

From ‘welfare without work’ to ‘buttressed liberalization’: The shifting dynamics of labor market adjustment in France and Germany

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Abstract. During the past decade, prevailing scholarship has portrayed France and Germany as suffering from a persistent syndrome of ‘welfare without work’ entailing a vicious circle between stubbornly high rates of unemployment and non-wage labor costs. Scholars blame this disease on dysfunctional political arrangements, deep insider-outsider cleavages and failed systems of social partnership. As a result, the two countries are said to be more or less permanently mired in a context of high unemployment that is highly resistant to remediation. This article departs from this conventional wisdom in two important respects. First, it argues that France and Germany have undertaken major reforms of their labor market policies and institutions during the past decade and remediated many of their longstanding employment traps. Second, it shows that the political arrangements that adherents of the ‘welfare without work’ thesis identify as reasons for sclerosis have evolved quite dramatically. The article supports these arguments by exploring some of the most significant recent labor market reforms in the two countries, as well as the shifting political relationships that have driven these changes. In both countries, recent labor market reforms have followed a trajectory of ‘buttressed liberalization’. This has involved, on the one hand, significant liberalization of labor market regulations such as limits on overtime and worker protections such as unemployment insurance. On the other hand, it has entailed a set of supportive, ‘buttressing’ reforms involving an expansion of active labor market policies and support for workers’ efforts to find jobs. The article concludes that these developments provide reasons for optimism about the countries’ economic futures and offer important lessons about how public policy can confront problems of labor market stagnation.

During the past twenty years, the prevailing climate of austerity and slow economic growth has undermined the labor market performance of many Continental European countries. Though common to much of the region, such difficulties have been particularly severe in France and Germany, which have been confronted with stubbornly high rates of unemployment generated in part by social protection arrangements that impede job growth. This pattern of poor labor market performance has not been lost on scholarly and journalistic observers of the two countries, which many see as exemplars of a failed European social model clinging to outdated arrangements that are incapable

of confronting the challenges of globalization (see, e.g., *The Economist* 2002). Such labor market difficulties are seen as both the source and the product of many of France's and Germany's ongoing economic problems, exemplars of interrelated problems in the labor market, the social protection system and the broader political economy.

The best-known of such critiques blame France's and Germany's labor market woes on a syndrome of 'welfare without work' characterized by a vicious circle between high non-wage labor costs deriving from payroll-tax-based financing of social benefits and high rates of unemployment (Esping-Andersen 1996b; Manow & Seils 2000; Streeck & Trampusch 2005). Adherents of this perspective contend that this syndrome is perpetuated by political dysfunctions in the two countries, themselves the products of moribund systems of labor market governance that reward people for not working rather than promoting their re-insertion into the labor market (see, e.g., Ferrera & Rhodes 2000; Esping-Andersen 1996a; Pierson 2001: 448). Due to a combination of weak or absent political will, political institutions that engender recrimination rather than reform, and dysfunctional economic arrangements, such observers argue, France and Germany are incapable of meaningful economic adjustment and have become fossils from a glorious, but increasingly distant, golden age of European economic dynamism (Esping-Andersen 1999: Chapter 8; Streeck 2005).

Though such scholars have identified correctly the symptom of high French and German unemployment, their focus on the ostensible syndrome of 'welfare without work' reflects a misdiagnosis of the disease based upon outdated characterizations of the two countries' labor markets and political systems. I argue that the French and German approaches to labor market policy have undergone a paradigmatic shift during the past decade that has led to significant progress in resolving the unemployment traps plaguing the two countries' labor markets. Though some of the details of reform have differed between the two countries, French and German reforms have followed the same broad trajectory, one to which I refer as '*buttressed liberalization*'. The 'liberalization' wing of this strategy has involved the loosening of many controls on labor market activity, including protections against layoffs and limits on overtime, and the promotion of non-standard employment arrangements such as defined-term contracts and part-time jobs. At the same time, authorities have dedicated significant financial and political capital to supporting job creation and workers' ability to compete in the labor market, thereby *buttressing* the process of liberalization for both workers and employers.

This shift in the character of labor market policy reflects an increasingly coherent and innovative strategy for revitalizing the labor market, one that is

beginning to pay off in terms of remedying the dilemma of ‘welfare without work’. The change in approach has been marked by a move away from traditional, passive labor market policies such as early-retirement schemes to ‘active’ policies designed to promote job creation, such as subsidizing the employers’ share of social contributions in order to reduce non-wage labor costs. This supportive ‘buttressing’ has been accompanied by a second, more coercive variant aimed at encouraging the unemployed to seek out and accept available jobs, including the introduction of limits on both the duration and generosity of unemployment benefits. Although France and Germany continue to experience relatively high (though declining) levels of unemployment, these difficulties are not simply the results of political stalemate. As I argue below, high unemployment and slow rates of job creation are instead the products of European Monetary Union (EMU)-based strictures on fiscal and monetary policy, the resulting climate of economic austerity and sluggish growth, and the fact that many French and German reforms are of relatively recent vintage and have not yet had time to be fully effective. Though under-recognized as such, France and Germany have actually been among the more active labor market reformers in Europe in terms of both the scope of policy change and the degree of innovation that such change reflects.

In the next section, I discuss the literature on French and German economic adjustment and identify some of the analytical problems that have led scholars to underestimate the degree of reform in the French and German labor markets since the late 1980s. In so doing, I contest both the view that French and German labor market policy has failed to adjust and prevailing arguments about the political sources of the two countries’ supposedly sclerotic labor markets. I then analyze developments in French and German labor market policy during the past decade and a half, placing particular emphasis upon those reforms that have been central to the shared strategy of ‘buttressed liberalization’. Each of these reforms has helped to reduce labor market rigidities, and many have resulted in significant progress in creating jobs and reducing the number of unemployment benefit recipients. I end with a brief conclusion in which I explore some of the implications of these policy developments for the future of the French and German political economies and the possible lessons that they can offer to other advanced industrial countries.

The shifting politics of labor market reform: France and Germany from crisis to renewal

Since the early 1990s, prevailing scholarship on Continental European labor markets has emphasized several key policy and institutional features that are

said to perpetuate high levels of unemployment. The first and most important of these characteristics is a reliance on payroll taxes, shared equally between workers and employers, for funding the bulk of their social protection systems. This 'Bismarckian' system (named after the social benefits introduced under the nineteenth-century German Chancellor) was designed to share the burden of funding social benefits between the two parties who benefited from them: workers, who were protected against the predations of old age, ill health and unforeseeable joblessness; and employers, who enjoyed the social peace and stable climate for investment that a well-developed welfare state helps to support. This approach to funding social benefits was also consistent with traditions of occupational independence in many Continental European countries and, particularly in Germany, of the idea awkwardly known as 'subsidiarity' that the state should intervene only in situations in which social actors could not themselves successfully confront social or economic challenges (Baldwin 1990; Kersbergen 1995).

This 'Bismarckian' system worked extremely well during the postwar boom, when rapid economic growth fueled high levels of employment growth¹ and ensured ample contribution bases for the social protection system, even as it limited the number of workers who were forced to rely on it. With full or nearly full employment, payroll tax rates could remain quite low, averaging, for example, around 13 per cent of wages each for workers and employers in Germany during the 1960s (Streeck & Trampusch 2005: 177). These modest contribution rates were more than adequate to ensure the solvency of social funds and were low enough to avoid any significant disincentives to job creation. A virtuous circle thus emerged among high levels of employment, healthy social security accounts and low non-wage labor costs, all of which fueled economic prosperity in France and Germany while promoting social peace and investment.

By the late 1960s, the virtuous circle had begun to turn vicious as slowing economic growth undermined the performance of the French and German labor markets and placed unprecedented strains on their postwar social protection systems. Beginning with the advent of the first oil shock in 1973, what had previously amounted to modest pressures on the French and German welfare states quickly became serious threats to the systems' very integrity. Between 5 and 6 per cent during the 1950s and 1960s, real GDP growth rates had fallen to 1.0 per cent in Germany and 1.6 per cent in France by 1980 and, by the early 1990s, had stagnated at below 2 per cent in both countries. Trends in the rate of unemployment were even more alarming, with joblessness increasing to over 6 per cent in Germany and 8 per cent in France in 1982, and hitting postwar highs of more than 10 per cent in both countries by the mid-1990s.² As the number of workers contributing to French and German

social insurance funds declined and the number of benefit recipients increased as unemployment grew, both social contribution rates and total social expenditures exploded, with the latter reaching around 30 per cent of GDP by the late 1990s (Scharpf & Schmidt 2000: 365).

Since the 1980s, the persistence of high rates of unemployment, rising social contribution rates and levels of social expenditures, and sluggish rates of economic growth have led many scholars to conclude that the two countries are hopelessly mired in labor market stagnation. Much of the blame for the continuing severity of these problems is laid at the feet of French and German policy makers, who are seen as beholden to entrenched, parochial interest groups and as unwilling to take the political risks required to address their respective economic challenges. While some adherents of this view recognize that some reform has taken place, they argue that such measures have been largely window-dressing for unresponsive political systems that are more interested in protecting the privileges of employed 'insiders' (as well as their own jobs) than in seriously addressing unemployment (see, e.g., Streeck 1997, 2005). As a result, in the rather categorical formulation of Gøsta Esping-Andersen, these systems suffer from 'extremely high labour costs and labour market rigidities because the "insiders" are compelled to defend their employment security. As such, the labour market remains rigidly closed and incapable of major job provision' (Esping-Andersen 1996b: 80).

Though their overarching diagnoses of political stalemate are similar with respect to France and Germany, scholars tend to blame particular political and institutional attributes in each. In the German case, they emphasize constitutional 'veto points', or 'places in the [legislative] process . . . where bottlenecks are likely to occur' (Immergut 1992: 8, 26) – in particular, federal and corporatist divisions of authority that yield a 'restricted capacity for active economic steering' (Manow & Seils 2000: 265) and interfere with policy makers' ability to implement needed spending cuts. Drawing from Peter Katzenstein's canonical study of German politics, such treatments contend that fragmented political power offers the state 'little more than semi-sovereignty' (Katzenstein 1987: 266–267) and limits both the scale and scope of reform, even in the presence of governments inclined to attempt significant policy change. Perhaps the best known of such analyses is Fritz Scharpf's contention that German politics is characterized by a 'joint-decision trap' whereby the federal distribution of authority and a collusive party system discourage policy change (Scharpf 1985).

For its part, France's 'poor capacity for reform' (Rhodes 1997: 16) is explained by the absence of functional bargaining frameworks between the state and social partners, itself the result of unions' and employers' historically antagonistic interactions with a dominant and insular state. These dysfunctional relationships, together with the political liabilities inherently associated

with welfare reform (Pierson 1996), are said to yield ambitious state initiatives that are often diluted or abandoned in response to social protest or in the face of the social partners' authority within welfare state and labor market institutions (Schmidt 2000: 293–298). With levels of social spending that are among the highest in Europe, France and Germany thus share a prevailing image of 'difficult, blocked' public debates (Crouch 2001: 117) and governments that are either unwilling or unable to enlist the political support required for policy change.

Despite differences in emphasis in each case, characterizations of political sclerosis and dysfunction in both countries tend to center upon the role of the social partners who enjoy important responsibilities for managing and financing social insurance funds in Bismarckian welfare states such as France and Germany.³ Because they are the chief beneficiaries of the protection and labor peace that employment-based social policies afford, unions and employers' associations are said to be extremely reluctant to enact reforms that would reduce levels of coverage, or to accept reforms that would either erode their qualified monopoly over major parts of the social protection system or undermine benefits that are widely seen as entitlements.

This view of the French and German labor markets as beset by insoluble problems arising from political and institutional dysfunctions has been reinforced, and indeed partially absorbed into, the literature on welfare régimes. The touchstone of this body of work is *Three Worlds of Welfare Capitalism* (Esping-Andersen 1990), which has inspired a cottage industry of typological modifications and qualifications (e.g., Bonoli 1997; Ferrera 1996; Huber & Stephens 2001; Castles & Mitchell 1993). Although some of this work provides useful comparative heuristics for understanding some of the key differences among national systems of social protection, it has also left behind a problematic analytical legacy for those wishing to understand the dynamics of labor market adaptation or welfare reform more broadly. Focusing upon regularities of welfare states over time, rather than the ways in which they evolve and adjust, scholars in this tradition see the 'worlds of welfare' and associated labor market institutions as highly path-dependent and resistant to change. On a theoretical level, this underestimation of the adaptive capacity of Continental labor markets such as those of France and Germany derives from an assumption of the continued coherence of these basic analytical categories, a tendency that diverts attention from developments that do not hew to typologically characteristic patterns. The recent trajectory of 'buttressed liberalization' in France and Germany represents just such a departure from past practice – one that has reoriented fundamentally the goals and modalities of labor market policy in ways that scholarship on Continental labor markets has failed to capture.

As I detail below, French and German labor market policy has undergone major adjustments during the past decade, developments that clearly contradict these images of economic stagnation and political stalemate. The policy developments that I explore here represent significant progress in attenuating some of the unemployment traps from which Bismarckian social protection systems tend to suffer – in particular their addiction to passive mechanisms of labor supply reduction, such as early retirement schemes, that perpetuate the vicious circle between unemployment and high non-wage labor costs. Furthermore, the shifting political dynamics that have driven these reforms indicate that the very arrangements that adherents of the ‘welfare-without-work’ perspective identify as the sources of sclerosis have likewise continued to change and adapt. In both countries, authorities have loosened labor market regulations while actively subsidizing job creation, expanding active labor market policies and increasing pressures on the unemployed to seek out and find available work, while increasing the resources devoted to helping them to do so. Though the two countries’ policy strategies have been shaped by nationally specific institutional and political contexts, they each demonstrate a capacity for political and economic innovation and adjustment that forces us to rethink prevailing images of political-economic sclerosis and structurally dysfunctional labor markets. As I discuss in this article’s conclusion, they also suggest the need for a broader re-examination of the capacity of active policy-making strategies to achieve meaningful and durable improvements in labor market performance in advanced industrial democracies.

Buttressed liberalization and political competition in French labor market reform⁴

Although beginning tentatively under previous administrations, the pace of innovation in French labor market policy increased rapidly under the center-left administration that came to power in 1997 under Prime Minister Lionel Jospin. Having failed to fulfill his 1995 electoral promises of ‘healing the social fracture’ and significantly reducing unemployment levels that were approaching 12 per cent, center-right President Jacques Chirac was stunned when the early elections he called in an effort to secure a clearer political mandate ended in defeat. Under the leadership of Socialist Prime Minister Jospin and Labour Minister Martine Aubry, the new administration of the Left rapidly enacted a series of measures that aimed to facilitate social dialogue on matters of labor market reform, reduce levels of unemployment and increase opportunities for workers across socio-economic groups (although somewhat more tentatively, reform has continued under succeeding center-right

administrations since 2002). Over this nine-year period, state authorities were not the only sources of innovation, however, as the main employers' association, which shares responsibility with French unions for administering many labor market policies, likewise undertook important reform initiatives and helped to see through significant changes in policy. Though governments and employers competed intensely over the direction that labor market reform should take, they each played critical roles in furthering reform and in promoting adjustment in ways that call into question entrenched images of 'statist' French policy making and marginalized, impotent social partners.

Upon taking office, the Jospin Administration acted quickly to confront France's mounting employment problems, which had constituted a major theme in its electoral campaign. Its first major labor market measure, the *Programme emploi-jeunes* ('Programme for Youth Employment'), offered generous subsidies to public-sector firms or agencies to hire workers between the ages of 16 and 25, paying 80 per cent of the minimum wage (or SMIC, *Salaire minimum interprofessionnel de croissance*) (Levy 2000: 338). This measure was enacted in the hopes of reducing high rates of joblessness among young workers and better preparing those leaving school to compete in the labor market.

The centerpieces of the administration's labor market strategy, however, involved two measures that reduced the work week to 35 hours while extending incentives to employers to create jobs. The first so-called 'Aubry Law', passed in 1998, increased social contribution exemptions to employers, but made them conditional upon a firm's or sector's negotiation of a 35-hour weekly work time limit accompanied by proportional job creation.⁵ The second law, adopted in 2000, introduced an exemption on social security contributions that rose with salaries up to 1.8 times the minimum wage (fixed above that level) and increased annual limits on work time and overtime for firms or sectors that negotiated new contracts under its aegis.⁶ The laws thus aimed to create jobs through a combination of coercion and incentives, even as they served the politically useful role of conveying an image of the Leftist administration as, in Aubry's words, 'the counter-current of ultra-liberalism'. Though such rhetoric was designed to appeal to the government's core constituencies and ensure the loyalty of the 'plural Left' parliamentary coalition (composed of Socialists, Communists and Greens), the substance of the laws was actually quite favorable to employers, to whom they granted greater flexibility in manpower decisions in an effort to deliver the economic goods by reducing unemployment.

The reforms' rhetorical appeal to the Left was reinforced by the heavy-handed manner with which the government introduced them, which voters on the Left perceived as evidence of a willingness to impose costs on self-serving employers. The government unveiled the first law as a sort of *fait accompli* at

a 1997 national conference of the new government, unions and employers' associations, which had been called ostensibly in order to demonstrate the government's commitment to social dialogue. In response, Jean Gandois, the president of the main employers' association the CNPF (*Confédération nationale du patronat français*) resigned in protest. He said that he refused to be a party to a measure that was authoritarian in impulse and both expensive and ineffective in fact. Spurred on by Gandois's resignation,⁷ employers undertook a high-profile campaign against both the 35-hour laws and the government's broader economic policy agenda. This confrontational posture was reflected in the association changing its name from CNPF to MEDEF (*Mouvement des entreprises de France*). MEDEF's post-1997 campaign brought the association out of the back room and onto the front page. By the late 1990s, MEDEF had begun to act as a sort of ultra-liberal political party (Howell 1998), publicly influencing a wide range of public policies, eroding the state's traditional quasi-monopoly over the reform agenda and providing an important impetus to reform.

Despite acrimonious conflict between MEDEF and the government, state authorities realized full well that the 35-hour laws would have to compensate employers if the measures were to lead to any significant job creation. Even as the government secured political support through its confrontational rhetoric and by increasing the number of workers' annual vacation days,⁸ the laws provided firms with both significant financial incentives and considerable flexibility over work time allocation. Privately, employers admitted that they objected primarily to the fact that the state had encroached upon their prerogative to negotiate wages and work time, rather than the actual substance of the measures, which they generally supported.⁹ Not only did the laws increase employers' social contribution exemptions and offer them greater discretion over the use of labor, they also accelerated the shift from national to sectoral and firm-level collective bargaining – a trend employers had long favored and that effectively gives them greater control over wage setting. These aspects of the 35-hour laws resulted in the creation of a significant number of new jobs. As early as the end of 2000, the measures had created 265,000 additional non-agricultural positions and 500,000 jobs overall (Brunhes et al. 2001: 9–10; OECD 2001a: 83).

Informed by a more deregulatory ethos, the conservative government of Jean-Pierre Raffarin, which succeeded the Jospin Administration in June 2002, modified some aspects of the Aubry Laws, but left the core of the measures intact. Soon after the election, the government introduced the *Loi Fillon*, named after the then-Labor Minister François Fillon, which permitted some employers to negotiate a return to a 39-hour week, raised annual limits on overtime and abandoned the application of the 35-hour week to those SMEs

that had not already negotiated an accord. The Raffarin Administration, however, resisted calls from MEDEF and other liberals to abolish the laws outright, leaving in place the firm-level and sectoral deals that had been negotiated under their auspices.

In the spring of 2006, the center-right administration of Prime Minister Dominique de Villepin proposed a reform that was cut from the same cloth – the now-infamous CPE (*Contrat première embauche*) – which made it easier to fire workers under the age of 26 in the hopes of encouraging firms to hire more of them in the first place. Though the law was rescinded after weeks of often-violent protest, this failure clearly stemmed more from the heavy-handed, arrogant political strategy adopted by de Villepin than from any sort of structural French incapacity for reform. It also reflected a continuation of the liberalizing strategy of the administration's predecessors – an approach that is likely to intensify following the election of center-right candidate Nicolas Sarkozy to the French Presidency in 2007 on a platform of ambitious liberalization and labor market reform. Broadly speaking, French governments of both Left and Right have continued the strategy of promoting job creation by subsidizing social contributions and liberalizing restrictions on labor contracts that were central to the Aubry Laws.¹⁰

Such measures relating to work time and non-wage labor costs have dovetailed with a number of recent attempts to reshape the demand side of the labor market, particularly with respect to unemployment insurance. These reforms have involved a combination of increasing pressure on the unemployed to find and accept available jobs and the expansion of less generous, means-tested benefits for those without access to other support. The most significant recent unemployment insurance reform grew out of MEDEF's so-called '*Refondation sociale*' ('Social Refoundation') campaign, launched in 2000 and involving demands for a broad program of liberalization of French social protection. Partly an effort to influence public debates and the trajectory of reform, the campaign also reflected MEDEF's attempt to combat what it viewed as the government's intrusion into the purview of the social partners and to reclaim some of the initiative for policy making from an overbearing state. In the words of Denis Kessler, the intellectual father of the *Refondation* and MEDEF's erstwhile *éminence grise*, the campaign was about a 'quest for rules' governing social dialogue and a clarification of the respective responsibilities of the state and social partners.¹¹ The *Refondation* thus represented both an effort on the part of employers to assert their influence over labor market policy and to address dysfunctions in France's system of social partnership, which had long been marked by state domination, ideological and politically marginalized trade unions, relatively passive employers' associations and political stalemate between the state and social partners.

Although the campaign resulted in modest reforms in some other areas, unemployment insurance witnessed quite substantive change, accomplished against a background of conflict between the government and employers.¹² In June 2000, MEDEF and the reformist CFDT trade union agreed to limit access to benefits and imposed significant new obligations upon job seekers. The *Plan d'aide et de retour à l'emploi* (PARE) made receipt of benefits contingent upon a signed contract obligating job seekers to work closely with the ANPE, the national employment office, in a personalized job search (the *Projet d'action personnalisé*, or PAP). If this contract is judged to have been violated, benefits can be cut or even terminated. Because French unemployment insurance administration is largely bipartite, the social partners were able to negotiate the original deal relatively free from state interference.

Following the conclusion of union-employer negotiations, the government initially refused to ratify the agreement, arguing that defining rights to benefits was the state's sole prerogative. Aubry's objections, however, were more jurisdictional than substantive since she and her closest advisors supported the basic policy direction represented by the deal. After more negotiations and several iterations of the reform, the conflict between MEDEF and the government was finally resolved by a phone call from Jospin to MEDEF's president at midnight on a Sunday in an effort to defuse the conflict. Jospin felt compelled to intervene in order to secure a reform that all sides (except for France's most radical trade unions) agreed was necessary¹³ and to preserve the government's credibility as a force for reform. Equally important, the government wished to prevent MEDEF's withdrawal from the administrative organs of France's social security funds, which the association had repeatedly threatened if legislative outcomes did not hew fairly closely to the agenda outlined under the *Refondation*. Keeping MEDEF within the system was important not only in order to maintain a functioning framework for bargaining over labor market and social policy, but also to preserve the legitimacy of the entire social security system, whose bipartite structure has long been an important source of public support. The final law, passed in autumn 2000, was the most significant reform of French unemployment insurance since the system's inception in 1958.

Recent French labor market reform has thus involved liberalization supported by the expansion of financial incentives for employers to create jobs and increasing pressure on the unemployed to seek out and accept available work. Although the state has played an important role in the reform process, it has had to compete with an increasingly aggressive employers' association, which, in tandem with moderate trade unions, has worked to enact its own vision of labor market reform. The positive effects of reforms devised by both the government and the social partners have been considerable. Although

growth has slowed relative to the late 1980s, the number of jobs created per point of GDP growth increased dramatically from around 183,000 in the late 1980s to 268,000 in the late 1990s. What is more, a significant share of total jobs created (832,000 between 1997 and 1999 alone) have been the direct products of labor market reforms, with 50,000 resulting from increased part-time employment, 106,000 from reductions in social security contributions and, as early as 1999, an estimated 67,000 from reductions in work time.¹⁴ Part-time jobs as a share of total employment increased from 12.2 per cent in 1989 to 14.7 per cent in 1999 (OECD 2001b: 18), as did the share of temporary jobs, from around 8 per cent of total employment in 1989 to more than 10 per cent in 1999 (OECD 2001a: 32), reflecting employers' increased flexibility in allocating work time. Furthermore, rates of increase in workers' hourly productivity grew from an annual average of 1.2 per cent between 1991 and 1996 to 1.5 per cent between 1997 and 2001 (OFCE 2002: 59).

Although France continues to confront relatively high rates of unemployment, these difficulties are clearly not the products of a moribund policy-making process, as many have argued. As we have seen, French labor market reform has undergone a period of rapid innovation driven by significant changes in the political model that scholars have long blamed for the ostensible absence of reform. Continuing labor market problems should be attributed instead to a climate of sluggish economic growth deriving from EMU-based strictures on fiscal and monetary policy, combined with the fact that many recent reforms will require additional time to realize their full effects.

State activism and labor market adjustment in Germany¹⁵

Like France, Germany has witnessed significant labor market reforms during the past decade as well as alterations in the policy-making model inherited from the postwar era. German reforms have been driven by an increasingly aggressive state, which has seized much of the political initiative from an unresponsive neocorporatist labor market policy-making system. Following a broad trajectory of 'buttressed liberalization' similar to France's, German reforms have involved state-directed expansions of active labor market policies and increasing pressure on the jobless to seek out and accept employment. As in the French case, German labor market policy has thus experienced a period of innovation that scholars have failed to recognize and that has been driven by significant shifts in the prevailing political dynamics of the reform process.

German authorities' efforts to revitalize a sluggish labor market have been colored by a distinct political context and a different distribution of political

authority than that existing in France. The constitutionally enshrined principle of *Tarifautonomie* ('wage independence') reserves to employers and unions the authority to bargain collectively over work time and wages, while firm-level works councils, composed of employers' and workers' representatives, control shop-floor decisions over the organization of production and working conditions (Thelen 1991). Tripartite labor market institutions – in particular the *Bundesanstalt für Arbeit* (Federal Labor Office, recently renamed the *Bundesagentur für Arbeit* (Federal Labor Agency), hereinafter BA) – have long controlled a broad range of labor market-policy domains from vocational training to unemployment benefits.¹⁶ This decentralized authority structure has yielded a context in which successive governments have been forced to confront not only firms' *de facto* control over employment decisions, but also substantial *de jure* control by the social partners over significant aspects of the policy-making process. While French labor market reform has been characterized by increasing political competition between the state and social partners, in Germany reform debates have witnessed increasingly aggressive, if sometimes problematic, attempts on the part of governments to adjust and reshape a policy area over many aspects of which they do not enjoy exclusive control.

This new state assertiveness has resulted in a series of significant alterations in how the German labor market is governed and major changes in the substance of labor market policies. To be sure, the neocorporatist labor market institutions, in particular the BA, continue to control many labor market instruments, from vocational training to unemployment insurance to many job-creation schemes. However, recent governments – in particular that of Social Democratic Chancellor Gerhard Schröder between 1998 and 2005 – have independently introduced a number of active labor market policies, even as they have worked to remedy the poor job-creation record left by tripartite labor market institutions. As a result, German labor market policy has become bicephalic, with expanded state-administered and state-funded policies working alongside established neocorporatist organs.

Having made the reduction of unemployment one of his central electoral promises during the 1998 campaign, Schröder, along with Labor Minister Walter Riester, quickly launched a series of important policy initiatives that emphasized the activation of labor and the 'rights and obligations' of the unemployed.¹⁷ Soon after his election, Schröder publicly declared: 'Whoever is able to work but refuses an appropriate job should have his support cut. There is no right to laziness in our society!' (Von Hammerstein & Sauga 2001: 96–97). This formulation reflected a significant departure from traditional German understandings of the relationship between social benefits and the labor market. For decades, unemployment insurance, for which workers furnish 50 per cent of the financing through social contributions, was considered a benefit

previously paid for and therefore owed to workers as a matter of right. By contrast, both the rhetoric and the policies of the Schröder Government suggested a new emphasis upon the centrality of state initiatives in addressing unemployment as well as making 'rights' previously taken for granted conditional upon workers' acceptance of new obligations.

The government's first major labor market-policy initiative was the *JOB-AKTIV Gesetz*, or law for 'Job-Activation, Qualification, Training, Investment and Placement (*Vermitteln*)', which, like the French PARE, entailed elements of coercion as well as components designed to expand employment opportunities. It mandated the restructuring of the BA's job-placement services and worked to encourage the unemployed to re-enter the labor market. Regional and local branches of the BA were obliged to create a personalized profile for each job-seeker, offering job openings and individualized counseling services. In return, the unemployed person was obliged to accept 'reasonable' job offers and make a concerted effort to find employment. The law also created a series of vocational training programs, expanded subsidies to employers to encourage hiring and instituted additional job-creation schemes aimed at improving public infrastructure (SPD und Bündnis 90/Die Grünen Bundestagsfraktionen 2001; Bundesanstalt für Arbeit 2003). Part of the government's effort to create a *Leistungsgesellschaft* ('performance society'), this measure reflected its desire to adjust the *soziale Marktwirtschaft* ('Social Market Economy') by enhancing the 'market' component without abandoning its 'social' counterparts.¹⁸

The Schröder Administration's reform strategy also entailed a significant extension of active labor market policies – an area traditionally neglected by Bismarckian welfare states such as Germany's. A central target of such policies was the stubborn problem of youth unemployment. Joblessness among workers under the age of 25 rose significantly in the 1990s, reaching a level of 10.4 per cent in 1998, with 476,000 youth without either jobs or apprenticeship places. Between 1991 and 1998, the number of young applicants registered with the BA for apprenticeship slots grew from 541,790 to 796,400, while the number of available positions decreased from 830,940 to 603,900 (Bundesanstalt für Arbeit 1999: 69, 72). In late 1998, the government passed the *Sofortprogramm zum Abbau der Jugendarbeitslosigkeit* ('Immediate Program for the Reduction of Youth Unemployment', JUMP) (Bundesanstalt für Arbeit 2000a), which introduced wage subsidies for firms that hire young workers from the unemployment rolls, instituted additional job-counseling services and devoted DM2 billion (€1.02 billion) annually to the goal of creating 100,000 new jobs for workers under 25.¹⁹ The measure had some positive effects, including the creation of 406,000 additional employment and apprenticeship slots between 1998 and 2001 (Bundesministerium für Arbeit und Sozialordnung 2002).

The expansion of active labor market policies has been accompanied by a growing willingness to devote federal tax money to reducing unemployment. In 1999, the government provided DM43.6 billion (€22.3 billion, up from €16.2 billion in 1995) out of DM150.3 billion (€76 billion) in total German labor market expenditures. This included a DM11 billion (€5.62 billion) supplement to finance the BA's budgetary shortfall.²⁰ In 2001, the government provided the BA with an additional DM1.2 billion (€614 million) to offset the costs of its JUMP reform. During the same period, outlays for active labor market policies rose substantially, with a record DM44.1 billion (€22.5 billion) budgeted for 2001 (*Frankfurter Allgemeine Zeitung* 2000). In 2002, the federal government supplied 29 per cent of the BA's annual funding in addition to the money spent on programs administered directly by the Labor Ministry. Between 1998 and 2002, then, the federal government raised its already-high level of overall funding for the BA's labor market policies, while the total share of funds devoted to active labor market policies increased significantly (from 34.6 per cent in 1998 to 43.6 per cent) (Bundesanstalt für Arbeit 2001: 9).²¹

The government also embarked upon a series of experimental policies designed to reduce unemployment. For example, in August 2001, it introduced a 'job-rotation' measure, inspired by a similar initiative in Denmark, involving the temporary replacement by the unemployed of existing workers, who were to use the time off to upgrade their skills through job training or other continuing education programs. The furloughed workers received normal unemployment benefits during their training period. In addition to increasing existing workers' productivity, the program was designed to offer the long-term unemployed 'renewed contact with the professional world' in the hopes of improving their sense of value as employees. In return for their participation, employers received federal subsidies of more than half of the total wage costs for each participating worker.²²

The state has also aggressively reformed the BA in an effort to increase the responsiveness and accountability of the organization (*Frankfurter Allgemeine Zeitung* 2002). In 2002, the highest German administrative regulatory agency found that the BA had falsified its placement record, with as many as 70 per cent of cases having been incorrectly reported – a scandal that placed the ineffectiveness of neocorporatist labor market regulation in stark relief. In the wake of the ensuing resignation of BA President Bernhard Jagoda in March 2002, the government created a three-person executive board appointed directly by the federal government to govern the BA. In the same year, the government established the Hartz Commission to make recommendations on further labor market reforms, thereby taking responsibility out of the hands of the BA and giving it to a group of experts selected by the administration itself. The Commission's recommendations called for the reinforcement of state

control of labor market policy, increased funding for active labor market policies, development of state-run, temporary job agencies to promote more flexible employment, and additional reforms of the BA's placement and training services (Hartz Commission 2002).²³

After its re-election in 2002, Schröder's Government further stepped up its efforts to revitalize the labor market, including a series of reforms that continued along the lines of those proposed by the Hartz Commission but went well beyond them. Under the banner 'Agenda 2010', the Administration introduced a comprehensive reform package designed to promote job-creation, reduce non-wage labor costs and liberalize labor market regulations. Announcing the reforms in March 2003, Schröder expressed the felt urgency of the measures with rhetoric similar to that associated with its initiatives in other areas of labor market and social policy: 'There are sometimes measures that must be pushed through, which arouse little enthusiasm in me or in others. They must nonetheless be undertaken' (*Frankfurter Allgemeine Zeitung* 2003).

The reforms liberalized protections against layoffs in Germany's smallest firms, loosened the country's notoriously strict shop-opening laws, reduced health insurance contributions and significantly cut tax rates.²⁴ In the realm of unemployment insurance, the reforms reduced the length of eligibility for primary jobless benefits (*Arbeitslosengeld*) to twelve months for all workers under the age of 55. The less generous unemployment assistance benefits (*Arbeitslosenhilfe*), paid to workers whose eligibility for unemployment insurance has expired, were reduced to the level of *Sozialhilfe* (the German basic income-support program). These cuts are quite significant as they reduce monthly benefits from 75 per cent of previous wages to a few hundred euros per month. Nor was the significance of these cuts lost on the German electorate. They sparked a series of massive protests during 2004, with tens of thousands of Germans marching for weeks through the streets of several major cities to protest what they saw as a violation of the German social contract. The unpopularity of the reforms clearly contributed to the SPD's disappointing performance in the 2005 elections, which forced the Social Democrats to cede the Chancellery to CDU leader Angela Merkel and to share power with her party in a 'Grand Coalition'. Though this government has so far failed to institute significant labor market reforms, this inactivity is a product of the inclusion of both major parties in the government and the fact that fundamental disagreements over labor market policy within the coalition have precluded major initiatives. One should expect the pattern of more ambitious reforms to resume once new elections, scheduled for 2009, place one or the other major party clearly in power.

Just as with the government's earlier labor market measures, the reform strategy with 'Agenda 2010' was one of imposition rather than consensus,

increasing influence of the state relative to the social partners, and a willingness to risk significant political capital in order to see through reform of the German labor market. Faced with an ineffective system of tripartite labor market policy making, the government undertook increasingly aggressive efforts to promote labor market adjustment. It assumed a variety of responsibilities that formerly lay within the domain of the social partners, increased public resources devoted to active labor market policies and developed a range of novel and aggressive policies aimed at promoting labor market activation. While these measures have not fully remedied Germany's unemployment problem, they have clearly begun to have the desired effect, despite the prevailing climate of economic austerity deriving from EMU-based fiscal and monetary strictures. Between March and October 2005, for example, the number of unemployed fell by more than 200,000, and the decline of 94,000 in October alone was the greatest in that month since reunification in 1990 (Bundesministerium für Wirtschaft und Arbeit 2005). Such encouraging trends have since continued, with a net decline of 383,000 in the number of registered unemployed between June 2005 and June 2006 (*Frankfurter Allgemeine Zeitung* 2006). By May 2007, the German unemployment rate had sunk to a five-year low of 9.1 per cent, with the number of registered unemployed at its lowest level since November 2001 (*Frankfurter Allgemeine Zeitung* 2007). Though partially the result of renewed economic growth, these trends also clearly demonstrate the positive effects of recent reforms and the continued capacity of the German economy to create jobs.

Conclusion: The legacies of buttressed liberalization and reasons for optimism

The past decade and a half has witnessed some of the most significant innovations in French and German labor market policies since the immediate postwar period. Though differing in the details of their approach, governments of various ideological stripes in both countries have increasingly abandoned traditional approaches to labor market adjustment that centered on labor supply reduction through mechanisms such as early retirement programs. In their place, authorities have liberalized existing labor market regulations even as they have devised novel instruments designed to promote both job-creation on the supply side and labor uptake on the demand side. French officials have significantly loosened regulations on overtime and part-time employment, stepped up subsidies of employers' social security contributions in an effort to promote private-sector job growth, expanded active labor market programs and increased pressure on the unemployed to seek out and accept available

work. In Germany, authorities have implemented a series of innovative job-creation schemes and subsidized social contributions for low-wage workers, while limiting the level and duration of unemployment insurance and, perhaps most significantly in the long run, imposing major reforms on ineffective (not to say corrupt) tripartite labor market institutions.

These patterns of dynamism and innovation bear little resemblance to the images of sclerosis, self-serving parochialism and moribund policy making that have come to dominate scholarly images of French and German politics in general and labor market policy in particular. Such images suffer from two major flaws. First, they fail to recognize the extent of labor market reform that actually has taken place in the two countries. Second, they accept far too uncritically stereotypical images of political dysfunction that is said to lie at the root of this putative sclerosis. Not only have French and German labor market reforms made significant progress in remedying some of the countries' labor market dysfunctions and helped to create a significant number of jobs, they reflect the capacity of their respective political systems to adapt to changing economic circumstances. In France, these shifting political dynamics can be seen in the growing influence of the social partners, and particularly that of the main employers' association. In Germany, they have entailed a growing state assertiveness that represents a significant departure from the postwar model of political consensus, incremental adjustment and reform determined by the least common denominator among key political actors. These developments in both policy and politics clearly contradict the entrenched image of sclerotic French and German political systems, adherents of which tend either to ignore countervailing evidence or to dismiss it as an insignificant outlier.

To be sure, this surprising degree of reform in the French and German labor markets does not mean that the two countries have surmounted their employment difficulties. Unemployment continues to run high, particularly for certain vulnerable groups such as the young and the long-term unemployed.²⁵ As this article has shown, however, these difficulties are not the products of a failure of political will or the absence of meaningful reforms. Rather, in France and Germany as elsewhere in continental Europe, they stem from sluggish rates of economic growth,²⁶ which have been exacerbated by EMU-based strictures on fiscal and monetary policy.²⁷ These limitations and the resulting deflationary economic climate have undermined job growth through the perpetuation of excessively high interest rates, which dampen incentives for corporate investment and hiring, and arbitrary and unreasonable constraints on public spending, which limit the resources that policy makers can devote to active labor market policies.

Despite the persistence of relatively high rates of French and German unemployment, however, the kinds of innovation and activism that authorities

have displayed during the past decade reflect a willingness to confront these difficulties (sometimes, as with Schröder's 'Agenda 2010' reforms, at significant political cost). Given time, the reforms that have resulted from this period of policy activism should have increasingly positive effects on the two countries' labor markets. Indeed, though many of these policies are of relatively recent vintage, by 2005, they had already begun to pay dividends in the form of reducing unemployment rates and increasing the pace of job creation.²⁸ These hopeful signs provide evidence for the view that an aggressive reform strategy supported by the devotion of significant financial resources can significantly improve labor market performance, *despite* slow rates of economic growth and strictures on fiscal and monetary policy. Such a contention finds support in a growing body of economic evidence showing that such policies are effective at achieving meaningful reductions in jobless rates (see, e.g., OECD 2005: Section 4).

Recent patterns of French and German labor market reform thus offer significant reasons for optimism about both the continuing vitality of Continental European political economies and the capacity of creative and energetic public policy to enhance economic performance. Although the degree to which France and Germany have confronted successfully their economic difficulties remains a matter of debate, these problems are clearly not the results of political lassitude or moribund policy-making processes. France and Germany have continued to adjust in the face of an economic context that is far from favorable. As rates of European economic growth continue to increase – with estimates for 2007 at 2.1 per cent for France and an even healthier 2.7 per cent for Germany (*The Economist* 2007) – and French and German labor market reforms are given more time to work, these measures should result in significantly higher rates of job-creation and continued improvement in overall labor market performance. The impressive record of French and German reform represents a significant capacity for political innovation and labor market adjustment that, at least so far, has remained largely unrecognized by scholars of European politics. If France and Germany have not yet become models of labor market adjustment, then neither are they the dysfunctional and moribund political economies portrayed by prevailing scholarly and journalistic discourses.

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Notes

1. Between 1959 and 1969, unemployment averaged a mere 1.8 per cent in France and, between 1965 and 1973, an even more remarkable 0.8 per cent in Germany (see Sautter 1982: 449; Glyn et al. 1990: 47).
2. One should emphasize, however, that many of Germany's economic woes were the result of the strains of reunification in 1990. For a detailed discussion, see Vail 2005: Chapter 4.
3. The label 'Christian Democratic,' popularized by many scholars in the 'worlds of welfare' tradition, is highly problematic, not only because it suggests an excessive degree of historical continuity and path dependence, but also because it is used to label the welfare states of countries like France that have no significant tradition of Christian Democracy.
4. For an expanded account of these reforms, see Vail 2005: Chapter 5.
5. The incentives for employers involved a FFr9,000 (€1,372) per worker annual subsidy offered in exchange for a 10 per cent reduction in work time against a 6 per cent increase in payrolls, and a FFr14,000 (€2,134) payment for a 15 per cent reduction in time against a 9 per cent increase in the number of workers. These subsidies were cut by FFr1,000 (€152) per year until they reached FFr5,000 (€762) in 2002.
6. In July 2000, these exemptions averaged FFr21,500 (€3,278) for workers earning the minimum wage, declining as wages increased to FFr4,000 (€610) at the ceiling of 1.8 times the minimum wage (DARES 2002: 10).
7. According to one Labor Ministry Official, Gandois' resignation was prompted by a 'misunderstanding' between Jospin and Gandois, who had met secretly with the Prime Minister before the laws had been made public. As a result, Gandois assumed that his demands, including those for substantive negotiations between the government and social partners over the measures' eventual details, would be taken seriously.
8. In many cases, firms took advantage of the flexibility the laws afforded by granting workers additional days off rather than actually shortening the number of hours worked per week. This 'annualization' of work time was among the reforms' most appealing aspects for French employers.
9. In the words of Denis Kessler, then second in command at MEDEF and the architect of MEDEF's reform agenda, the intrusion of the state represented by the Aubry Laws reflected the continued 'atrophy of civil society' (Interview with the author, 15 May 2002).
10. The resulting reduction in payroll taxes has been partially compensated for by the *Contribution sociale généralisée*, or CSG, a tax on incomes and returns to capital that has funded an increasing share of social benefits.
11. Interview with the author, 15 May 2002.
12. The other significant reform to come out of the *Refondation* involved modest changes to private-sector complementary pensions in 2001, which followed MEDEF's proposals to index benefits to inflation and slightly raise contribution rates and lower replace-

- ment rates. Like unemployment insurance, complementary pensions are bipartite and thus relegate the state's role to ratifying the accord. Claiming that it would not 'be responsible for the bankruptcy' of the system – and in a gesture that it would repeat in other contexts – MEDEF threatened to withdraw from the system's administration if its proposals were not accepted by the state and reformist unions. Hoping to protect the legitimacy of the bipartite management structure in which they had a significant political stake, the CFDT and CFTC trade unions signed the accord, which was duly approved by the government.
13. This account is confirmed by accounts from interviews with officials on all sides of the debate, from MEDEF to UNEDIC to members of the government at the time.
 14. Author's calculations and Pisani-Ferry 2000: 29.
 15. See Hemerijck and Vail (2006) for a comparison of the politics of recent labor market reform in Germany and the Netherlands.
 16. While the social partners manage social security funds in both France and Germany, in the latter, the state's signature is normally not required for changes in policies such as unemployment insurance, limiting the government's authority over such matters.
 17. For a more detailed account of some of these reforms, see Vail 2003.
 18. Even among Germany's more liberal *élites*, there is very little acceptance for mass privatization of the government's social- and labor-market responsibilities. At the same time, understandings of the Social Market Economy vary in the degree to which the system's market foundations or social components are emphasized.
 19. The law was initially intended to last only twelve months but has been extended each year by agreement between the BA and the government. For details, see Bundesanstalt für Arbeit 2000b.
 20. The federal government is required by law to cover the BA's deficit. Traditionally an exceptional measure for difficult years, by the early 2000s this supplement had become a nearly annual fixture due to the BA's continual shortfalls. The 2002 figures are drawn from Bundesanstalt für Arbeit 2003: 66.
 21. Although the case of labor market policy illustrates the government's willingness to devote federal funds to promoting economic adjustment, such spending has been used in other areas to preserve rather than transform existing arrangements. A notable example is the *Finanzausgleich*, a complex system of fiscal transfers from richer to poorer *Länder* that the government has continued to support. This system is extremely expensive and, given the vested interests of poorer *Länder* and the political sensitivity surrounding the former DDR, difficult to reform. I am indebted to Wade Jacoby for this observation.
 22. In much the same innovative vein, a series of regional labor market experiments has been implemented on the national level. The most celebrated of these was the 'Mainz Model', so-called because it was initiated in Mainz by the President of Rheinland-Pfalz. The scheme was extended to the rest of the country with the goal of creating 30,000–40,000 jobs. It involved federal subsidies to low-wage workers (those earning €320–€805 per month), such as reimbursing their social security contributions and increasing child benefits. The Greens, who have long championed an aggressive version of this policy, accepted a restriction of eligibility to the long-term unemployed in exchange for an agreement that the child benefit supplement would be financed through federal taxes rather than social contributions.
 23. The thin character of the Commission's tripartism could also be seen in the selection as its leader of Peter Hartz, the personnel director at Volkswagen, with which Schröder has

- long had business ties, rather than the creation of a board of co-equal union leaders and employers to direct its work.
24. Many of the 'Agenda 2010' reforms were proposed initially by the Hartz Commission and later subsumed under the aegis of the broader legislative initiative, which included proposals for reform in other policy areas such as health insurance and tax reform.
 25. In 2004, standardized overall unemployment rates were 9.7 per cent in France and 9.5 per cent in Germany, while rates for those aged 15–24 were 21.3 and 11.7 per cent in France and Germany, respectively (OECD 2005: 237, 241).
 26. Real GDP growth for 2004 was 2.3 per cent for France and 1.0 per cent for Germany (OECD 2005: 17).
 27. It is worth emphasizing that many of the European countries with the best labor market performance, including the United Kingdom and Sweden, are not members of EMU.
 28. E.g., in October 2005, due largely to the effects of active labor market policies, French unemployment dipped below 10 per cent and the number of registered unemployed declined for the sixth consecutive month. By July 2006, the French jobless rate had declined to 8.9 per cent, the lowest rate for four and a half years. German labor market performance has also improved significantly as 2006 witnessed the first July decline in unemployment in fifteen years to a rate of 10.5 per cent compared to 11.7 per cent at the same time in 2005. See *Le Monde* (2005) and *Les Echos* (2006) for details and a discussion.

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