EMU and Labor Market Institutions in Europe

The Rise and Fall of National Social Pacts

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During the 1990s, wage setting increasingly became coordinated in many Member States of the European Union (EU), often through new arrangements involving broad encompassing social pacts between employers, trade unions, and governments striking deals across policy areas from wages to social and employment policies. We argue that the different forms of institutional innovation in wage setting found in the EU depended on the combination of the character of external pressures and preexisting protoinstitutional structures in the labor market. The shifts in the institutions of wage-setting and macro-level labor market governance were directly related to shifts in macro-economic policy regimes, especially political-economic pressures associated with the advent of Economic and Monetary Union (EMU). Because these pressures were not symmetrically distributed across the different EMU candidates, both the urgency of the problems and responses they produced differed. Microinstitutions conditioned the ability of countries to "embed' these new arrangements in stable rule-based governance structures.

Keywords: *EMU; social pacts; varieties of capitalism; wage setting*

During the 1990s, labor relations systems in Europe went through several surprising large-scale changes. Wage setting increasingly became coordinated in many Member States of the European Union (EU): In some countries, this happened within existing institutions, whereas in others this process took place through new mechanisms, often involving broad

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encompassing social pacts between employers, trade unions, and governments striking deals across policy areas stretching from wages to social and employment policies.

Why did some countries adopt and develop broad social pacts, which were often radical departures from their traditional modes of labor market and social policy governance, whereas others did not? How much of the emergence of these institutional innovations was because of external constraints, such as Economic and Monetary Union (EMU), and how much of it followed an endogenous logic of restructuring? And given the answers to these questions, what is the future of social pacts in EMU after the introduction of the euro?

We argue, as others do, that the different forms of institutional innovation in wage setting and their consequences depended on the combination of the character of external pressures and the preexisting institutional (or protoinstitutional) structures in the labor market. More concretely, the shifts in the institutions of wage setting and macro-level labor market governance were directly related to developments in macro-economic policy regimes, especially the advent of EMU. They addressed the dual but mutually reinforcing pressures to stabilize nominal exchange rates within the Exchange Rate Mechanism (ERM) and meet the core convergence criteria of the Maastricht Treaty, expressed in low inflation rates, falling public debt, and low public deficits. However, these pressures were not symmetrically distributed across the different prospective EMU members, and both the urgency of the problems and the responses they produced differed as a result. Moreover, and at least as interesting as their emergence, it appears as if after the introduction of the euro in 1999, these pacts in their different forms slowly disappeared, as their core components became embedded in rules-based wage setting and fiscal policy systems.

Importantly, however, this macro-focus on EMU is only half the story: These macro-economically induced arrangements appear to have been most successful in achieving their aims where they dovetailed with existing microinstitutions in the labor market, or at least with elements of a protoinstitutional framework at the microlevel that could rapidly be assembled to perform the same function. In EMU Member States with labor markets that were organized around some form of interfirm coordination, which included coordinated wage setting and interfirm formalization of (local or regional) training systems, social pacts became embedded more effectively than in countries where those elements are absent.

This article, therefore introduces several new elements in the analysis of labor market governance in Europe. First of all, it links labor market innovations to the new hard macro-economic constraints that imposed adjustment

in wage-bargaining systems and labor relations more generally. Second, it embeds that link in a historically informed narrative on how these macro-economic constraints differed across the countries in Europe. On that basis, we offer a typology of social pacts in Europe based on the differential responses to the new macro-economic framework associated with EMU. Finally, it introduces microlevel institutions in the labor market as an element that helps understand the development, timing, and demise of social pacts.

The next section reviews the debate on social pacts and is followed by two empirical sections, organized around two hypotheses that will be tested on the basis of stylized descriptions of developments in European economies since the mid-1980s. Our first hypothesis is that explicit social pacts (i.e., those departing clearly from the norm of labor market governance) emerged only in those countries facing the most acute challenges of inflation reduction and fiscal consolidation. Central arrangements in the labor market and in wage setting allowed for more effective inflation control and debt-deficit reduction with lower social and political costs in the run-up to EMU. After this analysis of social pacts in the run-up to EMU, we shift the focus to developments after 1999, when encompassing labor market arrangements in the form of social pacts either disappeared or profoundly changed in nature. Our second hypothesis is that the demise of explicit social pacts in the post-EMU entry period is related to the internalization of the core elements of the social pacts of the 1990s (i.e., those that dealt with disinflation and debt-deficit control) in new wage setting and deficit rules. For other elements in the domestic policy arena that require some form of co-ordination across governments and social partners, the architecture of pacts is still often used, but in leaner form and in an ad hoc rather than systematic manner. We conclude by presenting some scenarios on the future of labor market governance in EMU-Europe.

UNDERSTANDING LABOR MARKET GOVERNANCE IN EUROPE

How should we understand the shifts and innovations in labor market institutions that have taken place in Europe during the last two decades? The debate, as we understand it, has been structured around three general positions. The first, which we refer to as the *endogeneity* argument, posits that developments in labor market institutions reflect endogenous solutions to long-standing problems. In one strand of this approach, focusing on the purported cyclical nature of corporatism, the emergence or reemergence of concertation is linked to the changing balance of power among actors, either when the problem load renders a cooperative game most appropriate (Regini,

2000) or when an adverse shift in the business cycle revives the search for consensus or creates it anew (Schmitter & Grote, 1997). The main empirical case informing this argument is provided by the Netherlands, where long before any profound external shock appeared, labor market parties, government, and central bankers redesigned the system in the 1982 Wassenaar Agreement (Hemerijck, Van der Meer, & Visser, 2000; Visser & Hemerijck, 1997). If EMU mattered at all, in this view, it was not because it imposed a completely new set of constraints, but because it made the existing need for reform more urgent or helped induce shared perceptions and economic understandings (Compston, 2003), sometimes referred to in the literature as *institutional learning*. The 1987 social pact in Ireland figures almost equally prominently among the paradigmatic cases for this approach (e.g., O'Donnell & O'Reardon, 2000). But although this argument certainly helps us understand how domestic problem loads in the Netherlands and Ireland led to reforms there, it is less clear why social pacts disappear or, at the very least, profoundly change in character in other countries when the problem load is still important. Despite innovative policies in 1990s Italy and Portugal, for example, these countries still face major ongoing problems that are related to the ways in which the welfare system imposes extra tax burdens on either workers or business. However, the social pacts that existed in these countries have unraveled during the last few years, without fully resolving any of these problems. Clearly, the problem load on its own is insufficient as an explanation, although, at the very least, the timing of the subtle collapse of social pacts suggests a strong relation with the achievement of EMU entry criteria.

The second position has been offered by one of us (Rhodes, 1998, 2001) and argues that social pacts, and other forms of new social partnership, emerged as a competitive corporatist response to pressures emanating from globalization, which imposed both labor market and welfare reforms to alleviate competitive pressures on business. In this position, as in the previous one, EMU matters primarily as a force, in addition to other external pressures, but much less so on its own. A related interpretation argues that national pacts emerged in the 1980s and 1990s to ensure a union commitment to wage moderation and greater labor market flexibility at a time when neoliberal standards were extending across Europe (Traxler, 2003, 2004). The problem with this position, we recognize today, is that it fails to account for two elements. First, why did new forms of labor market governance not emerge in countries such as Belgium and Germany, where, in the 1990s, unemployment rose rapidly and competitiveness fell (more so in Germany than in Belgium) and where expensive welfare systems may be endangering competitiveness via the tax burden on firms? Second, and put differently, the

problem load in these two countries was, at least after German unification in the case of that country, arguably not any smaller than in the Netherlands or Ireland in the 1980s, yet very few deep reforms took place. This suggests that, although competitiveness concerns certainly matter in any explanation of the emergence of social pacts, such arguments do not really help us understand the absence of pacts where competitiveness (and economic performance more generally) was falling, and these arguments fail to shed light on the timing of the new arrangements.

A third set of arguments has been related directly to EMU and claims that EMU itself imposes some form of social pact to bring all the relevant political-economic actors around the table to strike a deal that simultaneously addresses export competitiveness and the multiple policy issues triggered by the Maastricht criteria, especially those relating to inflation and budgets (Pochet & Fajertag, 1997, 2000). Social pacts allow labor market parties to strike such deals under the pressure of EMU convergence requirements for two main reasons: (a) because they assure a more or less negotiated and equitable division of responsibilities and tasks among them to reach commonly agreed goals and (b) because they allow all of the major interdependent elements of welfare regime regulation affected to be addressed, including wage bargaining, labor market policies, social transfers, and labor law (Ebbinghaus & Hassel, 2000; Hassel, 2003; Hassel & Ebbinghaus, 2000).

Although we certainly agree with the importance of EMU and the emphasis on addressing multiple, interrelated policy issues in this argument, once again there are several unresolved issues. First of all, not every prospective EMU member state, not even those in a position in 1991 that made it hard to meet the Maastricht criteria, adopted a social pact. Belgium, for example, was facing a steep uphill deficit and debt struggle, and a social pact might well have helped the country to bring debt under control. Yet an attempt at a social pact failed in the early 1990s and, instead, the government essentially decreed the Maastricht criteria by fiat. Second, nor has the existence of problem strains across welfare policy areas led naturally in many countries to successful coordination across those areas within tripartite social pacts; such examples are relatively few and far between (Siegel, 2004). Moreover, this argument fails to explain why social pacts seem much less viable today than they were in the past. There is no endogenous argument that claims that there is a difference between the constraints imposed by the Maastricht criteria and those imposed by EMU itself after 1999, as countries still face the complex task of tackling interdependent policy areas in reforming their welfare systems.

In sum, any explanation of the emergence and subsequent evolution of new forms of wage setting and labor market institutions in Europe during the

1990s needs to account for several stylized facts that the positions above fail to grasp: (a) the variation in the emergence of social pacts and of types of wage-setting systems across prospective EMU members, (b) the absence of a simple linear relation between pacts and the broad domestic problem load faced by political economies, and (c) the weakening disappearance or fragmentation of central national bargains after 1999.

Our position is that these new arrangements in wage-setting systems emerged in response to two external, primarily EMU-related pressures in particular: the requirements to bring inflation and deficits or debts down to the levels imposed by the Maastricht Treaty. Importantly, these pressures were not distributed symmetrically across all prospective EMU members. By 1991, a large group of economies had already restructured the institutions of their domestic political economies through the adoption of a fixed exchange rate vis-à-vis the German Mark (DM) and, therefore, did not face a novel hard currency regime. The others, who had remained outside the orbit of the DM, started that process of domestic restructuring after the adoption of the Maastricht Treaty in 1991 and relied on some form of central social consultation and negotiation both to expedite that process of adjustment and reduce the potential social costs of rapid disinflation.

The EMU adjustment process thus led to different forms of central arrangements in wage setting. We identify four types of pact. In the DM-block countries, which had a longer history of economic adjustment, these took two forms:

(a) simple but powerful incomes policies, anchored on institutionalized centrally coordinated wage-bargaining systems, and (b) routinized embedded pacts (i.e., neocorporatist concertation, characterized by high levels of political commitment and trust), which built on an existing almost permanent social dialogue between labor market parties and governments.

A different type of central arrangement, with a different logic of construction, is found in those countries that had to conform quickly with specific narrow wage targets and deficit reduction targets but without the benefit of well-established or routine mechanisms for managing these processes of adjustment. These also take two forms: (a) The first we will call *headline social pacts*, because they addressed several related policy areas simultaneously, and did so in a declaratory manner in publicly announced forums and texts, and (b) the fourth and final type that we characterize as *shadow pacts*, in which consultation and negotiation took place for political or functional reasons at separate tables without explicit (or often even implicit) links between them, but with effects that were very similar to those of headline pacts: disinflation and fiscal consolidation.

These pacts differ from each other along two key dimensions: degrees of institutionalization and levels of trust. Although as pure incomes policies underpinned by centrally coordinated wage-bargaining systems and embedded pacts are both typically well-institutionalized and based on strong long-term commitments to collaboration, headline and shadow pacts are more likely to be nonroutine responses to exogenous shocks, consisting of unstable relations of political exchange (policy package deals and trade offs) that compensate for the absence of mutual trust between the partners (Molina & Rhodes, 2002).

This process of building new macro-level institutions, in turn, was conditioned by the existence of microlevel institutional frameworks that allowed labor market parties to internalize the pressures for wage moderation and therefore supported the turn toward noninflationary wage setting that had become imperative after 1991. These microfoundations came in three forms: In the first, wage setting has been highly coordinated so that inflation constraints were internalized and that the organization of skills and work allowed for an upward move in product market strategies. The second consisted of a situation in which the organization of the labor market contained some forms of interfirm wage co-ordination, where skills were both certified and transferable across firms and where workplaces have been relatively peaceful. In this case, these protoinstitutions could be reassembled to produce microfoundations that are functionally equivalent to those in the first group. Third, there are countries where wage setting was decentralized, the labor market deregulated, and skills were of a general nature rather than based in industries or firms. In those countries, the requisite microfoundations for wage coordination and wage moderation were extremely weak or absent.

Comparing developments in Italy and Ireland illustrates how these microfoundations conditioned the construction of macro-arrangements. In contrast to Ireland, Italian labor markets had a strong organized, though often regional, wage-setting and training component. The national social pact of 1993 in Italy both found a translation in and reshaped these microlevel arrangements, by forging a new link between industry contracts (that set pay norms) and company contracts (that redistributed productivity gains). A new system of work-place representation was also constructed, providing for a stronger company-based representation of unions and management and a foundation for a more articulated and coordinated wage-setting system. As a result, the national social pact became sustained by a microdynamic, rendering an explicit national headline pact much less essential after EMU entry in 1999. The Irish pact, in contrast, is built on much weaker microfoundations. On most measures, the Irish labor market and its voluntarist industrial

relations system are no more organized than those in the United Kingdom. It is based on rapid hiring and firing mechanisms and high general (instead of firm or industry-specific) skills. Experiments with social partnership at enterprise level have been stunted by the absence of a strong, supporting legal framework, and local-level bargaining continues to prevail (Roche, 1998; Teague, 2004). Precisely because the macro-institution is not underpinned by micromechanisms, talks among the partners in the Irish social pact more often resemble the regular wage contract negotiations (found in many Anglo-Saxon economies) that are regularly contested and subject to frequent reiteration. We argue that these micro foundations in the organization of the labor market are important elements, not only for understanding the past, but also the future necessity for social pacts and similar arrangements.

Our claim in this article is, therefore, that under the external pressures that the EMU process produced, microfoundations that were already present or could be reconstructed sustained narrow-target incomes policies or embedded pacts (as in the DM-block countries) or supported the building of headline social pacts. Countries where microfoundations were relatively weak, in contrast, constructed shadow pacts (in the shape of augmented incomes policies) in the run-up to EMU.

This, in brief, was the story (which we elaborate below) for the period until the end of the 1990s. As for the situation after the introduction of the euro in 1999, there has been little analysis to date of pre- versus post-EMU entry social pacts, apart from speculation along the following lines: that the latter may face a new bargaining agenda, focusing on issues of competitiveness and social dumping (Pochet & Fajertag, 2000); that the incentives for reform-oriented pacts may be weaker after EMU membership than before it (Visser, 2004); and that, with time, forces in favor of decentralized bargaining and deunionization will counter those in favor of central pacts and lead to the breakdown of national coordination (Calmfors, 1998a, 2001).

In this article, we present a more systematic argument to account for post-EMU developments. Because these novel social pact arrangements for wage setting and labor relations were almost entirely determined by the need to meet the Maastricht criteria on inflation and deficits and debt, the introduction of the euro in 1999 considerably changed this context. By the start of EMU, the core constituent elements of social pacts had found a place independent of central arrangements, by becoming internalized as technocratically governed rules, underpinning reconfigured or newly established systems of wage setting or budgetary policy making. This internalization of inflation and fiscal constraints was easier in countries with strong labor market microfoundations and difficult in countries where these were absent. Consequently, although the need and incentives for broad,

encompassing social pacts diminished after the introduction of the euro, today we find two categories of country: those where microfoundations were present, and in which ad hoc negotiations and forums to resolve punctual problems continue to be used for policies that are not embedded in domestic macro-economic policy institutions (e.g., pensions and labor market reforms) and countries where those microfoundations were not present and incomes policies—based social pacts, which can sometimes be extended to adjacent policy arenas, remain extant.

The balance of this article will go through each of these points. We will start with a detailed analysis of the different roles of wage setting in the run-up to EMU, then discuss the shift in these institutional frameworks after the introduction of the euro in 1999, and conclude with a series of possible future scenarios.[1]

MACRO-ECONOMIC POLICY, WAGE SETTING, AND SOCIAL PACTS

Why did some countries in Europe adopt a path of economic restructuring that involved headline social pacts, whereas others relied on other institutional arrangements? Answering this question requires putting the developments of the 1990s in their historical context. During the 1980s, the European political economy divided de facto into two large blocks: some of the European economies adopted a hard currency regime organized around the German Mark, whereas most others were in a soft “shadowing” arrangement. One group of European countries decided to take the logic of the European Monetary System (EMS), and especially the ERM[2] at the heart of it, to its logical conclusion. By the late 1980s, all of the Northwest European economies, as well as France, had de facto subjected their monetary policy to the German central bank.

This dramatic shift in the macro-economic policy making framework followed directly from the close trade relations between these economies and Germany. As small economies, such as Holland and Belgium, which traded a large part of their GDP with Germany, pegged their currencies to the DM, by implication an ever larger part of the GDP of other countries became linked to this de facto currency block, thus inducing still other economies to tie themselves to the DM as well through a snowball effect (Andrews, 2001). Tying currencies closely together in such an asymmetric system (the ERM sanctioned deviations from the German inflation rate) required the swift adoption of the monetary stance of the country at the center as a monetary anchor, and this was provided by Germany’s Bundesbank (Calmfors, 1998a; Soskice,

2000). As a result, German inflation became the target rate for all of these economies.

The implication was that these economies either forced a reconfiguration of their wage-setting systems to accommodate low inflation (as in the Netherlands, Belgium, and Austria in the 1980s) or accepted large social costs in terms of unemployment (as in France in the 1980s). Yet whatever the actual political-institutional path followed by these economies, they led to the same substantive outcome, as inflation fell rapidly to the German level by the early 1990s. The Treaty of the EU, concluded in Maastricht in 1991, generalized this broad disinflationary macro-economic regime to the other economies of Europe. In practical macro-economic policy terms, the Maastricht convergence criteria concentrated on two issues: disinflation (which allows exchange rates against the German mark to stabilize and domestic interest rates to converge) and deficit reduction (which leads to sustainable debt).

This short stylized account of the emergence of the DM block and the translation of its main elements into the convergence criteria of the Maastricht Treaty offers a core hypothesis regarding our first question: Why do some countries take recourse to headline social pacts for macro-economic management in the 1990s, whereas others do not? Our hypothesis for explaining this basic variation is that we do not expect headline social pacts to emerge in countries that had already reconfigured their domestic institutions to produce low inflation[3] and had low public deficits and debts (no more than 3% and 60% of GDP, respectively). Empirically, this means that we should expect to find the following results: Headline social pacts do not emerge in the group of countries that belonged to the DM block in the 1980s (i.e., Germany, the Netherlands, Belgium, France, Austria, Denmark, Ireland, and Finland). In the others, those outside the core DM block and with inflation rates considerably above the German rate (i.e., Italy, Spain, Portugal and Greece), we would expect to find such explicit headline social pacts. With regard to public debt and deficits, the argument runs parallel to that on inflation: In countries with debt or deficit positions close to (or fulfilling) the Maastricht criteria, headline social pacts are absent, whereas, in the high debt or deficit countries, we expect to find them.

INFLATION, WAGES, AND SOCIAL PACTS

The labor market and wage-setting arrangements in prospective EMU Member States fall into three broad types, depending on (a) the nature of the external pressures on the economies of Europe and (b) the type of labor market microfoundations in existence in the early 1990s. A first large group of countries faced no immediate inflation-related pressures by 1991, as a result

TABLE 1: Labor Market Microfoundations

High Microfoundations	*Low Microfoundations*
Austria	France
Germany	Spain
Belgium	Portugal
Netherlands	Greece
Denmark	
Finland	
Italy	
Ireland	

NOTE: See the appendix for details.

of their earlier adoption of the German mark as their anchor currency. In these countries, both wage-bargaining systems and the microlevel labor market institutions had been reconfigured in the 1980s and, therefore, either continued a strict (and relatively narrow) set of incomes policies (negotiated or state led as in France) or on-going "soft" talks that resulted in broad bargaining arrangements within the frameworks of neocorporatist embedded pacts.

The second group of countries was facing inflation rates well above the Maastricht Treaty target rate. The capacity of these countries to build headline social pacts that cut across different social and labor market policy areas to bring down inflation (and deficits), however, was in part a function of the microlevel organization of the labor market (operationalized here as the combination of primarily industry-based training and skills systems and interfirm coordination of wage bargaining; Table 1 offers the broad distribution and the appendix offers the details). In one group, weak microfoundations existed, which could be reorganized to support, from the bottom up, the move toward central coordination of wage bargaining.

These countries tended toward trying or adopting headline social pacts; Italy is an example of this in our sample. In the other group of countries, which faced high inflation but were unable to rely on or build strong labor market microfoundations, explicit headline pacts were impossible to construct, and, instead, some form of consultation and negotiation took place in parallel but disconnected areas, a configuration that we label "shadow pacts," as they led to falling inflation as well, but without explicit central bargaining. Spain fits this category in our sample. Table 2 presents these data.

The combination of strong external pressures and the ability to build on microfoundations appear as very strong predictors for the type of central-level labor market arrangement that ultimately prevails in a country: Where inflationary pressures were absent or weak, not much changed in the governance of the labor market, because the institutions governing the labor

TABLE 2: Inflation and Social Pacts in the 1990s

High Inflation Countries (above 5% in 1992)		
Potential Microfoundations	*No Microfoundations*	*Low Inflation Countries*
Italy (1993 headline pact)	Portugal (1996 and 1997 headline pacts) Spain (shadow pact) Greece (no pact)	Austria (incomes policies) Belgium (incomes policies) Denmark (embedded pact) Germany (incomes policies) France (incomes policies) the Netherlands (embedded pact) Finland (social pacts) Sweden (embedded pact) Ireland (social pacts)

market had already internalized the inflation constraints. In contrast, where the pressures were powerful, the capacity to build new institutional arrangements was strongly conditioned by the existence of microlevel institutions that supported attempts at building new central arrangements. Put differently, the pattern of embedded consensus in traditional negotiating economies, or wage moderation via state-sanctioned bargaining extensions as in France, contrasts strongly with developments in the other prospective EMU Member States, those with high inflation and high deficits and debts, such as Italy and Portugal. In these countries headline social pacts (i.e., explicit national agreements that depart significantly from the labor market governance norm) emerged with an important incomes policy component aiming at disinflation. It is worth exploring in some detail how and under what conditions these departures in labor market governance occurred.

In Italy, 1992 proved to be a watershed year of twin crises, in the economy and government. The country's signature of the European Treaty in February 1992 was followed by a crisis of the EMS and Italy's exit from the exchange rate mechanism amid a massive speculative attack against the lira. Meanwhile, the major corruption investigations of the early 1990s triggered the electoral collapse of the traditional parties and brought technical governments, led first by Giuliano Amato and then by Carlo Ciampi, to power. An enormous task lay ahead in beating the economy into shape for EMU entry. It was this climate of national emergency that produced in short order a concerted reform of wage indexation in 1992, the introduction of an incomes policy (pegging wage rises to the expected inflation rate) in 1993, and a subsequent tripartite reconstruction of the collective bargaining system. In 1995, another technocratic government (led by Lamberto Dini) concluded a major

pensions reform with the unions (the employers abstained). This period of emergency pact also extended to the transformation of public sector industrial relations and health system reform and, thereafter, gave way to a phase of institutionalized political exchange, including the 1996 to 1997 reform of the social security system, a special tripartite agreement on job creation (the pact for employment) in September 1996 and the signature of a "constitution for concertation," in the so-called "Christmas Agreement" of December 1998 (Ferrera & Gualmini, 2004; Regini & Regalia, 1997).

In Portugal, as in Italy, it was a commitment to join EMU made in the early 1990s that produced a determined anti-inflation or debt consolidation strategy. The Portuguese pact took the form of a long series of successive tripartite agreements spanning the decade from 1987 to 1997. These were presented from the outset, but especially from 1988 to 1990, when discussions concluded in the major Economic and Social Agreement, as critical for the competitiveness of the Portuguese economy and integration into EMU. Also, as in Italy, the agreements were very wide ranging, covering pay-rise ceilings, levels of minimum wages, regulations on work organization and working hours and on hiring and firing rules, and were broadened after 1992 to cover social security and health reform. The 1996 and 1997 agreements covered an especially wide range of policy areas, including a complex new incomes policy system (linking wage rises to inflation and productivity forecasts), a broad program of working time reduction, and the introduction of a minimum income guarantee (Campos Lima & Naumann, 2000; Rhodes, 1998).

Both the Italian and Portuguese pacts, then, took the form of an augmented concertation, linking incomes policy and collective bargaining reform with broader innovations in the labor market and social security systems, amounting to an extensive remodeling of their respective political economies. Governments took the opportunity of EMU membership constraints to strike deals across adjacent policy arenas and bolster their legitimacy by making employers and unions their close accomplices in reform. As we discuss below, the special character of these pacts, which separates them from the other countries joining EMU, was because of the need simultaneously to tackle the twin imperatives of high inflation and high deficit or debt reduction and was made possible through the existence of microlevel labor market institutions that could be reorganized to allow companies and workers to upgrade skills and product market strategies (as in Italy) or a less well-organized industrial relations system that could be underpinned by state intervention and extension agreements to increase wage-bargaining coverage (in Portugal).

There are, however, a few important deviant cases that warrant closer attention. In Finland, for example, we find a social pact despite low inflation;

in Spain, attempts at a formal incomes policy do not lead to one, despite relatively high inflation, and no pact is achieved in Greece, regardless of its high inflation rate (and, partly as a result, it failed to meet the Maastricht criteria and entered EMU only in January 2001). The explanation for the pact in Finland is that the construction of its central social pact was driven by two preoccupations particular to that country. First, the business cycle of Finland was quite different from the rest of the EU because of its dependence on wood processing, which provoked considerable concern as to the effects of asymmetric cyclical economic fluctuations under EMU. The result was the November 1997 agreement between the social partners on "EMU buffer funds," that is, the payment of higher employer and employee social security contributions in good times to cover higher social security costs in bad. Second, as we will see below, Finland's public deficit had increased rather sharply in the early to mid-1990s as a result of the deep crisis that the country faced after the collapse of the Russian market. The existence of a social pact (including the buffer funds innovation) was also related to that turbulence (Kaupinnen, 2000).

As for Spain, the Socialist Partido Socialista Obrero Español Government in the early 1990s failed to achieve a global, tripartite pact, because of a combination of a highly fragmented bargaining system and union opposition to any tripartite agreement combining an incomes policy with welfare and labor market reform. Thereafter, the arrival of the conservative Popular Party in power led to the creation of a de facto pact with separate tables for welfare reform (unions and government) and labor reform (unions and employers). An informal wages policy was coordinated by the unions themselves to prevent a return to the state-governed industrial relations system of the 1980s (Pérez, 2000a, 2000b). The net result was that reform was undertaken across adjacent policy areas in the absence of an explicit, formal, and all-encompassing pact, ensuring that wage moderation and low inflation were nonetheless achieved, even at a time of strong economic growth. Instead of a headline pact, Spain thus adopted a shadow pact.

In Greece, on the other hand, and regardless of high inflation and an attempted "Pact of Confidence" in November 1997, neither a central pact nor policy-specific agreements could be achieved, because of highly fragmented and heavily politicized labor and employer organizations and a reluctance on all sides to engage in political exchange. Meeting EMU inflation targets by 2000 has occurred because of the ending of wage indexation in the 1980s, the use of projected inflation for biannual collective bargains in the 1990s, and the downward pressure of high manufacturing unemployment on wage claims (Ioannou, 2000). But an informal incomes policy also operates via government influence on public-sector wage contracts (from which private-

sector negotiators take their cue). As we argue below, a significant expansion of transfer payments throughout the 1990s can be seen as a quid pro quo for informal wage restraint in that period. Both in Greece and Spain, the attempts at building central-level pacts was undermined by the absence of microlevel labor market institutions that allowed all labor market parties to internalize (in the shape of productivity-oriented wage bargaining) the inflation constraints that EMU imposed.

The succession of pacts in Ireland in the 1990s is an equally interesting outlier, but for quite different reasons. The puzzle here is why a country that had already achieved low inflation by the early 1990s should continue to require incomes policy-based pacts throughout that decade. The essential answer is this: Although the first tripartite pact (exchanging wage moderation for tax reform) was negotiated in 1987, against a background of severe recession, high unemployment, and ballooning public sector deficits and debt (at 15% and 130% of GNP, respectively, that year), the pay agreements struck then and subsequently could not easily be embedded in the wage-setting system, for two reasons. First, the country's decentralized and fragmented labor market structure fails to provide such labor market microfoundations for disinflationary wage setting: tensions and conflicts regarding pay stem from sectoral diversity (a high-tech sector with strong upward pay pressures and high productivity alongside low-pay, low productivity traditional manufacturing), a large public sector devoted to traditional relativities (and largely immune to market disciplines or productivity-based assessment), and difficulties arising from growing income dispersion. Second, these problems have been compounded by the profound structural transformation of the economy since 1987 and by annual GDP growth in the second half of the 1990s at around 8.5%, almost four times the EU-15 average (Hardiman, 2000; Teague, 1995). As a result, national wage pacts have been concluded for a limited time, reflecting to some extent a latent distrust among labor market parties, regardless of the prevailing image of national consensus, and have to be renewed every few years. Indeed, in the sixth successive national partnership agreement, "Sustaining Progress," signed in 2003, the pay component was restricted to 18 months for the first time instead of the standard 3-year period. Paradoxically, therefore, it may be this constant need to revisit the national pay deal, rather than the arrival of a new era of Irish-style neocorporatism, underpinned by mutual trust between the government, employers, and trade unions that has sustained the "pacting" process and allowed its extension to other issues, including labor market and industrial relations reform, social policy, and public finances.

In sum, the argument that can be constructed from these data closely follows our initial hypotheses. Incomes policies and embedded pacts containing

incomes policy accords emerge in those countries with 1990s inflation rates that are roughly at the German inflation rate. In the others, headline pacts appear where the labor market is built around a set of microinstitutions that can be reassembled to support the central-level process, and fragmented shadow pacts appear in countries where no systematic linking of different welfare and labor market issues is possible, in large measure because the necessary microlevel counterpart is absent and cannot be constructed. Finally, in Ireland, where central wage guidelines have been in existence since 1987, the decentralized and fragmented nature of the labor market implies that sustaining social pacts is an increasingly cumbersome process. In the next section, we broaden our analysis to include the second of the core Maastricht norms concerning debts and budget deficits.

FISCAL CONSOLIDATION AND SOCIAL PACTS

As we pointed out earlier, the Maastricht convergence criteria can best be understood as consisting of two primary targets: low inflation (which allows for exchange rate stabilization and a convergence of interest rates around the German target) and low public debts and deficits. The two targets are, however, not symmetric in their implementation, because one important hard institutional constraint that existed in the disinflation scenario is not present in the case of debt and deficit control. Although central banks can independently impose nonaccommodating policies to curb inflation, they have very little direct power over debt and deficit targets. Because the institutional constraints are weaker, we can plausibly expect the correlation to be weaker as well.

Why does debt and deficit reduction matter at all? The standard answer in economics is related to the pooling of risks in a monetary union: the limiting case is one in which one member state defaults on government debt and all the others (or the central bank) are forced to bail it out, thus weakening the currency. A less dramatic scenario is one in which excessive debt in one Member States leads to a rise in the interest rate for all (either directly through "crowding out" or indirectly through a shift in the portfolio composition of investors, which has a price in the guise of a rising interest rate). Hence, in the run-up to EMU, the Maastricht Treaty imposed a 'sound finance' policy for prospective members, which included debt levels below 60% of GDP and an annual deficit level of 3% of GDP (at these levels, accumulated debt remains sustainable). Prior to the Maastricht Treaty, governments cared relatively little about their debt levels; states cannot go bankrupt in the same way as companies can if they fail to repay a loan. But the fear of a weak currency, which was shared between Germany, France, and a few of the smaller Member

States, led to the adoption of the debt and deficit criteria as a disciplining device for countries that ran high deficits. Because economic growth was relatively high and robust in the years of the negotiations of the Maastricht Treaty, very few doubts were raised about the sustainability of the debt or deficit criterion, and a large number of countries—Austria, Belgium, Finland, Ireland, Luxembourg, the Netherlands, and Spain—adopted strict deficit rules to signal to financial markets that deficit reduction had become a primary government objective.

The recession of 1992 to 1993 that hit Europe changed this political-economic calculus, and the hard criteria negotiated in Maastricht suddenly created problems for almost all prospective Member States. Rather than simply being able to stabilize debts and reduce deficits as a result of high growth, Member States needed actively to devise fiscal strategies that lowered government borrowing. By and large, two main strategies can be adopted: increasing government revenue through higher taxes, reducing expenditure through budget cuts, or a mix of the two. Precisely because both tax-based and expenditure-based strategies can have important social and political costs, governments generally tread carefully when consolidating budgets and may seek a broad consensus among relevant social actors (Rhodes, 2002, pp. 311-322).

The data presented in Table 3 broadly confirm this hypothesis on the relation between debts and deficits on one hand and the type of macro-level arrangements on the other hand. Out of the 12 countries that eventually signed up for EMU, 7 followed the pattern we predicted. Italy and Portugal had high deficits and concluded pacts. Germany, France, the Netherlands, Sweden, and the United Kingdom, all with low deficits, did not conclude special pacts on public finances in the wake of the Maastricht Treaty. However, as we predicted above, the correlation is weaker than in the case of inflation control. In several cases, in fact, the relation does not hold: Finland (low deficit or debt, and pact); Belgium, Greece, and Spain (high deficits or debts, but no pacts); and Ireland (low debt but pact). Nevertheless, on closer examination, Finland, Spain, and Ireland turn out to be confirmatory cases.

As already discussed above, Italy and Portugal, the two headline pact countries, responded to the twin imperatives of inflation and deficit debt reduction by engaging in broad, encompassing tripartite agreements that bridged a series of adjacent policy arenas. Although Italy still had a public debt of 118% of GDP in 1999, it had reduced its deficit from 11% to 2.3% of GDP since 1990 and had produced steadily growing primary surpluses from 1992[4]. Its social pact made an important contribution to those outcomes through the reorganization of the fragmented public sector pay system after 1993 and a series of major modification of the pensions system between 1993

TABLE 3: Budget Adjustment and Social Pacts

High Deficit Countries (Deficit/GDP > 3% in 1991)		
Potential or Existing Microfoundations	*No Microfoundations*	*Low Deficit Countries (Deficit/GDP < 3% in 1991)*
Belgium (no pact-incomes policies)	Spain (shadow pact)	Austria (savings packages—no pact)
Italy (1993 pact)	Greece (no pact)	Germany (incomes policies—no pact
	Portugal (1996 pact)	Finland (pacts 1995 and 1998 to 1999)
		France (no pact-incomes policies)
		the Netherlands (quasi-pact)
		Ireland (social pacts)
		Sweden (quasi-pact)

and 1997, including the encompassing Dini reform of 1995. Portugal was running primary surpluses already in the late 1990s and managed to retain them, while also reducing the deficit and debt (from 6.0 to 1.8, and 67% to 56% of GDP, respectively) between 1991 and 1998. Its social pact assisted in a reform of public sector wage setting, a revision of the pensions system, a reform of the health sector that significantly reduced its pressure on the government accounts, and an extension of income maintenance across the country, contributing to a strong fiscal expansion, especially in transfer payments, in the latter part of the decade.

In Finland, as mentioned above, the special circumstances of the crisis in the early 1990s linked to the breakdown of trade with the former Soviet Union spurred important revisions to public spending (these focused on high social transfers and generous pensions) when debt rose from 41% to 58% of GDP between 1992 and 1995 and the deficit increased to around 6%. Public debt fell back to 45% of GDP by 1999 (alongside a budgetary surplus of 3%) as a result of expenditure-based consolidation. The social pacts of the 1990s created an important facilitating framework for this process of adjustment.

The logic in the “high debt, no pact” countries is different. In Belgium, despite the scale of the problem load (a deficit of 7% and debt of 130% of GDP in 1992), a combination of strong unions, weak employers, linguistic conflict, and a cumbersome federal system, with multiple ministers competing for attention and resources at various levels, meant that the policies pursued via consensus in the Netherlands and Ireland had to be imposed on the Belgians. This was achieved via “crisis contributions” on top of various

personal and corporate taxes, ceilings on health spending, and a unilateral reform of wages and social benefits indexation—all helping to reduce public debt to a still high 114% of GDP by 1999. However, because debt in Belgium had been falling since the late 1980s as a result of large and growing primary surpluses (which increased from 2.0% to 6.7% of GDP between 1991 and 1999), the actual pressure emanating from high deficits was significantly lower than the figures suggest at first glance.

Greece's budget consolidation strategy reveals what we might call an implicit quid pro quo linking a gradual and informal moderation of wages in the 1990s with a marked expansion of government transfer payments and public-sector salaries, which, assisted by a drachma devaluation in 1998, gave a significant boost to economic growth. Between 1993 and 1998, subsidies and pensions were increased markedly in the agricultural sector, pensions to mothers and benefits to families were upgraded, and minimum and other unemployment benefits were raised substantially. Public-sector hiring continued to grow, and civil servants' incomes grew well ahead of inflation. Meanwhile, the public debt expanded from 65 to more than 100% of GDP. Nevertheless, because of a "'virtuous circle' of high primary surplus, lower interest rates and payments and falling debt levels" (the deficit fell from 14.4% to 1.6% of GDP during the decade, whereas a primary deficit of 7.8% of GDP in 1989 was turned into a surplus of 7.3% by 1999; Von Hagen, Hallet, & Strauch, 2001, p. 99), Greece still managed to qualify for EMU entry by January 2001.[5]

Spain, in contrast, as already discussed above, did manage to conclude a series of shadow pacts that did not include a formal incomes policy, but dealt with other reforms (of welfare systems and labor markets) at separate tables. Although these talks may be considerably less binding than incomes policies—based social pacts, they perform in essence the same function by allowing labor market parties to reorganize the welfare system and thus lower expenditure, confirming our conclusion below that Spain falls into the "social pact camp." A deficit of 6.6% and debt of 63.4% of GDP in 1993 had forced a substantial revision of the government's convergence plans in 1994 and a shift to an expenditure-based consolidation program. Especially critical was union support for a revision of wages and pensions' indexation, public-sector wage moderation, and a freeze on public-sector employment and payments from 1995 to 1998, measures backed up by the recommendations of the Toledo pact, signed by all major political parties in 1995. Spain produced its first primary surplus in 1999.

Ireland, once again, presents a puzzle as a low-deficit country with a social pact focused closely on budgetary reform. But it is important to note that in the early 1990s, Ireland was still a high-debt country, a legacy of the 1980s

when deficits of 10% and debts higher than GDP were the norm. Despite a relatively low deficit of 2.8% and a primary surplus of just less than 2% in 1990, public debt still stood at 93% of GDP. Ten years later, that debt load had fallen to 43%, alongside a remarkable budget surplus of 3.4%. The multiannual agreements between governments and unions and employers contributed significantly to this process of consolidation, while also encouraging an improvement in competitiveness and a relatively equitable distribution of extensive tax and social security reforms. Although the wage moderation discussed below produced a significant reduction in wage compensation in the public sector (falling from 10.4% to 8.7% of GDP between 1990 and 1999), agreements on social policy reform allowed a reduction of transfers and subsidies from 17.0% to 14.5% of GDP during the same period.

The general conclusion that follows from the two previous sections on disinflation and fiscal consolidation is relatively straightforward. There are strong links between the criteria laid down in the Maastricht Treaty and the emergence of different types of institutions for labor market governance. In countries where inflation rates in the early 1990s were close to the Maastricht inflation criteria, there was no need for social pacts, and none came into existence. Instead, these countries relied on existing incomes policies and ongoing consultation and negotiation rounds to control inflation. In prospective EMU members with an inflation rate above the Maastricht criteria, governments did try to engage social partners in broad social pacts that included other elements of labor market and welfare reform to bring inflation rapidly into line with the Maastricht limits. But the success of this move was limited to those countries where the preexisting microlevel organization of the labor market supported disinflationary wage policies. Similarly, when government deficits were close to the Maastricht norm (not higher than 3% of GDP), social pacts were unnecessary; when deficits were higher than that, social pacts were used as means for fiscal consolidation. Moreover, where governments faced both constraints simultaneously, as in the cases of Italy, Portugal, and Spain, social pacts, either headline pacts or shadow pacts, were critical for facilitating complex package deals that permitted problematic and contested reforms to proceed.

SOCIAL PACTS AFTER EMU

The second step in our argument involves three key points: (a) that after the introduction of the euro in 1999, broad encompassing social pacts rapidly disappeared; (b) in large part because the core Maastricht criteria (wage inflation and deficits) have become embedded in a set of framework rules

(often in a somewhat depoliticized manner, and often managed by experts, both at national and international level, as in the Stability and Growth Pact [SGP]); and (c) that tripartite or bipartite bargaining now relates primarily to those policy areas that have not been transferred to rules-based systems. In the following, we address this final set of issues.

The introduction of the euro in 1999 heralded a profound shift in the macro-economic regime of Europe, especially among those countries that joined EMU. As we saw earlier, throughout the 1990s, wages were increasingly set through some form of central co-ordination. In addition, wage setters in the prospective EMU Member States increasingly shadowed German wage settlements, as this secured convergent wage inflation. The fiscal policy regime changed as well: the Amsterdam Treaty of 1997 included the SGP, which made the Maastricht deficit criteria a semiconstitutional part of EMU. According to the SGP, countries faced hard sanctions if their year-on-year nominal deficits rose above 3%.

Both of these institutional mechanisms persisted after the establishment of EMU, but their effects differed once the euro was in place. In large measure, this was related to the changing incentive structures for national political economies under the single currency. In contrast to the ERM-Maastricht setup, the hard sanctions for above-average inflation rates—nonentry into EMU—have disappeared entirely, and countries with higher inflation rates are, in the short run,[6] rewarded under EMU, because they imply extremely low or even negative real interest rates. In addition, with the large economies in EMU (Germany, France, Italy) running deficits above 3% of GDP, the SGP increasingly turns out to be a paper tiger, which implies that the hard sanctions for deficits above the SGP norm have disappeared as well.

Against this background of shifting macro-economic policy constraints, the role of the labor market arrangements that were crucial for securing EMU entry has also changed profoundly. As we saw earlier, German wages have been set for at least 15 years prior to the introduction of the euro as a function of labor productivity, and this has remained the case throughout the 1990s. In the other countries, rules on wage setting have appeared, which are combined with some form of centrally coordinated, competitiveness-oriented wage setting. Fiscal policy similarly often takes on the form of domestically negotiated rules to comply with the spirit, if not the letter, of the SGP. But either because of institutional inertia, or to its utility for achieving political consensus, the architecture of social pacts persists in certain countries as a forum for punctual ad hoc negotiations on particular issues.

This narrative suggests two testable hypotheses. The first is that because the core elements of the social pacts of the 1990s (i.e. those that deal with disinflation and debt or deficit control) have been internalized in wage-setting

rules and deficit rules, the need and incentives for encompassing headline pacts have diminished accordingly. The second is that for other elements in the domestic policy arena that require some form of co-ordination across governments and social partners, the architecture of pacts may still be employed, but in ad hoc and in a typically devolved fashion. Where once the imperative was to resolve problems simultaneously across adjacent and functionally connected policy areas in response to incomes policy and budgetary challenges, the concern on the part of all parties today is to avoid the stress imposed by the multiple commitments that were always implicit in such deals, but which are increasingly unnecessary and perhaps even unattractive in a post-EMU world (Rhodes, 2003).

Regarding our first hypothesis, by the start of EMU, wage setting appeared to have become structurally disinflationary in all EMU Member States. Although the threat of being excluded from EMU offered strong incentives for low inflation to governments and social partners, in many countries, the mechanisms underlying this process of disinflation lived on after entry into EMU and became endogenous to the "normal" operation of the labor market (Hancké & Soskice, 2003). In countries where labor markets were reorganized to meet competition requirements that relied on higher workforce skills, wages increasingly were and are set by a small group of national experts (inside and outside the trade unions), who adopt a more or less binding wage norm that is built on export competitiveness and that forms the target for wage settlements in all sectors across the economy (Herrmann, in press).

The actual arrangements can take different forms. In a few EMU Member States, the preparation of wage setting has been transferred to a small group of outside experts, who base their advice on wage developments on a variety of indicators, usually involving some measure of wage growth in trading partners, domestic competitiveness, and prospective inflation. In Belgium, a small expert group in the Central Economic Council sets a wage norm that is binding for all negotiations. The wage floor is given by a combination of the past and expected inflation rate, whereas the wage ceiling is given by the wage level consistent with stable or improving competitiveness. In Italy, a small group of top union and employer experts determine, in co-operation with central bank officials, the past and expected inflation rate (based on the government's official rate, which, since 1999, also takes account of the European average rate) and set a central wage norm. In Finland, since 1995, social partner and government experts in an Incomes Policy Commission define the norm for wage increases as the sum of the inflation target and the average increase in the productivity of the economy. In Ireland, the 1987 social pact has also transferred the determination of wages to a small group of experts—

from the major union and employers' organizations and government—who set a pay norm in similar fashion in multiannual agreements. Portugal has followed suit in its 1990s pacts. As these cases suggest, wage norms can be more or less binding. In Belgium, for instance, the wage norm imposes a statutory limit; in Italy, it offers a focal point for negotiators, whereas, in Ireland, it provides basic pay terms, deviations from which are usually related to productivity improvements. In Portugal, which has one of the highest levels of wage flexibility in the Organisation for Economic Co-operation and Development, there is a significant firm-level, productivity-linked deviation from the collectively bargained interpretations of the central indicative guidelines (Cardoso & Portugal, 2004). However, even where the wage norm is not binding, it offers a strong authoritative framework because it is de facto used by governments, employers, and unions.

In a second group of countries, unions have kept control of the process, but have delegated responsibility to a small group of internal experts, who operate on a similar basis to their external counterparts in group one. In the German IG Metall—the wage leader for many decades—a small commission calculates an appropriate wage level (on the basis of past inflation and prospective labor productivity), which is then used by a pilot district as its regional benchmark, before being recommended to negotiators in other regions. In the Netherlands, a group of central union experts determines the appropriate level of wage growth (the sum of current labor productivity and the changes in producers' prices, though inflation, unemployment, and corporate profitability can also be considered) for contract negotiations at the start of each bargaining round. In Spain, where until recently there has been no formal, centralized incomes policy, in effect the major union confederations (UGT and CCOO) have agreed on guidelines in line with inflation and productivity, which they then transfer to their sectoral and territorial organizations[7]. France offers a functional equivalent without unions: Since 1983, when a de facto ceiling was imposed on wages (as part of the policy of competitive disinflation to keep the franc in the ERM), as elsewhere, wage norms compensate for past inflation while taking competitiveness into account. A small group of experts, from the Finance Ministry, the Plan, and the central bank, sends out strong appropriate wage-growth signals.

Something similar has happened in the area of fiscal policy (for details, see Von Hagen et al., 2001, and Hodson, 2004). By the start of EMU, government deficits had fallen dramatically in all prospective Member States from an average of 5.2% to 1.7%, and only Italy had a deficit that was marginally above the 3% Maastricht rule. However, in the years after the introduction of the euro in 1999, the average deficit rose again to 2.2%, and the EMU economies then divided into two distinct groups: one with fiscal positions close to

balance or in surplus and another with deficits that hover around the SGP's 3% deficit limit. The first group consists of Austria, Belgium, Finland, Ireland, Luxembourg, the Netherlands, and Spain; the second of Portugal, Germany, France, and Italy. In a move that paralleled developments in wage setting, fiscal policy in the first group has become increasingly rules based: these Member States installed systems of multiannual budget planning, national expenditure rules, and domestic stability pacts. Stability pacts have been especially important for countries where subnational governments control a significant proportion of public finances. Belgium, for example, passed a series of intergovernmental treaties between 1994 and 1999, which established permissible deficit levels for the federal government and the social security system, on one hand, and regions and local governments, on the other hand. In Spain, regions have to submit annual debt schedules to the government, and both parties then negotiate and agree to maximum deficits and debts allowed for each region (Von Hagen et al., 2001, pp. 52-55). The other countries, in the second group, failed to implement new rules-based fiscal systems, or if they did, as in the case of Italy, which introduced new rules-making subnational governments responsible for part of the central government deficit, achieved only limited results. When the EMU economy went into recession in 2001, the latter group's fiscal positions rapidly deteriorated, whereas those of the first group stabilized.

Regarding the second hypothesis (i.e., that the architecture of pacts is often now used in an ad hoc manner to cover those elements in domestic political economies that have not become the subject of a rules-based arrangement), the most telling points can be made by examining the fate of the most important headline pacts of the 1990s, those of Italy and Portugal, after they successfully achieved EMU entry.

Italy's pact's finest hour, the signature of the "social pact for development and employment" (or "Christmas pact") on December 22, 1998, was also apparently its last, at least in the form of a central, encompassing agreement. The aims were to confirm and reinforce the new collective bargaining system established in the national tripartite agreement of 1993 and create a constitution for concerted action, extending concertation to a range of new policy areas, including training and employment creation, and partners. But it was never implemented, not even under the center-left government that signed it during the 18 months before the return to power of Berlusconi's center-right coalition in May 2001. On incomes policy, employers and union organizations had long split over to the relative importance of sectoral and company-level agreements, whereas any intersectoral perspective had more or less disappeared, for reasons mentioned above. Meanwhile, the trade union unity of the previous decade (that had helped underpin central concertation) had

fractured over differing approaches to growth and local employment promotion. The core problem, however, appeared to be the "intrinsic inability of social dialogue to resolve issues other than incomes policy or economic recovery initiatives" (Pedersini, 2001). The employers actually proposed a relaunch of the social dialogue in 2001 to deal with pensions, labor market regulation, investment, and training, and, in July 2002, the government, employers, and unions signed the "Pact for Italy" (though the Confederazione Generale Italiana del Lavoro union abstained) that, among other innovations, made provision for social partner agreements that would then be taken into account in government legislation. The first of such agreements was that on "irregular work" signed in July 2002, followed by the launch in early 2003 of a bilateral dialogue at four "negotiating tables" on infrastructures and energy, research and innovation, and training and development in the Italian South. A pact for development was signed in June of that year. In reality, though, in the absence of any clear commitment by the state, which had clearly sought to deinstitutionalize concertation under Berlusconi, such pacts amount to little more than statements of intent or joint lobbying by unions and employers with no real influence on government policy making. As Ferrera and Gualmini (2004) remark, "entry into EMU seemed to be the last issue on which consensus was needed; after that, no shared goal appeared on the political stage" (pp. 146-147).

The demise of the Portuguese social pact occurred in the same period. The 1996 to 1999 tripartite economic and social agreement had already run into trouble in 1997 to 1998 when the Confederação Geral dos Trabalhadores Portugueses union (which had not signed the pact) launched a outright assault on it, and two important employers confederations (in commerce and agriculture) withdrew from the concertation process. Other organizations criticized the government for failing to legislate on most of its provisions, and, by 1999, as in Italy, relations had further deteriorated between the unions and employers and among the unions themselves. An attempt to renew concertation took place under government auspices in early 2000, but none of the partners was interested in launching a new, encompassing central pact. Instead (in a maneuver reminiscent of the Spanish construction of a fragmented shadow pact), they agreed to deal with employment, social security, and health and safety issues at separate "tables", whereas wage setting, reflecting employer preferences, would be left entirely to collective bargaining (Rhodes, 2003). This led to three tripartite agreements in 2001, on the labor market education and training, on working conditions and health and safety, and on pensions reform, creating a potential network of shared responsibilities for policy development. But a national agreement on productivity and pay (that was due for completion in late 2001) was shelved, and

talks on social security (including unemployment benefit) reform broke down in 2002 and 2003. In mid-2003, facing a worsening economic situation, as well as the possibility that Portugal would breach the SGP's 3% deficit limit, the government proposed a new social contract to revive the three table negotiations that began in 2000 and sought to reintroduce an incomes policy (in the form of biannual productivity-linked pay bargains) into the framework. But the incentive and opportunity structures were now quite different from a decade earlier. In particular, there is little incentive for employers to agree to a new national pay bargain, given the low wage floors now set by collective bargaining in Portugal and the high degree of freedom for firms to set their own rates of pay (Bover, García-Perea, & Portugal, 2000; cf., Royo, 2002).

Creating a new structure of wage setting on existing microfoundations was, as these case studies suggest, a strategy that was available to some of the countries that initiated social pacts but not to others. This might also help understand why some countries have to keep negotiating in social pacts (as in Ireland and Spain), at least if labor market parties are sufficiently strong internally and externally (i.e., where they have a power base independent of the state or employers and where they have sufficient internal authority to impose central deals on their membership). This, in turn, suggests three scenarios for the future of social pacts in EMU.

The first scenario is that once the emergency situation associated with meeting the Maastricht criteria passes, they fade away, and, in the meantime, wage-bargaining system reform in countries with strong labor market actors (both politically and in terms of representation and capacity for action) is transformed, turning microfoundations into a more complete and workable system, roughly along the lines of the countries that we associated with strong incomes policies (rather than broad pacts) or the embedded pacts. Note, however, that an important condition for this to work is a production system (which includes interfirm coordination of wages, training, etc.) that has large enough firms and is sufficiently organized for central coordination to take root. This, we would argue, is what has been happening in Italy during the last few years. The second scenario is slightly different. Here, the EMU-related pressures dissipate, and the rules that were implicitly adopted do not become embedded. Employers are too powerful and unions to weak in fragmented, small-firm-based production systems to make either a national pact or a real working form of wage coordination necessary. This seems to capture the dynamics in labor market governance in Portugal. In a third scenario, pacts continue to exist after EMU entry, because the centrally organized incomes policy cannot be embedded in a transformed industrial relations system that internalizes constraints, whereas high economic growth and

other inflationary pressures continue to demand wage moderation. This has been the case for Ireland during the last 5 years.

CONCLUSION

In this article, we have argued that the profound shifts in labor market institutions, and more generally in modes of economic governance, in Western Europe since the early 1990s are directly related to the constraints imposed by the decision of governments to join the European single currency. Incomes policies, often embedded in social pacts, significantly contributed to the ability of governments of the prospective EMU Member States to meet the dual core Maastricht criteria of low inflation and low government debt and deficits. In roughly half of the current EMU Member States, this process of adjustment of wage setting and other macro-level labor market institutions had already to a large extent taken place in the 1980s, when these countries joined the so-called Deutschmark block. In the other half, after the signing of the Maastricht Treaty, social pacts allowed these countries to meet these criteria as well.

Although these macro-economic constraints were important, because they produced the broad policy framework against which government policies were reorganized, microlevel elements supported this process of pacting in several countries. We argued that the existence of locally based protoinstitutional frameworks has allowed for the incomes policies component of the broad macro-political arrangements to become institutionalized as rules-based procedures before and beyond Maastricht and EMU, as in the Northwest European countries, but also in countries such as Italy and Portugal. This might therefore help understand the paradox that where incomes policies have not become embedded in a rules-based way, as in the Irish case and perhaps to some extent in Spain, where concerted wage setting between employers and unions has only emerged after EMU entry, there may be more chance of an ongoing political exchange linking wage moderation with more extensive reforms of adjacent policy areas.

The EMU has, therefore, been an important catalyst in the reorganization of the European labor market and its industrial relations institutions, both directly by imposing forms of wage co-ordination and indirectly by revealing inconsistent links between macro- and microlevels in West European political economies. But the moment of social pacts, at least in the form of grand encompassing bargains, as found in Italy and Portugal in the 1990s, would seem to have passed. For if the incentives for concerted incomes policy have weakened considerably, removing the essential “glue” that held these pacts

together, so too have those that brought governments and the social partners together for the purposes of budgetary consolidation, either because budgetary policy has likewise been recast within rules-based frameworks or because the "external constraint" of the SGP is proving to be weaker than that of the EMU convergence criteria. It is no coincidence, then, that attempts to revive pacting, either by the social partners as in Italy or by the government as in Portugal, should prove to be so difficult in the post-EMU period.

This is not to say, however, that concertation is dead. The problem-load facing reforming governments is still considerable across Europe, as demonstrated by pressures for pensions and labor-market reform in many countries. In the Bismarckian pay-as-you-go pension systems, unilateral rather than negotiated reforms are very difficult to achieve in most European countries (see Natali & Rhodes, 2004). Also, because monetary policy no longer stabilizes country-specific shocks, the incentives for what Calmfors (1998b) calls "precautionary" labor-market reform to reduce equilibrium unemployment may have increased for countries inside EMU. And as in pensions, reforming labor markets in most European countries is easier to achieve via consensus than by edict. Nevertheless, on the basis of our arguments above, we believe that striking deals across adjacent policy areas within national social pacts has become less, not more likely.

APPENDIX
THE OPERATIONALIZATION OF LABOR MARKET MICROFOUNDATIONS

How can we construct a plausible proxy variable for microfoundations in the labor market that supported central-level shifts in wage bargaining and the construction of social pacts? We identify two relevant dimensions: one is the nature of training and skills and the other some form of co-ordinated wage bargaining to avoid free riding and, therefore, lack of training (see Hall & Soskice, 2001, for the general point and Finegold & Soskice, 1988, for the specific version of that argument). The indicators used by Estevez-Abe, Iversen, and Soskice (2001) were used and added or updated for Greece, Spain, and Portugal.

Estevez-Abe et al. (2001) distinguish four types of vocational training: firm, industry, or occupational (FIO); industry or occupation (IO); firm or occupational (FO); occupational or general (OG). For the purposes of our argument, we treated those as forming a scale, whereby the first two, FIO and IO, are closer to our idea of strong microfoundations than the latter two. We therefore attributed FIO a score of 4, IO a score of 3, FO a score of 2, and OG a score 1. The wage coordination scores for 2000, in turn, are taken from Kenworthy's (2001) data set for his article on wage-setting measures (with added figures for Spain, Portugal, and Greece on the basis of Traxler, 2003) and range from 1 to 5 (with 5 being the highest).

In the third step, we simply added these two indices. As can be deduced from the table, countries cluster in two groups, strong and weak microfoundations (scores of 6, 7, and 8) and weak (scores below the mean of 4.5).

	Training and Skills	*Coordination*	*Proxy for Microfoundations*
Austria	4	4	8
Germany	4	4	8
Belgium	3	3	6
the Netherlands	3	4	7
Denmark	3	3	6
Finland	3	3	6
Italy	2	4	6
France	2	2	4
Ireland	1	5	6
Spain	1	2	3
Portugal	1	2	3
Greece	1	2	3

NOTES

1. The small number of cases that we discuss (12 countries within a few years, which divide into periods with structural breaks) means that statistical analysis is impossible. Hence, we rely as much as possible on structured comparisons.

2. The European Monetary System and Exchange Rate Mechanism was an attempt by the European economies to stabilize their mutual exchange rates after the collapse of the Bretton Woods System in 1971; the institutional mechanism was a pegged exchange-rate regime in which countries kept their currencies within narrow bands vis-à-vis a virtual common currency (the ECU, the predecessor of the euro).

3. Defined in the Maastricht Treaty as no more than 1.5% above the average of the three lowest inflation rates, and because the Germany inflation rate was almost always among these, it became de facto a target rate for the others.

4. These and subsequent figures on budget consolidation come from Von Hagen, Hallett, and Strauch (2001).

5. In September 2004, it transpired that the Greek government had systematically underrepresented its budget deficit.

6. Higher inflation is obviously harmful to an economy in the medium run, as it raises relative prices of domestically produced goods and thus reduces competitiveness and therefore growth. The argument in the text is about the short run, where low inflation can be used as a tool to stimulate the economy.

7. Since 2001, Spain appears to have moved closer to the first group, with the signature of annual interconfederal agreements between union and employer representatives establishing pay norms based on official inflation plus productivity, including wage revision clauses, in case inflation exceeds the official target.

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