



# Public sector reform under EMU



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A literature review

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European Foundation for the Improvement of Living and Working Conditions

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with Rob de Boer

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# Foreword

The developments in European integration, together with the social impact on living and working conditions and on industrial relations, have been the priority of the Foundation since the beginning of its activities. When, in 1999, eleven EU Member States joined the Economic and Monetary Union (EMU), the Foundation started to investigate the social impact this would have on the private and public sectors, on industrial relations, employment and working conditions.

The project started with two bibliographical reviews and proceeded with a company-level analysis of the impact of EMU in the private sector, specifically the automotive, financial services and road transport industries. Then, in 2000, the project was widened to cover the impact of EMU on the public sector.

This literature review of *Public Sector Reform under EMU* focuses on the social implications of EMU for the public sector and gives an overview of the policies and structure of the public sector in Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Sweden and the United Kingdom. The subject of the investigation is the relationship between EMU and reforms in the public sector, in particular the impact of EMU in the countries considered on changes in the scope of the public sector, on the public sector as a part of the European Social Model, on financial and budgetary frameworks, and on public sector labour relations.

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# Introduction

Eleven EU Member States joined the Economic and Monetary Union (EMU) in 1999 and Greece was later also accepted to join. EMU, as formulated in the Maastricht Treaty and complemented by the Stability and Growth Pact and further secondary legislation, introduced a number of changes at both national and European level. In the drive towards the establishment of the Euro Zone and EMU, the focus of attention was on technical preparations, fiscal arrangements, the handing over of monetary powers to the newly established European Central Bank (ECB), co-ordination of money market interest rates and the agreed policies to make the process successful. Debate about the crucial event of the introduction of the common currency on 1 January 1999 was thus concentrated mainly on the economic and financial arrangements for the euro and some important issues have been neglected, such as the social implications of monetary union. Studies have clearly shown that EMU does not only consist of those criteria, but is better understood as a process leading to increased economic unity.

In the wake of these arguments, the European Foundation for the Improvement of Living and Working Conditions (subsequently referred to as the Foundation) began a research project on the social impact of EMU, especially in relation to the private and public sectors, to be conducted in three phases.

The first phase of the Foundation's research consisted of two literature reviews, entitled *EMU and the Implications for Industrial Relations: A Select Bibliographic Review* (Observatoire social européen, 1999) and *Economic and Monetary Union, Employment, Social Conditions and Social Benefits: A Literature Survey* (Sisson *et al.*, 1999). Both studies revealed that the issue of the social effects of EMU had received little attention and that much of the debate is based on individual views and perceptions rather than on well-researched empirical evidence.

The second phase of the Foundation's research consisted of a study of the social implications of EMU for the private sector and was conducted in the financial, transport and automotive sectors of 6 Member States (Finland, France, Germany, the Netherlands, Spain and UK). National research reports covered three company case studies from each of the three sectors, totaling 54 company cases.

In this study, the impact of EMU on industrial relations in the private sector was considered from two viewpoints:

- *the narrow view* — of seeing EMU in terms of the single currency, the European Central Bank with responsibility for setting monetary policy, and the Stability and Growth Pact designed to put teeth into the public deficit provisions. There is relatively little impact on either the processes or the outcomes of private sector industrial relations; and
- *the wider view* — of seeing EMU as the ongoing process involved in establishing the single European market. The impact on processes or outcomes of private sector industrial relations is much more substantial, albeit indirect.

EMU was found to have a considerable impact on the strategies and policies of the companies analysed, which, in turn, had effects on employment, industrial relations and working conditions in each of the sectors. The automotive sector is already global. Banking is becoming more global. Although transport is still mainly a national sector, it is going through a transition period of

internationalisation. Thus, despite the national and company differences still present, it was observed that there was a clear trend towards 'Europeanisation' of industrial relations.

The third phase of the Foundation's research is ongoing and consists of a study of the social implications of EMU for the public sector. Based on the previous literature reviews and private sector studies, the aims of this third phase are:

- to identify information gaps in the field of the social impact of EMU on the public sector;
- to assist policy-makers and social partners to understand the main issues related to the impact of EMU on the public sector, especially the impact on the scope, mission, social protection, employment and labour relations in the public sector;
- to identify and analyse measures taken by governments to adapt the public sector to the guiding principles of EMU in each country;
- to identify measures taken by governments to adapt to the social implications of the euro;
- to assist policy-makers and social partners in developing effective policies in order to adapt, and possibly counterbalance, eventual negative developments; and
- to raise a debate on the implications of EMU for the structure of the public sector.

The Foundation has again commissioned a literature review as a preparation for this third phase of the research. This literature review, presented here, addresses four main points:

- the structural transformation in the scope and mission of the public sector;
- the change of government policy in terms of the changes in fiscal, social and employment policies;
- analysis of the different concepts of the public sector and public administration in EU Member States and the transformation processes which have taken place in recent years (this evolution often blends with a process called 'New Public Management'); and
- the reform of employment relations and industrial relations in the public sector.

The literature review should also answer the following questions:

- Are there any significant gaps in the literature?
- How to define and focus the various concepts of 'public sector'?
- Which research issues can be identified through the literature review?
- Which analytical framework is to be set up in order to pursue the research issues identified above?

In contrast to the private sector, EMU can be expected to have a direct impact on the public sector since the criteria of convergence have direct implications for the functioning of the public sector, as follows:

- a high degree of price stability apparent from a rate of inflation which is close to that of the 3 best-performing Member States (1.5%) in terms of price stability;
- a budget deficit not exceeding 3% for the ratio of the planned or actual government deficit to GDP at market prices;
- a public debt not exceeding 60% for the ratio of government debt to GDP at market prices;
- the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System (EMS), for at least 2 years, without devaluing against the currency of any other Member State; and
- an average nominal long-term interest rate not exceeding by more than 2% that of, at the most, the 3 best-performing Member States in terms of price stability.

In all EU countries during the mid-1990s, these criteria led to cutbacks in public spending in order to reduce public deficits and debt. Recovering EU economies in the late 1990s, however, made it easier for many governments to adjust their economies to the criteria. The Maastricht Treaty and the actual introduction of EMU represent the first dimension in the time-frame of our study.

As early as the mid-1980s, a substantial change took place in the public sector in many countries. The scope changed: re-organisation, liberalisation and privatisation have become common features of public administration in all EU Member States. The role of the State in general has also become a much discussed topic, together with the enhancement of international competitiveness of the economy and the reform of social systems. Employment and labour relations in the public sector have been in transition. These public sector reform trajectories represent the second dimension in the time-frame of our study.

As to the appropriate time-frame of our study, the issue was — should we focus on the post-Maastricht period or should we take a longer term perspective. We opted for the latter for the following reason: we take the introduction of EMU to be the culmination of a lengthy process of the institutionalisation of a hard currency policy regime across Europe. (Historically, the breakdown of the Bretton-Woods system in the early 1970s enabled the Bundesbank to pursue a hard currency policy, which it believed necessary for the German economy. In the wake of the second oil crisis of 1979 and given their strong ties to the German economy, Austria, the Netherlands, Denmark and Belgium shifted to a hard currency by tying the schilling, guilder, krone and Belgian franc to the German mark, thereby establishing a quasi-monetary union of the DEM zone.)

This third time-frame should allow us to observe whether or not variation in the timing of the shift towards a hard currency policy in various countries provoked specific reforms in the public sector. Is there a plausible connection in terms of timing between the choice for a hard currency and public sector reform, welfare retrenchment, the increased popularity of New Public Management (NPM) techniques and practices, and reform of public sector employment relations and industrial relations?

The main focus in this literature review is on the relationship between EMU and reforms in the public sector. The most general question is what impact does EMU have on public sector reform? More specifically, what impact does EMU have in various countries on when there are public

sector reforms and the kinds of reform involved? In a very tentative and provisional manner, we will try to distinguish between the domestic and European forces driving public sector reform.

In the final analysis, however, we cannot prove or measure in a positivist manner the effects of EMU. This is because, firstly, not every public sector reform effort since 1992 can be attributed to EMU, even if such reforms contribute to the meeting of the convergence criteria. Many reforms in the welfare state and public sector stem from responses of particular national political constellations to problems posed by specific national configurations of social institutions and policy programmes.

Secondly, causality does not necessarily run in one direction — from EMU to public sector reform. Domestic pressures in the public sector, budgetary or otherwise, may very well have influenced support for EMU, its specifics in terms of policy content and the policy choices of the European Central Bank (ECB).

The first 3 chapters of this report introduce the public sector from various angles:

- *Chapter 1* examines the public sector as part of the European Social Model. We turn to the prevailing literature on the potential economic and social consequences of EMU. We distinguish between optimistic studies, emphasizing Pareto-efficiency gains of EMU. More pessimistic studies raise the concern of a logic of ‘social dumping’, unleashed by EMU, which could undermine the normative principles and core practices of the European Social Model, characterised by comprehensive social protection, high levels of income redistribution and social partnership involvement in public policy-making.
- *Chapter 2* addresses the changing ideas of public sector management, in particular the various dimensions of New Public Management (NPM), which could be viewed as a new doctrine.
- *Chapter 3* explores the changing scope of the public sector. Scholars of public administration use a variety of terms for their subject, such as public sector, core public sector, extended public sector, public services, production of public services and government services. We attempt to distinguish what belongs to the public sector and where the line should be drawn with the private sector.

The next 2 chapters provide an analysis of EMU and quantitative indicators on fiscal, employment, social security and budgetary policies:

- *Chapter 4* examines the pressing issue of tax competition and how this relates to the broader picture of economic integration and the effect of EMU on public sector reform.
- *Chapter 5* examines a number of statistical performance indicators relating to employment, social security commitments and levels of taxation, together with the basic macroeconomic criteria of the EMU entrance exam concerning budget deficits, public debt and inflation.

The following 2 chapters analyse the country trajectories in the effects of EMU on public sector reforms:

- *Chapter 6* develops the analytical framework for countries studied. Four different models of welfare capitalism are identified (Scandinavian, Continental, Anglo-Saxon and South

European), each with its own regime-specific characteristics and avenues for policy reform. The differences between these four regimes are greatest with respect to labour market regulation and social security regulation. Further differences concern the shape and size of the administrative system and the characteristics of the political and industrial relations systems. These institutional features matter greatly when it comes to feasible policy responses to the challenge of changed external pressures.

For each of the four models, two countries (one large and one smaller) were selected for further analysis, as follows:

- Scandinavian: Sweden and Finland
- Continental: Germany and the Netherlands
- Anglo-Saxon: UK and Ireland
- South European: Italy and Portugal

Denmark was added to increase the range of countries which (together with the UK and Sweden) have not entered EMU. Also, France was added to this part of the analysis without being allocated to one of the models.

- *Chapter 7* presents the country trajectories. For these profiles of national trajectories of public sector reform, we also examine the broader issues of macroeconomic conditions and choices, social policy reform and budgetary policy. By doing so, we try to render a plausible account of the relationship between EMU and public sector reform.

The final section of the report addresses the impact of EMU on the reform of public sector employment relations and industrial relations:

- *Chapter 8* discusses how, in nearly all EU countries, reforms of public sector employment relations and industrial relations have been underway for some time, in some countries as early as the 1970s. We look in particular at the institutional dimension of the regulatory framework of employment and industrial relations, and the financial dimension of budgetary reform, involving changes in mechanisms used by governments to control and adjust pay bills as an important part of public budgets.
- *Chapter 9* presents a summary of the study, together with conclusions and recommendations for further research.



# The public sector as part of the European Social Model

The welfare states of Western Europe were fully established in the initial post-war decades and were characterised in important ways by direct state control of the production and distribution of politically salient goods and services (Heritier and Schmidt, 2000). Most important among these were those public interest services that were provided by the State, such as high quality education, health care and housing. Justification of the relatively large public sectors and state monopolies in Western Europe was generally couched in terms of economic theories of public goods and market failures. It was thought practically self-evident that the infrastructure of transport and communication systems, energy and water supply, waste disposal and a wide range of other services and facilities could not be provided by private companies operating in a competitive market if these services were going to satisfy politically defined requirements of universal access, security, continuity and affordability. In fulfilling these goals, public utilities (or rather the State) have in addition become important employers, providing large numbers of 'good' jobs that were secure from market pressures (Schwartz, 2001).

Solid budgetary discipline is considered to be an essential condition for the success of EMU. Whereas the EMU constraints (price stability, underpinned by central bank independence) for private economic agents are of an indirect nature, direct norms are imposed on Member States when it comes to public economic agents in order to preserve sound public finances. Easy to monitor numerical targets as entry criteria for participation in EMU were introduced in the Maastricht Treaty. These criteria forced Member States to commit to budgetary discipline within the constraints of 3% for the deficit and 60% for the debt (as a percentage of GDP).

This focus on budgetary discipline is both important from the national and the EMU perspective. The European Central Bank (ECB) cannot maintain price stability without the co-operation of the fiscal policies of the EMU Member States. The fiscal provisions are designed to reinforce the credibility of the ECB in pursuing its primary objective of price stability.

The logic of strict budgetary rules, laid down in the Stability and Growth Pact, is that high debts and deficits threaten the stability of the euro because they lead to debt runs, thereby putting pressure on the ECB to bail out countries in financial distress. Moreover, it is believed that the Maastricht convergence criteria force countries, biased towards spending and deficits, to 'tie their own hands'. Thus from the outset it was believed that EMU would be built on a strong foundation of budgetary discipline. The Maastricht criteria for joining EMU imply that EMU Members will have achieved a high degree of discipline in their public finances. The Stability and Growth Pact, by setting ambitious medium-term targets and providing a strong deterrent against budgetary 'misbehaviour', ensures that fiscal prudence will be a permanent feature of EMU. The Single European Act already reduced the scope of defensive industrial policy, such as state aid and subsidies, which had been used extensively in the past to cushion negative shocks and preserve employment in the public sector and nationalised industries.

## The European Social Model

The European Social Model is based on the normative ambition that no one will be abandoned to cope on their own in a competitive market system — a normative heritage closely related to the long-term influence of Christian Democratic and Social Democratic thought in Europe.



In terms of public policy, the European Social Model contains three distinctive components:

- *Coverage of basic social security is very extensive, almost universal.* European countries typically devote a quarter of their GDP to public spending on health and social protection and services (10 percentage points more on average than in the non-European OECD countries). Within the European Union itself, there are large differences in public spending, with Sweden, for example, allocating a third of GDP to social spending whereas Portugal's amount remains under a fifth of GDP. (Although spending less on social protection than any other EU country, Portugal still spends, in gross terms, more on social protection as a proportion of GDP than Australia or the USA.) The levels of social protection have their counterparts in average tax rates: taxes in most EU Member States amount to over 40% of GDP, compared with less than 30% in Japan and the USA.
- *The EU is marked by a higher degree of interest organisation and policy concertation between the government and social partners in the areas of employment relations and collective bargaining* (Ebbinghaus and Visser, 2000). Compared with North America, European systems of industrial relations are very stable. Europe is the only world region where the majority of workers are covered by collective agreements, most of which have a legally binding status. Furthermore, social partnership encourages a problem-solving style of policy-making, based on steady commitments and institutionalised trust, which enables the collective actors to overcome sectionalist interests and to seek common solutions. Practices of 'social dialogue' are not only distinctive at the national level. At the supranational level, the Social Dialogue and the Social Chapter, first advanced under the presidency of Delors, have produced a number of agreements which have attributed a public status to the social partners in the policy-making process on employment and social policy at EU level (Ferrera *et al*, 2000). In this respect, the European experience is unique; there are no other examples of such international social partnership and social policy initiatives in the world. This problem-solving, multi-level, multi-actor approach has more recently found its reflection in the Luxembourg process on employment and the open method of co-ordination, agreed to at the Lisbon Council in 2000, with respect to social exclusion and social protection.
- *The majority of EU economies preside over a more equal wage and income structure than elsewhere.* Closely related to the two above distinctive features, this allows for a substantial redistribution of income in fighting poverty. In the absence of social transfer payments, almost 40% of households in Europe would live in relative poverty, a figure which is contained through the tax and benefit system and (solidaristic) collective bargaining to about 17%.

At the cognitive level, the policy theory that lies behind the European Social Model is based on the recognition that the normative objective of social justice can be made to contribute to economic progress. This goes against the prevailing view of the big trade-off between economic efficiency and social justice in advanced welfare states. The idea that social justice can be made to support economic efficiency, and vice versa, that economic competitiveness is likely to foster social cohesion, is not necessarily an overly naive view in an era of economic internationalisation. Many of the small economies of Western Europe have taken the lead in welfare state expansion after World War II precisely as a means to facilitate their capacity to respond to changes in world markets (Katzenstein, 1985). While confidently letting international markets forge their strategies of adjustment, as a consequence of their extreme economic openness, Austria, Belgium, Denmark, Finland, the Netherlands and Sweden have all introduced a variety of comprehensive social

policies aimed at an acceptable distribution of the social costs of necessary economic change. Thus the dedication to international trade liberalisation was rendered socially acceptable and politically legitimate.

The positive appreciation of social policy as a 'productive factor', the idea that social policy can be made to contribute to economic competitiveness, was strongly endorsed at EU level by the Dutch presidency in the first half of 1997. Refinements were added in the areas of employment and macroeconomic policy during the presidencies of Luxembourg (1997) and Germany (1999). These initiatives were subsequently taken further by Portugal (2000) with respect to social cohesion and the Social Policy Agenda of the Commission. In contrast to classical liberalism, public and private spheres, politics and markets, are not seen as opposites, separated by the clear boundaries of property rights, but rather they are seen as complementary logics of provision, which also leaves ample scope for a shared policy space. As a 'productive constraint', a term coined by Wolfgang Streeck, social policy can contribute to reducing uncertainty, serve to create and stabilise collective goods, sustained by high levels of public support, allow for long-term skills investments, channel and mitigate social conflicts, encourage social partnership, foster social stability and cohesion, and create a positive investment climate (Streeck, 1992).

In short, a strong economy requires a strong welfare state. A reliable system of social security may enhance the capacity to adjust and the readiness to accept change. Adequate employment protection and co-operative industrial relations will enhance the involvement of employees with their companies and will make it profitable for both employers and workers to invest in training and education. Finally, developed welfare states may help to mitigate social conflict when industrial restructuring adjustment is necessary. By compensating workers and families who contribute to the common economic good by exposing themselves to periodic market contingencies, the welfare state encourages private initiative and economic progress.

The above policy theory, endorsed by domestic politicians and European policy-makers, occupies a far more difficult intellectual position than the neo-liberal argument of the perverse effects of social policy as hampering economic growth, impeding flexible adjustment, blocking technological innovation, undermining the work ethic, eroding the spirit of entrepreneurship, and crowding out private investment as a result of high taxes and excessive labour costs. To be sure, not every social policy intervention contributes to social cohesion and economic performance. The effect of social policy on social and economic performance is contingent. Classic policy deficiencies are poverty traps, inactivity pathologies, insider privileges, faltering demand for low-skill jobs in sheltered services, lack of supply in jobs for women and underdeveloped professional care provisions for two-earner households. It is, therefore, a permanent challenge for European policy-makers to achieve new, mutually reinforcing synergies between social policy and economic performance (Kaufman, 2001).

### **EMU effects on public finances**

With the introduction of EMU, the conduct of monetary policy is centralised at EU level and is thus no longer available as a policy instrument at national level. Budgetary policy will thus be the main macroeconomic policy instrument still available for individual nation states to combat recessions, especially when shocks are country-specific. This institutional division of labour suggests straightforward policy mandates for dealing with symmetric and asymmetric shocks:

Europeanised monetary policy should be deployed in response to symmetric shocks, while national fiscal policy should be used in response to asymmetric shocks. National budgetary policy should, in the first place, perform a shock-absorbing function at national level. Secondly, it should allow for the establishment of an optimal budgetary stance at EMU level.

Over the past 25 years, public finances in European countries have seriously deteriorated. The 'political economy' interpretation of the convergence criteria is that Member States, having become increasingly aware of the unsustainable nature of their public finances, have decided to tie their own hands *vis-à-vis* domestic public opinion. The unsustainable nature of public finances (most clearly depicted by a constant increase of public debt in most European countries) has become especially apparent for three reasons:

- changes in the demographic composition of national populations (a shift to a higher proportion of elderly people) will cause a sharp increase in spending on social arrangements;
- tax competition, due mostly to negative integration (abolishment of capital controls and tariff barriers), will decrease the ability of national governments to influence the revenue side; and
- the loss of the exchange rate instrument in EMU will increase the importance of fiscal policy for stabilisation purposes. High (and growing) debt ratios tend to increase interest rates by a risk premium and monetary policy is overburdened, both of which have a negative effect on the investment and business climate.

From the EMU perspective, budgetary discipline is mainly needed to relieve pressure from European monetary policy to maintain price stability. Excessive public financing in one or more Member States would make it extremely difficult for the ECB to control price stability. The deficit rule of 3% forces national governments to contain their budgets within acceptable limits. Furthermore, the debt rule is concerned with the threat of financial instability and inflationary pressures linked to unsustainable shocks of debt. In order to maintain budgetary discipline, the European Council decided on a Stability and Growth Pact, which contains rules on exceptional circumstances in which countries can deviate from the criteria and sanctions for EMU Members with a persistent excessive deficit.

Thus far, neither EMU nor the single European market seem to have had particularly adverse consequences for welfare states in terms of social expenditure, which on average has gone up since the early 1990s (Ferrera *et al*, 2000). With respect to the dimension of social partnership, EMU and the Stability and Growth Pact seem to have had a positive effect on the resurgence of the social pact between national governments and their social partners, allowing for various market and social policy reforms which encourage welfare sustainability.

In the literature, however, there are two arguments on the impact of EMU on the European Social Model. One is an optimistic view and the other, a pessimistic one.

**Optimistic view: 'EMU is good for the European Social Model'**

Many advocates of EMU — mostly economists judging a hard currency regime from the perspective of Pareto efficiency, defined without any reference to distributive consequences — argue that the monetary and fiscal rules in EMU are likely to have favourable effects on growth and employment, essentially through two mechanisms:

- a stable macroeconomic framework will result in lower and less variable interest rates, with positive effects on investment and consumption; and
- a credible environment of price stability will affect the strategic behaviour of the labour market parties, giving rise to employment-friendly, decentralised wage bargaining.

The benefits of budgetary discipline, reinforced by the Stability and Growth Pact, allow for a 'crowding in' of private investment, which will put the economy onto a higher growth path. By reducing the scarcity of capital, this will be reflected in permanently low real interest rates.

The Single Market Programme (SMP) has already fostered conditions for quicker reaction through prices by making markets more competitive. EMU basically further improves the functioning of the Single Market with the effect of intensified adjustment through prices and a reduction of adjustment costs of transitory asymmetric shocks.

In conjunction, the indirect effects on wage bargaining are likely to foster low and stable inflationary expectations, while the direct constraints on budgetary policy, triggering low budget deficits and public debts, serve to maintain stable prices. Moreover, lower deficit and debt levels create more room for manoeuvre to cope with adverse economic shocks. With the passing of time, as the euro gains important weight as a lead currency in the world economy, European monetary integration will encourage low interest rates worldwide. They will also reduce the likelihood of the economic costs of a market test of the anti-inflationary credibility of the ECB. Increasing public savings schemes are important to face the budgetary consequences of anticipated demographic developments. The aging of the population and the rise of dependency ratios will inevitably put a heavy burden on social spending, which will only be partly compensated for by the likely spreading of private pension schemes. Fiscal discipline, by curbing public debt ratios and hence reducing the interest burden on public debt, will allow the restructuring of government spending by devoting a higher share of public money to political and economic priorities, such as education and infrastructure investment.

#### **Pessimistic view: 'EMU may harm the European Social Model'**

A more worrisome note is struck by academic observers and political commentators, who (implicitly) reason from a Rawlsian position that the redistributive effects of policy change are only acceptable if they serve to raise the position of the worst-off group in society. There is a concern that EMU operates as a 'Trojan horse' for a neo-liberal policy shift across Europe, undermining the normative and cognitive assumptions of the European Social Model, while constraining the scope for national differentiation in social and economic policy solutions to cater for regime-specific problems and vulnerabilities (Blanchard, 1998; McNamara, 1998). Leading economists, like Jean-Paul Fitoussi and Olivier Blanchard, and political scientists, like Fritz W. Scharpf, have issued fair warnings against the negative side-effects of EMU for employment and social security (Blanchard, 1998; Scharpf, 1999). Some go so far as to argue that the macroeconomic policy priority of 'stable prices' could even frustrate the Pareto-efficient growth potential in Euroland. In the worst case, others argue that the restrictive EMU monetary regime might trigger a vicious cycle of deflationary 'beggar-thy-neighbor' strategies of internal devaluation through competitive wage moderation. They contend that the macroeconomic policy regime built into EMU (especially as it is interpreted by the ECB) is highly restrictive and as a result keeps the growth potential in Euroland as a whole too low to allow for a significant reduction of unemployment.

With the completion of full monetary integration in the EU, it is also feared that tax competition would become more severe, leading to an underprovision of public goods, reducing the returns to immobile factors and increasing tax pressures on such factors (Ganghof, 2000; Genschel, 2001). In order to attract and preserve business and capital, some countries may feel pressed to provide advantageous taxation and/or regulation for internationally mobile companies. Other countries will follow suit, ultimately causing a lower level of taxation and regulation than was previously found appropriate. Such developments would jeopardise the current mechanisms of redistribution and solidarity in national systems of social protection.

At a more abstract theoretical level, Scharpf observes a clear 'asymmetry' between market-making 'negative integration' (with SMP and EMU as the key watersheds) and market-correcting 'positive integration'. The predominance of the legal instruments of negative integration, he argues, prevents governments from interfering with the free movement of goods, services, capital and persons, while the procedures of EU political decision-making impede advancements in the direction of positive integration at the level of the Union. This, he argues, is particularly true for policy initiatives pertaining to the welfare state. In the European Social Model, markets are not only corrected by formal welfare policy, but also by direct State control of the production and distribution of politically salient goods and services (Heretier and Schmidt, 2000). These public interest services have, until the 1980s, been provided for by State monopolies. In fulfilling their public utility functions, these monopolies were important employers, providing large numbers of 'good' jobs that were protected from market pressures, and could thus be considered part of the 'informal welfare state' (Schwartz, 2000). Public monopolies came under attack in the 1980s for their poor performance in productive efficiency and consumer friendliness.

In the face of inherent institutional impediments to European-level policy co-ordination, therefore, Scharpf concludes, domestic policy-makers are likely to engage in a 'race to the bottom' of 'social dumping', whereby social security benefits, social services and the tax burden are progressively lowered to a 'lowest common denominator'.

# Changing ideas on public sector management

In the wake of the recessions of the 1970s and early '80s, the benign assumptions of public goods provision were challenged. The policy debate shifted from an analysis of market failures to government failure, especially with respect to the management of state monopolies. Poor performance, inefficiency, unfriendliness to the consumer and a perceived lack of service innovation led many policy-makers to follow the American example of privatising and deregulating their public services and instituting public sector reform. The UK was first into the field. With the adoption of the Single Market Programme in 1986, the movement towards the liberalisation of public services, the privatisation of public utilities and the adoption of New Public Management (NPM) techniques and practices became more widespread.

## The endogenous challenge

There are many volumes on the subject of public sector reform, with extensive and comprehensive case descriptions of country-specific developments in civil service systems and treatments of the political context, public opinion, domestic reform experiences, effects of privatisation and deregulation, and impacts of managerial trends sweeping across affluent societies around the globe. Most strikingly, the majority of research on public sector reform lacks a serious assessment of the effects on the reform process of the direct external constraints, such as economic internationalisation and EMU. The focus is almost exclusively on endogenous challenges and ideational factors like NPM (see, for example, Hood, 1996; Kickert, 1997; Lane, 1997). Toonen (2001) is an exception to this since he does take external constraints into account.

One of the reasons for not taking international constraints sufficiently into account in the study of public administration is that public administration studies are often content to describe, and not explain, patterns of policy change. Lane (1997) attributes the wave of public sector reform to the search for more efficiency due to the drastic expansion of the public sector since 1945 and more recent concerns about democratic legitimacy and corruption. According to Massey (1997a), the emergence of 'global megatrends' in public administration, centered around the principles of NPM, is mainly responsible for the massive wave of reforms in the 1980s and '90s. Rockman (1998) argues that changes in the role of the State, reshaped primarily by increasing deficits and debts as a result of an overburdened welfare state, have been the main impetus for public sector reform. Others argue that the rise of neo-liberal governments, combined with powerful leadership (notably Thatcher and Reagan), has been a key factor in the stimulation of public sector reform. The radical changes undergone by the public sector in the UK during the 1980s and '90s, for example, are mostly explained by emphasizing the ideological stance of the Conservative government of the time. Margaret Thatcher, who was Prime Minister for a large part of that period, is generally considered to be a strong believer in a small government and the efficiency of the private sector. More recently, the need for responsiveness and citizen participation in public policy is presented by Pierre (1998) as a key driving force behind public sector reform. The aim for more efficiency and savings, together with the need for an improvement in the quality of public services, seems to be the main explanatory factor according to Pollitt and Bouckaert (2000).

The factors that have been most influential, according to the majority of authors, can be summarised in the following four endogenous factors:

- the economic consequences of drastic increases in the size of and expenditures in the public sector (and the welfare state);
- fashionable ideas like NPM and 'Reinventing Government';
- the political factor of the emergence of many neo-liberal governments throughout affluent societies in the 1980s; and
- cultural factors of the felt need for higher quality servicing, citizen participation, better public accountability, transparency and citizen responsiveness of the civil service.

Although these endogenous influences have undoubtedly been strong and genuine, the international context is absent in most, if not all, accounts of public sector reform made by scholars in the discipline of public administration. Moreover, none of these publications explores the impact and timing of the processes of economic internationalisation and European economic integration on the evolution of public services. Pollitt and Bouckaert (2000) offer the most integrated contribution. In their comparative study, they have created room for 'global economic forces' and 'socio-demographic change' in an analytical framework that enables genuine comparative analysis and takes into account external factors and developments. They compare the reform trajectories of 10 countries and assess key factors influencing the scope, speed and depth of public sector 'transformations'.

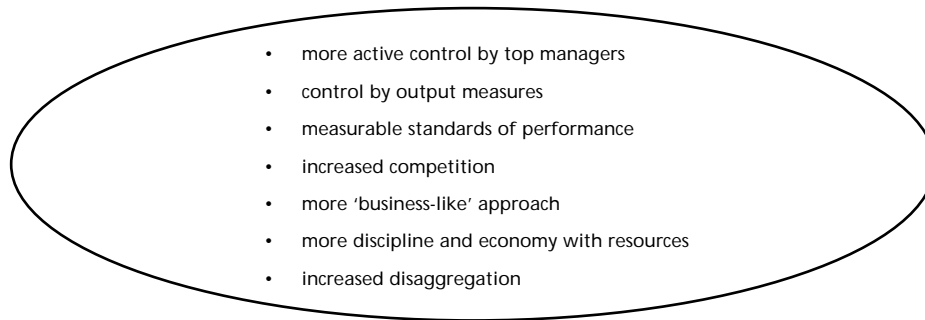
### **The principles of New Public Management**

In most of the accounts described above, New Public Management (NPM) plays an important and central role. To summarise the most salient features and status of this doctrine, the model of NPM aims to change the relationship between politics and administration from a situation of loyalty and hierarchy into a system of partnership and transaction. Generally, NPM is associated with a more 'business-like' approach to organisations and processes in the public sector.

There are various descriptions of NPM, but most writers identify a set of dimensions (see *Figure 1*) that include the following for public sector organisations (Hood, 1996):

- *more active control* by visible top managers wielding discretionary power;
- *explicit and measurable* (or at least verifiable) *standards of performance* in terms of the range, level and content of services to be provided;
- *control by output measures*, particularly pay-based, on job performance rather than on rank or educational attainment;
- *more disaggregation* into separate, self-contained units rather than operating as a single aggregated unit;
- *increased competition* between such organisations and with private organisations for the pursuit of particular tasks, rather than having semi-permanent 'ascribed' roles;
- *more business-like approach* to conducting business or using management practices that are broadly similar to those employed in the private corporate sector; and
- *more emphasis on discipline and economy* in the use of resources by public sector management.

**Figure 1 Ideas of NPM**



Originally, the NPM/'Reinventing Government' approach was associated with ideological notions of 'rolling back the state'. However, this notion has eroded in the last decade. A business-like approach to government these days does not necessarily lead to a preference for markets over governments or private goods over public goods. It might lead to a preference of government regulation and oversight over government production and provision. The question of what a government ought to do may logically be divorced from the question of how government manages the affairs it has decided to do.

What has globally been launched as an attack on 'big government' has evolved into the trademark of 'third way politicians'. This approach combines a Social Democratic outlook at the functions of government with a largely monetarist and managerial philosophy on how government ought to conduct its affairs. The process involves the replacing of ideological stands on the need for privatisation, deregulation and marketisation with an attitude of trying to break up bureaucratic monopolies and intelligently use competition to enhance the responsiveness of public service delivery.





# The changing scope of the public sector

A number of fundamental approaches are presented here in order to define the changing scope of the public sector. Scholars of public administration use a variety of terms for their subject, such as public sector, core public sector, extended public sector, public services, production of public services and government services. Each of the approaches ends with a severe warning on the possibility of defining the scope, one of the reasons being that efforts to define the public sector are in essence an exercise in a definition of the State. Therefore, we have opted for a more pragmatic approach, combining a sectoral perspective with a perspective of changes in organisational regimes. The outcome is a public sector matrix, which allows us to chart clusters of reform in the scope of the public sector.

## Fundamental approaches

One way of approaching the public sector is to try and establish *the demarcation* between it and the private sector. At least six questions can be asked according to Lane (2000) in order to approximate this demarcation:

1. What is the proper place of governmental authority in society? Or how much private autonomy are we to recommend? (The problem of individual freedom).
2. What proportion of the total resources of society should be left to government choice as public consumption and investment? And how much should be turned over to private choice? (The allocation problem).
3. How large should the governmental budget be? Or how much private income should be generated without governmental influence in the form of transfers? (The distribution problem).
4. How much of the goods and services provided by government should also be produced by government? (The production problem).
5. How much of the means of the production should be owned by government? (The ownership problem).
6. How much of the workforce should be employed in governmental organisations? (The problem of bureaucracy).

Stressing the allocation, production and distribution of public/collective goods is, according to Lane, a fundamental characteristic of the public finance approach. The distinction between the public and private sector is based mainly on economic criteria. However, a crucial element has been left out in this approach. How are collective decisions arrived at in the public sector? What is the logic of interest representation in the public sector? These questions are addressed in the institutional approach. Here political criteria are applied to define the demarcation of the public and private sector, stressing the importance of the process of interest representation and the role of institutions.

Lane (2000) thus defines the public sector as 'a set of institutions that co-ordinate the interests of different groups that ask in various ways for public activities of different kinds'. This is a very broad definition. Crucial features in this definition are institutions and co-ordination. Lane continues his analysis by developing a distinction between the private and public sector: whereas in the private

sector market institutions offer mechanisms for co-ordinating interests, public institutions co-ordinate interests by the making and implementation of policy. However, according to Lane, 'there is no single way to make the private-public distinction', 'there is no . . . synthesis in sight' and the 'continuation of various sharply competing approaches to the interpretation of the public sector seems inevitable'.

Another way of approaching the public sector is to try and define its *core activities*. Massey (1997b) states that the way core activities are selected and defined in the private sector can also be applied to a large extent in the public sector. He lists a total of four criteria, of which the first three are according to him also relevant for government services:

1. Activities traditionally performed internally within an organisation with long-standing precedent.
2. Activities critical to the performance of an organisation.
3. Activities that will drive the future growth, innovation and rejuvenation of an organisation.
4. Activities creating current or potential competitive advantage for an organisation.

However, Massey runs into the same problems as Lane. He stresses that 'there is no universally acceptable definition of what constitutes the core activities of the state, or even of government services'. Any definition must be placed within its paradigmatic context and that 'makes it fair game for those who are themselves located within a different set of values and beliefs'. He goes on to describe the inalienable core role of the state and government services, in the following rather abstract terms: 'to protect the citizenry from feral depredations of those who would prey upon society'.

One way of defining the core is the distinction made in the literature between public services and public services production. Two opposing definitions are given, for example, by Bach and by Olson. Bach (1999) defines the public services as employment in public administration and in publicly funded and managed services (i.e. the core public services, excluding public enterprises and public utilities). The defining element is employment, limited to the provision of services (as opposed to production). Olson (1996) defines the public sector as an overarching term, encompassing national and local government, different services provided by the public, as well as public utilities and companies. In this definition, (parts of) public services production are included.

Dunleavy (1994) defines the public services as the collective consumption provisions organised and subsidised by government. At the same time, however, he develops a distinction between public services and public services production: between the policy decisions about what is to be provided or what tasks should be undertaken, and the direct organisation of service provisions to take place or of tasks to be implemented. In this way, the core of a government's role can be limited to a 'kind of purchaser-in-chief', with the private sector providing public sector production. However, Dunleavy personally deplores such a limited role for the government since, in his view, it is synonymous with the withering away of the State.

Yet another way of approaching the public sector is to study *its development over time in different countries*. The public sector has been defined differently in the various countries of the EU

depending on the development of European State traditions over a long period of time. One of the following views, or a combination, could be the dominant view in a particular country:

- *the functional view*, in which the public sector includes those bodies with State authority or public service tasks;
- *the legalist/institutional view*, in which only those bodies that are explicitly listed in the relevant law or laws have a public sector character; and/or
- *the financial view*, in which the public sector includes all bodies mainly financed by public funds (i.e. not operating under the normal rules of the market).

One could delve deeply into the historical processes behind these views. However, in more recent history, the scope of the public sector has also been a dynamic entity. In the 1960s and '70s, Toonen and Raadschelders (1999) point to the creation, in the wake of the emergence and subsequent development of the welfare state, of a 'service-delivery state for which no historical precedent existed'. There was no limit to public spending until the end of the 1960s. The scope of the public sector had grown well beyond its traditional borders, increasingly taking on tasks carried out formally by, for example, the social partners, independent non-profit organisations and the private sector. Expansion of the government turned many government functions into specialised organisations.

Developments in the 1980s and '90s can be understood partly as offloading overstressed government functions by doing away with, decentralising or outsourcing the production of public services. However, this led to a diffusion between the public and private sectors, with intricate relations forming between public, semi-private and private organisations on the co-production of collective services.

In the present decade, there is a renewed interest in defining the scope of the public sector more precisely. Toonen and Raadschelders (1999) identify a resurgence of the 'importance of the craft of government', 'strong government is not confused anymore with big government' and 'a longing for the predictable and reliable bureaucracy'. There are signs of a retreat from privatisation or at least a more open discussion on its advantages and disadvantages. Again, however, as with the other approaches trying to establish the scope of the public sector, there is a warning: Toonen and Raadschelders state 'one cannot be but overwhelmed with the bewildering convergence as well as variety' in public sector developments between countries.

### **Practical approaches**

None of the approaches mentioned so far bring us much closer to defining the scope of the public sector or changes in it. We have thus adopted a more pragmatic approach, which must firstly be able to reflect the effects of European integration and of EMU on the public sector. Examples of these effects are (Toonen and Raadschelders, 1999):

- many governments would not have started on the road to public sector reform if the externalised pressure of European integration (SMP 1992 and EMU) had not posed clear constraints on *internal consensus-seeking processes*, while often 'Europe' is used as a scapegoat to legitimise and overcome resistance to reform in the public sector; and

- the development of a competitive European market has enabled, and perhaps encouraged, the privatisation of telecommunications, postal services and transport; integration has created a European market for former national 'natural' monopolies.

Secondly, in our pragmatic approach we must be able to identify areas or subjects for further research.

Three candidates for such a pragmatic approach stand out, namely:

- Sectoral approach
- Reform of organisational regimes
- Special status of employees

### 1. Sectoral approach

The sectors described in the literature include:

- public administration: territorial government (at national, regional and local level) or functional government (ministries, armed services, police, legal system);
- education: primary/secondary/tertiary, universities, research institutes;
- health: hospitals, care;
- public utilities: energy, water, waste disposal, etc;
- transport: railways, regional/local transport (such as bus or metro), airports, docks;
- communications: telecommunications, postal services.

Another classification used is:

- social sector: care, welfare;
- infrastructure: telecommunications, transport;
- production of services: government territorial/functional;
- utilities: energy, water.

In the *International Standard Industrial Classification* of both the United Nations (United Nations, 1990) and the European Union (Eurostat, 1996), the public sector is to a large extent defined as part of the service sector. In a further refinement, Elfring (1989) has divided the service sector into 4 sub-sectors, as follows:

- producer services: intermediate inputs to further production (such as insurance and finance);
- distributive services: moving of commodities, information and people (such as retail and transport);
- personal services: final consumption to households with a direct contact between the consumer and the service provider (such as domestic services and recreation); and

- social (and collective) services: final consumption for households with a non-market character, including 'government proper', health services, educational services and other miscellaneous social services.

These sub-sectors are used by the OECD in its analysis of recent developments in employment in the service sector (OECD, 2000b).

One step further is the introduction of the concept developed by the European Commission (2000b) in its *Communication Services of General Interest in Europe*. The term 'services of general interest' covers 'market and non-market services which the public authorities class as being of general interest and subject to specific public service obligations'. The market services refer to sectors such as transport, energy and communications.

One can decide which sectors are included and which are excluded.

## 2. Reform of organisational regimes

Three main streams of reform can be identified within the public sector. Firstly, there are reforms described in terms of *decentralisation of public administration* within functional levels of government. This involves public administration led by elected political authorities who are accountable to the electorate.

In many countries, the public sector is divided into at least two territorial levels of government — a central, national level (national government and its departments) and a decentral, regional level (federal or county government) and/or local level (municipal government). The actual division of tasks and responsibilities between these levels varies greatly between countries. While some tasks, such as defence, are the responsibility of the central government in all countries, responsibility for other tasks rests with regional or local government. In some cases, responsibility is shared between levels of governments; for example, financial responsibility is shared with central government and operational responsibility with regional government (EPSU, 1999). In some countries, sectors such as health, education and transport are part of one or more territorial levels of government, while in other countries they constitute a separate sector or they are partly in the public sector and partly in the private sector.

Secondly, there are reforms described in terms of *devolved autonomy* within the public sector or with public partners. The key here is the separation of policy-making and execution, or the separation of regulatory functions and delivery (production) functions and other ways of creating more autonomy for organisational entities. This involves administration through appointed officials, accountable to higher elected authorities who have defined the objectives, as well as the technical and financial competencies, of the service. It concerns in the main organisational regimes such as independent agencies, but also public enterprises can be included.

Thirdly, there are reforms described in terms of *privatisation*. Lane (2000) makes a useful distinction between internal and external privatisation. *Internal privatisation* is the application of market-type decision-making mechanisms within the public sector. The main purpose is the introduction of an internal market within parts of the public sector. The strategy may be aimed at removing a monopoly of a supplier of certain services or at increasing responsiveness of suppliers

to clients by giving them the opportunity to choose between service options (which also puts pressure on the price of those services). The introduced market elements include the following, among others (Bekke *et al*, 1996; EPSU, 1999; Lane, 1997; Massey, 1997b):

- contracting out: a system whereby private companies can bid against each other for the delivering of a certain service;
- consumer tagged financing (or even the use of vouchers), linking budgets to clients (customers) instead of assigning budgets directly to providing organisations;
- product market liberalisation and deregulation, especially in sectors supported by substantial public subsidies;
- purchaser/provider relations within government, with the purchasing role remaining a specific public sector function, while the providing function can turn into an area of competition.

*External privatisation* is the selling-off of parts of the public sector to the private sector. Former parts of the public sector or former public companies would then operate under market conditions and be subject to private and commercial laws.

One can decide which organisational regimes are included and which are excluded.

### 3. Special status of employees

In this approach, the public sector is defined in terms of its personnel — its core values and the consequent special status of its employees. Values such as independence, hierarchy and loyalty are originally connected with and attributed to the traditional activities of public administration (internal order, defence, justice and taxation). The idea of the State being the representative of the general interest was not only applied in the relationship between the State and its citizens, but also between the State and its employees. This has led to a distinction in employment relations between the public and private sectors, with a special employment status attached to employees in the public sector as public servants or employees under a public service 'statute'.

However, in many countries, public sector tasks are carried out by personnel without a public service status, rendering this third approach less useful than the other two approaches of sector and organisational regime.

### Public sector matrix

In order to describe the scope of the public sector, the sectoral and organisational regime approaches have been juxtaposed in a matrix (*see Table 1*). The sectors are represented on the vertical axis of the matrix, with the organisational regimes on the horizontal axis. In this way, one can decide which of the organisational regimes or sectors are to be excluded or included in the scope of the public sector, apart from 'classical public administration'. In other words, one may propose to include not only organisations operating directly as part of or within a budget from the government/State, but also operating, for example, according to:

- a mission as defined by the government/State;
- targets or service levels as defined by the government/State.

A similar approach is adopted by the European Commission (2000b) in its *Communication Services of General Interest in Europe*. In defining the term 'services of general interest', the crucial issue is not the actual body providing the service or the legal status of those providing it in terms of ownership, but rather the definition by public authorities at the appropriate national, regional or local level of the mission for services of general interest and the way they may be fulfilled. The EC considers services of general interest as a key element is the European Social Model, playing an important role in promoting social and territorial cohesion. When market forces alone do not result in a satisfactory provision of services (in terms of quality and price, responding to the needs of users and citizens generally), public authorities may trust certain operators of services with obligations of general interest and, where necessary, grant them special or exclusive rights and/or devise a funding mechanism for their provision.

Villeneuve (1997) draws attention to the regional and local dimension of services of general interest. The regional and local roots of operators of services of general interest are inseparable from their mission as defined by public authorities. It is the duty of the providers of the services to participate and contribute 'to fostering economic and social development in the region where they hold the concession'.

**Table 1 Matrix — Scope of public sector**

ORGANISATIONAL REGIME	Central public administration	Decentralised public administration	Devolved autonomy	Market-type decision-making mechanisms	Privatised (external)
	National government	Regional/local government	Within public sector	Within public sector	Outside public sector
<b>SECTOR</b>					
<b>Functional/ territorial government</b> Core functions Other functions					
<b>Education/science</b> Primary/secondary/ tertiary/higher Research					
<b>Health/care/ social services</b> Hospitals Care					
<b>Public utilities</b> Energy Water Waste disposal					
<b>Transport</b> Railways Airports Bus/metro					
<b>Communications</b> Telecommunications Postal services					



The scope of the public sector, as presented in the matrix in Table 1, is not a static entity in terms of sectors and organisational regimes. Indeed, there is potential for changes in both the vertical and horizontal axes:

- on the vertical axis, an important phenomenon is the blurring of boundaries between public and private sectors, especially under the impact of new technologies. The situation may change completely, for example, with the introduction of new technologies in the communications sector, as with the development of new energy sources or environmentally friendly waste disposal techniques. Similarly, new technologies may transform a particular branch of manufacturing or services.
- on the horizontal axis, there are experiments with new organisational regimes, for example, the development of public/private partnerships with a view to co-producing collective services. Often these experiments combine elements of the organisational regimes identified in the matrix, such as those between devolved autonomy and privatisation (agencies combined with private partners) in the case of public/private partnerships.

However, by and large, it is possible to identify 4 clusters of reform and to align them in a diagonal line from the top left of the matrix to the bottom right (see Table 2). These clusters of reform concern:

- Changes in organisational regimes within functional and territorial government. Tasks are being decentralised from central government departments to regional/local government or devolved to independent agencies.
- Within the sectors education/science and health/care/social services, most of the reform is best described by the terms decentralisation and devolved autonomy, although there may occasionally be some elements of (internal) privatisation.
- Within the sectors public utilities and transport, reform is best described in terms of devolved autonomy and market-type decision-making mechanisms. This can be seen in many European countries in the areas of energy, waste disposal, railways and local transport.
- Within the communications sector, telecommunications and postal services are either privatised or in the process of being privatised in many EU countries.

Table 2 Clusters of reform in the public sector

ORGANISATIONAL REGIME	Central public administration  National government	Decentralised public administration  Regional/local government	Devolved autonomy  Within public sector	Market-type decision-making mechanisms  Within public sector	Privatised (external)  Outside public sector
<b>SECTOR</b> <b>Functional/territorial government</b> Core functions Other functions	CLUSTER 1				
<b>Education/science</b> Primary/secondary/tertiary/higher Research		CLUSTER 2			
<b>Health/care/social services</b> Hospitals Care					
<b>Public utilities</b> Energy Water Waste disposal			CLUSTER 3		
<b>Transport</b> Railways Airports Bus/metro					
<b>Communications</b> Telecommunications Postal services					CLUSTER 4

An important warning is that aligning the 4 clusters of reform in a diagonal line does not suggest an arrow from the top left to bottom right of the matrix as a natural progression towards privatisation or that the last word has been said about costs and benefits of organisational regimes. Not only do trajectories of reform differ greatly from country to country (see Chapter 7), but there may also be arrows pointing to the left of the matrix, not just to the right.

Naschold (1996) has tried to group EU countries according to their regulatory regime (defined rather loosely as a particular interaction between economic, governmental and social mechanisms) in the process of restructuring the public sector. Andersen *et al* (1997), however, offer a critique of this grouping, but since it is not clear in their view why certain countries are grouped together, it is an arbitrary exercise. Nevertheless, there is a country dimension in the reforms.

In some EU countries in all sectors, reforms have been restricted largely to changes in the relationship between central government and regional/local government, with devolved autonomy or internal privatisation being largely absent. Other countries have been more active in the field of devolved autonomy and internal privatisation, while others have pursued external privatisation more rigorously. Again, in some countries, reforms are still in their infancy or in an experimental phase, awaiting the outcome of political decisions. An organisational regime in a country may be determined by opposing political forces. For example, a political decision by government to

privatise a sector, or part of it, may have been halted by parliament or because of changes in the opinions of the electorate or because of disappointing results. Consequently, such a sector may be characterised partly by elements of public administration and devolved autonomy or market-type decision-making mechanisms. This illustrates the point that in some sectors, two or even more (elements of) organisational regimes can be in place, often as a result of a political compromise between private (arrow to the right) and public (arrow to the left) sectors.

### **Future research**

The pragmatic approach developed here allows us to define the scope of the public sector for the purpose of further research. It would include the organisational regimes of national and decentralised public administration and devolved autonomy. In terms of sector, we would include functional and territorial government, education/science and health/care/social services, as these follow the official definitions of the UN, EC and OECD of the social services. It would exclude privatised and State-owned enterprises operating under market conditions and subject to private and commercial laws. External privatisation, however, would be included. In terms of sector, this in effect means excluding the communications sector. Future research would be valuable into all public services provided by organisational regimes with market mechanisms (internal privatisation) and, in terms of sector, public utilities and transport.

# Raising government revenue under EMU constraints

The following two chapters of this research project examine EMU and quantitative indicators on fiscal, public employment, social security and budgetary policies. Central to the debate about the effect of EMU on public sector reform is the extent to which reforms in the welfare state and public sector are triggered by the difficulties of raising revenue through taxes by national governments as a consequence of tax competition and increased tax migration across national boundaries.

EMU has created additional constraints on the public sector, more specifically on public expenditure. For example, the ability to use deficit spending is highly decreased by the EMU convergence criterion of 3% for the national budget deficit. Decreasing public spending by cutting into social arrangements (in most countries, one of the larger expenditure sectors) has also proved to be a difficult task, due to both the political unpopularity of such decisions and the 'path-dependency' effects caused by spending commitments made in the past. Furthermore, raising taxes to increase State revenue is, according to some authors (OECD, 1998; Scharpf, 1997a; Steinmo, 1994), virtually impossible due to the opened borders, allowing for the free movement of goods, services, people and capital in Europe. These authors argue that the open borders create an opportunity for immobile tax bases to be moved freely to favourable tax areas. In order to keep attracting business, countries will engage in a 'race to the bottom' with respect to taxation. Tax competition arises as soon as economic and financial openness make it possible for tax bases to migrate across jurisdictional boundaries (Genschel, 2001).

Before the 1980s, macroeconomic policy (including monetary, fiscal and taxation) was exclusively a domestic affair. Tariff barriers restricted international trade and capital controls restricted international capital movements. National governments were free to tax corporate profits, personal income and the consumption of goods and services at appropriate, and politically feasible, rates. In the 1980s, however, trade barriers and capital controls were removed, which made it easier for mobile tax bases to avoid high tax areas. Following the logic of tax competition, economic integration would result in two significant adjustments in national tax systems:

- a decline in the level of total taxation because the exit threat of mobile tax bases makes high taxes unsustainable (Steinmo, 1996; Tanzi, 1998);
- a change in the composition of tax revenues because governments are forced to shift the tax burden from mobile taxes, most importantly capital, to immobile bases, such as labour, consumption and real estate (Schulze and Ursprung, 1999; Steinmo, 1996).

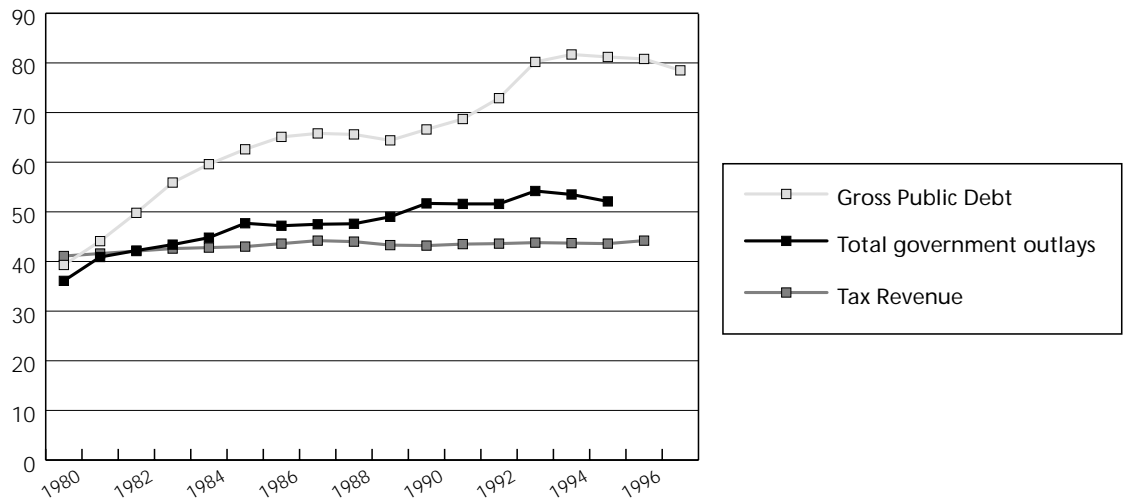
The empirical evidence, analysed by Genschel (2001), however, suggests that tax competition has so far been limited. As Figure 2 shows, there has been no decrease in total taxation. On the contrary, there has been an increase.

There is also no clear indication of a shift from taxing mobile to immobile sources. Figure 3 shows that, while property and consumption taxes have in fact gone down, corporate taxes have gone up. In short, there is no evidence for the conventional logic of tax competition.

Nevertheless, Genschel (2001) argues that the conclusion of certain authors that there is no significant pressure on taxation (Garrett, 1995, 1998a; Quinn, 1997; Swank, 1998) also remains

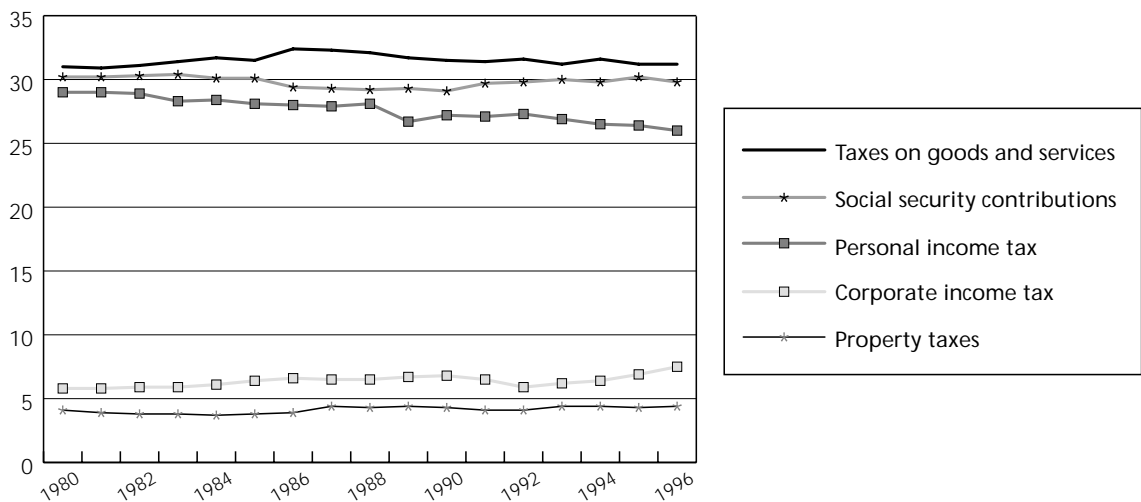
misguided. Surely, in the absence of tax competition and in the face of increasing unemployment, rising poverty, expanding pensions and health care costs would have most likely led to further increases in taxation. Instead, during the recession-prone 1980s, most developed welfare states turned towards deficit spending to relieve new social problems and mitigate social conflict. If countries were not affected by tax competition, there would no effective reason to use large deficits instead of increased taxation to finance increases in spending commitments.

**Figure 2 Total tax revenues, total government outlays and gross public debt as a share of GDP (EU15\*)**



\* Tax revenue statistics exclude Portugal, Spain, Luxembourg, Ireland and Greece.  
 Sources: Taxes: OECD Revenue Statistics, various years; GDP: OECD, 1997: Statistical Compendium (National Accounts); OECD, 1993: National Accounts; Total Government Outlay: OECD, Historical Statistics, various issues; calculations by MPIFG.

**Figure 3 Tax ratios, 1980 - 1995 (EU15)**



Source: Genschel (2001); OECD Revenue Statistics.

Figures 2 and 3 show that total tax revenues as well as tax ratios appear to be more or less 'frozen' since the early 1980s. This observation suggests that some kind of international downward pressure on taxation has indeed been operative. However, this apparently does not seem to have pushed national governments into a 'race to the bottom' downward spiral.

In order to understand the relatively benign effects of tax competition, we must establish a linkage between the economic logic of downward pressures on taxation and the political logic of outstanding social policy commitments. Genschel (2001) correctly emphasizes that governmental demand for tax revenue is not merely a function of the opportunity costs of taxation. The problem with the first assumption is that governments lack flexibility on the expenditure side because they are tied to prior spending commitments, which they cannot roll back without large political (electoral) costs. Social policy commitments, especially in the areas of pensions and health care, are a defining feature of developed welfare states. By themselves, they generate budgetary pressure and thereby put a pronounced constraint on domestic policy space to relieve additional social needs (Pierson, 2001c). Since governments must meet previously made financial commitments, this also constrains their flexibility to pursue tax competition. Governments are thus unable to respond to tax base erosion by cutting taxes. Sometimes, they are even politically forced to raise taxes in order to maintain revenue. Four factors influencing these spending commitments are:

- *Population aging*: Changes in birth rates, life expectancy and migration flows are changing the size as well as the structure of the population. The increase in the old-age dependency ratio is one of the most important trends. In the coming decades, demographic changes will affect public budgets, mainly through their effect on the demands for public services and transfers. Public health and pension systems will bear much of this pressure, since their expenditure is highly dependent on the age structure of the population.
- *Changes in household structure*: Family structures are changing rapidly. Households are becoming more fragmented. The one-breadwinner-household, which predominated in the 1950s and '60s, is progressively being eroded. The increase in the number of lone parents and, more generally, the reduction in the size of households tends to undermine the 'safety net' provided by the family, leading to an increase in the demand for welfare state services and transfer.
- *High and persistent unemployment*: Current unemployment rates in Europe are considerably higher than those in the past. Today, average unemployment in the EU is just under 10%. In addition, periods of unemployment are much longer than they used to be. High unemployment increases public expenditure on unemployment benefits and social assistance, and thus curtails tax revenues. It also tends to increase pension expenditure, since the actual retirement age falls under the pressure of demands for early retirement or disability pensions.
- *Baumol cost pressures*: As services directly provided or financed by the welfare state consist mainly of personal services whose productivity grows slowly (because they are essentially provided through labour input), their cost is bound to increase relative to the cost of other commodities. This implies that in order to satisfy a rising demand, society should allocate a rising share of national income to the welfare state.

Genschel (2001) also challenges the intuitively appealing assumption that immobile tax bases are not subject to tax base erosion. Higher taxes on labour will increase the labour costs for employers and thus decrease labour demand. Although taxes on labour are primarily borne by workers, in many cases higher tax burdens will be forwarded on to employers. Employers, in turn, will try to

shift the tax burden on to customers. In an open competitive economy, however, this will more likely lead to a decrease in labour demand. In addition, high taxes on labour generate incentives for workers to engage in the black economy. A similar argument can be applied to consumption taxes: consumers will want to buy products without paying taxes and producers will want to sell products without having to remit consumer taxes. The larger the difference between the price paid by the consumer (labour costs by the employer) and the final profit for the producer (actual wage for the worker), the more attractive the hidden economy becomes.

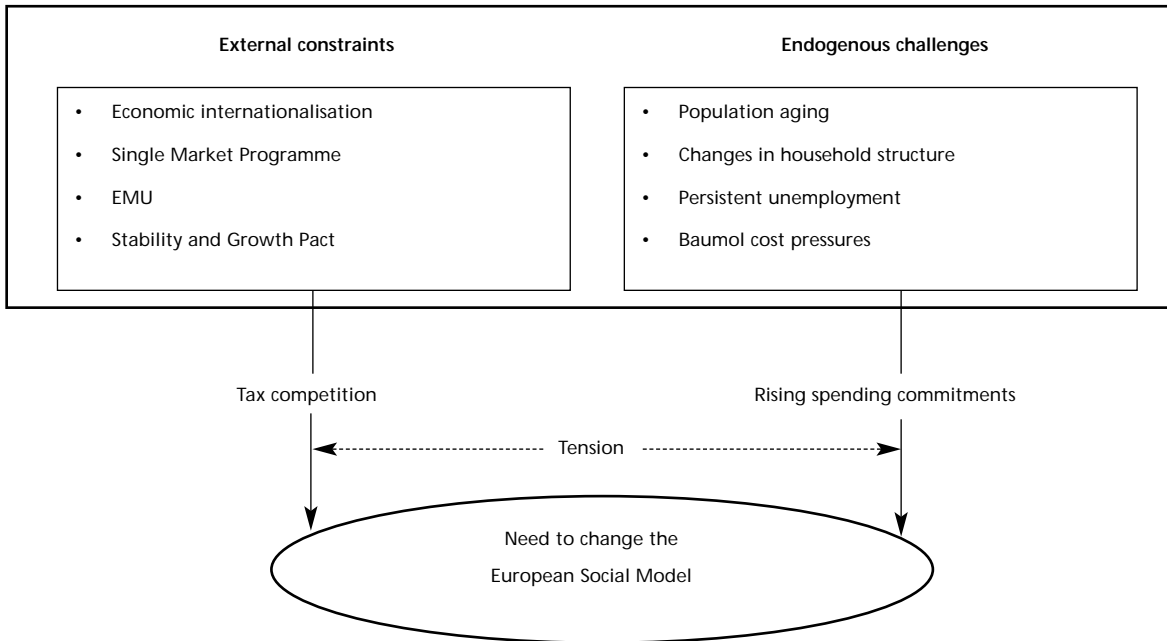
If tax competition is politically constrained by welfare state commitments, and if shifts from mobile to immobile taxation engender negative employment effects, what alternative in taxation policies are domestic governments left with? It is no surprise that tax reform has taken centre stage in processes of adjustment under the shift to a hard currency constraint since the 1980s. The general picture that emerges from a comparative analysis of tax reform (Ganghof, 2000) is that most countries embarked on strategies of cutting tax rates, on the one hand, while, on the other, broadening the tax base by, among other things, abolishing a number of tax exemptions (see *below*).

In retrospect, we can argue that the Maastricht entry exam has been highly effective in triggering a 'regime shift' in national budgetary and fiscal policy across the economies of the European Union. The scale of adjustment carried out since Maastricht has, in the majority of EU Member States, put government debt on a downward path. The scale of retrenchment was particularly important in those countries which, at the beginning of the 1990s, experienced the most serious public finance problems. The budgetary adjustments that have recently taken place in all EU Member States have involved large reductions in primary government expenditures (either outright over the whole consolidation period or, in a second phase, after initial tax increases). In a few Member States, budgetary consolidation took place via tax increases. Budgetary adjustment in the 1990s represents a clear break with past policy behaviour, especially that of the 1970s when EU countries tended to increase both expenditures and taxes.

However, many governments participating in the entry exam for EMU were caught in a squeeze between, on the one hand, pressures emerging from trade integration (especially European economic integration) and, on the other, pressures arising from prior spending commitments. So far, this tug-of-war does not seem to have had any particularly adverse consequences for welfare states in terms of levels of social expenditure, which have gone up, on average, since the early 1990s.

Caught between fiscal strain, on the one hand (but not of the 'race to the bottom' kind, which would inevitably lead to political panic) and constraints in policy flexibility to adequately address the new social risks associated with post-industrial change, on the other hand, strong supporters of the welfare state increasingly acknowledge that sustaining basic arrangements will require significant reforms. When the logic of fiscal strain meets the reality of standing commitments and new forms of social exclusion and underprivilege, the resurgence of social pacts and tax reforms (which combine rate-cutting and base-broadening) suggests an ongoing system-wide search for a new welfare policy repertoire that is economically viable, politically feasible and socially acceptable (see *Figure 4*).

Figure 4 The double bind of the European Social Model







# Statistical performance indicators and the EMU entrance exam

In Chapter 4, we argued that an increase in the level of tax revenue does not seem feasible under current international economic conditions. Countries are squeezed between EMU pressures, on the one hand, and prior domestic spending commitments, on the other. We will now examine a number of macroeconomic indicators, central to the EMU policy agenda, in order to assess the empirical viability of our hypothesis.

For our purpose, we distinguish three categories of performance indicators:

- *employment performance*, including levels of total employment, unemployment and public employment;
- *outstanding social security commitments*, in terms of levels of social security spending and total taxation; and
- *EMU entrance criteria*, concerning budget deficit, public debt and inflation.

## Employment performance

With respect to employment performance, we refer to total employment performance (*Table 3*), levels of unemployment (*Table 4*) and levels of public employment (*Table 5*).

### Total employment

While, historically, policy-makers were primarily concerned about the level of unemployment, more recently the level of employment has become recognised (and endorsed by the Lisbon European Council) as a more appropriate indicator of labour market performance. Employment performance is closely related to fluctuations in macroeconomic developments. The harsh economic conditions of both the early 1980s and the early 1990s are well reflected in these total employment figures. All the countries in our selection reveal a fall in employment ratios since the early 1980s. Also, the repercussions of the problematic situation of the early 1990s are reflected in the decline of employment. (Only the Netherlands and Ireland were able to maintain their increase in total employment that started in the second half of the 1980s.) High levels of employment are often associated with idiosyncratic economic developments; the employment crisis in Finland, for example, is closely related to the collapse of the economy of the former Soviet Union (Esping-Andersen, 1999).

Table 3 shows that, on average, total employment decreased steadily in the early 1980s, reaching a low of 63.5% in 1984. The ensuing rise in employment continued until 1990, when a high level of 66.3% was reached. After that, total employment receded until 1995, after which a steady rise set in again.

It can be seen that both Scandinavian countries, Sweden and Denmark, preside over higher total employment levels than any other country during the entire time span. However, Sweden experienced a sharp decline from a high of 81.3% in 1989 to a low of 68.9% in 1997, a difference of 12.4% in 10 years. Despite this dramatic drop in employment in recent years, Sweden remained in the group of the higher ratios of employment. Denmark also experienced a drop in total employment, but not nearly as sharp as Sweden and only until 1994, after which a steady increase took place.

Table 3 Total employment, 1980 – 1998 (%)

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1980	74.8	79.5	72.0	55.4	66.1	64.1	59.0	69.7	65.0	56.8	66.2
1981	73.3	79.0	72.3	54.1	65.1	62.9	57.6	66.9	64.1	56.1	65.1
1982	73.1	78.6	72.4	52.4	63.4	62.3	57.0	65.3	63.5	55.1	64.3
1983	73.0	78.5	72.3	51.1	61.9	61.4	55.1	64.6	65.8	54.4	63.8
1984	74.0	78.9	72.6	50.8	61.6	60.2	53.5	65.5	64.4	53.7	63.5
1985	75.6	78.7	73.0	50.9	62.0	59.6	51.8	66.0	63.8	53.4	63.5
1986	77.3	79.3	72.7	51.6	62.8	59.6	51.4	66.0	63.7	53.5	63.8
1987	77.6	79.8	72.4	52.0	63.2	59.5	51.8	67.5	65.2	53.1	64.2
1988	76.9	80.4	72.6	52.8	63.5	59.8	51.8	70.0	66.7	53.3	64.8
1989	76.1	81.3	73.8	53.5	63.9	60.3	52.0	71.8	67.9	53.0	65.4
1990	75.2	81.3	74.7	54.8	64.8	60.6	53.9	72.0	72.0	53.5	66.3
1991	74.5	79.5	70.3	55.8	66.0	60.4	53.0	69.7	70.4	53.7	65.3
1992	73.6	75.8	65.2	56.4	65.0	59.8	52.5	68.2	67.7	53.2	63.7
1993	72.3	71.3	60.1	56.5	63.8	58.8	52.4	67.8	67.0	51.7	62.2
1994	71.8	70.2	60.4	56.2	63.0	58.7	53.3	68.3	67.2	50.7	62.0
1995	72.5	70.8	61.6	57.4	62.6	59.0	55.1	68.8	66.5	50.4	62.5
1996	73.1	69.7	62.2	58.5	61.7	58.8	56.0	69.3	67.4	50.6	62.7
1997	74.6	68.9	63.4	60.3	60.7	58.8	57.5	70.2		50.6	62.8
1998	75.8	69.6	64.7	61.8	60.5	59.4	59.3	70.3		50.8	63.6

Based on total employment/population aged 15-64 years.

<sup>a</sup> Portuguese data from MPIFG adjustment database

Source: OECD (1999a)

Generally, low employment countries are Italy and Ireland. Italy floated around 53% for almost the entire period, peaking in 1991 with 53.7%, after which a sharp decline set in to the low level of 50.4% in 1995. Ireland floated around 52% for almost the entire period, but experienced dramatic employment growth from 1991 until 1998 (59.3%). The Netherlands experienced a steady increase in employment of 11% in 14 years, coming from a low of 50.8% in 1984 to a high of 61.8% in 1998. The other countries in our sample generally followed the average macroeconomic trends in rise and fall.

In general, the fluctuations more or less reflect the different European models of society. Scandinavian countries are characterised by relatively high levels of employment rates, closely followed by the Anglo-Saxon model. Ireland does not follow the gender-neutral Anglo-Saxon model because of its relatively low rates of female employment. Continental welfare states, particularly South European ones, preside over below average employment levels. An exception to this 'Southern rule' is Portugal, which experienced employment ratios permanently above average.

### Unemployment

Unemployment figures can provide additional information about the domestic and/or macroeconomic climate. As in the case of total employment levels, unemployment figures generally follow macroeconomic conditions: peaks can be distinguished both in 1984/85 and in 1994/95, while an obvious dip is seen in 1990.

Table 4 shows that unemployment did, on average, increase rapidly from 5.3% in 1980 to 9.0% in 1985. After that, there was a decrease, to 6.8% in 1990, after which the ratio increased again, to 10.8% in 1994. The following years saw a steady decline.

The uncontested champion in fighting unemployment has been Sweden, at least until the early 1990s, staying way below the average over the entire time span. However, from a percentage of 1.6 in 1990, unemployment shot up to 8.2% in 1993, a rise of 6.6% in 3 years. After that, the rate of unemployment came down to around 6% in 1998. Finland experienced a massive increase in unemployment in the wake of the collapse of the Soviet Union, experiencing a rise from 3.2% in 1990 to 12.6% in 1997. Next to Sweden, Germany managed to stay below average during most of the 1980s, but experienced a sharp increase in unemployment after the fall of the Berlin Wall, to a level of 11.2% in 1998.

Ireland is the country with the worst unemployment record in our sample, with double-digit levels for a large part of the 1980s and '90s. A sharp rise can be seen from 7.0% in 1980 to a high of 17.1% in 1986. In the 1990s, unemployment came down from a high level of 15.7% in 1993 to 9.1% in 1998. Italy also shows poor performance concerning unemployment. Being above average nearly all the time, it shows a general increase in unemployment from 5.6% in 1980 to 12.2% in 1998, with only very modest decreases in 1991 and 1993. The one country that experienced a far more general decrease in unemployment is the Netherlands, starting from a high of 11.0% in 1983, after which a steady decline occurred, reaching a level of unemployment of 4.1% in 1998. Most other countries generally follow the average rise and fall trends, either a few points above (France) or a few points below (Portugal) the average.

**Table 4 Levels of unemployment, 1980 – 1998 (%)**

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1980	6.9	2.0	4.7	4.0	3.2	6.2	7.0	6.1	7.7	5.6	5.3
1981	9.0	2.5	4.9	5.8	4.5	7.4	9.5	9.1	7.4	6.3	6.6
1982	9.7	3.2	5.4	8.5	6.4	8.0	11.0	10.4	7.3	6.9	7.7
1983	10.3	3.5	5.4	11.0	7.9	8.3	13.5	11.3	7.8	7.7	8.7
1984	9.9	3.1	5.2	10.6	7.9	9.7	15.0	11.4	8.4	8.5	9.0
1985	8.9	2.8	5.0	9.2	8.0	10.2	16.8	11.6	8.5	8.6	9.0
1986	7.7	2.5	5.4	8.4	7.7	10.4	17.1	11.8	8.5	9.9	8.9
1987	7.7	2.1	5.1	8.0	7.6	10.5	16.9	10.2	7.0	10.2	8.5
1988	8.4	1.7	4.5	7.8	7.6	10.0	16.3	7.8	5.7	10.5	8.0
1989	9.2	1.5	3.5	6.9	6.9	9.3	15.1	6.1	5.0	10.2	7.4
1990	9.4	1.6	3.2	6.0	6.2	8.9	12.9	5.9	4.5	9.1	6.8
1991	10.3	3.0	6.6	5.5	6.7	9.4	14.7	8.2	4.3	8.6	7.7
1992	11.0	5.3	11.7	5.4	7.7	10.4	15.1	10.2	4.1	8.8	9.0
1993	12.1	8.2	15.1	6.5	8.8	11.7	15.7	10.3	5.5	10.2	10.4
1994	12.0	7.9	16.6	7.6	9.6	12.2	14.8	9.4	7.0	11.3	10.8
1995	10.1	7.7	15.4	7.1	9.4	11.6	12.2	8.6	7.4	12.0	10.2
1996	8.7	8.1	14.6	6.6	10.3	12.3	11.9	8.0	7.5	12.1	10.0
1997	7.7	8.0	12.6	5.5	11.4	12.4	10.3	6.9		12.3	9.7
1998	6.5	6.5	10.9	4.1	11.2	11.8	9.1	6.5		12.2	8.8

Based on unemployed/total labour force.

<sup>a</sup> Portuguese data from MPIFG adjustment database

Source: OECD (1999a)

Denmark is an exceptional case, experiencing highly fluctuating unemployment figures. From 1980 until 1983, there was a rise from 6.9% to 10.3% in Danish unemployment. After an initial rise in the early 1990s, unemployment fell sharply in the second half of that decade, to reach a low of 6.5% in 1998.

### Public employment

The level of public employment is one of the most important indicators for our purposes. In comparison with levels of total employment, this indicator provides valuable information about the position of public employment relative to total employment. In general, where we clearly observe the fluctuations in total employment and unemployment figures largely following macroeconomic fluctuations, public employment figures seem to be much more stable over time (see Table 5). Between 1986 and 1992, the average public employment ratio of the selected countries never exceeded 13.6% or dropped below 13.5%. When total employment dropped by 3 percentage points in the early 1980s, public employment increased somewhat. Also, when total employment levels moved up in the late 1980s, the average public employment remained stable.

The latest figures available show that public sector employment in the Scandinavian welfare states is extremely high, at levels of 21.2% in Sweden and 23.0% in Denmark, compared to an EU average of 13.2%. These countries are followed by Finland and France, both with 14.8%. Most other Continental welfare states have rates of public employment of above or below 10% (Germany 9.1% and the Netherlands 8.1%). The Anglo-Saxon countries do not deviate much from the Continental average in public employment, with 9.6% in the UK and 9.4% in Ireland. Public sector employment is low in Southern Europe, with Italy having 8%, followed closely by Portugal at 12%.

**Table 5 Levels of public employment, 1980 – 1998 (%)**

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1980	21.7	24.4	12.5	8.1	9.6	13.0	9.5	14.8	6.8	8.2	12.9
1981	22.4	24.8	12.9	8.2	9.6	13.0	9.7	14.7	6.9	8.3	13.1
1982	22.9	25.0	13.3	8.2	9.6	13.2	9.8	14.4	6.7	8.2	13.1
1983	22.9	25.1	13.6	8.2	9.6	13.3	9.6	14.4	8.2	8.1	13.3
1984	22.5	25.8	13.7	8.1	9.5	13.4	9.6	14.4	8.5	8.1	13.4
1985	22.4	25.7	14.0	8.0	9.6	13.6	9.5	14.4	8.4	8.1	13.4
1986	22.4	25.6	14.3	8.0	9.8	13.8	9.6	14.5	8.9	8.1	13.5
1987	22.4	25.3	14.7	8.0	9.9	13.8	9.6	14.6	8.8	8.2	13.5
1988	22.3	25.3	15.0	7.9	9.9	13.8	9.3	14.6	9.2	8.3	13.6
1989	22.4	25.7	15.2	7.8	9.9	13.7	9.0	14.2	10.0	8.3	13.6
1990	22.3	25.7	15.3	7.8	9.8	13.7	8.9	14.2	10.1	8.3	13.6
1991	22.1	25.3	15.4	7.8	10.5	13.8	8.9	13.8	10.5	8.3	13.6
1992	22.0	24.3	15.0	7.8	10.4	14.0	9.0	13.2	12.0	8.4	13.6
1993	22.1	23.3	14.2	7.8	10.2	14.3	9.3	11.6	11.5	8.3	13.3
1994	21.9	22.5	14.1	7.8	9.9	14.4	9.4	10.3	11.5	8.2	13.0
1995	21.7	22.2	14.3	7.8	9.7	14.5	9.3	9.9	11.5	8.1	12.9
1996	22.1	21.7	14.5	7.8	9.5	14.6	9.3	9.6	11.7	8.1	12.9
1997	22.6	21.2	14.6	8.1	9.3	14.6	9.4		12.0	8.0	13.3
1998	23.0		14.8		9.1	14.8	9.4			8.0	13.2

Based on government employment/population aged 15-64 years.

<sup>a</sup> Portuguese data from MPIfG adjustment database

Source: OECD (1999a)

However, although the average public employment ratio shows a very stable picture, quite major shifts have occurred in some countries. Sweden and the UK both had sharp decreases throughout the 1990s. Sweden, which traditionally has a very large public sector, lost 5 percentage points in about 10 years, but still finds itself in a far-above-average position, albeit diminished. The UK saw a rapid acceleration of its steady decrease of public employment, which had been going on for over

10 years already. This acceleration started in the early 1990s and put the UK in a below average position, compared to its above average position up until 1991.

In addition to Sweden and the UK, with their remarkable decreases in public employment ratios, Portugal is the only country in our selection with a fairly sharp increase in public employment. The figures almost doubled, rising from 6.8% in 1980 to 12.0% in 1997. In contrast to Sweden and the UK, however, this change was a steadier one, accelerating only slightly in the early 1990s. All other countries did not experience any major shifts and either remained fairly stable or saw a slow but steady decrease (notably the Netherlands).

As with levels of total employment, the Scandinavian countries show permanently high numbers in government employment ratios, which is generally assumed to be a characteristic of the 'Scandinavian model'. Sweden, however, experienced a sharp decrease from 25.7% in 1989 to 21.2% in 1997, a decline of 4.5% in 8 years. In contrast, in the 1990s Denmark experienced a slight increase, to 23% in 1998. Both the Netherlands and UK experienced a general decrease in public employment over the entire period.

France and Portugal experienced general increases in public employment ratios. In France, government employment went up from 13.0% in 1980 to 14.8% in 1998. Portugal experienced a much sharper increase, from a low level of 6.8% in 1980 to 12.0% in 1997.

Noteworthy are developments in Germany since the fall of the Berlin Wall. While increasing steadily from 9.6% in 1980 to 9.8% in 1990, the public employment ratio went up 0.7% in one year, reaching 10.5% in 1991. A steady decline then ensued, down to a level of 9.1% in 1998.

An important note concerning public sector employment ratios is that differences in percentages of countries in some cases cannot be explained simply in terms of 'a larger public sector'. As emphasized previously, the definition of the public sector varies between countries (see *Chapter 3*). For example, the relatively low level of public employment in the Netherlands is closely related to the fact that many social services are delivered by voluntary associations which are funded by public finance but fall outside the jurisdiction of the public sector.

### **Outstanding social security commitments**

In order to capture the dimension of outstanding social security commitments, two indicators are used — social expenditure ratios and corresponding levels of taxation. By comparing levels of social protection and taxation, we continue to observe tremendous cross-regime variation (see *Table 6*).

As *Table 6* shows, Denmark, Finland and Sweden continue to be the most generous welfare states. Scandinavian levels of social spending have remained by far the highest in Europe throughout the 1980s and 1990s, with Sweden taking the lead at 34.8%, followed closely by Denmark at 33.6% and Finland at 32.1%. Besides generous benefits, a wide range of high-quality public social services are also offered. In this respect, these Scandinavian welfare states are important employers, especially for women in the social services sector. This also explains the high levels of total taxation in these countries, with Sweden again topping the list at 53.3%, followed closely by Denmark at 52.2% and Finland at 47.3%.

Table 6 Levels of social expenditure and total taxation (%)

	Social expenditure as % of GDP (1996)	Total taxation (1997)
DK	33.6	52.2
S	34.8	53.3
FIN	32.1	47.3
NL	30.9	43.3
D	30.5	37.5 <sup>a</sup>
F	30.8	46.1
IRL	18.9	34.8
UK	27.7	35.3
I	24.8	45.0
P	21.6	34.5
Average	28.6	43.5

<sup>a</sup> 1996 (Germany)

Source: Eardly et al (1996); Eurostat (1996); Gern (1998); OECD (1999b)

The Continental welfare states remain at intermediate to high levels of generosity, but clearly spend less on social services than their Scandinavian counterparts. Replacement rates are generous and coverage is highly inclusive, although fragmented. Whoever falls through the social insurance net is protected by fairly substantial social assistance schemes. Social expenditures are practically on a par with the Scandinavian countries, ranging between 30.5% for Germany and 30.9% for the Netherlands, with France at 30.8%. In the absence of a wide provision of public services, levels of total taxation (although still high compared to the OECD average) clearly fall behind Scandinavia. France takes the lead, with 46.1%, followed by the Netherlands at 43.3% and Germany at 37.5% (in 1996).

Social expenditures in Southern Europe are below the European average, with Italy at 24.8% and Portugal at 21.6%. At the lower end of the social protection scale are the Anglo-Saxon welfare states, lean both in term of transfers and public services. In 1996, measures of spending totalled 27.7% in the UK and 18.9% in Ireland, with levels of taxation as a percentage of GDP at roughly 35%.

### EMU entrance criteria

Looking back over the 1990s at the central criteria for EMU, launched at the Maastricht Council of 1992, we can only conclude from a macroeconomic perspective that the introduction of EMU has been a success. Easily monitored numerical benchmarks as entry criteria for participation in EMU, a temporal constraint requiring States to qualify within a set time scale, 'peer' and ECOFIN pressure to comply — all these conditions forced Member States to commit to budgetary discipline within the constraints of 3% for the budget deficit and 60% for the public debt (as a percentage of GDP). Moreover, the need to qualify significantly strengthened the relative position of many finance ministers and central bankers. Not surprisingly, there is clear convergence in performance with respect to public deficits, government debt ratios and inflation since the Maastricht Council.

### Budget deficit

In 1997, all the prospective EMU Members were able to contain their deficits between a 3.3% deficit (France) and a 3.0% surplus (Ireland) in 1998. Deficits came down most conspicuously

between 1994 and 1997 (see Table 7). The average deficit of the 9 researched countries has seen a constant decrease between 1982 and 1989. From a percentage of 5.9 of GDP, it decreased constantly to only 0.7% in 1989. The first 4 years of the 1990s show quite a sharp rise again, to a deficit of 6.3% in 1993. The following 4 years show a fall back to 0.3%.

In the Netherlands, this decrease had already started in 1990, with a deficit of 5.1%, dropping to 0.9% in 1997. Some countries (France, UK, Ireland, Denmark and Sweden) saw an increase of their deficit during the period 1990-94. Sweden even moved from a 5.4% surplus to a deficit of 12.3% in that time, which is a shift of 17.7% in only 5 years. Other countries (Italy and Ireland) hovered around the deficit levels they had reached in the late 1980s (Italy about 10% and Ireland about 2.5%) before they experienced a deficit drop in the late 1990s. Italy generally experienced the highest deficits until 1996, only exceeded by Ireland in the early 1980s and by Sweden in 1993 and 1994. However, Italy, like all other countries, saw a decrease in the 1990s, moving from 11.1% deficit in 1990 to 2.6% deficit in 1998. In Germany, the deficit floated between 3.5% and 2.1% in the period 1990-97. France also followed a stable development, although rising quite sharply between 1991 and 1993 and recovering thereafter.

Between 1985 and 1991, Sweden and Denmark performed extremely well with respect to deficit containment, with both Scandinavian countries running a surplus for 4 years in that period. Whereas Sweden seemed to lose control in the following years, Denmark managed to keep its deficit at least within 2.8% (1993).

**Table 7 Public deficits as % of GDP**

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1980	-3.3	-4.0	1.4	0.0	-2.9	0.0	-6.2	-3.3	5.6	-8.3	-2.1
1981	-6.9	-5.3	2.0	-5.4	-3.7	-1.9	-7.7	-3.9	-10.7	-11.4	-5.5
1982	-9.1	-7.0	1.2	-6.6	-3.3	-2.8	-9.2	-2.8	-7.7	-11.2	-5.9
1983	-7.2	-5.0	0.4	-5.8	-2.6	-3.2	-8.7	-3.3	-10.2	-10.5	-5.6
1984	-4.1	-2.9	2.1	-5.5	-1.9	-2.8	-7.7	-4.0	-7.1	-11.5	-4.5
1985	-2.0	-3.8	2.2	-3.6	-1.2	-2.9	-9.2	-2.9	-7.5	-12.3	-4.3
1986	3.1	-1.2	2.7	-5.1	-1.3	-2.7	-9.7	-2.8	-6.4	-11.4	-3.5
1987	2.1	4.2	0.9	-5.9	-1.9	-1.9	-7.9	-1.9	-5.6	-11.0	-2.9
1988	1.5	3.5	3.6	-4.6	-2.2	-1.7	-4.3	0.6	-3.6	-10.7	-1.8
1989	0.3	5.4	6.0	-4.7	0.1	-1.2	-1.8	0.9	-2.5	-9.8	-0.7
1990	-1.0	4.2	5.4	-5.1	-2.1	-1.6	-2.3	-1.5	-5.6	-11.1	-2.1
1991	-2.4	-1.1	-1.5	-2.9	-3.3	-2.1	-2.4	-2.8	-6.7	-10.1	-3.5
1992	-2.2	-7.8	-5.9	-3.9	-2.8	-4.1	-2.6	-6.5	-3.6	-9.6	-4.9
1993	-2.8	-12.3	-8.4	-3.2	-3.5	-6.1	-2.6	-8.0	-6.1	-9.5	-6.3
1994	-2.6	-10.3	-6.6	-3.8	-2.6	-6.0	-1.8	-6.8	-6.0	-9.2	-5.6
1995	-2.2	-7.8	-5.7	-3.7	-3.5	-5.4	-2.3	-5.8	-5.8	-7.7	-5.0
1996	-0.9	-2.1	-4.1	-2.0	-3.5	-4.6	-0.3	-4.4	-3.3	-6.7	-3.2
1997	0.2	-1.1	-1.6	-0.9	-2.8	-3.5	1.8	-2.0	-2.5	-2.7	-1.5
1998	1.0	2.1	1.0	-1.2	-2.5	-3.3	3.0	-0.4		-2.6	-0.3

<sup>a</sup> Portuguese data from MPIfG adjustment database  
Source: OECD (1999a)

### Public debt

A commitment to a hard currency policy in general also puts pressure on the debt ratio of a country. A higher debt ratio will increase the uncertainty of the amount of debt servings a country has to



put on its balance, since interest fluctuations will have larger impacts as the debt increases. With respect to government debt, we observe significant reductions in the years between 1995 and 1997 (see Table 8).

**Table 8** Gross public debt as share of GDP

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1980	44.7	44.3	14.1	46.9	31.1	30.9	72.7	54.0	32.8	58.1	43.0
1981	53.7	52.1	12.1	50.9	35.0	30.1	77.4	54.5	41.3	60.3	46.7
1982	65.5	61.7	14.5	56.5	39.0	34.2	83.3	53.2	44.3	65.3	51.7
1983	76.2	65.6	16.1	62.7	40.3	35.3	97.3	53.4	49.4	70.2	56.6
1984	77.5	67.0	15.9	66.8	41.8	37.1	101.6	60.3	55.0	75.5	59.8
1985	74.9	66.7	16.5	71.5	42.8	38.6	104.6	58.9	58.0	82.3	61.5
1986	71.8	66.2	17.3	73.5	42.7	39.3	116.3	57.9	68.0	86.4	63.9
1987	68.6	59.0	18.4	76.1	43.4	40.7	117.6	55.6	65.5	90.6	63.6
1988	66.7	53.1	17.4	79.2	43.4	40.6	113.8	49.3	66.2	92.8	62.2
1989	65.1	48.4	15.0	79.1	41.0	40.6	104.0	42.9	64.7	95.7	59.7
1990	65.8	44.3	14.5	78.8	45.5	40.2	97.2	39.3	66.9	104.5	59.7
1991	66.7	53.2	23.0	78.8	44.4	41.0	96.9	40.6	69.0	108.4	62.2
1992	70.6	71.1	41.5	79.6	45.7	45.5	94.3	47.6	61.5	117.3	67.5
1993	79.6	76.3	58.0	80.8	51.9	52.7	99.0	56.6	64.3	118.9	73.8
1994	77.5	81.2	59.6	77.1	51.5	56.1	92.2	54.2	66.3	125.1	74.1
1995	73.5	79.8	58.1	78.5	62.2	60.1	85.7	59.7	69.1	124.2	75.1
1996	70.5	77.5	57.6	76.6	64.9	63.0	76.3	61.2	68.7	123.7	74.0
1997	67.3	77.1	55.8	71.4	65.0	64.6	68.3	60.3	65.3	121.7	71.7

<sup>a</sup> Portuguese data from MPIFG adjustment database  
Source: OECD, Economic Outlook, various issues

Two countries, France and Germany, have had relatively low debts throughout the whole period. However, these debts have generally increased during this time: Germany moved from 31.1% in 1980 to 65.0% in 1997, while France moved from 30.9% to 64.6% in the same period. France managed to contain debt growth in the late 1980s and even achieved a slight decrease in 1990, after which the steady growth picked up again.

The Scandinavian countries of Sweden and Denmark generally experienced a similar pattern of rise and fall. In the early 1980s, there was a steady rise in debt for both countries, leading to a debt of 77.5% for Denmark and 67.0% for Sweden. After this period, both countries diminished their debt, leading to a low of 65.1% in 1989 for Denmark and 44.3% in 1990 for Sweden. Subsequently, debt shot up again, especially for Sweden with a 81.2% debt in 1994. Denmark managed to contain this rise somewhat better and kept its debt within 79.6% in 1993. Finally, both countries saw a decline to 67.3% in 1997 for Denmark and to 77.1% in the same year for Sweden.

Ireland and Italy are the only two countries in our selection that experienced debts of over 100% of their GDP. However, Ireland managed to turn around this increasing trend in 1987, when the 117.6% high was gradually diminished to 68.3% by 1997. Italy saw a constant increase to a peak debt of 125.1% in 1994, after which a slight decrease set in and resulted in 121.7% in 1997. By 1997, all countries, with the exception of Italy, had their debts within the range of 77.1% (Sweden) and 55.8% (Finland).

## Inflation

The main objective of EMU is price stability. By the late 1990s, inflation in European economies was at an all-time low, reaching an average of 2.0% in 1997 (see Table 9).

**Table 9 Consumer prices (% changes from previous period)**

Year	DK	S	FIN	NL	D	F	IRL	UK	P <sup>a</sup>	I	Average
1985	4.7	7.4	5.9	2.3	2.1	5.8	5.5	6.1	19.6	8.6	7.2
1986	3.7	4.2	2.9	0.1	-0.1	2.7	3.8	3.4	11.8	6.1	4.9
1987	4.0	4.2	4.1	-0.7	0.3	3.1	3.1	4.1	9.4	4.6	4.0
1988	4.5	6.1	5.1	0.7	1.3	2.7	2.1	4.9	9.7	5.0	4.3
1989	4.8	6.6	6.6	1.1	2.8	3.6	4.1	7.8	12.6	6.6	5.7
1990	2.6	10.4	6.1	2.5	2.7	3.4	3.3	9.5	13.4	6.1	6.5
1991	2.4	9.7	4.3	3.2	3.6	3.2	3.2	5.9	11.4	6.5	5.9
1992	2.1	2.6	2.9	3.2	5.1	2.4	3.1	3.7	8.9	5.3	4.7
1993	1.3	4.7	2.2	2.6	4.5	2.1	1.4	1.6	6.5	4.2	4.0
1994	2.0	2.4	1.1	2.8	2.7	1.7	2.3	2.5	5.2	3.9	3.3
1995	2.1	2.9	1.0	1.9	1.8	1.7	2.5	3.4	4.1	5.4	3.1
1996	2.1	0.8	0.6	2.1	1.5	2.0	1.7	2.4	3.1	3.8	2.5
1997	2.2	0.9	1.2	2.2	1.8	1.2	1.4	3.1	2.2	1.8	2.0

<sup>a</sup> Portuguese data from MPIfG adjustment database  
Source: OECD, Economic Outlook, various issues

Most conspicuously, inflation fell in Sweden from 10.4% in 1990 to 0.9% in 1997. In the UK, inflation in 1990 still hovered around 9.5%, but fell to 2.4% in 1996. Finland and Italy both experienced drops from 6.1% in 1990 to 1.2% and 1.8% respectively in 1997. Inflation in both Denmark and the Netherlands remained around 2% for the entire decade. France experienced a decline from 3.4% in 1990 to 1.2% in 1997. Similarly, inflation in Germany went down from 5.1% to 1.5% over the same period.

## Some important findings

Reviewing the performance indicators above, some interesting observations can be made. With respect to employment performance, social security commitments and total taxation, the various performance indicators reveal considerable cross-regime differences. With respect to the EMU entrance criteria, we observe considerable convergence. This also applies to countries which, for the time being, have decided to stay out of the EMU policy framework.

With respect to overall employment performance, two striking findings are observed. Those countries that display an employment performance significantly below average (Germany, France, and Italy) are welfare states of the Continental or South European regime type. This is, among other things, caused by their strong reliance on payroll taxes to finance social security, driving up non-wage labour costs, and the prevalence of labour supply reduction strategies in recent decades, which also constrained the fiscal room for public employment growth. This is not to say that Continental or South European welfare states are, per se, unable to escape the 'inactivity trap' (Hemerijck *et al*, 2000). The Netherlands and Portugal — with above average employment levels, low unemployment and modest levels of youth unemployment — seem to have been able to counter or reverse the syndrome of 'welfare without work' (Ferrera *et al*, 2000). In comparison to public employment, levels of total employment basically follow the macroeconomic trends. Public employment seems less affected by macroeconomic contingencies, although in the post-Maastricht period many countries did experience slight downward adjustment in government employment.

The comparison of public employment ratios with total employment and unemployment ratios also provides interesting insights. While total employment and unemployment seem to be highly influenced by economic circumstances, public employment stays quite stable whether in favourable or unfavourable economic conditions. During the entire time period of this study, the average public employment ratio found itself merely within 0.7 percentage points, while total employment fluctuated between 3.9 percentage points and unemployment between 3.8 percentage points. This does not mean that public employment is not subject to economic conditions, but it does mean that economic conditions are not reflected in public employment ratios the way they are reflected in total employment and unemployment figures.

The picture that emerges from the association between the total burden of taxation and social security contributions (measured as a share of GDP) is that Denmark and Sweden, the most redistributive welfare states with the highest tax burden, do better in employment terms than the low tax Anglo-Saxon welfare states of Ireland and the UK. Moreover, the Scandinavian countries also reveal that there is a clear positive relationship between public employment and total taxes. Still, this association is not borne out by the experience of the Continental welfare states with their medium to high tax regimes. It is only the Scandinavian welfare states that have systematically translated high tax revenues into high levels of publicly financed social services. The remaining medium to high tax Continental welfare states and the moderate tax South European welfare states have the lowest public and private employment scores. Relatively low rates of employment in Continental and Southern Europe seem to be less affected by the size of the overall tax system, more so by the method of social security financing.

The trends concerning budget deficits, public debt and inflation are particularly revealing. Where, during the 1980s, all three indicators in the countries studied developed in quite divergent ways — being subject to different country-specific challenges, vulnerabilities, political pressures and responses — they reveal an obvious convergent trend in the second half of the 1990s. The only exception perhaps is Italy, which in 1997 still carried a debt that was almost twice as much as the average of all the countries together; however, since the late 1990s, Italy's debt has been slowly but consistently reduced. With regard to inflation, the UK and Sweden are at opposite ends of the scale.

# Analytical framework of countries studied

When discussing viable responses to certain external pressures in terms of public sector reform, it is essential to go beyond the identification of policy problems and identified possible responses. It is also important to assess each country's institutional capacities and policy legacies in terms of the feasibility of adopting and implementing certain policy strategies. Thus, the analytical focus shifts from problem-oriented policy research to institutional policy analysis (Scharpf, 1997b). The importance of an institutional analysis cannot be underestimated in order to understand the diversity in responses to changed pressures to the public sector in different European welfare states. Differences in policy responses to new external challenges can probably in many cases be explained by differences in institutional contexts of the countries involved, especially with the large degree of institutional diversity present in European welfare states and political systems.

Four types of European 'welfare regimes' can be identified — Scandinavian, Anglo-Saxon, Continental and South European. The differences between these four regimes are greatest with respect to labour market regulation (in terms of rigid and flexible governance structures) and social security regulation (including risk coverage and eligibility, the structure of benefits, financing mechanisms and organisational arrangements). Further differences concern the shape and size of the administrative system (such as the level of decentralisation of authority, the existence of agencies), the characteristics of the political system and the traditions of the State. These institutional features matter greatly when it comes to feasible policy responses to the challenge of changed external pressures.

The principal unit of policy change is the nation-state. Public sector reforms have to be endorsed by elected governments and parliaments; political resistance and societal support behind reform initiatives are mediated by national political parties, organised interests and other relevant institutional structures, such as systems of interest intermediation and the organisation and administrative capacities of national bureaucracies. Domestic political rules of decision-making impose important constraints on the repertoire of feasible policy changes. In part, they determine the relative success or failure of the adoption and implementation of effective reforms in different countries. Political institutions exert a tremendous influence over the pace, scope, character and style of reform initiatives.

Various aspects are discussed in the sections below and are schematically integrated in Figure 5.

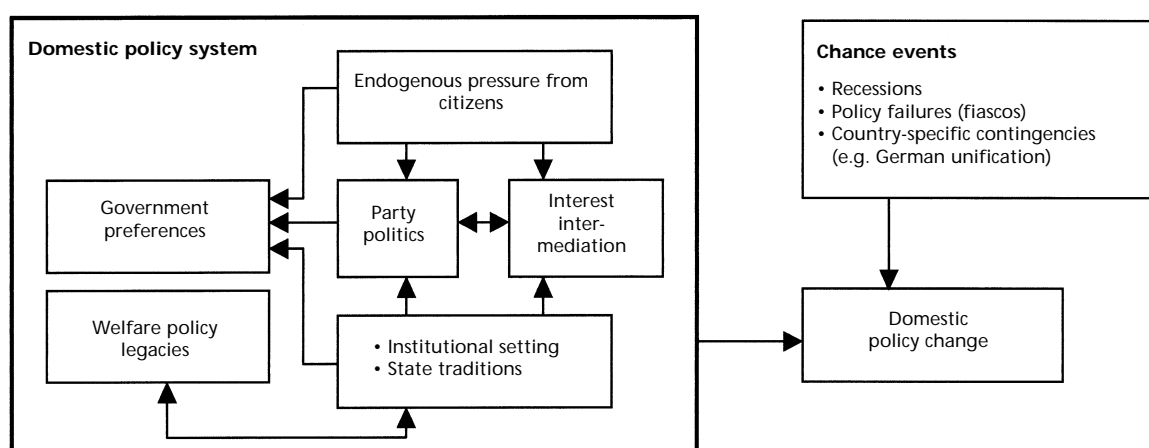
## **Institutional policy analysis**

In the literature on institutional policy analysis, we can identify a narrow and a broad perspective on policy change. At the narrow level, institutional analysis is focused on 'veto points' and on the capacities of domestic policy actors to adopt and implement their preferred reform alternatives. A broader perspective on institutional change involves an examination of the character or policy style of decision-making processes and the normative and cognitive orientations of the policy actors involved (Scharpf, 1997b, 2000).

Different political systems can be described and analysed by the number of veto players empowered to effectively block reform initiatives. At one end of the scale, strongly majoritarian political systems, such as the UK's Westminster, render single parties as governments, with clear

mandates for adopting radical and comprehensive reform efforts. At the other end of the scale, there are consensual democracies, based on proportional representation with multi-member constituencies, and coalition governments, bicameralism and sometimes federalism. Political systems with multiple veto points, where power is fragmented, are more biased towards slow, incremental, disjointed and negotiated patterns of policy change due to the large number of veto players that need to be accommodated. Reform initiatives can be frustrated. Effective public sector reform always depends on negotiated agreement.

Figure 5 Institutional channels for reform



The logical conclusion that follows from the veto-power explanation is that implementation of public sector reform will be more difficult in multiple-actor political systems than in single-actor ones. Governments presiding over unicameral parliamentary systems (as in Sweden) or asymmetrical bicameral parliaments (as in the UK and France, where approval of one chamber is sufficient to get legislation adopted) generally have greater control over policy-making. Countries with symmetrical bicameral parliaments have a second locus of decision-making, which increases the likelihood of amendment or defeat of government-sponsored legislation. This situation is especially prevalent where the two chambers are elected on different bases, as is the case in Germany.

Institutional constraints not only limit the repertoire of feasible policy options (more players are involved in the policy process, following a veto-power perspective), but constituting rules of decision-making also shape and regulate modes of interaction and styles of policy-making by way of stipulating norms of co-operation, reciprocity and consensus-building. From this perspective, it could be argued, that consociational democracies and corporatist interest intermediation favour consensual or problem-solving styles of decision-making. This stands in sharp contrast to the prevailing self-interest and ad hoc bargaining style in more fragmented systems of interest representation and collective bargaining. However, while multi-actor political systems run the risk of institutional self-blockage, they can rely on well-negotiated and thoroughly thought-through reform initiatives. Still, the unanimity rule which dominates corporatist industrial relations systems and consociational democracies can create 'joint decision traps' and 'policy immobilism' if consensus over objectives and/or values is lacking (Scharpf, 1988).

If we want to really understand the dynamics of public sector reform, we have to go beyond both veto power and policy style perspectives. We need to examine the cognitive and normative orientations of relevant policy actors — factors that are generally ignored in structural institutional explanations (Scharpf, 2000). The broader institutional approach takes a keen interest in the role of ideas in reform processes and the extent to which policy actors agree over the cognitive definition of policy problems and the normative aspiration of effective policy solutions. In this perspective, to use Hecló's powerful metaphor (1974), policy-making is seen as the outcome of *puzzling* (diagnosing the nature and magnitude of the problems at hand, setting priorities and identifying potentially effective solutions) and of *powering* (organising the political and societal support for the selection of particular solutions).

Much of the public administration literature on public sector reform highlights the role of ideas. To be sure, encouraged by processes of economic internationalisation, European integration and modern communication, international organisations, such as the Organisation of Economic Co-operation and Development (OECD), the World Bank or the International Monetary Fund (IMF), are critically involved in the active diffusion of the belief and values of New Public Management, privatisation of public pensions (the Chilean Model) and Managed Competition in health care. Recently, the OECD has opened its Best Practice Institute, which it advertises as a source for comparative and cross-national information and analysis in the area of public sector reform (it can be located at the following Web site: [www.oecd.org/puma/bpi/bpiste.nsf](http://www.oecd.org/puma/bpi/bpiste.nsf)).

Ultimately, policy reform, however much dependent on effective diagnosis and 'the play of ideas', is about 'the contest for power'. Implicit in this perspective is that governments may be capable of policy adjustment through 'learning' so as to better attain effective and legitimate policy solutions. Hall (1993) defined this as 'the deliberate attempt to adjust the goals or techniques of policy in the light of the consequences of past policy and new information'.

In most European States, the recession of the mid-1970s served as an important 'triggering device', discrediting many left-of-centre coalitions and providing the new Conservative governments with a major opening for a restrictive policy package of fiscal consolidation, privatisation and welfare retrenchment.

Mistakes are not necessarily a waste of time; they can energise the policy process by allowing political decision-makers to overcome institutional rigidities that would persist under normal circumstances. The cathartic experience of the 'Dutch disease' in the early 1980s is a good example of how policy mistakes generate positive learning effects: after a lengthy and painful period of policy immobilism, policy's self-correction in the Netherlands provoked a remarkable recovery of the Dutch economy without sacrificing core welfare goals. Italy's political and economic crisis in the early 1990s, which led to a comprehensive redesign of the Italian political system, was to a large degree fostered by the challenge of the EMU. The ideological turnaround in the UK fostered by Thatcher originated in the problem of the economy's mismanagement under the previous Labour government rather than in the appeal of neo-liberalism per se; Britain's 'winter of discontent' almost completely destroyed the Labour Party's reputation as a potential government party.

## State traditions and patterns of interest intermediation

Idiosyncratic reform experiences are not only associated with important differences in the formal rules of the game of government policy-making. They also reflect distinctly different State traditions, patterns of interest intermediation and welfare state policy legacies.

Two key historical processes stand out in shaping political institutions in Western Europe — an absolutist heritage and a liberal heritage. Both concern the historical contingencies of processes of State formation and cleavage mobilisation. Together, these factors have shaped State traditions and patterns of interest intermediation, especially in the domain of industrial relations.

### The absolutist heritage

Southern European countries share an absolutist heritage. This reflects a tradition of extensive State intervention in local and regional government, and hostility towards organised interests. Generally, such countries have until recently been centralised states, although in recent years there have been important experiments with regional decentralisation and autonomy, especially in Spain and Italy. A second distinguishing feature of this Southern European administrative system is widespread patronage and clientelism (Toonen and Raadschelders, 1999).

France is an example of a centralised strong State tradition, even more so than countries in Southern Europe. The French State still draws its inspiration from a long interventionist and *dirigiste* tradition, going back to the *Ancien Regime*. Civil servants there enjoy much higher status than in Southern European countries, while patronage and clientelism play a very small role in the administrative system. The French State has always been aimed at monopolising civil society (also in the sphere of industrial relations) rather than seeking compromises with organised interests (Toonen and Raadschelders, 1999).

Southern European industrial relations systems preside over multi-level bargaining systems with lower levels of co-ordination. High levels of unorganised industrial conflict are in part due, as in France, to rival political divisions within the trade union movement. Collective bargaining coverage is medium to high but, in comparison to the Scandinavian and Continental countries, both employers and trade unions remain relative players. State intervention is therefore widespread, but this does not seem to have made patterns of industrial relations in Southern Europe more stable. Contestation remains a distinctive feature of Southern and French industrial relations.

### The liberal heritage

In the British State tradition, characterised by the primacy of parliament, liberalism is responsible for the monopolised position of a rather small, *laissez-faire* central government. This prominent position of the central government is also apparent in its relationship with the local government. Local authorities traditionally have only very minor powers in executing or developing public policy (Toonen and Raadschelders, 1999). As in France, the liberal state is hostile towards 'rent-seeking' sectional interests since they can undermine the primacy of parliament.

With respect to industrial relations, Anglo-Saxon labour markets are voluntaristic and fairly uncoordinated, with medium levels of industrial conflict prevailing. Over the 1980s, the UK experienced a significant trend towards wage determination at company or plant level, sometimes even at individual level. Paradoxically, while Ireland in the early 1980s followed the British pattern of radical decentralisation, in the second half of the 1980s the Irish moved away from the Anglo-

Saxon pattern of adversarial and fragmented industrial relations towards a renewed emphasis on co-ordination between government and the social partners over issues of social and employment policy.

### **Traditions of sharing political space**

The *Rechtsstaat* tradition is characteristic of Germany and also the Netherlands. An important distinguishing feature of the German tradition is, of course, the federalist system, which means that central government does not have primacy over the sub-national level of the *Länder*. As in France, civil servants in Germany enjoy a high status. But contrary to the French members of the *Grand Corps*, who are educated in elite administrative schools, the Germans are generally educated in law.

Like other countries in the northern part of the European continent, Germany has a tradition of social partnership in industrial relations. This means a strong sense of mutual consultation and decision-making between employers, employees and government. Continental systems of interest intermediation developed with relatively strong State support. German and Dutch corporatist patterns of industrial relations are fairly stable and highly institutionalised, with comparatively low levels of industrial conflict. By engaging in corporatist exchange practices, as Crouch (1993) highlights, functional interests become important *Ordnungsfaktoren* or *Staatstragende Kräfte*, and thus come to 'share political space' over social and economic policy-making. Crouch's notion of 'shared' political space captures the proximity and reciprocity of the relationship between organised interests and the State. The coverage of collective bargaining is high, while co-ordination between trade unions and employers' associations and practices of co-determination are considerable. Coverage rates of collective bargaining agreements are generally much higher than the degree of unionisation, in large part due to the mandatory extension of the outcome of collective negotiations to the non-unionised sectors in the economy.

This tradition of sharing political space is also heavily institutionalised in the Scandinavian countries, which can be considered neo-corporatist consensus democracies or decentralised unitary states. This corporatism stems from the existence of strong intermediate structures of employers or employees, which have been present in Western Europe for many centuries (first as guilds and later as unions). These countries also accord high status to their civil servants and there is much less interference with sub-national levels of government by the central level. Political appointments of administrative positions is not common practice in these countries.

Scandinavian industrial relations systems are relatively centralised compared to those in the Anglo-Saxon and Continental welfare states. There is relatively low, but highly organised, levels of industrial conflict. Wage-setting and regulation of working conditions are left to bipartite bargaining between very strong unions and almost equally strong employers' organisations. The manifold interdependencies across the commitments of universal access, generous benefits, service intensity and 'activation' require extensive co-ordination among the key players in the Scandinavian model. In Sweden, the exemplar Scandinavian model, this has been achieved by the hegemony of social democracy in Swedish politics, a highly organised and cohesive workers' movement and 'Keynesianism' forming the long-term intellectual basis of Swedish social economic policy.



## **Welfare state policy legacies**

In addition to the State traditions and corresponding patterns of interest intermediation, a general classification can also be made on welfare state design or social policy legacies. Too often, 'the welfare state' is referred to as if it were a phenomenon uniformly manifest across national territories. It is worth alluding briefly to the most important differences between the countries in our sample. Different welfare states engender different institutional constraints and possibilities for public sector reform activities. As a consequence of institutional diversity, different policy options are appropriate to different welfare states. Drawing on the literature on welfare regimes, four different families of welfare capitalism can be identified — Scandinavian, Anglo-Saxon, Continental and South European — each with their own regime-specific characteristics and avenues for policy reform.

### **Scandinavian welfare regime**

The long-term mission of the Scandinavian social democratic welfare regime is the achievement of full employment, generous income protection and solidaristic wage and gender equality. Public policy bears a key responsibility for all of these. In the Scandinavian countries of Sweden, Denmark and Finland, eligibility to social protection is a citizen's right, coverage is fully universal and everyone is entitled to relatively high levels of benefits to protect the aged, sick and unemployed. The gainfully employed receive additional benefits through mandatory occupational schemes. Means-tested public assistance plays a rather circumscribed role. Besides generous income maintenance, the Scandinavian systems offer a wide array of free public social services, which sustain high participation rates for both men and women, and a strong work ethic. High levels of female participation in the labour market is intimately connected to the large coverage of public provisions of care for children and the elderly.

The role of the State as a provider of public services is extensive. Women are generally employed in the public sector and in care-related jobs. As such, the Scandinavian welfare states are also important employers: in Denmark and Sweden, for example, government employees (largely women, especially in the social services sector) represent more than 20% of the employed population, compared to an EU average of 12.1%.

In terms of financing, the Scandinavian regime relies heavily on general taxation for the financing of benefits and public services. This is especially true of Denmark, where social security contributions only amount to 3% of GDP, compared to the European average of 28.6%. In Sweden and Finland, contributions make up a smaller share of total taxation than in Continental Europe, but larger than those in the UK or Ireland.

The provision of benefits and services for various functions of social protection are highly integrated and is mainly the responsibility of public authorities, both central and local. High levels of social protection and the provision of high-quality public services is 'tightly coupled' to a strong emphasis on active labour market policies (pushing workers towards new job opportunities and out of unemployment, or providing training opportunities) and, historically, a centralised wage policy in the area of employment regulation to speed up structural change by not allowing inefficient companies to stay in the market.

### **Anglo-Saxon welfare regime**

The key normative aim of the Anglo-Saxon welfare regime is protection against poverty or, in the

words of Beveridge, protection against 'want, disease, ignorance, squalor and idleness'. In the 'liberal' pendant of 'social Europe', there is a strong emphasis on individual responsibility. Besides equal access to health and education, the State provides minimum social assistance provisions, targeted at poverty alleviation, so as not to undermine the work ethic.

The coverage of social protection in the Anglo-Saxon welfare states of Ireland and the UK is highly inclusive, though not fully universal (except for health care). Sickness, unemployment and retirement benefits, provided through the national insurance system, are relatively low and unemployment benefits are of short duration. Private (in-company) social insurance schemes play an important role in both countries. For those who do not work and are not eligible for national insurance, there is an extensive 'Beveridgean' social assistance safety net, providing for flat-rate and means-tested benefits which are high enough to prevent poverty.

Like in Scandinavian regimes, the Irish and UK welfare states rely on general taxation for about 50% of the financing of benefits and public services. On average, taxes are relatively low. The national insurance system also relies on social contributions. Unlike the Scandinavian welfare regime, however, 'caring' services are relatively underdeveloped and mainly provided for through the market. Although there are no specific disincentives that make it difficult for married women to enter the labour market (like in the Continental welfare regime), the Anglo-Saxon model is rather gender-neutral and not particularly devoted to gender equality (quite unlike the Scandinavian welfare regime where gender equality is one of its defining features). The role of the State as care provider is practically limited to public health care, which provides free services. The administrative framework of the Anglo-Saxon welfare states is more centralised than in Scandinavia and entirely managed by public administration. The social partners are not so involved in policy-making and management, especially in the UK where unions are particularly weak and fragmented.

### **Continental welfare regime**

The Continental welfare states of France, Germany, Austria, Belgium, the Netherlands and Luxembourg are, in contrast to the Scandinavian and Anglo-Saxon models, conservative in their normative orientations. Historically, Continental social policy (Christian Democratic) is very much directed towards the preservation of traditional family patterns and the maintenance of occupational status differences. The principal goal is income support, rather than the advancement of employment opportunities, in the face of economic hardship. Social security provisions are based on the principles of compulsory 'Bismarckian' industrial insurance against occupational risks, except for health insurance for higher income groups in Germany and the Netherlands who take out private health insurance plans.

Social security benefits are predominantly financed out of ear-marked payroll contributions (raised as a proportional tax on total wages, with a cap at medium wage levels) from employees and employers, often subsidised by the State. In France, almost 80% of the system is financed by social contributions. Employment-related social security programmes revolve around income replacement and are targeted at the male breadwinner, supplemented by child benefits and tax privileges for single-earner families. Levels and duration of social insurance benefits are intimately linked to occupational and family status, and the payment (i.e. previous work experience) of contributions by employers and employees. Only the Netherlands provides for universal benefits

with respect to social assistance and basic pension provisions. Replacement rates are relatively generous and coverage is highly inclusive.

As a corollary of payroll financing, there is a strong tradition of social partner self-regulation in the 'compensatory' (transfer-heavy) Continental welfare states. The management of social insurance systems, based on the principle of subsidiarity, is relatively autonomous from the State and is predominantly administered jointly by trade unions and employers' associations. Individuals who are no longer covered by social insurance generally fall back on means-tested social assistance, financed through taxes. In contrast to the Scandinavian welfare states, professional social services are underdeveloped. This also applies to active labour market policies, which are a recent discovery in Continental 'social Europe'. Care for the young, sick and aged is expected to be catered for by the unpaid services of women (grandmothers, mothers and daughters) within the family.

### **South European welfare regime**

The South European welfare states of Greece, Italy, Portugal and Spain resemble in their normative orientations the basic Continental aspiration of the preservation of traditional family values through policy measures of income maintenance. Like the Continental cluster, they also rely heavily on payroll taxes for their financing. But the South European welfare states display a number of special features that set them apart from the Continental cluster. As Ferrera (1996) argues, rudimentary South European social protection systems entered the age of 'permanent austerity' in a state of institutional and financial underdevelopment, beset by internal imbalances. What separates the South European welfare states from the more robust Continental ones is, firstly, their relatively low rates of social security coverage. Secondly, the South European welfare system is mixed in terms of coverage: while it displays 'Bismarckian' features in social security transfers, it features a strong 'Beveridgean' imprint in the respective systems of national health, established between 1975 and 1985 (Guillen and Matsaganis, 2000). A basic safety net of social assistance is only weakly developed. The social partners co-manage the funds of occupational insurance. Public services are underdeveloped, unevenly distributed, insufficient and very often inefficient. Implementation failures are generally attributed to clientelism and other weaknesses in the South European systems of public administration. The family is still considered the prime source of informal care provision, supplemented by relatively underdeveloped public services, and dualistic insider-biased income protection provisions. Extended households, accommodating three or more generations under one roof, are a common phenomenon.

The distinguishing feature of the South European welfare regime is the insider-bias in social and employment protection. Core workers receive extremely generous social security benefits (in the form of unemployment benefits, early retirement pensions and disability benefits) and their jobs are protected by tough regulations against dismissals, especially for public sector employees. This has resulted in a highly segmented labour market, with young people and women usually excluded from employment protection, bargaining coverage and social insurance (Lodovici, 2000; Toharia and Malo, 2000). The majority of first-time job-seekers are usually not supported and must rely on family support and networks. There is a wide gap between labour market insiders, who have extensive social security coverage, and underprotected labour market outsiders. This divide is perhaps most pronounced in the pension-heavy Italian welfare state; the stringency of its employment regulations explains, at least in part, the large share of self-employment, small companies and the prevalence of the black economy.

## Categories of public sector reform

The scope of government has quite drastically changed in the last two decades (see Chapter 3). Generally, it can be said that the focus has shifted from a ('big') government as the provider of many, if not all, public services towards a ('lean') government as the facilitator of public services. The OECD even talks about a 'paradigm shift' towards a more business-like approach to public management. The 'old' paradigm is supposed to be the classic Weberian ideal type of bureaucracy, while the 'new' paradigm centres around the principles of New Public Management (Massey, 1997b). This paradigm shift can be characterised by:

- a greater focus on results and increased value for money;
- devolution of authority and enhanced flexibility;
- strengthened accountability and control;
- a client- and service-orientation;
- strengthened capacity for developing strategy and policy;
- introducing competition and other market elements; and
- changed relationships with other levels of government.

Although the concept of a global paradigm shift is widely contested, and countries differ greatly in the way and intensity with which they have engaged in public sector reform, it is possible to distinguish certain similarities in public sector reforms throughout Europe (and perhaps even the world). For our purpose, we have developed 5 categories, grouping public sector reforms as follows:

- *Administrative reform*: A wide range of reforms of the administrative system in our selected countries can be put under this heading. Usually, these initiatives concern themes like debureaucratisation, decentralisation, downsizing, increasing efficiency and more citizen-orientation. In many cases, these initiatives are grouped together with other types of reform into encompassing programmes; where necessary, these are mentioned under this category.
- *Tax reform*: Fiscal policy has a tremendous impact on the financial condition of a State and thus its public sector. Although taxation may not be part of the public sector as such, it does play an important role in public sector reform. A complete picture cannot be painted in the absence of data on tax reform.
- *Privatisation*: Generally, a company is considered to be privatised when shares are no longer exclusively available for the government. However, there are many intermediate stages between public and private. Both the outright selling-off of public organisations (external privatisation) and the introduction of market mechanisms within the public sector (internal privatisation) are discussed.
- *Budget reform*: Budget reform is frequently used, in accordance with other measures, to increase flexibility and insight in spending and revenue of public sector organisations. Changes usually concern the introduction of single budget lines instead of more specified budget allocations or the introduction of result-oriented budgeting systems.

- *Decentralisation, devolution and accountability reform*: This type of reform encompasses processes of decentralisation of authority, as well as devolution of autonomy. The first, decentralisation of authority, involves in general the transfer of (political) responsibilities, tasks and functions to other (lower) tiers of government. The second, devolution of autonomy, involves the transfer of (technical) responsibilities, tasks and functions to (service delivery) agencies within defined objectives. These transfers are quite often accompanied by the introduction of performance indicators to increase accountability.

It should be noted that these categories do not exclude each other in any way. Public sector reforms will often overlap two or more categories in a single reform package. The above categorisation is used here solely to increase comparability of the reforms in different countries (see *Figure 6*).

### **Integrated analytical framework**

In order to explain the pace and scope of public sector reform, we have devised an integrated analytical framework (see *Figure 7*), combining the institutional policy analysis with all the various insights about the external constraints of EMU, the endogenous challenges of the transformation of working life, family change and population aging for the viability of the European Social Model. Due weight has also been given to the autonomous influence of the ideas of New Public Management (see *Chapter 2*); country-specific chance events, which influence not only public reform as narrowly understood, but also, more broadly, social and economic policy; and novel concepts of social justice (although these policy areas and related principles and ideas are not explicitly dealt with in this report).

**Figure 6 Public sector reforms**

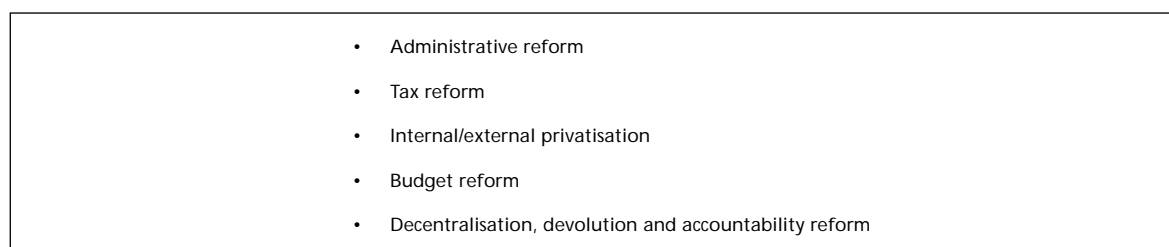
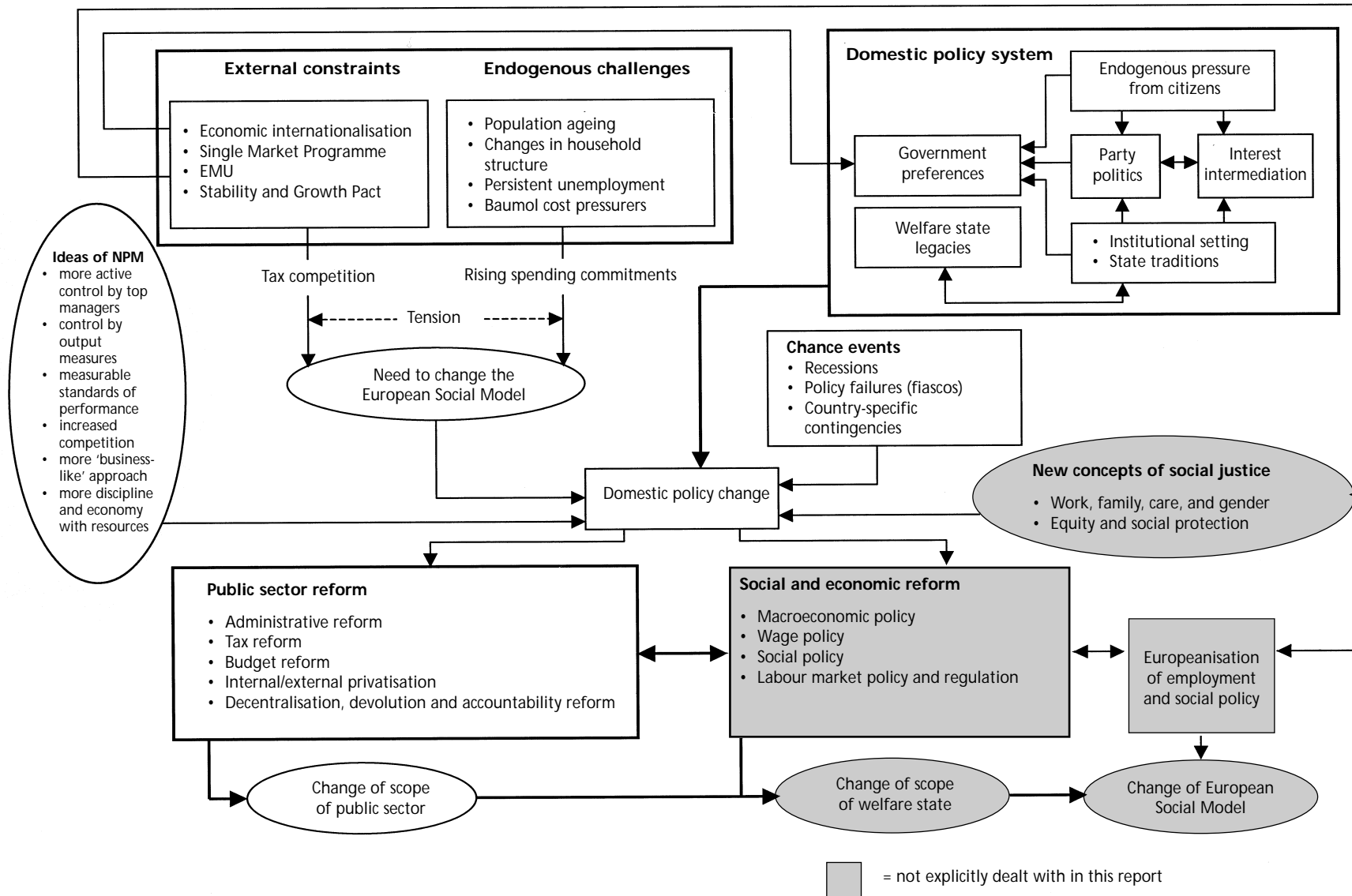
- 
- Administrative reform
  - Tax reform
  - Internal/external privatisation
  - Budget reform
  - Decentralisation, devolution and accountability reform

Figure 7 Integrated analytical framework





## Sweden

### **Institutional, macroeconomic and social context**

The Swedish administrative system can be considered unitary, though highly decentralised. A large number of agencies employ the majority of public servants and have their own operational autonomy protected by the constitution. Ministries confine themselves to policy advice and the preparation of legislation, and tend to be much smaller than the ministries in other European countries (Pollitt and Bouckaert, 2000).

Sweden traditionally maintains a very large public sector, as well as a very generous and egalitarian welfare state, when compared to other Western European countries (Esping-Andersen, 1990). This has had problematic implications for the Swedish budget, especially in the early 1980s and early '90s (see *Chapter 6*).

For most of the 1980s, Sweden effectively managed the trade-off between full employment and inflation: starting from a level of 13.7% in 1980, inflation was steadily reduced to 4.2% in 1986. However, due to an overheated economy in 1989, the Swedish government made a major shift in their macroeconomic policy priorities, whereby full employment was replaced by price stability as the primary macroeconomic target, and pegged the krona to the ECU in 1991. This resulted in a sharp drop in domestic demand (Benner and Vad, 2000). The recession led to a rapid deterioration of Swedish employment performance. Also, public finances deteriorated, moving from a surplus of 4.2% in 1990 to a deficit of 12.3% in 1993. Despite measures to defend the krona, the government was forced to let the currency float again in 1992.

In order to defend the Swedish krona, the centre-right coalition government, in office from 1991 to 1994, reached an agreement with the Social Democrats on two 'crisis packages'. These included cuts in replacement rates, the introduction of a waiting day in sickness benefits, reduction of pension and changes in eligibility criteria, as well as an expansion of active labour market policy. When the Social Democrats re-entered office in 1994, welfare cutbacks were even stronger than under the centre-right government.

Both the sharp rise in unemployment and the substantial cutbacks in welfare programmes have made income distribution more unequal. However, by international standards, Sweden still displays a very egalitarian income distribution (Ferrera *et al*, 2000). In terms of budget consolidation, the policy of simultaneous cuts in benefit levels and increases in employees' social insurance contributions and taxes on personal income have proved remarkably successful, bringing the budget into surplus again within only a few years. Since 1997, the recovered public finances have allowed for a cautious expansion of social benefits.

### **Public sector reform**

#### *Administrative reform*

In 1982, when the Social Democrats entered the Swedish government, efforts were made to increase the responsiveness and accessibility of the State machine. A ministry of Public Administration (*Civildepartementet*) was created, to concern itself exclusively with public sector reform. This act symbolised the government's strong commitment to reform. The Government Modernisation Programme of 1985 put most emphasis on decentralisation to lower tiers of



government (Premfors, 1998). Further reforms included more user choice, increased responsiveness, deregulation and debureaucratisation. Also, as regards personnel management, agencies could now hire their own staff and set their own wages within national frameworks (Pollitt and Bouckaert, 2000).

These reforms were in general all aimed at so-called 'power' problems (democratic participation and decentralisation) of the Swedish administration, rather than 'money' problems. Declining support for the Socialist Party and 'its public organisations', together with signs of a resurging economic crisis, shifted the emphasis more towards the containment of costs of public sector organisations. Until the mid-1980s, the Ministry of Public Administration had been in control of the administrative reforms. However, with the shift of focus towards 'management by results', the Ministry of Finance took over in about 1989 (Premfors, 1998).

Then, in 1991, a non-socialist government came to power and Sweden got its first Conservative Prime Minister since 1930. This led to a radicalisation of public sector reforms. Up until the late 1980s, privatisation was of great importance in Sweden; the main objection to it was that it would lead to distributive injustices (Gustafsson, 1987). Privatisation now became central to the reform effort of the Conservative government. The position of the Ministry of Public Administration was further weakened, while that of the Ministry of Finance was strengthened. A special unit was set up within Finance to formulate new ideas and initiatives. More than ever, economic efficiency gains became central goals of public sector reform in Sweden, expressed in concepts like 'streamlining', 'buyer/seller separation' and other market-type mechanisms (Premfors, 1998).

#### *Tax reform*

In order to defend the Swedish krona in the early 1990s, the Swedish government took a number of tax measures, but these proved insufficient for the purpose. While the Conservative government was chiefly concerned about Sweden's attractiveness to international investors, the reduction of taxes for capital and employers' social contributions took pride of place over the consolidation of the public budget. In 1991, a tax reform was introduced, aimed at broadening the base while cutting the rates. Also, a separation of capital taxation from labour taxation was implemented. The marginal tax rates thus reached an historical low. This changed again when the Social Democrats re-entered office in 1994. While welfare cutbacks were even stronger than under the Conservative government, the Social Democrats also increased taxes so as to balance the public budget. Quite remarkably, the top marginal rate of income tax, which had been reduced from 72% to 51% in 1991, was again raised, to 60%. Thus, while total taxation dropped from 55.6% of GDP in 1990 to 49.6% in 1995, the subsequent tightening of fiscal policy contributed to a rise in levels of taxation to 53.3% in 1997.

#### *Privatisation*

In the early 1990s, in the face of a fiscal crisis and with the arrival of a new Conservative government, privatisation became a realistic option for reform. The Administration Programme, launched in 1990, now had to generate a 10% reduction in public sector costs. This was to be achieved mainly through the abolishment or merging of agencies, increased delegation and various productivity improvement initiatives. In practice, not much actual privatisation was achieved in that period. But it remained an option and was widely debated among the Social Democrats after they re-entered government in 1994, though on a selective and pragmatic basis. Between 1990 and 1996, 13 State agencies became public companies, including the Swedish National Defense

Factories, the Swedish State Power Board, Swedish Telecom and Sweden Post (OECD, 1998). Although these agencies were privatised, they still remained in the hands of the State.

### *Budget reform*

Between 1988 and 1993, a series of strong financial management reforms were implemented. From 1988, result-oriented budgeting (output and outcome) was officially adopted for all State organisations. Since 1993, all agencies are required to publish an annual report, which includes performance data, income statement, balance sheet, appropriation account and financial analysis (OECD, 1997b). In 1996, the first stage of the budgeting procedure itself was reformed, with overall expenditure ceilings being fixed at that time. Different ceilings were set by the government for the entire public sector (the State, excluding interest payments on government debt, social insurance schemes and the municipalities) and the municipalities (OECD, 1998). In 1993, a system of strictly fixed frame budgets for municipalities, together with the decentralisation of the authority to the municipal level to spend those budgets, was expected to lead to savings in the national budget.

## Denmark

### **Institutional, macroeconomic and social context**

Denmark is a constitutional monarchy, with government by parliamentary majority. The parliament consists of one house (*Folketing*). Coalition governments, sometimes representing a minority in parliament, are more the rule than the exception, and dissolution of parliament occurs on average every two years. Political appointment of civil servants is absent in Denmark. The administrative system relies heavily on administrative and professional expertise. There is a system of sectoral ministries, which are in charge of a number of agencies. The ministries are headed by ministers who, together with the Prime Minister, comprise the cabinet. The power of the Prime Minister and his or her office is limited compared to other European countries like the UK. Power is shared sectorally among the different ministries. Because the local and regional levels play a large role in the execution of much of Danish public policy (including social security, parts of education and health), Denmark can, like Sweden, be characterised as a unitary state, though highly decentralised (OECD, 1992).

When the second oil crisis hit Denmark, the macroeconomic situation was already unfavourable, characterised by low growth, high unemployment, above-average inflation and a considerable and chronic current account deficit. While initially the Social Democratic-led government pursued a combination of repeated devaluation, together with a tighter incomes and fiscal policy, it was politically too weak to maintain this strategy. In September 1982, when the centre-right coalition government came into office, the direction of policy adjustment changed significantly. Tight fiscal policy and a reduction of the current account deficit gained priority. The Danish government of that time, under Poul Schlüter, committed itself to a hard currency regime. By the same token, the expansion of public employment and active labour market policy came to a halt.

These measures, together with changes in social policy and tax reform, contributed to a remarkable economic recovery. There was a sharp decline in real interest rates, the expansive effects of which outweighed the contractionary effects of government's tightening of fiscal and wage policy (Iversen, 1998b, 1999). However, the flip side of the coin was a further worsening of the current account balance, which reached a record deficit in 1986. As a result, the government tightened fiscal policy even more (the so-called 'potato diet') by way of raising taxes to dampen domestic demand.

Confronted with a substantial loss in popularity in 1987, the government loosened its restrictive stance on income policy, allowing wages to grow by more than 10%, which led to a serious decline in Denmark's competitive position (Benner and Vad, 2000). The cumulative effect of these measures was a sharp deterioration in the economic climate, resulting in low economic growth, rising unemployment and a reappearance of budget deficits in the late 1980s and early '90s. Thus, Denmark was practically decoupled from the international economic boom of the late 1980s. Partly because of the recession, inflation could be brought under control and the current account balance improved.

Low inflation, comparatively sound public finances and a considerable current account surplus in the early 1990s provided successive Danish governments with considerable leeway to pursue an anti-cyclical fiscal and tax policy. After the Conservative-led government resigned in January 1993, successive left-of-centre governments returned to a cautious Keynesian economic policy, based on income tax reform and a stronger reliance on active labour market policy.

In macroeconomic policy, the Social Democratic government did not give up the fixed exchange rate policy and the orientation towards price stability. This policy mix proved to be very successful. From 1994 onwards, Denmark not only saw a sharp decline in open unemployment (falling from 12% to 6.5% in 1998, partly the result of massively extended paid-leave arrangements in the mid-1990s), but also gained an above-average increase of 4 percentage points in employment levels (which had already been high by international standards). Part of this increase has to be attributed to an expansion of the public sector. Moreover, the deficit in the public budget has been turned into a surplus since 1997, while both inflation and the current account balance are still within tolerable limits. In 1982, automatic indexation of wages was suspended or abolished (for example, the automatic indexation of public sector wages to wage increases in the private sector) as a result of which wage increases dropped to half the figures of previous years. Interestingly, these measures went hand in hand with a change in policy style since support from the trade unions was no longer an indispensable precondition for policy adjustment. While some substantial cutbacks in social benefits were enacted, the basic structure of the Danish welfare state remained intact. The centre-right coalition government did not launch an ideological attack on the welfare state.

While the level of unemployment benefits remained unchanged in the late 1980s and early 1990s, the maximum duration period of and eligibility criteria for unemployment benefits have been restricted so as to strengthen work incentives. Thus, while the Danish welfare state has become more employment-friendly in the 1990s, it did not become subject to major retrenchment. However, the element of private mandatory insurance has been strengthened by making occupational pension schemes quasi-compulsory through collective wage bargaining in the early 1990s. As these are fully funded, defined contribution plans, this increased the robustness of the Danish pension system to demographic change. Moreover, the positive impact of these schemes on national savings contributed to the remarkable improvement in the Danish current account balance, which had been in chronic deficit until the late 1980s (Andersen, 2000).

## **Public sector reform**

### *Administrative reform*

A modernisation programme was launched in 1983 and implemented in three phases, up to 1990. It aimed at increasing efficiency, improving service quality at all levels of the administration and

improving motivation and job satisfaction among public employees. Much emphasis was put on deregulation measures (OECD, 1997a).

When, in January 1992, a coalition government under the leadership of Poul Nyrup Rasmussen (Social Democrat) came to office, the emphasis of this modernisation programme was shifted. The main reform guidelines that replaced the current programme, which had been running for almost ten years, were a focus on customers; a focus on employees as an important resource in the public sector; continuation of budget reforms, with stress on the decentralisation of authority; use of contracts in policy management of public institutions; and extensive use of the limited company as an organisation form in public sector activities. The most recent reform aimed at improving public sector performance and efficiency is the use of national and international benchmarking to enhance knowledge about Best Practice in public sector institutions and allow national bodies to learn from others (OECD, 2000a).

#### *Tax reform*

In the early 1980s, taxes were raised substantially in order to balance the public budget. Later on, in the mid-1980s, there was another rise in taxation, together with a tax reform that reduced the tax deductibility of interest payments on real estate mortgages. This reform was part of a larger set of measures aimed at coping with the deteriorating current account balance around 1986. In 1987, dual income taxation was introduced into Denmark, separating taxation of capital gains from taxation of personal income. Contrary to original plans, the marginal tax rate on capital was raised to 50%. In 1992, VAT was increased to 25%, together with an extension of other indirect regressive taxes.

#### *Budget reform*

Throughout the 1980s, Denmark went through extensive decentralisations of its State budget and appropriation system. As a result, Denmark now has a relatively decentralised budget system compared to other European countries. In addition, budgeting became more and more result-oriented. For this reason, long-term performance contracts are being used, which specify objectives and time scales in which they are to be achieved. This practice is considered to be one of the major achievements of public sector reform in Denmark, with approximately 80 agencies and other institutions entering into performance contracts up to 1999 (OECD, 1998).

In 1991, a major technical budget reform took effect that included a more programme-oriented structure of the budget system. In order to stimulate the integration of administration policy and expenditure policy, the Danish Ministry of Finance combined the Administration and Personnel Department with the Budget Department in 1994. In 1995, the first trials with annual reports for ministries and their agencies were carried out, which led to the permanent introduction of such reports a year later (OECD, 1998).

#### *Privatisation*

In Denmark, only 3 public sector companies were really privatised: a public insurance company called Danica, Danish Telecom and the Girobank (Lane, 1997). Danish Telecom had been in private hands since the mid-1990s. However, the reform of the public sector has had a sharp focus on the creation of the so-called 'gray zone' (*den grå zone*). This involves new organisational structures for the delivery of public services, like the transformation of State enterprises into joint stock companies. These companies are still State-owned, but are made subject to market mechanisms (OECD, 1997a), a process also known as corporatisation.

In 1991, steps were taken to stimulate public sector companies to work more like private companies by introducing more market-type mechanisms. Contracting out was also promoted as a way to increase the efficiency of public sector companies. In 1992, 7 contract agencies were set up and market-tested for all State activities that were suitable for contracting out. New regulations gave State institutions greater freedom and incentives to generate revenue. In 1995, the results of the contract agency trials were assessed and new trials with contracts for Directors General were initiated. The use of these contracts became permanent in 1997 (OECD, 2000a).

## Finland

### **Institutional, macroeconomic and social context**

Like both Scandinavian countries in our selection (Sweden and Denmark), Finland is also a unitary state, though highly decentralised. There is a multi-party political system and governments are usually coalitions, presided over by a Prime Minister who is considerably less powerful than in the UK, for example. The Finnish President can be considered more active and powerful than his or her German counterpart, although not as dominant as the French. Municipalities in Finland are relatively autonomous compared to municipalities in other European countries. Their importance is reflected in the percentage of national representatives in the legislature (80%) who are also active in local politics.

The administrative system in Finland consists of two levels. At national level, there are 12 ministries with rule-making and intervention powers. However, over 75% of public servants work at local level. Thus Finland, like Sweden and Denmark, can be considered a highly decentralised state. In the 1990s, the focus for the national ministries shifted away from detailed regulation towards more broad goal-setting activities (Pollitt and Bouckaert, 2000).

At the beginning of the 1980s, Finland, like others, was in recession due to the second oil crisis. But for the rest of that decade, it went through quite a favourable economic period, with good growth and fairly low unemployment figures, partly influenced by the devaluation of the Finnish markka by 10% in 1982 (Kauppinen, 2000). However, the sudden collapse of trade with the Soviet Union, combined with a general deterioration of the economic climate throughout the world, led to a serious economic crisis in Finland in the early 1990s. Unemployment figures soared into double digits (18.4% in 1994) and the GDP volume fell by 12 percentage points.

In June 1991, an initial commitment to a hard currency was made by the government of the day, pegging the Finnish markka to the ECU. The unfavourable economic position that Finland was then in was supposed to improve by way of 'internal devaluation', which in practice meant lay-offs, terminations and cuts in wages and social security payments. However, the trade unions did not support the proposition of wage cuts, which would have been necessary to seal a collective agreement. The only way out of the ongoing economic crisis was yet another devaluation of the markka by effectively 12.3% in November 1991, widening the ECU bandwidth to 14%. Together with the strong budgetary reform programme launched by the central government, this measure led to the return of economic growth, although not until 1995. In September 1992, the government even let the currency float again.

Later, in 1995, Finland joined the EU and made preparations to join the EMU, which shifted the economic focus more towards Brussels. Policy was aimed at halving unemployment and improving

economic growth. The social partners decided to back the government's policy by signing a social pact, which proved to be very successful and led to an economic growth of 4-5% a year. Finally, due to the successful government policies of the late 1990s, Finland met the EMU convergence criteria in 1997. The unions supported Finland's intention to join the EMU, but not until the government agreed on the use of 'buffer funds', which were to be used to level the effects of business cycles for employees in cases of asymmetric shocks (Kauppinen, 2000).

The general tendency of the social pacts in Finland has changed slightly throughout the years. In the 1980s, the main focus of the social pacts was the protection of the rights of workers, with very detailed collective agreements. The social pacts of the 1990s can be characterised as focused on the competitive position of companies in order to preserve jobs and to insure better working conditions, which implied wage moderation (Kauppinen, 2000; Sauramo, 2000). In the 1970s and 1980s, bargaining was aimed at equal income distribution, but with the changing emphasis of the social pacts towards economic growth and halving unemployment, the income distribution changed in favour of capital and managers. The social pact of 1995, agreed upon in order to support government policy, included quite drastic cuts in social security. An amount of FIM25 billion was to be saved from a total budget of FIM190 billion, which is over 13 percentage points. In addition to these changes, bargaining moved increasingly away from the central level. Many issues were transferred and decided at company level (Alestalo, 2000; Kauppinen, 2000).

## **Public sector reform**

### *Administrative reform*

Although there had been discussions about public sector reforms in Finland for quite some time already in the early 1980s, it was not until 1987 that major initiatives were taken. In that year, an agency was set up that was solely concerned with the support of public sector reforms. Also from that time, a general trend towards decentralisation and devolution can be distinguished. This meant that agencies at the national or central level were downsized and transformed from regulating bodies into research and development/advisory bodies for their ministries.

Another central issue throughout the 1980s and '90s was the improvement of the quality of public services. A variety of reports, acts and other measures were taken. For example, multi-service centres (also called 'one-stop-shops') were introduced in 1993 as service units to provide two or more public services at one location (OECD, 2000a).

In general, political interest in public sector reform in Finland has never been as great as in a country like, for example, the UK. Although Finland took an active part in many international organisations concerned with public sector reform (such as PUMA and EGPA), it did not follow the new trend and developments all the time. Rather, it pragmatically used and piloted those ideas that were suitable for the Finnish situation. Also, the use of consultants or other outsiders to implement reform has been quite scarce in Finland (Pollitt and Bouckaert, 2000).

### *Budget reform*

In 1987, a start was made with pilot projects for result-oriented budgeting. This led to a government-wide introduction of this kind of budget system in 1994, which provides ministries with a better insight into the costs of their agencies.

With respect to the financial relationship between the central government and municipalities, framework budgeting was introduced in 1993. With the high economic pressure of the time, this seemed like a good way to keep control over total amounts of financial support transferred to the municipalities, as well as a good way to shift responsibility for painful decisions about cuts in certain local services to a lower level. In practice, the use of this system means that only one total amount of money per municipality is set and the municipalities themselves decide how to spend it (Pollitt and Bouckaert, 2000).

#### *Privatisation*

There has never been broad political support for massive privatisation in Finland. However, there have been some privatisations on a pragmatic basis over the years (like the government printing company). Also, some agencies have been transformed into State enterprises first and then subsequently into State-owned companies, for example, Post and Telecommunications in 1994 and the Railways, Government Purchasing Centre, State Uniforms Factory, State Granary and Public Building Services in 1995 (OECD, 2000a; Pollitt and Bouckaert, 2000).

#### *Decentralisation, devolution and accountability*

In line with the decentralisation of the Finnish administrative system, policy responsibilities were strengthened in the lower tiers of public administration. The framework budgeting measure, introduced in 1993, is a notable feature of this tendency, as well as the downsizing and/or transformation into State enterprises of many agencies. In addition, some reforms in human resource management were carried out, including a provision for performance-related pay and more decentralised management of staff. These decisions were mostly taken during the Aho administration of 1991-95, but were implemented quite slowly (Pollitt and Bouckaert, 2000).

## **United Kingdom**

### **Institutional, macroeconomic and social context**

Unlike the Scandinavian countries in our selection, the British political system is unitary and highly centralised. The Executive or Cabinet of Ministers is very powerful, reinforced by tight party discipline in the lower house of the legislature (House of Commons). The administrative system is neutral in Britain, which means that up to the level of Permanent Secretary, no political appointments are made. Civil servants are supposed to support and protect 'their' ministers, who are ultimately responsible for the actions of their civil servants. A large proportion of civil servants work in semi-autonomous executive agencies, which are still officially part of the 'parent' department. The existence of these so-called quangos is, in many cases, the result of the redefinition of the competence of local authorities. These competencies were increasingly eroded by central government during the Conservative period, spanning 1979-1997 (Pollitt and Bouckaert, 2000).

Until 1979, before Margaret Thatcher was elected UK Prime Minister, there had always been a macroeconomic policy aimed at full employment in Britain. From 1979 on, that path was abandoned and macroeconomic policy was redirected to fighting inflation ('hard currency'), which had been incredibly high in the years before. This 'paradigm shift' is considered to be mainly driven by liberal ideological considerations of the Conservatives.

The UK recovered remarkably quickly from the recession suffered in the early 1990s. The recovery process was supported by an expansive monetary and fiscal policy. Membership of the EMS was

cancelled in 1992, which led to a substantial lowering of the exchange rate and a sharp fall in short-term interest rates. Fiscal policy was quickly relaxed, allowing the public deficit to rise to 8% in 1993. This had a stimulating effect on the economy and also paid off in terms of employment.

Substantial cuts were carried out in the area of pensions, reducing the replacement rates of the State earnings-related pension scheme from 25% to 20% and extending the calculation basis from 20 to all working years. Since private pension schemes were also encouraged by tax concessions, they increasingly crowded out public pensions, thereby gradually undermining support for public welfare provision. Unemployment benefits also became subject to retrenchment: earnings-related supplements to the basic income allowance were abolished in 1982, while unemployment benefits became liable to taxation. These cuts also had an additional disciplinary effect on the position of trade unions in wage bargaining. The reduction of benefit levels was accompanied by a stronger reliance on means-tested benefits (such as housing allowances), whose proportion in total benefits almost doubled during the Thatcher years. In-work benefits were expanded in the late 1980s and throughout the '90s in order to provide more incentives to make work pay and remove poverty traps. All in all, in combination with the shift to a more regressive tax system and a rise in earnings dispersion resulting from massive labour market deregulation, welfare state retrenchment led to a rapid increase in poverty and inequality in the UK.

The New Labour government, elected in 1997 and led by Tony Blair, modified the Conservative heritage in a number of important ways. Firstly, the Bank of England gained independence from the government; its constitution recognised the need for price stability as a key goal of monetary policy. 'Education, education, education!' were singled out as the top three policy priorities of New Labour. Individual Learning Accounts (ILAs) were introduced to provide subsidised training opportunities to groups that would not generally participate in systems of vocational education and training.

In 1998, New Labour introduced the New Deal as its flagship programme to fight youth unemployment. This programme provides intensive help with skills and job searches to young people between the ages of 18 and 24 who have been unemployed for more than 6 months. It provides mandatory options of subsidised jobs and work experience for 6 months or full-time education and training for up to 12 months. Under the so-called New Contract for Welfare (1998), tax credits were expanded to mitigate unemployment traps.

Also in 1998, the 'Family Credit' scheme was replaced by a new 'Working Families Tax Credit' (WFTC). While the structure of the WFTC is largely similar to its predecessor, some conditions for eligibility have made it more generous (such as the earnings threshold above which the credit is reduced on a tapered basis and the rate of the taper itself). It was expected that in 2001, 1.4 million people would receive the new benefit. Lone parents benefit most from the WFTC scheme.

Another important government initiative was the introduction of a statutory minimum wage in 1999. The National Minimum Wage (NMW) was devised to tackle two problems. Firstly, it is designed so as to avoid the poverty trap of the working poor and, in accord with other policy developments, raise the basic standard of living for British workers. Secondly, it is expected that employers will respond to the higher cost of labour by investing more in the skills of their workers (Clasen, 2000).



## Public sector reform

### *Administrative reform*

Of all the countries engaged in public sector reform, the UK can be said to have the most radical reform history. The first relevant period of reform began in 1979, when the Conservative-led government came to office and launched an attack on 'the big state'. Initiatives in this period were basically aimed at cutting back expenditures of the public services. From 1982 until the late 1990s, more emphasis was placed on increasing efficiency, financial and general management and the performance of public service organisations (Clark, 2000; Pollitt and Bouckaert, 2000). Also, a very important feature of public sector reform in the UK has been the definition of the boundaries of the State and, as a result, the emergence of a vast amount of quangos (new, non-elected single-function agencies, funded and controlled by central government) and later, in the 1990s, many agencies (Clark, 2000).

The era of Conservative governments, from 1979 to 1997, can be characterised by large-scale reform initiatives in multiple areas. Even with the switch to Labour under Tony Blair in 1997, most of the reforms introduced under the Conservatives were kept in place, with only a few minor exceptions. However, further reforms put the emphasis more on the quality of services that the public sector was delivering rather than on trimming down the public sector and introducing and using various market-type elements. Also, further reforms were nowhere near as radical as they had been in the decades before (Pollitt and Bouckaert, 2000).

### *Tax reform*

Consequences on the supply side of this 'paradigm shift' towards a hard currency regime included tax cuts for higher and middle incomes, privatisation of national industries and deregulation of product and labour markets. To make up for losses in the budget, VAT and indirect taxes were raised, a shift that again clearly favoured the better-off.

### *Privatisation*

The UK can be seen as one of the world leaders when it comes to privatisation. In the early and mid-1980s, many public organisations were privatised. With the sale of British Gas, water supply and sewage, British Airports Authority and public housing, among others, about 800,000 employees were transferred to the private sector, comprising almost 50% of the state sector of 1979. This wave of privatisation continued throughout the 1980s and into the 1990s with electricity and railways (Richardson, 1994).

While the budgetary reforms of the early 1980s were already quite a major turnaround in the British public sector, the most radical changes were still to come. After the re-election of Thatcher in 1987, a series of fundamental restructurings were launched. Market-type mechanisms were introduced in health care, community care and education. The 'purchaser/provider' split was imposed by central government as a basic model for most locally provided services (Pollitt *et al.*, 1998). The two main trends of the reforms in the 1990s were a great emphasis on 'customer service' and a sharp tendency towards contracting out and marketisation. Both can be identified in the launch of the so-called Citizen's Charter and the ambitious contracting out and market-testing of programmes.

Although the ideological stand of the 1997 Labour government was one of more sympathy towards public employees and their organisations, it did not reverse the privatisations made by its Conservative predecessor. Even though the urge to privatise was absent during that Blair administration, there still existed a general belief in the scope for improving public management and providing more efficient and high-quality services (Pollitt and Bouckaert, 2000). The Blair administration is now putting great emphasis on public/private partnership. However, there is a shift away from purely transferring risk from the public sector to the private sector towards mobilising private sector expertise and management for large projects.

#### *Budget reform*

In 1982, the Financial Management Initiative was launched in the UK. This required departments to set clear objectives, measure performance against those objectives and critically scrutinise costs. These measures gave way to more decentralised budgets and management to lower levels of the public service (Rhodes, 1998; Zifcak, 1994).

#### *Decentralisation, devolution and accountability reform*

The *Next Steps* report of 1988 led to the creation of about 140 agencies, employing in excess of 70% of the non-industrial civil service (Chancellor of the Duchy of Lancaster, 1997; O'Toole and Jordan, 1995; Pollitt and Bouckaert, 2000). Central to the creation of these types of semi-autonomous bodies is the distance to the central department, so there is freedom to manage (Rhodes, 1998). During the mid-1990s, a number of central ministries were significantly downsized, following a programme of management reviews.

Because the British government wanted to stay in control of most of the devolved public tasks, there has been an enormous increase in arrangements and organisations that regulate or audit the execution of those public tasks. In line with the budgetary reforms in 1982, the National Audit Office and the Audit Commission were created. Their mandate stressed the '3 Es' of economy, efficiency and effectiveness. Later in the 1980s, performance measurement systems were sharpened and annual publications of national league tables for schools became significant media events (Rhodes, 1998).

Another result of the massive devolution of public tasks is the emergence of a gap between the policy-making 'core' civil service and the 'executive' civil service. When Labour came to power in 1997, it hardly reversed any of the measures taken by the Conservatives in the decades before. Rather, the new government intensified the 'league table' system, 'rebranded' the Citizen's Charter programme and launched a Service First initiative. The only things that suffered under Labour were the most unpopular measures of the introduced purchaser/provider split (Pollitt and Bouckaert, 2000).

## **Ireland**

### **Institutional, macroeconomic and social context**

Ireland is a democratic republic, with a directly elected President as head of state. The parliament consists of two houses: the lower house or House of Representatives, and the upper house or Senate. A Prime Minister (*Taoiseach*) heads up the government, which is usually a coalition of two or more political parties.

The administrative system consists of a number of ministries, each headed by a cabinet minister. The power of the local bodies does not cover many policy areas and Ireland can thus be considered as quite a centralised state. Generally, Ireland resembles the British system, having only become independent of it in 1922 (OECD, 1992).

The economic performance of Ireland can be considered dramatic. In the 1980s, extremely high unemployment rates, low growth, low employment, double-digit deficits and an ever-increasing debt characterise that period for Ireland. Then, in 1987, Ireland started conducting economic and social policy on the basis of social partnership agreements, which at the time meant trade union support for radical correction of public finances and a government promise to maintain the value of social welfare payments and to reduce the income tax burden on workers.

From 1987 onwards, Ireland experienced a remarkable recovery of its main economic indicators. Growth resumed and both debt and deficit decreased rapidly. Initially, the unemployment figures seemed to remain at the previously high levels, but that changed in the mid-1990s when unemployment in Ireland was reduced rapidly down to the European average. This turnaround is partly due to the fact that subsequent social pacts emphasized the stimulation of employment growth and addressed the problem of long-term unemployment. Wage restraint enhanced competitiveness, which has been converted into employment growth during the period of *Partnership 2000*, the main social pact negotiated in 1996.

In addition to the adoption of a social partnership approach to economic restructuring and the nature of the subsequent social pacts in Ireland, other factors that have contributed firmly to Ireland's economic recovery during the 1990s include investments in education, information technology, the attraction of inward investment and full participation in European integration. But despite this dramatic improvement, Ireland's economy was impacted by the Europe-wide recession of the early 1990s. However, after that minor setback, rapid growth set in again while debt and deficit also started to decrease.

With the introduction of social partnership in Ireland, a new impetus was given to the development of social policy. Various new measures were taken, not all of which improved the high rates of inequality that Ireland dealt with. The use of percentage (instead of flat-rate) wage increases only widened the gap between high and low wages. Also the tax cuts (expressed in rates) that were carried out favoured skilled workers over unskilled as income from capital over income from labour. Inequality in Ireland still remains among the highest in the OECD. However, the fact that the fiscal stabilisation of the late 1980s was not achieved by placing the burden of adjustment on the welfare state can be called an achievement, as can the incredible employment growth that was reached in the following years.

## **Public sector reform**

### *Administrative reform*

As a result of the economic and budgetary pressures of the 1980s, cuts were made in the public expenditures. This caused growing concern about the quality of the delivered services, which led to a reform initiative in the mid-1980s. This 'Serving the country better' programme, however, failed to have a great impact on the public sector.

The ongoing economic pressures of the late 1980s put public sector reform back on the political agenda in the early '90s. This led to the development of the Strategic Management Initiative (SMI), launched in 1994 by the Prime Minister and aimed at providing an excellent service to the public, contributing to national development and making the most efficient and effective use of resources. Furthermore, there have been several sectoral initiatives aimed at improving the organisational capability to deliver high-quality service in a flexible, responsive and cost-effective way in specific sectors (OECD, 1998).

Two years later, in May 1996, another integrated programme of change was introduced. Called Delivering Better Government (DBG), it can be considered an outgrowth of the SMI programme. The key initiatives of both programmes are delivery of quality services; regulatory reform; open and transparent service delivery; effective management of cross-cutting issues; devolving authority and accountability; new approaches to human resource management; more effective financial management; and improved use of information technology to meet business and organisational needs (OECD, 1998). The public sector reforms in Ireland can thus be seen to be highly integrated, especially when compared to the multitude of separate initiatives taking place, for example, in France.

#### *Tax reform*

During the period of economic hardship in the 1980s, Ireland tried to close large gaps in its budget by increasing taxes. However, the economic position of Ireland only worsened in those years. In addition, employment figures became more and more unfavourable, which again led to a decrease of the income tax base.

The social pact that was closed in 1987 contained, among other things, a reform of the income tax system. In practice, this reform meant a reduction of the tax burden on workers in exchange for wage moderation. In the years following, this type of exchange has played an important role in the establishment of new social pacts. Even until recently, Irish tax reform quite prominently features reductions in order to maintain and improve competitiveness and to encourage the take-up of employment.

#### *Budget reform*

As a part of the DBG programme, a start was made with introducing a new system of multi-annual budgeting in 1996. This system operates to a fixed annual cycle to produce a rolling 3-year budgetary process. In addition, each programme of expenditure is subjected to a thorough review at least once every 3 years (OECD, 1998).

#### *Decentralisation, devolution and accountability reform*

With the SMI programme, there has been some advancement in devolution. Several sectoral strategies were developed under SMI and in close co-operation with social agreements. It is recognised that successful change must be based on a partnership approach, both at the overall public service level and within individual sectors and organisations.

The *Programme for Prosperity and Fairness* (PPF), which is the latest agreement of the social partners, takes the reform of accountability a step further by introducing performance indicators for organisations in each sector. These organisations have committed themselves to meeting performance criteria that have been developed in each sector. The other features of the programme

aim to further improve the quality of service delivered by these organisations by increasing flexibility, adaptability and capacity.

## The Netherlands

### **Institutional, macroeconomic and social context**

The level of decentralisation in the Netherlands is substantially higher than in the UK, but is still below the level in Sweden, Denmark and Finland. The sub-national authorities (provinces and municipalities) have a considerable package of labour-intensive welfare state services. The Netherlands is a unitary state, the government of which usually consists of two or more coalition parties that form a majority in the Second Chamber, the most important legislative body.

In the Netherlands, there is a long tradition of deliberation, consultation and a never-decreasing search for consensus. This tradition is reflected in extensive advisory and consultative networks around certain policy areas and ministries, as well as in the Social Economic Council, an institutionalised consultative body with representatives from employers, workers and policy experts. The ministries have, in the absence of a strong central power, a good degree of autonomy and are quite open to external policy advice (Pollitt and Bouckaert, 2000).

With the second oil crisis of 1979, the Netherlands experienced a more severe recession than any other country in Western Europe. Real demand suffered a serious decline, while unemployment reached double-digit levels. Employment fell to an all-time low of 51% and the public deficit jumped to 5.8% in 1983. In the face of rising real interest rates, the main policy objective became fiscal retrenchment. The depth of the crisis of 1981-82 was the catalyst for policy change. The newly elected centre-right coalition government under Lubbers in 1982 immediately threw its support behind a deflationary macroeconomic policy programme. Since 1983, a hard currency regime is being followed, with the guilder pegged to the German mark. Wage indexation was suspended and a freeze imposed on the minimum wage after it had been reduced by 3%. Public sector wages were also cut by 3%.

The shift towards fiscal retrenchment and a hard currency meant that changes in the international economy had to be countered by voluntary wage restraint and/or productivity increases. With soaring unemployment and declining union membership, after a decade of failed tripartite encounters, the Lubbers coalition's entry into office was crowned by the now famous Wassenaar Accord in November 1982. With the Accord, the unions recognised that for a high level of investment, essential for job creation, a higher level of profitability was required. They agreed to moderate wages below productivity growth in exchange for a modest reduction in annual and weekly working hours. Wage restraint in the Netherlands ultimately paid off in terms of revolutionary job growth. After having fallen to the lowest employment ratio of all countries in our study (50.8%) in 1984, employment increased steadily to a ratio of 54.8% in 1990 (still about 13% below the OECD-18 average).

By the late 1980s, it became obvious that the Dutch welfare state, despite economic recovery through wage restraint, was trapped in a vicious cycle of 'welfare without work'. Cuts in benefit levels by 10% in 1985 and 1987 were not enough to manage the crisis of inactivity. Employment growth, however, did create the economic and political preconditions for the transformation of social security and labour market policies in the 1990s.

In the area of social security policy, the no-nonsense Lubbers I and II governments had exhausted the 'price' policy of bringing expenditures under control through the freezing and lowering of benefits. Emphasis therefore shifted to the 'volume' policy, aimed at reducing the number of recipients (Visser and Hemerijck, 1997). Unavoidably, the political crisis of the Dutch welfare state came to revolve around the extended use of disability pensions for reducing labour supply. In spite of massive popular resistance, the reforms enacted a reduction of replacement rates, with new medical examinations on the basis of stricter rules. Over time, benefits would decrease to 70% of the statutory minimum wage.

In the 1994 Dutch elections, the Lubbers III coalition was effectively voted out of office. However, the new 'purple' coalition of Social Democrats, Conservative Liberals and Progressive Liberals (the first government since 1917 without a Christian party) did not slow down on the reform effort. The PvdA (Labour Party) had a bottom-line condition: the level and duration of social benefits would not be tampered with. From this position, the government committed itself to the 'Jobs, Jobs and More Jobs!' strategy. This approach made its imprint on all kinds of social security and labour market policy initiatives. There were efficiency improvements in social security, including the introduction of financial incentives through a partial re-privatisation of social risks (i.e. shift the financial responsibility for sickness benefits to individual employers) and a managed liberalisation of social policy administration, which reduced the involvement of the social partners in the system of social insurance. A second string of measures concentrated on the introduction and intensification of activation obligations for the long-term unemployed.

In the area of labour market policy, an underdeveloped area in the Dutch post-war policy profile, many new initiatives were launched. The public employment service was further liberalised. Additional job programmes for unemployed youths and long-term unemployed gained in importance. Finally, the government has introduced several kinds of employment subsidy schemes, based on a reduction of social security contributions paid by employers.

## **Public sector reform**

### *Administrative reform*

Important objectives of public sector reform in the Netherlands during the 1980s were coherence and integration, and reduction in the size of government. Apart from an emphasis on privatisation, the centre-right government of 1982-86 deployed a series of 'great operations' that focused on trimming central government spending, decentralisation to lower levels of government and simplifying legal and bureaucratic rules and procedures.

Between 1992 and 1994, the path of size reduction was still pursued, while attention was also focused on the core tasks of government departments. In 1993, a policy document entitled 'Towards core ministries' was published by a committee on political, administrative and constitutional renewal. The strategy involved was to analyse the various tasks of government departments and if a task was found to be a non-core task, it was reallocated or reduced (OECD, 1997b).

### *Privatisation*

During the centre-right coalition years of 1982-86, privatisation was a prominent feature of the radical reform package of the time. Four main State companies were either corporatised or wholly

sold off (Postbank, Post and Telecommunications, Royal Mint and the Fishery Port Authority). An important privatisation, under a Liberal/Social-Democrat coalition (1994 until the present day), was that of the administration of social security. This was part of the general tendency towards a smaller, more decisive and transparent government (OECD, 1998).

#### *Budget reform*

In the 1980s, extensive financial reforms were instituted both in central and local government. A key element of this initiative was in the introduction of encumbrance accounting in central government, to be applied in conjunction with the cash concept of accounting already in use. Accounting for obligations may be considered a key factor in controlling central government spending, since cash disbursements will inevitably result from previously established operations (Boorsma and Mol, 1995).

During the 1990s, more budget reforms were carried out, mainly aimed at increasing flexibility and accountability. The latter objective was to be met by introducing performance indicators for government departments. These indicators make the relationship between funds deployed and the resulting activities more visible, thus making it easier to steer the government in a more result-oriented way. Increasing flexibility was done by, among other measures, introducing an 'end-of-year margin' of 0.25% in 1993 (increased to 1% in 1995), allowing government departments to transfer that percentage of their initial budget to the next year.

#### *Decentralisation, devolution and accountability reform*

The 1980s saw the creation of many ZBOs or autonomous administrative authorities in the Netherlands. This course was abandoned in the 1990s, when the more fashionable way to devolve tasks was to establish agencies. These agencies can be considered semi-privatised bodies, with broader powers on the deployment of resources. At the same time, various instruments were developed, such as indicators, policy evaluation and studies of financial renewal. These instruments, together with the broadening of powers on resources, made it possible for the agencies to work more efficiently (OECD, 1998). Between 1991 and 1998, more than 20 departmental agencies were set up. Throughout the whole period, there was a trend to develop and refine performance indicators for a widening range of public services (Mol, 1995; Pollitt and Bouckaert, 2000).

Apart from the devolution of autonomy to bodies like ZBOs and agencies, and as part of an operation aimed at moving the execution of tasks closer to the public and strengthening the accountability of elected representatives, a decentralisation operation was carried out in 1991. This operation consisted of transferring tasks to the other two levels of government — the provinces and municipalities (OECD, 1998).

## **Germany**

### **Institutional, macroeconomic and social context**

The administrative system in Germany is quite a complex one. At the base, there is a large number of municipalities (*Gemeinde*), which are grouped into a number of counties (*Kreise*). These counties are part of one of the 16 states or *Länder* which, in turn, comprise the Federal Republic of Germany. The *Länder* have sovereign power of their own, while still being part of the federal state. Thus, with the multitude of administrative levels and the distribution of public tasks among these levels, the

management of public administration and reform is a complicated matter. All in all, Germany can be considered a highly decentralised state, with the federal administration mainly concerned with law-making and not so much with the execution of public policy. For that reason, the central administration is relatively small compared to that of other countries (Pollitt and Bouckaert, 2000).

Whereas most other European countries responded to the first oil crisis with Keynesian measures, Germany had adopted a tight monetary policy already in the 1970s. It entered the 1980s under comparatively favourable conditions: inflation was modest by international standards and public deficits were within tolerable limits, while unemployment was still at the comparatively low level of 3.2% in 1980. In the wake of the second oil crisis of 1979, however, the central bank, faced with a still expansionary fiscal policy, put on the brakes by sharply raising interest rates. Moreover, when the economy started to recover in 1983, policy-makers did not sufficiently support the recovery process by way of monetary and fiscal expansion, although wage policies were moderate and oil prices falling at the time. In the second half of the 1980s, macroeconomic policy and wage policy worked together much more smoothly. Inflation had fallen from 6.3% in 1981 to -0.1% in 1986 as a result of moderate wage policies and falling oil prices. Due to the then stimulating effects of monetary and fiscal policy, the economic recovery also paid-off in terms of rising employment levels, reaching almost 65% at the end of the decade (Franzmeyer *et al*, 1996).

In 1990, German unification changed things dramatically. The East German economy collapsed immediately in the face of Western competition. The conversion rate of 1:1 for cash deposits and 2:1 for savings (reflecting a political decision in the run-up to federal elections rather than to sound macroeconomic analysis) more or less destroyed the competitiveness of East German companies and led to a collapse of production and employment. Moreover, wage increases during the initial unification boom and rising budget deficits triggered inflationary pressures. While inflation on the OECD-18 average fell from 5% in 1990 to 2.9% in 1992, the opposite occurred in Germany, where inflation rose from 2.7% to 5.1% over the same period. The Bundesbank, strictly committed to maintaining price stability, reacted with a very restrictive policy between 1990 and 1993, as a result of which the German mark appreciated massively against other currencies. Together, these factors triggered a deep recession in 1993.

During the early years of the 1990s, the German government increased social security contributions sharply. This was a result of massive labour shedding at the time due to unification, which had put Germany (especially East Germany) in a poor competitive position and forced many companies to reduce their workforce. Those involved in wage bargaining reacted to the higher social contributions by ever-increasing wage demands, thus forcing companies to lay off even more workers. This downward spiral led to increasing unemployment ratios during the early 1990s.

## Public sector reform

### *Administrative reform*

The administrative reforms made in Germany are in general characterised by 'incrementalism' (Benz and Götz, 1996; Clark, 2000) instead of real fundamental changes. The 1970s and '80s reform package consisted of a citizen-oriented administrative simplification, the contents of which were debureaucratisation, increased transparency and improved participation. Reform initiatives have for the most part been carried out at local level, with not many initially at state (*Länder*) or federal level. The lower the level of government, the more reforms that have been carried out



(Reichard, 1997). Also, most of the public service reforms have been initiated within local bureaucracy by senior administrators and academic specialists, rather than by politicians. The German administrative modernisation may thus be understood as a 'bottom-up' process (Klages and Löffler, 1995).

In the 1990s, a reform package called the 'New Steering Model' (*Neues Steuerungsmodell*) was put into practice by local governments and some *Länder* in Germany. This initiative can be seen as a modernisation of the administration, which is seen as a performance-oriented delivery service to citizens. Elements of this model include result-oriented budgeting, cost calculation of administrative products, introduction of commercial bookkeeping, decentralised resource accountability, definition of indicators for quality standards, customer orientation, outsourcing, contracting out, privatisation and openness to competition. In addition, attempts were made in the 1990s to increase flexibility in personnel management. However, these had only a slight effect and left the German personnel system relatively rigid compared to other countries (Pollitt and Bouckaert, 2000; Röber and Löffler, 2000).

Because of the specific problems facing public administration in East Germany, that part of the country had a totally different trajectory of modernisation of local government than West Germany (Pollitt and Bouckaert, 2000). The transformation encompassed changes in governmental competencies (from holistic planning authority to a balancing function, typical for a market economy), civil service (from political cadre administration to a civil service based on professional qualifications), organisation (from unity of powers to horizontal and vertical separation of powers) and procedures (from the guidance principle of the Party to legalistic administrative behaviour).

Although the emphasis of public sector reform in Germany lies at the local level, there have also been reforms at federal level. As in the Netherlands, the reform policy is aimed at a 'lean state' that confines itself only to its core tasks. In 1995, the Lean State Advisory Council was created and produced 15 resolutions on specific public management issues and a detailed final report before its work was concluded in 1997. The focus of this lean state policy was on the modernisation of ministries and agencies in a gradual way, so that those bodies got the chance to prepare their own path. All of the individual measures were merged into a single overview, called 'Administrative Reform of the Federal Administration', from which every agency or ministry can take new ideas for their own modernisation. This process is ongoing, at least up until 1998 when two federal reports were issued on the state of the process of federal modernisation (OECD, 1998).

#### *Tax reform*

In 1990, the Kohl-led government decided to implement a demand-stimulating tax reform, while from an economic point of view, a more restrictive stance in fiscal policy would have been required during the unification boom. In addition, throughout the 1990s, there was a rapid increase of the tax burden on labour. Also, between 1990 and 1998, social security contributions rose from 35.6% to 42.1% (Manow and Seils, 2000a).

#### *Privatisation*

Privatisation has not been the most important element in public sector reform in Germany. However, the Liberal Conservative government decided on an overall privatisation programme in 1983, reacting to pressures exerted by neo-liberal circles and its Free Democratic coalition partners. It was not until 1985 that the Minister of Finance presented the general programme and

actual privatisation proceeded. The programme was far from radical (compared to privatisation in the UK, for example), with only 13 companies being judged to be in a fit state to be privatised. In the majority of these cases, the intention was to retain a share of at least 51%. Nevertheless, this decision triggered such a fuss within the Coalition that the cabinet finally decided to reduce the list to 5 eligible companies. The upshot, far from resembling anything like a full privatisation, was a reduction of the government-owned shares in some of these companies (Esser, 1994). However, by 1988, the federal government had got rid of its remaining shares in Volkswagen and VIAG, and those companies were thus officially privatised. An important note here is that although the federal government sold all of its shares, the *Länder* in many cases retained their shares in certain companies for reasons of regional, industrial and employment policy (Derlien, 1996; Esser, 1994).

In the end, only a few German State companies were genuinely privatised — the mail (after being divided into 3 sectors in 1987) in 1995, Telekom in 1994 and federal rail in 1993 (Pollitt and Bouckaert, 2000).

#### *Budget reform*

In 1986, a uniform accounting system was introduced that involved organisational simplification and better use of IT. In the early 1990s, global budgets were introduced as part of the *Neues Steuerungsmodell* in order to increase flexibility. The local council no longer decides on the details of a department's budget, but concentrates on the political implications of the budgetary framework (Reichard, 1997). In addition, various other measures were introduced to increase efficiency and accountability, including result-oriented budgeting. In 1995, a pilot project was launched to test flexible budgeting instruments. This led to the incorporation of experiences with these instruments into the Budget Law Further Development Act (*Hauhaltsrechts Fortentwicklungsgezetz*) of 1998. Also in that year, Cost and Result Accounting (CRA) was introduced in more than 20 ministries and other authorities.

#### *Decentralisation, devolution and accountability reform*

A major part of the *Neues Steuerungsmodell* was the strengthening of accountability by means of decentralised resource responsibility. The transfer of responsibility from central service departments to sectoral units finally led to semi-autonomous result centres, which are fully accountable for their tasks and the utilised resources (Reichard, 1997).

In addition, changes in accounting systems have been made in various communes. Although German law still prescribes the use of a cameralist accounting system, changes to accounting systems have already been made by local authorities. This has been done by introducing cost accounting methods to identify the cost of certain public services and to allow the internal clearing of overhead costs among service and other sectoral units.

## Italy

### **Institutional, macroeconomic and social context**

Italy is a democratic republic and unitary state, headed by a President, elected by parliament, who has substantial influence on the composition of the Council of Ministers and the nomination of its head, the Prime Minister. The Italian parliament consists of two chambers with identical powers ('perfect bicameralism'). There is no majority voting system in Italy, which quite often leads to unstable coalitions and a certain instability of the executive branch.

The administrative system consists of ministries at the central level, headed by ministers who are part of the Council of Ministers. Below this level are the provinces, each with central government represented in the form of a 'Prefect of the Republic'. The lowest level with some administrative power are the municipalities, which take care of certain functions such as social aid, primary education and some aspects of health care. Despite these various levels, Italy can nonetheless be considered as quite a centralised state (OECD, 1992).

In the early 1980s, high levels of public deficits and escalating inflation made a re-orientation of macroeconomic policy inevitable for Italy in the wake of the second oil crisis. The so-called 'divorce' in 1981 between the government and central bank implied that the Banca d'Italia was no longer obliged to finance residual government debt. The bank's restrictive policy pushed the government to adopt a policy of budgetary restraint. This, however, did not suffice to reduce the double-digit budget deficit (since rising real interest rates required higher spending on public debt serving), which rose from 4.4% of GDP in 1979 to almost 11% in 1993 (OECD, Economic Outlook). Nevertheless, the tighter stance in macroeconomic policy had a depressive effect on domestic economic activity. Although this brought down inflation from 21.2% in 1980 to a low of 4.6% in 1987, employment fell from the already low level of 56.8% in 1980 to 53.4% in 1985. In spite of a growing world economy in the second half of the 1980s, employment in Italy remained stagnant at about 53% for the rest of the decade.

It was only in the 1990s, pressed by the impending Maastricht entry exam for EMU and the growing pressure from international financial markets, that Italian policy-makers were able to turn a vicious cycle of industrial decline, budgetary crises, welfare without work for some and poverty for many, into a virtuous policy cycle of the *risanamento* of the Italian economy and its welfare state.

The rapid growth of the public debt until the early 1990s favoured a number of speculative attacks on the Italian lira in 1992. For this reason, Italy had to resign from the EMS. However, the EMU entry exam made fiscal restraint indispensable. A strong devaluation of 30% in 1992 formed the stepping stone for a miraculous recovery and a succession of policy reforms in the areas of industrial relations, social security and labour market policy and regulation. During the 1990s, the public deficit at last came down from over 11% in 1990 to 2.6% in 1998. Outlays for public debt serving fell steadily from 1995 onwards and inflation dropped from 6.5% in 1991 to 1.7% in 1998, thereby allowing Italy to join the EMU in 1999.

The record of social policy of the Italian governments of the 1980s is mixed. Although policy-makers introduced a number of restrictive reforms, designed to keep inflation and public expenditures at bay, the guiding principles of Italian social policy were left intact. Italian social security systems largely follow the Continental pattern of transfer-oriented, payroll-financed social insurance. However, social protection in Italy is more skewed in favour of insider groups in the labour market than in such Continental welfare states as Germany and the Netherlands.

Ground-breaking advances in welfare expansion were made during the 1960s and '70s in the areas of old age, disability, survivor and short-term income compensation. But, as Ferrera (1996) argues, these policies disproportionately benefited the older generation of labour market insiders at the expense of unprotected younger cohorts working under atypical contracts. By the late 1980s, Italy was becoming a pension state rather than a modern welfare state, with pension benefits absorbing

about 50% of total social expenditures. With relatively low contributions, public deficits needed to finance Italian welfare. In addition, the polarised system of Italian social protection had a territorial component, reflecting the split between the rich and industrialised northern regions and the poor and underdeveloped *mezzogiorno* to the south.

For most of the post-war period, clientelism reinforced the high degree of labour market segmentation and social protection dualism. The insider-outsider divide was finally reinforced by the fact that, as in many other Continental welfare states, the administration of social security funds was largely in the hands of the social partners, who were primarily concerned about the interests of their core constituency rather than the interests of the labour market outsiders. While some proposals were put forward to rationalise the pension system and restore its financial balance (by raising the age of retirement and changing the benefit formulas), no progress was reached beyond incremental cuts.

### Public sector reform

#### *Administrative reform*

It cannot be denied that Italian governments did adopt administrative reforms in the 1980s and early 1990s. However, the reforms carried out were far from radical or numerous compared to those, for example, in the UK (Cananea, 1996). Some steps were taken in 1990-91, such as measures aimed at creating a more transparent and accountable administration, narrowing the gap between the administration and ordinary citizens, and strengthening the role of local authorities in delivering public services. Then, in early May 1993, the Ciampi government launched a more general and encompassing public sector reform programme (Cananea, 1996; OECD, 2000a). This had four main goals: the reorganisation of all areas affected by referenda; the prevention of corruption; the separate consideration of administrative procedures in the light of a statute already enacted in 1990; and a radical change in the role of the public sector by means of privatisation and the introduction of regulatory bodies. Also in 1993, a report was issued on the condition of the public administration. This advised that administrative bodies had to be rationalised in several ways — eliminating waste and inefficiencies, and reorganising functions, structures, staff resources and procedures, yet maintaining the quantity of public services but with increased quality (Cananea, 1996).

In 1996-97, the reform process was further developed with a new and broad strategy formulated by the Prodi-led government. A period of intense legislative and management changes followed, carrying out as far as possible the reform lines already begun. The principles of this strategy are still efficiency, accountability and citizens' participation and empowerment (OECD, 2000a).

#### *Privatisation*

During the 1980s, a series of privatisations were implemented in Italy. However, these were not directed by government policy or initiated by the Ministry of the Treasury, but done on the initiative of the so-called public holding companies (*enti di gestione*). These privatisations were thus pragmatic actions by different companies and were not part of an encompassing governmental policy (Cassese, 1994).

However, in 1989, when the Andreotti administration came to office, this stance changed. A proposal was made to turn the public holding companies ENI and ENEL (both *enti di gestione*) into

joint stock companies, with the Treasury as the beneficiary of the privatisation proceeds. There were major objections to this plan by the *enti di gestione*. At the end of 1991, a decree was approved by the government, which eventually became law, making it possible to privatise the *enti di gestione* and two other types of company falling under public competence. However, further objections (mainly against the destination of the privatisation proceeds) from many companies still made implementation difficult. After the next government came to office in 1992, the project was given an extra impetus, resulting in the conversion of 5 State-owned giants (including railways) into joint stock companies and thus moving a step closer towards privatisation of those companies. Further privatisations included the bank Credito Italiano and the steel and engineering company, Nuovo Pignone, at the end of 1992 (Cassese, 1994).

A number of companies were semi-privatised during the 1990s, including many banks and the postal service. Shares may thus be freely acquired by parties other than the State so long as they comprise a minority share. In this procedure, the Treasury is not the beneficiary of the proceeds (Cassese, 1994).

After this somewhat slow start, a massive wave of privatisation occurred in the 1993-99 period, generating a revenue of up to €91 billion (OECD, 2000a).

#### *Budget reform*

Between 1992 and 1998, major budget reform was carried out, which, along with other measures, helped turn around the vicious economic cycle that Italy was in at the time. These reforms stimulated the *risanamento* that Italy was experiencing and finally led to the achievement of the EMU entry criteria.

## Portugal

### **Institutional, macroeconomic and social context**

The political system in Portugal can be characterised as a parliamentary republic, with the parliament consisting of one chamber. There is a President of the Republic, who is directly elected by the people. The Portuguese public administration can be considered as highly centralised.

At the time of the democratic revolution in 1974, Portugal had a small public sector and underdeveloped welfare institutions. In the course of democratic institution-building, the public sector and welfare state expanded rapidly. Simultaneously, the country entered a deep post-revolutionary crisis. Until the middle of the 1980s, the situation was characterised by political and economic instability, high unemployment and inflation, and a deep crisis in the public finances. In the late 1970s and early '80s, governments were forced to submit to the IMF's recovery plans for the country.

In the mid-1980s, a major shift occurred in Portugal's situation, starting with the stabilisation of public finances and the joining of the EC, supported by growing political stability. The economy and employment began to recover and inflation decreased, from almost 30% in 1984 to about 12.6% in 1990.

In 1989, a major amendment to the constitution (*Constituição da República Portuguesa*) opened the way for the liberalisation of the economy and the privatisation of public enterprises, starting with

the banks and insurance companies that had been nationalised in 1975. Liberalisation and privatisation, as well as moderate monetary policies to guarantee the country's entry into the Euro Zone, have been consensual between the two major parties in parliament (the Socialists and Liberal-Conservatives) and continue to be the 'leitmotiv' or trademark of Portuguese macroeconomic policies.

In the latter part of the 1990s, the Socialist government clearly fixed the objective of participating in the first phase of the euro and reaching the required EMU convergence criteria. Macroeconomic policy was oriented to this principal objective, as well as to preventing asymmetrical shocks and their different internal sectoral impacts. The defined strategy was to improve competitiveness, skills and education, together with new concerns on active employment policies and social policy. EMU criteria regarding inflation and public deficit become more important in the debate on public finance.

As a result of these measures, Portugal complied in time with the EMU criteria. The objective was attained without a decrease in public employment, with a very low unemployment tax (compared with the EU average), with an increase in the level of employment (both in the public and private sectors), but with the lowest level of wages in the EU. The inflation rate in 1999 was 2.2% and increased to 2.8% in 2000, a change also observed in 2001. This increase is more a result of major external factors (oil prices and raw material) than internal ones and is common to that observed in other Euro Zone countries.

During the 1970s and '80s, while other Western European countries made serious cutbacks in their welfare programmes, basic welfare institutions were created in Portugal, including the general public scheme for old-age pensions (*Segurança Social*) and the national health service (*Serviço Nacional de Saúde/SNS*). The expansion of welfare institutions was limited by tight budgetary constraints and never reached the levels of north-western European countries (efforts to control the SNS' dramatic budgetary situation have not yet succeeded).

Since 1995, the Socialist government has been successful in consolidating the public pension scheme and also introduced, for the first time, a general welfare aid, the Minimum Income (*Rendimento Mínimo Garantido*), with controlled costs and considerable social pay-off. Another important issue was the social reform of 2000 (*Lei de Bases da Segurança Social*), which includes the principle to guarantee the public system of social security (although some open issues remain). It was approved despite opposition from the centre and right-wing parties, who are oriented to deregulation and privatisation (Paz Campos Lima, 2001).

## Public sector reform

### *Administrative reform*

The most important recent change in the Portuguese administrative system was the creation of a new ministry in 2000 by the XIV Socialist government. The State and Administrative Reform Ministry has competence to define the State and public administration reform, as well as the co-ordinated definition of organisation and management of human resources and public employment. Earlier administrative reforms were mainly aimed at the decentralisation of previously centralised authorities, but have not had much success as yet.

### *Tax reform*

Implementation of a major change in fiscal policy started in 1989 with the defining of income taxation (IRS or taxation on personal income, and IRC or taxation on corporate income). The taxation of goods and services include IVA (added value taxation), as well as specific taxes. The Social Security Public System is not funded by these taxes, but by autonomous contributions in charge of employees and employers.

Although incomes resulting from taxation increased, the total amount of fiscal incomes/GDP (approximately 35%) continues to be lower than the average in OECD countries (43%) and far below that of northern European countries.

Between 1994 and 1997, the total of corporate income taxes (IRC) increased to 63.5%, while personal taxes (IRS) increased to 23%. For many years, companies and individual liberal contributors were, and still are, responsible for fiscal escape and fraud. Fiscal escape has been, and remains, the major reason for the low level of tax income. In fact, this low level does not correspond to the increasing of corporate profits and economic activity observed. As the CGTP (1999) state: 'More or less 50% of companies don't pay year after year any tax, and the vast part of IRC is based on the 200 bigger companies, in particular those where the state has participation on the capital.'

Taxation on wealth and patrimony is lower in Portugal than in other European and OECD countries (approximately 2.5% of fiscal income in 1995-97, compared to 4.5% EU average), while the weight of the goods and services taxation is higher. Last but not least, the fiscal benefits to companies had a spectacular increase (324% in 1993-97).

With the 1999 State Budget (*Orçamento Geral do Estado*), some corrections were made, in particular regarding fiscal benefits to diminish the pressure on low incomes and employees' income. But the 2000 Fiscal Reform represents a major shift on that issue, as well as the aim of improving fiscal control and implementing fiscal innovations, such as the partial lifting of bank secrecy regulations and the taxation of the 'holdings' added value (previously tax-free). However, this reform did not finalise the 'off-shore' regime of Madeira (Paz Campos Lima, 2001).

### *Privatisation*

Immediately after the constitutional amendment on economic liberalisation in 1989, a vast privatisation programme was implemented in Portugal, starting with public companies in financial services (banks and insurance companies), transport and manufacturing. This was part of a common understanding that State subsidies to inefficient, overstaffed and uncompetitive industries had to be cut in order to tackle inflation and improve long-term industrial competitiveness (Corkill, 1994).

In a second phase, public utilities (energy and telecommunications) were partly privatised, while the process continued in services and manufacturing. After a third wave of privatisations, the public sector had been radically reduced to a few core units (one financial group, national post service, railway and air transport).

At the same time as these privatisations were occurring, higher education and health services were opened to private initiative. But these sectors have continued to be dominated by public services.

*Budget reform*

The Socialist government has recently improved the process of budget reform with two new laws that have contributed to the modification of the State Budget's configuration. Indirectly, major changes with important consequences in budget reform were established with the social reform of 2000 (*Lei de Bases da Segurança Social*). Solidarity functions, previously funded by Social Security, were transferred to the State Budget, which had only dealt with Minimum Income up to then. Directly, the 2001 Law of Budget Reform (*Lei do Enquadramento Orçamental*) defines a new global framework concerning the organisation of public accounts and procedures for their elaboration, together with how the government must present them, the way in which they should be controlled and new guidelines for the 2002 State Budget. (This law was approved by parliament in June 2001, despite opposition from the right-wing parties of the PSD and CDS, and published in August that year.) The application of the reform includes a limit to the current expenses of 4%.

*Decentralisation, devolution and accountability reform*

Attempts in Portugal to improve regional decentralisation, with the creation of regions having an elected administration, have failed up to now. Although Socialist governance submitted a proposal, the results of a national referendum were negative. So far, there is a trend towards 'soft' decentralisation, more in the form of devolved autonomy (not elected bodies).

**France****Institutional, macroeconomic and social context**

An important feature of the French political system is the existence of a strong, directly elected President next to a separately elected government. The occurrence of a situation in which the President has a different party identification to the current government is not uncommon. The French administrative system is not nearly as decentralised as, for example, the German system. The execution of public policy is carried out mainly at central level or through a prefect (*préfet*), whose job it is to co-ordinate the central government services (Pollitt and Bouckaert, 2000).

The macroeconomic course followed by the French government of the early 1980s was a purely Keynesian one. Mitterand's *programme commune* included raising the minimum wage by over 10%, creating additional jobs in the public sector, lowering the retirement age to 60 years and providing one extra week of vacation (bringing the total to 5 weeks), together with two devaluations of the franc and the nationalisation of 36 banks and 11 large industrial conglomerates. The aim of creating 'national champions' was in full agreement with the French tradition of indicative planning and statism. The policy strategy of an isolated Keynesian experiment of 'competitiveness through nationalisation', in the midst of a low growth and highly restrictive international economic environment, proved wholly ineffective. An imminent monetary crisis in 1983 forced the French Socialists to make a complete U-turn on their Keynesian *programme commune* to a policy of competitive disinflation or *désinflation compétitive*, involving the rather orthodox strategies of monetary stability and fiscal retrenchment (Boltho, 1996).

With the paradigm shift towards *désinflation compétitive*, interventionist or *dirigiste* principles were gradually abandoned. For example, the heavy State subsidisation of selected industrial sectors was reversed; credit, price and capital controls were lifted; and restrictions on layoffs and temporary and part-time employment were relaxed (Levy, 2000). However, central to the strategy of competitive disinflation was the *franc fort*. By pegging the French franc to the German mark in the



second half of the 1980s, monetary policy-makers hoped to bring inflation down to the German level and to lower interest rates by reducing the risk premium for foreign investors. Thus, at the end of the 1980s, *désinflation compétitive* was firmly rooted in French macroeconomic policy. As it turned out, macroeconomic key indicators did converge towards German levels, but employment has been declining ever since the French (successfully) adopted a hard currency regime. Although public employment increased by 1.1% in the 1990-98 period, this was not enough to compensate for the decrease in private employment.

In order to avoid resistance to the strategy of *désinflation compétitive*, the French Socialists expanded the welfare state. Consistent with responses in other Continental welfare states, the French response to industrial decline was to establish so-called 'conversion pools', again with heavy State subsidies, which in many cases allowed for early retirement on a full pension at the age of 50. Moreover, the general age of retirement was reduced from 65 to 60. However, like other Continental countries, France suffered from the problem of generous minimum wages and high non-wage labour costs, frustrating the creation of the kinds of low-skill, low-productivity jobs that are needed to bring down unemployment. This unfavourable position incurred chronic deficits in social insurance funds.

In a later round of reforms, Prime Minister Juppé (following on from Balladur) proposed to extend the restrictions in the pension system to the public sector, with particular emphasis on eliminating the special measures that allowed public employees to retire at the age of 50. The response to the Juppé plan was a 6-week strike in the public sector, which paralyzed the country and incurred a substantial loss to the economy. Juppé was forced to back down on his pension reform proposal.

The Jospin-led government was elected on the promise of a more equitable and fair approach to welfare retrenchment. It eliminated the allowances to more well-off families and abandoned the introduction of means-testing. In 1998, it increased corporate taxes slightly. It also supported the creation of private pension funds, to be managed collectively by employer and union organisations, as a complement to the French 'pay-as-you-go' system. While social policy reform gained in importance during the 1990s, the cuts in benefit levels remained very limited by international standards. As Levy (2000) points out, the end of *dirigiste* economic policy has by no means marked the end of State activism. On the contrary, while continuing to play a crucial role in cushioning the transformation from a *dirigiste* to a more liberal economic policy, the French welfare state has actually grown during the 1990s: between 1989 and 1995, social spending has increased from 25.7% to 30.1% of GDP. This might also explain why income inequality grew only little in recent years (Bonoli and Palier, 1997; Palier, 2000).

## Public sector reform

### *Administrative reform*

Unlike some other countries, France cannot be said to have a single encompassing package of administrative reform. Rather, there has been a series of separate reform initiatives that can be grouped around some broad themes (Pollitt and Bouckaert, 2000). The first of these involves a shift towards decentralisation, apparent in the mid-1980s. The power of local authorities was greatly increased in such areas as taxation and budget-making. In addition, the 'deconcentration charter' of 1992 marked a further step in shifting authority from the centre to the periphery.

A second broad theme is modernisation, which has been an issue since the early 1980s. In general, one can say that the successive phases of administrative modernisation have been characterised by a broad continuity of policy, rather than by partisan differences between governments of the Left or Right (Clark, 1998; Pollitt and Bouckaert, 2000). In 1989, Prime Minister Rocard issued the important circular *Renouveau du service public*, which contained a series of initiatives including the creation of responsibility centres within ministries, personnel reforms, greater emphasis on decentralised management of field services and responsiveness to public service users, and the institutionalisation of policy evaluation across many sectors of government. Modernisation continued under the governments of Cresson and Bérégovoy in the years 1992-93. Then in 1995 the Juppé government's circular *Réforme de l'Etat et des service public* proposed an experiment with contractualising the relationship between certain field services and their superior ministries.

### *Privatisation*

Unlike the broad continuity of policy on administrative modernisation (*above*), privatisation has been a more contentious issue among successive governments. Socialist governments always had a tendency towards nationalisation, whereas neo-liberal governments tended towards privatisation. During the Socialist period of 1981-86, extensive nationalisations were carried out. Then the Chirac government of 1986-88 totally reversed this process, returning most of the companies that were nationalised in the early 1980s to the private sector (Dumez and Jeunemaitre, 1994). Furthermore, a list was issued of 66 companies that were 'privatisable' in that period. However, when the Socialists regained power in 1988, this process of radical privatisation was again stopped. This time, the Socialists refrained from nationalising already-privatised companies; their policy was now no privatisation *and* no nationalisation (*ni-ni* policy). In practice, this did not work: under Prime Ministers Rocard, Cresson and Bérégovoy, there was a sort of concealed privatisation tendency, leading to a FRF50 billion revenue of public assets sales, a remarkable amount for a *ni-ni* policy (Dumez and Jeunemaitre, 1994). In 1993, the right-wing Conservatives regained power and returned to yet another, even more encompassing wave of privatisation. This time, two of the largest banks and some of the most important insurance companies, among others, were privatised.

### *Budget reform*

An important step concerning budget reform was made in 1989, when the creation of responsibility centres led to the use of more deconcentrated budgeting for local authorities. In 1991, budgetary and accounting procedures were simplified to a system of 'deconcentrated block appropriation', whereby budgets were appropriated in blocks to public bodies without sharply defining how each organisation should allocate its budget. To get a clearer picture of budget implementation, a reform of financial control of this deconcentrated spending was issued in 1996. In 1997 and in 1998, the proportion of public policy areas working with deconcentrated block appropriation was further increased.

Efforts have also been made recently to increase the efficiency of the budget's preparation and the transparency of the process. The first objective is being dealt with by reforming the budget procedure throughout the year. The second objective is handled by introducing indicators and a monthly publishing of the status of the implementation of the budget (OECD, 1998).

### *Decentralisation, devolution and accountability reform*

French public sector reforms have mainly consisted of decentralisation and deconcentration. In the French context, decentralisation means 'transfer of authority from the central state to regional and local governments', whereas deconcentration means 'devolution of competence and managerial authority to the local administrative units of central government . . . as well as agencies' (Pollitt and Bouckaert, 2000). This path was taken in the mid-1980s by the Socialist Mitterrand-led government and continued up to 1989, when a circular was issued by the Rocard-led government that contained, among other initiatives, the creation of responsibility centres. The process was given extra impetus in 1992 with the 'Deconcentration Charter' (Pollitt and Bouckaert, 2000). Then, in 1995, the circular on 'Reform of the State' by Prime Minister Juppé reinforced the strategy, with the stated objective that relationships between central ministries and their territorial field services should be contractualised and that the responsibility centres should be confined to the functions of setting policy, allocating resources, monitoring and evaluation (Clark, 2000).

Although there has not been an 'audit explosion' in France (as in the UK, for example), new machinery for independent policy evaluation has been set up. In practice, this has turned out to be an extension of the executive branch of government (Clark, 2000).

## **Conclusions**

It is our contention that the public sector reform movement of the last quarter of the 20th century is closely related to changes in the international economic environment since the mid-1970s. Reviewing the various country trajectories of public sector reform under the intensifying macroeconomic constraints of a hard currency regime, culminating in EMU, we can discern substantial cross-national variation in the scope, modes, patterns and intensity of reforms in different countries. However, there are also important diachronic similarities with respect to the direction and timing of reform initiatives and the shift to a hard currency regime. The balance of political power, social and employment policy legacies, political institutions and idiosyncratic political crises (like the fall of the Berlin Wall for Germany or the collapse of the Soviet Union for Finland) — all are important causal variables for the modes, patterns and styles of public sector reform. Consensualism and incrementalism predominate in negotiating political systems, where organised interests partake in arenas of policy-making. Radical and far more ideologically driven reforms prevail in Majoritarian political systems. (Thatcherism in the UK is a case in point.) But whereas radical reform is unlikely in more negotiating political systems, we nevertheless observe important transformative long-term changes in the public sector within the large clusters of Bismarckian and Scandinavian welfare states. The timing and extent of transformative change is easily attributed to the timing of the shift to a hard currency policy in the 1980s and '90s, with the Netherlands in the vanguard and Finland bringing up the rear.

Over the past 25 years, we can in general perceive a shift in the public sector reform political agenda. In the 1970s, the public reform agenda centred around the ambition to bridge the perceived divide between politician and the government and critical citizens, making the state bureaucracy more transparent and open to citizen initiative, led by very active ministers and ambitious ministries of internal affairs. In the wake of the oil crises of the mid-1970s and early 1980s, the emphasis shifted to the quest for economic efficiency. Where such efficiency operations were underpinned by a hard currency regime in the early 1980s, this particularly strengthened the power and initiative of finance departments and ministers, disciplining spending ministries in the

reform effort. (The Dutch and Danish experiences are cases in point.) This took place at the expense of the ministry of internal affairs. A soft money policy allowed countries like Italy, France and Sweden to postpone efficiency operations. But once central banks became independent, or currencies were tied to the EMS, we observe an intensification of public sector reform, with efficiency aims also in latecomer countries like France and Ireland in the second half of the 1980s.

What about the effects of EMU on the scope and intensity of reform of hard currency latecomers in the 1990s? It is true that the Maastricht criteria for those countries that hoped to join EMU in the first instance served as an additional triggering device, helping policy-makers in Finland, Portugal and Italy to overcome resistance to unpopular public sector reform efforts, driven by finance ministries. These reforms may have been politically unfeasible in the absence of the Maastricht entrance exam.

Even for countries that preferred to stay outside the EMU framework in the early stages, like the UK and Denmark, it should be emphasized that, indirectly, the Maastricht criteria put considerable pressure on them for budgetary consolidation. For these countries, the Maastricht convergence criteria became important foreign benchmarks because under conditions of high capital mobility, ever since the late 1980s, excessive public spending will be punished by high risk premia on their public debt and may thus trigger speculative runs on their currencies (Scharpf, 2000). Debt financing surely is no longer a viable option, both in and outside of EMU. In summary, in an environment of internationally mobile capital, public sector reform geared towards efficiency will remain high on the political agenda in order to control the burden of the public budget and especially the growth of wage costs. This will happen irrespective of participation in EMU.

For the foreseeable future, we do not expect there to be convergence of reform across European public sectors, but rather processes of hybridisation, in tune with prevailing domestic policy legacies and political institutions, supported by procedures of open co-ordination from Brussels. This conjecture is more likely than an intensification of regime competition for the simple reason that, as European economic growth becomes ever more interdependent, clearly the performance of each national economy will depend more on the conditions of its neighbours (including the public sector and welfare state). It must be remembered that 90% of total EU trade occurs between Member States. As the competitive edge of the EU will depend increasingly on the qualities of its social services and public sectors, each Member State will have a rising stake in the public policy capabilities of the other Member States. Thus, it becomes essential to encourage and promote procedures of effective learning between EU countries through a process of open co-ordination.



# Reforms of public sector employment relations and industrial relations

In nearly all EU countries, reform of public sector employment relations and industrial relations has been underway for some time, as early as the 1970s in some countries. This is well before the public sector reforms described in previous chapters of this report, let alone the introduction of EMU.

To start, a simple test is presented here of the impact of EMU on reforms of public sector employment and industrial relations as expressed in major changes in labour laws or innovative 'basic' collective agreements. We try to establish whether the impact in the selected countries is absent, moderate or profound.

In this study, a distinction is made between reforms in the employment relationship and in industrial relations. The term 'employment relationship' has become a popular concept of late and is often used as a synonym for industrial relations. (Storey (1992) found a similar situation in the use of the term 'HRM' when personnel management was being referred to.) The concept of the employment relationship is outlined in depth by Huiskamp (1995 and 1998). Here, the employment relationship concerns the underlying fundamentals of the employment contract and its basic regulatory mechanism in the public sector. 'Industrial relations' is used to refer to the bargaining structure in terms of bargaining agents and bargaining units.

Following on from this test, we next try to ascertain whether its outcome holds up in a more detailed analysis of the impact of EMU on:

- *the institutional dimension of the regulatory framework*: on the one hand, changes in employment contracts and their basic regulatory mechanism and, on the other, changes in bargaining agents and units;
- *the financial dimension of budgetary reform*: changes in mechanisms used by governments to control and adjust pay bills as an important part of public budgets.

Thirdly, further analysis results in a model of the impact of EMU (see Figure 8). Finally, attention is turned towards the inherent tension, highlighted under the impact of EMU, between developments in the institutional and financial dimensions. This part of the study is limited to national and territorial levels of government in the public sector, referred to as public administration (the central government at national level and one or more levels of regional/local government, often at federal/county/provincial level and/or at municipal/community level). The sectors of health and education are only included if they are part of one or more of the above levels of national or territorial government. Public utilities, transport and communications are excluded since they are usually not part of levels of national and territorial government.<sup>1</sup>

<sup>1</sup> In this part of the analysis, in order to provide an up-to-date report, we made use of a survey which was part of the third phase of the Foundation's research project on the social implications of EMU in the public sector. Two countries are included from each model. (Denmark was substituted for Sweden; France is not included.) We wish to thank the following national correspondents for their crucial contribution: Carsten Jørgensen (Denmark); Veikko Liuksia (Finland); Mary McKeon (Ireland); Maria da Paz Campos Lima (Portugal); Paolo Sestito (Italy); Bruno Barth (Germany); and Koen van de Heuvel and Chris Moll (The Netherlands).

### Impact of EMU on major reforms

According to two studies, the impetus for employment and industrial relations reform lies primarily in governments trying to limit public spending. The OECD (1997c) reports that countries faced with serious economic problems have implemented limits on public spending, especially on the share of compensation for the pay bill (personnel costs) in the total government budget. Bach (1999) reports that rising levels of unemployment and the associated transfer payments have been the main force behind efforts to curb public expenditure. The influence of the Maastricht convergence criteria on changes in public service expenditure is significant in many countries, but should not be accepted uncritically.

As a simple test for the impact of EMU on reforms of public sector employment and industrial relations, a list of major reforms, as expressed in labour laws or innovative 'basic' collective agreements, was compiled from the literature (see *Table 10*). We then asked our national correspondents to put these reforms in context for each country and to assess the impact of EMU (we expected many of them to predate EMU). The ideas for reform may originate, for example, in reforms in the private sector or in national pacts or social accords; these, in turn, could be part of a country's reaction to increasing international competition or a major event or economic shock.

As can be seen from *Table 10*, major reforms have occurred in nearly all countries, often as part of a broader context since public sector employment and industrial relations are very much part of national pacts in the wider national industrial relations system.

In considering the effects of EMU on reforms of public sector employment and industrial relations from 1990 to 2000, a distinction can be made between countries where the effect was either absent (or negligible), moderate or profound. The results of this classification are presented in *Table 11*. Of crucial importance is the timing of the reforms — whether they were introduced long before EMU or just shortly before EMU or during or after EMU.

In Denmark, for example, EMU has had no influence or impact on the reforms, or at least very little. The reforms should rather be seen as part of a modernisation programme that was speeded up in the 1980s in order to make the public sector more effective. Other countries that conform to this pattern are the Netherlands, Germany and UK. Quite the opposite situation occurs in Italy, where the domestic crisis and EMU coincide. The effect of EMU is profound, sparking off many reforms in public sector employment and industrial relations. Finland experienced a similar profound 'whip effect' of EMU. There is a degree of overlap in Ireland, where the effect of EMU acts as an extra incentive and is part of the reason for reaffirming and deepening reforms. Portugal also fits this scenario.

Table 10 Major laws or innovative 'basic' collective agreements, 1990-2000

	Laws or innovative 'basic' collective agreements	Context of reforms
<b>Ireland</b>	<ul style="list-style-type: none"> <li>• 1994: new schemes for conciliation and arbitration</li> <li>• 2001: introduction of benchmarking for the public service</li> </ul>	<ul style="list-style-type: none"> <li>• national partnership agreement</li> <li>• need to avoid cycles of claims and cross-sectoral relativities</li> </ul>
<b>Netherlands</b>	<p>1993: decentralisation of collective bargaining, from central level to sectoral level (state, education, police, defence, judiciary, provinces, municipalities, district waterboards)</p> <p>1995: extension of coverage of Works Council Act (1979) from private sector to public sector</p> <p>1996: privatisation of State employees' pension scheme</p> <p>1999: decentralisation of collective bargaining below the sub-sectoral level in education</p>	<p>In 1982, the Netherlands was in bad economic shape. Against this background, central employers' and employees' organisations came together in the Foundation of Labour (strongly pushed by government) in November 1982. In 1992-93, a new recession occurred, not as bad as that of 1982 but sufficient to send shock-waves throughout the country. As a consequence, a new framework agreement, 'A new course', was reached in 1993 between the peak organisations in the Foundation of Labour. This was followed in 1997 by 'Agenda 2002: Collective bargaining for the years ahead'.</p>
<b>Italy</b>	<p>1993: comprehensive reform, with</p> <ul style="list-style-type: none"> <li>• separation of political authority and management, with more autonomy for management;</li> <li>• dejuridification of employment relation for large majority of employees;</li> <li>• abolishment of automatic system of indexation (as in private sector);</li> <li>• collective bargaining as the principal mechanism for establishing terms of employment for majority of employees;</li> <li>• establishment of one agency as the employers' negotiation side (ARAN);</li> <li>• role of local bargaining (more centralised version of 1993 reform in private sector);</li> <li>• 'compulsory selectivity' in application of performance-related pay.</li> </ul> <p>1997: amendments to 1993 Act and subsequent relevant trends:</p> <ul style="list-style-type: none"> <li>• more groups under 1993 regime;</li> <li>• temporary contracts for top managers in public sector, with introduction of individual bargaining (but within a framework strictly dictated by collective bargaining rules);</li> <li>• increasing role for local bargaining (local and regional authorities).</li> </ul>	<p>EMS crisis in 1992-93 (with exit of Italian currency from the system in September 1992), together with widespread fears of a financial crisis, contributed to the start of a process of wage moderation and 'responsible behaviour' by the social partners. Other factors may also be cited since the 1980s, including:</p> <ul style="list-style-type: none"> <li>• the extended political role of the social partners, because of the crisis of most of the traditional political parties;</li> <li>• a move towards less confrontationist behaviour (with a reduction in social conflict, at least in the manufacturing sector).</li> </ul> <p>Within the public sector, long-standing issues were its low efficiency and public finance burden. While most of the public finance adjustment came from the revenue side (particularly at the beginning of the above-mentioned process), controls over the number of public employees and the evolution of average wages were tightened.</p>
<b>Denmark</b>	<p>1997: basic agreement on new pay system for public sector employees gives more priority for individual pay (allowances for competence, results, etc). There are pilots in the national government sectors. Also, implementation for particular groups in county/municipal sectors.</p>	<p>The private sector — or, more precisely, the leading peak organisations of employees (confederation LO) and employers (DA) — sets the trend on wages, being generally ahead of the public sector as regards industrial relations. The 'New Wage' reform in public sector is a desire to follow the trend of flexibility prevalent in the private sector, where wages are mostly negotiated at company level.</p>
<b>Portugal</b>	<p>1990/1995: introduction of new short-term contracts regulated by legal norms of private sector and increase of hourly paid/fee 'independent work' (although in practice subordinated). The increase of private contracts is linked to the new recruitment of Public Institutes with private management (devolved autonomy).</p>	<p>After Portuguese integration into the EU (1985), major changes in constitutional law (1989) triggered a cycle of privatisation of large economic sectors which had been nationalised during the revolutionary period.</p> <p>Social Tripartite Pacts from 1991 onwards, aimed at moderating wages and reducing inflation, became more oriented to reducing public deficit. In private</p>



## Public sector reform under EMU: A literature review

	Laws or innovative 'basic' collective agreements	Context of reforms
	<p>1996: Public Sector Agreement, with</p> <ul style="list-style-type: none"> <li>• reorganisation of the collective bargaining system in the public sector, extending trade union negotiation rights and the scope of issues to negotiate. Expressed in 1998 in legislation on collective bargaining in the public sector, obliging the government to implement the agreements with trade unions regarding Public Service Statute (<i>Estatuto da Função Pública</i>);</li> <li>• enactment of clear regulations of hourly-paid contracts and transfers of fixed term contracts of employment into permanent contracts.</li> </ul>	<p>sector (newly privatised companies), there was an increase in external flexibility on the labour market.</p> <p>The Strategic Concertation Agreement 1996-99 combines the objective to participate in the first phase of the euro and reach convergence criteria, as well as preventing asymmetrical shocks. Moderation of wages combined with regulating external and internal flexibility on the labour market and implementation of the 'Minimum Guaranteed Income' (<i>Rendimento Mínimo Garantido</i>).</p> <p>In 1999/2000, government redefines concertation strategy in order to improve the application, control and articulation of the negotiated issues. Creation of Ministry for State and Public Administration Reform in 2000.</p>
<b>Finland</b>	<p>1991: delegation of pay policy to agencies in line with the process of management by result. Agencies have the authority to decide on pay system according to general outlines and collective agreements at central level guiding general pay increases.</p> <p>1993: reform of the State Pension Act in line with the private sector to provide a buffer for the payment of future pensions. Its position and independence was strengthened in 2000.</p> <p>1994: reform of the State Civil Service Act, bringing the civil service employment relation closer to that of the private sector.</p> <p>1997: EMU 'buffer funds'. Agreement reached between the social partners and adopted by the government. The idea was to gather extra money during the recession for training and early pensions in order to decrease negative effects of asymmetric economic shocks.</p> <p>1996: amendment of legislation on working hours in new Working Hours Act and extension of the law to State agencies.</p> <p>1999: under legislation, the option of forming personnel funds is extended to State agencies and State enterprises in relation to a result-based reward system.</p>	<p>The Finnish economy suffered a major upheaval during the 1990s, which has inevitably affected the workings of the public sector and its scale relative to the economy as a whole.</p> <p>The first steps towards adjusting government finances to the new economic situation and to longer term prospects were taken in 1992. In 1993, the government took a comprehensive decision-in-principle on reforms in central and regional government, which laid down main principles and also prescribed a number of practical steps to be taken. The local authorities, which provide most of the public services, had to get their finances into balance again after the recession. This involved staff cuts and payroll reductions.</p>
<b>Germany</b>	<p>1997: reform of the law concerning civil servants at national/state level, including</p> <ul style="list-style-type: none"> <li>• introduction of performance-orientated elements in basic pay;</li> <li>• further flexibilisation of working hours;</li> <li>• higher mobility;</li> <li>• managerial positions on probation or for a limited period of time.</li> </ul>	<p>The reform of the public service law seeks to strengthen the idea of performance, improve the mobility of staff, intensify leadership qualities and performance-oriented employment of staff, and strengthen the sense of competition and efficiency in the public administration.</p>

## Reforms of public sector employment relations and industrial relations

	Laws or innovative 'basic' collective agreements	Context of reforms
<b>United Kingdom</b>	<p>Many reforms in employment relations, with often no clear distinction between private and public sector reforms. Some of the relevant public sector reforms include:</p> <p>1992: delegation of pay (level) negotiation to departments/agencies, except senior civil servants (Managements Functions Act)</p> <p>1996: delegation of pay structures and pay systems to departments/agencies</p> <p>1997: reform of bargaining structure of local government (an integrated national framework agreement with local bargaining)</p>	<p>The UK recovered remarkably quickly from the recession suffered in the early 1990s. The recovery process was supported by an expansive monetary and fiscal policy. Membership in the EMS was cancelled in 1992. During the Thatcher years and after, there was an array of reforms in employment relations and industrial relations. Under the Blair government, the National Minimum Wage was introduced.</p>

**Table 11 Examples of the impact of EMU on reforms**

Impact	Country
None	<p><b>The Netherlands:</b> The origin of many reforms go back to the early 1980s when after the crisis in the Dutch economy of 1982-83 a hard currency regime was introduced, cutbacks in government spending were implemented and reforms of the welfare state were instigated.</p> <p><b>Denmark:</b> EMU has had no or at least very little influence or impact on reforms. Reforms are part of a modernisation programme that was speeded up in the 1980s in order to make the public sector more effective.</p>
Moderate	<p><b>Ireland:</b> The need to meet with the EMU convergence criteria, coupled with loss of monetary policy instruments, promoted a greater drive for efficiency, effectiveness and control of public finances. This was part of the reason for alternative means of determining public sector pay.</p> <p><b>Portugal:</b> Trends of liberalisation and deregulation started before the 1992 setting of the EMU convergence criteria, but from 1992 onwards the political agenda regarded more closely the preparations for EMU. The reforms can be linked to the issue of reducing public expenses by increasing labour market flexibility and by facilitating adjustments in employment levels in the public sector in the future. In 2000-01, the EMU criteria on inflation and public deficit became more important because of tension between the improvement of social protection and the promotion of employment (even in the public sector), while at the same time keeping a low public deficit.</p>
Profound	<p><b>Italy:</b> The EMS crisis of 1992-93 was instrumental in starting the era of social pacts (two overall agreements were signed in July 1992 and July 1993). Participation in EMU was also instrumental up to 1998-99 to maintain such a framework (two further social pacts were signed in September 1996 and December 1998). EMU participation has also had an impact on public sector evolution since it has placed constraints on the public finance budget.</p> <p><b>Finland:</b> In September 1995, the government approved Finland's first convergence programme. This laid down the extent to which the criteria of the Maastricht Treaty should be achieved between 1995 and 1999. Special note was taken of the effects on fiscal policy and on the sustainability of the government's financial position and public debt.</p>

## Reforms in the institutional dimension of the regulatory framework

### The employment relation

There is a crucial distinction in employment relations between the public and private sectors, with a special employment status attached to employees in the public sector as public servants or employees under a public service 'statute'. This statute can be traced back to values such as

independence, hierarchy and loyalty, originally connected with and attributed to the traditional activities of public administration — internal order, defence, justice and taxation. The idea of the State as the representative of the general interest was not only applied in the relationship between the State and its citizens, but also between the State and its employees. The statute was complemented with the mechanism of unilateral regulation of the terms and conditions by the State as employer through laws or administrative measures (often referred to as the denial of collective bargaining rights).

In some countries, nearly all or a large majority of employees in the public sector are employed under a single civil service statute (the single status model). In other countries, apart from the civil service statute, employees in the public sector are salaried employees under special contracts or under contracts similar to the private sector (the two status model). A development in nearly all selected countries in the 1990s has been a further restriction of the civil service statute to core groups like senior executives, the army and judges, while other employees are increasingly employed under contracts similar to the private sector.

As to the basic mechanism for the regulation of terms of employment, in most countries the terms of employment of both civil servants and public sector employees with a status similar to the private sector are increasingly regulated through bilateral collective bargaining. In some countries, it is more proper to speak of a mixture of unilateral and bilateral regulation ('quasi' system of collective bargaining), occasionally with some element of arbitration. A more recent phenomenon in some countries is the introduction of special individual contracts for senior executives. Table 12 shows the main elements of the status of the employment relation and the basic regulatory mechanism used in each country.

**Table 12 The employment relation**

	Employment contract	Basic regulatory mechanism
<b>Ireland</b>	<ul style="list-style-type: none"> <li>• Civil servants: majority of employees of the central government, including prison officers</li> <li>• Public service employees: local authorities, health boards (including public hospitals and medical personnel), teachers, courts service, judiciary, members of parliament, Gardai (police), army, non-commercial state-sponsored bodies</li> </ul>	<ul style="list-style-type: none"> <li>• Collective bargaining for all civil servants and public service employees as part of the mechanism of the National Partnership Agreements, setting pay increases over a number of years for both public and private sectors.</li> <li>• Other mechanisms concern arbitration and conciliation, benchmarking and a review body, often for specific groups of civil servants or public sector employees.</li> </ul>
<b>Italy</b>	<ul style="list-style-type: none"> <li>• Civil servants: core groups such as army and senior executives</li> <li>• Other: under same laws regulating private sector contracts</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral collective bargaining for most employees in central and territorial government.</li> <li>• Unilateral for specific groups: police, military, executive management (up to 1997).</li> <li>• Individual contracts (senior executive staff).</li> </ul>
<b>Netherlands</b>	<ul style="list-style-type: none"> <li>• Civil servants: large majority in central and territorial government</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral collective bargaining with inbuilt mechanism for reaching agreement (compulsory).</li> </ul>
<b>Denmark</b>	<ul style="list-style-type: none"> <li>• Civil servants: core groups in central government (statutory civil servants)</li> <li>• 'Collective agreement-covered' employees on contracts similar to private sector (also called contractual staff); also central government, but mainly county/municipal government</li> </ul>	<ul style="list-style-type: none"> <li>• Statutory civil servants: mixture of unilateral legislation and bilateral collective bargaining (in case an agreement cannot be reached, the State, as employer, can use legislation).</li> <li>• Salaried employees/contractual staff: bilateral collective bargaining.</li> <li>• Individual contracts (senior executive staff).</li> </ul>

## Reforms of public sector employment relations and industrial relations

<b>Portugal</b>	<ul style="list-style-type: none"> <li>• Civil servants (<i>funcionários públicos</i>): vast majority at central government and municipal level</li> <li>• Other: mainly in Public Institutes with private management; under same laws regulating private sector contracts</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral collective negotiation for majority to define the wage increase for all careers. Specific negotiations on sectoral/occupational regimes, statutes, careers (health, education, justice, etc).</li> <li>• Mixture with unilateral regulation (private individual contracts and unilateral legislation).</li> </ul>
<b>Finland</b>	<ul style="list-style-type: none"> <li>• Central government employees are primarily (nearly 80%) hired as civil servants, the rest are under a contract of employment</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral collective bargaining for both civil servants and employees under contract of employment.</li> </ul>
<b>Germany</b>	<ul style="list-style-type: none"> <li>• Civil servants (<i>Beamte</i>): various groups at national, federal and local levels</li> <li>• Salaried employees (<i>Angestellte</i>) and manual workers (<i>Arbeiter</i>)</li> </ul>	<ul style="list-style-type: none"> <li>• Civil servants: unilateral, legislation.</li> <li>• Salaried employees and manual workers: bilateral collective bargaining.</li> </ul>
<b>United Kingdom</b>	<ul style="list-style-type: none"> <li>• Civil servants: majority of employees of the central government</li> <li>• Public servants: local authorities, health board areas, teachers</li> </ul> <p>But absence of clear legal distinction in the status of public and private sector employment.</p>	<ul style="list-style-type: none"> <li>• Civil servants: collective bargaining.</li> <li>• Public servants: collective bargaining.</li> <li>• Senior civil service and other groups (such as teachers, nurses): pay review bodies.</li> <li>• Police, firemen: index-linking.</li> </ul>

The conclusion is that the model of private sector employment relation (especially the model of the fixed contract and, to a lesser extent, the temporary contract) and the private sector regulatory mechanism for establishing wages and conditions is applied more and more in parts of the public sector. Both of these developments predate EMU and the evidence is that there has been little or no impact of EMU on the fundamental aspects of the employment relation, apart from Italy.

### The bargaining structure

The focus here is on the bargaining agents on the sides of employers and trade unions, and the collective bargaining units, including the main structure of pay agreements (see Table 13).

On both employer and union sides, there can be a variety of negotiating partners. On the employers' side, reforms have resulted in a greater variation of bargaining agents. Apart from government, an agent can be one of the following or a combination of two or more, either in formal or informal co-ordination:

- a central government department, such as the Ministry of Finance;
- chief executives of government departments or agencies;
- a specially instituted public sector bargaining agency, sometimes acting and behaving as a quasi employers' federation;
- one or more employers' federations for national government employers and/or for territorial government employers.

On the unions' side, the situation is even more diverse. Depending on the country, bargaining can be carried on by one of the following organisations or a combination of two or more, either in formal or informal co-ordination:

- national trade union federation with a mixed membership of public and private sector employees;

- national trade union federation with a membership of public sector employees only;
- separate public sector unions for specific groups of employees, organised along sectoral, occupational or professional lines. These types of union are limited in some countries and prevalent in others.

Another possible development is the merger between unions active in the public and private sectors. For example, in Germany, the former Union for the Public Service, Transport and Traffic (ÖTV) merged with several other unions to form the United Service Union (*Vereinigte Dienstleistungsgewerkschaft — ver.di*).

Collective bargaining arrangements in most countries can be classified as either bargaining at single level or dual level. There is great variation within these categories.

Single level collective bargaining can take place at the level of:

- the whole of the public sector (sometimes even the whole of the private and public sectors);
- the national and territorial governments;
- an organisational unit, such as a department or agency (higher level is lacking).

**Table 13 The bargaining structure**

	Bargaining agents on employers' and unions' side	Collective bargaining units and main structure of pay agreements
Ireland	<ul style="list-style-type: none"> <li>• Employers: government is partner in national agreements/social accords</li> <li>• Ministry of Finance is central negotiator on pay, with input from Prime Minister's Office and relevant government departments (such as health, education, local government, justice, defence)</li> <li>• Unions: national federation of trade unions at national level and specific trade unions for professions, occupations and sectors</li> </ul>	<ul style="list-style-type: none"> <li>• National agreements (long-term) on pay, encompassing both private and public sectors.</li> <li>• Arbitration and conciliation on additional pay increases (awards) for specific civil servant groups, teachers and clerical or administrative staff of the new courts service.</li> <li>• Benchmarking for most of civil and public service to establish pay rates and jobs in comparison with private sector.</li> <li>• Review body for top civil servants, judiciary and members of parliament.</li> </ul>
Italy	<ul style="list-style-type: none"> <li>• Employers: Public Administration Negotiating Agency (ARAN) for all sectors</li> <li>• Unions: 3 central federations (mixed private/public memberships) and up to 40 or 50 unions per sector</li> </ul>	<ul style="list-style-type: none"> <li>• Sectoral bargaining units for central government (ministries), municipalities, provinces, regions and sectors (such as education, health service and social security). These address basic pay (80% of all earnings) and the (precise) level of additional wage increases at local level.</li> <li>• Level of administrative units: distribution of additional wage increased over groups of employees (such as allowances and performance-related pay).</li> </ul>
Netherlands	<ul style="list-style-type: none"> <li>• Employers: each government department for its own employees (police, defence, judiciary, education) and employers' federations at sectoral levels of provinces, municipalities and district waterboards</li> <li>• Unions: 4 confederations of public sector trade unions, jointly operating at central level. At sectoral level, confederations represented by members unions and some smaller unions based on occupational or professional criteria.</li> </ul>	<ul style="list-style-type: none"> <li>• Central level: pensions and elements of social security.</li> <li>• Sectoral levels of ministries ( police, defence, judiciary, education), provinces, municipalities and district waterboards, on pay and all other matters.</li> </ul>

## Reforms of public sector employment relations and industrial relations

	Bargaining agents on employers' and unions' side	Collective bargaining units and main structure of pay agreements
Denmark	<ul style="list-style-type: none"> <li>Employers: Ministry of Finance at central government level and employers' federations at county and municipal levels</li> <li>Unions: coalition (CFU) of 4 central federations of public sector employees, with an array of affiliated unions at central level and at local level one bargaining agent (KTO) representing about 65 unions</li> </ul>	<ul style="list-style-type: none"> <li>Central government bargaining unit: dominant initiating role, across-the-board wage increases.</li> <li>One integrated bargaining unit for county and municipal level: additional and following role, allowances for individual pay. Although reform has led to an increase in dual level bargaining within strict parameters, new performance-related pay system is not yet an important part. Agreements signed with every union.</li> </ul>
Portugal	<ul style="list-style-type: none"> <li>Employers: central government, but conduct of negotiations increasingly dependent on Ministry of Finance. Since 2000, the newly created Ministry of State and Public Administration Reform is the main bargaining agent, with the Finance Ministry represented at negotiation table. Other ministries (such as health, education, justice) have particular statutes in this area. The Municipal Employers have indirect influence.</li> <li>Unions: several trade unions, organised on 2 major platforms for negotiations, most of them linked to the 2 national confederations (CGTP and UGT). Some unions organised on professional or occupational lines.</li> </ul>	<ul style="list-style-type: none"> <li>One central unit for all central government and municipal employees on pay and all other matters. Wage increase is defined for all careers under juridical regime of public sector. There are specific negotiations on sectoral/ occupational specific regimes, statutes, careers, etc.</li> <li>Local bargaining within reference to the central agreement, only on specific issues.</li> </ul>
Finland	<ul style="list-style-type: none"> <li>Employers: Ministry of Finance (State Employer's Office) at central level and Employer Agencies at agency level</li> <li>Unions: employees' sector-level central unions and employees' agency-level unions</li> </ul>	<ul style="list-style-type: none"> <li>Central level: expenditure framework, general employment terms, obligation to maintain labour peace.</li> <li>Agency level: flexible working hours, system of wages and salaries, other field-specific issues.</li> </ul>
Germany	<ul style="list-style-type: none"> <li>Employers: Ministry of the Interior at federal level, in conjunction with 2 employers' federations at State and municipal levels.</li> <li>Unions: one major union across all levels and some smaller unions based on sectoral and employment status criteria.</li> </ul>	<ul style="list-style-type: none"> <li>Although legally separate agreements for salaried employees at the 3 levels, one bargaining round with identical across-the-board wage increases.</li> <li>Civil servants follow in practice outcome of public/private sector.</li> </ul>
United Kingdom	<ul style="list-style-type: none"> <li>Employers: chief executives of central government agencies or departments at central government level and Local Government Management Board at local authorities level</li> <li>Unions: several main, recently merged, unions and an array of other unions, both within and outside TUC along professional, occupational or sectoral lines</li> </ul>	<ul style="list-style-type: none"> <li>Separate bargaining units for majority of central government departments and agencies on pay levels and pay structure.</li> <li>One national bargaining unit for local authorities covering all staff (manual and non-manual) within a single national 'pay spine' of pay grades, with options for local/ domestic pay additions.</li> </ul>

Dual level collective bargaining involves in some countries a combination of bargaining first for the whole of the public sector (often the central government) and subsequently for territorial government. In other countries, dual level bargaining involves a combination, firstly, of central government or territorial government, and subsequently at the level of organisational units, such as departments or agencies. Bargaining at this second, lower level may have an important independent role, but in most countries its role is defined within very strict parameters at the first or higher level. Basic pay is negotiated at the higher level and additional pay (in the form of allowances, bonuses, payments by results) at the lower level. In many countries, additional pay is becoming increasingly important, but its specific form varies widely.

Another important aspect of industrial relations in the public sector is the density of employers covered in employers' organisations and of employees covered in trade unions. Only data on the latter is available in the literature: it shows that membership of trade unions is disproportionately concentrated in the public sector (see Table 14).

**Table 14 Union density in the public and private sectors, 1993 (%)**

	Public sector	Private sector
Ireland	61.2	36.1
Italy	47.4	25.4
Netherlands	43.5	26.9
Denmark	93.5	84.0
Portugal	44.0	19.6
Finland	90.0*	80.0*
Germany	37.7	24.5
UK	57.0**	26.0**

\* Estimate by national correspondent

\*\* Cully *et al* (1999)

Source: Beaumont and Harris (1998)

Based on these figures, Beaumont and Harris (1998) conclude that for the 12 EU countries studied, the gap between public sector and private sector union density is, with very few exceptions, significant and on the increase. A 'public sector effect' has been estimated, controlling for personal characteristics (age, gender, marital status, occupation, part-time status, years since full-time education), size of employment establishment and country effects. This public sector effect is the extent to which being employed in the public sector increases the probability of being a member of a union. The proposition was that the public sector effect is significant in countries with a relatively low overall level of union density and in countries with a relatively large public sector. But the results were not conclusive, there being 'no obvious explanation for the revealed pattern'.

Balado (1999) reports that it is by no means obvious how unions in central administration should respond in a sector that is relatively protected from international competition and in which they enjoy high levels of membership. Pragmatism characterises the unions' relations with political parties and political activity at present. In general, political involvement is a delicate path that has to be trodden by all unions in central administration.

Unions focus on two principal areas: defence of the public sector and welfare state, and a quest for favourable institutional arrangements regulating the employment of civil servants. Other trade unions' responses are an awareness of fiscal constraints; opting for a co-operative rather than a confrontational relationship with employers; and increasing attention to qualitative issues on bargaining agendas.

As to maintaining a high level of membership, a union's dilemma lies in managing the dynamic relationship between individualism and collectivism. Although a union's most important and realistic objective is the consolidation of its existing membership, ways of increasing membership include:

- linking up with the more tangible day-to-day activities of staff councils on issues that relate more directly to the individual situation of employees and improving work- and non-work-related services;

- maintaining membership by offering individual representation and services to members who are transferred to the private sector, where bargaining rights do not exist, and/or to reduce the rate of subscription for privatised sectors, where the union does not have collective bargaining rights but members are still entitled to individual services;
- recruiting other groups, more women and young employees in the lowest paid grades of casual workers; and
- presenting joint claims to employers through mergers and greater collaboration between unions and integrating professional associations into unions by offering them representation at national level.

To sum up, reforms in bargaining agents and units lead to:

- an increase in the importance of the Ministry of Finance or the Treasury in internal co-ordination and as a bargaining agent;
- an increase in dual level bargaining;
- an increase in strict parameters for the role of lower level bargaining; and
- an increase in payment by results as a mechanism for additional pay.

Many of these reforms in bargaining agents and units predate EMU, but the increasingly important role of the Ministry of Finance or the Treasury in many countries in the actual bargaining signals that EMU is giving added impetus to these developments, with one or two exceptions.

Unions accept the inevitability of a decentralisation of collective bargaining (Balado, 1999). Given the financial constraints imposed by governments, there is limited scope for unions to make progress in the area of pay. Therefore, unions in many countries are seeking to negotiate framework agreements and the introduction of a performance-related component into employees' salaries, which would leave scope for further negotiation at regional or local level. Pay increases related to productivity are a useful method of enriching decentralised bargaining.

The advantages of decentralisation include the possibility of tailoring pay and grading systems. However, limits on public expenditure make it difficult to reward good performance meaningfully within tight budgets. An important disadvantage of decentralisation lies in the difficulty of monitoring pay increases in order to ensure that information is exchanged between bargaining units and to provide guidelines for important principles, such as fairness, comparability, pay progression and the need for cost of living-related increases. In addition, decentralisation of bargaining arrangements and greater managerial autonomy can erode the ability to monitor and sustain equal opportunities practices.

## Reforms in the financial framework

The financial dimension is described in terms of the role of central government in financial constraints and adjustment of the annual pay bill at central level (see *Table 15*).



This part of the analysis is based mainly on a typology developed by the OECD (budget powers of regional/local authorities are excluded from the analysis). In analysing financial constraints, the OECD distinguishes between governments that set:

- the volume of the pay bill;
- the budget volume; and
- key performance targets.

In some countries, the volume of the pay bill for the entire public service is set and managed by central government. In other countries, central government has shifted towards setting the budget volume, making no distinction between personnel costs (i.e. the pay bill and other costs), which may provide some leeway for the level of pay settlements. Again, in other countries, running costs budget management is decentralised within key performance targets (on service level, productivity, staff levels), which allows for some pay bill autonomy as long as management stays within the targets.

Adjustment of the annual pay bill at central level may take place sometimes at the beginning (ex ante) of the budget cycle (taking into account expectations of pay levels) or at the end (ex post) of the budget cycle (taking into account actual development of pay levels). References in adjusting can be made to factors external to or internal to the public sector. In most countries, there is a mix of these approaches.

A useful classification is:

- ex ante or ex post pay bill adjustment;
- reference to external factors: private sector pay, purchasing power, general economic indicators;
- reference to internal factors: efficiency, productivity, staff levels.

**Table 15 Financial constraints and pay bill adjustment**

	Financial constraints	Pay bill adjustment
<b>Ireland</b>	<ul style="list-style-type: none"> <li>• Central government sets the volume of the pay bill. Ministry of Finance plays crucial role in authorisation and monitoring pay awards and pay developments.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex post, based on the outcome of national across-the-board increases for the public sector and additional sectoral/professional pay awards in conjunction with development of numbers of employed.</li> </ul>
<b>Italy</b>	<ul style="list-style-type: none"> <li>• Government directives (with role of the Treasury much stronger than it used to be) for ARAN: total budget and criteria for apportioning these among sectors, guidelines for negotiation.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex post, depending on changes in numbers of staff, differences between estimated and actual expenditure, and actual versus predicted inflation.</li> </ul>
<b>Netherlands</b>	<ul style="list-style-type: none"> <li>• Central government sets a contribution to the pay bills of the sectors as part of the total budget volume.</li> <li>• Central government sectors each decide how much of their budget is allocated to pay increases, taking into account the central government contribution, development of number of employees, allocation between budget posts and allocations of the pay bill over a number of years.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex ante and ex post, based on pay levels in private sector, overall economic situation and state of public finances.</li> <li>• Additional personnel costs can be transferred to other administrative costs and exceed the operating budget within a limit of 1%.</li> </ul>

## Reforms of public sector employment relations and industrial relations

	Financial constraints	Pay bill adjustment
	<ul style="list-style-type: none"> <li>• Municipalities and provinces are more autonomous in fixing budget for pay increases since they have their own independent sources of income.</li> <li>• In agencies with devolved autonomy, management is free to manage their budget and pay.</li> </ul>	
Denmark	<ul style="list-style-type: none"> <li>• Central government/Ministry of Finance sets the volume of pay bill for central government employees.</li> <li>• Ministry of Finance reviews budget of counties and municipalities after conclusion of negotiations.</li> <li>• A limited number of agencies are free to manage their own budgets.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex ante, based on changes in private sector pay. Private sector dominant in pay.</li> </ul>
Portugal	<ul style="list-style-type: none"> <li>• Central government sets the volume of pay bill.</li> <li>• Ministry of Finance plays an important role in authorisation and/or monitoring pay awards and pay developments.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex-post adjustments on the budget approved.</li> <li>• Ex ante increases related to career restructuring.</li> <li>• Trends to ex ante adjustments to become more important.</li> </ul>
Finland	<ul style="list-style-type: none"> <li>• Central government (Ministry of Finance) approves the volume of pay bill after it is determined by the overall tripartite Incomes and Labour-market Policy Agreement (government being one of the 3 partners).</li> </ul>	<ul style="list-style-type: none"> <li>• Ex post, pay increases negotiated in the State sector reflect overall economic situation and the state of the public finances.</li> </ul>
Germany	<ul style="list-style-type: none"> <li>• Central and federal governments set the volume of pay bill in close co-operation with Federal Ministry of the Interior and Federal Ministry of Finance.</li> </ul>	<ul style="list-style-type: none"> <li>• Ex ante, no fixed mechanism, but based on income changes and the general situation of the economy.</li> </ul>
United Kingdom	<ul style="list-style-type: none"> <li>• Central government (Treasury) sets key performance targets (finance, efficiency, quality of service) of departments and agencies, and monitors results (in 1997, 138 agencies employing 75% of civil servants).</li> </ul>	<ul style="list-style-type: none"> <li>• Pay increases which lead to overspending can be compensated through efficiency and productivity increases within departments, agencies and local authorities.</li> </ul>

The impact of EMU on the financial framework is diverse:

- Reforms reflect a decreasing scale of financial constraints by central government. However, EMU tends to increase financial constraints of central government directly in the budget or indirectly through performance targets.
- The Ministry of Finance is increasingly involved in a co-ordinating and monitoring role concerning input and outcomes. In many countries, the strengthening of the role of the Ministry of Finance predates EMU since it was linked at the time to the introduction of a hard currency regime. Nevertheless, EMU reinforces this trend.
- An increase of permanent monitoring ex ante and ex post and of reference to Maastricht criteria as an external factor.
- Reform of the budgetary framework in terms of more autonomy for lower levels predates EMU since it is often part of the introduction of newly decentralised and devolved organisational regimes in the public sector. EMU may counteract this trend because of the above developments.

### Impact of EMU on the interaction between institutional and financial frameworks

So far, we have analysed separately the impact of EMU on the employment relation, industrial relations and the financial framework. But the impact of EMU becomes most evident in the way it influences the interaction between reforms in the institutional framework (particularly industrial

relations) and reforms in the financial framework. Some examples are presented here from the Netherlands, Italy, Finland, Ireland and Portugal, based on information provided by the national correspondents of the network. It is clear from the examples that in most of the countries analysed, the Finance Ministries are not content with just applying financial constraints, but are also becoming more and more involved in the set-up of the institutional framework.

### The Netherlands

In the Netherlands, the outcome of our simple test on the EMU is reflected in the relative absence of the impact of EMU on the interaction between the developments in the institutional framework (i.e. the decentralisation of collective bargaining) and the financial framework. As the Dutch national correspondent reports:

A debate is gathering pace on a further decentralisation of bargaining units (analogous to the decentralisation of bargaining which occurred in the sector Education to a lower level, such as primary and secondary education, higher education, research institutes). The reason is the need for flexibility and tailor-made solutions at the lower level. Arguments against concern the risk of leap-frogging in wage bargaining and the need to maintain quantity and quality of service levels. Pay increases should not be at the expense of service levels either because of a reduction in number of employees or in services.

A further issue in this respect is the highly compartmentalised nature of the central government contribution to budgets for pay in separate compartments for particular pay components, while at the same time at the sectoral level there is quite a lot of autonomy in the allocation between budget posts, level of pay and number of employees, and allocations of the pay bill over a number of years.

In the whole of the debate in the Netherlands, EMU is not mentioned:

- firstly, EMU is one of the many factors influencing the budget;
- secondly, if there is no direct link between the government budget and the outcome of collective bargaining, even in money terms, then there is no direct link between EMU and outcomes;
- thirdly, possible effects of EMU are mitigated by many levels before it could reach the pay bill.

### Italy

In contrast to the Netherlands, there is a clear impact of EMU in Italy on the interaction between decentralisation of industrial relations and the financial framework, in line with the outcome of our simple test. A tighter financial framework inspired by EMU seems to facilitate and legitimise the decentralisation of industrial relations. As the Italian national correspondent reports:

Public sector wages, which had been rising at the end of the '80s, were falling behind the private sector ones in the 1993-95 period. Paradoxically, such an action has somehow reinforced the cycling behaviour of public over private wages, with public sector wages falling behind and subsequently recovering (especially if general elections are due: peaks in public sector wages growth have happened in 1996 and 2001). Reference to Maastricht criteria and the need to respect them has been instrumental in increasing the governability of the public budget. This was also because public opinion mostly accepted the EMU participation goal (in 1997 Italy experienced a temporary surcharge tax, equivalent to half a percentage point of GDP, which was called Eurotax).

The establishment of ARAN [Public Administration Negotiating Agency] has been instrumental in easing the pressure from public sector unions on the government. ARAN is also the employers' agency for local and regional authorities. To some extent, there is a preliminary bargaining round in order to decide the amount of resources available and a subsequent sectoral bargaining round. The preliminary bargaining round takes place directly between the government (with the role of the Treasury much stronger than it used to be) and trade unions (more the general ones than the sectoral ones). Later on, when ARAN has received precise directives from the government (directives whose content to some extent has already been 'bargained for'), the second bargaining round starts between ARAN and the unions at sectoral level.

**Italy (continued)**

Basically what has emerged so far is the following:

- In decentralised bargaining a limited amount of resources, predefined at a higher bargaining level, is distributed. The general goal has been that of distributing these resources according to 'productivity criteria'. It is unclear to what extent this has happened, not only because the amount is limited but also because public sector top managers only feel to a limited extent the pressure coming from budgetary allocations or targets to be fulfilled.
- For the sectoral contracts involving local and regional employees, a mechanism similar to the one existing for the rest of the public sector has been introduced, i.e. there are directives from a board made up from representatives of the local and regional authorities. However, whether these directives are representative is open to question.

What really matters is the amount of resources more or less explicitly provided for those sectoral contracts in the national budget. So far, a good amount of the wage bill has been decided at a rather centralised level. The instrument for public sector wage bill governance has been the introduction in the yearly budget law (presented in September and usually approved during the autumn) of the amount of resources for new contracts and adjustments already in the pipeline from the existing contracts. No major role has been played by budgetary allocations and targeting exercises in controlling the costs and performance of the public sector. As the process of devolution towards local and regional authorities advances, it is very likely that some changes will emerge.

**Finland**

In Finland, the Ministry of Finance is becoming more actively involved in personnel policy as decentralisation continues. As the Finnish national correspondent reports:

Now that result management has become the established practice, the ministries' role has changed: instead of merely controlling in detail how budgets are spent, they guide operating policies and strategies in their own sphere of government. The freedom of ministries and government agencies to run their own affairs in matters such as the use of budgets and personnel management has been greatly increased in recent years. This freedom has naturally brought more responsibility. Ministries and government agencies are given clearer result targets and the attainment of these targets is monitored.

Power over personnel policies and changes in pay policies has been delegated to the individual agencies and units. However, the Ministry of Finance is developing new methods to establish the optimal number and structure of personnel in each agency. In addition, new principles and practices for evaluating, structuring and developing 'intellectual capital' will be introduced. The Ministry has set up a project to improve the management of leadership skills and the assessment and development of management potential. Exemplary methods will be widely introduced through training and information campaigns.

**Ireland**

The tighter financial framework inspired by EMU acted in Ireland as an extra incentive, facilitating the refinement of mechanisms to monitor and control the decentralisation of industrial relations. As the Irish national correspondent reports:

The discipline imposed by the Maastricht criteria, the loss of monetary policy instruments and the drive for efficiency/effectiveness contributed to a situation where the process of reform in industrial relations was given added impetus.

First of all, in the latest National Pay Agreement it is specified that the last instalment of 4% can only be paid when it is confirmed that certain targets have been met. This is because some earlier pay awards were made on the basis of promised change which was not delivered in full. Now payment is contingent on the delivery of change. Examples of the targets are level of savings in administrative budgets, progress on implementation of the devolution of bodies, progress on implementation of IT and implementation of performance pay for management.

The second key innovation provided for in the *Programme for Prosperity and Fairness* is the establishment of an independent Public Service Benchmarking Body. The background to the establishment of the Body is that public service employers and unions recognise that the traditional approach to pay reviews in the public service, based on analogues and relativities, had given rise to serious difficulties in the past. They agreed that an alternative approach was required, which would be grounded in a coherent and broadly based comparison with jobs and pay rates across the economy.

**Ireland (continued)**

The Benchmarking Body was formally established in July 2000. As well as examining pay rates, the Benchmarking Body will examine and compare existing roles, duties and responsibilities in the public service and across the economy. It is to report by 30 June 2002. The two features which distinguish the Benchmarking Body from what has been done in the past are that it will:

- look at all of the main groups at the same time;
- have a strong, well-resourced and fully independent research function.

The Benchmarking Body is fully independent: its research, deliberations and recommendations are entirely a matter for the Board itself. It is the Benchmarking Body alone which will decide on the appropriate recommendations and not anybody else — not government ministers, departments, trade unions nor any other body.

Thirdly, the creation of Courts Service (moving administration from central civil service to Public Service) has led to the creation of another Conciliation and Arbitration Scheme.

**Portugal**

The impact of EMU in Portugal seems to shift from a moderate to a profound effect. As the Portuguese national correspondent reports:

In 2000/2001, EMU criteria regarding inflation and public deficit have become more important in the debate on public finance. A correction of the Budget 2001 is taking place (*Orçamento Rectificativo*) in order to deal with growing public deficit. About 50 measures are presented by government to cut public expenses, having direct consequences in the public sector. However, the growing public deficit is more a result of the decrease of the tax income (employer's IRC and IVA, related with economic performance and fiscal evasion) than with the growing of public expenses.

Although the Ministry of Finance sets the general limit to recruitment, there is no overall control on recruitments. The reason is that the Ministry of Finance does not control recruitment through administrative contracts (*contratos administrativos de provimento*) and short-term contracts. For instance, in 2000, the limit was on 4,000 admissions, but an increase of 40,000 was registered. The Ministries of Health and Education were responsible for 80% of those recruitments.

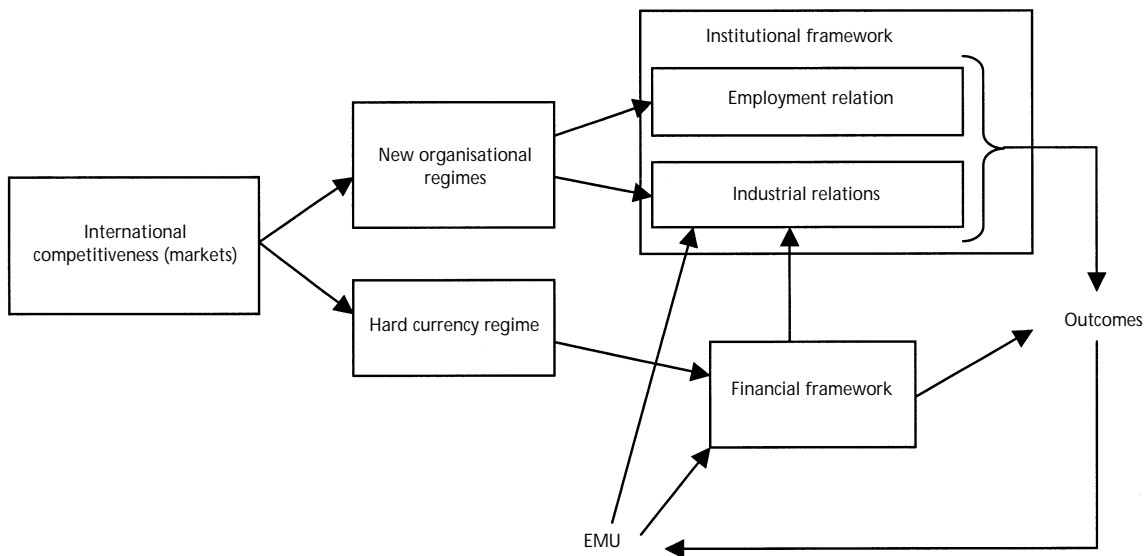
Some groups and political parties openly press for cutting welfare expenses.

At the end of the first semester 2001, negotiations between the government and unions in the public sector proved very difficult on such crucial issues as reductions in public employment, blockage of career restructuring and wage moderation.

**Further analysis and conclusions**

This part of the study started with a simple test of the impact of EMU on major reforms as expressed in labour laws or innovative 'basic' collective agreements in 1990-2000. The effect was judged in terms of an absence of an impact, a moderate impact or a profound impact. After analysing more in depth the impact of EMU on reforms in the institutional and financial frameworks, we conclude that EMU is in most countries strengthening and giving added impetus to existing trends predating EMU, which are in themselves related to efforts to strengthen international competitiveness. This would suggest the model illustrated in Figure 8:

Figure 8 Model of impact of EMU



Although we are careful not to suggest any proven causal relationship, there seems to be:

- An ongoing process of institutional reform of the employment relation and its basic regulatory mechanism. This is linked to a long-standing wish for convergence with the private sector and for the introduction of new organisational regimes in the public sector, which is relatively insulated from EMU.
- An ongoing process of institutional reform of industrial relations, which is also linked to a long-standing wish for convergence with the private sector and for the introduction of new organisational regimes in the public sector. However, there is a direct link with EMU, especially in terms of the bargaining agents, i.e. the role of the Ministry of Finance in co-ordination and monitoring. To make matters more complex, experiences with decentralised and devolved organisational regimes elsewhere in the public sector are applied within industrial relations (the establishment of semi-independent bargaining agencies to act as employers' federations).
- An additional process of financial reforms, where EMU impacts in particular on the interaction between financial reform and decentralisation of bargaining units and pay agreements, depending on the degree to which hard currency regimes predate EMU.

The need for international competitiveness has triggered hard currency regimes and new public sector organisational regimes, and these in turn influence both institutional and financial reforms. The financial reforms have an independent effect on the institutional reforms, especially the industrial relations aspect (bargaining agents and units). The impact of EMU on the reform process primarily acts through the financial reforms. EMU is becoming a crucial, European-wide feedback mechanism, established in the Stability and Growth Pact, on the outcomes in this model. It is important to note that the outcomes have, from the onset, not been part of this study.

As to the effect of reforms on outcomes in terms of wages and employment, the OECD (1997c) has attempted a comparison of reforms in a number of OECD countries, among them some of the EU

Member States. This analysis is carried out to test the validity of the hypothesis that the reforms have an impact on trends in the pay bill and on trends in the levels of public employment.

The OECD report (1997c) states that a division of countries into two major groups — those with a centralised system of industrial relations and those with a decentralised system of industrial relations in the public sector — is not satisfactory.<sup>2</sup> A wide variety of pay determination systems is to be found in OECD countries, reflecting differences in the structure of the public sector, institutions, collective bargaining arrangements and job classification systems. The OECD thus developed a specific decentralisation index of pay determination systems, reflecting two sets of reforms, each with two components:

*Reforms in the institutional framework*

- the degree of decentralisation of the level of pay negotiation (from entire public sector to sub-sector and department/agency); and
- the degree of differentiation in payments systems (from single pay scales/bonuses for the entire public sector to different scales/bonuses per sector or department/agency).

*Reforms in the financial framework*

- the degree of decentralisation in pay bill management (from total management of pay bill for entire public sector by central government to sub-sectors or departments managing part of their pay bill to a certain degree autonomously); and
- the degree of flexibility in annual pay bill adjustment (from ex ante adjustment of the pay bill to ex post adjustment of the pay bill, and from adjustment of total budget to adjustment per department/agency).

The first hypothesis on outcomes to be tested is whether an increase in the decentralisation index leads to a fall in the rate of increase in the wage bill. The dependent variable to be explained is the observed annual change in the total wage bill. The explanatory variables are the total weighted decentralisation index and its four components.

There is a significant correlation between the total weighted decentralisation index and changes in the total wage bill. This means that a high degree of decentralisation goes hand-in-hand with low values for the increase in the wage bill.

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<sup>2</sup> A good example of this problem is the study by Elliott *et al* (1999). In differentiating between systems of wage-setting for public sector employees in 6 countries, Elliott and his fellow-researchers created two groups: Sweden and the UK in one group and France, Germany, Italy and Spain in the other. They characterise the difference between these two groups by suggesting that the UK and Sweden have sought to adopt the model of wage-setting from the private sector in order to set the pay of large numbers of their public employees. The private sector model is in their terms a market-based competitive model of wage-setting. The essential characteristics of the market-based model are decentralised decision-making, with the opportunities this presents in adapting wages to conditions in the distinct product and labour markets in which organisations operate. This can be distinguished from the co-ordinated model used to set pay in the public sector in the other 4 countries studied. The essential characteristics of the co-ordinated model are service-wide or industry-wide wage and career structures, with the emphasis on fair and equitable pay structures across the many departments or organisations that populate a public service. This distinction is highly debatable. For example, there are also co-ordinated wage-setting models in the market sector, as in Ireland and the Netherlands.

As to the institutional framework, a similar but slightly less strong correlation is found for the decentralisation of the level of pay negotiation: when pay is negotiated on two levels (central level plus agency or departmental level) or only at the decentralised level (in agency or department), changes in the pay bill are lower than when pay is negotiated centrally. However, there is no significant correlation with the degree of differentiation in pay systems.

As to the financial framework, pay bills are lower if a part of pay bill management is decentralised or when agencies can autonomously manage their own running costs budgets or when the total budget of the public service (pay bill and all other costs) is adjusted based on various internal and external factors.

The OECD report (1997c) concludes that since the beginning of the 1990s, those countries that have reformed their pay systems are the ones most successful in holding down their wage bills. In other words, countries with a decentralised pay determination system have experienced lower pay bill growth than countries with more centralised systems.

The second hypothesis on outcomes to be tested is whether the decentralisation index is linked to changes in the level of public employment. These results are not significant: changes in levels of public employment are not linked to decentralisation of pay determination systems. Also, empirical findings suggest that changes in the volume of employment have not in themselves produced significant and lasting changes in the volume of the pay bill.

The OECD report (1997c) states that the results of its analysis should be interpreted with caution. One of the reasons is that the quality of data is an area of concern. Elliott *et al* (1999) confirm this state of affairs on pay data and report that the study of pay in the public sector is only in its infancy. They state that the detailed analysis of pay in the public sector in a number of European countries is only as good as the data the researchers had at their disposal and that the data in this area of research is still relatively poor. Apart from the quality of data, the comparison between pay in the private and public sectors in each of the countries is a complex issue.

This makes the comparison between the public sectors of EU countries difficult not only on real pay growth but also on public-private pay differentials. Indeed, one of the interesting conclusions of Elliott *et al* (1999) is that there is as yet no clear pattern for either pay growth in the public sector or public-private pay differentials. The patterns of real wage growth and of wage dispersion revealed no clear distinction between the more centralised and more decentralised systems of industrial relations. Perhaps, the authors argue, the reforms introduced in decentralised systems are still relatively young and it may be some time before the full advantages of the opportunities to negotiate locally become evident. Clearer patterns may emerge once the reforms have settled down.

This last issue is also taken up by Balado (1999), who queries whether the OECD survey presents an accurate picture of what is actually happening on the ground. It suggests a convergence of views and actions towards a managerial approach. The official reports may not, however, reflect the degree of implementation of reforms and the co-existence of contradictory approaches within the same country. Denmark is a case in point as Jørgensen (2000) explains:



The outcome of the collective bargaining round completed in the spring of 1997 signalled a decision to go ahead with the long-mooted proposal to conduct a reform on Denmark's public sector pay system. The decision was reached primarily to meet employer demands for a more flexible pay system.

It was agreed that the main goal was to devise a public sector pay system in which aggregate pay would consist of four separate pay components:

- (1) a basic wage, fixed at centralised level;
- (2) a supplementary amount, negotiated at decentralised and/or centralised level, based on job function (special areas of work, responsibility, etc);
- (3) a qualifications allowance (education/further training, experience, etc);
- (4) a component based on results/performance (i.e. efficiency), to be agreed at decentralised level.

Considered as a whole, the reform can be perceived as a show-down — as a determination to replace the automatic, seniority-based increment system with a system in which pay more accurately reflects the actual qualifications and performance of the single public sector employee and of groups of employees.

The new pay reform was launched as:

- a three-year pilot scheme in the state sector, commencing in January 1998;
- all major groups of employees in the local government sector were transferred to the new pay system by the 1999 round of collective bargaining.

As the agreements were concluded in both the state and the local government sectors, there were some differences in opinion on how large a percentage of aggregate pay should be negotiated at decentralised levels. The most often heard aim to reach in the long run was something in between 15-30 per cent. Still, today — three years after the introduction of the pay reform — only around two per cent of the total wage sum is to be negotiated at decentralised levels. Consequently, outcomes of the reform must so far be described as limited. But it must be emphasized that the principles of the new pay system enshrine the potential for developing both collective and individual negotiations on pay at decentralised levels.

### **Inherent tension**

One of the most important issues coming out of our analysis is the inherent tension between institutional decentralisation and financial decentralisation. Gelever (2000) studied the interaction between decentralisation in both the institutional framework and the financial framework. He tries to show, for example, that although two countries may be both decentralised in their respective institutional frameworks (especially bargaining agents and units), there could be great differences in the decentralisation of their financial frameworks. One country could pair its decentralised institutional framework with a more centralised financial framework, while the other country could pair its decentralised institutional framework with a more decentralised financial framework. One of the most crucial effects of EMU is that this tension is highlighted.

Bach (1999) concludes that governments are reluctant to risk losing control of the public sector pay bill by encouraging decentralised collective bargaining. As EMU reduces the capacity of national governments to shape economic policy, governments may cling more tenaciously to those aspects of economic policy which remain in their grasp. Controlling the public sector pay bill and public sector employment policies then become even more central to effective economic policy. Bach suggests that perhaps it may be possible to combine forms of 'organised decentralisation' with tight overall expenditure control by central government, with scope for employers to negotiate forms of flexibility at more local level.

Traxler (1995) coined the concepts of organised and disorganised decentralisation. He describes changes from a centralised to a decentralised system of industrial relations, firstly, in terms of a shift in levels of bargaining (from a higher to a lower hierarchical level) and, secondly, in terms of the degree of co-ordination (goals and capacity) between and within federations of employers and

unions. If a loss or breakdown of co-ordination accompanies decentralisation, he labels it 'disorganised decentralisation'. 'Organised decentralisation' occurs when a shift to lower levels materialises whilst co-ordination is either maintained or even strengthened (a shift towards a lower level is not a zero-sum game at the expense of a higher level).

The issue is made all the more complex, as Sisson and Marginson (2000) rightly point out, by the occurrence of a twin process of centralisation and decentralisation at the same time within private sector industrial relations in European countries. This possibility is equally true for the institutional framework in the public sector: a process of decentralisation because of the introduction of new public sector organisational regimes and a process of centralisation because of EMU.

### Convergence

Closely related to the issue of institutional and financial decentralisation is the issue of convergence. This has traditionally been less relevant in the public sector than in the private sector because the former has been shaped so strongly by distinctive national State traditions. Bach (1999) develops two propositions concerning convergence and divergence of employment and industrial relations:

- *First proposition:* Macroeconomic integration within the EU and microeconomic concerns in all public service organisations about efficiency and service quality are producing greater similarity in the structure and outcome of public service employment regulation within Europe. Public sector industrial relations are becoming more alike between countries.
- *Second proposition:* The restructuring process within each country may partially erode the separation between public and private sector employment relations. Public and private industrial relations within a country are becoming more alike.

Bach rejects a strong version of the first proposition because it is not in the interest of the State. Convergence of public sector industrial relations across countries diminishes the possibilities for a competitive advantage of one State over another even more. There is stronger support for the second proposition, of growing convergence between public and private sector employment relations in each country.

Based on the material presented in our analysis, it is possible to present a more systematic assessment of convergence. Firstly, with regard to the employment relation within the institutional dimension, one can speak of a trend:

- Towards convergence between the public sectors in EU countries and within each country with the private sector, in the sense that the model of private sector employment relation is increasingly applied in most countries in parts of the public sector (with one or two exceptions). This holds for both the model of fixed and temporary contracts.
- Towards convergence between the public sectors in EU countries and within each country with the private sector on the basic regulatory mechanism. Again, with one or two exceptions, parts of the public sector in most countries are increasingly moving towards collective bargaining, real or quasi.

Both these trends add up to a basic long-term underlying convergence between public sector employment relations in different countries and between public and private sector employment relations in individual countries.

Secondly, with regard to the industrial relations within the institutional dimension, there is a trend towards convergence of the bargaining agents on the employers' side between the public sectors of EU countries since, under the influence of EMU, there is a larger role for the Ministry of Finance to play in co-ordinating, negotiating and monitoring. There is also an element of convergence with the private sector as increasingly independent or semi-independent employers' federations are created. In some countries, such as Italy, both developments have occurred at the same time under the impact of EMU.

On the union side, the issue of convergence of bargaining agents depends very much on the traditional structure of the trade union organisation — whether public sector trade unionism is an integral part of the trade union movement or whether there is quite a separate set-up. In some countries, there is a large degree of co-ordination through national federations, while in other countries co-ordination is absent or occurs in a more limited form.

As to bargaining units, there seems to be a clear convergence with both the private sector in individual countries and the public sector in other countries, with a tendency to decentralise in order to deliver tailor-made solutions and agreements.

Thirdly, if one thing sets the public sector industrial relations apart from the private sector, it is the financial dimension. Here, there are clear signs of convergence between the public sectors of different countries as financial constraints have converged (in the Growth and Stability Pact) and finance ministries are becoming involved in the set-up of the institutional framework. However, the degree of and the route towards decentralisation in the financial framework differ between the public sectors of European countries and, hence, the degree to which EMU highlights the tension with the decentralisation of the institutional framework.

The introduction of EMU has an impact that goes far beyond a change in monetary policy. It involves a 'paradigm shift' affecting the behaviour of all key economic agents in the European Union. Central to the EMU policy framework are the objectives of price stability, central bank independence and sound public finances. The primary mandate of the independent European Central Bank, as laid down in the Maastricht Treaty, is 'to maintain price stability'.

The main focus in this literature review is on the relationship between EMU and reforms in the public sector. The most general question is what impact does EMU have on public sector reform? More specifically, what impact does EMU have in various countries on changes in the scope of the public sector, on the public sector as part of the European Social Model, on the financial and budgetary frameworks, and on public sector labour relations?

One of the aims of this study in answering these questions is to close the gap between macroeconomic literature, literature on comparative welfare states with strong roots in (international) political economy studies, literature on public sector reform rooted in studies of public administration, and literature on public sector industrial relations.

## Main conclusions

- Important international economic and political changes, like the shift to a hard currency regime, culminating in EMU, motivated domestic policy actors to restructure a wide range of public sector institutions and policies.
- The Maastricht entry exam for EMU has been effective in triggering a 'regime shift' in national budgetary and fiscal policy across the economies of the European Union. Budgetary adjustment represents a clear break with past policy behaviour, especially in the 1970s when EU countries tended to increase both expenditures and taxes.
- Many of the ideas of the New Public Management concept are strong in ideological content, but still have to be proven in practical application. The ideas do not provide sufficient impetus for the debate on the changing scope of the public sector.
- There are four main streams in the reform of organisational regimes in the public sector: decentralisation, devolved autonomy, internal privatisation and external privatisation. The relatively simple distinction between the private and public sector, both in sectoral terms and in terms of organisational regimes, is something of the past.
- The public sector is a crucial part of the European Social Model. Most countries did not experience any major shifts in public sector employment and either remained fairly stable or saw a slow but steady decrease. With the revival of interest in the public sector in many EU countries, right across the political spectrum, more research effort should be put into the development of other public sector indicators, such as the quality of public services.
- EMU leads to an increase in the importance of a country's Ministry of Finance or the Treasury in public sector industrial relations in the areas of monitoring, internal co-ordination and bargaining, as well as an increasing involvement in the set-up of the industrial relations framework.

- EMU may counteract the trend of reform in financial and budgetary frameworks towards more autonomy for lower levels (often part of the introduction of newly decentralised and devolved organisational regimes) since EMU tends to increase financial constraints of central government.
- EMU may create an inherent tension between the reform of the financial and budgetary framework and the ongoing decentralisation of industrial relations in the public sector.
- As the competitive edge of the EU will depend increasingly on the qualities of its social services and public sectors, each Member State will have a rising stake in the public policy capabilities of the other Member States. Thus, it becomes essential to encourage and promote procedures of effective learning between EU countries through a process of open co-ordination.
- Much work needs to be done on indicators of public sector pay in EU countries before standards of comparability are anywhere near those of pay in the private sector.

### **EMU as the culmination of a hard currency policy regime**

In the Foundation's study of the impact of EMU on industrial relations in the private sector, a distinction was made between the narrow view (of EMU in terms of the single currency, the European Central Bank with responsibility for setting monetary policy and the Stability and Growth Pact) and the wider view (of EMU as the ongoing process involved in establishing the single European market). In the narrow view, there is relatively little impact on private sector industrial relations, while in the wider view the impact is much more substantial, albeit indirect.

In this study, we present a long-term view of EMU — the introduction of EMU as the culmination of a lengthy process of the institutionalisation of a hard currency policy regime across Europe.

With the introduction of EMU, the conduct of monetary policy is centralised at the level of the European Union and is no longer available as a policy instrument at national level. Budgetary policy will thus remain the main macroeconomic policy instrument still available for individual nation states to combat recessions, especially when shocks are country-specific. Whereas the EMU constraints (price stability, underpinned by central bank independence) for private economic agents are of an indirect nature, direct norms are imposed on Member States when it comes to public economic agents in order to preserve sound public finances.

The general shift from full employment towards price stability as a primary policy goal — a process that has been underway since the early 1980s, culminating in EMU — essentially implies that macroeconomic policy can no longer serve as a buffer, shielding other areas of social and economic policy from the burden of external adjustment to the ongoing process of economic internationalisation. We argue that important international economic and political changes, such as the shift to a hard currency regime, culminating in EMU, motivated domestic policy actors to restructure a wide range of public sector institutions and policies.

Reviewing the various country trajectories of public sector reform under the intensifying macroeconomic constraints of a hard currency regime, we can discern substantial cross-national variation in the scope, modes, patterns and intensity of public sector reform in different countries.

When discussing viable responses to ascertain external pressures in terms of public sector reforms, it is essential to assess each country's institutional capacities and policy legacies in terms of the feasibility of adopting and implementing certain policy strategies. The importance of such an institutional analysis for understanding the diversity of European welfare states cannot be underestimated. Differences in policy responses to new external challenges can in many cases be explained by differences in the institutional context of the countries involved. Too often, 'the welfare state' is referred to in terms of a phenomenon uniformly manifest across national territories.

In retrospect, we argue that the Maastricht entry exam has been effective in triggering a 'regime shift' in national budgetary and fiscal policy across the economies of the EU. Even for hard currency latecomers (Finland, Portugal and Italy), the Maastricht criteria served in the first instance as an additional triggering device, helping policy-makers to overcome resistance to unpopular public sector reform efforts, driven by finance ministries. These reforms may not have been political feasible in the absence of the Maastricht 'beauty contest'.

For those countries that prefer to stay outside the EMU framework for the moment (the UK, Sweden and Denmark), it should be emphasized that, indirectly, the Maastricht convergence criteria also put considerable pressure on them for budgetary consolidation. The criteria have become important foreign benchmarks for them because under conditions of high capital mobility, ever since the late 1980s, excessive spending is punished by high risk premia on their public debt and may thus trigger speculative runs on their currencies (Scharpf, 2000).

The scale of adjustment carried out since Maastricht has put government debt on a downward path in the majority of EU Member States. The scale of retrenchment was particularly important in those countries which, at the beginning of the 1990s, experienced the most serious public finance problems. The budgetary adjustments that have taken place in all EU Member States have involved large reductions in primary government expenditures (either outright over the whole consolidation period or in a second phase, after initial tax increases). Only in a few Member States did budgetary consolidation take place essentially through tax increases. Budgetary adjustment represents a clear break with past policy behaviour, especially in the 1970s when EU countries tended to increase both expenditures and taxes.

### **Indicators of the public sector**

In this study, we looked at several indicators of the public sector — fiscal policies, public deficit and debt, and public employment as part of total employment. Central to the debate about the effect of EMU on public sector reform is the extent to which reforms in the welfare state and public sector are triggered by the difficulties of raising revenue through taxes by national governments as a consequence of tax competition and increased tax migration across national boundaries. Governments can be caught in a squeeze between, on the one hand, the pressures emerging from economic internationalisation and, on the other, the pressures from prior spending commitments. In other words, governments have to be able to keep financing their public spending without losing too much of the tax base to either international competition or unemployment and the hidden economy.

However, many governments participating in the EMU entrance exam were caught in the squeeze of pressures emerging from trade integration (especially European economic integration) and

pressures arising from prior spending commitments. This tug-of-war seems, so far, not to have had any particularly adverse consequences for welfare states in terms of levels of social expenditure. These have, on average, gone up since the early 1990s.

The public deficit and debt of the analysed countries developed in very different ways during the 1980s, being subject to different country-specific challenges. Both these indicators show an obvious convergence in the late 1990s. It should be emphasized that excessive deficit spending is no longer a viable option, both in and outside of EMU. In an environment of internationally mobile capital, public sector reform is high on the agenda so as to lower the burden on the public budget, irrespective of participation in EMU.

Most countries did not experience any major shifts in public sector employment and either remained fairly stable or saw a slow but steady decrease. The comparison of public employment levels with those of total employment and unemployment also provide interesting insights. The most striking observation here is that, where total employment seems to follow the macroeconomic trends, public employment ratios seem to ignore or even go against these developments and remain quite stable, whether in favourable or unfavourable economic conditions. This does not mean that public employment is not subject to economic conditions, but it does mean that economic conditions are not reflected in public employment ratios in the way they are reflected in the figures for total employment and unemployment.

### **Changing organisational regimes and scope of the public sector**

Apart from the above indicators, this study also looks at the changing organisational regimes and scope of the public sector. The model of New Public Management (NPM) aims to change the relationship between politics and administration from a situation of loyalty and hierarchy to a system of partnership and transaction. Generally, NPM is associated with a more business-like approach to organisations and processes in the public sector. Originally, the approach was associated with ideological notions of 'rolling back the state'. However, this notion has been eroded in the last decade. A business-like approach to government these days does not necessarily lead to a preference for markets over governments or private goods over public goods. It might lead to a preference of government regulation and oversight over government production and provision. The question of what a government ought to do may logically be divorced from the question of how a government manages the affairs it has decided to do.

We have distinguished four main streams in the reform of organisational regimes:

- *decentralisation* from central government departments to regional/local governments, which involves public administration led by elected political authorities who are accountable to the electorate;
- *devolved autonomy* often from central government departments to mainly independent agencies, which involves administration through appointed officials, accountable to higher elected authorities who have defined the objectives and technical and financial competencies of the service;
- *internal privatisation* or the application of market-type decision-making mechanisms within the public sector, the main purpose of which is the introduction of an internal market within parts of the public sector; and

- *external privatisation* or the selling-off of parts of the public sector to the private sector.

Apart from a country-specific trajectory, these reforms also have a sector-specific dimension. This leads to four clusters of reform that define the changing scope of the public sector at sectoral level (see *Table 2*):

- the 1st cluster concerns decentralisation and devolved autonomy within government administration, with tasks being decentralised from central government departments to regional/local governments or devolved to mainly independent agencies;
- the 2nd cluster also concerns decentralisation and devolved autonomy, but occasionally with some elements of internal privatisation in the sectors of education and health/care/social services;
- the 3rd cluster concerns devolved autonomy and internal privatisation with market-type decision-making mechanisms in the sectors of public utilities and transport;
- the 4th cluster concerns the external privatisation of the communications sector (telecommunications and postal services).

These clusters are not static entities. An important phenomenon is the blurring of boundaries between public and private sectors, especially under the impact of new technologies and the ongoing experimentation with new organisational regimes, such as private-public partnerships, often combining elements of the organisational regimes identified. The relatively simple distinction between the private and public sector, both in sectoral terms and in terms of organisational regimes, is something of the past.

## Reform of employment and industrial relations

In this study, a distinction is made between reforms in the employment relationship and in industrial relations. The employment relationship concerns the underlying fundamentals of the employment contract and its basic regulatory mechanism in the public sector. Industrial relations refer to the bargaining structure in terms of bargaining agents and bargaining units.

Examining these two elements in relation to the institutional dimension of the regulatory framework and the financial dimension of budgetary reform (changes in mechanisms used by governments to control and adjust pay bills as an important part of public budgets), there seems to be three interrelated processes of reform:

- There is an ongoing process of institutional reform of the employment relation and its basic regulatory mechanism. The model of private sector employment relation (especially the model of the fixed contract and, to a lesser degree, the temporary contract) and the private sector mechanism for establishing wages and conditions (bilateral collective bargaining) is applied more and more in parts of the public sector. Both of these developments predate EMU and the evidence is that there has been little or no impact of EMU on the fundamental aspects of the employment relation. It is linked to a long-standing wish for convergence with the private sector and for the introduction of new organisational regimes in the public sector.



- Reforms in bargaining agents and units lead to an increase in the importance of the Ministry of Finance or the Treasury in internal co-ordination and as a bargaining agent. Also, there is an increase in dual level bargaining within strict parameters at the lower level of, for example, local authorities or agencies, while payment by results provides a mechanism for additional pay. These reforms in bargaining agents and units predate EMU, but the increasing role of the Ministry of Finance or the Treasury in many countries in the actual bargaining signals that EMU is strengthening and giving added impetus to these developments. It is also linked to a long-standing wish for convergence with the private sector and for the introduction of new organisational regimes in the public sector. To make matters more complex, experiences with decentralised and devolved organisational regimes elsewhere in the public sector are applied within industrial relations (the establishment of semi-independent bargaining agencies to act as employers' federations).
- There is a direct impact of EMU on the financial framework. In many countries, there is a decreasing scale of financial constraints by central government on the budget for pay bills. These reforms of budgetary frameworks, in terms of more autonomy for lower levels, predate EMU as they are often part of the introduction of newly decentralised and devolved organisational regimes in the public sector. EMU may, however, counteract this trend as it tends to increase the financial constraints of central government directly in the budget or indirectly through performance targets, strengthening the role of the Ministry of Finance in co-ordinating and monitoring. EMU impacts in particular on the interaction between financial reform and decentralisation of bargaining units and pay agreements.

In summary, the need for international competitiveness has triggered hard currency regimes and new public sector organisational regimes and these, in turn, influence both institutional and financial reforms. The financial reforms have an independent effect on the institutional reforms, especially the industrial relations aspect (bargaining agents and units). The impact of EMU on the reform process primarily acts through the financial reforms. EMU is becoming a crucial European-wide feedback mechanism, established in the Stability and Growth Pact, on the outcomes in this model (see *Figure 8*).

One of the most important issues emerging from our analysis is the inherent tension between institutional decentralisation and financial decentralisation. One country could pair its decentralised institutional framework with a more centralised financial framework, while another could pair its decentralised institutional framework with a more decentralised financial framework. One of the crucial effects of EMU is that this tension is highlighted. Closely related to the issue of institutional and financial decentralisation is the issue of convergence. There are clear signs of convergence between the public sectors of different countries as financial constraints have converged in the Growth and Stability Pact and finance ministries are not only content with applying the constraints, but are also becoming involved in the set-up of the institutional framework. However, the degree to which and the route towards decentralisation in the financial framework differ between the public sectors of European countries and, hence, the degree to which EMU highlights the tension with the decentralisation of the institutional framework.

## Recommendations

### Public sector as part of the European Social Model

The normative principles and core practices of the European Social Model are defined in this study in terms of comprehensive social protection, high levels of income redistribution and social partnership involvement in public policy-making.

We argue that the Maastricht entry exam has been effective in triggering a regime shift in national budgetary and fiscal policy across the economies of the EU. Budgetary adjustment represents a clear break with past policy behaviour, especially in the 1970s when EU countries tended to increase both expenditures and taxes.

Thus far, neither EMU (nor the single market) seem to have had particularly adverse consequences for welfare states in terms of levels of social expenditure, which on average have gone up since the early 1990s. Second, with respect to the dimension of social partnership, EMU and the Stability and Growth Pact seem to have had a positive effect on the resurgence of social pacts between national governments and social partners, allowing for various market and social policy reforms that encourage welfare sustainability.

We look upon the public sector as a crucial part of the European Social Model. There is a revival of interest in the public sector in many EU countries, right across the political spectrum. Therefore, there should be more research effort put into the development of public sector indicators. An important issue is the quality of the public services.

### The role of open co-ordination

As the competitive edge of the EU will depend increasingly on the qualities of its social services and public sectors, each Member State will have a rising stake in the public policy capabilities of the other Member States. Thus, it becomes essential to encourage and promote procedures of effective learning between EU countries through a process of open co-ordination.

Although we expect each country to keep its economic and social characteristics within EMU and the European Social Model, we also expect there will be a process of hybridisation, rather than convergence, between countries, with countries picking up on the policy initiatives of other countries that are in tune with their own country-specific institutions and policy legacies. Preferably, such processes of hybridisation will be embedded in contextualised procedures of open co-ordination (Hemerijck and Visser, 2001). There are grounds for believing this to be the case. Progress in the direction of policy learning, we maintain, is more likely than regime competition for the simple reason that, as European economic growth becomes increasingly interdependent, clearly the performance of one national economy will depend more and more on conditions among its neighbours, including policy development. It must be remembered that 90% of total EU trade occurs between Member States.

### Changing management and scope of the public sector

The relatively simple distinction between the private and public sector, both in sectoral terms and in terms of organisational regimes, is something of the past. Many of the ideas of the New Public Management are strong in ideological content, but still have to be proven in practical application. The ideas do not provide sufficient impetus for the debate on the changing scope of the public sector.

It would be especially important to study the dynamics of organisational regimes in terms of decentralisation, devolved autonomy and internal privatisation under the conditions of changes in the financial budgetary framework because of EMU. Sectors could include not only local authorities, health and education, but also public utilities and transport.

#### **Decentralisation in industrial relations and role of the Ministry of Finance**

The degree to which and the route towards decentralisation in the financial budgetary framework differ between the public sectors of European countries and hence the degree to which EMU highlights the tension with the decentralisation of industrial relations. A central issue for research is the role of the Ministry of Finance in the development of this relationship. The tension between decentralisation in industrial relations and the budgetary framework will manifest itself most of all in labour-intensive sectors, such as local/regional administration, education and health/care, where reforms of organisational regimes are best described in terms of decentralisation and devolved autonomy.

#### **Comparisons of pay in the public sector**

We have found some important gaps in the literature on pay in the public sector. Although there is a substantial comparative literature on employment and industrial relations in central government, there is less for local/regional government and in particular for sectors like education, health/care, transport and public utilities. Also, there is a considerable literature on EMU and wage bargaining in the private sector or the national economy, but much work needs to be done on the development of pay in the public sector before standards of comparability are anywhere near the private sector.

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