The Diversity and Dilemmas of Europe's Capitalisms

Seán Ó Riain

NIRSA and Department of Sociology

NUI Maynooth

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Introduction

In 2013 Europe is both slowly stabilising (and possibly recovering) and also locked into a deeply worrying path. If the project of fiscal consolidation and saving the financial system fails disaster looms for the European project and the place of Europe on the global stage. If it succeeds, it may be at such a cost that the public legitimacy of the European project will be deeply undermined. The classic European model, combining fiscal discipline and productive investment as well as social protection, has not been promoted at the European level since the 1990s. Having been undermined by financialisation and current account imbalances in the 2000s, it is now weakened by the exclusive focus on fiscal discipline at significant cost to the real economy and society. This approach also represents a crucially partial version of the 'European model'.

This paper examines the European crisis through the lens of comparative political economy. It first outlines the diversity of capitalisms within Europe, not only in terms of welfare and taxation but also in terms of fiscal policies, investment and production regimes. The dynamics of these diverse capitalisms are outlined and the dilemmas of interaction and integration between them are explored. Finally, it is argued that the European policy level response to the current crisis represents a contractionary combination of the features of Europe's capitalisms.

Economic Integration and the Interaction of Societies in the Formation of Capitalism

The emergence of regional blocs for both trading and governance is one of the major developments in the organisation of global capitalism in recent decades (Solinger, 2009). Europe is a particularly fascinating and important case as it is the most ambitious of all such projects – in terms of its historical origins in preventing world war, its global ambitions and the degree of its internal integration. How do we understand these new social orders? Most fundamentally, economic integration creates new "fields of action" (Fligstein, 2008), incorporating not only market action but a wide range of relationships and possible modes of cooperation and competition.

This is not the place to rehearse the many debates on European integration. It is a process, however, that is increasingly recognised as riven with tensions that the once dominant functionalist understanding of European integration ignored. The neo-functionalist approach argued that integration in one realm (for example, the economy) would drive further integration in other areas (e.g. the political) through spillover effects across sectors and spatial levels (Haas, 1958). Its main rival theory, inter-governmentalism, viewed integration as a process of self-interested negotiation between national states. More recent theories of multi-level governance retained this emphasis on the negotiated character of European development alongside the neo-functionalist emphasis on the changing character of the actors and levels within the governance process. While this approach directs us towards the changing authority patterns within the European Union, it has relatively little to

say about the deeper socio-economic and socio-political transformations occurring across Europe.

The European project is intimately connected to issues of uneven economic development, particularly as it has spread ever further beyond the continental European ‘core’. Furthermore, these issues of uneven structural development have intersected disastrously with the financialisation of the global and, particularly, European economies. In practice, recent decades have seen a financial system in pursuit of a crisis – whether in the Nordic economies in 1991, the East Asian economies in 1997 and 1998, the dotcom bubble in 2001, the commodities bubble of the mid-2000s or, most disastrously, the real estate and credit bubble of 2008.

Spatially, these processes of globalisation and financialisation are uneven. From a comparative perspective, there are many national forms of financialisation. Nonetheless, these national histories of financialisation also have distinctive cross-national patterns, linked to their ‘variety of capitalism’. The most dramatic financial booms and busts have been in those political economies that are generally clustered together as ‘liberal’ (US, UK, Ireland and others). More importantly still, the liberalisation of financial flows has intensified an already growing interdependence between political economies of different sizes, types and at different levels of organisation (regional, sectoral, national, and so on). The focus of this paper is not on the process of financialisation itself but on the challenges it posed for Europe’s diverse capitalisms.

Rodrik (2012) identifies a core tension between ‘deep’ globalisation (understood as genuine factor mobility) and national democracy (understood primarily as the power of publics and mass opinion). This became clear in the European integration process also. Economic and monetary union promoted a radical programme of internal capital mobility, driven largely by elites. At the same time, national worlds of welfare capitalism (Esping-Andersen, 1990, 1999) remained largely intact with significant differences between them.

For critics of European integration as a neoliberal project, these national worlds of welfare are overwhelmed by the European market-building project. For others, the problem is that the euro allowed national governments very little flexibility in handling the imbalances and disruptions of capitalist growth. As Lane (2011) notes, the loss of monetary and exchange rate flexibility meant that financial prudence (to avoid bubbles and busts) and fiscal discipline (to withstand their effects) were crucial.

Fligstein (2008) argued that a deep fault line or ‘Euroclash’ was emerging between three groups: elite and younger groups with strong European ties; older and working class citizens whose social ties are national and who have benefited far less from Europe; and a crucial swing group of the 50% or so of middle class citizens who sometimes think of themselves as Europeans and sometimes primarily in national terms. Hooghe and Marks (2009) identify a similar divide and argue that it is increasingly a barrier to further European integration. They

argue that mass opinion regarding Europe has become a major factor in shaping European integration – the once silent masses that provided a 'permissive consensus' for the elite project of European integration have become restless, creating a 'constraining dissensus'. As Schmitter (2003) argues, where neofunctionalism expected the masses to drive further integration in the face of the reluctance of national elites, in practice the dynamic has taken precisely the opposite form, with national elites promoting integration in the face of scepticism at home.

These analytical developments are welcome and push significantly beyond functionalist theories of integration. However, they skip too quickly over the structure of existing societies in Europe, as documented extensively in comparative political economy and sociology (e.g. Esping-Andersen, 1990, 1999; Amable, 2004). We do not have to essentialise national societies to recognise that a number of durable social formations have taken hold in countries across Europe, held together through social compacts of different types. These compacts are institutionally located within nations for the most part but also cluster in mini-regions within Europe – the social democratic Scandinavian countries, the Christian democratic continental core, and so on.

These debates, and the study of the European Union in general, have largely been focused on economics and on political science. The study of Europeanisation has, for example, involved a fairly narrow definition of the process – examining how the evolution of European institutions has shaped national politics (Favell and Guiraudon, 2009). 'Social factors' have been incorporated largely by adding the study of norms into the existing frameworks, through the constructivist paradigm in political science. But this is a narrow basis for dealing with the more profound social transformations involved in European integration. More recent sociological approaches have focused on the question of whether a 'European society' is emerging. A sociological approach defines the European Union and the degree of integration in terms of the extent to which it has created a common field of action across Europe – or at least to which fields of action at the European level are superseding national fields of action.

Sociological approaches are well placed to examine the spatial and political-cultural remaking of these 'fields of action' (Parsons, 2010). However, this must involve the study of how these different national and transnational social formations interact with one another and are transformed within that interaction. A sociological approach must take seriously the middle range of analysis – seeing European integration as neither simply the negotiations of elites, nor only the formation of new European social forms, but as the interaction and transformation of existing societies within Europe and the unsettling, reformulation and potential integration of their social compacts (as is suggested but not made explicit in Favell and Guiraudon's (2009) agenda for a sociology of the European Union). This suggests that the interaction within the European field of the institutionalised social compacts in national

societies is a critical feature of the current impasse and this paper explores some of the deeper reasons why that proved to be the case.

Capitalisms

The character of welfare regimes had long been debated in the social sciences, with significant shifts from the analysis of trends and patterns in the level of taxation and spending to a focus on how different welfare regimes are organised in different ways and embody and implement different principles of social provision. Such analyses have identified a range of "worlds of welfare capitalism" (Esping-Andersen, 1990, 1999). There have of course, been lively debates within this literature regarding the membership and the key characteristics that define each of the different welfare regimes. Esping-Andersen himself, for example, focused on the degree of decommodification provided by the welfare states to citizens – that is, the extent to which the welfare state made it possible for citizens to sustain their lives outside the market. There is also an extensive literature on wage bargaining and corporatism across Europe, extended in recent research to incorporate the interaction of wage bargaining and monetary policy (Iversen, 1999). These research strands were integrated through the important role of 'social compensation' for wage restraint in small open economies, organised through democratic corporatist institutions (Katzenstein, 1985).

However, these accounts miss two crucial – and ultimately interlinked mechanisms – investment and 'discipline', both public and private. These elements were critical in Europe's 'Golden Age'. For example, Ó Gráda and O'Rourke (2000) argue that post-war growth in Europe was built on a grand bargain where wage restraint on the part of labour was exchanged for reinvestment of profits by business and the expansion of the welfare state, all helped along by European integration and Marshall Aid. In the private sector, the central element was the inter-sectoral and inter-temporal allocation of resources through productive investment, marshalled through hausbanks and other forms of 'patient capital' (in itself a form of 'discipline'). On the public side, this took the form of extensive public (and social) investment, associated with larger welfare states and significant social protections but also with conservatism in relation to public deficits.

I look here at a number of these different elements of such social compacts, including measures of the welfare regime, the production regime and the macroeconomic order (Table 1). These include the contribution of business to the productive economy through investment in R&D and other forms of industrial upgrading as well as the organisation of labour in the workplace, as measured by the participation of workers in "learning" organisations. Social spending is included as an indicator of public investment in social reproduction, while public deficits and fiscal balances are included as a summary measure of the balancing of this social spending with available resources. Current account balances for

the 2000s are also included to indicate the structural economic position underpinning the social compacts.

Table 1: Social Compacts in Europe: Welfare, Production and Macroeconomic Regimes

	Average Fiscal Balance 1999-2007 (% GDP)	Current Account Balance, 2003-2007 (% of GDP)	Average Business R&D Investment 1999-2007	Social Spending, 2002	'Social Investment', 2000	'Learning' Organisation of Work, 2000 (Holm et al, 2010)
	Christian Democratic					
Austria	-1.8	3.98	1.63	34.5	9.6	47.5
Belgium	-0.5	6.66	1.35	30.4	10.2	38.9
Germany	-2.2	12.54	1.74	33.4	9.0	44.3
France	-2.7	-0.32	1.35	36.7	11.4	38.0
Netherlands	-0.5	15.58	1.02	27.4	8.4	64.0
	Social Democratic					
Denmark	2.4	0.62	1.67	38.6	12.7	60.0
Finland	3.8	4.99	2.39	33.3	10.4	47.8
Norway	12.6	30.25	0.89	32.4	10.7	-
Sweden	1.3	4.04	2.73	38.0	11.3	52.6
	Liberal					
Ireland	1.6	-5.37	0.8	27	7.5	24
UK	-1.4	-9.54	1.13	27.9	8.4	34.8
	Mediterranean					
Greece	-5.3	-5.65	0.18	-	5.1	18.7
Spain	0.2	-8.04	0.56	23.7	6.9	20.1
Italy	-2.9	-4.42	0.54	28.8	6.7	30.0
Portugal	-3.6	-22.90	0.3	27.3	7.2	26.1

This table shows that there are significant differences in the underlying social compacts across the various worlds of capitalism in Europe. In addition to the differences in fiscal policies noted above we can see that there are major differences in the current account balances of the different clusters of countries. The Christian democratic and social democratic countries run huge current account surpluses from 2003 to 2007, the height of the bubble era. These are reflected in major current account deficits in the liberal and Mediterranean cases. But these differences are themselves rooted in deeper differences in social and business investment and organisation. Social spending is not surprisingly higher in the Christian democratic and social democratic countries but so too is business investment, with business R&D investment running well above the liberal and especially Mediterranean countries right across the period.

Furthermore the organisation of society and economy in the workplace is structured differently. Drawing on work by Holm et al (2010) the final column shows what percentage of workers in each country work in a "learning" system of work, which emphasise worker skills and learning, autonomous decision making and theme work among other features. Learning systems of work are much more prevalent in Christian democratic and social democratic economies – even than in the putatively innovative liberal economies of the UK and particularly Ireland. More detailed results in Holm's (2010) study show that Mediterranean economies had very high level of traditional work organisation based on low levels of formalisation of work and high managerial discretion, while liberal economies tend to emphasise "lean" systems of work organisation, emphasising worker input and team work but within a framework of managerial control and hierarchy.

Table 2 shows that significant differences persisted across countries in budget balances – both the actual balance and the 'potential' balance (calculated by the IMF to take into account the effects of the business cycle). These are contested concepts but the pattern is clear enough. The Nordic economies do best in terms of 'fiscal discipline', running an actual surplus but also balancing their books, even on the basis of the underlying structural deficit (largely because of the effects of the Norwegian oil boom on Nordic surpluses). While running deficits a little larger than the social democracies, Europe's Christian democracies remained comfortably within the eurozone criteria. The liberal economies of Ireland and the UK appear to do better, based on their actual balance, but this masked a significant bubble as their large underlying deficits indicate. In keeping with our analysis to date, this structural deficit emerged in the 2003-7 period. The Mediterranean economies also had significant difficulties with budget deficits, which were already present in the early 2000s.

Table 2: Actual and 'Potential' Budget Balances in the 'Varieties of Capitalism' in Europe, 1999-2007

	1999-2007 (% Actual GDP)	1999-2007 (% Potential GDP)	1999-2002 (% Potential GDP)	2003-2007 (% Potential GDP)
Nordics/ Social Democratic	2.5	0.3	0.1	0.5
Continentals/ Christian Democratic	-1.5	-1.7	-1.7	-1.6
Mediterranean	-2.9	-4.0	-3.1	-4.7
Liberal	0.1	-2.5	-0.6	-3.8
Including: Ireland	1.6	-2.7	-0.7	-3.9

Source: Actual Balances - Eurostat; 'Potential' Balances – IMF

The project of European integration reached a new high point in the 2000s, with economic and monetary integration and greatly increased flows of labour and, particularly, capital within the EU. Countries were arguably "better behaved" during the 1990s when seeking admission to the Euro club than they were under the disciplines of the Euro itself – although this is also explained by the intensified financialisation of this later period. However, the 'flattening' of the legal and policy space within the eurozone and EU masked a deeper process of uneven development and significant financial imbalances. Despite universal fiscal rules, the fiscal policies and outcomes of member states were diverse – and bore the stamp of the different 'worlds' of European capitalism. Indeed, the social democracies outside the euro stuck more closely to the budgetary criteria than many of the member states. In the liberal economies, the divergence between actual and underlying deficits was particularly striking, reflecting their exposure to the business cycle and the asset bubble. Although apparently neoliberal, the Eurozone policy rules were much closer to German 'ordo-liberalism', linked not only to fiscal conservatism but also the broader social compact. In many respects, the most liberal of the EU economies, the UK, deviates the most from these rules and policies. Despite their uniform character, these measures interacted with quite different national worlds of capitalism and that their effects within national economic systems were significantly different.

This analysis challenges existing views of comparative differences among capitalisms, while at the same time strengthening the notion that the analysis of specific capitalist economies requires a detailed engagement with the institutional context and social and political relations. Jessop, for example, argues that advanced political economies are going through a transition from Keynesian national welfare states to Schumpeterian workfare post national

regime (Jessop, 2002). But when we look at each of these dimensions, we find that the Nordic economies have long emphasised each of these aspects of the apparently new, liberal states. As we will see later in our analysis, Nordic economies have long been as Schumpeterian as they are Keynesian in their approach to macroeconomic management, favouring fiscal disciplines and export competitiveness (Erikson, 2008). While they have not undertaken punitive forms of workfare, for the most part, they have exceptionally high labour force participation rates and strongly emphasised labour market activation, including significant decreases in benefits for the long-term unemployed combined with very generous short-term replacement rates (Huo, Nelson and Stephens, 2008). The Nordic and other small open economies of Europe have also long seen a close tie between their openness to the global economy and their national political institutions and social contracts, being globalised before many of the larger liberal political economies such as the US and UK (Katzenstein, 1985). Furthermore, the liberal political economies have tended to emphasise the power of central state and parliamentary politics while more decentralised mechanisms of government have been more prevalent in a social democratic economy (Ó Riain, 2014: Chapter 5).

Creative Corporatism and Its Apparent Demise

How do these differences play out in Europe's political economies – and how does Ireland fit into these patterns? Here it is instructive to review the political economy of bargaining in Europe's small open economies from the 1990s to the crisis. Ornston (2012) has recently compared Irish corporatism unfavourably with corporatism in Finland and Denmark. Ornston argues that corporatism in all of these countries came under severe pressure in the 1980s and the 1990s. However, he argues that corporatism in Denmark and Finland was of a "creative" character while corporatism in Ireland was "competitive". In keeping with other analyses of Nordic economies in the 1990s and 2000s, Ornston argues that corporatism was reinvented in Denmark and Finland in order to support industrial transition, redesign welfare state supports and adapt systems of social protection and wage bargaining and industrial policy supports to an era of globalisation and structural change. He argues that "If a crisis forces stakeholders to jettison conservative corporatist bargains, stakeholders can use existing patterns of cooperation to achieve more complex and sophisticated objectives. More specifically, they can convert neo-corporatist institutions to invest in new, supply-side resources such as risk capital, skill formation, research and development. This pattern of "creative" corporatism has very different implications for economic adjustment. In contrast to conservative corporatism, investments explicitly target new enterprises, occupations and industries. In contrast to competitive corporatism, high-quality inputs support more knowledge-intensive activities such as research and design" (Ornston, 2012: 11). In this way economic progress and social equality were reconciled in the face of challenging circumstances. In our terms, the classic European model was retooled for a new era.

Ornston identifies the provision of risk capital, the provision of supports for training and other forms of labour market adjustment, and the provision of supports for research and development to facilitate industrial adjustment and upgrading as key policy measures in creative corporatist systems. While acknowledging that Ireland made efforts in all of these areas, Ornston ultimately classifies Ireland as a competitive corporatist economy. However, a closer look at Ireland in comparative perspective suggests a more complex pattern. Table 3 provides a comparative look at "competitive" Ireland, "creative" Denmark and Finland, "conservative" Austria and Belgium and the liberal UK for each of these three key policy areas, for both private business and public sector. The analysis provides indicators for both the late 1990s and mid-2000s, with the specific periods indicated in the table notes. Most of the indicators are offered as a percentage of GDP and it should be noted that this generally underestimates Ireland's efforts in these areas because of the significant gap between GDP and GNP.

Looking first at the late 1990s there are a number of important aspects to Ireland's comparative position. Firstly, it is strikingly different from the UK, especially in the area of public supports for business, which are much higher in Ireland, and in public spending on active labour market policies, which is almost non-existent in the UK but was very significant in Ireland in the late 1990s. This is particularly important given that these spending figures relate only to active labour market policies and not to "passive" spending such as unemployment assistance. Ireland differs significantly therefore from the liberal UK in the activism of its public agencies in support of business and labour activity. Comparisons with other small open economies in Europe are also instructive. Except for research and development investments, where Ireland has historically been particularly weak, Ireland's efforts to develop business through risks capital and public aid and to activate labour were significantly higher in the late 1990s than in the classically "conservative corporatist" countries of Austria and Belgium.

Table 3: Key Indicators of Types of Corporatism in Selected European Economies, Late 1990s and Mid-2000s

		Ireland		*Denmark/ Finland*		*Austria/ Belgium*		*UK*	
		Late 90s	*Mid-2000s*	*Late 90s*	*Mid-2000s*	*Late 90s*	*Mid-2000s*	*Late 90s*	*Mid-2000s*
Risk Capital									
Business	*Early Stage Venture Capital (% of GDP)*	5.2	2.0	6.7	4.5	4.4	1.2	4.7	8.7
Public	*Sectoral Aid (% of GDP)*	.69	.19	.81	.55	.37	.13	.18	.08
Active Labour Market Supports									
Business	*% of Labour Costs spent on Training*	2.4	2.2	2.7	2.1	1.5	1.5	3.6	1.3
Public	*Spending on Active Labour Market Policies (% of GDP)*	0.95	0.53	1.35	1.04	0.67	0.67	0.09	0.05
R&D									
Business	*Business Funded R&D*	.82	.70	1.48	1.93	1.31	1.72	.86	.74
Public	*Government Funded R&D*	.29	.38	.78	.79	.79	.84	.55	.56

Dates:
Venture Capital, 1998-2001 and 2003-2006
Training, 1999 and 2005
Active Labour Market Policy, Sectoral Aid, R&D: 1996-99 and 2003-2006

Sources: EVCA (2012), Cedefop (2010), Eurostat

Notes: The Eurostat data on sectoral aid offers the advantage of comparison although only covering aid scrutinised by the EU. Irish data on grants and subsidies to enterprise (CSO, 2012) does not track this series directly but offers the same basic picture – with the CSO figures indicating that state aid consisted of 0.81% of GDP from 98-99 and 0.52% from 03-06. Note these figures are almost identical to the Eurostat figures for Denmark and Finland.

Figures given in % of GDP understate Ireland's spending effort, given the gap between GDP and GNP. An added 15% on to the existing figure for Ireland gives a truer measure of Ireland's share of national resources devoted to particular goals.

In the 1990s Ireland was comparable to Denmark and Finland in its levels of risk capital provision, driven by the State, and of supports for training – particularly impressive given that the Irish figures are underestimated due to the use of GDP. As an aside it is also worth noting that there are differences between Finland and Denmark. Both are high on R&D levels but Finland provides higher levels of risk capital, both through private venture capital and public State aid, and Denmark's training effort is higher in both the private and public spheres. Nonetheless it is striking that in this period of the late 1990s Ireland appears closest to the "creative corporatist" economies in its provision of risk capital and training and active labour market supports.

The 2000s present a different picture. The profiles provided at the height of the financial bubble in Europe show that in most countries and in many different categories levels of support for economic adjustment declined. While this process varied across the different types of countries and different types of supports, the shift of Europe as a whole from developmentalism to financialisation is clear in the figures. In the UK, for example, business spending on training declined while venture capital increased. Denmark and Finland weakened their efforts in all areas of promotion of risk capital and labour adjustment. Ireland's fall was particularly dramatic, except in the area of R&D where the State concentrated its resources during the period. Despite remaining at a very low level of R&D as a percentage of GDP, Ireland had one of the highest growth rates in R&D spending and personnel across the OECD. This was particularly the case in the public system. However in the areas of risk capital and labour market policy the Irish public effort declined very significantly, such that it fell well behind Denmark and Finland and, in the case of active labour market policy, even behind Austria and Belgium. Nor is it the case that Ireland simply did not need venture capital or active labour market policy in the 2000s. Indeed Ireland continued through the height of the boom to have the highest rate of jobless households in the European Union (Maitre et al, 2012). In addition, the challenges facing export industries based in Ireland in the 2000s were widely recognised and the need for significant additional support for the development of Irish owned companies, for example through the promotion of venture capital, was widely discussed.

Ornston's analysis fails to distinguish clearly enough between the Irish economy of the late 1990s and that of the 2000s. Ireland was more "creative" than Ornston recognises in the 1990s and the drop-off in this creative effort in the 2000s was even more dramatic than he remarked. There is a significant broader point here. If Ireland's form of corporatism changed so dramatically from the 1990s to the 2000s this cannot be due to constant structural features of the economy or polity. Instead, the story of Irish corporatism is one of surprising if hidden progress in the 1990s but a progress whose promise was never fulfilled and indeed was undermined in the 2000s.

Many of the elements that Ornston recognises in Denmark and Finland are also, as he himself notes, present in Ireland. The state did play a role in supporting dynamic

adjustment among firms, supporting venture capital, research and development and other elements of the innovation system. In addition, especially in the 1990s, there were significant attempts to deepen the reach and scope of social partnership. These included the development of local area partnerships, policy committees addressing a variety of social issues, and significant expansion of public sector employment. It is perhaps best to understand Irish corporatism, at least in the 1990s, as the product of competing tendencies towards competitive and creative corporatism. Furthermore these strands on the economic and social sides were supported through European structural funds, which provided both the capital and the institutional and political space for new initiatives in public policy in Ireland. This support from structural funds for infrastructure spending, industrial and innovation expenditures, and actions aimed at improving social cohesion were linked to a form of European developmentalism rooted in the Delors project of territorial and social cohesion.

The distributional dynamics of the differing worlds of capitalism also vary in interesting ways. Flaherty and Ó Riain (2013) analysed the determinants of labour's share of national income in Ireland and Denmark. One of the central organising claims of the dominant 'Varieties of Capitalism' perspective has been that specific assets (including skills but also linked to union membership and firm employment) were particularly important to the fortunes of workers in 'coordinated market economies' (such as Denmark) while general assets were more important in 'liberal market economies (such as Ireland). However, they found that it is specific labour market assets such as union membership, allied to the short-run effects of improved welfare spending, that enhance labour share in Ireland whereas the Danish dynamics operate more general 'social compensation' trade-offs. Similarly, in terms of industrial transformation, high tech growth in Ireland serves as a benefit for specific sectors of a labour force that is losing income share through broader increases in trade and services. However, in Denmark broad-based economic transformation enhances labour share, with a much weaker specific effect for high tech exporting. In practice, it is in liberal market economies that workers rely more heavily on the mobilisation of specific social and economic power resources, given their greater exposure to market insecurities and the weaker ability to arrive at long run collective institutional compromises. Labour's share of national income is less dependent in Denmark on the power resources (whether political mobilisation of marketable skills) available to specific groups than it is in Ireland, where the level of such resources is significantly lower.

The Logics of Capitalisms

Can we generalise about the kinds of dynamics that are hinted at in the discussion of Ireland and Denmark and that underpin the comparative patterns identified above? Karl Polanyi's notion of the double movement is useful here. For Polanyi, the double movement consists of firstly a movement to establish a market society, where market relations dominate social

life, and, secondly, separates from within the society to protect themselves against the corroding effects of market society.

Figures 1 and 2 show that this creates different dynamics within liberal and social democratic economies. In liberal political economies these movements are particularly violent because of the dominance of market society. They are characterised by strong inequalities in market power and by weak credible commitments on the parts of all actors to long-term goals and action, including economic security, social protection and economic and social investment. The promotion of market society is also a feature of social democratic societies but takes a quite different form. As Pontusson (2010) has noted, most citizens are market actors with very high levels of employment and economic participation. However, they enter the market much more empowered than citizens and workers in liberal political economies. Given this, and the strong historical development of the welfare state, most actors are in a position to make and expect strong credible collective long-term commitments.

Figure 1: The Polanyian Double Movement in Liberal Political Economies

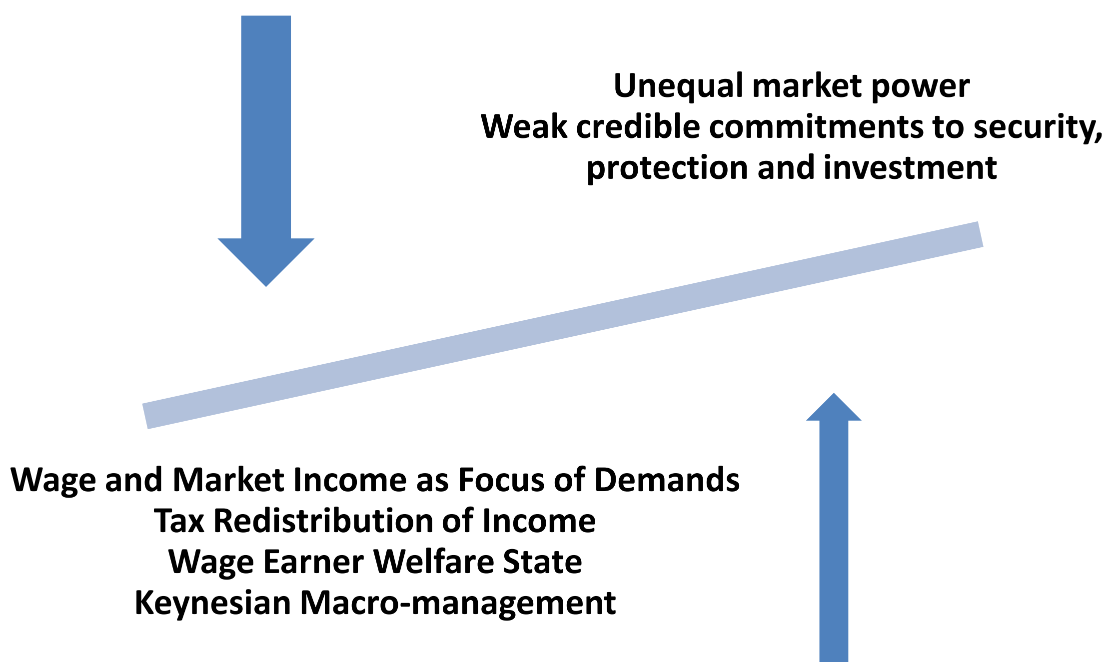
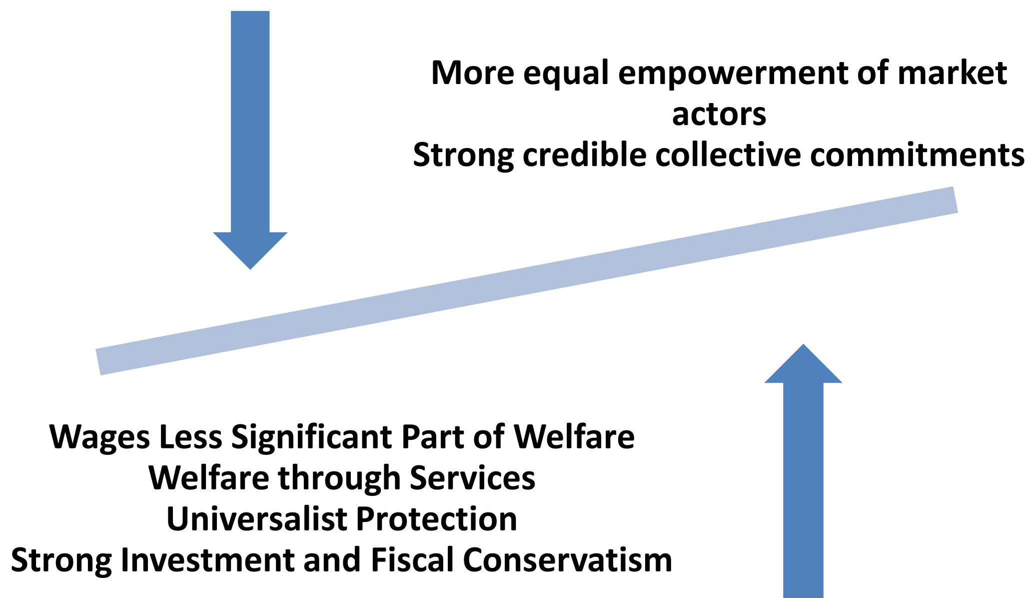


Figure 2: The Polanyian Double Movement in Social Democratic Political Economies



More significant still, the nature of the second part of the double movement is different in the two different types of political economy. In liberal economies, the most realistic avenues of action mean that social protection is most likely to be pursued through market centred mechanisms. These include Keynesian macroeconomic policy, the demand for welfare state expansion linked to wages and occupational earnings of benefits, the attempt to protect wage and market income as a focus of labour's demands rather than the expansion of welfare, and the re-distribution of income through the taxation system. In macroeconomic policy, welfare state development, tax policy and industrial relations, the focus of movements for social protection is the securing of gains in the market, as the development of large scale welfare or other programmes is a much more risky political prospect.

The double movement in social democratic political economies is quite different. The second part of the double movement relies much less on market centred social protection. Instead, universalist collective systems of social protection, strong emphasis on long-term social and economic investments, expansion of the welfare state as a compensation for wage restraint, and the distribution and redistribution of welfare through universal services and the overall size of the welfare states rather than through progressive taxation, are key features of the social democratic double movement.

We can point to three key dimensions along which these double movements differ, with significant implications for Europe's current dilemmas – their version of Keynesianism and understanding of public and social investments; the underlying conceptualisation of macroeconomic risks; and their notion of fiscal conservatism and its relation to the political economy of the state.

Each of the contending views of how to exit the crisis draws on different strands of Keynesianism. Why Keynes is often read as an advocate of counter cyclical spending and quantitative easing, this relies purely on a reading of Keynes as macro-economic manager. Keynes also emphasised a more general role for government, particularly in securing social protection and investment and generally managing the economy and ensuring appropriate level of investment and other long term economic requirements (Block, 2012). While most commentators associate the social democratic worlds of capitalism with Keynesianism, in practice it is this more general argument of Keynes for social investments and long range planning and management that is most characteristic of the social democratic and Christian democratic countries. The Keynes who advocated counter cyclical spending and macro-economic reflation to escape from crisis is in practice more widely favoured in liberal political economies – as seen in the persistently higher deficits run in such economies. This is perhaps not surprising given our discussion of the varying worlds of capitalism. A focus on public investments, particularly when organised and delivered by public agency, makes demands on the public to have faith in public institutions and to recognise that the returns are likely to be uncertain, in that they are revealed over the medium to long term, and subject to significant spillovers, generating benefits for unanticipated recipients within the society. There is therefore a challenging social logic at work here that is not required to the same extent for a Keynesian approach focused on 'pump priming' or accommodating monetary policy (Iversen, 1999).

Underlying this, each political economy relies on a different system for managing risks. In social democratic countries the risk is internalised within the society itself through high levels of taxation and spending, linked to strong underlying fiscal discipline. The society insulates itself relatively effectively from the vagaries of capitalist business cycle and crises. However, in liberal political economies risk is externalised as the society tends to follow the ups and downs of the business cycle, and indeed of boom and crisis, relying on external adjustments to escape from crisis. These external adjustments include measures such as currency devaluation and international borrowing to fund domestic counter cyclical measures.

In addition, the two double movements relate to quite significantly different notions of the state and its role in the economy and vulnerability in an economic crisis. In liberal models, the state itself becomes an instrument of flexibility through monetary and currency policy. In social market capitalisms the focus is on defending the state from the vagaries of capitalist business cycles and crises. Fiscal discipline is not simply a matter of prudence or conservatism but is based on, ironically, a view where the state (and by extension the society) needs to be protected from capitalism.

European Integration

Table 4 briefly reminds us of the basic differences in Europe's worlds of capitalism, as early as the 1960s. However, it also identifies in particular the distinctive profile of the German economy, the central actor in the EU over the past decade (after a period when France had arguably been more influential through Delors and others). Germany shows a particularly distinctive profile of central bank independence and collective bargaining coordination with a substantive policy focus on hard currency, liberalised capital and fiscal balance. With the exception of coordinated bargaining, this is the basic policy prescription for the euro and for recovery. Europe's integration not only links distinctive worlds of capitalism but is shaped by some more than others.

Table 4: Comparative European Capitalisms 1960-1972

	Average Budget Surplus	Coordination Index	Central Bank Independence	Liberalisation of Capital Controls	Hard Currency Index
Social Democratic	2.6	0.72	0.29	2	0.37
Christian Democratic	-0.3	0.59	0.43	3.1	0.5
Germany	0.4	0.88	0.66	4	0.6
Liberal	-2.5	0.13	0.42	2.8	.15 (UK only)

Huber and Stephens, 1990, Table 4.3; Iversen, 1999, Table 3.1

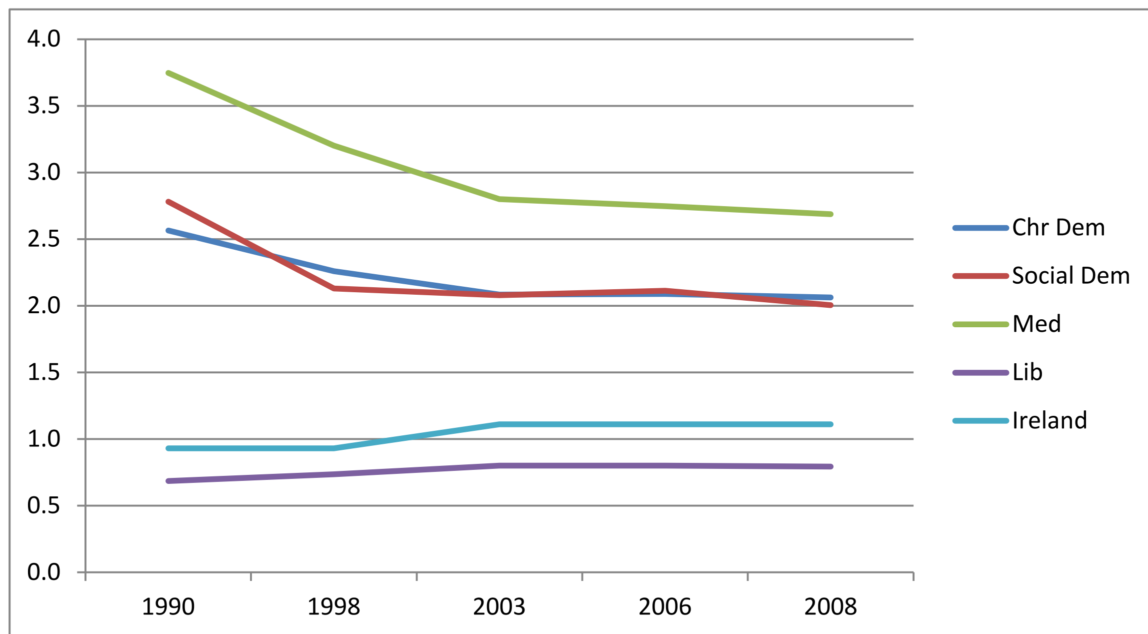
In the 1990s, these national differences persisted. Many of the European economies ran significant deficits through the mid-1990s but that these were highest in the Mediterranean economies and that this vulnerability in the public finances extended to the debt level of Italy, Greece and also Belgium. In addition, again with the exception of Belgium, the Mediterranean economies were much more heavily subject to fluctuations in interest rates and in exchange rates. The use of a "hard currency" policy was by far the most widespread in the Christian democratic continental core with the Nordic social democracies following behind, although more likely to use currency policies for strategic reasons (as in the Finnish cycle of devaluations (Vartiainen, 2011)). The UK's relatively soft currency and willingness to run fiscal deficits helps to explain why it remained outside the Euro. Mediterranean countries had few if any of the conditions for operating under the Euro regime. The Nordic economies are probably closest to the Euro policy regime. However, Finland was the only social democratic country to enter the euro – and this is part as a deliberate strategy to break the cycle of constant booms and devaluations, most painfully experienced in the early 1990s. The other social democracies retained control of their currency, although maintaining a high level of institutionalised fiscal discipline, as shown in their other

indicators. It is noteworthy that in many respects Ireland appears to be in a healthy shape in the mid-1990s with strong budgetary balance, declining debt levels and a current account surplus. However, it is also clear that it had relatively little policy experience dealing with hard currency constraints.

The rules around Euro membership are of course widely known and debated. Much less widely recognised is the process of institutional convergence that was promoted throughout the 1990s, largely through the open method of co-ordination. These institutional convergences took place in a number of different areas, and to some extent moved in different directions at the same time. Most obvious is the promotion of market mechanisms through de-regulation of product and labour markets, linked to the "negative integration of the European economy" (Scharpf, 2000).

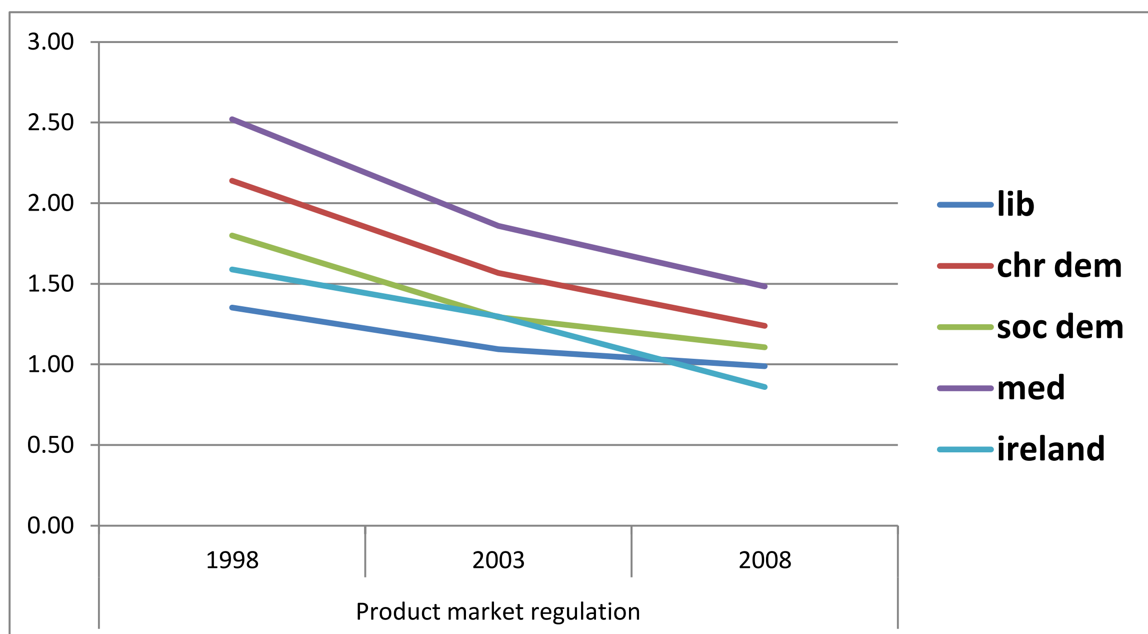
Figures 3 and 4 examine trends in such market-led processes of deregulation. Figure 3 refers to the degree of protection afforded to employees across the different clusters of European capitalist economies. There are significant differences between the different types of capitalist economies, with the liberal economies of the UK and Ireland having by far the lowest levels of employment protection. Christian democratic and social democratic countries of the classic European model have substantial levels of employment protection and the highest levels of employment protection are found in the Mediterranean political economies. The 1990s through to the early 2000s was a period of significant liberalisation and deregulation of employment protection, with declining employment protection in social democracies and Christian democracies and particularly among Mediterranean countries. There is convergence on a more liberal model while significant differences between different clusters of countries and types of capitalism remain. Figure 4 shows similar patterns of difference among countries in the degree of product market regulation within those countries. However, it is also clear that there is a strong trend across all clusters of countries towards less regulation of product markets. There is significant convergence therefore on a liberal model of employment and product market regulation.

Figure 3: Employment Protection Index in European Worlds of Capitalism, 1990-2008



Source: OECD

Figure 4: Product Market Regulation in European Worlds of Capitalism, 1998-2008

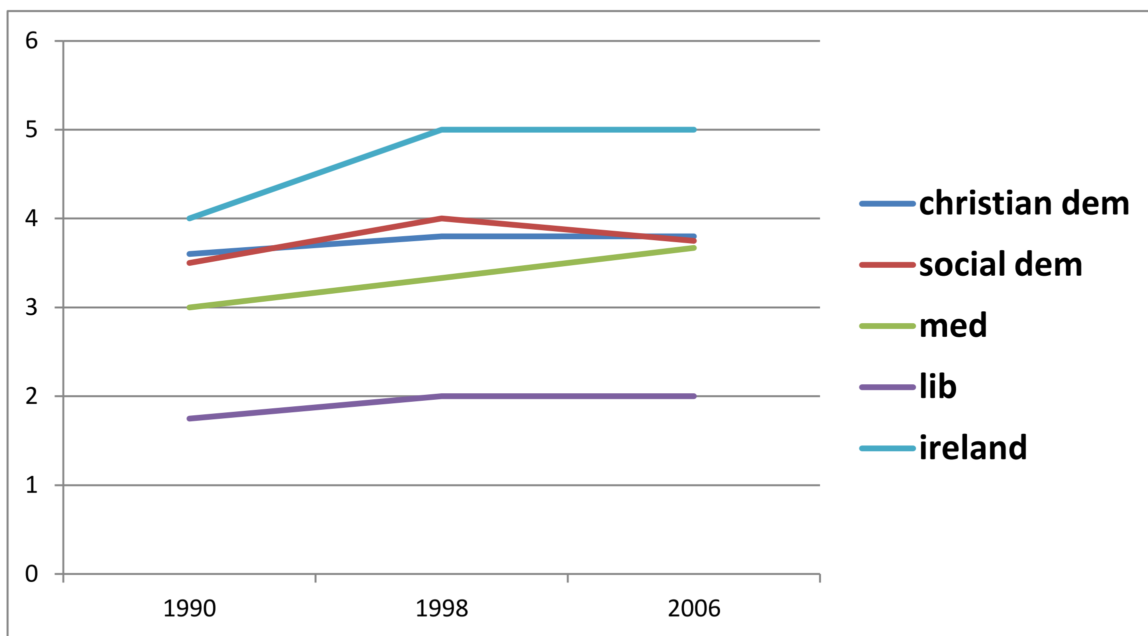


Source: OECD

However, not all convergence is liberal. A distinctively European institution – or one that has been most fully developed in Europe – is corporatist bargaining and Figure 5 provides a measure of a specific feature of corporatist institutions, the presence of institutions that coordinate wages through negotiation. While I do not assess the effectiveness of these

institutions, the claim is that such institutions enable greater control over wage increases and promote wage solidarity (Iversen, 1999). There was a mild increase in wage co-ordination among European economies through the 1990s and into the 2000s. In particular Mediterranean countries and Ireland showed a much stronger trend towards centralised wage bargaining while Christian democratic and social democratic countries remained stable. The peripheral economies developed a series of ‘social pacts’, at least partly motivated by the prospect of monetary union and the need to manage cost pressures and enhance competitiveness (Regan, 2012; Avdagic et al, 2011).

Figure 5: Wage Coordination in European Worlds of Capitalism, 1990-2006

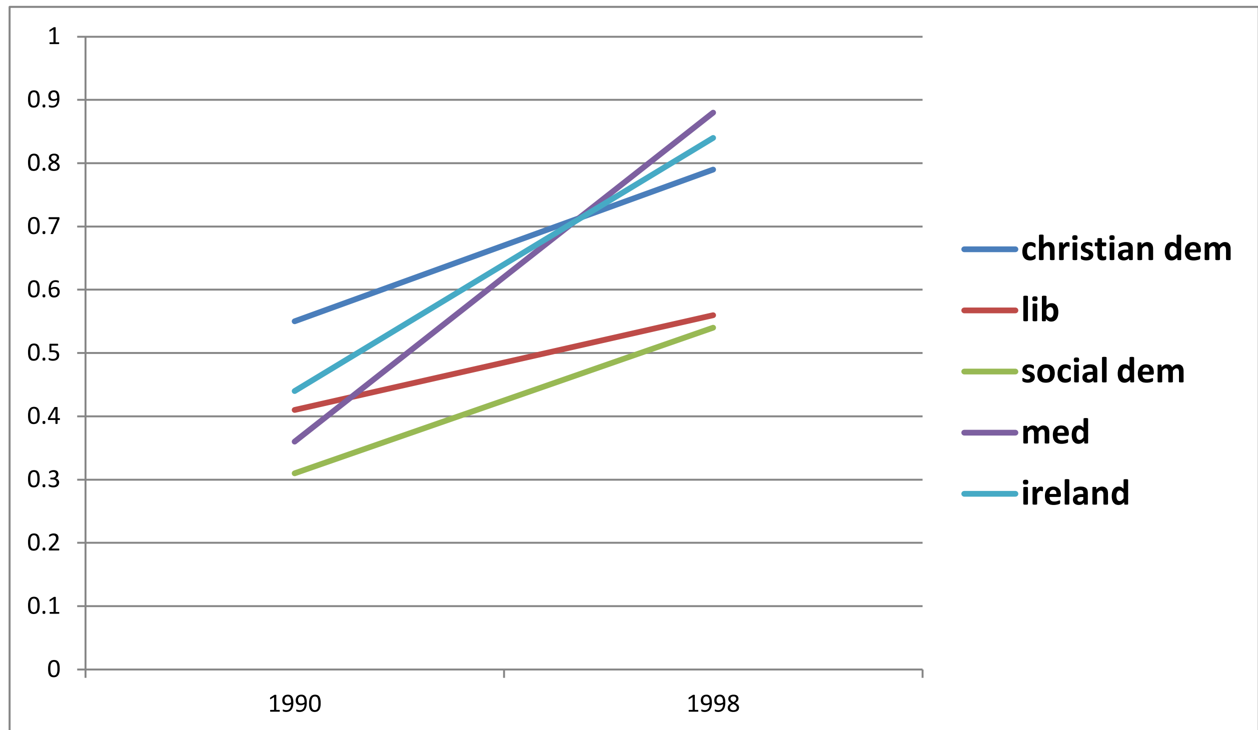


Source: Visser (2011)

Finally, the 1990s was an era when political economies around the world gave their central banks significantly greater independence from governments (Polillo and Guillen, 2005). Central Bank independence provides ‘discipline’ by creating an institution that is (typically) legally independent and committed to various elements of financial and fiscal discipline – including reducing inflation and maintaining the government financial balance close to surplus. Figure 6 shows that during the 1990s there were dramatic trends towards promotion of central bank independence. This was true across all of the worlds of capitalism. However, the most dramatic increases were not in liberal countries but in the Mediterranean and Irish cases, and to a slightly lesser extent the Christian democracies. Furthermore this is not convergence on a liberal model, as central bank independence is much lower in both the liberal and social democratic countries, but on a Christian

democratic model which had by far the highest level of central bank independence in 1990 and is now clustered in a group with Ireland and the Mediterranean economies.

Figure 6: Central Bank Independence in European Worlds of Capitalism, 1990-1998



Source: Polillo and Guillen (2005)

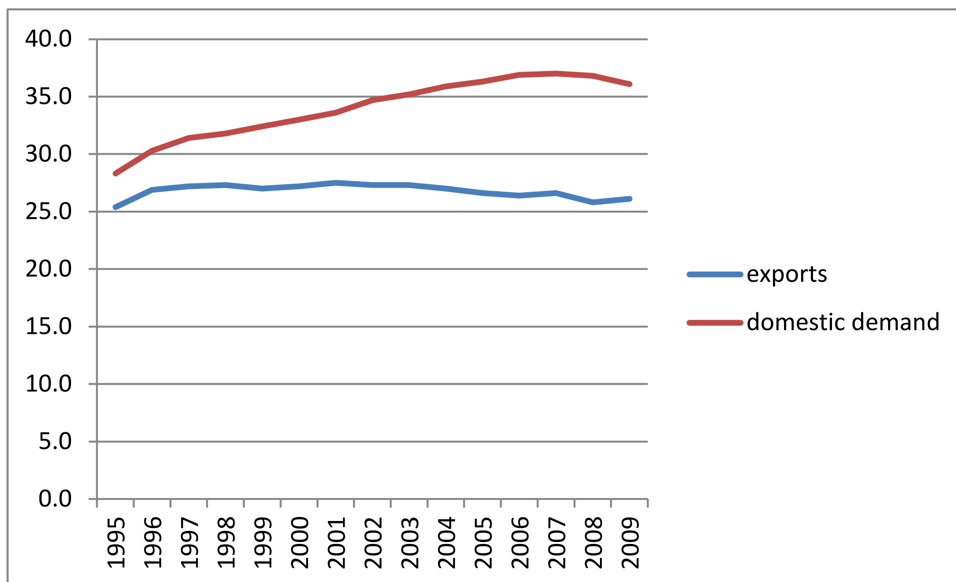
Formal institutional convergence therefore is a mixed story with liberal convergence on weakened regulation of product markets and employment, Christian democratic convergence on central bank independence and increasing wage co-ordination in the periphery in the 1990s (also a strong feature of social democracies). In the EU, these reforms were largely initiated through the Open Method of Coordination, a form of loose coordination across governments and societal actors, rather than through administrative fiat or governmental decision – with the exception of product market deregulation which was put on a legal footing. These measures were intended to remake national institutions – typically in preparation for EMU. They were at least as representative of the Christian democratic policy mix as of the liberal model. The Mediterranean and Irish economies sought hasty institutional convergence with the 'European model' of institutional management of the economy, arguably without the supporting institutional and normative foundations that were present in the countries where they had been longer established. In many respects, alongside Europe's market liberalisation, Europe pursued a project of convergence on a Christian democratic ordo-liberal model – through the combination of the creation of the Euro, its fiscal rules and the ECB's mandate, alongside the 'open coordination' of trends towards central bank independence and coordinated wage bargaining (particularly in the European periphery).

Nonetheless, differences in social compacts persisted that were to be disastrous as financialisation placed ever greater strains on the structural dynamics of the European economy. As Senghaas (1985) argued, the post-war history of Europe was centred on the creation of institutions, coalitions and compacts that could manage both the economic relations and social structural changes associated with capitalist development in Europe – and deliver autocentric development. Ireland and the other peripheral countries only partially succeeded (at best) in undertaking this task, even as income converged. In Europe, as in the US (Krippner, 2011), financialisation depoliticised growth and distribution and allowed these cracks in the European economy to be papered over - even as it drove a further wedge between core and periphery in Europe. This was reflected in European politics as the euro project further sought to enshrine this depoliticisation in fiscal rules administered in a technocratic manner. This in turn was consistent with the 'permissive consensus' in Europeanisation that created a space for technocratic and/or inter-governmental advance of the European project (Hooghe and Marks, 2009). However, this came at the cost of a failure to address the very different social compacts, and therefore economic models, that were to be integrated within the European economy.

Fundamentally, the partial policy regime did not stabilise the European economy but turned it inside out. The relationship between the core and the periphery of Europe, and the financial flows between them, were dramatically restructured between the 1990s and the 2000s. The public developmentalism of the structural funds programme was overwhelmed by the capital flows from core to periphery associated with financial liberalisation. In the process a dramatic structural change was produced within the real European economy, reflected in significant current account imbalances.

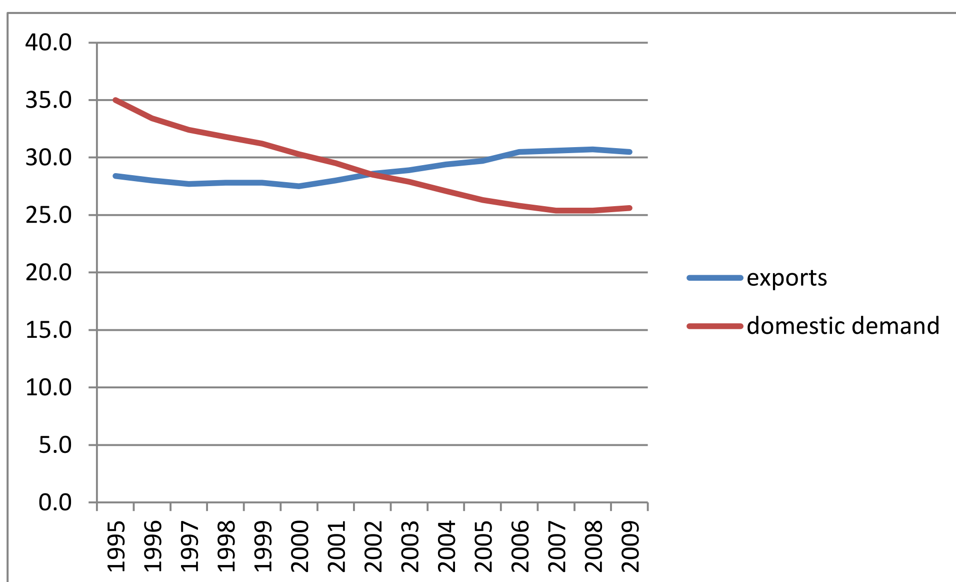
Figures 7 and 8 show the shifting compositions of the core and peripheral economies in Europe as a proportion of the structure of the entire Eurozone economy. They show that in the 1990s Spain, Ireland, Italy, Greece and Portugal saw significant increases in their share of total exports in the Euro area increasing from just above 25% in 1995 to approximately 28% in 2001 and that at the same time these countries' share of domestic demand in Europe increased. Export growth and domestic demand were linked in a reasonably healthy manner, suggesting that the virtuous circle of the European model had begun to embed itself within the European periphery. During the same period German exports remained stable and its share of domestic demand in Europe declined significantly.

Figure 7: Exports and Domestic Demand in the European Periphery, 1995-2009



Note: % is of total exports/demand in the Euro Area (16 countries)

Figure 8: Exports and Domestic Demand in Germany, 1995-2009



Note: % is of total exports/demand in the Euro Area (16 countries)

In the 2000s these patterns shifted. The peripheral share of Eurozone exports decreased once more although remaining slightly above the 1995 level while Germany's share of Eurozone exports increased rapidly. However the peripheral countries' share of domestic demand continued to increase. Just as importantly, Germany's share of domestic demand

continued to decline. The 2000s in Germany were a period of increased export competitiveness disconnected from the virtuous circle of increased domestic demand that is crucial to the European model. Domestic demand and export competitiveness were de-linking in both the periphery and in the core. This created major structural imbalances within the European economy and suggests that the underlying European model of development was compromised both by the bubble growth in the peripheral economies and by the failure to generalise export growth in the core to the living standards of the broader population. The crucial feature linking both of these processes together was the shift to a deeply financialised relationship between core and periphery. We might expect core economies to be the Keynesian anchors in an economic union while the hungry peripheral economies pursued catch-up through Schumpeterian competitiveness strategies. In practice Europe was characterised by the opposite – a disastrous combination of a Schumpeterian core and a Keynesian periphery, facilitated by financialisation and core banks.

The challenges of dealing with the European crisis since 2008 have involved not simply national interests of elites or the level of attachment of individuals to the European project – but have been heavily shaped by different expectations in European countries of what is fair, rational and reasonable to expect of other European nations and citizens. This has been a clash not only of social classes and of national interests but also of institutionalised social compacts. The stabilisation of capitalist economies depends heavily upon the social compacts in the surrounding societies.

Given this approach, we can see that the euro and the stability and growth criteria were in practice designed to act as just such a framework for integration of multiple social compacts. As is well known, these mechanisms were sorely lacking and Europe as turned inside out, riven by structural divergences and weakened by institutions that were too weak and fragmented to address those fractures.

In the 2000s Europe was left with a set of persistent dilemmas for governing economic life, despite the advent of the euro. How should economies conform to the new economic rules with only recent institutional transformation and a very partial and uneven social compact across the member states? These questions were all the more pressing because the stability arising out of the 'market test' that German policy elites had expected did not materialise. In practice, the opposite happened as financial 'discipline' disappeared in speculative financial markets and significant imbalances emerged in Europe's economic flows.

The desire of the French left had been to build the social market economy at the European level, having failed at the national level. Ironically, when the institutional shape of the new European economy emerged, it looked more German than French, accompanied by a distinctly Anglo-American taste for financial speculation. But whether it was the German ordo-liberal model advancing through the euro or the French statist model led through the increasingly marginal European Commission, both neglected the foundation of their national models, and the new European model, in deeply institutionalised social compacts.

This left significant challenges for national political economies, to which they responded in different ways.

At either end of the spectrum were the continental countries and the UK. The Christian democratic economies were firmly within the euro and signed up to the policy regime – despite their failure to stick to the rules in the initial years and not surprisingly given their economic rules were the basis of the European model. At the other end sat the UK, outside the euro and with limited or no institutional convergence. It remained 'liberal' and far from this new European terrain. The other cases were less clear-cut. The Social democratic economies also had long histories of conforming to similar kinds of policies and building similar institutions – even product market deregulation emerged early in the Nordic economies. However, while they largely followed the economic disciplines of the euro, they almost all stayed out of the euro itself. Because their internal compacts allowed them to follow the disciplines associated with the euro, they were able to forego the loss of overall control attached to the euro.

Finally, there is the crucial category of the European periphery, including the Mediterranean economies and Ireland. These countries sat in a difficult position. In one way or another, their histories were most closely tied to the liberal model, often mediated through clientelism. The development of the welfare state, and even the administrative state, was at a much lower level than in the continental economies whose policies and institutions were now spreading into the periphery. They found themselves within the euro but with only new institutions and weak social compacts to manage risks and sustain them through crises.

The kinds of demand made from the periphery for more Keynesian responses and similar anti-crisis measures were always likely to fall on deaf ears until some reconciliation of these different logics within European capitalism could be found. Table 5 provides a schematic outline of the typical response to economic crisis in liberal and social market capitalisms. Despite being highly schematic the table gives us a sense of the set of typical options available within the worlds of European capitalism. The table suggests that in each world of capitalism, a contractionary response is combined with a counter balancing expansionary response. The liberal approach relies primarily on private investment to drive recovery, restricting the expansionary contribution of the public sector, but compensates for this with flexibility in expansionary monetary, currency and sometimes fiscal policy. Despite their association with Keynesian demand management, social market capitalisms are typically more conservative in terms of fiscal consolidation, at least in recent decades. However, they are willing to use state investment to drive recovery (for example, the activities of the German state investment bank after 2008).

Both approaches combine expansionary and contractionary elements in their stylised 'policy mix'. However, the Eurozone-level response has emphasised the contractionary dimensions of both models without taking on the counter balancing expansionary measures. This transnational response has involved fiscal consolidation and restoring confidence in public finances in order to drive future private investment (an investment that has been predictably weak, at least where it is needed most). There was been some discussion of Keynesian measures in the core, including loosening of fiscal policy and increase in wages to boost demand (and ideally, though not necessarily, imports from peripheral economies). However, this made limited progress and in 2013 both France and Germany were planning significant national fiscal consolidation. Less prominent in public debate were suggestions for the expansion of transnational state-led investment – and indeed the EU budget for 2014-2020 was cut by 3.3%, particularly in growth-promoting investments including R&D and structural funds for regional development. The European-level policy response has primarily combined the two contractionary elements from each national policy mix and ignored their expansionary counterweights – providing a policy mix of the worst of both worlds of capitalism.

Table 5: The European Union Response to the Crisis

	Liberal Capitalisms	**Social Market Capitalisms**	**European Union, 2008-2012**
Macro-Economic Management	**Keynesian Demand Management**	**Fiscal Consolidation**	**Fiscal Consolidation**
Supporting Real Economy Recovery	**'Confidence' and Private Investment**	**State-Led Investment**	**'Confidence' and Private Investment**

Armingeon and Baccaro (2012) document the variety of Eurozone level responses that were possible and that were mooted at the European level during the crisis. One possibility was a more activist monetary policy by the European Central Bank, loosening its dedication to maintaining low levels of inflation. The European Commission in 2011 also endorsed an alternative involving the introduction of Eurobonds to be jointly guaranteed by Eurozone members. Financial guarantees voluntarily provided by Euro area members are another option and are the basis of the European Stability mechanism (ESM) which was put in place in 2012. Despite the large amounts of funds available, approximately one trillion euro, these funds are dwarfed by the overall level of debt within the Eurozone. Crucially, "all

proposals discussed would mutualise, and hence reduce, the risk associated with GIIPS [Greece, Italy, Ireland, Portugal, Spain] sovereign debt" (Armingeon and Baccaro, 2012:184).

These strategies all would face significant legal and political difficulties. Crucially in our terms they involve a mixing of the internal logics of Europe's capitalisms. Behind the accounting and financial flows of "mutualisation" lies a fusing of two different social logics. One emphasises the externalisation of economic risk and the flexible revaluing of state and society alike, while the other emphasises the internalisation of risk and a kind of defence of state and society even at the cost of significant losses of national and household income. The European crisis has made demands on the European economic system that go to the heart of the differing socio-political and socio-economic logics at work within the social field of the European Union. Where the response required seems to demand a more creative and deeper form of integration or a complete loosening of the bonds within Europe, the response has been to fall back on the "thin integration" of the fiscal rules at the heart of the euro. While these rules and criteria have been expanded and their legal basis and enforcement mechanisms strengthened in the Fiscal Treaty of 2012, the underlying relations between Europe's capitalisms remain much the same.

These differing worlds of capitalism can be integrated but only if political creativity can be rediscovered. Indeed, the flip side of these challenges of integration is that the 'institutional menu' available to policy makers is much more diverse in Europe than elsewhere. The implication of this paper is that such European integration over the long term will require not simply a banking or fiscal – or even a transfer – union but a developmental and investment union, where the demands for enhanced competitiveness in the periphery are backed up with significant investment, policy learning and other supports. Transnational investments in infrastructure and in social and business resources would also be crucial. This would pose very great challenges to both core and peripheral economies but also to the euro itself. The euro area will need to shift its underlying compact from a currency bargain that boosts export competitiveness because of the structural inequalities in development that it contains to one based on a genuinely integrated socio-economic region based on both investment and discipline. In short, Europe will need to rediscover the 'European model'.

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