

# The Nation-State, Social Policy, and Economic Performance

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THE NATION-STATE, SOCIAL POLICY,  
AND ECONOMIC PERFORMANCE

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TABLE OF CONTENTS

- I. The Nation-State is Alive and Well -- p. 4
- II. The Welfare-State and Economic Performance: Lessons  
from the Past -- p. 16
- III. Convergence Downward, Upward, or Just Persistent  
Differences? -- p. 25

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by

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Among the basic questions about the impact of  
"globalization" on public policy three are of great interest  
to both scholars and policymakers:

1. Is the nation-state eroding as a unit of social-  
science analysis and as the center of political  
action?
2. Do capital and labor flows across national boundaries  
threaten the social policies of the rich democracies -  
- especially job protection and good earnings and  
welfare-state benefits?

Because these questions assume that globalization gives  
countries with low labor costs and lean social policies a

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presented to the Conference on "Globalization and Welfare  
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competitive advantage over their rivals, we must give an estimate regarding a third question:

3. Leaving aside the net contribution of the welfare state to such values as dignity, security, equality, family well-being, social integration, and political legitimacy, what are the net effects of social policies and the welfare-state on productivity and economic performance?

In my exploration of these issues I shall use data and arguments from my study of the political economy and performance of 19 rich democracies (the universe of advanced industrial democracies with a population of at least one million).\*

#### The Nation State is Alive and Well

In recent decades one group of social scientists have argued that the nation-state is eroding in its political capability and analytical utility. They include Immanuel Wallerstein's analysis of the relations of core, semi-periphery, and periphery in the modern "world system" (1974), Peter Evans's

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\*If no specific reference is made in the text, the argument rests on data in Wilensky 1975, 1976, 1985, 1987 and Wilensky, Tax and Spend: The Political Economy and Performance of Rich Democracies, in preparation.

treatment of "dependent development" in Latin-America (1979) and such students of international relations as Robert Keohane and Joseph Nye (1971 and 1977) who emphasize the increasing power of transnational and international actors (multinational corporations, international organizations) and the global forces of technology, communications, and trade. Peter Gourevitch articulates these views in a more cautious and balanced way in his analysis of the international sources of domestic politics (1978 and 1986). When they analyze national differences in public policy, these scholars generally argue that a nation's position in the world economy determines its institutions and policies more than anything else. Oil producers want higher oil prices and vice versa; energy-dependent countries such as France will do more about conservation and alternative sources of energy than the United States or Canada; as a superpower, the U.S. has carried heavy military burdens and that is why its civilian public spending in general and social policies in particular are so laggard. It is international position that counts, not domestic politics.

A second group of scholars, which includes myself (1975, 1976, 1981, 1983, 1987), Peter Katzenstein (1985), Peter Flora (1986 and Flora and Heidenheimer, eds., 1981), David Cameron (1982, 1984), Hugh Heclo (1974), Gøsta Esping-Andersen (1986), and most students of the welfare state, are much more impressed with the importance of national

differences in social, political, and economic organization as sources of variations in public policy and performance.

In our excitement about EEC 1992 or the fiscal crisis of the state, or the crisis of the welfare-state, we often attribute changes in national policies and patterns of behavior to globalization, international competition, or external shocks rather than to these internal structural differences. There are two things wrong with this. First, it ignores the previous history of diverse national responses to cross-national capital and labor flows and external shocks. Second, it ignores evidence of the internal causes of welfare-state development and its economic effects.

Capital flows and mass migrations across national boundaries are hardly new. It is not even clear what the trend is. One can argue that in recent decades capital has become more mobile internationally so the decade ahead will be a continuation of a well established trend. Labor, however, may or may not be more mobile. For the European countries where data are available, migration rates (immigration plus emigration as a percentage of total population) was only slightly higher in the early 1970s than it was at the turn of the century.\* For the United States, Canada, and New

\*For example, total migration in the UK as a proportion of population increased only from .83 percent in 1901 to .90



Zealand -- countries of popular destination -- there was less immigration in the early 1970s than there was before 1920.\* As Kuznets shows (1966, pp. 51-56) the bulk of intercontinental emigration from the early 1800s to 1932 was from Europe, two-thirds of it to North America, Australia, and New Zealand. Since the 1920s "restrictions at points of origin and destination both tended to reduce the migration adjustments to economic growth to levels far below those prevailing in the nineteenth and early twentieth centuries" (Ibid., p. 56). Although in recent years mass migrations have again picked up they do not match the historical patterns.

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percent in 1971, in Belgium from .81 percent in 1900 to 1.12 percent in 1970, in the Netherlands from 1.00 percent in 1899 to 1.13 percent in 1970. Of four countries for which these data are available (the UK, Belgium, Netherlands, and Sweden), only Sweden had a large increase in total migration, from .56 percent in 1900 to 1.31 percent in 1970. (Calculated from B.R. Mitchell, European Historical Statistics 1750-1975. New York: Facts on File, 1981, 2nd ed., pp. 29-34 and 150-155.)

\*Immigration as a percentage of population plainly dropped sharply from the early 1900s to 1971:

	1901	1911	1971
Canada	1.04%	4.59%	0.69%
New Zealand	3.06%	3.88%	1.57%
USA (1970)	0.59%	1.13% (1910)	0.18%

For the USA and Canada even the gross number of immigrants declined. (Calculated from B.R. Mitchell, International Historical Statistics: The Americas and Australasia. Detroit: Gale Research Co., 1983, pp. 47-53 and 139-146.)

Of course, in some cases the sending and receiving countries have switched places: with economic development such major 19th-century labor exporters as Sweden, Denmark, and Belgium have become labor importers, while such labor-supplying German states as those in the territory of East Germany became labor importers and, with unification, again exporters. And such traditional labor exporters as Spain, Italy, and Greece now have an influx of immigrant workers, especially undocumented workers from North Africa. The main point, however, holds: mass migrations are an endemic feature of industrialism, nothing new either in degree or kind.

Similarly, external shocks -- wars, energy-price fluctuations, and quick changes in trade patterns are not new. Neither are the concomitant dislocations of employment [noted by Ferrera (p. 8) and the other chapters].

Industrialization for two centuries has meant the continual dilution and obsolescence of old skills and occupations and the creation of new ones (Wilensky and Lebeaux, 1965, pp. 59-65, 90-94). I doubt that the rate of change since 1960 is greater than the rate for previous 30-year periods. That is why the early retirement schemes so prominent among rich countries are not a response to 1992 but a continuation of previous responses to a 100-year trend toward lower labor-force participation among older men (Wilensky, 1979, pp.

210-211). The main causes: the occupational obsolescence of older workers and the rise of compulsory retirement rules in legislation and collective bargaining contracts; employers prefer middle-aged women and young educated women and men to older, more expensive men; and unions press for jobs and promotion chances for non-aged members who comprise union majorities. The more important new social fact is the rapidly-increasing percentage of healthy older workers; the policy challenge is to devise flexible retirement systems, which the Swedes and French have tried to do.

Most of the variations we see before us in the welfare-state are a product of (1) the timing, rate, and level of industrialization and its demographic and organizational correlates and (2) the character of national bargaining arrangements between major blocs of economic power -- the number, structure, and degree of centralization and inclusiveness of labor unions and labor federations, of trade associations and employer federations; the degree of centralization and bureaucratic competence of governments; the character of other interest groups (churches, voluntary associations), their relation to one another and to political parties. From those long-standing national differences flow the public policies on taxing, spending, social issues, how well they are implemented, and their effects on economic performance, political legitimacy and human welfare.

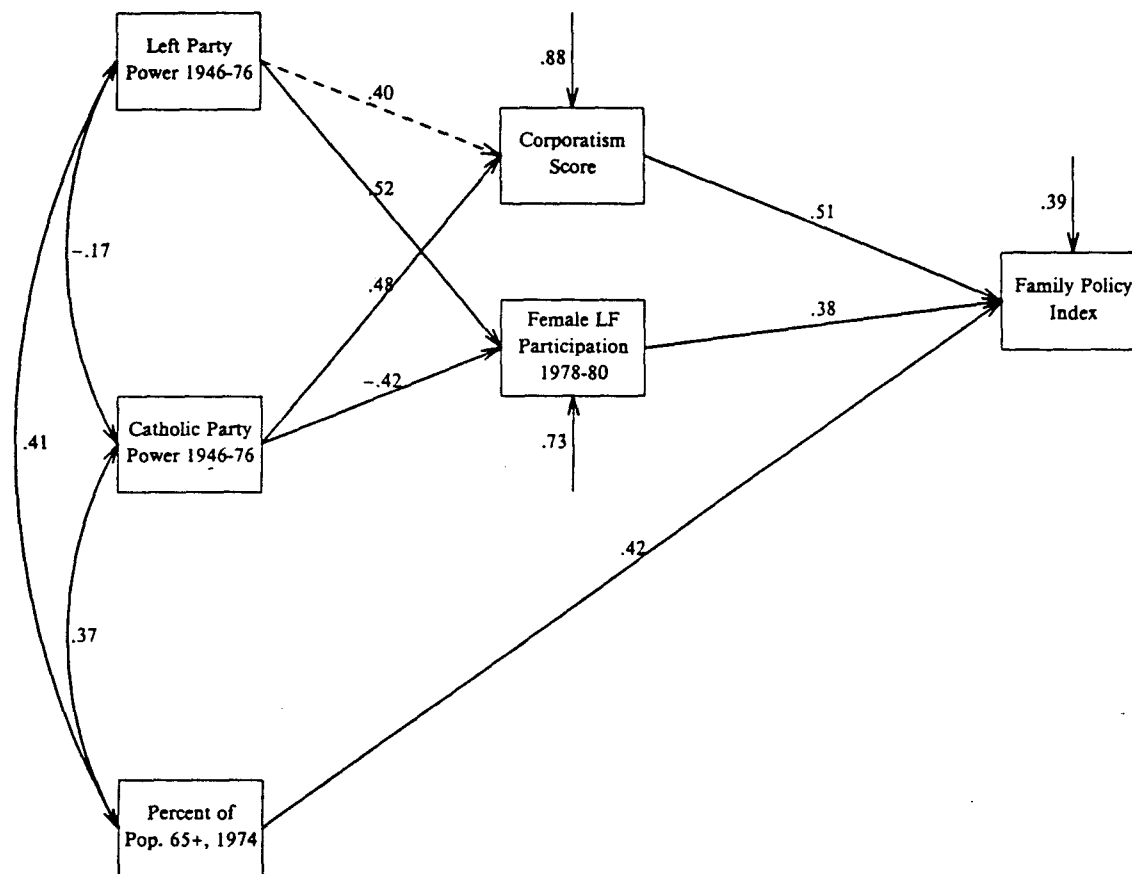
To illustrate the power of these internal structural variations I shall report a causal model for explaining differences among 18 rich democracies in their family policies. (The same model explains a great range of social and other public policies.) Figure 1 represents a final path diagram with path coefficients indicating the direction of influence and relative strength of each source of family policy.

[Figure 1 about here.]

We developed an index of innovative and expansive family policy 1976-1982 and ranked the 18 countries. The family-policy score is based on a scale (0-4) for each of three policy clusters: existence and length of maternity and parental leave, paid and unpaid; availability and accessibility of public daycare programs and government effort to expand daycare; and flexibility of retirement systems. They measure government action to assure care of children and maximize choices in balancing work and family demands for everyone. The countries and their scores are listed in Table 1, which shows the interaction of the main variables.

The results: the most innovative and expansive family policies (9-11) are in Sweden, France, Belgium, Norway, and

Figure 1. LEFT POWER ENCOURAGES BOTH CORPORATISM AND WOMEN AT WORK AND THEREBY EXPANDS FAMILY POLICY, 1976-82. CATHOLIC POWER KEEPS WOMEN HOME BUT FOSTERS CORPORATISM, WITH MIXED EFFECTS ON FAMILY POLICY. OLDER POPULATIONS INDEPENDENTLY ENCOURAGE FAMILY POLICY.\*



\*18 countries (Israel missing). Solid arrows indicate path coefficients significant at  $p < .05$ ; dashed arrow indicates significance at .10 level. Adjusted  $R^2$  for Family Policy Index = .85.

H. L. Wilensky  
*Tax and Spend*  
(forthcoming)

Finland; medium scorers (4-8) are Denmark, Germany, Austria, Italy, and marginally the United Kingdom and the Netherlands; the low scorers (1-3) are the United States, Japan, Switzerland, Canada, New Zealand, Australia, and Ireland. The causal model (Figure 1) shows why these countries differ.

I wanted to combine forces for convergence with forces for divergence in this analysis so the causal model examines the influence of both industrialization and politics. The findings, in brief, are:

[Table 1 about here.]

1. The more women at work, the more demand for government help in balancing the demands of family and work. While an increased rate of female labor-force participation is a common trend in all rich countries, there are still large national differences.
2. The more aged, the higher the score on family policy.

These two variables are clearly products of the level, timing, and rapidity of continuing industrialization, which everywhere increases women in non-agricultural work, lowers fertility rates and increases the percentage of aged, and increases family breakup.

Table 1. THE INTERACTION AFTER WORLD WAR II OF TYPES OF CORPORATISM, PARTY POWER AND IDEOLOGY, FEMALE LABOR FORCE PARTICIPATION, AND THE SIZE OF THE AGED POPULATION AS SOURCES OF FAMILY POLICY\*\*

Family Policy Score	Left Corporatist				Cath./Left Corporatist				Corporatist w/o Labor				Least Corporatist			
	Country	Policy Score	% Fem. in LF <sup>a</sup>	% Pop. 65+ <sup>b</sup>	Country	Policy Score	% Fem. in LF	% Pop. 65+	Country	Policy Score	% Fem. in LF	% Pop. 65+	Country	Policy Score	% Fem. in LF	% Pop. 65+
Most innovative (9-11)	Sweden	11	73	15	Belgium	10	47	14	France	11	54	14				
	Norway	9	62	13												
	Finland	9	69	10												
	Cell Avg.	9.7	68	13												
Average (4-8)	Denmark	8	68	13	W.Germany*	7	50	14					UK	5	58	14
					Austria	7	49	15								
					Italy*	6	39	12								
					Netherlands	4	34	11								
					Cell Avg.	6	43	13								
Least innovative (1-3)									Japan	2	55	8	USA	3	59	10
									Switzerland	2	49	12	Canada	2	56	8
													New Zealand	2	44	9
													Australia	1	51	9
													Ireland	1	35	11
								Cell Avg.	2	52	10	Cell Avg.	1.8	49	9	
Col. Avg.	9.25 68 13				6.8 44 13				5 53 11				2.3 50 10			

\*Italy, Catholic power only; W. Germany, ambiguously corporatist and marginally left.

\*\*Israel missing.

<sup>a</sup>Percent of females aged 15-64 in labor force, average 1978-80

<sup>b</sup>Persons 65 and over as percent of total population 1974

H. L. Wilensky  
Tax and Spend  
(forthcoming)

3. The interplay of left party power, Catholic party power, and corporatist bargaining arrangements accounts for the medium and high scorers.

Independently of industrialization these structures also shape women's participation rates. As expected, the combination of egalitarian ideologies in high places and democratic corporatism (Sweden, Norway, and Finland, with Denmark medium on corporatism) produces the highest scores. All four Scandinavian countries also had high rates of female labor-force participation and an abundance of old people.\*

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\*My model of corporatist democracy accents four interrelated tendencies in several modern political economies: (1) Bargaining channels develop for the interplay of strongly organized, usually centralized economic blocs, especially labor, employer, and professional associations with a centralized or moderately-centralized government obliged to consider their advice. (2) The peak bargains struck by such federations reflect and further a blurring of old distinctions between the public and the private. (3) These quasi-public peak associations bargain in the broadest national context rather than focusing only on labor market issues. (4) Consequently, social policy is absorbed into general economic policy, and chances for social consensus are enhanced. A variant is corporatism without full integration of labor -- epitomized by Japan and France, with Switzerland as a marginal case (Wilensky, 1976 and 1983). We defined political parties by their ideological stance not by their social base or behavior in office: Left parties (e.g., Social Democratic, Socialist, Labor) are committed to use the apparatus of the state to redistribute income, power, and status -- an egalitarian ideology; Catholic parties (Christian Democratic, Social Christian, etc.) are anti-collectivist, anti-liberal (not fond of free markets) and draw on a traditional humanistic concern with lower strata. We coded amount and duration of power in both executive and legislative bodies for every year of competitive politics from 1919 to 1976, for a measure of cumulative power (Wilensky, 1981b). Table 1 uses the power



The second cluster of countries reflects the ambivalence of Catholic parties toward women's place and the left offset: corporatist countries with Catholic and left parties -- Austria, Italy, Netherlands, and if we can count it as corporatist, West Germany (which scores medium on left power) -- all score medium on family policy (4-7). Belgium, which fits this category, has a higher than expected score of 10. Its strong family policy might be explained by the leftist character of its Catholic parties -- including a long history of Catholic workers' movements -- and by the unusual frequency with which left parties moved in and out of Catholic-dominated coalitions since World War I.

The third group -- corporatist without labor -- as predicted, has the third highest family policy score. But here France, like Belgium is deviant, with a score of 11, tying that of Sweden. In this case both women workers and demography offset the weakness and exclusion of labor from top policymaking. More important there was a brief period of left-Catholic rule -- Communist-Socialist-MRP tripartisme -- at the beginning of the first Legislature of the Fourth

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scores for the period 1946-1976; but the longer period from 1919 yields the same results.

Republic. Although in my scheme France is not counted as having either much left or Catholic party power, the Mouvement republicain populaire, a Catholic party, was the largest non-Communist group in the assembly in 1946; in coalition with the left it initiated much social legislation. The coalition increased coverage and benefit of family allowances established in the 1930s; they greatly enriched the "politique de la famille." Once in place those social policies tend to expand. So by 1980 France was second in paid parental leaves (15-18 weeks) including paternity leave, very high in unpaid leaves (two years), tops in childcare and the second only to Sweden on flexible retirement. Like Belgium, France also led the league in spending on family allowances.

The most fragmented, decentralized political economies -- United States, Switzerland, Canada, Australia, New Zealand -- with the United Kingdom as a partial exception, have lower scores. The United Kingdom's 5, a bit above the expected, might be explained by its high fraction of aged and its quite high rate of female labor-force participation. It also has experienced more than a touch of left power since World War II.

Note that all of the attributes of political, economic and social structure that explain family policy and, indeed, a wide range of other social policies, are internal; they are persistent structural differences -- party power and ideology, demographic composition (rooted in a country's timing and rate of growth), and the structure, functions, and interaction of labor unions, management, and the state.

It is true that trade dependence and international competition [the forces some of the authors in this book say will make the future of European welfare-states very different from the past] have an indirect effect on social policies. But like all external pressures and shocks they are filtered through and greatly modified by the domestic structures I have discussed. For instance, in my 19-country analysis of the structural and ideological sources of democratic corporatism (Wilensky 1981 and forthcoming), I show that trade dependence, measured by exports over GNP for various periods from 1880 until 1960, is less important than an electoral system using proportional representation and less important than the rising power of Catholic parties and left parties -- a finding somewhat at odds with the 12-country comparisons of Peter Katzenstein (1985, pp. 81-87, 137, 165-173). In fact, the export prowess of the corporatist democracies is more a consequence of their internal political bargains than a cause of them. Because these structures and the policies already in place mediate

the impact of the welfare-state on competitiveness, because so many politicians and scholars believe that the welfare-state is a drag on economic performance, we must first know precisely what social programs reduce productivity, what social programs increase it, and which are simply neutral.

### The Welfare-State and Economic Performance:

#### Lessons from the Past

My analysis of the economic performance of 19 rich democracies from 1950 to 1988 (Wilensky 1981 [OECD], p. 192; 1983; forthcoming; and Wilensky and Turner 1987) as well as the work of Cameron (1982), Schmidt (1982), and Scharpf (1981, 1983) and others, cast doubt on assertions that aggregate social spending is a threat to economic growth, inflation control, or low unemployment or that the lean welfare-states of Japan and the United States give them a competitive advantage over welfare-state leaders saddled with huge social budgets.\*

In fact, the comparative evidence shows that over long periods big spending has either made a positive contribution to economic performance or is unrelated to economic

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\*Cross-reference Ferrera, p. 10 on the new need to take account of social policies' effect on competitiveness and p. 16 where he notes "America's excellent ability to adapt".

performance, depending upon the period considered. The correlations between an index of economic performance combining good real growth in GDP per capita, low inflation, and low unemployment and a broad measure of social spending (SS/GNP) are positive before the oil shocks of 1973-74 and 1979 (for 1950-74,  $r = .48$ ; the aftershock correlations are insignificant -- for 1974-79,  $r = .26$ ; for 1980-84,  $r = -.22$ ; for 1985-88,  $r = -.37$ ). In multiple regression analysis, neither welfare effort (SS/GNP) nor its rate of growth nor the rate of growth of social spending per capita stand up against the robust causes of economic performance (the structure of the political economy, capital investment, and industrial relations systems).

If the welfare-state as a whole is either a benign influence on competitiveness or irrelevant, what is the explanation? Consider three sectors of social policy: medical care and health; occupational health and safety; and active labor-market policy. It seems reasonable to suppose that countries that increase dignified mass access to medical care and are aggressive in diffusing information about nutrition and other good health habits through schools, clinics, and childcare facilities will in the long run enhance the productivity of the labor force. Similarly insofar as the expense of job-injury insurance has inspired more preventative occupational health and safety programs in the workplace, it has enhanced productivity by reducing

absenteeism and turnover and cutting costs. Although systematic comparisons of many countries have yet to be done, my comparison of Sweden and Germany vs. the United States is suggestive. It shows that while all three increased both job-injury insurance spending and safety in the workplace, at least for the years data were available (1968 to 1976), the United States increased its accident-insurance spending more than Germany and Sweden with less effect on safety, measured by trends in spending per capita and the decline in deaths from industrial accidents. The cost-benefit ratio for the Swedes was best, the Germans next, the American last, a rank order that fits the degree of industry-labor collaboration in implementing safety regulations and the commitment to prevention: the Swedes most, the Germans next, the Americans, least (Wilensky, 1983, pp. 59-60). Finally there is strong evidence that those countries such as Sweden, Germany, and Japan that have invested in active labor-market policies and have tried to reduce their reliance on passive unemployment insurance and social assistance have got a productivity edge over their competitors (Wilensky 1985 and 1991b; Wilensky and Turner 1987, pp. 3-5, 25-31).

Beyond these still-tentative generalizations there is good support for the idea that countries with strong corporatist bargaining arrangements more flexibly adapt to external shocks and more effectively implement productivity-enhancing

social and labor policies. Corporatist democracies provide channels for the interplay of management, labor, and the state. The tradeoffs that such a structure facilitates are often directly relevant to productivity and macroeconomic performance (Wilensky, 1981a [OECD], p. 192; Wilensky et al. 1985a, pp. 43-47; and forthcoming). The corporatist tradeoffs most positive for economic performance follow:

1. Labor constraint on nominal wages in return for social-security and related programs and modest increases in real wages. (My findings are consistent with those of Cameron 1982 regarding inflation control and those of Lange and Garrett 1985 regarding nominal wage constraint.)
2. Job protection in return for wage constraint, labor peace, and sometimes tax concessions (lower taxes on corporations and capital gains). "While the employer may feel hemmed in by laws and customs in hiring and firing, workers are likely to feel reasonably secure . . . We must at least consider the possibility that job protection is a positive contribution to lowering unit costs" by reducing worker sabotage, output restriction, slowdowns, strikes, and turnover (Wilensky, 1981a, p. 192). One of the two most robust sources of good economic performance in all periods in my 19-country study is low strike rates -- a clue to

effective industrial relations systems characteristic of corporatist democracies.

3. Participatory democracy in the workplace or community in return for labor peace and wage constraint. A case in point: the German local works councils and national co-determination combined with regional collective bargaining that is coordinated by centralized unions and employer associations setting a broad framework. Several countries provide channels for worker and union leader participation in tripartite boards administering parts of the welfare state -- medical insurance, unemployment and accident insurance, and pensions (Wilensky, 1975, pp. 66-67).
4. In return for all of the above, the government improves its tax-extraction capacity and public acceptance of taxes on consumption -- not irrelevant to reduction of inflation and budget deficits. Thus, the combination of high VAT and social-security taxes is a moderately positive contribution to high scores on my economic performance index before 1974 (although it is insignificant after).
5. In return for all the above, both labor and the government tolerate low taxes on either capital gains or profits and avoid high property taxes. Although



my study shows that taxes on capital gains, corporate income, and profits have only moderately negative effects on capital investment and little effect on economic performance, property taxes may be a strong drag in all periods. Reliance on property taxes is characteristic of the more fragmented and decentralized democracies.

6. With the habit of making such tradeoffs and faced with strong labor movements, management in the more corporatist democracies tends to join labor in the implementation of a wide range of policies. The result: less intrusive regulation and more effective implementation of laws and executive orders. Thus, the complaint that Western Europe is hyperregulated and hyperprotected -- that it has the disease of "Eurosclerosis" -- while America has "an excellent ability to adapt" (as Ferrera puts it, pp. 15-16) ignores the evidence on types of regulation and regulatory styles. As Ronald Dore (1986) implies in his treatment of "flexible rigidity" in Japan and as Myles notes in his treatment of American health care regulations (chapter \_\_\_ of this book), an ideology of deregulation goes together with the most intrusive and rigid kinds of regulation while "statist" political economies may regulate more flexibly. As I have suggested (1983, pp. 58-59):

"In the corporatist political economy of Sweden, regulations of the Worker Protection Board (*Arbetskyddsverket*) are accepted by unions and employers; the atmosphere is one of negotiation and cooperation. In the United States, OSHA's regulations are constantly challenged in the courts; the atmosphere is confrontational. Unions complain of inadequate enforcement, employers denounce 'overregulation' (their propaganda campaign pictures mindless bureaucrats issuing frivolous orders requiring split-seat rather than round toilets).

Paradoxically it is in allegedly individualistic, decentralized America that government inspectors are intrusive and routinely fine employers for noncompliance. In allegedly collectivistic, centralized Sweden, inspectors are loath to punish employers; instead, they rely on consultation with health and safety professionals and other representatives of LO (the largest labor federation) and SAF (the employer federation) and look to local control -- the institution of the safety steward or workplace ombudsman -- for enforcement. They also set up joint research

and development projects to produce innovative solutions to difficult problems of the work environment.

The contrast in the operations of OSHA could not be sharper: adversary lawyers and environmental activists often perform in front of TV cameras in open hearings, make verbatim transcripts, and escalate conflict, thereby fostering deadlock, delay, and resistance to final decisions. Huge amounts of money and time are expended in diversions from problem solving. Employer backlash is then mobilized to weaken the law." (Wilensky 1983, pp. 58-59. Cf. Kelman 1981; Bardach and Kagan, 1982.)

The paradox that the most decentralized political economies with the most liberal (free-market) ideologies have the most rigid and intrusive regulations can be explained by the weakness of the structure and political power of labor and the absence of channels for collaboration among labor, management, and the state.

A final bit of evidence that corporatist democracies with big welfare-state burdens nevertheless adapt flexibly to external shocks is the record of responses to two Arab oil

shocks 1974 and 1979. One would think that a country that produces little energy and is highly dependent on oil would be handicapped in adjusting to those shocks. Yet in my 19-country comparison, energy dependence was simply unrelated to economic performance in each of two five year post-shock periods. This again underscores the overwhelming importance of structures of bargaining and their policy consequences (corporatism as it relates to strikes, capital formation, tax structures, as well as social, industrial, and labor-market policies). Such domestic structures and policies explain great national differences in the capacity to adapt to external shocks -- so much so that by 1979, with few exceptions, the countries most exposed (Japan, Switzerland, Sweden, Finland, Belgium) were able to adapt more quickly and effectively to the next big shock than countries well situated (Canada, United Kingdom, Ireland). It is striking that all six of the most energy-dependent, quickest-adjusting good performers are corporatist with or without labor, and three of them are big spenders. In contrast, three of the poorest performers after both shocks -- Canada, UK, Ireland -- were medium-to-low in social spending and much less energy-dependent.

Convergence Downward, Upward  
or Just Persistent Differences?

What is the lesson for the present context? Will the shock of increased globalization inspire a move of the most successful rich democracies downward toward Portugal, Greece, and Spain? That is very unlikely. If the structures and policies now in place have enabled Germany, Switzerland, Norway, Austria, Finland, and Japan to outperform the rest through thick and thin why should they now move toward low-wages, weak job protection, low social spending, less investment in education, training, and job placement, low productivity, and low value-added products? Why should they join Margaret Thatcher and Ronald Reagan in bashing unions? Even if they wanted to copy the US and the UK -- which I do not think they do -- their governments would encounter mass resistance as well as strong labor protest. To turn quiescent unions or reformist unions into radical confrontationist unions is not what most political and industrial elites desire.

Some recent evidence from Germany suggests that industrial managers themselves do not want what orthodox economists and center-right politicians say they want -- deregulation of the labor market -- and for good reasons.

The 1980s saw accelerated rhetoric regarding the evils of job protection in law and collective bargaining contracts; there was even some shift in public policy. A number of countries, especially the UK, Germany, France, Italy, and Spain, relaxed legal restrictions on layoffs and dismissals and widened existing loopholes in established systems of job protection. For instance, they encouraged fixed-term vs. permanent contracts or reduced barriers to hiring temporary labor (OECD 1989; Auer and Buchtemann 1989). The aim: reduce institutional rigidities, increase the efficiency of labor markets, and decrease labor costs and thereby increase employment, speed up innovation and industrial readjustment -- all the goodies in the promised land of the free marketeers.

If we examine employer behavior, however, we discover a radical disjunction between political rhetoric and industrial practice. Germany is a good case for examining the validity of the attack on the allegedly detrimental effects of job-security regulations on the firm and more generally, "Euroclerosis" in the economy. It has long had an elaborate system of job protection, a model followed by other countries in the 1960s and early 1970s, and in 1985 was the European leader in job stability; in continuous job-tenure rates Germany was second only to Japan (Buchtemann

1991, p. 10).<sup>\*</sup> To the tune of the ideological music of the early 1980s Germany passed a new "Employment Promotion Act" (EPA) in 1985. Among other legal changes, it relaxed job protection rules for new enterprises, extended maximum periods for the use of temporary workers hired from agencies, and, most important, made it easy for employers to hire workers on fixed-term contracts and fire them at the end without "just cause" or consultation. The law was pushed mainly by the Free Democrats (FDP), the right wing of Chancellor Kohl's coalition government.

In a careful evaluation of the employment impact of the law, based on a review of subsequent studies, including a representative sample survey of 2,392 establishments, using ingenious measures of changes in hiring and firing practices that could be attributed to the law, as well as in-depth case studies of the motives of employers who did and did not use the new law, Buchtemann (1989 and 1991) found that the employment effects of the EPA were negligible; employers

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<sup>\*</sup>"In 1985 almost two thirds of all workers in Germany had been continuously employed in their current job for more than five years (U.S.: 45%; France: 58%; UK: 52%)," most of them for more than 10 years (Buchtemann, 1991, p. 10). General restrictions on layoffs and individual dismissals imposed by collective bargaining and labor law are complemented by special job protections for vulnerable groups (e.g., pregnant women, the handicapped, draftees, older workers). If we add tenured public servants, about 20% of the total "dependent" workforce are totally protected against ordinary dismissal.

were overwhelmingly uninterested in using the law. Here are the relevant findings:

- o Despite strong job protection, the annual labor turnover and job separation rates of Germany both before and after the EPA of 1985 are quite high (more than one in four). (Buchtman, 1991, p. 10.)
  
- o In the two years after the law worker turnover was highly concentrated in small and medium-sized firms in construction, food processing, and low-skill personal services (hotel and catering, transportation, body care and cleaning). One-half of all terminations and new hires were accounted for by only 19% of all firms. These are firms with low-skill, high-labor costs as a fraction of total costs, and big fluctuations in demand. Their massive labor turnover, however, does not reflect superior adjustment efficiency. Both before and after the law these high-turnover firms pursued this "hiring and firing" strategy (Ibid., p. 11-15).
  
- o Before and after the law, dismissals have played only a minor role in total turnover; German employers tend to avoid layoffs as long as possible by attrition, adjusting hours, early retirement schemes, etc. Most turnover is from voluntary quits, expired



apprenticeship contracts, or early retirements. In downturns employers hoard labor to avoid high search, recruitment, and training costs on the upswing.

- o Before the EPA law a comprehensive study of dismissals in private industry in the late 1970s found that neither unions and works councils nor job protection laws strongly impede employers from firing workers they wanted to fire. That is why 85% of personnel managers interviewed at the time said that their firms had been able to fire and lay off close to all the workers they wanted to without any major financial and/or legal difficulty. Personnel managers in the post EPA period reported the same judgment: employment protection legislation both before and after the reforms was no major obstacle to dismissals and necessary workforce reductions.
  
- o Actual use of the options offered to employers by EPA for temporary hires was confined to a small minority (4%) of all private-sector firms and to a tiny number of cases (2% of all new hires) (Ibid., p. 22). Only 0.6% of all firms in the private sector used the new fixed-term contracts created by the EPA in order to adjust their workforces more flexibly to external demand.

o Far from expanding employment, deregulation had negligible net effects. If anything, it had slightly negative effects. It increased the layoff risks for fixed-contract workers in a downturn but increased hiring only slightly in expanding firms. (Ibid., p. 24).

Most damaging for the advocates of labor-market deregulation, the German employers in the most dynamic sectors, the expanding engineering and higher-skill service industries -- the drivers of the economic machine that conquered world markets -- said that they do not take advantage of the law because they do not want to incur the costs of a "hire-and-fire" strategy: transactional costs and productivity losses, training costs, loss of loyal workers motivated by job security and good wages and benefits.\* German employers, unlike the ideologues who inspire the laws, know that investment in human capital pays off in the superior productivity and flexibility of a stable work force.

In short, whatever the political rhetoric of deregulation and the free market, German employers in the late 1980s were

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\*This empirical finding is consistent with older industrial relations research and with recent economic theories of "efficiency wages": firms may pay a premium over market-clearing wages because they want to retain worker loyalty and encourage hard work (Katz, 1986).

pursuing the same labor policies that brought them success since 1960.

If there is convergence in the programs and expenditures comprising the welfare state it is not the convergence downward imposed by greater ease of mobility of labor and capital across national boundaries. It is instead the convergence rooted in continuing industrialization and the trends all rich democracies share: the continued aging of the population, now accelerating in Japan and North America, the upgrading of skills and job demands, and the convergence in female labor-force participation. These common trends will most affect family policy, active labor-market policy, and pension expenditures all of which I believe will become more, not less, alike.

Perhaps an increase of net migration to the successful political economies of Europe will make them look a bit more like Canada, the United States, and Australia in their cultural and social diversity and minority group conflict. But it is not clear that this will mean a dualism in jobs, wages, and living standards as radical as the dualism of North America and Australia, countries that have developed a large "underclass." Those latter countries have been among the leading job creators from 1968 through the 1980s while France, West Germany, Austria and the UK were below the median in job creation. The top job creators, as I have

shown in an 18-country comparison (Wilensky 1991a) were responding to demographic changes (high net migration rates and high rates of 15-24 year-olds entering the labor force) and changes in social structure (the combination of high rates of female labor-force participation, high rates of family breakup, and the feminization of poverty). The jobs they created were mainly low-paid, low-skill service jobs using migrants, young people, and divorced women pressed to the wall, many of them part-time or temporary workers looking for full-time work. The net outcome over long periods has been anemic productivity increases, high job turnover, lowered investment in training, deterioration in real wages, and an increase in unproductive welfare spending -- all of which puts them in competition with the newly-industrializing countries, e.g., South Korea and Taiwan, themselves moving in the opposite direction toward high-wages and high value-added products. (Wilensky 1991a.)

There is no reason that Germany, Japan, and the Scandinavian countries would now want to go down that road.

Some of these nations are able to regulate immigration from outside the EEC a bit better than the North Americans can. For instance, Switzerland has long practice in controlling its borders; Germany levies stiff fines and penalties on employers who hire illegal workers and enforces these regulations, more-or-less, by identity cards and inspectors

visiting work sites (e.g., building construction). Historically, both countries were able to incorporate immigrant labor into the secondary sector: a few years after foreign workers were stabilized, 73 percent of West German immigrants (1975) and 67 percent of immigrants to Switzerland (1972) were in manufacturing and related jobs, not in agriculture, construction, and service (Sassen, 1988, pp. 44-45). The Mediterranean countries -- Italy, France -- may have a harder time regulating and integrating foreign labor because of long coast lines and easier access. Because unskilled jobs are a declining portion of the labor force in all these countries, however, they all confront a choice between burgeoning welfare costs for new immigrants, women heading broken homes, and young people, on the one hand, or the more productivity-enhancing strategies they have already pursued, on the other. The German-Swedish-Japanese model (cultivate accomodative labor relations, invest heavily in human resources, maintain high rates of capital investment, etc.) or the North American model (maintain confrontational labor relations and adapt the technical and social organization of work to a large, cheap labor supply) -- these are the real choices. Happily the demographics of the next 20 years are favorable: the lower rate of entry of native young people will create labor shortages that immigrants, if trained, can fill.

Whatever the European political economies do about the welfare state, labor market, and social policies, I suspect that they will all experience a moderate increase in ethnic-racial-religious conflict, hardly unknown to the Continent in the past, only this time without war.

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