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EQUALITY, EMPLOYMENT, AND BUDGETARY RESTRAINT

The Trilemma of the Service Economy

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INTRODUCTION

THE two decades since the late 1970s have seen significant changes in the economic structure of advanced democratic societies. Compared with the 1960s the level of unemployment has doubled or tripled in many countries, inequality has risen dramatically in others, and tighter fiscal constraints have reduced the capacity of governments to cope with these problems through expansion of the public sector.

The dominant approach to explaining this new "problem load" and the failure of governments to cope with it has been to look for causes in the global economy. Thus, (1) the internationalization of capital markets has been blamed for a reduction in the macroeconomic steering capacities of governments.[1] (2) Growing levels of transnational investment have been seen to strengthen the structural power of capital and undermine the capacity of governments to pursue distinct social and economic policies.[2] And (3) greater exposure to low-wage competition from newly industrializing countries has been said to produce a universal rise in the level of wage dispersion and/or unemployment.[3]

[1] See Fritz Scharpf, *Crisis and Choice in European Social Democracy* (Ithaca, N.Y.: Cornell University Press, 1991); Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, N.Y.: Cornell University Press, 1994).

[2] See Paulette Kurzer, *Business and Banking* (Ithaca, N.Y.: Cornell University Press, 1993); Wolfgang Streeck, "German Capitalism: Does It Exist ? Can It Survive ?" in Colin Crouch and Wolfgang Streeck, eds., *Political Economy and Modern Capitalism: Mapping Convergence and Diversity* (London: Sage, 1997).

[3] See Adrian Wood, *North-South Trade, Employment and Inequality* (Oxford: Clarendon Press, 1994); Edward E. Leamer, "A Trade Economist's View of U.S. Wages and 'Globalization'" (Paper presented at the Political Economy of European Integration Study Group Meeting, University of California, Berkeley, January 1996).

This paper advances a different explanation, one that places much greater emphasis on processes of economic transformation and political-institutional conditions at the national level. Although we do not claim that globalization is unimportant, we do contend that explanations focusing almost exclusively on this factor tend to overemphasize the salience of the internationally integrated manufacturing sector and underestimate the growing salience of the largely nontraded services sector. For example, in focusing on employment and wages in manufacturing, trade economists overlook the fact that the most important generator of jobs, especially at the low end of the wage scale, is in the nontraded services sector. Similarly, arguments about the transnationalization of investment are primarily relevant to manufacturing, since most services can be supplied only on location and not through trade. Finally, although integration of capital markets undoubtedly renders active Keynesian demand management less feasible, government policies toward public and private services (public employment, competition policies, and so on) are having a growing impact on employment outcomes.

In contrast to the globalization literature, this paper argues that the most important change in the advanced liberal democracies over the past three decades has been the transition from an economy dominated by (exposed) manufacturing production to one dominated by (sheltered) services production.[4] Borrowing from portions of the emerging literature on the postindustrial society, the paper develops a political-economic model of the service economy which implies that governments and nations confront a three-way choice, or "trilemma," between budgetary restraint, income equality, and employment growth. While it is possible to pursue two of these goals simultaneously, it has so far proved impossible to achieve all three. Private service employment growth can be accomplished only at a cost of wage inequality. Therefore, if wage equality is a priority, employment growth can be generated only through employment in the public services sector—at a cost either of higher tax rates or of borrowing (both implying lack of budgetary restraint).

In the paper we identify three possible strategies that governments can pursue in the face of the trilemma, and we outline the distributional

politics inherent in each. Our emphasis on the scope for political choice and hence political-institutional divergence stands in sharp contrast to most arguments about globalization, which imply convergence of policies and institutions. In addition, our focus on an important new set of distributional trade-offs, with its associated conflict over material issues, contradicts the hypothesis of Inglehart[5] and others that the transition to postindustrial society is accompanied by a decline in distributional politics.

The paper is organized into three sections. The first outlines the theoretical argument. The second uses sectoral-level data on wages and employment to test the existence of the trilemma empirically and to estimate the severity of the associated trade-offs. The third, a case-oriented exploration of the argument in Britain, Denmark, and the Netherlands, highlights the economic costs and political conflicts associated with each strategic response to the trilemma.

THE ARGUMENT: THE TRILEMMA OF THE SERVICE ECONOMY

THE ECONOMIC LOGIC

The expansion of manufacturing employment in the wake of the industrial revolution and continuing into the 1960s was a result of two main forces of change. First, the demand for manufactured goods was rapidly increasing as growing incomes allowed people to spend proportionally less money on necessities, such as food and shelter, and more on nonnecessities, such as consumer durables. Unlike agricultural commodities, therefore, demand for manufactures was income elastic—a condition known as Engel's Law. Second, because the perceived need for material goods was high, demand for manufactures was price elastic: lower relative prices translated into large increases in demand. The latter condition is important because it created a positive link between productivity growth, demand, and employment. As long as wage increases did not absorb the entire improvement in productivity in the most dynamic sectors of manufacturing, the resulting reduction in relative prices could support an expansion of employment in these sectors. In turn, rapid productivity growth permitted real wages to grow and thus secured expanding markets and rising employment. Empirically,

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[5] See Ronald Inglehart, *The Silent Revolution: Changing Values and Political Styles among Western Publics* (Princeton: Princeton University Press, 1977); and idem, *Culture Shift in Advanced Industrial Society* (Princeton: Princeton University Press, 1990).

these relationships were convincingly documented by Salter[6] and sub-sequently by other economists as well.[7]

In contrast to this golden age of industrial expansion, the period since about the early 1960s has been marked by decreasing income and price elasticity for manufactured goods. The decline is due to a combi-nation of market saturation and increasingly wealthy and choosy con-sumers who are more concerned with the quality than with the quantity of manufacturing consumption. Under these conditions increases in productivity will no longer result in sufficient increases in demand to compensate for their labor-saving effects. Appelbaum and Schettkat,[8] for example, have found a significant *negative* relationship between manufacturing productivity growth and employment in most OECD countries during the 1980s—a relationship that stands in sharp con-trast to the golden age of industrialization. As a consequence, manu-facturing wages keep improving while employment declines (just as was the case for agriculture in the first half of this century).

The decline in manufacturing has been accompanied by a shift in demand toward services, and in this sense the service sector has as-sumed the role previously played by manufacturing as the main source of employment growth. This fact is brought out clearly in Table 1, which shows the rate of growth in employment in manufacturing and services for thirteen OECD countries during the 1970s and 1980s. With few exceptions, manufacturing employment has declined or stagnated while service employment has been rapidly expanding. The rate of growth in service employment slowed down somewhat in the 1980s, but at the same time the decline in manufacturing actually accelerated, thereby leaving a gap in growth rates of roughly 3 percent. Considering the deep structural causes of declining manufacturing employment—market saturation and declining price elasticity of demand—it is hardly realistic to hope for sustained future employment expansion *except* through services.

The transition from a predominantly industrial economy to a service economy resembles the shift in sectoral employment that accompanied the transformation of the agrarian economy earlier in this century—but with one critical difference. Unlike the golden era of manufacturing,

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[6] W. E. G. Salter, *Productivity and Technical Change* (Cambridge: Cambridge University Press, 1960).

[7] For excellent expositions of the argument and the evidence, see Eileen Appelbaum and Ronald Schettkat, "The End of Full Employment? On Economic Development in Industrialized Countries," *Intereconomics* 29 (May–June 1994); and idem, "Employment and Productivity in Industrialized Coun-tries," *International Labor Review* 134, no. 4–5 (1995).

[8] Appelbaum and Schettkat (fn. 7, 1995).

TABLE 1

GROWTH OF EMPLOYMENT IN THIRTEEN OECD COUNTRIES BY
SECTOR AND DECADE

	Manufacturing		Services		Gap	
	1970–79	1980–89	1970–79	1980–89	1970–79	1980–89
Australia	−0.90	−0.25	2.37	3.63	−3.27	−3.89
Belgium	−2.35	−1.98	2.78	0.72	−5.13	−2.70
Canada	1.85	0.28	3.86	2.54	−2.01	−2.26
Denmark	−1.32	0.60	3.36	1.43	−4.67	−0.83
France	0.94	−1.23	2.35	2.15	−1.41	−3.38
Finland	0.07	−2.01	2.19	1.49	−2.12	−3.50
Germany	−1.13	−0.31	2.38	1.21	−3.51	−1.52
Japan	−0.35	1.28	2.64	2.55	−2.99	−1.27
Netherlands	−2.37	−1.48	2.11	1.05	−4.48	−2.54
Norway	0.08	−2.19	3.57	2.00	−3.49	−4.19
Sweden	−0.67	−0.22	2.75	1.34	−3.42	−1.56
United Kingdom	−1.52	−3.16	1.67	1.28	−3.19	−4.44
United States	1.07	−0.75	2.75	2.57	−1.68	−3.32
Average	−0.51	−0.88	2.67	1.84	−3.18	−2.72

SOURCE: OECD *International Sectoral Data Base* (fn. 25).

the most rapid growth in services has come in branches such as educa-
tion, health care, personal services, and what Esping-Andersen[9] calls
"food and fun" services, where productivity growth tends either to be
slow or to mask declining quality. Although it is notoriously difficult to
measure productivity in services and although there are obviously im-
portant differences across branches, the pathbreaking studies by Bau-
mol and Bowen[10] have generated broad consensus among economists
that service production is inherently less conducive to productivity
growth.[11] Teachers can serve more students, nurses more patients, and
waiters more customers, but this is not easily achieved without a decline

[9] Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University
Press, 1990).

[10] William Baumol, "The Macroeconomics of Unbalanced Growth," *American Economic Review* 57
(1967); and William J. Baumol and William G. Bowen, *Performing Arts: The Economic Dilemma* (New
York: Twentieth Century Fund, 1966).

[11] See, for example, Robert J. Gordon, "Productivity, Wages and Prices Inside and Outside of Man-
ufacturing in the U.S., Japan, and Europe," *European Economic Review* 31 (April 1987); and Bart Van
Ark, "Structural Growth Accounting and Structural Change in Post-War Europe," in Bart Van Ark
and Nicholas Crafts, *Quantitative Aspects of Post-War European Economic Growth* (Cambridge: Cam-
bridge University Press, 1996). There is also evidence for a productivity gap between services and man-
ufacturing in the sizable economic literature on the link between real exchange rates and differential
productivity growth across sectors. For recent contributions to this literature, see De Gregorio, Gio-
vannini, and Wolf (fn. 4); and Kenneth Rogoff, "The Purchasing Power Parity Puzzle," *Journal of Eco-
nomic Literature* 34 (June 1996).

in the quality of the service. Having said this, we hasten to add that productivity in services is not a moot issue. Organizational and sometimes technological factors can inhibit or advance the efficiency of service provision; and with manufacturing employment in decline, the question of how to promote service productivity is in a sense more important than ever.

Whatever the size of the productivity gap between manufacturing and the majority of services, the obvious consequence of the shift in demand toward the latter is that it becomes increasingly difficult to combine rising wages with lower prices. The virtuous circle between falling prices and rising real demand, as experienced during the expansion of manufacturing employment, is therefore broken. Instead, the most important source of market-generated expansion of employment in services, apart from the effects of changing consumption patterns, becomes lower wages, which translate into cheaper prices and higher effective demand. Consequently, if wages in services are tightly coupled with wages in manufacturing—where productivity growth is faster— private service production will contract Baumol's cost disease and employment expansion will be slowed down.

High growth in market-provided services—necessary to compensate for declining manufacturing employment—therefore presupposes a more *in*egalitarian wage structure. Whereas solidaristic wage policies in the industrial economy tended to shift production to the most efficient sectors where the scope of productivity increases was the greatest (as elegantly formulated in the Rehn-Meidner model),[12] solidaristic wage policies in the service economy tend to squeeze out the least productive workers without creating a compensating expansion in the overall level of activity. The effect of wage compression on employment has thus been reversed: in the past it promoted employment because it kept down relative wages in highly dynamic sectors facing price-elastic demand; in the present it inhibits employment because relative wages are kept high in the *least* dynamic sectors, which also face price-elastic demand.

THE SERVICE ECONOMY TRILEMMA

As pointed out by Esping-Andersen,[13] there are essentially two responses to this problem: (1) wages in services, especially in the lowest-

[12] Gösta Rehn, "Swedish Active Labor Market Policy: Retrospect and Prospect," *Industrial Relations* 24 (Winter 1985); Rudolf Meidner, *Co-ordination and Solidarity: An Approach to Wages Policy* (Stockholm: Prisma, 1974).

[13] Gøsta Esping-Andersen, *Changing Classes: Stratification and Mobility in Postindustrial Societies* (London: Sage, 1993); and idem, "The Eclipse of the Democratic Class Struggle? European Class

paid occupations, can be permitted to fall in order to lower prices and increase demand and employment, or (2) the government can assume the responsibility for employing workers at relatively high wages by expanding public sector consumption. The latter option, heavily favored by social democratic governments, has the obvious drawback that taxes and/or public debt must be increased to finance the growing public wage bill. Socializing production of services can also create difficult incentive problems that are liable to undermine economic inefficiency.[14] Budgetary restraint in the sense of no or only moderate government spending on services[15] is therefore difficult to combine with earnings equality and high employment in the emerging service economy. This set of trade-offs is what we call the "trilemma of the service economy," to borrow a term from Swenson.[16]

The argument is illustrated in Figure 1. Each of the three corners of the triangle is a desirable objective for economic policies, but at most two of these can be satisfied simultaneously. Because budgetary restraint precludes any rapid expansion of public sector employment, governments wedded to such discipline must either accept low earnings equality in order to spur growth in private service employment or face low growth in overall employment. Alternatively, governments may pursue earnings equality and high employment, but they can do so only at the expense of budgetary restraint.

The trilemma suggests three ideal-type political economies. We use Esping-Andersen's[17] designations of his three worlds of welfare capitalism to identify each type, although we caution that our use of the terms has a much narrower (and precise) meaning that is not directly concerned with the welfare state. In some respects our discussion will be closer to Kitschelt's[18] account of the tensions between the French Revolution's triple objectives of liberty, equality, and fraternity, though the main purpose of the typology is simply to elucidate the political dilemmas and choices associated with the economic trade-offs discussed above.

Structures at Fin de Siècle" (Paper presented to the study groups on Citizenship and Social Policies and State and Capitalism, Center for European Studies, Harvard University 1994).

[14] See Terry Moe, "The New Economics of Organization," *American Journal of Political Science* 28 (November 1984).

[15] Here and throughout the article the term "budgetary restraint" is used to indicate no or little government provision of services, and hence lower spending, taxes, and/or deficits.

[16] Peter Swenson, *Fair Shares: Unions, Pay, and Politics in Sweden and Germany* (Ithaca, N.Y.: Cornell University Press, 1989).

[17] Esping-Andersen (fn. 9)

[18] Herbert Kitschelt, *The Radical Right in Western Europe* (Ann Arbor: University of Michigan Press, 1995)
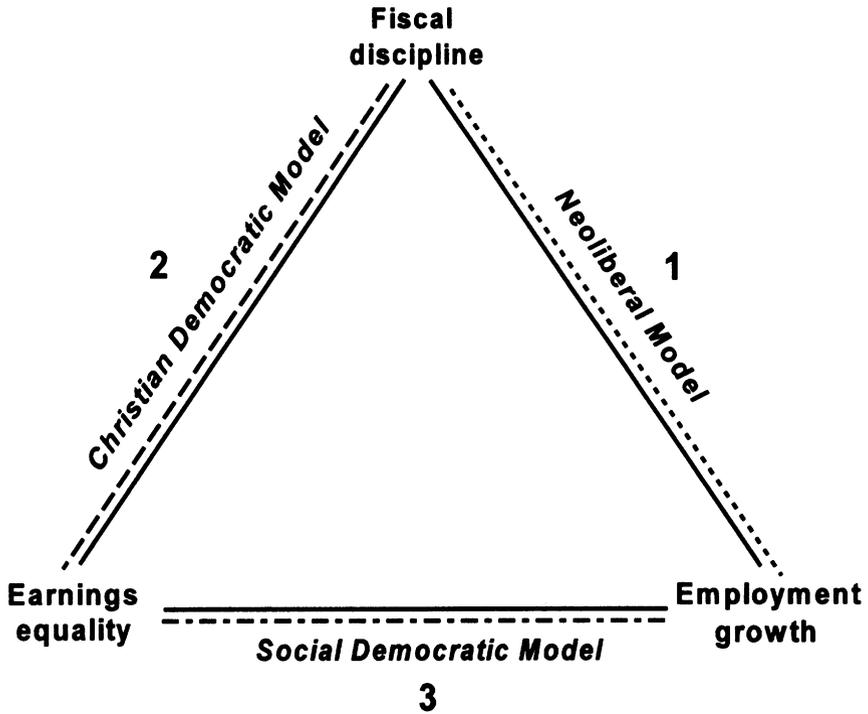
FIGURE 1
THE TRILEMMA OF THE SERVICE ECONOMY

The first ideal type is called neoliberal because market-generated in-
equality is traded for budgetary restraint and high private sector em-
ployment. Ideologically, this model is grounded in a belief that freely
operating markets are inherently welfare maximizing, whereas state in-
volvement in the economy leads to a misallocation of resources. The
neoliberal ideology is combined with a work ethic that underscores
self-reliance through active labor-market participation, while market
wages are seen to reflect the contribution of individuals to overall wel-
fare. In its pure form, the neoliberal model implies that policies inter-
fering with the free operation of markets, with the exception of a few
important public goods such as law and order, threaten the pursuit of
individual liberty.[19]

The second model also emphasizes budgetary restraint, but it places
greater weight on equality and less on individual self-reliance and free
markets than does the neoliberal type. This model has its origins in

[19] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

corporatist and Christian democratic thought where community, church, and family are seen as bulwarks against the dehumanizing and alienating effects of unfettered markets, as well as against the potential encroachments of state power on the independence and freedom of associational life.[20] Although society is recognized as inherently hierarchical and status differentiated, stark market-generated inequalities are seen as a potential danger to the social order. High employment levels, by contrast, are a relatively low priority in this model because women are viewed as the guardian of the traditional family and hence are encouraged to stay at home and care for children and spouse.

The third ideal type prioritizes earnings equality and high employment performance, but sacrifices budgetary restraint. This model has its origins in the European labor movement and in social democratic ideology, and it combines a strong egalitarian ethos with a work ethic that emphasizes employment as the root of collective identity and pride. Although social democratic parties, initially rising with the growth of a predominantly male blue-collar workforce, only gradually shed their traditionalist views on women and the family, modern social democratic parties have everywhere come to recognize women as equal partners in the social democratic project for solidarity and employment for all. Unlike the other models of society, social democracy sees the state as a necessary tool to achieve its egalitarian and full-employment objectives, and this has involved a certain measure of deliberate sheltering from the inegalitarian effects of the market through an expansion in public services and employment.[21]

We would like to underscore that the three ideal-type labor-market regimes are not logically exhaustive of all responses to the trilemma. Rather, they emerge through the interaction between the economic constraints defined by the trilemma and the political projects expressed in historically inherited ideological constructions. Conceived as an economic constraint, the trilemma undermines the viability of political projects that seek to achieve all three objectives simultaneously, but it does not logically preclude projects that seek to maximize a single

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[20] Kees van Kersbergen, *Social Capitalism: A Study of Christian Democracy and the Welfare State* (London: Routledge, 1995).

[21] It has been suggested to us that social democratic parties have a positive preference for expanding public provision of services and that budgetary restraint is therefore not a concern. We disagree for two reasons. First, despite the rhetorical commitment to socialization of production, mainstream social democrats recognize that such socialization creates incentive problems and economic inefficiencies. Second, public provision implies higher prices on services (paid through taxes), and although the median voter may willingly sacrifice lower prices to support a certain measure of equality, this represents a trade-off where the utility-maximizing level of provision and taxes places an electoral constraint on government spending policies. We are grateful to Geoffrey Garrett for helping us to clarify these issues.

goal—say, employment—or achieve only modest success on all accounts.

In order to understand the underlying causal dynamics that push countries to adopt different responses to the trilemma, and in order to understand the political-economic tensions inherent in each ideal type (as well as the possible strategic responses to these), one must pay close attention to the political coalitions, institutions, and political-economic constraints that support or challenge the perpetuation of any particular model. Thus, the neoliberal model draws its support primarily from the middle and upper middle classes in relatively secure labor-market positions, and it tends to exacerbate class distinctions (though not necessarily class organization), in what Jessop[22] has dubbed two-nations projects.[23] The model, while promoting job creation and low taxation, tends to perpetuate poverty and inner-city decay by trapping large numbers of people in insecure and poorly paid jobs.

The Christian democratic model facilitates more egalitarian labor markets by encouraging associational inclusion (hereunder unions) and by engaging in a consensual and often dense regulation of labor and product markets. The actual provision and administration of many services are delegated to private associations of businesses, workers, and professions that constitute the main pillars of support for the system. The downside of the model is its relative incapacity to generate well-paid jobs for all who are willing to work, thus producing problems of long-term unemployment and labor-market exclusion, especially among women and older workers. It is therefore no coincidence that much of the political economy literature on countries such as Germany and Austria is replete with references to insider-outsider divisions.

The social democratic model, finally, promotes equality and labor-market inclusion by encouraging solidaristic wage policies and by expanding job opportunities in the public sector. By emphasizing solidarity, employment for all, and labor-market security, support for the model extends from the working class well into the middle class.

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[22] Bob Jessop, *Thatcherism: A Tale of Two Nations* (Cambridge, England: Polity Press, 1988). The deep-seated Christian democratic suspicion of the state goes back to the "national revolution" in the eighteenth century, when church privileges were being challenged. See Seymor M. Lipset and Stein Rokkan, "Cleavage Structures, Party Systems, and Voter Alignments: An Introduction," in Lipset and Rokkan, eds., *Party Systems and Voter Alignments* (New York: Free Press, 1967).

[23] In the U.S. case, where the worst paid and most insecure jobs are concentrated among minority groups, ethnic divisions generate demands for labor-market regulations (such as affirmative action) that are clearly contrary to the neoliberal ideal of efficiency and self-reliance. See also the discussion of dualism in John Goldthorpe, "The End of Convergence: Corporatist and Dualist Tendencies in Modern Western Societies," in Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (Oxford: Clarendon Press, 1984).

Yet the escalating financial requirements of the social democratic state engender tax revolts and divisions between public and private sector employees. In addition, by sheltering a large portion of service production from market competition, the model is liable to create pockets of inefficiency and undermine international competitiveness through high taxation. When these constraints on fiscal expansionism become narrow, the trilemma turns into a difficult dilemma for social democracy: governments can choose either to promote wage flexibility and deregulation/privatization of services (a neoliberal tool for employment expansion) or to encourage labor-market exit through early retirement, work sharing, and policies that encourage women to stay at home (a Christian democratic recipe).

The basic logic of our argument can be readily illustrated with some comparative data (see Table 2). For each country there are three rows of data: one for private services sector employment, one for public sector employment, and one for wage equality. Note that equality, as well as the magnitudes and composition of services sector employment growth, differs sharply from country to country. The social democratic–dominated Scandinavian countries have the most egalitarian wage structures, while private services employment has been stagnant. Public sector employment, however, rose rapidly during the 1970s and the early 1980s, causing a substantial increase in public spending (more than 70 percent of all government consumption goes to paying wages). By contrast, in countries such as the United States and Britain, where neoliberal policies for privatization and deregulation held sway during the 1980s, employment in private services rose rapidly while public sector employment and consumption remained largely unchanged. Not surprisingly, these are also the countries in the table with the most inegalitarian wage structures and the only countries that display an increase in inequality during the 1980s. Finally, in two countries where Christian democratic parties have been dominant, Germany and the Netherlands, service employment has been stagnant in *both* the public sector (as in the neoliberal countries) *and* the private sector (as in the social democratic countries). These countries have instead performed well in terms of holding back public consumption and taxes (budgetary restraint) and maintaining a relatively egalitarian earnings structure.

As the discussion in this section is intended to convey, we categorically reject the notion that the rise of the service economy is tantamount to a decline in distributive politics. Neoliberal solutions impose the costs of a rising private service economy on people who cannot afford even modest health care insurance or adequate education for their

TABLE 2

SERVICE EMPLOYMENT, GOVERNMENT EMPLOYMENT, AND
WAGE EQUALITY IN SIX OECD COUNTRIES
(1970–89)[a]

		1970–74	1975–79	1980–84	1985–89	Change
Denmark	private services	20	21	20	21	1
	public services	15 (21)	18 (24)	22 (27)	22 (25)	8 (4)
	wage equality	—	71	71	71	1
Sweden	private services	19	20	20	22	2
	public services	17 (23)	22 (27)	25 (29)	26 (26)	9 (3)
	wage equality	75	76	76	75	1
Britain	private services	20	22	23	27	7
	public services	13 (19)	15 (21)	15 (22)	14 (20)	1 (1)
	wage equality	—	60	59	56	−4
United States	private services	26	27	30	34	9
	public services	10 (18)	11 (17)	10 (18)	11 (17)	0 (−1)
	wage equality	—	54	51	49	−5
Netherlands	private services	21	21	21	21	0
	public services	7 (15)	8 (17)	8 (15)	7 (17)	0 (2)
	wage equality	—	—	65	65	0
Germany	private services	17	18	18	19	2
	public services	8 (17)	9 (20)	10 (21)	10 (20)	2 (3)
	wage equality	—	—	60	64	4

SOURCES: OECD *International Sectoral Data Base* (fn. 25); and OECD *Employment Outlook* (Paris: OECD, 1991, 1996).

[a]*Private services* refers to total employment (excluding transport and communication) as percentage of the adult population; *public services* refers to total government employment as percentage of the adult population (first entry), and total government consumption as a percentage of the GDP (in parentheses); *wage equality* is measured as the ratio of gross earnings of a worker at the bottom decile of the earnings distribution relative to the worker at the median (d1/d5 ratios). *Change* is the difference between the first and last period.

children; consequently, such solutions perpetuate class divisions. The Christian democratic model, by its very emphasis on delegated associational self-regulation, fails to provide adequate employment opportunities for all who want to work and thereby breeds labor-market exclusion and resentment among the outsider classes. The social democratic model, finally, generates its own set of political divisions by pitting the interests of public and private sector workers against each other.[24] Thus, while postmaterialism may be a concept that usefully re-

[24] Peter Swenson, "Labor and the Limits of the Welfare State," *Comparative Politics* 23, no. 4 (1991). See also Geoffrey Garrett and Christopher Way, "The Sectoral Composition of Trade Unions, Corporatism and Economic Performance," in Barry Eichengreen, Jeffry Frieden, and Jürgen von Hagen, eds., *Monetary and Fiscal Policy in an Integrated Europe* (New York: Springer, 1995).

flects some aspects of electoral politics and although traditional blue-collar class politics is clearly in decline, the rise of postindustrial society does not imply a decline of, let alone an end to, materialist (or, if one prefers, class) politics. The remainder of this article supports this thesis by empirically demonstrating the political-economic trade-offs inherent in the trilemma and by highlighting the political struggles associated with each of the trade-offs.

Exploring the Argument: Quantitative Evidence

In mapping out the distinct political responses to the trilemma, each goal variable can be treated identically. In testing the argument, however, it is important to be clear about the underpinning causal structure. In particular, the economic argument implies that the expansion of service sector employment is negatively affected by both wage equality and budgetary restraint. In contrast, we are *not* saying that equality and restraint can be explained by changes in service employment (or by one another). Although we will allow for recursive causation in the statistical analysis, our aim is not to explain wage equality and public manpower policies. Instead, we treat these as policy instruments.

In the case of public employment, this argument is straightforward, since the government (subject to the usual parliamentary constraints) can directly employ people to perform public service functions. In the case of earnings equality, the role of the government is more complex and indirect, but it can clearly exert a substantial influence over the wage structure. As we discuss in the case-oriented section, minimum-wage legislation, mandatory employer social contributions, automatic cost-of-living adjustments, collective bargaining extension laws, and a host of regulatory measures that affect the strengths of unions (as well as the pressure on employers to compete on the basis of wage costs) can have notable consequences for relative earnings. We obviously do not dispute that other factors are important, but we do maintain that the government can have a sufficiently strong impact on the earnings structure such that it is informative to treat earnings equality as an instrumental variable.

Data and Operationalizations

One of the few data sources on the service sector is a recent study by the OECD[25] containing earnings and employment data for both manu-

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[25] OECD, *The OECD International Sectoral Data Base* (Paris: OECD, 1993).

facturing and private and public services in thirteen OECD countries.[26] The study includes annual wage and employment data for about thirty branches of industry and services in the period from 1970 to 1990.[27] Despite the somewhat limited country coverage, this is by far the most comprehensive source for economic data on the service economy.[28]

One class of services—transport, storage, and communication—is historically so closely integrated with manufacturing that it is unclear whether it should be counted as a service.[29] Fortunately, the employment changes in this sector are so similar across countries that it does not matter much for the results whether this category is treated as a service sector or a manufacturing sector. We therefore simply excluded it from the analysis. A second category of services—finance, insurance, real estate, and business services—had to be excluded because of incomplete data.[30] To gauge the consequences of this exclusion, we examined the data for countries using compatible definitions and failed to find any apparent relationship between the wage structure and employment in this sector. The reason may be that some of these services are more traded and knowledge-intensive than most others. This in turn could afford opportunities for countries to specialize in high-value-added services—perhaps the most promising path out of the trilemma. However, when a poor performer (Japan) is removed from the sample, the negative relationship between equality and employment reappears in this sector.[31]

[26] The thirteen countries are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Japan, the Netherlands, Norway, Sweden, the United Kingdom, and the United States. The study also includes Italy, but that case presents intractable data problems. Our suspicion was raised by the results for wage dispersion, which indicate that dispersion in Italy is nearly twice that of the country with the next highest score. In view of other data pointing to a relatively compressed wage structure, this is simply inconceivable; see Robert Rowthorn "Corporatism and Labour Market Performance," in Jukka Pekkarinen, Matti Pohjola, and Bob Rowthorn, eds., *Social Corporatism* (Oxford: Clarendon Press, 1992); and Jonas Pontusson "Labor Market Institutions and Wage Distribution," in Torben Iversen, Jonas Pontusson, and David Soskice, eds., *Unions, Employers and Central Banks: Wage Bargaining and Macroeconomic Regimes in an Integrating Europe* (Cambridge: Cambridge University Press, forthcoming). As it turns out, some sectors have wages that are much higher but employment that is much lower than in comparable countries. This suggest that some of the wage data in Italy refer to small and relatively well-paid segments of all employees in certain sectors. In lieu of detailed documentation that could help us to pinpoint the problems, we had to exclude the Italian case.

[27] Some data are also available for 1990–92, but they are incomplete.

[28] For a fairly detailed account of sources and methods, see Meyer-zu-Schlochtern, *An International Sectoral Database for Thirteen OECD Countries*," Economics and Statistics Department Working Paper (Paris: OECD, 1988).

[29] This similarity also holds for the tradedness of this sector. See De Gregorio, Giovannini, and Wolf (fn. 4).

[30] For some countries only a subcategory is available, while for others data are provided only for the whole sector.

[31] The effect of excluding Japan points to another methodological problem, since it is well known that many financial and producer services are provided in house in Japan and counted as manufactur-

All told, the services that we were able to include in our analysis —
wholesale, retail trade, restaurants and hotels, community, social and
personal services, and a wide range of publicly provided services—ac-
count for about 80 percent of total service employment, and they in-
creased their share of total employment from about one-third in 1970
to about one-half in 1989. This shift occurred as a result of a 53 per-
cent increase in the number of people employed in these sectors
(amounting to more than 3.5 million workers), while employment in
the rest of the economy declined. It is also noteworthy that wages in
the private services we include were everywhere significantly *below* the
level of earnings for the economy as a whole (20 percent on average).
Much of the expansion in private service employment thus seems to
have come in relatively low-paid occupations.[32]

Considering the salience of the services that we include for the
growth of employment in the 1970s and 1980s, understanding the
causes of this growth would tell a very important part of the story about
the rise of the service economy. Specifically, since we are interested in
explaining cross-national variance in the rise in services employment,
we use period changes (first differences) in the employment ratio as a
dependent variable, that is, the total number of employees in services as
a proportion of the working-age population.[33] The periods are defined
as three-year intervals that are short enough to capture interesting vari-
ance in the rate of change across time, yet long enough to reduce the
impact of short-term fluctuations unrelated to our theoretical argu-
ment.[34] This gives us a total of ninety-one observations (thirteen coun-
tries times seven periods).[35]

The earnings equality measure is based on the standard deviation of
earnings across all sectors of an economy, divided by the overall mean of
earnings.[36] For example, an earnings dispersion of 0.2 means that one

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ing, whereas in countries like Britain and the U.S. outsourcing has been very widespread since the early
1980s. See Stephen S. Cohen and John Zysman, *Manufacturing Matters* (New York: Basic Books,
1987), chap. 4.

[32] It is not clear that it is meaningful to assess public growth sectors in terms of their wage rates
since these are politically determined; see Garrett and Way (fn. 24). Yet in countries where public em-
ployment grew fast, public wages were generally lower than in the rest of the economy.

[33] The employment *ratio* is distinct from the more familiar concept of the employment *rate* (the
number of employees divided by the total labor force). While the latter is highly correlated with the
former, we are primarily interested in the capacity of the economy to generate jobs for those in the
working-age population, not just for those registered as seeking employment

[34] A more practical reason is that some pairs of figures are identical, suggesting that these are not
truly independent observations.

[35] Because we used lagged variables in the regression analysis, the effective number of cases is re-
duced to seventy-eight.

[36] The branch-level data are nearly complete for twelve of the thirteen countries; for Australia earn-
ings data are missing for several sectors. In order to obtain comparable earnings equality figures for

standard deviation of earnings is equivalent to 20 percent of average earnings. For our purposes this dispersion measure is preferable to the more familiar earnings decile ratios reported in Table 2 because it eliminates problems of limited time coverage and because it is not affected by the number of people employed in high- and low-wage sectors (which is part of the employment performance to be explained).[37] In order to measure earnings *equality* (rather than dispersion), we inverted the dispersion variable so that higher values imply higher equality. The earnings data are based on OECD's figures for gross earnings per employee, which include both wages and nonwage benefits (such as pensions and social security contributions).

The other policy instrument, public employment, is simply the number of people employed directly by the government to perform public services (including teachers, nurses, postal workers, and so on). To gauge the effect of public manpower policies on budgetary restraint, we devised a variable that is the inverse of the change in total public outlays for wages as a proportion of the gross domestic product. A value of 0.02 on the budgetary restraint variable means that government spending on wages and salaries as a proportion of GDP was reduced by 2 percent between two periods. If the measure is negative, it means that spending is rising faster than the GDP and consequently that the public services sector is expanding as a share of the total economy. Holding all other public expenses constant, a negative value would imply rising taxes and/or growing deficits.[38]

DESCRIPTIVE STATISTICS

Our expectation is that high earnings equality will inhibit expansion of employment in the private service sector. The scatterplot in Figure 2 lends preliminary support to this hypothesis by indicating a fairly tight negative fit between earnings equality and change in the private service

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this country, we first calculated the level of equality in all countries based on the restricted set of branches available for the Australian case. Using the relative levels of Australian earnings equality (measured against overall annual means), we then inferred the absolute levels from figures calculated on the basis of all branches in the twelve remaining countries. The procedure assumes that relative earnings equality in Australia is the same for the full set of branches as for the restricted set, an assumption that would appear fairly innocuous.

[37] In a related paper we show that the trade-offs between earnings equality and employment also hold when using decile ratios. See Anne Wren and Torben Iversen, "Choosing Paths: Explaining Distributional Outcomes in the Post-Industrial Economy" (Paper presented at the annual meeting of the American Political Science Association, Washington D.C., August 28–31, 1997).

[38] On average, the government wage bill constituted 14 percent of GDP in 1985, which is equivalent to about three-fourths of total civilian government consumption and somewhat less than half the total average government budget (the rest going to military spending and a variety of subsidies and transfer programs).
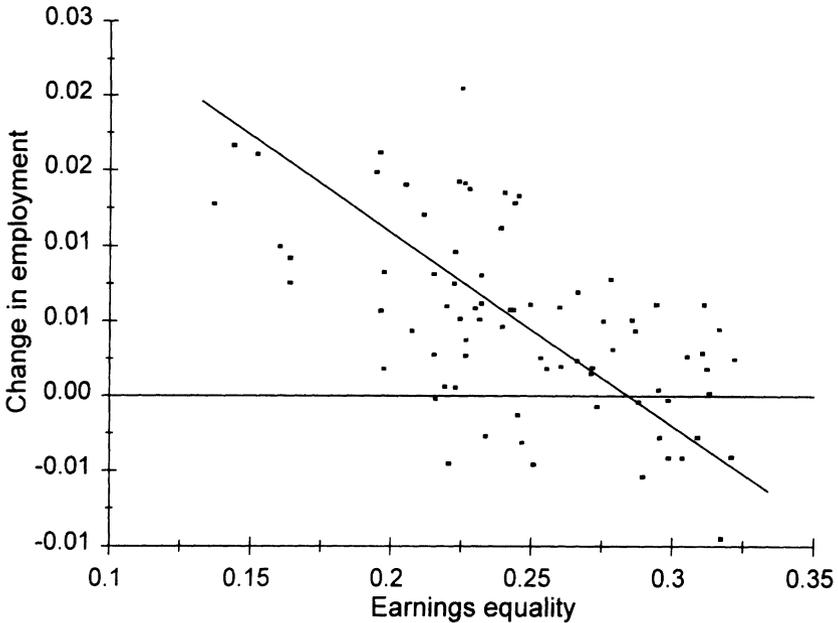
FIGURE 2
EARNINGS EQUALITY AND CHANGE IN PRIVATE SERVICE EMPLOYMENT

employment ratio. Clearly, the argument passes this initial test, although we do not want to exaggerate the determinism of the relationship. Not only should one be cautious in drawing causal inferences from bivariate correlations, but there is also obviously room for variation in the severity of the trade-off. In fact, our theoretical discussion implies that greater capacity for productivity growth in services would expand employment opportunities and thus shift the equality-employment schedule outward. Hence, a whole range of nationally specific trade-offs may be represented simultaneously in Figure 2.[39]

It is instructive to compare this pattern with that in manufacturing (Figure 3). For this sector there is *no* apparent relationship between employment and earnings equality, thus supporting the Rehn-Meidner argument that linking wages in low- and high-productivity firms enables redundancies in the former to be compensated for by expansion

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[39] There is an analogy here to the second-generation literature on the Phillips curve, which likewise allowed for differences in the location of the trade-off between unemployment and inflation depending on national institutions (especially wage-bargaining institutions). Unlike this literature, however, our argument is not vulnerable to the rational expectations critique.
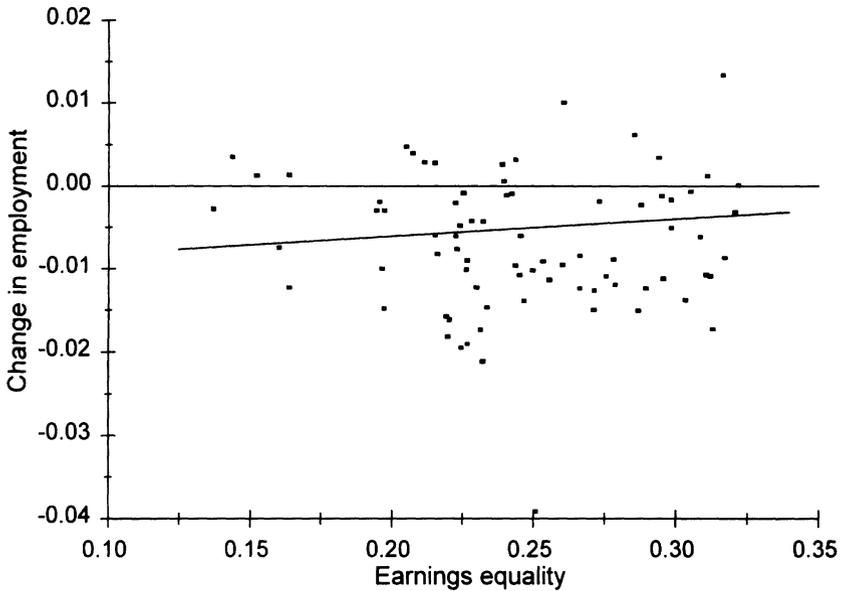
FIGURE 3
EARNINGS EQUALITY AND CHANGE IN MANUFACTURING EMPLOYMENT

of employment in the latter. In the past the promotion of wage equal-
ity, by inducing faster productivity growth, may even have led to an ex-
pansion of aggregate employment (especially if accompanied by active
labor-market policies).[40] In the rising service economy, however, this
logic no longer applies.

As argued above, governments can compensate for the cost of equal-
ity in terms of lower capacity of the private service sector to expand by
increasing public sector employment. However, such expansion obvi-
ously comes at the expense of a rising wage bill and thus of a reduction
in budgetary restraint. As noted above, lack of restraint has to be paid
for in the form of either rising public deficits and debt or higher taxa-
tion. The relationship is illustrated in Figure 4, which plots budgetary
restraint against changes in public employment as a proportion of the
total working-age population (measured analogously to private service
employment).

[40] The argument by trade economists that competition from low-wage countries has created a
negative link between wage equality and manufacturing employment would make the equality-
employment trade-off in the trilemma even more severe; see Wood (fn. 3); Leamer (fn. 3). However,
we do not find any evidence in the data that this has occurred.
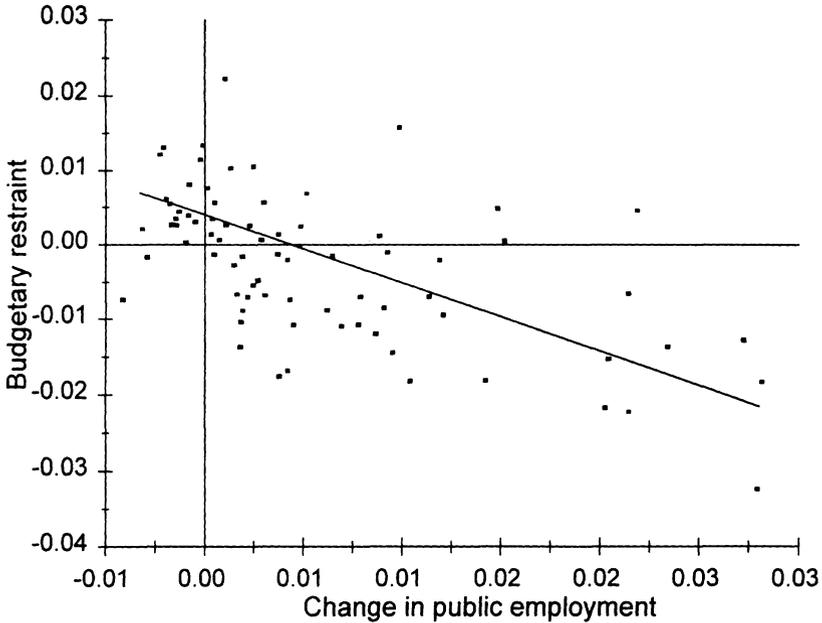
FIGURE 4
CHANGE IN PUBLIC EMPLOYMENT AND BUDGETARY RESTRAINT

Not surprisingly there is a clear negative relationship between a change in public sector employment ratios and budgetary restraint. However, the coupling is not as tight as one might have suspected. The main reason is that the price of labor is a variable that determines the budget effects of employment expansion. Although ceteris paribus an expansion of employment levels *must* result in higher expenditures, an effective policy of public sector wage restraint can greatly reduce the fiscal pressures resulting from such expansion. This points to the importance of the institutional setting for wage setting in the public sector—a topic that has received relatively little attention in the comparative political economy literature.[41]

MODEL SPECIFICATION AND ESTIMATION

Because we are interested in explaining change in employment and because the modeling of the level of employment variable has unit roots, we use an error correction model. Moreover, since it is reasonable to

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[41] Important exceptions are Garrett and Way (fn. 24); and Swenson (fn. 24).

expect the sectoral composition of employment to exhibit equilibrium qualities over time, an error correction model is well suited to capture long-term relationships (in addition to offering an intuitive interpretation of the short- and medium-term dynamics).[42] The model has the following form:

$$\Delta\ Employment(t) = \beta_1 \cdot Employment(t-1) + \beta_2 \cdot Equality(t-1) +$$
$$\beta_3 \cdot \Delta\ Equality(t) + \beta_4 \cdot Government(t-1) + \beta_5 \cdot \Delta\ Government(t) +$$
$$controls + \varepsilon$$

where $Employment(t)$ is the ratio of total (service sector) employment at time t, $Equality(t)$ is the level of earnings equality at time t, $Government(t)$ is the level of government employment at time t, and Δ is the first difference operator.

The use of both levels and changes of the earnings equality variable permits a very straightforward interpretation of causal effects. Thus, the coefficient on the lagged level of equality measures the long-term or *permanent* effect on employment of an increase in equality, whereas the coefficient for the first difference indicates the short-term or *transitory* effect of such an increase.[43] We should note that the independent variables in the model include both the level and the change in government employment, even though, by definition, public employment constitutes a portion of the change in total service employment. The reason is that public employment decisions may not be fully carried over into service employment outcomes (which would affect the trilemma). It is common in new classical economics, for example, to argue that raising public sector employment will crowd out private sector employment, thereby increasing the costs of using public manpower policies to regulate total employment. By including these variables, we want to control directly for potential crowding-out effects.

A special issue concerns the possible role of recursive causation, since it is conceivable that change in equality is affected by changes in employment. For example, rapid growth in employment could improve demand for the low paid, thereby raising low wages and overall wage equality. To take account of this possibility, we employ a two-stage least squares regression model with change in equality treated as an endogenous variable.[44] All regressions were executed with a full set of dummies

    [42] For details, see Nathaniel Beck, "Comparing Dynamic Specifications: The Case of Presidential Approval," in James Stimson, ed., *Political Analysis* (Ann Arbor: University of Michigan Press, 1992).
    [43] Ibid.
    [44] Only *change* in equality should be treated as an endogenous variable since change in employment at time t cannot affect equality at time t-1. We estimated the instrumental variable for change in equality by using all exogenous variables (both levels and change) except country dummies. Country dummies were left out to avoid problems of multicollinearity in the second-stage regression.

TABLE 3

THE DETERMINANTS OF EMPLOYMENT RATIOS AND
BUDGETARY RESTRAINT[a]

	Dependent Variables					
	Change in Services Employment Ratio		Change in Manufacturing Employment Ratio		Budgetary Restraint	
	b	t	b	t	b	t
Intercept	0.047***	3.36	0.051***	3.99	0.115***	3.85
Lagged dependent level variable	−0.134*	−1.88	−0.147*	−1.93	−0.523***	−3.58
Lagged earnings equality	−0.093***	−3.13	−0.047**	−2.29	−0.032	−1.14
Change in earnings equality	−0.474***	−2.63	−0.072	−0.61	−0.030	−0.52
Lagged public employment	0.067	0.84	—	—	−0.307***	−3.04
Change in public employment	1.197***	9.70	—	—	−0.924***	−3.26
Growth of productivity in services	0.000	0.24	—	—	−0.033	−0.94
Growth of productivity in manufacturing	—	—	−0.076***	−7.12	—	—
Trade	0.020	1.29	0.046***	2.79	0.009	0.42
Capital market liberalization	−0.038	−0.55	−0.158**	−2.26	0.029***	3.68
International capital flows	−0.006	−1.64	0.001	0.17	−0.005	−1.66
Economic boom	0.003***	7.23	0.004***	7.26	0.237***	2.79
Adjusted R-square	0.85		0.73		0.67	
Number of cases	78		78		78	

* Significant at a .10 level; ** significant at .05 level; *** significant at .001 level (two-sided tests with panel-corrected standard errors)

[a] Results are from a two-stage least squares regression, including the listed variables plus a full set of country and period dummies (not shown).

for both countries and time periods since F-tests indicated that these belonged in the model.[45] The substantive results are very similar, however, whether or not the dummies are included.[46] The results using both equality measures are shown in Table 3. In interpreting the findings,

[45] Durbin's h and m tests did not indicate problems of serially correlated error terms.

[46] In fact, while the parameters are nearly identical, the t-scores for the theoretical variables (especially equality) are considerably increased if the dummies are excluded. (The ones reported in Table 3 can thus be considered lower bounds.) However, excluding the dummies has the unfortunate consequence of rendering the model no longer stationary, because different country intercepts affect the

begin by noting that earnings equality has a statistically highly signifi-
cant *negative* effect on service sector employment. Part of the effect is
transitory, but there is also a large permanent effect, which implies that
a particular level of wage equality greatly affects the capacity of labor
markets to adapt to changing supply-and-demand conditions (here
primarily the capacity to absorb the flow of labor from the manufactur-
ing sector). In substantive terms, a standard deviation increase in equal-
ity leads to 12, 14, and 16 percent reductions in the employment ratio
after 1, 3, and 6 periods, respectively (short-term losses are consider-
able due to a large transitory effect). In several of our countries this
translates into hundreds of thousands of workers, posing difficult em-
ployment problems in a deindustrializing economy.[47]

The parameter for change in public sector employment is close to
unity, which implies that public sector hiring is not causing any imme-
diate displacement of private sector employment. Over time the em-
ployment effect from government hiring slowly dissipates, but our
simulations suggest that the crowding-out effects are so gradual that
the government can compensate through new hiring without raising
spending as a proportion of the total economy.[48] In turn, this gradual
rise in government employment is sufficiently small that it does not ap-
pear to outpace population growth, allowing the public employment
ratio to settle at a stable level after a targeted increase.

In the short to medium term the government may also be able to in-
fluence employment performance through active macroeconomic poli-
cies. To allow for this possibility, we devised a variable, called "economic
boom," which measures changes in the differences between OECD's es-
timates of national equilibrium rates of unemployment (called NAIRUs)
and the actual rates of unemployment. If governments differ in their
use of macroeconomic instruments and if these instruments are indeed

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estimated parameter for the lagged dependent variable. Fortunately, multicollinearity problems are not
severe enough to preclude the use of a full set of dummies.

[47] Our interindustry measure of wage equality refers to the economy as a whole, which raises the
logical possibility that the employment effect of equality is an unexplained consequence of wage level-
ing within manufacturing. To check this we tried to control for the level of interindustry equality
within manufacturing. This did not substantially affect either the parameters or the t-scores. The pa-
rameter for economy-wide wage equality was in fact slightly raised, to -0.104, while the parameter for
intramanufacturing leveling was small, positive, and statistically insignificant. All other parameters
were essentially unchanged. In other words, what seems to matter is the degree to which wages in ser-
vices are tied to wages in manufacturing—precisely what the theory tells us.

[48] These simulations are logically simple (they simply employ the regression results reported in Table
3), but they are computationally quite complex because of the need for backward induction in the pres-
ence of permanent and transitory effects in three separate equations. We have devised a spreadsheet
program to make the calculations more manageable; this program is available from the authors upon
request.

effective, the effect should be revealed in the form of deviations from the NAIRU rate of unemployment.[49] Deviations may of course also be caused by swings in the economic business cycle, but either way the effects are exogenous to our model and should be controlled for. As it turns out, economic booms— whether politically engineered or resulting from swings in the business cycle—*do* improve employment performance, but the effects are cyclical and do not affect our main conclusions.

We also tested for the potential effects of globalization, using three separate indicators. The first measures trade exposure and is the sum of exports and imports as a proportion of GDP, the second seeks to capture capital-market liberalization by the relative absence of capital controls, and the third is a measure of the actual cross-border flows of capital as a proportion of GDP.[50] All variables are in the form of first differences, since we want to assess the effect of *increasing* internationalization on *changes* in employment. Looking first at service employment, none of these variables have notable (or statistically significant) effects. This is hardly surprising, given that there are no compelling reasons to expect internationalization to affect employment in sectors that are largely sheltered from processes of globalization. In manufacturing, capital-market liberalization is negatively associated with employment, but actual capital mobility has no discernible effect, and trade appears to improve performance. While it is unclear why openness of capital markets but not actual movement of capital should affect employment, the positive effect of an increase in trade can be explained by the fact that domestic markets are effectively being enlarged by such trade.

The strongest effect of capital-market liberalization is clearly on budgetary restraint (see the third column in Table 3). It does indeed appear that in the absence of restrictions on capital movement governments feel pressed to be more fiscally conservative, probably because of the higher costs of running deficits. To the extent that governments can

finance higher consumption through taxes, however, capital-market integration should not pose a problem. Compared with the sometimes grandiose claims for the negative effects of globalization on all aspects of the domestic economy, our results therefore point to a more cautious position. While capital-market liberalization clearly places constraints on deficit-financed fiscal expansionism, it has little effect on employment, and trade seems to improve performance in manufacturing. Most importantly, the engine of employment growth over the past three decades—services—appears to have been largely unaffected by trends toward greater globalization.[51]

An important issue concerns the employment effects of productivity growth. Unfortunately, the measurement of productivity in services is marred by methodological difficulties. Since there is no international market for most services, the price of an identical service can vary considerably across countries, making simple indicators of output per employee highly misleading. The problem is somewhat alleviated by our focus on productivity *growth*, since this requires only reliable comparisons across time. Nevertheless, since output per employee will necessarily incorporate increases in both underlying productivity *and* the cost and price of a service, comparisons of trends are problematic. The main difficulty is that while we expect underlying productivity to be positively related to employment, cost-push induced price increases must necessarily be negatively related to employment. The *net* effect (as measured by output per head) therefore depends on the strength of these opposite forces.

Nevertheless, although a negative value would tell us little about the "true" employment effect of productivity (it could be negative, zero, or positive), a zero or positive effect would suggest that productivity had at least *some* employment-enhancing consequences (since all movements in cost conditions imply a negative relationship). To examine this possibility, we incorporated a variable for the average output per employee across all services. It turns out that the effect of this variable is indistinguishable from zero (and positive), which suggests that the true underlying rate of productivity growth is employment augmenting. But even if one does not buy the assumptions underlying this interpretation, the absence of a negative effect is important in itself because it implies that the pressure for greater wage inequality can be alleviated through higher services productivity *without* generating negative employment effects.

[51] Data on the tradedness of services also show no signs of growth. See De Gregorio, Giovannini, and Wolf (fn. 4).

The output per head measure is also useful because it helps verify the existence of a gap in productivity between services and manufacturing —a gap that we have argued is a major source of the tension between equality and employment growth. Although the measurement for services productivity may be exaggerated, a comparison of the growth in output per head in the two sectors shows that it is much lower in services than in manufacturing. Thus, whereas output per head increased by an average of about 1 percent in services, it increased by an average of well over 3 percent in manufacturing—a pattern that is consistent across countries and time.[52] This being the case, the infeasibility of hiring at low wages in the case of an inflexible and compressed wage structure would raise the relative prices of services and hence reduce demand and employment (the magnitude of which depends on the elasticity of demand).

In testing our theoretical argument, an important question is how wage equality and productivity affect employment in manufacturing. The results (shown in the second column of Table 3) stand in sharp contrast to those in services. Thus, while the effect of wage equality is substantially smaller (though statistically significant), productivity has a strong and significant *negative* effect on employment. When we included a control for intramanufacturing equality, the coefficient for economy-wide equality dropped only slightly, but the coefficient for intramanufacturing equality turned out to be statistically and substantively indistinguishable from zero. In other words, much of the negative effect of equality for manufacturing employment turns out to be a consequence of the linking of wages across sectors rather than across manufacturing industries.[53] Interindustry wage leveling within manufacturing therefore does not seem to be a problem for employment, a result that is consistent with the Rein-Meidner model. When this result is juxtaposed to the results for private services, there emerges a clear pattern that is unambiguously supportive of our theoretical argument: wage equality reduces employment growth in services but not in manufacturing, while productivity growth is labor saving in manufacturing but not in services.

[52] These figures are similar to those estimated in one of the most comprehensive studies of productivity by Gordon (fn. 11), 714–16. Gordon finds that services productivity lagged manufacturing productivity in Europe and the U.S. by a factor of about 2–4 from the early 1970s to the mid-1980s. The gap was greater for Japan.

[53] A likely reason is that high-productivity workers in manufacturing will seek to recapture the "productivity rent" by raising real wages, with deleterious consequences for competitiveness and employment. This is similar to the argument by Garrett and Way that cross-sectoral coordination of wages undermines wage restraint and competitiveness (fn. 24).

Turning now to our third dependent variable, budgetary restraint, it is hardly surprising to discover that increasing public sector employment reduces the government's capacity to exercise restraint (see the third column of Table 3). Yet the statistical model leaves a considerable amount of unexplained variance. While it is not obvious that this should be the case, it *is* obvious that the only source of this variance—given the definition of budgetary restraint—is differences in the cost of labor. Although it is not central to the argument, we conjecture that differences in the public wage formation process have important fiscal consequences (given that most of the variance in labor costs is between countries). Effective public sector wage policies and well-designed institutions for public sector wage bargaining would therefore appear to be critical for an effective public employment policy.[54]

Our findings section can be summarized in terms of the trilemma by treating public employment and earnings equality as policy instruments. Thus, the results for service employment make it possible to estimate performance under different assumptions about policy choices, and through backward induction we can estimate the policies required to bring about a particular combination of employment performance and equality/restraint.[55] Thus, Figure 5 illustrates the consequences of high performance on two dimensions in the trilemma for the value on the third. The examples correspond to the three ideal types discussed above, and for each model the policy goals that are highly valued (indicated by double lines) have been set to one standard deviation above their mean. The implication for the third is then calculated in terms of both its absolute value and the number of standard deviations by which it differs from *its* mean.

The main cost of pursuing a neoliberal strategy—that is, combining budgetary restraint with high employment in the private sector—is substantially lower earnings equality. Thus, the estimated level of equality in this scenario is 2.1 standard deviations below the mean. Because the wage structure affects only private service employment, the distribution of earnings has to be highly inegalitarian in order to achieve high overall employment performance, while making up public employment losses necessitated by budgetary restraint. The U.S. comes closest to the neoliberal ideal type, although even in the U.S. case, earnings are somewhat less inegalitarian and performance on the employ-

[54] For a similar argument, see Scharpf (fn. 1), chap. 10.

[55] As noted above, these simulations are logically straightforward but computationally complex. Readers who would like to make similar simulations on results derived from the same or different data can acquire a simple but useful spreadsheet program from the authors.

a) The Neoliberal Model
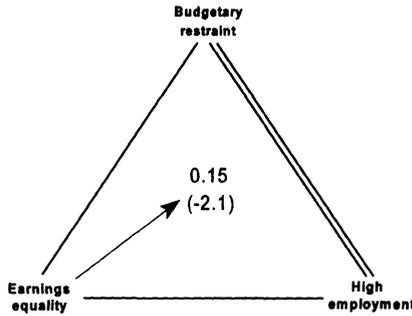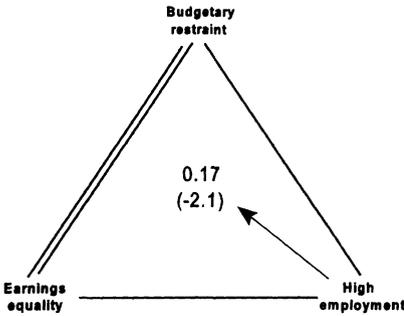
b) The Christian Democratic Model   c) The Social Democratic Model
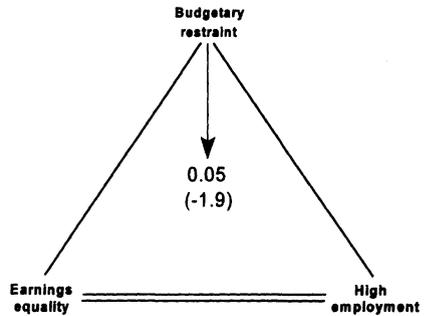
FIGURE 5
THREE MODELS OF THE TRILEMMA AND THEIR ASSOCIATED COSTS[a]

[a] The double lines indicate that the associated variables are one standard deviation above their mean. The top figures inside the triangles show the predicted level on the third variable (the "cost"), and the figures in parentheses represent the number of standard deviations from the mean. All calculations are for the long run. .

ment and budgetary restraint variables somewhat less impressive than implied by the ideal type. Still, countries such as the U.S. and the U.K. clearly sacrificed equality in order to achieve better private sector employment performance in the 1980s.

In the Christian democratic model of combining budgetary restraint with relative earnings equality, the cost is measured in terms of substantially lower service sector employment growth (equal to 2.1 standard deviations). As illustrated in Table 2 above, Germany and the Netherlands come close to this ideal type with exceptionally poor employment performance but low government consumption and fairly

high levels of wage equality. By contrast, the social democratic model achieves high employment expansion and equality by increasing public sector employment and sacrificing budgetary restraint (the latter being 1.9 standard deviations below the mean). Denmark, Norway, and Sweden are almost perfect examples of this ideal type, since employment and equality are both about one standard deviation above the mean, while budgetary restraint is on average 1.2 standard deviations below.

Clearly, not only are the regression results supportive of the notion of a service economy trilemma, but they also resonate well with actual country experiences. In the following section we will look more closely at the experiences of three of these countries—Britain, Denmark, and the Netherlands—which represent the different ideal types. The purpose of this discussion is not only to describe the political-economic logic of each model but also to show the inherent contradictions and the strategic predicaments to which each gives rise.

EXPLORING THE ARGUMENT: THREE COUNTRY EXPERIENCES

THE UK: INCURRING THE COSTS OF THE NEOLIBERAL ROUTE

The U.K. case provides the most dramatic example in our sample of a shift from one political-economic model to another, as is clearly visible from Table 2. In the early 1970s the magnitude and composition of services employment in the U.K. most closely resembled that of the social democratic countries (Denmark and Sweden), while wage equality, although below social democratic levels, was relatively high. With the arrival of Thatcherism in the 1980s, however, private service employment soared, employment in the public sector declined, and income equality dropped rapidly to well below average European levels.

The 1970s had proved a particularly difficult period for the advancement of a social democratic agenda in Britain, in spite of the presence of a Labor government from 1974 to 1979. High levels of debt, a currency crisis, and finally the attachment of demands for strict reductions on borrowing to the emergency loan extended by the IMF increasingly tightened fiscal constraints, forcing the Wilson government to cease the expansion of public employment (which had increased by ten million in the preceding decade).[56] However, the fiscal benefits of these cutbacks were undermined by continued wage pressure. Relations between

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[56] Peter Hall, *Governing the Economy* (Oxford: Oxford University Press, 1986), chap. 4; Terry Ward, "From Mounting Tension to Open Confrontation: The Case of the UK," in Robert Boyer, ed., *The Search for Labour Market Flexibility* (Oxford: Clarendon Press, 1988).

the government and the unions were largely conflictual throughout the period and the attempt at increased cooperation between the Labor Party and the unions represented by the Wilson government's "social contract" had already begun to disintegrate by 1975.[57] In this atmosphere, union strength and the absence of effective public sector wage-bargaining institutions combined to significantly increase the employment costs associated with reducing the fiscal burden. The British case in the 1970s thus highlights the previously noted significance of public wage formation procedures in determining the effectiveness of public manpower policies.

As the voluntary social contract began to collapse, the government came to rely increasingly on mandated incomes policies. While chiefly anti-inflationary in nature, these policies also imposed proportionately greater restraint on the wages of high-paid skilled workers.[58] The dissatisfaction that this outcome generated among unions of skilled laborers became a contributory factor in the collapse of both the incomes policies and the Labor government in 1979. When the government failed in its attempts to impose restrictions on private sector wages in the face of increased union opposition in the private sector, the unwillingness of public sector unions to shoulder the burden of economic sacrifice alone led to the strikes of the "winter of discontent."[59]

In response to these problems, the Thatcher governments of the 1980s instituted a series of radical reforms that would place the British labor market firmly on a neoliberal path. As Garrett[60] has pointed out, their fears of an electoral backlash against unpopular reforms and the emergence of mass unemployment were substantially reduced by the division in opposition support caused by the foundation of the Social Democratic Party and its alliance with the Liberals in 1983.

Thatcher's neoliberal strategy involved an interrelated set of reforms directed at all three points of the labor-market trilemma and served ends that were both economic and political. The economic goals of the program were twofold: (1) to eliminate labor-market rigidities, thus allowing wages and labor to become fully flexible and removing the perennial problem of achieving wage restraint in the British labor

[57] Hall (fn. 56), chap. 4; Ward (fn. 56); Hugh Compston, "Union Participation in Economic Policy Making in France, Italy, Germany and Britain, 1970–1993," *West European Politics* 18, no. 2 (1995).

[58] Robert J. Flanagan, David W.Soskice, and Lloyd Ullman, *Unionism, Economic Stabilisation and Incomes Policies: European Experience* (Washington, D.C.: Brookings Institution, 1983); William Brown, "Incomes Policy in Britain: Lessons from Experience," in Ronald Dore, Robert Boyer, and Zoe Mars, eds., *The Return to Incomes Policy* (London: Pinter Publishers, 1994).

[59] Scharpf (fn.1), chap. 5; Hall (fn. 57), chap. 4; Brown (fn. 58).

[60] Geoffrey Garrett, "The Politics of Structural Change: Swedish Social Democracy and Thatcherism in Comparative Perspective," *Comparative Political Studies* 25, no. 4 (1993)

market; and (2) to institute fiscal discipline. The political goal was to
weaken the power of the labor movement, the chief obstacle to Con-
servative political hegemony.

The new government abandoned all involvement in the wage-set-
ting process. No attempt was made to revive the broken social contract,
income policies were dropped, and wage bargaining, already relatively
decentralized, moved increasingly to the company level.[61] Thus, several
potentially significant sources of institutional bias toward solidaristic
wage policies were removed. Legal and regulatory obstacles to low pay
were already limited; for example, there was no general minimum wage
law in place. And such legal obstacles as did exist were gradually dis-
mantled. The power of the Wage Councils, which had been responsible
for protecting the wages of younger workers and setting a minimum
wage in the most vulnerable industries (such as retail and catering), was
significantly reduced. Also abolished was the Fair Wages Resolution,
which had obliged government contractors to pay the prevailing collec-
tively bargained wages in their industry.[62]

The widespread privatization of public services, largely justified as an
effort to achieve budgetary restraint, also contributed to increasing
wage flexibility and the incidence of low-paid employment. By trans-
ferring large numbers of workers from the public services sector, the
most highly unionized sector in the economy, to the private services
sector, one of the sectors where unions were weakest, it was hoped that
service sector wages could be reduced. In many cases this goal seems to
have been achieved. Ward cites the example of hospital cleaners who
often experienced wage reductions of between 30 and 40 percent when
cleaning jobs were contracted out to the private sector.[63] The reforms
also had the desirable political effect of weakening the public sector
unions.

The unions were attacked more directly by the Employment and
Trade Union Acts of the 1980s and were further weakened by the gov-
ernment's adherence to tight fiscal and monetary policies throughout

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[61] Colin Crouch, "United Kingdom: The Rejection of Compromise," in Guido Baglioni and Colin
Crouch, eds., *European Industrial Relations* (London: Sage, 1990); Hall (fn. 56) chap. 4.

[62] See Ward (fn. 56); Alice Brown and Desmond King, "Economic Change and Labour Market
Policy: Corporatist and Dualist Tendencies in Britain and Sweden," *West European Politics* 11 (July
1988); Gerda Falkner and Emmerich Talos, "The Role of the State within Social Policy," in Wolfgang
Muller and Vincent Wright, eds., special issue, The State in Western Europe: Retreat or Redefinition?
Western European Politics 17 (July 1994); Christel Lane, "From 'Welfare Capitalism' to 'Market Capi-
talism': A Comparative Review of Trends towards Employment Flexibility in the Labour Markets of
Three Major European Societies," *Sociology* 23, no. 4, (1989).

[63] Ward (fn. 56).

the decade. By pursuing a strictly anti-inflationary policy, the government placed the entire responsibility for unemployment with the unions. It was hoped that abandoning the government's commitment to full employment would weaken the unions' political power, as well as inducing wage restraint.[64] The immediate effect was a rise in unemployment from a little under 5 percent in 1979 to a peak of nearly 12 percent in 1986. At the same time, union power and militancy did decline, and the government used the opportunity to remove many of the rights extended to workers by the Labor governments of the 1970s.

The economic effects of these reforms were dramatic. All available measures of wage inequality show that the U.K. now exhibits levels of wage inequality and private service sector growth comparable to those of North America.[65] It is also the only country in our sample that has exhibited a decline in public sector service employment in the last decade. Nevertheless, by the end of the 1980s, the unemployment level had fallen almost to its 1979 level, largely because of a strong expansion in private service employment.

The benefits of an improved private service employment performance must be weighed against the costs incurred, not just in terms of wage inequality, but also in increased labor market insecurity. The weakening of the trade union movement and the high threat of unemployment in the mid-1980s allowed a substantial number of cutbacks in workers' rights and tipped the balance of bargaining power firmly in favor of the employer. Rights to employment protection and maternity leave, as well as protection against unfair dismissal and redundancy, for example, were all reduced.[66] The simultaneous achievement of budgetary restraint and employment growth in the U.K. case has thus been paid for by a deepening of class divisions.[67] These social costs were ultimately translated into political ones for the Conservative Party, which was voted out of office in April 1997. With the election of New Labor we would expect to see a shift in priorities over the policy goals contained in the trilemma, with a greater emphasis in particular on removing some of the inequities created in the British labor market since the mid-1980s. A crucial test for the reformed Labor Party is whether it will be able to achieve this goal without either lifting its self-imposed cap on public spending or inhibiting job creation.

[64] Garrett (fn. 60); Crouch (fn. 61); Hall (fn. 56).
[65] See, for example, Rowthorn (fn. 26); and Pontusson (fn. 26).
[66] Brown and King (fn. 62); Lane (fn. 62); Falkner and Talos (fn. 62).
[67] Jessop (fn. 22).

DENMARK: THE LIMITS TO EQUALITY AND
PUBLIC SECTOR EXPANSION

During the 1960s and 1970s in Denmark, as in the rest of Scandinavia, consecutive social democratic governments sought to advance their traditional platform of wage equality and employment for all. Unlike in Britain, solidaristic wage policies were facilitated by centralized wage bargaining (in which high-wage workers "subsidized" higher-than-average wage increases for low-paid workers) and directly pursued through generous unemployment benefits and a flat-rate wage indexation system. High employment growth was achieved through a rapid expansion of public sector employment (as is apparent in Table 2) and through the provision of social services (such as public day care), which facilitated female participation in the labor market. For a while at least, this strategy had the desired consequences. Available industrial earnings statistics suggest that between 1963 and 1977 wage dispersion for Danish manual workers diminished by about 54 percent, while in the period from 1970 to 1982 the decline for salaried private employees in Denmark was 26 percent.[68] Meanwhile, rates of female participation in the labor market increased from 62 percent in 1973 to 74 percent in 1983, a rise that was achieved almost entirely through expansion of public service employment.

But in the 1970s the social democratic strategy in Denmark ran into severe difficulties similar to those found in Britain. On the one hand, the increasing use by employers of nonstandard forms of payment systems (aimed at increasing labor productivity and in-house training), combined with a shift in labor demand toward higher-skilled workers, led to the rise of cross-class "flexibility coalitions" between export producers and better-trained workers—coalitions that undermined the centralized bargaining system.[69] On the other hand, the government's room for maneuver in fiscal policies was increasingly circumscribed by capital-market integration that made deficit spending more costly by raising inflation expectations and necessitating a substantial "risk premium" on interest rates.[70]

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[68] Calculations are based on data published in Dansk Arbejdsgiverforening, *Lønstatistikken* (Copenhagen, various years).

[69] See Flemming Ibsen and Jørgen Stamhus, *Fra Central til Decentral Lønfastsættelse* (From centralized to decentralized wage setting) (Copenhagen: Jurist- og Økonomforbundets Forlag, 1993); Torben Iversen, "Power, Flexibility and the Breakdown of Centralized Wage Bargaining: The Cases of Denmark and Sweden in Comparative Perspectivem," *Comparative Politics* (1996).

[70] Torben Iversen and Niels Thygesen, "Denmark: From External to Internal Adjustment," in Erik Jones, Jeffry Frieden, and Francisco Torres, eds., *Joining Europe's Monetary Club: The Challenge for Smaller Member States* (New York: St. Martin's Press, 1998).

In Denmark, however, an even more severe constraint on continued fiscal expansion was political in nature. Growing taxation met with increasing opposition from both business and private sector unions, and the dramatic electoral success of the new antitax Progress Party in the "earthquake" election of 1973 unambiguously signaled the potential electoral costs of continued public sector expansion. This helped to encourage the social democratic government to take tougher stands against the demands of public sector unions, although the most dramatic policy changes came under the center-right government that took office in 1982.

Macroeconomic polices under the new government were strictly subordinated to support a hard-currency policy, the large budget deficit was completely reined in, and a series of budget and administrative reforms was adopted to bring public expenditures under control.[71] In addition, the cost-of-living indexation of wages was eliminated and the automatic regulation of public sector wages to compensate for private sector wage drift was restricted and eventually suspended.[72] Tripartite bargaining over wages and social policies had no place in the new government's strategy, and nothing was done to rescue the centralized bargaining system that had been the institutional foundation for the solidaristic wage policy.

The new government's challenge to the social democratic project was preceded by deeper changes in electoral alignments. Thus, while the social democratic strategy—with centralized, solidaristic wage bargaining and a commitment to full employment—had engendered broad class solidarity, decentralization of the bargaining system and rising unemployment undermined the economic rationale for solidaristic policies and brought to the fore distributive divisions between low- and high-productivity labor and between those in secure market positions and those in insecure ones. In Denmark and in Scandinavia more broadly the manifestation of these changes was particularly evident in a growing electoral division between low-skilled workers in the public sector and high-skilled workers in the private sector. The division was both over pay relativities (that is, over whether the pay of low-productivity public service workers should follow those of their higher-

[71] See Jesper Due and Jørgen Steen Madsen, Når der slås søm i: overenskomstforhandlinger og organisationstruktur (Sealing the deal: Wage bargaining and organizational structure) (Copenhagen: Jurist- og Økonomforbundets Forlag, 1988); Herman Schwartz, "Small States in Big Trouble: State Reorganization in Australia, Denmark, New Zealand, and Sweden in the 1980s," World Politics 46 (July 1994).

[72] See Peter Nannestad, Danish Design or British Disease? Danish Economic Crisis Policy 1974 in Comparative Perspective (Århus: Århus University Press, 1991); Due and Madsen (fn. 71), 41, 55.

productivity colleagues in the private sector) and over the need for wage restraint (an issue of more concern to exposed private sector workers than to sheltered workers in the public sector).

The growing salience of this division is clearly detectable in voting patterns. Thus, while in the early 1970s private sector employees were slightly more likely than public sector employees to vote for parties to the left of the social democrats, over time the direction of these differences shifted and their magnitudes multiplied, so that by 1990 the proportion of public employees voting for new left parties (especially the Socialist Peoples' Party) was about three times that of private employees. Correspondingly, the sectoral profile of new left supporters changed from being three-quarters private to being two-thirds public.[73] We submit that the reason for this rise of left-libertarian parties in Denmark has little to do with the rise of a new postmaterialist cleavage and everything to do with old-fashioned distributive conflict in the context of a rising service economy. Old wine in new bottles, so to speak.

The emerging realignment of Danish electoral politics has been accompanied by welfare reforms. The purpose of these reforms was not just to impose greater budgetary restraint but also to increase labor-market flexibility and private sector employment.[74] Policies were also initiated to flexibilize the public sector wage structure and to raise competition in services through privatization and greater consumer choice. More recent deregulation of business hours for stores has also contributed to the emergence of a more liberal and consumer-oriented service economy.

One should not exaggerate the scope of these reforms, however. The wage structure has been highly resilient to change, and measures to deregulate markets and privatize public enterprises have been modest by British standards. In addition, some reforms have clearly followed a more Christian democratic pattern, with the introduction of early retirement schemes and facilitation of part-time employment, though not nearly on the scale seen in the Netherlands (see below). In comparative

[73] The figures are based on national election data. The growing electoral salience of the public-private sector division has been analyzed extensively in Jørgen Goul-Andersen "Social Klasse og Parti," in Jørgen Elklit and Ole Tonsgaard, eds., *To Folketingsvalg* (Århus: Politica,1989); and idem, "The Decline of Class Voting Revisited," in Peter Gundelach and Karen Siune, eds., *From Voters to Participants* (Copenhagen: Politica, 1992).

[74] A primary target for the reforms was the extremely generous unemployment benefit system. The center-right government was particularly keen to eliminate what it regarded as union disincentives to engage in responsible wage behavior and to reduce the overall financial burden of the system. The result has been a substantial reduction in average replacement rates; see Steen Scheuer, "Denmark: Return to Decentralization," in Anthony Ferner and Richard Hyman, eds., *Industrial Relations in the New Europe* (Oxford: Basil Blackwell, 1992).

perspective, the Danish experience still represents a distinctly social democratic route, but it also illustrates how this route has engendered new lines of division in the service economy, and how alternative, non–social democratic strategies to cope with the trilemma have assumed greater political salience over time.

THE NETHERLANDS: OPERATING BETWEEN FISCAL AND EGALITARIAN CONSTRAINTS

When compared with Denmark and Britain, the strength of Christian democratic political influence in the Netherlands is clearly visible in labor-market strategies and outcomes.[75] In particular, the goal of employment creation has consistently been assigned a lower priority than those of either budgetary restraint or equality. As we would expect from our quantitative estimation of the trilemma, this combination of budgetary restraint and egalitarian wage policies has produced a low capacity for employment growth—a problem that has traditionally been dealt with through policies of job sharing and minimization of labor-market participation.

Throughout the postwar period Christian democratic governments in the Netherlands have intervened heavily in the wage-setting process, beginning with the highly egalitarian and anti-inflationary incomes policies of the 1940s and 1950s.[76] In the tight labor markets of the 1960s, however, these policies were overtaken by wage drift. Faced with increasing union militancy, employers conceded inflationary wage settlements that seriously undermined the competitiveness of the manufacturing sector. As a result, many industries found themselves unable to compete when the first oil crisis struck in 1973.

These events coincided with the formation (in 1973) of the first social democrat–dominated government in Dutch history, under den Uyl. The new government found itself faced with an economic and industrial relations crisis, as unemployment rates started to rise and tripartite negotiations with employers and trade unions became increasingly deadlocked. In response, it embarked once again on a policy of direct intervention in wage setting. Wages were periodically frozen and increases were controlled. The government continued to make use of the opportunity afforded by direct intervention to pursue egalitarian policies, however. Income differentials were reduced both by the imposition of flat-rate increases and by the inclusion of specific compensations

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[75] Christian parties dominated every postwar government until the early 1970s.

[76] Steven B. Wolinetz, "Socio-economic Bargaining in the Netherlands: Redefining the Post-War Policy Coalition," *West European Politics* 12, no. 1 (1989).

for low-wage workers. More direct action on equality was taken with the indexation of minimum wages and social benefits to the average private sector wage.[77]

Den Uyl's choice of economic strategy in response to the crisis was constrained by his government's dependence on Christian democratic coalition partners. Thus, while it was possible to pursue the goal of equality, the pursuit of a full-scale social democratic strategy based on the large-scale expansion of public employment was effectively blocked.[78] Extensive public sector employment schemes to increase overall employment levels ran counter to Christian democratic ideals of the minimization of direct state involvement in the economy and seriously threatened the goal of budgetary restraint.

In fact, the strategy of the den Uyl government (which was voted out of office in 1977) left the Dutch economy poorly equipped to deal with the second oil crisis in 1979. Wage indexation had undermined the flexibility of real wages so that the shock caused a dramatic doubling of unemployment, from 5.7 to 11.9 percent, between 1979 and 1982.[79] Meanwhile, the indexation of public to private sector wages—a mechanism jealously guarded by public sector unions—made expenditures increasingly difficult to control.

The unions and the socialists proposed a solution to the unemployment problem that advocated the use of public sector employment. But in its emphsis on the need for job sharing and the creation of part-time employment (strategies that are more compatible with budgetary restraint), their plan also reflected an awareness of the political strength of Christian democracy. Meanwhile, employers, liberals, and conservative elements within the Christian Democratic Party advocated a more radical "liberal" route—the decentralization of wage bargaining, removing labor-market rigidities (including the system of income linkages), lowering minimum wages, and cutting public sector expenditure.

The neoliberal position began to gain prominence with the formation in 1982 of a coalition of Christian democrats and liberals, under Luebbers. The new government introduced a strict austerity package that included a 3 percent cut in public sector salaries and widespread cutbacks in welfare state benefits. In addition, the system of wage and

[77] Ibid.; Kees Van Kersbergen and Uwe Becker, "The Netherlands: A Passive Social Democratic Welfare State in a Christian Democratic Ruled Society," *Journal of Social Policy* 17, no. 4 (1988).

[78] Dietmar Braun, "Political Immobilism and Labor Market Performance: The Dutch Road to Mass Unemployment," *Journal of Public Policy* 7, no. 3 (1987); van Kersbergen and Becker (fn. 77).

[79] Erik Jones, "The Netherlands: Top of the Class," in Erik Jones, Jeffry Frieden, and Francisco Torres, eds., *Joining Europe's Monetary Club: The Challenge for Smaller Member States* (New York: St. Martin's Press, 1998).

benefit linkages was removed.[80] However, there is little indication that these changes actually resulted in a broadening of earnings differentials in the Dutch case. Certainly by 1990 (when our time series end) no substantial change in overall earnings differentials could be detected.[81] This stability may be at least partially attributable to the continued government practice of imposing mandatory extensions of collective agreements on nonunionized firms, since collectively agreed-upon wages in the lowest grades have tended to be considerably higher than the statutory minimum.[82]

Dutch unemployment performance improved substantially in the second half of the 1980s. But it would clearly be incorrect to attribute this performance to the pursuit of a neoliberal strategy based on the trade-off between employment and equality. In fact, the reduction in unemployment is largely attributable to extremely high rates of increase in part-time female employment in the services sector.[83] It was also facilitated by a very substantial rise in the number of unemployed listed as "disabled" and by early retirement.[84] Thus, a large component of the improvement in employment performance represents an increase in job sharing and labor-market exit rather than a genuine increase in full-time employment equivalents. The Dutch solution to the unemployment problem thus remains essentially Christian democratic in nature. An emphasis on work sharing and exit rather than on overall employment creation allows for high levels of equality and fiscal discipline and for simultaneous reductions in unemployment.

New strategies for job sharing are likely to become more necessary in all Christian democratic countries as a concomitant to the increasing political difficulty of pursuing the more traditional Christian democratic strategy of reducing unemployment by minimizing the labor supply. The pressure on traditional Christian democratic models arising from political mobilization around issues of women's rights is already visible in the Netherlands, where in recent years labor-market

[80] With the election of a socialist government in 1990, minimum wages were recoupled with average wages.

[81] The remarkable stability of earnings differentials over the last decade is also noted in Jelle Visser, "Two Cheers for Corporatism, One for the Market: Industrial Relations, Unions, Wages and Labour Markets in the Netherlands," *British Journal of Industrial Relations* (forthcoming).

[82] Ibid.

[83] Seventy-five percent of the increase in service sector employment between 1985 and 1990 was part time. With the exception of Belgium, no other EC country recorded a value of more than 43 percent (Germany). Eighty-six percent of part-time employees in the Netherlands are female. Cf. Daniele Meulders, Olivier Plasman, and Robert Plasman, *Atypical Employment in the EC* (Brookfield, Vt.: Dartmouth Publishing Co., 1994).

[84] By 1989 an astonishing 13 percent of the total labor force was listed as worker disabled; Jones (fn. 79).

policy has displayed an increasing emphasis on raising the level of labor-market participation.[85]

CONCLUSIONS

The evidence presented in this paper clearly supports the existence of a trade-off between intersectoral wage equality and the expansion of employment in the private services sector. Given the declining capacity of the manufacturing sector to generate employment in most OECD countries, the existence of this trade-off presents governments with a trilemma, or three-way choice, between the goals of earnings equality, budgetary restraint, and employment growth. Employment growth can be achieved only in the private services sector, at a cost of higher levels of wage inequality; or in the public services sector, at a cost either of higher taxes or of higher deficits. Strict adherence to the goals of budgetary restraint and wage equality simultaneously will therefore result in an inferior employment performance.

In analyzing the paths followed by individual countries in the face of these choices, the influence of ideological legacies and existing socioeconomic institutions becomes clear. Traditionally countries dominated by social democrats display a commitment to equality and employment and a willingness to sacrifice budgetary restraint. The pursuit of this ideological agenda has been supported by the institutionalized system of centralized solidaristic wage bargaining. In the Christian democratic countries the goals of equality and budgetary restraint have assumed primary importance with visible costs in terms of employment growth. This outcome has been facilitated by a system that combines centralized wage-bargaining institutions with tax codes and other policies aimed at discouraging labor-market participation. The neoliberal route rests on the free operation of markets, and the associated outcome has been employment growth and budgetary restraint accompanied by increasing levels of inequality.

While recognizing the significance of ideological and institutional legacies in determining the distributional outcomes associated with the trilemma, the paper also seeks to emphasize that existing institutions and ideological platforms are themselves placed under an entirely new set of strains by the growing salience of the trilemma. The emergence

[85] Robert C. Kloosterman "Three Worlds of Welfare Capitalism? The Welfare State and the Post-Industrial Employment Trajectory in the Netherlands after 1980," *West European Politics* 17, no. 4 (1994).

of a stark new trade-off between equality and employment expansion, which did not exist in the golden age of manufacturing, creates a critical tension in the ideological platform of social democrats. While we have demonstrated that a strategy of expanding public sector employment can obviate the need to choose between the goals of equality and employment, there are political limits to the feasibility of this strategy, as is evidenced by the Danish tax revolts and divisions between the private and public sectors. The Danish case also highlights the strains imposed on solidaristic wage policies by distributional conflict between high- and low-productivity workers.

For Christian democrats the trade-off between equality and employment creates a different kind of tension. Christian democrats have traditionally placed a relatively low priority on employment creation, relying on a strategy of minimizing labor force participation to prevent unemployment rates from rising. In traditionally Christian democratic countries, therefore, the strains associated with the trilemma are likely to become most visible where policies designed to discourage participation become politically infeasible. In the Dutch case it appears that policy choices may have begun to narrow in this way. The dominant response so far has been an attempt to share limited employment opportunities rather than the alternative of increasing earnings inequality or expanding the public sector.

Much of the institutional change that we observe arises from distributional struggles at the margin. However, the British case demonstrates the proactive capacity of governments to radically alter the institutions and hence to affect the distributional outcomes associated with the trilemma. By reducing the power of unions and deregulating markets, the Conservatives in Britain managed to increase private service sector employment. However, the dramatic increase in inequality and poverty that accompanied these changes contributed to the climate of political discontent that led to the recent removal of the Conservatives from office.

The Danish and British cases thus provide clear evidence of the political limits of the social democratic and neoliberal strategies. The social and political costs associated with the new strain of Christian democratic policies being pursued in the Netherlands have yet to be fully assessed. However, one is well advised not to declare the Dutch cure an unqualified success. Although many of the overt unemployment problems have been dealt with, labor-market marginalization and exclusion continue to plague the Dutch economy. So while a fundamentally

Christian democratic model has been spiced up with some neoliberal re-
forms, the Netherlands has not overcome the trilemma and continues to
be one of the worst employment performers in the OECD area.

   One final point to note is that the severity of the trilemma depends
on the continued inability to increase productivity in the services sector.
Increases in services productivity would allow prices to fall and wages
to rise simultaneously, as in the golden age of manufacturing. Where
governments and economic actors can successfully adopt new strategies
to bring services productivity closer in line with that of manufacturing,
the starkness of the employment equality trade-off and the distribu-
tional conflicts that surround it will be reduced. The issue of whether
such strategies exist, which we believe is intimately tied to the emer-
gence of international markets for services, is therefore a critical one for
future research.