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# **The Politics of Labor Market Reform in Coordinated Welfare Capitalism: Comparing Sweden, Germany, and South Korea**

**Timo Fleckenstein and Soohyun Christine Lee\***

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## **Abstract:**

Since the 1990s, coordinated welfare capitalism has been subject to comprehensive change, with workfare measures and the deregulation of employment protection at the heart of labor market reforms. Developments in Sweden, Germany, and South Korea not only challenge the assumption of relative stability that is commonly associated with the study of coordinated market economies, but also the assertion that this stability is associated with the persistence of established political coalitions. Instead, we contend a collapse of old welfare state coalitions as key political driver of labor market reform, with the withdrawal of employers from previous welfare settlements at the center of this development.

## **Key Words:**

Coordinated Welfare Capitalism, Labor Markets, Sweden, Germany, South Korea, Employers, Varieties of Capitalism, Globalization, Dualization.

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## **The Politics of Labor Market Reform in Coordinated Welfare Capitalism:**

### **Comparing Sweden, Germany, and South Korea**

Over the last 20 years, labor markets across the OECD have been subject to comprehensive change, with workfare measures and the deregulation of employment protection at the heart of labor market reforms. Whilst workfare and little employment protection have long been key features of the liberal welfare capitalism of the Anglophone world<sup>1</sup>, strict labor market re-commodification is a more recent phenomenon in the welfare capitalism of Northern and Continental Europe, where coordination between the state, business, and labor allowed for greater levels of egalitarianism and social solidarity.<sup>2</sup> In East Asia, state-led coordination achieved high levels of employment during the period of late industrialization, which produced low levels of social inequality despite very residual social welfare provision. However, sharp increases in unemployment in the wake of the economic crisis of the late 1990s undermined the ‘welfare-through-work’ system, and subsequent labor market deregulation accelerated this erosion.<sup>3</sup>

In this article, we assess the development of labor market policy in three coordinated market economies (CMEs); namely, Germany, Sweden, and South Korea. Whilst the Varieties of Capitalism (VoC) dichotomy of liberal and coordinated market economies tends to underappreciate differences within CMEs in particular<sup>4</sup>, we underline the variation in the welfare/production regime in CMEs. Admittedly, all three cases have traditionally been characterized by high employment protection, but presented themselves very differently with regard to social welfare provision. Germany is the archetypical CME with a conservative-corporatist (or Bismarckian) welfare state, whereas Sweden is the prime example of social-democratic welfare

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<sup>1</sup> Esping-Andersen 1990; Gilbert 2004.

<sup>2</sup> Esping-Andersen 1990; Hall and Soskice 2001; Thelen 2012.

<sup>3</sup> SC Lee 2012; Miura 2012.

<sup>4</sup> Cf. Hall and Soskice 2001; Estevez-Abe, Iversen and Soskice 2001.

capitalism.<sup>5</sup> Although Japan is widely considered the prototype of the developmental state<sup>6</sup>, the Korean case represents the archetype of the developmental *welfare* state, where modest social policy “is intimately linked with and subordinated to the supreme goal of economic development.”<sup>7</sup> Recent labor market reforms in these three critical cases in the study of CMEs call into question ‘orthodox’ claims of policy stability that dominate much of the institutionalist welfare state and political economy literature.<sup>8</sup> Even though we have seen the emergence of a large body of *theoretical* institutionalist literature discussing institutional change and its sources in advanced political economies<sup>9</sup>, the predominant literature continues to downplay the scope of change that advanced welfare capitalism (especially, in CMEs) has been experiencing over the last 20 years. Most prominently, Thelen identifies distinct varieties of liberalization, with which she supports the claim that different forms of welfare capitalism remain distinct.<sup>10</sup> Looking at the case of Sweden, Thelen acknowledges comprehensive liberalization weakened coordination mechanisms, but she insists that the Swedish variant of liberalization did not compromise social solidarity.<sup>11</sup> By contrast, Germany saw a decline in social solidarity in the wake of dualization, but this did not significantly compromise coordination that is typically associated with social partnership. In fact, coordination between business and labor is seen as the driving force behind dualization.

Challenging this perception of coordinated welfare capitalism, we argue that labor market reforms in Sweden –entailing retrenchment, workfare measures, and labor market deregulation– have involved an erosion of social solidarity. As far as the German case is concerned, we agree that social solidarity has been on the decline since the mid-1990s, but we also find a

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<sup>5</sup> Esping-Andersen 1990; Hall and Soskice 2001.

<sup>6</sup> Johnson 1982.

<sup>7</sup> Ringen, Kwon, Yi, Kim and Lee 2011, 31f.

<sup>8</sup> Hall 2007; Hall and Soskice 2001; Pierson 2004.

<sup>9</sup> Deeg and Jackson 2007; Mahoney and Thelen 2010; Streeck and Thelen 2005.

<sup>10</sup> Thelen 2012.

<sup>11</sup> See also Steinmo 2010 on the resilience of the Swedish model.

collapse of the cross-class compromise of the post-war settlement driving this transformation of the labor market. Lastly, calling into question the mainstream East Asian welfare state and political economy literature, we show a decline of the state in Korea, where economic liberalization and democratization have undermined the steering capacity of the state.

This study of the critical cases of Sweden, Germany, and Korea shows that labor market reforms starting in the 1990s have successively undermined the defining feature of each world of coordinated welfare capitalism – that is social solidarity in Sweden, corporatism in Germany, and the developmental state in Korea. However, not only does this research challenge the assumption of relative stability that is commonly associated with the study of CMEs, we also contest the assertion that this stability is associated with the persistence of established political coalitions. Instead, we contend, across all three cases, a collapse of old welfare state coalitions as key political driver of labor market reform, with the withdrawal of employers from previous welfare settlements at the heart of this development. Before the investigation of Sweden, Germany, and Korea in greater detail, we examine the politics of labor market reforms, which allows us to conceptualize our empirical findings and discuss the drivers of labor market reform in the three case studies in comparative perspective.

### **The Politics of Labor Market Reform**

Much of the welfare state literature of the advanced political economies of the ‘West’ has been dominated by the power resources approach (PRA), which essentially argues that the generosity of welfare states and the decommodification of workers are associated with the strength of social democracy and organized labor. This approach assumes a basic antagonism between the welfare state and the market, as the costs of social policy undermine the profitability of businesses. Employers are accordingly perceived to be opponents of the welfare state as its being an intervention into their autonomy, whereas social-democratic parties, as the ‘natural allies’

of organized labor, are thought to challenge employers' interests in capitalist societies. Therefore, the welfare state is depicted as a distributional struggle between labor and business, in which left parties and trade unions are the driving forces behind the expansion of social policy and social citizenship.<sup>12</sup> The social-democratic power resources literature greatly relies on the Scandinavian experience and, especially, on the paradigmatic case of Sweden.

In Continental Europe, however, Christian rather than social democracy was the key architect in welfare state building.<sup>13</sup> Admittedly, the Christian-democratic welfare state (such as the German exemplar) is concerned with status preservation and risk pooling through Bismarckian social insurances rather than vertical redistribution; this should, however, not deflect from the principal 'pro-welfare' stance of Christian democrats. It is also worth noting that Christian democracy received considerable political support from workers, and their 'labor' wings had great political weight.<sup>14</sup> Thus, while social democracy might have been the preferred ally of trade unions, many workers and trade unionists found a political 'home' in Christian-democratic parties with their distinct welfare state project. And, in fact, trade unions and skilled workers often preferred Bismarckian earnings-related social protection over Swedish-style egalitarianism, as the former was considered to offer a 'better deal' to industrial workers.<sup>15</sup>

PRA and the related parties-matter thesis (with the Christian-democratic 'modification') appear powerful for explaining the emergence of welfare states and their divergent development during the Golden Age, but accelerating globalization and de-industrialization raise the question as to whether partisan difference has been blurred in the face of socio-economic pressures. Whilst Korpi and Palme argue that partisan differences have persisted in the era of retrenchment and global market integration<sup>16</sup>, Mishra describes social democrats as 'reluctant

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<sup>12</sup> Esping-Andersen 1990; Korpi 1983.

<sup>13</sup> Kersbergen 1995.

<sup>14</sup> Manow and Kersbergen 2009.

<sup>15</sup> Baldwin 1990.

<sup>16</sup> Korpi and Palme 2003; see also Allan and Scruggs 2004; Huo, Nelson and Stephens 2008.

modernizers,' who might not want to engage in welfare retrenchment but cannot escape structural pressures confronted with the 'imperatives' of globalization.<sup>17</sup>

From a rational-choice point of view, Rueda also questions the conventional wisdom that the interests of the working classes are well represented by social democrats and organized labor, assuming greater conflicts between labor market insiders and outsiders after the end of the Golden Age. The former are not expected to show much interest in generous unemployment protection and active labor market policy. Not only do these policies primarily benefit labor market outsiders, they also involve a heavier tax and/or social insurance contribution burden on insiders, as well as greater wage competition and corresponding downward pressure on wages. Instead, insiders favor strong employment protection, reducing their risk of becoming outsiders. When the interests of these two groups collide, the insider/outsider partisanship theorem expects social democrats and organized labor to prioritize the interests of insiders over those of outsiders, as insiders form the core constituency of both social-democratic parties and trade unions. Outsiders, by contrast, engage less in the political process (as expressed in low electoral turnouts) and show lower levels of unionization.<sup>18</sup>

Turning from political parties and organized labor to employers, the VoC approach highlights possible business support for social policy expansion with the argument of a nexus between public welfare provision and skills formation. In particular, CMEs relying on firm- and industry-specific skills (i.e. skills of low portability) face a critical challenge, as risk-averse employees (as well as employers) may shy away from making investments into these skills in an uncertain future environment. However, comprehensive employment protection and generous unemployment benefits are viewed as providing an institutional framework that encourages workers to invest in specific skills. Whilst *firm*-specific skills are said to be best supported with

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<sup>17</sup> Mishra 1999, see also on the limited steering capacity of the state: Scharpf 2000.

<sup>18</sup> Rueda 2007.

high levels of employment protection (reducing the risk of unemployment; as exemplified by the Korean case), generous earnings-related unemployment protection is most important for the formation of *industry*-specific skills as a means to protect ‘skilled wages,’ as exemplified by the German case. Although Sweden with its social-democratic welfare state is underexplored in the VoC literature, it is seen as broadly corresponding with the German case.<sup>19</sup> Against this background, social policy is argued as complementing the production regime in CMEs. In fact, without sufficient social and employment protection in place, this literature anticipates market failure in the formation of specific skills. For this reason, employers in CMEs with heavy reliance on industry-specific skills in particular are expected to support social policies facilitating skills formation. Accordingly, the VoC literature makes the proposition of a “strong alliance between skilled workers and their employers in favor of social protection.”<sup>20</sup>

Comparing PRA and VoC, the difference in coalition politics is straightforward. The former views the alliance of social democracy and the labor movement as being at the heart of generous welfare states (with employers opposing social policy expansion), whereas the latter considers cross-class coalitions with employers supporting certain social policies, presuming these contribute to skills formation. As PRA, VoC has been criticized for its bias towards stability and failing to account for paradigmatic institutional change. In this literature, the stability bias has its foundation in the concept of institutional complementarities, which captures the idea of linkages between sub-systems of the economy (such as the welfare state and skills formation).<sup>21</sup> Institutional complementarities provide strong incentives to stick with an existing institutional configuration, and political economies are accordingly expected to follow their

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<sup>19</sup> Estevez-Abe et al. 2001; Mares 2003.

<sup>20</sup> Estevez-Abe et al. 2001, 147.

<sup>21</sup> Hall and Soskice 2001, 17.



paths.<sup>22</sup> Yet, socio-economic change, such as globalization, could be expected to alter the (perceived) benefits of particular institutional settings. For this reason, an actor that previously endorsed an institutional equilibrium might withdraw support in the face of dwindling benefits (or even incurring costs), which might have far-reaching implications for the political foundations of institutional settings. Old political coalitions might fall apart (destabilizing institutional reproduction), and new coalitions engaging in institutional redesign might arise.

While political parties and social partners have a prominent place in the analysis of ‘Western’ political economies and welfare states, these actors are regarded as largely insignificant in the study of East Asian welfare states. Influenced by the developmental state thesis with its focus on the steering role of the state in the economic development in East Asia, the mainstream scholarship on East Asian social policy, the developmental *welfare* state approach, explains the development of social policy in the region as a state-led process that is closely embedded in the project of economic development.<sup>23</sup> Coinciding with the period of industrialization, the welfare state in the region was institutionalized during the authoritarian regimes in Korea (1961-1987) and Taiwan (1949-1987), and the ‘soft-authoritarian’ regime in Japan (1948-1993) wherein the conservative Liberal Democratic Party (LDP) dominated the political system.<sup>24</sup> In policy-making, bureaucrats were given substantial autonomy; and they pursued economic development first and foremost, as the regimes in East Asia sought to legitimize their rule by delivering growth and employment. In this context, it was understood that the welfare regime in the region was shaped by growth-oriented bureaucrats, who subordinated all aspects of state policy to the objective of economic growth through industrialization. Limited social policy was promoted, not in terms of social citizenship, but to facilitate industrialization. As a

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<sup>22</sup> Hall and Thelen 2009; Palier and Thelen 2010.

<sup>23</sup> Tang 2000; HJ Kwon 2005.

<sup>24</sup> Johnson 1987.

matter of principle, bureaucrats wanted to minimize welfare expenditures.<sup>25</sup> Rather than providing social welfare, the state preferred the role of regulator, imposing the costs of social welfare on non-state actors, especially on employers.<sup>26</sup>

Compared to all-powerful bureaucrats, business influence in policy-making was limited. Certainly, employers enjoyed privileges as the state's ally in its bid for rapid industrialization, but in the end state always had the upper hand in the so-called 'developmental alliance,' as the government set directions and used incentives, or sometimes even disciplinary measures (such as tax probes), to ensure business compliance.<sup>27</sup> By contrast, labor unions had no meaningful influence over policy, because governments suppressed them as potential opposition forces.<sup>28</sup> Enterprise unionism was promoted, which prevented unions (especially those of large enterprises) from developing an interest in national level agendas (such as social policy) and incentivized them to focus on particularistic interests (namely, employment protection, wages, and enterprise welfare).<sup>29</sup> Political parties as such also played an insignificant role in social policy development. Opposition parties were weak, while incumbent parties largely delegated policy issues to bureaucrats. Parties were seen as personalistic rather than programmatic in Japan, and simply non-programmatic in Korea and Taiwan.<sup>30</sup> The observation that social policy was introduced and advanced under conservative authoritarian regimes with little involvement of political parties led to the conclusion that social policy development in East Asia cannot be explained by partisanship.<sup>31</sup>

The political landscape, however, changed with democratic transition and consolidation from the late 1980s. Whilst the 'democratization' literature acknowledges the emergence of

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<sup>25</sup> Gough 2004; Holliday 2000.

<sup>26</sup> Huck-Ju Kwon 1997.

<sup>27</sup> Johnson 1987; Woo-Cumings 1999.

<sup>28</sup> Deyo 1987.

<sup>29</sup> Haggard and Kaufman 2008; Wong 2004.

<sup>30</sup> Rosenbluth and Thies 2010; Wong 2004.

<sup>31</sup> Goodman and Peng 1996.

qualitatively different welfare politics and highlights the importance of electoral competition (though in somewhat vague terms)<sup>32</sup>, little attention is paid to political parties in the democratic era. The literature also fails to pay sufficient attention to trade unions and employers as actors in policy-making. Unable to move forward from the conventional view that trade unions in the region are preoccupied with particularistic interests, the role of organized labor in the reform is understood to be secondary, merely following the lead of civic groups, at best; and employers' associations are still seen as being in the 'shadow' of bureaucrats. In the following, we examine labor market reforms and their politics in Sweden, Germany, and Korea as critical cases in the comparative political economy and welfare state literature.

### **Labor Market Reforms in Sweden: The Decline of Social Solidarity**

The Swedish welfare state presents the prime example of comprehensive decommodification, universalism, and *vertical* redistribution based on the idea of social citizenship. Social-democratic welfare provision is generous and is credited with a long track record of low social inequality and poverty by international standards; and, indeed, a high level of social solidarity is widely considered the defining feature of social-democratic welfare capitalism.<sup>33</sup> In the domain of the labor market, the Swedish model is characterized by generous unemployment benefits through voluntary, state-subsidized unemployment insurances, combined with a long tradition of employment protection and active labor market policy (including extensive training programs).<sup>34</sup> Despite the acknowledgement of some change, the Swedish welfare state is typically perceived in terms of great continuity, where social-democratic ideas governing social policies persist during difficult times.<sup>35</sup> Historically, the Swedish welfare state is associated with the

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<sup>32</sup> Haggard and Kaufman 2008; Wong 2004.

<sup>33</sup> Esping-Andersen 1990; Baldwin 1990.

<sup>34</sup> Sjöberg 2011, 209f.

<sup>35</sup> Cox 2004; Thelen 2012.

political power of the social-democratic party (SAP) in conjunction with a strong labor movement, as earlier discussed in the power resources approach. However, the literature also highlights the role of employers in creating generous welfare states. Whilst the mainstream VoC literature focuses on social policies with a wage replacement function (such as unemployment benefits) and their contribution to industry-specific skills formation, Swenson, with reference to post-war Sweden, shows that employer support can extend to active labor market policy. In the context of labor shortages in the 1940s and 1950s (which increased competition between employers for skilled labor, and accordingly put upward pressure on wages), initiatives for the expansion of employment promotion (namely, investments in training and measures increasing geographical mobility) received strong support from organized business – allowing for a broad cross-class coalition.<sup>36</sup>

The Swedish post-war system of unemployment protection, however, was put under enormous stress during the global economic crisis of the early 1990s, which might be considered a critical juncture for the Swedish model.<sup>37</sup> The country's GDP dropped by 5 percent, and unemployment rose dramatically from 1.5 to almost 10 percent. Unsurprisingly, the crisis produced an enormous public deficit. The social-democratic government was replaced by a center-right coalition (1991-1994), which pursued an economic strategy of deregulation, structural reform, and austerity. As part of larger austerity efforts, the new government led by the Moderate Party reduced the generosity of unemployment benefit and terminated early retirement for labor market reasons. Critically, the automatic adjustment of the benefit ceiling to changes in the manufacturing sector was abolished, with which the real value of the unemployment benefits was significantly undermined over time and effectively turned into a flat-rate system

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<sup>36</sup> Swenson 2002.

<sup>37</sup> Schnyder 2012.

for the great majority of benefit recipients.<sup>38</sup> According to the Comparative Welfare Entitlement Dataset, the replacement rate for an average production worker with family dropped sharply from 89.2 percent in 1991 to 64.4 percent in 2011 (from 87.5 to 60.3 percent for a single person) – Sweden thus losing its status of exceptional benefit generosity.<sup>39</sup> In addition to retrenchment in unemployment protection, the country also saw the deregulation of employment protection for temporary workers on different occasions (from 4.08 in the early 1990s to 0.81 in 2008, according to the OECD Employment Protection Index; this pushes Sweden below the OECD average of 1.75). By contrast, regular employees have experienced only insignificant labor market deregulation over the last 20 years.<sup>40</sup>

We find that, starting with the economic crisis in the early 1990s, Swedish labor market policy experienced a gradual transformation changing the face of social protection for the unemployed and employment protection. Labor market reforms driven by the center-right government appears, at first glance, to provide support for the power resources model, as a coalition of the political right implemented retrenchment and workfare measures. However, it is critical to acknowledge that the social-democratic opposition, by and large, supported retrenchment and workfare in the face of the global economic and associated fiscal crisis.<sup>41</sup> From this point of view, Swedish social democrats might be described as ‘reluctant’ reformers who might not have a genuine preference for retrenchment (unlike parties of the political right) but who ‘surrendered’ to perceived imperatives.<sup>42</sup> Ryner highlights the importance of globalization on the perceived feasibility of the Swedish model of welfare capitalism<sup>43</sup>, and Swank and Timonen elaborate, with specific reference to the economic crisis of the early 1990s, that the conjuncture

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<sup>38</sup> Sjöberg 2011.

<sup>39</sup> Scruggs, Jahn and Kuitto 2014.

<sup>40</sup> OECD 2015.

<sup>41</sup> Anderson 2001.

<sup>42</sup> Cf. Mishra 1999.

<sup>43</sup> Ryner 2004.

of globalization (most notably, international capital mobility but also the increasing multi-nationalization of Swedish companies) and fiscal crisis put downward pressure on the welfare state by, more generally, undermining macro-economic policy autonomy.<sup>44</sup> With a similar impetus, Klitgaard as well as Lindvall underline the importance of economic constraints and fiscal pressure for the ‘market-oriented’ reforms of social democracy.<sup>45</sup> Crucially, in light of the economic crisis, the SAP moved ideologically towards the political center and gave up its objective of full employment – a cornerstone in traditional social-democratic economic and social policy.<sup>46</sup> To understand the ‘neo-liberalization’ of Swedish social democracy, Ryner draws attention to the importance of employers adopting a ‘Thatcherite political orientation’ and their mobilization for neo-liberal reform, which had an immense impact on senior economic policymakers in social democracy and their perception of feasible economic and social policies.<sup>47</sup> Thus, accepting the ‘imperatives’ of globalization, social democrats effectively accepted a shift in power towards employers with their ‘exit’ option.

Business, as documents reveal, took indeed an increasingly outspoken approach against social welfare and employment protection. Specifically, employers pressed for the deregulation of the labor market making it easier to hire and fire staff. Comparing Sweden with its Danish neighbor, employers noted that the Danish economy benefits from outsourcing, whilst the Swedish one did not, which was argued to be associated with the great flexibility of the Danish labor market. Thus, this observation was used to reinforce business calls for the deregulation of the Swedish labor market.<sup>48</sup> In addition to this policy lesson from Denmark, employers

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<sup>44</sup> Swank 2002; Timonen 2003.

<sup>45</sup> Klitgaard 2007; Lindvall 2010.

<sup>46</sup> Seeleib-Kaiser, Van Dyk and Roggenkamp 2008.

<sup>47</sup> Ryner 2004, 106.

<sup>48</sup> Confederation of Swedish Enterprise et al. 2005, 7; see also Confederation of Swedish Enterprise 2012, 15.

looked at the Continent, and identified the Netherlands as a “European leader in the labor market field.”<sup>49</sup> Besides labor market deregulation, the Netherlands were praised for the restructuring of unemployment protection (including reduced unemployment benefits and stricter eligibility criteria) and for reducing marginal taxes on labor income and reduced payroll taxes. Employers viewed the benefit and tax system increasingly critically: “The high marginal taxes, complemented with generous transfer systems, are to blame for diminishing the incentive to work.”<sup>50</sup> It was called for increasing the gap between labor incomes and transfer incomes by reducing marginal tax rates, funded through “larger restraints on public spending on services – first of all on transfer payments.”<sup>51</sup> As for labor costs, employers pushed for reductions in order to maintain the competitiveness of investments and production in Sweden, and employers’ contributions to social protection were viewed particularly critical. Contextualizing labour market and social policy preferences, employers highlighted the country’s changing place in the world economy and explicitly identified globalization as the “most important change” for Swedish businesses – this “leads to the strategic decisions on the future of a company to an ever greater extent being taken against the backdrop of a global perspective.”<sup>52</sup> Whilst it was acknowledged that Sweden had been long dependent on international trade for prosperity, employers argued that, after 1990, the globalization of the Swedish economy had seen a “giant leap,” and as an important consequence “the relevance of the old Swedish model of negotiation (...) is diminishing.”<sup>53</sup>

With this sharp change in preferences, employers departed from the previous politics of compromise that long characterized the Swedish model, but took an “aggressive neoliberal

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<sup>49</sup> Confederation of Swedish Enterprise 2009, 33.

<sup>50</sup> Confederation of Swedish Enterprise et al. 2005, 11.

<sup>51</sup> Confederation of Swedish Enterprise et al. 2005, 42; see also Confederation of Swedish Enterprise 2012, 15.

<sup>52</sup> Confederation of Swedish Enterprise 2007, 2.

<sup>53</sup> Confederation of Swedish Enterprise 2007, 29.

posture,”<sup>54</sup> which challenges the idea of the persistence of cross-class alliance in CMEs in the face of globalization. The VoC proposition that “firms and workers have common interests to defend because they have invested in many co-specific assets, such as industry-specific skills”<sup>55</sup> does not seem to have sound empirical foundation in recent Swedish labor market policy. In pursuit of their interests, employers funded university departments to promote neo-classical economic teaching and professionalized their media work to promote changes in public attitudes, in addition to more direct interventions into the political process through the funding of conservative politicians, such as Carl Bildt of the Moderate Party who became prime minister of the center-right coalition in the early 1990s.<sup>56</sup> Employers’ new “politics of confrontation”<sup>57</sup> and dissatisfaction with the status quo manifested itself most strongly when, in 1991, business, with great symbolic power, removed their representatives from the boards of most government agencies, including the Labor Market Board (AMS) with responsibility for active labor market policy.<sup>58</sup> We thus not only observe firmer linkages between employers and the political right, but also a deliberate business strategy of abandoning corporatist institutions, which previously served as important means of interest mediation. Politically, employers’ withdrawal from the post-war welfare settlement left social democracy and organized labor increasingly vulnerable; and there is “no doubt that the desire to weaken LO’s [the Swedish Trade Union Confederation’s] political clout was a prime motivation for SAF’s [the Swedish Employers Association’s] broader push to weaken Swedish tripartism in general.”<sup>59</sup> With a similar impetus, Steinmo concludes that employers “came to believe that the LO and Social

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<sup>54</sup> Huber and Stephens 2001, 241.

<sup>55</sup> Hall and Soskice 2001, 58

<sup>56</sup> Agius 2007, 590.

<sup>57</sup> Pestoff 1994, 102.

<sup>58</sup> Gould 2001.

<sup>59</sup> Huber and Stephens 2001, 253.



Democrats could no longer be trusted.”<sup>60</sup> Employers’ increasingly critical stance towards organized labor was broadly shared by the Moderate Party, which displayed some significant hostility towards unions (especially, with the attempts to nationalize the union-run unemployment insurance funds).<sup>61</sup> Thus, unlike their German counterparts, the Swedish labor movement had no significant links with the center-right, which seriously undermined unions’ political capacity when social democracy took place on the opposition benches.

After returning to government in the second half of the 1990s, the SAP continued on the path of welfare state restructuring despite much resistance from organized labor, indicating an increasing rift between the two sides. As for unemployment protection, social democrats further reduced benefit generosity and tightened the sanction regime in order to cope with the financial pressures they faced.<sup>62</sup> Thus, the SAP in opposition not only supported retrenchment by the center-right in government, they continued on this trajectory when they returned to power, as social democrats (against strong opposition from unions) pushed labor market deregulation. In fact, it has been argued that the total sum of retrenchment by the SAP exceeded the cuts made by the center-right coalition.<sup>63</sup> The government also looked into other options for reducing costs; including the abolition of the so-called ‘requalification condition,’ which since the 1980s had allowed the building up of new unemployment benefit entitlements through participation in labor market programs. However, this proposal was met with rather strong union opposition, and was eventually dropped. When relations with unions further deteriorated, the government re-raised the unemployment benefit replacement rate (though financed with cuts elsewhere), which could be viewed as a measure to appease organized labor.<sup>64</sup> This episode is important, as it shows that unions were still in a position to exercise some (though

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<sup>60</sup> Steinmo 2010, 61.

<sup>61</sup> Anderson 2001.

<sup>62</sup> Sjöberg 2011

<sup>63</sup> Gould 2001; Lindbom 2008.

<sup>64</sup> Anderson 2001, 1082.

increasingly limited) influence on the SAP, even though the party had successively departed from traditionalist labor market and social policy. In this context, it is also critical to note that, despite increasing ideological distance and conflicts between SAP and organized labor (especially, the LO), institutional linkages between the two sides persisted, and that the party continued to rely on unions' financial support and their mobilization of union members in general elections.<sup>65</sup> Thus, social democrats find themselves in the difficult position to balance the perceived necessity of programmatic modernization and the need to maintain reasonably good relations with their old ally.

At the beginning of the millennium, the SAP, in addition to raising the ceiling for unemployment benefits, introduced further changes in labor market policy, wherein activation was addressed more explicitly. The government eventually removed the re-qualification condition, and replaced it with the so-called 'activity guarantee' as a new program for the long-term unemployed, combined with a tightening up of job-search criteria and the sanction regime.<sup>66</sup> Whilst trade unions broadly supported these changes (though unsuccessfully demanding more generous benefits), employers showed much skepticism. The latter called for even tougher job-search criteria and considered the raising of the benefit ceiling as giving a wrong signal to the unemployed, resulting in longer unemployment. Organized business also remained unconvinced of the benefits of the activity guarantee, calling instead for a reduced tax burden to promote job growth.<sup>67</sup> Whilst the 'activity guarantee' might suggest some renewed labor market policy activism on behalf of the social-democratic government, it is important to note here that, overall, we have seen active labor market policy becoming less prominent in the Swedish policy-mix, and a sharp decline in spending since the 1990s. With 2.8 percent of GDP in the first half of the 1990s, spending on active labor market policy peaked, but dropped to 1.0

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<sup>65</sup> Allern, Aylott and Christiansen 2007.

<sup>66</sup> Sjöberg 2011, 213.

<sup>67</sup> European Industrial Relations Observatory 1999.

percent in 2009 despite an unemployment rate of more than 8 percent (which compares with unemployment levels in the late 1990s when Sweden spent more than 2 percent of GDP on active labor market policy). Looking at training measures (which are at the core of ‘social-democratic’ activation), we observe a collapse in spending with a fall from 1.0 percent of GDP in the early 1990s to 0.1 percent of GDP in 2009; with this, Sweden became a low spender in its efforts to improve the employability of jobseekers.<sup>68</sup> In light of these figures, it is not surprising that it has been argued that Swedish policy-makers (including social democrats) ‘lost faith’ in traditional active labor market policy, which of course has huge implications for the previous strong focus on human capital investments<sup>69</sup> – suggesting the erosion of a key pillar of the Swedish model across the political spectrum.

These reforms did not translate into greater electoral support for the government. In the 2006 election, a coalition led by the Moderate Party defeated the social-democratic government. The new government continued on the path of restructuring unemployment protection, and in fact accelerated the speed of restructuring.<sup>70</sup> As a measure of high symbolic power with great implications for social solidarity in society, the government increased the financing fees for insurance funds, which translated into considerably higher membership fees and sharply declining membership, especially among low-income workers.<sup>71</sup> After the failure to nationalize union-run unemployment insurance funds in the early 1990s, this can be interpreted as another attempt by the Moderates to weaken organized labor. Whilst there is some evidence that the differences between the political left and right have diminished since the 1990s, we find that the Moderate Party campaigned aggressively on the issue of employment, and did not disguise its policy program of cutting unemployment benefits in order to boost job growth.<sup>72</sup> Among

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<sup>68</sup> OECD 2015.

<sup>69</sup> Lindvall 2010, 166.

<sup>70</sup> Sjöberg 2011.

<sup>71</sup> Schnyder 2012, 1135.

<sup>72</sup> Agius 2007; Lindbom 2008.

the different social policy programs, retrenchment of unemployment protection could be considered an electorally smart strategy, as labor market policy receives less electoral support than most other social policies.<sup>73</sup> So, it might be viewed as the ‘weakest link,’ and Davidsson and Marx suggest that the Moderates used retrenchment in unemployment protection for political credit claiming.<sup>74</sup> Lindvall and Rueda argue that social democrats lost the confidence of labor market insiders in particular, in the face of the Moderate Party campaigning for unemployment benefit cuts and presenting itself as the ‘new labor party’ – corresponding with the argument that insiders have no strong interest in generous unemployment protection.<sup>75</sup> Thus, Svallfors might conclude that the social-democratic welfare state is thriving and more popular than ever in Sweden. Yet, changes in the support for unemployment protection need to be noted. Admittedly, employment policy experienced an increase in public support in the 2000s, but this should not deflect from a considerable erosion in public support in the previous 20 years.<sup>76</sup> This secular decline of social solidarity among voters, it appears, allowed the Moderate Party to pursue a strategy of selective welfare state retrenchment, and the confirmation of the party in government in the 2010 election indicates the political viability of this strategy.

These developments in labor market policy from the early 1990s suggest a considerable decline in social solidarity in Sweden, as far as the unemployed and labor market outsiders are concerned. Unemployment protection has seen a reduction of benefit generosity, in addition to the strengthening of workfare. At the same time, human capital investment has lost its previous importance in the Swedish policy-mix. With comprehensive labor market deregulation, temporary workers have also experienced a greater exposure to the market. Recommodification

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<sup>73</sup> Cf. Svallfors 2011.

<sup>74</sup> Davidsson and Marx 2013.

<sup>75</sup> Lindvall and Rueda 2012; see also Agius 2007.

<sup>76</sup> Svallfors 2011; see also Steinmo 2010.

has gained much more prominence in Swedish labor market policy. The argument of unchallenged social solidarity in Sweden is further undermined by a considerable increase in poverty. From the mid-1990s to 2011, the poverty rate in Sweden after taxes and transfers (60 percent poverty line) more than doubled to 17.4 percent, with which Sweden reached UK poverty levels (17.0 percent) and exceeded poverty in Germany (15.0 percent). Admittedly, Sweden, with a Gini coefficient (post taxes and transfers) of 0.273 in 2011, still displays less income inequality than the UK (0.344) and Germany (0.293). However, since the early 1990s, income inequality has seen a marked increase (0.209 in 1991); and, by 2011, the country has lost its status of exceptionally low income inequality (see, e.g., Belgium: 0.264, Denmark: 0.253).<sup>77</sup> Whilst the most comprehensive labor market restructuring was pushed by the political right, it needs to be acknowledged that social democracy also engaged in retrenchment, workfare policies, and labor market deregulation. For this reason, even though some differences between the main political parties persisted (for instance, conflicts over replacement rates), it has been suggested that Sweden has experienced a decline in the importance of partisanship in labor market policy<sup>78</sup>, which presents an important challenge to the power resources model. Paradoxically, one might argue, intense political conflict between the two main political blocs has persisted despite the narrowing down of programmatic differences. It has also been pointed to great conflict between the social partners and the breakdown of corporatism, with the social partners failing to develop a common understanding of the problem of unemployment.<sup>79</sup> In addition to very conflicting views on labor market policy, low levels of trust are observed.<sup>80</sup> This has made it rather difficult to assume the cross-class compromise that has long been associated with the Swedish model of welfare – especially with the withdrawal of employers, which (contrary to

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<sup>77</sup> OECD 2015.

<sup>78</sup> Lindbom 2008; Sjöberg 2011.

<sup>79</sup> Lindvall 2010, 176, 180.

<sup>80</sup> Öberg and Svensson 2002.

the VoC skills argument) increasingly challenged the social-democratic welfare state of the Swedish model in the face of globalization. The crumbling cross-class compromise provided the political foundations for the successive decline of social solidarity in Sweden. Yet, whilst the ideological shift of social democracy suggests the possibility of a new broad coalition without labor, the SAP's need to at least partly accommodate trade union views (in addition to the more severe political conflicts after the end of social-democratic hegemony, the breakdown of corporatism, and the associated lack of trust among labor market elites) make it difficult to identify a new, meaningful political coalition at the heart of Swedish labor politics that can compare with the previously stable, cross-class coalition of the Golden Age.

### **Labor Market Reforms in Germany: The Decline of Social Partnership**

As the prime example of a CME<sup>81</sup>, Germany has received much attention in the comparative political economy literature, and its welfare state has been used to illustrate employer interests in generous social protection. Bismarckian social insurance legislation created a system of earnings-related social protection geared towards core industrial workers, complemented with strong employment protection. To cope with social change, the social insurance state, prioritizing *horizontal* redistribution, expanded over time to include other groups rather than establish universal citizenship-based rights (as seen in the Swedish case of *vertical* redistribution).<sup>82</sup> The institutionalization of the Bismarckian welfare state is typically associated with the political rationale of integrating the working classes into the young German nation state.<sup>83</sup> Although the initial impetus for the Bismarckian welfare state can clearly be located in the political realm, the system of earnings-related social protection is thought to have met the criteria of functional feasibility as well by facilitating economic coordination and a production regime based upon a

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<sup>81</sup> Hall and Soskice 2001.

<sup>82</sup> Schmuhl 2003, 143-156.

<sup>83</sup> Manow 2001.

highly skilled workforce. This provided, as VoC theory contends and discussed earlier, an incentive structure for both employers and employees to invest in skills (especially in *industry-specific* skills), which formed the functional foundations for broad cross-class support in favor of the Bismarckian welfare state and, specifically, generous earnings-related unemployment protection and strong employment protection.<sup>84</sup> The social partnership of employers and trade unions underpinning the Bismarckian welfare state is widely considered a defining feature of the conservative-*corporatist* welfare regime.

In the wake of the economic crisis of 1966/67 (when Germany first experienced recession and increasing unemployment rates after its post-war ‘economic miracle’), the system of employment promotion was comprehensively modernized with the 1969 ‘Employment Promotion Act,’ which displayed some similarity with the Swedish approach to active labor market policy. This legislation (pursuing the objective of full employment, productivity, and economic growth) placed a strong focus on human capital investments to cope with the consequences of structural change. Improving the skills profile of the workforce by further vocational training and retraining was considered decisive in the preventive approach of the Employment Promotion Act, as job creation programs were pursued to improve skills and assist structural change. The importance ascribed to a skilled workforce was also reflected in the protection of occupational status and the prescription to avoid ‘substandard employment;’ essentially, employment not meeting the minimum standards set in collective agreements.<sup>85</sup> This legislation passed parliament unanimously and received great support across the political spectrum, including principal support from employers.<sup>86</sup>

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<sup>84</sup> Estevez-Abe et al. 2001; Manow 2001; Mares 2003.

<sup>85</sup> Schmuhl 2003, 445-462.

<sup>86</sup> Confederation of German Employers' Associations [BDA] 1968.

This early focus on human capital investments, however, was rather short-lived. The economic crises of the 1970s and accelerating de-industrialization driven by technological progress (especially, improvements in productivity) increased unemployment, and confronted policy-makers with unknown challenges. To cope with rising unemployment figures, strategies to reduce the supply of labor featured very prominently. Especially the center-right government of the Christian-democratic Chancellor Kohl (1982-1998) promoted large-scale early retirement. At the same time, fiscal pressures typically translated into cutting measures that had improved the skills of jobseekers and the employed.<sup>87</sup> With the ‘welfare-without-work’ strategy of early retirement, the Kohl government improved the politically very sensitive unemployment figures, and also social partners benefited from early retirement. It offered large firms an attractive tool for ‘externalizing’ the costs of laying off older employees in corporate restructuring in order to increase productivity, imperative in an environment of high non-labor costs like Germany. This ‘productivity whip’ accelerated the process of de-industrialization. These corporate strategies received broad support from trade unions in affected industries, as their members also benefited from publicly subsidized early retirement. Consequently, employment losses in manufacturing and early retirement became one of the main drivers of expenditure expansion of the post-war welfare state.<sup>88</sup>

Here, it is important to underline that the cross-class coalition of large employers and manufacturing unions, which had earlier provided critical support for the stabilization of the Bismarckian welfare state, persisted and backed the ‘welfare-without-work’ approach of early retirement. This is not to argue that there were no voices in government and business for a ‘neo-liberal turn.’ Thelen highlights that organized business was internally divided, and was

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<sup>87</sup> Schmuhl 2003, 527-531.

<sup>88</sup> Iversen and Cusack 2000; Manow and Seils 2000.



eventually reluctant to call into question long-standing institutions without having a clear alternative at hand.<sup>89</sup> It is also worth noting that the rather strong labor wing in the Christian-democratic party operated as a partisan veto player within the government.<sup>90</sup> Apparently, the interests of workers, typically associated with social democracy, were not unrepresented in the center-right government, but had a powerful voice with trade unionists in Christian democracy. As noted earlier, this was rather different to the experience of labor in Sweden during the rule of the political right.

The political landscape changed in the aftermath of unification in 1990, which resulted in a massive increase in unemployment in East Germany. Following the ‘routine response’ to a rise in unemployment, the Kohl government engaged in large-scale early retirement and job-creation programs.<sup>91</sup> However, the approach of ‘welfare without work’ was increasingly considered unfeasible because of its great financial costs. The Kohl government restructured labor market policy, by putting a stronger emphasis on workfare measures, in addition to reducing the generosity of early retirement schemes in order to make these less attractive. The legislation of the late 1990s also formally gave up the objective of full employment. For the ‘tougher’ stance in labor market policy in the last Kohl government, a shift in the political strategy of organized business appears critical, as observed in the Swedish case. Starting from the mid-1990s, employers showed increasingly open hostility towards the welfare state of the German model. With support from the liberals (who wanted to sharpen their ‘pro-market’ profile within the government), employers pressed the Kohl government for a neo-liberal turn and comprehensive welfare cuts.<sup>92</sup> Employer documents show: whilst retrenchment in unemployment protection had not featured prominently on the agenda of employers in the first half of the 1990s<sup>93</sup>,

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<sup>89</sup> Thelen 2000.

<sup>90</sup> Zohlnhöfer 2003.

<sup>91</sup> Manow and Seils 2000, 293.

<sup>92</sup> Schmidt 2000, 280f.

<sup>93</sup> Confederation of German Employers' Associations [BDA] 1994.

we find, a few years later, the rise of a rather skeptical approach towards unemployment benefits and employment promotion, where benefits were considered to promote welfare dependence and measures of active labor market policy were viewed as failing to deliver the skills needed for labor market integration. Accordingly, employers called for reduced benefit generosity and shorter unemployment benefits. In the long term, it was proposed to reduce the maximum benefit to 60 percent of the average wage, by which unemployment insurance would effectively turn into a flat-rate benefit for many jobseekers (especially skilled workers, who should profit from unemployment protection according to VoC). Furthermore, employers put forward the merger of unemployment and social assistance at the level of the latter, complemented with better ways to combine the receipt of benefits and employment to ‘make work pay.’ With respect to employment promotion, it was demanded that a greater focus be put on immediate reintegration into the labor market (concentrating on youth and long-term unemployment), for which wage subsidies and short training measures were suggested, whereas job-creation schemes were rejected as costly and ineffective programs.<sup>94</sup> These proposed labor market reforms, as in the Swedish case, are obviously at odds with the VoC skills argument, according to which employers and workers have common interests to defend. Instead, changed business preferences undermined the cross-class coalition underpinning the Bismarckian welfare state.

As a result of resolute business mobilization for neo-liberal policy, the employer wing within the Christian-democratic party gained political influence, whereas the labor wing saw its power dwindling and partisan veto disappearing. Importantly, business calls for welfare state restructuring were part of a broader debate on Germany as an industrial/business location

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<sup>94</sup> Confederation of German Employers' Associations [BDA] 1998; see also European Industrial Relations Observatory 2000.

in the context of intensified competition in the ‘global economy’ (the so-called *Standortdebatte*). In this globalization discourse, the reduction of (non-wage) labor costs was moved center stage in order to improve the competitiveness of German businesses and to tackle the perceived ‘cost crisis’ of the German welfare state – this line of argument was very similar to the concerns raised by Swedish employers. Critically, the globalization discourse was shared across the political spectrum, even though social democrats initially continued to oppose labor market restructuring.<sup>95</sup> Here, it is important to highlight the changing position of social democracy, as it indicates that the party started ideologically shifting in the 1990s in response to the perceived ‘imperatives’ of globalization. With these developments, displaying considerable similarities with the experience of their Swedish counterparts, social democrats effectively accepted a shift in power towards business – with huge implications for future social democratic governments. In the last Kohl government (1994-1998), organized labor tried to regain political influence with an initiative for a tripartite ‘Alliance for Jobs’ between the government, business, and trade unions. This Alliance, which had no equivalent in Sweden, quickly fell apart when the center-right government continued to push its agenda for welfare state restructuring.<sup>96</sup> With employers’ gradual withdrawal from the cross-class alliance, the political equilibrium for labor market policy experienced a critical destabilization – and the crumbling of the cross-class alliance for Bismarckian unemployment protection continued under social-democratic leadership in government. So, as with the Swedish case, social democrats in Germany underwent a change in their approach to social welfare.

The Red-Green alliance (1998-2005) came to government office without a great master plan for welfare and labor market reform. Inspired by the success of social concertation in the Netherlands, Chancellor Schröder invited the social partners for talks to revitalize the Alliance

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<sup>95</sup> Seeleib-Kaiser 2001, 107-123; Swank 2002, 182-186.

<sup>96</sup> Bispinck and Schulten 2000.

for Jobs in order to overcome the widely perceived reform gridlock. Social democrat Schröder was confident that he would be more successful in social concertation than his conservative predecessor. However, the Red-Green Alliance for Jobs did not prove to be particularly successful either, as government and social partners did not achieve shared problem analysis to develop a consensual reform agenda, which resembles the Swedish case. Neither employers nor trade unions were prepared to make any meaningful concessions for an ambitious labor market and welfare reform in consensus, and the Chancellor did not show sufficient political leadership and authority to have allowed political exchanges between the parties involved, which (also similar to the Swedish experience) have seen a sharp decline in trust. Unsurprisingly, the labor market reform of the first Red-Green government was of rather cautious character, focusing on the improvement of job placement. Substantive investment in human capital through training programs was prevented by the Ministry of Finance and ‘modernizers’ in the social-democratic parliamentary party, whereas ‘traditionalists’, with support from organized labor, vetoed any benefit cuts or other workfare measures (as pushed for by modernizers who sought to ideologically move the party towards the center with support from the Chancellor).<sup>97</sup> Accordingly, trade unions largely welcomed the reform (though demanding more employment promotion for jobseekers), whereas employers took a more critical stance (calling, for instance, for a tougher sanction regime and labor market deregulation).<sup>98</sup> The labor market reform was widely perceived as not meeting the challenge of (long-term) unemployment, but a more comprehensive reform was considered politically unfeasible in the run-up to the 2002 general election.

In early 2002, the scene changed dramatically with a scandal around manipulated placement statistics at the federal employment service, which provided a window of opportunity for

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<sup>97</sup> Blancke and Schmid 2003.

<sup>98</sup> European Industrial Relations Observatory 2001.

comprehensive labor market reform. Chancellor Schröder set up the so-called Hartz Commission for the development of reform proposals; and after its re-election, the Red-Green government, with social-democratic modernizers in the ‘driving seat,’ used the commission instrumentally for agenda-setting in the reform of the labor market. Although the report of the Hartz Commission did not include explicit proposals for curtailing benefit generosity (demanded by employers but vetoed by trade unions)<sup>99</sup>, the actual Hartz Legislation – challenging power resources theory – involved some major retrenchment and workfare with the merger of unemployment and social assistance at the benefit level of the latter, and a reduction of unemployment benefit duration. Furthermore, labor market policy saw some significant change with the deregulation of employment protection for temporary workers and the promotion of atypical employment.<sup>100</sup>

In the politics of the Hartz Legislation, it is critical that the placement scandal and agenda-setting through the Hartz Commission allowed the Schröder government to largely exclude trade unions from labor market policy-making and to minimize the influence of social-democratic traditionalists. Both, previously vetoing reform proposals by social-democratic modernizers, were seen as defenders of the status quo in labor market policy, which was heavily discredited by the failings of the employment service. Providing momentum for ‘radical’ reform, the employment agency scandal allowed the sidelining of organized labor, as well exemplified in the composition of the commission. Of its 15 members, trade unions were only allowed to send in two representatives, whereas eight commission members were associated with business interests (including the commission’s chair). This marginalization exceeded the experience of Swedish trade unions, which also faced problems with *their* social-democratic party

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<sup>99</sup> European Industrial Relations Observatory 2002.

<sup>100</sup> Eichhorst and Marx 2011.

ideologically moving towards the political center. In this new political environment, comprehensive workfare policies became possible that had not been politically feasible in the first Red-Green government.<sup>101</sup> Streeck contends that the Hartz Commission signaled the ultimate failure of tripartite social concertation as represented by the Alliance for Jobs, which eventually heralded the end of the corporatist century.<sup>102</sup> Importantly, the break with corporatist policy-making resulted in isolating trade unions, but not the neglect of employers. In fact, the Hartz Legislation shows some significant overlap with business demands from the late 1990s<sup>103</sup>; and indeed employers showed great contentment with the legislation, whereas trade unions expressed their sharpest opposition.<sup>104</sup>

Thus, whilst Bismarckian unemployment protection rested upon a strong cross-class consensus for most of the last century, we have been observing a disintegration of this consensus with the withdrawal of employers from the second half of the 1990s. Organized business, in a broader globalization discourse, called for comprehensive labor market restructuring, which appears largely incompatible with the bias to stability in the VoC approach. The departure from the previous cross-class compromise and the new political stance of German employers are well reflected in the setting-up of the so-called ‘New Social Market Initiative’ in 2000 as a well-funded neo-liberal think-tank with the mission to influence economic and social policy-making. It is important to underline that this think-tank goes back to an initiative of the employers’ association of the metalworking industry.<sup>105</sup> This is worth noting, since this industry, with its reliance on industry-specific skills, should be the one least interested in the dismantling of the German model and its social insurance system.<sup>106</sup> Hence, the assumption of a

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<sup>101</sup> Fleckenstein 2011.

<sup>102</sup> Streeck 2003.

<sup>103</sup> Confederation of German Employers' Associations [BDA] 2002.

<sup>104</sup> European Industrial Relations Observatory 2004b, 2004a.

<sup>105</sup> Kinderman 2005.

<sup>106</sup> Estevez-Abe et al. 2001; Hall and Soskice 2001.

stable cross-class alliance with its foundation especially in the manufacturing industry<sup>107</sup> and its interest in industry-specific skills formation has become ever more difficult to perceive in welfare politics. In this context, it is worth noting that employers are not only operating in an environment of globalization, but also that the German economy has been experiencing accelerating de-industrialization. While much of the VoC literature, despite pointing to labor market and welfare dualization<sup>108</sup>, emphasizes continuity in the German welfare/production regime, the VoC argument of a linkage between generous social protection and specific skills formation might also suggest that de-industrialization and the corresponding decline in specific skills have successively undermined the German system of earnings-related unemployment protection.<sup>109</sup>

To conclude, business mobilization for neo-liberal reform and the globalization discourse had a huge impact on both Christian and social democracy; and within the ‘social partnership,’ power resources shifted towards business. With the greater prominence of employer preferences in political parties (where we observed a decline in programmatic difference, as in Sweden), unions were successively marginalized in labor market policy-making – at first through the declining influence of the labor wing in the Christian-democratic party, and then through the loss of power of the traditionalists and trade unions in the social democracy. Thus, the break with corporatist policy-making increasingly isolated organized labor, whereas employer preferences gained weight across the political spectrum indicating a ‘grand coalition’ without labor.

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<sup>107</sup> Thelen 2012; Palier and Thelen 2010.

<sup>108</sup> Hall 2007; Hall and Thelen 2009; Palier and Thelen 2010.

<sup>109</sup> Fleckenstein, Saunders and Seeleib-Kaiser 2011.

## **Labor Market Reforms in South Korea: The Decline of the Developmental State**

Korea has been typically classified as a developmental welfare state, in which social policy was regarded as handmaiden to the economy, and where a dominant state was at the heart of the economic modernization project. During the period of industrialization from the 1960s to the 1980s, the Korean state steered economic coordination among capital and labor in pursuit of speedy ‘catch-up’ with advanced economies. At the core of this state-led coordination was the developmental alliance, a coalition between the state and business, to nurture ‘national champions’ (especially, large business conglomerates; the so-called *chaebols*) in strategic industries that could compete in the global market. The project required long-term investments for which the state engineered a system of patient capital. Through direct and indirect control of the banking sector, the state ensured the supply of long-term, low-interest credits, in addition to industrial subsidies. The state’s control over finance is widely considered the most important aspect of the developmental state, as it made it very difficult for companies to ignore the state’s expectations.<sup>110</sup> In contrast to its dominant role in coordinating economic development, the state performed a marginal role in social welfare provision, unlike the experiences in the CMEs of Sweden and Germany with their primary concern for industry-specific skills formation. Instead, the Korean state imposed welfare provision on employers, which had to bear the costs of enterprise welfare<sup>111</sup> and high employment protection.<sup>112</sup> According to the VoC line of argument, we would expect Korean employers to accept these costs willingly, as generous company welfare provision and high employment protection are deemed to encourage workers to commit to *firm-specific* skills formation<sup>113</sup>; and, in fact, many and especially large employers exceeded statutory requirements in enterprise welfare provision. The predominance of firm-

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<sup>110</sup> Amsden 1989; Johnson 1987.

<sup>111</sup> Ringen et al. 2011; Song 2003.

<sup>112</sup> Woo-Cumings 2007.

<sup>113</sup> Cf. Estevez-Abe et al. 2001; Thelen and Kume 2001.



specific skills is critical for understanding the much greater prominence of enterprise welfare in Korea, as compared to Germany and Sweden; and unlike the European CME experience, public welfare provision was undesirable from an employer's point of view, as it did not promote but rather undermine firm-specific skills formation. To achieve a conducive long-term employment system, the authoritarian state effectively enforced a no-lay-off policy at large firms<sup>114</sup>; and, as a result, core workforces (i.e. male regular workers in large manufacturing enterprises) enjoyed de-facto lifetime employment<sup>115</sup>, in addition to extensive company welfare.<sup>116</sup>

These characteristics of the Korean developmental welfare state underline the centrality of work, resembling the Japanese model of 'welfare through work.'<sup>117</sup> The Korean state also emphasized job creation through public work schemes and infrastructure investments rather than social safety nets as a means to eradicate poverty.<sup>118</sup> The absence of unemployment protection and generally very residual public welfare provision meant extremely low levels of decommodification. Yet, the welfare-through-work model performed well during the period of industrialization due to high economic growth, allowing the booming manufacturing sector in particular to absorb migrant workers from rural areas.<sup>119</sup>

From the perspective of PRA, the high level of commodification in the Korean welfare state can be understood as an outcome of the exclusion of organized labor in policy-making. The labor movement was severely repressed – not only because this was deemed necessary to

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<sup>114</sup> Gourevitch and Shinn 2005; Amsden 1989.

<sup>115</sup> Woo-Cumings 2007.

<sup>116</sup> Song 2003.

<sup>117</sup> Miura 2012.

<sup>118</sup> Ringen et al. 2011, 43.

<sup>119</sup> Song 2003.

achieve wage restraint and industrial peace for economic development, but also labor was considered a possible opposition force to the regime, as discussed earlier.<sup>120</sup> While industrial unions were outlawed, enterprise unions were promoted. This was because the former would have facilitated the mobilization of the working class as a political force, and the latter limited union activities to company-level issues.<sup>121</sup> As political activities of unions were prohibited, they were neither able nor inclined to engage in broader issues of public policy.<sup>122</sup> Thus, the politics of the Korean developmental welfare state can be explained in terms of a state-business coalition which promoted a welfare-through-work model in order to facilitate firm-specific skills formation, whereas labor was excluded from social policy-making.

The developmental welfare state and its state-business alliance experienced increasing pressure in the mid-1990s with the decline of the coordinating capacity of the state. The success of state-led industrialization resulted in an alteration of the power balance between the state and business, as chaebols had become to control large parts of the economy by the end of the 1980s; and democratization towards the end of the decade allowed them to exercise a louder voice. With greater confidence, business demanded neo-liberal reform, as the Swedish and German employers did, calling for an end to excessive state intervention in the financial and labor markets. Moreover, similar pressure for the liberalization of the Korean economy came from the United States, which became, after the end of the Cold War, increasingly intolerant towards the substantial trade deficits with Korea and the Korean government's protection and control of its domestic market. Thus, the American pressure to push back the government's strong grip on the economy strengthened the position of employers. In this context, the conservative Kim Young-Sam government (1993-98) pursued a set of so-called 'liberalization reforms.' The infamous Economic Planning Board was abolished, and the financial sector was

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<sup>120</sup> Koo 2001.

<sup>121</sup> Kwon and O'Donnell 1999.

<sup>122</sup> Ringen et al. 2011, 51.

liberalized allowing firms entrance into the non-bank intermediaries sector as well as greater access to equity markets and foreign credit. At the same time, industrial subsidies had been almost phased out, largely due to mounting budget deficits.<sup>123</sup> Once the state relinquished its control over corporate finance (i.e. the key tool of state-led coordination), business no longer depended on the state for its success; and in the following we observe that business became very outspoken about its unwillingness to bear the costs of high employment protection. When global competition was becoming fiercer, employers, in parliamentary hearings and policy documents, articulated their strong preference for neo-liberal labor market reform, arguing that high labor costs and rigid employment regulations were the very sources of the declining competitiveness of the Korean economy. They threatened to ‘hollow out’ the manufacturing industry by relocating production to developing countries, especially China, unless reforms to increase the flexibility of the labor market were implemented (notably, the legalization of layoffs and temporary agency work).<sup>124</sup> It was argued that increased global competition no longer allowed the retention of redundant workers created by the automation of production lines since the late 1980s (which appears similar to the ‘productivity whip’ at German workplaces). Employers also began to show an increasing unwillingness to shoulder the burden of company welfare provision.<sup>125</sup> Employers’ push for employment deregulation and retrenchment in enterprise welfare challenges the VoC proposition that, in CMEs with a high reliance on firm-specific skills, employers would support high employment protection and company welfare to promote the formation of such skills. Instead, we find employers using a rhetoric of cost pressures and globalization that resembles the arguments of their German and Swedish counterparts.

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<sup>123</sup> Kong 2000.

<sup>124</sup> National Assembly 1995; Korea Employers Federation 1993b, 1996.

<sup>125</sup> Song 2003.

At the same time, the state's loss of grip on labor became also obvious during the Kim Young-Sam government. Playing a pivotal role in democratization, the power of the labor movement had been on the increase. As the Kim government was still reluctant to fully incorporate organized labor in the policy-making, unions used their newly obtained power to achieve particularistic interests – often employing militant tactics. Wage increases were exceptional, especially among large firms, far higher than the government wage guidelines. Rising labor costs contributed to a declining competitiveness among Korean industries, as well as a widening wage gap between workers of large and small enterprises, which amplified existing labor market dualism.<sup>126</sup>

In awareness of the rising power of organized labor, the government attempted to 'trade' some limited unemployment protection for desired labor market deregulation in order to appease unions for the loss of job security that deregulation would cause. Business accepted the government's proposal most reluctantly as the price to pay to realize its policy priority of labor market liberalization.<sup>127</sup> For organized labor, however, unemployment protection was low on the agenda at this early stage of democratic transition; and therefore employment deregulation in exchange for meager unemployment protection were simply unacceptable. When the incumbent conservative party passed a government bill permitting layoffs in case of managerial needs, the two rival national labor federations came together to launch a general strike. The strike displayed the new powers of organized labor in democratic Korea<sup>128</sup>, and the government, unprecedentedly, was forced to postpone the implementation of the labor market reform bill for two years, opening up the possibility that the bill could be scrapped by a new government.

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<sup>126</sup> KYShin 2010.

<sup>127</sup> Korea Employers Federation 1993a.

<sup>128</sup> Koo 2001.

The departure from the welfare-through-work model, initiated by the conservative Kim Young-Sam government, was unexpectedly consolidated during the center-left Kim Dae-Jung government (1998-2003). The East Asian financial crisis of 1997/98, with unemployment rising from 2.5 to 8.7 percent and a massive 5.8 percent drop in GDP, revealed the increased vulnerability of Korea in the global economy, especially with largely unregulated flows in global capital but also the great export orientation of Korean manufacturing companies and their ability to relocate production.<sup>129</sup> Unlike patient capital engineered by the state, much of foreign capital was quick to exit Korean firms in the crisis, resulting in an unparalleled scale of bankruptcies across the economy (including chaebols). Critically, the increasing importance of short-term profit maximization made the pursuit of full employment increasingly untenable. For the firms to better adjust to a changing business cycle and external environments (in addition to remain attractive for foreign capital), greater labor market flexibility was deemed critical across the political spectrum, and also pushed for by the US-dominated International Monetary Fund. In the wake of the crisis, the new government, thus, immediately implemented the postponed labor market liberalization, which translated into a considerable increase in atypical employment (approximately 35 percent of all wage-earners according to conservative estimates) – thus reinforcing labor market dualism and greatly contributing to rising income inequality.<sup>130</sup>

The erosion of employment protection, a key pillar of the welfare-through-work model, was accompanied by a growth in social welfare provision. In the young Korean welfare state, unemployment protection experienced a considerable expansion with the universalization of the unemployment benefit (though still modest by international standards). Unemployment protection was extended to all full-time workers and later on to some atypical workers.<sup>131</sup> Fur-

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<sup>129</sup> DM Shin 2000.

<sup>130</sup> JH Lee 2011.

<sup>131</sup> Ministry of Labor 2005.

thermore, non-contributory unemployment protection policies underwent a significant expansion: the public assistance scheme was extended to the able-bodied for the first time, providing a functional equivalent of unemployment assistance, and public work schemes were used for those who still fell outside unemployment insurance.<sup>132</sup> Essentially, these reforms were geared towards protecting labor market outsiders (namely, employees of small firms and atypical workers) against the risk of unemployment. It should be highlighted that the expansion of unemployment protection, especially non-contributory programs, was increasingly financed by general taxes. This is to say that the state took on a new role in welfare provision, moving away from its previous role as a ‘regulator’ of welfare.<sup>133</sup> In a nutshell, labor market reform during the Kim Dae-Jung government considerably undermined the welfare-through-work model by expanding social protection for the unemployed and by undermining job protection for the shrinking number of insiders.

Behind what can be described as the Korean version of flexicurity was the transformation of Korean welfare politics. The economic crisis created a critical juncture that allowed the rise of a reform alliance of the left, which could be interpreted in terms of power resources theory. On the one hand, the crisis facilitated a change of government. For the first time, the center-left party won the presidential election, as the electorate wanted to punish the conservatives for its mismanagement of the economy. On the other hand, the crisis played a key role in the center-left party and unions making a critical policy u-turn with the acceptance of labor market deregulation.<sup>134</sup> Witnessing a series of bankruptcies of chaebols (which were long regarded as ‘safe havens’ of employment), leaders of both labor federations arrived at the understanding that it was impossible to defend high employment protection. This ‘turnaround’ of the political left towards accepting labor market liberalization, together with the conservative party

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<sup>132</sup> OECD 2000.

<sup>133</sup> Ringen et al. 2011

<sup>134</sup> Choi, Chun, Lee and Yoo 2000.

and business pushing for labor market deregulation since the mid-1990s, indicates that the previous full employment model of welfare through work was effectively abandoned by both the political left and right.

However, it should be highlighted that, despite accepting ‘retrenchment’ in the form of labor market deregulation, the reform coalition of the left seized the opportunity to champion the welfare state. This alliance, much to the surprise of insider/outsider theory, promoted especially an expansion of social protection towards labor market outsiders (i.e. employees of small firms, workers in atypical employment, and the unemployed). Within the alliance, labor federations took a leading role in advocating the welfare rights of labor market outsiders, and the center-left party followed the unions’ advocacy.<sup>135</sup> This begs the question why, contrary to the common perception that Korean labor movements did not promote the welfare state, unions shifted their priority from particularistic interests, largely benefiting insiders, to the expansion of the welfare state, mostly for outsiders. Once again, the crisis played a key role. For organized labor, it was an eye-opener to the limits of enterprise unionism in the era of globalization. In the wake of the crisis, employers were quick to abandon their commitment to lifetime employment and generous company welfare benefits. The state had no power over employers to reinforce the old welfare-through-employment system. For the labor movement, pursuing the old strategy of material gains at company level increasingly became a dead end. Also, this strategy caused a popular criticism of ‘self-serving’ behavior benefiting only labor market insiders and neglecting an ever-increasing number of outsiders. Hence, public support for unions had been on a steep decline, causing an existential crisis of the labor movement.<sup>136</sup> Thus, labor federations endeavored to ‘reinvent’ the labor movement to reestablish itself as a legitimate political force. In this context, advocating the rights of outsiders was deemed imperative. This new

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<sup>135</sup> SC Lee 2012.

<sup>136</sup> KY Shin 2010; Chang 2011.

strategy of labor federations, however, created a schism between federations and company unions. While most enterprise unions (especially, those of large workplaces) were still occupied in protecting the prerogative of insiders, labor federations placed a greater emphasis on the expansion of the welfare state for outsiders.<sup>137</sup>

Against this background, labor federations advocated the extension of unemployment insurance to employees of small enterprises, and part-time and daily workers. Moreover, the ‘radical’ federation, the Korean Confederation of Trade Unions, was at the center of the civil society’s campaign for a public assistance reform in order to extend its coverage to the unemployed. While much of the literature highlights the role of civil society, we underline not only the contribution of organized labor, but also the importance of the center-left party in overcoming resistance from the old alliance of bureaucrats and employers in the reform of unemployment insurance and public assistance. Critically, the party successfully portrayed the old alliance as being responsible for the crisis – due to their collusive relationship, with bureaucrats overlooking reckless corporate expansion and high leveraging that put the Korean economy into unprecedented turmoil and unemployment. This strategy of political scapegoating created widespread anti-sentiment towards the old alliance and especially chaebols, taking away much of their political influence. In other words, unlike the experience in Sweden and Germany, employers were perceived as part of the *problem* in Korea, and crisis was associated with ‘crony capitalism.’ Capitalizing on the huge swing in the public opinion against the old alliance, the center-left president Kim Dae-Jung was able to break some considerable opposition among bureaucrats<sup>138</sup>, as he could afford ignoring employers’ strong opposition to the expansion of social protection. Thus, whilst globalization politically strengthened the power position of employers in Sweden and Germany (making their positions acceptable across the political

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<sup>137</sup> JH Lee 2011; SC Lee 2012.

<sup>138</sup> Ringen et al. 2011.



spectrum), Korean business was severely discredited by the East Asian financial crisis, opening up a window of opportunity for the improvement of unemployment protection that was skillfully used by the Korean left.

To summarize, the rise of the political left, paradoxically, consolidated the conservative reform agenda of labor market deregulation, in an acceptance of the ‘reality’ of intensifying economic competition created by globalization, yet with a substantial expansion of the social safety net, which would not have happened under the conservative leadership. This finding indicates that the old politics of the developmental welfare state has been replaced by a new politics in which political parties (especially, the political left in an alliance with trade unions) have started to make a difference, providing some support for power resources theory in the expansion of unemployment protection. The Korean case also suggests that globalization is not an ‘objective’ force with an inevitable ‘race to the bottom’, but highlights the continued importance of politics. As in the cases of Sweden and Germany, globalization strengthened the position of Korean employers (i.e. the threat to hollow-out manufacturing industries), but this strategy found its limits when the East Asian financial crisis discredited employers. Whilst business achieved its policy objective of labor market deregulation, it could not prevent the improvement of unemployment protection. This and earlier reform episodes show that Korean employers, with the state’s loss of control over business, present social policy preferences that are very similar to their LME counterparts, suggesting employers’ declining interest in investing in firm-specific skills. And indeed, from a VoC point of view, it comes with considerable surprise that we see the most comprehensive deregulation of the labor market (affecting both insiders and outsiders) in the least-likely case of Korea with its traditional predominance of firm-specific skills.

## **Conclusions**

The labor markets in all three coordinated market economies examined here have experienced far-reaching change since the 1990s, and have effectively abandoned the full employment objective of their post-war welfare settlements. Sweden and Germany have seen comprehensive retrenchment in unemployment protection and a shift towards workfare. The development intensifying the recommodification of labor undermines social solidarity and challenges the egalitarianism that was widely associated with coordinated welfare capitalism. In Korea, we have observed a departure from the previous welfare-through-work model, which in the past produced comparatively high levels of social cohesion in the absence of generous social welfare provision. In addition, all three countries have deregulated temporary employment, undermining regular employment that long characterized their labor market and welfare regimes. Only regular workers in Korea have also seen a decline in employment protection. Labor market insiders in Germany and Sweden have been spared labor market deregulation.

These empirical developments call into question the emphasis on stability that is typically associated with the institutionalist study of CMEs, which have not only experienced a decline in social solidarity but also a decline in coordination. In both Sweden and Germany, we have seen the erosion of the post-war compromise that allowed generous social policies and support for the unemployed. In the face of greater competitive pressures, increased employer opposition to social welfare provision challenged the cross-class alliance that brought stability for so long. The decline in partisan difference, especially with social democracy ideologically moving towards the political center and accepting retrenchment and workfare, put trade unions further on the defensive. The persistence of unemployment weakened trade unions, and strengthened the bargaining position of employers. Critically, in Sweden, social democracy appears to have lost its hegemonic status, and the center-right is in a position to engage in

retrenchment without electoral repercussion. As far as the German case is concerned, the argument of a decline of social partnership and coordination is particularly notable, as the German CME is still widely associated with high levels of coordination and cross-class support.

In Korea, coordination rested upon a strong state, with growth-oriented bureaucrats dominating policy-making. Economic liberalization and democratization challenged the dominance of the bureaucracy and state-led coordination of the developmental (welfare) state. In an environment of increased global competitive pressure, business withdrew its support for the old welfare-through-work system, and showed increasingly liberal social policy preferences. Employers also, breaking with the ‘developmental alliance,’ did not hesitate to loudly voice their policy preferences. Yet, whilst important for the deregulation of employment protection, employers’ influence in the aftermath of the East Asian financial crisis was limited, as Korean business (unlike their Swedish and German counterparts) was discredited by reckless corporate behavior that was thought to have at least contributed to the crisis of the Korean economy. At the same time, democratization ended the repression of organized labor, which developed into being a champion of the welfare state for both labor market outsiders and insiders. Lastly, political parties became a significant agency in social policy-making. Unlike our observations in Germany and Sweden, we still find some significant partisan difference in Korea as far as unemployment protection is concerned. However, despite some considerable welfare state expansion, the decline in employment protection has made Korea more ‘liberal.’

To conclude, our examination of Sweden, Germany, and Korea –three critical cases in the study of coordinated welfare capitalism– not only questions the assumption of relative stability that is commonly associated with the study of CMEs, but also the assertion that this stability is associated with the persistence of established political coalitions. Instead, we contend, across all three cases, a collapse of old welfare state coalitions as key political driver of labor market reform, with the withdrawal of employers from previous welfare settlements at

the heart of this development. Importantly, regardless of the institutional context (that is, social-democratic, conservative-corporatist or developmental welfare), employers in all three countries increasingly behave like their LME counterparts with respect to public social welfare provision and employment protection – undermining the argument of cross-class coalitions in recent welfare reforms in CMEs. Whilst business responded to perceived pressure from globalization, (partisan) policy-makers also responded to perceived fiscal constraints. Our findings, thus, very much challenge the VoC argument of “limited movement”<sup>139</sup> in CMEs in the face of globalization, which shifted power resources in favor of employers. Despite considerable liberalization in coordinated welfare capitalism, this is not to argue that we are simply converging to one model of capitalism, but that the observed decline of social solidarity and coordination suggests that all three countries are in a state of flux, which has not been fully acknowledged in the literature. The findings call for greater empirical scrutiny in the study of coordinated welfare capitalism, and for greater scrutiny in the comparison of CMEs and LMEs, so as to be in a better position to assess to what extent CMEs and LMEs might or might not be converging.

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<sup>139</sup> Hall and Soskice 2001, 58.

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