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Dis-embedding Welfare, or The Politics of Increasing Labor Market Flexibility in Europe

Project Overview

This dissertation explores the changing contours of the work-welfare nexus in Western Europe's rich democracies as their economies are undergoing fundamental sectoral transformations. Just as the Industrial Revolution drove the people off the land and into the factories, the Digital Revolution and the concomitant increasing scope of international trade are reducing the number of manufacturing (and certain kinds of service-sector) jobs in Europe. Strong pressure for increasing labor market flexibility and dis-embedding social protection out of the labor market has accompanied this sectoral shift.

My work seeks to construct a framework for understanding national variations in attempts to make the labor market more flexible and also how these attempts have affected the level and character of social protection. Methodologically, this dissertation follows a qualitative small-n approach. On the basis of detailed process tracing and pattern matching through case studies of the British, German and Danish experiences, this thesis seeks to identify causal mechanisms for the observed variation. These three countries, which were chosen to represent the variety among European countries along four analytically consequential categories, differ in how they combine relative labor market flexibility with the social protection of workers. While the United Kingdom scores high on labor market flexibility and low on welfare, and Germany scores low on labor market flexibility and high on welfare, Denmark scores high on both.

Matrix for Dependent Variable

	Labor Market Flexibility	*Social Protection*	*Character of Labor Market*
United Kingdom	High	Low	Flexibility w/o Welfare
Germany	Low	High	Inflexibility w/ Welfare
Denmark	High	High	Flexibility w/ Welfare

In an attempt to produce a dissertation that is both contemporary, policy-relevant and academically rigorous, I will pay close attention to the increasing off-shoring of service-sector activities as a potential driver of reform. For the dependent variable, my research will focus on changes in the systems of employment and layoff protection, the usage and structure of collective wage agreements, working-time regulation, performance-based pay for managers and unemployment insurance benefits. Theoretically, this study brings together the analysis of cross-class coalitions with the study of Varieties of Capitalism in the context of historical-institutional analysis.[1]

Setting the Scene

The postwar welfare states of western Europe co-evolved with the national political economic systems. In relatively closed national economies that offered many jobs in the manufacturing sector, cross-class bargains between relatively unified camps of employers and workers gave rise to welfare state structures that provided workers with levels of social protection that they desired and incentives for work, skill investment and labor peace that employers wanted. As a result, increasingly elaborate structures and levels of social protection were embedded within the regulation of the labor market. Breadwinner

[1] It thus consciously follows Kathleen Thelen’s recommendation in her contribution to the recent edited book on “The State of the Discipline”, published by the American Political Science Association.

welfare states provided job protection and employment-linked social benefits for the core male workforce.

Resulting from the inter-linked nature of the societal bargaining games in the realms of work and welfare, strong institutional complementarities developed between the two realms in European countries' political economy. In the early postwar years, social programs supported national Fordist production regimes by acting as automatic Keynesian stabilizers. Over the decades, the micro-incentives provided by social programs and the production strategies pursued by employers became aligned. For instance, in many countries, generous unemployment benefits provided the insurance that people need to invest in specific skills, because these benefits guaranteed status-maintaining income in case of these skills would become outdated. Furthermore, as earnings-linked pension systems could be conceived as a 'deferred wage', increases in pension benefits reduced upward wage pressure.

As an external shock to national political economic systems, the advent of the digital revolution calls into question the often positive economic effects of many social welfare policies. Effects of the Digital Revolution and the concomitant increasing scope of international trade have been felt for years, but they have been intensifying over the years. The adoption of new technology usually goes through at least three analytically distinct stages. First, the new technology is used to speed up old processes. Second, the technology is used to devise new processes to solve old tasks. Third, the organizational structure is changed so that new tasks can be formulated. We can trace how the effects of the digital revolution on economic organization in Western Europe's rich democracies have followed this logic. At the beginning we only saw the substitution of local low-skilled labor through computer-aided machine or the off-shoring of simple manufacturing abroad. Soon afterwards we saw the reorganization of production such that now whole production processes are either automated at home or off-shored abroad. Most recently, the revolution is hitting services with back-office tasks or telephone customer contact being either automated or off-shored.

Technological change and trade liberalization have exposed an increasing number of jobs, first in manufacturing and increasingly also in services, to either competition from abroad or automation. In the wake of this competition, we observe downward pressure on wages and reductions in the labor force in many established job categories. At the same time, European companies have internationalized, many of them having reached a stage of development in which a large share of innovations is generated abroad in newly established R&D facilities, or derived from process and product developments for foreign markets.

The structure of welfare programs both constrains and enables production strategies of employers, but in the last fifteen years the number of companies profiting from welfare programs has shrunk, while the number of companies and potential workers being hurt has grown significantly. Established institutional complementarities between the worlds of work and welfare serve the interests of shrinking constituencies and have increasingly become dysfunctional. For instance, generous early retirement schemes might help some industrial companies through difficult adjustment periods, but they increase social insurance contributions, which price many workers out of the labor market.

A renegotiation of established political bargains is necessary as European policy-makers face the challenge of trying to create conditions that facilitate the creation of domestic service-sector jobs and support the competitive position of their countries' value-generating corporations. However, the content, speed and structure of these new deals differ from country to country depending on the underlying economic structures, institutional make-ups and the framing used by ideologically dominant actors. There is nothing automatic about the process in which an exogenous pressure affects the reform of an institutional settlement. The pressure's influence is entirely contextual. As such, this dissertation will try to dissect the effects of various contexts.

Parallel to deregulatory efforts in other policy areas, politicians have adopted the goal of increasing labor market flexibility. In popular discourse, labor market flexibility is often seen as a general panacea for curing the ills of unemployment and low growth by boosting domestic job creation and increasing competitiveness. While in most instances the idea of 'labor market flexibility' is not clearly defined, it often generally alludes to removing all those regulations that inhibit the clearing of the labor market, i.e. matching labor supply and demand through price adjustment. Regulations perceived to contribute to 'rigidities' in the labor market include collective bargaining arrangements, lay-off protections, and employment-linked social benefits. Attempts to increase labor market flexibility thus result in fundamental changes in the nature of social protection that was established during the postwar development of the European welfare state. How that is done and the consequences of such changes for the status of social protection for workers depend on the specific characteristics of each country's domestic political game. It is not only the outcomes that diverge between countries. Well before, it is the framing of the whole issue that shows significant variation. Sub-groups of the employer and the worker camp diverge in their interests as to how they would like the issue to be framed.

One might think that companies would always be in favor of increasing labor market flexibility. After all, it would by allow them to reduce their pay-rolls during economic downturns, which should put them into the position to increase their pay-rolls at a higher rate during economic upturns and thus improve efficiency of labor allocation. Furthermore, as the speed of economic competition changes, firms are finding themselves in ever more rapidly occurring processes of reorganization (e.g. mergers and acquisition activity). It seems reasonable to expect that they would seek to be able to shift workers to those places in which they are of most benefit to the organization. Finally, as much as the 'new' economy is becoming a 'knowledge' or 'learning economy', companies are face with the task of finding solutions to the dual challenge of organizing company hierarchies and moving people between companies in such ways that support process and product innovation. Again, flexible labor markets are often seen as efficiently supporting both knowledge generation and transfer.

However, hypothesizing employer preferences in this way overlooks that there are various dimensions to labor market flexibility, some of which are in conflict with each other. For example, a sharp trade-off exists between certain types of wage flexibility and the functional and temporal flexibility with which companies can employ their labor. In the words of one analyst, "too much of the former usually prevents achievement of a sufficient amount of the latter, in that it implies a lack of trust and cooperation, an unwillingness to share information, a disincentive against long-term investment in human resources, and greater resistance to technological and organization change (Regini 2000, 20)."

Employers will diverge in their interests over different forms of labor market flexibility, and so will workers. In general, insiders (employers and workers) of those sectors that benefit from old institutional complementarities are likely to oppose increasing flexibility while many outsiders (the unemployed and those precariously employed, very high skilled 'knowledge workers' and executives from service-sector companies) will support it. If social protection is brought in as another variable into the game of making the labor market more flexible, the structure of the preference sets changes further. Among those employers who desire flexibility, subgroups can reasonably be assumed to hold very different preferences towards the level of social protection. Providers of low-wage personal services might be against generous welfare protection, because without it their workers will be very dependent on their employer. The employees are likely to put up with a high work load and bad working conditions, largely out of fear that quitting the job would leave them unsupported. Providers of high-quality services might much prefer their higher skilled workers to have a positive motivation to work, because flexible work organization with high employee autonomy would otherwise be difficult to sustain.

Recent studies of different European countries have shown that the locus and content of corporatist bargains are undergoing significant change. Long gone is the old-style macro-corporatist bargaining which had its heyday in with the fight against inflation in the 1970s (Scharpf 1991). National deals that divided the annual productivity gains between organized labor and capital lie in the past. When labor and capital strike bargains today, it is not their highly concentrated, exclusive national organizations that are involved. Rather, the current bargains often take the form of narrower social pacts at the firm or sectoral level (Hassel 2003). Misleadingly called “competitive corporatism” by one analyst (Rhodes 2000), collaboration between employees and employers at lower levels of aggregation has become the basis of - often experimental - company strategies. National deals, if they occur, are more important for increasing the political legitimacy of policies than for supporting a particular economic logic (Katzenstein 2003).

How can we then analyze the bargains which give rise to increases of labor market flexibility? We can take to heart the insights of the more recent scholarly treatments of the social foundations of national models of capitalism (see e.g. Esping-Andersen 1999). National institutional settlements, be they particular wage-bargaining arrangements or welfare state structures, were never only due to ‘labor push’ or ‘employer pull’ as earlier analysts wanted to make us believe (Korpi 1983; Piven and Cloward 1972). Rather, they derived from cross-class coalitions which sacrificed the interests of a minority in each camp for the benefits of more powerful constitutive elements in each group (Swenson 1991). The re-arrangement of political economic institutions is a reaction to the two challenges of allowing economic growth and maintaining socio-political order. It thus constitutes the product of optimization under both economic and political constraints. If lasting, an institutional settlement will allow economic change to take place by offering a political formula that silences the losers of this change, either through compensation, disenfranchisement or cognitive reframing.

These considerations leave us with a set of questions which this dissertation tries to address: As labor market flexibility is increased across Europe, what happens to the levels of social protection? Is it inevitable that levels of social protection will be reduced as welfare is being dis-embedded out of the labor market? Are governments successful at constructing models of social protection that fit the evolving systems of value creation?

Methodology

This small-n study is intended to complement recent large-n work looking at the effects of globalization on the evolution of national welfare capitalisms in Europe (e.g. Swank 2002). These recent large-n studies feature two short-comings in particular. First, as quantitative studies their measures for welfare state effort are highly problematic, because purely quantitative measures do not convey changes in the character of the dependent variable. Second, these studies suffer from an inattention to causal mechanisms. Both short-comings will be addressed with the research set-up of this dissertation. As much as the work-welfare nexus presents the core of the European Social Model, this dissertation directly targets both its determinants and its changing nature.

The three case studies will be situated within a survey of the state of labor market flexibility across the countries of the European Union. The research strategy is generally inductive. It thus departs from the popular 'varieties of capitalism' approach to political economy, so heavily inspired by the New Institutional Economics. In my view, the VoC assumption of national institutional matrices constituting institutional equilibria leaves this approach overly static and prevents it from addressing the effects of the changing competitive environment of the world economy. Furthermore, while the VoC pretends to be firm-centered, in all actuality it reads off firm preferences from the national institutional map in which firms are embedded. Both of these short-comings can be addressed by adopting a more historical institutionalist approach, paying attention to the politics surrounding the shifting contours of interest aggregation and expression, and informing our analysis with recent findings from work on national innovation systems.

The Dependent Variable

In looking at a dependent variable that combines labor market flexibility with social protection, this thesis builds on Esping-Andersen (1990) who stressed the centrality of de-commodification for the character of a welfare regime. Building on Polanyi (1944), Esping-Andersen used the concept of de-commodification to capture the degree to which people's income security and exposure to social risks was independent of their performance in the labor market. According to Polanyi, societies could never sustain a total commodification of labor and would naturally place limits on market determinants of welfare.[2] Both Polanyi and Esping-Andersen give many examples of diverse social

[2] According to Polanyi, labor was a 'fictitious commodity'; according to Robert Solow, it is a very special one with unique features.

security arrangements setting different boundaries of labor's exposure the laws of supply and demand. Increasing labor market flexibility represents an attempt to increase labor's exposure to the market mechanism. However, this does not necessarily mean that a person's welfare is determined by the market. Post-allocation universal welfare arrangements can provide the support that people desire. By distinguishing labor market flexibility and the level of social protection, this dissertation disaggregates Esping-Andersen's concept of de-commodification.

National Stories

I want to go to the field to research if the following hypothesized stylized 'stories' hold up to the evidence:

In the **United Kingdom**, we saw ideologically motivated increases in labor market flexibility, led by the Thatcher government and maintained by New Labor. These changes were supported by service-sector companies.

In **Germany**, moves towards labor market flexibility have been channeled into creating part-time jobs that are not restricted by the same rules as regular employment relationships. There have been strong insider-outsider cleavages. Dominant large manufacturing companies and unions have protected the old institutions of the work-welfare nexus as the serves them well. These dynamics have tended to squeeze the profitability of small and medium-sized enterprises as well as entrepreneur-owned firms. The job base in manufacturing has been maintained rather well, but not all are sustainable long-term. In this large country economic interests have been very diverse, a situation which prevent a new bargain being stuck. Furthermore, there politicians are heavily unionized and tend to have a professional background as civil servants; they tend to pay less attention to the needs of entrepreneurs and labor market outsiders. For sure, there have been smaller changes within the institutions which this dissertation will illuminate, but the overall story is one of continuity. Particular attention will be paid to the "Hartz" labor market reform packages and the changing parameters of social partnership.

Denmark has successfully combined labor market *flexibility* with employee *security* in what has been termed a new system of *flexi-curity*. In the eyes of the business community, the new system has underwritten a speedy sectoral transformation by allowing the necessary re-allocation of economic resources while safeguarding social order. Because generous social benefits (such as unemployment insurance with very high replacement rates) have cushioned the implementation of a 'hire & fire' system, Danish workers actually feel more secure than those in other European countries. The flexicurity system seems to be the outcome of a new social bargain, struck by homogenous producer groups in this small country. Close social ties have helped employers to overcome the collective action problems in the provision of employee training that typically open up as labor markets are made more flexible. Flexicurity institutions seem to uniquely support the competitive position of Denmark in the globalizing learning economy. They provide both the incentives for skill acquisition (underwriting employee autonomy that allow companies to have flat hierarchies) and allow for the movement of workers (and knowledge) between companies.

Case Selection

This dissertation attempts to both synthesize different scholarly literatures and push theory development in the political economy of Europe further. It brings together the four literatures on welfare regimes, national models of capitalism, small states and the post-taylorist modes of corporate organization, because they offer complementary insights into social preferences and the ability of national institutions to structure the political game. The United Kingdom, Germany and Denmark were chosen as cases to represent the largest possible variation among European economies within the category established in these separate literatures. This case selection achieves a high level of representativeness among all possible cases, not the isolation of potential variables.

Welfare Regimes

An extensive literature on comparative welfare systems has delineated the differences between European countries. Since Titmus (1974), scholars typically distinguish between three separate models of welfare state development. Titmus contrasted a 'residual welfare' model with minimal state involvement in poverty relief, an 'industrial achievement-performance' model with a status-preserving welfare state and an 'institutional redistributive' model with need-based universal services. The most famous formulation of the difference between welfare regimes can be found in Esping-Andersen's account of the "Three Worlds of Welfare Capitalism" (1990), in which he developed the distinction between 'liberal' regimes in the Anglo-Saxon world, 'conservative corporatist' regimes in Continental Europe and 'social democratic' regimes in Scandinavia.

Countries cluster according to features of the systems of welfare provision, in particular the division of responsibilities between state, market and the family (Esping-Andersen 1999). Furthermore, we can contrast the different clusters with reference to historically dominant ideologies, eligibility criteria for welfare programs, modes of benefit distribution and the systems of class relations. While in Anglo-Saxon countries, liberalism has long been the dominant ideology, conservatism has been stronger in Continental Europe and socialism in Scandinavia. While in the liberal regime, demonstrated need underlies program eligibility, it is a record of contributions in conservative regime and citizenship in social democratic countries. Benefit dualism of low-level public benefits and private benefits for the rich in liberal countries contrasts with status-maintenance in conservative and high-level universal flat benefits in social democratic countries. Finally, while in liberal countries, class divisions are stark between the 'angry' working-poor, the 'hated' non-working poor and the 'supported' middle-classes, class relations in conservative countries are much more splintered. In social democratic countries in theory a one-class society exists.[3]

Clustering according to type of welfare regime	
Liberal	**United Kingdom**, Ireland
Conservative	**Germany**, Austria, Belgium
Social Democratic	**Denmark**, Sweden, Norway, The Netherlands

Varieties of Capitalism

In their research on the 'varieties of capitalism' (2001), Peter Hall and David Soskice make a distinction between liberal and coordinated market economies. Among coordinated market economies, a further distinction has been made between sectorally and nationally administered variants. Liberal market economies (LMEs) display a high share of competitive market arrangements in the governance of company relations, which allow actors to pursue individual unconstrained strategies, often by matching demand and

[3] I would like to acknowledge Jonah Levy as the source for this characterization of the differences between clusters. The 'affiliation' of Austria and the Netherlands are often contested. Here, I follow Goodin et al in lumping the Netherlands with the social democratic cluster and Esping-Andersen's lead for Austria's characterization as a conservative case.

supply through relative prices. In contrast, non-market institutions are much more prevalent in coordinated market economies (CMEs). Focused on longer-term outcomes than firms in LMEs, firms in CMEs coordinate their activities largely through non-market means, such as extensive relational or incomplete contracting and network monitoring based on the exchange of private information inside of networks.

The varieties of capitalism (VoC) is the most recent embodiment of a longstanding research tradition that has attempted to account for the distinctiveness of national models of capitalism among the advanced industrialized countries. Hall and Soskice's focus on the firm as a strategic actor contrasts with earlier literatures that sought to explain national differences in economic structures and performance through national cultures (e.g. Shonfield 1965), relative state strength (e.g. Zysman 1983) and the degree of corporatism in state-society relations (e.g. Scharpf 1991). Hall and Soskice try provide micro-foundations for macro-divergences across economies by embracing the assumptions of the new institutional economics. Most importantly, they conceive of the national institutional matrices they describe as constituting an equilibrium. The institutional equilibrium of the LME optimizes principle-agent relationships, that of the CME reduces transaction costs.

In each type of economy, strong complementarities exist between institutions from such realms as industrial relations, vocational training and education, corporate governance, inter-firm links and internal company relations. Conceived as tightly-coupled institutional systems within which the presence of one institution increases the returns from another, both CMEs and LMEs endow their constitutive firms with a comparative institutional advantage for particular production strategies. While LME institutions provide an edge to service-sector companies and the establishment of new industries, CME institutions have proven particularly adept at supporting companies in mature industrial sectors (e.g. machine tools or automobiles). LME structures are most prevalent in the Anglo-Saxon countries, i.e. the US, UK, Australia, Canada, New Zealand and Ireland; CME structures dominate in Germany, many other Continental European countries (Austria and Switzerland, the Benelux and Scandinavia) as well as in Japan. LMEs tend to be better than CMEs in 'radical' innovation, sustained by the wide availability of venture capital financing, human capital investment in transferable skills and financial reward for risk-taking behavior. In contrast, large skill and capital investments in specific technologies and long-term relationships among economic actors give CMEs an edge in 'incremental' innovation.

Germany is often invoked as the ideal-typical case of coordinated market economies. Many areas of the German economy feature institutions which promote non-market coordination between and within the companies rather than market institutions which require companies to pursue unilateral strategies. For example, high levels of patient capital are available through a system of company finance dominated by universal banks. Labor market institutions such as collective wage bargaining, co-determination and restrictions on lay-offs promote labor flexibility internally within the company at the expense of external labor market flexibility. Rather than individual skill acquisition in the market, public tertiary education and apprenticeship schemes administered collectively by employers and unions are widely available. In game theoretic terms, CME institutions allow companies to pursue ‘cooperative’ strategies within positive-sum games.

The United Kingdom is often invoked as the ideal-typical case of liberal market economies. The institutional structures of the UK economy do not allow for the type of non-market coordination associated with Continental Europe’s corporatist networks, or with the close state-society links, the keiretsus and enterprise unionism in Japan. While the CME institutions in Continental European countries or Japan promote labor productivity, LME institutions optimize the productivity of capital. As evidenced by a high number of mergers and acquisitions, an liquid market for corporate control exists. Individual investment decisions are motivated by the potential direct pay-offs, less by systemic considerations. Rather than relying on established relationships, transactions between and within companies tend to be open, transparent and with a focus on the short term.

Clustering according to level of employer coordination	
Liberal Market Economies	**United Kingdom**, Ireland
Sectorally Coordinated Market Economies	**Germany**, Austria, The Netherlands
Nationally Coordinated Market Economies	**Denmark**, Sweden

Small States

In his influential book “Small States in World Markets” Peter Katzenstein (1985) argued that the politics surrounding the increasing exposure to trade differs between small and larger countries. According to Katzenstein, the small size of a country creates both a uniquely open economy and a contained political game with a limited number of players.

Increasing trade exposure not only affects a larger number of people than it would have done in larger countries, but the interests of these people are expressed through national associations that are more encompassing than their equivalents in larger countries. The result is explicit compensation for the losers of increasing trade exposure through welfare state benefits.

	Clustering according to Country Size
Small	**Denmark**, Sweden, Austria, The Netherlands
Middle	**United Kingdom**
Large	**Germany**

Post-Taylorist Forms of Corporate Organization

In their recent contribution to the literature on national innovation systems in the globalizing learning economy, Lorenz and Valeyre (2004) distinguish between two distinct post-taylorist models of organization. Both 'lean' and 'learning' models, as they term them, are geared toward the competitive marketplace of the digitally-enabled economy. According to the researchers, there is a systematic variation in in the prevalence of different post-taylorist models of economic organization across countries. Their results show that 'learning' forms of post-taylorist organization are most prevalent in Scandinavia and the Netherlands, found in average numbers among the Germanic countries, and highly under-represented in the Anglo-Saxon world. Compared to the lean model, the learning model allows for much more employee autonomy.

	Prevalence of learning model as corporate organization
Low Prevlance	**United Kingdom**, Ireland
Average Prevalence	**Germany**, Austria

High Prevalence	**Denmark**, Sweden, The Netherlands

Summary Case Selection

The following chart can be constructed to show the logic of case selection in detail. A statistical analysis would show a high co-variation among the highlighted characteristics of my three chosen cases. As will become clear in my sections on hypotheses and national stories, I expect all characteristics to come into play in explaining the eventual outcome.

Country Case Matrix

	Welfare Regime	*Type of Capitalism*	*Size*	*Prevalence Learning Model*
UK	Liberal	Liberal Uncoordinated	Medium	Low
Germany	Conservative	Sectorally Coordinated	Large	Medium
Denmark	Social Democratic	Nationally Coordinated	Small	High

Appendix: A research note on "Organisational Innovation in Europe: National Models or the Diffusion of a New 'One Best Way'" by Edward Lorenz and Antoine Valeyre (2004)[4]

In their recent paper on the changing pattern of corporate organization in Europe, Lorenz and Valeyre address two important questions. First, how can companies leverage organizational learning to drive innovation? Second, how do national institutional maps differentially shape the conditions for this capacity in firms? In formulating their answers, the authors reject a dichotomous distinction between taylorism and lean production. Instead, they conceptualize two distinct post-taylorist models of organization, a 'lean' and a 'learning' model, both of which are geared towards the competitive marketplace of the E-conomy. The authors find that countries with a high prevalence of the learning model tend to be very innovative. Surprisingly, these countries also tend to have the strongest employment protection legislation.[5] Lorenz and Valeyre build their argument on the recently completed Survey of Working Conditions in 15 EU countries, which was conducted by the European Foundation for the Improvement of Working Conditions.[6]

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[4] Lorenz, Edward, and Antoine Valeyre. 2004. Organisational Change in Europe: National Models or the Diffusion of a New 'One Best Way'? Paper read at DRUID Summer Conference 2004, at Elsinore, Denmark. Available online: http://www.druid.dk/wp/pdf_files/04-04.pdf

[5] They also show that the national producers' position on the high or low quality end of product markets does not explain the differences in the prevalence of the learning model, as there exists no statistically significant correlation between innovation effort (measured by R&D expenditures as percent of GDP) and the relative share of the learning model in the Northern and Central European countries with high R&D expenditure (see p. 21).

[6] Paoli, Pascal, and Damien Merllié. 2001. *Third European Survey on Working Conditions 2000*. Luxembourg: Office for Official Publications of the European Communities.

The 'lean' versus the 'learning' model

The authors' lean model corresponds to the Japanese lean production model originally formulated by Womack et al.[7] Rather than interpreting the organizational variety in EU countries as evidence of the hybridization of this lean model, the authors conceive of the emergence of the learning model as a separate phenomenon. In their view, the learning model constitutes a distinct way of delivering flexibility and cooperation within the company. It is uniquely socially-embedded, because it builds on local traditions in work organization.[8] Companies following the lean model display such attributes as the strong use of teamwork, job rotation, quality management and multiple work pace constraints. In contrast, the learning model is more decentralized and grants employees a high degree of autonomy. However, both the lean and learning organizational forms display stronger learning dynamics and higher problem-solving activity on the part of employees than either taylorist or pre-Fordist traditional organizations.

In their paper, Lorenz and Valeyre ultimately focus on the existence of strong national differences in the prevalence of the learning and lean models independently of occupational category and economic sector. Laying the foundations for this discussion, they acknowledge that the learning model is more prevalent in certain parts of the service sector, such as financial and business services, and the utilities. In contrast, the lean model is employed in manufacturing, particularly in the production of transport equipment, electronics, wood and paper products, as well as printing and publishing. In

[7] See Womack, James P., Daniel T. Jones, and Daniel Roos. 1991. *The Machine that Changed the World*. New York: Harper Perennial.
[8] In particular, Lorenz and Valeyre point to the Swedish socio-technical principles of the 1970s as sharing many properties of their learning model.

terms of occupational categories, the ‘learning’ model particularly characterizes the work of managers, professionals and technicians. In contrast, lean forms of work organization are more characteristic of blue collar employees.

Diverging innovation patterns

The distinct properties of the lean and the learning organization are evident in the way each promotes innovation. Going beyond Lorenz and Valeyre’s paper to bring in recent research by scholars of innovation allows us to illustrate how the lean and learning models tend to follow different approaches to sustaining competitiveness in the E-conomy. The two organizational forms’ typical innovation profiles correlate with different interpretations of what constitutes knowledge in the E-conomy. Embracing knowledge as structured information, lean organizations focus on the gathering and digitization of information. In contrast, learning organizations build on a dynamic conception of knowledge as fluid, contingent on context, dependent on continuous recombination, and ultimately resting in people.

A recent contribution by Johnson *et al* stressed that digitization in the E-conomy does more than provide ‘tools for thought.’[9] Digitization implies that knowledge is created and destroyed at a faster rate, i.e. becoming obsolete more rapidly than before.[10] Giving employees the flexibility and autonomy for experimentation and allowing them to take the initiative in the pursuit of complex tasks, the learning organization tries to leverage the interaction of its skilled employees into individual competence-building,

[9] On ‘tools for thought,’ see Cohen, Stephen, Bradford Delong, and John Zysman. 2000. Tools for Thought: What is New and Important about the "E-conomy"? BRIE Working Paper 138. Berkeley: Berkeley Roundtable on the International Economy.

[10] Johnson, Björn, Bengt-Aake Lundvall, Edward Lorenz, and Morten Berg Jensen. 2004. Codification and Modes of Innovation. Paper read at DRUID Summer Conference 2004, at Elsinore, Denmark. (p. 14)

organizational learning and innovation. In contrast, the learning dynamics of the more hierarchical lean model "are embedded in a more formal structure based on codified protocols (e.g. teamwork and job rotation practices) often associated with tight quantitative production norms."[11] Learning organizations promote what Niels Christian Nielsen and Maj Cecilie Nielsen call 'spoken-about knowledge' in another chapter in this volume. Learning in these organizations is a continuous process of accumulating, applying and combining employees' knowledge. With this strategy, learning organizations should display strengths in the realm of 'interpretation' in addition to mere 'rational problem solving.'[12]

Clearly, the lean and learning models of organization promote innovation in quite distinct ways. However, according to Lorenz and Valeyre, they both represent the same one of two complementary modes of innovation recently identified by Johnson *et al*. The authors see both the learning and lean models as promoting the DUI (Doing, Using, Interacting) mode of innovation, a type which focuses on human capital investment, embraces the unity of learning and working, and seeks to stimulate directly applicable 'know-how.' The DUI mode is complemented by the STI (Science, Technology, Innovation) mode of innovation, a more mechanistic, rules-based approach, which displays the logic prevalent in the natural sciences and seeks to generate knowledge of the 'know-why' type. Firms need to use both STI and DUI modes to be innovative

[11] Lorenz, Edward, and Antoine Valeyre. 2004. Organisational Change in Europe: National Models or the Diffusion of a New 'One Best Way'? Paper read at DRUID Summer Conference 2004, at Elsinore, Denmark. (p. 18)

[12] The distinction between 'interpretation' and 'rational problem solving' is developed in another recent contribution to the literature, see Lester, Richard, and Michael Piore. 2004. *Innovation: The Missing Dimension*. Cambridge, MA: Harvard University Press.

overall. As Lorenz points out, STI needs DUI to overcome bottlenecks in absorbing new technologies and anchor R&D activities in the overall business environment by tacit links to procurement, production and sales. The lean and learning models are thus two distinct ways of organizing DUI-mode innovation, with the main difference being the relatively high levels of employee discretion/autonomy in the learning form. Crucially, autonomy favors the exploration of new knowledge.[13]

The learning model is very successful at generating incremental innovation. Countries that display a high prevalence of the learning model exhibit high rates of patent applications to the European Patent Office. On average, these rates are higher than those of countries in which the lean model dominates as a post-taylorist organizational form. The question arises if the prevalence of the learning or lean models in a country is determined by the position of national producers in high-tech or high-quality product markets. Admittedly, on average, countries with a high prevalence of the learning model spend more on research and development (R&D) than those with a high prevalence of the lean model.[14] However, R&D spending does not correlate with the share of workers in either type of organization at a statistically significant level, if the Southern European countries are excluded from the analysis.[15] Given the learning model's strong record, the potential institutional preconditions for its implementation constitute an important research question.

[13] I want to thank Edward Lorenz for clarifying the relationship between lean/learning and DUI/STI during personal correspondence.
[14] Spending is measured as expenditure in percent of GDP.
[15] Lorenz and Valeyre write: "The Pearson correlation coefficient recalculated without the fours southern European nations, although positive, is not significant at the 10 percent level." (p. 21)

The connection between national context and company strategy

Lorenz and Valeyre find that learning organizations are prevalent in Sweden, Denmark, the Netherlands and, to a lesser extent, in Germany and Austria. Meanwhile, the 'lean production' model is more widespread in the Anglo-Saxon countries of the United Kingdom and Ireland. These findings contribute important micro-level evidence in support of the continued existence of varieties of capitalism under the conditions of the E-conomy.[16] However, what is it about countries that allows the learning organization to blossom? Can companies adopt the learning model anywhere, or is there a particular reason why British and Irish companies do not adopt the learning model in greater numbers? If learning strategies are dependent on institutional context, can governments facilitate such a context and provide the right incentives for the adaptation of the learning organization as a model?

Lorenz and Valeyre suggest an answer that builds on a recent literature in political science, highlighting the increasing divergence in labor politics between the Anglo-Saxon liberal market economies (LMEs) and the continental European coordinated market

[16] The clustering of countries identified by Lorenz and Valeyre corresponds with the patterns established in other recent scholarship. For influential recent theorizing on the varieties of capitalism, see Soskice and Iversen, Torben, Jonas Pontusson, and David Soskice. 2000. *Unions, Employers, and Central Banks. Macroeconomic Coordination and Institutional Change in Social Market Economies*. Cambridge: Cambridge University Press. Consult also Doremus, Paul N., William W. Keller, Lous W. Pauly, and Simon Reich. 1998. *The Myth of the Global Corporation*. Princeton, NJ: Princeton University Press. For the dominant perspective in the comparative scholarship on the welfare state, see Esping-Andersen, Gøsta. 1990. *Three Worlds of Welfare Capitalism*. Princeton: Princeton University Press. Esping-Andersen identifies the Nordic countries as part of a social democratic welfare regime, the continental European ones as part of a conservative corporatist welfare regime and the Anglo-Saxon countries as constituting a liberal regime. Subsequent criticism addressed the placement of particular countries, see e.g. Ferrera, Maurizio. 1996. The 'Southern Model' of Welfare in Social Europe. *Journal of European Social Policy* 6 (1):17-37. An important contribution to the literature is also Goodin, Robert E., Bruce Headey, Ruud Muffels, and Henk-Jan Dirven. 1999. *The Real Worlds of Welfare Capitalism*. Cambridge: Cambridge University Press. Using panel data to demonstrate how different national social program structures matter greatly for populations' welfare over time, Goodin and his collaborators use the Netherlands as a stand-in for the social democratic regime.

economies (CMEs) under the pressure of globalization.[17] They argue that successful adoption of the learning organization model might presuppose employer coordination on wage-bargaining at a higher level than that of the firm. Accepting the argument of the political science literature that labor market regulation prevents a collective action problem and thus acts as an enabler of higher-level employer coordination, Lorenz and Valeyre present data on how the relative national prevalence of the learning and lean models correlates with the amount of employment protection legislation as expressed by an OECD index. This data shows a starkly higher degree of employment protection legislation in continental Germany, Sweden, Austria, the Netherlands and (with some distance) Denmark than in the liberal UK and Ireland.

Lorenz and Valeyre stress two reasons for why employer coordination in regional or sectoral bargaining has played an important role in supporting companies' adoption of the learning model. First, employer coordination buffers the individual company management from distributional conflict, which can otherwise easily spill over into areas of labor-management cooperation. Employer coordination facilitates local bargaining between employers and workers in pursuit of more flexibility and greater cooperation of labor at the shop level. Second, it provides a solid foundation upon which employers can make extensive collective investments in training and skills, investments which are a precondition for adopting the model of the learning organization.

[17] See in particular Thelen, Kathleen. 2001. Varieties of Labor Politics in the Developed Democracies. In *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, edited by P. Hall and D. Soskice. Oxford: Oxford University Press. In contrast to the other chapters in the book, Thelen's contribution stresses the importance of politics over more narrow arguments that are heavily influenced by the new economics of organization.

Lorenz and Valeyre are skeptical about the viability of learning organizations in the deregulated labor markets of the liberal Anglo-Saxon countries. The authors argue that the lack of employment protection legislation translates into low employer capacity for coordinated action around wage and skill provision, making it hard to sustain substantial forms of autonomy in work. In addition to local distributional conflict, which might prevent employers from securing labor's commitment to progressive improvements in product quality, the risk of competitors poaching skilled workers will provide the incentive to under-invest in the provision of training. According to Lorenz and Valeyre, potential substitutes, such as in-house training schemes linked to firm-specific internal labor markets, are likely to prove unstable. Without the broader supporting labor market infrastructure, they are likely to fail to structure careers and provide incentives for skill acquisition. Therefore, Lorenz and Valeyre deduce that employers in the 'liberal' regime would logically chose the lean over the learning model as their preferred post-taylorist strategy. It would be easier to sustain this relatively hierarchical model of work organization, in which worker autonomy is limited and tight quantitative production norms commonly fix the pace of work.

Lorenz and Valeyre make a much-needed contribution by linking the varieties of labor politics in the different varieties of capitalism with evolving patterns of corporate organization. In doing so, the authors disagree with a simplistic one-dimensional vision of labor market flexibility, which tends to underpin the calls by many economists and editorial writers for more labor market flexibility in Europe. Instead, they argue against a zero-sum trade-off between flexibility at the plant-level and higher-level coordination.

There are various dimensions to labor market flexibility, some of which are in conflict with each other. Most importantly, a sharp trade-off exists between certain types of wage flexibility and the functional and temporal flexibility with which companies can employ their labor. In the words of another analyst, "too much of the former usually prevents achievement of a sufficient amount of the latter, in that it implies a lack of trust and cooperation, an unwillingness to share information, a disincentive against long-term investment in human resources, and greater resistance to technological and organization change."[18]

Taking this research further

Lorenz and Valeyre's analysis provides fertile ground for future research, not only because the authors present hard data and an interesting hypothesis to be tested in further research. More importantly, their research launches an interesting line of inquiry, because they do not address alternative interpretations of their results. Specifically, Lorenz and Valeyre do not directly analyze the correlation between the degree of social protection legislation an the national prevalence of learning organizations. Important questions remain to be answered. Is employer coordination as important as Lorenz and Valeyre suggest? Are there alternative explanations available for this interesting observed correlation? How do these potential alternative explanations rate against the one presented here? Finally, could different explanations be combined?

We need to ask if the lens chosen by Lorenz and Valeyre is the right one for interpreting the correlation between employment protection legislation and the relative prevalence of

[18] Regini, Marino. 2000. The Dilemmas of Labour Market Regulation. In *Why Deregulate Labour Markets?*, edited by G. Esping-Andersen and M. Regini. Oxford: Oxford University Press. (p. 20)

learning organizations. Lorenz and Valeyre's explanation follows an approach that was largely elaborated based on empirical research on the German case.[19] What speaks for or against this approach, given that the highest prevalence of the learning organization is found not in the Germanic countries, but in Sweden, Denmark and the Netherlands? Future scholarship that builds on Lorenz and Valeyre's research needs to address, first, which institutions are necessary for companies to choose to adopt the learning model, and second, whether these institutions are sufficient for doing so.

In developing answers to these questions, we need to take note of the fact that Denmark and the Netherlands – which together with Sweden display the highest share of learning organizations - trail Germany (with Sweden being about equal) in their degree of employment protection legislation. We need to pay attention to the degree to which countries protect against unemployment and how they treat the unemployed. In particular, we should look at the distinction between passive (job protection) and active labor market policy (training and placement), as well as develop an appreciation for the national differences in the conditionality, duration and generosity of high-spending countries' unemployment benefits. Denmark, the Netherlands and Sweden are important examples of the success of 'flexicurity', an approach to labor market regulation that tries to combine the flexibility that companies want and workers should display with the security that workers want and should enjoy.[20] Policymakers in these countries have

[19] See e.g. Thelen, Kathleen. 1991. *Union of Parts. Labor Politics in Postwar Germany*. Ithaca, NY: Cornell University Press. A more recent treatment is Soskice, David. 1999. Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and the 1990s. In *Continuity and Change in Contemporary Capitalism*, edited by H. Kitschelt, P. Lange, G. Marks and J. D. Stephens.
[20] See e.g. the following contributions by Torfing, Jacob. 1999. Workfare with Welfare: Recent Reforms of the Danish Welfare State. *Journal of European Social Policy* 9 (1):5-28. Green-Pedersen, Christoffer. 2001. Welfare-State Retrenchment in Denmark and the Netherlands, 1982-1998. *Comparative Political*

focused on maintaining workers' employability through well-funded public training programs and the conditioning of generous benefits on individuals' participation in these programs. Such labor market policy sharply contrasts with that of Germany and Austria, countries whose labor laws tend to protect currently employed workers and in which most expenditures flow into consumption by the long-term unemployed rather than skill investment.

Focusing on the actual policy profiles of the different systems of welfare capitalism, we have taken the first steps toward developing the first of two further alternative hypotheses for why countries with the highest degree of employment protection legislation might show the greatest prevalence of the learning organization. Motivated by the previous discussion, we might think about the role of the state in sustaining an environment in which flexible workers with sought-after skills are readily available for employment in learning organizations. As a second line of inquiry, we might consult the writings of economic sociologists in order to look more closely at the social embeddedness of the learning organization.[21] Lorenz and Valeyre stress that the learning model is an alternative to the lean model, deriving its comparative advantage from building on local traditions. They show that taylorism is comparatively underdeveloped in Sweden, Denmark and the Netherlands. With older traditions of workmanship only rarely replaced by taylorism in these countries, it seems likely that learning organizations could

Studies 34 (9):963-985. Benner, Mats, and Torben Vad. 2000. Sweden and Denmark: Defending the Welfare State. In *Welfare and Work in the Open Economy Vol. II - Diverse Responses to Common Challenges*, edited by F. Scharpf and V. Schmidt. Oxford: Oxford University Press.

[21] For this perspective, see e.g. Polanyi, Karl. 1944. *The Great Transformation. The Political and Economic Origins of Our Time*. Boston: Beacon Press. See also Granovetter, Mark. 1985. Economic Action and Social Structure: The Problem of Embeddedness. *American Journal of Sociology* 91:481-510.

use workers' pre-Fordist identities and tap into accumulated social trust.[22] At this stage, both of these rather undeveloped hypotheses point to the learning organization being supported primarily by the policies and social institutions associated with the social democratic welfare state.

Finally, future research might show that the mechanisms highlighted by Lorenz and Valeyre are most powerful. At this point, however, we should not yet settle on the authors' narrow interpretation. While the prevalence of the learning organization is likely to be highly influenced by the wage-bargaining structures in a particular country, we should also keep in mind the policy feedback from government labor market policy and the broader welfare state structures. Scholars increasingly note that welfare state structures play a strong role in sustaining particular production regimes. Social programs provide individuals with incentives and capital for appropriate skill investments as well as nurture collective identities and conceptions of justice into which companies can tap.[23] The systems of production and welfare have co-evolved and continue to condition each other. The success of the learning organization might be the most recent example of this dynamic.

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[22] For an account that stresses such factors, see e.g. Piore, Michael J. , and Charles F. Sabel. 1984. *The Second Industrial Divide. Possibilities for Prosperity*. New York: Basic Books. A recent treatment of the Danish experience along these lines is Lundvall, Bengt-Åke. 2002. *Innovation, Growth And Social Cohesion: The Danish Model*. Cheltenham, UK: Edward Elgar.

[23] See e.g. these contributions: Estevez-Abe, Margarita, Torben Iversen, and David Soskice. 2001. Social Protection and the Formation of Skills: A Reinterpretation of the Welfare State. In *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, edited by P. Hall and D. Soskice. Oxford: Oxford University Press. Van Kersbergen, Kees. 1995. *Social Capitalism: A Study of Christian Democracy and the Welfare State*. New York: Routledge. Ebbinghaus, Bernhard, and Philip Manow, eds. 2001. *Comparing Welfare Capitalism: Social Policy and Political Economy in Europe, Japan and the USA*. London: Routledge.

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