

**Coordinated Capitalism and Monetary Union:  
Wage Bargaining and Social Partnerships in the Euro-Era**

By

Ivan Frederick Dumka  
BA, The University of Western Ontario, 2008  
MA, Queen's University, 2010

A Dissertation Submitted in Partial Fulfillment  
of the Requirements for the Degree of

Doctor of Philosophy

in the Department of Political Science

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University of Victoria

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## **Supervisory Committee**

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## **Abstract**

Throughout the Eurozone's economic crisis, little attention has been given to wage-setting practices. This lack of attention is surprising given that wages have been considered an important instrument for managing the economy in a currency union since the 1960s and have even been emphasized in successive blueprints for Economic and Monetary Union (EMU). Recent scholarship has found differences in wage-setting practices a key feature distinguishing healthy and crisis-stricken Eurozone countries. Indeed, in this emerging literature, countries that coordinate wages effectively have remained competitive under EMU and had fewer troubles in responding to the crisis, while those with weakly-coordinated wages have struggled mightily. In effect, this literature finds differences in EMU members' wage-setting regimes at the heart of the economic crisis now facing the Eurozone and the trade imbalances between its Northern and Southern members.

However, very little work has examined the specifics of individual labour market models under EMU. Indeed, while this new literature on wage setting and the crisis places wage setting models at its centre, it does not delve into the differences among highly coordinated systems. This oversight is problematic given that scholars of monetary union have suggested that the single currency may amplify the effects of subtle differences in national socioeconomic models, while others have suggested that EMU may be corrosive to some labour market models that coordinate wage setting.

This study addresses this gap in the literature, dissecting labour market models by the mechanisms that deliver horizontal and vertical coordination, as well as the indicators to which they are calibrated. Using this framework, it then traces the experiences of Belgium, Germany and the Netherlands under EMU, who use very different mechanisms to coordinate wages. It argues that while EMU has exacerbated longstanding problems in the Belgian wage-bargaining system, it has had little impact upon the German and Dutch systems. Rather, underlying changes in the institutions that manage wage setting in these countries, and changes in social partner organizations – particularly the trade unions – are far more consequential for their continued functioning under EMU.

More broadly, these findings suggest that in fact, many designs of highly coordinated wage setting are capable of managing pressures from the single currency. For those Eurozone countries currently refashioning their labour market models, tighter coordination may be just as viable an option as dismantling their wage-bargaining institutions.

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## List of Abbreviations

AWVN: Algemene Werkgeversvereniging Nederland (the Netherlands)

BDA: Bundesvereinigung der Deutschen Arbeitgeberverbände (Germany)

CAP: Common Agricultural Policy

CBA: Collective Bargaining Agreement

CCE: Conseil Central de l'Economie (Belgium)

CGSLB/ACLVB: Centrale Générale des Syndicats Libéraux de Belgique/Algemene Centrale der Liberale Vakbonden van België (Belgium)

CNV: Christelijk Nationaal Vakverbond (the Netherlands)

CPB: Centraal Planbureau (the Netherlands)

CSC/ACV: Confédération des Syndicats Chrétiens/Algemeen Christelijk Vakverbond (Belgium)

DG: Directorate General (European Commission)

DGB: Deutscher Gewerkschaftsbund (Germany)

DNB: De Nederlandsche Bank (the Netherlands)

ECB: European Central Bank

EEC: European Economic Community

EMF: European Metalworkers Federation

EMS: European Monetary System

EMU: Economic and Monetary Union

ERM: Exchange Rate Mechanism (of the EMS)

EU: European Union

FEB/VBO: Fédération des Entreprises de Belgique/Verbond van Belgische Ondernemingen (Belgium)

FGTB/ABVV: Fédération Générale du Travail de Belgique/Algemeen Belgisch Vakverbond (Belgium)

FNV: Federatie Nederlandse Vakbeweging (the Netherlands)

FPS: Federal Public Service (Belgium)



GDP: Gross Domestic Product

IG BCE: Industriegewerkschaft Bergbau, Chemie, Energie (Germany)

Minszw: Ministerie van Sociale Zaken en Werkgelegenheid (the Netherlands)

OECD: Organization for Economic Co-operation and Development

SER: Sociaal Economische Raad (the Netherlands)

STAR: Stichting van de Arbeid (the Netherlands)

UK: United Kingdom of Great Britain and Northern Ireland

US: United States of America

VNO-NCW: Verbond van Nederlandse Ondernemingen-Nederlands Christelijk Werkgeversverbond  
(the Netherlands)

VoC: Varieties of Capitalism

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## **Dedication**

To everyone who has joined me through this part of the journey

## Chapter 1: Introduction

### 1.1: The Research Question

Persistent economic troubles in Southern Europe and the sovereign debt crisis have focused attention upon tools for macroeconomic management under the euro. Institutionalized wage-setting practices are a crucial part thereof. Indeed, even early theorists of monetary integration, such as Mundell (1961, 657), had highlighted wage setting as a crucial instrument of economic management in a currency union, while subsequent work has reaffirmed its importance and placed wage-setting practices at the centre of the economic crisis in the Eurozone, i.e. those member countries of the European Union (EU) having already adopted the euro (e.g. Hancké 2012; 2013; Johnston and Hancké 2009; Johnston, Hancké and Pant 2014). Similarly, growing attention from European-level actors such as European Trade Union Confederation (ETUC) or the European Commission to the wage-setting practices of both healthy and crisis-stricken Eurozone members alike suggests that this issue is not just one of academic interest.

Nonetheless, our understanding of the ways that wage-setting systems behave in the context of Economic and Monetary Union (EMU) is at best incomplete. Certainly, several peripheral countries have suffered under EMU as existing literature had suspected they might. Indeed, as intermediate systems in Calmfors and Driffill's (1988) parlance, or as weakly coordinated ones in Soskice's (1991), these countries have struggled with inflation and unemployment, and this struggle has become more acute under EMU (Johnston and Hancké 2009). Likewise, emerging scholarship is increasingly pointing to wages and unit labour costs, and in turn the systems that help set them, as underappreciated ingredients that can help in tackling the negative effects of the current crisis. At the same time, Crouch (2000) has suggested that under a common currency, countries that coordinate wages very tightly, such as Austria, Belgium, Finland, Germany or the Netherlands, are likely to outperform countries which have highly decentralized wage setting. The UK is a prime

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example of a country with decentralized wage setting, even if it has not adopted the euro. However, there is far more variation among 'centralized' or highly coordinated systems than their rates of union coverage, as in Calmfors and Driffill (1988), or their level of coordination, as Soskice (1991), might suggest.

Certainly, some previous studies had argued that monetary integration may undermine wage bargaining (Leander and Guzzini 1998; Crouch 2000; Verdun 2000; Magnusson and Stråth 2001). However, much of this past scholarship is just that, predating the latest advances in institutional theory, as well as significant changes in context. Likewise, several scholars have sketched the broad dynamics of the relationship between EMU and wage-setting practices (Soskice and Iversen 2001, Hancké and Rhodes 2005, Enderlein 2006). Others, such as Johnston and Hancké (2009) have had the benefit of examining what has happened in practice since EMU began. However, the very institutions that some scholars blame for the crisis in select countries, that others see as a potential solution, and that others still see under threat, are highly idiosyncratic. Indeed, previous scholarship, such as Dyson (2008, 21), has argued that the effects of the single currency vary widely among euro area members, i.e. the EU Member States that have adopted the euro as their currency. Indeed, for Dyson (2008, 21), the effects of adopting the euro vary so much between countries because of the mediating effects of idiosyncratic domestic institutions, national comparative advantage, as well as varying trade and economic patterns. The implications of Dyson's (2008) observation for highly coordinated systems are fascinating in that, while they are so often grouped together, significant variations in the institutions that they use to manage wages should beget very different experiences under EMU.

However, while much progress has been made in parallel areas, such as social pacts, less attention has been given to dissecting wage-setting systems under the single currency and what it is that allows healthy systems to function in this context. It follows then that a proper examination of specific wage-setting systems and their functioning under EMU is overdue. To that end, comparing

Belgium, Germany and the Netherlands, this study investigates how, under the euro, strains from the transition from national central banks to a European one and the loss of other policy instruments have affected wage-setting practices and the social partnership between industry and labour.

Specifically, it asks: *is monetary integration detrimental to coordinated wage setting and how do institutional variations affect a system's ability to cope with new pressures under EMU?* The aim of this introductory chapter is to present the topic in more detail, to briefly situate this study amid previous work in this area, to elaborate upon the main research question and the key variables, to examine briefly the broader implications of the issue and to provide an outline for the subsequent chapters.

## **1.2: Background**

The economy-wide coordination of wages is a common feature of many European countries. Historically, wage coordination has proven a useful tool, alongside fiscal and monetary policy, for promoting economic competitiveness, adjusting to macroeconomic shocks, as well as encouraging industrial peace. Nonetheless, as a number of scholars have highlighted, there are several institutional designs capable of delivering wage coordination, and where necessary, wage restraint, each with a set of unique side effects.

Although the institutions that deliver it have many other roles, wage coordination in the countries that practice it has traditionally aimed to manage the level and growth of wages with two aims, which different systems achieve with varying degrees of success. Ideally, wage-setters manage the rate of wage growth, often with changes in either productivity or prices in mind. Therein, they attempt to ensure that unit labour costs do not grow so quickly as to make their products uncompetitive, while also factoring in the effects of wage settlements on domestic demand. They also attempt to manage the effects of asymmetric economic shocks by imposing control over wages

and prices as a form of internal devaluation or revaluation. By so doing, they affect changes in the real exchange rate in the same way that currency fluctuations would affect nominal exchange rates.

Expectations about inflation (hence, about real wages) are central to wage negotiations. Prior to 1999, when the exchange rates of participating countries were irrevocably fixed, Germany's central bank was considered a reliable guarantor of stable inflation, with other European central banks following its lead under the Exchange Rate Mechanism (ERM), a system of fixed but adjustable exchange rates, of the European Monetary System (EMS) (Kennedy 1991). Indeed, as Verdun (2000) has noted, this system of fixed exchange rates proved extremely difficult to maintain in practice. However, for the purposes of wage setting, it left central banks the scope to target domestic conditions in ensuring price stability and low inflation with predictable cues from the centre of the system in the German central bank, the Bundesbank. In this context of stable cues from the centre, and monetary policy targeted towards local conditions, the social partners devised wage policy under the threat of discipline from the national central bank. These points are discussed in more detail in Section 2.5.2.

Similarly, while several current Eurozone members had maintained a currency peg to the deutschmark, currency devaluation had remained a viable, if contentious instrument for countries participating in the ERM. Indeed, it was not uncommon for countries experiencing economic difficulties to have their exchange rates to other participating currencies adjusted (Verdun 2000, 79). This route was taken by Belgium and France, for instance, who significantly devalued their currencies in the 1980s in response to economic crises. In effect, while this system of currency pegs did constrain the use of exchange rate policy, the option for participating countries to have their exchange rate adjusted did preserve currency devaluation as a viable instrument for responding to economic shocks.

January 1 1999 marks an important departure from this period of fixed but adjustable exchange rates. Indeed, while euro coins and banknotes only began circulating in 2002, the

irrevocable fixing of exchange rates and the transfer of powers to the European Central Bank (ECB) in 1999 marks the formal beginning of EMU. The period since has been marked by the foregone threat of discipline from the central bank for wage setters, as well as fewer instruments for dealing with economic shocks and troubles with competitiveness. Indeed, in the context of the single currency, the incentives for wage moderation are very different from those present under the ERM. Several scholars have noted that where the ECB targets EU-wide inflation, countries failing to control national inflation do not face the same sorts of pressure on their currency for failing to control wage inflation at the national level (Soskice and Iverson 2001). Furthermore, while these countries do face competitiveness pressures from wage-inflation, the central bank is incapable of using interest rates to discipline individual members as national central banks could under the ERM. In some cases, this change has resulted in relaxed wage discipline, where wage setters at national level are no longer faced with pressures from the central bank, but instead face an ECB that cannot target them specifically. Having already adopted the euro, countries in this position no longer face the threat of exclusion from the single currency by other Member States.

While EMU has introduced new incentives into the process of determining wages at national level, it has also introduced outside influences, as transnational and European-level actors have been become increasingly interested in collective bargaining at national level. Similarly, EU institutions such as the Commission are free to deliver terse warnings and recommend reforms in the form of annual Country Specific Recommendations. Likewise, new instruments of economic governance have emerged out of the euro crisis and operate at the European level, such as The Scoreboard, a set of indicators comparing Eurozone economies (Visentini 2012). Certainly, while EU institutions and peak associations at EU level have no legal competence to intervene in national wage bargaining, they constitute a source of outside pressure that had not previously existed. Nor is this interest one-sided. With expanded economic governance at European level touching areas parallel to wage bargaining, the national social partners in many countries are increasingly attuned to developments at European level.



However, for all the emphasis that scholars from Calmfors and Driffill (1988) to Johnston, Hancké and Pant (2014) place upon the economic merits of wage coordination, a common worry since the start of EMU is that it might make concertation more difficult and perhaps more open to outside influence. Paradoxically, while EMU may create conditions that are challenging for wage coordination, monetary integration also makes more demands of it (Crouch 2000, 225). Indeed, wage setters now bear more of the pressures associated with economic adjustment, where previously fiscal or monetary policy would be used in tandem. This heightened emphasis on wages has raised serious questions about some wage-bargaining models' ability to promote economic competitiveness and to adjust quickly to economic shocks. Even early theorists of monetary integration, such as Mundell (1961) had stressed that factor mobility would be essential for adjusting to shocks within the currency area. In this line of thinking, capital from economically flush regions of a currency union would move to depressed ones in search of new investment opportunities. Conversely, workers might be expected to migrate from depressed regions to booming ones, redressing high unemployment in the former, and helping to meet demand for labour in the latter. However, neither these early theorists nor contemporary observers, such as Callow (2010) or Parsons and Pochet (2008), have been convinced that factor mobility in Europe then or now, particularly for labour, is sufficient to adjust for economic imbalances. Indeed, Parsons and Pochet (2008) or Eichengreen (2012), amongst others, have noted that remaining differences in national labour markets, as well as cultural and linguistic differences between Eurozone countries prevent movements of labour that might also help smooth asymmetric shocks. Likewise, although several alternative designs for EMU had contained plans for fiscal transfers between Member States that were intended to redress emerging imbalances between EMU countries, they were not included in the design adopted in the Maastricht Treaty.

As a result, under EMU competitive imbalances between members and asymmetric shocks cannot be corrected by fiscal transfers from booming countries to depressed ones, or by the movement of labour from stagnant members to thriving ones. However, in the context of the single

currency, many instruments that governments might use to correct for such shocks and imbalances are no longer available. Indeed, while in the 1980s, ERM countries could devalue their currencies, a single currency, by definition, prevents competitive devaluation against other euro area countries, while the focus of the European Central Bank upon the integrity of the currency generally prevents devaluation against the currencies of the EU's trading partners. Similarly, where the role of fiscal policy in managing economic shocks is well established, and in systems where wage coordination is weak, it is a necessity (Carlin 2013), agreements restraining fiscal policy under EMU limit its effectiveness as a tool for economic stabilization. Certainly, while a significant number of observers have noted that limits on government deficits and debt were imperfect in the past, they did place limits on the use of fiscal policy, and only stand to become more onerous in future. This point about the constraints that EMU places upon fiscal policy is discussed in more depth in Section 1.4.

Hence, wage coordination may be one of the few tools available to pursue macroeconomic stabilization and economic competitiveness in countries with the appropriate institutions (Crouch 2000, 225). Interestingly, while greater reliance upon wage setting has the potential to strain and damage these institutions, it also has the potential to accentuate select features of them. Indeed, some have noted the side effects inherent in the models which may become more pronounced as they are relied upon more often by policymakers. Crucial here are the variations in the mechanisms which euro area countries use to coordinate wage levels as well as the constraints and incentives that they provide.

In short, wage-coordination is important because it is an instrument for managing economic competitiveness, and correcting for asymmetric shocks. However, EMU comes with a new set of pressures, while also demanding more of these systems where fewer policy instruments exist for managing national economies.

### **1.3: Unpacking the Research Question**

The central question of this study is: how has Economic and Monetary Union influenced the coordination of wage bargaining in different institutional settings? This is a broad question indeed. To address it, this study compares the Belgian, Dutch and German wage-bargaining systems and their experience under EMU. Broadly speaking, all three have successfully continued the practice of coordinating wage setting, although the institutions responsible for doing this vary in important ways. This study proposes comparing them along three dimensions: the mechanisms that they use to achieve (1) horizontal coordination, or how they coordinate across sectors, (2) vertical coordination, or governability, referring to the connections between bargainers at different levels. These two variables are well developed by Traxler and Kittel (2000), to which this study adds (3) calibration, or the indicators to which these systems are designed to respond (discussed in Section 1.3). It then looks at how pressures arising from EMU have manifested themselves in these different national institutional contexts, either through changes to the formal-legal underpinnings of their institutions, in changed patterns of behaviour by key actors, or indeed in the actors themselves and changes in the role they play in wage coordination.

Given the broader context of economic and institutional upheaval in other Eurozone members, this study offers in the concluding chapter some tentative insights might be derived from this study of Belgium, Germany and the Netherlands for Member States in the south of the EU such as Greece, Italy, Portugal and Spain who are currently refashioning their bargaining and economic models. It considers as well the implications for the EU's eastern Member States, all of which have a formal commitment to adopt the euro and many of which already have. To these ends, this study investigates the implications for different national wage-bargaining systems of two crucial changes that EMU has brought about. The first concerns the transferring of authority from national central banks to a single European Central Bank and a single euro area-wide monetary policy. The second concerns the loss of other instruments of macroeconomic governance. Both sets of concerns are discussed below. This study investigates, further, how key actors have responded to these changes.

The first set of factors concern the pressures imposed by EMU upon different models of wage bargaining by the creation of a single European Central Bank. Certainly, alternative blueprints for EMU had held out the possibility that national currencies might coexist with a single shared European currency (Dyson 1994; Dyson and Featherstone 1999; Verdun 2000). Likewise, other proposals for monetary union, for instance by the United Kingdom (H.M. Treasury 1989), had relied upon the fixing of national exchange rates, rather than the adoption of a single currency. In both instances, national central banks were left to target domestic economic conditions and were able to discipline wage setters for inflationary wage developments with higher interest rates. Setting interest rates for the entire euro area, the European Central Bank cannot discipline wage setters in individual countries. Without this threat of discipline in the form of higher interest rates, an emerging literature (Hancké 2012; 2013; Johnston and Hancké 2009; Johnston, Hancké and Pant 2014) has argued that this shift from national central banks to the European Central Bank may result in relaxed wage discipline in some types of coordinated systems. In effect, this change may distort systems' calibration. Others, such as Johnston (2009) have suggested that this relaxation of wage discipline may only affect sheltered sectors, straining systems' horizontal coordination as wage discipline continues in exposed sectors.

The second set of factors concern the impact of lost policy instruments under EMU. Where historically, exchange rates and fiscal policy had acted as economic stabilizers, the former is not available to governments under EMU, while the latter is restrained in two respects. In fact, the powers of the EU to tax and spend have remained very limited, with the EU budget accounting for 1-2% of the Union's GDP (Verdun 2000, 187). Furthermore, while the discord in the negotiations over the most recent EU budget suggests that there is little appetite for expanding it, the criteria for adopting the euro specified strict limits on the debt and deficits of EMU members. Certainly, these criteria were not observed as strictly as one might have expected in the early 2000s, but nor were they ignored altogether. In fact, by the late-2000s, these debt and deficit rules had been widely accepted by most EMU countries (Enderlein and Verdun 2009, 501). In this context, where nominal

exchange rates are locked, real exchange rates continue to fluctuate, and are far more heavily dependent upon productivity and wage developments. Both of these factors are closely linked to the way in which countries set wages.

What these choices about the design of EMU mean is that there is greater pressure on wage-setting systems to compensate for economic shocks (Dølvik 2000; Traxler 2002), some of which are not able to manage them. Magnusson and Stråth (2001), as well as Mundell (1961), Hancké and Soskice (2003), Allsopp and Vines (2008) and Zemanek, Belke and Schnabl (2010), have argued that flexibility in real wages is a necessity under a currency union. Their contribution carries the implication, not just that tight coordination of wages is necessary, as suggested by Hancké (2012; 2013), Johnston and Hancké (2009), and Johnston, Hancké and Pant (2014), but that specific characteristics of coordinated systems matter. Other scholars, such as Blanchard and Philippon (1998) have pointed to the quality of the relationship between the social partners as a key determinant of successful wage coordination, with the implication that greater pressure on wages to adjust under EMU may also adversely affect some coordinated systems.

The core aim of this investigation is to analyse to what extent different institutional designs are more or less susceptible to the above pressures and if any particularly resilient institutional features are replicable elsewhere. Some of the systems under study have undergone highly conspicuous changes during the period being investigated, such as growing decentralization of wage-setting in Germany. Thus, one of the aims of this line is to investigate to what extent, or not, EMU has contributed to these changes. In turn, this study also aims to investigate what changes such as these, whether caused by EMU or not, mean for coordinated systems' continued functioning under the single currency.

This study employs a neoinstitutionalist framework, as outlined by Streeck and Thelen (2005), and subsequently expanded by Mahoney and Thelen (2010). This body of theory represents an important advance in our understanding of institutions and of institutional change in two

respects. First, this framework includes mechanisms by which institutions change gradually, even in absence to changes to the formal-legal underpinnings of institutions. Second, where private actors they have state sanction, this framework incorporates them and their patterns of behaviour as part of a definition of institutions. This treatment of private actors is vitally important given that the social partners, representatives of business and labour, are both private entities separate from the state, but have such an important role in making public policy in many European countries. As sources of institutional change then, this framework focuses attention upon changes in both the formal-legal underpinnings of institutions, and upon the ways in which key actors interpret them and behave. Such a framework is useful because it defines institutions in a way that is highly relevant for this study and because its emphasis on mechanisms of gradual institutional change allows one to recognize subtle forms of institutional change and to make sense of them when they occur.

This study takes these key insights from the neoinstitutionalist literature as its point of departure, considering the implications of new pressures from EMU upon the formal-legal aspects of institutions and upon the behaviour of the actors that inhabit and animate them. It begs the question: how have these pressures from EMU been manifested in changes to institutions' formal-legal basis, or in the behaviour of key actors, such as government and the social partners? Conversely, to what extent are governments and the social partners still willing and able to perform their traditional duties? Has the crucial relationship between them altered or rebalanced under EMU? To what extent are external actors coming to play a role in different wage-setting systems?

Certainly, wage setting is an area where extra-national actors have no formal role. However, as a result of deeper economic integration under EMU, EU-level actors, such as ETUC and the sectoral peak associations have taken an increased interest in wage setting since the mid-1990s and have worked to develop networks among national trade unions. Likewise, in the context of the Eurozone crisis, which began in 2009 with concerns about the solvency of the Greek government and steep recessions in many EMU countries, and which has continued with broader economic malaise

across the EU, new instruments of economic governance have been crafted at the European level that touch upon wage policy. Indeed, the European Commission now comments on sensitive details of national wages and wage-setting systems in its Country Specific Recommendations, while new instruments of economic governance introduced in the midst of the crisis, such as the macroeconomic imbalance procedure are closely concerned with unit labour costs. These matters about external influences are discussed in Sections 2.5 and 3.2.

#### **1.4: Broader Consequences**

At the same time as EMU may be exerting pressures upon the social partnership, an emerging literature on wage setting has found differences in national wage-bargaining systems are at the heart of the euro area's economic crisis. Certainly, early diagnoses turned on government deficits and debt in crisis countries as the root cause of their current troubles. However, scholars such as Hancké (2012; 2013), Johnston and Hancké (2009), as well as Johnston, Hancké, and Pant (2014) have argued that while tightly coordinated systems in Northern Europe have fared well with the pressures from EMU, containing pressures for wage inflation in sheltered sectors of their economies. By contrast, countries with weakly coordinated systems have struggled with to contain wage growth, witnessing a steady growth of unit labour costs, and in turn growing competitiveness problems against other countries in the euro area. As before, their work suggests that wage coordination is an important economic instrument in a currency union. More broadly, this insight has important implications for the euro area itself. It means that where EMU may undermine the practice of wage coordination in some systems that hitherto have been tightly coordinated, it may mean that, in its current incarnation, EMU may be creating conditions which make it progressively less stable, as some member countries lose one of the few tools they have left for managing the economic cycle. Conversely, where specific designs of wage-bargaining systems are capable of coping with the

pressures that EMU exerts upon them, and where some of these practices may be exportable, the implications for those countries currently in need of changes to their own systems are intriguing.

## **1.5 Outline of the Study**

This study is divided into three parts. Part 1 lays the groundwork for a comparison of Belgium, Germany and the Netherlands, examining past research in the area, as well as theory and methods, and giving a brief overview of the cases. It also traces out the institutional choices in EMU that have led it to exert pressure upon national wage-setting systems. Chapter 2 examines the existing literature on wage coordination, deriving a framework for comparing coordinated wage-bargaining systems and the pressures that past scholarship has suggested might be exerted on them by EMU. Chapter 3 introduces the neoinstitutionalist theory and research methods underpinning this study, as well as discussing case selection. Chapter 4 briefly outlines the bargaining models and key actors at play in the three case studies, mapping them onto the framework developed in Chapter 2, while also tracing the institutional sources in EMU of pressures placed on wage-bargaining systems.

Part 2 contains examines the three cases under study in detail. Chapter 5 examines Belgium, where formally the institutions of its wage-bargaining system have remained remarkably stable since major reforms in 1996. While wages have remained tightly coordinated, the Belgian indexation system has received much negative attention from observers within and without of the process: while still highly coordinated, to what extent is the system able to correct for imbalances with other Eurozone members? Chapter 6 focuses on Germany: the German model has indeed evolved since the beginning of EMU, but how much of this is really because of EMU itself, and how do these changes affect its ability to cope with monetary integration? Chapter 7 is centred upon the Netherlands, where reforms in the early 1980s made it one of the success stories of the transition to the single currency. How though how has this reformed system fared since?



Part 3 draws conclusions and broader lessons. Chapter 8 draws together the studies of the cases, comparing how their systems have coped with pressures from EMU, while deriving common themes from their experience. It examines the broader implications of this study's findings for the Varieties of Capitalism (VoC) literature on wage setting and for other countries in the euro area as well. It argues that under the single currency, while automatic indexation of the sort practiced in Belgium makes correcting for economic shocks very difficult, many early concerns in the literature about the corrosive effects of EMU upon coordinated wage-bargaining systems have been overstated. On the contrary, institutional changes brought on by domestic factors are far more consequential for coordinated systems' ability to function under EMU. Nonetheless, in a context where many crisis-stricken countries are reconstructing their labour market regimes, tighter coordination has much to recommend it. Chapter 9 returns to the Belgian, Dutch and German cases, drawing country-specific conclusions and turning from their present circumstances to their future prospects.

## Chapter 2: What do we Know about EMU and Wage Setting?

### 2.1: Introduction

The formal study of wage-setting systems and economic performance began in earnest in the late 1980s following work in that decade to reintroduce the state and institutions into scholarly research. However, the role of wage setting in a currency union has been debated for over 50 years, while more recent writings have identified wage-setting institutions as a key factor in the current crisis. In parallel with this developing literature on institutions and the state, a literature examining wage setting and economic performance has begun to examine the various design features of coordinated systems, while other scholars have suggested some of the sorts of pressures that might be exerted upon wage-setting systems after the transition to the euro. Nonetheless, these various streams of work rarely intersect with each other, which leaves largely unaddressed the question of how different coordinated systems might be impacted by Economic and Monetary Union. The aim of this chapter is to bring together these streams of the literature on coordinated wage setting, deriving the key features of coordinated systems, as well as the pressures noted in the literature on EMU, and to contextualize these issues with recent work covering European-level influences on wage bargaining.

This chapter is structured as follows: Section 2 examines work on wage setting and monetary integration, tracing the role of wage setting from early theorizing on monetary union to more recent accounts of wages' role in the current crisis. Though wage setting and currency union is an under-explored issue, it is one that has been established as an important one by past scholarship. Section 3 examines the emerging literature on coordinated wage setting itself from the late 1980s. This forms the foundation of this project's classification of bargaining systems, but this section also finds that this work has overlooked the calibration of bargaining systems, or the indicators that wage-bargaining systems are designed to track. In many cases, scholarship in this field either predates or overlooks the influence of EMU upon differently designed wage-bargaining systems.

Section 4 examines the existing literature on wage setting under EMU itself. This scholarship on the single currency has pointed to pressures from relaxed incentives for wage moderation and a greater emphasis on wages as a result of the loss of devaluation and limitations on fiscal policy as tools for economic management. However, while this literature does note that different wage-setting systems are impacted differently by these pressures and captures well the current travails of several euro area economies, as well as their major struggles with wages under EMU, it leaves unexplored the more subtle impacts on healthier and better institutionalized bargaining systems of the euro area's core economies. Section 5 contains a brief history of EMU, tracing the key institutional decisions that have come to exert pressure on coordinated wage-bargaining systems. It finds that far from being inevitable, the pressures that EMU exerts upon wage-bargaining systems are rather the result of very specific decisions made about the form that monetary union would take. This is important in grounding the pressures posited by the literature, and in situating this study among the multitude of others that have called for a rethink of parts of EMU's institutional architecture, some of which touch upon the sources of these pressures.

Section 6 explores new work looking at the role of EU-level actors in national wage bargaining. It finds in this literature an acknowledgement that bargaining is still very much a national-level issue, but attempts since the 1990s in the labour movement to achieve greater coordination at the European sector level do represent an important contextualizing factor. A concluding section summarizes the findings of this chapter.

## **2.2: On Wages and Currency Union**

While the study of wage-setting institutions is a much more recent endeavour, the role of wage setting in currency unions is in fact well-studied. From its inception, debates within Optimal Currency Area (OCA) theory turned on the ideal characteristics of a currency area's members, as well as corrective mechanisms within an OCA. Early literature, beginning with Mundell (1961), stressed that

in order to compensate for the loss of exchange rates, an OCA must feature labour mobility, capital mobility, and flexibility in real wages as a means of adjusting to asymmetric shocks. Subsequent theorists added additional criteria for an OCA, with McKinnon (1963) arguing that in order to reap the benefits of reduced uncertainty over exchange rates, economic openness and trade integration were also necessary criteria for the optimality of a currency area. Likewise, Kenen (1969, 45-8), while also stressing labour mobility, emphasized fiscal transfers as an adjustment mechanism, while Flemming (1971) added that OCA members must have similar preferences for inflation.

De Grauwe (1975) compares the requirements for monetary union under Keynesian and monetarist economic assumptions, finding that in both, a stable currency union would require transfers between members, or equalized productivity growth. It would also require that differences in nominal wages mirror productivity growth, or that a system of transfers be instituted from countries with high productivity growth to those with lower growth rates in productivity. Though the connection is not addressed by De Grauwe (1975), nominal wages, and often productivity growth as well are heavily influenced by wage-setting practices. In any event, the point is that even prior to EMU, wage setting played a central role in the debate over the ideal design of a currency area, although these debates predated serious but complimentary discussion over wage-setting institutions that began to emerge in the late 1980s.

OCA theory fell out of favour from the mid-1970s, although interest in theorizing about monetary union was revived with debates surrounding the prospect of an actual monetary union in the early 1990s (e.g. in European Commission 1990; 1991). Early contributions to this revived OCA theory considered the extent to which monetary union and deeper trade ties might encourage greater convergence among the union's members. Eichengreen (1992), for instance argued that greater trade that would come with monetary union would encourage regional specialization within EMU, which would in turn desynchronize the business cycles of currency union's members. Drawing lessons from the US, Krugman (1993) posited that a currency area might be endogenously

suboptimal as certain economic activities become regionally concentrated, making individual areas in a currency area more susceptible to asymmetric shocks.

Against these pessimistic views, work following Frankel and Rose (1998) developed an 'endogenous' variant of OCA theory, arguing that the creation of a currency area creates the conditions for an OCA. Indeed, Frankel and Rose (1998) argue that creating a currency area creates the conditions for an OCA as members' economies converge: With deepened trade ties comes greater intra-industry trade and covariance of demand shocks, with the effect that members' business cycles should sync and their production profiles become increasingly similar. Their position finds some support in later work by De Grauwe and Mongelli (2005), who argue that EMU has encouraged a convergence of price changes, as well as increased trade and financial market integration, concluding that one might expect greater symmetry of shocks and business cycles across euro area countries.

Later work by De Grauwe (2006) does add some qualification to this rosy account, noting that, endogenities or not, absent deeper political integration the euro area would remain fragile. Similarly, Drudi, Durré, and Mongelli (2012) add that endogeneities alone are insufficient for stabilizing the single currency and that institutional change and deeper economic coordination are necessary accompaniments. De Grauwe (2011) notes elsewhere the challenges that emerge for member governments facing well-integrated financial and debt markets with fewer policy instruments under EMU. Similarly, where this endogenous branch of OCA theory had seen integrated financial markets as a stabilizing force, De Grauwe and Ji (2012) add further qualification still, examining the destabilizing effects that these integrated markets have had when mispricing default risk among Europe's crisis countries.

At the same time as some followers of this endogenous strand of OCA theory have become more equivocal in their positions, other work has had more in common with that of the early pessimists. Indeed, with the benefit of several years' observation, Bearce (2009, 584) finds that while

there is evidence that long term interest rates and real exchange rates have converged among countries that have adopted the euro, growth, employment, inflation rates among these countries have not converged. He also finds that growth rates vary more after 1997. On many key indicators, variations between euro area members are greater than among non-euro area members of the EU (Bearce 2009, 590-2). Cesarano (2013, 261-7) draws similar conclusions to Krugman. He contends that in the US, alongside economic prosperity, political unity and a single currency also coexist with striking regional differences, while the specialization that results from monetary union is even more acute in the US. Similarly, Hancké (2012, 8) has argued that EMU has amplified subtle differences among EMU members, rather than the reverse. However, while all of these scholars point to divergences on various key macroeconomic indicators and variously take this as an indictment of OCA theory, they have very little to say on whether EMU has promoted a convergence or a divergence of national business cycles, a point heavily stressed by Eichengreen (1992), as well as Frankel and Rose (1998).

Throughout, scholars following this debate have also stressed the role of mechanisms in a currency union to correct for asymmetric shocks. Even Frankel and Rose (1998), while at the same time arguing that monetary union will create the trade ties and convergence to make it an OCA, do not discount the importance of corrective mechanisms within a currency area (Frankel and Rose 1998, 1011). Indeed, some of the factors singled out by early theorists that might make imbalances self-correcting have not emerged, or have not been effective to that end. For instance, Eichengreen (1992) is only one of many to point out that labour mobility is unlikely to play a significant role in addressing imbalances under EMU (Eichengreen 1992, 23), and is pessimistic about the role of capital flows in redressing macroeconomic imbalances as well (Eichengreen 1992, 25). Lane (2006, 60) echoes this point about labour mobility, noting that cultural and linguistic differences, as well as limited mobility of social benefits have meant that workers in the euro area are far less mobile than those in the US, for instance, and reiterated by Eichengreen (2012).

Among corrective mechanisms, however, fiscal transfers feature prominently in accounts by Kenen (1969), De Grauwe (1975), and Eichengreen (1992), while retrospective accounts of the crisis by Hancké (2012, 21; 2013), among many others, have also stressed the need for fiscal transfers within EMU, although Glassner and Pochet (2011, 6) have pointed to the small size of the EU budget as a significant impediment to fiscal transfers and one that seems unlikely to change in the foreseeable future. Likewise, work by Jouen (2012) has suggested that the most effective uses of transfers at EU level, in structural and cohesion funds, for example, are those targeted at specific projects over long periods, and hence are a poor instrument for redressing shorter term macroeconomic imbalances.

Wages and wage setting, however, already have played an important role under EMU. Much work since Mundell (1961) has stressed the role of wage setting as a corrective mechanism in a currency union. Indeed, his emphasis upon flexibility of real wages implies that fixing nominal exchange rates would still allow the real exchange rate to fluctuate, i.e. changes in wages and prices may mimic currency fluctuations and help address competitiveness problems and cushion economic imbalances with other members of the currency union. Downward pressure on wages can have the same effect as currency devaluation, i.e. making imports more expensive and exports comparatively cheaper and vice versa. Indeed, this use of wages as a means of adjusting countries' competitiveness is implicit in later work by Hancké and Soskice (2003) or Allsopp and Vines (2008), for instance. It also informs the argument by Zemanek, Belke, and Schnabl (2010) that structural reforms in Greece to promote wage restraint would be a significant benefit to its current account balance and the conceptualization by Collignon (2013) of EMU as a 'payment union' rather than a 'single currency area'. It is with this connection between wages and real exchange rates in mind that many scholars had posited that wage-setting systems might serve as an instrument to correct for asymmetric shocks within the currency union and to address issues with the external competitiveness of national economies more broadly.

Certainly, while Lane (2006, 61) questions whether EMU has affected wage flexibility, Hancké (2012) is part of an expanding group of scholars who see not just wages, but wage-setting institutions at the heart of the EU's economic crisis. Indeed, examining competing explanations of the crisis, he notes that government finances played a role only in Greece, asset price booms only affected Spain and Ireland, and poor financial regulation was only a factor in Ireland (Hancké 2012, 8-10). He adds, however, that underlying the divide between healthy northern economies that have gained competitiveness and built large trade surpluses, and southern ones who have not, is the result of differences in wage-setting practices between the two (Hancké 2012, 12). This point is echoed by Hall (2013), who has also cast the euro crisis as one that showcases the effective coordination of wages and economic policy in Northern Europe with failed coordination of hybrid systems in peripheral EMU countries. This conclusion follows earlier work (Hall and Franzese 1998), where he had argued that tightly coordinated bargaining systems respond far more efficiently to signals from a highly independent central bank than less coordinated ones.

This point about wages made recently by Hall (2013), Hancké (2012) and others is particularly interesting, given Eichengreen's (1992, 21) insistence that wages in core EMU countries are less sensitive to unemployment than uncoordinated systems, thus unlikely to be helpful in managing imbalances, but that they are particularly sensitive to prices. Northern economies tend to have strong social partners, especially in export sectors, which have generally done well in managing inflation and labour costs and do well at coordinating wage growth across sectors, while stricken ones have tended to have weaker social partners and poor coordination between sectors (Hancké 2012, 12). He argues that it is these differences in the way these clusters of countries manage wage growth that explains their divergence (Hancké 2012, 11).

Nor is Hancké alone, with others, such as Zemanek, Belke, and Schnabel (2010) pointing to differences in wage growth as a key factor in the current economic crisis, or Glassner and Pochet (2011, 7) noting that macroeconomic imbalances built up among countries in EMU because wages



diverged from productivity in some countries. Vermeiren (2012) has echoed this point, arguing that EMU has reinforced institutional differences between core coordinated systems and peripheral mixed ones. This follows work by Johnston and Hancké (2009), who find origin of southern countries' struggles in their wage-setting systems, and by Beck, Hubrich, and Marcellino (2009), amongst others, who see wage-setting systems at the core of any solution to the economic crisis.

This expanding group of scholars is especially interesting for the advancements that they have driven in the Varieties of Capitalism literature (e.g. in Hall and Soskice 2001 or Hancké, Rhodes and Thatcher 2007). Indeed, this previous literature had taken a highly holistic approach to comparing countries' socioeconomic systems, often including far-reaching analyses of countries' training regimes, strategic coordination among firms, and welfare systems in explaining countries' comparative advantages, and indeed their comparative disadvantages in world markets. What sets apart this literature following Johnston and Hancké (2009) is that it has highlighted the important independent effect that different countries' wage-setting institutions exercise upon their competitiveness under Economic and Monetary Union in particular. This literature does not suggest that extremely high or runaway inflation has been commonplace under EMU, but rather that macroeconomic imbalances that result from these differences in wage-setting institutions have a tendency to accumulate and persist.

In sum, existing literature on currency union, from early work on OCA theory to recent dissections of the crisis have identified wages and wage-setting practices as an important part of regulating shocks and imbalances in EMU. Indeed, while early scholars had identified wages as an important factor in a currency union, others that might make macroeconomic imbalances and asymmetric shocks self-correcting, such as labour and capital mobility have either not materialized, or had limited effect. Furthermore, some more recent accounts have singled out wage-setting practices and labour market institutions as being at the core. However, what these accounts have yet to do is to dissect the individual wage-setting systems operating under EMU. Indeed, while Hancké

(2012) perhaps goes the furthest, the distinction that he draws between stricken peripheral economies and healthy northern ones covers much variation in the institutions that manage wage setting, but does not examine variations among the institutions within these categories.

### **2.3: Coordinated Wage Setting - A Framework for Analysis**

Although wage setting and labour market policy have been given an important role in the early debates and theory surrounding monetary integration, the study of labour market institutions and macroeconomic performance only began in earnest in the late 1980s. Likewise, recent work has focused upon wage setting and its hand in the economic crisis (Glassner and Pochet 2011; Hancké 2012, 2013; Vermeiren 2012; Zemanek, Belke, and Schnabel 2010). Specifically, this work emphasizes the role of strong social partners and mechanisms that link these agreements of the social partners across sectors as the distinguishing features of healthy coordinated systems which peripheral crisis countries lack. However, this scholarship does not dissect these systems. Given that many have suggested that subtle institutional differences are likely to condition different adjustments to EMU, the fact that 'coordinated systems' covers so many distinct models is problematic.

This diversity among 'coordinated systems', as well as the suggestion that even small differences between them may result in very different outcomes under EMU demands greater sensitivity to such differences. With this need for greater subtlety in the treatment of coordinated systems in mind, this section reviews the relevant literature on wage coordination, from early work on bargaining structure and macroeconomic performance through to more modern work on coordination in wage setting. This literature suggests that coordinated systems are best deconstructed by the mechanisms by which they achieve vertical coordination, which refers to the relationship between local bargaining units and those at macro and meso levels, which has important consequences for governability. This literature further suggests focusing upon systems' horizontal coordination, which refers to coordination of bargaining across the economy, although

vertical and horizontal coordination have been neither extensively nor intensively applied. This section argues, however, that a crucial shortcoming of this literature has been the neglect of 'calibration', or the indicators that each bargaining system is designed to track as another key determinant of their behaviour under EMU.

Early work by Cameron (1984), as well as Bruno and Sachs (1985) had found a linear relationship between the coverage of collective agreements and pay moderation, i.e. as organized wage-setting systems become more encompassing, they deliver greater wage discipline. Subsequent, and more frequently cited work by Calmfors and Driffill (1988) posited a 'hump-shaped' connection between a system's level of centralization, by which they meant how encompassing wage agreements are, and real wages. Highly 'centralized' systems, which have highly encompassing trade unions, and in highly 'decentralized' systems, where wages are the product of agreements between individual employees and individual employers tend to produce wage settlements that are consistent with low inflation and high employment, while intermediate systems do not. In highly centralized systems, unions with monopoly power also face the full effect of inflationary wage agreements. As a result, encompassing trade unions tend to moderate their wage demands, while in highly decentralized systems no actors involved in wage setting enjoy market power. As a result, for Calmfors and Driffill (1988), these two extremes tend to outperform intermediate systems, where wage setters enjoy market power but are not large enough that they bear the full cost of inflationary settlements. This situation allows them to externalize some of the cost of inflationary wage agreements, causing intermediate systems to underperform on inflation and employment.

Subsequent work in this stream by Danthine and Hunt (1994, 528) has examined this connection in the context of deepening economic integration in Europe. Although it does not consider monetary integration so much as the Single Market, it posits that while economic integration in Europe has not impacted labour mobility, it can be expected to affect the functioning of labour markets. The reason is that two countries forming a single market has the effect of

decentralizing their wage systems, in that formerly encompassing unions from each would then coexist within a single market, meaning that it is no longer centralized (Danthine and Hunt 1994, 530). With deeper economic integration, different wage systems, particularly polar opposites, cannot coexist to good effect (Danthine and Hunt 1994, 539), although it does suggest that the hump-shaped connection between centralization and macroeconomic performance put forward by Calmfors and Driffill (1988) is much flatter with greater trade openness, which means that intermediate systems of wage setting face fewer disadvantages vis-à-vis their more centralized and decentralized peers with deeper economic integration (Danthine and Hunt 1994, 536-7).

This insight by Calmfors and Driffill (1988) that fragmented but consequential labour unions beget troubles with wage inflation, while highly organized ones do not is at the core of this literature on wage setting and EMU following Johnston and Hancké (2009). Certainly, their work is more nuanced, including the influence of external constraints upon wage setting and greater attentiveness to unique dynamics in different sectors of the economy. Nonetheless, in their view those countries in EMU that have weak coordination and fractious but not inconsequential social partner organizations face precisely the incentives for inflationary wage growth that Calmfors and Driffill (1988) had suggested. As a result, these 'mixed' systems such as Greece, Ireland, Portugal and Spain have faced significant difficulties under EMU once the threat of exclusion from EMU and the threat of discipline from a national central bank had been removed upon their adoption of the euro.

Conversely, those countries with highly organized social partner organizations have both the incentives to internalize the effects of their wage demands and the means to achieve moderate wage growth. Consequently, countries of this sort, such as Austria, Belgium, Finland, Germany and the Netherlands have been comparatively successful in maintaining their competitiveness in the context of EMU. While they are not currently in crisis in the same way as Greece, Ireland, Portugal and Spain, France and Italy have share the fractiousness in their wage-setting systems and many of the accompanying troubles with wage inflation and unemployment.

Soskice (1990) introduced the role of coordination in wage setting. He notes that the German model, with a combination of sector-level bargaining, relatively low union density and wage moderation, maps awkwardly onto Calmfors and Driffill's (1988) framework. Indeed, he argues that Calmfors and Driffill (1988) conflate the level at which bargaining formally takes place with coordination, submitting that less centralized, but highly coordinated systems may also enjoy low inflation and high unemployment. With this in mind, Crouch (2000) has noted that centralization may be way of ensuring coordination, but is one among many. In any event, Soskice (1990) also notes that there are several mechanisms that might do this. Indeed, Soskice (1990) argues that where unions are not encompassing, but do coordinate their wage demands, they do still internalize the inflationary effects of their wage demands, with the implication that these systems behave much like those with encompassing unions. He also points to encompassing employers' associations, as well as arrangements by which public sector and non-union wage developments track those of unionized private sector workers as manifestations of highly coordinated but decentralized systems. Put more bluntly in his later work, Hancké and Soskice (2003, 152) argue that "a necessary condition for coordination is that employers organizations and unions are sufficiently strong that it poses no collective action problems".

In making sense of these coordinated systems in particular, Soskice's (1990) contribution is an important step forward from the work of Calmfors and Driffill (1988). Certainly, their point about encompassing unions and incentives to internalize the effects of wage deals is very well taken. Nonetheless, Soskice's (1990) notion of coordination highlights that not only does the coverage of unions matter, but the way in which they organize themselves and interact with other trade unions, as well as the nature of their relationship with employers matter as well. It highlights as well the role of employers in the process of wage bargaining. This emphasis is important because the employers play an important part in negotiating wage developments with the unions, but previously had been given little attention. It is also important because while union density has fallen significantly across the EU, the membership of employers' associations has remained much higher. As a result, all of the

employees of organized firms are covered by the collective agreements that they negotiate, regardless of whether they are members of a trade union. Thus, even where the unions are no longer encompassing, the wage agreements that they sign often still are. In fact, surveys by the ECB, for example, find the proportion of employees covered by collective agreements in the EU tend consistently to be higher than the proportion of employees covered by trade unions (ECB 2009, 18-9). By extension, non-encompassing unions that sign encompassing wage agreements face the same incentives for wage restraint that Calmfors and Driffill (1988) attribute to encompassing unions. This finding spawned much work on coordination in wage-setting regimes, much of which has been influenced by Traxler. Sisson and Marginson, for instance (2002, 203-4), the process entails information exchange, benchmarking, and target-setting, even if the framework in which they embed these concepts is far clumsier than that put forward by Traxler and Kittel (2002).

Certainly, Traxler (2002) finds no evidence that individual bargaining with low union coverage lowers labour costs, a point that chimes with his earlier scepticism about deregulation in coordinated systems (Traxler and Kittel 2000, 1170). This lack of evidence does suggest that even if he is highly critical of early work by Calmfors and Driffill (1988) and Soskice (1990), he does share their basic premise that encompassing systems are closely associated with low inflation and high employment. He and Kittel (2000, 1156-7) do argue, however, that previous studies had often ignored coordination, had used rather blunt indicators to compare the effects of different bargaining systems and had been overly simplistic, comparing systems only on the basis of their level of centralization. In addition to comparing how encompassing agreements are, they argue that bargaining systems must also be examined on the basis of two forms of coordination: (1) horizontal coordination, i.e. the extent to which the social partners are able to harmonize wage developments across sectors of the economy, and (2) vertical coordination, or the extent to which macro and meso-level agreements are followed by firms and unions at lower levels (Traxler and Kittel 2000, 1158). This latter point about is particularly striking, given that later conceptualizations of institutions and institutional change (such as Thelen and Mahoney 2010) take up the issue of compliance with established rules as a variable,

where previous strains of neoinstitutionalist theory had taken it as read that established rules are followed by key actors. What is also striking is that Traxler and Kittel (2000, 1172) conclude that performance gains in coordinated systems derive from an effective blend of vertical and horizontal coordination, the combination of which may vary between systems. For instance, they note that pattern systems, where national peak associations tend to be comparatively weak and much more work is done at sector level, require fewer instruments to provide effective vertical coordination, with the authoritative sector agreements being much closer to firm-level actors than in systems with national peak-level bargaining.

Traxler and Kittel (2000, 1173) also suggest several different mechanisms by which systems achieve horizontal coordination, namely inter-associational, or binding agreements by peak associations, intra-associational agreements, where peak associations merely coordinate amongst affiliates who do the actual bargaining, pattern-setting, state-imposed and state-sponsored coordination, and uncoordinated bargaining. The introduction of the state, either as a player in intra-associational agreements, or as a sponsor and leading player in coordination itself, captures the tripartite nature of some systems, where earlier works such as Soskice (1990) and Calmfors and Driffill (1988) had focused solely upon the social partners. Nor are Traxler and Kittel (2000) alone in having this focus, with Brandl (2012), for example, noting instances where government interventions may promote coordination in wage setting where the social partners are weak. This finding dovetails with greater interest in state-promoted concertation in the parallel literature on social pacts, which often have a bearing upon wage setting (e.g. Natali and Pochet 2009; Hassel 2006; Avdagic, Rhodes, and Visser 2010; Hamann and Kelly 2007). It also compliments elaborations by Hancké, Rhodes, and Thatcher (2007), Molina and Rhodes (2007) and Royo (2007) amongst many others, of Hall and Soskice's (2001) Varieties of Capitalism framework, to include Mixed Market Economies, which are built around more fragmented social partners and a more central role for the state. Indeed, this innovation plays an important role in Hancké's (2012; 2013) more recent work on wage developments in coordinated and mixed systems through the crisis.

While the state's inclusion is a welcome change, greater subtlety is needed the way it is treated. Indeed, while it is not incompatible with Traxler and Kittel's (2000) framework, they are not explicit about the state's role in supplementing other patterns of coordination. For example, the Dutch system uses non-binding intra-associational agreements at national level to manage separate negotiations by the social partners' sectoral affiliates, the state involvement plays an important, but crucially an intermittent role in Dutch collective bargaining at national level and only a limited role at sector level. With this in mind, Verdun (2002; 2008, 224-5), for example, cites a well-established definition of the Dutch model as a state of quasi-permanent dialogue between employers, unions, and government where trust makes possible mutually beneficial agreements. In essence, the Dutch case thus becomes an example of successful tripartism. Likewise, the Belgian state plays a much more consistent, and certainly a more forceful role as well in Belgium than its counterpart does in the Netherlands, but intra-associational patterns of coordination are still clearly visible and highly influential as well. In both cases, the state plays an important role in buttressing the process with legal extensions of collective agreements. This issue is explored in greater detail in subsequent chapters, but presently, the point is that a state role does not preclude the existence of other consequential forms of coordination. Likewise, while Traxler and Kittel (2000) define 'state supported' systems simply by whether the state takes a role in negotiations, subsequent chapters find that between cases the state role varies significantly. Indeed, in these 'state supported' systems, the state's role varies in the extent to which it is a player in negotiations, but also in the role that it plays from outside negotiations in influencing the relationship between the social partners, or amplifying their influence, with legal extensions of collective agreements, for example.

Concerning vertical coordination, Traxler and Kittel (2000, 1175) point to the legal enforceability of collective agreements, as well as a peace obligation preventing industrial action by signatories as important pre-requisites of governability in a wage-setting system. This point is taken up by Brandl (2012, 488), for instance, who has highlighted 'governability', i.e. the strength of a system's vertical coordination, as key ingredient in successful tripartite pacts on wages. More recent



literature comparing wage coordination in countries in Northern and Southern Europe also discusses vertical coordination, because the high governability of northern systems sets them apart from those with much weaker governability in the south. While Traxler and Kittel (2000) emphasize peace obligations binding firm-level actors and the extent to which agreements to which they are bound are enforceable vis-à-vis actors at lower levels, they also suggest that the relationship between actors at firm, sector, and national level may be more or less hierarchical in different systems. Indeed, they acknowledge comments by Soskice (1990) that vertical coordination in some cases entails bottom-up processes as well, and do note that in systems where the state plays a smaller role in enforcement, the ability of actors at lower levels to articulate their interests plays an important role in vertical coordination.

This conceptualization of the ties between upper and lower-level negotiators as a (variably) bidirectional one is an important innovation. Indeed, as subsequent chapters will detail, while compliance with agreements struck by bargainers at higher levels is certainly an important part of vertical coordination, consultation with regional collective bargaining committees plays a very important role in informing the recommendations by sector-level unions in Germany, which in turn inform the actual negotiations of collective agreements by these same regional committees. Likewise, while negotiators at sector and firm level in the Netherlands are expected to follow national recommendations on wage developments, these recommendations are the product of intensive consultations between national trade union confederations and these same firm and sector-level affiliates. Likewise, often such agreements or recommendations are non-binding, which suggests quite strongly that 'enforcement' is not the only factor deciding whether actors at lower levels abide by them. Nonetheless, Traxler and Kittel's (2000) point that the connection between actors at different levels matters is an important one. Thus, this study conceives of vertical coordination more broadly as the relationship between negotiators at different levels, and the extent to which they respond to each other.

However, while this literature has come to cover the role of the state and refined its coverage of inter-sectoral coordination, it gives less attention to coordination within individual sectors, where the governability of coordination systems within individual sectors are often closely tied to broad or compulsory membership of employers' associations, as well as legal provisions to extend collective agreements to non-union workers. This omission is particularly important in examining the German case, for example, where the declining coverage of the system is a point of growing concern, and where wage developments in firms who are not covered by collective agreements tend to be quite different than those who are. The key implication of this observation is that the actual coverage of coordinated systems and the mechanisms that regulate coverage are an important part of vertical coordination.

This framework has made for more fine-grained predictions about the performance of different systems. For instance, Traxler and Kittel (2000, 1159) find that systems built around cross-sectoral horizontal coordination are most effective when they contain a mechanism to prevent drift at lower levels and that more centralized systems work best with a legally enshrined mechanism of vertical coordination (Traxler and Kittel 2000, 1160). More importantly, though, this work allows for much sharper distinctions to be drawn among coordinated systems, not just between systems based upon robust social partners and tight inter-sectoral coordination, and those built around state-led coordination which underlies Hancké's (2012) analysis of the crisis. For example, while early frameworks by Soskice (1990), or even Hancké's (2012) recent distinction between healthy 'coordinated' systems and stricken 'mixed' ones, would not differentiate between the highly centralized and legalistic Belgian system and the horizontally organized German one. Crucial then is the insight by Traxler and Kittel (2000) or Sisson and Marginson (2002) that there are multiple combinations of factors that can make for a healthy system of coordinated wage setting.

Previous literature largely overlooks a subtle but important factor in wage-setting systems, namely, their calibration. This factor is perhaps implicit in some of Sisson and Marginson's (2002)

work, although they never deal with it explicitly. Different systems are designed to account for different factors and to deal with different issues in collective agreements. This statement has potentially important implications for the behaviour of the system and the issues that it prioritizes, but has largely been overlooked in the literature. Certainly, where Traxler and Kittel (2002) are only one of many who note a strong connection between effective coordination and wage restraint, but considering calibration begs the question: 'coordinated to what ends?' Likewise, that the question of calibration is one taken up in recent neoinstitutionalist writings on institutional change, particularly in Streeck and Thelen's (2005) notion of institutional drift suggests it as an important factor in wage-setting systems. While these notions of institutional change in general, and institutional drift in particular will be examined in more detail in Chapter 3, Streeck and Thelen's (2005) understanding of drift has it that the outputs of institutions change in circumstances where there external environment changes, but they do not. The implication of drift is that in order to continue performing the same function, institutions must constantly be refocused and redirected as their environments change. More broadly, the idea that the ends towards which institutions are directed matters is inherent in this notion of institutional drift.

More to the point, the calibration of a system of wage bargaining is a highly conspicuous feature of the Belgian model, for example, although it plays an important role in guiding negotiations in other systems as well. Indeed, in Belgium, as well as in Luxembourg, Malta and Cyprus, a floor for wage negotiations tied to an inflation index is legally enshrined, while an inflation correction mechanism played an important role in collective agreements in pre-crisis Spain (Eurofound 2010), as well as in Slovenia. By contrast, the Dutch and German systems are built around a 'coordination rule' by which their negotiations track more loosely developments in inflation and productivity growth. What this suggests is that the different systems of wage coordination are more sensitive to different indicators, and that they can be expected to respond differently in subtle but important ways to new developments.

In brief, past literature has dissected highly coordinated systems of wage setting by way of the means that they use to coordinate wages across and within sectors, or horizontal coordination, and the relationship between the relevant levels of bargaining, or vertical coordination. Although it has gotten lost in more recent literature examining wage coordination and the crisis, in fact, these are important features in distinguishing between the coordinated systems that have recently been the focus of much attention. This project takes these markers as its point of departure, but adds ‘calibration’, or the specific factors that guide wage negotiations. The next section will examine the pressures that the academic literature has predicted will befall highly coordinated systems under EMU.

#### **2.4: EMU and its Challenges for Wage Setting**

While the previous section noted that an extensive literature has developed around wage coordination, much of it avoids engaging directly with EMU. Indeed, several foundational works long predate EMU, while Traxler and Kittel’s (2002) observations end at 1990, overlooking pressures exerted upon national bargaining systems in countries striving to meet the convergence criteria. Likewise, Brandl (2012), has argued that social pacts in the 1990s were in many cases a response to pressures to meet the convergence criteria for EMU, although he does not address pressures after euro adoption. Certainly, EMU has hardly been overlooked by scholars concerned with wage-setting regimes, although few of them have gone to the same lengths as Traxler and Kittel (2000), for example, in deconstructing individual systems and examining their behaviour under the single currency. This omission is particularly striking given Hancké’s (2012, 8) observation that EMU amplifies subtle differences among member countries, or Lane’s (2006, 49) point that differences between EMU economies show up very differently under EMU.

The literature that does engage with EMU and wage bargaining, however, points to pressures emanating from two crucial changes brought about the single currency. First, delegating monetary

policy from a national central bank to the ECB has created pressures in the form disincentives for wage restraint, divergence between sheltered and exposed sectors, and a mismatch between a single interest rate from the European Central Bank and national inflation preferences. Second, EMU has restrained the use of other instruments traditionally used to manage the economic cycle, placing added strain on wages as an adjustment mechanism. Some have interpreted the resulting need for flexibility in wages and work as a driver of greater decentralization of wage setting, but it may also place new strains on the relationship between the social partners. As Hancké (2012) and others have stressed, differing institutional arrangements are affected differently by EMU.

First, Hancké and Soskice (2003, 149), for example, argue that the incentives for pay moderation following euro adoption will be much relaxed. Indeed, they find that attempts to meet the Maastricht convergence criteria in the run up to euro adoption had been a significant driver of coordination and wage discipline during the 1990s because unions on the whole had favoured monetary integration (Hancké and Soskice 2003, 153; Verdun 2000), while German wage growth was restrained by the threat of raised interest rates and other aspiring members' wages and inflation rates contained by their central banks' commitment to maintain a peg to the Deutschmark (Hancké and Soskice 2003, 153-4). They note, however, that following euro adoption there is no means for the central bank to discipline individual members for inflationary wage growth (Hancké and Soskice 2003, 154). While prior to euro adoption, countries had retained a central bank operating at national level, even if they had accepted a currency peg, the European Central Bank, setting rates for the entire euro area has no tools to influence wage-setters in individual national contexts. As a result, while wage inflation had been low in the period leading up to euro adoption, there were few direct incentives for national wage setters to take into account when considering the possible effects of their wage settlements on the rest of the euro group (Hancké and Soskice 2003, 154). In essence, where countries' wage discipline is relaxed constitutes a change in their calibration.

Soskice and Iversen (2001) continue in this vein, arguing that while coordinated or centralized systems respond to an unaccommodating central bank with wage discipline, uncoordinated systems do not respond this way, and face higher inflation and unemployment as a result. Certainly, their warning that an ECB targeting inflation across many countries rather than focusing on German inflation may result in a relaxation of wage moderation there was not borne out. However, the implication Soskice and Iversen's (2001) prediction for EMU is that where multiple coordinated systems do not coordinate amongst themselves, there are fewer incentives for wage restraint. This line of reasoning is partially behind the observation by Hancké and Rhodes (2005) that social concertation along the lines of social pacts had begun to break down under EMU.

Subsequent scholars have noted a clustering effect, whereby in some cases these disincentives have indeed manifested themselves in relaxed wage discipline and deteriorating wage coordination, but not others. Indeed, Hancké (2012, 12), among many others has observed wage inflation in southern European countries, though not elsewhere, as a result of preferences for higher domestic inflation, low real interest rates, and limited means by the central bank to control them, while Lane (2006, 50) has noted that countries, often northern ones, that are trade-dependent and thus much more sensitive to rate changes by the ECB than are the southern countries. Others have noted a more subtle twist on this dynamic, which afflicts some coordinated systems. Johnston (2012), for example, notes that there has been a tendency for wage dynamics in sheltered and exposed sectors of economies in EMU to diverge. While exposed sectors are disciplined by international competition, governments and central banks have fewer tools to manage pay in sheltered sectors than they did under ERM. Johnston (2009) also points out, however, that there are important variations among highly coordinated economies. That there are important institutional variations among them as well is particularly suggestive. Traxler and Brandl (2012), for instance, emphasise the composition of bargainers, i.e. to what extent the social partners represent firms and employees from sheltered and exposed sectors, and the way this interacts with different bargaining

regimes, although they do not address EMU directly. Put another way, EMU may exert pressure on some systems' horizontal coordination.

Second, others have pointed to greater pressures placed on wages as an adjustment mechanism for redressing economic shocks and macroeconomic imbalances, where EMU has restrained the use of others. Indeed, prior to EMU, fiscal and monetary policy had played this role, along with wages. With a common currency and a fixed nominal exchange rate, monetary policy can no longer be used to manage imbalances among EMU countries, and is a blunter instrument for managing individual economies' activities with non-members than had been the national central banks that preceded it. Likewise, the role of fiscal policy in managing the economic cycle is well established, but heavily restrained under EMU. In part, fiscal policy is constrained by EMU because the convergence criteria required for adopting the euro, and subsequent rules crafted for Eurozone members limit government deficits to 3% of GDP and government debt to 60% of GDP, albeit with some caveats. Certainly, these restrictions on public debt and deficits do allow governments the choice to spend more or spend less on condition that they tax accordingly. However, Glassner and Pochet (2011, 6) note that because a lack of tax harmonization has led to tax competition among euro area members, which limits the use of taxes to manage the economic cycle, which suggests limits to the discretion offered to governments by EMU's official rules on fiscal policy.

Thus, the brunt of adjustments fall upon wages and wage-setting systems (Dølvik 2000; Traxler 2002), not all of which are able to manage these pressures. Indeed, Magnusson and Stråth (2001) have argued that this situation necessitates flexibility in workers' real wages, a significant determinant of which is the wage-setting system. Therefore, highly coordinated wage-setting practices may well be compatible with EMU, although those that are highly rigid on wages are likely to struggle to adjust to macroeconomic shocks. This conclusion is in line with early theorizing following Mundell (1961), as well as subsequent work by Hancké and Soskice (2003), Allsopp and Vines (2008), and Zemanek, Belke, and Schnabl (2010), for example. Certainly, Magnusson and Stråth

(2001) make this observation while considering the suitability of Norway and Sweden for euro adoption. However, the rigidity associated with automatic indexation systems, which use a measure of inflation as a hard floor for wage settlements come to mind. The wage-setting systems of Belgium, Luxembourg, and Cyprus, as well as pre-crisis Spain are calibrated in this way.

A related concern raised by Abraham and van Rompuy (1999) is that systems that set wages in a very uniform way across sectors, as is done in Belgium, will struggle with shocks affecting specific sectors differently. Others, such as Whittall (2007) have interpreted this need for flexibility in real wages as a need for greater differentiation in real wages, not just between sectors, but between firms in the same sector. A clear implication of this need for flexibility is that there should be pressure for greater decentralization of wage setting to allow for greater variation in wage developments between sectors under EMU. Scholars have debated whether decentralization necessarily implies a greater disorganization of coordinated systems, with firms opting out of multiemployer bargaining altogether, and there are those that see organized decentralization as a means of adding flexibility while preserving coordination. Among the former, Whittall (2005; 2007) implies that pressures for decentralization are largely manifested in disorganization of coordinated systems, although Streeck and Rehder (2003), Hassel and Rehder (2001), Thelen (2000), Sorge (1999), Thelen and Turner (1999), as well as Haipeter (2011) see derogations to firm-level bargainers in the context of opening clauses and looser sectoral agreements as a means of preserving coordination in the face of pressures from EMU, amongst other things. This pressure is related but distinct from the one noted by Johnston (2012), which entails a divergence in the outcomes of collective bargaining in different sectors, while this debate between Whittall (2005; 2007) and others turns on a decentralization of the mechanisms responsible for wage setting itself, as well as greater differentiation within sectors, rather than just between them.

Perhaps just as interestingly, fiscal policy has in some cases played an important role in supporting wage policy. Brandl (2012, 488), for example, has noted that some forms of state-



sponsored wage coordination rely upon material inducements from the state, although he makes no mention of EMU, a point echoed by Vermeiren (2012), who compares the performance of healthy 'coordinated' systems with currently stricken 'mixed' ones in the context of EMU. Certainly, these authors have peripheral countries in mind, although this phenomenon is not unique to them, as material inducements from the state have also played a role in Belgian collective agreements, and periodically in Dutch agreements as well. In any case, the ability of governments to promote coordination by way of material inducements is more restricted because of constraints on fiscal policy under the single currency.

A related pressure is suggested by Blanchard and Philippon (2006), as well as Traxler and Kittel (2002). Blanchard and Philippon (2006) argue that the quality of the relationship between unions and employers has an important impact upon macroeconomic performance. Indeed, they argue that conflictual industrial relations tend to cause higher unemployment in OECD countries, while Traxler and Kittel (2002, 1177) find that state-imposed coordination will be less effective in promoting economic performance as compared with voluntary arrangements. Likewise, this observation is partly behind that of Soskice (1990, 50) that trust between employees and employers is a crucial component of wage coordination, even if, as Traxler and Kittel (2002) note, trust is difficult to observe and measure. Put another way, the macroeconomic gains that authors such as Hancké (2012) ascribe to strong social partners may be at risk in some coordinated systems where this increased pressure on wages manifests itself in more fractious wage negotiations. Furthermore, Traxler's (2002) point that state-imposed coordination is often less effective than the voluntary sort suggests unpleasant prospects for systems where this fractiousness necessitates a larger state role. Lost policy instruments and greater pressure on wages as an adjustment mechanism under EMU may either strain the vertical coordination of coordinated systems, or force them to adapt in the form of organized decentralization.

In brief, the academic literature suggests that EMU may exert pressures on systems of coordinated wage bargaining because of the shift to a Eurozone-wide monetary policy and the loss of other policy instruments. In coordinated systems, these would be visible in the form of relaxed wage discipline, divergence in wage developments between sectors, declining cost competitiveness, as well as decentralized bargaining and increased tensions between the social partners.

## **2.5: Grounding Historically EMU's Challenges for Wage Setting**

The steps to Economic and Monetary Union from false starts in the 1960s and fits in the 1970s to successful adoption of a single currency in 1999 has been well chronicled by scholars such as Dyson (1994), Verdun (1996; 2000; 2013), Dyson and Featherstone (1999), Gros and Thygesen (1998), among many others. As such, the aim of this section is not to reconstruct events in exhaustive detail. Rather, the intention of this section is to trace the origins of the pressures that EMU exerts upon systems of coordinated wage bargaining. It finds that many of these pressures are unintended, though not unavoidable consequences of decisions taken about the specific form that EMU was to take. Understanding this context is important in grounding the pressures posited in the literature. It is also important in situating this study among many others that have called for a rethink of some key features of EMU and contextualizing its findings in this debate. Vandenbroucke and Vanhercke (2014), for example, are two of many since the crisis to have called for enhanced social dialogue at European level, as well as greater fiscal solidarity in EMU. Both of these features were included in the economists' blueprints for EMU, but left out of the current design of the single currency, which has in turn been an important driver of pressures on national wage-bargaining systems. Following a brief overview of the steps to euro adoption, this section examines the competition between different visions of EMU, the outcome of which has had important consequences for the process of monetary integration and for wage setting as well.

### **2.5.1: Steps to Euro Adoption**

While the first definitive steps towards monetary union were taken in the late 1960s, ideas about monetary union among continental European countries were given expression in the late 1940s (Dyson 1994, 68). Similarly, these ideas were very much on the minds of policymakers in the late 1950s during the negotiations over the Treaty of Rome (Verdun 2000), even if monetary union played no significant role in the treaty itself. However, it was expected that the issue of monetary union would resurface in tandem with increasing success of integration, as well as the completion of the customs union and the resulting trade openness among members of the European Economic Community (EEC), a forerunner of the EU (Dyson 1994, 65). This is precisely what happened during the 1960s alongside the completion of the customs union. Indeed, as scholars such as Mundell (1961) and other OCA theorists were making the intellectual case for a common currency, or at least attempting to set the terms under which one might be favourable, several proposals emerged throughout the 1960s for monetary union. Indeed, among the more notable was a plan floated for a monetary union based upon the American Federal Reserve System, although various other proposals emerged for deeper coordination on monetary policy throughout the decade (Verdun 2000, 54). These plans failed to gain traction, although problems throughout the decade with inflation in France and Italy, as well as Italian balance of payments problems and concerns in Germany about capital inflows saw EEC countries begin to warm to the idea (Dyson 1994, 69-70). Similarly, where policymakers came to see monetary integration as a means of consolidating the gains from the customs union and the Common Agricultural Policy (CAP), the exchange rate crisis in 1969 brought renewed fears of economic nationalism in Europe and focused minds around making plans for monetary integration in Europe (Dyson 1994, 74).

These favourable sentiments towards monetary union found expression in the 1970 Werner Report, which envisioned a staged adoption of a single currency with progress to be made in parallel with locking exchange rates on the one hand and then deepening economic integration and the coordination of national fiscal policy from a supranational Centre of Decision for Economic Policy

(Werner Report 1970, 12-3). However, the latter was not achieved, with divides between the Member States making deeper economic integration a political impossibility. The former, however, was successfully implemented, and a system of fixed but adjustable exchange rates, often referred to as the 'snake', was maintained between 1972 and 1978 (Verdun 2000). What is particularly interesting about the report is that its proposals for deepened economic and fiscal coordination demonstrate, even from this early stage, a concern for macroeconomic and trade imbalances within the proposed currency area.

Throughout the 1970s, however, the snake was the victim of dollar and oil crises, which tested Member States' ability to manage the system of fixed exchange rates and forced several out of the system at various points (Gros and Thygesen 1998; Kenen 1995; James 2012; Verdun 2000). However, these challenges also underscored the need for the economic calm that stable mediums of exchange could provide in the context of global exchange rate volatility. They similarly worried policymakers, who fretted that exchange rate volatility might undermine the gains that they had realized from the customs union and the Common Agricultural Policy (Gros and Thygesen 1998, 15).

In pursuit of the goal of monetary union then, the political climate, with a strong German allergy to fiscal transfers (James 2012), the system of fixed but adjustable exchange rates was relaunched in 1979. It was intended to deepen in stages like past and subsequent plans for monetary union, although familiar pressures from oil shocks and economic turmoil in the late 1970s meant that progress beyond this first stage was never achieved in this iteration of EMU (Verdun 2000, 78). While this system proved unstable until the early 1980s (Verdun 2000), it survived into the early 1990s. It is notable for being less ambitious than the plans outlined in the Werner Report, but in similar fashion made provisions for a European Monetary Fund that were never implemented (Gros and Thygesen 1998, 35). However, as the 1980s progressed, many concluded that with the deepened trade ties to be brought on by the Single Market, there was more to be gained from the certainty of permanently locked exchange rates than from the flexibility of occasional rate

realignments (Kenen 1995, 9). It was also believed that the abolition of capital controls that were part of the plan for the Single Market, might make a system of fixed exchange rates vulnerable to speculative attacks (Kenen 1995, 9). Interestingly, and for this reason, it was only in the later 1980s that firm decisions were made in favour of a single shared currency over permanently fixed national currencies (Kenen 1995, 9). In any event, renewed emphasis was given to deeper monetary integration in the late 1980s, with the blueprint for a staged entry into EMU devised in the Delors Report of 1989 and adopted in the Maastricht Treaty in 1992. In the meantime, however, where members had done away with exchange rate realignments by the late 1980s, speculative pressures and an unwillingness to adjust exchange rates brought about the collapse of the system of fixed exchange rates in the early 1990s (James 2012; Verdun 2000). This experience underscored yet again for policymakers the stability problems inherent in even a hard system of fixed exchange rates (Kenen 1995, 178).

Heavily influenced by the turn away from state intervention in the 1980s, as well as the constant frustration associated with past attempts at deepening economic integration, the plan for monetary union that emerged from the Delors Report was rather less ambitious in its scope than had been the Werner Report (Verdun 2013, 28). Indeed, deep coordination of economic and fiscal policy proved politically too difficult for Member States (Verdun 2013, 29). Instead, what emerged was a staged approach to adoption of a single currency, built around tight criteria for entry, but thereafter only agreements on spending limits for national governments. Departing from the tenor of past blueprints for a currency union, and in lieu of deeper economic integration as a means of stabilizing the system, EMU left the burden of adjustment to economic shocks falling to actors at national level (Verdun 1996).

### **2.5.2: Competing Visions of EMU and Wage Bargaining**

For wage bargaining and the pressures that monetary integration would exert upon it, two points about this transition to EMU stand out: first, the transfer of monetary authority to a European central bank and the decision to adopt a single currency, and second, the greater emphasis given to the 'monetary' in Economic and Monetary Union. Regarding the first, scholars such as Hancké and Soskice (2003) are certainly correct in noting that the pressure to meet the convergence criteria en route to joining the euro played a crucial role in driving wage discipline in weakly coordinated systems. Likewise, important adaptations were made during the run-up to euro adoption in Belgium and the Netherlands with monetary union in mind as well.

Just as interestingly, however, the decision to cede authority over monetary policy is one of several possible forms of monetary union considered by policymakers between the late 1960s and the early 1990s. Indeed, previous incarnations of monetary integration had retained national currencies in a system of fixed but adjustable exchange rates. Certainly, these were intended as temporary arrangements en route to full monetary union. Later work by Mundell (1973) had found that, whatever their merits as a stepping stone to full monetary union, fixed exchange rates were likely to invite speculative pressures that would destabilize the system. Policymakers arrived at similar conclusions, argues James (2012, 25), following the collapse of the Exchange Rate Mechanism (ERM) under pressure from exactly these sorts of pressures in the early 1990s.

However, compared with the current context, this system of fixed but adjustable exchange rates had the advantage, first, of allowing national central banks to discipline national wage setters, where the ECB's single rate is too blunt an instrument, and second, of leaving other means besides wages for adjusting to economic shocks. Indeed, between the early 1970s and the late 1980s, members of the ERM could respond to economic pressures by petitioning to have their peg to other currencies adjusted, or temporarily withdraw from the system altogether. Members made judicious use of both options in the mid-1970s and in the early 1980s as well. By contrast, Verdun (2000)

notes that the refusal by Member States from the late 1980s to adjust their exchange rates likely played a role in the system's demise in the early 1990s. Certainly, while plans existed for participating countries to cede control over exchange rate policy to a supranational authority since at least 1970, it was only in the late 1980s that the opinion among policymakers turned in favour of actually following them (Kenen 1995, 9), and only in the early 1990s that an explicit decision was taken to this effect.

Similarly, Dyson's account of parallel currency plans finds this distinction between monetary integration and lost monetary sovereignty. Indeed, he notes that blueprints had been developed in the mid-1970s for the introduction of a shared European currency to circulate alongside national currencies. Rather than replace national currencies, this parallel currency would provide a medium of exchange to reinforce the Common Market and the CAP, while leaving national currencies to fluctuate (Dyson 1994, 7). Under such a system, competitive pressures would still be exerted upon national currencies, while national central banks would remain able to exercise a moderating effect upon wage developments. Certainly, such a plan never found wide acceptance, although it was popular with German and British policymakers, resurfacing at key points in the 1980s and 1990s (Kenen 1995; 27). One such proposal was put forward by the British treasury in response to the Delors Report, for instance (in H.M. Treasury 1989). In any event, the point is that the decision to formally cede control over monetary policy to a supranational body was made relatively late and was one of several competing institutional forms that EMU might have taken. The pressures for wage-bargaining systems that have come from the delegation of authority over monetary policy to the ECB were hardly an inevitable part of monetary union, but rather were the unintended consequence of the very specific decision to equate monetary union with currency union. Indeed, following accounts of these proposals by Dyson (1994) and Kenen (1995), currency fluctuations and independent national central banks would remain important parts of an EMU that retained national currencies.

Concerning the second key facet of the transition to EMU, what marked even early debates, and what would define subsequent decisions on the shape of EMU was a divide among scholars, policymakers, and indeed Member States, over whether deep coordination of economic policy, or economic union, was a necessary precursor to monetary union or if a monetary union could successfully be created either without or before economic union. These are the debates referenced by Verdun (1996; 2000; 2013), Dyson (1994), Kenen (1995), James (2012), and many others besides, between the so-called 'economists' and 'monetarists' respectively. The outcome of this debate has had important consequences for the architecture of EMU and for its impact upon coordinated wage setting. Likewise, reverberations of this debate are evident in calls from academics (such as Sala-i-Martin and Sachs 1992, or Bayoumi and Masson 1995) who argued unsuccessfully in the early-mid 1990s for deeper economic integration as part of monetary union. Echoes of it are also evident in post-crisis reassessments of EMU's design as well. At any rate, as with the decision to delegate power over monetary policy to a single European institution, the choice of a monetarist blueprint for EMU would have important implications for the euro area's wage-bargaining systems. With shallower economic integration, individual Member States had to deal with more adjustment pressures to economic shocks and imbalances. With the loss of monetary policy and constraints placed upon fiscal policy, however, EMU also left them with fewer instruments, wage bargaining aside, for dealing with them.

Verdun (2000) and James (2012), among many others, are correct in noting that the political climate of the late 1970s and 1980s and an inability to find agreement on the parameters of deeper economic integration turned the debate in favour of the monetarist position. For this reason, the MacDougall Report (1977), for example, which recommended an expansion of Community spending for economic development, correcting cyclical shocks, and for interstate redistribution, failed to resonate with policymakers. However, the choice made in favour of a 'monetarist EMU' has had unintended, but important consequences for the pressures that the currency union would exert upon wage-bargaining systems. Certainly, those blueprints for EMU prior to the Delors Report (1989)



reflect a tense compromise between monetarist and economist approaches to EMU. Nonetheless, the contrast between the design for EMU developed in the Delors Report (1989), later adopted in the Maastricht Treaty, and its precursors is instructive. Where the current design of EMU entails constraints upon fiscal policy and much burden of adjustment left to policymakers and the social partners at national level (Verdun 1996), previous and abandoned designs were, consciously or not, far friendlier to coordinated wage bargaining.

The early plans that were adopted by the Member States, as laid down in the 1970 Werner Report proposed in stages to achieve full monetary union within a decade (Werner Report 1970). Certainly, it has been argued that it blended the monetarists and economists' opposing positions to an extent that made it untenable as a path to monetary union (Verdun 2000). Nonetheless, even as a compromise, two distinct features of this blueprint stand out. Specifically, the vision of EMU contained in the Werner Report entailed consultation with the social partners over their management of wage developments (Werner Report 1970, 11-12), and on major policy initiatives related to EMU (Werner Report 1970, 18). Also borrowed from the economists' side of the debate, it saw fiscal policy as a core component of European economic governance and showed an early sensitivity to the problem of macroeconomic and trade imbalances in a single currency area (Werner Report 1970, 13).

Going beyond the recommendation for supranational controls over national budgets in the Werner Report (1970), the 1977 MacDougall Report outlined a gradual approach to increasing the spending powers of European institutions to accompany monetary integration (MacDougall Report 1977). While the report was unequivocal about the need for fiscal transfers and a more robust Community budget as part of EMU, it made no mention of consultation with the social partners. However, it did emphasize the importance of employment and labour market policy, as well as social policy in EMU, i.e. areas that often involve the social partners. In any event, neither fiscal transfers, nor consultation with the European social partners appear in the Delors Report (1989). Indeed, it is

very clear about seeing wage formation and the social partnership as strictly national issues, although it does raise concerns about macroeconomic imbalances developing among EMU countries with pressures on exchange rates, explicitly citing labour and cost developments (Delors Report 1989, 17). There is something of an irony in this, where the Delors Report (1989, 20) eschewed consultation with the social partners, but at the same time reaffirmed their importance, in demanding that they take greater account for productivity growth in wage agreements. However, where the Werner Report (1970) called for consultation with the social partners at European level, the Delors Report (1989) instead stressed measures to increase factor mobility as the means for dealing with these macroeconomic imbalances.

These two choices about economic governance in the euro area, namely to forego fiscal transfers and deep consultation with the social partners would have two important consequences for wage setting. It has meant, first, that actors at national level bear the brunt of adjustments to economic shocks. It has meant, second, that these national-level actors would have fewer tools for making these adjustments. Regarding the first, the fiscal transfers mentioned in the Werner Report (1970) or Community fiscal policy as envisioned by the MacDougall Report (1977), alongside individual countries' automatic stabilizers, would have helped to cushion members of the currency area against asymmetric shocks and cyclical downturns. With this in mind, the pressure placed on the system of fixed exchange rates in the mid-1970s and the early 1980s is instructive. Indeed, this pressure had as its root cause the decades' infamous oil and exchange rate shocks, but were felt more acutely because they affected European countries in different ways and to different extents (Kenen 1995, 5). Absent fiscal transfers, redressing the differing implications of these shocks would be the task of other actors, chief among them are the social partners, with their role in wage setting. Indeed, German economic performance during the 1970s garnered it much positive attention in the academic community, for instance, while it is remembered less fondly in the Netherlands, where a wage-setting system capable of coping with inflationary pressures did not emerge until the 1980s.

It is interesting to recall that several key peak associations of the social partners formed in the years after the Werner Report. For example, the ETUC formed in 1973, and the EMF was established in 1971. It is also interesting to recall that these same organizations have evolved of their own accord mechanisms for coordinating among their members at national level, and in some cases, such as metalworking, are promoting exactly the sort of economic convergence that economist thinkers had hoped. Indeed, the EMF, for example, had agreed a common set of guidelines for its members to form their wage demands. Nonetheless, the design for EMU that was adopted took a dimmer view of consultation with the social partners on European economic policymaking, even if it did cite concerns about wages and productivity. Hence, absent fiscal transfers between Member States and a more robust role for the European peak associations of the social partners, the burden of adjustment to such asymmetric shocks within EMU falls upon actors at national level (Verdun 2000). This is very much in keeping with its explicit and frequent references to subsidiarity and the importance of Member state competences, which have no such prominence in the Werner Report (1970) and the MacDougall Report (1977).

Second, at the same time as policymakers relied heavily upon euro area members, rather than supranational bodies, to manage the pressures of the monetary integration, structural and cohesion funds notwithstanding, they turned to constraints upon national fiscal policy as a means of protecting the integrity of the currency (James 2012, 17). Certainly, Heipertz and Verdun (2004) are two of many who have noted that these constraints did not prove as restrictive in practice as had been intended. Nonetheless, the implication of this choice about economic management in the euro area is that at the same time as national actors must bear more of the brunt of economic adjustments within EMU, they have fewer tools for doing so.

Rather than being inevitable with monetary integration, the pressures exerted upon systems of coordinated wage bargaining are the result of very specific decisions taken about the form that EMU would take. Blueprints for a monetary union that retained national currencies alongside a

shared one emerged at key points in the 1970s, 1980s, and 1990s. While these plans never found wide acceptance and fixed exchange rates were seen in several iterations of monetary integration as a first step towards deeper integration, the actual decision to delegate authority to a single European Central Bank was one that was taken only in the early 1990s. This decision is behind pressures for relaxed wage discipline in euro area countries. Indeed, even where national currencies are retained, but exchange rates fixed, national governments still face pressures in currency markets that they do not with a single shared currency.

Likewise, while in its current design, Economic and Monetary Union has largely left the burden of economic adjustment to national actors, and left them with fewer tools, save wages, for doing so. This decision is behind possible strains on the relationship between the social partners because of the added burden upon them to adjust wages in response to economic conditions. It is also behind pressure for greater decentralization of wage-bargaining systems, where in the absence of other tools of economic management, shocks that affect different sectors and firms differently begets pressure for more tailored, hence, more differentiated wage developments between them.

This section has argued, in short, that the pressures exerted upon wage-bargaining systems, are in fact unintended though not unavoidable consequences of these crucial decisions. This examination of key institutional developments in EMU is important in contextualizing the pressures posited by the literature on EMU and wage bargaining. It is also important in the current context, where scholars and policymakers have called for changes to EMU that touch closely upon some of the institutional sources of these pressures, as in De Grauwe (2011), Hancké (2013), or Vandenbrouck and Vanhercke (2014), among many others.

### **2.5.3: Section Summary**

The pressures exerted upon national wage-bargaining systems by EMU stem from two crucial developments in its governance. First, while previous blueprints for EMU had as their stated objective the adoption of a single currency, it was only belatedly that policymakers took firm decisions to move beyond the existing practice of fixed but adjustable exchange rates towards irrevocably fixing exchange rates and introducing a new currency. This decision to equate monetary union with currency union placed more pressure on wages to act as an adjustment mechanism, while opening the possibility of relaxed wage discipline without pressure from a national central bank. Second, the outcome of the debate between the so called monetarists and economists meant that monetary union proceeded with only limited economic coordination, meaning that other means of adjusting to the business cycle, like coordination with the European social partners or fiscal transfers were eschewed. Far from being inevitable, this second set of pressures in particular is an unintended consequence of these design cues. Nonetheless, it is important to highlight the institutional sources of EMU's pressure on wage-bargaining systems to ground these pressures empirically, and given that some of these cues have been the subject of much post-crisis debate.

### **2.6: Wage Bargaining and Developments at European Level**

Much attention has been focused on new instruments for macroeconomic governance at the European level. Recent innovations like the annual Country Specific Recommendations and the new Macroeconomic Imbalance Procedure both sometimes touch upon wages and wage setting (e.g. European Commission 2013a). Doubtless a larger academic literature will emerge on the subject, but it is currently in its infancy (one exception is Verdun 2015). The Macroeconomic Imbalance Procedure was crafted as a response to the economic crisis in the euro area, and entails close monitoring of several headline economic figures for each EU Member state. Of particular interest is the fact that inflation and unit labour costs, which are intimately tied to wage-setting practices, are among the

figures that are tracked. Partly on the basis of these figures, annual recommendations for reforms are made by the European Commission, which have included critiques of both Belgian wage-setting practices (e.g. in European Commission 2013a) and German wage developments (European Commission 2013b).

Because these recommendations touch areas that are outside EU institutions' area of competence, they are from the outset non-binding, although Member States are expected to respond to them in detail, even if they choose not to comply with them. However, when specified thresholds are crossed for a number of indicators tracked, these recommendations become binding. As a supplement to these attempts at accelerating domestic economic reforms in response to the crisis, one German trade unionist had pointed to proposals calling for EU Member States to enter into legally binding contracts with the European Commission, which would formally exist outside of the Treaties, and thus introduce a form of hard governance into areas from which European institutions had traditionally been excluded, including wage setting (Interviewee 19 2013).

More socially-concerned actors have taken an interesting tack in responding proposals to tighten economic governance at European level. Indeed, Vandenbroucke and Vanhercke (2014) speak for many on the European left (as per Hemerijck 2014) in endorsing tighter economic conditionality, so long as it includes greater attention to socioeconomic factors. Hemerijck (2014) notes that conditionality may be more palatable to the European left if it comes with greater attention to social indicators, and minimum standards, i.e. if subsequent developments add a social tinge to the euro area's response to the economic crisis.

Just as importantly, comments by Hemerijck (2014), as well as Vandenbroucke and Vanhercke (2014) hint at a longstanding critique of EMU. Indeed, these scholars suggest that EMU has had a much stronger emphasis upon economics and business to the neglect of social issues. Observers such as Becker (2009, 98) are far more blunt, seeing EMU as a prominent expression of neoliberal thinking, seeing convergence criteria, emphases on monetarism, marketization, et cetera,

by which the single currency encourage important changes in national policy. He is certainly not alone in seeing a neoliberal tinge to the design of EMU, with others, such as Gill (1998), Palley (2013), Storey (2013) and many others besides making comments to this effect. Crucial for this study, many scholars, such as Hall and Soskice (2001) or Hancké, Rhodes and Thatcher (2007) group countries with institutions used for coordinating wages quite apart from more liberal, market-oriented models. Thus, one might expect that the conditions outlined by Becker (2009) to be highly corrosive for coordinated models of wage bargaining.

Conversely, some other policy innovations have been made, which attempt to add a more social tinge to EMU. Changes such as these might be expected to be less corrosive to national wage-setting practices, but nonetheless impinge upon them. Falkner (1996; 1998), for instance, has pointed to the creation of European Works Councils intended to deal with issues emerging from growing intra-European trade, but which draw upon the European social partners on matters traditionally handled by their national affiliates. She suggests further that these innovations represent some shifts toward a more corporatist style of policymaking, which align them more closely with the policymaking processes used by countries with coordinated systems. While the characterization of European Works Councils by Falkner (1996; 1998) clearly set them apart from the dynamics stressed by Becker (2009), these shifts do nonetheless represent changes that involve European-level actors in matters that had previously only concerned national-level actors.

Curiously, however, there were few concerns raised about direct effects on wage-setting institutions specifically prior to euro adoption, a point emphasized by Verdun (2000), and many interviewees besides. Bargaining had largely been conceptualized as a strictly national process and to a very large extent this is still the case. However, while the latest innovations in macroeconomic governance have been highly conspicuous because they comment on wage developments, other, less studied supranational innovations have emerged alongside EMU that have impinged upon national wage-setting practices in more subtle ways. As Sisson and Marginson (2002, 212) have pointed out,

while there is little room for supranational bargaining, some of the processes of coordination that they have witnessed in national-level wage coordination are clearly visible at European level. Indeed, they point to increasing information sharing between ETUC and the European institutions, as well as among national-level unions under the auspices of sectoral peak associations, as well as attempts at benchmarking which have only become more advanced since their article.

As Gollbach and Schulten (2000, 162) have noted, prior to euro adoption, concerns were raised within the labour movement that EMU may lead to competition over wages, culminating in wage-dumping and deflation. They note as well that while sectoral organizations like the European Metalworkers Federation (EMF) had been active since the 1970s, very little progress had been made in coordinating among member unions until after the Maastricht treaty. This manifested itself in an agreement within the EMF to coordinate unions' demands in line with a 'European Coordination Rule' centred upon inflation, productivity, and redistribution, or 'target-setting' in Sisson and Marginson's (2002) parlance. They conclude on a cautious note, pointing out that coordination by sectoral organizations like the EMF at European level, or even the ETUC are extremely limited as these bodies lack sanctioning power. However, they do note growing similarities of wage demands among member unions (Sisson and Marginson 2002, 166), as well as growing networks and information exchanges among member unions (Gollbach and Schulten 2000, 170).

Moreover, Glassner and Pochet (2011, 5) concur that the process of coordination at European level is both union-driven and directly linked to EMU. Indeed, they point out that coordination at the European level was an attempt to counteract pressures from economists and policymakers for decentralization and disorganization of wage setting (Glassner and Pochet 2011, 5), while noting that the practice is most advanced in export sectors (Glassner and Pochet 2011, 13). Glassner and Pochet (2011, 15-7) go on to outline paths by which the process might be strengthened, arguing that coordination at European level has been most successful when organized on a sectoral basis, but noting as well that success in this varies significantly by sector, contrasting



advances in the metalworking sector with the conspicuous lack thereof in services. This observation chimes with that of Sisson and Marginson (2002, 213) that any such Europeanization of wage setting would undoubtedly be multi-speed. Much like Gollbach and Schulten (2000), Glassner and Pochet (2011) end on a cautionary note. They argue that while the Doorn process, for instance, tying the metalworking sectors of Germany and the Benelux countries represented an important advance in European-level activity on wage setting, that meetings between the union representatives of the four countries have become less frequent since 2002. It underlines how difficult this sort of coordination is.

Traxler and Brandl (2009) have pointed to a convergence in the wage rates in the metalworking sectors of Germany and the Nordic countries and that this convergence is due to greater coordination and reliance upon the German sector as a pattern-setter. Likewise, Glassner and Pusch (2010) find evidence of coordination effects among the metal sectors of Germany, Belgium, and the Netherlands as a response to EMU. However, Glassner and Pochet (2011, 19-20) point to several hindrances to deeper coordination among European unions, such as significant differences in national bargaining systems, both in their institutional architecture and in the strength of coordination within them, as well as differing trajectories in national labour markets, such as the growth of low-wage work in Germany. They find as well that this has only become more acute since enlargement. Though not disputing the challenges involved, Collignon (2013), amongst others, has argued that better benchmarking and greater coordination among unions at the European level could potentially help redress macroeconomic imbalances within the euro area.

Briefly, while a wide literature on new economic governance as pertains to wage setting has yet to emerge, much attention has been paid to developments at the European level. A multitude of observers have suggested that EMU has driven a process of neoliberal-inspired adjustments in national policy, which suggests that the adoption of the single currency may be more than an environmental change. Likewise, European trade unions have responded to concerns over EMU by

developing greater contact in EU-level sectoral associations. Certainly, while these developments vary significantly by sector, greater information sharing and benchmarking is evident and in one instance there is some evidence that these developments have impacted wage developments. These moves by trade unions are not the corrosive influence that some see coming from EMU itself, although they do introduce new external influences into the wage-setting process. Scholars in this field are careful not to overstate the importance of these developments in the European trade union movement, although they are an important contextualizing factor for the present study nonetheless.

## **2.7: Chapter Synopsis**

To summarize, this chapter has reviewed the literature situating wage setting in the context of a currency union, finding that both longstanding theory and recent analyses of the economic crisis reserve a central role for wages in a currency union. They have, however generally avoided deconstructing the institutions responsible for managing wages in a currency union. Subsequent work on coordinated wage setting found that encompassing and coordinated systems in fact fare well economically, and are distinguished by the mechanisms that deliver horizontal and vertical coordination, as well as their calibration. Elsewhere it has been suggested that the impact of EMU will likely be felt very differently by different members. The literature suggests divergence between sheltered and exposed sectors, greater pressure on wages, and strains upon the social partners.

The pressures themselves result from two crucial decisions about EMU's design. First, where past incarnations of monetary union had relied upon fixed but adjustable exchange rates, decision makers opted to equate monetary union with currency union in its present form. This decision implied removing the exchange rate adjustment mechanism as an accompanying economic tool to wage setting, while reducing the discipline exerted by the national central bank for sheltered sectors. Second, the decision to forego deeper economic coordination placed a greater burden upon wages to adjust, while limiting member governments' discretion over fiscal policy and eschewing

coordination with the European social partners as complimentary policy instruments. Likewise, while coordination at the European level remains at most a subtle influence, it is an important contextualizing factor.

## Chapter 3: Theory and Methods

### 3.1 Introduction

The purpose of this chapter is to outline the theoretical and methodological considerations that have informed the design and implementation of this study. It is heavily influenced by neoinstitutionalist theory, following Streeck and Thelen (2005), as well as Mahoney and Thelen (2010). These scholars examine processes of gradual change in stable institutions and draw attention to actor behaviour as a key determinant of institutions' functioning. The project itself pursues an open-ended research question, but broadly, if imperfectly, follows a 'most similar systems design' (Lijphart 1971; Przeworski and Teune 1970), selecting cases that have much in common, but that have important differences in their wage-bargaining institutions. With the universe of potential cases very limited, it opts for a small-n design. Likewise, the suggestion in the literature that the institutions under study are highly idiosyncratic and that small differences are likely to have large implications under EMU necessitate the qualitative, interview-based approach that this study has followed.

This chapter proceeds as follows: Section 2 returns to the external influences discussed in Section 2.5. It argues that while these influences discussed in Section 2.5 are an important part of the context in which national wage-bargaining systems function, and may well become more consequential in future, EMU is best treated as an environmental change, whereby wage setting remains a largely national affair. Section 3 turns to theoretical considerations, examining the neoinstitutionalist literature on institutional change, while Section 4 outlines the research design and case selection of the project, as well as its external validity. Section 5 discusses data collection, while Section 6 examines data reliability. A final section summarizes the chapter.

### **3.2: When Europe does not hit Home – EMU as an Environmental Change**

While the model developed in Chapter 2 treats wage-setting as a strictly national affair, the findings of Section 2.5, examining the emergence of European-level influences over wage setting do demand greater nuance. Indeed, Section 2.5 found that in some cases, EMU has introduced new influences into wage setting, and some potential political pressures for changes to the institutions that manage wages as well. Following from discussions with policymakers, and indeed with one of the authors discussed in Section 2.5, in wage setting, EMU, at least for the time being is properly treated as an environmental change. Certainly, some of these developments at European level represent intriguing possibilities. They are also highly consequential for many crisis countries, whose bailouts come with strict conditions, but at present do not exercise a significant influence over wage setting in highly coordinated systems. Consequently, while these developments do demand some nuance in the study of wage-setting practices and further study as they develop, national wage-setting regimes largely remain just that in countries that effectively coordinate wages. This section addresses in turn the influence of new innovations like the Macroeconomic Imbalances Procedure, the political pressures stressed by Becker (2009), European Works Councils and then coordination efforts by the European arms of the trade unions.

First, recent innovations in European economic governance that emerged in response to the crisis have garnered much attention for their potential influence over wage setting. For instance, many policymakers in Belgium were displeased to see the Commission (2013a) commenting specifically on their wage-setting system in its new Country Specific Recommendations. Some in Belgium worry that under certain circumstances deteriorating economic conditions may trigger provisions in the Macroeconomic Imbalances Procedure that would make these recommendations binding and introduce significant changes to the Belgian system from outside. For Germany, the Commission had cited low wage growth as a point of concern (Commission 2013b).

Certainly, some observers are correct to note that supranational interventions have played an important role in suspending or dismantling wage-setting institutions in crisis countries (e.g. Visentini 2012). Policymakers in Belgium and Germany in particular have pointed to some worrying trends in these interventions. One German trade unionist noted that in their view the Recommendations were getting steadily more intrusive, following recommendations to liberalize services (Interviewee 17 2013). Many in Belgium as well have noted that subsequent rounds of recommendations had become far more pointed as well, noting that these more nuanced recommendations may be more likely to resonate as well (e.g. Jonckheere 2013). Similarly, one German trade unionist involved in the consultations over the national response to the recommendations, for instance, suggested that the government's interest in the concerns of stakeholders was less than sincere (Interviewee 19 2013). Ironically, they added that this lack of engagement with stakeholders in Germany had even been cited as a point of concern by the Commission itself (Interviewee 19 2013).

These developments are certainly consistent with the concerns raised by Becker (2009) about externally-inspired changes to national policy. However, what stands out in discussion with interviewees in Belgium, Germany and the Netherlands is how little influence these advances in European-level economic governance have had in their countries. Indeed, in the Netherlands, recommendations did not touch upon wages, while Tunnissen (2014), for instance, recounts that similar changes had already been proposed to parliament when the government received the Commission's Recommendations. Consequently, the Dutch government responded that the Recommendations were largely unnecessary. Indeed, Tunnissen (2014) recounts that "we could say to the Commission 'thank you for the recommendations, but we are already implementing them', so it wasn't a big debate because luckily it was what we were already doing".

In Germany, the government's blunt response to comments on wage developments was that they are a matter for the social partners, referencing protections for free collective bargaining in the

German constitution (Federal Ministry of Economics and Technology 2013, 12). Conversely, one trade unionist involved in European and international policy was derisive towards the Commission's comments on German wage developments (Interviewee 17 2013). Indeed, they found the implication of these comments, namely that German trade unions would not otherwise have thought to ask for higher wages, far more amusing than persuasive. More broadly, Schulten (2013) suggests that while the Country Specific Recommendations have failed to affect Germany, should select portions of the German model break down, they may well become influential in future. Sterkel (2014) suggested in a similar vein that the Country Specific Recommendations are far more influential in crisis countries and far less so in Germany. Comparable comments were made in Belgium, which suggest that at the present these Country Specific Recommendations are of small concern for healthy systems of wage coordination. Indeed, for all the controversy over an outside actor commenting on such a sensitive topic, the application of the wage norm keeps wage developments within the acceptable threshold set by the Macroeconomic Imbalances Procedure (Interviewee 10 2013). Consequently, the likelihood of the Recommendations on Belgium's wage index becoming binding is very remote, except perhaps in circumstances where its statutory ceiling on wage developments ceased to function. However, this finding comes with the caveat that several observers did note that the recommendations might serve an agenda-setting function should national actors choose to reopen the system (Interviewee 9 2013; Interviewee 10 2013). Furthermore, subsequent discussion with Becker (2014) adds further nuance to his views on the neoliberal tinge to EMU (in Becker 2009). Indeed, while he is highly critical of changes made in Spain, for instance, the Commission in particular is unlikely to exercise any serious influence over the Dutch system.

Concerning proposed bilateral contracts with the Commission, while one interviewee in Germany noted that they may open large and highly sensitive areas of labour market policy to hard governance (Interviewee 19 2013). However, Schulten (2013) counters that currently, concerns over contracts with the Commission are overstated, and that the proposal for them has failed to

resonate. For example, one expert in the Dutch Cabinet and Prime Minister's Office noted of this proposal of the German government: "This has been very sensitive in the Netherlands. I would also say that we have collided with Germany several times, which is not a position we are usually in or prefer to be in, but this idea of contracts has been very sensitive in the Dutch parliament...[if they're] legally binding, it's off limits for us, but political commitments we've always left the door open to that, saying 'we're politically committed to implementing our National Reform Program', which we are, but...we don't want socioeconomic policies to be decided at the EU level" (Interviewee 30 2014). Also on the topic of bilateral contracts with the Commission, Bulk (2014) noted that no further developments were expected until after the recent selection of a new Commission President, which suggests that while this process may be one to watch in future, it is not a concern for the present. In fact, both Schulten (2013) and Bulk (2014) speak for many interviewees outside government in Germany and across the Netherlands.

Second, the European Works Councils outlined by Falkner (1996; 1998) certainly do appear to touch a very sensitive area of national wage setting. Indeed, in Germany, for instance, works councils represent a long-lived and increasingly important part of their wage-bargaining system. However, Falkner's (1996; 1998) accounts of European Works Council's emergence also suggest that their role was to be kept very limited, given the sensitive nature of the policy area in which they operate, and because the consent of the social partners themselves was both required and very difficult to achieve in negotiations over the shape that the European Works Councils were to take.

Finally, while since the 1990s the European peak associations of the trade unions have devoted much energy to coordinate the wage demands of their affiliates, these efforts have yet to bear fruit on a large scale. Indeed, ETUC, the 'general' trade union confederation at European level has formed a collective bargaining committee, and organizes a regular collective bargaining school for its members (Dos Santos Costa 2013). However, observers like van der Woud (2014) have noted that significant differences among ETUC's member unions make it a highly fractious organization,



recalling as a for instance: “you know you had this gas blockade of Gazprom’s, and the funny thing was that ETUC was invited over by Putin in 2007-8, and they were still discussing who should go as the meeting already took place”. He further notes that “ETUC is quite leftist, its quite Marxist even, and that makes it quite difficult for us as a Christian federation who is moderately somewhere in the middle to rely on their analysis of things” (van der Woud 2014). That confessional and centrist-liberal trade unions are quite common in the EU suggests that many other national trade union confederations face similar difficulties. However, van der Woud (2014) does qualify this criticism, noting “because of their huge representative potential they can set up meetings with bodies that we cannot seek out on our own, so networking-wise it’s a huge asset to be a member of them”. Lamas (2014) makes similar comments about ETUC’s collective bargaining committee, noting that Scandinavian unions have had little interest in coordinating in this way, while many in the EU’s New Member States and in the UK as well are too frail to participate in European-level wage coordination.

By contrast, in the sectoral peak associations, member trade unions tend to have rather more in common, although their success has varied significantly. For instance, Sterkel (2014) recounts that having formerly been a member of IG Metall, she had been a part of the process of building coordination capacity among members of the European Metalworkers Federation, then the European peak association in that sector. Having had achieved a measure of success in agreeing to a common criteria for wage demands in the metalworking sector, she has since taken up similar work in Ver.di, the German service sector union. She notes, however, that much effort at coordinating in services has failed to yield similar results as among the metalworking unions. Specifically, after having worked on European-level coordination with IG Metall, “with this experience I tried to do this in Ver.di, but it was very very very difficult...[and as a result] you cannot say that there is coordination of collective bargaining at European level...not only in Germany, but also in the other countries” (Sterkel 2014). Interestingly, she finds that part of this frustration was explained by the unique and challenging way that Ver.di is structured. However, she also notes that the diversity

among public service unions and the fact that service industries tend to be more domestically oriented than industry make services inherently far more difficult to coordinate through the European peak associations.

Moreover, while the European peak associations of the trade unions have made strides in improving information sharing and in building networks among member unions, this still leaves open the question of whether member unions actually act on the information that they receive. In this respect, one German trade unionist recounts that as part of their role in a negotiation, they actively consulted their counterparts in other countries to garner information about wage agreements elsewhere (Interviewee 22 2013). However, accounts by Bulk (2014) and Pentenga (2014) in the Netherlands are rather more representative, where they note much more information reaching FNV from other European trade unions, but that this had little impact upon their own negotiations. Speaking to wage coordination at the European level, Pentenga (2014) states that “it will be impossible in my view...but I must say that they are much more successful in coordination on all other issues than wages”, while Bulk (2014) suggests that “wages will be the last to follow if it ever does. On other aspects, major progress has been made”. When asked whether these attempts at European-level coordination had to date impacted wage negotiations in Germany, an academic expert on German collective bargaining responded unambiguously, stating: “no. No no no. It’s not like that. It’s not like that. You cannot say that” (Interviewee 15 2013). However, van der Woud (2014) did note that there was evidence of useful work being done regionally on cross-border issues. Hence, this supranational dimension to wage coordination may be a very dynamic area in the years ahead, but in the years to date, it has yet to exercise a significant influence over national wage-bargaining practices. Of course, that Glassner and Pusch (2010) have found evidence of coordination effects among different national metalworking unions, and one interviewee from a large German industrial union noted that their organization is taking a growing interest in wage developments elsewhere (Interviewee 22) do strongly suggest that supranational wage coordination represents a fascinating area for further study. However, the skepticism towards supranational wage

coordination among many interviewees in all three case countries also suggest that it is not a development that runs afoul of this project's treatment of wage bargaining as a largely national affair.

Moreover, while literature has emphasized advances by the trade unions at European level as the chief drivers of attempts at pan-European coordination, there is little indication of similar moves by employers in coordinating wage negotiations across borders. Indeed, one official with BusinessEurope, for instance, confirmed that the activities of the organization more closely resemble that of a traditional lobby group, with the organization much more concerned with the activities of the European institutions than with coordinating affiliates' wage negotiations (Interviewee 5 2013). Likewise, there is no evidence among the employers of analogues to ETUC's collective bargaining committee or ETUC's regular collective bargaining schools, for instance. Rather, this same representative emphasized that the employers' groups at European level had much more circumscribed roles than those of the trade unions (Interviewee 5 2013). Another expert with a sectoral employers' group stressed their relationship with their affiliates would need to become much closer in order to help them navigate debates over changes in economic governance at the European level, although they made no mention of moves to coordinate wages (Interviewee 14 2013).

In short, while the developments outlined in Section 2.5 do demand some nuance around the treatment of wage setting as a strictly national affair, in none of the cases under study have they exercised a strong influence over wage negotiations. At present, the Country Specific Recommendations that have been introduced because of the crisis are only fleetingly observed in Belgium, Germany and the Netherlands, while proposals for contracts with the Commission have thus far failed to gain support. Work at coordination by the European confederations of the trade unions is fascinating for its potential first and foremost. Consequently, for the countries under study, EMU is best treated as an environmental change.

### 3.3: Theoretical Considerations

The model outlined by Traxler and Kittel (2000) and adapted to this project provides a comprehensive means of classifying and comparing different systems of coordinated wage bargaining, as well as to dissect the forms of coordination that are necessary parts of managing wages across an entire economy. It also offers some expectations about what sorts of pressures these models might encounter under EMU. However, it is also highly static, which poses a significant problem for an inquiry concerned with the ways in which these bargaining models are impacted by monetary integration, in which institutional continuity or change are a vital component. The same may be said of earlier contributions to this literature, from Cameron (1984) through Calmfors and Driffill (1988) and Soskice (1991). At the same time, while the economics-centred literature on optimum currency areas following Mundell (1961) certainly touches upon several important points of interaction between wage bargaining and currency union, it is insufficiently sensitive to institutions and institutional change as well.

In order to capture the institutional subtleties that commentators such as Crouch (2000) have emphasized so strongly, as well as gradual institutional change, this project draws heavily upon neoinstitutionalist theory. This body of literature began to emerge in the 1970s, reversing a long post-War neglect of the role of institutions and the state. By the 1990s, three distinct clusters of neoinstitutionalist theory were discernable (Hall and Taylor 1996). The first is a 'rational choice' variant following Scharpf (1997), for instance, which examines the effects of institutional rules upon the interactions of rational actors. Its point of focus tends to be upon institutions' coordination function, and the equilibria that different sets of institutions produce (Thelen 1999, 371). A second, 'sociological' variant following March and Olsen (1984) is built around logics of appropriateness and cognitive scripts as key determinants of actors' behaviour. A third and highly eclectic 'historical' variant concerned largely with the emergence of institutions and with contextualizing their contours

historically (Thelen 1999, 371). Thelen (1999) has gone to great lengths in arguing that the differences between these variants of neoinstitutionalist theory are exaggerated and that their underpinnings are in fact highly complementary. She notes, for example, the structure that rational choice might provide for rich, but at times undisciplined historical studies, or the role that historical analysis might play in stitching together different 'games' common in rational choice studies.

Previous strains of all three institutionalisms were seen as inattentive to institutional change (e.g. Hall and Soskice 2001). Later scholars have noted that the conservative bias in many previous permutations of neoinstitutionalist theory have led them to miss significant changes that have occurred as a result of cumulative, incremental changes (Hancké, Rhodes, and Thatcher 2007; Palier and Martin 2008; Palier 2010). This problem is behind Mahoney and Thelen's (2010, 2), as well as Thelen's (1999) charge that past neoinstitutionalist scholarship captures very well the emergence of some institutions, as well as large ruptures in them, but explains far less effectively gradual processes of institutional change. Indeed, the concept of continuity, or leastways a resistance to change is often inherent in definitions of institutions (Mahoney and Thelen 2010, 4). Crucially, this is a conservative bias which is common to all three strains of neoinstitutionalism, where Mahoney and Thelen (2010, 5) charge that the sociological institutionalism of March and Olsen (1984; 1989), Meyer and Rowan (1977), or Powell and DiMaggio (1991) provides few clues as to why reified cognitive scripts and patterns of behaviour might change. Levy (2008) sees in the rational choice institutionalism following Shepsle (1986; 1989) or Scharpf (1997) a proclivity towards comparative statics. However, Greif and Laitin's (2004) attempt to incorporate feedback effects and other sources of endogenous institutional change into a model derived from rational choice institutionalism is a partial exception.

Similarly, Capoccia and Kelemen (2007) are only two of many exemplifying the emphasis on critical junctures and significant institutional breakdown as the chief sources of institutional change in historical institutionalism. However, their argument that a critical juncture may not necessarily be

a discrete event, but rather a series of events in a compressed span of time (Capoccia and Kelemen 2007, 350) does give their account a more dynamic view of institutions. However, this neglect of gradual institutional change in past conceptualizations of institutional change is one stressed by Streeck and Thelen (2005) as well. A similar concern is aired by Thelen (1999), who argues that greater emphasis must be given in all three strains of neoinstitutionalist theory to the mechanisms that actually sustain institutions. She argues that institutional stability and institutional change, analytically, must be considered together.

Considered in the context of wage bargaining under EMU, this treatment of institutional change cannot capture the full effects of pressures posited in the literature, which has anticipated significant strains, but ones which would only be visible over time. Indeed, pressures such as relaxed wage discipline, or divergent wage evolutions between sectors fit awkwardly with a model that emphasizes breakdown as the chief means by which institutions change. Certainly, some countries have witnessed spectacular breakdowns in the functioning of their collective bargaining systems under EMU, where Greece, Ireland, Portugal and Spain come to mind. Nonetheless, this earlier theory misses important and gradual changes in these countries' bargaining systems leading up to the economic crisis and precludes altogether the possibility of institutional change in the coordinated systems that have fared much better. More importantly for this study, interviewees in Belgium, Germany, and the Netherlands did not describe the start of EMU in ways that suggested it was a critical juncture. Indeed, Mahoney and Thelen (2010, 7) find that the understanding of critical junctures commonly accepted by neoinstitutionalist scholars turns on a contingency that emerges around previously well-accepted rules, during which time key actors have the space to significantly redefine these rules. These periods tend to be times in which the 'normal' functioning of institutions is disrupted and rapidly changed. However, the absence in well-coordinated systems of significant breakdowns of their bargaining regimes, suggests that this bias towards punctuated equilibria in older strands of the neoinstitutionalist literature is inadequate for tracing the implications of subtle

and protracted, but potentially very important pressures acting upon coordinated bargaining systems under the single currency.

What is needed then is a theory of institutional change that can capture gradual change in institutions that continue to function. Thelen (1999) has argued that there is much room for borrowing among these three institutionalisms, and in subsequent work has done just that in redressing this inattention to gradual institutional change. Indeed, with critiques such as these in mind, work by Streeck and Thelen (2005), as well as Mahoney and Thelen (2010) represents an important step forward in two respects. First, they emphasize the importance of actor behaviour in explaining both institutional change and persistence, whereby both formal-legal rules and patterns of actor behaviour are constitutive of the functioning of institutions. This understanding of institutions borrows heavily from the encompassing definition of them in sociological institutionalism, but gives actors a level of agency more common to historical institutionalism. Therein, they treat compliance with formal legal rules as a variable, rather than a certainty, and allow that actors may have scope to interpret, and in turn to reinterpret the exact meaning of rules which may be more or less well specified or enforced. Consequently, changes in actor behaviour and emerging gaps between actor behaviour and formal legal rules represent an important source of gradual institutional change. Streeck and Thelen (2005) are not the first to centre their analysis on non-state actors, with Hall and Soskice (2001) developing a firm-centred model, for instance. However, Streeck and Thelen (2005), as well as Mahoney and Thelen (2010) go much further in emphasizing the importance of patterns of actor behaviour with rule-like qualities than do Hall and Soskice (2001).

Second, Streeck and Thelen (2005), and later Mahoney and Thelen (2010), draw attention to the context in which institutions are embedded as an important part of their functioning as well. These changes in institutions' context can affect their functioning, even if they are not formally altered. Stable institutions are not static, but rather are continually adjusting to new circumstances

around them, a fluid understanding of institutions that is more common in sociological variants of neoinstitutionalism. What emerges is that to persist, institutions must continually reproduce themselves through adaptation, and that the ways in which they do so, or indeed fail to do so, will have important implications for their functioning. What also emerges is that even in a stable state, institutions are highly fluid, and that transformative change need not be abrupt. Rather, transformative change can also result from incremental, intermittent, or gradual changes accumulating over time. With this emphasis on continual adaptation, the shift from national currencies to the euro comes to mind as a potentially transformative environmental change.

Certainly, Streeck and Thelen (2005) and Mahoney and Thelen (2010) are not the only scholars interested in gradual institutional change. Steinmo (2010), for example, has developed an approach to institutional change based upon evolutionary theory. Indeed, he shares with many scholars (such as Hancké, Rhodes, and Thatcher 2007; Mahoney and Thelen 2010; Thelen 1999; Palier and Martin 2008; Palier 2010; Streeck and Thelen 2005) a concern that historical institutionalism struggles with explaining institutional change, an emphasis on structure over agency, and an inattention to the impact that institutions' context have upon their functioning (Steinmo 2010, 15). In these concerns about context in particular, he shares much with Streeck and Thelen (2005), and indeed, he has much praise for them, as well as Pierson (2004) for their emphasis on gradual institutional change. Steinmo (2010, 17) even goes so far as to frame his contribution as a continuation of their work. This evolutionary view of institutions shares with Streeck and Thelen (2005) an emphasis upon the context in which institutions exist, as well as an emphasis upon both formal-legal institutions and the behaviour of key actors as factors composing and animating institutions. The emphasis in this evolutionary approach upon institutions as continually adapting and reproducing themselves resonates strongly with Streeck and Thelen (2005) as well. Similarly, while rejecting the institutional stasis of earlier neoinstitutionalist scholarship, the emphasis in Steinmo's (2010) evolutionary approach upon the causal importance of historical events does still leave his work at home among historical institutionalist scholarship.



Subsequently elaborated with Lewis, this evolutionary view of institutional change stresses variation, selection, and retention as the chief mechanisms by which institutions evolve (Lewis and Steinmo 2012, 316). Variation occurs where new 'mutations' emerge in the practices of institutions' subsystems or from without in the form of ideational changes. This human creativity in solving collective action problems leads to new practices being developed. Selection entails a process whereby trial and error, or 'deductive tinkering' selects 'fit' traits among these variations (Lewis and Steinmo 2012, 317). Once selected, mental schemas and limited time for actors to re-evaluate these new practices serve to lock them in, resulting in these traits' retention (Lewis and Steinmo 2012, 317). Interestingly, they emphasize that evolutions are not necessarily optimizing or improving. They also stress that the emergence of a trait in one locale does not mean that it will thrive elsewhere, arguing that many such changes lead to evolutionary dead ends (Lewis and Steinmo 2012, 319).

Issue framing and new ideas may also drive the process of institutional change as they influence actors' responses to new collective action problems, hence driving new 'mutations' (Lewis and Steinmo 2012, 316). Although Streeck and Thelen (2005) and Mahoney and Thelen (2010) certainly do not preclude new ideas as a driver of changing actor behaviour, Lewis and Steinmo (2012) address them far more explicitly. In this respect, Steinmo (2010) and Lewis and Steinmo (2012) share intellectual space with Schmidt (2008) and Schmidt and Thatcher (2013), who have emphasized the influence of ideas and discourse as a driver of institutional change and have examined the means by which ideas may become entrenched in the practices of different institutions. Schmidt (2010) goes so far as to describe this 'discursive institutionalism' as a fourth new institutionalism. Perhaps she even goes too far in this claim, arguing that scholarship taking discourse and ideas seriously constitutes an altogether new form of institutionalism. In this she casts a very broad net, whereby Kingdon (1984) or Sabatier and Jenkins-Smith (1993) will have discovered that they have unwittingly been discursive institutionalists for some time (Schmidt 2010, 3). Likewise, Schmidt's (2010, 5) argument that all three established institutionalisms are highly static represents an unfortunate caricature, especially considering the aforementioned contributions from

Thelen (1999), Streeck and Thelen (2005), Steinmo (2008), Mahoney and Thelen (2010), or Lewis and Steinmo (2010), among many others. Likewise, there is ample space for ideas in Streeck and Thelen's (2005) framework, which blends Streeck's sociological institutionalism and Thelen's historical institutionalism, although Schmidt's (2008; 2010) point about the importance of ideas and discourse is well taken, even if its implications for neoinstitutionalist scholarship are overstated.

Steinmo himself (2010) stresses that his contribution does not constitute a complete theory of institutional change, but rather represents an effort to bring together disparate attempts at conceptualizing gradual institutional change. While it proves an elegant means of structuring his narrative about the emergence of modern, though very different state institutions in Japan, Sweden, and the United States, it also leaves unanswered the question of how to conceptualize, and indeed to identify qualitatively different forms of institutional change, as well as their more immediate implications. This absence of different forms of institutional change and the very long time horizon over which Steinmo's (2010) framework attempts to capture such changes is problematic for projects such as this one, which are concerned with the implications of very specific institutional traits and with changes that would have occurred in a comparatively shorter period of time. Furthermore, Schmidt's discursive institutionalism finds some resonance with concerns raised by policymakers in Belgium (Interview 9 2013), who fret that ideas they brand as neoliberal in the Commission's Country Specific Recommendations may influence the contours of the debate the next time revisions to their wage-bargaining system are considered. However, the pressures that are being examined in this project, i.e. those emanating from European, rather than national monetary policy, and lost policy instruments, have as their most outward manifestations, material outcomes like asymmetric shocks or relaxed wage discipline, rather than ideational ones. Thus, while this discursive stream in neoinstitutionalism highlights some interesting concerns in the Belgian reform debate, it fails to grapple with the sorts of pressures that are under study in this project.

Streeck and Thelen (2005) and Mahoney and Thelen (2010), by contrast, have given much thought to different mechanisms by which institutions might change, as well as how to identify them, and some of the implications that come with specific forms of institutional change. Indeed, Streeck and Thelen (2005) have also identified five means by which this sort of gradual change might take place, namely *displacement*, *layering*, *drift*, *conversion* and *exhaustion*. For Streeck and Thelen (2005, 20), and Mahoney and Thelen (2010, 16) as well, *displacement* occurs as rival sets of institutions and practices emerge alongside existing ones. These rival institutions may either slowly or abruptly replace or reduce the dominance of existing practices. As subsequent chapters will explore in more detail, the slow process in Germany by which employers have become less likely to be members of an association, and hence, less likely to be bound by sectoral collective agreements may be conceptualized as a process of institutional displacement. Indeed, by this process a far less coordinated system of wage-setting has emerged alongside the well-known system of concertation between employers' associations and trade unions. Institutional displacement is a common theme among contributors to Ranci and Pavolini's (2013) study of reforms in long term care, for example.

*Layering* entails revising, amending, or supplementing existing institutions, but where the intent is not to replace them, as with displacement, but where their functioning or their ability to reproduce themselves may nonetheless be deeply altered (Streeck and Thelen 2005, 22; Mahoney and Thelen 2010, 17). The debate in Germany over changes to the rules governing legal extensions may be considered a debate over institutional layering as well. Indeed, the current discussion concerns easing the conditions for the use of a legal mechanism to extend a sectoral collective agreement to employers who are not part of an employers' association. If implemented, this change would mean that employers who are not signatories to the sectoral collective agreement would nonetheless be bound by it. This proposed change is intended to counter the process of institutional displacement outlined earlier, but would introduce a much stronger state role than had been present previously. Reforms in Belgium from the early 1980s and completed in the mid-1990s that introduced and refined the wage norm atop Belgium's existing system of wage indexation may also

be considered a form of layering. Layering has also been put to use by Chou (2012) to explore possible reform strategies for agents in the European Research Area. It has also been put to use by Eriksson and Pettersson (2012) in examining changes in Swedish interregional transport policy, although they seem to have processes closer to conversion in mind.

*Drift* occurs when institutions meet with changes in their environment but fail to respond to them (Mahoney and Thelen 2010, 17), or when gaps emerge between actor behaviour and institutions' formal rules (Mahoney and Thelen 2010, 21). The implication of this failure to adjust is that even where the institutions themselves are formally unchanged, the outcomes that they produce may be very different. Indeed, with this issue in mind, Streeck and Thelen's (2005) observe that institutions require constant maintenance. In the current context, cases where intersectoral divergence has occurred under EMU would be a very clear case of institutional drift, whereby changes in the environment of bargaining systems have changed, but their horizontal coordination has not been tightened in response. Similarly, as the next section argues, troubles in Belgium with wage competitiveness that have become more acute under EMU, i.e. in an environment with fewer instruments for correcting for wage inflation, but where the bargaining system itself has not changed in response, would be another example of institutional drift. Drift makes frequent appearances in Ranci and Pavolini's (2013) study as well.

*Conversion* is visible when existing institutions are redeployed or set new tasks. This often takes place through a process by which the institution undergoes little formal change, but where its guiding rules are "interpreted and enacted in new ways" (Mahoney and Thelen 2010, 18). This is more likely where these guiding rules are ambiguously stated. Processes of organized decentralization in systems of coordinated collective bargaining often make extensive use of conversion, where Dutch sectoral social partners responsible for collective bargaining have been set more tasks previously dealt with by the national peak associations. Similarly, while works councils in Germany were never intended to have such a large role in negotiating collective agreements, they

have an increasingly prominent role in the process. This is because sectoral agreements in Germany have become less prescriptive, and opening clauses more common, even if the legislation governing works councils has not changed since the 1970s. Conversion is put to extensive use in Graf's (2013) study of changes in training and education systems in Austria, Germany, and Switzerland, for example.

*Exhaustion* entails a process of institutional change leading to institutions' eventual breakdown (Streeck and Thelen 2005, 29). This may occur as new responsibilities overload existing institutions, either because resources bequeathed to them are insufficient to meet new demands placed upon them, or because subsequent adaptations give rise to unintended anomalies and perverse incentives. Given that EMU places new demands upon wage-setting institutions, this manifestation of exhaustion is an ominous one. Streeck and Thelen (2005, 29) also suggest that exhaustion may be an outgrowth of an ageing process in institutions. Therein, processes governing the internal mechanics of institutions and their interaction with their external environment are established in young institutions and may become progressively more elaborate and more deeply entrenched as they age. Streeck and Thelen's (2005) insight carries the implication that without regular maintenance, institutions may become unwieldy or rigid with time, which limits their ability to adapt to new circumstances and to reproduce themselves. By way of this process, institutions may become decrepit rather than spry. This concept of exhaustion touches several points in Belgium's debate over its wage-setting system, where inflation indexing emerged in the 1920s and was legally entrenched in the 1970s. Over this period, the processes governing the application of the index have become increasingly intricate, while key actors have become extremely attached to it in its current form. However, as subsequent chapters will argue, this rigidity in the Belgian wage-setting system presents significant challenges in adapting to the new environment that is EMU. Accounts by Streeck (2010) of institutional change in the German wage-bargaining system and by Busemeyer and Trampusch (2010) of change in the German welfare and training systems, for instance, are heavily influenced by this notion of exhaustion. This concept of exhaustion also touches some facets

of the turmoil in the Dutch labour movement, whereby its largest trade union organization is built atop a divide between a more activist wing and a more conciliatory one. Specifically, Streeck and Thelen (2005) suggest that where institutions freeze and contain conflicts without resolving them, changes that reanimate these conflicts may undermine the institutions around them.

Of particular interest for this project are displacement, drift and conversion. Specifically, processes of displacement are underway in the Belgian and German systems. In Belgium, there is evidence that the state-driven elements of its model are coming to overtake the social partners in deciding wage developments (discussed in Section 5.4). Germany is experiencing a process of displacement as well, whereby declining collective bargaining coverage is seeing its uncoordinated elements challenge the dominance of those that coordinate (Section 6.5).

Drift is at work in all three case countries. In Belgium, while the bargaining system has not undergone any formal changes since the country adopted the euro, changes in the system's external environment have seen it produce very different outcomes. Specifically, EMU's removing of currency devaluation as an instrument for alleviating competitive has accentuated the bargaining system's tendency to 'overheat' (Section 5.3.1). Likewise, changes in the Belgian system's external environment have made the relationship between the social partners far tenser by shrinking the space that they have to negotiate (Section 5.3.2). In Germany, subtle changes accumulating within the pattern-setting system have lessened the influence of the pace-setting metalworking agreement in other sectors (Section 6.5). By way of this process, the horizontal coordination of the German system has become looser. In the Netherlands as well, while there has been no formal change to the system under EMU, the decline in trade union membership is having important consequences for its leading trade union confederation and the way that it interacts with other players in the system (Section 7.4). This organization has successfully calmed these tensions, but that they have broken out along familiar fault lines that the organization was founded to contain is reminiscent of institutional exhaustion.

As well, both the Dutch (Section 7.3) and German (Section 6.3) systems have experienced processes of institutional conversion. In both these countries, the wage-bargaining system has undergone a managed decentralization that gives more autonomy to bargainers at lower levels while preserving coordination. In effect, parts of their systems have been repurposed, such that they allow for greater variation between firms covered by the same collective agreements.

In brief, this project adopts a neoinstitutionalist framework to capture institutional change in systems of coordinated wage bargaining deconstructed along the lines of the framework outlined in Chapter 2. Of particular interest in this respect are the concepts of institutional displacement, conversion, drift and exhaustion, and subsequent sections will examine in more detail whether and how EMU has begun these processes of institutional change in different systems of coordinated wage bargaining.

### **3.4: Research Design and Case Selection**

This study conforms broadly to the most similar systems design, albeit with important caveats. This section outlines the design of the research project, as well as the process by which appropriate cases were selected. Following Przeworski and Teune (1970) and Lijphart (1971), the most similar systems design compares cases that are as alike as possible, on the grounds that differing outcomes among them must be explained by the (few) factors that differ among them. The most similar systems design has the advantage in intricate cases of eliminating a multitude of variables that may otherwise complicate the task of comparing them. As the present study consists of a small number of cases, this choice of design reduces problems that emerge when many variables meet few cases in a research project.

Belgium, Germany and the Netherlands have a number of important points in common that set them apart from other countries in EMU: all three have long histories of concertation between business and organized labour, where all of them made pivotal decisions about their wage-

bargaining systems in the post-War period, but built them upon pre-War foundations. Well-established concertation with the social partners sets them apart from countries like France, for example, which took steps to limit the emergence of autonomous social partners in the post-War period, even if it is a similarly long-tenured member of the EU. Likewise, all three case countries are classed comfortably among the Coordinated Market Economies in the VoC literature (e.g. by Hancké, Rhodes, and Thatcher 2007) and are variously classified as neocorporatist countries for the large role that they give to the social partners. Belgium's system does have large role for the state, which is common in weakly coordinated systems, but also has highly consolidated and well-organized social partner organizations and is therefore often grouped among Coordinated Market Economies by VoC scholars (e.g. Feldmann 2007, 332; Soskice 2007, 98). These characteristics distinguish these coordinated systems from 'mixed' systems, who have consequential, but fragmented and fractious social partners such as Greece, Italy, Portugal or Spain (Hancké, Rhodes, and Thatcher 2007).

Certainly, the literature on social pacts, for instance (e.g. in Avdagic 2010, Avdagic, Rhodes, and Visser 2011, Hamann and Kelly 2007, Hancké and Rhodes 2005, or Natali and Pochet 2009), had to an extent blurred the distinction between these two clusters of countries, studying the conditions under which tripartite bargains might be struck, or the practice institutionalized, even in countries with traditionally weak social partners. Nonetheless, emerging work on wage coordination and EMU following Hancké (2012; 2013), Johnston and Hancké (2009), and Johnston, Hancké, and Pant (2014), in arguing that highly coordinated systems have done well in managing wage growth under EMU where weakly coordinated ones have not, has reinforced the distinction between the two. The same may be said of recent literature on social pacts themselves, examining with some dismay the breakdown of concertation in these mixed systems, as in Culpepper and Regan (2014), for instance.

The Belgian, German, and Dutch systems were highly developed prior to their moves towards euro adoption, even if, as in the Belgian and Dutch cases, adaptations were made in the early 1990s with EMU in mind. All three of these countries have a history of being highly open to



trade, being among the first countries to partake in efforts to increase trade among European countries after the Second World War and participants in parallel efforts at lowering barriers to world trade. Consequently, competitive pressures from trading partners exercised an early and important influence in the development of their wage-bargaining institutions.

Furthermore, a hard currency policy had long been a German preoccupation, although Belgium and the Netherlands were highly successful in their own hard currency policies. Certainly, many other EMU countries had participated in a system tying their currencies to the German mark at various points throughout the 1970s and the 1980s. However, what sets Belgium and the Netherlands apart from other participating currencies is the fact that their tracking of the German mark became progressively tighter between the early 1970s and the two were highly successful in maintaining this peg (Jones 1998a; 1998b). In fact, Belgium began its flirtation with a hard currency policy as early as the 1950s, jointly tracking the French franc and the German mark before moving towards the German currency in the early 1980s (Jones 1998a). For the Netherlands, while domestic struggles with inflation and competitiveness were important influences on exchange rate policy in the 1970s, the aforementioned openness to trade made the country especially vulnerable to exchange rate volatility, which was a significant point in favour of a peg to the deutschmark (Jones 1998b). By contrast, pressures such as these would certainly not be as acutely felt by much larger participants in ERM, such as France and Italy.

The timing of these developments set Belgium, Germany, and the Netherlands apart from other EMU countries, such as Ireland or Spain, for which foundational decisions about the shape and the role of the social partnership were made much later. In essence, these countries adopted a hard currency policy only with their attempts to enter EMU in the 1990s. As a result, their institutions were still very much at an early stage of development and coordination between the social partners only weakly established when they took the decision to move towards euro adoption. By contrast, in Belgium, Germany, and the Netherlands, the practice of wage coordination was longstanding in all

three by this period and had been previously subjected to less comprehensive forms of monetary integration as well. Their trade unions have similarly long tenures in supranational arrangements as well, with them forming the core of the Doorn process, an early attempt by European trade unions to coordinate their wage demands. Trade unions from Belgium, Germany, and the Netherlands have also played a central role in developing the European peak associations, like the former EMF. In fact, interviewees in Germany and the Netherlands each claim responsibility for the EMF's coordination rule, which sets common criteria for member unions to decide their wage demands.

Certainly, scholars such as Hardie et al. (2013) sound a cautionary note for adherents of the VoC framework because of important differences in the financial systems within individual varieties. However, the banking sectors of Belgium, Germany, and the Netherlands stand out among coordinated systems for faring particularly badly through the financial crisis (Hardie et al. 2013, 13). Indeed, although Hardie and Howarth (2013) do note that some sectors of the German banking system have avoided the move towards market-based banking, they point to recent developments in the German banking system that are not dissimilar to those observed by Chang and Jones (2013) in Belgium and the Netherlands. Taken together, comments by Chang and Jones (2013), as well as Hardie and Howarth (2013) suggest that all three cases are also alike in the trajectories of their financial systems.

While the above sets Belgium, Germany and the Netherlands apart from countries such as Greece, Italy, Portugal and Spain, their experience does hold much relevance for this latter group of countries. Indeed, some important components of wage coordination are shared across these two groups of countries. While the context in which these mechanisms exists often matters immensely, in some cases individual mechanisms may exercise an important independent effect. That Belgium's calibration has caused struggles with competitiveness, for instance, is an effect that one would expect to afflict other systems as well, even those with very different designs. As well, while the Belgian, Dutch and German systems are far more coherent today than these mixed systems, the

Belgian and Dutch systems underwent large changes in the 1980s and 1990s. The Dutch system in particular was highly dysfunctional prior to the 1980s. It featured struggles with competitiveness because of inflation indexing, as well as fractiousness and, at times, paralysis because its national social partner organizations were highly fragmented, while these national organizations tottered atop weak organizations and unresponsive affiliates. These past problems in the Netherlands are discussed in more detail in Chapter 4, but they are precisely the ones that scholars (e.g. Hancké 2012; 2013; Johnston and Hancké 2009; Johnston, Hancké and Pant 2014) highlight as the source of so much recent difficulty in countries such as Greece, Italy, Portugal and Spain. As a result, not only do the coordinated systems that grew out of these transformations hold lessons for those countries currently refashioning their bargaining systems, but the transitions themselves may be instructive as well.

Belgium, Germany, and the Netherlands are hardly the only highly coordinated systems to have adopted the euro. Slovenia's wage-setting system, for example, bears a striking resemblance to that of Belgium, with its own system of wage indexation (Banerjee, Vodopivec and Sila 2013). Thus, the two countries' systems are similarly calibrated. However, unlike the others it is a very recent entrant into EMU and into the EU itself. As a former Yugoslav republic, and indeed with several unique quirks that set it quite far apart even from other new Member States, Slovenia has many more important non-institutional differences from the other Western European cases. However, their institutional resemblance suggests that lessons from Belgium may be highly relevant there.

Luxembourg also shares several features with the Belgian system and even has the distinction of having shared the Belgian currency for a time as well. In particular, the wage-setting system in Luxembourg relies upon a system of inflation indexation as well (Eurofound 2014). However, Belgium boasts many more wage bargaining experts outside the process, which holds the prospect of richer interview data. Interviews with national experts in Brussels also offer greater opportunity for engagement with relevant EU-level officials based in the city than would similar

interviews in Luxembourg City. Nonetheless, findings from the Belgian case would have important implications for Luxembourg’s system, with the two being similarly calibrated.

Austria shares a number of key features with the German system and had been among those countries shadowing German monetary policy in the 1980s. Interestingly, its system requires that employers be part of an association, which gives its collective agreements broader coverage than in Germany. However, given the similarities of the two systems’ institutions, but the greater availability of English-language research on the German system suggests it as a better candidate for this study. Of course, lessons from the German system would have important consequences for Austria as well. Much like Austria, Finland is a (relatively) recent entrant into the European Union and lacks the same tenure in the Union and history of engagement with its institutions.

The literature on wage bargaining and EMU (following Crouch 2000) suggests that many different designs of wage-bargaining systems may successfully coordinate wages. However, it also suggests that differences both slight and considerable are likely to have outsized effects upon their experience under EMU and the pressures that it exerts upon them. These variations, as well as their historical roots, are discussed in Chapter 4, but are summarized below. Between the three cases there are important variations in the mechanisms used to deliver horizontal and vertical coordination, as well as their calibration.

Case	Belgium	Germany	The Netherlands
Vertical Coordination	Social Partners’ Internal Coordination  Legal Extensions  State Enforcement	Social Partners’ Internal Coordination	Social Partners’ Internal Coordination  Legal Extensions
Horizontal Coordination	Intra-Associational	(Weak) Pattern-Setting	Intra-Associational
Calibration	Inflation, Wage Norm	Inflation, Productivity	Inflation, Productivity

	(rigidly followed)	(loosely followed)	(loosely followed)
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Table 1

Certainly, all three systems developed with very similar pressures in mind and had varying degrees of success in managing the rigours of a hard currency policy in the period prior to EMU. Belgian and Dutch policymakers undertook changes to their systems in the run-up to EMU as well. Nonetheless, the institutional choices that these countries made about how to meet the pressures that they experienced in the pre-EMU period and that they anticipated under EMU were very different. With the literature’s observation of even small institutional variations having outsized effects under EMU, and indeed, following the logic of the most similar systems design, there is much room for variation in the experience of these countries’ bargaining systems under the single currency. As a result, while some of these institutional variations may be subtle, they are very important. However, an important shortcoming of the existing literature, following the study in Chapter 2, is that it fails to outline *precisely how* these institutional variations will be important in the context of EMU. Likewise, while new work in the VoC tradition (following Hancké 2013; 2014; Johnston and Hancké 2009; Johnston, Hancké, and Pant 2014) has found compelling evidence that differences between countries such as these three, and mixed systems, such as Greece, Italy, Portugal, and Spain, it does not offer any clues as to how different well-coordinated systems might behave. This study then departs from the most similar systems design, in that the precise outcome of interest is *not whether* institutional variations are consequential, but rather *how* they are consequential is the object the study. In essence, while the most similar systems design proves helpful for isolating and removing extraneous variables, the precise outcomes being investigated are unknown, even if the literature suggests that they should be significant.

In sum, this study has been designed along the lines of a most similar systems design. It studies the cases of Belgium, Germany, and the Netherlands because they have a similar history of engagement with EU institutions and permutations of EMU. They also have very long histories of wage coordination, but vary significantly in the institutions that do this.

### 3.5: Gathering and Using Data

This project makes extensive use of qualitative data in examining how different institutional setups have fared under EMU. This section discusses in turn the choice of small-n and qualitative methods over statistical techniques. It then turns to discussing the interview data upon which it is based, as well as the use of descriptive statistics and secondary sources.

Certainly, quantitative panel data and statistical techniques have been used to good effect in addressing related questions that span most of the countries having adopted the euro, such as Johnston, Hancké, and Pant (2014) or Soskice and Iversen (2002), among others. However, the limited number of highly coordinated systems available as cases to study, as well as the large number of authors who have stressed the importance of very specific facets of national wage-setting systems under EMU, recommend a small-n approach to casework. It is also recommended by the fact that the literature has thus far been coy as to which specific facets of national wage-bargaining systems might be important in the context of EMU. The attention to context offered by the small-n approach more effectively captures these very specific facets than might a large statistical analysis covering the whole range of coordinated systems in EMU countries. Certainly, an extensive body of casework and well-developed theoretical work in the literature makes possible work by Avdagic, Rhodes and Visser (2010), who use fuzzy set analysis to examine every relevant case in the parallel literature on social pacts in the EU. However, the literature on coordinated wage setting is less accommodating as a foundation for a project with such a large scope, further recommending the detailed study of fewer cases.

Moreover, the institutions in question for this study are being studied for subtle changes accumulating over an extended period. This emphasis on subtle, accumulated changes suggests process tracing as a means of making sense of protracted processes of institutional change. Process tracing seeks to establish causal connections between observations by mapping out the

intermediate links in a causal chain connecting them, thus linking initial conditions and eventual outcomes (Tarrow 2004). Tarrow (2004, 173-4) suggests process tracing as a means of drawing connections between stages of a protracted process, and for locating causal mechanisms at work throughout. As well, process tracing demands much richer observations on individual cases, as well as a more inductive approach to analyzing them. This emphasis upon complex, protracted processes captures very well the sorts of institutional change that under study in this investigation. Indeed, many of the changes underway in national wage-bargaining systems may have begun years or decades prior to their effects becoming evident.

Moreover, this sensitivity to intermediate links in a causal chain connecting a causes and effects over an extended period also resonates well with the emphasis placed by neoinstitutionalist scholars like Pierson (2004) upon the importance of timing and sequence in institutions' evolution. It also chimes very well with the sorts of institutional change emphasized by Streeck and Thelen (2005) or Mahoney and Thelen (2010), which only take place over a protracted period. Nonetheless, Collier, Brady and Seawright (2004, 253) suggest process tracing as an idiosyncratic, but highly useful instrument for uncovering new variables to be examined systematically and reduce problems with omitted variable bias. In fact, the concept of 'calibration' used in this study emerged in precisely this fashion. In any event, process tracing's ability to suggest new variables is particularly important in a study such as this one, where work dissecting the components of national wage-bargaining systems has been sparser.

However, as Collier, Brady and Seawright (2004, 255) have noted, the sorts of 'causal process observations' are qualitatively quite different from the sort of 'dataset observations' that drive statistical analysis. Thus, more often they are found in qualitative analyses (Collier, Brady and Seawright 2004, 260) such as this one, rather than quantitative ones. This point is echoed by Tarrow (2004), for instance, who further recommends a qualitative approach to studying wage-bargaining institutions.

Highly specific information on wage bargaining and the relationship between the social partners is far more likely to be the sole preserve of policy experts and those party to the process itself. This problem rules out the use of widely-distributed surveys as an effective means of gathering data about national wage-setting systems and their experience under EMU, although it does recommend seeking these experts out directly. Interestingly, while King, Keohane and Verba (1994) take a much narrower view of process tracing than does Tarrow (2004), they suggest a strong complementarity between process tracing and rich casework, as well as data collection via interviews with key actors. In effect, King, Keohane and Verba (1994) suggest an excellent fit between process tracing and precisely the methods used in this investigation.

Thus, this study is first and foremost based on an intensive study of few cases and supplemented by in-person interviews. These interviews were conducted with experts close to the bargaining process in the three case countries, drawn from government, as well as from the trade unions and employers' associations. It is also informed by interviews with experts in European-level organizations and independent experts outside of the process. In all, over 40 separate semi-structured interviews were conducted with 48 interviewees. A further two persons responded via email because of logistical challenges that ruled out meeting in person or via telephone. Almost all of these interviewees were reached by way of personal recommendations: The first interviewees were recommended by a colleague or supervisor with a special connection to the policy community in each the case country, with snowballing techniques used to connect with other interviewees. Trade unionists, independent experts and to a lesser extent government officials were often very accessible when approached in this way.

By contrast, employers' organizations, except for Germany's ZDH, were more difficult to contact, often requiring a recommendation from a very senior counterpart in government or a trade union confederation. This is a shame, although given how poorly the internal coordination processes among employers are understood, especially as compared with the trade unions, this is clearly not



the first study to encounter this challenge. It is further to the challenges with surveys that many requests for interviews without a personal recommendation went unanswered. Similarly, all but a few requests directed to a generic organizational email or website requesting to be connected with 'an appropriate person' went unanswered. Interviews themselves often lasted 90 minutes, although a few were much longer and several were tailored to meet the time constraints of particularly busy interviewees. In both instances, this flexibility would be impossible with surveying techniques.

Interviewees were posed questions drawn from the same four thematic fields. Specifically, they were asked to speak to developments or concerns surrounding their wage-bargaining system and expected pressures from EMU prior to euro adoption. They were then asked to identify any pressures that they had observed acting upon their organization and the wage-setting system after euro adoption. They were asked how their organization had responded to these pressures, and then to what extent external actors had come to play a role in wage setting. An anonymized list of interviewees and a sample list of questions are provided in the Appendix. The interviews themselves were recorded and transcribed word for word. With interviews typically lasting 90 minutes, many of the transcripts were far too long to be used efficiently in a qualitative study such as this one. Thus, the transcripts themselves were not coded, but rather were condensed into much shorter summaries, with interviewees' answers sorted into the four thematic fields listed above. Summarizing interviews in this way held the advantage of presenting interviewees' answers in a format that was much more manageable. Furthermore, sorting answers by thematic field also made the summaries more manageable than the transcripts, as some interviewees' answers spanned multiple fields, or shifted back and forth between them over the course of the interview. As a result, while the transcripts were referred to in the writing of this study, and are referenced directly when an interviewee is quoted, condensed summaries of interviewees' answers were relied upon much more heavily than the transcripts.

Publically available data played an important role in grounding the information gathered from these interviewees. Certainly, while this study has eschewed quantitative analysis, a number of figures pertinent to wage bargaining, such as collective bargaining coverage, inflation, union density, unit labour costs, productivity, etc. are widely published and important in contextualizing other data used in this project. However, these figures, for instance from the OECD, the Visser Database and other statistical agencies, are presented in this project in the form of descriptive statistics.

Similarly, a body of literature has emerged on wage setting under EMU from select corners of the policy community, and reports by Eurofound, the European Trade Union Institute (ETUI), or the Wage Dynamics Network, for example, are important sources of secondary research. Likewise, as Maes and Verdun (2009) have noted, both the Belgian and Dutch central banks have developed much more robust research units since the transition to EMU. Indeed, the Belgian central bank in particular has been a useful source of English-language research on wage setting in that country. The relevant academic literature on OCA theory, wage coordination, EMU, and supranational wage coordination are also important in framing the information gathered from interview subjects.

As part of moves towards developing more robust macroeconomic governance at European level as a result of the crisis, the European Semester has come to include annual recommendations from the Commission that touch much more directly upon national wage-bargaining practices. Indeed, in some cases, particularly in the Belgian case, the furore and debate that these recommendations caused among national policymakers is quite informative in itself. The research informing these recommendations, as well as the National Reform Programmes, which contain national governments' response to the recommendations are informative as well.

In sum, this study makes extensive use of qualitative interview data as part of a detailed analysis of a small number of cases. Certainly, large-n quantitative studies have made an important contribution to the literature informing this project. However, the stress in the literature upon very specific facets of national bargaining systems and their outsized effects under EMU and the need for

process tracing to capture subtle, protracted changes in institutions, merits a qualitative approach. The fact that crucial data on the cases are the sole preserve of a small group of policy experts implies that interviews are to be preferred over surveys as a means of gathering primary data. Publically available labour market indicators, as well as policy research from such groups as Eurofound or the Wage Dynamics Network, are used to contextualize interview data.

### **3.6: Reliability of Data**

Of course, following Dandashly (2012) and Verdun (2000), interview data may be less reliable at times because interviewees would like to use the researcher as a medium to convey a specific message. Some interviewees may also prefer to defer to their organization's official position. Sometimes interviewees may be concerned that their views, if published and attributed, may undermine them professionally. This final concern was especially common among interviewees whose position put them in frequent contact with a counterpart from other organizations involved in collective bargaining.

This issue of interviewees attempting to use the researcher as a medium was particularly evident in some interviews about the Belgian case, for example. Though frustrating, given how charged discussions around the Belgian wage index have become this is perhaps not surprising. A variation of this problem concerned interviewees who actively avoided the subject at hand or preferred to frame the issue in such broad terms that they might avoid answering the question posed. Again, some interviewees in Belgium preferred to discuss everything but the wage index about which they had been asked very explicitly. Considering this problem, one interviewee in particular, who was clearly very knowledgeable about the index and highly articulate as well, comes to mind: posed a very direct question about proposals for including a productivity link in the Belgian wage index, the interviewee preferred to avoid addressing the index and instead responded by

situating the issue in a much broader discussion about productivity gains to be had from proposed government investments in education, research and training.

To address these problems with reliability, follow-up questions were frequently used. Furthermore, extensive use was made of cross-checking, where answers from previous interviews were put to subsequent interviewees, which often informed follow-up questions in subsequent interviews with interviewees from different organizations. Of course, being experts in the area, interviewees were also given time at the conclusion of each interview to address any points that they felt had been overlooked. This opportunity to address any remaining points that the interviewee felt pertinent proved useful in informing new follow-up questions, as well as helping to avoid 'leading' interviewees. Opportunities such as these to ask follow-up questions, and to allow the interviewee (selectively) to add relevant information beyond that explicitly sought, were both enriching in ways not possible with surveying or other statistical techniques.

Moreover, outside experts from academia and policy think tanks, who have a keen interest in the issues under study, but no formal stake in them, were consulted as well to cross check answers from policymakers. Such outside experts were consulted for all three case studies. Independent experts on European-level coordination by the trade unions were also consulted. Their contributions proved particularly helpful in providing historical context to more contemporary developments as well. Similarly, where all interviewees were asked at the outset to identify their specific area of expertise and how far back in time they could confidently speak, many did not have first-hand experience of important events in the early 1990s, for example. These outside experts often proved much more able to speak to earlier events than policymakers as well. Moreover, to address interviewees' concerns about their views being attributed, each interviewee was given the option to be identified only in general terms or not at all and given the option to speak off the record at times as well.

In some cases, the same publically-available labour market statistics and outside policy papers that were used to ground and contextualize interview data were particularly helpful in checking the claims of interview subjects. For instance, another interviewee claimed that on productivity growth Belgium was a star-performer and well ahead of countries such as Germany or the Netherlands. Their position was clearly not supported by any of this publically-available data or third-party research. However, considered in this light their claims were quite telling in other ways because the question flowed from proposals for changes to the Belgian wage index that they preferred not to discuss.

In short, to improve the reliability of interview data, extensive use was made of follow-up questions, as well as cross-checking answers with other interviewees. Independent experts proved to be very useful for the purposes of cross-checking as well. The ability to speak anonymously or off the record also encouraged more frankness from interviewees engaged in sensitive positions, while publically-available labour market data and other secondary research was used to check interviewees' claims as well.

### **3.7: Chapter Synopsis**

In sum, this project draws heavily on theoretical contributions from neoinstitutionalist scholars, emphasizing mechanisms by which institutions change gradually, while drawing attention to patterns of behaviour of key actors as well. This body of theory suggests institutional displacement, layering, drift, conversion, and exhaustion as possible mechanisms by which institutions may change gradually in the context of EMU. Cases were selected in accordance with a most similar systems design, where Belgium, Germany, and the Netherlands varied the least in as many respects as possible, but for the institutions that they use for managing wage developments. The literature suggests that institutional differences should account for important differences in their experience under EMU, although this project deviates from the most similar systems design, in that the precise

outcomes being that they cause were unknown at the outset of the project and are in fact an object of investigation.

In collecting data, given limited cases and demands from the literature for attention to detail and context, qualitative data informs this study. Specifically, interview data was collected from policymakers, as well as independent experts operating at both national and European level. Secondary sources from the policy community and academia are important sources of supplementary data. Reliability of the data was ensured using cross-checking, as well as follow-up questions and consultations with independent observers. Interviewees were given the option to speak anonymously where it would allow them to be more frank.

These interviews, as well as the mechanisms of institutional change outlined in this chapter play an important role in the country case studies in Part 2, which examine changes that have taken place in the Belgian, Dutch and German systems since the beginning of EMU. Before examining institutional change, however, a fuller exploration of the institutions in question is necessary. Thus, the next chapter turns to the systems themselves, expanding upon the themes broached in Figure 1. More specifically, it traces historically the development of the Belgian, Dutch and German wage-bargaining systems, examining the development of the mechanisms that they use to deliver horizontal and vertical coordination, as well as their calibration.

## **Chapter 4: The Cast of Characters**

### **4.1: Introduction**

As Chapter 2 noted, large literatures around OCA theory, as well as that around EMU and Varieties of Capitalism have suggested that organized wage setting is an important part of economic management under a currency union, but also that EMU may exert pressures upon the institutions and actors that coordinate wages. However, as several scholars, such as Crouch (2000) have noted, the highly idiosyncratic institutions of each system are likely to handle very differently the pressures exerted upon them by Economic and Monetary Union. With the importance of subtle institutional differences in mind, this chapter provides an overview of the institutions that Belgium, Germany, and the Netherlands use to manage wages, the functioning of which under EMU will be the focus of subsequent chapters. It also traces the emergence of the institutions that they use for managing wages, as well as the features of EMU that are behind the pressures that it exerts. This chapter notes that while these countries are often grouped together for having a strong role for the social partners, neocorporatist institutions and a long history of concertation between business and labour, as well as similar welfare regimes, there are important differences in the way that they manage wage setting.

This chapter is structured as follows: Sections 2-4 outline respectively the Belgian, German, and Dutch systems of wage bargaining, mapping them onto the framework developed in the last chapter and tracing the evolution of mechanisms that provide horizontal and vertical coordination, as well as their calibration. This account is intended to give an overview of developments up to their adoption of the euro. Section 5 summarizes the findings of this chapter.

### **4.2: Wage Setting in Belgium**

The Belgian model is often characterized as being centralized (e.g. by Abraham and van Rompuy 1999) and legalistic (e.g. in Vandekerckhove and van Gyes 2012). Much of this view is informed by its

use of a system of automatic indexation, whereby negotiations between the social partners take place in the space between a legally-mandated floor for wage increases tied to inflation and a legislated ceiling tied to wage developments in three other European countries. However, there remains an important role for the social partners in both the intra-associational agreements that promote horizontal coordination and in ensuring broad coverage of collective agreements that helps provide vertical coordination, as well as in the setting of the wage norm. Throughout, where the state was a dominant actor in the wartime Belgian economy, this design cue was carried over into the post-War period (Cassiers and Denayer 2010) and the state has come to play an important role in the horizontal and vertical coordination of the system, as well as in its calibration. This section is intended to give an overview of the Belgian wage-bargaining system. More specifically, it provides an abridged history of the system, examines in turn the mechanisms that provide horizontal coordination and vertical coordination before focusing on the calibration of the system. It then turns to emerging critiques of it and expectations about its experience under EMU.

#### **4.2.1: The Emergence of the Belgian Wage-Bargaining Model**

The foundations of the modern Belgian wage-setting system began to emerge in the interwar years as a response, first, to high inflation but comparatively low wages in the 1920s, and second, in response to stagnation in the 1930s. The use of an inflation index was developed following the First World War in the mining sector in response to rising costs of living in Belgium, but where industrial wages lagged well behind those in Britain, France and the Netherlands (Cassiers and Solar 1990, 438; Hassel 2006, 204). It was then slowly extended to other sectors (Cassiers and Solar 1990). Likewise, the practice of tripartite consultation between the state and the social partners was added in the 1930s as part of Belgium's attempt to manage the implications of the Depression (Cassiers and Solar 1990), although it proved ineffectual in tackling Belgium's economic troubles in the interwar years.



The post-Second World War Belgian system built upon these foundations, entrenching the role of the state in economic management. This post-War settlement also gave rise to state institutions for interacting and coordinating with the social partners where few had previously existed. The creation of the Conseil Central de l'Economie (CCE) is chief among these. Dating from 1948, the CCE was designed with important economic responsibilities of its own, but was also intended to institutionalize tripartite social dialogue in Belgium (CCE 2014). Crucially, while was intended as a forum to draw together the social partners, it exists by way of government legislation and serves as an important link between government and the social partners. Likewise, while wage agreements were concluded by the social partners, the inflation link also remained a central feature of Belgian collective agreements. Indeed, where the social partners had fared well in making agreements on working hours, vacations, and other parallel issues, disputes over wages and fractious industrial relations in the early 1950s saw a tripartite agreement in favour of a return to inflation indexing in 1954 (Interviewee 4 2013).

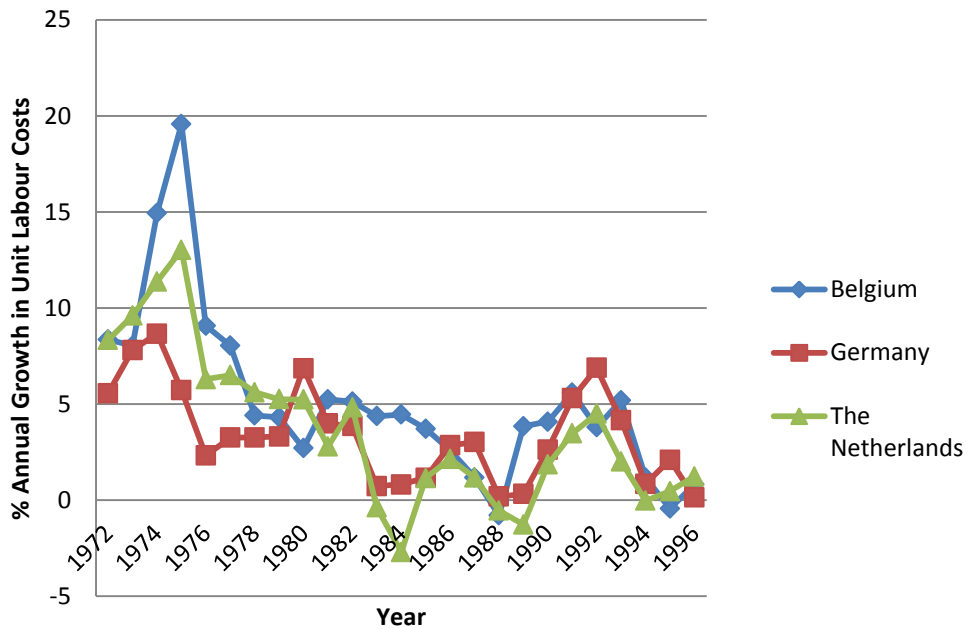
As Cassiers and Denayer (2010) have noted, several factors made inflation indexing workable in the 1950s and 1960s. First, where Britain struggled with unfavourable exchange rates, France with runaway inflation, and Germany with destroyed factories and infrastructure, productive assets in Belgium were left largely intact by the War, resulting in a short-lived 'Belgian Miracle' immediately following the War's conclusion. Second, significant US investment, as well the transfer of technology and production processes made for productivity growth that more than outpaced the evolution of indexed wages (Cassiers and Denayer 2010). As a result, in the 1950s and 1960s productivity increases in Belgium were large enough that unit labour costs developed at a rate that kept the Belgian economy competitive with its closest trading partners in continental Europe, even with wage developments tied so closely to inflation (Interviewee 4 2013).

Subsequently, however, the maturing of the Belgian economy produced much lower productivity growth from the early 1970s onwards (Interviewee 4 2013). With much lower

productivity growth and much higher inflation in Belgium through the 1970s and 1980s, the competitiveness of the Belgian economy declined on the back of the rising unit labour costs that resulted, where inflation indexing translated pressures on prices directly in to upward pressures on wages. While to 1981, policymakers had been convinced that these pressures would be transitory, a deepening economic slump precipitated a devaluation of the Belgian franc in 1982 and a wage freeze for that year (Cassiers and Denayer 2010).

All of these struggles in Belgium stand in marked contrast with the German experience during the 1970s and 1980s. Indeed, the ability of German employers and trade unions to balance wage and productivity growth and to contain inflation earned its system plaudits from the policymakers of the day (Streeck and Kitschelt 2003, 1). For these reasons, the German system subsequently gained many admirers in academia as well, even if their support has been more qualified since the early 2000s. Similarly, while the Netherlands faced similar problems with inflationary wage growth, and indeed, like Belgium employed a form of wage indexation, a significant reworking of its system redressed these troubles from the early 1980s. In any event, intermittent but worried discussions between the Belgian government and the social partners around institutional change followed between 1983 and 1996. Figure 1 below traces developments in unit labour costs in Belgium, Germany, and the Netherlands between 1972 and 1996, when the most recent set of laws currently governing the Belgian system were passed. What is particularly notable is that with the economies of all three maturing and productivity growth declining in the 1970s, Belgian wage costs consistently outpaced those of Germany. The gap with Germany and with the Netherlands as well was particularly pronounced in the early-mid 1980s, and again from the late 1980s into the early 1990s.

**Figure 2: Unit Labour Cost Growth in Belgium, Germany and the Netherlands 1972-1996**



Source: OECD Stat Extracts

Figure 1

Troubles with cost competitiveness were a significant source of concern for Belgian policymakers throughout the 1980s and 1990s and were a key driver of reform efforts as well. These troubles were compounded by the fact that at the same time as Belgium had struggled with wage competitiveness in the 1970s and 1980s, it also adhered very rigidly to its peg to the deutschmark throughout (Jones 1998a, 45). Indeed, while the Belgian franc jointly shadowed the French franc and German mark after the Second World War, it moved progressively closer to the deutschmark from the 1980s on (Jones 1998a, 47). Certainly, a large devaluation of the Belgian franc was carried out in 1982, although currency devaluation has not been a favoured tool of Belgian policymakers in the post-War period. Indeed, Jones (1998a, 44) notes that extensive reliance on imports made the inflationary effects of currency devaluation much more acute, which is in turn translated directly into wage increases by way of Belgium’s wage index, a point that was well-understood by policymakers.

This point is important for a country like Belgium because it limits significantly the benefits for economic competitiveness of currency devaluation. Interestingly, Belgian central bankers were often credited with managing the peg to the deutschmark better than even their Dutch counterparts up to the moment of Belgium's withdrawal from the system under speculative pressure in the early 1990s (Jones 1998a, 45). However, the combination of a rigid wage policy with a strong currency policy made for trying economic conditions in such a small, open economy as Belgium's, especially one that on wage costs consistently underperforms Germany and the Netherlands, two countries with which it trades extensively (Jones 1998a, 47). Jones' (1998a) observation in the late 1990s about mixing rigid wages and hard currency pegs is an ominous one as well, considering that the move from national currencies to a shared one under EMU locks nominal exchange rates.

The reforms that flowed from these concerns in the 1980s and 1990s are notable for allowing the state to intervene in wage setting more directly, and for the introduction of a 'wage norm'. The latter innovation was intended to contain wage growth by setting a ceiling for wage increases negotiated by the social partners. Early iterations of the wage norm took an average of wage developments in seven of Belgium's closest trading partners and attempted to set this average as a ceiling for Belgian wage developments (Cassiers and Denayer 2010). The guidelines underpinning this ceiling were first introduced in 1983 and revised in 1985 (Cassiers and Denayer 2010), coinciding with a prolonged gap in wage growth against Germany and the Netherlands. These reforms did not, however, rework the index that had produced inflationary wage developments in the first instance (Cassiers and Denayer 2010). This omission was on display when a return to growth in the mid-1980s and the subsequent 1989-92 economic boom produced wage growth well in excess of this ceiling, as well as yet more fractious discussions around institutional reform in the early 1990s.

Alongside the periodic competitiveness problems that had marred Belgian economic performance since the 1970s, additional external pressure came to bear upon policymakers in the

early 1990s. Indeed, the decision to peg the Belgian franc to the deutschmark in 1989 exacerbated the system's troubles with wage inflation. This latest bout of competitiveness problems that followed coincided in the early 1990s with concerns in government circles about Belgium's ability to join the single currency. One official close to the process recalls that the government of the day knew it would face a significant challenge in convincing other EU countries to allow it to adopt the euro. Policymakers faced a choice between dealing with its unwieldy public debt and attempting to address longstanding problems with its bargaining system (Interviewee 4 2013). While it has fallen significantly as a share of GDP in the time since, Belgian public debt in the early 1990s was well in excess of the formal convergence criteria. Rather than tackle its debt, the government of the day instead opted to reopen Belgium's wage-bargaining system as part of its plan for euro adoption, and began talks with the social partners to that effect. However, negotiations aimed at recasting Belgium's wage-bargaining system proved difficult through 1992-3, and when government was unable to find an agreement with the social partners, it moved unilaterally. The reforms that followed entailed a suspension of wage negotiations for 1995-6, altered the basis for calculating the inflation index, but ultimately preserved it, while revising the basis for the upper limit on wage developments in a 1996 law (Interviewee 4 2013). Bargaining between the social partners resumed in 1997.

The reformed wage norm was to be determined by wage developments in three neighbouring countries and set a threshold beyond which government would intervene, suspending wage negotiations and imposing a wage freeze as a corrective mechanism. Discussions over introducing a productivity link in wage setting had proved too divisive. Instead, rather than use domestic productivity, the wage norm makes use of wage developments in France, Germany and the Netherlands because they were expected to be among the first to enter EMU and because they were similarly developed economically (Interview 4 2013). Ironically, for not including domestic productivity in their negotiations, but instead capping them based on wage developments in countries that do, Belgian wages are in part influenced by productivity developments in neighbouring

countries instead. One observer notes with some consternation that relying upon developments in these three countries assumes that the evolution of their productivity, hence their unit labour costs, would be similar to that in Belgium, which has not been the case in practice (Interview 8 2013). Nonetheless, the reforms were successful in keeping wage developments in line with these three countries from the mid-1990s into the 2000s and allowing Belgium to adopt the euro.

Throughout, these reforms are also notable for growing the role of the state in Belgian collective bargaining in two important respects. First, the state has been a more consistent presence in negotiations as a party to the national agreements that establish a framework for negotiations at lower levels (Cassiers and Denayer 2010). This is particularly striking considering how the Belgian government had successfully extricated itself from collective bargaining through the 1960s as the system of social dialogue designed and built in the 1940s and 1950s matured, but where the Dutch government had failed in similar attempts throughout the 1960s (Woldendorp 2011). Likewise, reforms in 1989 authorized government intervention without consulting parliament if wage developments violated specific indicators (Interviewee 4 2013). Unsurprisingly given its new role in correcting for wage drift, these reforms are also notable, in that the Belgian state assumed a much more important role in the monitoring and enforcement of wage settlements at sector level as well (Vandekerckhove and van Gyes 2012, 7).

Second, and more subtly, successive reforms carved out a progressively larger role for the CCE, a state-connected but formally independent body. Indeed, the decision to entrench in law inflation indexation in the 1970s made the CCE's monitoring role all the more important, while its responsibility for tracking the wage developments in other countries that inform the wage norm, and finalizing the norm with the social partners gives it a larger role than it had previously enjoyed. This is to say that the CCE now plays a larger role in structuring interactions between employers and trade unions in Belgium, where the equivalent body in the Netherlands, for instance, has slowly withered over this same period of time.

These reforms in Belgium from the early-1980s through the mid-1990s are also notable for what they did not include. Indeed, productivity plays an important role in guiding negotiations in the Netherlands, where inflation correction had previously been an implicit part of wage agreements, and in Germany, where productivity growth serves as a guide for wage negotiations. In Belgium, by contrast, while an official close to the negotiations noted that a productivity link had been part of discussions between government and the social partners in the early 1990s (Interviewee 4 2013), this was left out of the 1996 law that capped that round of reforms. Then as now, some within the trade unions have feared that the inclusion of productivity in wage discussions would lead to labour-saving moves by employers (Interview 10 2013). Others more sympathetic to discussions over productivity prefer to set in a broader context alongside innovation, education, and so on (Jonckheere 2013; Lamas 2013). Likewise, the introduction of an 'inflation spring' which would have allowed for the temporary suspension of the index to correct for inflationary wage developments was also rejected by one of the three trade union confederations (Interviewee 4 2013).

Today, wage bargaining in Belgium is conducted on a biennial basis by representatives of trade unions and employers. Trade unions at sector and firm level are all affiliates of one of three trade union confederations, the Centrale Générale des Syndicats Libéraux de Belgique/Algemene Centrale der Liberale Vakbonden van België (CGSLB/ACLVB), the Fédération Générale du Travail de Belgique/Algemeen Belgisch Vakverbond (FGTB/ABVV), and the Confédération des Syndicats Chrétiens/Algemeen Christelijk Vakverbond (CSC/ACV). The CGSLB/ACLVB is a smaller centrist trade union, with 289 600 members (CGSLB/ACLVB 2014), while the FGTB/ABVV has historically had a more socialist and radical disposition, today representing 1.5 million members. The CSC/ACV has historically had a historically confessional and Christian Democratic leaning, and is the largest of the three Belgian trade union confederations, representing 1.7 million members (CSC/ACV 2014). Belgian trade union density stood at 50.4% in 2011 (OECD 2014c). These trade union confederations are joined by the affiliates of the Fédération des Entreprises de Belgique/Verbond van Belgische Ondernemingen (FEB/VBO) representing employers. FEB/VBO members employ 76% of the

workforce in Belgium (Ajzen 2013). These national confederations are also responsible for representing their affiliates in their European-level groupings, namely the European Trade Union Confederation (ETUC) for the trade unions, and BusinessEurope for the employers. Although both partners are crucial players in the Belgian system, they serve quite different functions in the wage-setting process, as discussed below. Indeed, while both are signatories to collective bargaining agreements, the trade unions tend to be organizationally far more robust and have much more developed processes of internal coordination than do the employers. Throughout the collective bargaining process in Belgium, two state bodies, the Conseil Central de l'Economie, which is formally independent, and Federal Public Service (FPS) Employment play important roles in guiding negotiations between the social partners.

Negotiations between the Belgian social partners are guided by a report from the CCE, which details predicted inflation in Belgium for the two-year period for which the subsequent agreement of the social partners is intended to cover. This report also details anticipated wage developments in France, Germany, and the Netherlands, which informs the setting of the wage norm. The final setting of the norm is the subject of some limited negotiation with the social partners. Throughout, FPS Employment plays an important role in monitoring the negotiations and final agreements of the social partners.

#### **4.2.2: Vertical Coordination in the Belgian Wage-Bargaining Model**

Vertical coordination in the Belgian system is provided by a mix of linkages between the national social partners and their sector and firm-level affiliates, particularly on the union side, a significant role for the state and large membership of employers' associations. Wages in Belgium are decided in a three-stage process of collective bargaining that emerged in the 1960s (Cassiers and Denayer 2010). In the first, employers and the three union confederations at national level agree upon a set of non-binding recommendations every two years that is intended to guide more intensive negotiations



at sector level. Negotiations at sector level then finalize the pay scales for employees covered by the agreement, but also negotiate the exact timing of wage increases, as well as crucial details around the application of the index. The final details are settled at firm level. This distance between negotiators at national level and the application of the final agreement at firm level presents a number of challenges for the governability of the system.

Traditionally, information sharing and market research by the trade unions had played an important role in coordinating and guiding the negotiation strategies of the sectoral branches of the trade unions, although the linkages between them are increasingly less important for wage negotiations (van Gyes 2013). Just as importantly, however, the state has evolved an increasingly important role in the monitoring and enforcement of collective agreements, not just to ensure that collective agreements are followed, but also to ensure that the agreements themselves comply with the index and the wage norm. Indeed, one expert noted as a for instance, the extensive discussions between employers and FPS Employment, a government department, to ensure that benefits and job perks do not violate the national wage norm (van Gyes 2013).

The use of legal provisions to extend the coverage of sectoral agreements to companies who are not members of employers' associations is very common in Belgium, playing an important role in the governability of its bargaining system. Indeed, legal extensions are so frequently used that following the negotiation of a new collective agreement, companies who are not members of the employers' association, and hence not formally signatories of the collective agreement, often apply the agreement immediately, in anticipation of extension laws being invoked (Vanderkerckhove and van Gyes 2012, 4). The use of legal extensions means that collective agreements cover 89% of the workforce in Belgium, well above the European average of 65% (Vancerkerckhove and van Gyes 2012, 4).

### **4.2.3: Horizontal Coordination in the Belgian Wage-Bargaining Model**

Horizontal coordination in the Belgian system is provided by the intra-associational agreement signed at national level by representatives of employers and the three major trade union confederations. This agreement is non-binding, but highly influential for affiliates of the national confederations, who conduct separate negotiations at sector level. Likewise, since the 1970s the state has periodically offered material inducements to the social partners to facilitate the completion of these agreements and to encourage wage discipline in collective agreements across sectors. For instance, in the 1970s the state had introduced several measures to draw older workers out of the labour market as a prod to the social partners (Cassiers and Denayer 2010). Furthermore, it has not been uncommon for the state to offset employers' social insurance contributions as another way of facilitating negotiations between the social partners (Interviewee 4 2013).

### **4.2.4: The Calibration of the Belgian Wage-Bargaining Model**

All of this negotiation over wages at national, sector and firm level takes place within the bounds set by the inflation index, which sets a floor for wage increases and the wage norm which is meant to set a ceiling. This is to say that the Belgian system is calibrated very tightly to inflation, which forms the basis of the index, and then expected wage developments in three other European countries, which inform the wage norm. The connection between wage negotiations and both of these indicators is legally enshrined.

Although inflation indexing is a longstanding practice in Belgium, in its modern form, the floor for wage developments is set by the Health Index rather than the Consumer Price Index, which attempts to exclude the influence more volatile commodities such as energy, and also excludes some consumables like alcohol and tobacco (Luzio and Zhou 2007, 22). The basket of goods that it tracks is updated periodically in consultation with the social partners. More importantly, however, the Belgian system, and indeed several others that rely on inflation indexing, is extremely rigid in its tracking of

the health index. This is to say that neither agreements of the social partners, nor government action short of revising the relevant legislation can override the application of a wage increase stipulated by the index. Put another way, a wage freeze, whether agreed by the social partners or imposed by government only negates wage increases above those stipulated by the index.

Interestingly, while the firm floor set by the index has been credited with protecting domestic consumption through economic downturns, it has also been accused of promoting wage inflation. Indeed, in the 1950s and 1960s, productivity growth outpaced inflation and wage growth. However, since the 1970s, where much lower productivity growth has been the norm, setting past inflation as a hard floor for wage developments has tended to produce a wage handicap against Belgium's closest trading partners and competitors (Interview 4 2013; Interview 8 2013; Interview 9 2013), who can more readily adjust their wages to new circumstances. Some observers have also noted that automatically having a wage increase commensurate with inflation puts additional pressure on union negotiators to deliver increases beyond this as a show of their utility to affiliates and members (Interview 8 2013). The resulting tendency for the Belgian system to 'overheat' was very much on display in economic crises in the 1970s, the early 1980s, the early 1990s, and since about 2007 as well. In this respect, the contrast with the Dutch system, which emerged from the War with very similar institutions, but which today is at once highly coordinated and highly flexible on wages, is particularly striking. The reasons for this change of course in the evolution of the Dutch system will be discussed in more detail in Section 4.4.1.

As a corrective mechanism, revisions introduced in the 1980s and refined in the 1996 law introduced the 'wage norm', setting a ceiling for wage increases based up projections of hourly wage growth in Germany, the Netherlands, and France, all close trading partners of Belgium. However, neither state intervention nor the wage norm may push wage developments below the level stipulated by the index. As a result, the wage norm can correct for inflationary wage developments, and hence competitiveness problems *ex post*, rather than *ex ante*. Furthermore, when corrections

are necessary, they can only be made over a very long period of time, where Dutch and German negotiators' ability to agree cuts in real wages makes their systems much more nimble in this respect. For these reasons, one government official notes that the 1996 reforms giving rise to the wage norm weren't seen, even at the time, as a permanent solution (Interview 9 2013).

Interestingly, where the model has found flexibility on labour costs, it has had the perverse effect that firms have been more apt to vary employment where they cannot adjust wage levels. As representatives of government and a Belgian employer noted, this rigidity in Belgian wages has accentuated insider-outsider divides in the labour market, where firms retain a core of protected workers, and an ever-varying number of contract and agency workers (Interview 8 2013; Interview 9 2013). Certainly, this insider-outsider divide is not uncommon in many continental labour markets, although it is more pronounced in Belgium as a result of wage rigidities.

#### **4.2.5: The Belgian Wage-Bargaining Model and EMU**

In the academic literature, the Belgian model has been heavily criticized for its rigidity and its struggle with competitiveness. Indeed, Abraham and van Rompuy (1999) are only two of many to argue that while the Belgian system in its current guise has kept labour costs on a steady trajectory, it is highly unresponsive to shocks affecting separate sectors of the economy differently. This, they argue, is because the level of uniformity in the wage settlements between sectors does not allow those affected to adapt accordingly, and should be a point of concern under EMU. Others have noted that the high degree of uniformity in wage developments across the country make for a mismatch between the agreed wage developments, and diverse conditions in local labour markets. Indeed, beneath the highly uniform pay scales between them, there is a stark difference in the growth of productivity in Flanders and Wallonia (Interview 4 2013). However, there is debate over the exact meaning of this mismatch, where it is in some cases seen as an efficiency problem, but in others characterized as interregional and inter-sectoral solidarity (Jonckheere 2013; Lamas 2013).

Consequently, one would expect wage developments in the context of EMU to be similar to those in the period before euro adoption. Indeed, that the social partners so constrained by the wage norm and the index would seem to rule out an explosion in labour costs. Likewise, being so centralized, one would expect the Belgian system to contain pressures for divergence between sectors as well, even if such a high level of centralization invites pressure to loosen the horizontal coordination of the system in order to deal with asymmetric shocks. However, the loss of an independent national monetary policy should be a point of concern under EMU, where devaluation has been leaned upon historically to redress competitiveness problems flowing from inflationary wage growth, and where adaptations to the system have failed to address its tendency to produce wage inflation. This loss of monetary sovereignty can be expected to place far more strain on the social partners than in countries like Germany and the Netherlands who had relied much less heavily on currency devaluation. Similarly, where the Belgian state has played a facilitating role, using material inducements to encourage agreement among the social partners, constraints upon fiscal policy under EMU can also be expected to strain the social partnership.

#### **4.2.6: Section Summary**

In sum, wage negotiations in Belgium are calibrated to a floor set by inflation and a ceiling set by expected wage developments in France, the Netherlands, and Germany. Though often characterized as being highly centralized, negotiations at sector level are the most comprehensive, and while the index is calculated to account for national inflation, its application varies significantly across sectors, even if wage dispersion is low. Horizontal coordination is provided by a national agreement between the social partners, which is non-binding, but highly influential for subsequent negotiations at lower levels. Vertical coordination is the product of linkages between the national social partners and lower-level affiliates, as well as extensive state monitoring and enforcement, and judicious use of legal extensions. Throughout, the state plays an important role in guiding, overseeing, and enforcing

wage agreements and while the practice of wage coordination has continued, the system has been criticized for its rigidity and its tendency to overheat.

### **4.3: Wage Setting in Germany**

Traditionally, the German model has been treated in the academic literature as a case of very tight wage coordination, with strong social partners organized at sector level, and a pattern-setting system tying wage developments in other sectors to developments in the metalworking sector.

More contemporary accounts have pointed to a long process of institutional change in the German model, which have begun to alter the mechanisms by which wages are coordinated. This section gives an overview of the German model of wage bargaining and its evolution, mapping the model onto the framework outlined in Chapter 2 and examining the mechanisms that deliver vertical and horizontal coordination, as well as the system's calibration. It then turns to expectations for how the German system might cope with pressures from EMU.

#### **4.3.1: The Emergence of the German Wage-Bargaining Model**

The German wage-bargaining system exhibits an interesting mix of pre-industrial roots and post-War influences. Streeck and Kitschelt (2003), among many others, have noted that the German system of trade unionism and vocational training date from the 19<sup>th</sup> century and were heavily influenced by a guild system that was comparatively long lived in Germany. Likewise, the factory councils, of which modern works councils are descendants, emerged in the middle of the century (Whittall 2005, 573).

As a late industrializer, strategic coordination among firms is a practice that also dates back to the later part of the 19<sup>th</sup> century, where cooperation between firms, with a crucial role for banks, evolved as a means of speeding Germany's convergence with earlier industrializers like the US and the UK. All of these features, in the sectoral organization of German trade unions, and coordination among firms in the form of employers' associations, have modern analogues.

Moreover, prior to the Second World War, German industrial relations had been heavily influenced by the state. This is partly the result of state industrial policy, which had knock-on effects on industrial relations, but it is also because the state played a more active role in moulding the social partners and structuring the ways in which they interact than has been the case since. In this respect, Whittall's (2005) account of the evolution of works councils is instructive, where they had existed previously, but were given legal recognition and a more prominent role in the mid-1920s in a concerted effort among the state, employers, the Social Democratic Party, and moderates in the trade unions to tame anti-capitalist factions within the labour movement.

In the immediate post-War period, discussions around industrial relations in particular mirrored broader debates about the role of the state in Germany (Glossner 2010, 11). Where in Belgium and the Netherlands the state played a significant role in post-War wage setting and attempts at withdrawing from this role were made only later, German policymakers made very different decisions. Certainly, the Social Democratic Party (SPD) had been especially keen on central planning and a decisive state role (Glossner 2010, 13) until their turn towards the political centre in the later 1950s. However, the Christian Democratic Union/Christian Social Union (CDU/CSU) governments that took power after the Second World War made a conscious decision to limit the state role in wage setting. Indeed, this decision to limit the state role in industrial relations mirrored other post-War institutional choices in the electoral system, the German parliamentary system, and many other areas intended to limit the scope for unilateral state action.

Two broad sets of decisions in the immediate post-War period account for the limited state role in wage setting. First, power in economic policy at the federal level was deliberately dispersed, with several independent agencies, foremost among which was the Bundesbank, being given a large role very early (Streeck 1997, 242). Furthermore, constitutional provisions and the decentralized nature of the German federal system that was adopted left the state with limited means and weak autonomy in industrial relations (Streeck 1997, 241-2). This limited state role meant that by design

the state in Germany could not play the part that it did in Belgium or the Netherlands during the same period. Second, policymakers in the immediate post-War period inherited well-established interest associations, while the previously fragmented labour movement consolidated in an effort to promote its inclusion in the post-War settlement (Streeck 1997, 238-9). The German labour movement stands out for having merged trade unions with confessional and socialist leanings at this early stage, where most other trade union movements in continental Europe still reflect these ideological and religious divides, even if they are far less pronounced today.

That business associations were well established and trade unions consolidated made them easier for post-War policymakers to entrench than to dislodge. What emerged from the meeting of a deliberately weakened state and strong interest associations is what has subsequently been referred to as *Tarifautonomie*, where the state has been barred from playing a direct role in wage negotiations as it does periodically in Belgium and the Netherlands, but where the social partners are responsible for coordinating wage developments for the majority of the economy (Streeck 2005, 139). Similarly, in Belgium and the Netherlands, the social partners developed strong national associations and institutionalized forums for them to interact with the state and each other around a strong state role early in the post-War period. By contrast, absent centralized wage setting and a strong state role, the national associations of the social partners in Germany have never developed the same organizational muscle that they have in many other systems.

Hence, in the German system, the state plays a much less significant role than in other continental systems (Behrens and Jacoby 2004, 96). At the same time, much less of the process is codified in the form of formal legal institutions (Sterkel 2013), although the codification of works councils in law is an important exception. These bodies serve as meeting points between firm management and employees. While the first examples of works councils emerged in Germany in the mid-19<sup>th</sup> century, the authoritative legislation governing them in their modern form dates from 1952 (Whittall 2005; 2007). This legislation formally separates works councils from trade unions and



employers' associations (Haipeter 2011, 679), and indeed a not insubstantial proportion of representatives on German works councils are not members of a trade union (Whittall 2007, 31). Nevertheless, a peace clause in the 1952 legislation bars works councils from initiating industrial action and the fact that union members are disproportionately represented on them means that works councils are quite closely tied to the trade unions in practice (Whittall 2005; 2007). Indeed, being a body closely linked to the trade unions, but being highly visible to employees, works councils have traditionally been a useful instrument in trade unions' recruitment drives (Whittall 2007).

Unlike in Belgium and the Netherlands, the period of institutional stability in Germany after the War lasted much longer. Indeed, Belgium experienced a marked slowdown in growth from the 1970s that continued well into the 1980s, and conditions in the Netherlands in the 1970s provoked a significant institutional rethink in the 1980s. German institutions, by contrast, have been remarkably stable. However, there is a debate over the precise meaning of this stability, where Streeck (1997; 2005) has argued that the German system was ideally suited to the conditions of the 1960s and 1970s. However, in the time since then, demographic changes, as well as changes in world markets with the end of fixed exchange rates in the 1970s, and new competitors in traditionally German markets from the 1980s on, mean that the German model is no longer suited to its external environment. In fact, Streeck and Kitschelt (2003, 4) have argued that the stability of the German system, as well as labour market rigidities, have hindered its adjustment to new conditions. Likewise, the limited scope for state action has hindered this adjustment (Streeck 2005, 154), where state action proved decisive in institutional changes in Belgium and the Netherlands.

There is something of an irony in Streeck's dating of the German system's problems, as it was precisely the period from the later 1970s well into the 1980s that German wage setting was the focus of so much positive academic attention. More interestingly, however, the German social partners' response to these strains in the 1980s began a slow process of managed decentralization in the German system, but one that left the formal legal institutions involved in the process

unchanged. Indeed, while significant revisions of the Dutch system were made in the early 1980s and considered in the Belgian system, the German social partners opted to respond to economic pressures in the early 1980s with reduced working time and increased flexibility around working hours (Haipeter 2011, 680). Because these issues are negotiated at firm level, it has meant a larger role for the works councils where these negotiations take place, at the expense of the regional collective bargaining committees that sign sector-level agreements. This process of derogation to works councils is one that accelerated in the 1990s and 2000s (Haipeter 2011, 680). At the same time, the trade unions have attempted to meet these decentralizations by consolidating further, although this process has weakened the national peak association by producing larger and more coherent affiliates at sector level, while failing to reverse the decline in collective bargaining coverage that Germany has experienced (Streeck 2005, 152).

Similar to this process of decentralization, in formal terms, the German wage-setting system has gone largely unaltered by German Unification. Indeed, in the early 1990s, a conscious decision was taken to transfer wholesale the institutions, and crucially, the pay scales that had developed in West Germany to the new Länder. This transfer minimized disruption in West Germany, but had dire consequences in the East, with workers shed because of new pay levels vastly outstripping productivity and employers struggling to adapt to their new conditions (Streeck 1997, 250-1). The implications for wage bargaining are that employers in the new eastern Länder are far more likely to have opted out of employers' associations, meaning these firms are not bound by collective agreements signed by them and contributing to the declining coverage of the system noted by Streeck (1997; 2005), Streeck and Hassel (2003), and many others besides. Similarly, the Unification bust casts a very long shadow over other parts of the German industrial relations system, with dreadful unemployment figures placing much downward pressure on wages subsequently.

Today, the German trade unions are represented at national level by the Deutscher Gewerkschaftsbund (DGB), which is joined from the employers by the Bundesvereinigung der

Deutschen Arbeitgeberverbände (BDA). These bodies have a small role in facilitating exchanges of information between their sector-level affiliates, although they have no direct role in wage setting (Interviewee 22 2013) as their counterparts do in Belgium and the Netherlands. Their chief function is representing their sector-level affiliates in negotiations and lobbying government and each other over issues relevant to the social partners and in the relevant groupings for employers and trade unions at the European level (Interviewee 17 2013; Müller 2013).

In Germany, much of the actual negotiation, and indeed most of the organization muscle of the social partners, is located at sector level. Some of the more notable organizations include IG Metall and Gesamtmetall, representatives of labour and employers respectively in the metalworking sector, and Ver.di, the largest service sector union. Trade union density in Germany, as in the Netherlands, is low, standing at 18% in 2011 (OECD 2014c). Collective bargaining coverage is lower in Germany than in the Netherlands or Belgium, with collective agreements binding for 61% of the workforce in western Germany, and for 49% in the east (Vogel 2013). However, the BDA's assertion that the social partners make decisions covering 70% of national income and that collective agreements in Germany apply 'in full or in large part' to 80% of working relationships does suggest that agreements of the social partners cast a significant shadow beyond their formal coverage (BDA 2014).

Unlike their counterparts in Belgium and the Netherlands, the German social partners have fewer legal supports from the state. However, much like in the other two cases, the specific function of the employers' associations and trade unions are subtly different. Indeed, while the sectoral organizations of the trade unions and employers are equal parties to collective agreements, internal coordination between the sectoral organizations of the trade unions and their regional and firm-level affiliates are more developed than for the employers (Interviewee 15 2013). As discussed below, while employers' organizations certainly do coordinate with their regional affiliates (Interviewee 26 2014), they play a much larger role in extending the coverage of these agreements.

#### **4.3.2: Vertical Coordination in the German Wage-Bargaining Model**

Vertical coordination in the German system is the product of close ties between the sectoral social partners and their regional and firm-level members. Sectoral collective agreements are the product of intense negotiation between and within employers and union federations' regional collective bargaining committees, their sectoral peak association, and firm-level works councils (Interviewee 15 2013). National-level federations of the unions and employers play a comparatively small role.

Bargaining rounds begin with surveys by regional collective bargaining committees of the conditions of the sector in their region, which then form the basis for consultations with other regional committees and their respective peak associations. These interactions are often much more intense among the unions than among the employers. The sectoral peak associations have no direct role in negotiation, but on the basis of these discussions, each sectoral peak association issues a broad set of recommendations to guide the separate regional negotiations (Interviewee 22 2013). These organizations also act as a conduit for subsequent exchanges and information sharing between regional committees (Interviewee 22 2013). Once negotiated, a pilot agreement in a leading region often serves as the template for others in the sector. Certainly, while this process is most intensely studied in the context of the metalworking sector, where the Baden Württemberg agreement typically serves as the template, this process is commonplace in other sectors as well (Interviewee 15 2013). As a result, the signed agreements in the different bargaining regions look very similar, even though formally they are negotiated separately (Interviewee 22 2013).

Once signed, these sectoral agreements are buttressed by broad membership of employers' associations, such that all employees of affiliated firms in that sector are covered by the agreement, and not just union members. Interestingly, the coverage rate for employees is comparatively high because large companies are very well represented in employers' associations, although they cover a very low percentage of companies, with many small and medium sized firms not represented

(Dannenbring 2014; Interviewee 15 2013). Thus the coverage of collective agreements in Germany is far broader than its low union density would suggest. In contrast with Belgium and the Netherlands, where the social partners often apply to the state for legal extensions to expand coverage of agreements to the entire sector, in Germany, such extensions play no meaningful role in the bargaining process. Indeed, post-War legislation governing extensions was designed to limit their role, although provisions allowing for them do exist and changes to make them more accessible have been written into the coalition agreement of the current government (Müller 2013).

Moreover, while in Belgium and the Netherlands the respective government ministries responsible for employment policy plays a significant role in monitoring the application of collective agreements, the monitoring and enforcement of German collective bargaining agreements is largely done by works councils that operate at firm level (Whittall 2007, 27). Although they are formally separate, works council members maintain close ties to the trade unions, which is especially important given their role in monitoring collective agreements' application, as well as their growing role in the collective bargaining process. In fact, where traditionally the works councils had been charged with negotiating only the minute and final details of collective labour agreements, the proliferation of opening clauses and looser sectoral agreements have given them much more latitude and a larger role in negotiations as part of a managed decentralization of the system since the 1980s (Haipeter 2011, 679-80). In other words, they now have a much more important role in maintaining the governability of the wage-setting system.

With the limited organization above the sector level, collective bargaining in Germany, and the German social partners themselves, are highly decentralized. With sector-specific organizations, their activities tend to be highly differentiated between sectors (Behrens and Jacoby 2004, 101). For example, Ver.di, the main service sector union, oversees negotiations for 60 distinct professional branches, where the metalworkers' union oversees only one of consequence (Sterkel 2013). Sterkel's account of Ver.di's dealings with multiple and highly fragmented employers' organisations

also contrasts sharply with the state of the employers in the metalworking sector (Sterkel 2013). Put more bluntly, this image clashes with the traditional assumption in the literature that the German system displays a high degree of cohesion and uniformity between sectors (Behrens and Jacoby 2004, 97).

#### **4.3.3: Horizontal Coordination in the German Wage-Bargaining Model**

The decentralized nature of the German system presents a challenge for coordination across sectors in Germany: The intersectoral coordination of collective bargaining had traditionally conformed very closely to a pattern-setting model (as outlined by Sisson and Marginsen 2002, or Traxler and Kittel 2000, for instance), or perhaps more accurately, academic accounts of pattern setting have conformed very closely to German intersectoral coordination. In any event, negotiators in most sectors of a pattern-setting system take as a template the agreement of a leading sector.

Traditionally in Germany, this agreement has been that of the metalworking sector. Although many scholars still view the German system in this way, many observers closer to the process and indeed many of the participants in it, no longer see such a significant role for pattern setting in German wage setting (Interviewee 16a 2013; Schulten 2013; Sterkel 2013). Certainly, negotiators in the service sector, for example, do still take note of developments in metalworking, although they play a much less significant role in the subsequent negotiations (Sterkel 2003). Likewise, where traditionally, contract lengths and the timing of collective bargaining campaigns had been deliberately synchronized to allow negotiators in other sectors to take account of the pace-setting contract in their own negotiations, increasingly contracts in different sectors are agreed for differing lengths as well (Schulten 2013). However, while Schulten (2013) highlights a significant move away from pattern setting in the early 2000s, he also notes that the pace-setting role of exporting sectors has become less pronounced, rather than disappearing altogether.

#### **4.3.4: The Calibration of the German Wage-Bargaining Model**

Finally, negotiations in the German system have been calibrated to a 'coordination rule', by which negotiators use economy-wide inflation and productivity measures as reference points for negotiations, which are followed loosely, much as they are in the Netherlands. In contrast with Belgium, where the calibration of the wage-bargaining system is established by government statute, the German coordination rule was developed by the social partners. Specifically, the German coordination rule was originally developed by industrial trade unions, which in Germany tend to operate in sectors that are highly sensitive to international competition. As a result, these trade unions settled upon guidelines for their wage demands that are intended to maintain inflation-neutral wage settlements, thereby preserving the competitiveness of the industries in which they operate (Interviewee 15 2013; Sterkel 2013). While it is traditionally associated with the industrial unions, the coordination rule guides union demands in the service sector as well, although varying conditions in different sectors do mean that the actual outcome of the negotiations varies somewhat between sectors (Sterkel 2013).

#### **4.3.5: The German Wage-Bargaining Model and EMU**

Considering the German model against the pressures from EMU suggested by the academic literature, the weak role of national peak associations would seem to suggest that strains on the horizontal coordination of the German system as a likely occurrence under EMU. Specifically, it suggests a divergence in the wage developments between sheltered and exposed sectors as a distinct possibility under EMU, especially with the decline of pattern setting. However, Germany's heavy reliance on exports suggests that significantly relaxed wage discipline would be unlikely. However, where the state plays such a small role in wage-setting, constraints upon fiscal policy would seem to be a less likely source of pressure in Germany than in Belgium or the Netherlands. Indeed, while in Belgium and the Netherlands, material inducements by the state have historically

helped to facilitate wage negotiations in difficult circumstances. This practice is not followed in Germany, with the implication that constraints upon the state's ability to provide inducements to the social partners would not have the same impact in Germany as in Belgium or the Netherlands. Likewise, while the fact that agreements are negotiated so close to firms in regional bargaining councils would suggest limited pressure for decentralization as well, although some, such as Whittall (2005; 2007) have suggested that pressures for decentralization and disorganization under EMU should be rife.

#### **4.3.6: Section Summary**

In short, considered against the framework developed in Chapter 2, in the German system of wage-bargaining, vertical coordination emerges from tight internal coordination within the sectoral social partners, with close cooperation between regional affiliates, unionized works council members, and the sectoral peak associations playing a crucial role in producing wage agreements. Broad coverage of employers' associations buttresses this process by extending the coverage of these agreements to non-union workers. Horizontal coordination has traditionally been provided by pattern setting. Although the leading role of the metalworking agreement is far less pronounced today, all sectors demands are calibrated to a common coordination rule, taking national inflation and productivity as references for negotiations.

#### **4.4: Wage Setting in the Netherlands**

Emerging from the Second World War, the Dutch system began the post-War period with institutions very similar to that of Belgium, although since the mid-1970s, the two have taken very different evolutionary paths. Today, the Dutch system is highly decentralized, following significant institutional change in the early 1980s, which was reinforced in the 1990s. This section examines in overview the evolution of the Dutch wage bargaining system before mapping it onto the framework



from Chapter 2, and addressing some expectations thereof about the pressures exerted upon it under EMU.

#### **4.4.1: The Emergence of the Dutch Wage-Bargaining Model**

In the immediate post-War period, wage setting in the Netherlands was a highly centralized affair, whereby a single agreement on wages covered the entire economy. This agreement emanated from the Sociaal Economische Raad (SER), a tripartite but at the time state-dominated body, formed in 1950. This practice was the norm throughout the 1950s, where the task of the social partners was to implement this agreement on wages for the entire economy, rather than actually deciding upon them (Hemerijck and Visser 1999). This highly centralized form of coordination struggled in the later 1950s and early 1960s, where government-imposed wage discipline produced a labour shortage (Hemerijck and Visser 1999), and where employees and employers subsequently relied upon 'under the table' payments. These payments defied government-mandated wage moderation, and also produced greater differentiation in wage developments between sectors (van den Toren 2007, 6). This process of wage drift prompted discussions in policymaking circles about decentralizing wage setting to the social partners.

However, while in Belgium government successfully withdrew from wage setting for most of the 1960s (Cassiers and Denayer 2010), Dutch policymakers made similar attempts from 1962, but with less success. Van den Toren (2007) notes that these attempts to decentralize wage setting posed significant problems for the trade union confederations, which were themselves highly centralized and had yet to develop the requisite organizational muscle at lower levels. Likewise, even if individual social partner organizations were highly centralized, it was only from the 1970s that they began to consolidate. In other words, the social partner organizations were both highly centralized, but also highly fragmented while the first attempts at decentralization were being made.

Woldendorp's (2011) account of wage negotiation in the Netherlands following this first attempt to decentralize it is particularly revealing. Therein, wage negotiations between and within the social partner organizations in the 1960s and 1970s were typically fractious and bitter, while often failing to produce agreements. These failed negotiations then resulted in a settlement being handed down by the state. Certainly, his account is not without a touch of humour, where seemingly the only consistent point of agreement between the social partners was a resentment of wage settlements imposed by the state. This point about failed negotiations precipitating state intervention is partly behind the observation by Visser (1998) that the Netherlands kept a statutory wage policy longer than most and by van den Toren (2007) that by the 1970s the trade unions were in agreement that the government role in wage setting was too large, even if they were too fragmented to act on this impulse.

In the 1970s policymakers in the Netherlands faced pressures similar but more acute to those in Belgium at the same time, where slowdowns in post-War growth met with inflationary pressures. Between the late 1960s and 1982, Dutch wage agreements adopted an inflation correction mechanism much like in Belgium (Hemerijck and Visser 1999), which meant that large growth in energy prices stemming from the oil shocks were translated directly into growing wage costs (Den Butter and Mosch 2003, 362). This inflation correction combined with a labour shortage to produce worsening competitiveness throughout the decade. Likewise, with inflation indexing narrowing the scope for negotiations, and with employers increasingly obstinate over growing wage costs, the relationship between the social partners, and between the social partners and government deteriorated markedly (Hemerijck and Visser 1999). Reform efforts gained pace during the late 1970s, although these were scuppered by more radical affiliates of the largest trade union confederation (Hemerijck and Visser 1999).

However, while Belgian policymakers moved in the mid-1970s to enshrine inflation correction in law, and in the early 1980s to preserve the practice, an acute sense of crisis and a new

centre-right government in the Netherlands began a significant rethink of the Dutch wage-setting system. Jones (1998b, 155) notes that between 1973 and 1981, labour's share of economic output had grown from 68.9% to 80.1%, while unemployment doubled from 5.7% in 1979 to 11.9% in 1982. All the while, deteriorating public finances gave the problem much more urgency in the eyes of government (Jones 1998b, 155). Where discussions in the late 1970s had failed to find agreement among the social partners, the government cajoled unions with the threat of an imposed wage policy and the reopening of existing collective agreements (Woldendorp 2011), while simultaneously brandishing the threat of imposed working time reductions upon employers (Visser 1998).

Subsequent discussions between government and the social partners culminated in a 1982 agreement struck in the town of Wassenaar (close to The Hague), and henceforth referred to as the 'Wassenaar Agreement'. As part of this agreement, the social partners allowed much more autonomy to their sector and firm-level affiliates in negotiating wages (Woldendorp 2011). For their part, the national confederations of the social partners directed their affiliates to abolish inflation correction mechanisms in their agreements (Visser 1999). The abolition of inflation correction mechanisms precipitated a sharp fall in real wages thereafter (Visser 1999), although employers conceded working time reductions in exchange (Hemerijck and Visser 1999). These changes formed the basis of the subsequent 'Dutch Miracle' that earned the modernized Dutch model so much praise in the 1990s and 2000s. However, Jones (1998b) has argued that a closer look beneath headline economic figures of the mid to late-1980s requires some qualification of the 'Miracle' moniker. The process proved very trying for the trade unions, where union leaders had become converts to wage discipline, but where the unions' rank and file members remained more sceptical, while slow employment growth saw union density decrease dramatically to 1991 (Jones 1998b, 159). Jones (1998b, 158) also notes that while unemployment figures tumbled throughout the 1980s, wage discipline and the dramatic expansion of part-time work were only partly responsible, at least at first. Indeed, but for early retirement and a spike in workers claiming disability, common instruments in many continental welfare systems for removing workers from the labour market,

unemployment would have been 26.8% in 1985 and 25.1% in 1991 (Jones 1998b, 158). By contrast, the official harmonized unemployment rate for these two years was 7.3% and 4.8% respectively (OECD 2014a).

The point here is not to suggest that the Wassenaar Agreement had been a failure, nor to belittle the economic success that the Netherlands enjoyed subsequently. Rather, the point is, first, that the first steps toward the subsequent miracle would hardly have felt divine, and second, that while fiscal consolidation had certainly been one of the government's goals in the 1980s, making the necessary adjustments in the labour market and wage-bargaining system required generous dollops of state support during this critical early phase of the transition (Jones 1998b, 168). Extending this necessary support required the state to make its goal of fiscal consolidation a longer-term project. Indeed, Jones (1998b, 164; 168) finds that government spending remained very high in the Netherlands throughout the 1980s, in no small part because of the government's role in smoothing the transition in the labour market and wage-bargaining system.

Jones' (1998b) observation is particularly interesting given the inherent irony that a process that was intended to, and indeed succeeded in removing the state as a dominant actor in wage setting should require it to become more involved in supporting the process. Similarly, throughout the 1980s, legal extensions of collective agreements made the more moderate agreements of the day binding across the entire economy. At the same time, however, the state made successive moves to limit its legal bases for direct interventions in wage setting. In the end, it retained only the right to intervene in severe declines of competitiveness, although it does also retain many informal tools for influencing the wage-setting process (Visser 1998). The Ministry of Social Affairs and Employment, which registers and extends collective agreements, allows the minister to refuse an extension, although this power has never been exercised in practice and its legal basis has been questioned by the trade unions in any event (Bulk 2014). Interestingly, and in response to this growing decentralization and receding state role, from the early 1980s the social partner

organizations developed tighter linkages between affiliates at different levels. This organizational tightening has been most visible among the trade unions. These mechanisms were further developed and reinforced in the 1994 New Course Agreement, a social pact in which wage setting was further decentralized, but where linkages between the affiliates of the social partners tightened again in response.

Today, and as in Belgium with the CCE reports, Dutch agreements begin with a report by the Centraal Planbureau (CPB), a state-affiliated, but highly independent body, which tabulates figures for, amongst other things, Dutch inflation and productivity growth. These figures are used as a guide for the social partners in their negotiations, although they are followed much more loosely than the figures from the CCE are in Belgium. Also as in Belgium, Dutch negotiations begin at national level, bringing together the representatives of multiple trade union confederations and employers groups. Representing the trade unions are the Federatie Nederlandse Vakbeweging (FNV), a traditionally left-leaning confederation, the protestant-tinged Christelijk Nationaal Vakverbond (CNV), and the Vakcentrale Voor Middengroepen en Hoger Personeel (MHP), a very small group representing 65 000 managers and professional staff (van het Kaar 2014). Representing 1.1 million workers (van het Kaar 2014), FNV is by a wide margin the largest of the three and is the most influential in wage negotiations, where the CNV, with nearly 300 000 members (van het Kaar 2014), tends to play a much smaller role (De Beer 2014). Some have suggested that because of either its smaller size (van der Woud 2014) or the differences in their organizational cultures (Interviewee 41 2014), CNV exercises a moderating influence over the negotiation process. Union density in the Netherlands is low by European standards, standing at 17% in 2013 (van het Kaar 2014). Among the countries under study, union density in the Netherlands is similar to that of Germany, which had a trade union density of 18% in 2011, but well below Belgium, where the equivalent figure was 50.4% in 2011 (Visser 2013).

The employers are represented by the Verbond van Nederlandse Ondernemingen-Nederlands Christelijk Werkgeversverbond (VNO-NCW) and the Algemene Werkgeversvereniging Nederland (AWVN). The exact density of the Dutch employers' organizations is a point of dispute, although it has been estimated that members of VNO-NCW employ approximately 85% of the workforce (van het Kaar 2014). Between this high employer coverage and legal extensions, approximately 80% of the workforce is covered by a collective agreement in the Netherlands (van het Kaar 2014). Traditionally, the Dutch social partners had been highly fragmented, although both the trade unions and employers' confederations have consolidated since the 1970s, with the FNV formed by a merger of the former social democratic and Catholic confederations, and VNO-NCW the product of a merger of liberal and Catholic organizations, for example. These national representatives of the trade unions and employers agree to a set of recommendations surrounding wages that provide parameters for more intensive negotiations among their affiliates at sector level (Borghans and Kriechel 2007, 4). As in Belgium, the sectoral affiliates of these confederations, working within the national recommendations negotiate the pay scales for their sector, with remaining issues dealt with at firm level.

In common with Belgium and Germany, internal coordination is much more highly developed within the organizations of the trade unions than among the employers (de Beer 2014). The internal mechanics of employers' associations are not as well understood as they are for the unions, although it is understood that internal consultations are less intense (de Beer 2014). While the employers' associations do provide research and recommendations for affiliates, dialogue between levels of their organization is less regularized and they do not have tools for sanctioning affiliates as the trade unions do (Harteveld 2014). As a consequence, while employers' associations and trade unions are equal parties to Dutch collective agreements, their functions are subtly different, as they are in Belgium and Germany. These points are explored below.

#### **4.4.2: Vertical Coordination in the Dutch Wage-Bargaining Model**

Vertical coordination in the Dutch system is provided by tight coordination within the trade union confederations and legal extensions of collective agreements. Indeed, the national recommendations negotiated by the social partners are preceded by extensive consultations between the national confederations and their sector and firm-level affiliates, which serve as the basis for their demands in negotiations over the national recommendations. Certainly, there is consultation between the different levels of employers' associations, although these internal processes within the employers' associations, as well as the means by which they arrive at decisions about their negotiating positions are less thoroughly understood than for the trade unions. However, these linkages between employers at different levels are far less developed and the consultation less intensive than among the trade unions (De Beer 2014). Furthermore, while trade union density tends to be quite low, membership of employers' associations is comparatively high, which helps to ensure high coverage of collective bargaining agreements (Hemerijck and Visser 1999).

Crucially, that affiliates at lower levels have had such an important role in deciding their confederation's demands in the national recommendations in turn helps to ensure that they actually abide by the recommendations that result. In this respect, the Dutch trade union confederations play a similar role in coordinating the activities of their sector-level affiliates as the German sectoral peak associations do with their regional bargaining committees. Moreover, the national confederations of the trade unions may refuse support to affiliates who deviate from the recommendations and cannot reach an agreement with the employers (De Beer 2104). This threat is particularly compelling where a failure to reach agreement might result in industrial action.

In addition to these mechanisms that have evolved within the social partners' organizations, the state does still maintain an important role in vertical coordination. Certainly, the SER no longer has any formal role in wage setting as it is now a strictly consultative body. However, the Ministry of

Social Affairs and Employment (Minszw) is responsible for registering agreements made by the sectoral social partners, and for extending the coverage of sectoral collective agreements to non-union workers. These legal extensions of collective agreements, as in Belgium but in stark contrast with Germany, are easily obtained and widely used in the Netherlands. A sectoral agreement in the Netherlands may be declared generally binding for workers in that sector where a specific proportion of workers are covered by it (Pentenga 2014), and where an extension is requested by one of the parties to the agreement. In the event, the trade unions request an extension of every agreement they sign (Bulk 2014). Members of employers' associations tend to employ a much larger proportion of the workforce than are covered by trade unions, and employ approximately 80% of the workforce (van het Kaar 2014). The high coverage of employers' associations makes this threshold required for a legal extension far easier to reach, which is one reason why the coverage of collective agreements is far higher than the low union density in the Netherlands would suggest. The minister maintains a host of other instruments inherited from past state-dominated incarnations of the Dutch wage bargaining system, such as imposing a wage freeze for a specified period and refusing to extend a collective agreement, although the former has never been exercised (Biemans 2014) and some trade unionists question the legal grounds underpinning the latter (Bulk 2014), which has never been exercised either (De Beer 2014).

#### **4.4.3: Horizontal Coordination in the Dutch Wage-Bargaining Model**

Horizontal coordination in the Dutch system is provided by the national recommendations themselves, which in Traxler and Kittel's (2000) phrasing are a form of intra-associational agreement as in Belgium. That is, while historically, national agreements on wages had been legally binding, following decentralization of wage setting to the social partners, national recommendations in the Netherlands, also as in Belgium, are non-binding but highly influential. Their function is to coordinate the demands made by the social partners' sectoral affiliates in negotiations that are otherwise



conducted separately from one another. The industrial arms of the trade union confederations, whose workers tend to be employed in trade-sensitive sectors, tend to be dominant during the negotiations of these recommendations (Borghans and Kriechel 2007, 6). This prominent role for industrial unions provides the crucial link between developments in exposed and sheltered sectors that authors such as Johnston and Hancké (2009) or Johnston, Hancké, and Pant (2014) have highlighted in cases of successful wage coordination under EMU. Several observers have noted that these recommendations have become less prescriptive over time, with the recommendations now suggesting a broad range within which wage demands should fall, rather than a specific target (Haket 2014). However, De Beer (2014) has argued that, averaged over time, wage dispersion between sectors in the Netherlands, i.e. the results of negotiations following these recommendations, is not significantly higher for these developments.

#### **4.4.4: The Calibration of the Dutch Wage-Bargaining Model**

Dutch negotiations over wage levels are calibrated to track developments in inflation and productivity in much the same way as German negotiations. From the late 1960s until the early 1980s, the calibration of Dutch wage negotiations had been very similar to those in Belgium, as an inflation correction mechanism had been an integral part of Dutch wage developments. However, whereas in Belgium, policymakers opted in the 1970s to entrench a firm link to inflation in law, this link in the Netherlands served to reinforce a spiral of inflationary pressures through the decade before being abolished in the early 1980s. In contrast with Belgium, the inflation link in collective agreements was never entrenched in law. Likewise, the Belgian response to its own crisis in the early 1980s was to introduce a legislated ceiling for wage growth. However, while state pressure was instrumental in convincing the trade unions to abolish inflation correction mechanisms, the guidelines that subsequently emerged for wage setting in the Netherlands were not legislated ones.

What emerged in place of wage indexation in the Netherlands was a practice developed by the trade unions of taking the sum of inflation and productivity growth, both calculated independently by the CPB, as a ceiling for their demands. This practice was intended, first, to avoid a repeat of the inflationary pressures of the 1970s, and second, to focus negotiations upon dividing the fruits of productivity gains. However, these figures are tracked more loosely in the Netherlands, where the figures guiding negotiations are calculated on a national basis, but where conditions in individual sectors, as well as a willingness by the trade unions to accept lower wage developments in exchange for protecting employment in economic downturns allow for some deviation from the coordination rule between sectors and over the economic cycle.

While the state role in Dutch wage setting has shrunk dramatically since the 1980s, the account by Johnston (forthcoming) of the Dutch wage pacts of the early 2000s also suggests a small state role in maintaining the system's calibration. Specifically, she finds that concessions on social policy reforms were essential to moderating inflationary wage demands of public sector unions that were later taken up by the national organizations of the trade unions. These material inducements in the early 2000s thus helped moderate the demands of these public sector unions that had filtered up to national negotiations. However, state inducements such as these exercise only an intermittent influence upon wage bargaining in the Netherlands and were not singled out by interviewees as a key component of the Dutch system.

#### **4.4.5: The Dutch Wage-Bargaining Model and EMU**

In the context of EMU, a system as decentralized as the Netherlands would be expected to struggle with intersectoral divergence. Following Johnston and Hancké (2009), one might expect that with the high and growing degree of autonomy afforded to bargainers in individual sectors would allow those in more sheltered sectors to pursue comparatively higher wage developments. Similarly, Johnston (2009) has pointed to a relaxation of wage discipline in the Netherlands in the early 2000s,

which she argues has necessitated a cyclical reimposition of wage moderation in the form of a social pact. Further investigation is needed to establish whether EMU was in fact the cause of greater volatility in wage settlements and if it is a pattern one can expect to persist.

#### **4.4.6: Section Summary**

In brief, while it shared several features with the Belgian wage-setting system in the early post-War period, Dutch collective bargaining has followed a very different path since the 1980s. In its modern form, vertical coordination is the product of tight coordination within the social partners' organizations, especially within the trade unions, high coverage of employers' associations, as well as support from the state in the form of legal extensions of collective agreements. Horizontal coordination emerges from the national recommendations, which, being non-binding agreements of the social partners that are nonetheless highly influential, are a form of intra-associational agreement. Although it practiced a form of wage indexation not dissimilar to that in Belgium in the immediate post-War period, the Dutch system was recalibrated to track inflation and productivity growth in the early 1980s.

#### **4.5: Chapter Synopsis**

In sum, this chapter has examined the cases of Belgium, Germany, and the Netherlands, three cases with longstanding traditions of coordination between the social partners on wages. In all three cases, post-War decision makers drew upon pre-War institutions in developing systems to coordinate wages. The Belgian and Dutch systems had for much of their post-War history a very close resemblance before diverging in the 1970s. They rely upon intra-associational agreements for horizontal coordination, then coordination within trade union organizations, coverage of employers' associations, and legal extensions by the state for vertical coordination. The German system relies

upon coordination within the trade unions as well, although vertical coordination is between sectoral peak associations and regional bargaining committees, with national associations of the social partners playing a much smaller role than in Belgium or the Netherlands. As in the other two cases, the German system relies upon broad coverage of employers' associations for vertical coordination, although legal extensions have traditionally played no role in German wage setting. The German model relies upon pattern setting for horizontal coordination, with wage setters following the settlement in a lead sector, although they have tended to follow it less closely of late. The German and Dutch cases are loosely calibrated to inflation and productivity, while the Belgian system is tightly calibrated to inflation and wage developments in three other EU countries.

The next three chapters build upon these points, examining in turn the experiences of Belgium, Germany and the Netherlands under EMU. Specifically, they focus upon what has happened as a result of wage-bargaining institutions and their key actors, having evolved as have in Sections 4.2, 4.3 and 4.4 meeting with a currency area designed along the lines outlined in Section 2.5.

## Part 2: Belgium, Germany, and the Netherlands under EMU

Part 1 examined the intellectual and empirical context of the study, while establishing the frameworks for comparing systems of coordinated wage bargaining and for conceptualizing institutional change. Specifically, Chapter 2 developed a framework for comparing each country's bargaining system on the basis of the mechanisms that it uses for delivering horizontal coordination, vertical coordination and calibration. These concepts are discussed in more detail in Section 2.3. Chapter 4, tracing the emergence of the Belgian, German, and Dutch wage-bargaining systems in Sections 4.2, 4.3 and 4.4 respectively, established that each uses a different combination of mechanisms for these purposes. Part 1 also outlined the pressures that EMU might be expected to exert upon coordinated systems of wage bargaining in Section 2.4.

Part 2 builds upon these foundations, examining in turn the actual experiences of Belgium, Germany and the Netherlands under the euro. It probes whether and how the differing designs of the Belgian, German, and Dutch systems subject them to the pressures outlined in Section 2.4. More precisely, it examines whether in each case the individual pressures outlined in 2.4 have caused institutional change of the sorts outlined in Section 3.3, namely *displacement*, *layering*, *drift*, *conversion*, and *exhaustion*. Chapter 5 examines the Belgian case under EMU and Chapter 6 studies Germany, while Chapter 7 turns to the Netherlands. Belgium does indeed show evidence of strain from EMU, although there is nothing to suggest that the single currency has caused changes to the Dutch or German systems. Rather, Chapters 6 and 7 find that institutional changes from other quarters are impacting the mechanisms that Germany and the Netherlands rely upon to coordinate wages under the euro and investigate the implications of these changes for their systems' functioning under EMU.

## Chapter 5: The Belgian Model under EMU

### 5.1: Introduction

This chapter examines the experience of the Belgian wage-bargaining model under the single currency. Specifically, it looks at Belgium's combination of internal coordination by the social partners and legal extensions for managing relations between bargainers at national, sector, and firm-level (discussed in Section 3.2.2), intra-associational agreements for managing wage developments across sectors (Section 3.2.3), as well as tight calibration to inflation and wage developments in other EMU countries (Section 3.2.4), and how this system has coped with pressures from EMU.

Interestingly, this chapter finds that under EMU, wage coordination has remained common practice in Belgium, and that the core mechanisms that it uses for coordinating wage negotiations remain intact. In formal legal terms, the Belgian system has remained unchanged since revisions in the mid-1990s. Beneath this apparent stability, significant concerns have been raised about the performance of the Belgian model and its fit with its new environment under EMU. Organizations such as the Banque National de Belgique (2012), Belgium's central bank, have raised concerns about the competitiveness of the Belgian economy against its closest trading partners in the EU. The Bank is not the only one to raise such concerns. Criticism has come from the OECD (2011), the Wage Dynamics Network (European Central Bank 2009), and several other outlets besides. Many of these concerns have turned on developments in Belgium's wage-setting system. Likewise, the Belgian social partners, and policymakers in government as well have raised concerns about the stability of the system, and the relationship between the social partners as well.

This chapter takes these concerns as its point of departure. It is structured as follows: Section 5.2 provides an overview of the Belgian model's performance under EMU. It reviews the claims of policymakers about the mechanisms that the Belgian system uses for vertical and horizontal coordination under EMU, finding that while the Belgian model has clearly struggled in some respects,

the mechanisms it uses to deliver horizontal and vertical coordination are not to blame. Sections 5.3 and 5.4 turn to the calibration of the Belgian system, examining in turn the processes of institutional drift and institutional displacement introduced above. Section 5.5 concludes.

This chapter argues that the mechanisms that the Belgian system uses to maintain horizontal and vertical coordination are not in themselves incompatible with EMU. Indeed, consistently low wage dispersion between sectors suggests that horizontal coordination remains taut. Few complaints have been raised by policymakers and the social partners about the practice of internal coordination within trade union organizations, the breadth of employers' organizations coverage, or the use of legal extensions under EMU. However, the calibration of the Belgian model, tightly tracking inflation and wage developments elsewhere poses serious challenges under EMU because policymakers have fewer instruments for managing the economy and where the social partners have less room to bargain over wages. Indeed, the calibration of the Belgian system under EMU has begun two important processes of institutional change in Belgium that put its model under growing strain.

First, while the index and wage norm do keep the evolution of wages on a steady trajectory, they have struggled to keep the Belgian economy competitive with those of its neighbours and closest trading partners. Specifically, while Belgium's wage norm does help to correct for competitiveness problems, it does so only slowly. Certainly, this is not a new development, but instruments such as currency devaluation that had been used to offset the worst effects of the system's slow corrections are no longer available under EMU. Thus, the loss of other policy instruments has begun a process of institutional drift in Belgium, whereby its continuing to function in this new context as it has in the past is increasingly manifesting itself as lost competitiveness.

Second, the practice of conducting wage negotiations between a hard floor in the form of the index and a firm ceiling in the wage norm have had deleterious effects upon the social partnership itself under EMU. Indeed, with the inflation informing the index being stable in the pre-crisis period, wage moderation in Germany and the Netherlands under EMU has lowered the ceiling

for Belgian wage negotiations (as in Figure 4). This development makes negotiations increasingly delicate but tense and means that a growing proportion of wage increases are delivered by the index, and not by the social partners. As a result, the social partners are being slowly squeezed out of the wage-setting process. Interestingly, while the evolution of Belgium's wage index, with growing complexity in the application of the index and increasingly delicate negotiations invokes Streeck and Thelen's (2005) notion of institutional exhaustion, these developments do not suggest an end to wage coordination in Belgium. Rather, this growing role for the index engenders a worrying process of institutional displacement, whereby challenges for the social partners are threatening their role in the vertical coordination of the system. At the same time, this development accentuates the role of the state-enforced index at the expense of the social partners' role. In the short term this change has resulted in reduced governability, but may in time increasingly make the Belgian system resemble the stricken, state-dominated mixed systems currently in crisis.

## **5.2: Areas of Continuity from the Pre-EMU Period**

As noted in Chapter 4, the Belgian model could be expected to cope well the pressures for relaxed wage discipline and a divergence between wage developments in sheltered and exposed sectors. Indeed, the pressures emanating from the delegation of monetary authority from a national central bank to a European one could be expected to be well-contained by the Belgian system. Some of the pressures from lost policy instruments, particularly for decentralization could be expected to be well-handled as well. Section 5.2 argues that in practice, this is exactly what has happened in Belgium under EMU. It considers in turn pressures for relaxed wage discipline, growing wage dispersion, and then pressures for decentralization. It argues that the mechanisms that the Belgian system uses to manage horizontal and vertical coordination have coped well with direct pressures from the single currency. Rather it is the calibration of the Belgian system that has emerged as a point of concern for policymakers.



As van Gyes (2013) has noted, wage developments in Belgium have continued on a consistent trajectory under EMU. This point has been echoed even by critics of the Belgian model within the Commission. Indeed, it notes that on unit labour costs under EMU, while the Belgian economy has underperformed Germany, Finland and Austria, it has fared similarly to France, slightly better than the Netherlands on balance, and is average among EMU countries (Commission 2013a, 12). The Commission does however include a caution about an emerging competitiveness problem against Germany because the Belgian wage norm can redress these problems only very slowly (Commission 2013a, 30). These dynamics are borne out in official figures on unit labour costs in Figure 2, which follows Belgian wage developments since 1997, the first round of bargaining under the 1996 law that introduced the wage norm. Therein, Belgium can clearly be seen underperforming Germany since the time prior to the beginning of EMU in 1999 and the Netherlands since 2004.

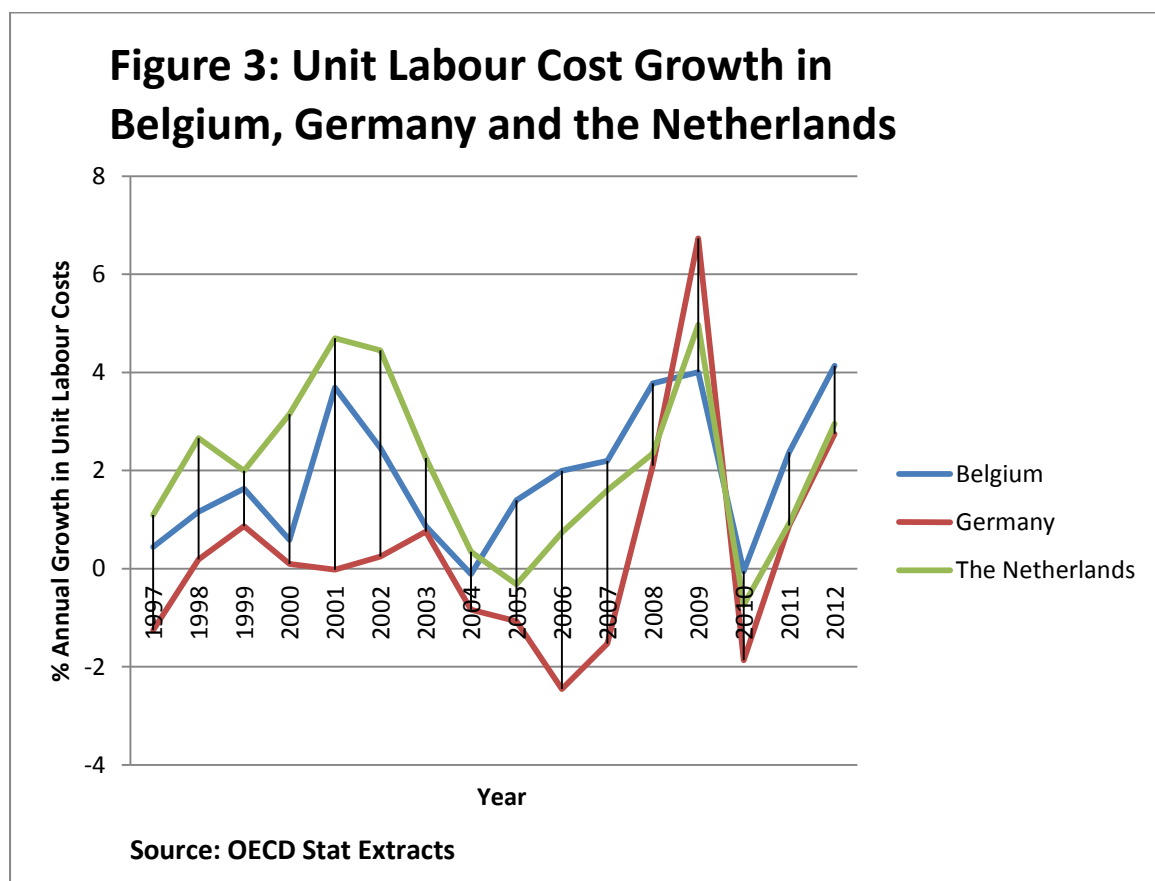


Figure 22

As this section argues, there is no evidence that wage growth in Belgium has increased dramatically absent the threat of discipline from a national central bank, even if this positive view does require some qualification. This development is all the more striking given Maes and Verdun's (2009, 94-5) observation that the pressure to meet the convergence criteria on inflation and long-term interest rates had a powerful focusing effect upon minds within the Belgian central bank during the 1990s. They similarly note that reforms to the Bank's statutes in anticipation of euro adoption gave it more independence in pursuit of that goal. Consequently, and with some qualifications, wage developments in Belgium hardly mark it out as a laggard despite a seemingly powerful constraint upon wage setters being lifted by euro adoption.

Moreover, following the concerns of Abraham and van Rompuy (1999), who fretted that Belgian wages were too tightly coordinated across sectors, Belgium has not witnessed a divergence between developments in sheltered and exposed sectors. Indeed, where Abraham and van Rompuy (1999) had cited this as a point of concern, framing tight horizontal coordination as a lack of flexibility, following the observation by Johnston and Hancké (2009) that EMU creates inflationary pressures in sheltered sectors, this taut horizontal coordination has likely been a point in Belgium's favour. Indeed, what appears to Abraham and van Rompuy (1999) as rigidity seems to have helped to contain inflationary pressures in the sheltered sectors of the Belgian economy.

What is particularly interesting is that after 1999, when the exchange rates of prospective EMU countries were locked as part of the euro adoption process, wage developments in sheltered and exposed sectors have only become more synced (Johnston and Hancké's 2009: 615). Certainly, Vandekerckhove and van Gyes (2012, 16) have noted that there are persistent differences between sectors in actual wage levels for otherwise similar workers. However, the evolution of wages is very similar across sectors. Furthermore, while the observations informing Johnston and Hancké (2009) end in 2006, their point that EMU has not undermined the horizontal coordination of the Belgian system is one echoed by interviewees referring to the time since (Dos Santos Costa 2013; van Gyes

2013). In some respects, that wage developments in different Belgian sectors have not diverged under EMU is unsurprising. Indeed, the system's tight tracking of inflation and the wage norm limit the room for manoeuvre of negotiators at sector level just as much as at national level, even if individual sectors retain some discretion over how to apply the index. In fact, a representative of a Belgian employer made precisely this connection (Interviewee 8 2013). Likewise, as the next parts of this chapter will explain in more detail, the countries whose wage developments inform the wage norm have responded to EMU with wage restraint, hence lowering the wage norm and further limiting the scope for different sectors in Belgium to diverge.

These observations by both scholars and interviewees suggest that the horizontal coordination of the Belgian system has thus far successfully contained pressures from EMU. Why this is the case is less clear, however. Indeed, the above suggests that the highly restrictive calibration of the system has had a hand in keeping a tight link between wage developments across sectors. This observation is particularly troublesome when so many interviewees and independent assessments have for other reasons cited the Belgian system's calibration as something that must change under EMU. However, as will become clearer in the examination of the Dutch case in Chapter 7, the sorts of intra-associational agreements used in both Belgium and the Netherlands are highly compatible with EMU. Certainly, the wage norm's restricting of sector-level actors' room for manoeuvre has done just that, although comparison with the Dutch case does suggest a powerful independent effect of intra-associational agreements of the sort that Belgium employs.

Moreover, no interviewees saw a significant challenge in mismatches between a central bank rate set for the entire euro area and national condition. Instead, many noted that shadowing German monetary policy well prior to EMU had had similar effects, and that the single currency presented no new challenges in this respect. Thus, the Belgian system has coped well with pressures emanating from having delegated authority from a national central bank to a European one, even if the Belgian

case alone does not suggest conclusively whether its intra-associational agreements or its calibration are responsible.

The literature had also suggested the possibility of strains upon the vertical coordination of Belgium's wage bargaining because of lost policy instruments under EMU. Certainly, there is persistent pressure to loosen the vertical coordination of Belgium's system. In some cases, this appears as pressure for decentralization in Belgium, although it has been argued that this is better framed in the context of Belgian regional divisions than pressure from the single currency (e.g. Dos Santos Costa 2013), and has not been acted upon in any event. On that subject, Dos Santos Costa (2013) noted that "we are in a very centralized system, which makes that everyone will have the same wage raises, and...if you go to something more decentralized...[to the regional level] you are going to...really deepen the contrast between the regions, and this is really a threat for Belgium as a country". Dos Santos Costa (2013) further noted that institutional change of this sort was hardly imminent, but the point is that comments along these lines were very typical, in that they frame moves for decentralization in terms of pressure from Belgium's regions, rather than pressure from EMU.

Regional quirks and a highly centralized wage-setting system have combined to produce some interesting dynamics under EMU, although there is no indication that that this has led to institutional change. A representative of a Belgian employer did note with some consternation that highly uniform wage developments across Belgian regions made for a mismatch of wage evolution and local productivity developments (Interviewee 8 2013). One observer in government noted as well that differences in productivity growth between exporting sectors and sheltered ones have made for different evolutions of unit labour costs beneath near-uniform wage evolutions (Interviewee 4 2013). One representative of the trade unions made a similar observation (dos Santos Costs 2013). Pressures such as these are more acutely felt under EMU, although there is no evidence to suggest that a decentralization to redress them is being considered.

Other reform proposals have considered 'opt outs' from sectoral collective agreements that would allow for closer matches between wages and local conditions and presumably avoid the legal extensions that are frequently used in Belgium, hence loosening the vertical coordination of the system. Recommendations along these lines which would decentralize and disorganize the system have been common among Commission recommendations (Interviewee 9 2013). However, while there are discussions around institutional change in Belgium, they have explicitly ruled out these sorts of 'opt outs' (Interviewee 9 2013).

However, while the mechanisms that deliver horizontal and vertical coordination in Belgium have coped well with direct pressures from EMU, this apparent institutional stability coexists with grave concerns about the health of the Belgian system. There is evidence of weakening linkages among different levels of the trade union confederations, which have hitherto been very important to the governability of the system. There is also evidence of a more strained relationship between the social partners under EMU. These developments present challenges for the vertical coordination of the system, but as the next section argues, they do not suggest any inherent incompatibility between these mechanisms and EMU. Rather, they are the consequence of the calibration of the Belgian system in its new environment under the single currency. Echoing all of these points, interviewees have largely avoided citing the mechanisms that Belgium uses for horizontal and vertical coordination as points of concern under EMU. Instead, those interviewees finding fault with the Belgian system have focused upon its calibration (Interviewee 4 2013; Interviewee 7 2013; Interviewee 8 2013; Interviewee 9 2013).

In sum, the Belgian system has resisted pressures for relaxed wage discipline, increased wage dispersion, and for decentralization as well. What much of this suggests is that the mechanisms that the Belgian system has used to deliver horizontal coordination, i.e. its system of biennial intra-associational agreements, as well as its use of coordination within social partner organizations and legal extensions are not in themselves incompatible with the single currency.

### **5.3: Institutional Drift in the Belgian Wage-Bargaining System**

In formal legal terms, the Belgian model was last amended in 1996, when the legislation introducing the wage norm in its current form was passed (Vandekerckhove and van Gyes 2012). However, two government officials recalled that even at the time, it was understood in policymaking circles that these reforms would be insufficient for the challenges that Belgium was to face under the single currency (Interviewee 4 2013; Interviewee 9 2013). While discussions had countenanced a significant rethink of Belgium's system of wage indexation, i.e. a more significant recalibration, the index was left largely unchanged. That further-reaching changes were not made stands as a point of concern under EMU, where such a close tie to inflation makes corrections in the event of downturns or lost competitiveness very slow.

This section argues that the calibration of the Belgian system in its new context under EMU has been the cause of a process of institutional drift, whereby the Belgian system, unchanged in a new context, is producing two new and worrying effects. First, the index's inbuilt struggle with competitiveness against other EMU economies has much more acute consequences in a context where policymakers have fewer instruments for dealing with the symptoms of this problem. Second, where the countries whose wages inform Belgium's wage norm have responded to EMU with wage discipline, the space for the Belgian social partners to negotiate has narrowed significantly and is straining the relationship between the social partners.

#### **5.3.1: Wage Indexation and 'Overheating' Under EMU**

As part of joining EMU, Belgium surrendered the use of currency devaluation. The effects of this choice have been acutely felt in Belgium, where currency devaluation had served as an important pressure release when indexed wages grew beyond those in neighbouring countries. The utility of an

independent currency for Belgian policymakers was very much the case in the economic crisis of the early 1980s, where a sharp devaluation of the Belgian franc in 1982 was used to offset competitiveness problems that had accumulated since the mid-1970s. Even then, the spurt of growth that followed depended as well upon the radical step taken by the government of the day to suspend the application of the index (Maes and Verdun 2005, 334). By contrast, when Belgium adopted a firm peg to the deutschmark in 1990 (Bank National de Belgique 2014), what followed the subsequent round of wage inflation was instead hurried discussions over institutional change, absent the ability to devalue.

The wage norm that resulted from these hurried discussions can only deal with competitiveness problems *ex post* (Interviewee 4 2013; Interviewee 9 2013), meaning that it can only redress competitiveness problems after they have emerged by freezing real wages or constraining subsequent wage growth. It does this rather more slowly than currency devaluation because it cannot by law override the application of the wage index. Hence, wage freezes that the wage norm can trigger only prevent increases beyond those mandated by the index, freezing wages in real terms. This state of affairs in Belgium contrasts sharply with that in the Netherlands or Germany, where the social partners are able to negotiate a freeze in nominal terms, which in practice often means a cut in real wages.

Consequently, the reforms put in place in anticipation of EMU failed to deal with the model's inbuilt tendency to overheat, while adoption of the single currency removed an effective means of cooling it. Indeed, where Johnston and Hancké (2009) also note that wage moderation had been the order of the day for the period to 2006, the Belgian Central Bank takes 2007 as the beginning of an emerging wage handicap against the rest of the Eurozone (BNB 2012). In this respect, Belgium compares unfavourably with the performance of the German and Dutch models, which are calibrated to productivity and inflation, but less tightly synced to the latter. As a result, the Dutch and German social partners can correct for economic shocks and emerging competitiveness gaps more quickly.

Hence, the growing wage handicap in Belgium against these countries since 2007 (BNB 2012) is a source deep concern from observers in government (Interviewee 4 2013; Interviewee 9 2013) and from an employer as well (Interviewee 8 2013). This shortcoming in the Belgian system is all the more troubling given that under EMU, wages are relied upon to play a much more central role in protecting economic competitiveness. However, that it has emerged as an issue under EMU is perhaps unsurprising, given that even early theorists of monetary integration following Mundell (1961) had stressed the need for flexibility in real wages of the sort that is incompatible with the Belgian system. Observers outside Belgium have taken note of this problem as well, with the Commission echoing these sentiments in occasional papers and in its Country Specific Recommendations (Commission 2013a, 29; Commission 2013).

As Figure 2 makes clear, in the pre-crisis period, growth rates in unit labour costs began to diverge from those of Germany and the Netherlands in 2004. To be sure, the difference in growth rates is subtle and comes at a time where both Dutch and German wage costs were growing as well, but it does bear out the concerns raised by the Belgian central bank. With the wage norm correcting only ex post, these competitiveness gaps have a tendency to accumulate, and to linger as well. This development in Belgium stands in contrast with the Dutch and German systems, where the social partners are able to negotiate wage developments below the rate of inflation to correct for economic shocks. Where the Belgian system can only correct for competitiveness problems and shocks after they emerge, the Dutch and German systems are able to respond to new developments far more quickly. Figure 2 illustrates this struggle for Belgium, with an emerging gap in wage costs with Germany and the Netherlands from 2004 and a less sharp correction during the acute phase of the economic crisis. Figure 2 also shows a much sharper acceleration of wage cost growth in Belgium than in Germany or the Netherlands following this correction as well.

As Figure 3 notes, the Belgian system's inability to respond like the Dutch and German systems to economic shocks puts it in interesting company in the time between 2005 and the onset



of the crisis. Certainly, figures for 2008 onward do show a very rapid decline in crisis countries' wage costs, vastly outpacing Belgium's response to the crisis (OECD 2014b). These changes, however, are not the product of bargaining systems' normal functioning in crisis countries, but more likely the drop in wage costs is explained by the suspension or dismantling of large sections of their wage-bargaining models as a response to the crisis.

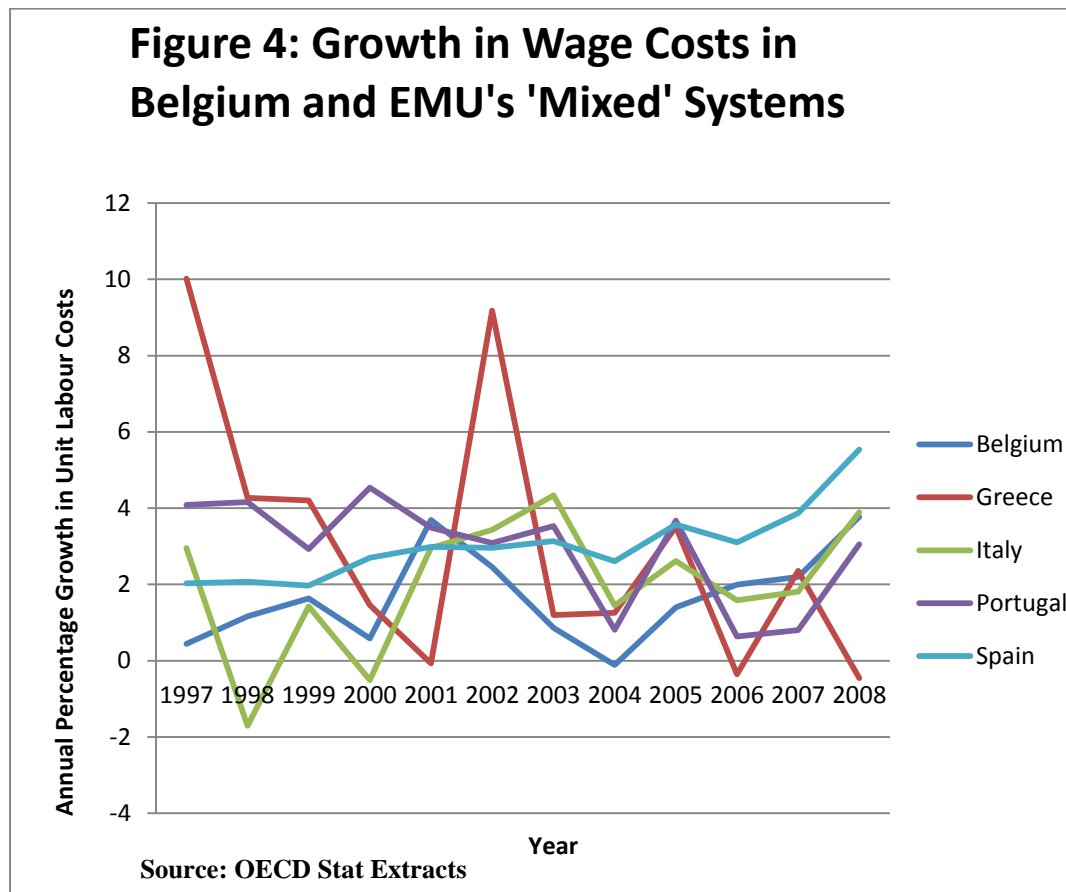


Figure 33

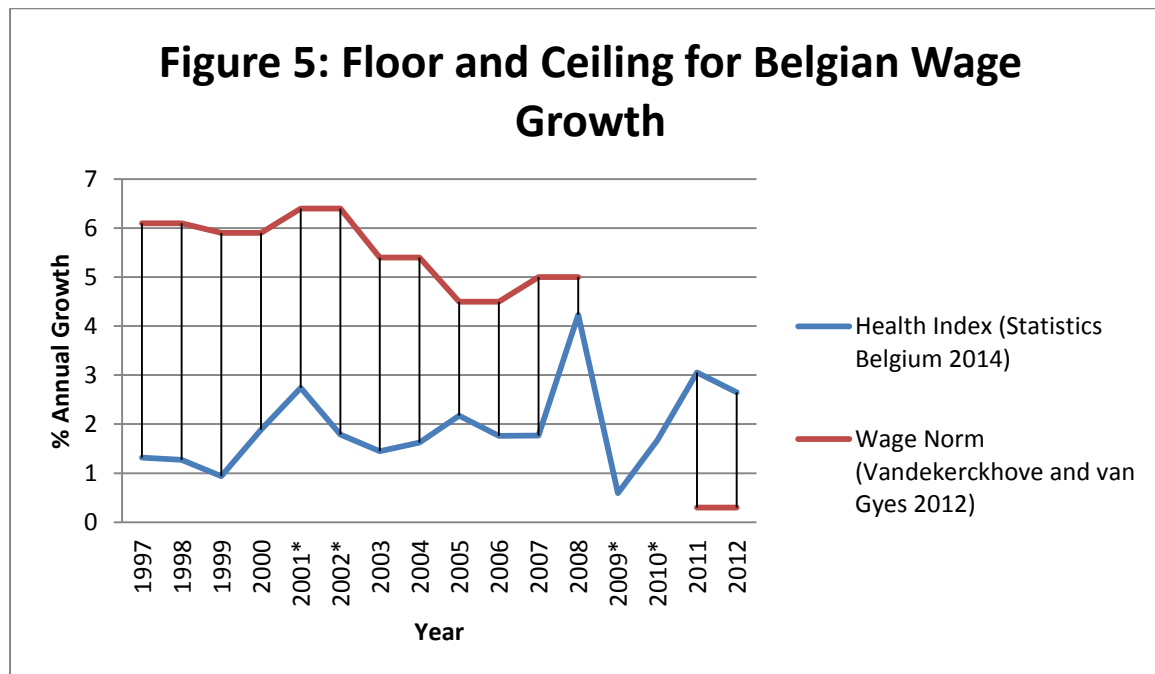
What is also notable is that where previously the Belgian model had been calibrated to expected inflation, with all of the problems with overshooting and correction that this entails, its current practice of tracking past inflation (Vandekerckhove and van Gyes 2012, 17) through the crisis would have slowed wage adjustments, as would the wage norm's inability to override the index. As a result and in addition to chronic problems with overheating, the calibration of the model leads it to struggle with cyclical adjustments as well. In past downturns, the option to devalue to Belgian franc would have had a moderating effect upon Belgium's competitiveness gap with its neighbours.

However, without this option under EMU, Belgium bears the worst effects of an inability to vary wage levels as many of its neighbours can. Belgium's trouble with cyclical adjustments was very much in evidence through the crisis. Indeed, from Figure 2, while the social partners in Germany and the Netherlands made a sharp correction in wage growth in response to the economic crisis, strict application of the index in Belgium made this correction far more difficult, with growth in Belgian wage costs outstripping that of Germany and the Netherlands. This comes despite very low increases above the index allowed by the wage norm for 2009-10 and a freeze in increases above the index for 2011-12. Certainly, the slow cut in Belgian wage costs did help preserve purchasing power through the downturn, although the Belgian system's inability to override the application of the inflation index clearly puts it at a competitive disadvantage against Germany and the Netherlands.

Just as interestingly, the meeting of rigidities in wages with a context offering fewer adjustment mechanisms has had important consequences for firm responses to the economic cycle as well. Indeed, a representative of a Belgian employer has noted that Belgian companies, unable to vary wages, or renegotiate wages, are more apt to rely upon dismissals for reducing costs. This point is noted by Vandekerckhove and van Gyes (2012, 16) as well. More interesting still, Vandekerckhove and van Gyes (2012) have noted that higher-skilled white collar employees are more apt to have wages and benefits above the minimum mandated by the index. In downturns, this cushion can be cut in lieu of termination. By contrast, for case of lower-skilled workers without such a cushion, termination is a much more common response to downturns than in other coordinated systems (Interviewee 8 2013). This point is echoed by an official at the Belgian employment ministry (Interviewee 9 2013). Thus, the calibration of the Belgian system and greater reliance upon wages for adjustment has both competitiveness and distributional consequences.

### 5.3.2: The Wage Norm and the Falling Ceiling for Wage Negotiation

As the Belgian system is calibrated to wage developments in France, Germany, and the Netherlands with the wage norm, changes in their behaviour under EMU is impacting the Belgian system as well. Figure 4 below traces these developments in the wage norm since the first round of bargaining under the 1996 law introducing the wage norm in its modern form. It sets these developments against the evolution of the Health Index, which forms the basis of Belgium’s wage indexation system. In Belgium, the social partners bargain in the space between the index, which sets a minimum for wage increases, and the wage norm, which sets a ceiling. As Figure 4 makes clear, the ceiling for Belgian wage developments has dropped since euro adoption. Given wage discipline in Germany throughout this period and the Netherlands after 2004, this development should not be surprising. More to the point, the ceiling set by the wage norm has come progressively closer to the floor set by Belgium’s wage index, dipping below it during the crisis. Thus, as a result of EMU, the space that the social partners have to negotiate, i.e. that between the index and wage norm, has shrunk significantly.



Notes (Vandekerckhove and van Gyes 2012):

- For 2002-3, the wage norm was as high as 7% in some sectors
- For the two years covering 2009-10, the wage norm allowed a maximum wage increase of 250 euros

As a result of this reduced room for negotiation, the negotiations themselves have become ever more delicate, and the relationship between the social partners has become tenser in sector-level negotiations (Interviewee 4 2013; Interviewee 8 2013; Interviewee 10 2013). Likewise, the suspension of wage negotiations for 2011-12 and 2013-14 triggered by wage growth outpacing the wage norm has been a significant point of contention for the trade unions (Interviewee 10 2013). A representative of a Belgian employer raised concerns about the health of the social partnership more broadly as a result of the suspension of negotiations (Interviewee 8 2013).

Interestingly, while the room for the social partners to negotiate over wages has narrowed, the focus of these negotiations has broadened in response. Indeed, negotiators have increasingly come to haggle over other issues, such as benefits, retirement, training, and the like where there is more space to bargain (Dos Santos Costa 2013; Interviewee 8 2013; Interviewee 9 2013; van Gyes 2013), attempting to find needed flexibility on these issues where they could find none on wages. By one account, this strategy has channelled some of the best creative impulses of the sectoral social partners, where agreements over perks and benefits are often cleverly trimmed, tailored, and targeted to avoid them counting against the wage norm (van Gyes 2013). Nonetheless, for the unions this makes the discussions increasingly opaque and technical (Lamas 2013) at a point in time where their ability to connect with affiliates and members is increasingly being challenged (Interviewee 10 2013). This same interviewee, reflecting upon the changes in the bargaining process that he had observed over years with a Belgian trade union confederation, stated that:

“it’s more complicated the stuff we negotiate... and it’s very difficult to defend the agreement when you go back to your affiliates and you try to defend. Sometimes it’s so technical that it’s very difficult to explain, because when it was so simple as 'okay we obtain 2 more days of vacation leave, or employment creation, or increase in wages', and now sometimes there are mechanisms of training schemes, but so technical that nobody understands.”

This broadening of negotiations poses different problems for the employers, in that while negotiating over non-wage issues does offer some flexibility, they nonetheless still add labour costs in the context of a model that struggles with wage inflation in the first instance (Interviewee 8 2013). What this means is that while the social partners have taken steps to adapt to restrictions from the falling wage norm, the root problem of reduced room for manoeuvre and heightened tensions between them remains. Recalling the point by Blanchard and Philippon (2006) about the connection between quality of labour relations and unemployment this trend in Belgian industrial relations is a worrying one.

In sum, the meeting of the Belgian system's calibration and EMU has triggered two processes of institutional drift. First, the model's inbuilt problems with wage inflation are exacerbated in a context where policymakers have fewer instruments to address the symptoms of them. Second, where those EMU countries whose wages inform the Belgian wage norm have responded to EMU with wage discipline, the scope for the Belgian social partners to negotiate has narrowed considerably, which has complicated and strained their relationship.

#### **5.4: Institutional Displacement in the Belgian Wage-Bargaining System and the Squeezing Out of the Social Partners**

As Section 5.2 noted, in formal-legal terms, the Belgian system has remained largely unchanged since the mid-1990s, and despite much concern about the model's performance, many of the mechanisms that it uses to maintain horizontal and vertical coordination seem at home under the single currency. This section takes as its point of departure the observation in Section 5.3 that the space allowed to the social partners by the Belgian system's calibration has narrowed significantly under EMU. It argues that this development is not only straining the social partners' relationship, but

increasingly squeezing them out in favour the 'automatic' and state-driven elements of the model in two respects. First, the social partners' decreased room for manoeuvre means that the legislated and 'automatic' elements of the system decide a much larger proportion of Belgian wage developments. This in turn is having adverse feedback effects upon the social partner organizations and damaging the mechanisms that they use for vertical coordination. Second, the responses of the social partners to this reduced room for manoeuvre is increasingly inviting state involvement, which reduces their role still further.

As Figure 4 makes clear, the range for wage negotiation between the hard floor of the index and the ceiling set by the wage norm has become progressively smaller under EMU. This change has taken place because while Belgian inflation under EMU has remained largely similar to the period prior, wage moderation, particularly in Germany and the Netherlands, has lowered the ceiling for wage negotiations (Interviewee 4 2013). In this context, the index has become even more 'automatic' (van Gyes 2013), where a growing proportion of wage developments are decided by the legislated index, and not by negotiation between the social partners. In other words, the social partners have a progressively smaller role in deciding wage developments. In fact, the discussions of the sectoral social partners are hardly concerned with wages anymore (van Gyes 2013).

In addition to having their room for manoeuvre constrained by the automatic legislated components of the Belgian system, the ways in which the social partners have responded by inviting the state to take on a larger role in wage setting in two respects. First, the tenser and more complex negotiations that take place in the small band between the index and wage norm are more apt to see government intervention in the form of a wage freeze, either because negotiations fail, or because the social partners cannot keep wages below the agreed wage norm. Second, in attempting to find flexibility in negotiations by broadening them to include benefits, these discussions increasingly involve negotiation with the state. As a result, the social partners are progressively less engaged in

the process of collective bargaining, while the state is becoming more involved through automatic legislated mechanisms, and as a participant in the process as well.

Interestingly, the trade unions in particular have pointed to a growing lack of engagement by the social partners in the bargaining process as a result of reduced room for manoeuvre under EMU. Admittedly, industrial relations in Belgium are not known for being especially harmonious in the first instance. For instance, one Dutch trade unionist recalled a Belgian colleague contrasting the tenor of wage negotiations in their two countries, saying that “you [in the Netherlands] start with talking and end with striking, while we [in Belgium] start with striking and end with talking” (Pentenga 2014). Nonetheless, on Belgian one trade union official in particular has argued that with so little room to negotiate, the social partners face fewer incentives to bargain in good faith. Indeed, they insist that, facing a hard floor for wage settlements, employers have fewer incentives to complete an agreement, where failed negotiations may trigger a government-imposed wage freeze (Lamas 2013). In a system that struggles with cost competitiveness at the best of times, the prospect of triggering a wage freeze would indeed be an enticing one for employers, even if it is one that compromises their role in the wage-setting process. Specifically, this trade unionist noted that:

“Employers are more aggressive and the employers know if there is no agreement, the government will accept more easily to intervene...That is one of the problems, more and more in Belgium and other countries the employers didn't want to negotiate with us because they say 'let's do nothing like that, and we will see: if [the trade unions] don't want to negotiate or go in our direction, we will receive more with the intervention of the government.’”

(Lamas 2013)

The trade unions have adopted a similar scepticism to the process of bargaining as well. Indeed, with so little space for negotiation above the minimum increases mandated by the index, the gains from participating in what is an increasingly strenuous bargaining process are very limited.

Consequently, the bargaining process is increasingly unappealing for the trade unions as well (Lamas 2013). A representative of a Belgian employer added some nuance to this position, noting that while the trade unions tend to favour the index, demonstrating their utility to their members requires that they negotiate wage increases in excess of what the index provides (Interviewee 8 2013). With so little room to negotiate under EMU, this goal is one that they are far less apt to meet. Indeed, one trade union official argued that in the current context, with so few of their demands being met, trade unions face fewer incentives to bargain (Lamas 2013). Lamas summarized the dilemma for the trade unions, stating: “it’s true also that we see it more and more complicated the negotiations, so the problem is do you want still to negotiate? The answer is yes, but to negotiate what? If the answer is to negotiate only concessions, you say ‘no’”.

Conversely, while the low ceiling for wage increases is putting off the trade unions, it is unlikely that wage settlements that would come from much more intense negotiation would be much better than those mandated by the index anyway (van Gyes 2013). As with the employers then, the calibration of the Belgian system under EMU presents the trade unions with a set of circumstances where the immediate needs of their members are met, but which compromises their position in the bargaining process. One employer said of this dilemma for the trade unions:

“Because of this, there is practically no common ground anymore to conclude a wage agreement between the social partners, so the only thing that can solve this is if economic growth becomes very high again, but this is not what we expect, although they are becoming much more conscious of the fact that at a certain time, at a certain moment, they need to decide what is the most important for us:...Are they going to choose for the social dialogue, but that means okay, we are going to need to see how can we reform this indexation, or are they going to say ‘no we are going to stick with this indexation, but this means that for the next years, social dialogue will be almost dead, or almost non-existent’ and it will always be the government that needs to fix the wage-norm.”



(Interviewee 8 2013)

Moreover, where the social partners are increasingly taking a dim view of wage negotiations, the state is becoming more active in policing these narrowed boundaries of these negotiations under EMU. Indeed, where the index limits the social partners' ability to control wage drift, under EMU the state is now more apt to play a direct role in correcting for it. Absent currency devaluation, where constraints on fiscal policy limit its ability to provide material inducements to the social partners in exchange for wage restraint, combined with a hard floor and ceiling for wage developments, the state is obliged to intervene more directly in the form of an imposed wage freeze. Furthermore, the narrowing gap between the index and the wage norm, as well as neighbouring countries' habit of responding to economic shocks with wage moderation make a wage freeze much more likely in response to both cyclical and chronic competitiveness gaps.

More to the point, these sorts of interventions are not only a source of resentment and tension with the unions (Interviewee 4 2013; Interviewee 9 2013; Interviewee 10 2013). Indeed, where wage freezes in the Netherlands, for instance, are a negotiated affair between the social partners, though often at the behest of the state, Belgian wage freezes are the result of failed negotiations or violations of the wage norm, and suspend negotiations between the social partners altogether. Nor is this a purely hypothetical concern, where the growing wage handicap in Belgium from 2007 and wage moderation in Germany and the Netherlands because of the crisis resulted in a wage freeze in Belgium for the 2011-12 and 2013-14 bargaining rounds. Not only do these wage freezes involve the state in a much more direct way, but with the suspension of wage bargaining throughout this period and likely beyond, concerns have been raised about the social partnership slowly beginning to atrophy (Interviewee 8 2013; Interviewee 9 2013). In turn, this raises questions about the social partners' willingness and ability to resume an active position in the wage-setting process.

What is particularly interesting about this development, and indeed worrying, is that a reduced role for negotiation between the social partners is creating feedback effects that are undermining the ways that they implement and enforce wage settlements. This has important implications for the vertical coordination of the system. In particular, several observers, and indeed representatives of the trade unions themselves, have noted that this lost room for manoeuvre is eroding linkages between different levels of the trade union organizations.

Speaking to this reduced space to bargain, one official with a national trade union confederation, though disagreeing strongly with making changes to the index, raised concerns about a growing lack of negotiation over wages (Interviewee 10 2013). Indeed, they noted that where a growing proportion of wage increases are credited to the index and not to negotiations conducted by the confederations, questions within the trade union movement were being raised about the confederations' value to their affiliates, and ultimately to the workers that they represent (Interviewee 10 2013). They cast this issue as one that is undermining the linkages between the different levels of the trade unions (Interviewee 10 2013). A similar point is raised by van Gyes (2009), who notes a disconnect between the national confederations of the trade unions and their sectorial affiliates on wage moderation. Where these links between levels in the trade union movement have played an important role in the vertical coordination of the system, their deterioration could ultimately weaken its governability. A representative of a Belgian employer has pointed to this dynamic as well but with an important twist, noting the trade unions' tendency to push for wage increases in excess of the index-mandated minimum as a show of utility to members (Interviewee 8 2013), which is now much more difficult under EMU. Indeed, they found that with the index "this wage increase is automatic: companies still need to pay for it, but there is no negotiation between trade unions, with trade unions, but trade unions want to negotiate because they want to say to their members 'okay we're here for you and this is what we have achieved'. They cannot say this with the automatic wage indexation because they have this already achieved, so automatically

there is a big pressure to increase wages even further than this automatic wage indexation...and there is a big pressure for wages to increase faster” (Interviewee 8 2013).

While one observer cites concerns in government circles about the linkages between negotiators at different levels that go back to the early 1990s (Interviewee 4 2013), all of this chimes with the observation made by van Gyes (2013) that there is a growing disconnect between the national and sectoral branches of the trade unions. Specifically, for the national confederations, wage moderation is an increasingly hard sell to their sectoral affiliates, particularly in the service sector (van Gyes 2013). For negotiators at sector level, these tight restrictions on their talks over wages mean that they are very apt to rely on more simplistic bargaining strategies on wages, where negotiators will refer to company profits and other figures fed to them from firm-level union officials, but are far less apt to rely upon extensive economic research or broader economic forecasts (van Gyes 2013). This suggests not only declining linkages between firm, sector, and national trade union organizations, but also eroding organizational capacity on the part of Belgian trade unions. This development is doubly concerning considering how much more delicate these negotiations are because of the social partners’ limited room for manoeuvre, and how much more complex and technical they have become, with the broadening of the scope of negotiations to include benefits. In this respect, the contrast with Dutch negotiations, in which linkages between union negotiators at different levels have only become tighter, for instance couldn’t be starker. Developments in Belgium also contrast with those in Germany, where firm-level works councils are now charged with a larger role in wage negotiations, but maintain very close links with the trade unions. Indeed, these German developments are suggestive of a managed decentralization, rather than a disconnect between levels of the sort that is increasingly evident in Belgium.

Furthermore, even in areas where the social partners have remained engaged and highly active, the state has come to play an ever more important role in the negotiations themselves. Indeed, where the social partners have attempted to find flexibility on benefits where they could find

none on wages, broadening the scope of collective bargaining also means that government must be included more prominently in negotiations. Indeed, because talks over benefits increasingly touch upon issues where there is a well-developed state role (Lamas 2013), including them in negotiations compounds the problem of the social partners' shrinking role. These developments stand in contrast with those in the Netherlands, where the state's role in structuring wage negotiations was trimmed in the 1980s and has not grown back under EMU, and where its role as a party to wage negotiations remains intermittent, rather than expanding. It contrasts with developments in Germany as well, where the autonomy of the social partners remains jealously guarded.

In short, the calibration of the Belgian system has meant that where inflation has remained stable, and where the countries whose wages inform the wage norm have met EMU with wage moderation, the room for the social partners to negotiate has become much more limited. This shift in other countries, imported through the Belgian wage norm, has begun a process of institutional displacement, whereby the role of the social partnership is slowly being overshadowed by the state. In part, this is because with so little room for negotiation, the legislated wage index plays a proportionately larger role in deciding wage developments in Belgium, while wage freezes are more likely responses to competitiveness problems. It is also because the state is being engaged more actively in the negotiation process, where limited flexibility on wages has seen the social partners attempt to find common ground on issues that include a well-developed state role. This reduced room for manoeuvre is in turn having feedback effects that are limiting the social partner organizations ability to coordinate among themselves and with their affiliates.

## **5.5: Conclusions and Chapter Synopsis**

In sum, Belgium has not witnessed significant strains upon its horizontal coordination, with wage dispersion remaining very low in the country, and has not acceded to pressures for decentralization and disorganization as a result of direct pressures from EMU. Wage discipline has also not been

significantly relaxed, even if the Belgian model does struggle with competitiveness. This development means that the mechanisms used by the Belgian system to provide horizontal and vertical coordination have coped well with direct pressures from EMU. It suggests no inherent incompatibility between the intra-associational agreements responsible for horizontal coordination in Belgium and EMU. Likewise, there is the strong suggestion from this case that the coordination within the trade union movement, broad membership of employers' associations, and legal extensions of collective agreements are not in themselves out of place under the single currency. Both these points will be explored further in the Dutch case, which uses these mechanisms as well. This point should come as a significant relief for policymakers Belgium, who have tended to be far less sanguine on the subject of collective bargaining and EMU than those in Germany and the Netherlands. Likewise, where discussions over loosening the horizontal and vertical coordination of the system often bleed into the debate in Belgium over regionalization, with all the added complexity that this entails (Dos Santos Costa 2013; Interviewee 4 2013), that these mechanisms are well suited to handling pressures for decentralization under EMU should be welcome news.

However, the meeting of EMU and the calibration of the Belgian system has begun processes of institutional drift and institutional displacement that pose significant problems for the Belgian system, but for very different reasons. Institutional drift in Belgium encapsulates an increasingly strained relationship between the social partners and exacerbated problems with competitiveness. Work by Blanchard and Philippon (2006) suggests the former as a significant point of concern, although interviewees were more apt to identify the latter as a worry. Indeed, officials in government (Interviewee 4 2013; Interviewee 9 2013) cite this mix of competitiveness problems and the single currency as an existential problem for the system. Indeed, one official, likening the Belgian index to a car that frequently overheats, pointed to the strong possibility of an explosion, absent appropriate tinkering with the system (Interviewee 9 2013). Another argued that with the instrument of currency devaluation gone, reform of the Belgian system is inevitable under EMU (Interviewee 4 2013). However, they leave open the question of whether Belgium takes this up

sooner and of its own volition, or later under duress from the Commission and financial markets (Interviewee 4 2013). Indeed, problems with macroeconomic imbalances and with cost competitiveness have been a point of contention in the Commission's In Depth Reviews (2014) for Belgium, while its Country Specific Recommendations (2013) have mentioned the Belgian index explicitly as a point of concern.

Moreover, the calibration of the system to inflation, and then to French, German, and Dutch wage developments under EMU is slowly squeezing out the role of the social partnership in favour of a larger state role, and having deleterious effects upon the social partners themselves. Worryingly, where the social partners are meant to play a crucial role in the system's governability, with linkages between levels of union negotiators decaying, the ties between the social partners at every level stressed, and the state and legislated dimensions of the system are increasingly taking their place. This process of displacement is behind one official's argument that the index must be reformed to allow the social partners more room to negotiate (Interviewee 4 2013).

What is particularly interesting about this process of institutional displacement is that while interviewees had seen drift as a process that might lead to the breakdown or dismantling of the system, the effects of displacement are much more subtle. Indeed, this process of squeezing out the social partners significantly remoulds the process of coordination, but retains the practice of wage coordination nonetheless. What is concerning about this process, however, is that many of the changes that it is bringing about resemble more closely the dynamics in currently stricken mixed systems than in other tightly coordinated systems. Indeed, while highly coordinated systems often have state-driven dimensions, as with legal extensions and intermittent interventions in the Netherlands, the state role in mixed systems is far more pronounced. Moreover, a dominant state role in these systems coincides with highly fragmented social partners. In these systems, scholars point out that a dominant state role has evolved to paper over weaknesses and pathologies in the social partnership, but ultimately preserves a system of industrial relations that is highly fractious

and often inefficient. Molina and Rhodes (2007), for example make this point very forcefully, and note that it applies well beyond wage setting as well. Certainly, Belgium's story is subtly different, in that an expanding state role is in fact a cause of this fragmentation of the social partners in some respects as much as it is a consequence in others. Nonetheless, the lessons from this literature about the pathologies of fractious and fragmented wage negotiation are well-taken.

Recalling the point made by other Varieties of Capitalism scholars (Hancké 2012; 2013; Johnston and Hancké 2009; Johnston, Hancké and Pant 2014) these developments bear a worrying resemblance to the conditions behind the travails of the crisis countries. In their account, weak coordination means that wage discipline in exposed sectors is not mirrored in sheltered ones, resulting in a divergence in wages between them. Following work by Calmfors and Driffill (1988) and Soskice (1991), weak coordination between the social partners may create conditions in which negotiators actively compete with each other to capture increases in real wages and with inflationary consequences. Certainly, rigorous enforcement of the wage norm prevents the same developments in Belgian wages as in Spanish ones (Figure 3), for instance. Likewise, tight horizontal coordination rules out significant divergences in wage developments between sheltered and exposed sectors. Nonetheless, in the context of a model that struggles at the best of times to close competitiveness gaps with its well-coordinated neighbours, and in the context of EMU where wages are all the more important, the potential for jockeying among fragmented bargainers to capture gains in real wages is a worrying development indeed. With this in mind, van Gyes' (2013) observation that already, national confederations of the trade unions are beginning to struggle in selling wage discipline to some of their sectoral affiliates, particularly in the sheltered service sector is all the more concerning. However, there is little evidence to suggest that state dominance effective in countering the troubling incentives facing weakly coordinated social partners. Indeed, the lesson from the Netherlands in the late 1950s and early 1960s, where the state attempted to impose wage discipline, is that compliance by the social partners is a variable.

In brief, while a thorough discussion of reform proposals for the Belgian model is beyond the scope of this chapter, the point is that many of the mechanisms that it uses to manage wages under EMU appear to be compatible with new demands placed upon them under the single currency. Internal coordination within the social partner organizations and legal extensions in particular are explored further in the Dutch case, which shares these features. The calibration of the Belgian model stands as a point of concern, for the immediate problems that it faces with competitiveness, and the more subtle problems that its meeting with EMU is causing for other parts of the Belgian system. Before examining some of these mechanisms in the Dutch context, however, the next chapter turns to Germany.



## Chapter 6: The German Model under EMU

### 6.1: Introduction

As in Belgium, wage coordination has remained common practice in Germany. Also as in Belgium, a number of important areas of institutional stability coincide with several subtle and some very overt processes of institutional change. Indeed, over the course of the 2000s, the German wage bargaining model has seen several important changes to the mechanisms that manage its horizontal and vertical coordination. Some of these changes even are consistent with those suggested by the literature on EMU and wage bargaining. However this chapter argues that, unlike changes in Belgium, EMU is not their root cause in Germany. Many of these changes began in the mid-1980s or early 1990s, well prior to Economic and Monetary Union, and were accelerated by the weak labour market in Germany characteristic of the mid-late 1990s and early 2000s (see more below). Many interviewees cite domestic causes for changes in the functioning of the German bargaining system that have occurred since euro adoption. In fact, those who do stress external pressures pick out globalization or the Single Market rather than EMU. Certainly, this observation does suggest that the design of the German system itself is well-suited to pressures from EMU. However, some of the changes that are currently taking place in German wage bargaining should be a source of concern for German policymakers because, connected to EMU or not, some of these changes in German wage bargaining are slowly undermining the instruments that its system uses to manage economic pressures under EMU.

This chapter examines the areas of institutional stability in Germany and the changes that have taken place in Germany under EMU. It is structured as follows: Section 2 examines areas of institutional stability in the German system under EMU. It argues that the transfer of powers to a European Central Bank has not had the effect of relaxing wage discipline or encouraging wage dispersion that might have been expected. It adds the caveat, however, that domestic conditions have also played an important role in this development. Attention then turns to institutional change

under EMU, with Sections 3 and 4 examining changes in the vertical coordination of the system whereby it has become more decentralized and Section 5 exploring changes in the horizontal coordination of the system. Section 3 discusses a process of institutional conversion, whereby negotiations within German sectors are being refashioned to allow for more differentiated wage developments between firms. It argues, however, that for the purposes of the German system's performance under EMU, this change constitutes a benign process of managed decentralization.

Section 4 examines the declining coverage of German sectoral agreements. It argues that this development constitutes a process of institutional displacement, whereby the uncoordinated segments of these sectors are increasingly rivalling those covered by the traditional system of bargaining between trade unions and organized employers. It argues further that while this development is unconnected to EMU, unlike conversion, which remoulds, but nonetheless maintains vertical coordination, this process of displacement is slowly undermining it. Section 5 examines changes in horizontal coordination, finding a slow process of institutional drift at work, whereby the role of pattern setting has slowly declined. It finds that this process is also unconnected to EMU, although it remains unclear what the precise implications of this development may be, although it does stand as a point of concern.

## **6.2: Pressures from a European Central Bank and Institutional Stability in Germany**

This section examines areas of institutional stability in the German wage-bargaining system. Specifically, it finds that there is no evidence of institutional change in Germany consistent with pressures from lost national monetary policy. This finding comes as something of a surprise given how powerful the German central bank, the Bundesbank, had been prior to euro adoption. This section argues, first, that contrary to some expectations, the German social partners have continued in their practice of wage discipline, even without the powerful constraint of a national central bank setting monetary policy. It argues, second, that wage developments between sectors have diverged

somewhat, although wage restraint is still clearly visible in the sheltered sectors of the German economy.

Germany's central bank stands out for having been among the EU's most independent central banks in the post-War period. Indeed, this has been a characteristic feature of German central banking for almost the entirety of the post-War period. In fact, the Bank deutscher Länder, the Bundesbank's post-War forerunner, was responsible to the Allied Bank Commission, but received no direction from government, with the Federal Republic being formed only later, in 1949. When the role of the Allied Bank Commission waned, the central bank president of the day convinced the new federal government to make the bank fully independent, rather than simply substitute the Allied Bank Commission for a government committee (Marsh 1992, 166). This design cue was then carried over into the blueprints for the Bundesbank, which replaced the Bank deutscher Länder as West Germany's central bank in 1957.

Being fully independent since its inception sets the German central bank apart from its Belgian and Dutch counterparts, for whom the legal bases for state intervention in central banking were only formally removed in the 1990s because of EMU (Maes and Verdun 2009). In practice, if not in law, the Dutch central bank was largely independent by the time of the negotiations over the Maastricht Treaty (Maes and Verdun 2009). However, the Bundesbank was fully independent from a much earlier stage, having been designed from the outset to be fully independent and having been described by the German finance minister who presided over its creation as "the central bank that can topple the government" (cited in Marsh 1992, 169). Thus, while the Bundesbank did have to account for the broad economic policy goals of the government of the day, it did not have to follow directives from the government. By contrast, it is required of British central bankers, and previously of French ones as well, to follow directives from government, making the Bundesbank by far the more independent among its European peers (Kennedy 1991, 3).

Moreover, the Deutsche Bundesbank, was one of the earliest and most zealous converts to the goal of price stability. Indeed, in crafting the Bundesbank, policymakers channelled inflation fears originating in the hyperinflation of the early 1920s (Kennedy 1991; Marsh 1992). In fact, a preoccupation with sound money prevailed for much of the time from 1923, although achieving it in practice was a post-War phenomenon (Marsh 1992, 29). Sound money was closely associated with the post-War recovery (Marsh 1992, 30) and with the recovery of Germany's international standing (Marsh 1992, 49). Kennedy (1991, 11), for example, goes so far as to liken monetary stability to a constitutional principle in the post-War German system and one that has been interpreted very strictly by the German central bank. A multitude of other studies find the roots of this institutionalization of the German preference for low inflation, and indeed the preference itself, in an attempt to avoid a repeat of pre-War hyperinflation.

Interestingly, even as the institutional design of the Bundesbank was being finalized in the early 1950s, government policymakers fretted deeply about the influence that the bank might wield (Marsh 1992, 169). Indeed, Marsh (1992, 170) notes that with successive Bundesbank presidents prizing sound money over the fate of the chancellor of day, as well as the independence to act on that impulse, high interest rates were behind the resignation of three chancellors. Suffice then to say that, where the bank also tracks wage developments, the threat of increased interest rates was particularly potent for the German social partners as well (Marsh 1992, 170). By contrast, the Belgian and Dutch central banks had struggled with disciplining wage setters at various points prior to EMU. In fact, following these struggles, Belgian and Dutch policymakers had hoped in the 1970s and 1980s that a hard currency policy enforced by shadowing the Bundesbank might succeed in disciplining wage setters where they had failed (Maes and Verdun 2005; Maes and Verdun 2009).

Likewise, as the country at the core of pre-euro currency pegs, the German central bank enjoyed more discretion than other central banks participating in these currency systems. Certainly, Kennedy (1991) describes a delicate balancing act taken up by German central bankers in managing

the German currency within bounds set by these pre-EMU pegs against the need to respond to domestic developments. Nonetheless, managing the anchor currency in these pegs offered the bank more latitude to address inflation at home. This asymmetry in the EMS, for instance, was in evidence in the bitter complaints of other EMS countries that the Bundesbank's attempts to tamp down post-Unification inflation made for monetary policy very ill-suited to the conditions in countries whose central banks had been shadowing it. Regardless, this important point of contrast between the German central bank on the one hand and the Belgian and Dutch central banks on the other means that the transfer of monetary sovereignty to the ECB lifted what was a uniquely powerful constraint upon wage negotiators in Germany. Indeed, looking ahead from his vantage point in the mid-1990s, Kenen (1995, 179), for instance, articulated exactly this concern about the possibility of German inflation under EMU. Soskice and Iversen (2001), writing shortly after the transfer of powers from the Bundesbank to the ECB, also note that the very real possibility of relaxed wage discipline in Germany without the constraint of a national central bank targeting wage inflation.

Moreover, the loss of monetary sovereignty is one that happened far later in the process of monetary integration for Germany than for other EMU countries. Indeed, posed questions about the transition from monetary policy set by a national central bank to a European one, observers in Belgium, for example do not pick out the early 2000s as the beginning of this transition. Rather, they trace the relinquishing of monetary sovereignty to the decision to lock exchange rates in the late 1980s (e.g. Interviewee 10 2013). A similar view is expressed by Verdun (2000) as well. Kenen (1995, 10) highlights this not just as a point of contrast, but as a point of consternation for other EMU countries, with the Bundesbank's militancy towards post-Unification inflation in the mid-1990s jarring with the conditions in recession-hit countries shadowing it. Further then to concerns raised by Kenen (1995) about wage inflation in Germany resulting from lost monetary sovereignty, the German social partners had far less time to adjust to these sorts of pressures than their counterparts in other EMU countries.

Interestingly, the German social partners have continued to practice wage discipline after euro adoption and have in some circles been heavily criticized for doing just that. Indeed, as Schulten (2013) has observed, the transition from bargaining under a national central bank to bargaining under a supranational one has had little impact upon the way the social partners negotiate. This outcome seems counterintuitive given how much weight observers like Kenen (1995) and March (1992), amongst others, had given to the tight money policy of the Bundesbank in explaining German wage discipline. Two related explanations suggest themselves: first that the institutions managing wage coordination are sufficiently entrenched and second that the social partners then face other incentives than sanction by the central bank for moderating their wage demands.

First, recent literature following Hancké (2012; 2013), has noted that coordinated core countries have been best equipped to manage economic shocks under EMU by way of effective manipulation of labour costs. With this in mind, Johnston (2009) compares wage developments in Germany through the 2000s favourably with Austria and the Netherlands, neither of which had experienced the pressures and changes in their labour markets that Germany had. Her observation is highly suggestive of wage-bargaining institutions that are very much still intact from the pre-EMU period.

In fact, contrary to some concerns expressed in the 1990s, on wage discipline the German system has behaved precisely as recent VoC scholarship (e.g. Johnston and Hancké 2009; Johnston, Hancké and Pant 2014) might expect. This point is borne out in Figure 2 in the previous chapter, where growth rates of German wage costs can be seen clearly outperforming those in Belgium and the Netherlands. The German social partners can also be seen making a sharp correction during the early stages of EMU's economic crisis. Recalling from Figure 3, also in the last chapter, that the distinction between Belgian wage developments and those of the mixed systems having adopted the

euro became less pronounced in the mid-2000s, German wage developments under EMU compare favourably to EMU's mixed systems in the pre-crisis period as well, as Figure 5 below makes clear.

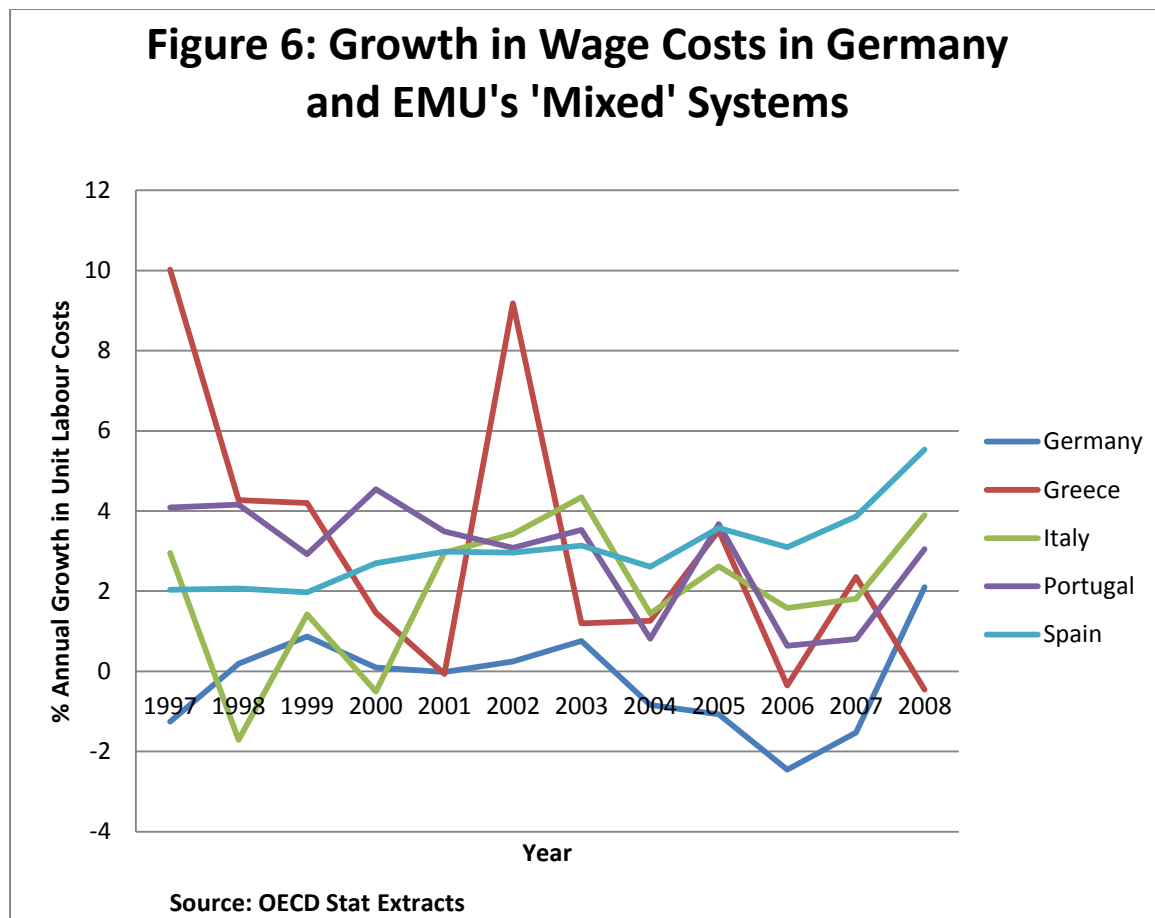


Figure 55

Furthermore, absent the threat of interest rate increases from a national central bank, one might expect wage discipline to continue in highly export-dependent sectors, but to deteriorate in sheltered ones. Put another way, EMU might be expected to strain the horizontal coordination of wages. Certainly, Schulten (2013) does note an increase in wage dispersion through the 2000s, which is consistent with weakened horizontal coordination, although Johnston and Hancké (2009, 617) still find a close connection between developments in the highly export-sensitive sectors and the less well-organized sheltered ones in Germany, grouping its performance alongside that of Austria in this respect, who also uses a pattern-setting system.

Second, while the actual behaviour of German wages under EMU is certainly consistent with the expectations that VoC scholars had of highly coordinated systems, this development still leaves open the question of what has motivated the social partners to this end. Certainly, following Soskice (1991), that its institutions for coordinating wages have remained intact strongly suggests that the German social partners face strong incentives towards wage restraint, bearing as they do the worst of inflationary wage settlements. More specific to Germany, however, Hall and Franzese (1998, 514) note that post-War German wage discipline had rested upon signals from the Bundesbank and having the lead sector in the pattern-setting system be highly export dependent, although on occasion trade unions had pushed for more generous pay settlements to test the bank or to placate membership. Clearly, then, with the former pillar gone, the latter has been sufficient to maintain wage discipline since the transfer of powers to the ECB. Interestingly, even if the metalworking agreement has become somewhat less influential as a pace-setter for other sectors (Schulten 2013), the German economy overall has only become more export sensitive over the course of the 2000s (Darvas 2013; World Bank 2015). Darvas (2013) also notes that for Germany extra-EU exports have come to significantly overshadow that with other EMU or EU members. A clear implication of this development is that the German economy has only become more export-sensitive, with the inherent incentives towards wage discipline that this entails. However, Hancké and Soskice (2003) also point to competitive pressures from EMU itself as a source of German wage discipline as well. In fact, Hancké and Soskice (2003, 4) suggest that even in the early years following euro adoption, there is evidence of wage competition among EMU members, although they add that the incentives to restrain wages under the single currency are more acutely felt by small open economies. Indeed, from Figure 5, that wage moderation in Germany accelerated in tandem with euro adoption in the early 2000s is certainly consistent with Hancké and Soskice (2003).

Certainly, many observers within Germany are quick to point out that domestic economic conditions have also played an important role in influencing wage developments during this period. Indeed, the weak economic growth, and by German standards, horrific unemployment figures (see



Figure 6 below) characteristic of the mid-2000s constitute and important source of downward pressure on German wages (Schulten 2013). This observation by Schulten (2013) is borne out in Figure 6 below, which tracks German unemployment against a several other EMU countries. Therein, unemployment figures for the mid-2000s until the crisis put Germany in company to which it is very much unaccustomed. Furthermore, considered against historical figures, spikes in unemployment in the late-1990s and mid-2000s in Western Germany compare unfavourably with any other point in the post-War period save the early-1950s at the beginning of the post-War reconstruction (Destatis 2014). The period from the beginning of the Unification Bust in the mid-1990s also easily represents the longest period of high unemployment in Western Germany since the Second World War (Destatis 2014). Although unemployment in the former East Germany has halved in the last decade, the rate has never fallen below 10% since Unification (Destatis 2014).

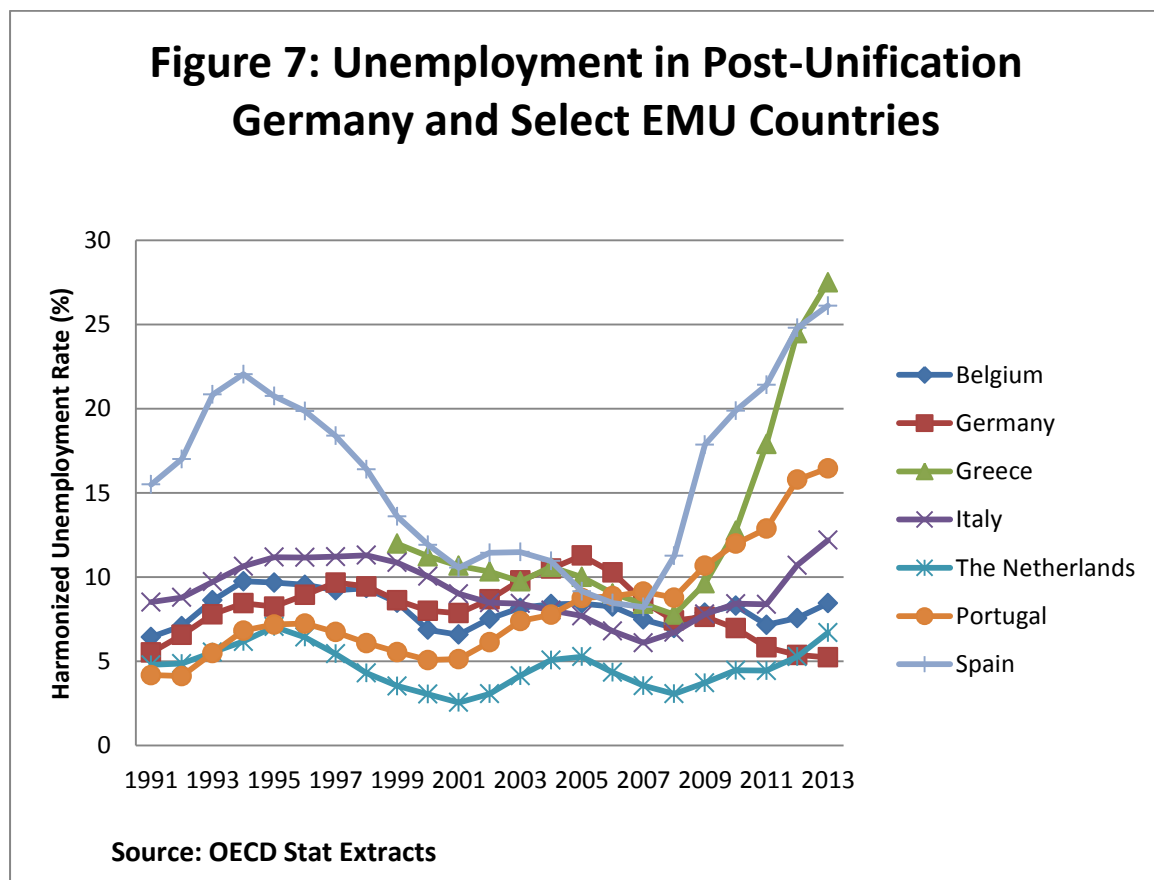


Figure 66

Likewise, Gartner (2013) sees the expansion of low-wage work from the mid-1990s as exercising an influence on wage developments as well. One trade unionist pointed to declining coverage of the bargaining system and the expansion of low-wage and flexible work in Germany as important sources of downward pressure on wages as well (Interviewee 22 2013). In many respects the Unification Bust of the mid-1990s casts a long shadow indeed.

Moreover, there is no evidence that the loss of other policy instruments under EMU has tested the relationship between the German social partners as they have the Belgian ones. Certainly, employers have tended to be more aggressive in wage negotiations since the early 2000s, although Schulten (2013) attributes this behaviour to coinciding pressures from enlargement, temporary and agency work, as well as the free movement of labour. Interestingly, employers have been most aggressive in wage negotiations in the service sector (Schulten 2013), which is precisely the area that the literature had predicted would experience pressure for wage inflation under EMU. Moreover, what Schulten (2013) notes as well is that what sets services apart from other sectors, and what has factored in employers' stance towards wage negotiation, is that the trade unions operating in the sector tend to be much weaker and fragmented. One representative of Ver.di, the service sector trade union confederation notes that its affiliates oversee more, as well as more diverse negotiations than the metalworkers union, for instance, and that coordination capacity is less developed in Ver.di (Sterkel 2013). Describing how varied the activities of the service sector union are, Sterkel notes:

“we have 60 professional branches and we make more than 2000 collective agreements every year, so it is very differentiated, and from the structures, very different than IG Metall, for instance, which has one important branch, so this is a big difference with Ver.di, and the merger...the new branches make every collective bargaining negotiations and collective agreements independently, so they are autonomous...I had the impression here that you

think very much in an institutional way, so this must be very anarchistic what I tell you, how we act actually”.

Crucially, the difficulties currently being experienced in the service sector are outgrowths from longstanding features of the German service industry and quirks in the evolution of its trade union, rather than anything related to EMU. Indeed, further to the point raised by Schulten (2013), neither the employers nor the trade unionists interviewed raised this issue as a significant point of concern that they connect to EMU. Moreover, the mismatch of European central bank rates and German domestic conditions did not emerge as a significant point of concern among interviewees (e.g. Interviewee 15 2013).

In short, one researcher speaks for many interviewees in arguing that EMU’s impact upon German wage bargaining has been greatly overestimated (Interviewee 15 2013). Wage discipline has continued in Germany and there has been no significant growth in wage costs in the sheltered service sector since euro adoption. Likewise, while there is evidence of strain between the social partners, this is much more closely connected to other facets of European integration, just as enlargement and the free movement of workers, as well as domestic developments acting on the labour market, such as the expansion of low-wage work. The next section takes this image of stability as its point of departure. It argues that alongside this image of institutional stability since the beginning of EMU, several subtle changes are taking place in German wage setting. These changes coincide, but are not caused by EMU, although some of them may have important implications for the system’s functioning under the single currency.

### **6.3: Institutional Conversion and Managed Decentralization in German Vertical**

#### **Coordination**

Where the last section examined areas of institutional stability in the German system, this section turns to institutional change under EMU, examining the first of three processes of change that have coincided with Germany's adoption of the single currency. It argues that moves to decentralize the German wage bargaining system by way of derogations and opening clauses constitute a process of institutional conversion. Change of this sort entails refashioning existing institutions for new ends, but ultimately preserves the institutions in question (Streeck and Thelen 2005). By way of this process in German vertical coordination, coordination by the sectoral social partners has been refashioned to allow for greater differentiation within German sectors. However, this process of change preserves coordination, rather than undermining it, and for the German model's compatibility with EMU, this change is a benign one.

Whittall (2007), for example, has cited opening clauses and decentralization in German wage bargaining as a source of disorganization in German wage coordination. Certainly, he is correct that the German system has become increasingly decentralized, with much greater inclusion of opening and hardship clauses into German collective agreements. These clauses allow for deviations by individual firms from the sectoral collective agreement. Heinbach (2006, 4) finds that for those German employees covered by a collective agreement, by the early 2000s only 9% did not have an opening clause in the agreement. Of the remaining 91%, 81% had clauses allowing for derogations on pay, while the rest had clauses covering adjustments on working time (Heinbach 2006, 4). However, Brändle and Heinbach (2013) do note that not all firms covered by such clauses actually invoke them, or are even fully aware of them.

These clauses have led to greater differentiation in German wage developments between firms and regions. Heinbach (2005), for example, finds that wage developments tend to vary more in sectors covered by agreements containing opening clauses. Likewise, Ellguth et al. (2014, 105) have

found greater variation still among firms invoking opening clauses, where those without works councils tended to reduce wages by around 8%, while those with works councils saw reductions of around 1.6%. Work by Haipeter (2011) has suggested as well that works councils, operating at firm level have become much more important in industrial relations. Consistent with Streeck and Thelen's (2005) notion of conversion, this process of decentralization in German vertical coordination has clearly reshaped wage bargaining to produce greater differentiation in wage developments within sectors.

Just as importantly, while these developments are consistent with the literature on EMU and wage setting that suggest that the single currency would exert pressure for decentralization, there is no evidence to suggest that EMU is the cause of these developments in Germany. Indeed, observers have noted that the move to decentralize the German system predates EMU. Accounts by Hassel and Rehder (2001), as well as Thelen (2000) are a case in point. Their observations accord with those of interviewees closer to the process. Indeed, many of the pressures driving this decentralization of wage negotiations are the product of domestic pressures, such as Unification and a weak labour market in the 1990s and early 2000s (Interviewee 15 2013; Sterkel 2013). Brändle and Heinbach (2013) date the beginning of this process to the mid-1980s, with the trade unions acceding to demands for greater flexibility as part of a move to dissuade firms from leaving employers' associations and thus no longer being parties to sectoral collective agreements. Certainly, the Pforzheim agreements in the mid-2000s, whereby IG Metall and IG BCE made significant moves in favour of greater derogation do follow closely on the heels of euro adoption. However, EMU was not raised by interviewees as a cause of these continued movements to allow opening clauses during the 2000s.

What is particularly interesting, however, about this process of institutional conversion is that while it is certainly reshaping German industrial relations, there is no evidence that it is anything but benign to German performance under EMU. Indeed, the literatures that grew up around

Calmfors and Driffill (1988) and are emerging around Johnston and Hancké (2009) emphasize the deleterious consequences of wage bargaining that is organized but fragmented. This process of change in Germany, however, does not suggest growing disorganization or fragmentation. Indeed, Hassel and Rehder (2001), as well as Thelen (2000) have pointed to derogations to works councils as a process of organized decentralization. Whittall (2007), by contrast, characterizes this change as part of a process of growing disorganization in German wage setting, and this process certainly does allow for greater differentiation of wage levels within the system.

However, rather than disconnecting firm-level actors from sectoral collective agreements and the sectoral social partners, the use of opening clauses and less prescriptive sectoral agreements has engaged works councils more intimately in the bargaining process (Haipeter 2011). Recalling that even if the two are legally separate, the works councils are closely tied to the trade unions (Whittall 2005; 2007), Haipeter (2011), for example has found that not only have works councils generally managed their expanded role well, but that the connections between firm-level works councils and sector-level trade unions have become denser as a response, even if these derogations make negotiations more challenging from a technical standpoint (Interviewee 22 2013). Consequently, this sort of derogation should not be mistaken for disorganization, although it does make for a greater administrative burden upon the trade unions. Sterkel (2013) finds that for Ver.di, “we have had to change our strategy: we have a lot more collective agreements, and more bargaining...and this is the biggest challenge, I think, at least for my organization.”

Moreover, other observers have noted that while opening and hardship clauses have allowed firm-level actors more latitude, they also preserve an important role for the sectoral agreements as well. Indeed, such clauses do allow for deviations from the sectoral collective agreement under certain circumstances. However, the exact circumstances under which firms may do so are prescribed in the collective agreement itself (Brändle and Heinbach 2013, 6). Likewise,

actually invoking such a clause often requires the consent of employees, typically through the relevant union and works council in firms where they operate (Brändle and Heinbach 2013, 6).

Considered this way, rather than a lurch towards disorganization, this tightened internal coordination within trade union movement has acted to preserve the vertical coordination of wage setting. As a result, rather than inviting disorganization or fragmenting social partner organizations, this change constitutes an organized decentralization, but preserves coordination. In this respect, the move towards greater derogations to works councils by the German social partners resembles those by the Dutch trade unions to tighten their internal coordination in response to the decentralization of bargaining after the 1994 New Course Agreement. More to the point, in the eyes of the literatures concerned with wage coordination and concerned by weak wage coordination, this process of institutional conversion in Germany is a benign one under EMU. While this process of conversion clearly does reshape German wage coordination, it ultimately preserves the practice.

In brief, the move to decentralize German wage bargaining by way of opening and hardship clauses, as well as greater derogation to firm-level works councils constitutes a process of institutional conversion. The vertical coordination of the German system has been reshaped to produce greater differentiation, but has ultimately been preserved as sectoral collective agreements very clearly outline the circumstances under which firms may deviate from the agreement, because invoking them often require employees' consent and because linkages between different levels of the trade unions have tightened in response. This process is unconnected to EMU and because it reshapes coordination rather than undermining it, this process is benign for the German system's functioning under the single currency.

## 6.4: Institutional Displacement and Declining Coverage of German Wage Bargaining

Whereas the previous section examined the process of institutional conversion, by which derogations from sectoral collective agreements constitute a managed decentralization of the German system, this section turns to a different sort of decentralization. It examines the declining coverage of the German system, whereby individual firms are coming to exercise greater discretion over wages for having eschewed joining employers' associations. As a result, these firms are no longer party to collective agreements for their sector. This section argues that this dynamic constitutes a process of institutional displacement, whereby the uncoordinated elements of the German system, present from its inception, are coming to rival those governed by free collective bargaining. It argues further that unlike the managed decentralization in the previous section, this process of displacement is a concern for the model's functioning under EMU, even if the single currency is not its root cause.

Declining coverage has long been a point of concern among academic observers (e.g. Behrens and Jacoby 2004; Haipeter 2011; Streeck and Hassel 2003; Whittall 2007, among many others), as well as those closer to the process (Interviewee 17 2013; Sterkel 2013). A crucial implication of this change is that decreasing union density, and crucially, declining membership of employers' associations has slowly shrunk the segments of German sectors covered by a collective agreement. This development is borne out in Figure 7, which shows collective bargaining coverage from the eve of Unification in 1990 to 2010 and also shows that German coverage has declined substantially compared with other coordinated countries. The contrast with Belgium, which for all its other travails has had consistently high coverage, and the Netherlands, whose coverage has increased slightly over the same period could not be starker. Interesting as well is the fact that Austria, whose system bears a very striking resemblance to that of Germany, has faced none of these same problems with declining coverage.



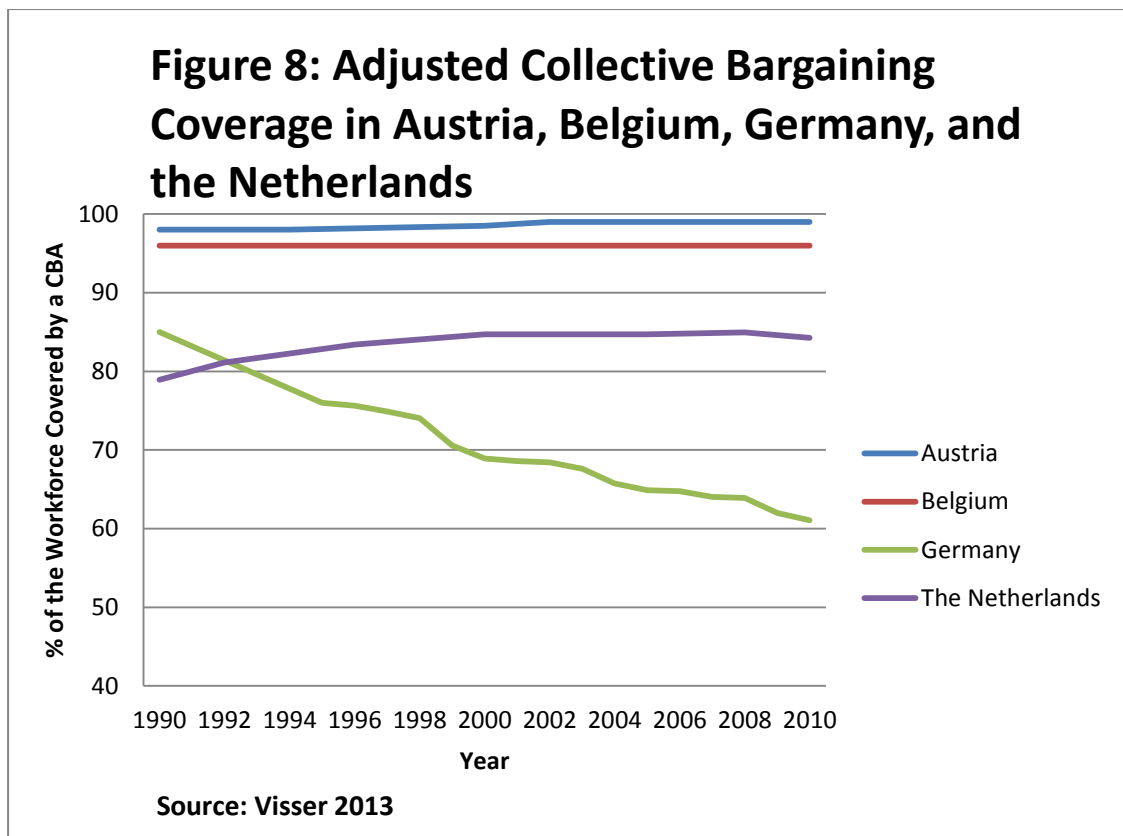


Figure 77

Perhaps it is unsurprising, if one considers the information in Figure 7, but this displacement of the coordinated elements of the German system with uncoordinated firm-level wage setting has not been tied to EMU, even if this sort of decentralization and disorganization is consistent with some of the pressures suggested by the literature. Indeed, this process of institutional displacement is one that began in the early 1990s following Unification, after bargaining coverage had been stable around 85% to that point (Visser 2013) and thus long predates EMU. Likewise, euro adoption in the early 2000s does not appear to have impacted the rate of this decline. This point is corroborated by interviewees, none of whom suggested EMU as a cause of this process of institutional displacement. Hassel (1999), for example, has cited Unification and subsequent weakness in the German labour market as a cause for this overall decline in bargaining coverage.

This decline in German collective bargaining coverage is particularly pronounced in the service sector. Indeed, in this sector, not only have unions and employers' associations lost

members, but the growth of low wage work, as well as part time and flexible work (Sterkel 2013) has challenged the governability of the system by expanding the share of workers in that sector who are difficult to organize. This development comes in addition to the challenges emanating from longstanding fragmentation among unions and business associations in the service sector, as well as the much more varied activities that the sector covers (Sterkel 2013). Another German trade unionist had made the complimentary observation that in the metalworking sector, organizing by the sectoral trade union, IG Metall, provides a powerful incentive for firms to remain with the employers' federation (Interviewee 22 2013). Central to this trade unionist's observation, however, is a level of uniformity in the sector and a level of organization in its chief trade union that the German service sector cannot match. Similarly, Schulten (2013) is very explicit about the influence of EMU on declining coverage, noting that much of the decline in membership of employers' associations is not because of firms exiting for greater flexibility under EMU. Rather, membership of employers' associations has declined because of a reluctance of new companies to join in the first instance (Schulten 2013). In any event, the point is that this process of institutional displacement predates Economic and Monetary Union and that its contours have been determined by domestic factors.

Moreover, while neither Belgium nor the Netherlands have faced a shock along the lines of German Unification, they have dealt with similar expansions in employment among difficult to organize groups. Likewise, while Belgian union density has remained high, Dutch union density has declined as it has in Germany. What the comparison highlights, however, is that while all three rely upon broad membership of employers' associations to increase the coverage of collective agreements, only Belgium and the Netherlands supplement this with legal extensions. As a result, any declines in membership of employers' associations in these two countries are less acutely felt. Indeed, these countries make much more extensive use of legal supports to supplement the role of the social partners in collective bargaining than is the case in Germany. Certainly, the assertion by Traxler and Kittel (2000) that horizontally organized systems such as that of Germany require less

stringent vertical coordination is well taken. However, the declining reach of the social partners is a point of concern for both participants in the wage-setting process (Müller 2013; Interviewee 22 2013) and observers (Gartner 2013; Schulten 2013). Similarly, Austria, whose system look very similar to that of Germany, has avoided this problem of declining coverage because membership of employers' associations is compulsory in Austria.

However, while the displacement of the coordinated elements of the German system is not caused by the single currency, unlike the earlier process of conversion, this development stands as a point of concern under the single currency. Indeed, employers and workers not covered by a sectoral collective agreement do not respond to cues from the social partners (Haipeter 2011) and respond very differently to the business cycle than do those bound by a collective agreement (Gartner 2013). Indeed, Addison, Bellmann and Kölling (2004) find very different behaviour of firms with works councils depending upon whether they are covered by a collective agreement. Others, such as Hübler and Jirjahn (2003), have found that works councils in firms covered by a collective agreement tend to concern themselves with improving productivity, while their counterparts in firms not so covered tend to be more concerned with rent seeking. The implication of their findings is that one can expect different evolutions of wages and unit labour costs between firms that participate in wage coordination and those that do not. Similarly, Bohachova, Boockmann and Buch (2011) have found that German firms covered by collective agreements were more apt to hoard labour through the acute phase of the current economic crisis, while uncovered firms were not. In any case, the point is that firms that coordinate wages by way of sectoral collective agreements and those that do not coordinate tend to behave very differently, both at the best of times and in response to economic shocks. That the proportion of the latter group of firms has grown suggests a growing fragmentation of the German system and marks out declining coverage a challenge for its governability. Where recent VoC scholars following Johnston and Hancké (2009) stress the deleterious consequences of weak coordination under EMU, this development in Germany stands out as a worrying one.

In brief, the steady decline of German collective bargaining coverage constitutes a process of institutional displacement. By way of this process, the uncoordinated elements of the system, present since its inception, have steadily expanded at the expense of its coordinated core. This process predates EMU, and while it has not been caused by the single currency, uncoordinated firms behave very differently than those covered by a collective agreement. Consequently, this shrinking of the coordinated components of the German system stands to undermine its vertical coordination, which is a point of concern under EMU. Contrasting Germany with similar coordinated systems that have not struggled with this problem suggests strongly that the absence of a legal mechanism to expand the coverage of collective agreements is what sets Germany apart in this respect.

### **6.5: Institutional Drift in German Pattern Setting**

While Section 6.2 had argued that, among other things, wage dispersion in Germany had been largely stable under EMU, this section finds that this development raises as many questions as it answers. Indeed, beneath this apparent stability, the German pattern-setting system has undergone a process of institutional drift, whereby several changes have begun to weaken the linkages between German negotiators in different sectors. This section argues that this process of institutional drift is unconnected to EMU, but rather is the product of several domestic changes, whereby the horizontal coordination of the system has weakened. As this section also argues, even if EMU is not their cause, these changes do stand as a concern for the German system under EMU.

As Streeck and Thelen (2005) have noted, drift entails a process by which institutions' external environment changes but they do not, or by which neglect of institutions' maintenance results in them functioning differently. Changes in German pattern setting resemble closely the latter, whereby developments within different sectors are limiting their ability to track the metalworking agreement, which traditionally serves a pace-setting role for wage negotiations in other sectors. Schulten (2013) has noted, for instance, a growing desynchronization of bargaining

rounds, whereby changes in the lengths of collective agreements between sectors stagger the negotiations. Where historically, many sectors had timed their collective bargaining rounds to follow closely the conclusion of the pace-setting agreement in the metalworking sector, staggering these negotiations makes the metalworking agreement less influential in subsequent bargaining.

The expansion of low-wage and temporary work, concentrated largely in the service sector has also posed problems for the horizontal coordination of the German system. Certainly, the coexistence in Belgium of persistent differences in wage levels between sectors with near-uniform wage increases suggests that the expansion of low-wage work is not in itself a hindrance to intersectoral coordination. Rather, in Germany the expansion in low wage employment has tended to be concentrated in a sector that is highly heterogeneous and weakly organized. Indeed, many of the same reasons for tenuous relations between employers and the service sector union, Ver.di, discussed in Section 6.2, are behind its struggles in following the metalworking agreement. Sterkel (2013), for instance, has noted that struggles and frustration are a consistent feature in many of the areas that the union attempts to coordinate. For example, fragmentation among the social partners in that sector and very heterogeneous negotiations among Ver.di affiliates makes coordination within the sector very difficult for the union, but has also played a role in its struggles to organize with other German sectoral unions and with the European peak association in services (Sterkel 2013). It follows then that the growth of this sector compared with others expands the proportion German employees whose wages are more loosely tied to the metalworking agreement.

The growth of temporary and agency work has also been cited as a challenge for coordination as well (Sterkel 2013). Partly, this is because agency work blurs the distinction between service employment and that in other sectors, which in turn complicates negotiations (Sterkel 2013), but also because workers of this sort tend to be difficult to organize. Certainly, this challenge is not unique to Germany, with Dutch unions, for example, struggling in this area as well. What is particularly interesting about Germany, however, is that there are significant differences in sectoral

unions' ability to deal with this new challenge. For example, one trade unionist noted with some pride that IG Metall had successfully concluded collective agreements stipulating the terms under which temporary workers may be hired and under which long-tenured temporary workers must be offered permanent contracts (Interviewee 22 2013). This point is highlighted by Vogel (2012) as well in her review of the 2012 bargaining round in the metal and electrical industry.

By contrast, the same fragmentation and organizational weakness behind Ver.di's other struggles suggest that it is unlikely to replicate the industrial unions' progress in this area in the foreseeable future. In any event, the point is that this growing differentiation from sector to sector in the ways workers are organized and their wages set makes coordination between sectors all the more difficult. Schulten (2013) has noted as well that the declining coverage of the German system discussed in Section 6.4 has compounded this weakening of horizontal coordination in Germany. Certainly, he qualifies this, noting that the pattern-setting role of the metalworking agreement has declined, rather than disappeared altogether. Similarly, Sterkel (2013) has noted that service sector unions still use the same coordination rule as the industrial unions to guide their wage demands.

In any event, Schulten (2013), among many others, considers the weakening of pattern setting as a response to domestic developments in the labour market, rather than to EMU. Gartner (2013) has made a similar point, dating the beginning of the German move into low-wage employment implicated in this process to the mid-1990s, long predating EMU. Thinking along similar lines, an academic observer was quite insistent that the influence of Economic and Monetary Union on collective bargaining in Germany has been greatly overstated (Interviewee 15 2013).

However, as with the process of institutional displacement discussed in Section 6.4, even if this process of drift is not caused by EMU, it certainly does have important implications for the German system under the single currency. Indeed, Johnston and Hancké (2009, 602) have argued that wage restraint in sheltered sectors can be maintained under EMU with some combination of mechanisms tying wage developments to those in exposed sectors, or by imposing constraints on

wage growth in these sectors. In Germany, however, constraints upon sheltered-sector wage growth have never existed and it has relied upon mechanisms tying wage developments there to exposed sectors which are now deteriorating. The implications of this change in Germany, however, are not immediately obvious.

Certainly, Johnston and Hancké (2009) suggest that weakened coordination should eventually result in relaxed wage discipline. Consistent with this prediction is the observation by Gartner (2013) that one driver of sheltered-sector wage restraint has been an expansion of low wage work. That this expansion began in a period of very high unemployment and has continued with the expansion of the labour market to include traditionally excluded low-skill work suggests that there has been significant, but likely declining slack in that portion of the labour market. This declining slack may hold out the possibility of faster wage growth in the sheltered service sector once this segment of the German labour market begins to tighten following its rapid expansion, should Ver.di be able leverage this into higher wage growth. In the medium term, however, weakened intersectoral coordination could also mean that the relative success of the metalworkers union in its most recent round of bargaining (Vogel 2013) might not be replicated in the service sector, with unfortunate consequences for domestic consumption. In either eventuality, subsequent economic shocks are likely to test the horizontal coordination of the German system more severely, as better-organized trade unions in export-sensitive sectors negotiate wage restraint, but the service sector's response is either different or incoherent. Indeed, Gartner (2013) has noted that being in the midst of this transition in Germany to a higher employment equilibrium very likely spared it just such a test through the current economic crisis.

In short, the pattern-setting system that provides horizontal coordination in German wage negotiations has undergone a process of institutional drift, whereby different sectors, particularly services, have come to follow less closely the pace-setting metalworking agreement. This process is not caused by EMU, but rather is the result of a slow desynchronizing of different sectors' bargaining

rounds, the expansion of low-wage and temporary work, as well as declining coverage of the system. However, as with the process of displacement acting on the system's vertical coordination, even if this drift is not caused by EMU, it does hold out some worrying prospects for the system's continued functioning under the single currency.

## **6.6: Conclusion and Chapter Synopsis**

The German system of wage bargaining has experienced very little strain as a result of Economic and Monetary Union. Indeed, there is little evidence of institutional change in the German wage-bargaining system from pressures associated with EMU. Interestingly, the lifting of a uniquely strong constraint upon the German social partners in the transferring of monetary authority from the Deutsche Bundesbank to the ECB. Wage discipline has continued in Germany and wage dispersion has not increased dramatically, nor has wage growth increased significantly in sheltered sectors of the economy. Similarly, greater emphasis upon wages as an adjustment mechanism has not placed undue strain upon the social partners and has not been implicated by interviewees in changes that have occurred in German wage setting. In fact, posed follow-up questions about external pressures on the German system, interviewees pointed to pressures other than those from EMU. Eschewing EMU, interviewees instead pointed to pressure from the Single Market (Interviewee 17 2013), enlargement (Dannenbring 2014; Interviewee 22 2013) and greater reliance on posted workers (Dannenbring 2014; Interviewee 19 2013; Interviewee 22 2013). Other sources of external pressure on the German system include globalization (Gartner 2013) and a broader trend in many advanced economies towards greater labour market flexibility (Gartner 2013) rather than the single currency.

What these findings suggest is that the basic design of the German wage-bargaining system is well-suited to conditions under EMU. More specifically, the mechanisms of internal coordination by the social partners, pattern setting and the German coordination rule calibrating its system to inflation and productivity are highly compatible with EMU. In this respect, the German experience



under the single currency stands in marked contrast to that of Belgium. In fact, one interviewee in Germany noted bluntly that its system had not faced the acute pressures that the Belgian system had because of important differences in their designs. Specifically, this interviewee noted troubles with the Belgian system of wage indexation (Interviewee 17 2013). Another interviewee also drew contrasting conclusions about Germany and Belgium, noting that while there was pressure on Belgium to bring wage developments into line with Germany, there was very little pressure of this sort on Germany (Interviewee 19 2013).

However, even if EMU has not been the cause of institutional change in the German wage-bargaining system, subtle but important changes have indeed taken place in the German system. Some of these changes even have implications for its functioning under EMU. Certainly, the move to decentralization of the German system by way of institutional conversion is a benign process under EMU which preserves coordination, even if it does reshape it (Section 6.3). However, the process of institutional displacement (Section 6.4), by which the uncoordinated parts of the German system are increasingly rivalling its coordinated core does represent a point of concern. Though not caused by the single currency, this change threatens the vertical coordination of the system under the single currency. Similarly, the pattern setting that had traditionally maintained close links between sectors in the German economy is now far less pronounced, with deleterious consequences for horizontal coordination.

A discussion of reform proposals for the German system is beyond the scope of this chapter. However, the findings of this chapter do strongly suggest that while the basic design of the German system is well-suited to EMU, changes from other avenues are in cases undermining some of its key features. Some, such as Gartner (2013) have even suggested that the next economic shock in the euro area will be less kind to Germany. In closing then, while the fit of the German system with EMU should come as a source of comfort to policymakers, it should not come as a source of complacency.

Institutional change in Germany to arrest these processes of displacement and drift are necessary to preserve effective wage coordination in the country.

## Chapter 7: The Dutch Model under EMU

### 7.1: Introduction

This chapter turns to developments in the Netherlands, examining the experience of its wage-bargaining system and how it has coped with pressures from the single currency. As in Belgium and Germany, Dutch wages have remained highly coordinated under EMU; indeed through the crisis as well. Despite struggles with competitiveness in the early years following euro adoption, the Dutch model has been singled out for its successful management of wage developments, as well as the mix of flexibility and coordination that it offers. In many ways, and in contrast with the acute concerns that have emerged around the Belgian model and the chronic concerns in Germany, the Dutch model has lived up to early praise. In fact, academic observers such as Verdun (2000) have noted a very sanguine view of EMU by key policymakers prior to euro adoption, a point corroborated by many interviewees. In many ways, developments since have vindicated their confidence in the Dutch model. Indeed, wage growth has remained competitive with other coordinated systems and there is no evidence of a significant divergence between sheltered and exposed sectors of the Dutch economy. Similarly, the coverage of the Dutch system has remained very high, and formally, the system has not been significantly reworked since the 1990s. In fact, the New Course Agreement of 1994, which further decentralized the Dutch system and cemented many of the changes made in the 1980s currently stands as its last significant revision. As in both Belgium and Germany, however, beneath this apparent stability, several changes are indeed taking place in the Dutch wage-bargaining system that are not caused by EMU, but some of which do have implications for its smooth functioning under the single currency.

This chapter is structured as follows: Section 7.2 examines the areas of stability in the Dutch model under EMU, arguing that in many ways the Dutch system has lived up to optimistic predictions (e.g. Jones 1998). Sections 7.3 and 7.4 turn to processes of institutional change: 7.3 finds that while the formal legal institutions underpinning it have not been significantly reworked in some

time, the Dutch system has become progressively more decentralized, with more autonomy being given to local bargaining units. There is a dispute among experts over whether this has manifested itself in greater wage dispersion. However, Section 7.3 argues that in either case, this decentralization has been of the managed sort, meaning that it preserves coordination and is benign for the Dutch system's functioning under EMU. In this respect, this process of decentralization resembles the process of conversion underway in Germany.

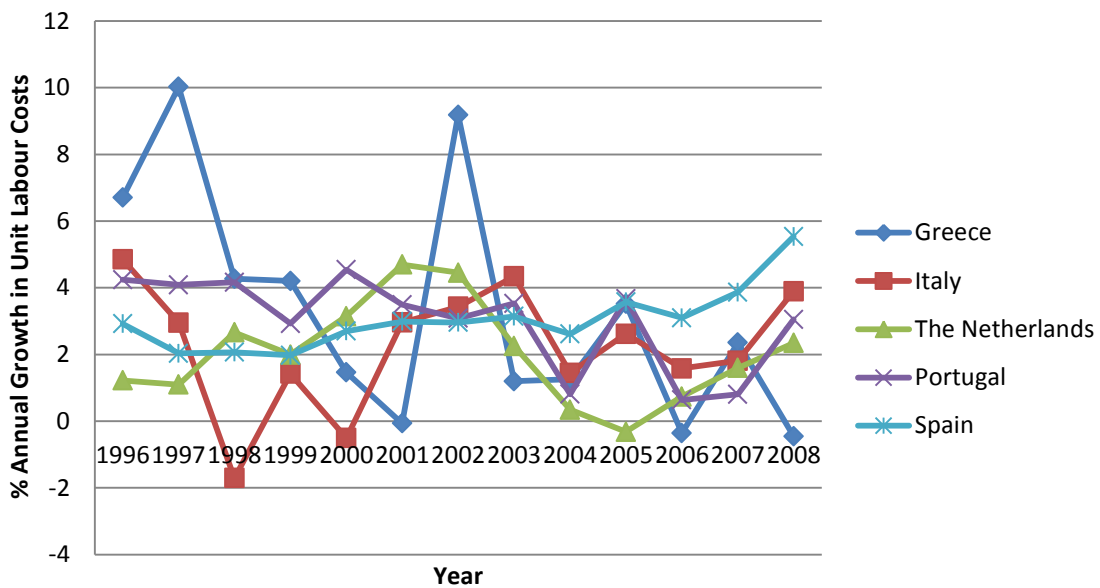
Section 7.4 examines recent changes within the Dutch labour movement. It finds that while it has yet to significantly undermine wage negotiation, there has been a worrying decline in trade union density in the Netherlands. Section 7.4 argues that this process of institutional drift is unconnected to EMU, but rather is part of a secular trend that predates the single currency. Wages have nonetheless remained highly coordinated, but this decline has caused internal upheaval in the largest trade union confederation, FNV. This development represents a point of concern, in that while bargaining coverage and the capacity of the trade unions have remained high, it does threaten to make the relationship between the social partners more tense and to undermine the coherence of one of the system's crucial actors. While the most recent social pact has contained this conflict, meaning that this process of change remains a process of institutional drift, many of its contours invoke Streeck and Thelen's (2005) notion of institutional exhaustion. Section 7.5 concludes.

## **7.2: What has not Changed in the Netherlands**

This section examines areas of institutional stability in the Netherlands. Interestingly, it finds that there is no evidence of institutional change consistent with lost monetary sovereignty. It argues, first, that there has been no significant relaxation of wage discipline under EMU, either overall or in sheltered sectors of the economy. It argues, second, that the Netherlands has not suffered from a mismatch of bank rates and national inflation preferences, with the social partners long being accustomed to bank rates set elsewhere under pre-EMU currency pegs.

First, the practice of wage discipline in the Netherlands has continued much as before. As Figure 2 in Chapter 5 makes clear, the Dutch social partners have avoided the prolonged period of negative real wage growth that was characteristic of Germany from the late-1990s. However, since the beginning of EMU, the Dutch social partners have not had the same cause for concern about competitiveness that their counterparts in Belgium have. Indeed, since adopting the euro, wage costs in the Netherlands have tended to grow more slowly than in Belgium, while the Dutch social partners opted to restrain wage growth after the acute phase of the economic crisis as well. Similarly, as Figure 8 below makes clear, the Dutch system's management of wage growth since the adoption of the single currency compares favourably with EMU's mixed systems as well, with wage growth being positive during this time, but more than competitive with these peripheral countries in the pre-crisis period. It stops at the outset of the economic downturn because in the years following, some elements of the bargaining systems in Greece, Portugal and Spain were suspended or dismantled (Visentini 2012), such that wage growth figures for the years since do not reflect their normal functioning.

**Figure 9: Growth in Wage Costs in the Netherlands and EMU's 'Mixed' Systems**



Source: OECD Stat Extracts

Figure 88

What is particularly fascinating about Dutch wage developments in Figure 2 and Figure 8 is that this prolonged period of wage discipline from the mid-2000s comes on the back of a spike in wage growth coinciding with the beginning of Stage 3 of EMU in 1999. This development is especially interesting, in that while the circulation of euro coins and banknotes only began in 2002, by December 31 1998, the exchange rates of the first EMU members had been locked and the ECB become responsible for monetary policy. That a spike in Dutch wage costs followed is highly suggestive of relaxed wage discipline following the lost constraint upon the social partners of national monetary policy. Indeed, some observers, such as Johnston (2009) have suggested that this spike in wages and the sharp correction that followed from 2004-2006 were part of a new pattern in Dutch industrial relations. Indeed, while the sharp correction that followed this spike in wage growth in the early 2000s is hardly evidence of a breakdown of the system under EMU, Johnston (2009) suggests that wage discipline in the Netherlands would be a more cyclical phenomenon, with protracted periods of wage inflation followed by sharp corrections.

Certainly, relying on figures for wage developments to 2006, Johnston's (2009) hypothesis is a plausible one. However, posed questions following from this observation, experts closer to the process and speaking to the years since have noted that this development in the early-mid 2000s is not part of a new pattern in Dutch wage-setting practices. Nor, in their view, were wage developments during this period strongly influenced by EMU (Becker 2014; Haket 2014; Interviewee 37b 2014; van Riel 2014). Rather, interviewees stressed that the causes of this spike and subsequent correction was a coincidence of several transitory factors, most of them unconnected to EMU. Indeed, Becker (2014) stressed that this development resulted from the coincidence of a housing boom with an IT boom, a point echoed by Hemerijck (2014) as well. Hemerijck (2014) does note that a single European central bank, unable to raise rates specifically in the Netherlands, would have facilitated this bubble. However, at its roots he finds the expansion of the Dutch labour market and a finance-centred growth strategy in the 1990s, rather than EMU (Hemerijck 2014). The former point about the expansion of employment in the Netherlands was one stressed by van Riel (2014) as a contributing factor to the housing bubble, while Borghans and Kriechel (2007, 2) have stressed a labour shortage as the cause of rapid wage growth during this period. Becker (2014) stressed as well that the Dutch housing boom of this period was in no small part connected to lax rules around borrowing for the purchase of second residences, which have since been revised.

Despite the very compelling coincidence in timing between the transfer of powers to the ECB and a spike in wage costs, the emphasis by experts on the Dutch system upon domestic causes of this spike is well-founded. Indeed, as discussed in Section 6.2, the handover of responsibilities for monetary policy to the ECB represented a significant change in the German wage-setting landscape. However, long-tenured members of the ERM such as Belgium and the Netherlands can reasonably claim to have surrendered control over monetary policy well prior to the formal beginning of EMU. Jones (1998, 150), for example, notes that the exchange rate between the Dutch guilder and the deutschmark effectively became locked in 1993. At the time of the ERM crisis, in August 1993, the Dutch guilder and German D-mark opted to stick with the narrow band of  $\pm 2.25\%$  whereas others in

the ERM expanded the bandwidth to  $\pm 15\%$  (Verdun 2000, 93). The implication of this decision is that Dutch monetary policy was set in Frankfurt six years prior to the ECB's inception. Jones (1998, 150) further notes that the locking of exchange rates in 1993 came after Dutch central bankers had manoeuvred them progressively closer since the early 1970s.

In its current guise, the Dutch system was designed specifically to avoid a repeat of the runaway wage inflation of the 1970s. Indeed, it was because of this experience in the 1970s that the abandoning of wage indexation was so important in the Wassenaar Agreement of 1982. Interestingly, Jones (1998, 150) adds that the social partners were early converts to exchange rate stability in their small, open economy, with trade unions disliking the knock-on effects that currency devaluations tend to have on real wages and employers well aware that competitiveness gains from devaluation dissipate quickly through inflation. A clear implication of this preference is that the Dutch social partners had grasped well prior to EMU the connection between their decisions on wages and their external competitiveness in conditions where monetary policy is set elsewhere. Consequently, the Dutch social partners would have long internalized the need for wage discipline, and had been accustomed to operating without the threat of increased interest rates from the central bank since at least the early 1990s. Thus, while the coincidence of a spurt of inflation and the inception of the ECB in 1999 is striking, given their prior history of wage bargaining without the threat of discipline from the central bank, 1999 seems an odd point in time for the social partners to change course.

Moreover, the correction that followed this spike in wage costs in the early 2000s, with wage freezes agreed in the collective bargaining round that followed is hardly indicative of a system that has lost control of wage growth. In fact, the response of the Dutch social partners to the recession that followed this spike in wage costs, and indeed, their response to the crisis highlights one of the underlying strengths of the Dutch system. Indeed, prior to EMU, Broersma, Koeman and Teulings (2000) had argued that even more so than wage restraint, the ability of the Dutch model to



respond quickly to negative shocks is one of its chief advantages under EMU. Calibrated as it is, loosely to inflation and productivity, the Dutch social partners have been able to meet shocks such as these much more easily than their Belgian counterparts. Likewise, while Section 6.3 will examine changes that have allowed for greater variation in Dutch wage settlements, there is no evidence that wage discipline has been relaxed in the sheltered sectors of the economy (Bulk 2014; Pentenga 2014) with one caveat. Indeed, the account by Johnston (forthcoming) of this spike in Dutch wage growth in the early 2000s is instructive, where the growth in wage demands by the trade unions began with a push from the FNV's public sector affiliate. The demands of the national confederation were eventually revised upwards under severe pressure from its affiliate, but this also caused significant tensions within the organization. This tension does strongly suggest that the rest of the organization had significant reservations about deviating from its more restrained wage policy.

Just as importantly the episode does underscore the intermittent role of the Dutch state in the wage-setting process. In this instance, the account by Johnston (forthcoming) also suggests some adaptations of the system in response to EMU. Indeed, behind these demands by the public sector unions was the perception that external constraints such as the threat of exclusion from EMU had been lifted, but that discipline from the central bank would not be forthcoming under EMU (Johnston forthcoming). Thus, while wage growth in this instance was successfully contained, it required a somewhat different response than in the past, with material inducements from the state in the form of delayed cuts to social programs helping to contain pressure for wage growth.

Considering other pressures, particularly interesting as well has been the fact that the mismatch of central bank rates and domestic conditions in the Netherlands has been rather small. In fact, interviewees have noted that as a longstanding participant in pre-EMU currency pegs, and as a traditionally open and invariably small economy, policymakers in the Netherlands have long been accustomed to managing external shocks, as well as delegated monetary policy. Indeed, while Jones (1998a, 45) notes that the Belgian central bankers had been more successful in shadowing the

deutschmark in the 1970s and 1980s than their Dutch counterparts, a hard currency policy and a tight link to the deutschmark had long been a preoccupation of Dutch policymakers (Hemerijck 2014).

These early commitments to monetary policy set elsewhere have meant that, unlike in Germany, where the loss of national monetary policy only happened with the formal transfer of powers to the European Central Bank, the Dutch social partners have long been accustomed to managing central bank rates set with other conditions than their own in mind. Indeed, Verdun (2008, 224) notes that where there has been a mismatch of central bank rates set elsewhere, either by the ECB, or indirectly by way of a peg to the deutschmark, Dutch policymakers have made a habit of making necessary adjustments by way of wages and prices, rather than by central bank rates. This point is also stressed by interviewees (e.g. Interviewee 37b 2014), who note that in practice Dutch monetary sovereignty had been given up well prior to EMU because of pre-EMU currency pegs and a national hard currency policy. Speaking both the embeddedness of wage discipline in Dutch collective bargaining, as well as the country's history with interest rates set elsewhere, a central banker and member of the SER noted:

“People tend to think that for the Netherlands EMU was a watershed moment. It was not in terms of labour issues. Remember that the Netherlands had an exchange rate link with Germany long before EMU. In fact, you might add that we were addicted, or felt happy with de facto monetary union long before European Monetary Union, so at least since 1979 we had a semi-permanent fixed exchange rate to the German mark...The idea was that by this fixed exchange rate we were able to import this relatively-low German inflation rate. The only proviso was that you had to have domestic cost developments, a real exchange rate that was consistent with that objective, and for that you need wage developments that are more or less in line with productivity, or not in line with, but consistent, and indeed this was and is the Dutch tradition long before EMU.”

Concerning lost policy instruments, Hemerijck (2014) has found that budget constraints under EMU have affected the way that the social partners and government interact, with a turn to smaller and more ad hoc agreements between the three. He has also noted a degree of acrimony between the trade unions and the state at various points in the 2000s. However, this turn has been the product of a change in attitude by the government towards the social partnership, rather than an outgrowth of EMU (Hemerijck 2014). This point is echoed by Biemans (2014), as well as Bulk (2014) and Pentenga (2014) who note important differences in the view of the social partnership between governments. Hemerijck (2014) notes as well, however, that budget constraints have been 'quasi-internalized' by the social partners, and are not contested politically. With this in mind, a representative of the employers had noted that they were happy to negotiate over issues besides financial ones (Harteveld 2014). The key implication of the observations of Harteveld (2014), and what Hemerijck (2014) notes about budget constraints being internalized, is that while the contours of the social partners' relationship with the state have changed, there is no evidence that it has been undermined by EMU. Considering the point by Johnston (forthcoming) that part of the pressure from these public sector unions for significant wage increases in the early 2000s was in their perception that external constraints had been lifted with the Netherlands' joining EMU, these comments by Hemerijck (2014) are intriguing. Indeed, that budget constraints from the single currency have come to be internalized by the social partners would seem to represent a countervailing external constraint upon spending on wages in the public sector.

Moreover, following Bulk (2014) and Pentenga (2014) domestic politics is a much better predictor of relationship of the state with the social partners than the single currency. Berk (2014) makes a similar point, arguing that the influence of elections and politics has been underplayed in the study of social partnership in the Netherlands. From his vantage point in the Ministry of Social Affairs and Employment, Biemans (2014) has observed that changes of government, rather than

EMU have had a very important role in the developing relationship between the state and the social partners. He notes as a for instance that several Ministers of Social Affairs have taken a dim view of the social partnership in general or the trade unions in particular, which has at times soured relations with the social partners.

However, at the same time as the relationship between the state and the social partners has changed under EMU, other interviewees (e.g. Abbing 2014; de Beer 2014; Biemans 2014; Haket 2014; Hemerijck 2014; Tunnissen 2014; van Riel 2014) have stressed that EMU has not affected the relationship between the social partners themselves. Haket (2014) stated frankly that on the relationship between employers and trade unions in the Netherlands: "I don't see any difference before and after introducing the euro." Interestingly, one might expect much greater tension in their relationship because even as late as the early 1990s, state supports had been very important in facilitating wage negotiations between the social partners, as well as easing pressures on the labour market with generous retirement and disability programmes (as in Jones 1998). More specifically, government spending worked as an important lubricant for negotiations between the social partners, which has now been curtailed with new budget rules under EMU.

However, representatives of the major trade union confederations and the employers have emphasized this point, have stressed that their relationship has not changed because of EMU (Bulk 2014; Harteveld 2014; Pentenga 2014). This point is echoed by a representative of STAR, the bipartite body that serves as a forum for some of their negotiations at national level (Haket 2014). Indeed, interviewees have been more apt to cite difficult negotiations over sensitive areas of national public policy than issues to do with wages or EMU as a source of tensions. For instance, Bulk (2014) and Pentenga (2014) note that while there were heightened tensions in the early 2000s between government and the social partners, these tensions were the result of difficult talks over controversial pension reforms, rather than wages. Considering as well the relationship between the social partners, van Riel (2014) suggests that the habit of relying upon calculations of inflation and

productivity from the Centraal Planbureau (CPB), in which the social partners have traditionally had a high level of trust, has had a sobering effect upon their dealings with each other. This development means that while the negotiation of social pacts and other policy changes may be qualitatively quite different in future, the bipartite negotiations between the social partners that govern wage developments have been largely unchanged by these new budget constraints under EMU.

In sum, much about wage setting remains the same in the Netherlands under EMU. Wage discipline has continued apace after a brief interruption, caused by other factors, in the early 2000s, while there is no evidence of a divergence in wage developments between sheltered and exposed sectors of the Dutch economy. Interestingly, while lost policy instruments, specifically constraints upon fiscal policy, have impacted the relationship between the social partners and government, the relationship between the social partners themselves has not changed significantly since the adoption of the single currency. Said Berk (2014) on the euro's impact on Dutch wage negotiations: "I'm afraid that you're overselling EMU".

### **7.3: Institutional Conversion and Decentralization in Dutch Wage Bargaining**

Just as in Germany, while wage coordination has continued under the single currency, some of the contours of the process have begun to change in the Netherlands. What is particularly interesting is that, just as in Germany, changes in the Netherlands allow for much greater differentiation in wage settlements within sectors. By way of this process, wage setting in the Netherlands has become progressively more decentralized. However, there is a debate in the Netherlands over the extent to which firms and trade unions have actually acted on the greater scope for differentiation offered to them.

Following a brief overview of these developments, Section 7.3 argues that as in Germany, Dutch wage negotiation has undergone a process of institutional conversion, whereby the processes

governing wage setting have been repurposed to allow for greater differentiation in wage developments. As in Germany, EMU is not the root cause of these changes in the Netherlands. This process of conversion in the Netherlands, however, is more far-reaching than in Germany, with changes to its vertical coordination, as well as to its horizontal coordination, where other processes are responsible for changes in German pattern setting. However, these changes in the Netherlands preserve coordination, rather than undermine it, and thus, under EMU they constitute a benign process.

Certainly, the literature has posited that EMU would exert pressure for greater decentralization and disorganization of wage setting between and within sectors as a means of meeting asymmetric shocks under the single currency. That the Dutch system, with institutional roots very similar to the highly-centralized Belgian system has become progressively more decentralized is compelling. As in Germany, this process in the Netherlands constitutes a process of institutional conversion, whereby the Dutch system has been reworked to allow for greater differentiation in wage settlements.

Concerning its vertical coordination, moves have been made to allow for greater variation in wage developments within individual sectors. As in Germany, there has been much greater use of opening clauses in Dutch collective agreements, which allow for derogations from the relevant sectoral agreement. Interestingly, performance pay has been deployed far more often than has been the case in Germany, allowing for greater variation in pay within individual firms than is the case in Germany. The implications of this development are particularly interesting in the Netherlands, because industrial relations at firm level are organized quite differently. Indeed, there is a longstanding point of contrast between the two countries in the level of organization of the trade unions within individual firms.

Dutch unions today tend to be at their weakest at firm level, having much of their organizational muscle concentrated in the national confederations and their sector-level

organizations (Interviewee 40 2014). Similarly, van den Toren (2007, 4) notes that this is a longstanding issue for the Dutch trade unions, with decentralization attempts clashing with the highly centralized organizations of the trade unions as early as the 1960s. Interestingly, Dutch employers prefer to deal with the sectoral arms of the trade unions than to engage in bargaining in works councils, finding that the professionalism of the sectoral organizations makes for smoother negotiations, while preserving the consultative role of the works councils by separating them from the bargaining process (Hemerijck and Visser 1999). Hartog (1999, 461) has observed as well that the rules governing industrial relations at firm level are weakly codified in the Netherlands. This situation contrasts with German industrial relations at firm level, where, as described in Chapter 3, the trade unions tend to have more organizational muscle than in the Netherlands, and where the rules governing industrial relations were heavily codified in the 1970s, although the first legislation on firm-level works councils dates back to the 1920s.

As in Germany, while this process of institutional conversion is consistent with some of the pressures that the literature has associated with EMU, it predates the single currency. Indeed, moves to loosen the vertical coordination of the Dutch system began in earnest with the Wassenaar Agreement in the early 1980s (Hemerijck and Visser 1999), although attempts at decentralizing wage setting had been made as early as the 1960s (van den Toren 2007). Likewise, the key changes to the Dutch system allowing for greater differentiation in pay developments within individual sectors date from the New Course Agreement, a key social pact agreed in the early 1990s that cemented the changes made in Wassenaar (Woldendorp 2011, 73-4).

Similarly, the last major revision to the Dutch wage-bargaining system in the New Course Agreement was indeed influenced by a report of the SER (specifically SER 1990) on the possible impact of EMU (Interviewee 40 2014). Furthermore, the agreement was struck in a context where research from influential research bodies in the Netherlands like the WRR had been examining possible pressures and consequences of currency union for some time (e.g. De Grauwe et al. 1989).

Agreement between the Dutch social partners was found only after a threat by the government to repeal laws governing extensions of collective agreements (Hemerijck and Visser 1999), although the negotiated settlement left policymakers with a sanguine view of impending monetary union, convinced that reforms between 1982 and 1994 were sufficient to deal with any pressures that the wage-bargaining system might encounter under EMU (van Riel 2014).

However, while the latest steps in this process of institutional reform in the Netherlands were taken in the shadow of monetary union, the process itself began much earlier. In fact, what began this process of decentralization in the Wassenaar Agreement was a prolonged period of economic malaise, including notably high unemployment, and strife between the social partners that marked the Dutch experience of the 1970s, which was a process quite apart from currency union. Much like in Germany then, while the Dutch system has experienced decentralization of the sort consistent with the literature on EMU and wage bargaining, the process was begun well prior to the adoption of the single currency. The timing of the events driving this process stand out as well, with changes in Germany in the 1980s and reverberations from Unification in the 1990s driving changes in its vertical coordination, and Dutch economic malaise in the 1970s followed by an acute crisis in the early 1980s driving its own changes. These formative events predate decisions to pursue EMU, decisions about the design of EMU, with the implication that, as in Germany, the single currency cannot be the cause of these changes in the Netherlands.

Moreover, as in Germany, this process of change in Dutch vertical coordination has been a negotiated one between the social partners. Indeed, opening clauses and agreements on performance pay are negotiated as part of the collective agreement for each sector. What is particularly striking about this process is, as van den Toren (2007, 8) has observed, at the same time as Dutch collective bargaining practices have changed to allow for greater differentiation in wage developments, there has been a corresponding tightening in the internal coordination of the social partner organizations following the New Course Agreement of 1994. Certainly, differences in the



way that industrial relations are managed at firm level demand that some distinctions be made with the corresponding process in Germany. Nonetheless, as in Germany, while there certainly is much more scope for differentiation within each sector, this process is indicative of changes in the way in which wages are coordinated, rather than a weakening of coordination itself. Consequently, for its continued functioning under EMU, this process of change in Dutch vertical coordination is a benign one, as it is in Germany.

Concerning Dutch horizontal coordination, there have been moves to allow for greater variation in collectively agreed wage developments between sectors. Indeed, traditionally the national agreement between the trade union confederations and the employers that guides negotiations at sector level had agreed a single figure for wage increases upon which the sectoral social partners' agreements were expected to converge (Haket 2014). Over the course of the 2000s, however, there has been a change in the way these national agreements have been formulated, and instead of a single figure, agreements through the 2000s had come to settle upon a range within which sectoral agreements on wages were expected to fall (Haket 2014). A key implication of this change has been that while the national confederations of the trade unions still have the right to refuse support to affiliates in industrial action should their demands deviate from the national recommendations, they have allowed these affiliates far more latitude. As with changes in the vertical coordination of the system, then, these changes to the intra-associational agreements managing horizontal coordination in the Netherlands constitute a process of institutional conversion. By way of this process, the intra-associational agreements have been repurposed to allow for greater variation between sectors.

What is particularly interesting about this switch to agreeing upon a range for wage developments is that it does largely coincide with the adoption of the euro. However, as with changes to Dutch vertical coordination, these latest changes are in fact only the most recent in a long process that predates the single currency. Indeed, where in the immediate post-War period, the

sectoral social partners were charged with implementing a single national collective agreement emanating from the SER, attempts at offering them more latitude began with the first attempt at decentralizing the system in 1962. While this process is examined in detail in Chapter 2, suffice to say that this same process that has of late seen the use of a range for wage agreements by the national social partner organizations long predates the single currency, and cannot have been caused by it. It is further to this point that most interviewees in the Netherlands found the suggestion of a link between changes in wage-setting practices and EMU to be a strange one.

Fascinatingly, while there is broad agreement among interviewees that the process of wage bargaining has changed in ways that allow for greater differentiation in wage developments, there is dispute over its precise implications. This debate is focused around changes to the horizontal coordination of the Dutch system. Specifically, de Beer (2014) has argued that while the system itself has changed in ways that allow for greater variation in wage developments between sectors, the social sectoral partners themselves have not actually acted upon this newfound latitude. Indeed, he finds that wage dispersion in the Netherlands today is very similar to that of the early 1980s (de Beer 2014). By contrast, Hartevelde (2014) and Verhoeff (2014) have argued that moves to add flexibility in the Dutch system have in fact made for greater differentiation in wage settlements between sectors. Hartevelde (2014) and others (e.g. Interviewee 40 2014) note, however, that EMU is an unlikely cause of greater wage dispersion.

However, a common denominator between the views of de Beer (2014) and Hartevelde (2014) is that wage settlements themselves have remained highly coordinated. Indeed, de Beer (2014) has found that the national recommendations are as influential for the sectoral social partners as ever. Hartevelde (2014) similarly has raised no specific concerns about the continued functioning of the system. Indeed, their accounts and those of others of the Dutch response to the crisis in particular are hardly indicative of a system that is struggling to manage wage developments either within or between sectors. A report of the Dutch central bank has shown that wage dispersion

in the Netherlands contracted dramatically in the years immediately following the onset of the crisis (DNB 2014). As part of this contraction, fresh national recommendations called for a wage increase of 1% for 2009, in line with inflation, and the renegotiation of many existing contracts in line with these recommendations saw wage dispersion decline significantly. In real terms, this amounted to a wage freeze for 2009. This agreement is particularly striking given that, as late as 2008, the trade unions had called for wage increases of 3.5%, while there had been overarching concerns about a labour shortage (Harteveld 2014). Berk (2014) notes as well that this is precisely the response that the Dutch social partners had offered to the recession of the early 2000s, where in real terms wages had been frozen, and wage dispersion contracted dramatically as well. What is also particularly interesting about this process is that while there has been a greater incidence of failed negotiations between the sectoral social partners, there has not been a greater incidence of industrial action (Harteveld 2014).

Harteveld (2014) disputes some of the findings of this report by the DNB, noting that while wage levels have remained low for employees of domestically-oriented firms, export-oriented industries in the Netherlands have recovered far more quickly since the acute phase of the crisis. Consequently, they have been more apt to offer wage increases to their employees, and with them, wage dispersion has increased. Nonetheless, none of these developments either under EMU in general, or through the crisis in particular are indicative of a system that is struggling to manage wage developments. Indeed, the experience of the Dutch system contrasts markedly with those of the Irish or Spanish systems, where coordinated wage setting disintegrated during these years. Further to this contrast, Visentini (2012) notes that in crisis countries such as these, collective bargaining activities were often suspended following the onset of the crisis. More to the point, however, this process of institutional conversion in the Netherlands has not compromised the horizontal coordination of wages. For the purposes of its functioning under EMU, then, this development in horizontal coordination in the Netherlands is a benign one as well.

Interestingly, while in Germany it is only the wage-bargaining system's vertical coordination that has undergone such a process of conversion, in the Netherlands, it extends to the process of horizontal coordination as well. This point of contrast is particularly important given that while changes in the German system do allow for greater variation between German sectors as well, this has come as a result of a process of drift that has weakened the pattern-setting system that manages wage developments across the economy. Consequently, while changes in the horizontal coordination of the German system represent a point of concern under EMU, changes in the Netherlands to its horizontal coordination are similarly benign to the organized decentralization underway in its and Germany's vertical coordination.

In short, the Dutch system has undergone a process of institutional conversion, whereby collective bargaining practices have been reworked to allow for greater differentiation both within and between sectors of the economy. This process of conversion touches both the vertical and the horizontal coordination of the system, but preserves coordination nonetheless, rather than undermining it. This process of change long predates EMU, with the first attempts at decentralizing the system date from the 1960s. More importantly, because these changes preserve coordination, they represent a benign process for the Dutch system's functioning under the single currency.

#### **7.4: Institutional Drift and Declining Trade Union Membership**

As a final form of institutional change, this section argues that the Dutch social partnership has undergone a process of institutional drift, whereby beneath the high coverage of the Dutch wage bargaining system, the membership of the trade unions has declined significantly since the 1980s. Certainly, this is a common phenomenon in some other coordinated systems, although, some emerging fault lines within the Dutch trade unions, as well as some unique features of the Dutch system single out this development as a point of concern. Certainly, there is little evidence that this

development has yet done serious damage to the Dutch system, although it is one that has been highlighted by interviewees as a source of concern.

As Figure 7 noted in the last chapter, collective bargaining coverage in the Netherlands has remained very high, as it has in many other highly coordinated systems. Indeed, where in Germany, declining density of employers' associations and an aversion to legal extensions have seen coverage decline significantly, membership of Dutch associations has remained high. Visser (2013) places the coverage of Dutch employers' associations today stable at 85%, as compared with 60% and declining in Germany, and a stable 82% in Belgium. This consistently high coverage in the Netherlands comes despite the observation of Hartevelde (2014) that the membership of employers' federations has declined in the Netherlands.

As Section 6.4 noted, the decline in collective bargaining coverage represents a point of concern in Germany, but not one that is afflicting either Belgium or the Netherlands. The ready use of legal extensions in both Belgium and the Netherlands keeps coverage high and represents powerful incentives for employers to remain inside associations. Beneath this apparent stability, however, trade union membership in the Netherlands has declined significantly, even if the coverage of the agreements that they sign remains very high. It is because of this mix of strong formal integrity of Dutch wage-bargaining institutions and some atrophy of its underpinnings that the decline in Dutch trade union density very closely resembles institutional drift (Streeck and Thelen 2005; Mahoney and Thelen 2010). Figure 9 below traces trade union density in the Netherlands against that in select other EMU countries from the Wassenaar Agreement in 1982 to 2011.

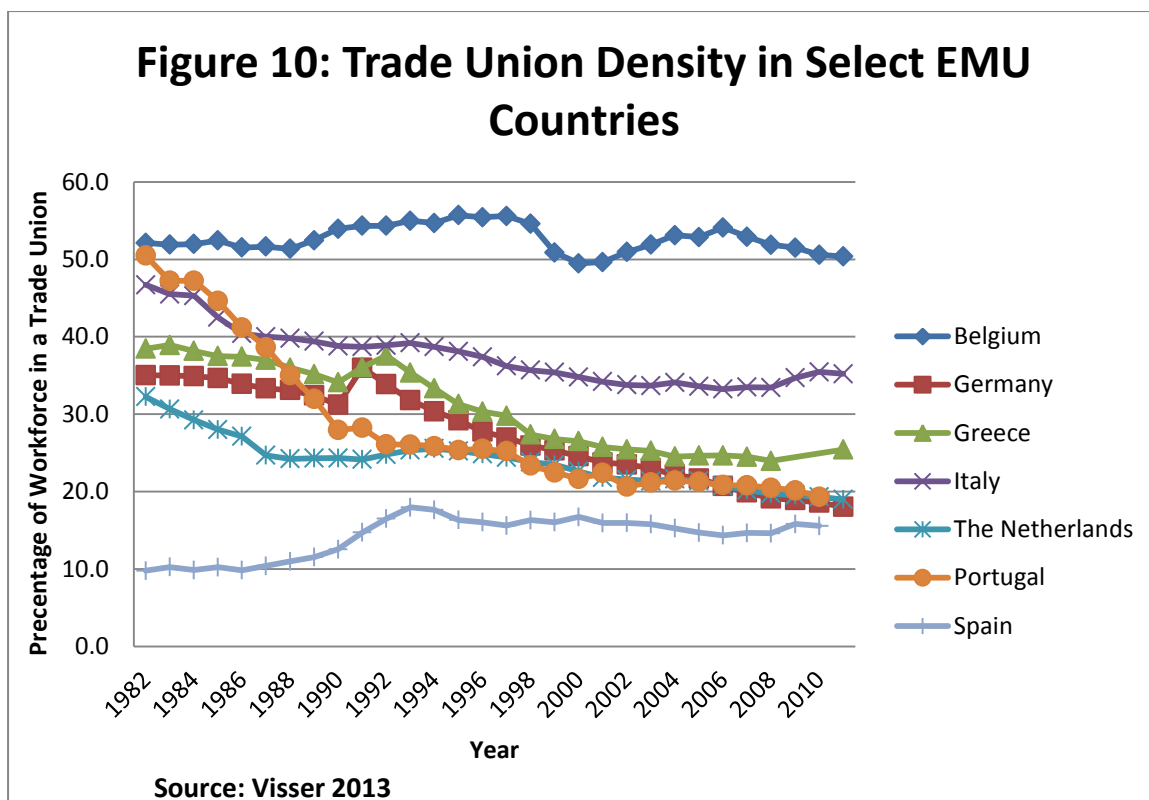


Figure 99

Concerning this decline in Dutch trade union density in Figure 9 above, two points stand out. First, the decline in trade union density in the Netherlands long predates the single currency. Indeed, trade union density declined most significantly during the labour market realignment following the Wassenaar Agreement in the 1980s. This development predates even the agreement of a blueprint for EMU in the Delors Report (1989), to say nothing of EMU itself. Van Riel (2014) goes still further, tracing the beginning of this trend to the 1960s, whereby it predates even the Werner Report (1970). There was a similar, but less acute decline following the New Course Agreement of 1994. Certainly, the time since euro adoption has seen a further decline in trade union density, although there is nothing to suggest that it has accelerated or otherwise impacted these pre-existing trends in Dutch union density (van Riel 2014). Indeed, OECD figures highlight that many other industrialized countries have experienced similar declines in trade union density over this period, both inside and outside the euro area (OECD 2014c). Second, considered comparatively, trade union density would appear to be at best a very blunt indicator of effective wage coordination. Indeed, Figure 9 makes no

meaningful distinction between countries like Germany and the Netherlands, and some mixed systems like Portugal and Spain. By this measure, one might expect a much better experience under EMU for Italy, or even Greece for that matter, than for Germany or the Netherlands.

However, there is little evidence that the capacity of the Dutch trade unions has yet been severely compromised, or their ability to coordinate limited. The Dutch situation differs starkly from the developments in Belgium, where observations depicted in Figure 9 show consistently high trade union density coincides with the findings in Section 5.4 that the role of the trade unions, and indeed the employers, are slowly being displaced by its state-driven elements. Indeed, having their system calibrated so differently, the Dutch social partners have had none of the troubles with a hard floor and lowering ceiling for wage negotiations. Interestingly, Streeck and Thelen (2005) discuss drift as part of a slow process by which institutions decay and lose their grip on their social reality, and by which their continuing to function unchanged in new circumstances produces very different outcomes. Nonetheless, that the Dutch wage-bargaining system has continued to produce the same outputs in terms of coherent wage policy and quick responses to economic shocks despite important changes in its underpinnings should represent a source of comfort.

However, this point of contrast between Belgium and the Netherlands, indeed between the Netherlands and countries such as Italy or Portugal, which have higher trade union density but significant troubles under EMU, underscores a crucial point of this investigation: rather than raw membership, the labour movement's capacity and coherence, as well as individual trade union confederations' ability to manage their organizations matter immensely for such countries' ability to coordinate wage policy effectively. It is for precisely this reason that recent developments in the Netherlands stand out: this decline in trade union membership stands out as a point of concern because of the impact that it is having within the Dutch labour movement itself. Concerning changes within the trade union movement, many interviewees have noted deepening fault lines within the

Netherlands' largest trade union confederation, FNV. Specifically, there has been a split between moderates and radicals inside FNV.

Certainly, there is evidence of divides within the employers' camp as well. Indeed, one interviewee noted that larger companies tend to dominate in negotiations with government and the trade unions and that smaller companies tend to resent this (Abbing 2014). Others have noted fault lines emerging through the crisis over problems with company financing, which are acutely felt by small and mid-sized companies, but much less so with larger ones (Bulk 2014; Pentenga 2014). Nonetheless, they have not suggested that this has seriously affected the coherence of the employers' associations.

By contrast, divides in the labour movement represent a much larger point of concern. These divides have been brought out most forcefully because of the crisis, and the inherent challenge of negotiating under conditions of economic malaise. Similarly, this observation of internal strife in a social partner organization is consistent with the expectation in the literature that wage negotiations may become more laboured under EMU. However, Hartevelde (2014) has stressed that this split is also a response to declining density, whereby moderates and radicals have reached different conclusions about how best to preserve the role of the confederation. Curiously, interviewees in Belgium, with union density much higher than that of the Netherlands, reported no such splits in the Belgian trade union confederations. Concerning this split, Hartevelde (2014) observed that "one group within the unions is becoming more radical. They believe that they can increase the number of members by, not by consultation, that's the key work of our model, but by action, so not talk but strike...they're the organizers, so to say, and that philosophy is gaining and gaining in importance in the union." Thus, moderates have seen continued engagement with employers and the state as the best means of preserving FNV's position in the system, as well as the system itself. By contrast, radicals have come to see the enhanced visibility that comes with demonstrations and mobilization as a means to gather new membership and to arrest the decline in



Dutch union density (Harteveld 2014). Interestingly, where this split is in large part an outgrowth of a decline in density unconnected to EMU, a closer examination of its contours further discounts the single currency as a cause of this split.

Figure 10 below follows the share of union membership represented by each of the major trade union confederations from the New Course Agreement in 1994. What is notable about this figure is how consistent the share of membership has been for each of the major trade union confederations. Indeed, that these shares have been consistent over time suggests that the relative decline of union density in the Netherlands has been distributed relatively evenly among the different trade union organizations. More to the point, this development suggests that FNV affiliates have not been affected disproportionately by the decline of Dutch trade union density.

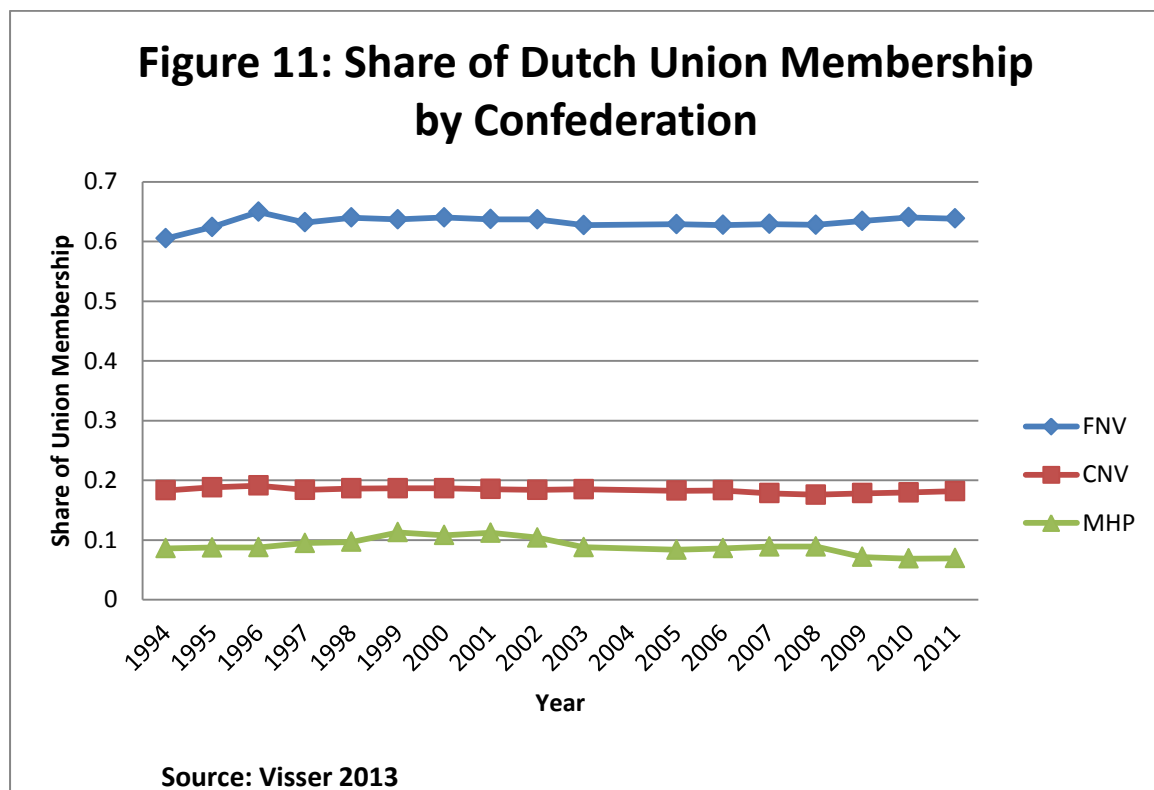


Figure 1010

Rather, interviewees have pointed to unique features of FNV's organization that explains the split between radicals and moderates. Indeed, one trade unionist has argued that of FNV's large share of union membership and the leading role that it takes in negotiations make it more apt to

adopt a tough stance towards employers (van der Woud 2014). They compare this stance to the CNV's role in wage negotiations, noting that mass rallies come less naturally to the much smaller confederation with fewer members to rally. Consequently, it is often much more docile and conciliatory in negotiations (van der Woud 2014). Specifically, he states that:

“We are the second largest trade union federation, and that means a lot here, so FNV really takes the brunt of all the nasty aspects of economic and social policies, so they're into...protests. They organize the sit-ins and we keep on talking (chuckles) and that's the way it works. They make the public statements and we negotiate behind the scenes: that's the way it works. We work closely there because someone needs to keep open the channel of communication with government while the other is screaming murder (chuckles).”

(van der Woud 2014)

Another policy advisor with a Dutch trade union confederation similarly contrasts FNV and CNV behaviour, but points to different causes of their behaviour (Interviewee 41 2014). Indeed, they point to organizational culture, noting the confessional protestant roots of CNV and contrasting this with the socialist underpinnings of FNV's organization that lend themselves more easily to a tough stance in negotiations, as well as mobilization and mass demonstrations as instruments in these negotiations (Interviewee 41 2014). Specifically, on the roots of this approach to wage negotiations, they note that CNV is “not based on a class struggle. Class struggle has never been part of our ideological thinking, so the Christian Democratic thinkers, the Christian social fold so to speak, has always had the principle of shared responsibility, so based on that you don't go on strike. You negotiate” (Interviewee 41 2014).

As noted in Chapter 3, the development of the Dutch trade union movement contrasts with that of the German trade unions, for instance, for whom consolidation and moderation were essential to their inclusion in the post-War settlement, and in effect, for their survival. This

consolidation produced trade unions organized on a sectoral basis with only a single national confederation. Likewise, efforts by the German state, as well as moderates in the labour movement to tame its more radical elements date back to the 1920s. By contrast, the corresponding consolidation in the Netherlands did not occur until the 1970s, by which point the predecessor of FNV was already the leading trade union confederation.

Furthermore, another expert has noted that the traditional weakness of Dutch labour unions at firm level makes the sorts of demonstrations favoured by radicals much more appealing as a means of improving the confederation's visibility to potential members (Interviewee 40 2014). By contrast, the strong and highly visible works councils that are characteristic of the German system make this need for additional visibility less acute. Nonetheless, the contours of this split in the Dutch labour movement have been driven by domestic factors that existed apart and prior to EMU.

However, while the present troubles of the Dutch labour movement are not the result of EMU, they do represent a point of concern because of the implications that they may have for Dutch wage coordination. Although there is not yet strong evidence that this development has significantly disrupted wage negotiations. Indeed, most interviewees have been unequivocal that over the course of the 2000s, the relationship between the social partners has largely remained stable. The bitterness surrounding the recession and subsequent freezes in the early 2000s notwithstanding, wage negotiations have largely remained a smooth and consensual process in the Netherlands. Nonetheless, the split within FNV, especially recently over pension reforms holds worrying prospects, even if it has yet seriously to undermine wage negotiations, for two reasons.

First, internal coordination within trade union organizations is essential for the continued functioning of the Dutch wage-setting system and an emerging split within FNV poses significant problems because it represents by a wide margin the majority of organized workers in the Netherlands. Such a split poses problems for both the horizontal and vertical coordination of the Dutch system. Indeed, where internal communication within trade union organizations is essential

for managing the bargaining process, from consultation prior to negotiating the national recommendations through the subsequent rounds of bargaining at sectoral level, splits in one such organization raises serious challenges for the governability of the system. Furthermore, relying upon intra-associational agreements for Dutch horizontal coordination means that a split in one of the chief participants in this process makes coordination across sectors all the more difficult, especially with one faction pushing for a tougher stance towards another social partner organization. This development is particularly perplexing, given Hartevelde's (2014) observation that these splits did not just afflict the sectoral affiliates of the FNV, but extended to the leadership of the national confederation.

By contrast, while there is no evidence in Germany of an emerging split within the trade union movement nationally, as it is organized on a sectoral basis with only a weak role for the national confederation of the trade unions, the DGB. Indeed, that German negotiations have been organized in this way means that declines in membership and militancy in the service sector, for instance, are isolated to the service sector, and have no impact on the vertical coordination of other sectors. Likewise, Ver.di's troubles do not seriously impact the ability of IG BCE in the chemical-electrical sector, for instance, to continue to follow the lead set by the metalworking agreement. As a result, much of the German pattern-setting system can continue to function in many sectors, even where the social partner organizations in one are experiencing problems with their internal coordination.

Second, the split within FNV is notable for its impact upon other organizations. Certainly there is no evidence of a similar split within CNV and nor have interviewees come to characterize relations with the employers as adversarial or bitter. However, the employers watched this leadership crisis inside FNV with much concern, and even noted that these tensions had spilled over into wage negotiations (Hartevelde 2014). Indeed, from his vantage point at AWWN, an employers' association, Hartevelde recounted that:

“At the moment that [Ton Heerts] became director [of FNV], the influence of the radical wing was increasing, and we were concerned that the radical wing would win, but fortunately, Ton Heerts won, so the consultation wing was more dominant. Still, you see that the radical part is very important...we view that also there is pressure on wage consultations, yes, so actually this year (2014) there is a lot of pressure”

(Harteveld 2014)

Fascinatingly, as part of the settlement that saw the moderates in FNV retain control of the confederation, one Dutch trade unionist (Interviewee 41 2014) noted that this same agreement had caused discord among the employers. Specifically, they noted that while the agreement had placated factions inside FNV, there had been grumbling among some employers that in pursuing this end, the agreement had been overly generous to the trade unions. While this chain of events is highly suggestive of a system able to cope with and to contain conflicts such as these, it also suggests limits to its coping ability.

Certainly, that this most recent flare-up of factionalism within FNV appears to have been contained, and thus the process of institutional change at work remains institutional drift. What is particularly disconcerting about this latest episode is the number of features that it shares with Streeck and Thelen's (2005) notion of institutional exhaustion: They describe a process whereby behaviours allowed by a set of institutions gradually act to undermine them, making this a process that flirts with a breakdown of the institutions involved. There is also the very strong suggestion in Streeck and Thelen's (2005) development of the concept that inherent flaws in institutions' design or key points of conflict that institutions contain but do not resolve play an important role in this process of institutional change. There is much in the notion of institutional exhaustion that resonates with the current spat within the Dutch labour movement. Indeed, the note by Streeck and Thelen (2005) about conflicts that are contained but not resolved resonates with events in the Netherlands, which turn on a split inside FNV that has opened along familiar fault lines. These events

also invoke exhaustion in that this conflict within FNV has spilled over into conflicts with other social partner organizations, with the more radical arm of the organization taking a tough line vis-à-vis the employers. Recalling one the point of one observer (Interviewee 40 2014) that some in the employers' camp were dissatisfied with actions taken by the employers' association to preserve the position of FNV moderates suggests the possibility that new cracks may result from this fault line in FNV. Likewise, the central role that the Dutch system gives to these organizations makes this development all the more worrying.

Fractiousness prevailed in the Dutch trade union movement from the conclusion of the Second War until a wave consolidation in the 1970s. This fractiousness mirrored the situation on the employers' side, as much of the period from the War until Wassenaar was marked by highly conflictual relations between the social partners. However, during this earlier period, these divisions had been managed by the state, which enjoyed a highly privileged position in the wage-bargaining system. Its role has been gradually pared back since the early 1980s, such that the state no longer plays this role today and has relieved itself of the instruments that it had once used to that end. This situation contrasts markedly with that of the Belgian social partners and the process of displacement that they are experiencing. In this process the state-driven elements of the system are becoming more prominent, although wages remain tightly coordinated. Certainly, this most recent flare-up of conflict inside the FNV has been successfully contained and this process of institutional change remains drift. However, the declining union density and the internal divides inside the organization remain unresolved, meaning that the stakes in subsequent flare-ups may be very high indeed.

In short, the density of Dutch trade unions has declined steadily over the period since the adoption of the euro as part of a process of institutional drift. Nonetheless, the coordination of wages has continued much as before, although this decline has stoked conflicts within one of the chief trade union confederations, the FNV. Many of the events surrounding this internal conflict invoke Streeck and Thelen's (2005) notion of institutional exhaustion. While this conflict was

successfully contained, its underlying causes have not been resolved. Thus, while the key process at work is still a less worrisome process of drift, the stakes for subsequent clashes along these lines may be very high.

## **7.5: Conclusions and Chapter Synopsis**

As in Germany, the Dutch wage bargaining system has experienced none of the strains from Economic and Monetary Union that the literature has suggested should afflict coordinated wage-bargaining systems. In the Netherlands, wages remain highly coordinated; there is no evidence that the single currency has caused wage inflation nor that the country has struggled with a mismatch of central bank rates and national conditions. Indeed, while there was a spike in wage costs coinciding with the first years of EMU (1998 through 2001, see Figure 8), interviewees insist that this increase was the result of coincidence of transitory factors unconnected to EMU. The system did respond with a correction in the mid-2000s in the form of agreed wage freezes. Moreover, having participated in pre-EMU currency pegs, wage setters in the Netherlands have long been accustomed to making necessary adjustments to wages and prices where otherwise monetary policy would take on this role. This habit has served them well with the transition from a national central bank to a European one.

The Dutch system has undergone two processes of institutional change. While none have been caused by EMU, they have very different implications for the system's continued functioning under the single currency. Section 7.3 details a process of institutional conversion similar but further-reaching than that in Germany, whereby the Dutch system has undergone a continued process of managed decentralization. This process began in earnest in the 1980s, but followed attempts at decentralizing wage setting since the 1960s and is unconnected to EMU. By way of this process, the national agreements that manage wage growth across sectors have become less prescriptive, while opening clauses and performance pay rules at work at sector and firm level are

giving individual firms and works councils more latitude within individual sectors. However, there is a debate over the extent to which actors at lower levels have actually acted upon the greater latitude afforded to them. Nonetheless, the common denominator among these two schools of thought is that wage developments in the Netherlands remain highly coordinated. This point about Dutch wages remaining highly coordinated was in evidence with the rapid response by the social partners to the crisis. Consequently, this process of conversion represents a benign one under EMU, as it has in Germany.

By contrast, the Dutch wage-bargaining system has undergone a process of institutional drift, whereby collective bargaining coverage has remained very high, and thus the formal integrity of the system has been preserved, but trade union density has declined significantly. Once again, the beginning of this process long predates EMU, which has had no discernable impact upon subsequent changes in Dutch trade union density. However, while the system has continued to function with less representative trade unions, this slide in density has aggravated underlying conflicts within FNV. While these conflicts have been contained, because FNV is so central to the Dutch system, much more so than any of the individual German trade union confederations, for instance, that the underlying causes of this rift were not resolved represents a point of continued concern.

What these findings suggest is that there is nothing inherently incompatible between the design of the Dutch wage-bargaining system and EMU. As it has been in Belgium and Germany, internal coordination by social partner organizations, particularly the trade unions, has been equal to the task of managing vertical coordination in these more challenging circumstances. As in Belgium, the intra-associational agreements, relied upon by the Dutch social partners, have continued to be effective in maintaining horizontal coordination. What stands out about this comparison is that while the highly restrictive calibration of the Belgian system has helped to keep wage dispersion low, developments in the Netherlands suggest that absent such restrictive calibration, national intra-associational agreements are entirely capable of managing pressures to decouple wage



developments in different sectors. Certainly, it is very much the case that these agreements in the Netherlands have changed to allow for greater variation between sectors, but there is no evidence to suggest that coordination has been weakened as a result.

More interesting has been the fact that the calibration of the Dutch system has allowed it to manage wage developments such that the Dutch economy has remained competitive against its closest Eurozone trading partners. It has also allowed the Dutch social partners to make sharp corrections in the face of economic shocks, while also preserving their role in managing wage developments. Indeed, the contrast with Belgium, where calibration to inflation and wage developments in other EMU countries are posing significant challenges for both competitiveness and the social partnership, could not be starker. Curiously, that the Dutch government, and later the social partners, arrived at such different conclusions about wage indexation in the early-1980s than did their Belgian counterparts in the mid-1970s seems fortuitous. Certainly, the labour market realignment that followed played an important role in cutting Dutch union density. However, the abolition of escalator clauses following the Wassenaar Agreement appears to have spared the Dutch social partners so many of the problems now facing their Belgian counterparts.

### **Part 3: Drawing Conclusions**

Where Part 2 examined in depth developments under EMU in Belgium, Germany, and the Netherlands, Part 3 draws conclusions. It is divided into two chapters: Chapter 8 examines the broader relevance of these three country case studies, examining the implications of their experience under EMU for our understanding of coordinated wage setting and more broadly for the rest of the euro area. Chapter 9 returns to the cases themselves with some concluding remarks on institutional change in their systems.

## Chapter 8: So What?

### 8.1: Introduction

This chapter brings together conclusions from the experiences of Belgium, Germany, and the Netherlands, returning to the question posed at the outset, specifically, *is monetary integration detrimental to coordinated wage setting, and how do institutional variations affect a system's ability to cope with new pressures under EMU?* In each of the three countries, i.e. in Belgium, Germany, and the Netherlands, distinct national institutions have made for unique experiences under EMU. Indeed, many of the processes of institutional change underway in each country are unique to them. Nonetheless, several common themes emerge from their time under the single currency. This chapter proceeds thematically, examining in turn in these common themes, tracing their theoretical implications, as well as the empirical implications for the rest of the euro area.

Specifically, Section 2 finds that, except in Belgium, EMU has had very little direct impact upon many of the mechanisms that these coordinated systems use to manage wage setting. Rather, this chapter finds that far more consequential are other external pressures (Section 3) and underlying changes in social partner organizations (Section 4). It finds in Section 5 that more distinction must be drawn between 'decentralization and disorganization', while more attention must be given to the state role in collective bargaining (Section 6) and to the role of calibration in coordinated systems (Section 7). Section 8 provides a chapter synopsis.

### 8.2: The (Limited) Impact of EMU on Highly Coordinated Systems

What stands out among all three cases is that, contrary to what much of the relevant literature had predicted, EMU does not actually undermine many of the key components of highly coordinated wage-bargaining systems. This finding is apparent from Sections 5.1, 6.1 and 7.1. In fact, many interviewees in both Germany and the Netherlands were struck by the notion that Economic and

Monetary Union might have some impact upon their wage-setting practices. However, considering that in neither country was there evidence of institutional change tied to EMU, this view among interviewees is well-founded.

Similarly, while interviewees in Belgium pointed to very acute pressure from EMU because of the calibration of their system, other facets of the system itself raised little concern. More specifically, of the mechanisms outlined by Traxler and Kittel (2000), internal coordination by trade unions, as well as coverage extended by broad membership of employers' associations and legal extensions may continue to function under EMU in systems that effectively coordinate wages. The same may be said of pattern-setting systems and intra-associational agreements.

Concerning pressures from the transfer of powers from national central banks to a European one, Soskice and Iversen (2001), had suggested that wage discipline would be relaxed because national wage setters do not coordinate across national boundaries. However, there is no evidence of such a change in any of the three cases under study. Even in Belgium, which struggles mightily with cost competitiveness, EMU has not so much encouraged inflationary wage growth, but rather removed other tools that policymakers had used to address it in the past. In this respect, the findings of this project are in line with arguments by Johnston (2009) and others in the VoC literature, who conclude that the social partners in highly coordinated systems still face important incentives for wage moderation, even without the threat of sanctions from the central bank. In fact, while there is increasing evidence that coordination through the European peak associations of the trade unions is becoming more robust, the overriding concern among many interviewees was that greater pressure on wages to adjust under EMU would have the opposite effect. Indeed, many more interviewees were concerned about deflationary pressures in coordinated systems under EMU, rather than the reverse. In this regard, then, the social partners in well-coordinated systems, with encompassing organizations, and having internalized the need for wage discipline, deserve far more credit than they received in the early literature on EMU.

Concerning lost policy instruments, the findings of this project are very much in line with the emphasis in OCA theory (both early, e.g. Mundell 1961 and late, e.g. Commission 1990; 1991) on the importance of flexibility in real wages under a currency union. OCA scholars had argued that without the buffer of exchange rate fluctuations, real wages needed to be flexible in order to manage economic shocks. Certainly, theorists such as these do not explicitly reference wage-setting institutions, although it is particularly notable that those countries, namely Germany and the Netherlands, in which the social partners have greater flexibility in deciding wage developments, have faced far fewer concerns about their competitiveness under EMU. This finding is very much in line with predictions by Magnusson and Stråth (2001), Hancké and Soskice (2003), Allsopp and Vines (2008), as well as Zemanek, Belke and Schnabl (2010).

Contra Abraham and van Rompuy (1999), highly uniform wage developments across sectors proved less problematic. Indeed, while Belgium is known for highly uniform wage developments, it maintains highly uneven wage levels between sectors. While this issue of highly uniform wage developments but highly uneven wage levels was mentioned as a point of concern by several interviewees (e.g. Interviewee 8 2013), it was not cited as a concern for the model's performance under EMU.

Moreover, constraints placed upon fiscal policy, which limit the range of inducements that can be offered to the social partners proved to be less important in state-supported systems with robust social partner organizations. Indeed, there is no evidence of a breakdown in coordination in the Netherlands, for example, and the social partners report that where state inducements are necessary, they are happy to haggle over non-monetary inducements (Harteveld 2014). This trait very much sets them apart from weakly coordinated systems that rely so heavily upon such inducements to align highly fragmented social partner organizations.

Following Crouch (2000), Belgium, Germany and the Netherlands have had very different experiences under EMU and the single currency has indeed amplified the effects of subtle

differences in their systems. However, much of the literature on coordinated wage setting and EMU appears to have overestimated the possible effects of currency union upon coordinated systems. What is particularly interesting, however, is that following Johnston and Hancké (2009), Johnston, Hancké and Pant (2014) or Hancké (2013), for instance, some of these pressures have indeed affected weakly coordinated systems, though this is less the case for highly coordinated ones. This point is also borne out in Figures 3, 5 and 8, where the three coordinated systems under study have generally outperformed their weakly coordinated counterparts in the time since euro adoption. Consequently, while the concerns of the early literature on wage setting and EMU were not necessarily unfounded, they were perhaps misdirected.

These findings should come as a source of comfort for other highly coordinated systems that are currently EMU members, such as Austria, Finland and, with some important caveats, Slovenia. These countries also offer a perspective on recent changes in the weakly coordinated systems of EMU's crisis-stricken countries. Indeed, concerns were raised by Visentini (2012) and Pochet (2012) that the weakly coordinated systems in crisis countries were in serious danger of being dismantled. Comments by Pochet (2012) in particular suggest that these systems may become increasingly uncoordinated as a result. This development is indeed a curious one: work following Calmfors and Driffill (1988) does suggest that uncoordinated systems should outperform weakly coordinated ones just as easily as coordinated systems should.

However, work by (Soskice and Iversen 2001) suggests that uncoordinated systems under a currency union are more likely to face inflation and economic stagnation. At the least, the suitability of uncoordinated systems for EMU has never been tested empirically, with the UK having abstained from joining, while Estonia, Latvia and Lithuania have only recently adopted the euro. Similarly, Ireland shares many traits with the UK, but maintained a weak form of coordinated wage setting prior to the crisis, and offers few hints as to how truly uncoordinated systems may fare. Certainly, while the adoption of the euro by the Baltic countries does represent a fascinating opportunity to

study how uncoordinated systems function under EMU, their entry into the euro area is far too recent to properly assess uncoordinated wage bargaining under the single currency. To be sure, work by VoC scholars following Johnston and Hancké (2009) does strongly suggest that the position of weakly coordinated systems under EMU is indeed a tenuous one. However, what this uncertainty surrounding uncoordinated systems, as well as the finding of this study that most designs of coordinated wage-bargaining system cope well with pressures from the single currency suggest is that movements in the opposite direction, i.e. moves to tighten coordination rather than dismantle it may be favourable for some of EMU's crisis-stricken systems.

Returning to the theoretical framework developed by Traxler and Kittel (2000), the key implication of this study's findings is that intra-associational coordination and pattern-setting are not inherently incompatible with EMU. In fact, systems designed along these lines have done comparatively well since the adoption of the single currency. What stands out about systems such as these, and about Germany and the Netherlands in particular, is the importance of robust social partner organizations for effective coordination under EMU. What also marks them out is the importance of the space that they give to the social partners in deciding wage developments. Just as important is the subtle role that internal consultations have in ensuring that decisions by the peak associations serve affiliates, and in turn that affiliates follow the lead of the peak associations, without making the system rigid. Indeed, it is these consultations that make the Dutch system highly coordinated, but also famously nimble. Conversely, the importance of these features in a highly coordinated system is underscored by troubles that rigid calibration and decaying linkages between levels of the trade unions have caused in Belgium. In turn, what these findings suggest is that systems built around state-imposed coordination are apt to struggle, but also those designed to use inter-associational agreements, which feature binding agreements between peak associations of the social partners, but not the consultation with affiliates (Traxler and Kittel 2000).

Returning as well to the discussion in Section 3.3 on institutional change, this study's findings have very interesting implications for the treatment of EMU. Specifically, Section 3.3 considered at some length various forms of gradual institutional change developed by Streeck and Thelen (2005) and Mahoney and Thelen (2010). These concepts captured very well the institutional change that has occurred in Belgium, Germany and the Netherlands. Section 3.3 also discussed the concept commonly used by neoinstitutionalist scholars of a critical juncture, namely a point in time where institutions become far more fluid, and open to large changes or even breakdown and replacement. Clearly for Germany and the Netherlands, where there is no evidence of institutional change caused by EMU, let alone radical change, EMU is clearly not a critical juncture. However, the experiences of Belgian wage-bargaining system and those of the mixed crisis countries do demand a different treatment of the single currency. Specifically, for these mixed systems, EMU has brought about circumstances that have severely weakened their wage-bargaining institutions and has opened the possibility of significant institutional change. For Belgium, however, the notion of Cappoccia and Kelemen (2007, 350) that a critical juncture need not be a discrete event, such as the crisis, but rather be a sequence of events in a compressed span of time that may lead to significant institutional changes raises intriguing prospects. Indeed, for Belgium, the adoption of the euro has slowly exacerbated its model's inbuilt problems with competitiveness and begun to displace the social partners' role in bargaining, which some observers (such as Interviewee 4 2013 or Interviewee 9 2013) have noted raise the prospect of reforms that go much further than previous rounds of institutional change in Belgium. Thus, the gradual processes of institutional change underway in Belgium may in time culminate in something much larger.

### **8.3: The Impact of (Other) External Forces**

Certainly, external forces have indeed impacted coordinated systems, but interviewees cited external forces other than EMU as points of concern. Indeed, many interviewees cited concerns



about globalization in particular. These concerns ranged from the broad challenge of facing increased international competition to far more specific issues tied to dealing with multinational companies. Indeed, some representatives of the social partners reported new challenges in dealing with the subsidiaries of multinationals that had a poor grasp of their labour market models. For instance, Haket (2014) at STAR has noted that a fair amount of the organization's workload involves dealing with the subsidiaries of foreign companies who are far less versed in the finer points of Dutch industrial relations. Likewise, Harteveld (2014) at AWVN reported that a not insubstantial proportion of his organization's work entails instructing foreign-trained managers in the Dutch subsidiaries of various multinationals on precisely these finer points mentioned by Haket (2014).

Interestingly, when pressed about pressures from European integration itself, many interviewees instead highlighted other facets of the integration process. Indeed, far more commonly cited points of interest from both policymakers and external experts were the Single Market and more acute pressures upon producers from fiercer competition. Certainly, those countries having adopted the euro would likely be more sensitive to these competitive pressures from other quarters, as constraints imposed upon fiscal and monetary policy by the single currency affect the way that they deal with competitive pressures from the Single Market as well, although no interviewees made this specific connection.

One interviewee with a German trade union noted that since 2004-5, the threat of offshoring production had become more acute, where free movement of goods under the Single Market also offers more options to companies as to where they produce their wares (Interviewee 22 2013). They also noted however, that many manufacturing jobs had returned to Germany since the crisis, and that many producers had returned the production of some more complex goods to Germany after some forays into production in new Member States (Interviewee 22 2013). This trade unionist used with some pride the example of a manufacturer of construction equipment that discovered welding done once in Germany was cheaper than the same work done again a second or

third time by less skilled employees elsewhere. Just as interestingly, they suggested further that ease of relocating production within the EU had required that their trade union be much more communicative about wages and production costs with their counterparts other European trade unions as part of the bargaining process (Interviewee 22 2013).

Enlargement emerged as a point of concern as well, with new Member States' entry into the Union increasing the wage differentials within it. Visentini (2012), for instance, has suggested that these differentials encourage wage dumping, which ultimately places downward pressure upon the wages of workers in older Member States. More commonly cited, however, was new pressure upon national wage-bargaining systems from migrant workers. Certainly, migrant labour is hardly a new or novel phenomenon in the post-War period. However, rather than EMU, interviewees cited pressures upon their wage-bargaining systems from workers posted on a temporary basis from other EU Member States. This competition is a more recent phenomenon following attempts to liberalize trade in services, whereby unlike previous waves of migrants, workers from one EU Member State may be posted to another under the pay scales, and many other provisions besides, of their home country rather than their host country. For countries with highly coordinated labour markets like Belgium, Germany and the Netherlands, this raises significant challenges, with some segments of their workforce governed and paid very differently.

This issue of posted workers came through most forcefully in interviews in the Netherlands, but what is particularly interesting is that the matter emerged as a concern not only among trade unionists concerned about pressure on wages, but in government circles as well (e.g. Biemans 2014; Tunnissen 2014). Over the longer term, one wonders to what extent rapid growth in many new Member States and commensurate growth in wage rates in these countries will make this particular pressure a more transitory one, or at least a less acute one. Nonetheless, the point here is that many interviewees, especially in the Netherlands, cited posted workers as a far more acute source of pressure upon their wage-bargaining system than EMU. Certainly, one might argue that the posting

of workers is made possible in part by the exchange rate stability offered by EMU in tandem with the Single Market, and that indirectly the single currency has contributed to this pressure upon national wage-setting systems. However, this is not a connection that was made by interviewees, who instead tend to associate this form of labour mobility with the Single Market. In fact, many of the workers in question are posted from new Member States, whose low wages and working standards make their workers appealing as a source of low-cost labour. However, many of these countries have yet to adopt the euro, ruling out exchange rate stability as a significant driver of labour mobility in these countries. Reflecting upon the literature following Mundell (1961), which stressed factor mobility as a key element of an optimal currency area, that interviewees are so deeply concerned about labour mobility is curious. Indeed, the need for mobility of labour is a point reiterated by later scholars, such as Eichengreen 1992; 1996) or Lane (2006), among many others, en route to criticizing EMU for a lack of it.

Regardless, further research is needed to establish the precise effects of these other sources of external pressure, such as these that affect coordinated systems' functioning under EMU. Concerning posted workers in particular, following Menz (2005), EU Member States have made very different decisions about how to regulate posted workers, which demands more detailed casework for untangling the implications of labour mobility upon coordinated systems. Likewise, Biemans (2014) and Tunnissen (2014) had suggested that the Dutch government was pursuing changes to the relevant EU directives to strengthen the legal framework governing posted workers, which suggests that as an issue impacting wage setting, this will be a dynamic one in the years ahead. More broadly, these findings underscore the conclusions of Section 8.2, namely that EMU is not the foremost external challenge to coordinated systems of wage bargaining. In fact, considered in comparison with these other sources of external pressure, the single currency falls very low indeed on many observers' list of concerns.

#### **8.4: The Impact of Changes to the Social Partnership**

What also emerges as a significant point of interest from these cases is that, far more consequential for their functioning under EMU, are pre-existing dynamics and other sources of institutional change in highly coordinated systems. Particularly for Germany and the Netherlands, underlying changes to their social partner organizations proved very important, and indeed, particularly worrying. In both cases, changes in social partner organizations, and then changes in German horizontal coordination, have very little to do with Economic and Monetary Union. In fact, many such changes have roots that long predate the single currency, although these same changes can still have profound implications for national systems' ability to function under EMU.

Following from this point, for assessing the state of coordinated systems' functioning under EMU, all three cases demand that a closer look be taken at the deeper health of social partner organizations. Certainly, for state-dominated systems, changes in social partner organizations are likely less important. However, in most other designs of coordinated system, internal coordination by the social partners, and especially trade unions, as well as coverage provided by employers' associations mean that changes in their organizations have important consequences for wage coordination.

Moreover, comparison of developments in the three cases suggests that more traditional measures of these organizations' health, such as membership density, are at best a blunt indicator. Two points stand out: First, as in the case of Belgium, a close look at how social partner organizations coordinate among themselves, and what is happening to their role in the system more broadly, is warranted. Second, from Germany and the Netherlands, the context in which declining membership of social partner organizations takes place is crucial: with weak extension laws in Germany, the decline in employers' associations' membership is felt particularly acutely, but much less so in the Netherlands, which makes extensive use of legal extensions. The presence of legal

extensions likely presents strong incentives for Dutch employers to remain in associations in the first instance, in order to influence the negotiation of agreements by which they will be bound.

However, what also emerges from both the cases of Germany and the Netherlands is that declining membership of trade unions in particular is certainly worrying because of the central role played by organized labour in their systems, but the implications for coordination are rather nuanced. In Germany, declining union density in the service sector in particular has allowed individual employers to leave their respective associations without consequence. However, a representative of a particularly well-organized industrial union noted that this was less a problem for their organization, with whom bargaining individually is much more daunting for companies not affiliated with the sectoral employers' association (Interviewee 22 2013).

The design of the Dutch system begets very different consequences of a strikingly similar decline in union density. It has not seen the same slide in employers' association membership or lost coverage because of liberal use of legal extensions. Rather, the bigger challenge for coordination has been the reaction of the trade union movement to this slide. More to the point, the use of pattern bargaining in Germany, with only a weak role for national peak associations, means that problems in one of its major confederations have more limited implications, while in the Netherlands troubles within one of its major confederations have system-wide consequences. For instance, while the split within FNV is a matter of national importance in the Netherlands, Ver.di's problems in Germany are just that. This is not to suggest that Ver.di's troubles are inconsequential, but rather that they are largely limited to one sector.

Conversely, more work is needed to make sense of the role of employers' associations. It is clear that in all three cases, they play a role in expanding the coverage of collective agreements: in Germany, the coverage of the system itself is only as broad as its employers' associations' membership, while in Belgium and the Netherlands, use of a legal extension demands that an existing agreement cover half the workforce in a given sector, making membership of employers'

associations an important factor as well. It is generally acknowledged that employers' associations in coordinated systems tend to have much weaker internal coordination than their counterparts in the labour movement, a point acknowledged by Harteveld (2014), for instance. However, their internal workings of employers' associations are only poorly understood. Paul de Beer (2014), for instance, who is a recognized expert on collective bargaining in the Netherlands, noted quite simply that researchers do not actually know how these organizations function. Certainly, employers' associations in these three case studies tended to be far more reclusive than their opposite numbers in the labour movement, although they represent an important part of many coordinated systems that warrants further investigation.

More broadly, this project's findings on the role of changes to social partner organizations concur with observations by Streeck and Thelen (2005) about processes of gradual institutional change, as outlined in Chapter 3. Indeed, in all three case countries, the institutions that manage wage setting have seemingly remained largely stable. The last major revisions to the Belgian system were made in 1996, while in Germany they were made in the 1970s and for the Netherlands, the last major changes were agreed in 1994. As a result, many of the changes that have taken place in Germany and the Netherlands, and to an extent in Belgium as well, have been subtle changes in the role and the behaviour of social partner organizations, even as the systems themselves remain formally unchanged.

More deeply, however, some of these gradual changes in all three systems speak to the point made by Streeck and Thelen (2005), that institutions are constantly changing and evolving, whether they are consciously reworked or not. One of the implications of this insight, they add, is that institutions require conscious and constant maintenance if they are to continue to perform the same functions. This study found that some such changes clearly did not affect coordination. In this respect, the managed decentralizations in the German and Dutch systems discussed in Sections 6.3 and 7.3 come to mind. Other changes clearly did affect coordination, a finding that suggests that

more work in this field must pay closer attention to sorting those changes are truly consequential from those that are merely interesting. More importantly, however, this insight of Streeck and Thelen (2005) are constantly changing means that they must be constantly, or at least regularly revised and updated. This insight is particularly important for Germany, where some important changes have been enacted and others proposed, and for Belgium, which has for some time flirted with deeper changes to its system.

Furthermore, that fractiousness in the labour movements of Germany and the Netherlands are such a concern for wage coordination in those countries resonates with expectations from early scholars of wage coordination (e.g. Soskice 1991) to more recent ones (following Johnston and Hancké 2009). Indeed, that fragmentation represents a significant challenge for coordination in systems that rely upon social partner organizations to play a key role very much resonates with their findings. In many ways, this finding also chimes with concerns raised about crisis-struck countries such as Spain, which have struggled mightily with wage growth against highly coordinated systems (Figure 3; Figure 5; Figure 8). That these struggles coincide with a highly fragmented labour movement (as in Molina and Rhodes 2007, for instance), then, is unsurprising. These same afflictions are less acute, though clearly evident in Italy as well (Molina and Rhodes 2007), which has not suffered as Spain or Portugal have, but has clearly struggled under EMU.

What a closer look at the experiences of Germany and the Netherlands suggests is that consolidation of trade union organizations may be an effective means of dealing with fragmentation. Indeed, prior to re-launching its economic model following the Second World War, organizations of the trade unions in Germany consolidated significantly, in order to play an effective role in post-War policymaking. It is for this reason that German trade unions today are not demarcated along ideological lines, as is more common in other continental European countries. Likewise, while successive Dutch governments had attempted to build up the role of the social partners in wage

setting since the early 1960s, they only succeeded in the task following significant consolidation of the trade union organizations in the mid-1970s.

Looking ahead, a particular point of interest for systems such as these is how trade unions address problems with membership among workers who are difficult to organize. Indeed, the growth of part time and agency work have proven a significant challenge for the German service sector union in particular, while much recent employment growth in the Netherlands has been among workers such as these. Certainly, there is evidence that trade unions in these countries have made new and creative efforts to reach hard-to-organize workers such as these: efforts have been made to organize agency workers as a separate sector in the Netherlands, while German industrial unions have made efforts build paths into permanent employment for long-tenured agency employees, for instance. However, these efforts vary significantly between countries and even between sectors. Nonetheless, the point is that these developments represent early efforts at coming to grips with this broader shift in the labour market whose later success or failure may have important consequences for systems that rely upon well-organized trade unions.

Moreover, that this investigation has underscored the importance of coherence in social partner organizations does suggest some interesting developments ahead in some recent and future EMU members. Some VoC scholars, such as Bohle and Greskovits (2007) or Mykhnenko (2007), classify the Visegrad countries, Czech Republic, Hungary, Poland and Slovakia, alongside crisis-stricken Mediterranean countries for their fragmented social partner organizations and weak coordination. All of these countries all have a formal commitment to adopt the euro as part of their accession agreements with the EU. Certainly, while these countries' dedication to meeting this goal varies significantly, they are likely to experience challenges with competitiveness in the time following their adoption of the euro. At a minimum, the inclusion of more weakly coordinated systems among EMU's membership stands to make economic governance in the euro area far more complex.



The Dutch case in particular holds some interesting lessons for Slovenia, unique among the EU's new Member States for having a highly coordinated wage-bargaining system and a recent entrant into EMU. In Slovenia, trade union membership has declined dramatically over the course of the 2000s, from around 40% at the beginning of the decade to 26.6% in 2008 (Visser 2013). However, the Dutch experience suggests that where collective agreements remain encompassing, it is the impact upon the coherence of trade union organizations of declining membership, rather than declining membership in itself stands out as the chief point of concern for the system's functioning.

### **8.5: Decentralization, Disorganization and the Distinctions between Them**

While the Belgian system has experienced very little decentralization, the Dutch and German cases suggest that some of the changes that have taken place in their systems do not actually undermine coordination, even if they do reshape it. More specifically, the sorts of change examined in Sections 6.3 and 7.3 demand that a distinction be made between decentralization and disorganization.

Indeed, the sorts of decentralizations examined in these sections maintain coordination, even if they do offer local bargaining units more room for manoeuvre. These sorts of changes that preserve coordination are to be distinguished from other changes in Germany, as examined in Section 6.4, whereby the coverage of the system has declined, to the detriment of its coordination. While this change also offers more autonomy to individual firms and employees, they do this by undermining coordination in the German system.

More broadly, what these developments in Germany and the Netherlands mean is that highly coordinated systems can also be highly flexible. These developments also mean that much differentiation within a system can coincide with tight coordination. From the Dutch and German cases, managed decentralization demands robust social partner organizations. Specifically, it requires that social partner organizations strengthen their internal coordination, as occurred in both the Dutch and German cases. By way of this process, tighter linkages have developed between the

national organizations of the trade unions and their sectoral and firm-level affiliates in the Netherlands and between the sectoral confederations in Germany and their firm-level affiliates operating in works councils. This process also requires developing greater organizational capacity at lower levels, where decentralization involves them in the bargaining process much more prominently. The burden of adjustment in both cases has largely fallen upon the trade unions, as employers' associations are often much less robust organizationally.

What these findings suggest is that managed decentralization need not pose a threat to coordination in systems with strong employers and trade union organizations. For countries like Austria or Finland, for example, decentralization may be possible without harming coordination in their systems. Conversely, state-dominated systems like Cyprus or Malta, which are highly centralized, but where trade unions and employers have only very limited organizational capacity at national or sector level are far more likely to struggle with decentralization of the managed sort, were they inclined to pursue it.

This point about decentralization is one that is less fully addressed in the literature on wage coordination, but it is one that requires clarification in subsequent work. For instance, what the Dutch case in particular demands is more work on conceptualizing 'flexibility' in wage setting. More specifically, while the system is often famed for allowing so much differentiation between and within sectors, at select periods, specifically economic crises in the early 2000s and through the current crisis, the system becomes much more rigid. During these crises, the national recommendations become much more prescriptive and as a result, wage dispersion declined dramatically. Thus, the flexibility of the Dutch system varies significantly over the run of the business cycle. At the same time, however, through the crisis the social partners have shortened the length of collective agreements to one year from an average of two to three years, which makes the system as a whole more flexible in meeting new developments in the broader euro area, but flexible in quite different ways than prior to the crisis.

## 8.6: Calibration Matters!

Moreover, what emerges very forcefully from the Belgian case is the importance of a bargaining system's calibration. This theme is explored more fully in Sections 5.3 and 5.4. Just as importantly, however, this point about calibration emerges from interviews in Germany and the Netherlands as well. Indeed, one German interviewee was quick to note that without anything approximating the Belgian index, the German system had experienced none of Belgium's problems (Interviewee 17 2013). In other discussions, however, the point about calibration came through more subtly in discussions with Dutch and German policymakers as well. Indeed, many Dutch policymakers had emphasized the importance of the 'wage space' calculated for them by the CPB in guiding their discussions. By contrast, one interviewee from the German service sector union, Ver.di, framed her concerns about changes to the pattern-setting system, emphasizing that recent wage developments in the sector had come to follow more loosely the German coordination rule (Sterkel 2014).

Not only did interviewees in individual case countries emphasize calibration, but what the comparison of Belgium and the Netherlands in particular suggests is that the ends to which different systems are coordinated has an important effect upon their experience under EMU. Indeed Belgium and the Netherlands are the most alike among the cases under study. However, having abandoned wage indexation, the Netherlands faces none of the troubles that Belgium has with competitiveness or any of its troubles with displaced social partnership or atrophying organizations. Rather, the Netherlands faces very different problems (which are discussed in Section 7.4). Conversely, that neither Germany nor the Netherlands have experienced issues linked to their calibration while Belgium has strongly suggests a good fit between their calibration and the conditions that they face under the single currency. Indeed, the pressure upon wages to redress competitiveness problems under the single currency would seem to favour their coordination rules for both their attempts to be inflation-neutral and the productivity link that they include. A point in favour of the Dutch and

German coordination rules would also be the flexibility that they allow the social partners in correcting for the business cycle.

Interestingly, policymakers from the international divisions of German trade unions in particular had emphasized the importance of calibration as well. Certainly, representatives of the Dutch trade unions (e.g. Bulk 2014; Pentenga 2014; van der Woud 2014) had been more measured in their assessment of attempts at cross-border coordination by trade unions. However, one representative of a German industrial union had emphasized heavily attempts by the European peak association, IndustriAll, to promote a common coordination rule among its affiliate industrial unions (Interviewee 17 2013). Certainly, a detailed discussion of attempts at pan-European coordination by trade unions in the EU is well beyond the scope of this investigation. Rather, the point is that systems' calibration is taken very seriously by policymakers and that its omission has been an important oversight in the literature on wage coordination.

More broadly, the Belgian experience in particular stands out as one case among many in the EU where some form of automatic wage indexation is practiced. Indeed, the wage-setting systems of Cyprus, Luxembourg and Malta all practice a form of legally-entrenched wage indexation, while inflation indexing was a common part of Spanish collective agreements prior to the crisis (Eurofound 2010). Slovenia similarly maintains a statutory system of wage indexation. What the contrast between Belgium and the Netherlands on calibration suggests is that for those countries that practice it, rigid tracking of inflation is likely to pose problems for them under EMU. What the Belgian experience suggests for Spain is that the use of inflation correction mechanisms would have exacerbated its troubles with wage inflation in the years prior to the crisis and that their inclusion in a revised Spanish model should be seriously reconsidered. Similarly, the Belgian experience suggests that Slovenia is likely to encounter troubles with wage inflation and perhaps damage to social partner organizations as its indexation system meets new with constraints under EMU.

The Luxembourgish, Cypriot and Maltese cases are somewhat more complex in this regard. The system of indexation used in Luxembourg is not dissimilar to that of Belgium, although it includes an inflation spring, whereby the application of the index can be suspended by agreement of government and the social partners (Eurofound 2010). This quirk suggests that the Luxembourgish model would be less prone to overheating than the Belgian model, although it is unclear whether under EMU, the role of its social partner organizations have been diminished as they have in Belgium. Further study is needed, although the Luxembourgish model represents a point of curiosity for the Belgian reform debate.

The Belgian experience with indexation under EMU also bodes ill for Cyprus and Malta. Certainly, their indexation systems exist in systems that are very different from that of Belgium, although the Belgian case does strongly suggest that the practice of wage indexation does exercise an important independent effect. As a result, the competitiveness problems that it has experienced are likely to be at work in even very different cases, although changes to the indexation systems in different countries may have very different implications than in Belgium. In both the Cypriot and Maltese cases, social partner organizations are much less robust than in Belgium, and multi-employer bargaining is much less common. There are some sectoral agreements present in Cyprus, but firm-level agreements are the most common (Eurofound 2010). As a result, while the Cypriot and Maltese systems are likely to be prone to overheating, as the Belgian system is, absent robust social partner organizations, their systems would be much more fragile in the event that their indexation systems are reopened. They highlight as well the importance of context in the study of wage-bargaining models, in that while the Belgian system has an increasingly pronounced state role, the Cypriot and Maltese systems are by design state-dominated.

## 8.7: On the Role of the State

As well, what emerged in all three cases was that greater subtlety is needed in the treatment of the state. Certainly, Traxler and Kittel (2000) distinguish between state-supported and state-dominated forms of wage coordination. Furthermore their distinction goes some way toward explaining Belgium's current dilemma, with its state-driven elements slowly displacing the social partners. However, what is crucial to their distinction is the extent to which the state is a key party to wage negotiations or a decisive actor in them. What emerges from all three cases is that, to varying degrees, the state plays an important role in structuring collective bargaining, whether or not it is a regular party to negotiations.

In both Belgium and the Netherlands, legal extensions of collective agreements play a crucial role in their systems, although invoking these laws does not present strong opportunities for the state to exercise agency. Indeed, it is in the Netherlands where the state has perhaps the strongest influence over wage settlements through the use of legal extensions. As part of the process, the Minister of Social Affairs and Employment, whose ministry administers extensions, does retain some sway over wage negotiations through an assumed ability to deny an extension. In practice, this power has never been exercised and one trade unionist questions the legal basis for denying an extension (Bulk 2014). In any event, such a subtle influence by the minister falls well short of being an active party to negotiations. Nonetheless, these legal extensions, and the role for the state inherent them, are crucial to the functioning of the Dutch system.

Similarly, in Belgium, the state role is highly conspicuous because the index and wage norm are governed by acts of parliament and involve very heavily the CCE, which is an independent, but state-affiliated body. However, while the index, the wage norm and the CCE play a decisive role in structuring wage negotiations by the social partners, they do not allow the state an active role in the wage negotiations themselves. Similarly, state monitoring and enforcement of collective agreements at sector and firm level play a very important role in the Belgian system, but are not avenues for the

state to play an active role as a party to wage negotiations. Certainly, the state is a party to the parallel process of the sectoral social dialogue, which is increasingly important as the social partners have attempted to find flexibility in benefits and other non-wage costs (Interviewee 9 2013). As a result, the relevant ministry in Belgium, FPS Employment, looms much larger in this part of the wage-setting process than does its counterpart in the Netherlands. Nonetheless, this part of its role was not raised as a point of concern in interviews with representatives of the social partners or in the relevant literature. What this observation suggests for Belgium, and indeed for those countries currently refashioning their wage-setting systems, is that this form of state support may be a useful instrument in supporting the coordination of wage setting, or is at the very least not a detriment to it.

Even in Germany, where the state has no meaningful role in wage negotiations themselves, and where mention of 'wages' and 'the state' together is highly controversial, conscious decisions by the German state to reinforce in law the role of works councils cast a very long shadow indeed. Likewise, the debate and subsequent legislation in Germany on the minimum wage highlights another subtle but important role for the state. Indeed, while in Germany, and indeed in Belgium as well for instance, the minimum wage is not the subject of negotiations with the social partners, and nor does it have any formal impact upon collective bargaining. Nonetheless, Pochet (2012), for instance, has emphasized that rules on minimum wages represent an important form of wage coordination that involve the state very intimately, albeit one that targets only a very specific part of the labour market. They also represent an interesting point for further investigation, as the rules governing them vary between European countries. Pochet (2012) has also emphasized the role of the state as an employer as well, and while in the countries under study, public sector wage settlements often track those in the private sector, the matter remains under-investigated in the literature on wage coordination. One of Schulten's (2013) points plays to Pochet's (2012) note about the state as an employer. Specifically, Schulten (2013) argues that changes in the Single Market program have seen a renewed push for privatization and liberalization in public services, which has

in turn had substantial effects upon the trade unions representing workers in newly privatized industries.

Perhaps most importantly, in all three cases the state played a decisive role in crafting national wage-bargaining systems after the Second World War and then played a very important part in their subsequent evolution. In Belgium (Section 4.2.1), the wage-bargaining system was highly centralized from the outset, with a very strong role for the state prior to its decision to expand the role of the social partners. Likewise, the decision to reintroduce indexing in the 1950s was a tripartite decision involving the state, while the later divergence between the Belgian and Dutch models occurred on the back of a state decision in the mid-1970s to entrench indexation in legislation in Belgium, while the Dutch government drew different conclusions. In the 1990s as well, while it had sought an agreement with the social partners to make deeper changes to the index, failing to reach a negotiated settlement, the latest changes to the Belgian system made by the state unilaterally.

In a similar fashion, the Dutch state has played a pivotal role in the development of the Dutch model (Section 4.4.1). Leaving aside the fact that the Dutch state played a critical role in deciding wage settlements for much of the time from the War until the Wassenaar Agreement, it was instrumental in crafting and recrafting the wage-bargaining system, as well as cementing the latest changes to it. Indeed, while Wassenaar is fondly remembered for its later economic implications, the relationship between the key parties to the agreement would hardly have been fond at all. In fact, agreement with the social partners was found only under duress: employers were threatened by the state with imposed working time reductions, while trade unions faced a protracted wage freeze enacted by the state had they failed to come to an agreement. Similarly, while the New Course Agreement was indeed a tripartite accord in which the social partners' agreement was essential, this agreement was struck following a threat by the government to abolish



extension laws. Considering the important role that extension laws play in the Netherlands, this would have been a grave threat indeed.

Conversely, at the same time as pressure from the state played a crucial role in the shaping of the Dutch system, its role in ensuring that large realignments ‘took’ was extremely important as well. In fact, this point recalls Jones’ (1998) argument about the role of generous use of unemployment and pension benefits between Wassenaar and New Course. In effect, the state consciously delayed its goal of balancing the budget to numb the worst effects of what was an extremely painful realignment of the labour market and to allow the social partners time to adapt.

In Germany (Section 4.4.1), while there have been significant knock-on effects of decisions by the state upon the wage bargaining system, as with its handling of the details around Unification, for instance, a state role in German bargaining conspicuous by its absence. The reinforcing of works councils notwithstanding, this absence is the result of a very conscious choice made by post-War decision makers, but one that has had profound effects upon many other facets of the wage-bargaining system. Indeed, in Belgium and the Netherlands, strong peak associations of the social partners emerged at national level, tottering atop weakly organized employers and a highly fractious labour movement in order to interface with the national wage system devised by the state. Absent such a state role in Germany, it is hardly surprising that the national peak associations of the social partners are so frail and that their sectoral organizations were so much more robust from the outset than in Belgium or the Netherlands. In the German case, then, it is the conscious abstention by the state from intervening in collective bargaining that looms so large.

The broader implications of this finding are fascinating, but two points in particular stand out. First, decisive state action can indeed create a functioning system from even a highly dysfunctional one. Second, while reformed systems can survive without financial inducements from the state, generous use of fiscal policy may be very important in supporting sharp labour market realignments.

First, the state role in developing the Belgian and Dutch systems is highly pertinent for those systems currently being refashioned. Indeed, coordination between and within sectors in Germany was conjured by the social partners themselves, with a state role in buttressing some parts of the process. However, the state has played a decisive role in Belgium and the Netherlands in building functioning systems of wage coordination from models that were at various points in the post-War period, highly dysfunctional. For all of its current troubles, the Belgian system today is far more stable than it was prior to reforms in the mid-1990s. Certainly, one interviewee is correct in arguing that reforms then should have gone further and must be taken up again now (Interviewee 4 2013). However, while the Belgian systems suffers from chronic problems with competitiveness, following reforms made unilaterally by the state, it has yet to experience a return of the acute problems with wage inflation that it experienced in the early 1980s and early 1990s.

The Dutch case demonstrates even more forcefully that decisive state action may be required in making sharp realignments in national wage-bargaining models. Indeed, of the three cases under study, it is the Netherlands that executed the most radical realignment of its wage-setting model. A comparison of one of EMU's star performers with members who have struggled most may seem far-fetched. Indeed, scholars such as Hancké, Rhodes and Thatcher (2007) have distinguished such struggling systems by a strong state role that drives coordination and papers over much of the dysfunction bred by weak and fragmented social partner organizations. However, this state of affairs is precisely the one that prevailed in the Netherlands from the end of the Second World War until the early 1980s. Indeed, the system of wage setting that was devised immediately following the Second World War featured the state as a dominant actor in the process. Attempts were made from the early 1960s to decentralize wage bargaining to the social partners, although the social partner organizations of the day were too fragmented to assume full responsibility for wage setting. As a result, the state continued through the 1960s and 1970s to play a dominant role in the process, in effect papering over the weakness of the social partners during this period. This sequence of events is discussed in greater detail in Section 4.4.1, but the point here is that the highly

successful wage-bargaining system of the Netherlands and the economic miracle that followed built upon a system that shared many of the pathologies of today's mixed systems.

Second, the Dutch case suggests some subtleties in the role of fiscal policy in wage bargaining, which is particularly important in a political context that so heavily emphasizes fiscal austerity. Indeed, posed questions about the role of fiscal constraints under EMU, interviewees such as Hartevelde (2014) have suggested that in a system that relies upon occasional inducements from the state, these need not be financial. In fact, he has suggested that the social partners are quite happy to haggle over other aspects of labour market policy, such as tweaks to employment protection regulations, instead. His view is consistent with that of many other interviewees, who were unconcerned about the effects on bargaining of constrained fiscal policy. The crucial implication of this observation is that functioning systems of wage coordination can survive without significant financial support from the state.

Following Jones (1998), however, the Dutch case also suggests that generous use of fiscal policy may be a necessary part of sharp labour market realignments. Indeed, during the 1980s, the Dutch government consciously delayed reaching its ultimate goal of balancing its budget in order to support the labour market transition. The crucial implications of these two points is that while fiscal discipline and highly coordinated systems of wage bargaining may indeed coincide, fiscal orthodoxy may undermine their formation if deep changes to existing institutions are required. Conversely, one would expect that the dislocation inherent in dismantling weakly coordinated systems instead would place large demands upon national unemployment and pension systems as well.

Certainly, there are important points of contrast between the Dutch case prior to 1982 and the stricken euro area economies of today. Indeed, differences in union density stand out, while reforming governments in the current context face more external constraints than did the Dutch government of the early 1980s. Nonetheless, the point is that highly effective systems of wage

bargaining can indeed be built in crisis conditions, even upon seemingly flawed institutional foundations.

## **8.8: Chapter Conclusion**

This study began by posing the question: *is monetary integration detrimental to coordinated wage setting and how do institutional variations affect a system's ability to cope with new pressures under EMU?* What emerges from all three cases is that, contrary to many expectations, EMU has little impact upon many key components of highly coordinated wage-bargaining systems. Troubles with Belgium's calibration aside, there is no evidence that the intra-associational agreements and pattern setting used for horizontal coordination have been affected by direct pressures from the single currency. Similarly, there is no evidence that the social partner organizations have been seriously threatened by direct pressures from EMU, although pre-existing dynamics within them have proven enormously consequential and warrant more attention in subsequent investigations. Likewise, while decentralization has been a common theme in the literature on wage bargaining, Germany and the Netherlands in particular demand that a sharper distinction be drawn between many forms of decentralization on the one hand, and disorganization on the other. The role of the state proved to be consequential as well, although in all three cases, it demanded more nuanced treatment. Specifically, in all three cases, the state has played a vital role in crafting and recrafting the wage-bargaining system, while providing supports to the social partners that are vital to the system's functioning, but stop well short of allowing the state to participate regularly in wage negotiations.

## Chapter 9: Looking Ahead

### 9.1: Introduction

While the last chapter addressed the broader implications of the Belgian, Dutch and German experience of EMU for the literature and for the rest of the euro area, this chapter considers the implications of this study for the cases themselves. In essence, Chapter 8 addressed the question *is monetary integration detrimental to coordinated wage setting and how do institutional variations affect a system's ability to cope with new pressures under EMU?* With some caveats, Chapters 5, 6, 7 and 8 found that EMU does not undermine many designs of coordinated wage-bargaining system, but did not address in detail what these countries must do to continue to cope with the rigours of Economic and Monetary Union. This omission is important because the country case studies uncovered processes of institutional change in each country that, while unconnected to EMU, do affect the mechanisms that they rely upon to manage their economies under the single currency. This chapter aims to address this omission, examining in turn institutional reform in Belgium, Germany and the Netherlands, in Sections 9.2, 9.3 and 9.4 respectively. Section 9.5 concludes.

This chapter finds that a recalibration is necessary for the Belgium's competitiveness and for the social partners to continue to play a meaningful role in wage setting. The German and Dutch systems have experienced troubles not caused by EMU, but which, conversely, affect their functioning under the single currency. Germany must countenance a greater state role in amplifying and ultimately preserving the influence of the social partners, while it and the Netherlands face challenges with deteriorations in key social partner organizations which have no easy solutions.

### 9.2: Country-Specific Conclusions for Belgium – ‘Don't Mention Indexation!’

Concerning Belgium in particular, and despite significant challenges that this would entail, a key implication of this investigation is that a recalibration of the Belgian system is necessary for its long-

term viability under EMU. However, there is also much about the Belgian system that, defying some expectations, has also fared well under EMU.

Its calibration to inflation and then to wage developments in other EMU countries is a central feature of the Belgian system and a crucial part of Belgium's struggles under Economic and Monetary Union. Indeed, it is evident that in the context of EMU, where there are fewer instruments available for redressing the competitiveness problems that frequently hobble the Belgian system are more acutely felt, as argued in Section 5.3. Likewise, under EMU, the ceiling for wage negotiations has fallen considerably since euro adoption, slowly squeezing the role of the social partnership, as argued in Section 5.4. As a result, serious consideration should be given to a recalibration of the Belgian wage-bargaining model.

Certainly, there is much resistance to a recalibration domestically, which in no small part explains why indexation was retained through previous crises in the early 1980s and early 1990s. There are also well-founded concerns that reopening the system to adjust some of its core features at a point in time where it is the subject of much outside pressure, may subject the process to unwelcome external influences (Interviewee 9 2013). Indeed, Belgium is unique among the three cases under study for facing such forthright criticism of its wage-bargaining model as part of the Commission's annual round of Country Specific Recommendations. In fact, criticisms of the Belgian wage-setting model have been a consistent feature of these Recommendations since their first round in 2012 (European Commission 2013ab; 2013; 2014b).

At the same time, for all the criticism it faces, the Belgian experience also suggests that much about the model is appropriately suited to conditions under EMU. Indeed, Belgium's experience suggests is that there is very little about highly coordinated and very centralized systems that is necessarily incompatible with euro area-wide monetary policy or surrendered policy instruments. Indeed, contrary to some expectations, the pressures exerted upon the Belgian system by its new environment have not increased the role of firm-level bargaining, and the close

correlation between developments in different sectors has been maintained. Put another way, the horizontal coordination of the Belgian system provided by its use of intra-associational bargaining has fared well under the single currency. This point is addressed more thoroughly in Section 5.5, but a key implication of this observation, and policymakers' concerns that reforms in the current context may begin an unraveling of the model (Interviewee 9 2013) is that many otherwise serviceable parts of the model may be undermined by the meeting of its calibration and EMU.

However, there are similarly well-founded concerns being articulated by policymakers in Belgium that a failure to arrest the competitiveness problems and the declining role of the social partnership in the shorter term may make more drastic changes and even greater outside influence inevitable in the longer term (Interviewee 4 2013; Interviewee 8 2013; Interviewee 9 2013). Their concerns are consistent with the processes of institutional change examined in Section 5.3.1, 5.3.2, and Section 5.4. As a result of the model's tendency to 'overheat' studied in 5.3.1, competitive pressures are likely to become more acute with time, possibly paving the way for much deeper changes to the Belgian system. Of note as well is the fact that recent innovations in European economic governance now include much closer monitoring of many headline economic figures, with unit labour costs being one of these figures, which suggests that in tandem with this process of drift underway, external scrutiny of the Belgian system is likely to intensify. Added urgency should come from the findings of Section 5.3.2 and 5.4, which note that under EMU, a core component of the Belgian system, the social partnership is slowly becoming a soured relationship (Section 5.3.2), while at the same time being displaced from the system altogether (Section 5.4).

These issues are addressed in more detail in Chapter 5, although one does wonder how long social partner organizations can continue to function effectively under these circumstances if these issues are not redressed presently, or indeed, whether they can be salvaged if the redress is delayed. What this examination of the Belgian experience suggests is that any recalibration of the Belgian system must allow greater space for the social partners to decide the course of wage developments:

doing so would arrest the processes of drift discussed in Section 5.3 and halt the process of displacement discussed in Section 5.4, whereby the state-driven elements of the Belgian model are becoming increasingly prominent. Put more bluntly, the social partners must be allowed to be social partners. Such a change would meet concerns by government and employers about flexibility in wages. Interestingly, while the trade unions would have to accept greater uncertainty over their outcomes, they would have much greater certainty over their role in negotiating them. This larger and more conspicuous role in negotiating would also go some distance towards improving the union confederations' credibility with their affiliates and members, and make for a healthier trade union movement overall.

As a result of the existential concerns raised by interviewees (Interviewee 4 2013; Interviewee 8 2013; Interviewee 9 2013), and the findings of Chapter 5, any debate around recalibrating the Belgian system is likely to be an extremely challenging one, but also an increasingly necessary one. Reform discussions are particularly difficult for the trade unions, and as a result have tended to very hushed. Indeed, many interviewees both inside and outside of Belgium emphasized both the necessity and the sensitivity of institutional change in the Belgian system. Said one employer:

“It’s even more impossible to reform the automatic wage indexation system because this is really a symbol for them...its taboo...although they are becoming much more conscious of the fact that at a certain time, at a certain moment, they need to decide what is the most important for us: the social dialogue, but that means that we are going to discuss how we are going to reform this automatic wage indexation because we don’t demand, we don’t ask it to be eliminated...we want a reform, not an elimination of this, so they need to make up their mind.”

(Interviewee 8 2013)



Curiously, a Dutch researcher (van Riel 2014) summarized very aptly the state of discussion over institutional change in Belgium, noting that many of the same problems in the Netherlands had been addressed in the 1970s and 1980s. He described the discussions, or rather the lack thereof by invoking a particularly controversial episode of *Fawlty Towers*, a British television series filmed in the mid-1970s. The series centres upon a stuffy but scatterbrained owner of an English bed and breakfast, played by John Cleese. In the episode in question and whereupon a group of well-mannered middle-aged German tourists come to stay at the bed and breakfast, Cleese's character insists that his staff avoid mentioning the War out of consideration to the guests. The year being 1975 and the topic being both important and highly sensitive, avoiding mention of the War becomes a point of obsession for Cleese's character: so fixated upon the War, he is guilty of several highly inappropriate outbursts about it, which become a source of deep offence to the German tourists that he had hoped to charm. Van Riel (2014) drew the comparison to illustrate both the gravity of institutional reform in Belgium, but also taboo nature the discussion around. However, there is perhaps a deeper lesson for Belgium to draw from Cleese's antics, because fundamentally the episode is about the perverse consequences of a failure to properly acknowledge an important but highly charged issue and to address appropriately.

A thorough discussion of reform proposals, though there are many, for the Belgian wage bargaining system is beyond the scope of this project. However, that there is evidence of some debate over a recalibration of the Belgian system is indeed encouraging. The Belgian central bank, for instance has been producing studies examining other possible anchors for the Belgian index (BNB 2012), while one interviewee close to the process did note a small uptick in tripartite discussions around the index (Interviewee 4 2013).

In brief, the Belgian case demands a much greater appreciation of coordinated systems' calibration in making sense of its experience under EMU. To be sure, there is much about the Belgian system that functions well under the single currency, and many of these mechanisms have been

used to good effect in the Netherlands, which is calibrated differently. However, the meeting of EMU and the Belgian index is doing serious harm to these otherwise well-functioning portions of the Belgian system. While the reform debate in Belgium is highly charged, and the index in its current form very well entrenched, a recalibration of the Belgian system is needed to preserve both the competitiveness of the model, but also to preserve the role of the social partners. There is no evidence that changes are forthcoming, although the fact that there is increased discussion on the topic in policymaking circles is encouraging.

### **9.3: Country-Specific Conclusions for Germany – Interesting Times Ahead**

Interestingly, the German system has experienced a number of important changes in the mechanisms that it uses to coordinate wages since the beginning of Economic and Monetary Union. The pre-EMU roots of these changes in Germany were very much in evidence in the process of conversion, whereby the German system has become more decentralized (Section 6.3) and the process of displacement, by which the coverage of the German system is eroding (Section 6.4). The same can be said of the process of drift, whereby the pattern-setting role of Germany's leading sectors is in decline (Section 6.5). These findings all strongly suggest that the basic design of the German system is well-suited to cope with pressures from EMU.

Nonetheless, while Economic and Monetary Union has not proved deleterious to the German system of wage bargaining, many of these parallel developments are a source of concern for the continued coordination of German wages under EMU. There is much more uncertainty surrounding the horizontal coordination of the system. Indeed, while the metalworking contract remains an influential one, it is not evident that new mechanisms for maintaining such tight links between exposed and sheltered sectors of the economy have evolved. Certainly, information sharing between negotiators in different sectors through the national peak associations and the shared coordination rule may help intersectoral coordination. At present, it is unclear how far the horizontal

coordination of the system may loosen, although this in no small part depends upon developments in the trade union organizations of sheltered sectors, which have struggled of late to negotiate wage increases at the level of the metalworkers.

Disconcerting as well are comments by Gartner (2013), who has suggested that the Eurozone crisis has been a poor test of the German system's ability to cope with shocks under EMU. Indeed, he has argued that the economic crisis came at a point in time where unit labour costs were falling in Germany and where a slow transition to a higher employment equilibrium went a very long way towards offsetting the effects of the crisis on unemployment, but that these are merely transitory factors. As a result, once these transitions have finished, similar shocks would likely result in higher unemployment (Gartner 2013). This finding suggests that the real tests of horizontal coordination in Germany following the decline of pattern setting are still ahead.

At the same time, while the increased use of opening clauses and looser sectoral agreements may be benign (Section 6.3), the declining coverage of collective agreements in Germany, if left unchecked, represents a significant challenge to the continued governability of the system (Section 6.4). Certainly, one trade unionist was especially keen to highlight provisions in the most recent metalworking agreement extending permanent contracts to longer-serving agency workers (Interviewee 22 2013). This development does suggest that negotiators have given serious thought to including employees who have traditionally been difficult to organize, and being paid very differently than permanent employees, complicate the work of the trade unions. This interviewee's observation further suggests that negotiators are gaining some traction on this issue, although there is no evidence from Germany to suggest that these sorts of strategies are yet bearing fruit on a large scale.

Concerning the process of displacement in Section 6.4, the discussion over revisions to German extension laws to expand their use brings with it intriguing possibilities for shoring up the system. Certainly, while the debate over extensions is longstanding, beginning at least in 2008, with

the DGB deciding in its favour in 2010 (Schulten 2013), that the issue has been taken up in the coalition agreement of the current government is timely. Interestingly, one observer hinted at some disagreement within the trade union movement over legal extensions, noting that, with sufficient organizational muscle for the task, the metalworkers have preferred to mobilize in order to keep individual companies within their respective employers' associations (Interviewee 22 2013). However, changes to extension laws have been put forward as a means of arresting the declining coverage of the system, and perhaps the declining membership of employers' associations as well. When deployed in Belgium and the Netherlands, laws such as these have done just that.

Just as interestingly, wider use of extension laws would certainly be a departure from existing practice in German wage setting. Indeed, expanding the state's role in structuring collective bargaining runs counter to well-established views of the appropriate role of the state in post-War German politics. However, as controversial as the subject has been, a closer examination of the state role suggests that it is not as radical departure as it may seem. In fact, changes to extension laws appear in principle very similar to the decision in the 1970s to reinforce in law the role of works councils. The debate over changes in extension laws is in many ways a product of its time, with renewed interest in legal extensions following closely the agreement to introduce for the first time a statutory minimum wage in Germany.

Moreover, considered comparatively, such a role for the state in amplifying decisions made by the social partners is hardly incompatible with the autonomy of the social partners, which is one of the principles that makes this debate such a contentious one in Germany. This point is abundantly clear in the Belgian and Dutch cases. Indeed, while there are many avenues in Belgium through which the state exercises influence over wage setting, extension laws are not among them. Likewise, while in the Netherlands the act of registering collective agreements with the Ministry of Social Affairs and Employment does offer the Minister and the Ministry opportunities to comment and voice concern over wage development, this subtle form of influence stops well short of overt

meddling. In what is one of the systems most similar to the German one, the Austrian system, a subtle state role is evident in expanding coverage, where membership of employers' associations was made compulsory. The lesson from these other European countries, then, is that in extending the coverage of agreements reached by the social partners a state role can complement the social partnership without compromising the autonomy of the partners themselves. Considering, however, that the German model has been held up in the literature (as in Behrens and Jacoby 2004, 96) and by policymakers in other European countries (Sterkel 2013) as a model for other coordinated systems, changes to German extension laws to mimic those of Belgium or the Netherlands would certainly be an intriguing turn of events. In fact, Schulten (2013), in addition to making some of the foundational contributions to this debate, cites extension laws in Belgium and the Netherlands in particular as possible templates to guide changes to German laws.

However, while changes to the extension laws certainly do address one of the foremost troubles in German wage coordination, some of the deeper causes of declining employers' association membership remain. Chief among them is declining union membership, particularly in services, where the sectoral peak association, Ver.di, struggles with a weak organization and job growth in areas where workers are difficult to organize. To be sure, the aforementioned work by IG Metall to bring tenured agency workers into permanent employment (Interviewee 22 2013) suggests an ability by German trade unions to adapt to the challenges of organizing new sorts of employees. Likewise, work by the social partners in the Netherlands in negotiating a long term agreement for temporary agency workers is encouraging as well although the trouble of declining density among trade unions does still represent a point of concern.

In sum, the findings of Chapter 6 suggest that the basic design of the German system is well-suited its new environment under EMU. In fact, there is no evidence to suggest that EMU is responsible for any of the changes that have taken place in the German system. However, some of these changes do have implications for the system's functioning under EMU. Changes to the pattern-

setting system in Germany raise a host of issues, and it is not immediately clear how far this process will progress. Considering comments by Gartner (2013), some transitory factors spared it a severe test during the crisis, and that subsequent shocks may be far more trying. No simple resolutions to the matter are evident, although there has been a recent debate over changes to German extension laws. While these proposed changes run counter to established views on the role of the state in Germany, evidence from Belgium and the Netherlands suggest quite strongly that liberal use of extension laws could address Germany's problem with declining collective bargaining coverage. They also suggest that they are in fact highly compatible with free collective bargaining as well.

#### **9.4: Country-Specific Conclusions for the Netherlands – Still 'Top of the Class'?**

Concerning the Netherlands, the Dutch model is perhaps the healthiest of the three under EMU: as with Germany, the basic design of the Dutch model is well-suited to the pressures from the single currency and there is no evidence that EMU has undermined any of the core planks of the Dutch model. In fact, as discussed in Section 7.2, the modern Dutch system was devised, and new social partner organizations matured in the context of a tight peg to the deutschmark. In effect, the Dutch model was built for conditions very similar to EMU. There have been changes in the Dutch model noticeable in the time since euro adoption, although these changes are unconnected to the euro.

Section 7.3 found two processes of institutional conversion, whereby changes to decentralize the system have allowed for greater variation both within and between sectors. These changes are nonetheless part of a process that predates EMU, and in any event are benign for the system's functioning under EMU because they preserve coordination rather than undermine it. However, as discussed in Section 7.4, there is also evidence of strain from declining trade union membership that stands out as a point of concern for the way that it is dividing the labour movement. Certainly, the underlying problem of declining trade union density is one that dates at least to the 1980s, predating both EMU and the treaties that established its design. It is also a

problem that suggests no straightforward solutions. Indeed, the decline in trade union density appears to be a common theme in many industrialized countries, with countries like Belgium being the exception rather than the rule. Certainly, Germany has struggled with declining trade union density as well, which has played a role in both declining employers' association membership and the weakening of the pattern system. However, German trade unions have the benefit of a robust and highly visible system of works councils, which have proven useful recruiting tools for the trade unions (Whittall 2007), while the Dutch unions tend to be far weaker at firm level (Interviewee 40 2014). Nonetheless, one of the key implications of Section 7.4 is that a more conciliatory approach to recruitment is favourable, considering the significant challenges that the uptick in radicalism in FNV have posed for the organization. It is also favourable, considering the disaffection that attempts to preserve the moderates' position had caused the among employers' associations' affiliates.

On this issue, the Dutch trade unions have also attempted to redress this problem in more conciliatory ways than the recent split inside FNV would suggest. In fact, the Dutch trade unions have enjoyed a measure of success in organizing workers who are traditionally very difficult to organize. Indeed, temporary agency work in the Netherlands has been defined as a distinct sector, while the distinction remains muddled in Germany, which has been covered by a sectoral collective agreement for some time. Where in Germany moves to accommodate this sort of work in collective agreement is highly suggestive of a labour movement learning to cope, the same may be said of the Netherlands.

Certainly, these moves by the social partners to adapt to new forms of work are encouraging, although trade union density remains low in these sectors. Indeed, while collective bargaining coverage in the sector is approximately 90% (Arrowsmith 2008, 13), trade union density is 7% (Arrowsmith 2008, 18). At issue then is that while the Dutch social partners have adapted well in expanding the coverage of collective bargaining, these adaptations have not redressed declining

trade union density. As in Germany, then, this issue of declining trade union membership is one in which there are some interesting counter-dynamics, but is one that remains unresolved.

However, and perhaps unsurprisingly, the reform debate in the Netherlands has been far more muted than in Belgium or Germany: many interviewees saw no need for deep changes to the system, and considering its performance under EMU, as well as through the crisis, they do have a point. In fact, what stands out in discussions with Dutch policymakers and the social partners is how sanguine many interviewees are about the performance of the Dutch model under EMU. Indeed, Section 7.1 found that since euro adoption, the Dutch social partners had managed well wage developments compared with other euro area countries. This point is borne out in Figure 8 as well. Through the crisis years in particular, the social partners responded very quickly with wage restraint and took the further steps of reopening and reworking many existing agreements. For a time, they have also shortened the duration of new collective agreements to one year from the usual 2-3 years as a means of making the system more nimble in the face of uncertainty over developments in other EU countries. In tandem, while negotiations were more difficult because of the divides in the labour movement, a social pact was successfully concluded as well (Biemans 2014; Tunnissen 2014).

Certainly, one interviewee did fret that the system might become more regionalized as a result of the crisis (Interviewee 40 2014), although most were convinced that the length of collective agreements and the incidence of failed negotiations would normalize with more settled economic conditions. Interestingly, that the model had contained the worst effects of the crisis in the Netherlands has to an extent influenced the views of Dutch policymakers toward changes in macroeconomic governance in the euro area. Biemans (2014) and Tunnissen (2014), for instance, note that because policymakers and the social partners had coped so well with EMU and the crisis, many policymakers are much more at ease with outside scrutiny, reasoning that their performance would see off interference from outside actors like the Commission. An expert from the trade unions interpreted the government's position in a very interesting, if ominous way, arguing that many



policymakers have yet to see a day when the tightened rules are turned against the Netherlands (Interviewee 41 2014). However, one expert in government adds some qualification to Biemans' (2014) and Tunnissen's (2014) note, pointing out that in some cases, policymakers have been highly cognisant of the potential implications for the Netherlands of binding common rules, referring specifically to the discussions over trade balances in the Macroeconomic Imbalances Procedure (Interviewee 30 2014).

Other observers like Abbing (2014) and van Riel (2014) have suggested that this forms part of an interestingly nuanced view in policymaking circles about reforms to euro area governance: Abbing (2014) notes that while the Dutch government favours strongly tighter conditionality for crisis countries, it has reservations about universally binding rules that would impact the Netherlands, referring specifically to contracts with the Commission. Van Riel (2014) puts a very fine point on these discussions, arguing that with the Netherlands having performed well under EMU, many policymakers have drawn the conclusion that tighter rules and conditionality are for other countries. Thus, while EMU has not significantly affected the outlook for the Dutch wage bargaining model, the country's performance under EMU, in which wages and wage-setting play an important role, may have a subtle influence on policymakers outlook on changes to EMU.

In sum, the Dutch model appears well suited to conditions under EMU, and many interviewees have noted with some justification that the same pressure for changes as exists in Belgium and Germany does not exist in the Netherlands. Issues with declining trade union density persist, but suggest few straightforward solutions, although the troubles that trade union militancy has posed for the FNV, and perhaps even for their counterparts in the employers' camp, suggest that a conciliatory approach is preferable. Interestingly, it does appear like the performance of the model under EMU and through the crisis may have had some impact upon the outlook of policymakers in the Netherlands towards macroeconomic governance in the euro area, favouring a more differentiated approach to individual euro area countries.

## 9.5: Concluding Remarks

In closing, this project set out to assess the impact of Economic and Monetary Union upon different systems of coordinated wage bargaining. To that end, it selected three otherwise similar cases that have important variations in the design of their wage-bargaining systems. It brought together past work on wage coordination and the latest theory on institutional change, while introducing some innovations as well, such as systems' calibration, and subtle differences in the treatment of bargaining coverage and vertical coordination.

This project found, surprisingly given some of the early literature on the subject, that in fact, EMU is not the corrosive influence upon many core features of highly coordinated systems that one might expect. Indeed, the institutions responsible for managing wage setting, as well as the social partners in these countries deserve far more credit for their managing of new pressures from EMU than the early literature on the subject extended them. In Germany and the Netherlands, there was no discernable impact of the single currency upon their national wage-bargaining systems. Indeed, both countries have defied some of the more pessimistic expectations of scholars like Hancké and Soskice (2003) or Soskice and Iversen (2001) that the transfer of powers to a European Central Bank would lead to relaxed wage discipline in coordinated systems. Rather, the findings of this project are more closely aligned with work following Johnston and Hancké (2009), arguing that systems which coordinate wages across sectors still face powerful incentives to moderate their wage developments.

However, this project also suggests some important caveats to this argument that highly coordinated systems are especially well suited to EMU. Indeed, in Belgium, wages remain very highly coordinated and there are many serviceable components of its model. However, the calibration of the Belgian system, rigidly tracking inflation and developments in other EMU countries, posed serious problems in a context where currency devaluation is no longer possible. The combination of struggles with the index and the presence of many other serviceable components in the Belgian

wage-bargaining model strongly suggest that a recalibration of its system is necessary to maintain both its competitiveness and the integrity of its institutions as well. What is particularly notable about Belgium, however, is that wage discipline has not relaxed per se, but it is continuing to have familiar struggles with competitiveness in an external environment that has become less forgiving. As a result, the Belgian case does not bear out the predictions of Hancké and Soskice (2003) or Soskice and Iversen (2001) about relaxed wage discipline.

However, the contrast between Belgium's experience and those of Germany and the Netherlands is consistent with arguments by Mundell (1961), Magnusson and Stråth (2001), Hancké and Soskice (2003), Allsopp and Vines (2008), and Zemanek, Belke, and Schnabl (2010) that flexibility in workers' real wages is a necessity under EMU. More broadly, this point of contrast between Belgium's calibration and the others' certainly does bear out Crouch (2000) and Lane's (2006) observation that adoption of the euro would magnify the effects of idiosyncratic national institutions. This finding further underscores that careful attention must be given in subsequent studies to these sorts of idiosyncrasies.

Moreover, in Germany and the Netherlands, changes to the institutions and the actors that manage wage developments in such systems, that were at root unconnected to EMU, proved to be far more consequential than pressures from having adopted the euro. Indeed, many crucial changes in Germany and the Netherlands long predate Economic and Monetary Union, which rules out the single currency as a cause, although changes in social partner organizations in both countries, as well as deteriorating horizontal coordination and declining coverage in Germany may have important consequences for their continued functioning under EMU. Certainly, one might argue that countries maintaining a tight peg to the deutschmark prior to EMU faced many of the same constraints in this earlier period. However, as Chapters 2 and 4 found, while some of the pressures exerted by ERM were not dissimilar to those exerted by EMU, the two are distinct because of the constraints on fiscal policy and the irrevocability of the locking of exchange rates inherent in the latter. Likewise,

many observers of the Netherlands stress the domestic roots of its troubles, rather than external constraints like the exchange rate regime.

These findings from Germany and the Netherlands are very much in line with theoretical arguments by Streeck and Thelen (2005) that the formal integrity of institutions may in fact disguise much change in their functioning, and in the behaviour of the key actors that animate them. As managed decentralization in both Germany and the Netherlands demonstrates, some such changes do not undermine their ability to coordinate in the context of EMU. Other sorts of changes do impact countries' ability to coordinate, which is disconcerting given how important coordination is under the single currency. More broadly, this suggests that attention to precisely these sorts of changes is needed in assessing the prospects for other coordinated systems under EMU.

Finally, one of the implications of work by Johnston and Hancké (2009) is that the position of weakly coordinated systems under EMU is highly tenuous. Section 9.4 found that Johnston and Hancké's (2009) observation about weakly coordinated systems, and the presence of several such systems among the countries with a commitment to adopt the euro, certainly stand to make economic governance in the Eurozone more interesting in future. However, there is a point from the Dutch case of more immediate interest for countries such as Italy, Portugal and Spain, and perhaps even Greece or Ireland. Indeed, there is much about the Dutch system's experience that recommends tightened coordination in some crisis-stricken countries in the euro area, rather than the reverse. As Section 9.7 had found, there clearly a strong fit between many systems with taut wage coordination and new demands made of them by the single currency and that the performance of uncoordinated systems under similar circumstances is largely untested. Just as importantly, countries such as the Netherlands demonstrate that systems like these can be consciously crafted in crisis conditions. They also demonstrate that this requires resolve and decisive action by the government of the day, as well as a commitment to nurture the institutions and the social partner organizations that emerge from this process. Jones' (1998) point that generous use of

fiscal policy was necessary to support this transition in the Netherlands is a striking feature of the labour market realignment in that country as well. Indeed, it strongly suggests that for those countries that are able, delaying government's goals of fiscal consolidation may be a vital part of righting their labour market models.

Cases such as Belgium, and to a lesser extent, Germany suggest that such systems require active maintenance and at times a willingness to reconsider some of their key tenants to preserve their functioning. Such systems can be fussy, and at times demanding, although as Hemerijck and Visser (1999) suggest, sometimes they repay with miracles.

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## Appendix 1: List of Interviewees

Interview w	Interviewee	Affiliation	Position	Interview Date
1	Philippe Pochet	ETUI	Director	17-Jul-12
2	Georgios Dassis	EESC Group 1	President	17-Jul-12
3	Luca Visentini	ETUC	Head of Interregional Trade Unions Councils Committee	19-Jul-12
4	Interviewee 4	Conseil central de l'économie		04-Jun-13
5	Interviewee 5	Business Europe		05-Jun-13
6	Interviewee 6	National Bank of Belgium	Researcher	06-Jun-13
7	Vera Dos Santos Costa	ACLVB/CGSLB	Head of International Department	07-Jun-13
8	Interviewee 7	"a Belgian employer"		10-Jun-13
9	Interviewee 9	FPS Employment		10-Jun-13
10	Interviewee 10	ACV/CSC		12-Jun-13
11	Guy van Gyes	KU Leuven	Researcher	27-Jun-13
12	Caroline Jonckheere	ACLVB/CGSLB	Indexation Specialist	01-Jul-13
13	Rafael Lamas	ABVV/FGTB	Economist	02-Jul-13
14	Interviewee 14			04-Jul-13
15	Interviewee 15	University of Bremen	Professor	14-Nov-13
16a	Interviewee 16a	Eurofound	Researcher	28-Nov-13
16b	Interviewee 16b	Eurofound	Researcher	28-Nov-13
16c	Interviewee 16c	Eurofound	Researcher	28-Nov-13
17	Interviewee 17			05/12/2013
18	Andre Müller	BDA	Rechtsanwalt: Lohn und Tarifpolitik	09-Dec-13
19	Interviewee 19	DGB		09-Dec-13
20	Gabriele Sterkel	Ver.di	Researcher, Tarifpolitische, Grundsatzabteilung	11-Dec-13
21	Hermann Gartner	IAB	Senior Researcher	14-Dec-13 (Rescheduled)
22	Interviewee 22	IG Metall		19-Dec-13
23	Thorsten Schulten	Hans Böckler Stiftung	Senior Researcher for Labour Politics and Collective Bargaining in Europe	20-Dec-13
24	Jan Dannenbring	Zentralverband des Deutschen Handwerks	Rechtsanwalt: Leiter der Abteilung Arbeitsmarkt, Tarifpolitik, und Arbeitsrecht	10-Jan-14
25	Interviewee 25			10-Jan-14
26	Indra Hadeler	Gesamtmetall	Deputy Managing Director:	13-Jan-14

			International Relations	
27	Eddy Haket	STAR	Deputy Secretary	18-Feb-14
28	Arthur van Riel	WRR	Scientific Staff Member	19-Feb-14
29a	Michiel Tunnissen	Minszw	Policy Advisor	20-Feb-14
29b	Paul Biemans	Minszw	Senior Policy Advisor	20-Feb-14
30	Interviewee 30	Cabinet and Prime Minister's Office		21-Feb-14
31	Paul de Beer	AIAS/de Burcht	Co-Director/Scientific Director, The Castle, Scientific Bureau of Labour	24-Feb-14
32	Uwe Becker	UvA	Associate Professor	24-Feb-14
33a	Erik Pentenga	FNV	Employment Policy Officer	25-Feb-14
33b	Marjolijn Bulk	FNV	Europe Specialist	25-Feb-14
34	Rick van der Woud	CNV	Senior Policy Advisor	27-Feb-14
35	Jan Marc Berk	DNB/University of Groningen	Director of Economics and Research/Professor	28-Feb-14
36	Anton Hemerijck	VU Amsterdam	Dean: Faculty of Social Sciences	13-Mar-14
37a	Interviewee 37a			19-Mar-14
37b	Interviewee 37b			19-Mar-14
38	Mark Roscam Abbing	Minszw	Director of Labour and Social and Economic Affairs	20-Mar-14
39a	Laurens Harteveld	AWVN	Senior Policy Advisor	21-Mar-14
39b	Arjen Verhoeff	AWVN	Policy Advisor	21-Mar-14
40	Interviewee 40		Researcher	24-Mar-14
41	Interviewee 41	CNV	Policy Advisor	25-Mar-14

## Appendix 2: Sample Interview Schedules

### Interview Schedule

**Research Project:** Coordinated Capitalism and Monetary Union: Wage-Bargaining and Social Partnerships in the Euro-Era

**Primary Researcher:** Mr. Ivan F Dumka

**Funding Agency:** Social Sciences and Humanities Research Council of Canada (SSHRC)

#### General Information on the Interview:

This project examines the effects of monetary integration upon the coordination of wage setting and the social partnership in three Eurozone countries. It asks whether the single currency has been detrimental to the coordination of wage-setting, and if there is a specific combination of institutional features and response strategies by key actors that best meets the challenges arising from EMU, and allows for a continuation of wage-coordination. It considers as well whether EU-level organizations now play a meaningful role in national wage bargaining.

Before beginning the interview, I would like to allow a moment for any questions you may have about the process, or about any issues arising from the Participant Consent Form. I would also ask that you tell me when the views you convey are the position, policy, or strategy of the organization you represent, and when I may interpret them as your personal opinion. If at any point in the interview, you wish to speak off the record, please do inform me. After briefly discussing your role within your organization (job title, length of service, professional background), I would like to raise the questions below:

*[Below are three sets of questions designed specifically for each cluster of interviewees]*

#### Questions for Government Civil Servants/Policy-Makers

Thematic 1: Pressures Facing Each Wage-Bargaining Model

- 1a) What pressures on labour market policy had been anticipated by your government when it agreed to join monetary union?
- 1b) What concerns did government have about their body of labour market policy going into Economic and Monetary Union (EMU)?
- 1c) To what extent do the pressures witnessed accord with expectations?
- 1d) What have been the actual consequences of prior reforms, or non-reforms? Have there been any unintended consequences?

Thematic 2: Institutional Change and its Consequences

- 2a) In retrospect, how effective have changes (or non-changes) been in addressing the concerns raised in Thematic 1, and unexpected pressures encountered after euro adoption?
- 2b) To what extent is wage setting becoming a substitute for currency devaluation and fiscal policy for macroeconomic adjustment? What about your wage bargaining model makes it effective/ineffective?
- 2c) Elaborate upon the consequences of relying more heavily upon wage-setting (if they are in fact doing this). Specifically, what are the side effects of wage setting/wage discipline given the mechanisms by which this is done in your country?
- 2d) Given the above does your department/government have any reservations about using wage setting in this way (or doing so with greater frequency)?

Thematic 3: Response Strategies/Patterns of Behaviour

- 3a) How has government's role in setting wages (or involvement in bargaining) changed under EMU?  
3b) To what extent has EMU changed the priorities of your department and of labour market policy more broadly?

Thematic 4: Concluding Thoughts

- 4a) Considering the above, what advice might you give to policymakers in other Eurozone countries? (*Stress that interviewee may speak off the record here*)  
4b) Anything else not raised that would be pertinent?

**Questions for Representatives from the Social Partners (Peak Associations of Labour and Employers)**

Thematic 1: Pressures Facing Each Wage-Bargaining Model

- 1a) Describe the pressures faced by your organization as a result of EMU:  
1ai) Pressures from unpredictable market signals (inflation and bank rates: press for comparisons with Germany):  
1aii) How has this affected the dynamic in negotiations (more difficult negotiations? Does this favour one partner over another?)?  
1aiii) Were any of these pressures unanticipated?  
1b) What was the impact of institutional features in the Belgian and Dutch system designed to cope with this (inflation indexing in Belgium and flexibility in the Netherlands)?

Thematic 2: Institutional Change and its Consequences

- 2a) How has greater reliance upon the social partnership by government affected wage negotiations?  
2ai) Has it placed more strain on the partners? Made negotiations more difficult?  
2b) Has all of this affected the size or cohesion of your membership?

Thematic 3: Response Strategies/Patterns of Behaviour

- 3a) How has your organization responded to pressures under EMU and to corresponding changes to the bargaining system by government (if applicable)?  
3b) To what extent does your organization still view the social partnership and engagement with the other partners as a way to achieve its ends (*stress that the interviewee may speak off the record*)  
3c) Changes by government included, have you noticed a difference in the level at which negotiations take place because of EMU (i.e. centralization or decentralization)? If so, how has this affected wage negotiation for your organization?  
3d) Germany has remained relatively successful in continuing to coordinate wages; has this been the case in the other two cases? How do the social partners explain these developments?  
3e) To what extent do other organizations outside your country play a role in national wage setting?  
3ei) If so, are these influences welcome?

Thematic 4: Concluding Thoughts

- 4a) Considering the above, what advice might you give to organizations in a similar position in other Eurozone countries?  
4b) Anything else not raised that would be pertinent?

**Questions for Representatives of EU Institutions and European-Level Organizations**

- 1a) How does your organization see the role of EU-level groups in the process of national wage bargaining?  
1ai) How has your organization's view of its role changed/developed as a result of EMU?



1b) In what ways is your organization attempting to coordinate among national policymakers and social partners on wage setting? Through what mechanisms is it doing this?

1bi) Have they been receptive to EU-level influence over wage negotiations? How has their receptiveness changed over time?

1bii) To what extent is there a variation between national actors' receptiveness to EU involvement in wage setting (e.g. Have the unions or employers been more or less open to EU influence)?

1c) How do you see your organization's role developing? What other initiatives are being undertaken to coordinate between national actors?

1ci) How has this changed given the current social/economic context in the EU?

1d) Anything else of relevance that has not been raised?