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The Politics of an Experimental Society: Creating Labor Market Flexibility in Europe

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(With a Prologue by John Zysman)

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In the quest for economic growth, rich democracies' governments have embraced the goal of creating labor market flexibility. To that end, they have pursued simultaneous changes in the three main institutional realms structuring modern welfare capitalism – the industrial relations system, the set of labor market regulations and the welfare state. While commonly framed as the removal of workers' social protections, the politics of labor market adjustment continue to differ in unexpected ways across diverse national contexts. This paper introduces the analytical tools for a comparative analysis of the quest for labor market flexibility in the United Kingdom, Germany and Denmark. Among a set of alternative perspectives on national variation during the last three decades, the paper stresses the importance of inherited institutional arrangements for social protection. Systems built around occupational status preservation tend to block measures that could increase labor market flexibility, while those offering universal provisions based on citizenship can help achieve flexibility in the labor market. This perspective puts into question the dominant frame of associating the achievement of labor flexibility with the removal of social protections. It indicates that – even in today's post-Keynesian world – social protection does not have to be economically harmful. If substantiated by further research, these findings have obvious implications for the United States, another rich democracy.

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[1] This paper represents an early summary of arguments and analytical perspectives compiled in the summer of 2005 for an ongoing dissertation project. The author would like to thank John Zysman, J. Nicholas Ziegler and Jennifer M. Dixon for constructive feedback, the BRIE staff for maintaining a pleasant working environment and UC Berkeley's Institute of Industrial Relations for generous financial support of the research for this paper.

Growth, the Labor Market and Social Protection[2]
A Prologue by John Zysman

Economic growth in a textbook is the painless accumulation of compound gains from productivity increases and increased deployment of productive resources (savings). All those productivity increases involve imaginative deployments, redeployments and reorganizations. Certainly there need to be rewards as incentives to risk and innovation, and a social capacity to make those adaptations, but the adaptations represent not only new firms and new practices, but a shift of resources out of some sectors into others, a movement of many peasants off the land as they move to small towns and cities, factories closing, layoffs, and displacement. The easy assumptions of painless, or not too painful (for whom?) movement of resources producing collective gain in the form of growth hide the reality that there are real losses and real losers along the way. And the losers rarely volunteer for the role.

Economic development always requires resolving a particular simultaneous equation. The technical equation is that how goods and services are produced and distributed must evolve flexibly. No investment and productivity gain; no growth. The political equation is that the allocation of gains and losses must be stably resolved or the fights over distribution will interfere with the technical processes. Economic development, to put the notion of growth back into the context of real communities, is a difficult, politically troubled and sometimes even bloody process. In response to the dislocations of the market, each advanced economy has created some system of social protection. It is not just a matter of demands from the left. The surprise to some is that that great Prussian conservative Otto von Bismarck created an early system of social protection to limit the capacity of labor to organize politically. Sometimes it has been the left demanding and insisting on state protection against the market. Sometimes the mechanism of "delivery" has been the employment security provided by firms.

The often expressed concern is that growth slows without the flexibility to adapt. The notion is often that social protection mutes market signals, slowing or preventing adaptation. The counterpart fear is that a rapidly adapting flexible economy must increase the number of losers or the costs that the losers bear, that the imperative of experimentation, competitiveness, or adjustment will be claimed to justify reducing social protections. In fact we do not need to make a choice between establishing the flexibility needed to adapt to an evolving economy and sustaining the social protections against the vagaries of the market that make economic growth worthwhile.

The mechanisms of social protection can be the foundations of flexibility. Of course those displaced may fear and resist; but accepting the necessities of the broader economic adjustment is always easier if one can see the possibility of one's own place in that future. Reconciling social protection and flexibility, or better making social

[2] This section is based on John Zysman's draft chapter (pages 32-35) for the forthcoming co-edited book *How Revolutionary was the Revolution? National Responses, Market Transitions and Global Technology in the Digital Era. A BRIE/ETLA/Helsinki Project*. Stanford: Stanford University Press

protection a foundation for flexibility, requires that all sides reconsider old debates. We need to separate out and consider the several dimensions of social protection.

A social protection system has at least four different dimensions:

- Who is protected;
- The level and form of protection, which is not just a monetary amount but a matter of whether particular jobs or positions are supported;
- The mechanism of delivery, whether there is administered aid for example or cash grants;
- The influence on the operations of adjustment in the economy.

The same level of protection for the same groups of people can be delivered in very different ways with very different consequences. And the obvious is not always the most important. The most politically difficult controversies are often about social identity. Often what is in dispute is not just economic well-being, the level of support, but the social place of particular groups and jobs in the economy which turns on the character and form of protection.

Let us glance for a moment at the influence of social protection on the operations of labor markets and financial markets. It is conventional to assume that labor market flexibility means stripping job protection, and that social protection means rigidity. Great Britain and the United States are the models for that argument; they are taken to have extensive labor market flexibility and lower social protections. They constitute one model of how to achieve labor market flexibility. Germany, France, and Japan would be considered examples of social protection interfering with labor market operations. Consider Japan. Social protection is often embedded in private employment structures. One consequence is that firm failure is quite socially expensive; often leading to continued bank financing to prop up troubled companies. Cumulated, that has contributed to the financial troubles and rigidity of the Japanese economy over time. Flexibility in Japan requires unwinding the company-finance-social protection nexus (Miura 2002). Consider France. Apart from the formal system of government financed social protections, the French economy abounds with an array of "acquired rights", *situations acquis*, which embed privileges from taxi licenses through café licenses to protection of job locations. Social protection is embedded in the defense of particular social and employment arrangements (Cahuc and Kamartz 2005). Now consider Denmark. The Nordic tradition of social protection as part of citizenship rights prevails (Esping-Andersen 1990). The broad social foundation of social protections contributed to a political deal that makes easy firing and labor market flexibility simple (Fuller 2004). And easy firing means easy hiring. The situation is well summarized in Thomas Fuller's fascinating article:

> *Denmark is a European welfare state par excellence. It comes as a surprise to many outsiders that Denmark is actually one of the easiest places to get fired in Europe. A construction worker here can be fired with as little as three days' notice. Salaried employees get a longer notice period – three to six months,*

depending on seniority – but do not expect severance pay, which generally does not exist… "Protection against dismissal has never been a major issue," said Einar Edelberg, deputy permanent secretary in the Danish Ministry of Employment. "It's easy to fire - and accordingly, it's easy to hire."

"The Danish system creates a flexible labor market," the Danish Confederation of Trade Unions said in an official document. "Danish companies are more willing to hire new employees in times of economic revival than their European competitors, who have trouble letting off workers when the economy goes downhill again." Note that the source of this last comment is the country's largest labor union confederation, a sign of the consensus surrounding the easy-to-fire policy.

Changing jobs has become part of Danish work culture. About one-quarter of the Danish work force switches employers every year, a churning labor market that constantly creates new openings. The bottom line for Denmark is an unemployment rate that, at 5.3 percent, is well below the 8.9 percent average for the European Union and that of the Continent's economic heavyweights, France (9.5 percent) and Germany (9.9 percent).

Clearly there is more than one road to achieving economic flexibility. The conclusion simply is that social protection and labor market flexibility are not alternatives. The question, the task, is to reconsider and reconfigure the packages of social protections so they support experimentation and adjustment. Conservatives should recall that Bismarck established the early Prussian welfare system in pursuit of social order. They must consider that a truly secure community may in fact be the base of a flexible economy. The left must recognize that social protections can be reconfigured without actual protection being reduced. Our conclusion here is that the experimental economy of today will require imaginative policy and politics.

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This paper delves more deeply into what amounts to the "politics of an experimental society." John Zysman's claims are both conceptually interesting and – if substantiated – important for the current political reform debate. Further theoretical clarification of the underlying concepts and extended empirical research are needed to demonstrate the validity of the claims. Taking the form of a structured literature review, this paper is an early attempt to present the theoretical perspectives that can inform delivering on this pressing set of tasks.

In the quest for economic growth, rich democracies' governments have embraced the goal of creating labor market flexibility. To that end, they have pursued simultaneous changes in the three main institutional realms structuring modern welfare capitalism – the industrial relations system, the set of labor market regulations and the welfare state. These changes have affected the lives of millions of workers. At the same time, the politics of creating labor market flexibility continue to differ cross-nationally, as national labor markets display markedly different rates of mobility, firms advocate different types of flexibility, and labor unions' willingness to go along with reform initiatives diverges greatly between countries. This paper lays the conceptual groundwork for an analysis of the politics of labor market adjustment in the United Kingdom, Germany and Denmark during the last three decades (1975-2005).

This research project has three interconnected goals. First, it strives to contribute to the research program on the effects of economic globalization on the national arrangements of social protection. Second, it wants to use the national politics of increasing labor market flexibility as an analytical prism to deepen our understanding of the particular dynamics of economic and social adjustment within different countries. Third, it seeks to inform the policy discussion on the reform of the European social model.

The analysis presented in this paper in pursuit of these three goals will stress the importance of inherited institutional arrangements for social protection for the national politics of achieving labor market flexibility. Achieving labor market flexibility does

neither depend nor necessarily lead to reductions in the level of social protection. This paper will develop the argument that systems built around occupational status preservation tend to block measures that could increase labor market flexibility (and eventually undermining the economic basis of the system of social protection itself). In contrast, those systems offering universal provisions based on citizenship can help achieve flexibility in the labor market (and thus offer more security long-term). Calling into question the dominant frame of associating the achievement of labor flexibility with the removal of social protections, this framing indicates that – even in today's post-Keynesian world – social protection does not have to be economically harmful. Indeed, in the context of the globalizing knowledge economy, particular types of social protection might eventually turn out to be highly beneficial for achieving the twin goals of social cohesion and competitiveness.

This paper proceeds along the following five steps. An introduction elaborates on the intended contribution to established research programs and policy discussions, lays out the reasoning for the selection of the studied cases, and defends the choice of methodology. A second section situates national attempts to create labor market flexibility within both the changing realities of the global economy and the evolving perceptions of the adjustment challenge in the labor market. The third section introduces and justifies the particular theoretical lenses chosen to guide the inquiry into the national patterns of choice and change in labor market governance. Section four presents early findings from the empirical research I have recently begun. A fifth section concludes with a review of the paper's main contributions and points to a set of further questions arising from this research.

I - Introduction

The political economy of Europe's democracies has undergone a far-reaching transformation in the wake of fundamental changes in the structures of economic organization and public policy that have dominated most of the postwar period. In the economy, Fordist production patterns and taylorist management practices have receded in prominence as new 'lean' and 'learning' forms of experimental corporate organization have been adopted by managers who want to tap into new business opportunities associated with the arrival of the digital era (Lorenz and Valeyre 2004; Zysman 2004).

Within the realm of government, following the shift in the dominant policy paradigm in economic policy-making from Keynesianism to neo-liberalism, the politics of economic growth have turned away from a focus on managing the economy's demand side to improving its supply side and from government intervention to making use of market mechanisms as the dominant form of economic governance (Campbell and Pedersen 2001; Hall 1986). The labor market is a key realm in which this structural and ideological change has left a lasting impression. However, as indicated by the continued display of strong cross-national variation in labor market structures, the particularities of national politics have remained central to the creation of economic realities. In short, the prominent call to increase labor market flexibility seems to have very different national dialects.

Contributing to Research Programs and Policy-Making

The first objective of this project is to contribute to a body of research in comparative political economy that is concerned with the effects of globalization on the evolution of different models of national welfare capitalism. In stark contrast to widespread popular opinion and prominent journalistic accounts (e.g. Friedman 2000; 2005), recent scholarly – often large-n – studies have found very little influence of globalization on national welfare state arrangements (e.g. Swank 2002). This paper tries to bridge the apparent chasm between popular and academic views by addressing some key shortcomings of the recent academic works on the topic. I contend that most of the academic work in this area has come up empty-handed due to a rather narrow, occasionally imprecise and often biased specification of the dependent variable.[3]

Rather than changes in individual welfare state programs, it is the evolution of the labor market that has had the biggest impact on individuals' economic security (Standing 2000). For example, the sets of national labor market institutions are the primary determinant of earnings inequality in the rich democracies. According to Esping-Andersen (1990), they constitute the key institutions of the work-welfare nexus that

[3] Most political science research is currently of the institutionalist bend, geared towards finding differences – a clear reaction to the universalism of structural Marxism and liberal Modernization theory. Institutionalists thus tend to look for data to counter the claim that globalization leads to homogenization.

determines the character of different models of welfare capitalism.[4] Consequently, attempts to create more labor market flexibility thus constitute attempts to shift the very core of national models.

Strongly influenced by Pierson's path-breaking theoretical work on the "new politics of the welfare state" (Pierson 1996)[5], scholars studying the reform of systems of social protection have focused on state programs, thereby neglecting the fact that in all welfare regimes the responsibility for the population's welfare is shared between the state, the market and the family (Esping-Andersen 1999).[6] Because systems of public social policy and economic production have evolved and continue to develop in tandem (Ebbinghaus and Manow 2001), it is thus high-time to bring the evolution of capitalism back into the study of the changes in national systems of social protection. With the recent new interpretations of the evolution of the varieties of capitalism from such theoretical perspectives as institutional economics (Hall and Soskice 2001) and organizational sociology (Whitley 1999), the time for synthesis in the study of evolving welfare regimes has clearly come (Streeck 2001).

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[4] Of course, the choice of the nation state as the level of analysis constraints the types of causal mechanisms that this research can identify (Campbell 2004). It is the dominant approach that pervades much of policy analysis (see e.g. OECD 2005) – for good reason, as most labor market and social regulations remain nationally anchored. Labor market institutions have remained nationally bounded to a much greater degree than other parts of national institutional matrices such as the financial system or the corporate governance regime.

[5] Extrapolating from earlier historical institutionalist work (especially Weaver's work on blame-avoidence and Skocpol's work on policy feedback), Paul Pierson made a strong case in support of the claim that the contemporary politics of welfare state reform did not follow the patterns common during the long postwar period of welfare state expansion. See Skocpol, Theda. 1992. *Protecting Soldiers and Mothers: The Political Origins of Social Policy in the United States*. Cambridge, MA: Harvard University Press; Weaver, R. Kent. 1986. The Politics of Blame Avoidance. *Journal of Public Policy* 6:371-98.

[6] Welfare state scholarship has been innovating its concepts in a quest to gain more analytic leverage. In his more recent work, Pierson (2000) speaks of patterns of "re-calibration" and "re-commodification" rather than simple retrenchment. Furthermore, in their attempts to solve what they have now identified as "the dependent variable problem within the study of welfare-state retrenchment" (Green-Pedersen 2004), scholars currently strive to combine such measures as (adjusted) social spending levels, social rights and benefit conditionality (Clasen and Siegel 2005). They thus go some way beyond the limitations of simple unadjusted quantitative measures of social expenditure used in Swank's large quantitative study, in particular, when they concern themselves with public services rather than only monetary benefits. See Pierson, Paul, ed. 2000b. *The New Politics of the Welfare State*. Oxford: Oxford University Press. Green-Pedersen, Christoffer. 2004. The Dependent Variable Problem within the Study of Welfare-State Retrenchment: Defining the Problem and Looking for Solutions. *Journal of Comparative Policy Analysis* 6 (1):3-14. Clasen, Jochen, and Nico A. Siegel. 2005. Exploring the Dynamics of Reform: The Dependent Variable Problem in Comparative Welfare State Analysis. University of Stirling.

Of course, one should also be as precise as possible about my specification of the dependent variable.[7] The choice of indicators and the selected level of analysis strongly influence the causal relationships that can be identified (Campbell 2004; Clasen and Siegel 2005). The dependent variable should be chosen on the basis of clear theoretical considerations (see e.g. Clasen and Siegel 2005, 11). My focus is on the relationship between state action and market governance in the provision and allocation of labor in support of developing competitive companies.[8] Thus this inquiry differs greatly in focus from those inspired by the frameworks of the regulation school, which chronicle the changing nature of the state under in an age of Post-Fordism (as in Jessop 1994), or the evolution of risk-sharing between different social groups – e.g. classes or generations – and between the public and private sphere (Clasen and Clegg forthcoming). Finally, by going beyond solely quantitative measures of both changing international economic structures and domestic welfare effort, this approach provides a better reading of potential changes in the composition of the independent and dependent variables than the existing large-n literature.

The second objective of this research is to use the issue of labor market flexibility as a lens to analyze some of the key national political dynamics in the current transformation of welfare capitalism. Creating more 'labor market flexibility' is one of the key goals of economic and social adjustment within the context of a changing global division of labor. Important question to address include: Which institutional changes have taken place in the different national contexts? How have they shaped the patterns of adaptability that employers demand from their employees and the level of income security for the population enjoys?

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[7] Even the doyen of comparative welfare scholarship, Gøsta Esping-Andersen, could be more precise in his specification of the dependent variable. In his work, there exists conceptual confusion if the welfare state represents 1) the dominant characteristic of the postwar 'golden age', 2) a distinct ontology or form of the state, or 3) particular sectors of state activity (Wincott 2001); furthermore, Wincott convincingly argues that the exact relationship between *welfare state*, *welfare state regime* and *welfare regime* remains underspecified. See Wincott, Daniel. 2001. Reassessing the Social Foundations of Welfare (State) Regimes. *New Political Economy* 6 (3):409-25.

[8] I hereby acknowledge my awareness of the importance of changing family patterns and female labor force participation for the evolution of labor market regimes. However, my analysis will not be in detail concerned with these developments in an attempt to keep this project manageable. Other authors have productively addressed these issues.

Taking seriously the conceptual frameworks used by the actors themselves, the chosen framing simultaneously achieves multiple goals. First, it can avoid some of the natural biases inherent in established conceptual categories usually used by scholars, i.e. it consciously uses an inductive rather than deductive approach to establish the categories of comparison (see e.g. Smith 1987). Second, by stressing the (often intimate) connections between changes in such areas as wage-bargaining, corporate governance, social pacting and welfare programs, this approach breaks down the artificial barriers that exist between the separate literatures that typically examine only these particular aspects of countries' political economy. Of course, I cannot delve as deeply into each area as the more specialized literatures do. However, there is a lot of value in stressing the connections between these areas, because it is their interaction that drives the evolution of the labor market.[9] I would go as far as to argue that we have to proceed in this manner, if we want to track both the changing nature of different models of welfare capitalism as well as the determinants of this development. To get to the causal mechanisms at work, this research will employing such qualitative techniques as detailed process tracing and pattern matching in the country case studies.[10]

Inspired by the theoretical contributions of earlier comparative three-country studies, such as the one by Scharpf (1991) on the attempts by Great Britain, Germany and Austria to fight inflation during the 1970s, this paper wants to take steps toward developing potential answers to big, politically very relevant questions. Naturally, the choice of a low number of cases emphasizes internal over external validity concerns. However, the choice of putting two theoretical perspectives against each other (see section three), rather than merely assessing a single one, improves the validity of the research exercise. The reader should also be reminded that the epistemological goal of

[9] The common tendency to focus solely on the changing conditionality of public unemployment benefits in studies of labor market evolution falls short of what is required: a study of both public and private action such as employer strategy, one that takes the concept of 'welfare capitalism' seriously and does not forget about the market side of the interaction between state and market.

[10] Process tracing looks closely at the sequence of events in a specific time period. Pattern matching tries to adjudicate between rival hypotheses by seeking supplementary evidence such as multiple testable implications. For elaborations, see Brady, Henry E., and David Collier, eds. 2004. *Rethinking Social Inquiry: Diverse Tools, Shared Standards*. Lanham, MD: Rowman & Littlefield; George, Alexander L., and Andrew Bennett. 2005. *Case Studies and Theory Development in the Social Sciences*. Cambridge, MA: MIT Press; King, Gary, Robert O. Keohane, and Sidney Verba. 1994. *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton, N.J.: Princeton University Press.

this research project is much more modest than that of (often) positivist large-n studies that strive to discover law-like relationships in the social world. Supporters of such work can conceive of this study as a probability probe geared towards improving the specification of large-n work on the subject, serving an integral role in the process of cross-fertilization that lies at the heart of an iterative multi-method research enterprise. Personally, however, I remain skeptical of the ability of statistical work to deal with interaction and sequencing effects between multiple causal factors. As a note of caution, I would thus like to suggest that small-n research might be actually the only option that we currently have to address the questions posed in this research.[11]

The third objective of this research is to contribute to the policy discussion on the future of the European social model, the distinctiveness of which has been often stressed by European leaders. Most recently, they have discussed its modernization to fit the changing times. In March 2000, the heads of state in the European Council committed themselves to the Lisbon Agenda, emphasizing that "the Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion." Academic contributions have reflected these policy concerns. One of the key issues that has emerged is question if achieving the goal of flexibility pre-supposed implementing cuts in social welfare protections (see e.g. Atkinson 2003; Auer 2005). Does attaining the goal of increasing labor market flexibility require the removal of rules, which buffer workers from the consequences of the commodification of labor? Does the removal of such rules increase the flexibility in the labor market? What is the relationship between the goals of modernizing the welfare state, reigning in public social expenditures and creating flexibility in the labor market – are these policy goals complementary, unrelated, or do they contradict each other? Addressing these questions with three case studies, I will argue that the answers depend on choosing particular conceptions of 'flexibility' and 'social welfare protection.' In particular, it matters greatly if the latter is understood to refer to reducing people's exposure to market mechanisms or seen as a post-allocation buffer to market outcomes.

[11] On theoretical grounds, there does not exist any way to say how widely a relationship established in small-n research holds. The examination of shadow cases might, however, increase the research's external validity.

At the end of the chosen research period, the three countries display distinct patterns in how they combine relative labor market flexibility with the social protection of workers. On the face if it, Britain seems to score high on labor market flexibility and low on welfare, while Germany appears to score low on labor market flexibility and high on welfare, and Denmark manages to score high on both. Studying these national experiences, this research wants to provide data on the existence of certain trade-offs between policy goals. Importantly, there are multiple reasons to believe that increased levels of labor market flexibility might prove to be destabilizing for social stability. Labor is merely a "fictitious commodity" (Polanyi 1944), because it is not produced for sale. Having learned the lessons of periods of economic volatility such as the Great Depression, postwar domestic elites – strongly influenced by working-class pressure – constructed new social programs and labor market institutions. By reducing the individual's dependence on the specific patterns of labor demand for his economic security, these programs and institutions played a major role in improving the relative peace of social relations in Europe over the course of the twentieth century.

The Importance of Case Selection: Earlier Waves of Scholarship

Case selection is critical for securing the validity of small-n work. The United Kingdom, Germany and Denmark are representatives of separate clusters of different forms of advanced (welfare) capitalism as they have been identified by two consecutive waves of political economy scholarship, a first one largely focused on the path-dependent development of postwar national models and a second one on the national variants of economic transformation towards a service-heavy, digital-era form of capitalism. The contributions to the two waves of literature have identified different but closely resembling country clusters, which tended to identify some variant of a division between Anglo-Saxon, Continental European and Scandinavian countries (including the occasional outliers).[12] Britain, Germany and Denmark were chosen for this research project, because in sum they were closest to the core of what constituted ideal-types in the various identified categorizations.[13] The country cases of this research project display

[12] Typical outliers were France with its strong-state tradition and small Continental European countries such as the Netherlands and Austria who had more redistributive welfare states than their larger neighbors.
[13] While the choise of Britain and Germany should be uncontested, some might question the choice of Denmark as the representative of the Scandinavian cluster. Indeed, Sweden was often invoked as a

the largest possible variation in domestic structures identified among European economies by the different analytical perspectives in these interconnected literatures. They thus allow us the maximum leverage to identify different elective affinities, complementarities and inter-dependencies between the countries' respective worlds of work and welfare.

Let me review the body of scholarship on the path-dependent development of postwar national capitalist models. Analysts of political economic arrangements used multiple analytic frames to explain national differences in economic structures and performance, invoking differences in national cultures (e.g. Shonfield 1965), relative state strength (e.g. Zysman 1983) and the degree of corporatism in state-society relations (e.g. Scharpf 1991). While their theoretical commitments and explanatory perspectives differed, the authors seemed to reliably arrive at three different types of national models. Early analysts distinguished between liberal, statist and corporatist models of national economic governance. The currently dominating perspective is that of the varieties of capitalism (Hall and Soskice 2001), which is heavily inspired by theorizing in institutional economics. Built around a conception of the firm as a strategic actor, the varieties of capitalism perspective recasts familiar national distinctions as those between the Anglo-Saxon liberal market economies and two variants of coordinated market economies, those with sector-wide coordination in large Continental European countries and nation-wide coordination in Europe's small countries (particularly Scandinavia). This analytical perspective sees liberal market economies as displaying a high share of competitive market arrangements in the governance of company relations, allowing actors to pursue individual unconstrained strategies, often by matching demand and supply through relative prices. In contrast, it sees non-market institutions as much more prevalent in coordinated market economies. Focused on longer-term outcomes than firms in liberal market economies, firms in coordinated market economies are seen as coordinating their activities largely through non-market means, such as extensive

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paradigmatic case in older scholarship. However, newer scholarship has increasing focused on Denmark. I rationalize my choice of Denmark with the wish to be most relevant to contemporary scholarship, and filling a relative void in analysis by contributing to a growing body of comparative work that will have to grow further to come even close to the size of the literature taking a closer look at the Swedish case.

relational (or incomplete) contracting as well as network monitoring based on the exchange of private information inside of networks.

The scholarship on postwar welfare state development identified very similar country clusters. Titmus (1974) contrasted a 'residual welfare' model with minimal state involvement in poverty relief (the ideal-typical case being Britain), an 'industrial achievement-performance' model with a status-preserving welfare state (the ideal-typical case being Germany) and an 'institutional redistributive' model with need-based universal services (mostly in Scandinavia). The most famous formulation of the differences in countries' social policy can be found in Esping-Andersen's account of the 'three worlds of welfare capitalism' (1990), in which he developed the distinction between 'liberal' welfare regimes in the Anglo-Saxon world, 'conservative corporatist' regimes in Continental Europe and 'social democratic' regimes in Scandinavia.

According to Esping-Andersen (1999), countries cluster according to features of the systems of welfare provision, in particular the division of responsibilities between state, market and the family. Furthermore, the different clusters differ in such respects as the historically dominant ideologies, eligibility criteria for welfare programs, modes of benefit distribution and the systems of class relations. While liberalism has long been the dominant ideology in Anglo-Saxon countries, conservatism has been stronger in Continental Europe and socialism in Scandinavia. In the liberal regime, demonstrated need underlies program eligibility – in contrast, it is the record of contributions in conservative regimes and citizenship in social democratic countries. Benefit dualism of low-level public benefits and private benefits for the rich in liberal countries contrasts with status-maintenance in conservative and high-level universal flat benefits in social democratic countries. Finally, while in liberal countries, class divisions are stark between the 'angry' working-poor, the 'hated' non-working poor and the 'supported' middle class, the relations between classes in conservative countries are much more splintered. In social democratic countries come closest to a one-class society.[14]

Some scholars of political economy have recently brought together the varieties of capitalism perspective with that of the scholarship on welfare regimes (e.g. Ebbinghaus

[14] I would like to acknowledge Jonah Levy as the source for this characterization of the differences between clusters.

and Manow 2001; Kitschelt et al. 1999). In that quest, these contributions are venturing in the footsteps of earlier research that tried to address the interdependence of the worlds of work and welfare with respect to the relative openness of countries' national economies. Cameron (1978) was first in line to argue that open economies had the largest welfare states. He was followed by Katzenstein (1985) who identified the very particular nature of the politics of domestic compensation for the effects of international trade that could be found in small countries with open economies. Recent work by Rodrik (1998) explicitly argues in support of understanding welfare state growth as a direct consequence of the opening of national economies to international trade.

A second wave of scholarship on country clusters looks more closely at the patterns of social re-organization linked to the countries' adaptation to rapid technological change and the deepening of the global economy. European countries are currently undergoing their second fundamental sectoral transformation. The Industrial Revolution had driven the people off the land and into the factories, out of agriculture and into industry. More recently, the changes associated with the Digital Revolution have led to stark reductions in the number of manufacturing jobs in advanced economies, leaving a diverse set of services as the main provider of employment opportunities.

For Iversen and Wren (1998), the economic structures and political challenges of a service-heavy economy are fundamentally different from those in an economy dominated by manufacturing. In the 'golden age' of the 1960s, large productivity increases in manufacturing served as the basis for steadily increasing standards of living for large parts of the population. People's income increased, and the price of consumer goods decreased. In an environment characterized by low degrees of capital substitution for labor, even unskilled workers were in demand. According to these authors, the situation today is very different, largely because the economics of services are very different from those of manufacturing. Iversen and Wren argue that services display much lower productivity increases than manufacturing, which – if workers' wage increases match cost increases in the rest of the economy – might price services out of the market, a phenomenon also well-known as Baumol's cost disease. They claim that a higher share of services in the economy has contributed to lower rates of growth in the economy, in government tax receipts and in average individual incomes. Furthermore,

compared to manufacturing employment, service employment contributes to an increasing bifurcation of the income distribution. Skill premia have increased, because lucrative professional services are only accessible to skilled workers, leaving the large pool of low-productivity personal services to the un-skilled or low-skilled. In the new environment, Iversen and Wren argue, states can only achieve two out of the three "golden-age" goals of attaining relative income equality, full employment and balanced budgets. Facing what they call the "trilemma" of service economy, they see Anglo-Saxon countries reneging on the first, Continental European countries on the second, and Scandinavian countries on the third commitment of the former golden age.

In contrast, according to Cohen and Zysman (1987), announcements of the arrival of the post-industrial economy (Bell 1973) are misleading. The authors doubt that the rise of the service economy translates into manufacturing becoming unimportant. Rather, manufacturing continues to matter as the old dominant production paradigm of Fordism has been supplanted by lean production in Japan and flexible specialization in Europe. According to this perspective, the turn to services is not only an inter-sectoral but also an intra-sectoral transformation: The service content of activities within the manufacturing sector is growing in the wake of attempts by manufacturing companies to essentially re-launch themselves as services providers. For example, former product suppliers have transformed themselves into service providers. In the computer industry, IBM is in the midst of transforming itself to a 'solutions' company, having bought the consulting business of PWC and sold off its mobile computer unit. In the car industry, suppliers complete increasing shares of the actual assembly while the original equipment manufacturers (OEMs) concentrate on product development, design, marketing and customer service.

It turns out that according the research programs pursued by Robert Boyer (2001; 2004a) and others (see e.g. Kogut 2003), the familiar clustering of countries continues to hold for the digital era. Different countries seem to have embraced different new growth regimes (Boyer 2004b). A short glance at the most basic OECD statistic of countries' macro-economic data shows clearly that sectoral compositions of the European economies continue to differ along historically common patterns.

Recent micro-level evidence on the distribution of post-taylorist forms of corporate organization points to this point most clearly. Based on survey data collected by the European Foundation for the Improvement of Working Conditions, Lorenz and Valeyre (2004) demonstrate that the prevalence of what they conceive of as a learning model of corporate organization tends to differ across the clusters of countries identified by the long trajectory of diverse research programs reviewed above. Rather than interpreting the variety in corporate organization in EU countries as evidence of the hybridization of the lean (production) model as originally identified by Womack et al (1991) in the Japanese context, the authors conceive of the learning model as a separate phenomenon. In their view, the learning model constitutes a distinct way of delivering flexibility and cooperation within the company. It is uniquely socially embedded, because it builds on local traditions in work organization. While the lean model displays such attributes as the strong use of teamwork, job rotation, quality management and multiple work pace constraints, the learning model is more decentralized and grants employees a high degree of autonomy. Specifically, Lorenz and Valeyre present data that shows learning organizations to be prevalent in Sweden, Denmark, the Netherlands and, to a lesser extent, in Germany and Austria. Meanwhile, the lean model is more widespread in the Anglo-Saxon countries of the United Kingdom and Ireland.

The collective findings of these studies give rise to the question if the national politics of creating labor market flexibility also differ between these clusters. This research projects will try to answer this question, while using the focus on the quest for labor market flexibility as a lens to highlight the political dynamics underlying economic and social adjustment within these clusters.

Reflections on the Appropriate Methodology

Adopting a historical-institutionalist approach, this paper uses the most fitting methodology for a set of research questions that touches on substantive policy agendas and requires a recognition of temporal arguments as well as attention to contexts and configurations (Katznelson 1999; Pierson and Skocpol 2002).[15] The mid-level historical-

[15] According to Pierson and Skocpol (2002, 4), the historical institutionalist research approach is characterized by three important features: "Historical institutionalists *address big, substantive questions that are inherently of interest to broad publics as well as to fellow scholars*. To develop explanatory arguments about important outcomes or puzzles, historical institutionalists take time seriously, specifying

institutionalist approach provides a good fit to an ontology that recognizes the importance of sequencing and interaction effects for forms of causality that are both multiple and conjunctural (see e.g. Hall 2002; Pierson 2004; Ragin 1987). Historical institutionalism is a methodology that is open to both incorporating and the intellectual commitments of the connected but separate epistemic trajectories of economic sociology (see e.g. Smelser and Swedberg 2005) and political economy scholarship (see e.g. Hall 1999) as well as fruitfully joining the distinct insights of different traditions of institutionalism (Campbell 2004).

It rejects the notion of stable revealed preferences employed by rational-choice scholars. Preferences can shift over time as policy feedback changes institutional constraints (Trampusch 2005), and – most importantly in the context of studying long-term processes – actors' identities and collectivities' compositions may undergo change. Historical institutionalists focus on institutions as formal organization with resources and power over these resources (material as well as procedural). They study how political institutions structure not only the interaction of political actors but also how they affect the actual make-ups of groups, i.e. they conceive of institutions as constitutive and not merely regulative. On that basis, historical institutionalists can be quite sociological by embracing a narrow coupling of actors' interests and identities.

A study of the politics of creating labor market flexibility promises to contribute to the scholarly debate on how to best conceptualize contemporary institutional changes in the rich democracies (see e.g. Streeck and Thelen 2005). Prominent commentators have argued in favor of going beyond the binary division between incremental and revolutionary institutional change originally inspired by the writings of Joseph Schumpeter (1942). Incremental changes associated with the day-to-day political maneuvering of actors within the institutional structures may cumulatively end up greatly altering the character of particular institutions, so much so that their current embodiment shares very little with the original intentions of its founders (see e.g. Pierson 2004; Thelen 2004).

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sequences and tracing transformations and processes of varying scale and temporality. Historical institutionalists likewise *analyze macro contexts and hypothesize about the combined effects of institutions and processes* rather than examining just one process or institution at a time (*italics* as in the original)."

In the process of reflecting on their analytical categories, historical institutionalists have largely abandoned their long-preferred punctuated equilibrium model of political evolution (Krasner 1984). This model had stipulated a world in which at critical junctures (usually induced by an exogenous shock such as war or technological change) room was opened for agency to free itself from dominant structures in order to establish new institutional settlements (conceived as equilibria), in the process consolidating the reconfigured relations between social groupings and thus forming the foundation for future periods of path-dependent political development. As scholars have demonstrated the existence of cumulatively transformative changes during phases of relative equilibrium (see e.g. Thelen 2002a) and path dependencies during moments of radical changes (Katznelson 2003), scholarly inquiry has already pushed beyond the boundaries of the old model. It is less clear what is taking its place. Scholars have yet to develop models that address the limits of the punctuated equilibrium framework while still being able to answer Thelen's call (2002b) to bring together the analysis of cross-class coalitions with the study of "varieties of capitalism" in the context of historical-institutional analysis.

Important questions, such as how best to conceptualize the impact of globalization on national models of welfare capitalism, remain unanswered. More detailed studies that pay close attention to levels of analysis are needed to answer such questions as the following: Should globalization be conceptualized as an exogenous shock? If one chose to do so, would it be an exogenous shock that sufficiently changes the power constellations between social groupings to prompt a re-negotiation of national institutional settlements? Alternatively, should globalization be studied as an endogenous development? Finally, when and how do changing power constellations between social groups lead to institutional reconfigurations? When can an institutional configuration be considered a settlement? Are they conscious and intentional? Finally, should the notion of institutional equilibrium be abandoned altogether? Preliminary research on the three chosen cases points to widespread policy experimentation and institutional changes that are uninformed by grand bargains between social groups. These results seem to indicate lower levels of intentionality (on the part of actors) and

determinacy (in probabilistic causal relationships) than historical institutionalists often invoke – pointing to the need for more empirical research.[16]

The choice of methodology should be determined by the analytical question posed. For research on market processes, it often is a reasonable assumption that individuals strive to maximize their own incomes, thus allowing the researcher to side-step issues of social identity. However, in contrast, studies of economic policy involve a research subject for which the dimension of variable ideas and beliefs is more important, in particular, when policy-makers actively try to change the interpretive frames for interpreting policy challenges (see e.g. Hall 1993). In such a situation, political analysts should adopt a thicker understanding of social processes than usually allowed for by rational-choice modeling.[17]

While prominent historical institutionalists such as Pierson and Skocpol (2002), Thelen (1999) and Immergut (1998) emphasize the coherence of their approach, historical institutionalism remains at its heart an eclectic approach, whose practitioners borrow both from rational-choice and sociological institutionalism (Hall and Taylor 1996). Each scholar, who intends to use the historical institutionalist approach, thus needs to decide how interpretivist he/she wants to be – the approach of historical institutionalism does not predetermine the choice of degree. Scholars also should answer for themselves how much they want to self-consciously engage in developing new interpretive scripts that can guide practitioners' understanding of the empirical world. In

[16] The eventual findings, however, will never yield any definite answers. Any scholarly treatment will be peculiarly constrained by the particular epistemological strategy chosen by the researcher to deal with the complexity of the social world. For instance, among the community of small-n researchers in political science alone, scholars' epistemological strategies diverge greatly. Using deductively derived models and tapping the power of mathematical formalization to ground parsimonious explanations, rational-choice modelers explicitly assume away part of the complexity of the social world. Interpretivists, in contrast, embrace it by striving to understand the inter-subjectivity of meaning that cannot be revealed by the methodological individualism of rational-choice analysis or traditional survey research. The large-n research enterprise represents on altogether different – if complementary – epistemological strategy using high external validity for the purposes of generalization. Established researcher do not deny the complexity of the world, but their own ontological commitments lead them to employ different research strategies of addressing it. See Stoker, Laura. 2003. Is it Possible to do Quantitative Survey Research in an Interpretive Way? Comments presented at the roundtable on "Can the Study of Politics be Scientific? A Conversation on Interpretive, Qualitative, and Quantitative Methodologies," APSA 2003.

[17] Commonly pursued by economic sociologists, these more interpretivist approaches have led to the development of perspectives on the constitution of market processes that – emphasizing the dimension of power – are very different from those stipulated by the economics discipline. See Fligstein, Neil. *The Architecture of Markets. An Economic Sociology of Twenty-First Century Capitalist Societies* Princeton University Press, 2001.

the context of studying issues in political economy, such considerations will be determined by the scholar's proclivity to accept the established narratives offered by structural Marxism and neo-classical Economics. For example, motivated by a strong commitment to radical voluntarism, Charles Sabel demonstrates the importance of looking beyond the confines of the pursuit of self-interest maximization and class interests stipulated by the other two analytic approaches. Since Sabel stressed the role of pre-industrial identities for the preferences of industrial workers in his book on "work and politics" (1982), he continues to offer new interpretative scripts.[18]

Conceptualizing 'Labor Market Flexibility'

Theoretical definitions of 'labor market flexibility' diverge from the term's meaning when it is used during political discourse in a climate favoring economic deregulation. On its face, the term alludes to a high degree of price elasticity and liquidity in the supply of labor to meet changing patterns of demand. Defined in this way, labor market flexibility refers to actual practice, which is different from the absence of labor market regulation. In fact, however, because labor is a commodity with special qualities, additional rules in the labor market can often increase the labor market's flexibility. In contrast, as deregulation and flexibility are increasingly equated in political discussions, the meaning underlying most of the concept's actual usage has become narrower.

Students of political economy and industrial relations have long pointed out that labor markets do not share the same properties of other goods markets. Polanyi (1944) was first to point out that labor was a fictitious commodity, one that could never be commodified completely without undermining the health of the fabric of society. Other scholars (Esping-Andersen 1990; Titmuss 1974) have since agreed with him, further

[18] His current writings are concerned with the evolution of post-taylorist forms of economic organization conceived as 'flexible specialization' and the institutionalization of 'soft' governance mechanisms such as the Open Method of Coordination (OMC) in the European Union. Openly embracing his own normative commitments to personal autonomy and direct deliberative democracy, Sabel's contributions have emphasized the importance of "learning to learn" in the emerging knowledge economy and interlinked world polity. As social theorists of the current socio-economic transformation, intellectuals like Sabel play an important role in an epistemological enterprise that joins academics with practitioners in business and politics. Sabel does not directly engage in the positivist research tradition striving to rate variables according to their causal primacy. Instead, he highlights the interpretations embraced by the actors themselves. Thus, Sabel often pays attention to processes, the scope of which may seem restricted at present but could develop into assuming more prominence in the future.

elaborating on Polanyi's idea that in a 'second movement' societies set up welfare systems to contain the effect of marketizing the allocation of labor. Subsequently, economists have pointed to the high likelihood of market failures in institutionally weakly-endowed labor markets. Information asymmetries between workers and employers as to the employees' true work effort and the high costs to the employer of overcoming this asymmetry through monitoring can lead to over-payment of shirking workers and, more importantly, under-payment (and thus under-provision) of high-effort individuals. Employers who want to avoid the latter might pay higher efficiency wages, a situation in which shirkers are consciously over-paid to sufficiently compensate the hard workers. The Spence Signaling Model (1972) nicely illustrates how educational investment might pay off for hard workers because it allows them to signal to their employers that they are not of the shirking type.[19] Addressing the special properties of labor as a commodity during the 20th century, governments in the rich democracies have – with the support of important social groups – constructed elaborate institutional edifices surrounding the allocation of labor (the collective representation of workers in unions for wage-bargaining being one of the main features).

Capitalists' ability to employ labor flexibly relates to four different dimensions of the employment relationship – entry and exit from employment, the assignment of tasks and horizontal and vertical mobility, the level and structure of compensation, and working time – between which there exist strong trade-offs and linkages (Regini 2000). Additionally, the distribution and certification of skill levels among a company's workforce greatly condition managers' options for flexible labor deployment (Kern and Schumann 1986; Marsden 1999; Ziegler 1997). For example, employers who want to implement mobility for workers across job categories and pursue variable work schedules to meet shifting demands, often need to give their workforce firm assurances in the areas of pay and job security. In short, internal mobility tends to presuppose external stability. In countries, in which deregulated industrial relations systems do not automatically provide this external stability, companies often introduce functional substitutes at the firm level.

[19] This fully separating rather than a potential pooling equilibrium will result if the cost of attaning the educational signal is sufficiently large to turn away the shirkers.

In order to compare different combinations of flexibility across my chosen cases, I want to distinguish between those dimensions of flexibility (e.g. hiring and firing, working time rules) that treat labor as a commodity while others (e.g. task assignment) allow more development of labor's non-commodity characteristics. When I study countries' labor market adjustments, I will do so with the awareness both that different definitions of 'labor market flexibility' can become nationally dominant, and employers might have diverging preferences regarding specific combinations of the dimensions of flexibility.

All the OECD provides us with are conceptualization of measures that increase labor market flexibility, not conceptualizations of labor market flexibility itself. Economists at the organization distinguish between those policies aimed at increasing labor productivity and those geared towards improving the utilization of labor resources. According to the OECD, reduction of employment protection legislation (EPL) and the liberalization of professional services are aimed at the former, and the latter is achieved by labor supply activation policies aimed at strengthening work incentives. As long as one remains aware of the critical trade-off that often exists between the dual policy goals of maximizing the population's labor market participation and the labor force's productivity, this policy metric can usefully help to ground the discussion on the different pathways to increase flexibility.

However, further conceptual innovation is needed about how to conceive flexibility itself, if the goal is to arrive at a macro-story that pulls together the developments along the five dimensions on the micro-level elaborated above. Ellerman's distinction between two basic alternative logics of the governance of the employment relationship might provide a starting point. Building on Hirschman (1970), Ellerman (2005) disguishes between one logic built on 'commitment' and one on 'exit'. For our purposes, a conceptualization of "labor market flexibility" needs to allow us to understand the interactions between societal-macro conditions and the firm-level micro constraints giving rise to particular patterns adjustment (see e.g. Vogel 2003).[20]

[20] Vogel largely looks at corporate adjustment through a lens relying heavily on new institutional economics.

Regini (2000) distinguishes three meanings of labor market flexibility from the firm perspective. He reviews that one can follow Piore and Sabel (1984) in conceptualizing flexibility as the 'ability to combine resources,' such as e.g. the ability to use machines and workers in different combinations in order to adapt to changing market conditions. In particular, the authors refer to the ability to combine the different components of the employment relationship (wage levels, skills, working time, job security etc). Second, one can conceive of flexibility as the 'ability to accept diversified regulation,' building on the finding that labor markets have become sticky and similar across sectors. Flexibility in this context means non-standardization, diversification, and non-uniformity of labor performance and conditions; i.e. companies wish to de-standardize labor contracts, and employees are more interested in the diversification of working time or work roles. Third, one can think of flexibility as the 'ability to adapt to changing needs': Authors such as Stigler (1971) stress how companies need to react to market volatility, thus equating flexibility in labor markets with adaptability and versatility.[21]

Measuring 'Labor Market Flexibility'

As a case-oriented small-n study, this research project strives to track national experiences. My attempts to link micro-changes at the firm-level with macro-developments in the countries within my sample will be facilitated (but not defined) by quantitative indices on different aspects of labor market flexibility. For instance, the OECD has recently developed such indices in support of the organization's attempt to track policy initiatives. The OECD index data on the changing stringency of employment

[21] Subsequently, Regini reviews three examples of how post-Fordist companies' alternative company product market strategies in manufacturing require different combinations of the various dimensions of flexibility. First, if a company chiefly competes on quality or design, high functional flexibility is required of the whole workforce, matched by low levels of numerical, wage, and temporal types of flexibility. Second, if competition is chiefly on product diversification (i.e. flexible mass production), then we often see a dualism between low-skilled and high-skilled workers. Firms mainly want functional (polyvalence) and wage (incentives) flexibility types for the core occupational groups, while mainly numerical (temporary work, training and work contracts, possibility to lay-off) flexibility for the low-skilled groups. Third, if competition is chiefly on organizational flexibility (i.e. flexible specialization), then these usually small firms tend to be dominated by the entrepreneur and his assistant. The few employees (enjoying less institutional protection) know that they are 'naturally' subject to numerical flexibility. In addition, they also have to exhibit high temporal and functional flexibility, pragmatic adaptability, and a general willingness to cooperate.

protection legislation in the different countries point to a starkly higher degree of employment protection legislation in continental Germany, Sweden, Austria and the Netherlands than in social democratic Denmark and especially the liberal UK and Ireland. In tracking countries' adjustment paths, further research will focus on changes in such areas as the usage and structure of collective wage-bargaining, systems of employment and layoff protection, working-time regulation, and unemployment insurance benefits.

My attempt to track the changing social (cross-class) coalitions will be facilitated by looking at legislative changes as indicators, allowing me to address such questions as if the old divisions of exposed and sheltered sectors still hold as services get exposed to the international economy. Importantly, it is high time that somebody looked at potential changes in employer behavior, because the last major political science study on Germany and Britain is ten years old (Wood 1997). For example, we need to ask if it is still true that German employers are not very interested in making use of new legal provisions design to increase external labor flexibility (Schettkat 2000).

II - Pressures for Labor Market Adjustment

Driven by such developments as the liberalization of the regulatory environment for economic exchange and technological progress, the character of the world economy has greatly shifted during the period of observation. This paper's second section lays out the effects of the changing dynamics in the global economy on the labor market in the advanced countries. Pressures of the global economy on national politics are never directly or automatically transmitted into national politics. Agents on the domestic level – such as governments or companies – have to develop some understanding of the realities of the global economy to perceive particular pressures and then conceive of responses to them. There always exists a strong element of social construction of meaning in governments' understanding of the world. However, while I acknowledge that actors' perceptions of reality are socially constructed, it also remains clear that the changing economic foundations of the global economy give rise to certain imperatives that exist beyond the level of inter-subjective meanings: These imperatives represent the quasi-objective necessities that economic actors have to adhere to if they want to survive in the global marketplace.

My way of analytically dealing with the partial social construction of international pressures is to try to strip away the changing perception of economic reality from the changing underlying economic conditions that – in a very real way – cannot be changed by one state alone. I will thus use this section to first lay out how the continual evolution of the global economy has changed the demand patterns for labor in the advanced countries – complemented with a brief reference to the impact of changing domestic social preferences on the patterns of labor supply. Second, I will review the changing perceptions among experts of the adjustment challenge in the labor market.

In my causal model, the changing international economy represents a *contextual* variable for national labor market adjustments, which exerts causal force largely in interaction with other causal variable (such as differential institutional legacies and patterns of domestic sectoral distribution). What varies for each country is how diverse sets of domestic institutional, political and economic legacies filter the impact of the contextual variable on the national dynamics of labor market reform. The legacies of particular domestic institutions and production structures can be conceived as different *independent* variables.

At time t, each country occupies a particular position in the world economy – with a specific set of economic comparative advantages, a certain production profile (e.g. a particular optimization of production with respect to quality or cost) and a specific institutional endowment. At time t + 1, after a shift in the contextual variable has altered the terms of trade and the distribution of comparative advantage, each country faces a distinct adjustment challenge. The challenge is to adapt national structures – with their different institutional, political and economic legacies, and differentially enabled by national institutional capacities – to fit the competitive demands of the changing international landscape.

Changing Patterns of Labor Demand and Supply

Labor market policy adjustments have reflected changes in the patterns of both labor demand and supply. Reductions in the demand for labor in low-skill manufacturing and tradable business services exert downward wage pressure in the short-term and

reductions in the availability of jobs in these areas in the long-term.[22] While demand for skilled manufacturing jobs has been sustained in certain national and industrial contexts, the widening of effective labor cost differentials associated with the entry of Eastern Europe, China and India into the world economy and the expanding opportunities of automation have pushed the rich democracies further away from an emphasis on manufacturing towards service-sector dominance in employment provision. As a consequence, high-skill professional services and low-skill personal services are two main growth areas for jobs in the economies of the rich democracies. In the context of current labor productivity levels and elasticity rates of labor supply and demand, these trends have resulted in widening earnings inequality in almost all rich democracies.[23]

No single country or company is able to independently alter these pressures stemming from the expansion of international trade and continuing technological progress. Both developments have expanded the opportunities for efficiency improvements in economic organization. Genuinely transnational product markets have come into existence, as governments from within the European Union and among the members of the World Trade Organization have removed perceived trade barriers. In the wake of this transition, the character of state action has changed considerably. Switching from using interventionist to regulatory policies, states have given up many of the traditional policy levers that allowed them to promote growth and employment.[24]

Technological change in the form of digitization has provided these new transnational markets with great depth. By reducing transaction costs, enabling the modularization of production processes and removing the physical constraints associated with the delivery of many business processes, digitization has allowed managers to shift the geography of global capitalism. As companies specialize in core competencies and source parts and marginal activities from suppliers, new global value chains have started

[22] For numbers, see Wood, Adrian. 1994. *North-South Trade, Employment and Inequality. Changing Fortunes in a Skill-Driven World*. Oxford: Oxford University Press.
[23] The globalization of value chains has not only put on downward wage pressure on lower skilled workers in the advanced countries, but – often over-looked and just as important for workers' income security – it has increased the price elasticity of labor demand. See Rodrik, Dani. 1997. *Has Globalization Gone Too Far?* Washington DC: Institute for International Economics.
[24] For instance, in the realm of monetary policy, governments have given policy-making authority to independent central banks, even pooling it supra-nationally within much of Europe.

to span across multiple countries.[25] Under pressure from global markets to reduce costs and safeguard quality, managers often have to decide between automating and outsourcing (often translating into off-shoring) parts of their production and business processes. Especially, the scope of off-shoring strategically non-significant activities has recently been increased, now stretching beyond manufacturing to business services. Many North American and European companies have outsourced such business processes as back-office processing and customer relations. Increasingly, companies outsource (and off-shore) much higher-value added services, for example, research and development functions as these are becoming commodified to a growing degree. In the process, the boundaries of firms are reconfigured.[26]

In the current phase of capitalism, knowledge management in the 'learning economy' has replaced Fordism's maximization of economies of scales as the overriding organizational paradigm, at least in the advanced economies. As a result, the success of company executives today often depends on making a strategic decision about what constitutes their company's core value-added and on following up with fervent protection of the underlying intellectual property (IP).[27] With a deepening world economy pushing for economic re-organization at an ever-increasing pace, competitive success requires the ability to adapt the allocation of labor resources to suit the demands of the global marketplace. Because the 'global' and the 'digital' constantly shift the levers of advantage in value creation, countries' and companies' traditional strengths are no longer enough.

Another important driver for calls to create labor market flexibility can be found in the changing social structures and individual preferences during the last few decades.

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[25] See Gary Gereffi and Timothy Sturgeon. 2004. "Globalisation, Employment, and Economic Development." (available at: http://www.ids.ac.uk/globalvaluechains/publications/SloanGVCbriefingFinal.pdf)

[26] Gecis Global, a former subsidiary of General Electric, is leading many of these transformations. Originally founded to serve as a provider of backoffice and simple accounting services to the group, it has since been partially spun off (60 per cent). Their service offerings have gained a very high level of sophistication, with particularly such divisions as "Finance and Accounting" employing many PhD and Masters-level graduates. Rather than merely offering cost arbitrage to its customers, Gecis Global's high value-added services are marketed as improving business processes for multi-national companies that want to serve the markets across the globe. See Dossani, Rafiq, and Martin Kenney. 2005. Globalization of Services: A Conference Casebook. Stanford: mimeo.

[27] This explains companies' intensive lobbying for stricter rules for IP governance. In this context, it is important to recognize that the core IP can also include the knowledge about particular production processes.

In the rich democracies, family bonds are loosening – thus making individuals more dependent on the market. Furthermore, women want to enter the workforce. As normative changes have led to an expansion in the labor supply, a strong case can be made for the revision of welfare programs incentivizing early retirement or tax systems promoting inactivity of spouses.

Rich democracies' governments have tended to accept both the structural changes in the world economy and changing social preferences. With few remaining policy levers and a constrained ability to increase public investment in the wake of demographic change, governments have taken to improving the supply side of their countries' economies. They have continued to formulate policies intended to boost employment and growth, in each instance influenced in their perception of the policy challenge by national institutional legacies and party-political ideological commitments. In spite of individual differences in policy changes, all of these countries placed a heavy emphasis on creating greater labor flexibility.

Different Interpretations of the Adjustment Challenge

One can distinguish between at least four separate frames for the adjustment challenge in the labor market. Their relative impact on policy reform and company strategy has varied across the sample throughout the observation period.

A first frame is provided by orthodox economics, as it tends to be espoused by analysts with a macroeconomic perspective. Many neo-classical economists and the great simplifiers of their ideas in think tanks and media organizations treat labor as an undifferentiated commodity. Consequently, their policy recommendations are line with those that they tend to give with respect to any commodity market: Institutional rigidities should be removed so that prices can fall to match demand and supply (Siebert 1997).[28]

This line of reasoning – often nothing more than an argument by assumption – gained wide popularity after Keynesian macroeconomics had come under pressure in

[28] Neoclassical economists did not attempt to construct labor market models that analytically captured the often rather successful oligopolistic practice in individual countries. Instead, they advocated as policy recommendations the correction of the empirical world to fit to the assumptions of the microeconomic theoretical edifice. A partial exception was the insider-outsider analysis by Lindbeck and Snower, which diagnosed rent-seeking behavior by collectively organized labor market insiders that hurt the often only marginally or unemployed outsiders. See Lindbeck, Assar, and Dennis J. Snower. 1988. *The Insider-Outsider Theory of Employment and Unemployment*. Cambridge, Mass: MIT Press.

both academic analysis and policy-making.[29] Under the ascendancy of neoclassical economics, government (rather than market) failure entered the political agenda (Stigler 1971). Economists maintained that government meddling in the allocation and provision of goods and services had not met consumer demand and were ripe with inefficiencies. Subsequently, starting with the deregulation of the US airline industry, many areas of the economy were liberalized and the role of competition in the governance of economic affairs increased – all in the name of increasing efficiency and achieving lower prices.[30]

After the end of the Cold War, the interpretive frame provided by orthodox economics became dominant in much policy analysis. International organization – such as the OECD, the IMF and the World Bank – had adopted the neo-liberal Washington Consensus.[31] For example, when the OECD published its "Jobs Study" (1994), the report's most important message was widely perceived to be the need for deregulation of the labor market in the name of increasing labor market flexibility (Freeman 2005a).

A second frame is provided by more specialized economic thinking in the sub-discipline of industrial organization, which has paid more attention to the special properties of labor as a commodity – its highly differentiated and "fictitious" nature. In contrast to many orthodox economists with their tendency to advocate that reality should

[29] In the world of politics, old Keynesian recipes proved to be unsuitable remedies for the new world of 'stagflation' (*stag*-nation + in-*flation*). The simultaneous occurrences of lack of growth and inflation in the 1970s, largely due to the negative supply shocks associated with the increases in oil prices, did not fit within the analytical schemes of Keynesian economic policy built on the reading of crisis as negative demand shocks. In the world of economic analysis, this failure at the policy level boosted the standing of the Chicago School critics of Keynesianism. In the race to provide macroeconomic analysis with 'proper' microeconomic foundations, the Keynesians lost out to the camp of neo-classical analysts. The macroeconomic behavior stipulated by Keynesianism seemed irrational in the light of the assumptions of microeconomic utility theory. Thus Keynesian economics fell out of favor as economist switched their assumptions of expectation formation from adaptive to rational and increased the mathematical power of their aggregate models. It took a while for New Keynesians to re-legitimize older Keynesian claims about the existence of slack in the economy through theoretical innovations such as the introduction of menu costs.

[30] Furthermore, following the slogan of pursuing a 'New Public Management', public bureaucracies were brought in line with the principles of private organizations rather than traditional Weberian organizations. As liberalization hit such sectors as finance, utilities, telecommunications and even postal services, it became increasingly clear that – contrary to common belief – liberalization was a phenomenon of re-regulation rather than de-regulation. Freer markets were in fact accompanied by more rules, as governments set up regulatory agencies that tried to both check the tendencies of oligopoly formation and contain perceived negative consequences of private competition. See Vogel, Steven K. 1996. *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*. Ithaca, NY: Cornell University Press.

[31] For a comprehensive overview piece on the rise of neo-liberal ideas, see Fourcade-Gourinchas, Marion, and Sarah Babb. 2002. The Rebirth of the Liberal Creed: Paths to Neoliberalism in Four Countries. *American Journal of Sociology* 107 (9).

be changed to fit the assumptions of their models, labor specialists refined their analytical tools to better understand reality.[32] In consequence, they have found that there existed efficiency reasons for the common oligopolistic organization of the labor market, that the actual clearing of a labor market might reduce the overall efficiency of allocation, and that social protection policies could increase the labor market performance. Collective wage-bargaining ensured that employers could solve collective action problems that often prevented their investments into increasing workers' human capital in environments where poaching and pay differentials between companies were common. On unemployment, Layard et al (1991) stressed that welfare policies such as active labor market policy can effectively reduce the unemployment rate and that high replacement rates of passive unemployment policy do not increase unemployment as long as the length of the eligibility period is limited.[33]

[32] Economists have long had difficulty constructing parsimonious labor market models that incorporate the most important dynamics in the labor market. In contrast to the common assumption of labor market clearing, unemployment has been a widespread. Of course, there exists voluntary unemployment, which commonly takes one of two forms. First, family members (historically typically mothers) might work within their families rather than on the official market, and second, workers might experience temporary short-term unemployment associated with changes between jobs. However, current unemployment statistics record a lot of unemployment that is of neither type. Involuntary unemployment exists for many reasons, not least because it is in the interests of capitalists to retain a 'reserve army of the unemployed', so that they can use the threat of unemployment to moderate the wage demands of employed workers. See Layard, Richard, Stephen Nickell, and Richard Jackman. 1991. *Unemployment: Macroeconomic Performance and the Labour Market*. Oxford: Oxford University Press. Early labor market models in the late 1960s worked from the idea that every individual can set his own price for his labor rather than having it determined through collective bargaining. Such models logically implied that all unemployment was voluntary, which – for all practical purposes – disqualified them for informing policy-making during the stag-flationary 1970s and beyond. Furthermore, early work on the Philips Curve relationship between unemployment and inflation, such as Friedman's analysis of the national rate of unemployment was based on the assumption of 'irrational' adaptive expectation formation. Following the rational expectations revolution in economics, the theorizing on the NAIRU (non-accelerating inflation rate of unemployment) became more sophisticated.

[33] The contingent nature of many of the authors' arguments led to difficulty in adopting them as policy-making guidelines, especially so since the interests of the stakeholders of policy continued to diverge on the details of potential implementations. Overall, the sophisticated analyses by Layard et al also came too late for having much impact on policy-making, as political leaders in many Anglo-Saxon countries had already been busy pursuing the removal of rigidities for a decade. Furthermore, the combined switch to increasing the independence of national central banks and the plan to introduce monetary union in Europe had changed the structure of the national signaling games that were laid out in the literature. For an explanation on the origins of central bank independence and monetary union, see Kathleen MacNamara MacNamara, Kathleen. 1999. Consensus and Constraint: Ideas and Capital Mobility in European Monetay Integration. *Journal of Common Market Studies* 37 (3):455-76. or Jones, Erik. 2002. *The Politics of Economic and Monetary Union: Integration and Idiosyncrasy*. Lanham: Rowman & Littlefield. Incidentally, Oliver Blanchard's attempts to re-invigorate a discussion about the effect of negative supply shocks as lying at the foundation of the European unemployment malaise came also too late to have impact on public debate.

A recent contributions by a prominent labor economist stressed the likely effects that the entries of China and India into the world economy will have on the domestic labor market of the advanced countries (Freeman 2005b). With their 1.47 billion workers, the two countries alone effectively double the size of the world's newly connected workforce. According to Freeman's calculations, the entry of China, India ad the former Soviet bloc in the global economy cut the global effective capital/labor ratio by 55-60%. Even the simplest model of international trade would predict such a shift to have very significant effects on the patterns of demand for labor in the advance countries, particularly for low-skilled labor. In this context, the current shortfall of labor income generation in the US during a period of rapid productivity growth seems hardly surprising. The Unites States is in the midst of the weakest hiring recovery on record, during which the inflation-adjusted hourly wage rate – three and a half years into the recovery – is still fractionally below the level prevailing that the trough of the last recession. It is particularly interesting to note that the divergence between productivity and pay increases has been starkest outside of manufacturing, a result which would be highly consistent with the increasing international tradability of services to have a negative impact on wage levels (Roach 2005a).

It has been popular to point out that the advanced countries could counter this trend by increasing the investment in education and continuous learning, thus taking its subsequently higher-skilled labor force out of direct competition with those in the developing world. Additionally, it has been argued that the open and democratic nature of the advanced countries' political systems can attract increasingly mobile international talent (Florida 2005). That either of these strategies are viable as a comprehensive 'solution' seems rather doubtful, given that by 2010, China will graduate more PhDs in science and engineering than the United States (Freeman 2005b).

Writings on management strategy provide a third frame. They contain the "management models" and "organizational paradigms" (Guillén 1994) that corporate decision makers put into action in their attempts to tap into the business opportunities associated with "global labor arbitrage" (Roach 2005b) in both manufacturing and large parts of the services. Recent literature has stressed the importance of organizational learning and the need to leverage the accumulated knowledge to stay competitive in the

globalizing economy of the digital era (Archibugi and Lundvall 2001; Zysman and Newman 2006). Many companies are taking on the characteristics of learning organizations as they take on features that were once restricted to professional service firms (Lorenz and Valeyre 2004; Scott 2001). Giving employees the flexibility and autonomy for experimentation and allowing them to take the initiative in the pursuit of complex tasks, learning organizations try to leverage the interaction of their skilled employees into individual competence-building, organizational learning and innovation. Learning in these organizations is a continuous process of accumulating, applying and combining employees' knowledge.

With digitization providing "tools for thought" (Cohen, Delong, and Zysman 2000) and leading to knowledge creation and destruction at faster rates (Johnson et al. 2004, 14), corporations have been advised to develop a "global innovations process" (Santos, Doz, and Williamson 2004) and embrace frequent corporate reorganization in the pursuit of experimental strategies (Eliasson 2004).[34] As businesses adapt their corporate structure to fit such strategies, off-shore locations become more than cheap production sites (Dossani and Kenney 2003; 2005). Rather, multi-national companies have started to drive some innovation processes from these locations. Management scholars Hagel and Seely Brown (2005) find that a dynamic interaction between the corporate core and a company's periphery to be the basis for capability-building, which is likely to provide the "only sustainable edge".[35] As off-shoring is packaged with business re-organization into "transformational outsourcing", established views about the firm's most efficient boundaries themselves are being re-evaluated (Sako 2005).

From the vantage point of management strategy, arguments for flexibility are of different nature than in the interpretative frames provided by orthodox economics and industrial relations. First, in an environment in which managers are ready to adapt their business models after months rather than years, they want their workforce to comply, i.e. flexible labor market seem necessary to enable staff turnover to match the frequent corporate re-organizations. Second, policy-makers might be interested in flexible labor

[34] Fittingly, scholars of industrial relations also report experimentation in this area. See Jacoby, Wade, and Martin Behrens. 2001. Experimentalism as a Tool of Economic Innovation in Germany. *German Politics and Society* 19 (3):1-33.

[35] They strongly criticizing equilibrium-centered analysis for preventing scholars and managers from grasping the opportunities for business organizations associated with dynamic capability-building.

markets to ensure that those workers whose jobs are being off-shored will find new employment. Influential recent studies by the McKinsey Global Institute, for example most recently on "The Emerging Global Labor Market" (2005) estimates the impact of off-shoring to be positive for those advanced countries with flexible labor markets.[36] Earlier studies (2004; 2003) contrasted the likely benefit of off-shoring to the economic performance of the United States with the negative effects of higher unemployment and lower growth for Germany with its inflexible labor market that prevents efficient reallocation of labor.

A fourth frame for the perception of the adjustment challenge in the labor market is provided by scholarship and ideational entrepreneurship of social (and particularly family) policy experts. They see labor market flexibility as enabling the shift from a gendered division of labor under a male breadwinner model to an adult worker model (Lewis 2001). Furthermore, experts argue that increasing working-time will not only improve the work-life balance of both sexes, but that it will also prove beneficial for economic growth (Rürup and Gruescu 2005). Labor market flexibility has become part of a new paradigm in social policy that aims to promote an active society. It is a paradigm that is less concerned with securing equality (of outcome) than on social inclusion and equality of opportunity (Lister 1998). Pursuing a strategy of "supply-side egalitarianism" (Streeck 1999), policy-makers are encouraged to increase the flexibility of "transitional labor markets" to increase the flows into regular employment from such areas as education as well as family and voluntary work (Schmid 2003). Labeled as the the "LEGO paradigm" (for the similarity with the product philosophy of the Danish toy company), this new approach of social protection is often sold as the logical complement of the rise of the knowledge economy and the demise of Keynesianism: It stresses the importance of life-long learning, investments over consumption and the collective benefits of activity (Jenson and Saint-Martin forthcoming).

[36] The assumptions and methodoly of the McKinsey Global Institute report on the emerging global labor market have been criticized as underestimating the impact of the combined effects of offshoring and outsourcing (see discussions on Sloan Foundation Industry Center Listserver, in particular, contributions by Rafiq Dossani, Frank Levy and Lori Kletzer). Furthermore, being based on expert interviews, it is difficult to validate its findings. This is not to say that the report does not make an important contribution. According to Kletzer, the data on global labor supply is breaking new ground.

The relevance of each frame differs across national contexts and time periods. It is important to point out that – parallel to the revision of the Washington Consensus on general development policy – recent reports from the World Bank, IMF and OECD have taken more moderate stances. The OECD's policy advice has relied less on theoretical choice-theoretic mathematical models and more on elaborate statistical analysis and benchmarking against the United States as the perceived out-performer among the rich democracies.[37] When OECD economists reflect on structural policies to increase growth, they focus primarily on increasing labor market flexibility with a view of increasing the utilization of labor resources and improving labor productivity.[38]

However, in contrast to the moderation in the tenor coming from these institutions, the originally orthodox ideas have displayed a lot of staying power in larger political discourse. To quote a prominent practitioner (Mulgan 2002, 3), "a more centrist, or centre-left ideological position, is now at least partly dominant in institutions like the World Bank and most of the OECD countries … (, having) brought with it a far greater emphasis on the positive role that government and governance can play. However, ... neoliberalism's continuing influence can be seen in the extent to which many decision-makers have simply internalised its doctrines." Finally, at this point, there does not exist conclusive empirical evidence on the effect of increasing labor market flexibility on economic performance. Rather, the results of published research represent are pre-determined by the assumptions that went into the analysis (Freeman 2005a; Ganßman 2000).

III – Analytic Approaches: Explaining Countries' Adjustments

What particular form of historical institutionalist scholarship should this research take? Should this project follow the common approach of political economy scholarship to attribute preferences to core actors based on the researcher's reading of the strategic landscape facing the players and assume (economic) interest-based action? Or, alternatively, should it be more openly constructivist, paying more attention to the

[37] See again OECD. 2005. *Going for Growth*. Paris

[38] Even here it is fascinating how the positivist research outlook leads the analysts to embrace causality claims. For example, it is hardly obvious that the success of small countries is not largely due to housing prices appreciation as a recent contribution claims. See Becker, Uwe, and Herman Schwartz, eds. 2005. *Employment 'Miracles': A Critical Comparison of the Dutch, Scandinavian, Swiss, Australian and Irish Cases versus Germany and the US*. Amsterdam: Amsterdam University Press.

perception of actors as it might be evidenced in discourse? The first option would require us to stipulate preferences for the core groups of actors. The latter option would require us to research if different national discourses actually give rise to different meanings of flexibility.

In the first approach, we can stipulate employer, worker and government preferences with particular reference to incentives for skill provision stemming from the particulars of the work-welfare nexus. Research on labor market institutions has shown that collective wage-bargaining and high unionization can help to prevent employer free-riding associated with poaching. Such institutions provide a solid foundation upon which employers can make extensive collective investments in training and skills without having to fear that competitors will poach their newly trained labor. Based on this solution to the collective action problem of financing investments in workers' skill endowment, companies in these high-coordination regimes can tap into an expanded set of options when it comes to production strategies that focus on leveraging employee learning and granting their workers a high degree of work autonomy. This particular perspective on the varieties of capitalism (Thelen 2001)[39], further focuses on the trade-off between labor market flexibility above the level of the firm, usually in the realms of wage-bargaining, and companies' ability to flexibly manage labor locally, e.g. reassigning work tasks to workers. Often supported by labor market regulations, wage-bargaining above the level of the firm allows for employer coordination that gives company executives more room for maneuver at the level of the firm. Clearly, employer coordination buffers the individual company management from distributional conflict, which can otherwise easily spill over into areas of labor-management cooperation. Higher-level employer coordination facilitates local bargaining between employers and workers in pursuit of more flexibility and greater cooperation of labor at the shop level.

Worker preferences can be deduced from the literature on institutional complementarities. Resulting from the inter-linked nature of the societal bargaining games in the realms of work and welfare, strong institutional complementarities developed between the two realms in European countries' political economy. In the early

[39] In contrast to the other chapters in the book, Thelen's contribution stresses the importance of politics over more narrow arguments that are heavily influenced by the new economics of organization.

postwar years, social programs supported national Fordist production regimes by acting as automatic Keynesian stabilizers. For instance, in many countries, generous unemployment benefits provided the insurance that people need to invest in specific skills, because these benefits guaranteed status-maintaining income in case of these skills would become outdated. Furthermore, as earnings-linked pension systems could be conceived as a 'deferred wage', increases in pension benefits reduced upward wage pressure. There are at least two basic different logics[40] of institutional complementarities, i.e. one stressing functional interdependence and one acknowledging the importance of politics and distribution of power between groups with different interests (see Streeck 2001). The existence of complementarities between the institutions of different parts of the economy and increasing returns (Pierson 2000a) of institutional configurations have received increasing attention in the writings on the varieties of capitalism.

Finally, we need to pay attention to the actions of the state (Levy 2004), to new public policy in support of new regimes of labor force segmentation (Miura 2002) that embrace the changing demands for skill sets in the digital era, such as in Britain – "education as industrial policy" (Stedward 2003).

However, do national discourses actually create different meanings for flexibility? Various lines of scholarship – in my view correctly subsumed by Campell (2004) under the label of organizational institutionalism might give us answers to that question. This scholarship spans the realms of currently prominent economic sociology (e.g. Beckert and Zafirovski 2005; Dobbin 2004; Guillén 2002; Swedberg 2003), research under the label of sociological institutionalism (e.g. Blyth 2002; Herrigel 2000), scholarship on international organizations and in the vein of the emerging constructivist school in international relations (Haas 2004; Ruggie 1982), as well as what is more traditionally considered organization theory (DiMaggio and Powell 1991; March and Olsen 1989). All variants of this perspective on social change recognize the pervasive power of organizational context on actors' identity and their repertoires of action.

[40] For many more, see the contributions to the symposium on institutional complementarity and political economy (published in the May 2005 issue of the *Socio-Economic Review*) and Boyer, Robert. 2005. Coherence, Diversity and Evolution of Capitalisms: The Complementarity Hypothesis. Presented at UC Berkeley on February 22.

These lines of scholarship are anchored at different levels of analysis, such as particular domestic organizations, societies or transnational epistemic communities. They are all inspired by Bourdieu's theory of "fields" (Fligstein 2001), however, they have different assumptions about what level of aggregation constitutes a field. As a joint perspective, they all stresses how certain "norms of reciprocity" and "conceptions of control" tend to become dominant within organizations, in consequence often allowing for easier cooperation among members of that organization.

The literature on 'small states' is a particular version of this common theme. Going back to Katzenstein's influential book "Small States in World Markets" (1985), this literature argues that the politics surrounding the increasing exposure to trade differ between small and larger countries. This perspective stresses that – based on the "shared social purpose" among a small country's population – small countries tend to be high-trust environments with a large endowment of social capital that increases the capacity for economic performance (Ganßman 2003; Rothstein 2003). The small size of a country creates both a uniquely open economy and a contained political game with a limited number of players. Increasing trade exposure not only affects a larger number of people than it would have done in bigger countries, but the interests of these people are expressed through national associations that are more encompassing than their equivalents in larger countries. The result is explicit compensation for the losers of increasing trade exposure through welfare state benefits. A set of forthcoming works addresses the organizational perspective with respect to the Danish case (Albaek, Eliason, and Noergaard 2005; Campbell, Hall, and Pedersen 2006).

IV – Some Empirical Findings: A Very Small Selection

Interesting contrasts between the sampled countries emerge. During the period of observation, Britain experienced broad ideologically-motivated government attempts to alter the fundamental structure of the British political economy and increase the flexibility in its labor market. External labor market flexibility has been greatly increased, and the levels of collective corporate investment in worker skill acquisition remain low (King and Wood 1999). Many of the labor market policies formulated by the Conservative Thatcher government have been maintained under New Labour. However,

important public investments into raising skill levels and social standards have recently been made (Glyn and Wood 2000).

In Germany, moves towards labor market flexibility have been channeled into the creation of special part-time jobs, not subject to the same rules as regular employment contracts. Strong insider-outsider cleavages have become evident, as large manufacturing companies and unions have protected the old institutions of the work-welfare nexus. Providing high internal and low external labor flexibility, these institutions have long supplied the incentives for high levels of collective corporate investment in worker skill acquisition and acted as "beneficial constraint" for a very successful manufacturing production regime (Streeck 1991). The job base in manufacturing has been maintained rather well, but does not seem sustainable long-term.[41] Within the last few years, real wage increases have been very low, leading to a strong increase in Germany's price competitiveness and pointing in the direction of substantial wage flexibility.[42] However, in this large country, economic interests have had very diverse sets of preferences that have so far prevented the striking of a new grand social bargain that could lead to institutional re-organization. While there have been small changes within the politico-economic institutions that will be illuminated by this research project, the overall story seems to be one of continuity.

In contrast, Danish policy-makers claim to have successfully combined labor market *flexibility* with employee *security* in what has been termed a new system of *flexi-curity*. In the eyes of both the Danish business community and the unions, the new system has underwritten successful economic adjustment by allowing the re-allocation of economic resources while safeguarding social order. Because generous social benefits (such as unemployment insurance with very high replacement rates) have cushioned the implementation of a 'hire & fire' system, Danish workers actually feel more secure than their equivalents in other European countries. The flexicurity system seems to be the outcome of a new social bargain, struck by homogenous producer groups in this small

[41] Germany heads the world's exporters ranking: "The German manufacturing model remains extremely strong, so that country has less need than many others to move into new service sectors in order to protect its economic performance." See Crouch, Colin. 2001. Welfare State Regimes and Industrial Relations Systems: the questionable Role of Path Dependency Theory. In *Comparing Welfare Capitalism: Social Policy and Political Economy in Europe, Japan and the USA*, edited by B. Ebbinghaus and P. Manow. London: Routledge..

[42] Reporting by *The Economist*.

country. Close social ties have helped employers overcome the collective action problems in the provision of employee training that typically open up, as labor markets are made more flexible. Flexicurity institutions seem to uniquely support the competitive position of Denmark in the globalizing learning economy. They provide both the incentives for skill acquisition (underwriting employee autonomy that enable companies to have flat hierarchies) and allow for the movement of workers (and knowledge) between companies.

The Dis-Embedding of Social Protection

In general, there seem to be trends toward both the dis-embedding of social protections out of the labor market and a change in the character of potential bargains between social groups. The postwar welfare states of Western Europe evolved together with the national political economic systems. In relatively closed national economies that offered many jobs in the manufacturing sector, cross-class bargains between relatively unified camps of employers and workers gave rise to welfare state structures that provided workers with levels of social protection that they desired and incentives for work, skill investment and labor peace that employers wanted. As a result, increasingly elaborate structures and levels of social protection were embedded within the regulation of the labor market. Breadwinner welfare states provided job protection and employment-linked social benefits for the core male workforce.

The structure of welfare programs both constrains and enables production strategies of employers, however, the long-standing links between the worlds of work and welfare serve the interests of shrinking constituencies and have increasingly become dysfunctional. For instance, generous early retirement schemes might help some industrial companies through difficult adjustment periods, but they increase social insurance contributions, which price many workers out of the labor market.

Towards a New Social Liberalism

Governments have tried to achieve allocative efficiency in the labor market while guaranteeing social inclusion. Policy-makers seek the maintenance of equality of opportunity by granting post-allocation income adjustments inform of negative income taxes, topping-up wages etc. Increasing labor market flexibility does not have to led to reductions in social protection levels, as long as the latter is understood to refer to post-

allocation buffers to market outcomes rather than mean reducing people's exposure to market mechanisms. Much of Europe seems to be witnessing a 'liberal' revolution, which has also seems to have influenced the current thinking in social democratic and conservative parties, a trend for which some drivers can be found in the new politics of retrenchment in established welfare states (Pierson 2000b). Following strategies of progressive politics (Levy 1999), some European social democratic parties have more successful than others in adopting their ideological commitments in the direction of the Third Way and New Center (Giddens 1998; Hombach 2000; White 2001). Some convergence on a new social policy paradigm has certainly been noticeable between the political left and right – with important differences in the implementation of general principles.[43] Rather than the LEGO paradigm of the knowledge society, this new policy regime might well be appropriately labeled one of "Social Liberalism" as a less evocative and more descriptive phrase (Buckler and Dolowitz 2004; Levy 2004).

However, even early readings of the case study evidence amply demonstrate the importance of inherited institutional arrangements for social protection for the politics of achieving labor market flexibility. Systems built around occupational status preservation tend to block measures that could increase labor market flexibility, while those offering universal provisions based on citizenship can help achieve flexibility in the labor market. This perspective puts into question the dominant frame of associating the achievement of labor flexibility with the removal of social protections. It indicates that – even in today's post-Keynesian world – social protection does not have to be economically harmful.

Changing Patterns of Social Concertation

As European policy-makers face the challenge of trying to create conditions that facilitate the creation of domestic service-sector jobs and support the competitive position of their countries' value-generating corporations, the content, speed and structure of potential social concertation in support of institutional renegotiation has changed from earlier periods. Long gone is the old-style macro-corporatist bargaining which had its heyday in with the fight against inflation in the 1970s (Scharpf 1991). National deals that divided the annual productivity gains between organized labor and capital lie in the past.

[43] There exists a trade-off between participation and productivity growth. British productivity growth slowed recently, but much higher rates of activity in the labor force.

When labor and capital strike bargains today, it is not their highly concentrated, exclusive national organizations that are involved. Rather, the current bargains often take the form of narrower social pacts at the firm or sectoral level (Hassel 2003). Misleadingly called "competitive corporatism" by one analyst (Rhodes 2000), collaboration between employees and employers at lower levels of aggregation have become the basis of – often experimental – company strategies. National deals, if they occur, are more important for increasing the political legitimacy of policies than for supporting a particular economic logic (Katzenstein 2003).

Employers diverge in their interests over different forms of labor market flexibility, and so do workers. In general, insiders (employers and workers) of those sectors that benefit from old institutional complementarities tend to oppose increasing flexibility while many outsiders (the unemployed and those precariously employed, very high skilled 'knowledge workers' and executives from service-sector companies) support it. If social protection is brought in as another variable into the game of making the labor market more flexible, the structure of the preference sets changes further. Among those employers who desire flexibility, subgroups hold very different preferences towards the level of social protection. Providers of low-wage personal services might be against generous welfare protection, because without it their workers will be very dependent on their employer. The employees are likely to put up with a high workload and bad working conditions, largely out of fear that quitting the job would leave them unsupported. Providers of high-quality services might much prefer their higher skilled workers to have a positive motivation to work, because flexible work organization with high employee autonomy would otherwise be difficult to sustain.

V - Conclusion

This paper has introduced some important analytical tools for a comparative analysis of the quest for labor market flexibility in the United Kingdom, Germany and Denmark. It represents an early attempt to address the themes that I want to engage in my dissertation research, i.e. the impact of globalization on domestic systems of social security, using the politics of labor market flexibility as a prism to learn about the national dynamics of economic and social adjustment and how to build a European social

model that combines the provision of social security with supporting structural economic change.

This research project does not aim to establish which national combinations of specific forms of labor market flexibility add up to the most successful adaptation or if alternative combinations deliver the 'same' result in the degree of national competitiveness. Rather, this question will be a topic for a later inquiry, albeit one for which this research aims to establish some important foundations. The study of the politics of labor market adjustment in three different welfare regimes will allow us to study the institutional determinants for country's ability to shifting employees into new productive activities, generate the skills set necessary for these activities and providing income security in the process. Trying to assess how economic globalization has affected domestic systems of social protection, we will learn a lot about the role of domestic welfare systems in supporting a successful globalization strategy. In short, this research will raise many of the issues that will be important for such a study.

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