development is the main such EU policy but to date its impact has been limited, with all countries other than Sweden and Germany falling well below the EU target of 3% of GDP.

Two identifiable problems emerge from this neglect of the notion of social policy as a productive factor. First the importance of the labour market and of job quality for the achievement of social protection has not been taken into account. As Wickham argues, policies to destabilise labour markets through privatisation and competition may in fact serve to undermine the basis for a European social model. In the short term, these processes enhance the power of those EU institutions concerned with market expansion, but in the long term they may well undermine the rationale of the European project itself.

The survival of the European social model as a means of promoting both a productive and a cohesive society is thus dependent on the rediscovery of two important linkages. Firstly, social policy, in so far as it develops capacities within the population of Europe, should be seen as a core element of the strategy to create a productive knowledge-based society. As such we need to refocus on the employment-production nexus in developing Europe's comparative advantage. Secondly, we need to focus not only on how reform of welfare systems can contribute to getting people into work but also on how trends in the development of the quality as well as the quantity of jobs impact upon the ability to provide social protection. A more extensive and inclusive social protection system covering flexible and non-standard employment requires the extension of job quality characteristics to a wider range of employment forms and employees if the virtuous circles hoped for in the European employment strategy are to be achieved.