



# Danger, One EU Crisis May Hide Another: Social Model Anxieties and Hard Cases

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It is widely agreed in the wake of the French and Dutch referendum rejections of the Europe Constitution that the EU is in serious crisis. This article argues that the EU's crisis is much deeper than ordinarily understood, however. The weak performance of key continental EU economies, particularly France and Germany, is related to structural problems in continental social models and casts a large shadow over the Union's medium-term prospects. The roots of these problems cannot be easily understood using the different institutionalist analytical techniques of contemporary political economy. Nor are they likely to be amenable to quick and clever policy reforms. Instead they are rooted in long-standing features of national social model architecture that have been reinforced, in recent decades, by the domestic consequences of fundamental foreign policy choices, in the French case for renewed European integration in the 1980s and in the German by unification.

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## Introduction

'Danger, one train may hide another' goes a French rail crossing warning. Referring to the European Union's (EU's) present situation, it might be rephrased as 'danger, one crisis may hide another.' The rejection of the constitutional treaty in the 2005 French and Dutch referendums left the EU in a crisis situation. Potentially, EU institutions could be paralyzed. Nonetheless, behind this lay another equally significant crisis. The EU's survey of France concluded that the '... people voted "no"...based...on national and/or social themes which take precedence over European considerations...' (Flash Eurobarometer, 2005a, 17). The Dutch no was more EU-centered, but 21% of voters were worried about their economic situation and 65% thought that rejection might 'allow... renegotiation...to place greater emphasis on...more social aspects' (Flash Eurobarometer, 2005b, 18, 23). At about the same time, voter anxieties about the economy and the federal government's social policy



reforms caused the German SPD to lose decades-long power in North-Rhine Westphalia, with the same themes repeated in the September federal elections. Thus, not only was the EU in institutional crisis, but key members also faced ‘social model anxieties’ about their systems of social regulation.

In the abstract, ‘European social model’ refers to institutional arrangements comprising the welfare state (transfer payments, collective social services, their financing) and the employment relations system (labor law, unions, collective bargaining) that occur primarily in northern and continental Western Europe. In this model, institutions of the welfare state and employment relations have combined to make citizenship, more than markets and families, the most significant axis of solidarity. The model typically has had high levels of taxes, transfers, legal regulation of labor markets, and institutionalized bargaining between legitimate social partners. It has also developed generous transfer programs to counter life course risks such as unemployment, illness, and old age. As a rule, inequality and poverty have been low and insecurity in the face of market forces limited.

The term ‘European Model’ breaks down into many variants when one gets closer to the differences within Europe, however (Esping-Andersen, 1990; Ebbinghaus, 1999; Hall and Soskice, 2001; Martin and Ross, 2004). When specific cases are examined it becomes clear that some social models in EU member states have combined sustained economic success with generous social protection systems. A few are more deeply troubled, however, particularly those of France and Germany. Given that these are the EU’s most important member states economically and, arguably, politically, their ‘social model anxieties’ may loom large over EU Europe’s immediate future.

What follows seeks the sources and the consequences of social model anxieties in France and Germany. It situates the French and German hard cases, compares the nature and development of their particular problems, and then seeks analytical ‘metanarratives’ to account for their difficulties. The article concludes with consideration of relationships between French and German ‘social model anxieties’ and prospects for the EU.

### **Social Models ...and Hard Cases**

Over the last decade US economy grew at an annual 3.3% rate while averaging 4.8% unemployment. The EU-15 grew more slowly — 2.1% annually — with 10% unemployment. Table 1, which follows the Esping-Anderson taxonomy of welfare states (Esping-Andersen *et al.*, 1990), suggests that there are signal economic performance differences for different European social models, however. EU economies outside European Monetary Union (EMU) (the UK, Denmark, Sweden) have done better than EMU members, sometimes nearly as well as the US, hinting an EMU effect that may explain some

**Table 1** Growth, unemployment and social expenditures in different social models

Regime type	Country	Average annual GDP growth: 1995–2005	Unemployment			Social spending % GDP <sup>a</sup>	
			1990	2000	2005	1990	2002
Scandinavian	Denmark	2.1	7.2	4.4	4.9	27.0	29.1
	Finland	3.6	3.2	9.8	8.4	24.2	25.6
	NL	2.2	5.8	2.9	5.2	29.6	26.7
	Sweden	2.7	1.7	5.6	5.9	31.6	31.3
Continental	France	2.2	8.5	9.1	9.4	26.5	29.0
	Germany	1.4	6.2	7.2	9.7	24.4	29.4
Anglo-Saxon	UK	2.8	6.9	7.7	4.7	21.9	26.6

<sup>a</sup>Public plus private. *Source:* Tables 2, 3, 5 in Aiginger and Guger, 2005.

variance (Martin, 2004). In addition, smaller EU-15 members have performed better than larger ones, the UK excepted. This is particularly the case for ‘smalls’ with generous social models (Austria, Sweden, Denmark, and the Netherlands). Several of these smalls have also reformed their social models while maintaining commitments to equity and even equality (Auer, 2000). Sweden reconfigured its pension system, ‘capitalizing’ part of pension programs, in ways compatible with Sweden’s traditional commitment to equality. The Danes have created a successful system of labor market ‘flexicurity’ (Madsen, 2002). The Finns, following the loss of Soviet markets, have also maintained their model. The ‘Dutch miracle,’ pushing much of the female labor force into part-time work (Visser and Hemerick, 1997), has performed strongly.

Some European social models have coped well in the new, market-liberalizing, economic circumstances of Europeanization and globalization, therefore. Others have not. First among these are France and Germany, the EU’s most significant economies. Germany is the third largest economy in the world and the largest in the EU, with 22% of EU GDP in 2003, and perennially the world’s leading exporter. Depending on the year, France is number two or three in the EU (trading places with the UK) with 16% of EU GDP, and fourth or fifth largest global exporter. France and Germany both grew very slowly through the 1990s and even more slowly in the new century. Each has had consistently high unemployment, around 10% in recent years. Each has had chronic public financial problems, with difficulties meeting EMU and Stability and Growth Pact (SGP) targets, particularly the 3% annual



budget deficit criterion. In terms of general economic performance, France and Germany are today's EU 'hard cases,' therefore.

Analysts and public officials alike agree that reforming EU social model institutions is very important to EU economic success. Contemporary trends of Europeanization and globalization prod such changes, directly and indirectly. EMU creates strict controls over national public finances that often requires cuts in national social spending, sometimes inciting program reconfiguration, for example. The European Employment Strategy pushes EU member states to 'activate' national labor markets through various changes in social policy (Rhodes, 2005). Other EU processes involving the Open Method of Coordination promote pension reform and policies to moderate social exclusion. The Lisbon Strategy pushes and prods change to enhance EU competitiveness (Pochet, 2005). The EU Single Market, EMU, and multiple processes of globalization (trade liberalization, global financial markets, and the workings of trans-national corporations among them) place national social models in more intense international competition, giving mobile firms more exit options, and enhancing the domestic power of well-organized business groups. In different ways all of these processes limit what can be undertaken, sharpen national choice between the status quo and transferring resources to confront new problems, and establish new barriers on how much can be spent (Rodrik, 1997; Esping-Andersen *et al.*, 2002; Rieger and Leibfried, 2003).

Reforming European social models and the anxieties that reform stimulates are in themselves nothing new. The present situation is different, however, because these models have now reached 'maturity.' Recent social and economic changes have intervened to make new reforms more likely to create losers, many of whom are politically well armed (Pierson, 1994, 2001). Aging populations strain intergenerational transfers in pensions, for example, but attempts to reconfigure such transfers mobilizes those who stand to lose to resist change. Analogous difficulties arise in health care, where demographic pressures interact with vertiginous cost increases, and other social policy areas. Confronting more open international markets involves 'flexibilizing' employment relations systems and labor markets by reconfiguring collective bargaining mechanisms and relaxing certain labor laws. Such change threatens already weakened labor organizations whose political clout remains significant (Martin and Ross, 1999; Dølvik, 2004).

Beyond maturity, at least two other things may make it harder to change social models in countries like France and Germany. First, their size and complexity create additional barriers to reform. For small, open European economies, threats to social models often impact on institutional settings where 'encompassing' social partner organizations facilitate consensual adaptation. In contrast, France and Germany have large economies that until quite recently lived with reasonable prospects for relative self-sufficiency. The French



social model was founded inside a protectionist imperial system and consolidated during the EU's early years of cautious market opening and rapid growth. The German social model was rebuilt after 1945 around an export-led strategy centered on firms that produced high-quality manufactured goods interacting with cooperative unions nourishing the rest of German society to prosperity. Secondly, in both France and Germany economic growth has been hard to come by since the early 1990s. It is much easier to adapt social models, even mature ones, when their national economies are growing.

Before we can make sense of the French and German hard cases, however, we need know more about their recent histories. The stories that follow emphasize two interconnected social model realms, employment relations structures and welfare state programs. Particular care will be taken to specify the actions and actors that pushed these stories forward and the broader conjunctures in which developments occurred.

## **French and German Stories**

### **France: much reform, little success?**

France, by the 1970s, had a welfare state that was a Gallic translation of Bismarckian social insurance with 'paritary' (corporatist) management, backed by a strong state (Palier, 2002). It also had a solid if idiosyncratic employment relations system where weak, politicized, competitive unions and anti-union employers, both reticent about bargaining, were balanced by a strong state and legal order (Labbé, 1996). Both dimensions of the French social model benefited from strong post-war economic growth. However, the end of the Bretton Woods system and the 1970s oil shocks, however, brought changing fortunes. In the background, internationally were exchange-rate fluctuations threatening the European Community, and particularly the Common Agricultural Policy, at the core of France's position in Europe. European Commission (EC) leaders rapidly sought new monetary policy arrangements, eventuating in a 1978 deal between German Chancellor Helmut Schmidt and President Giscard d'Estaing to found the new European Monetary System (EMS) (Heisenberg, 1999, chapter 3), a key thread in the rest of the story.

The French economy, France's social model, and the European monetary compromise were all severely tested after Socialist François Mitterrand won the French Presidency in June 1981. Mitterrand proposed broad and expensive nationalizations, new planning and industrial policies, employment relations reforms to give more power to unions and workers, devolution of power to the regional level, redistributive shifts in social protection programs, and Keynesian stimulation that included extensive public sector job creation



(Favier and Martin-Roland, 1990). The ‘Mitterrand experiment’ was brief, however, running into difficulties intensified by recession in the United States and EMS uncertainties. The Left’s post-1981 Keynesianism fueled France’s already high inflation rate, stimulated waves of imports from neighbors revealing France’s competitive weakness. There were three devaluations between May 1981 and March, 1983, each involving tough negotiations with EMS partners, the Germans in particular (Cameron, 1995).

By winter 1982–1983, with the third devaluation on the horizon, it was clear that short-term austerity fixes — wage, price, currency, and export controls among them — were insufficient to stabilize things. The larger choice on the table was between leaving the EMS to float the *franc* (which would almost certainly have been a huge blow to European integration) or staying in EMS and making major economic policy changes. Mitterrand made the second choice, initiating a 180° policy shift. He then tied this choice politically and economically to a diplomatic mission to renew European integration. Thus, the 1984 French EC presidency resolved the biggest issues underlying the ‘Euro pessimism’ of the period — Spanish and Portuguese accession, the ‘British check’ problem — and elected Jacques Delors as president of the EC. Delors and his Commissions, with backing from Mitterrand and Helmut Kohl, the German Chancellor, then promoted the program to complete the single market and the Single European Act, reformed EC budgeting, linked it to reconfigured and greatly expanded regional development policies, and prodded movement toward EMU.

France’s abrupt turn from nationalist, statist social democracy and its almost simultaneous ‘choice for Europe’ necessitated a range of new domestic economic policies. Thus, post-1983 France turned to austerity, budgetary constraint, and market liberalization, ended the practice of using the public sector to maintain employment, and began harsh industrial restructuring (Favier and Martin-Roland, 1990). The turn to a hard-currency monetary policy aimed at rapid ‘competitive deflation’ to parity with the Deutschmark underlined the significance of ‘Europe’ to the reform package. The immediate results were dramatic. Growth dropped precipitously in the 1980s, and inflation fell from double digits to 3% by 1990. The share of wages and capital in GDP shifted against wages (from 74% in 1981 to 68.5% in 1990), and inequalities grew. Most important, economic policy changes (including privatization, beginning with the first cohabitation government of Jacques Chirac — 1986–1988), contributed to new mass unemployment, which governments had to handle carefully to have any hope of surviving electorally.

Such careful handling brought major changes to the French social model. The initial policy option of choice was work-sharing by reducing labor market participation rates (Heller, 1987). The Left lowered the retirement age to 60 years in 1982 and in the same year created strong incentives for older



workers to take early retirement or go half-time (often being obliged to do so) at 55 years, in some cases even at 50 years. In the same year, it also reduced the work week to 39 h and added a 5th week of paid vacation. Successive governments also promoted early retirement schemes for hundreds of thousands of workers in the areas where restructuring had hit hardest. Policies moving potentially unemployed workers out of the labor market were applied to younger people as well. A higher percentage of each youth cohort was channeled into university and technical training and there were innumerable internship, apprenticeship, and other schemes to keep young people off unemployment rolls (Gauvin, 1993, 162–169). Different governments continued similar policies throughout the 1990s, culminating in the 35 h week legislated by Lionel Jospin's 1997–2002 Left government. Results of work-sharing are tangible today. France has the lowest average retirement age in the EU-15, the second lowest average age for exit from the labor force (next to Belgium), among the lowest total employment rates of older workers and, by 2002, the lowest hours worked per week in the EU-15 (Eurostat, 2004). Alas, work-sharing has done little to lower general unemployment.

In labor market areas, economic liberalization and higher unemployment created new flexibility automatically. Union membership eventually dropped to the lowest level in the EU while strike levels nosedived. Workers, fearing for their jobs, became more risk averse and amenable to employers' ideas about cooperation and work floor change. Government policies promoting greater labor market flexibility sometimes worked indirectly. The 1982 Auroux Laws, initially denounced by employers, created new worker representation plus obligatory annual wage negotiations, and quickly became vehicles for flexible scheduling, wage lowering, and anti-unionism. Atypical hiring contracts and working-time schedules — weekends, night shifts, staggered hours — became more common. Governments were reluctant to change the standard labor contract (the *contrat à durée indéterminé*) protecting those employed under it from dismissal, however. Because of this employers grew wary of new hires under its terms, contributing to the steady rise in part-time and precarious employment (INSEE, 2005; OECD, 2005, 2005a). In general, these multiple labor market changes led to greater job insecurity and accentuated insider–outsider biases.

The massive economic policy shifts of the early 1980s strained established social programs mainly because pay-as-you-go financing linked revenues tightly to a deteriorating business cycle. This was particularly important for health care, which combined social insurance financing, state control of hospitalization, and 'paritary' co-management. Costs had already begun to go up faster than GDP in the 1970s, and, while the effects of an aging population did not kick in until the 1990s (the share of health care in GDP rose from 7.6% to nearly 9.0% between 1980 and 2000 — Insee, 2001, 211), erratic



revenue flows tied to fluctuating payroll taxes obliged governments to devise frequent fixes including user fees, new deductibles, and tough cost controls for hospitals. Financing public pensions became more difficult while, in addition, government work-sharing policies increased costs.

New mass employment challenged poverty policies (Palier, 2002, 282–287). By the mid-1980s ‘social exclusion’ was being discussed far and wide, celebrities ran soup kitchens, and ghettos, whose existence the French had been wont to deny, had begun to explode. After Mitterrand’s 1988 re-election, the Rocard government responded with the RMI (*Revenu Minimum d’Insertion*), perhaps the Left’s most significant innovation in French welfare state programming. The RMI was a new means-tested minimum ‘citizen’s income’ tied to commitments to seek ‘*insertion*’ — usually training or work. Immediately on its heels came a major financing reform, the *Contribution sociale généralisée* (CSG), a flat tax dedicated to financing social protection via a broadened tax base.

It is significant that French social spending grew rapidly until the early 1990s, then stabilized at slightly under 30% of GDP (close to big spenders Sweden and Norway). Increased spending was necessitated by social policy changes following the economic U-turn of 1983. Stabilization in the 1990s was tied to the coming of EMU, the final great leap forward of France’s European integration strategy. France had been in good enough shape in 1992, after negotiations for the Maastricht Treaty on EU, to meet the EMU convergence criteria. The situation changed, however, after German unification policies fueled European inflation, EMS instability, and a brutal European recession (Heisenberg, 1999, 132–134). As a result France fell far off EMU convergence targets, making new reforms inevitable. The first manifestation was negotiated reform of unemployment insurance in 1993 that brought a streamlined system with benefits that decreased over time (Palier, 2002, 216–225). Changes to pensions began in 1993 when the reference period for benefits was changed (*de facto* cutting pension levels), contributions lengthened from 37.5 to 40 years, and growth in benefits indexed to price rises rather than wage growth (Palier, 2003).

The 1993 pension reforms covered only the ‘general regime’ (private sector workers), leaving civil servants, public sector workers and others in an even more privileged relative position than before. In 1995, facing a 5% budget deficit 2 years before eligibility for EMU was to be decided, Alain Juppé, Jacques Chirac’s first Prime Minister after victory in the 1995 presidential election, proposed a large package of reforms, including extending 1993 pension reforms to other categories of workers. The 5-week strike that followed rocked the Chirac presidency and caused the pension scheme’s withdrawal. Other provisions in the plan were enacted, however. Changes to the ‘paritary’ management of health care gave governments new powers over the direction



and amounts of social security spending and gave Parliament a vote on the entire social security budget. Most health-care financing was, in time, shifted from payroll taxes to the CSG, making it a larger source of revenue than the income tax. Finally, a special income tax supplement, the CRDS (*Contribution au remboursement de la dette sociale*, 5% over 13 years) was introduced to cover the accumulated deficit of the health-care system. From this point meeting the EMU criteria meant more budgetary compression, even slower growth, and additional unemployment that topped out at 12.8% in early 1997.

Chirac imprudently dissolved Parliament in 1997 and his coalition lost the ensuing election, bringing to power a government under Socialist Lionel Jospin. Jospin faced constraints similar to his predecessors, in particular the EMU 3% deficit limit. Since unemployment had, again, been the biggest election issue, Jospin pledged to create 700,000 new jobs over 5 years. His biggest effort was a new 'youth employment' program for 'jobs of a third type' (i.e. 'third sector,' real work that the market did not remunerate) with 5-year limited contracts, activation,' but was essentially another variation on work-sharing. This was also the case for the 35 h week mentioned earlier. The Jospin government's social protection policies were also a continuation of earlier approaches. The Juppé Plan had already initiated far-reaching financing changes for health care that shifted the funding base toward the CSG. The 1998 *Couverture Maladie Universelle* (CMU, or Universal Illness Coverage) enacted a proposal that the Right had made earlier. The government, sensitized by Juppé's 1995 disaster, judged pension issues as politically dangerous and anticipating the 2002 presidential elections, chose to nourish debate by commissioning reports whose contradictory arguments create confusion. The 2003 reform that finally emerged, with the Right back in power, unified public and private eligibility requirements, raised contributions, and lowered benefits. The basic public system remained intact, however, along with second-tier complementary pension programs. Small new 'third-tier' individual pension funds had an uncertain future.

The French story demonstrates hyper-active reformism rather than failure to reform, as is sometimes alleged, and has distinct economic and social policy tracks. Examining both tracks, it is hard to avoid thinking that policy architects thought that they were coping with a difficult moment that would soon give way to better times. Alas, these better times had not yet come by the time of the 2005 referendum, when unemployment remained at 10%, young people were still chronically under-employed, and a wide swath of French citizens continued to worry whether they would be able to find and/or keep a job. The 1992 referendum on the Maastricht treaty, which barely passed, had already provided a glimpse of social model anxieties among workers, farmers, and parts of the middle classes. By 2005 peoples' situations had, if anything, worsened. In 1992, the Center-Left and Center-Right had beat the



hustings energetically for yes votes. In 2005, amidst jockeying among potential presidential candidates for the 2007 elections, the Center-Left split, with a Socialist faction around Laurent Fabius advocating a no vote on populist grounds. The debate focused on Part III of the Constitutional Treaty, which laid out EU market-liberalizing mandates in great detail. This, plus EU efforts to liberalize public services and utilities, and the Bolkestein Directive for liberalizing the EU service market more generally (which brought the visit of the ‘Polish plumber’), did a great deal of damage. In many voters’ minds the French social model was already so fragile that any further ‘neo-liberal’ logic from European integration threatened it.

### **Has model Deutschland worn out?**

Peter Katzenstein has described the German state as ‘semi-sovereign’ — comparatively weak because of complex federalism, electoral laws, and a centripetal party system in which both large parties backed Germany’s social model (Katzenstein, 1987). Semi-sovereignty placed a premium on consensus-building at the expense of governmental power, decisional speed, and efficiency. The model worked, in large part, because of decentralized coordination among non-state actors. Wage determination came from collective bargaining between powerful industrial unions and employers’ associations set up to be encompassing enough to promote public responsibility. Works councils, co-determination, employee rights, and effective training systems enhanced incentives to cooperate. The ‘social partners’ also managed a generous set of social programs committed to maintaining high levels of income replacement during unemployment, sickness and retirement in classically Bismarckian ways, using revenues from social insurance contributions. Financial and industrial sectors engaged in cross-ownership, encouraging ‘patient’ capital and long investment horizons. Finally, the German Central Bank (the Bundesbank), statutorily independent of politics and mandated to promote price stability, ran a rigorous monetary policy that disciplined actors — including governments, unions, and employers —tempted to produce inflation. At their best, the results were growth, prosperity, a high degree of social protection, a world class range of highly engineered goods through diversified quality production kept on track by continual skills upgrading, and wage growth at or below productivity growth.

In the 1980s, when Germany avoided the turbulence that shook virtually everyone else, Modell Deutschland’s social market economy was touted as an alternative to harsh liberalism. One reason for this success was that Germany occupied a privileged position in the on-going international shift from Keynesian demand management to price stability. This shift, led by the USA, came easier for those countries with pre-existing hard currency,



price-stability-oriented outlooks. Unlike France, Germany had to do little to accommodate. 'Smooth consolidation' in the 1980s (Siegel, 2004) did not preclude mini-reproduction of the work-sharing that the French had undertaken, however. But unlike in statist France, where work-sharing was high politics, in Germany it was done quietly by non-state actors. Thus in 1985, with the Center-Right in power and slower growth, IGMetall (the large metalworkers union), pushed for and won a 35h week, while other unions, led by IGChimie (the chemical workers union), sought reduced lifetime working hours. To sustain competitiveness, German companies, particularly larger, export-oriented ones, began to shed labor, mainly by pushing older workers into retirement. Unemployment rose only from 3.5% in 1975 to 4.8% in 1990, however. But one implication of work-sharing was that rising payroll taxes would make German labor more expensive in the medium term, with the ultimate consequence being more labor-shedding (Manow and Seils, 2000). In the background, foreshadowing medium-term danger, was an aging population. Nonetheless, excepting small pension changes begun in 1989, 'no consistent pattern of reform' was observable (Leibfried and Obinger, 2005).

German Unification in 1990 started shock waves that changed almost everything, however. The story is familiar. Following the removal of the Berlin Wall, Chancellor Kohl offered the GDR quick unification with a highly favorable currency conversion and an export of West German institutions to the East. Economics had its revenge, however. The ex-GDR collapsed under the combined weight of the generous currency exchange and export of the Western industrial relations model, high wages and all. In time, the gap between the Western system and Eastern reality led to decentralization of the industrial relations system and decline in union membership more generally (Hassel, 1999; Thelen, 2000; Siegel, 2004; Streeck and Hassel, 2005). In general, a decade after unification, one of every three marks spent in the East still came from the West while the West continued to transfer 4.5% of its GDP eastward (Sinn, 2000, 6). The costs of cushioning the debacle pushed up social spending, payroll taxes, and general debt (Wiesenthal, 2005, 49–49).

EMU created new shocks on top of those tied to unification. When EMU first came onto the EU agenda in the late 1980s, German elites divided. Leading politicians, particularly Kohl, were willing to pursue the matter, but the Bundesbank resisted. Diplomacy around unification led the politicians to over-ride the Bundesbank, but not before German priorities for a completely independent European Central Bank dedicated to price stability and stringent convergence criteria won out in the Maastricht negotiations (and were later reconfirmed in the 1997 SGP). For Germany the constraints of EMU might not have been difficult to meet prior to unification, but the game changed dramatically after it. The Bundesbank overshot in responding to



unification-based inflation in 1992, playing into a brewing EMS crisis, and contributing to a severe recession that obliged EU governments to cover revenue shortfalls through heavy borrowing. Germany shouldered its EMU burdens (Dyson, 1998), but amidst growing social spending, debt and industrial relations problems that had begun to spill over into social security costs and tax levels. In this changed context Germany's aging population loomed ominously as yet another burden. It was symbolic was that in 1998 Germany could barely meet the EMU criteria that German politicians themselves had insisted on only a few years earlier. 'Maxed out' by the 'most expensive welfare state in the world' (Leibfried and Obinger 2005, 203), Germany found it difficult to sustain existing programs and commitments, let alone confront new needs (e.g. for childcare).

Germany thus lost its earlier advantages because of unification and EMU. Growth dropped, unemployment rose to unprecedented post-war levels, debt grew, and public finances deteriorated. In 1995, the Kohl government added an expensive program of long-term care insurance, but this was the last gasp of optimism about the German social model. In 1996, the government convened a peak-level Alliance for Work (Bündnis für Arbeit) including employers, unions, and politicians, to seek reform solutions. Its failure underlined the limits of peak-level corporatism and consensual reform. The government then legislated cuts in health care and unemployment benefits, loosened labor law about hiring and firing, and passed a pension reform Act in 1999 (enacted just before the 1998 elections) which altered pension calculation formulae. Even this modest package was doomed, however, when the SPD promised to repeal most of it during the 1998 election campaign that resulted in a new Red-Green coalition government.

After repealing Kohl's reforms the Schröder government convened its own Alliance for Work. Under ineffective leadership, it quickly settled into acrimonious and unproductive interactions between 'social partners' (Streeck and Hassel, 2005). Pressure to reform was eased by economic upturn from 1998 until 2001, however, when the government legislated a pension change lowering replacement rates and establishing a regulated private supplementary pension to cover the difference (called the *Riester-rente*, after the Minister responsible). The government quickly lost popularity and lost its Bundesrat majority. It was able to avoid defeat at federal level in 2002, however, by Schröder's clever handling of dangerous summer floods and opposition to the American war in Iraq.

Re-elected, the Red-Green coalition confronted the post-2001 recession, the ECB's pro-cyclical response to it, a rapid rise in the Euro-dollar exchange rate slowing down exports, and competitiveness challenges from Central and the Far East. Persistent gloom, fed by low growth, high unemployment, public financial problems, and inability to meet the SGP 3% deficit target, continued



through the 2005 elections. Backed to the wall, the government turned to social model reform. First came new cost control measures in health care and pensions. Then came the Hartz Commission's 2002 recommendations, followed by the 'Agenda 2010' proposals in 2003. Hartz suggested changing restrictive craft trades laws, easing dismissals for small employers, encouraging small business start-ups, and supplementing governmental employment agencies dealing with part-time work with semi-private recruitment offices. Hartz's main thrust, however, involved changes to unemployment insurance to institutionalize new 'activation' (Gray, 2004, chapters 4–6). Federal job agencies would become one-stop shops for job and benefit seeking while unemployment insurance and general welfare safety net supports would be combined. Hartz IV, the toughest of the proposals, reformed unemployment and safety net benefits themselves. Earlier the unemployed could claim from 12 to 32 months at 60–67% of salary and then subsequently count on 53–57%. Hartz IV cut full benefits to 12 months (18 for those over 55 years) after which recipients would receive much lower 'social allocation' payments. Those unemployed also lost the right to turn down offers that were not equivalent to the job they had earlier lost.

In theory, reforms should discourage long-term removal from the labor market, reduce social spending, and stimulate job creation. But whether the reforms will help Germany out of low growth and mass unemployment — for the first time since Hitler the unemployed numbered more than 5 million in 2005 — is the big unknown. They did not provide the economic 'electroshock' for which some had hoped. Moreover, reforming unemployment insurance is only one of Germany's problems. The German industrial relations model is clearly deteriorating, but toward what end beyond union weakness it is impossible to know. There continue to be severe insider–outsider problems, and costly outsiders (particularly Easterners) will continue to pressure social insurance funds, payroll tax levels, and public finances. But there are too many other causal processes at work — the US and international markets, euro-dollar exchange rates, ECB and Euro-level behavior under redefined SGP rules, the fortunes of the rest of Europe — to allow prediction.

The political consequences of the Red-Green reforms are easier to assess. Although neo-liberal critics argued that the reforms, although welcome, were not nearly enough, many Germans, and particularly those whose insecurity was enhanced, saw them as too much and went out of their way to say so. There was street protest against Agenda 2010 and Hartz IV, notably in the East. Unions and the Left of the SPD vocally opposed the changes (contributing to the formation of the new Left Party), and provisions of Hartz IV have been taken to the Supreme Court to test their constitutionality. Most important of all, the Red-Green coalition and the SPD, defeated repeatedly in *land* elections, lost the September 2005 general elections, with the SPD



subsequently agreeing to participate in a new grand coalition government with the CDU–CSU.

## Metanarratives?

The underlying economic problems emerging in France and Germany in the 1980s and 1990s prompted social policy responses to protect insiders and pushed social protection programs and public budgets to the financial edge. These consequences may have been predictable for social models designed in the post-war period to preserve the living standards of unequally endowed occupational groups through ill health, employment insecurity, and old age. Both designs worked through the post-war boom because near-full employment generated resources to cover groups that were less protected. They have worked much less well since the early 1980s, however. The results are relatively inflexible labor markets and high-cost welfare states that contribute to higher unemployment, low labor force participation rates, public finance problems, and losses in competitiveness.

Case studies of France and Germany have often been used to illustrate ‘path dependency’ and, more broadly, today’s historical institutionalism (Mahoney and Rueschemeyer, 2003; Pierson, 2004). In these views, institutions move most easily in the directions they are accustomed to moving, tend to be sticky, to change slowly and incrementally, and, finally, such change as may occur need not necessarily be ‘functional’ to broader social goals. It is interesting to note that in historical institutionalist terms, the French and German cases look strikingly different.

The French Fifth Republic’s institutional system grants unusual power to the Presidency. This, plus statism, encourages frequent reform. Since the early 1980s this has been true both in economic policy, with strong liberalization, privatization and attenuation of *dirigisme*, and in social policy areas, with new labor market flexibility and continual welfare state change. Coping with ‘permanent austerity’ (Pierson, 2001) has been a challenge to France, as elsewhere, but responses have not been lacking. Some of these confirm institutionalist intuitions. Work-sharing policies had become default approaches to labor market difficulties prior to the early 1980s, and our review shows that they were used extensively to cope with the intensified labor market difficulties that have occurred since. To the degree that French labor force participation remains relatively low, this can be seen as the product of energetic but path dependent reformism, rather than any institutional inertia or resistance to retrenchment. Jonah Levy concludes about this that for France ‘the concerns of modernization’s losers have been addressed, but not by blocking economic reform...[but]... under a...’social anesthesia strategy...[in which]... public resources are mobilized to pacify and demobilize the victims



and opponents of market-led adjustment' (Levy, 2005). Saying this is not enough, however. Alongside work-sharing 'social anesthesia,' the social policy paths have also changed significantly, largely through 'layering' (adding new elements and new logics onto existing systems, often to confront new problems), and 'conversion' to shift the missions of older institutions (Campbell, 2004; Streeck and Thelen, 2005). Governments have massively intervened to slow rising health-care costs, marginalized 'paritary' (corporatist) management structures (Palier, 2002, 406–422) and, through the CSG, replaced most payroll taxes. Such discontinuous 'statizing' reformism has also led to major reconfiguration of poverty policy through the CMU (universal medical coverage), RMI and FNV (old age safety net), all means-tested programs financed out of general taxation rather than social insurance. In all, France now has a new welfare state mix for health care and poverty policy in which Bismarckian social insurance covers those employed and Beveridgean safety nets service those who are not (Palier, 2005). Clearly, the simple fact of institutional openness to reform does not provide the key to understanding France, however. This is because, despite it, the French social model still contains an overburdened welfare state, serious insider–outsider labor market problems, persistently low economic growth and mass unemployment.

In the 1980s, while the French energetically produced change, the Germans followed a steady, almost majestic, path. This was not because of institutional stickiness — although Germany, whose institutions were explicitly designed to be sticky, clearly has had an inordinate amount of this. Instead, put simply, there seemed no good reason to reform. Pressure on the German model greatly intensified in the early 1990s, however, following decisions to unify and move to EMU. From this moment onwards, efforts at elevating institutionalist logic to explain Germany are quite beside the point, because unification and EMU abruptly overloaded a social model that might otherwise have had the resources to confront its problems. Stickiness did mean that despite the rapid appearance of new challenges in the 1990s there was no parallel rush to reform. But politicians and social 'partners' were remarkably unable to achieve consensus on what to do, while governments, with a few exceptions, were hesitant to abandon consensual approaches to legislate reforms. Finally, in desperate economic circumstances, the Red-Green coalition proposed the Hartz-Agenda 2010 package of legislated changes, at what turned out to be a large political cost. By 2005, despite a very different trajectory, Germany, like France, had an overburdened welfare state, insider–outsider labor market problems, low growth and mass unemployment.

Institutionalist analyses shed light on the different responses in the French and German cases. They really do not 'explain' them, however, largely because arguments about ongoing institutional life underplay the 'motors' that generate institutional response in the first place and which, for both cases, lie outside



ongoing institutional life. In other words, the pressures and constraints that have obliged French and German social model institutions to change, either in path dependent or path-shifting ways, have been largely exogenous. Expanding narrow institutionalist views to incorporate broader institution–society or state–society relationships may help, in particular because of the large role that elected politicians have played in obliging institutional responses.

The French Fifth Republic was designed deliberately to neutralize France's centrifugal multiparty instincts and to strengthen the executive. From 1958 to 1981 the system kept Center-Right presidents and majorities in power and channelled centrifugal partisanship toward Center-Right and Center-Left coalitions that were both committed to the existing French social model. Changing economic circumstances since the 1970s have rebalanced electoral struggle between an evenly divided Right and Left leading to frequent changes in majorities and 'cohabitation' (divided government) with presidents and parliamentary majorities on opposite sides. The patterns of challenge and response to the French social model that we have reviewed have occurred in this demanding new iteration of Fifth Republic institutions. Since the later 1970s the shifts that emerge from France's almost annual election cycles (regional, municipal, European) have been significant indicators for all-important presidential and legislative elections to come. This has brought quasi-constant campaigning where the votes and opinion of any well-placed group are always in play. Moreover, given France's comparatively unusual predilections toward rebelliousness and mobilization — the other side of France's statism — pertinent state–society connections in France go beyond electoral competition. The results have been paradoxical. France has a powerful executive branch and the state has the capacities to move — and reform — unusually quickly. Changes in 'social model' policy areas — employment relations and welfare state programs — are of vital importance to a broad range of groups who have many ways to mobilize. For political elites, managing such a universe of potential veto mobilizations in a context of persistent economic problems, constant campaigning, and electoral vulnerability has become an acute concern. This undoubtedly helps explain why governments have been so attentive to insider interests and, in addition, helps to explain why French reformism has had such parlous results.

Germany also has a multiparty system, albeit less complicated and potentially centrifugal than the French, and its two major parties, the Center-Right CDU/CSU and Center-Left SPD, have also been supportive of the existing social model. German governments, like their French counterparts, have also faced an electoral world constant campaigning for elections at different levels that provide key indicators about power balances at federal level. German federalism makes a big difference, however. Each regional election not only tests a federal government's popularity, it also determines the



balance in the Bundesrat. Divided government, German-style, with different majorities in the Bundestag and Bundesrat, has been common, obliging governments to promote consensus on policy with a second house dominated by its opponents. The German state's 'semi-sovereignty' is a second big difference. Decentralized neo-corporatism in industrial relations and social partner management of welfare state programs do not completely disarm governments in matters of social model policy, but they do oblige a quest for social partner consensus around serious change. Over the past decade, as need for reform became clearer, this first led governments to seek change initially through peak-level neo-corporatist conclaves — the Kohl and Schröder Alliances for Work. Alas, the social partners have refused to agree, revealing significant flaws in a model that had appeared self-monitoring and highly adaptive. Peak-level neo-corporatist deliberation did work to formalize and sharpen the positions of social partners that left governments politically exposed when they then turned to proposing reforms via legislation, or, in the revealing words of many observers, proceeded 'unilaterally.' It comes as no surprise, therefore, that federalism, electoral concerns, and semi-sovereignty have enjoined governmental caution and slowed movement toward reform.

We need here to ask some obvious questions. First, why was a strategy of 'social anesthesia' chosen in France? The most plausible meta-narrative begins with the high politics of foreign policy. In the brief years around 1983 the Mitterrand presidency had to make historic choices. To be sure, the economic U-turn of 1983 was first a recognition that the statist-nationalist-social democratic initiatives of 1981 had turned out vastly more dangerous and costly than the French Left had calculated. Something different had to be done, and at least in the shorter term, whatever it was would be painful for the French and electorally dangerous for governments. Quickly, however, this 'something different' was tied to French efforts to renew 'Europe' and promote monetary integration. Austerity and retrenchment thus acquired the larger purposes of preparing France for the new Single Market and the franc for combat with the dmark in EMS monetary trenches, with the latter quickly becoming movement toward Economic and Monetary Union. As domestic liberalization, austerity, retrenchment and the renewal of European integration came to be bound together, French politicians and policy makers had to manage the large adjustment costs that this would bring. French social model choices and, quite as important, their intensity and direction, thus followed in large part from concerns about managing the domestic fallout of very large foreign policy initiatives. It may well be that these politicians and policy-makers calculated that the business cycle would in time ease things, which it did — briefly — in the later 1980s and after 1997. It turned out, however, that the coming of EMU and the SGP dampened already weak growth and placed large new constraints on what governments could do over the medium term. Reformist social model



policies designed to cushion vulnerable groups through a difficult period of transition thus became quasi-permanent and, arguably, problems rather than solutions in any question for broader economic success.

This thesis about the centrality of large foreign policy decisions to domestic social model policy choice focuses in Germany on unification and EMU. German unification had little to do with the ongoing movement of the German social model. It emerged when the Cold War unfroze in ways that no one had predicted. The Kohl government chose to seize the occasion quickly given real risk that the opportunity would evaporate, and did so to minimize potential GDR opposition and ensure CDU votes in the new *länder*. There would thus have been no decision that the five new *länder* should adopt the Western industrial relations system and welfare state lock, stock, and barrel in the absence of high foreign policy opportunities. It has become obvious that this decision, although laudable in a great many ways, was made with little concern for the future of Modell Deutschland, however. Given what existed on the ground in the ex-GDR, unification greatly intensified slow deterioration in German industrial relations and, through new unemployment and vast West-East transfers, created new pressures on the German welfare state and public finances. Modell Deutschland, thus weakened by unification, then had to confront EMU, Germany's Euro-political quid pro quo for unifying. Today's conundrums have followed.

### **Conclusions: Social Model Anxieties and EU Futures**

In both France and Germany, in different ways, decisions on high matters of foreign policy played crucial roles in the directions that social models subsequently took. In 1983, Francois Mitterrand had to decide between staying in — and under what circumstances — or leaving, the ERM (and probably the EMS), and later, how to confront German power in EMS, leading to EMU. To be sure, France in this period would have faced large economic pressures because of the on-going international shift from Keynesianism to a new regime of price stability. Thus, there would have been austerity and retrenchment of some kind, no matter what. However, adaptation to change in exogenous economic conditions acquired a strongly 'European' shape after Mitterrand and French governments tied their domestic politics to new initiatives in European integration like the Single Market and movement to EMU. On the German side, in 1989–1990, Helmut Kohl had to decide how to respond to imminent changes in Central and Eastern Europe that became a totally unanticipated melt down of the geo-strategic equilibrium of the Cold War. Unification and the coming of EMU — which was Kohl's European quid pro quo for unification — disequibrated Modell Deutschland in major ways.



Social model policy concerns were secondary in the making of these choices about French and German places in the world. What subsequently made these concerns significant were the domestic consequences of the large and long-term international choices. Here the EU enters in important ways. European integration has deprived member states of much of their capacity to structure domestic markets and, in addition, members of the Eurogroup have lost their ability to design their own monetary policies. The currencies of domestic political exchange that remain are in macroeconomic policy, after monetary integration has already shaped the field, and, above all, social policy. Conversely, the EU has very little direct power to shape social model practices in its member states.

Within these constraints, Mitterrand, Kohl and their successors have had to find ways to manage the national implications of their international decisions, if only to hold onto power and/or maximize electoral scores. Social model policy became the most important arena for such management, as our review shows. The French social model has been massively reformed, the German dramatically less so, but broader results have turned out similarly. In both countries social models built after 1945 remain intact but fundamental issues of growth and employment remain unresolved.

Why does this constitute an EU ‘crisis?’ Many would say that a situation of low growth and high unemployment lasting for 15 years or more in the two most central EU economies is answer enough. In the absence of economic dynamism in France and Germany, the EU’s economic future and, probably, its international competitiveness, are heavily mortgaged. Looking more closely at the social model evidence others would argue that in both France and Germany blockages to intelligent social model reform — roughly ‘insider–outsider’ deadlock — in themselves augur badly for the EU’s future. While it would not be difficult to envisage modernizing paths that could preserve the basic logic of existing social models while better internalizing new constraints from European and global markets, the French and German problem is building credibility and political support for such paths. ‘Insiders’ may play, or be ‘played’ by ambitious politicians, to prevent reformist adaptation of the existing social model, often in the name of anti-liberal purism. This fuels the expression of social model anxieties in both countries. In Germany these anxieties loomed large in the 2005 federal election. The grand coalition that has emerged could promote greater reform but more likely will be an arena for party partners/rivals to jockey for advantage in new elections that are certain to come soon. In France, the 2005 referendum demonstrated that many French citizens, perhaps a majority, are prepared to blame the EU for the threats to their social model. If the EU cannot thrive economically without France and Germany moving forward, and if such forward movement depends more than anything upon what happens in French and German domestic politics, and in



particular, on intelligent confrontation with popular anxiety about social issues, then the EU's hidden crisis is likely to persist.

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