Balancing protection and investment: structural reforms in five countries

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European Trade Union Institute (ETUI)

Brussels, 2016

Print: ETUI Printshop, Brussels

D/2016/10.574/32
ISBN: 978-2-87452-424-0 (print version)
ISBN: 978-2-87452-425-7 (electronic version)

The ETUI is financially supported by the European Union. The European Union is not responsible for any use made of the information contained in this publication.

Contents

Introduction

The present book is the result of the project 'Fiscal Austerity and Welfare Reforms' funded by the ETUI and carried out by the European Social Observatory (OSE). The book has two aims. First, it provides an interpretative grid for the analysis of structural reforms in the Member States of the European Union. Both domestic and supra-national factors are considered in the framework proposed below for looking at how EU Member States have fared in the crisis. Second, it assesses the reform trends in five EU countries in an attempt to shed light on possible common lines of action or, alternatively, differing structural reform paths followed in the recent economic, social and fiscal crisis. By structural reforms we mean policy measures that are expected to help improve economic growth prospects and the ability of economies to adjust to shocks. From the perspective of international organisations, structural reforms affect a number of policy areas: labour market policies, the public sector, research and development (R&D), education and training, and social protection.

As we shall show, the typical neoliberal approach to structural reforms, based on a desire to promote the liberalisation and deregulation of labour and product markets (see Alesina *et al.* 2011), has recently been joined by a more neutral perspective. According to the latter interpretation, structural reforms are part of a broad strategy to improve a country's economic growth potential and are not confined to a 'supply-side' perspective (Dølvik and Martin 2014). From an analytical point of view, structural reforms largely overlap with the policy areas that are at the core of the comparative analysis of countries' political economy. Many strands of the literature, from varieties of capitalism to welfare regime analysis, from the study of employment regimes to those focused on social models, address public policies that affect economic and social conditions. They do so in order to better understand the way contemporary economic and social systems work and evolve over time.

The book looks at five different policy areas: pensions, labour market, education, R&D and the public sector. This selection is consistent with the policies usually analysed by the EU and other international organisations.[1]

In what follows we look at the reforms adopted in five EU members – Finland, Germany, Ireland, Italy and the Czech Republic – in the shadow of the Great Recession. These five countries are representative of different welfare regimes, labour market regimes and varieties of capitalism.

The Czech Republic is an example of an 'embedded neoliberal market economy' (ENLME) and belongs to the 'fifth European welfare model'. Finland has a social-democratic welfare regime, with a Nordic labour market regime, and is a national coordinated market economy (NCME). Germany is representative of a conservative-corporatist welfare regime, a continental European labour market regime and sectoral-coordinated market economy (SCME). Ireland has a 'liberal' welfare regime (with an Anglo-Saxon labour market regime) and is a 'liberal market economy' (LME). Italy is representative of the Southern European welfare model (with a Southern-European labour market regime) and is a 'mixed market economy' (MME).

In line with the interpretative grid we present in Section 1, we think of reforms as the result of a number of factors. The magnitude of the crisis is a first factor: it tends to accelerate reforms. New measures have been adopted to deal with recession and to open up more opportunities for growth. But the crisis has not been the only factor. It has interacted with other factors: domestic politics, policy legacy and the EU constraints and opportunities that have largely shaped national policymakers' strategies.

Reforms are adopted by governments of different ideological orientations. Left-of-centre, right-of-centre and technocratic governments have promoted different sets of measures to restore growth and political confidence. Policy measures inherited from the past (the so-called 'policy legacy') are a further domestic variable to consider. On the other hand, external and supranational factors also contribute to shaping reforms.

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1. The decision to focus on these fields and not others is to some extent arbitrary. However, the list seems comprehensive enough to shed light on different areas that are assumed to be strategic for economic growth (see the EU through the European Semester documents) and is thus in line with the analytical aim of the book.

The selected country cases provide evidence of the EU's influence on reforms. Ireland is the country subject to the highest level of EU pressure (through the Memorandum of Understanding, MoU), having been severely hit by the crisis. Italy has seen huge external constraints in a period of dramatic economic recession: by means of the European Semester, the reformed Stability and Growth Pact and more de facto conditionality exerted by the ECB (through the Securities Markets Programme) and other EU institutions. In turn, the Czech Republic has been affected by EU governance in a 'softer' way – through the European Semester and other forms of economic and social coordination – because it is not a member of the euro zone.

The book is structured as follows. Section 1 summarises the interpretative approach we propose to use in order to analyse structural reforms adopted in the countries under scrutiny. Section 2 focuses on each 'determinant' of the reforms, while providing a typology of structural reforms. Section 3 provides evidence of the structural reforms adopted in the wake of the crisis. Section 4 concludes.

1. The interpretative grid: the crisis, domestic factors and the EU's leverage

According to the most recent contributions in the literature (see Stamati and Baeten 2014; de la Porte and Natali 2014), we maintain that the structural reforms implemented in the shadow of the current economic and financial crises are influenced by two sets of factors: (i) domestic factors, namely the 'policy legacy' dating back to the original welfare capitalist model and domestic political dynamics; (ii) supranational factors, mainly the EU constraints on national reform processes (see Table 1).

As we shall see, the magnitude of the crisis is a first element to consider. The ways in which European countries have reacted to the crisis are shaped by domestic and supranational factors. The former consist of socio-economic institutions (for example, capitalist models, employ-

Table 1 **Structural reforms in the wake of the crisis**

	Domestic factors		Supra-national factors (EU leverage)	Structural reforms
Great Recession	Policy legacy	Variety of capitalism Welfare regime Labour market regime	Conditionality - MoU - SMP/OMT Economic coordination - European Semester - SGP - Euro Plus Pact EU regulation - MFF - ESF	Social standards devaluation Social protectionism Selective investment Social standards improvement
	Political dynamics	Political orientation of governments and political majorities		

Source: Authors' elaboration.

ment and welfare regimes) inherited from the past (policy legacy) and domestic politics. As far as socio-economic institutions are concerned, and as stressed by Schröder (2009), in Europe (and in the EU) we have a number of varieties of capitalism. Coordinated market economies (CME) are based on high-level institutional capacities for coordination (for example, in terms of wage setting and skills formation), consistent with export-led growth and high value-added production. This is often combined with generous welfare systems (high coverage and high-level benefits). Liberal market economies (LME), by contrast, are based on competitive industrial relations and formal contracting, and the operation of supply and demand in line with price signalling (Kang 2006). These traits are accompanied by typical 'liberal' welfare programmes (not very generous and even residual in some cases). By contrast, mixed market economies (MME) are characterised by more active macroeconomic policies to boost domestic demand and productivity, a low-skilled workforce in need of public investments and subsidised jobs. Embedded neoliberal market economies (ENLME) are typical of the Visegrad countries. They are based on a compromise between economic competitiveness and some form of social and industrial protection, with the former dominating the latter. It is precisely these institutions that shape the recent economic and social trends in EU members. It is the interaction between these sets of institutions that provides a much more effective analytical tool to trace and interpret recent reforms and to anticipate possible further developments (Hicks and Kenworthy 2003). Economic, social and labour market policies inherited from the past – and represented by the typologies mentioned above – are a key variable for interpreting reforms in the shadow of the crisis.

Domestic politics is a third factor to analyse. National policymakers have maintained some room to manoeuvre in the design and implementation of their national reform agenda. Here we will limit our analysis to the nature (left/right orientation) of governments and parliaments in the countries under scrutiny and the strategies they have pursued to develop and implement reforms. We also consider the role of technocrats who have been asked to steer reforms in many EU countries. EU constraints are the fourth, supranational potential driver of reforms. In line with Stamati and Baeten (2014), we use the 'EU influence effort' as a qualitative working concept that takes into account the content of country recommendations and other EU governance instruments. In the next section we focus on each of the variables of our analysis.

2. Key factors shaping the path taken by structural reforms

2.1 The Great Recession and the subsequent reform wave

As stressed by Starke *et al.* (2013: 32), an economic crisis is a sudden, often unexpected, deterioration of key macroeconomic indicators: GDP growth, inflation, public debt, poverty risks. Global crises are those experienced simultaneously by different countries on different continents.

The so-called Great Recession is precisely a serious and global disruptive event that has hit the political economy of many countries in Europe. The crisis began in mid-2007 with the drying up of liquidity in money markets, until it took a turn for the worse following the collapse of Lehman Brothers in 2008. This was followed by a broad economic recession that hit Europe in 2009. The third step was the Greek budgetary crisis and the consequent tensions in the EU. In its early stages, the crisis manifested itself as an acute liquidity shortage among financial institutions. The inter-bank market virtually closed and risk premiums on inter-bank loans soared. Banks faced a serious liquidity problem, as they experienced major difficulties in rolling over their short-term debt. In this phase, concerns over the solvency of financial institutions increased, especially when a major investment bank defaulted in September 2008. Confidence collapsed, taking down major US and EU financial institutions.

The crisis thus began to feed on itself, with banks forced to restrain credit, economic activity plummeting, loan books deteriorating, banks cutting down credit further, and so on. The EU economy entered the steepest downturn since the 1930s. The transmission of financial distress to the real economy evolved at record speed, with credit restraint and sagging confidence.

The drop in financial wealth, across-the-board deleveraging, credit rationing and the rise in the prices of capital and debt, as well as the drop

in demand worldwide, came together to make a severe recession. Negative growth was particularly severe in the United States, but Europe was hard hit, too. Economic activity was affected by the crisis, as was potential output (the level of output consistent with full utilisation of the available production factors labour, capital and technology).

Labour markets in the EU started to weaken considerably in the second half of 2008, deteriorating further in the course of 2009. The EU unemployment rate rose by more than 2 percentage points. The condition of the European economy in this crisis corresponds almost exactly to the textbook case for a budgetary stimulus. In the aftermath of the crisis, short-term fiscal expansion was perceived as necessary to deal with the downturn (Natali 2010).

The decline in potential growth due to the crisis has put further pressure on public finances and contingent liabilities related to financial rescues and interventions in other areas add further risks. Part of the improvement in fiscal positions in recent years was associated, among other things, with growth of tax-rich activity in the housing and construction markets. The unwinding of these windfalls in the wake of the crisis, along with the fiscal stimulus adopted by EU governments as part of the EU strategy for coordinated action, has weighed heavily on the fiscal challenges even before the budgetary cost of demographic ageing kicks in.

The resulting surge in budget deficits has been unprecedented in the EU. As a result of automatic stabilisers and discretionary measures to save the banking sector and stimulate economic growth, EU countries have suffered increased budgetary tensions. This fiscal stimulus amounted to up to 2 per cent of GDP, on average, in the EU for the period 2009–2010. Since 2010, analysts have seen a return to a much more familiar scenario: the banks have gone back to business as usual, governments have unveiled budgetary restraint measures or 'austerity' programmes, while unemployment has risen. In 2009–2010 massive amounts of private banking debt were transferred to states, which felt compelled to keep their financial industries, and the economy in general, at arm's length. The sub-prime crisis became a sovereign debt crisis (Degryse and Natali 2011).

In the following years, austerity has continued to be put forward as the key to overcoming the crisis, despite evidence of ongoing economic diffi-

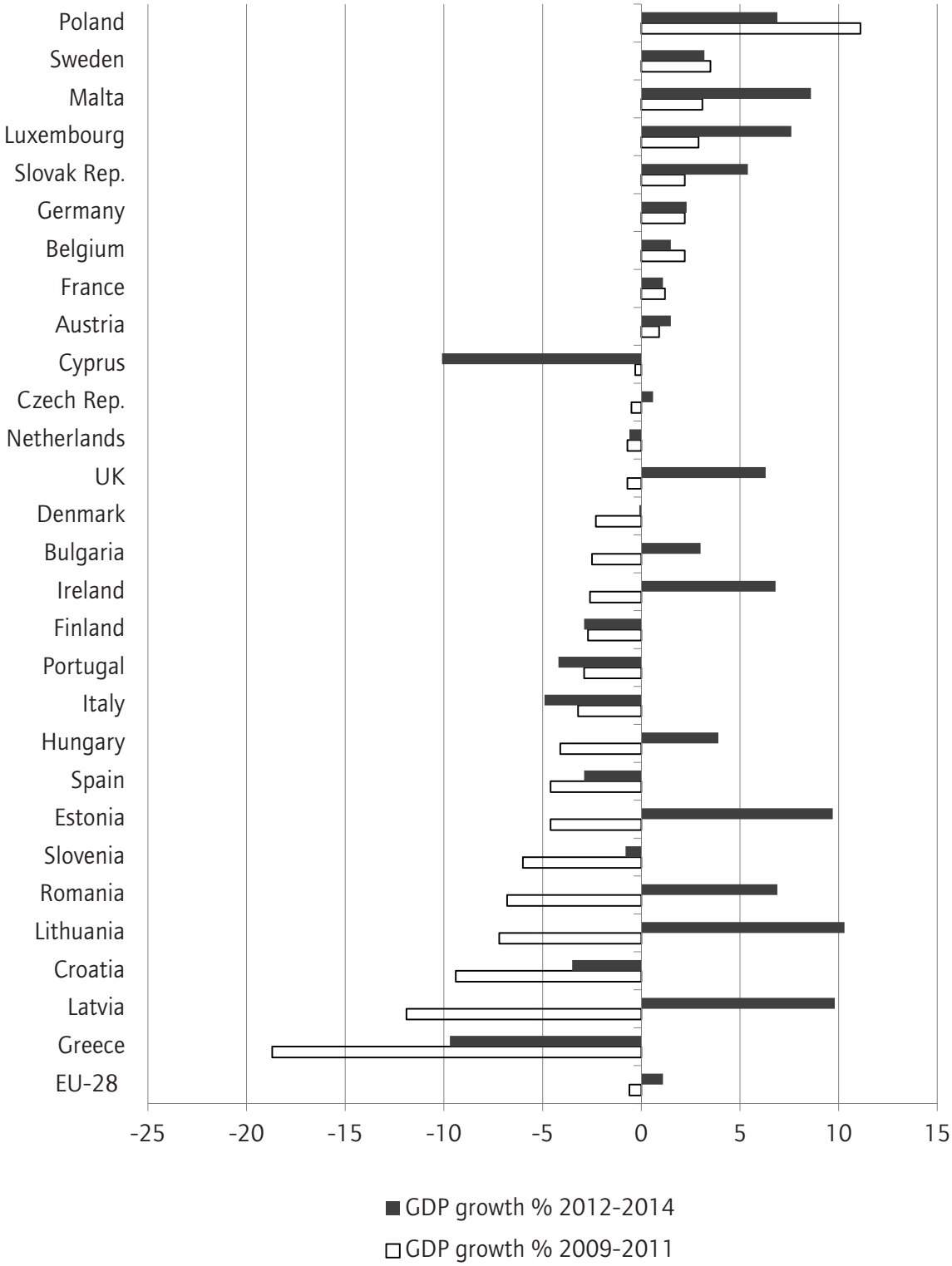
culties in a large number of Member States. Southern Europe in particular is still trapped in a 'double dip' economic recession. A vicious circle of austerity plans, budgetary tensions and political and social dissatisfaction has characterised recent months. In Continental and Northern Europe the economic cycle seems more reassuring. Summing up, some years after the start of the crisis, Europe is the only major world region in which unemployment is not decreasing. Long-term and structural unemployment have continued to grow in most Member States. Poverty and social exclusion are on the rise in one-third of EU Member States. This is most visible in the increase in the numbers of people living in jobless households and those suffering severe material deprivation. Young people have been most seriously affected: they increasingly face considerable problems in making the transition from education into employment, and many of those in work often hold unstable jobs with unfavourable conditions (Natali and Vanhercke 2012).

During the crisis, the labour market performance in the EU was, on average, worse than that in other developed countries. Employment rates in the EU between 2008 and 2013 were lower than the OECD average, while unemployment rates were higher. In 2013, unemployment reached a peak of 27 million (about 11.5 per cent). These negative labour market trends were accompanied by negative GDP growth in both the EU and the euro area in 2011 and 2012. Income and wage inequalities have further increased in the period.

One of the key features of the crisis in Europe has been the increasingly divergent trends in the socio-economic performance of different countries. Since 2008, most employment and social indicators have pointed to growing divergence between the Southern and peripheral European Member States and those of Northern and Central Europe. Data on GDP trends prove that the crisis hit different EU Member States with different degrees of magnitude (Figure 1).

The average unemployment rate reached 17 per cent in the south and periphery of the euro area, as against 7 per cent in the northern part of the continent. The gap has now reached its maximum level in the euro zone (about 10 per cent), around 10 times the difference between the same regions outside the euro zone. Thus, the financial crisis that erupted in 2008 has contributed to a huge divergence between the different European regions (Natali and Vanhercke 2013).

Figure 1 **GDP trends between 2009 and 2014**



Source: Eurostat.

2.2 Domestic factors: policy legacy and political dynamics

The crisis is understood here as an accelerator of reforms of economic and social policies at country level. But the economic shock did not determine the reforms. The latter are the result of a complex interaction of both domestic and supranational factors. By domestic factors we mean both (policy) institutions inherited from the past and national political dynamics.

2.2.1 Policy legacy

Exogenous challenges do not impact on immovable objects. But they do interact with highly complex institutions characterised by a more dynamic evolution over time. The term 'institution' is used as a synonym of policy arrangements, which create rules, constraints and incentives for political action (Myles and Pierson 2001). Welfare and production regimes together represent the cornerstone of capitalist systems and their policy institutions tell us a lot about how a political economy works and reacts to crises. While in the past few years different clusters have been proposed in terms of social models (Dølvik and Martin 2014; Schweiger 2014) and employment models (Bosch, Lehndorff and Rubery 2009), in the following we refer to the varieties of capitalism approach and to welfare and labour market regime approaches.

With regard to varieties of capitalism in Europe, we first refer to the seminal work of Hall and Soskice (2001) and the definition of two varieties of capitalism in Europe. The coordinated market economy (CME) is based on non-market relations, collaboration, credible commitments and deliberative calculation on the part of firms. The liberal market economy (LME), by contrast is described in terms of arms-length, competitive relations, competition and formal contracting, and the operation of supply and demand in line with price signalling (Hall and Soskice 2001). In the LMEs, fluid labour markets fit well with easy access to stock market capital and the profit imperative, making LME firms 'radical innovators'. In the CMEs, by contrast, long-term employment strategies, rule-bound behaviour and durable ties between firms and banks underpinning patient capital provision predispose firms to be 'incremental innovators'. CMEs then split into two sub-clusters (Thelen 2014): national-CMEs (NCMEs), in which coordination takes place at national level through

comprehensive industrial relations with high levels of social partner density; and sector-CMEs (SCMEs), in which coordination happens at sectoral level and with weaker social partners.

Mixed-market economies (MMEs) are the third model proposed by the literature. The state is an important actor through the creation of a large state-controlled business sector and control of the financial system. At the same time, interest associations of both business and labour have stronger organisational structures than in LMEs, but are more fragmented and weaker than in CMEs. Interest groups demand some form of compensation from the state for their acquiescence (Molina and Rhodes 2007). Compensation usually consists of passive labour market policies and a transfer-oriented welfare state. More recent analysis of central and eastern Europe has proposed some further varieties. In line with Bohle and Greskovits (2012), we refer to Visegrad countries as part of the embedded neoliberal market economies (ENLMEs), based on relatively generous targeted social protection packages – a sort of side-payment for the opponents of neoliberal reforms – together with measures and nstitutions to attract multinationals.[2]

Whereas the varieties of capitalism approach tries to understand how firms deal with institutional environments that vary between the production systems of different countries, Esping-Andersen analyses how welfare is distributed in terms of individuals' rights and duties vis-à-vis the state. Similarly, with regard to labour market policies, Bonoli (2013) has distinguished between four clusters of countries in Western Europe. Anglo-Saxon countries, namely the UK, have taken a liberal approach: low levels of labour protection and unemployment benefits. The United Kingdom has reinforced the role of the market in addressing socio-economic challenges, with low public spending on both passive and active policies. Nordic countries – Denmark, Finland and Sweden – have put more emphasis on active policies. These have been combined with low levels of labour protection and generous unemployment benefits. In Continental European countries, labour market protection has been

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2. Eastern Europe is characterised by, first, the Baltic countries, which are neoliberal market economies (NLMEs): with small fiscal and welfare states, which perform well in terms of macroeconomic stability. Slovenia is a neo-corporatist market economy (N-CME) with highly developed industrial relations institutions and a generous welfare state. The peripheral market economies (PMEs) are represented by Bulgaria and Romania: they are weak economies based on cheap labour, weak infrastructure and firms that enjoy some independent sources of finance (Drahokoupil and Myant 2012).

traditionally high and combined with high levels of spending on passive measures. However, there have been few active labour market policies. These traits are even more evident in Southern Countries, where labour market protection has been high, active labour market policies of limited importance and passive labour market policies rudimentary. Davidsson (2011) has confirmed the existence of such clusters for Western countries, and has added a fifth: Emerging Eastern European Economies. The latter are characterised by segmented and deregulated labour markets and weak passive protection and active policies (see Agostini and Natali forthcoming).

All these typologies arrive at very similar country groupings, because 'virtually all liberal market economies are accompanied by "liberal" welfare states' (Hall and Soskice 2001a: 50) and all coordinated market economies are accompanied by either a social democratic or a conservative welfare arrangement. Southern and Eastern European countries belong to further coherent clusters of economic, social and labour market policies.

2.2.2 Domestic political dynamics

The question 'does politics matter?' has for decades been at the centre of the academic debate about the role of domestic political dynamics in shaping policy change and continuity. In the past, authors have stressed how much the partisan composition of parliamentary majorities and governments matters in addressing the critical economic conditions related, for instance, to the Great Depression (Castles 2010). The same has been found for the European and North American reply to the oil shocks at the end of the twentieth century. Others have shown that party politics do not matter so much especially in the shadow of critical economic junctures. For Starke *et al.* (2013), the basic finding is that social democratic parties – often aided by trade unions (Korpi 1983) – have had a positive effect on the expansion of welfare states across the OECD. In addition, Christian democratic parties have had a similar effect on expansion, albeit with particular emphasis on specific types of policies (Starke *et al.* 2013).

Between the end of the twentieth and the beginning of the twenty-first centuries, however, partisan politics has been seen as less significant. Social democratic parties are often no longer seen as the guarantors of

welfare state expansion, either because of a general ideological shift, constraints stemming from economic globalisation or policy legacy (Huber and Stephens 2001; Kittel and Obinger 2002).

Lipsmeyer (2011) finds a diminishing partisan impact on social expenditure during downturns, because economic shocks affect a large share of the population, including both left- and right-wing voters. Hence, left- and right-wing parties tone down their policies in the aftermath of shocks. Vis *et al.* also find that immediate crisis reactions in 2008/09 were enacted 'irrespective of the political leaning of the ruling parties' (2011: 349).

A further element to consider is the suspension of ideological differences. In general, technocratic governance, the centralisation of decision-making and consensus at the top should be the rule during periods of economic shock. This 'crisis centralisation' thesis would predict decision-making in small groups involving the executive and a loss of power of typical veto players. This is largely consistent with the emergence of caretaker governments, which have led reform efforts in some EU countries.

Populism has returned to European politics, with an impact on the reform agenda. Terms such as 'welfare chauvinism' can be used to describe the attitude of right-wing and populist movements towards social policy and industrial protectionism (Mewes and Mau 2013). Evidence collected so far shows that these populist movements tend to defend social spending against neoliberal strategies, especially for native citizens, while excluding immigrants.

2.3 The supra-national factors: EU leverage

Since the outbreak of the financial and economic crisis, several initiatives aimed at better synchronising and coordinating Member States' fiscal and macroeconomic policies and at strengthening the EU's ability to monitor and steer domestic policies have been undertaken (cf. De La Parra 2013; Degryse 2012; Martin 2015; Schweiger 2014; Zeitlin and Vanhercke 2014). Existing instruments and coordination procedures in these policy domains have been made more stringent and new initiatives have been developed, in some cases through international agreements outside the EU treaties. In order to identify the possible channels

through which any kind of 'EU influence' on Member States' structural reforms could develop (as well as the strength of such 'EU pressures'), we will briefly illustrate a number of key procedures and tools developed or reinforced by the EU over the crisis years: (i) developments related to fiscal, macroeconomic and sectoral policies coordinated through the European Semester; (ii) arrangements to provide financial assistance to Member States experiencing financial difficulties; and (iii) 'conditionality' attached to the Structural and Investment Funds 2014–2020.

2.3.1 The European Semester: 'building blocks' and governance procedures

Formally codified in the Six Pack,[3] the European Semester is an annual policy cycle coordinating procedures related to three processes: the Europe 2020 Strategy and the Integrated Guidelines for growth and jobs (thematic coordination aimed at fostering structural reforms); the reformed Stability and Growth Pact (fiscal policy); and the Macroeconomic Imbalances procedure (macroeconomic policy).

Launched in 2010, the *Europe 2020 Strategy* is aimed at fostering structural reforms in a number of policy domains in order to promote 'smart', 'sustainable' and 'inclusive' growth. Europe 2020 relies on a set of 10 'Integrated Guidelines for growth and jobs' (Council of the European Union 2010) which concern – besides budgetary and macroeconomic issues (IGs 1–3) – policy areas such as research, development and innovation, climate change and energy sustainability, the business environment, employment, education and training, and social inclusion. Five quantitative EU headline targets related to these policy areas – to be translated into national targets and achieved by 2020 – have been agreed on and seven 'flagship initiatives' aimed at facilitating progress towards the targets have been set up (cf. Vanhercke 2013). As for reporting and monitoring procedures, both EU guidance/monitoring and Member States' reporting are embedded in the procedures of the European Semester (see below). Further cooperation in some of the policy domains of the Europe 2020 Strategy has been introduced through the *Euro Plus Pact*, an agreement signed in March 2011 by 23 Member States[4] that committed

3. The 'Six Pack' consists of five Regulations and one Directive adopted in 2011.
4. The euro area countries plus Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

themselves to take action in priority policy areas essential for fostering competitiveness and convergence, including competitiveness, employment, sustainability of public finance, financial stability and cooperation on tax policy (European Council 2011: Annex 1). Every year each Member State identifies a series of concrete initiatives to be completed within 12 months in the domains covered by the Pact and the implementation of those initiatives is monitored through the European Semester.

With regard to fiscal surveillance and coordination, provisions introduced through the 'Six Pack' and the 'Two-Pack' legislation[5] have reinforced the *Stability and Growth Pact*, strengthening both its preventive and corrective arms. Under the former, every year the Member States must submit their budget plans for the next three years (the 'Stability Programmes' for euro zone countries and the 'Convergence Programmes' for the countries outside the euro zone), which are assessed by the Commission (ex-ante assessment). Negative assessment may lead to a series of consequences, including: (i) country-specific recommendations issued by the Council or (ii) Commission 'warnings' followed by Council recommendations, possibly leading to financial sanctions (for euro-area Member States). As for the 'corrective arm' of the SGP, the *Excessive deficit procedure* (EDP) has been reinforced, especially with regard to euro-area Member States, the latter being subject to closer monitoring and regular reporting requirements to the European Commission when subject to EDP. Indeed, euro zone countries under EDP must regularly submit reports allowing the Commission to assess whether there is a risk that the Member State will be unable to correct the excessive deficit by the deadline set by the Council, a circumstance that may entail a new recommendation containing further or different actions. Furthermore, those countries are requested to draft 'Economic Partnership Programmes' (EPPs), providing 'a roadmap for structural reforms considered as instrumental to an effective and lasting correction of the excessive deficit' (European Commission, n.d.). Finally, financial sanctions are possible for euro-area Member States that fail to address excessive deficits. Further provisions aimed at strengthening fiscal discipline in the Member States and EU-level surveillance have been introduced through the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) and the Two Pack. The core of the TSCG – an intergovernmental agreement signed in March

5. The 'Two Pack' includes two Regulations which entered into force in May 2013.

2012 by 25 MS (all the Member States except the Czech Republic and the United Kingdom) – is the so-called '*Fiscal compact*', which commits the contracting parties to embed into national legislation (preferably at the constitutional level) the 'balanced budget rule'. As for the Two Pack, besides the provisions directly related to the SGP illustrated above, it has introduced a *common budgetary timeline* for the members of the euro zone, whose draft budgetary plans are now subject to a preliminary assessment by the European Commission.

In the domain of macroeconomic policy, new procedures aimed at identifying at an early stage, monitoring and correcting 'macroeconomic imbalances' have been introduced by the Six Pack. A new surveillance and enforcement mechanism – the *Macroeconomic imbalances procedure* (MIP) – has been introduced, under the responsibility of the ECOFIN Council. The MIP consists of three steps (Vanhercke 2013: 98). First, an 'early warning system' based on a set of 11 macroeconomic indicators – with specific 'alert thresholds' – concerning both external and competitiveness imbalances. The scoreboard is published in the 'Alert Mechanism Report' (AMR) – drafted by the European Commission – and allows the Commission to identify countries whose situation needs an 'in-depth review'. Second, the Commission and the Council can adopt preventive actions consisting of recommendations to the Member States enshrined in the set of country-specific recommendations issued in the context of the European Semester. Finally, if severe macroeconomic imbalances are detected, an 'Excessive imbalance procedure' (EIP) can be opened (corrective actions). In this case, the Member State concerned must submit a corrective action plan (with a precise roadmap and deadlines for implementing corrective actions) and regular progress reports. Sanctions may be imposed if the Member State does not comply with the recommended corrective actions or if it fails twice to submit a sufficient corrective action plan.

As for the governance procedures, the *European Semester* annual policy cycle starts in November, when the European Commission publishes the Annual Growth Survey and the Alert Mechanism report. While the latter document specifically relates to the macroeconomic imbalances procedure, in the AGS the European Commission identifies the main economic challenges facing the EU and recommends priority measures to address them in the coming year. These priorities concern both economic and fiscal policies, as well as the other policy areas covered by Europe 2020. Priorities and guidelines set out in the AGS should feed

into Member States' Stability or Convergence Programmes (SCP) and National Reform Programmes, which deal, respectively, with budgetary policies and with reforms in the areas of the Europe 2020 Strategy. In order to ensure complementarities between fiscal and other structural policies, SCPs and NRPs must be submitted simultaneously in April. On the basis of the NRPs and of the SCP – as well as relying on other information gathered by its country-desks and services – in May the European Commission issues draft country-specific recommendations to be approved by the Council and then endorsed by the European Council.[6] The CSRs are not addressed to countries under the adjustment programmes, which receive only the generic recommendation to implement actions agreed in their Memoranda of Understanding (see below).

2.3.2 Financial assistance

Since the beginning of the crisis, financial assistance has been provided to Member States experiencing financial difficulties that might threaten the financial stability of the EU and of the euro zone. Two intergovernmental support mechanisms were created between May and June 2010: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF), the latter concerning euro-area Member States only. The EFSF, initially conceived as a temporary arrangement, has been replaced by a permanent mechanism – the *European Stability Mechanism* (ESM) – operational since October 2012. The activation of financial assistance mechanisms[7] is subject to strong elements of conditionality: once a Member State requests financial assistance, negotiations with the so-called 'Troika' (the European Commission, the IMF and the European Central Bank) start, eventually leading to the elaboration of an 'Economic Adjustment Programme'. This document (also known as a 'Memorandum of Understanding' or MoU) details the structural measures to be implemented by the borrowing country in order to receive further tranches of the loan.[8] Progress towards im-

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6. For a more in-depth discussion on the CSRs, cf. Clauwaert 2014, Bekker 2015, Zeitlin and Vanhercke 2014.

7. For Besides balance of payments assistance for Latvia, Hungary and Romania, financial assistance has so far been granted to four euro zone countries: Greece (May 2010), Ireland (November 2010), Portugal (April 2011) and Cyprus (March 2013).

8. Measures contained in the MoU are extremely prescriptive and typically include (Greer 2013) reforms of fiscal policy (with a view to reducing public expenditure), reforms of state-owned enterprises (generally, their privatisation), reforms of the financial sector (*cont. on next page*)

plementation of the programmes is assessed by the Troika on a quarterly basis and, at each stage, the results of the assessment are reported in two documents drafted, respectively, by the European Commission and the IMF. Countries completing their adjustment programmes (so far, Ireland and Portugal) continue to be subject to an enhanced post-programme surveillance by the EC and the ECB until they refund at least 75 per cent of the financial assistance received.

Alongside the financial assistance mechanisms described above, in 2010 the ECB launched the *Securities Market Programme* (SMP), whereby it would purchase, on the secondary markets, government bonds of euro-area Member States. While this programme was formally unconditional, in some cases ECB interventions have been linked to a sort of 'informal conditionality', namely to stringent and pervasive requests to the Member States concerned to introduce specific measures aiming at enhancing growth, competition and accelerating liberalisations (Agostini *et al.* 2015).[9] In 2012, the SMP was replaced by *Outright Monetary Transactions* (OMT), a programme that can be accessed only by euro zone Member States that have formally entered the European Stability Mechanism, thus entailing 'explicit' conditionality (ibid.).

2.3.3 Structural funds

EU cohesion policy has traditionally been linked to the promotion of economic, social and territorial cohesion in Europe, and the Structural Funds have provided the Member States – especially the most disadvantaged regions – with additional resources for their development. One feature of the recent reform of the Funds appears particularly important for the present research: the reinforcement of the conditionality attached to their use. Indeed, in the context of the European Structural and Investment Funds 2014–2020, 'conditionality' can take on two connotations likely to have contrasting effects in relation to the capacity of EU Funds to exert a direct and positive influence on Member States' so-

(*cont. from previous note*) and market-promoting sectoral reforms (including labour market, wage-setting systems, pensions and health care, services liberalisation). Cf. Merisio (2014) for a detailed description of the various steps leading to the definition of MoU.

9. The most striking example is Italy, whose government received, in summer 2013, a letter jointly signed by the President of the ECB and his designated successor. The letter set out a detailed policy agenda, as well as the legal instruments through which it should be implemented (Sacchi 2013). On the role of the ECB during the crisis, see Barbier (2012).

cial policies. On one hand, the Funds are subject to 'ex-ante conditionality', meaning that funding is conditional on the fulfilment of specific requirements linked to each investment priority (including, for instance, the requirement to define national strategic frameworks for poverty reduction or for reinforcing administrative efficiency). On the other hand, they are subject to 'macroeconomic conditionality': the contribution of the Structural Funds may be suspended when a Member State reaches a significant level of non-compliance under the various EU economic governance procedures such as the EDP or the MIP.

To sum up, looking at the policy developments described above, what has been emerging is an increasingly complex system of governance, where EU 'pressure' on Member States' policies may assume different forms and intensity, and may derive from the interplay between a variety of instruments and procedures. Indeed, on one hand, the coordination processes developed/reinforced over the years in the various policy domains do not have the same 'strength'; on the other hand, not every country is equally affected by the new economic governance arrangements and the stringency of the enforcement mechanisms (hence, the degree of 'EU intrusiveness') differs, largely – but not exclusively – depending on whether the country is a euro zone member or not.[10]

There are many references in the literature to an altered and reinforced Europeanisation of socio-economic policies, where austerity measures are increasingly put at the top of the agenda by EU policymakers and consequently shape national reforms (de la Porte and Heins 2015). Others have painted a more complex picture, in which the reinforcement of EU economic and social governance has evolved over time. While the first post-crisis phase was characterised by austerity measures pushed through the European Semester and the other tools mentioned above, since 2013–2014 a more complex programme of structural reforms and more relaxed fiscal consolidation has been proposed by the EU (see Zeitlin and Vanhercke 2014; Schmidt 2015).

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10. In their analysis of health-care reforms implemented during the crisis, Stamati and Baeten (2014: 15–16) have tried to capture this variation of EU pressure on domestic reforms by setting up an index of 'EU leverage'. The highest value of EU influence is attributed to countries that have signed a Memorandum of Understanding, while the other countries are classified under the remaining groups (moderate or weak leverage) taking into account factors such as the number and content of the Country-specific Recommendations they have received, whether they are euro zone countries and whether they have been subject to an Excessive Deficit Procedure or have signed an Economic Partnership Agreement.

2.4 Assessing structural reforms

Structural reforms are in fact a vague concept. These measures are expected to help improve economic growth prospects and the ability of economies to adjust to shocks. Product and labour market reforms should promote more efficient use of scarce resources (Canton *et al.* 2014). In the words of Rubio (2014: 2), structural reforms promote both countries' competitiveness and their adjustment capacity. While there is general agreement on what structural reforms are expected to contribute to, the precise definition of their substance is much more diverse. For some, in line with the liberal paradigm, these reforms are interpreted in terms of (de-)regulation of product markets – through the limitation of entry barriers, price control, public ownership and so on, and of labour markets, decentralisation of collective bargaining, stricter definition of wage setting targets and reform of unemployment protection. For others, and in line with a less normative interpretation, the term refers to a much longer list of policy areas: from competition and the regulation of labour and product markets, to areas such as education, pensions and social protection systems, and even sectors concerning the core activities of the state (tax collection, public administration, the judicial system). The IMF (2015), for instance, concentrates on labour and product market policies, education, health, innovation, housing policies, the efficiency of public sectors and tax systems. The European Commission (2014a) has provided a detailed set of policies under the broad definition of structural reforms in the European Semester: market competition and regulation, tax reform, unemployment benefit reform, labour market reforms (including active labour market policies), human capital investment and R&D investments.

From an analytical point of view it is possible, through the study of different policy areas and their evolution, to grasp the complex interplay of policy decisions and the importance of institutional complementarities. Eichorst *et al.* (2010) point out that institutions do not work in isolation. On the contrary they form complex institutional arrangements. System coordination and institutional complementarities are key elements of capitalist models, and 'when present in the "right" form, mutually reinforce each other' (Hassel 2014: 11). It is precisely these interactions that determine the economic and social performance of a country or group of countries. The focus on different policy areas first helps with the identification of national political economies, their logic and functioning. Second, it allows us to trace common and coherent trends where they exist,

Table 2 **Different types of structural reform**

		Investments	
		Decrease	Increase
Protection	Decrease	Social standards devaluation	(Selective) investment strategy
	Increase	(Socio-economic) protectionism	Social standards improvement

Source: Authors' elaboration.

or, on the other hand, to avoid over-estimating policy coherence. Thus, different arrangements may lead to equivalent performances. More than one model for economic growth and prosperity, indeed many models may coexist (Hall and Soskice 2001).

But what is the reform trend in the EU countries? To address this question we need to clarify what structural reforms look like and how they can be assessed. The more recent literature has clarified that not all reforms involve retrenchment and a reduction of social and economic rights. Reform packages can be varied and consist of different measures with different outcomes. Echoing Polanyi (see Bohle and Greskovits 2012) we focus on two different policy approaches reflecting two organising principles of contemporary welfare capitalism: economic liberalism and social and industrial protection. These two approaches inspire two policy agendas that are both included in structural reforms: one focused on investment in productive capacities (to increase the country's competitiveness); the other on protection (see Table 2).[11]

Table 2 shows four ideal-types of structural reform. In line with the literature on welfare and economic reforms – Hausermann (2012) and Thelen (2014), as well as Starke *et al.* (2013) – we first identify the two polar opposites. We refer to *social standards devaluation*, in cases of a set of measures aimed at cutting spending and consolidating public finances and with an overall decline in social rights (for example, deregulation,

11. The distributional consequences of structural reforms constitute another analytical dimension of considerable interest. In the following sections we do not refer to this, but other contributions in the literature have focused on the issue (see Almendinger and von den Drieschs 2014).

the decentralisation of collective bargaining and so on). Social standard devaluation is based on the idea that the deliberate deflation of domestic wages and prices through cuts to public spending and deregulation is designed to reduce a state's debts and deficits, increase its economic competitiveness and restore what is vaguely referred to as 'business confidence' (Blyth 2013). This is the case of countries more affected by the crisis, in which a combination of economic recession, fiscal stress, speculative attacks in the financial markets and social tensions have led to a systematic decrease in social rights and protection, while cutbacks have hit investments as well. This reminds us of the 'low road' to economic competitiveness based on cost-cutting, conflictual labour relations and a narrow set of social programmes (Millberg and Houston 2005).

At the opposite end of the spectrum we see *social standards improvements*: this consists of increased spending in order to improve a country's growth potential. This is also the type of policy pursued in the first years after the emergence of the *Great Recession*, when policymakers aimed to bail out the European economy, to implement 'Keynesian' policies and, some said, to take the opportunity afforded by the crisis for a 'paradigm shift' (Degryse and Natali 2011). Beyond an increase in social protection and consumption, the social standards improvement scenario consists of increased investments in the country's productive capacity through skills formation, R&D, education and innovation policies and so on. This is the 'high road' to economic competitiveness, with innovation based on cooperative labour relations and generally stronger and more centralised labour unions, high quality production and higher wages and costly welfare programmes (Millberg and Houston 2005).

As stressed in Table 2, we add two intermediate reform paths. On one hand, there is the (*selective*) *investment path*, based on cost-containment in the field of 'non-productive' spending and an expansion – in parallel – of specific growth-oriented policies (Kolev and Matthes 2013). The aim is to set up effective consolidation programmes that foster long-term growth and minimise the potentially negative short-term effects on economic activity. Comprehensive expenditure reviews are used to single out spending items that can be reduced without significantly endangering the effectiveness of government spending. Countries with sufficient fiscal space should aim at a gradual fiscal adjustment, while improving long-term growth prospects by moderately increasing public investment and education expenditures. Social investment can be part of this strategy of investments in human capital and knowledge to support

labour market participation, or to confront new social risks (Morel *et al.* 2012). A more selective investment strategy is the so-called 'Schumpeterian Workfare State' based on 'the promotion of product, process, organisational, and market innovation; the enhancement of the structural competitiveness of open economies mainly through supply-side intervention; and the subordination of social policy to the demands of labour market flexibility and structural competitiveness' (Jessop 1993: 9).

On the other side, we refer to *socio-economic protectionism*, where reforms tend towards strengthening social protection, while investment is sacrificed. Here the priority is to address the resulting social and economic difficulties. This does not involve an overall increase of public spending, but rather the definition of a strong network of protection and the promotion of social rights through the rationalisation of some public spending. A high level of public spending contributes to internal demand and consumption. This reform path aims at improving growth through domestic demand and at safeguarding social peace, for instance, through the segmentation if not dualisation of welfare recipients and the labour force (Hausermann 2012). This is also the case of populist forces that have a reform agenda consistent with the protection of domestic firms and the increase of social protection spending (for example, pensions) at least for native citizens.

3. Country cases

3.1 Czech Republic

3.1.1 Setting the scene: key traits of the country's political economy

The Czech economic and financial outlook is showing signs of recovery after the years of fluctuating economic trends noted since the outbreak of the crisis. Following a period of rapid economic expansion, the country experienced a double-dip recession from 2009 to 2014. The GDP growth rate started to decline in late 2008 and reached its lowest level in 2009 (–4.8 per cent), mainly triggered by exports and financial channels. In 2010 and 2011, the national currency depreciation relative to the euro – limiting to a certain extent the drop in exports – as well as an increased public deficit (–5.5 per cent in 2009) led to slight GDP improvements. However, recession was experienced again in the next two years, followed in 2014 by an increase in the GDP growth rate of 2 per cent. Despite a regular increase of the gross government debt as a percentage of GDP in the aftermath of the crisis (from 28.7 per cent of GDP in 2008 to 45 per cent in 2013), its level remains well below the limit of 60 per cent and the EU average, and, for the first time since 2007, it experienced a reduction in 2014 (42.6 per cent of GDP) (Table 3).

With regard to labour market trends, the crisis has had a negative impact on both employment and unemployment rates. However, the Czech employment rate returned to growth in 2010, and in 2014 reached a high point of 73.5 per cent. Also, the national unemployment rate in 2014 fell to 6.1 per cent, while the region of Prague alone scored the lowest unemployment rate among all the European regions (2.5 per cent). However, this positive result influences the national performance, which is also characterised by a substantial gap between regions (Eurostat,

Table 3 **Czech Republic: selected socio-economic indicators, 2007–2014**

	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	5.5	2.7	-4.8	2.3	2.0	-0.8	-0.7	2.0
General government gross debt (EDP concept)	27.9	28.7	34.1	38.2	39.9	44.6	45.0	42.6
General government deficit/surplus (% of GDP)	-0.7	-2.1	-5.5	-4.4	-2.7	-3.9	-1.2	-2.0
Employment rate (% 20-64)	72.0	72.4	70.9	70.4	70.9	71.5	72.5	73.5
Unemployment rate (%)	5.3	4.4	6.7	7.3	6.7	7.0	7.0	6.1
People at risk of poverty or social exclusion (% of the total population)	15.8	15.3	14.0	14.4	15.3	15.4	14.6	n.a.

Source: Agostini and Natali (forthcoming: Appendix).

2015).[12] As for poverty levels, in 2013 the Czech Republic was in a better position than the average of its peer economies from central and eastern Europe and the EU28. The country registered lower rates of people at risk of poverty or social exclusion (14.6 per cent against 24.5 per cent in the EU28). Moreover, the poverty statistics did not turn out to be seriously affected by the economic downturn, showing stable results during the whole post-crisis period.

As outlined by Agostini and Natali (forthcoming), the Czech Republic, along with its central and eastern European peers, is characterised by a highly internationally integrated neoliberal market economy, developed along with generous but targeted social protection measures and deregulated labour markets. With regard to the 'varieties of capitalism' approach, these are features of the cluster 'embedded neoliberal market economy', in which the Czech Republic is included (Table 4).

Nevertheless, even if the Czech Republic ultimately developed a similar economic and social model to its neighbours, the path followed from the Velvet Revolution to the economic downturn experienced in the country

12. The second lowest rate registered among regions is 5.1 per cent and the highest 8.7 per cent.

Table 4 **The Czech social model**

Country	Labour market regime	Welfare regimes	Variety of capitalism
Czech Republic	Central Eastern Europe (CEE)/Emergent	CEE/Post-communist	Embedded neoliberal market economies (ENLME)
			Peculiarities: – key role of FDI; – national sovereignty as a keystone of the country's political economy; - egalitarian welfare

Source: Agostini and Natali (forthcoming).

in 1996–1997 consistently differed from the process of transition undertaken in Hungary and Poland. This factor ultimately led to the development of some peculiarities within the model that still exist.

The national path to capitalism pursued in the Czech Republic until the economic recession of 1996–1997 was the product of two main factors: a political élite driving the transition from a state-planned to a market-oriented economy devoted to defending the national sovereignty of the newly born Republic – the Prime Minister Vaclav Klaus in the first place – as well as a different legacy of economic reforms implemented before the collapse of the regime – or rather, the lack of such reforms. Indeed, unlike Hungary and Poland, the Czech Republic started its transition phase from a solid financial position, a low level of government indebtedness and little or no reliance on foreign capital. Additionally, Prime Minister Klaus firmly pursued his attempt to create his own national way to capitalism, of which the 'voucher privatisation' scheme provides one of the most telling examples (Bohle and Greskovits 2012).

After 1997, it did not take long for the Czech Republic to become highly competitive in attracting FDI in comparison with its neighbours. Nowadays, therefore, the country can be fully included in the economic and social model of the whole central and eastern European region. As already mentioned, this model is strongly influenced by the marked presence of transnational companies within national borders, as well as strong reliance on the inflow of FDI and on exports of complex manufactured goods, of which the automotive sector is the leading industry (Myant and Drahokoupil 2012). The sound financial and macroeconomic condi-

tions of the Czech economy are still an important feature of its capitalist model. This keeps the country on safer ground than its peer economies, which bear the weight of larger public debts.

The sought-after neoliberal market economy has been combined in the Czech Republic with a relatively generous (but targeted) welfare state, built on the previous socialist experience. This has resulted in greater levels of egalitarianism of pensions and greater concern for the prevention of unemployment, rather than compensation for job loss (Bohle and Greskovits 2012). The reasons behind the creation of the so-called 'pensioners' welfare state' varied from ideological motives to more practical political reasons. In this regard, both the influence of the socialist ideology rewarding work and productivity and the importance of generating consent through social provision have played an important role (Sirovátka 2011).

Despite the country's high level of political, economic and financial international integration, the government is the most important actor in shaping taxation, employment and welfare policies. This tendency became less clear during the process of accession to the EU, but it was confirmed in the aftermath of the crisis, partly because of the Eurosceptic position taken by the centre-right government coalitions. At the national level, the Czech political scene has suffered from a certain degree of instability, which saw the centre-right governments headed by Topolánek and Nečar fail to complete their terms of office and alternate with non-partisan caretaker governments (Table 5).

The peak of the instability was the corruption and spying scandal that led Nečar to resign in July 2013. Consequently, as a result of the last parliamentary elections, a clear political shift occurred. This was marked by the victory of the Czech Social Democratic Party (ČSSD), led by Prime Minister Sobotka and, more surprisingly, the Action of Dissatisfied Citizens (ANO 2011). The latter became the second most-supported party in the country at its first political elections. The economic programme of the current government was built on the desire to move away from the social standard devaluation implemented by the previous centre-right governments during the period 2007–2013. It includes more social expenditure in order to increase the minimum wage and pensions, introduce new pro-family relief, as well as public investments in infrastructure and construction. In order to make such an expensive programme more affordable, spending on administration is expected to be cut, while

Table 5 **Governments of the Czech Republic from 2006 to 2015**

Years	Prime Minister	Position in the political spectrum	Coalition forces	Reform programme
September 2006–May 2009	Mirek Topolánek (ODS)	Centre-right	Civic Democratic Party (ODS); Christian and Democratic Union–Czechoslovak People's Party (KDU-ČSL); Green Party	Social standard devaluation
May 2009–June 2010	Jan Fischer	Caretaker government		(1)
July 2010–July 2013	Petr Nečas (ODS)	Centre-right	Civic Democratic Party (ODS); Public Affairs (VV); Top 09	Social standard devaluation
July 2013–January 2014	Jiří Rusnok	Caretaker government		(1)
January 2014–	Bohuslav Sobotka (ČSSD)	Centre-left	Czech Social Democratic Party (ČSSD); ANO 2011; Christian and Democratic Union-Czechoslovak People's Party (KDU-ČSL)	Social standard improvement (key role of investments)

Note: (1) Due to the peculiar nature and short duration of the mandate, the caretaker government's approach to reform is not clear.
Source: Kałan 2014; Malek 2013.

corporate taxation and the budget deficit are expected to grow, although the latter will remain under the 3 per cent limit (Kałan 2014).

The clear political shift has been mirrored also at European level, where the cohabitation of the Prime Minister Sobotka with the first directly-elected President Zeman – who calls himself a European federalist – should make the Czech Republic a more predictable member of the EU. Indeed, in the wake of the crisis and after the launch of the new EU system of economic governance, the Czech Republic has resisted deeper integration by refusing to adopt the Fiscal Compact on financial stability and slowing the path towards the adoption of the single currency (Kałan 2012).

Therefore, the 'EU influence effort', as defined by Stamati and Baeten (2014), could only be effective in the country by means of the country-specific recommendations (CSR) and the Excessive Deficit Procedure (EDP) launched in December 2009. However, the latter turned out to be a rather light fiscal and financial conditionality tool from the EU, as the country is not a member of the euro zone. Nevertheless, it is worth mentioning the decision taken by the Sobotka cabinet to adopt the Fiscal Compact (not yet ratified) and to move forward on the path towards the adoption of the single currency, which could ultimately occur not earlier than in 2020.

3.1.2 Structural reforms, sector by sector

Pensions

Although generous public pensions have been depicted as one of the main features of the Czech welfare regime, the reforms implemented since 2009 altered this tendency, as they were devoted mainly to improving the financial sustainability of the whole system. Restrictive reforms were introduced from 2008, when the revision of entitlements to disability pensions adopted by the Topolánek-led government – and coming into force in 2010 – led to a drop in the number of newly granted disability pensions. The measure prevented an increase in this kind of pension throughout the crisis period, also producing a long-term impact on the extension of working lives in the country (Natali and Zaidi 2015).

Between 2011 and 2013, the Nečar government adopted various measures in order to improve the financial sustainability of the pension system. The results of these changes, however, did not significantly affect pension benefits in relative terms (Natali and Zaidi 2015), nor were these restrictive measures continued by the following government. With regard to the reduction of pension payments, in 2013 the centre-right government introduced a temporary change to the indexation mechanism for old age, survivor and disability pensions, aiming to reduce the increase in pension benefits for financial consolidation purposes. Also, another measure to reduce public spending was the prevention of economically active pensioners from applying a basic tax credit when calculating their personal income tax from labour income. However, the measure, which was supposed to be implemented in 2013–2015, was abrogated by the Constitutional Court in mid-2014.

Upon adoption of the act introducing a (funded) pension savings pillar in November 2012, pension savings were launched at the beginning of 2013. This reform was intended by the government to be an instrument to increase the long-term security of the system, through diversification of the pension system and by providing a viable complement to the pay-as-you-go system. The reform envisaged voluntary entry for persons under 35 years of age to the savings pillar and it was open to employed (or self-employed) persons when the reform was launched, but not to unemployed or economically inactive persons (Ministry of Finance of the Czech Republic 2013).

Furthermore, the ODS-led government introduced an increase in the retirement age by two months per year without setting a final target age. For women, the amendment of the Act on Pension Insurance speeded up the increase in retirement age temporarily from four to six months per year until 2041, when the unification of the pension age is expected to occur (Office of the Government of the Czech Republic 2014). The amendment has been shaped in accordance with the prospect of an ageing population and changes in life expectancy, also responding to specific EU pressure related to this concern. It will gradually lower the average period of pension payments for individual generations to approximately 20 years.

Nevertheless, the Sobotka government, in power since January 2014, reversed the approach to reform characterising the centre-right governments preceding it and set out on a path of deficit spending with regard to pension benefits. It also proved to be less prone to follow recommendations from Brussels with regard to further increases in the retirement age and pre-retirement schemes. Indeed, while maintaining unaltered the legislation on the retirement age, it restored the standard formula that links the indexation of pensions to 100 per cent of the consumer price index and one-third of real wage increases. Moreover, it included in the 2015 budget a discretionary 1.8 per cent pension increase (Office of the Government of the Czech Republic, 2014). It also planned to make the second pillar inactive starting from January 2016, when contributions to the fully-funded pillar will be either returned to the participants in cash or transferred to the existing voluntary third pension pillar.

Summing up, the economic downturn and more stringent budget constraints have led to a high concentration of new measures in the field of pensions. Specifically, from 2008 to 2013 the clear attempt to reduce the

state budget deficit led to the adoption of restrictive policies. This implied more difficult pension entitlement and increased retirement age, as well as changes to the indexation mechanism. Nonetheless, since 2014 there has been a move towards a social standards improvement strategy especially with regard to pension indexation and with the possibility of discretionary increases in pension payments.

Labour market

In the aftermath of the crisis, the Czech labour market has suffered mainly from worsened services offered to job seekers as a consequence of major reshuffling of the Public Employment Services (PES) and cuts in unemployment benefits. Nevertheless, since 2010 the labour market has responded positively to the crisis. There have been improved performances in terms of both employment and unemployment rates, although structural problems were still identified, and started to be addressed only in 2013 and in 2014, as outlined below.

With regard to Passive Labour Market Policies (PLMP), the tendency of centre-right governments was directed mainly towards the implementation of restrictive measures, while no major reforms have been adopted since 2013. In 2010 unemployment benefits were cut from 65 per cent to 45 per cent of previous earnings from the first month of unemployment. Furthermore, in January 2012 an important attempt to reduce unemployment benefits was made by the Nečar government, through the introduction of a measure whereby the unemployed could be obliged to participate in the public service programme. If the unemployed person refused, their entitlement to unemployment benefits would have been lost. However, the measure was not implemented because it was cancelled by the Constitutional Court in November of the same year (Sirovátka *et al*. 2015).

During the period 2010–2012, the attempt to reduce public spending was also pursued through restructuring of the Czech PES, the Labour Office of the Czech Republic. This attempt was accomplished by means of a substantial cut in the number of Labour Office employees from 8,136 to 6,237. This staff reduction was combined with the merging of the minimum income scheme/social assistance administration with the employment offices, thus adversely affecting the performance of both offices in delivering their services (ibid.). However, given the shortcomings experienced as a result of the cuts, the year 2013 represented a turning point in the restructuring of the Czech Labour Office, which started

during Nečar's mandate and continued during the caretaker government in office since July 2013. The number of employees was raised twice: slightly in March and more substantially in July, when 700 new jobs were created (Office of the Government of the Czech Republic 2014). For the Sobotka government, the commitment to continue restructuring the Labour Office through improved efficiency and streamlined cooperation between the central and regional level is also a result of pressures from specific EU recommendations on the topic.

Although public expenditure on ALMP remains substantially lower in the Czech Republic than in other Member States, the number of participants in these policies has increased in the past few years. Specifically, in 2014 accessibility to ALMP increased thanks to the high participation of the unemployed in the vocational training programme 'Requalification by Choice', as well as the implementation of the Youth Guarantee scheme (Sirovátka *et al.* 2015). The Czech Republic presented a Youth Guarantee Implementation Plan in December 2013, which was revised in April 2014. Several actions were launched during the year, mainly delivered by the PES, although their main focus was on education. The implementation of these policies was supported by European funds. Nonetheless, despite the responsive approach shown in implementing the Youth Guarantee, further national funding for the Youth Guarantee Implementation Plan was not provided. Further financing of youth programmes is also available in the Severozapad region (the only eligible region in the country) thanks to the allocation of 13.6 million euros from the Youth Employment Initiative (European Commission 2015e).

The focus on job creation was also included in the reform of the system of investment incentives provided to employers. This was done through an amendment to the Act on Investment Incentives introduced by the current government (Office of the Government of the Czech Republic 2014). The main implications for the labour market produced by the amendment – which took effect on 1 May 2015, will result from the increase in incentives in the form of cash grants provided to employers in order to create new jobs, and an increase in retraining and training activities in regions with higher unemployment rates in comparison with the national average. The amendment also removes previous restrictions in certain fields of investment, including limits on job creation for technology centres and business support services centres (CzechInvest 2015).

As outlined above, labour market policies in the Czech Republic included a tightening of unemployment benefits throughout the period 2008–2014. Restrictive measures were taken also in relation to the restructuring of the PES by means of substantial staff cuts and mergers. An increased focus on ALMP since 2014 is visible through the implementation of programmes using EU funds, as well as in the provision of investment incentives to businesses to finance job creation and training activities.

Education

In the aftermath of the crisis, public expenditure on education as a percentage of GDP was lower in the Czech Republic than the EU average for the whole period. It experienced a slight decrease relative to GDP and as a percentage of total public expenditure in 2008, followed by slight increases in the following years (Agostini and Natali forthcoming).

In 2011, the amendment to the Education Act of 2004 brought about modifications in the financing of schools and school facilities, including the addition of a differentiation between teaching and non-teaching staff and between employees by school types (OECD 2015a; 2015b). Prior to 2013, allocation of resources for non-teaching staff was reduced by 9.5 per cent, particularly staff in early childhood education and care, while the pay cuts in the public sector did not affect teachers' wages. School management, especially in small schools, has faced financial difficulties, as salaries of pedagogical staff have increased, while those of non-pedagogical staff have been reduced (Sirovátka *et al.* 2015). Shortages of places in early childhood education and care and, more in general, shortcomings in the management of childcare facilities have been addressed subsequently to the approval of the Act on Children's groups in 2014. Responding to the necessity to facilitate the participation of women in further education and the labour market, the Act represents an increase in public expenditure of about CZK 1.5 billion, with about 300,000 children in pre-school care, aged between 3 and school age, benefiting from the measure (ibid.).

During the EU budgetary period 2007–2013, through the Education for Competitiveness Operational Programme (ECOP), grants based on project applications were allocated, most of them to promote the use of ITC. The programme, mostly covered through the European Social Fund, also aimed at prioritising the further training of teachers and other education staff.

On a similar trend, the education reform strategy approved by the Sobotka government, also responding to specific CSRs on the topic, has focused on enhancing quality and equity in education, thus taking a restructuring approach to reform. Moreover, the focus on pro-growth measures in the fields of education, R&D and transportation has been mirrored in the 2014 state budget, where national financing (before additional European funding) for the purpose has been established to the tune of CZK 26.6 billion for the three-year period from 2014 to 2016 (Annex, Office of the Government of the Czech Republic 2014).

As for higher education, in 2010 the Ministry of Education, Youth and Sport presented a Strategic Plan for 2011–2015 devoted mainly to bringing about a change in the focus of higher education institutions from quantity to quality in all their main activities and functions. Indeed, slow reactions to labour market needs and increased participation in tertiary education without a proper increase in resources have led to concerns about the quality of the services offered (OECD 2013a). A substantial reform in the field was recently adopted by the coalition government headed by Sobotka in March 2015. The amendment to the Higher Education Act, already under discussion by previous governments, established rules for the evaluation of universities. It also creates academic and professional profiles in order to support synergy between study programmes and the specificities of the labour market. The transition between education and the labour market is a focus of national policies, partly those favouring cooperation between businesses and universities, which is still at a low level of development in the country. Additionally, within the framework of the Youth Guarantee, several measures related to education policies are now active. This is particularly the case with regard to preventive actions taken in relation to early school leaving and facilitating the return of early school-leavers back to education (OECD 2013a).

It follows that the reform path taken in the field of education has been rather selective in the choice of investment. Spending cuts were experienced in terms of wage reductions for non-teaching staff. Moreover, the reforms implemented were mainly devoted to improving the quality and fairness of the system, thus achieving better outcomes with the resources allocated. However, the country has relied substantially on European funds in operational programmes devoted to increasing the national competitiveness through higher educational outcomes and improved ICT knowledge. Several measures were also implemented in 2014 within the framework of the Youth Guarantee.

Public sector

In the aftermath of the crisis, the process of restructuring the public sector in the Czech Republic has been characterised by measures devoted to cost-containment and modernisation. In 2011, one of the most significant and contested measures implemented was a 10 per cent reduction in the budget for public sector wages (Eurofound 2015). The measures impacted government departments and organisations fully or partly funded by the state. Only teachers were not subject to the reduction, while the budget to pay their wages was expected to increase. Whether the reduction of the budget affected the number of employees through lay-offs or whether it meant a reduction of wages (or both) was up to ministries. However, as provided for by law, in case of lay-offs the government was still required to propose reallocation options and the employee was entitled to an allowance (OECD 2015d). The main input for the launch of this restrictive reform process came from the national level, where the newly elected Nečar government in 2010 decided to pursue its objectives of financial containment by substantially reducing public expenditure on employment in the public sector. However, additional external elements such as the EDP may have played a role in this process.

The introduction of restrictive legislative measures was opposed by trade unions. This prevented the government from abolishing the automatic progression of public employees' salaries through a 12-point pay scale on the basis of service and replacing it with one based purely on performance. However, the pay cuts were ultimately adopted despite the protests. Indeed, social dialogue remains rather weak and uncertain in the country and the decision-making process in the Czech labour market, regulated in detail by the Labour Code, is shaped around a top-down approach of legal regulation rather than on consultation with the social partners (EPSU 2012).

Specific pressure from the EU has been highlighted in the CSRs addressed to the Czech Republic concerning the need to start restructuring of the public administration in order to improve its quality and efficiency. Specifically, the recommendations stressed the importance of adopting the long-awaited Civil Service Act, ultimately adopted by the Sobotka government and effective since January 2015. This act aims at improving the efficiency of the public service, which would be consistent with the process of social investment and increased productivity pursued by the centre-left government – although new regulation on remuneration in the sector is still pending adoption. However, when it comes to the

transparency and efficiency of the Public Administration, influence has been exerted by the EU on the national decision-making process, as an improved and more transparent funding administration is instrumental in the total allocation of European funds.

Overall, the strategy pursued in reforming the public sector in the Czech Republic in recent years has been consistent with the path of selective investment. Restructuring of the sector did indeed lead to the deterioration of employees' protection and salaries, especially during the period 2010–2011, but it was also focused on modernising the sector and improving its efficiency and transparency. This is particularly true with regard to public administration reforms and the need to improve the management of EU funds.

Research and development

Gross domestic expenditure (as a percentage of GDP) on R&D has increased regularly since 2002. The country has formally reached its national Europe 2020 target and is well placed to achieve the common European target of 3 per cent of public and private spending on R&D. Total public and private expenditure in 2012 amounted to CZK 72.36 billion, of which total public expenditure on R&D support was CZK 39.1 billion. This led to an increase in public spending in this area to 1.02 per cent of GDP. The largest share of the R&D conducted (53.6 per cent) in 2012 was carried out in the corporate sector, 18.4 per cent in the government sector and 27.4 per cent in higher education (Office of the Government of the Czech Republic, 2014).

Despite the substantial public investment effort in the sector, poor innovation outcomes in relation to the level of R&D spending and a lack of cooperation between the public research sector and the sphere of application, particularly the corporate sector, have proved to be major causes for concern. The reforms implemented and the strategies applied attempted to address these structural weaknesses. The amendment of the Income Tax Act (Act No. 458/2011 Sb) adopted in 2011 boosted tax deductibility to include services related to R&D projects. In 2014, the reduction would have increased from 100 per cent to 110 per cent if expenditure had also increased in comparison with the previous tax period (OECD 2014b). As for cooperation among the different bodies, a continuation of the cooperation programme between businesses and higher education institutions – the 'education for competitiveness' operational programme – has been planned for the period 2014–2020.

To sum up, when it comes to R&D spending and programmes activated in the field, government activities over the years have aimed at implementing an investment strategy and improving educational outcomes, as well as cooperation between the public and private sector.

3.1.3 Preliminary remarks on Czech structural reforms and their determinants

In the Czech Republic, the structural reforms undertaken during 2008–2015 have been influenced mainly by domestic factors. Within this framework, the EU played a restrictive role – by imposing fiscal and financial constraints by means of the EDP and the CSRs – as well as providing a stimulus for the optimisation of resources and pro-growth investment through the allocation of structural and cohesion funds.

As for the implementation of restrictive measures and cuts during 2008–2013, a certain level of agreement between national reform programmes and EU pressure helped in shaping the economic policy of the centre-right governments with regard to ways of 'reducing the deficit'. The launch of the EDP in December 2009 might have played a formal role in this regard. Nonetheless, the corrective instrument was not so severe, because the country is not a member of the euro zone and it did not sign the Fiscal Compact in 2012. During the aforementioned period, the path to structural reforms undertaken in the country reflected, to some extent, a *social standards devaluation* strategy, combined with limited investment, especially in policy sectors defined as growth-enhancing, such as education and R&D. Even more so, this was due to the use of EU funds.

Since January 2014 and the change of government's stance, the national political factor has become more important in shaping the reform programme. The government is indeed more willing to increase deficit spending on both social and pro-growth policies, thus adopting a *social standards improvement* strategy. However, the allocation of EU funds remains an important instrument for influencing national policies. This is proved by the responsive approach of the Sobotka government to the Youth Guarantee and to the recommendations on the need to improve the quality of the European Parliament, as well as the management of the funds for the period 2014–2020.

Table 6 **Summary table: drivers of reform and major reform trends in the Czech Republic, 2008–2014**

	2008–2009	2010–2013	2014–2015
Drivers of reform			
Economic crisis	Economic recession; excessive general government deficit	Slight economic recovery (2010–2011)/ slight recession (2012–2013); excessive general government deficit	Slight economic recovery; general government deficit below the threshold
Coalition governments	Centre-right	Centre-right	Centre-left
EU influence	EDP (from Dec 2009) EU funds	EDP; European Semester; EU funds	EDP (until June 2014) European Semester; EU funds
Structural reforms			
Reform path (for the five policies under scrutiny)	Social standards devaluation	Social standards devaluation	Social standards improvement
Main reforms in each policy field			
Pensions	- Revision of entitlement to disability pensions - Increased retirement age from 62 to 65	- Temporary change to indexation mechanism - Introduction of pension savings pillar - Increased retirement age	- Restoration of standard formula for pension indexation; - (planned) increase of pensions by 1.8%
Labour market	- Tightening unemployment benefit	- Cuts in unemployment benefits from 65% to 45% of previous earnings - Reform of PES	- Youth guarantee - Youth Employment Initiative - Investment incentives for job creation - ALMP
Education	- Strategy of lifelong learning (2007) - ECOP	- Cuts in resources for non-teaching staff - ECOP	- Youth guarantee - Higher Education Act - Investment in early childhood education and care
Public sector		- 10% reduction in public sector wages - Public Procurement Act	- Civil Service Act
Research and development		- Income Tax Act	- Education for competitiveness operational programme

Source: Authors' elaboration.

Overall, the Czech capitalist and social models have significantly influenced reform of taxation and investment incentive policies aimed at attracting inward FDI. This is also true of spending on R&D and the focus on improving educational outcomes, as well as on increasing possibilities for the private sector, mainly corporate, to invest in research in the Czech Republic.

3.2 Finland

3.2.1 Setting the scene: key traits of the country's political economy

Finland has been hard hit by the economic and financial crisis. Being an open, export-oriented economy, the worldwide recession and the collapse in trade entailed a huge decline in manufacturing exports. This situation has been further aggravated by more structural problems confronting key sectors such as electronics (notably Nokia) and forestry (Dølvik *et al*. 2014; Hopia and Metelinen 2013). Looking at GDP growth, the country has experienced a 'double dip': the recession in 2009 (–8.3 per cent of GDP) was followed first by a recovery in 2010, then by a second drop from 2012. According to a recent forecast (European Commission 2015c) the Finnish economy is expected to recover slowly from 2015. Both the general government gross debt and deficit were affected by the economic downturn. The debt almost doubled – from 32.7 per cent of GDP in 2007 to 59.3 per cent in 2014 – thus approaching the 60 per cent Maastricht threshold, and the country's budget moved from being in surplus in 2008 (4.2 per cent of GDP) to a persistent deficit in the following years (with a low-point of –3.2 per cent of GDP in 2014).

Social indicators, too – though less dramatically than in other EU countries – have deteriorated over the crisis years. The employment rate registered a decrease in 2009 (73.5 per cent, compared with 75.8 per cent in 2008) and then remained quite stable in the following years (Table 7). Similarly, the unemployment rate increased by about 2 percentage points between 2008 (6.4 per cent) and 2009 (8.2 per cent), then remaining fairly flat until 2014 (8.4 per cent). However, while the Finnish unemployment rate is still below the EU average, the 0.5 percentage points increase between 2013 and 2014 is particularly worrisome insofar as it represents the biggest increase in the EU over that period (Europe-

Table 7 **Finland: selected socio-economic indicators, 2007–2014**

Indicators/years	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	5.2	0.7	–8.3	3.0	2.6	–1.4	–1.3	–0.1
General government gross debt (EDP concept) (% of GDP)	34.0	32.7	41.7	47.1	48.5	52.9	55.8	59.3
General government deficit/surplus (% of GDP)	5.1	4.2	–2.5	–2.6	–1.0	–2.1	–2.5	–3.2
Employment rate (% 20-64)	74.8	75.8	73.5	73.0	73.8	74.0	73.3	73.1
Unemployment rate (%)	6.9	6.4	8.2	8.4	7.8	7.7	8.2	8.7
People at risk of poverty or social exclusion (% of total population)	17.4	17.4	16.9	16.9	17.9	17.2	16.0	17.3

Source: Annex to Agostini and Natali (forthcoming).

an Commission 2015c: 46). The rate of people at risk of poverty or social xclusion remained fairly stable (around 17 per cent) over the crisis years and even declined slightly in some years.

Finland displays the key traits of 'national-coordinated market economies' (NCME), characterised by a comprehensive industrial relations system with a high-level of social partner density and a key coordination role played by national-level wage bargaining (Agostini and Natali forthcoming) (Table 8).

Table 8 **The Finnish social model**

Labour market regime	Welfare regime	Varieties of capitalism
Nordic	Social democratic	National-coordinated market economy (NCME)
		Peculiarities: - Member of the euro zone since 1999

Source: Authors' elaboration of Agostini and Natali (forthcoming).

The presence of strong, centralised worker and employer organisations, the development of institutions facilitating tripartite cooperation and the emergence of stable party constellations or hegemonic parties are in fact strongly characteristic of Nordic countries (Dølvik *et al.* 2015: 20). Because their economies are highly reliant on international trade, collective agreements have been fundamental to enhancing export competitiveness by allowing for wage flexibility, technological change and investment (Vartiainen 2011b). In Finland, the role of the state in supporting centralised pay setting has been even more accentuated than in other Nordic countries: indeed, through the so-called 'incomes policy' developed since the 1950s, Finnish governments have facilitated wage bargains by linking these to economic policies and social reforms (ibid.). Looking more specifically at social policy, Finland can be included among the 'social democratic' welfare regimes, typically characterised by a comprehensive welfare state granting universal rights to income security and education, a high level of decommodification, high social spending and extensive provision of public services (Dølvik *et al.* 2014; Agostini and Natali forthcoming). The Finnish pension system is rather unusual by international standards, given the specific features of the employment pension[13] (which, together with the national pension, until 2011 represented one of the two schemes of the first pillar) and the fundamental decision-making role given to the social partners (Kautto forthcoming). In terms of labour market regime, Finland is part of the 'Nordic' cluster, characterised by a certain degree of internal flexibility and a relatively low degree of external flexibility, coupled with fairly generous unemployment benefits and high expenditure on ALMP (Sturn 2011). Legislation on collective dismissal associated with economic downturns has traditionally been flexible, while provisions on individual terminations are stricter (with the exception of Denmark) (Dølvik *et al.* 2015: 68).

Many observers describe the economic crisis that hit the Nordic countries at the beginning of the 1990s as a critical juncture that significantly shaped their socio-economic models (Dølvik *et al.* 2014; Dølvik *et al.* 2015; Jochem 2011): it was a sort of 'existential crisis' that called into question the viability of the Nordic social model (Dølvik *et al.* 2014: 249). Confronted with such economic turmoil, the Nordic countries re-

13. The employment pension can be described as a 'functional hybrid' incorporating many features that, in other countries, are generally attached to second pillar schemes (Kautto, forthcoming).

acted with a series of reforms of macroeconomic and fiscal policies, the financial sector, wage setting arrangements and labour market regulation (Dølvik *et al.* 2014).[14] In Finland (a member of the EU since 1995), the wage moderation and fiscal consolidation efforts pursued over the 1990s were also linked to the need to meet the Maastricht criteria, given the decision to join EMU among the first participants (Vartiainen 2011a). Although most social benefits were either cut or not adequately raised compared with living costs or wage developments (Jutila 2011), reforms undertaken over the 1990s and 2000s did not result in the dismantling of the traditional social model but rather in its 'consolidation' (Dølvik *et al.* 2014).[15] In particular, social and tax policies were reoriented towards labour supply, the education and skills formation systems were expanded, and social benefits were made more conditional and linked more closely to the 'activation' of the recipients. Moreover, public services were reinforced, more emphasis was put on programmes for the reconciliation of work and family life and a series of pension reforms were implemented (Dølvik *et al.* 2014; Dølvik *et al.* 2015). Finland, along with the other Nordic countries, introduced or reinforced many elements of what is currently labelled the 'social investment' approach.

Summing up, on the eve of the Great Recession Finland was characterised by good socio-economic conditions, with relatively high rates of GDP growth, a sound budgetary situation, a robust financial sector, comparatively good labour market performance and a fairly comprehensive and effective welfare state. That said, especially due to rapid population ageing and the shrinking working age population, doubts about the long-term sustainability of the Finnish welfare system persisted and were an important theme already in the pre-crisis public debate (Vartiainen 2011a). In particular, the sustainability of the pension and health-care systems were a matter of concern. Furthermore, the centralised wage setting system – which had played a pivotal role in the socio-economic development of the country – was seriously called into question in 2007, when employers refused to take part in nationally coordinated wage settlements (Vartiainen 2011a, 2011b).

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14. These measures were accompanied by huge currency depreciations in Finland and Sweden (ibid.: 264).

15. For more critical accounts, see Blomgren *et al.* (2012) and Jutila (2011). While stressing that the Finnish welfare state is still enviably effective, Blomgren *et al.* (2012) identify cuts/slow increase in social benefits and in tax rates (the latter since the 2000s) as key determinants of the rise in income inequality over the past twenty years. Jutila (2011) concludes that these changes have entailed a gradual but continuous retrenchment of the Finnish

Table 9 **Finnish governments, 2007–present**

Years	Prime Minister	Position in the political spectrum	Coalition forces	Reform programme
2007–2010	Matti Vanhanen (II)	Centre-right	- Centre Party - National Coalition Party - Swedish People's Party - Green League	Social standards improvement (2009–2010)
2010–2011	Mari Kiviniemi	Centre-right	- Centre Party - National Coalition Party - Swedish People's Party - Green League	Social standards improvement (based on PM Vanhanen's government programme)
2011–2014	Jyrki Katainen	Grand coalition	- National Coalition Party - Social Democratic Party - Left Alliance - Green League - Swedish People's Party of Finland - Christian Democrats	Social standards devaluation
2014–2015	Alexander Stubb	Grand coalition	- National Coalition Party - Social Democratic Party - Green League (until September 2014) - Swedish People's Party - Christian Democrats	Social standards devaluation (based on PM Katainen's government programme) Some selective investment
29 May 2015–present	Juha Sipilä	Centre-right	- Centre Party - Finns Party - National Coalition Party	Social standards devaluation (some selective investment)

Source: Hopia H. and Metelinen S. (2013); Jokivuori P. (2011); Prime Minister's Office (2015).

The development of the crisis in the EU significantly influenced Finnish politics in terms of coalition composition, reform programmes and stability. Since 2007, five coalition governments have taken office in Finland as a result of the parliamentary elections held in 2007, 2011 and 2015 (Table 9).[16] With regard to the reform pattern of the crisis years,

16. The Kiviniemi and Stubb governments were both in office for one year and were formed because of the resignations of the Prime Ministers Vanhanen (for personal reasons) and Katainen (who joined the Juncker cabinet as Commissioner for Jobs, Growth, Investment and Competitiveness). These governments followed the path taken by previous cabinets, as the structure of the coalition remained more or less unchanged.

two broad trends can be identified. At the beginning of the crisis, Finnish governments supplemented the work of the automatic stabilisers by expansionary policy packages (social standards improvement). However, after a stimulus package of approximately 1 per cent of GDP implemented in 2009 by the Vanhanen government (Jochem 2011: 141), more restrictive budget choices were gradually implemented (Dølvik *et al.* 2015: 36). A clear trend reversal is visible after the 2011 parliamentary elections, marked by the historic success of the populist True Finns Party (nowadays the Finns Party) and the sharp decline in popularity of the Centre Party (Hopia and Metelinen 2013: 165). Indeed, fiscal consolidation was a priority for the coalition government formed by Prime Minister Katainen (in which the True Finns Party decided not to take part despite the election results). The common trend towards social standard devaluation in the EU and the increasing pressure from the European Union in this direction might have played a role in shaping the reform pattern towards fiscal consolidation. However, given the industry-specific shocks experienced and the stagnating labour force, the Grand Coalition government would probably have managed to implement such a programme even without pressure from European institutions in this regard (Dølvik *et al.* 2014: 271). A similar focus on the sustainability of public finances characterises the Strategic Programme of Prime Minister Juha Sipilä, which combines this priority with a clear will to implement structural reforms promoting employment, entrepreneurship and economic growth (Prime Minister's Office 2015: 10).

When it comes to 'EU pressure' coming from the European Semester, messages recommending Finland to continue its fiscal consolidation efforts and preserve a sound fiscal position have been a constant of CSRs received between 2011 and 2015. In 2010, an Excessive Deficit Procedure was launched, based on the expectation that – in 2011 – the public deficit would have exceeded 3 per cent of the GDP. Since the forecast proved to be wrong, the EDP was closed in 2011. Growing concerns about the trend of the public budget emerge, in particular, from the CSRs for 2014 and 2015. Other CSRs received by Finland between 2011 and 2015 concerned a number of sectors covered by the present research, including pensions, the labour market and the public administration.

3.2.2 Structural reforms sector by sector

Pensions

Confronted with a rapidly ageing population, the Finnish pension system has been reformed several times over the past 20 years. Reforms undertaken in the 1990s and the 2000s especially concerned the 'first pillar' of the system, with a view to ensuring both its sustainability and its adequacy (Kautto forthcoming). Raising the effective retirement age was a key goal of these reforms but, despite remarkable improvements, the progress achieved before the crisis was insufficient (Natali and Stamati 2013). Furthermore, the crisis has uncovered some shortcomings related to poverty protection, insofar as Finland's rate of people aged 65 or more at risk of poverty is higher than the EU average (ibid.).

Changes made over the crisis years have been characterised by continuity with the previous reform pattern. Most of them concerned the first pillar of the pension system and consisted of a mix of interventions aimed at reinforcing financial sustainability by promoting longer working careers and more expansive measures (Kautto forthcoming; Natali and Stamati 2013). In spring 2009, the social partners and the government agreed to discuss measures aimed at achieving a three-year increase in the effective pension age by 2025. However, due to trade union opposition, no agreement was reached on the government proposal to gradually raise the minimum retirement age by two years (Vartiainen 2011a). In the same year, taxes on pension income were lowered and the government intervened to prevent benefit indexation from turning negative in 2010 (Natali and Stamati 2013).[17] Furthermore, employer contributions to the Social Insurance Institution (responsible for the national pension) were gradually eliminated from 2010, while employee and employer contributions to the TyEL fund (for private employees) were raised by 0.4 percentage points a year between 2011 and 2014 (ibid.). In March 2011, the government introduced the 'guarantee pension', a scheme intended to top up the national pension for low-income pensioners and to cover people who do not qualify for the national pension due to insufficient years of residence (Kautto forthcoming). A further agreement concluded by the social partners in spring 2012 introduced additional measures such as the discontinuation of 'early old age retirement' (a scheme that

17. As reported by Natali and Zaidi (2015: 5), over the crisis years pension payments have been affected by the decision to decrease the indexation for both national and earnings-related benefits.

allowed retirement at the age of 62) from 2014, a one-year increase in the age limits to qualify for part-time pensions and the unemployment benefit system (from 60 to 61), and a 0.4 percentage point increase in contributions in 2014 and 2015 (ibid.).

An agreement on the new reform was reached by the social partners in autumn 2014 and was due to be discussed by Parliament in autumn 2015 with a view to entering into force in 2017. Among the main changes agreed are (Ministry of Finance 2015: 18–19): a two-year rise in the retirement age, abolition of the part-time pension (to be replaced by a 'partial early old-age pension') and the introduction of a new pension benefit (the 'years-of-service pension'). The minimum age of eligibility for the old age pension will gradually increase until it reaches 65 years in 2025 and, from 2027, it will be linked to life expectancy. The new 'partial early old-age pension' will initially concern individuals aged 61. Then, by 2025, the minimum age for this benefit will be raised to 62 and, from 2027, it will be linked to life expectancy. Finally, the newly introduced 'years-of-service pension' will apply to individuals aged at least 63 (from 2027 the age limit will be linked to life expectancy) with a working career spanning at least 38 years in work that is either physically or mentally wearing, and with an impaired work capacity.

Overall, looking at pension reforms implemented in Finland over the crisis years, we can identify two sub-periods. At the beginning of the crisis, some expansive measures were enacted, especially aimed at ensuring the adequacy of pensions. Since late 2011, however, initiatives aimed at ensuring the financial sustainability of the system (notably, by extending working life) have prevailed. Generally speaking, these measures go in the direction suggested by the CSRs on pension policy addressed to Finland since 2011, which have repeatedly pointed to the need to increase the retirement age and to reduce early exits from work. That said, considering the remarkable degree of continuity between changes undertaken over the crisis years and the pre-crisis reform pattern (Kautto forthcoming), the impact of pressure coming from the European Semester should not be overestimated. Indeed, the latter seems to have simply been an additional stimulus to implement decisions already taken at the national level.

Labour market

After the employers' decision to withdraw from nationally coordinated wage setting (in 2007), social partner negotiations took place at the sectoral level. However, already in 2011 there was a return to centralised

wage bargaining and, in 2013, a traditional incomes policy settlement was concluded. The latter foresaw a very modest pay increase for the period 2014–2015[18] and was facilitated by the government, which linked inflation adjustments of income taxation to the success of the negotiations (Dølvik *et al.* 2014: 278). Though centralised wage agreements concluded over the crisis years did not include either wage freezes or wage cuts, such decisions were in many cases taken in the firms hardest hit by the crisis (Dølvik *et al.* 2014; Svalund *et al.* 2013). Local-level flexibility was important for coping with the crisis and to avoid, whenever possible, dismissals: a number of firms made extensive use of such solutions as flexible working time, internal redeployment and temporary lay-offs. The latter option was facilitated by the government which, in 2009, relaxed the access requirements for these schemes and extended to workers temporarily laid off the 'change security' activation programme, thus offering further retraining opportunities (Svalund *et al.* 2013).

The rate of unemployment benefits remained unchanged over the crisis years, although the duration of earnings-related unemployment insurance benefits was marginally reduced for some groups (Dølvik *et al.* 2014: 278). Conversely, at the beginning of the crisis replacement rates were raised moderately (OECD, 2012) and access criteria were eased in 2009 and 2010 (Svalund *et al.* 2013: 188). However, the conditionality attached to the benefits (notably, activation requirements) was tightened and sanctions for non-compliance were made more stringent.[19] Furthermore, in order to push municipalities to take more responsibilities towards the long-term unemployed, financing criteria for both the basic unemployment allowance and labour market subsidies were modified, introducing an earlier and more substantial participation of the municipalities in the co-financing of these schemes (Kangas and Kalliomaa-Puham 2015: 16).

Especially since 2013, the provision of ALMP has been extended (Dølvik *et al.* 2014; Jochem 2011), with a focus on specific target groups, such as the long-term unemployed, people with reduced work capacity, elderly workers and unemployed young people. Measures implemented since 2013 include (European Commission 2015c; Ministry of Finance 2015):

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18. 'Promoting wage development in line with productivity' was among the CSRs addressed to Finland under the European Semester.

19. In particular, legal requirements for the geographical and occupational mobility of the unemployed were tightened.

(i) the introduction of an income disregard (up to 300 euros) on earnings-related incomes for the beneficiaries of the labour market subsidy; (ii) a reorganisation of the wage subsidies system introducing subsidies for long-term unemployed, elderly workers and workers with disabilities (effective since 2015); and (iii) provisions targeted at young people, implemented mainly within the framework of the 'Youth Guarantee'. As for the latter, measures already existing since 1996 were amended in 2013 with a view to strengthening and better integrating the two components of the model (employment and education), broadening the target group, enhancing measures for reaching the most vulnerable (through vocational, medical and social rehabilitation services) and renewing financial investments (Ministry of Employment and the Economy n.d.).

Other changes concerned the governance of labour market policies, with a view to enhancing the coordination between the various measures and the actors involved and improving the provision of individualised assistance (especially for categories such as the long-term unemployed and young people). In 2013, in order to improve their efficiency and their capacity to offer customised services, the Public Employment Services were reformed: the 74 local Employment and Economic Development offices were merged into 15 regional offices (OECD 2014a).[20] The 'Act on multi-sectoral services cooperation' (2014) aims at facilitating the development of one-stop-shop arrangements by obliging the Social Insurance Institution (KELA), municipalities and public employment services to draft, in collaboration with the job seeker, multi-sectoral plans for employment (Kangas and Kalliomaa-Puha 2015: 16).

Overall, looking at labour market policy, one can conclude that measures adopted over the crisis years have further reinforced the 'social investment orientation' of the Finnish model. Most of these changes were in line with recommendations coming at EU level, emphasising the need to target labour market measures at the long-term unemployed, young people and older workers.

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20. As reported by the Finnish Ministry of Finance (2015: 17), since 2014 the Employment and Economic Development Centres have significantly increased job offers made to the unemployed, and employment plan monitoring and job-seeker reporting have been enhanced through the development of an electronic service. Probably, the reform of the PES also has budget saving objectives and, as reported by the European Commission (2015c: 48), the budget of the public employment services has indeed been cut.

Education

The Finnish education system has traditionally been highly effective by international standards. Public spending on education is higher than the EU average and general government expenditure on education as a percentage of GDP remained fairly stable in the first years of the crisis (European Commission 2014b: 3). Nevertheless, from 2011 several fiscal consolidation measures were introduced. Data on year-on-year changes in constant prices (Agostini and Natali forthcoming: Appendix) show that real government expenditure decreased both in 2011 and 2012. Additionally, the 'Structural Policy Programme' adopted in 2013 foresaw a further reduction of approximately 280 million euros (5 per cent of the education budget) over the period 2014–2017 (European Commission 2015c: 50–51). According to the European Commission (ibid.: 51), these cuts risk having an impact on the quality of educational outcomes.

Over the crisis years, the Finnish education system has been subject to a number of reforms, which have concerned early childhood education and care, tertiary education, and vocational and educational training.

With regard to early childhood education and care, a first change concerned the governance of the system, responsibility for which was transferred, in 2013, from the Ministry of Social Affairs and Health to the Ministry of Education and Culture. Therefore, early childhood education and care is now an integral part of the education system. Second, in order to facilitate early interventions in learning difficulties and ensure that every child has access to high quality pre-primary education, irrespective of their social background (Ministry of Finance, 2015), a mandatory school year for children aged 6 was introduced in 2013. As pointed out by Kangas and Kalliomaa-Puha (2015), both these interventions have reinforced the social investment orientation of the Finnish early childhood education and care system, whose effectiveness may, however, be reduced by recent fiscal consolidation measures. The latter have indeed affected municipalities' budgets, leading to an increase in the child-to-staff ratio and in the average number of pupils in classrooms and to the cutting of some support measures for children with specific needs (ibid.).

Finland has traditionally been characterised by a high rate of participation of upper secondary students in vocational education and training and a relatively low level of participation in apprenticeship training (Eu-

ropean Commission 2014b: 4). The provision of vocational education and training and apprenticeships for young people has recently been increased, especially since 2013, within the framework of the Youth Guarantee (Ministry of Finance 2015: 23–24). As for vocational education, the reform of the selection criteria in upper secondary education is expected to give priority to people without a post-basic education qualification, while the reform of the vocational education qualification – aimed at improving the skill-base and the flexibility of the system – will come into force in August 2015. In 2014, the system of on-the-job learning and apprenticeship training (targeted at people under 25 without a post-basic education qualification) was reformed in order to increase the availability of apprenticeship training placements and to promote the development of training models combining institutional training and apprenticeship. As for adults, in spring 2014 the government decided to allocate 20 million euros for 2014–2015 for programmes aimed at strengthening the skill-base of adults without basic or post-basic education qualifications.

As for tertiary education, a comprehensive 'university reform' aimed at improving both the effectiveness and the efficiency of the system was enacted in 2009. The objectives of the reform were to improve universities' capacity to react to changes in the operational environment, to diversify their funding base, to better compete for international research funding and to enhance international cooperation (Aarrevaara *et al.* 2009: 93). In order to do so, the reform enlarged the financial and administrative autonomy of the universities (transformed into independent legal entities taking the form of either public corporations or foundations under private law) and increased the incentives to search for private funding (ibid.: 94). In order to further rationalise the university system, the reform was accompanied by a proposal to merge some universities. A common goal of the reforms implemented since then has been the attempt to shorten the duration of studies in order to accelerate the transition to working life. Such an objective is apparent in the reform of both the funding model of universities (2013) and students' financial aid (2014). The 2013 revision increased the importance attached to the number of qualifications attained by students and their progress in their studies in determining the amount of funding for the universities (Ministry of Finance 2014). The new funding model was extended to universities of applied sciences in 2014. The reform of the students' financial aid came into force in 2014 and aimed at supporting full-time studies and accelerating the completion of studies (among other things by introducing

an 'incentivising study loan compensation for the efficient completion of studies) (Ministry of Finance 2015: 35).

Overall, reforms undertaken over the crisis years aimed at improving the effectiveness and efficiency of the Finnish education and training system, from early childhood education and care to tertiary education. However, the education budget has been cut since 2011 within the framework of fiscal consolidation policies.

Public sector

Over the crisis years, the Finnish public sector did not experience major structural reforms. This is also true of the central public administration,[21] in which little change has occurred since 2008. Specifically, no pay cuts were introduced for employees in the sector, nor were changes in working time agreed or implemented (EurWORK 2014b). By contrast, tripartite negotiations in 2011 led to a pay increase of 4.3 per cent for 94 per cent of the Finnish workforce (ibid.: 18). This trend is confirmed when looking at the general government public expenditure on compensation of employees (as a percentage of GDP), which even increased in the aftermath of the crisis, from 12.9 per cent in 2008 to 14.3 per cent in 2009, and then remained fairly stable in the following years (Annex to Agostini and Natali forthcoming).

However, although the crisis did not worsen public workers' conditions, it is worth mentioning that a reduction of about 6,400 has been reported in the number of employees in 'public administration, defence and social security'[22] from 2008 (116,300) to 2013 (109,900) (ibid.). The substantial downsizing of the sector, however, followed a path already started in 2003 with the adoption of the Finnish State Productivity Programme (planned to end in 2015), which by 2011 had reduced the central public administration by 8,000 jobs with the aim of reducing costs and improving the efficiency of the system. The effectiveness of the programme itself has been questioned as it has been shown to have brought about little (or no) productivity gains (EurWORK 2011).

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21. In this case, following Eurofound (2015: 2), we understand by public administration 'those central government departments or ministries that carry out planning, management and coordination functions rather than public-service delivery functions'. Therefore, the definition excludes all the other sectors providing services of general interest, such as education and health care.

22. The 'public administration, defence and social security' classification refers to the Statistical Classification of economic activity in the European Community (NACE), Rev. 2 (2008).

Nonetheless, although major restructuring was implemented in the pre-crisis years, new adjustments are under way, especially at local level, also because of EU pressure coming from the Country-Specific Recommendations addressed to Finland with regard to the public sector. The Local Government Structure Act, which entered into force in summer 2013, is aimed at achieving productivity gains and cost savings in the provision of public services (Ministry of Finance 2014: 17) by means of mergers of municipalities and reductions of their tasks. Consequently, the reform will have a strong impact on Finnish administrative structure, which expresses the constitutional value of self-government with a high degree of decentralisation and a large share of local government spending as a percentage of GDP (OECD 2014a). According to an estimate of the Finnish government, the reform – when fully implemented between 2015 and 2017 (indicatively) – will result in a reduction of 1 billion euros in operating expenditure for local authority duties and obligations. Additionally, the new local administrative structure aims to generate 1 billion euros in savings through measures implemented by local authorities, for instance by improving productivity and through tax revenues (Ministry of Finance 2014: 17), although the effects of these measures will be visible mainly in the medium and long term.

Summing up, no restrictive reforms in the public sector have been implemented since 2008. The explanation is twofold. First, the role played by the social partners, especially the trade unions, which have managed to block unfavourable reform processes, such as (at least until 2014) the increase in the retirement age (EurWORK 2014b). Second, the reform of the sector already undertaken in the early 2000s, in common with other Northern European Member States, subsequent to the economic crisis experienced in the 1990s (Eurofound 2015).

Research and development

Given the innovation-driven nature of the Finnish economy, gross domestic expenditure on R&D in Finland has been the highest in the EU since 2007. Specifically, it reached a peak of 3.8 per cent of GDP in 2009 and – despite a reduction – in 2013 the level of domestic expenditure on R&D was 3.3 per cent of GDP, an outstanding result in comparison with the 2 per cent EU average registered in the same year. Nevertheless, the country is not on track to reach the Europe 2020 national target on R&D (4 per cent of GDP). This is mainly due to the decline in business expenditure registered since 2011 (European Commission 2015c: 61), despite the internationally high figure when it comes to pri-

vate spending on R&D[23] (Ministry of Finance 2014: 39). As for public spending on research and innovation, expenditure rose continuously from 2000 and declined for the first time in 2013, although it is still one of the highest values in the EU (1.01 per cent of GDP). However, consistent public spending on research and innovation did not directly translate into equivalent innovation outcomes (European Commission 2015c: 56).

Comprehensive reform of research institutions and research funding was launched in 2013, aimed at tackling this lack of efficiency by strengthening multidisciplinary and high-level research of significance for society, including research promoting renewal of the country's economic base and competitiveness, the development of working life and enhancement of the public sector (ibid.). Therefore, the reform addresses the specific recommendations issued by the European Commission with regard to innovation policies and attempts to find new solutions and fields of specialisation to increase the competitiveness of the Finnish economy (hard hit by the fall in productivity of the electronics and forestry industries). However, evaluation of the reform's outcome in this respect will be possible only in the long term. In particular, the measures implemented include the organisation of research institutes into larger and stronger entities and a new funding system for universities. The research activities of universities of applied sciences saw an increase in the allocation of resources of 10 million euros in 2013 and a new funding model implemented at the beginning of 2014 (Ministry of Finance 2014: 40).

Moreover, in order to reverse the declining trend in business R&D investment registered in the past few years, the Finnish government has put in place, for 2013–2014, a system of incentives including a tax incentive for research and development activity and a double depreciation allowance for industrial investments (ibid.). Additionally, with the attempt to promote research and development and enterprise growth, Finland has also resorted to a significant allocation of European Regional Development Funds for the budgeting period 2014–2020 (European Commission 2015c: 60).

To sum up, despite remarkable performances in comparison with other EU Member States, Finland is experiencing a reduction of its gross

23. In 2013, it accounted for 69 per cent of total spending.

domestic expenditure on R&D, mainly as a consequence of shrinking private investment. Following this development, the measures implemented in recent years have aimed at increasing private investments by means of tax incentives for conducting R&D activities. In 2013, additional emphasis was placed on the need to make the research environment more responsive to the needs of the Finnish economic model through the implementation of a comprehensive reform of research institutions and research funding.

3.2.3 Preliminary remarks on structural reforms in Finland and their determinants

Finland has traditionally been considered to be a country following a 'high-road' to economic growth and competitiveness, characterised by the desire to combine sound budgetary conditions, high quality production and innovation-driven growth, fairly high wages and social standards. This development model was consolidated over the 1990s and 2000s, when a series of reforms in various policy areas strengthened the 'social investment orientation' of the Finnish model, though at the cost of some cuts to social benefits, which contributed to an increase in income inequality.

Attempts to preserve the model while coping with the global crisis (as well as with more country-specific problems affecting the Finnish economy and society) are apparent from policy choices made over the crisis years. In fact, changes undertaken over the period generally display a significant degree of continuity with past reforms, although in a context characterised by deteriorating budgetary conditions and growing importance attached to the objective of fiscal consolidation. In more detail, while the initial reaction to the crisis consisted in the implementation of a series of measures aimed at preserving or improving social standards, since 2011 more restrictive measures (social standard devaluation) have been implemented, although they have sometimes been accompanied by investment-oriented initiatives. Particularly worrisome signals are coming from two key sectors of the Finnish development model: education and R&D. The former has been heavily hit by budget cuts undertaken since 2011, although public spending on education is still above the EU average and various measures aimed at improving the efficiency and effectiveness of the system have been implemented. Similarly, although it is still the highest in the EU, gross domestic expenditure on R&D as a

Table 10 Summary table: drivers of reform and major reform trends in Finland, 2008–2014

	2008–2011	2011–2014
Drivers of reform		
Economic crisis	Economic recession (slight recovery in 2010); Drop in exports; Increase of public deficit and debt	Economic recession; Increase of public deficit and debt
Coalition governments	Centre-right	Grand coalition
EU influence	EDP (2010–2011); European Semester (2011)	European Semester
Structural reforms		
Reform path (for the five policies under scrutiny)	Social standards improvement	Social standards devaluation/some selective investment
Main reforms in each policy field		
Pensions	- Reduction of taxes on pension income and measures to ensure benefit indexation; - Introduction of the 'Guarantee pension'	- Measures aimed at extending working life
Labour market	- Measures facilitating temporary lay-offs; - Changes to unemployment benefits (replacement rates/ access conditions/activation requirements/ sanctions)	- Extension of ALMP (for specific target groups); - Reform of PES
Education	- University reform	- Decrease of government expenditure; - Reform of early childhood education and care; - Reform of the on-the-job learning and apprenticeship training systems
Public sector		- 4.3 per cent pay increase (2011); - Local Government Structure Act (2013)
Research and development		- Reform of research institutions and research funding; - Tax incentives on R&D

Source: Authors' elaboration.

percentage of GDP declined in 2012 and 2013, mainly as a consequence of a reduction in private expenditure.

Most of the reforms referred to in this report are consistent with the contents of CSRs received by Finland since 2011 within the framework of the European Semester. That said, the role of the EU in 'pushing' these changes should not be overestimated. Indeed, considering the remarkable continuity of changes implemented over the crisis years with the reform path of the past, messages coming from the EU level cannot be understood as 'strong pressure' on domestic policymakers. Probably, it would be more correct to interpret most of these recommendations as additional stimuli to implement decisions already taken at the national level. This holds true also for the fiscal consolidation measures implemented by the Finnish government since 2011. Although recommendations to continue fiscal consolidation efforts and preserve a sound fiscal position have been a constant of CSRs addressed to Finland, Dølvik *et al.* (2014: 271) suggest that the Finnish grand-coalition government would have probably managed to implement this sort of fiscal consolidation programme even in the absence of those recommendations. However, it is possible to expect that – in parallel with the deterioration of the budgetary situation – the degree of pressure from the EU level is likely to increase in the coming years, as such a trend is already apparent from the tenor of some of the CSRs received by Finland in 2014 and 2015.

3.3 Germany

3.3.1 Setting the scene: key traits of the country's political economy

Germany's export-led economy was hit hard by the outbreak of the global crisis. Nonetheless, its economic and social performances in the years that followed differed from those of most EU Member States in a number of respects. In terms of GDP development, Germany has experienced fluctuations: a significant fall in the GDP growth rate (from 1.1 per cent in 2008 to –5.6 per cent in 2009) was followed by a remarkable recovery of 9.7 percentage points from 2009 to 2010 and a second collapse in 2012, which nevertheless did not lead the country into recession. Government gross debt rose steadily from 2007 to 2010 – when it registered a peak of 80.5 per cent – and then decreased consistently for the next few years. Also, the government deficit as a percentage of GDP followed a similar V-shaped trend. The budgetary effect of the crisis-related measures im-

Table 11 **Germany: selected socio-economic indicators, 2007–2014**

Indicators/years	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	3.3	1.1	–5.6	4.1	3.6	0.4	0.1	1.6
General government gross debt (EDP concept) (% of GDP)	63.7	65.1	72.6	80.5	77.9	79.3	77.1	74.7
General government deficit/surplus (% of GDP)	0.3	0.0	–3.0	–4.1	–0.9	0.1	0.1	0.7
Employment rate (% 20-64)	72.9	74	74.2	74.9	76.5	76.9	77.3	77.7
Unemployment rate (%)	8.5	7.4	7.6	7.0	5.8	5.4	5.2	5.0
People at risk of poverty or social exclusion (% of total population)	20.6	20.1	20.0	19.7	19.9	19.6	20.3	n.a.

Source: Annex to Agostini and Natali (forthcoming).

plemented and the activation of the automatic stabilisers in the first two years after the outbreak of the crisis is reflected in the low point registered in 2010 (–4.1 per cent). However, the improvements reported subsequently, in terms of both gross debt and deficit/surplus, show the German political authorities' degree of commitment to 'fiscal responsibility'.

Indicators of social conditions – such as labour market or poverty statistics – show substantially diverging trends from the economic and financial indicators previously considered. The employment rate increased steadily in the aftermath of the crisis, rising from 72.9 per cent in 2007 to 77.7 per cent in 2014. This is in marked contrast to the average EU28 performance, which has seen a decrease in the employment rate, particularly in the Southern European economies. Similarly, the German unemployment rate has continuously diminished during the period in question. This peculiar trend of the German labour market must be attributed at least partially to the changes that have occurred in Germany's social model since reunification, combined with important ongoing characteristics limiting the negative influence of the crisis on employment (Carlin *et al.* 2015: 49). Nonetheless, the launch of the so-called 'mini-jobs' strategy through the adoption of the so-called 'Hartz reforms' between 2002 and 2005 (further investigated later in this section) also

produced employment growth, albeit by enlarging the low wage sector of the labour market and increasing market-income inequalities (Carlin *et al.* 2015). In other words, although the labour market reforms – which occurred until the mid-2000s – played a role in reducing the crisis-related effects on employment in Germany, they also increased the number of a-typical and 'flexible' work contracts. This may partly explain the limited change in the percentage of people at risk of poverty or social exclusion from 2007 to 2014, despite the steady increase in the employment rate during the period.

According to the 'varieties of capitalism' approach, as defined by Hall and Soskice in 2001, the German model belongs to the group of 'coordinated market economies (CME)', usually based on the principle of collaboration, credible commitments by firms, as well as non-market relations. More specifically, the peculiarities of the continental European economies fit better with the definition of the sectoral-CMEs sub-cluster, characterised by sectoral coordination and weaker social partners than in the national-coordinated Nordic countries (Agostini and Natali forthcoming). Nonetheless, the German model fits poorly into general categories due to its specific features. According to Hall (2015: 45), 'the German political economy displays some distinctive features constitutive of a German model of economic development', as it has been shaped by the combination of specific institutional, political and economic elements both at the micro and macro levels of the economy. At the macro level, both institutions and policies have helped to shape a favourable environment for business, combined with a generous welfare state. At the micro level, firm organisation and coordination, as well as the institutional environment in which they operate, are determining factors of the high quality of their production (ibid.: 46). The manufacturing sector, which plays a leading role in Germany's export-led economy, is characterised by numerous medium-sized firms, preference for business strategies focused on high-quality production and a thriving innovation system (Calvo 2015: 336). The whole microeconomic level is supported by a strong system of higher education and vocational training, local banks with specialised business knowledge, a dense and high-quality network of institutions devoted to industrial innovation and consensual collective agreements (ibid.).

The industrial relations system constitutes an additional peculiarity of the German model compared with its peer sectoral-CMEs. Indeed, soon after reunification, employers began increasingly to oppose sectoral col-

Table 12 **The German social model**

Labour market regime	Welfare regime	Varieties of capitalism
Continental European	Conservative-corporatist	Sectoral-coordinated market economy
Peculiarities: - Labour market protection relatively high for insiders (even though reduced following implementation of the Hartz reforms), but substantially lower for outsiders - Reduced unemployment benefits and increased ALMP (following adoption of the Hartz IV reform)		Peculiarities: - Strong reliance on plant-level agreements between management and work councils. - Historically strong trade unions at national level.

Source: Agostini and Natali (forthcoming).

lective agreements, preferring to adjust pay and working hours according to local needs (Carlin *et al.* 2015: 53). By the late 1990s, plant-level agreements between management and works councils became frequent, and these even started to shape sectoral agreements rather than the other way round (ibid.). Nowadays, however, sectoral collective bargaining remains the dominant level of collective bargaining in Germany, although company-level bargaining is increasingly important (EurWORK 2015). With regard to worker representation at national level, trade unions used to be a cornerstone of German social dialogue, with a high level of worker participation, especially in western Germany (Schweiger 2014: 107). However, their position has become increasingly weak, in terms of both union density and their inability to rally support for industrial action (Carlin *et al.* 2015: 55–56).

As for the specificities of the labour market, Germany belongs to the Continental European cluster, characterised by a traditionally high degree of labour market protection, combined with high levels of spending on passive measures and few active labour market policies (Agostini and Natali forthcoming). However, in Germany there is a large gap in the degree of labour protection between insiders and outsiders. This has been partly reduced by the implementation of the 'Hartz reforms' in the early 2000s, although more by reducing labour protection for insiders than improving protection for outsiders (Carlin *et al.* 2015: 65). These early 'austerity'-related labour market reforms were aimed at fostering 'activation'

of the unemployed by introducing new flexible and part-time contracts. With regard to passive measures – although the unemployment insurance system was one of the basic pillars of Germany's Bismarckian welfare state – these were reduced and reshaped by the 'Hartz IV' reform in order to lower the costs of the welfare system, ostensibly because of high unemployment (Carlin *et al.* 2015). Also, active labour market policies gained momentum during this period, although they were not usually a key element of the Continental European labour market strategies.

Drawing on the index of EU leverage on Member States' policies outlined by Stamati and Baeten (2014), Germany can be included in the group of countries subject to moderate leverage from the EU system of economic governance. The country is indeed a member of the euro zone and subject to the Fiscal Compact. It underwent an Excessive Deficit Procedure (EDP) from 2009 to 2012, but has never been subject to a Macroeconomic Imbalances Procedure (MIP). However, it is worth mentioning that the country managed to close its EDP well ahead of the deadline set for 2013, reducing its deficit to 1 per cent as early as 2011 (Council 2012). The improved budgetary situation was driven by favourable cyclical conditions, a robust labour market, fiscal consolidation efforts and the phasing-out of economic stimulus and financial sector stabilisation measures (ibid.). Within the European Semester and on publication of the European Commission's in-depth reviews on macroeconomic imbalances, causes for concern were highlighted, mainly with regard to the large and recurrent German current account surplus, as this restricts the neighbouring Member States' possibilities to compete internationally with the German export-led economy. For the same reason, pressure to increase public investment in order to support domestic demand has been a recurrent theme in the Council's CSRs addressed to Germany.

Angela Merkel has dominated German politics for the past 10 years. Due to the narrow victory of the Christian Democrats over the Social Democrats in the 2005 general election a Grand Coalition government of the two largest German political parties was formed. This limited to a certain extent the government's ability to carry out controversial 'reforms' (Funk 2013: 202), although it still managed to implement several crisis-related measures during the 2008–2009 emergency period. These were mainly measures to support the financial sector, boost domestic demand and strengthen active labour market policies with a view to reducing the shock produced by the considerably worsened export prospects and the financial instability related to the crisis (ibid.) Nonetheless, the resulting

Table 13 **German governments, 2005–present**

Years	Prime Minister	Position in the political spectrum	Coalition forces	Reform programme
2005–2009 (October)	Angela Merkel	Grand coalition	- Christian Democratic Union (CDU)/Christian Social Union (CSU) - Social Democratic Party (SPD)	Selective investment; Crisis-related stimulus measures
2009–2013	Angela Merkel	Centre-right	- Christian Democratic Union (CDU)/Christian Social Union (CSU) - Free Democratic Party (FDP)	Selective investment; Fiscal consolidation package
2013–	Angela Merkel	Grand coalition	- Christian Democratic Party (CDU)/Christian Social Union (CSU) - Social Democratic Party (SPD)	Some social standards improvements; 'Fiscal responsibility'; Growth-enhancing and social investment

Source: Funk 2013, Federal Government of Germany.

surge in general government debt has been taken by the following Merkel government as a cue to pursue more restrictive economic policies. In 2009, the Christian Democratic Union (CDU) formed a new coalition government with the Free Democratic Party (FDP), its former partner in government from 1982 to 1998. The reforms implemented between 2009 and 2013 were heavily influenced by these parties' perception of the economic crisis and the increasing public debt levels affecting EU Member States. Therefore, the so-called 'debt brake' and, more generally, the government's commitment to 'fiscal sustainability and responsibility' became the dominant policy tools of German economic and financial policy.

The federal election held in 2013 resulted in a clear victory for the Christian Democrats (The Economist, 2013), but the CDU did not gain enough seats to form a one-party government. Nevertheless, due to the poor results obtained by the CDU's previous coalition partner, which even failed to get into Parliament at all (the FDP), Chancellor Merkel agreed to form a new coalition with the SPD (Spiegel Online International 2013; Federal Government 2013). The new government's programme includes measures new to labour market developments in Germany (EurWORK 2014a), including the establishment of a national minimum wage aimed

at tackling pay gaps and reducing the share of low-wage earners. It is just as committed to fiscal consolidation as the previous Merkel government, but fiscal restraints will seemingly not be applied to growth-enhancing policy sectors, such as education and research (a strategy of selective investment).

3.3.2 Structural reforms sector by sector

Pensions

Public expenditure on pensions in Germany was above average in comparison with other Continental economies until 2005, when an important reform of the pension system was adopted. After starting to decrease in 2006, federal government expenditure on pensions remained fairly stable during the crisis-related years and even increased between 2008 and 2009 (Annex to Agostini and Natali forthcoming). Indeed, pension reforms implemented in Germany in the wake of the crisis have not followed the same retrenchment trend typical of several other countries in the EU. Germany is part of the group of Member States – also including Austria and the Netherlands – that have adopted a rather mixed set of reforms, resulting in a longer term reduction, but also some benefit improvements (Natali and Zaidi 2015). In other words, pensioners in Germany did not suffer a reduction of pension payments, but rather improvements in adequacy (ibid.). Specifically, pensions increased by 2.41 per cent in 2009 (rather than 1.76 per cent as set out in the 2005 rules), although there was no increase in 2010 (–2.1 per cent) (OECD 2013d: 30).

As for the retirement age, the legislation adopted in 2007 increased the pension age from 65 to 67 (OECD 2013d: 30). However, the pension reform adopted in 2014 by the new CDU–SPD coalition government has again provided more generous pension entitlements. The reform, particularly sought by the Social Democrats, has come with no pressure from the European institutions and has been widely criticised in economic terms, including by the European Commission in its 2015 Country Report. The new regulation accounts for most of the planned federal government's higher spending. It provides for pension increases to women who gave birth before 1992, while workers with more than 45 years of contribution records can retire on a full pension at 63 years, rising to 65 years, in line with the increase in the standard legal pension age from 65 to 67 years (OECD 2014c: 107). According to the EC, the measure

puts additional strain on the sustainability of the pension system and affects intergenerational income distribution, especially given the projected strong decline in Germany's working-age population and a possible shortage of skilled workers in the medium term (European Commission 2015:59). Moreover, despite the CSR issued in 2014 on the necessity to improve the sustainability of the pension system, no major actions have been taken in this direction during the year.

To sum up, pension payments remained stable in the wake of the crisis, with some improvements in adequacy. Nonetheless, the reform path was less generous with regard to the changes of the retirement age (2007) professedly adopted to cope with an ageing population and lack of skilled workers in the country. However, the reform path initiated by the new 'grand coalition' government is deviating from this fairly mixed set of reforms towards a strategy involving increased investment in pensions.

Labour market

As already mentioned, the German labour market was subjected to many structural reforms during the early 2000s. However, in the period that followed the outbreak of the economic and financial crisis, several measures were implemented and, combined with a flexible collective bargaining system, this allowed the labour market to adjust to the new crisis situation. As for the results of collective agreements with regard to wage setting and working time provisions, the mainstream trend during the recession has been to flexibilise working time, as well as to reduce wage increases in exchange for job security. Specifically, the average wage increase fell from 2.9 per cent in 2008 to 2.6 per cent in 2009 and 1.8 per cent in 2010 (Reisenbichler and Morgan 2015: 70). It finally began to rise again in 2012 and 2013 (+2.7 per cent) (ibid.: 73).

The economic stimulus packages adopted in 2008 and 2009 – the so-called ESP I and ESP II – introduced market measures, including the extension of the entitlement period for short-time working benefits to 18 (ESP I) and 24 (ESP II) months by the end of 2010 (Funk 2013: 211). In 2011, entitlement to short-time allowances was reduced to six months by the second Merkel government, but it was later (temporarily) extended to 12 months one year later (Bandau and Dümig 2014: 340). The overall trend in labour market policies between 2009 and 2013 – in other words during the mandate of the centre-right CDU–FDP government – was limited mainly to readjustments of existing policy measures. Nonetheless, these readjustments were aimed primarily at fiscal consolidation.

The austerity package approved in 2010 led to a series of cuts to the basic social security scheme for job-seekers – also known as Hartz IV – only partially mitigated by the intervention of the Federal Constitutional Court (FCC) (ibid.: 342–343). As for active labour market policies, the government had recourse mainly to cuts and mergers of single measures (ibid.: 344). Nonetheless, the relative scarcity of reforms during the period compared with under previous governments was probably due to the good economic environment at the time.

In 2015, the second Grand Coalition government of the CDU/CSU and the SPD introduced a national minimum wage set at 8.5 euros per hour for all workers in order to reduce the gap between insiders and employees in insecure employment (OECD 2014c). Some important exceptions included those sectors already covered by minimum wages stipulated in the Posted Workers Act. Moreover, sectoral collective agreements between social partners can be exempted from applying the fixed minimum wage until the end of 2016, after which time all sectors will have to comply with the new regulation (EurWORK 2014a). The measure aims at counteracting the dualisation of the German labour market, extensively criticised by European institutions as well as benchmarking organisations. Therefore, after increasing employment rates, often to the detriment of outsider workers' conditions, the path of reform seems aimed at reducing the gap between core workers and those with a-typical, low-income jobs. That said, there is the risk that the introduction of a statutory minimum wage could actually bring about job losses and reduced opportunities for low-skilled workers to enter the labour markets. In order to prevent negative effects from the new measure, a commission composed of representatives of the employers' associations and trade unions will review the level of the minimum wage, with a first review set for June 2017 (EurWORK 2014a).

To sum up, three major trends can be identified in the labour market policies promoted by the authorities in 2008–2015: (i) introduction of stimulus measures and use of automatic stabilisers during the 2008–2009 crisis period (Funk 2013); (ii) the implementation of restrictive, though minor, measures devoted to fiscal consolidation between 2010 and 2013 (Bandau and Dümig 2014); and (iii) de-dualisation of the labour market by improving the conditions of the low-wage sector earners in 2014 and 2015 (Reisenbichler and Morgan 2015). Therefore, the reform path undertaken has been fairly irregular. However, this has helped the labour market to adjust in timely fashion to the various economic shocks.

Education

Public expenditure on education in Germany increased slightly, but steadily in the first years following the outbreak of the crisis,[24] both in terms of percentage of GDP and as a percentage of total public spending (Annex to Agostini and Natali forthcoming). According to the EC country report, these increases are not sufficient, as the level of expenditure on education is below the EU average (European Commission 2015d). However, expenditure per student is well above the EU average, as the country has a ranking of eighth among the EU27 (European Commission 2014c: 3). Additionally, Germany spends below the EU average on primary education, but above average on upper secondary and tertiary education (ibid.), a policy in line with the need for a highly-skilled and specialised labour force for its innovation-driven economy.

Nonetheless, early childhood education and care is the policy field in which the greatest improvements have been made in the past decade (Hanesch *et al*. 2015), through the provision of new facilities, regulation and funding. Specifically, since the Day Care Development Act (*Tagesbetreuungsausbaugesetz*) came into force in 2005 and the Childcare Funding Act (*Kinderförderungsgesetz, KiföG*) in 2008, important changes have occurred in terms of the range of childhood services offered, especially to children under three years of age (International Centre Early Childhood Education and Care 2015). These included funding from the federal government and the *Länder* for the expansion of facilities, which occurred until 2013. Moreover, in August 2013 the Childcare Funding Act introduced a statutory right for children to attend centre-based early childhood services or family day care from the age of one onwards (ibid.). The crisis seems to have brought about little or no change in the national priorities for early childhood education and care policy, or in the field of education in general.

In 2009, additional funding was made available for all levels of education under the Investing in the Future Act, which provided 8.7 billion euros between 2009 and 2011 for early childhood education, school and university infrastructure, local facilities for further education and for research. Also, in recent years policymakers have devoted some attention to improving the quality of teaching, an objective pursued in various stages through the adoption of the Quality Pact for Teaching in 2010 (OECD

24. Data available until 2011.

Education Reform Finder) and afterwards with the introduction of a new federal government/*Länder* programme (*Qualitätsoffensive Lehrerbildung*) concluded in 2013 in support of teacher training through the introduction of innovative concepts (European Commission, 2015d: 65, Federal Ministry for Economic Affairs and Energy, 2014: 42). Although these measures had differing objectives (the former concerns only public higher education institutions) both involve significant public investment in the education system. Specifically, the first provides for investment of 2 billion euros in the timeframe 2011–2020 and the second involves 500 million euros (OECD 2015b; European Commission 2015d: 65).

Vocational Education and Training (VET) has always been an important element of both the German education system and the labour market, as it is one of the reasons for the country's low youth unemployment rate (European Commission 2014c). Therefore, the VET system has been regularly updated to meet labour market needs in recent years (OECD 2014c: 44). By contrast, according to the recurrent CSRs received by the country on the theme of education, still more should be done in terms of raising the educational level of disadvantaged people and providing greater opportunities for entry into the education system. Action has been taken by some *Länder* with a view to reducing the stratification of the school system by combining different school tracks in one school type (OECD 2014c: 43). Moreover, several other measures were implemented in the *Länder* between 2013 and 2015 with the purpose of raising the level of education of disadvantaged people, as underlined in the National Reform Programme (NRP) for 2014. This shows some degree of concern to comply with recommendations issued by the Council on the topic.

Overall, the policies implemented in the field of education, in terms of both expenditure and programmes aimed at improving the quality and fairness of the system, have been fairly consistent during the whole period with expansionary reform activity. In this regard, neither the economic and budgetary situation of the country, nor the different colours of governments in power have seemed to produce substantial changes in this pro-growth reform path.

Public sector

Since 2008, there have been no special adjustment programmes or structural reforms in the German public sector (Bosch *et al.* 2012). Pay reductions and wage freezes have been less common in Germany than in other Member States (Eurofound 2015: 8). From 2009 onwards, this

singular trend could also be seen in the area of job losses, as the number of employees in the public sector slightly increased. However, this was the result of the increase in employment in the education and child-care subcategories (Keller 2014: 389), while the number of employees in public administration, defence and compulsory social security[25] remained fairly stable in 2008–2013, with an average change of 0.2 per cent (Annex to Agostini and Natali forthcoming). Nonetheless, it is worth mentioning that the lack of major reforms and restrictive measures since the outbreak of the crisis is at least partially the result of significant job losses and early austerity measures in the 1990s and 2000s, which also produced important cumulative effects in the following years (Bosch *et al.* 2012: 7; Keller 2014: 388). Overall employment in the sector dropped from 6.7 million in 1991 to 4.5 million in 2009 – later increasing to 4.6 million – thus contributing to the development of a 'lean' public sector (Keller 2014: 389).

The structure of German public services is characterised by three levels of government: the Federal level, the *Länder* and the municipalities. Moreover, public employees are divided into salaried employees and civil servants (*Beamte*). The latter category has a unique status regulated by the Constitution, including life-long employment. Both these distinctions are of particular importance for understanding the early austerity measures implemented from the 1990s. Indeed, the measures affected employees mainly at municipal level – especially in eastern Germany after reunification – and non-civil servants, whose status was less well protected by law than that of the *Beamte*.

With regard to pressure from European institutions to reform the public sector in Germany – more specifically the public administration – the only cause for concern (also expressed in the Country Report published by the EC in 2015) is the need to reduce the administrative burden on businesses and to improve e-government services. Indeed, Germany is among the Member States with the least online interaction between public authorities and citizens (23rd out of 28 Member States – European Commission 2015d: 72). However, no specific mention of the need to improve the public administration can be found in the CSRs addressed to the country in recent years.

25. Classified according to the NACE Rev. 2.

It follows that, when it comes to reform of the public sector – besides the cutbacks of the years preceding the outbreak of the crisis – there is no important reform trend to underline. Nonetheless, a slight increase in the number of employees in the public sector, as a result of increased employment in education – especially the early childhood education and care sub-category – might suggest the presence of a lean expansionary trend.

Research and development

In the field of innovation, Germany is close to achieving its Europe 2020 expenditure target of 3 per cent of GDP. The country performs above average also in terms of outcomes, as it is the best performer in the EU according to the European Innovation Output Indicator (European Commission 2015d: 71). Nonetheless, in recent years, pressure to increase public investment in R&D has come regularly from the CSR addressed to Germany. The level of investment in Germany is indeed lower than in other innovation-driven economies in Europe, such as Denmark, Finland and Sweden (Annex to Agostini and Natali forthcoming). Moreover, R&D activities and expenditure remain mainly supported by the private sector in the country, as industry accounts for well over half of all spending on R&D (Federal Ministry for Economic Affairs and Energy, 2014: 27). Nevertheless, the federal government has made consistent efforts to improve national competitiveness in terms of research and innovation, as shown by the additional funding included in the 2014 stability programme, providing 3 billion euros for research, combined with increased expenditure of 6 billion euros for financing childcare facilities, schools and higher education institutions (European Commission 2015d: 31).

The expansionary trend in R&D expenditure has not changed in the aftermath of the crisis. This can be partly shown by the extension – in terms of both timing and funding – of the programme 'Research at Universities of Applied Sciences', fostering application-related research in the fields of engineering, natural sciences, social sciences and economics in collaboration with business enterprises (especially SMEs) and university-based and non-university research institutions. The joint programme between the federal government and the *Länder* was launched in 2005 and since then its funding has quadrupled from 10.5 million euros in the first year to roughly 41.5 million euros in 2013 (Federal Ministry for Economic Affairs and Energy 2014: 61). Moreover, the new coalition government has taken further steps to improve national business capacity by adopting the new Digital Agenda 2014–2017, approved in August 2014. This will expand high-speed data lines, boost internet security and foster

cyber-related entrepreneurship. It will also provide fast broadband (50 Megabits per second) internet to rural and urban areas by 2018 (European Commission, 2015d: 71). Additionally, the update of the High tech strategy in 2014 is aimed at strengthening economic growth by means of a coherent innovation policy, supporting knowledge transfer and innovation in future markets (ibid.).

To conclude, the reform trend with regard to R&D policies has been fairly consistent over the years with the investment strategy typical of highly innovation-driven economies, although the level of public expenditure is still below the average performance of similar economies within the EU. However, different digital strategies and the focus on increased cooperation between academic and non-academic research institutes and businesses prove the level of commitment of public authorities to constantly improving economic competitiveness.

3.3.3 Preliminary remarks on structural reforms in Germany and their determinants

In the wake of the crisis, the restrictive measures implemented in Germany have spared the sectors of education and innovation, especially with regard to R&D activities, tertiary education and VET. Thus, the variety of capitalism pursued in the German innovation-driven economy has played a role in defining the reform path taken, also at a time of financial and economic constraints.

However, the country's welfare model and labour market underwent significant restrictive changes in the years before the crisis and continued to undergo adjustments in its aftermath. The reforms ultimately led to the shrinking of the welfare state and dualisation of the labour market, despite an above-average level of employment, also among young people and women. Nonetheless, the policies implemented and planned by the new CDU–SPD coalition government will supposedly reduce the labour market gap between insiders and outsiders and increase social investment, while remaining committed to the principle of 'fiscal responsibility'. As regards pensions, the federal government has been relatively independent in pursuing its programmed reform path, also in the presence of opposing recommendations from the European institutions. Indeed, the EU's influence on the path of reform in Germany was fairly substantial at the time of the launch of the EDP, but shrank after its closure.

Table 14 **Summary table: drivers of reform and major reform trends in Germany, 2008–2014**

	2008–2009	2010–2012	2013–2014
Drivers of reform			
Economic crisis	Deep recession; Surge of general government deficit	Economic recovery; High general public deficit (2010)	Slight economic growth; Slight general government surplus
Coalition governments	Grand coalition (CDU/CSU-SPD)	Centre-right (CDU/ CSU-FDP)	Grand coalition (CDU/CSU–SPD)
EU influence	EDP (from December 2009)	EDP (until June 2012) European Semester	European Semester
Structural reforms			
Reform path (for the five policies under scrutiny)	Selective investment	Selective investment	Social standards improvements
Main reforms in each policy field			
Pensions	- Improvement in adequacy ratio - Increased retirement age (2007)		- Reform of pensions 2014
Labour market	- Automatic stabilisers - ESP I and ESP II	- Downward readjustment of existing policies	- National minimum wage
Education	- Childcare funding act - Investing in the future act (2009–2011)	- Quality pact for teaching - Investing in the future act (2009–2011)	- Steps to increase the fairness of the system (some *Länder*)
Public sector	Minor reforms (early austerity measures adopted before the outbreak of the crisis)		
Research and development	- Research at universities of applied sciences (from 2005, ongoing)		- Digital agenda - High tech strategy

Source: Authors' elaboration.

Overall, the reform trend has reflected, to a great extent, a *selective investment strategy*. Substantial investments in those policy sectors defined as growth-enhancing were combined with a shrinking level of workers' protection and a fairly mixed set of pension reforms. However, more generous measures were implemented horizontally among policy sectors in 2008 and 2009, in reaction to the recession, while fiscal consolidation measures were implemented soon afterwards with a view to improving the federal budgetary condition. In 2014 and 2015, a new tendency towards social standards improvements was launched through the adoption of the pension reform and the establishment of a national minimum wage.

3.4 Ireland

3.4.1 Setting the scene: key traits of the country's political economy

Ireland has been one of the EU countries hardest hit by the financial and economic crisis that began in 2008. In 2010, the Irish government asked the European Union and the International Monetary Fund for fi-

Table 15 **Ireland: selected socio-economic indicators, 2007–2014**

Indicators/years	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	4.9	–2.6	–6.4	–0.3	2.8	–0.3	0.2	4.8
General government gross debt (EDP concept) (% of GDP)	24.0	42.6	62.3	87.4	111.2	121.7	123.2	109.7
General government deficit/surplus (% of GDP)	0.3	–7.0	–13.9	–32.5	–12.7	–8.1	–5.8	–4.1
Employment rate (% 20-64)	73.8[b]	72.2	66.9	64.6	63.8	63.7	65.5	67.0
Unemployment rate (%)	4.7	6.4	12.0	13.9	14.7	14.7	13.1	11.3
People at risk of poverty or social exclusion (% of total population)	23.1	23.7	25.7	27.3	29.4	30.0	29.5	n.a.

Note: b = break in time series.
Source: Annex to Agostini and Natali (forthcoming: Appendix).

nancial assistance. Before 2008, the country experienced a fairly high rate of GDP growth (4.9 per cent in 2007) and sound budgetary conditions (public debt and deficit were, respectively, at 24 per cent and +0.3 per cent of GDP in 2007). However, the years between 2008 and 2013 saw a sharp deterioration of those indicators, with GDP growth falling by –6.4 per cent in 2009, the public deficit reaching 32.5 per cent of GDP in 2010 and public debt touching 123.2 per cent of GDP in 2013. The employment situation deteriorated significantly over the crisis years: the employment rate decreased from 73.8 per cent in 2007 to 63.7 per cent in 2012, while the unemployment rate, which stood at 4.7 per cent in 2007, peaked at 14.7 per cent in 2011. In 2007, the rate of people at risk of poverty or social exclusion was 23.1 per cent, rising to 30.0 per cent in 2012 (Table 15).

In 2014, the Irish economy showed some signs of recovery, at least in terms of GDP growth (+4.8 per cent) and some improvements of budgetary indicators: in 2014, public debt was 109.7 per cent of GDP (13.5 percentage points lower than 2013) and the deficit was 4.1 per cent of GDP (1.7 percentage points lower than 2013). However, only modest progress was registered for employment and social indicators: in 2014, the employment rate reached 67.0 per cent (+1.5 percentage points compared with 2013, –6.8 percentage points compared with 2007) and the unemployment rate was 11.3 per cent (–1.9 percentage points compared with 2013 and +6.6 percentage points compared with 2007). In 2013, 29.5 per cent of the Irish population were at risk of poverty and social exclusion, which means a decrease of 0.5 percentage points compared with 2012 and an increase of 6.4 percentage points compared with 2007 data.

Scholars invoking the ‘varieties of capitalism’ approach generally situate Ireland among the liberal market economies. However, the country shows some important peculiarities, inherited mainly from economic policy choices made at the end of the 1980s (Kirby 2008; Schweiger 2014). First, the Irish economy has traditionally been highly dependent on foreign direct investments and on exports, much more than other countries in the liberal market cluster. Second, the country’s industrial relations system displays some features comparable to the coordinative arrangements characterising coordinated market economies. Ireland is indeed among the most open economies in Europe: the establishment in the country of large multinational companies and the export of their products were the basis of the ‘Celtic Tiger’ boom during the 1990s, a

Table 16 **The Irish social model**

Labour market regime	Welfare regime	Varieties of capitalism
Anglo-Saxon	Liberal	Liberal market economy
		Peculiarities: - Strong dependence on FDI and important presence of multinational companies; - Coordinative arrangements at both sectoral (REAs, EROs) and national level (social partnership)

Source: Authors' elaboration on Agostini and Natali (forthcoming).

period characterised by high rates of GDP growth, increasing employment and decreasing unemployment rates. Policy choices made in that period pursued a precise strategy for increasing national competitiveness, creating an attractive environment for foreign direct investments, which have indeed given the Irish economy a comparative institutional advantage (Kirby 2008). Foreign investors were offered among the lowest corporation taxes in Europe and a stable, non-conflictual industrial relations system. Employment relations in Ireland have historically relied on a 'voluntarist' approach, with the state providing a supportive framework for collective bargaining, which results in non–legally enforceable collective agreements binding only on the signatory parties (Doherty 2014). At the sectoral level, important exceptions are the Registered Employment Agreements (REAs) – sectoral agreements registered with the Labour Court applying to all the employers and employees in the sector – and the Employment Regulation Orders (EROs) agreed by Joint Labour Committees (JLCs) and setting legally binding minimum wages and working conditions for the relevant sector (ibid.). At the national level, a peculiar feature of the Irish industrial relations system is the so-called 'social partnership' model, a 'semi-corporatist' model (Schweiger 2014) based on triennial social pacts signed by the government, employers' representatives and trade unions. Social partnership, developed since 1987, has entailed a strong centralisation of the social relations system, although it still relies on a regulatory framework based on voluntarism (Baccaro and Howell 2011; Doherty 2014). While social pacts agreed over the years have focused on a variety of issues, the key feature of these deals has remained constant: wage moderation in return for a reduction in personal taxation (Kirby 2008). That said, wage mod-

eration has been more rigidly enforced in the private sector than in the public sector (Baccaro and Howell 2011: 546).

In terms of welfare regime, Ireland displays most of the characteristics of liberal welfare regimes (Kirby 2008). The Irish welfare system has a residual nature and relies substantially on non-contributory, means-tested benefits. Cash benefits – generally kept at a low level – significantly prevail over services. Social protection spending as a percentage of GDP has traditionally lagged behind the EU average – even during the years of sustained growth of the 'Celtic Tiger' – and the system has proved to be scarcely effective when it comes to the reduction of poverty and inequalities. Overall, though social spending has increased and new provisions have been gradually introduced over time, the Irish social protection system has always remained aligned with the imperative of cost competitiveness characterising the country's economic policy objectives (Dukelow 2015). Looking more specifically at labour market policies, the Irish model has taken some inspiration from the Danish and Dutch systems of flexicurity, with some emphasis on activation and human capital development: however, the presence of a significant degree of flexibility[26] was never accompanied by equally generous unemployment benefits (Baccaro and Howell 2011: 546).

The beginning of the 2000s represented a turning point for the Irish economy. Although still extremely important, foreign direct investment started to slow down and the importance of domestic demand increased (Schweiger 2014: 156). The latter was fuelled by an expansion of the construction sector and the development of risky financial practices, which favoured private borrowing and the development of a property bubble. Thus, despite the country's growth rate and its sound budgetary position, the business model of many Irish banks left them significantly exposed to the turmoil of the US financial sector in 2007–2008. In September 2008, the Irish government announced that it would guarantee all the banks' liabilities. Because of this cash inundation into the banking system, the financial crisis rapidly turned into a sovereign debt and economic crisis and, in November 2010, the Irish government officially asked for financial assistance from the EU and the IMF. As is the case for the other countries under financial assistance, the Economic Adjustment

26. Considering the strictness of employment protection over the period 1999-2013, Ireland displays values among the lowest in the EU (Agostini and Natali forthcoming: Appendix).

Table 17 **Irish governments, 2007–present**

Years	Prime Minister	Position in the political spectrum	Coalition forces	Reform programme
2007–2008	Bertie Ahern (Fianna Fáil)	Centrist-conservative	- Fianna Fáil - Progressive Democrats - Green Party	Social standards devaluation
2008–2011	Brian Cowen (Fianna Fáil)	Centrist-conservative	- Fianna Fáil - Green Party	Social standards devaluation
2011–	Enda Kenny (Fine Gael)	Right-left coalition	- Fine Gael - Labour Party	Social standards devaluation

Source: Authors' elaboration.

Programme (EAP) for Ireland, signed in December 2010, foresaw three types of measure (European Commission 2011): (i) financial measures (with the aim to achieve a fundamental downsizing and reorganisation of the banking sector); (ii) fiscal measures (restoring fiscal sustainability through expenditure cuts and changes to the tax system); and (iii) structural reforms (including, for instance, reforms of the labour market). Ireland officially left the financial assistance programme in November 2013, entering into the post-programme surveillance phase. Furthermore, since 2009 the country has been under the corrective arm of the SGP (Excessive Deficit Procedure) and, for 2014 and 2015, it was among the countries for which the Commission had detected macroeconomic imbalances, which require 'specific monitoring and decisive policy action'.

Three governments have been in power over the period 2008–2015. In 2007, a coalition government headed by Bertie Ahern (Fianna Fáil) was formed. The lead party was Fianna Fáil, a centrist/conservative party, while the other members of the majority were the Progressive Democrats (liberals) and the Green Party (Table 17).

In 2008, a period characterised by significant political turmoil, Mr Ahern was replaced by Brian Cowen (Fianna Fáil) and the new government coalition was made up of Fianna Fáil and the Green Party. The rapid deterioration of the financial situation from 2008 made the Cowen government extremely unpopular and Mr Cowen resigned in 2011. The two opposition parties – Fine Gael (centre-right) and the Labour Party

– won the early general election held in February 2011 and formed a coalition government headed by Enda Kenny (Fine Gael). Looking at the governments' stance during the crisis, some observers point out that – overall – the interpretation of the causes of the crisis and of the actions needed was not disputed by members of the Irish political and economic elites (Dukelow 2015). The crisis was attributed to an excessive growth in expenditure and a related loss in competitiveness and reputation, so priority was to be given to cost containment and to the rescue of the banking system in order to preserve investors' confidence. An austerity plan amounting to 9 per cent of GDP was implemented in 2008–2009 and the Kenny government basically continued the austerity policy of its predecessors (social standards devaluation).

3.4.2 Structural reforms sector by sector

Pensions

Pension reforms have been at the heart of fiscal consolidation efforts of Irish governments over the crisis years. Measures implemented since 2009 have included cuts in pensions, changes concerning the retirement age and access conditions and cuts in public support to pre-funded pension schemes (Natali and Zaidi 2015).

The Irish MoU (European Commission 2011) contained measures related to pensions, including a reduction in pension tax relief and pension-related deductions to be undertaken in 2011 and the enactment of a reform increasing the state pension age in line with the government's National Pension Framework.[27] Specific provisions concerned public service pensions: existing benefits had to be reduced on a progressive basis averaging over 4 per cent, while a reform to be enacted in 2011 was expected to set up a new regime for new entrants. Notably, the 2011 reform was expected to provide for: a review of accelerated retirement for certain categories of public servants and an indexation of pensions to

27. The *National Pensions Framework* – published by the Cowen government in March 2010 as part of the negotiation for the rescue programme – set out the direction of future reforms. It included provisions on public sector pensions, higher retirement ages, the reform of tax subsidies as well as the expansion of coverage among low and middle income groups (Natali and Stamati 2013: 27). This document foresaw a gradual increase in the age for qualifying for the state pension to 66 years in 2014, 67 in 2021 and 68 in 2028.

consumer prices; linking pensions to average career earnings; and linking new entrants' retirement age to the state pension retirement age.

An initial set of measures was introduced between December 2010 and February 2011 (Natali and Stamati 2013: 27). First, current civil servants' pensions above 12,000 euros were reduced by an average of 4 per cent.[28] Second, provisions contained in the Finance Act enacted in February 2011 entailed a reduction of the maximum earnings limit for tax relief on pensions and of the limit on the 'tax-free' lump sum, as well as a gradual reduction of tax incentives for voluntary retirement savings.

In continuity with the approach followed by the Cowen government, the Social Welfare and Pensions Act enacted by the Kenny government in June 2011 contained the bulk of pension reforms. Besides increasing the standard retirement age for the state pension, as foreseen by the National Pension Framework, the Act also introduced disincentives for early retirement in the public sector, abolished exemptions from contributions for very low-income workers and put in place a new regime for newly hired civil servants (Natali and Stamati 2013: 27). The latter were assigned to a Public Service Pension (Single Scheme), paying a single price-indexed pension calculated on career average wages and with age prerequisites equalised to the new levels for private employees (ibid.).
As for private pensions, a 0.6 per cent annual levy for the years 2011–2014 was introduced in 2011, followed by an additional levy of 0.15 per cent for 2014 and 2015 (Natali and Zaidi 2015: 36). Considering the scope and speed of the changes described above, Natali and Stamati (2013: 29) conclude that in Ireland '(…) pension austerity has probably reached its limits'.

Labour market

Two main lines of change can be identified in labour market policies over the crisis years: (i) a review of minimum wage and sectoral wage agreements; (ii) reforms of unemployment benefits and active labour market policies (ALMP). The changes implemented largely went in the direction of the measures listed in the Irish MoU (European Commission 2011).

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28. A pension levy on civil servants, reducing benefits by 7 per cent on average, had already been introduced in 2009. Furthermore, the 2013 public service wage agreement included pension cuts for annual pensions above 32,500 euros for new retirees from 31 August 2014 (European Commission 2015b: 18).

As for wages, the Irish government was asked to reduce by 1 euro per hour the nominal level of the national minimum wage and to extend the scope of the 'inability to pay clause'.[29] Furthermore, an independent review of the REA and JLC arrangements was to be carried out in order to avoid distortions of wage conditions across the sectors associated with the presence of sectoral minimum wages in addition to the national minimum wage. The national minimum wage was actually reduced by 1 euro (12 per cent) through the Budget Law for 2011 (December 2010). However, after negotiations with the Troika, the Kenny government succeeded in reversing this decision in 2011. As for the REA and JLC arrangements, the results of the review conducted in 2011 were in favour of keeping the system in place, while reforming it. This reform was enacted in 2012 through the Industrial Relations (Amendment) Act.[30]

According to the Irish Economic Adjustment Programme, social benefits had to be included in the fiscal consolidation plan to be implemented by Ireland. In particular (ibid.: 63), changes were to be introduced to avoid unemployment benefit – as well as social assistance benefits – leading to so-called unemployment and poverty 'traps', including a possible reduction of replacement rates for individuals accumulating more than one benefit. Furthermore, conditions concerning work and training availability and activation measures were to be strengthened.[31] Finally, the governance of the system was to be improved by exploiting synergies and reducing the overlapping of competencies across the departments responsible for the administration of the various benefits.

With regard to measures on unemployment benefits implemented over the crisis years, there has been a mixture of negative incentives for activation (including a reduction of the replacement rate and the duration

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29. As reported by Schweiger (2014: 547), during the crisis, '[m]any private sector companies used the "inability to pay" clause in the national agreement either to freeze wage increases or even implement nominal pay cuts'.

30. According to some observers, the new provisions have entailed a downgrading of the social partners' role when it comes to negotiating terms and conditions of employment, while a subsequent decision of the Irish Superior Court has declared the *erga omnes* extension of the contents of the REA agreements unconstitutional (Doherty 2014: 87–88).

31. According to the MoU, improvements were needed in the identification of jobseekers' needs and the monitoring of jobseekers' activities, and to make sanction mechanisms for jobseekers not complying with labour-market activation more effective. EU attention to ALMP – as well as to Vocational and Educational training – would remain high even after the Irish exit from the financial assistance programme, resulting in a country-specific recommendation on those issues addressed in 2014 (cf. European Commission 2015c).

of unemployment benefits, as well as the introduction/reinforcement of sanctions) and positive incentives (the development of ALMP). In 2009, the number of contributions required to be entitled to Job Seeker's Benefit was doubled and, by 2013, the maximum claiming period was reduced from 15 to 6–9 months (Dukelow 2015: 105).[32] As for the Jobseeker's Allowance, in 2010 its level was cut for young recipients: 51 per cent of the full payment for recipients aged 18–21, 30 per cent for those aged 22–24 and, since 2014, 51 per cent of the full payment for all recipients aged up to 24 (ibid.). Overall, subsequent cuts to the value of the benefit made since 2009 have entailed a decline in the net replacement rate of unemployment benefits from 57 per cent in 2008 to 53 per cent in 2011 (Daly 2015:13). As for sanctions, a 30 per cent reduction in payments was introduced in 2010 for recipients not complying with activation conditions, and a further sanction in the form of a nine-week suspension of full payment was introduced in 2013 for claimants repeatedly refusing or failing to comply with activation conditions (Dukelow 2015: 106).

Since 2010, the measures described above have been accompanied by increased attention to ALMP and the development of related programmes and services. In this regard, particular emphasis has been put on the 'Pathways to Work' strategy, launched in February 2012 and revamped every year, which is supposed to complement the Plans for Jobs published annually since 2012 (Government of Ireland 2014). A key element of the strategy is the creation of Intreo offices, 'one-stop shops' integrating welfare and employment services, thus providing a single reference point for unemployment and welfare recipients and offering tailor-made support to benefit claimants. The Intreo working methodology has been gradually introduced in the Irish Employment offices, a process that should be completed by 2015 (Government of Ireland 2015). Since 2013, within the framework of the 'Pathways to Work' strategy, measures addressed to the long-term unemployed have been extended, including incentives for employers who recruit long-term unemployed people (JobPlus), relief from income tax for individuals who start a new business (Start Your Own Business), training opportunities and temporary employment schemes. Besides measures concerning public services, a new

32. In detail, Jobseeker's Benefit duration was reduced from twelve months to nine months for recipients with 260 or more contributions paid and from nine months to six months for recipients with less than 260 contributions paid, in 2013 (OECD 2013c: 35).

labour market activation service specifically targeted at the long-term unemployed – JobPath – is expected to begin in 2015. JobPath is to be delivered by private providers, on the supposition that it will entail gross benefit savings estimated at 525 million euros (European Commission 2015c: 38).

While political attention to ALMP has grown over the crisis years and a number of new initiatives have been implemented, data on expenditure suggest a more nuanced interpretation of these developments (cf. Agostini and Natali forthcoming: Appendix). Indeed, total expenditure on labour market policy measures[33] as a percentage of GDP was fairly stable between 2008 and 2011 and total expenditure on labour market policy supports (as a percentage of GDP) increased between 2008 and 2010, but has been on the decline since 2011. As a consequence, when looking at the percentage of ALMP expenditure out of total labour market policy expenditure, a negative trend emerges, with the level of this expenditure declining over the crisis years and slightly increasing only from 2011 (although still at a lower level than in the pre-crisis period). Data on expenditure in relation to GDP may be misleading, however, because they are extremely sensitive to the economic cycle: other indicators appear better suited to capturing trends in labour market policy over the crisis years and in particular the scope of 'activation efforts' (Eurostat 2011; on this point, see also Dukelow forthcoming).[34] Expenditure on labour market policy support for people wanting to work (in purchasing power standards) grew between 2007 and 2010, but has declined since 2011. Conversely, expenditure on labour market policy measures per person wanting to work (in pps) collapsed between 2008 and 2009, although since then it has been increasing at a slow pace (always remaining well-below the pre-crisis level). Overall, the financial effort to support the introduction of new ALMP initiatives seems uncertain and doubts can be raised about the adequacy of the resources made available. Furthermore, the number of people involved in labour market policy measures has also declined compared with the pre-crisis period. Notably, the rate of participants (per 100 persons wanting to work) fell significantly between

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33. 'Labour market policy measures' can be broadly equated with activation measures, while 'labour market policy supports' generally involve income maintenance benefits.

34. Eurostat (2011) defines activation efforts as 'efforts that countries make to help people in the transition from unemployment or inactivity to work'. In this case, the target group considered is the 'population wanting to work', that is 'unemployed and inactive people who do not qualify as unemployed because they are either not actively seeking work or not immediately available for work but who would nevertheless like to work'" (ibid.).

2008 and 2009 and then continued to decline until 2011. Besides calling into question the effectiveness of the activation effort, this circumstance may also indicate an attempt to target interventions better.

Budget constraints have also affected the implementation of the Youth Guarantee, which is proceeding gradually, starting with long-term unemployed young people and mostly adapting some of the already existing schemes for the long-term unemployed to the requirements of the Youth Guarantee (Government of Ireland 2014; 2015).

To sum up, it is possible to detect two main directions in labour market policies implemented in Ireland over the crisis years. On one hand, unemployment benefits have been a target of fiscal consolidation measures, entailing some reduction of their replacement rates and duration and more emphasis on sanctions. On the other hand, since 2010 more attention has been paid to the development of ALMP: the scope of measures has been enlarged and their governance strengthened. That said, doubts arise when considering the trends of expenditure actually devoted to those initiatives.

Education

In Ireland, public spending on education as a percentage of GDP increased over the crisis years (4.9 per cent in 2007 vs 6.2 per cent in 2011), while the percentage of public spending on education out of total spending basically remained unchanged (23.4 per cent in 2007 vs 23.1 per cent in 2011) (Agostini and Natali forthcoming: Appendix). However, data on year on year changes in constant prices reveal a significant reduction in real government expenditure between 2008 and 2011, with a peak in 2009, when expenditure declined by 7.6 per cent compared with the previous year (ibid.). That said, despite severe budget constraints and cutbacks, a number of measures concerning the education system – from early childhood education and care[35] to primary, post-primary and higher education, and, in particular, vocational and educational training (VET) – have been implemented since 2010 (European Commission 2014d; OECD 2013b; Government of Ireland 2014: 2015).

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35. As for early childhood education and care, the most significant measure is the introduction in 2010 of a free pre-school year for all 3 to 4 year olds: this measure is on a part-time basis, consisting of a maximum entitlement of 3 hours per day, 5 days per week, 38 weeks per year (Daly 2015: 9).

A strategy to improve the quality of early childhood, primary and secondary education – the National Strategy to Improve Literacy and Numeracy among Children and Young People – was launched in July 2011, with a budget of 9 million euros (Government of Ireland 2014: 40). The strategy set a number of performance targets to be reached by 2020 and it foresees the implementation of a series of concrete actions over the years. Also, in order to support the national strategy, primary and secondary initial teacher education courses were reconfigured in 2011 (OECD 2013b). Furthermore, a new system for school self-evaluation was put in place in 2012 (European Commission 2014d).

As for higher education, in the EAP the Irish government put forward their intention to increase charges on students in tertiary education, while providing means-tested support for lower-income groups (European Commission 2011:54). Indeed, in 2011/12 a new student charge of 2,000 euros replaced the previous Student Services Charge of 1,500 euros. This charge was then increased to 2,250 euros in 2012/13 and is expected to rise by 250 euros each year up to a maximum of 3,000 euros by 2015 (OECD 2013b: 16). At the same time, a new scholarship scheme for higher education – the Student Universal Support Ireland (SUSI) – has been introduced to improve access for students from disadvantaged backgrounds (Government of Ireland 2014).

A number of initiatives have targeted the VET sector, closely monitored by the Commission under the 2014 and 2015 European Semester process. First, in 2013 the Education and Training Board Act was passed with a view to rationalising and boosting the efficiency of the VET system by merging the existing 33 Vocational Education Committees into 16 Education and Training Boards (ETB). The latter now include the functions previously performed by the VECs (vocational education committees) and the FÁS training centres (vocational training) (Government of Ireland 2014: 28). Second, the 2013 Further Education and Training Act led to the establishment of SOLAS, an agency responsible for the development, funding and supervision of the further education and training sector (including the development of multi-annual strategies) (ibid.: 29). Finally, a review of the apprenticeship system was launched in 2013 with a view to adapting the system to the new needs. The review resulted in the publication of an Apprenticeship Implementation Plan in June 2014 which foresees – among other things – the establishment of an Apprenticeship Council bringing together representatives from business, trade unions and higher education bodies (Government of Ireland 2015: 20).

Overall, the analysis shows that a number of measures aimed at improving the effectiveness and efficiency of education and vocational training systems have been enacted in Ireland over the crisis years. The implementation of those measures, however, took place in a context characterised by fiscal consolidation priorities, with a significant overall reduction of government expenditure on education between 2008 and 2011.

Public sector

In the public sector, pay cuts and freezes have been a constant over the crisis years. Already in 2008 the government withdrew from the national pay agreement settled in November 2006 and unilaterally decided to freeze public servants' wages at least until 2010 (Glassner 2010: 18). In March 2009, as part of an emergency budget plan (the Financial Emergency Measures in the Public Interest Act), a cut in public sector pay was decided, followed by a further reduction introduced through the budget law enacted in December 2009 by the Cowen government.[36] After a difficult negotiation, a four-year Public Service Agreement (known as the 'Croke Park Agreement') was signed in March 2010. The agreement provided protection for public sector pay levels in exchange for a reduction in employee numbers and a commitment to reform working practices in the public sector (Doherty 2014: 86); a pay freeze in the public sector until 2014 was also decided on.

In the Irish Memorandum of Understanding (European Commission 2011), the 'reduction of public service in terms of numbers', the implementation of the provisions concerning public servant pensions (cf. Section 2.1) and a 10 per cent pay reduction for new entrants are listed among the fiscal consolidation measures to be implemented, together with the pay freeze already decided by the government.[37]

The recommendation to reduce the number of public employees appears particularly telling, taking into account the fact that, on the eve of the crisis, Ireland already had one of the lowest shares of public administration jobs in total employment, which indeed had remained stable over the period 1999–2008 (Glassner 2010: 7–8). In any case, the reduction

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36. In 2009, the introduction of a pension levy inversely related to the level of income entailed a cut in net pay of 5 per cent to 7 per cent, while cuts from 5 per cent to 8 per cent (inversely related to the level of income) were introduced with the December 2009 budget law (Glassner 2010: 28).

37. The latter measure was not explicitly required by the MoU, but it was considered part of the fiscal target (Sapir *et al.* 2014: 77).

in the number of public service workers, to be completed by 2015, was quantified in the National Recovery Plan 2011–2014 – presented by the Cowen government in November 2010 – at approximately 24,750 people compared with the 2008 level.[38] Numbers reported in the Public Service Reform Plan presented by the Kenny government in November 2011 refer to a 37,500 staff reduction (compared with 2008 levels) by 2015 (DPER 2011) and, according to data provided by the Irish government, overall staffing levels were reduced by 10 per cent, from 320,400 in 2008 to 289,600 in 2014 (DEPR 2014). This reduction was obtained mainly through early retirements, non-replacement of departing staff and the imposition of strict limits on public sector recruitment, thus avoiding compulsory redundancies (Doherty 2014: 89).

A new triennial agreement – the Haddington Road Agreement – was signed in 2013, foreseeing further pay cuts, new pay freezes and changes to public sector working conditions. The latter include additional working hours, greater use of redeployment, the reform of work-sharing arrangements and a reform of flexible work arrangements (Doherty 2014:90). The Haddington Road Agreement was followed by the publication, in January 2014, of the Second Public Service Reform Plan 2014–2016.

Initiatives undertaken in the public sector between 2009 and 2014 are clearly in line with what we define as a social standards devaluation strategy. Over the years, the various Irish governments have enacted measures freezing or cutting public servants' wages and reducing the number of public sector employees.

Research and development

Over the crisis years, in Ireland gross domestic expenditure on R&D increased from 1.2 per cent of GDP in 2007 to 1.6 per cent in 2012 (in the latter year, the EU average was 2.0 per cent of GDP) (Agostini and Natali forthcoming: Appendix). This resulted from the growth of business expenditure on research and development, in particular by foreign firms, while government expenditure declined in real terms from 169 million euros in 2008 to 129 million in 2013 (Government of Ireland 2015: 40).

An important factor in stimulating private expenditure in R&D has traditionally been the existence of a fairly generous tax credit, recently re-

38. The same plan also foresaw the introduction of a reformed pension scheme for new entrants to the public service and a reduction of their pay by 10 per cent.

formed in 2014 in order to increase the generosity and flexibility of the system (OECD 2015c: 221).

Besides the reform of this tax credit, other actions implemented over the crisis years were aimed at rationalising the R&D system, which, due to the plethora of programmes and agencies created over the years, was sometimes considered rather fragmented (OECD 2013c: 25). A first initiative in this direction has been the implementation, since March 2012, of the National Research Prioritisation Exercise, which has entailed the identification of 14 priority areas on which public funding should be concentrated in the coming years. Moreover, this measure also entailed the reinforcement of the mandate of the Science Foundation Ireland, the body charged with the funding of institutions operating in those areas (Government of Ireland 2014). In order to strengthen the commercialisation of publicly funded research, a new national Intellectual Property Protocol has been developed and a central Technology Transfer Office, charged with providing an interface between industry and the research community, was set up (ibid.).

To sum up, mixed evidence emerges from the analysis of developments in the R&D sector in Ireland over the crisis years. Gross domestic expenditure on R&D as a percentage of GDP increased between 2007 and 2012 but this increase was largely due to private expenditure, while government expenditure declined. Public initiatives in this domain basically aimed at facilitating private investment (compare the reform of tax credits) and rationalising the R&D system.

2.1.3 Preliminary remarks on structural reforms in Ireland and their determinants

The pattern of reform over the crisis years in the policy domains considered in this report puts Ireland close to the 'low-road' to economic growth and competitiveness, a model reliant mainly on cost containment and narrow welfare provisions. Fiscal austerity – in the context of a strategy of social standard devaluation – has indeed been the main goal of the reforms implemented since 2009 in the domains of pensions, unemployment, education, R&D and the public sector. That said, the present report also identifies some policy changes likely to positively affect human capital development. In particular, some initiatives aimed at rationalizing and improving the quality of ALMP, education and VET

systems have recently been undertaken. This may be the source of a new selective investment strategy in the future, although the adequacy of financial resources currently devoted to those measures can be questioned.

The model of economic development embraced in the past, significantly dependent on foreign direct investment and exports, has arguably played a major role in shaping the Irish reaction to the crisis. The latter was attributed to an excessive growth in expenditure and a related loss in competitiveness and reputation; given this assumption, priority was to be given to cost containment and to the rescue of the banking system in order to preserve 'investors' confidence' (Dukelow 2015). Consequently, a severe austerity plan of 9 per cent of GDP was implemented already in 2008–2009, a period when most EU governments were still trying to implement expansionary policies. Austerity provisions contained in the MoU with the EC and the IMF signed in 2010 were largely in line with – and, in a way, further reinforced – such a stance. While cost containment messages undoubtedly represented the bulk of the 'EU pressure' on Ireland, one can also observe other kinds of 'stimuli'. Notably, the insistence of the EU on the need to strengthen ALMP and the VET system may have played a role in the recent developments in the sectors illustrated above.

Finally, looking at party politics, one can note that the historic success of the opposition parties in the 2011 general election and the consequent formation of a coalition government supported by Fine Gael and the Labour Party have not entailed any major changes in the government attitude towards fiscal consolidation. Even if the Kenny government succeeded in negotiating a few aspects of the MoU (among them, the cut in the national minimum wage), its policy choices have been basically in continuity with the austerity actions of the previous government. This is particularly evident when looking at initiatives related to pensions, unemployment benefits and the public sector. Furthermore, according to many observers, the Irish governments have assumed an increasingly unilateral stance in taking policy decisions, a circumstance that has led to a crisis of the Irish social partnership model.

Table 18 Summary table: drivers of reform and major reform trends in Ireland, 2008–2014

	2008–2010	2011–2014
Drivers of reform		
Economic crisis	Financial crisis and economic recession; Strong increase of public deficit and debt	GDP growth (except 2012); Slight increase of public debt (until 2013) and decrease of deficit
Coalition governments	Centrist-conservative	Right-left coalition
EU influence	EDP	Economic Adjustment Programme (until 2013); Post-programme surveillance (since 2014); European Semester (since 2014); EDP; MIP (2014)
Structural reforms		
Reform path (for the five policies under scrutiny)	Social standards devaluation	Social standards devaluation
Main reforms in each policy field		
Pensions	- National Pensions Framework	- Restrictive measures (including cuts to pension payments); - Social Welfare and Pensions Act
Labour market	- Unemployment benefits: reduction of duration and replacement rates/ introduction or reinforcement of sanctions	- Industrial Relations (Amendment) Act; - Further changes to unemployment benefits; - Reinforcement of ALMP (especially for LTU) and institutional reconfiguration (e.g. Intreo offices)
Education	- Reduction in real government expenditure - Free pre-school year for children aged 3 to 4	- National Strategy to Improve Literacy and Numeracy; - Higher education: reforms of students' contributions and scholarships; - Education and Training Board Act
Public sector	- Wage freeze and cuts; - Staff reduction	- Staff reduction; - Haddington Road Agreement (further pay cuts and freezes; changes to working conditions)
Research and development		- Tax credit reform; - National Research Prioritisation Exercise

Source: Authors' elaboration.

3.5 Italy

3.5.1 Setting the scene: key traits of the country's political economy

In the late 1980s and early 1990s, Italy was characterised by significant economic growth, but later on, growth stagnated and between 2001 and 2008 average growth was 0.8 per cent of GDP (roughly half the euro-area average). Economic contraction was particularly evident in 2009 (–5.5 per cent) and in 2012 (–2.8 per cent). Italy thus experienced a 'double-dip': the Great Recession of 2009 was followed by some first signs of recovery (in 2010 and 2011) and then by further economic decline in 2012.

Moreover, for many years in the 2000s Italy's national debt was the highest in Europe, and currently it is second only to Greece's. The government gross debt constantly increased between 2007 (99.7 per cent of GDP) and 2011 (132.1 per cent of GDP). As regards the deficit, during the first years of the crisis, it significantly increased (–2.7 in 2008 and –5.3 in 2009), but it started to fall between 2010 (–4.2) and 2013 (–2.9) (Table 19).

Table 19 **Italy: selected socio-economic indicators, 2007–2014**

Indicators/years	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	1.5	–1.0	–5.5	1.7	0.6	–2.8	–1.7	–0.4
General government gross debt (EDP concept) (% of GDP)	99.7	102.3	112.5	115.3	116.4	123.1	128.5	132.1
General government deficit/surplus (% of GDP)	–1.5	–2.7	–5.3	–4.2	–3.5	–3.0	–2.9	–3.0
Employment rate (% 20-64)	62.8	63.0	61.7	61.1	61.2	61.0	59.8	n.a.
Unemployment rate (%)	6.1	6.7	7.8	8.4	8.4	10.7	12.2	n.a.
People at risk of poverty or social exclusion (% of total population)	26.0	25.3	24.7	24.5	28.2	29.9	28.4	n.a.

Source: Agostini and Natali (forthcoming: Appendix).

Table 20 **The Italian social model**

Labour market regime	Welfare regime	Varieties of capitalism
Southern European	Southern European	Mixed market economy (MME)
		Peculiarities: - high level of debt; - falling productivity; - falling share of national goods and services in world trade; - declining role of the state in the national economy; - coordinated decentralisation of collective bargaining

Source: Authors' elaboration on Agostini and Natali (forthcoming).

The economic and financial crises have significantly affected the social situation; in particular, the unemployment rate doubled between 2007 (6.1 per cent of population) and 2013 (12.2 per cent of population). At the same time, the employment rate decreased between 2008 (63 per cent of population) and 2013 (59.8 per cent). As regards the percentage of the population at risk of poverty or social exclusion, we see a significant increase between 2010 (24.5 per cent) and 2012 (29.9 per cent). On the contrary, a slight improvement emerged in 2013 (28.4 per cent) (OECD 2015e).

A mixed market economy, the variety of capitalism typical of Southern European countries, characterises Italy. Mixed-market economies (MME) are political economies governed by non- market forms of coordination. The state is an important actor through the creation of a large state-controlled business sector, and the control of the financial system (Pagoulatos 2003). At the same time, interest associations of both business and labour have stronger organisational structures than in liberal market economies, but are more fragmented and weaker than in coordinated market economies. As a result, they are unable to deliver collective goods or develop strong autonomous forms of coordination throughout the economy, but they are powerful and demand some form of compensation from the state for their acquiescence (Molina and Rhodes 2007). Compensation usually consists of passive labour market policies and a transfer-oriented welfare state.

With regard to the economic model, Italy's major problem – partly explaining low growth – is its competitiveness gap, in particular high average unit labour costs and low productivity (Goretti and Landi 2013). Italy's position has deteriorated steadily since the launch of the euro area, after a decade of economic slowdown and declining exports. Italy's share in world trade has fallen since the mid-1990s, and the country has not profited from increased demand in fast-growing emerging markets. This seems to be closely related to the typical profile of Italian firms: they are very focused on low-technology and labour intensive products (such as textiles). Recent decades have seen no significant shift in the industrial specialisation pattern, while economic regulation and openness to competition lag far behind other Western countries. Another structural characteristic is the traditional predominance of small and medium-sized enterprises that are unable to fully exploit economies of scale. Furthermore, access to the equity market to finance firms is underdeveloped (especially for SMEs) (ibid.: 9).

As regards the social model, Italy is a typical example of a South European welfare state (Ferrera 1996). It is a typical 'transfer-centred' welfare state, where social and employment policies are very fragmented (with various schemes along occupational and social lines). The spread of a universalist health care system has hybridised the system rooted in occupational welfare provision in other policy fields. Italian welfare is therefore characterised by the individual appropriation of welfare resources, related to a low degree of state penetration of welfare institutions and a low degree of state power, with the consequent spread of political clientelism (social benefits exchanged for political support and votes) (Katrougalos and Lazaridis 2008).

In this context, at the beginning of the 1990s welfare programmes presented two main problematic aspects. The first was the financial strains upon them, part of the broader tensions in the public budget. The second was the inequity implicit in the system: across occupational groups, as well as in terms of standard risks (for instance, pensions versus unemployment benefits) and regions and gender (Ferrera, Fargion and Jessoula 2012).

Owing to its large public debt and low growth, Italy was vulnerable to the economic and financial crises of 2008. The European institutions applied pressure on national policymakers to address the country's structural weakness, considered to be the cause of the low growth rates

Table 21 **Italian governments, 2007–present**

Years	Prime Minister	Position in the political spectrum	Coalition forces	Reform programme
May 2008–November 2011	Silvio Berlusconi	Centre-right	PdL, Lega Nord e MpA	Social standards devaluation
November 2011–April 2013	Mario Monti	Technocratic government	PdL, PD, UDC	Social standards devaluation
April 2013–February 2014	Enrico Letta	Left-right	Pdl, PD, UDC, Lista Civica	(1)
February 2014–	Matteo Renzi	Left-right	PD, NCD, UDC, Lista Civica	Social standards devaluation and improvements

Note: (1) Due to the peculiar nature and short duration of the mandate, the approach to reform of the caretaker government is not clear.
Source: Authors' elaboration.

(Caritas Europa 2013). When the sovereign debt crisis began in the euro zone (in 2010) Italy was in a fragile position, and the effects of the crisis were particularly severe. Any request for an external loan was viewed as a danger to the entire euro zone (Oxfam 2013). For that reason, the reform programmes were based mainly on severe austerity measures. In particular, in December 2011, the technocratic government headed by Mario Monti adopted a package of fiscal reforms called 'Save Italy' in order to push the view that without such changes Italy would go bankrupt.

Italy has been subject to manifold EU pressure: 'informal conditionality' has influenced many reforms (in particular in the field of pensions and the labour market). This conditionality (differently from countries such as Greece, Portugal or Spain) was not linked to a 'memorandum of understanding'. Rather, it was put into action by supervision and coordination of economic and budgetary policies (particularly within EMU and often through unprecedented procedures) and through the leverage provided by the ECB's autonomous decision to purchase bonds on the secondary market within the Securities Markets Programme (SMP) (Sacchi 2013; Agostini *et al.* 2015). The ECB's support was made conditional on Italy following the EU prescriptions for budgetary austerity and structural reforms of the social models; in line with the idea that the social

model played a key role in determining the fate of the country during the euro-crisis. As regards the policies adopted by Italian governments, it is clear that the euro zone crisis impacted significantly on social spending and public employment. In sum, the austerity policy implemented in recent years has led to a serious lowering of social standards (Perez and Rhodes 2015).

During the financial and economic crisis period, structural funds also played a significant role, particularly in the field of employment policies. These funds were used mainly to finance pre-existing programmes (short-time working schemes by way of a derogation) and the provision of active measures linked to them (Agostini *et al.* 2015).

3.5.2 Structural reforms sector by sector

Pensions

In Italy, public pensions have been extremely generous and costly (Italy has been one of the highest-spending EU countries). Since the 1990s, a long list of reforms has radically transformed the system, with a move to a (still incomplete) multi-pillar pension model (in line with a gradual reduction of public pensions and more room for supplementary pension funds).

While the so-called welfare protocol of 2007 adopted by the left-of-centre Prodi government reduced cutbacks introduced earlier by the right-of-centre parliamentary majority, three different pension reforms were introduced in the period 2009–2011 (Natali 2011). Both were shaped by external constraints. The EU put pressure on Italian policymakers by means of a range of different instruments. First, direct pressure came from the European Court of Justice (ECJ). Its ruling C 46/07 found Italian legislation on the retirement age – in particular, the different legal retirement ages for men and women in the public sector – to be discriminatory. This led to the opening of an infringement procedure against Italy. The Berlusconi government decided to introduce a revision of pension legislation in 2009, to equalise the retirement age for men and women in the public sector at 65 (for women it was 60), with a phase-in period of 9 years. This direct pressure from the ECJ was supplemented by the first impact of the economic recession. The Italian government had to pass measures to stabilise the public budget deficit in a context of huge recession. The increase of the legal retirement age was thus supple-

mented by automatic mechanisms to further increase the retirement age (for both social assistance, old-age and seniority pensions) in line with the gradual increase in life expectancy. These measures were introduced through a short phase-in period, with full implementation since 2015.

A second reform package was passed in 2010. Due to the persistent economic recession and the gradual deterioration of the public budget, the Berlusconi government reduced the transition period for full implementation of the measures introduced in 2009. As a consequence of the new law of 2010, the equalisation of the retirement age for men and women (in the public sector) became operative in 2012, and the activation of the automatic adjustment of the legal retirement age to life expectancy has applied since 2010.

The dramatic context of the so-called 'spread-crisis' in 2011 led to a more radical revision of the Italian pension system. The Monti government passed a new set of measures in 2011 (the so-called 'Save Italy' decree of December 2011). Law Decree 201/11 (December 2011) – then translated into Law 214/11 – introduced major changes, in particular:

- a move towards a single retirement age for men and women (66 years and 7 months by 2018), for employees in both the public and private sectors, and the self-employed;
- a flexible retirement age, with a minimum retirement age of 63 (in the case of pension benefits above the minimum level of 2.8 times the *assegno sociale*), and a postponed retirement at 70;
- regular adjustment of the retirement age in line with increases in average life expectancy since 2013 (while before the reform it was supposed to be introduced in 2015) with a rise of three months, and further increases every three years up to 2019;
- from 2012, the full enforcement of a defined-contribution pension scheme introduced in earlier reforms to replace the earnings-related defined-benefit scheme;
- the seniority pension – allowing workers with at least 35 years of pension contributions to retire early – was eliminated;
- gross monthly pensions above 1,400 euros were not indexed to bring pension spending under control for 2012 and 2013.

These new measures were expected to produce savings from 2012 (around 2.7 billion euros) reaching 22 billion euros in 2020. Accordingly, the reduction in public pension expenditure in terms of GDP was

deemed to be 0.2 percentage points in 2012, 0.9 in 2015 and 1.4 in 2020, then gradually declining to 1.1 percentage points in 2025, 0.9 in 2030 and 0.5 in 2035 (Jessoula and Pavolini 2013). In distributive terms, this reform largely reduced the transition towards the full implementation of cutbacks (related to the introduction of the defined-contribution type of benefit). This has addressed the inter-generational divide between younger generations (already affected by previous reforms) and older cohorts.[39] But there is a risk that retrenchment will lower the adequacy of pension benefits and put some elderly people at risk of insufficient protection: this is the case with regard to workers on low wages and with interrupted careers (ibid.).

Labour market

In the shadow of the economic and financial crisis, the main measure adopted by the Italian government to reduce its impact involved short-time working schemes and the new regulation of labour contracts. These measures (adopted by the Berlusconi government) did not structurally affect the employment benefit system (Sacchi 2013). As far as short-time working schemes are concerned, the *Cassa Integrazione Guadagni* (CIG) is used in a new version that derogates to current legislation by extending protection to further categories of worker, enterprises (including small and medium-sized enterprises), economic sectors and extending the duration of the measure. The so-called *Ammortizzatori Sociali in Deroga* (AD) – the CIG plus other short-term work schemes – are aimed at: (i) extending income support measures to some categories of workers (especially those in small and medium-sized enterprises) previously excluded from the scheme; and (ii) finding, with the help of the regions, the necessary funds to cope with the increasing demand for wage support due to the economic crisis. The Italian government signed an agreement with the regions, which calls on them to cover 40 per cent of the cost of AD, partly through the European Social Fund. As has been noted, the social safety net has not been revised in response to the economic crisis, but it is subject to a temporary derogation, thus leading to the further fragmentation of the sector (Sacchi and Vesan 2011; Vesan 2012). As regards employment legislation, the package of emergency measures adopted by the Berlusconi government recognised the possibility of derogating from the principle of the individual employment relationship in

39. The Dini reform of 1995 that introduced the defined-contribution logic in the PAYG pension system had a 40-year transition before its full implementation in 2035. The Fornero reform of 2011 cut this transition and made the new rules operative from 2012.

national contracts and law, through collective bargaining agreements at the industrial or territorial level (the so-called 'proximity agreements'). This provision was introduced under pressure from the EU and international institutions to reform the labour market and promote decentralisation of the collective bargaining system (Vesan and Pavolini 2015).

On April 2012, the executive led by Mario Monti passed the so-called 'Fornero reform' (named after Ministry of Labour Elsa Fornero) (Law No. 92/2012). The reform regulates individual dismissal and fixed-term employment contracts, with the aim, on one hand, of favouring the use of permanent contracts (reducing atypical contracts) and, on the other hand, of simplifying the procedures for laying off employees. In this framework, Law No. 92/2012 reformed Article 18 of the Workers' Statute by limiting the reinstatement of workers in case of unlawful dismissal only to specific circumstances. At the same time, this law introduced monetary compensation as a general rule for unlawful dismissal (Vesan and Pavolini 2015).

Moreover, the reform defined new measures for income support. It redefines the system of social safety nets, distinguishing between measures to support wages in the case of unemployment and measures to complement wages in the case of suspension or reduction of working hours. A new scheme called *Assicurazione Sociale per l'Impiego* (ASPI) has been introduced and, for the government, it should represent the first step towards a unique scheme of income guarantees in case of unemployment. Finally, as regards 'proactive employment policies', contracts 'with training contents' were introduced. Apprenticeships are considered the main way to promote the access of younger workers to the labour market. The reform also introduces some measures to promote women's labour market participation. These measures are, however, limited compared with what has been implemented in other European countries (Vesan 2012).

At the end of 2014, the centre-left government led by Matteo Renzi introduced the so-called 'Jobs Act'. As regards the regulation of employment relationships, the Act introduced a new kind of contract (*contratto a tutele crescenti*) that, by replacing permanent contracts, has made it even easier to dismiss workers employed in firms with more than fifteen employees. In the framework of the new '*contratto a tutele crescenti*', reintegration has been limited to discriminatory and unlawful dismissals, whereas for all other situations, and if the dismissal is declared unlawful by the judge, the employer has to pay monetary compensation.

Moreover, the Renzi government introduced a further liberalisation of temporary contracts in 2014 and limited the use of other forms of atypical contract. The Jobs Act reformed also the unemployment benefits system. In particular, the reform reviewed the strict eligibility criteria for unemployment insurance. To obtain the ASPI (now called NASPI), the jobseeker must have paid three months of contributions in the past four years and worked for at least 30 days in the past year. The amount of NASPI is 75 per cent of the previous salary up to 1,195 euros (for 2015), and 25 per cent for the share exceeding that amount up to a maximum amount. Its duration is related to the length of the period of contributions and with the new rules, the effective average duration of NASPI is estimated to be equal to 8.6 months. Finally, another important change concerns the introduction of a social assistance allowance for the unemployed (*assegno sociale per la disoccupazione* – ASDI). This measure is reserved for workers who have finished NASPI. This scheme is means-tested and gives access to a sum equal to two-thirds of the last NASPI benefit for six months. Due to budgetary constraints, this new scheme has been introduced on an experimental basis and it will be provided only up to the exhaustion of the available budget set by the government (400 million euros for 2015 and 2016). If ASDI becomes permanent, it will be the first universal unemployment assistance scheme to be introduced in Italy (Vesan and Pavolini 2015).

Education

Various laws were adopted to reform the education system in the period between 2008 and 2010. The so-called 'Gelmini Reform' (after a Minister of Education and Research in the Berlusconi government) prioritised the reduction of education expenditure, for both the school and university systems. The school reform, for example, reduced the hours of teaching in primary schools, in particular the afternoon schedule (*tempo pieno*), which was transformed into a sort of complementary activity also with the payment of fees (Pattarin 2011; Saraceno 2010).

Concerning the main measures affecting mandatory schooling since 2008, we refer to Decree-Law 112/2008 (*Decreto Brunetta*) that:

– increased the student/teacher ratio by 1 per cent;
– reduced schools' staffing levels (administrative, technical and auxiliary) by 17 per cent;
– reorganised schools, curricula and classes; and
– cut public expenditure by at least 7.8 billion euros by 2012.

In an effort to justify the cuts in public expenditure, the Decree-Law makes express (and generic) reference to international and EU commitments to stabilise public finances.

Provision was made also to increase the size of school classes:

– about 18 to 29 pupils in pre-primary school classes;
– about 15 to 27 pupils in primary school classes;
– about 18 to 28 pupils in lower secondary school classes.

Moreover, to implement the budget goals, measures were taken to assign only one teacher (no longer three) to primary school classes. Reductions were also made regarding hours of teaching, subjects and staff. Finally, a number of schools were merged. As a result, between the school years 2007/2008 and 2013/2014 the number of pupils increased by nearly 2 per cent, whereas the number of classes and teachers fell by more than 2 per cent and 12 per cent, respectively.

Law 122/2010 and DPR 122/2013 have frozen teachers' salaries since 2009. This helped to increase the gap between Italy and other OECD countries, because the starting salary for teachers in upper secondary school is 6 per cent lower than the OECD average. This gap is wider for experienced teachers: they are paid 11 per cent less than the OECD average (European Parliament 2015).

The university reform made significant cutbacks to the 'ordinary funds' at national level (*Fondo di Finanziamento Ordinario*) (Ichino and Terlizzese 2012). Moreover, the 'Gelmini Reform' has heavily restructured the internal organisation and governance of the university system. Two main changes were inspired by 'New Public Management' and cost containment. The first concerns the governance structure of universities, which became more centralised. At the same time, the reform has changed recruitment and careers, abolishing permanent positions for new entrants and increasing the importance of merit-based selection in the careers of professors (Ballarino 2015).

Cutbacks did not stop with the Monti government. As has been pointed out (European Parliament 2015), after the public budget spending review of August 2012, cost-sharing for higher education was increased, while fees rose by between 25 per cent and 100 per cent for students graduating with some delay (after the statutory deadline). In the wake

of the financial and economic crisis, Italy registered a significant drop in real public education expenditure. Italy is the only Member State that has reduced this kind of expenditure for four consecutive years: –0.2 per cent in 2009, –3.0 per cent in 2010, –4.0 per cent in 2011 and –1.8 per cent in 2012.

In 2015, the Renzi government passed the so-called 'Good school' reform. The bill redesigned the powers of head teachers and allowed for pay increases based on merit (rather than on seniority). It also provided tax incentives for private schools and launched a plan to hire about 100,000 full-time teachers. The government budgeted about 3 billion euros for the reform (Binnie 2015).

Public sector

Italy has introduced two main measures to reform the public sector (Bach and Stroleny 2013; Setnikar Cankar and Petkovšek 2013), involving the freezing of recruitment and wages. Also in this case, the measures were approved after the ECB pressed the government to take measures to reduce the cost of public employees by strengthening staff turnover rules and, possibly, by reducing wages (Bordogna and Neri 2014). On the first point, since 2008 recruitment of public employees has been significantly limited (10 per cent in 2009, 20 per cent in 2010 and 2011, 50 per cent in 2012). The rationalisation measures have applied to schools and staff with flexible employment contracts. The effect of the freeze on recruitment was evident in 2010, when the total number of public employees was 4 per cent lower than in 2008. This decrease applied to the number of permanent employees (3.6 per cent) and, even more (almost 13 per cent), the number of employees with flexible contracts. Other measures for strengthening and prolonging the recruitment freeze were adopted in 2010; as a result a contraction of 10 per cent in the public sector was expected by 2014. In 2012, these measures were confirmed and reinforced by the Monti government.

As regards the second point, the measures adopted in 2008 implemented the national wage freeze, which was extended from 2010–2011 to 2013 and 2014. In particular, for 2011–2013, the wages of individual employees may not exceed the level of 2010. With the partial exception of the component linked to performance or merit pay, the economic effect of career promotions has also been frozen. Moreover, other measures concerned higher wages and, in particular, cuts of 5 per cent for those with a gross wage of between 90 and 150 thousand euros a year, and of 10 per

cent for the proportion exceeding 150 thousand euros. In sum, in comparison with the 2000–2007 period, wage growth slowed significantly in 2008–2009 and has substantially been frozen since 2010.

Research and development

In the shadow of the economic and financial crisis, R&D investment has not been significantly reduced. In Italy, the level of R&D expenditure is lower if compared with the average level of the EU28 (–0.7 percentage points in 2013). Average EU28 expenditure in R&D is 2 per cent of GDP, in Italy it is 1.3 per cent. This level of expenditure remained substantially stable during the crisis: it was 1.2 per cent between 2008 and 2011 and 1.3 per cent in 2012 and 2013. This increase should be understood in terms of trends in GDP.

The government has adopted various measures for promoting investments. They include a temporary tax credit for companies that increase investment and specific loans (for small and medium-sized enterprises for the purchase of machinery, equipment, capital goods and for investments within the country). A specific tax credit devoted to an increase in investments in R&D has been introduced for the period 2015–2019. Moreover, a favourable 'patent box' taxation on income derived from the use of intellectual property, patents and trademarks has also been introduced. Project bonds for infrastructure investment have been made cheaper and simpler to issue. Similarly, regulations governing the involvement of institutional investors in real estate have been relaxed (OECD 2013e).

3.5.3 Preliminary remarks on structural reforms in Italy and their determinants

The Italian reform pattern seems consistent with the 'low-road' to economic growth and competitiveness, a model reliant mainly on cost containment in the different policies under scrutiny. Budgetary cutbacks – in the context of broader social standards devaluation – have been the main goal of the reforms implemented since 2009 in the domains of pensions, unemployment, education, R&D and the public sector. All these fields have experienced retrenchment both in the long- and short-terms. The latter has become a key part of the reforms since the eruption of the 'spread-crisis'.

This reform path has reflected the guidelines laid down by the EU. Italy has experienced huge constraints, related to the SGP (application of EDP), hard regulation (for example, the role of the ECJ in the field of pensions) and tough forms of conditionality implemented by the ECB. The EU has also shaped – but with a more limited impact – social policy and labour market policies in order to favour the move towards activation in the two policy areas through the structural funds. The role of domestic political forces has proved limited, but the Renzi government has implemented a more pro-growth agenda with more flexibility in application of the EU budgetary rules (despite ongoing austerity measures, more social standards improvements have appeared).

Table 22 **Summary table: drivers of reform and major reform trends in Italy, 2008–2014**

	2008–2011	2011–2012	2013–2014
Drivers of reform			
Economic crisis	Deep recession; Surge of general government deficit	Deep recession; High general public deficit (2010)	Slight economic growth
Coalition governments	Centre-right (PdL/ Northern League)	Grand Coalition (Pdl; PD; UDC) supporting a technocratic government	Left-Right (PD; NCD; LC)
EU influence	EDP	EDP; European Semester; Financial Assistance (Securities Markets Programme)	European Semester; Financial Assistance (quantitative easing)
Structural reforms			
Reform path (for the five policies under scrutiny)	Social standards devaluation	Social standards devaluation	Social standards improvements and devaluation
Main reforms in each policy field			
Pensions	- Increased retirement age (e.g. for women)	- Increased retirement age (automatic mechanisms) - Cut in seniority pensions - Introduction of the NDC system since 2012	
Labour market		- Increased flexibility - Recalibration of passive labour market policies	- Increased flexibility - Recalibration of passive labour market policies
Education	- Retrenchment	- Retrenchment	- Increased spending through the 'Good School' reform
Public sector	- Retrenchment	- Retrenchment	
Research and development	- Stability	- Stability	- Tax incentives to favour private investments

Source: Authors' elaboration.

4. Conclusion

The evidence collected for the five countries under scrutiny allow us to draw some broad conclusions. In the following section we first provide some concluding remarks on the key characteristics of the structural reforms adopted in these countries. Then we look at the key factors that have shaped these reform trends.

As far as the nature of the reforms is concerned, we should first stress that the structural reform path of the different countries has changed over time. While some form of social standards devaluation – for example, fiscal austerity, wage freezing, weakening of collective bargaining institutions, more limited employment protection – has characterised the whole period under scrutiny (2008–2014), the five countries have gone through different phases. Just after the recession started to hit Europe, some of these countries adopted anti-cyclical packages. This first step, largely involving improvements in social standards, was a short-term strategy, followed since 2010 by austerity packages. All the five countries have seen, in the period between 2010 and 2013, the implementation of a social standards devaluation strategy. The only major exception is Germany, where more favourable economic conditions and a huge reform programme between the end of the twentieth and the beginning of the twenty-first century allowed more room for investment. A third phase has been characterised by a more relaxed budgetary policy – inspired by the EU – and a shift towards some selective investment, if not a more ambitious social standards improvement path. This is the case of the Czech Republic, Italy and Germany, while in Finland and Ireland persistent financial stress has limited the opportunity for pro-growth reforms.

Second, while the paradigm of fiscal austerity and pressure on social standards has dominated the reform process in all the countries under

scrutiny, its actual implementation has varied from one country to the other. The two countries hardest hit by the sovereign debt crisis – Ireland and, to some extent, Italy – have seen the most radical social standards devaluation. In Ireland, cutbacks to social spending have been accompanied by the deconstruction of the system of industrial relations inherited from the past. The coordination of socio-economic and employment variables, mainly through social pacts, has been replaced by unilateral reforms adopted by the government with the help of the so-called Troika. Italy has also experienced weakened social standards with cutbacks in pensions, a further reduction in EPL for typical workers and the decline of social dialogue. These countries, at least between 2010 and 2013, have experienced an overall devaluation strategy with a reduction of both social protection and investment. The case of Italy is intriguing, in that both the social standards devaluation phase and the subsequent more growth-oriented strategy have been characterised by a non-selective approach. Both the reduction and then partial improvement in social standards have been implemented by means of both investment and protection policies. In other words we do not see any proof of a move towards social investment or pro-competitive policies. Finland has experienced a less severe adaptation to the new recessive economic cycle. National coordination of wages, welfare and labour market reforms has been maintained, but the apparent consolidation of the system may hide an institutional drift. Social investments, at the core of the Finnish model, have been cut and this risks undermining the country's 'high road' to competitiveness. As stressed above, Germany has experienced a peculiar trend in structural reforms. Some social standards devaluation began well before the Great Recession and reflect a selective investment strategy in a context of fiscal stability. Finally, the Czech Republic has seen the parallel development of austerity measures, on one hand, and selective investment and pro-growth reforms, on the other. All in all, the four ideal-typical reform paths proposed in Section 2 (social standards devaluation, social standards improvement, selective investment and protectionism) have been useful for assessing complex structural reform paths involving both devaluation and some measures to boost investment and/or consumption.

With regard to the key factors shaping structural reforms in Europe, the report provides evidence of the complex interplay between domestic and supranational stimuli. The role of path-dependency is evident in the case of Finland, where the old institutions of a national coordinated market economy have survived. Italy is another case where old institutions (and

paradigms) largely survived in the context of austerity: both devaluation and improvements have been implemented across the board, with limited proof of any paradigm shift. In such a context, some institutional features of the varieties of capitalism under scrutiny seem crucial to shaping structural reform decisions. We have spoken, with reference to the Czech Republic and Ireland, of the role of FDI in shaping policymakers' agenda on R&D and education reforms. The need to attract foreign investors has led to ongoing investment in knowledge and to the safeguarding of tax benefits to provide incentives for private sector investment. The role of exports in the country's economic model seems to be another key dimension. Countries more open to international trade and with an export-led economic model have invested more in knowledge and R&D, with the exception of Finland. These traits of national political economies need further investigation.

While supranational constraints are particularly important in this phase, national policymakers have been seen to have some room for manoeuvre: the Czech Republic, Italy and Germany provide evidence of a more pro-growth orientation of left-wing parties or coalitions including left-wing parties.

As far as the EU is concerned, the study of five EU members has provided evidence of increased EU constraints on national decision-makers. This is particularly the case of those countries subject to some form of conditionality: Ireland under the MoU and Italy under the Securities Markets Programme. The European Semester has also shaped some reforms, as we have seen with regard to the Czech Republic and Finland. But the EU has also activated other tools to influence structural reforms: the structural funds and the Youth Guarantee programme have had a role in promoting (and financing) active labour market policies (for example, in Ireland, Italy and the Czech Republic), and public sector reforms (Czech Republic).

What is more, the EU strategy with regard to social, economic and labour market reforms has not been stable, but has changed over time. While the neoliberal paradigm remains dominant, its actual implementation has changed slightly, with more flexible implementation of fiscal consolidation and more explicit priority given to structural reforms since 2014.

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