2. Key factors shaping the path taken by structural reforms

2.1 The Great Recession and the subsequent reform wave

As stressed by Starke *et al.* (2013: 32), an economic crisis is a sudden, often unexpected, deterioration of key macroeconomic indicators: GDP growth, inflation, public debt, poverty risks. Global crises are those experienced simultaneously by different countries on different continents.

The so-called Great Recession is precisely a serious and global disruptive event that has hit the political economy of many countries in Europe. The crisis began in mid-2007 with the drying up of liquidity in money markets, until it took a turn for the worse following the collapse of Lehman Brothers in 2008. This was followed by a broad economic recession that hit Europe in 2009. The third step was the Greek budgetary crisis and the consequent tensions in the EU. In its early stages, the crisis manifested itself as an acute liquidity shortage among financial institutions. The inter-bank market virtually closed and risk premiums on inter-bank loans soared. Banks faced a serious liquidity problem, as they experienced major difficulties in rolling over their short-term debt. In this phase, concerns over the solvency of financial institutions increased, especially when a major investment bank defaulted in September 2008. Confidence collapsed, taking down major US and EU financial institutions.

The crisis thus began to feed on itself, with banks forced to restrain credit, economic activity plummeting, loan books deteriorating, banks cutting down credit further, and so on. The EU economy entered the steepest downturn since the 1930s. The transmission of financial distress to the real economy evolved at record speed, with credit restraint and sagging confidence.

The drop in financial wealth, across-the-board deleveraging, credit rationing and the rise in the prices of capital and debt, as well as the drop

in demand worldwide, came together to make a severe recession. Negative growth was particularly severe in the United States, but Europe was hard hit, too. Economic activity was affected by the crisis, as was potential output (the level of output consistent with full utilisation of the available production factors labour, capital and technology).

Labour markets in the EU started to weaken considerably in the second half of 2008, deteriorating further in the course of 2009. The EU unemployment rate rose by more than 2 percentage points. The condition of the European economy in this crisis corresponds almost exactly to the textbook case for a budgetary stimulus. In the aftermath of the crisis, short-term fiscal expansion was perceived as necessary to deal with the downturn (Natali 2010).

The decline in potential growth due to the crisis has put further pressure on public finances and contingent liabilities related to financial rescues and interventions in other areas add further risks. Part of the improvement in fiscal positions in recent years was associated, among other things, with growth of tax-rich activity in the housing and construction markets. The unwinding of these windfalls in the wake of the crisis, along with the fiscal stimulus adopted by EU governments as part of the EU strategy for coordinated action, has weighed heavily on the fiscal challenges even before the budgetary cost of demographic ageing kicks in.

The resulting surge in budget deficits has been unprecedented in the EU. As a result of automatic stabilisers and discretionary measures to save the banking sector and stimulate economic growth, EU countries have suffered increased budgetary tensions. This fiscal stimulus amounted to up to 2 per cent of GDP, on average, in the EU for the period 2009–2010. Since 2010, analysts have seen a return to a much more familiar scenario: the banks have gone back to business as usual, governments have unveiled budgetary restraint measures or ‘austerity’ programmes, while unemployment has risen. In 2009–2010 massive amounts of private banking debt were transferred to states, which felt compelled to keep their financial industries, and the economy in general, at arm’s length. The sub-prime crisis became a sovereign debt crisis (Degryse and Natali 2011).

In the following years, austerity has continued to be put forward as the key to overcoming the crisis, despite evidence of ongoing economic diffi-

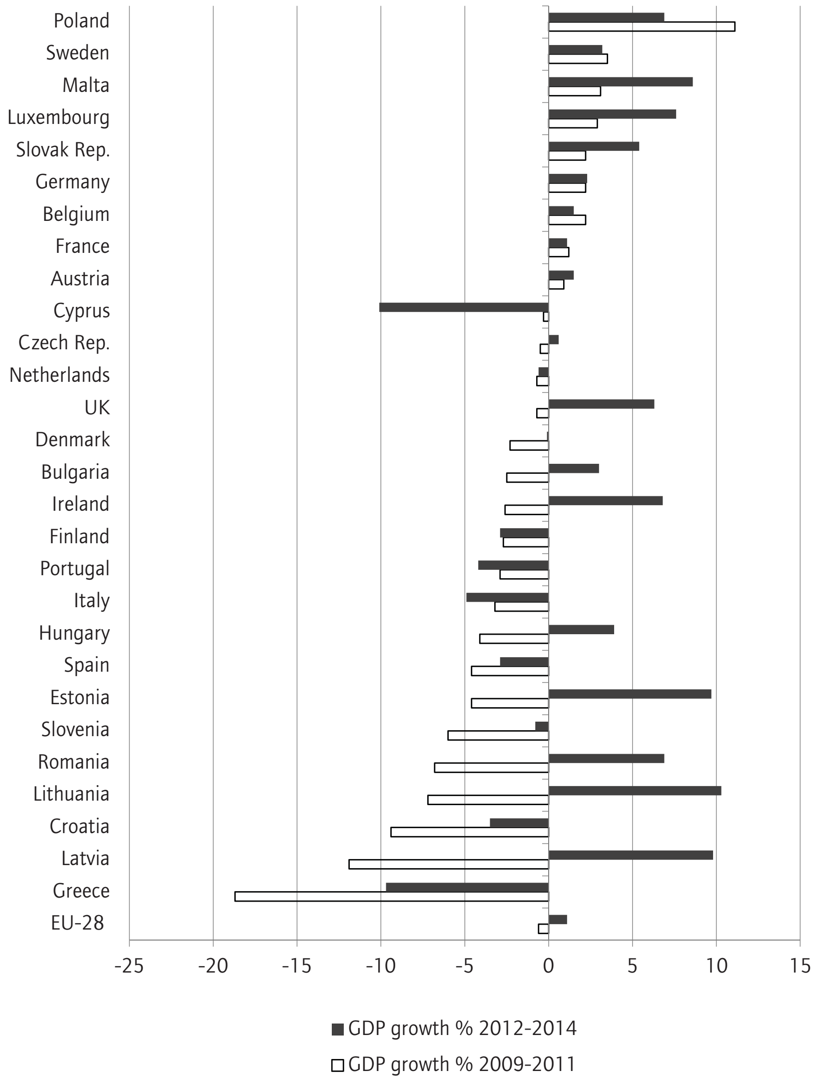
culties in a large number of Member States. Southern Europe in particular is still trapped in a 'double dip' economic recession. A vicious circle of austerity plans, budgetary tensions and political and social dissatisfaction has characterised recent months. In Continental and Northern Europe the economic cycle seems more reassuring. Summing up, some years after the start of the crisis, Europe is the only major world region in which unemployment is not decreasing. Long-term and structural unemployment have continued to grow in most Member States. Poverty and social exclusion are on the rise in one-third of EU Member States. This is most visible in the increase in the numbers of people living in jobless households and those suffering severe material deprivation. Young people have been most seriously affected: they increasingly face considerable problems in making the transition from education into employment, and many of those in work often hold unstable jobs with unfavourable conditions (Natali and Vanhercke 2012).

During the crisis, the labour market performance in the EU was, on average, worse than that in other developed countries. Employment rates in the EU between 2008 and 2013 were lower than the OECD average, while unemployment rates were higher. In 2013, unemployment reached a peak of 27 million (about 11.5 per cent). These negative labour market trends were accompanied by negative GDP growth in both the EU and the euro area in 2011 and 2012. Income and wage inequalities have further increased in the period.

One of the key features of the crisis in Europe has been the increasingly divergent trends in the socio-economic performance of different countries. Since 2008, most employment and social indicators have pointed to growing divergence between the Southern and peripheral European Member States and those of Northern and Central Europe. Data on GDP trends prove that the crisis hit different EU Member States with different degrees of magnitude (Figure 1).

The average unemployment rate reached 17 per cent in the south and periphery of the euro area, as against 7 per cent in the northern part of the continent. The gap has now reached its maximum level in the euro zone (about 10 per cent), around 10 times the difference between the same regions outside the euro zone. Thus, the financial crisis that erupted in 2008 has contributed to a huge divergence between the different European regions (Natali and Vanhercke 2013).

Figure 1 **GDP trends between 2009 and 2014**



Source: Eurostat.

2.2 Domestic factors: policy legacy and political dynamics

The crisis is understood here as an accelerator of reforms of economic and social policies at country level. But the economic shock did not determine the reforms. The latter are the result of a complex interaction of both domestic and supranational factors. By domestic factors we mean both (policy) institutions inherited from the past and national political dynamics.

2.2.1 Policy legacy

Exogenous challenges do not impact on immovable objects. But they do interact with highly complex institutions characterised by a more dynamic evolution over time. The term ‘institution’ is used as a synonym of policy arrangements, which create rules, constraints and incentives for political action (Myles and Pierson 2001). Welfare and production regimes together represent the cornerstone of capitalist systems and their policy institutions tell us a lot about how a political economy works and reacts to crises. While in the past few years different clusters have been proposed in terms of social models (Dølvik and Martin 2014; Schweiger 2014) and employment models (Bosch, Lehndorff and Rubery 2009), in the following we refer to the varieties of capitalism approach and to welfare and labour market regime approaches.

With regard to varieties of capitalism in Europe, we first refer to the seminal work of Hall and Soskice (2001) and the definition of two varieties of capitalism in Europe. The coordinated market economy (CME) is based on non-market relations, collaboration, credible commitments and deliberative calculation on the part of firms. The liberal market economy (LME), by contrast is described in terms of arms-length, competitive relations, competition and formal contracting, and the operation of supply and demand in line with price signalling (Hall and Soskice 2001). In the LMEs, fluid labour markets fit well with easy access to stock market capital and the profit imperative, making LME firms ‘radical innovators’. In the CMEs, by contrast, long-term employment strategies, rule-bound behaviour and durable ties between firms and banks underpinning patient capital provision predispose firms to be ‘incremental innovators’. CMEs then split into two sub-clusters (Thelen 2014): national-CMEs (NCMEs), in which coordination takes place at national level through

comprehensive industrial relations with high levels of social partner density; and sector-CMEs (SCMEs), in which coordination happens at sectoral level and with weaker social partners.

Mixed-market economies (MMEs) are the third model proposed by the literature. The state is an important actor through the creation of a large state-controlled business sector and control of the financial system. At the same time, interest associations of both business and labour have stronger organisational structures than in LMEs, but are more fragmented and weaker than in CMEs. Interest groups demand some form of compensation from the state for their acquiescence (Molina and Rhodes 2007). Compensation usually consists of passive labour market policies and a transfer-oriented welfare state. More recent analysis of central and eastern Europe has proposed some further varieties. In line with Bohle and Greskovits (2012), we refer to Visegrad countries as part of the embedded neoliberal market economies (ENLMEs), based on relatively generous targeted social protection packages – a sort of side-payment for the opponents of neoliberal reforms – together with measures and nstitutions to attract multinationals.[2]

Whereas the varieties of capitalism approach tries to understand how firms deal with institutional environments that vary between the production systems of different countries, Esping-Andersen analyses how welfare is distributed in terms of individuals' rights and duties vis-à-vis the state. Similarly, with regard to labour market policies, Bonoli (2013) has distinguished between four clusters of countries in Western Europe. Anglo-Saxon countries, namely the UK, have taken a liberal approach: low levels of labour protection and unemployment benefits. The United Kingdom has reinforced the role of the market in addressing socio-economic challenges, with low public spending on both passive and active policies. Nordic countries – Denmark, Finland and Sweden – have put more emphasis on active policies. These have been combined with low levels of labour protection and generous unemployment benefits. In Continental European countries, labour market protection has been

2. Eastern Europe is characterised by, first, the Baltic countries, which are neoliberal market economies (NLMEs): with small fiscal and welfare states, which perform well in terms of macroeconomic stability. Slovenia is a neo-corporatist market economy (N-CME) with highly developed industrial relations institutions and a generous welfare state. The peripheral market economies (PMEs) are represented by Bulgaria and Romania: they are weak economies based on cheap labour, weak infrastructure and firms that enjoy some independent sources of finance (Drahokoupil and Myant 2012).

traditionally high and combined with high levels of spending on passive measures. However, there have been few active labour market policies. These traits are even more evident in Southern Countries, where labour market protection has been high, active labour market policies of limited importance and passive labour market policies rudimentary. Davidsson (2011) has confirmed the existence of such clusters for Western countries, and has added a fifth: Emerging Eastern European Economies. The latter are characterised by segmented and deregulated labour markets and weak passive protection and active policies (see Agostini and Natali forthcoming).

All these typologies arrive at very similar country groupings, because 'virtually all liberal market economies are accompanied by "liberal" welfare states' (Hall and Soskice 2001a: 50) and all coordinated market economies are accompanied by either a social democratic or a conservative welfare arrangement. Southern and Eastern European countries belong to further coherent clusters of economic, social and labour market policies.

2.2.2 Domestic political dynamics

The question 'does politics matter?' has for decades been at the centre of the academic debate about the role of domestic political dynamics in shaping policy change and continuity. In the past, authors have stressed how much the partisan composition of parliamentary majorities and governments matters in addressing the critical economic conditions related, for instance, to the Great Depression (Castles 2010). The same has been found for the European and North American reply to the oil shocks at the end of the twentieth century. Others have shown that party politics do not matter so much especially in the shadow of critical economic junctures. For Starke *et al.* (2013), the basic finding is that social democratic parties – often aided by trade unions (Korpi 1983) – have had a positive effect on the expansion of welfare states across the OECD. In addition, Christian democratic parties have had a similar effect on expansion, albeit with particular emphasis on specific types of policies (Starke *et al.* 2013).

Between the end of the twentieth and the beginning of the twenty-first centuries, however, partisan politics has been seen as less significant. Social democratic parties are often no longer seen as the guarantors of

welfare state expansion, either because of a general ideological shift, constraints stemming from economic globalisation or policy legacy (Huber and Stephens 2001; Kittel and Obinger 2002).

Lipsmeyer (2011) finds a diminishing partisan impact on social expenditure during downturns, because economic shocks affect a large share of the population, including both left- and right-wing voters. Hence, left- and right-wing parties tone down their policies in the aftermath of shocks. Vis *et al.* also find that immediate crisis reactions in 2008/09 were enacted 'irrespective of the political leaning of the ruling parties' (2011: 349).

A further element to consider is the suspension of ideological differences. In general, technocratic governance, the centralisation of decision-making and consensus at the top should be the rule during periods of economic shock. This 'crisis centralisation' thesis would predict decision-making in small groups involving the executive and a loss of power of typical veto players. This is largely consistent with the emergence of caretaker governments, which have led reform efforts in some EU countries.

Populism has returned to European politics, with an impact on the reform agenda. Terms such as 'welfare chauvinism' can be used to describe the attitude of right-wing and populist movements towards social policy and industrial protectionism (Mewes and Mau 2013). Evidence collected so far shows that these populist movements tend to defend social spending against neoliberal strategies, especially for native citizens, while excluding immigrants.

2.3 The supra-national factors: EU leverage

Since the outbreak of the financial and economic crisis, several initiatives aimed at better synchronising and coordinating Member States' fiscal and macroeconomic policies and at strengthening the EU's ability to monitor and steer domestic policies have been undertaken (cf. De La Parra 2013; Degryse 2012; Martin 2015; Schweiger 2014; Zeitlin and Vanhercke 2014). Existing instruments and coordination procedures in these policy domains have been made more stringent and new initiatives have been developed, in some cases through international agreements outside the EU treaties. In order to identify the possible channels

through which any kind of 'EU influence' on Member States' structural reforms could develop (as well as the strength of such 'EU pressures'), we will briefly illustrate a number of key procedures and tools developed or reinforced by the EU over the crisis years: (i) developments related to fiscal, macroeconomic and sectoral policies coordinated through the European Semester; (ii) arrangements to provide financial assistance to Member States experiencing financial difficulties; and (iii) 'conditionality' attached to the Structural and Investment Funds 2014–2020.

2.3.1 The European Semester: 'building blocks' and governance procedures

Formally codified in the Six Pack,[3] the European Semester is an annual policy cycle coordinating procedures related to three processes: the Europe 2020 Strategy and the Integrated Guidelines for growth and jobs (thematic coordination aimed at fostering structural reforms); the reformed Stability and Growth Pact (fiscal policy); and the Macroeconomic Imbalances procedure (macroeconomic policy).

Launched in 2010, the *Europe 2020 Strategy* is aimed at fostering structural reforms in a number of policy domains in order to promote 'smart', 'sustainable' and 'inclusive' growth. Europe 2020 relies on a set of 10 'Integrated Guidelines for growth and jobs' (Council of the European Union 2010) which concern – besides budgetary and macroeconomic issues (IGs 1–3) – policy areas such as research, development and innovation, climate change and energy sustainability, the business environment, employment, education and training, and social inclusion. Five quantitative EU headline targets related to these policy areas – to be translated into national targets and achieved by 2020 – have been agreed on and seven 'flagship initiatives' aimed at facilitating progress towards the targets have been set up (cf. Vanhercke 2013). As for reporting and monitoring procedures, both EU guidance/monitoring and Member States' reporting are embedded in the procedures of the European Semester (see below). Further cooperation in some of the policy domains of the Europe 2020 Strategy has been introduced through the *Euro Plus Pact*, an agreement signed in March 2011 by 23 Member States[4] that committed

3. The 'Six Pack' consists of five Regulations and one Directive adopted in 2011.
4. The euro area countries plus Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

themselves to take action in priority policy areas essential for fostering competitiveness and convergence, including competitiveness, employment, sustainability of public finance, financial stability and cooperation on tax policy (European Council 2011: Annex 1). Every year each Member State identifies a series of concrete initiatives to be completed within 12 months in the domains covered by the Pact and the implementation of those initiatives is monitored through the European Semester.

With regard to fiscal surveillance and coordination, provisions introduced through the 'Six Pack' and the 'Two-Pack' legislation[5] have reinforced the *Stability and Growth Pact*, strengthening both its preventive and corrective arms. Under the former, every year the Member States must submit their budget plans for the next three years (the 'Stability Programmes' for euro zone countries and the 'Convergence Programmes' for the countries outside the euro zone), which are assessed by the Commission (ex-ante assessment). Negative assessment may lead to a series of consequences, including: (i) country-specific recommendations issued by the Council or (ii) Commission 'warnings' followed by Council recommendations, possibly leading to financial sanctions (for euro-area Member States). As for the 'corrective arm' of the SGP, the *Excessive deficit procedure* (EDP) has been reinforced, especially with regard to euro-area Member States, the latter being subject to closer monitoring and regular reporting requirements to the European Commission when subject to EDP. Indeed, euro zone countries under EDP must regularly submit reports allowing the Commission to assess whether there is a risk that the Member State will be unable to correct the excessive deficit by the deadline set by the Council, a circumstance that may entail a new recommendation containing further or different actions. Furthermore, those countries are requested to draft 'Economic Partnership Programmes' (EPPs), providing 'a roadmap for structural reforms considered as instrumental to an effective and lasting correction of the excessive deficit' (European Commission, n.d.). Finally, financial sanctions are possible for euro-area Member States that fail to address excessive deficits. Further provisions aimed at strengthening fiscal discipline in the Member States and EU-level surveillance have been introduced through the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) and the Two Pack. The core of the TSCG – an intergovernmental agreement signed in March

5. The 'Two Pack' includes two Regulations which entered into force in May 2013.

2012 by 25 MS (all the Member States except the Czech Republic and the United Kingdom) – is the so-called '*Fiscal compact*', which commits the contracting parties to embed into national legislation (preferably at the constitutional level) the 'balanced budget rule'. As for the Two Pack, besides the provisions directly related to the SGP illustrated above, it has introduced a *common budgetary timeline* for the members of the euro zone, whose draft budgetary plans are now subject to a preliminary assessment by the European Commission.

In the domain of macroeconomic policy, new procedures aimed at identifying at an early stage, monitoring and correcting 'macroeconomic imbalances' have been introduced by the Six Pack. A new surveillance and enforcement mechanism – the *Macroeconomic imbalances procedure* (MIP) – has been introduced, under the responsibility of the ECOFIN Council. The MIP consists of three steps (Vanhercke 2013: 98). First, an 'early warning system' based on a set of 11 macroeconomic indicators – with specific 'alert thresholds' – concerning both external and competitiveness imbalances. The scoreboard is published in the 'Alert Mechanism Report' (AMR) – drafted by the European Commission – and allows the Commission to identify countries whose situation needs an 'in-depth review'. Second, the Commission and the Council can adopt preventive actions consisting of recommendations to the Member States enshrined in the set of country-specific recommendations issued in the context of the European Semester. Finally, if severe macroeconomic imbalances are detected, an 'Excessive imbalance procedure' (EIP) can be opened (corrective actions). In this case, the Member State concerned must submit a corrective action plan (with a precise roadmap and deadlines for implementing corrective actions) and regular progress reports. Sanctions may be imposed if the Member State does not comply with the recommended corrective actions or if it fails twice to submit a sufficient corrective action plan.

As for the governance procedures, the *European Semester* annual policy cycle starts in November, when the European Commission publishes the Annual Growth Survey and the Alert Mechanism report. While the latter document specifically relates to the macroeconomic imbalances procedure, in the AGS the European Commission identifies the main economic challenges facing the EU and recommends priority measures to address them in the coming year. These priorities concern both economic and fiscal policies, as well as the other policy areas covered by Europe 2020. Priorities and guidelines set out in the AGS should feed

into Member States' Stability or Convergence Programmes (SCP) and National Reform Programmes, which deal, respectively, with budgetary policies and with reforms in the areas of the Europe 2020 Strategy. In order to ensure complementarities between fiscal and other structural policies, SCPs and NRPs must be submitted simultaneously in April. On the basis of the NRPs and of the SCP – as well as relying on other information gathered by its country-desks and services – in May the European Commission issues draft country-specific recommendations to be approved by the Council and then endorsed by the European Council.[6] The CSRs are not addressed to countries under the adjustment programmes, which receive only the generic recommendation to implement actions agreed in their Memoranda of Understanding (see below).

2.3.2 Financial assistance

Since the beginning of the crisis, financial assistance has been provided to Member States experiencing financial difficulties that might threaten the financial stability of the EU and of the euro zone. Two intergovernmental support mechanisms were created between May and June 2010: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF), the latter concerning euro-area Member States only. The EFSF, initially conceived as a temporary arrangement, has been replaced by a permanent mechanism – the *European Stability Mechanism* (ESM) – operational since October 2012. The activation of financial assistance mechanisms[7] is subject to strong elements of conditionality: once a Member State requests financial assistance, negotiations with the so-called 'Troika' (the European Commission, the IMF and the European Central Bank) start, eventually leading to the elaboration of an 'Economic Adjustment Programme'. This document (also known as a 'Memorandum of Understanding' or MoU) details the structural measures to be implemented by the borrowing country in order to receive further tranches of the loan.[8] Progress towards im-

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6. For a more in-depth discussion on the CSRs, cf. Clauwaert 2014, Bekker 2015, Zeitlin and Vanhercke 2014.

7. For Besides balance of payments assistance for Latvia, Hungary and Romania, financial assistance has so far been granted to four euro zone countries: Greece (May 2010), Ireland (November 2010), Portugal (April 2011) and Cyprus (March 2013).

8. Measures contained in the MoU are extremely prescriptive and typically include (Greer 2013) reforms of fiscal policy (with a view to reducing public expenditure), reforms of state-owned enterprises (generally, their privatisation), reforms of the financial sector (*cont. on next page*)

plementation of the programmes is assessed by the Troika on a quarterly basis and, at each stage, the results of the assessment are reported in two documents drafted, respectively, by the European Commission and the IMF. Countries completing their adjustment programmes (so far, Ireland and Portugal) continue to be subject to an enhanced post-programme surveillance by the EC and the ECB until they refund at least 75 per cent of the financial assistance received.

Alongside the financial assistance mechanisms described above, in 2010 the ECB launched the *Securities Market Programme* (SMP), whereby it would purchase, on the secondary markets, government bonds of euro-area Member States. While this programme was formally unconditional, in some cases ECB interventions have been linked to a sort of 'informal conditionality', namely to stringent and pervasive requests to the Member States concerned to introduce specific measures aiming at enhancing growth, competition and accelerating liberalisations (Agostini *et al.* 2015).[9] In 2012, the SMP was replaced by *Outright Monetary Transactions* (OMT), a programme that can be accessed only by euro zone Member States that have formally entered the European Stability Mechanism, thus entailing 'explicit' conditionality (ibid.).

2.3.3 Structural funds

EU cohesion policy has traditionally been linked to the promotion of economic, social and territorial cohesion in Europe, and the Structural Funds have provided the Member States – especially the most disadvantaged regions – with additional resources for their development. One feature of the recent reform of the Funds appears particularly important for the present research: the reinforcement of the conditionality attached to their use. Indeed, in the context of the European Structural and Investment Funds 2014–2020, 'conditionality' can take on two connotations likely to have contrasting effects in relation to the capacity of EU Funds to exert a direct and positive influence on Member States' so-

(*cont. from previous note*) and market-promoting sectoral reforms (including labour market, wage-setting systems, pensions and health care, services liberalisation). Cf. Merisio (2014) for a detailed description of the various steps leading to the definition of MoU.

9. The most striking example is Italy, whose government received, in summer 2013, a letter jointly signed by the President of the ECB and his designated successor. The letter set out a detailed policy agenda, as well as the legal instruments through which it should be implemented (Sacchi 2013). On the role of the ECB during the crisis, see Barbier (2012).

cial policies. On one hand, the Funds are subject to 'ex-ante conditionality', meaning that funding is conditional on the fulfilment of specific requirements linked to each investment priority (including, for instance, the requirement to define national strategic frameworks for poverty reduction or for reinforcing administrative efficiency). On the other hand, they are subject to 'macroeconomic conditionality': the contribution of the Structural Funds may be suspended when a Member State reaches a significant level of non-compliance under the various EU economic governance procedures such as the EDP or the MIP.

To sum up, looking at the policy developments described above, what has been emerging is an increasingly complex system of governance, where EU 'pressure' on Member States' policies may assume different forms and intensity, and may derive from the interplay between a variety of instruments and procedures. Indeed, on one hand, the coordination processes developed/reinforced over the years in the various policy domains do not have the same 'strength'; on the other hand, not every country is equally affected by the new economic governance arrangements and the stringency of the enforcement mechanisms (hence, the degree of 'EU intrusiveness') differs, largely – but not exclusively – depending on whether the country is a euro zone member or not.[10]

There are many references in the literature to an altered and reinforced Europeanisation of socio-economic policies, where austerity measures are increasingly put at the top of the agenda by EU policymakers and consequently shape national reforms (de la Porte and Heins 2015). Others have painted a more complex picture, in which the reinforcement of EU economic and social governance has evolved over time. While the first post-crisis phase was characterised by austerity measures pushed through the European Semester and the other tools mentioned above, since 2013–2014 a more complex programme of structural reforms and more relaxed fiscal consolidation has been proposed by the EU (see Zeitlin and Vanhercke 2014; Schmidt 2015).

10. In their analysis of health-care reforms implemented during the crisis, Stamati and Baeten (2014: 15–16) have tried to capture this variation of EU pressure on domestic reforms by setting up an index of 'EU leverage'. The highest value of EU influence is attributed to countries that have signed a Memorandum of Understanding, while the other countries are classified under the remaining groups (moderate or weak leverage) taking into account factors such as the number and content of the Country-specific Recommendations they have received, whether they are euro zone countries and whether they have been subject to an Excessive Deficit Procedure or have signed an Economic Partnership Agreement.

2.4 Assessing structural reforms

Structural reforms are in fact a vague concept. These measures are expected to help improve economic growth prospects and the ability of economies to adjust to shocks. Product and labour market reforms should promote more efficient use of scarce resources (Canton *et al.* 2014). In the words of Rubio (2014: 2), structural reforms promote both countries' competitiveness and their adjustment capacity. While there is general agreement on what structural reforms are expected to contribute to, the precise definition of their substance is much more diverse. For some, in line with the liberal paradigm, these reforms are interpreted in terms of (de-)regulation of product markets – through the limitation of entry barriers, price control, public ownership and so on, and of labour markets, decentralisation of collective bargaining, stricter definition of wage setting targets and reform of unemployment protection. For others, and in line with a less normative interpretation, the term refers to a much longer list of policy areas: from competition and the regulation of labour and product markets, to areas such as education, pensions and social protection systems, and even sectors concerning the core activities of the state (tax collection, public administration, the judicial system). The IMF (2015), for instance, concentrates on labour and product market policies, education, health, innovation, housing policies, the efficiency of public sectors and tax systems. The European Commission (2014a) has provided a detailed set of policies under the broad definition of structural reforms in the European Semester: market competition and regulation, tax reform, unemployment benefit reform, labour market reforms (including active labour market policies), human capital investment and R&D investments.

From an analytical point of view it is possible, through the study of different policy areas and their evolution, to grasp the complex interplay of policy decisions and the importance of institutional complementarities. Eichorst *et al.* (2010) point out that institutions do not work in isolation. On the contrary they form complex institutional arrangements. System coordination and institutional complementarities are key elements of capitalist models, and 'when present in the "right" form, mutually reinforce each other' (Hassel 2014: 11). It is precisely these interactions that determine the economic and social performance of a country or group of countries. The focus on different policy areas first helps with the identification of national political economies, their logic and functioning. Second, it allows us to trace common and coherent trends where they exist,

Table 2 **Different types of structural reform**

		Investments	
		Decrease	Increase
Protection	Decrease	Social standards devaluation	(Selective) investment strategy
	Increase	(Socio-economic) protectionism	Social standards improvement

Source: Authors' elaboration.

or, on the other hand, to avoid over-estimating policy coherence. Thus, different arrangements may lead to equivalent performances. More than one model for economic growth and prosperity, indeed many models may coexist (Hall and Soskice 2001).

But what is the reform trend in the EU countries? To address this question we need to clarify what structural reforms look like and how they can be assessed. The more recent literature has clarified that not all reforms involve retrenchment and a reduction of social and economic rights. Reform packages can be varied and consist of different measures with different outcomes. Echoing Polanyi (see Bohle and Greskovits 2012) we focus on two different policy approaches reflecting two organising principles of contemporary welfare capitalism: economic liberalism and social and industrial protection. These two approaches inspire two policy agendas that are both included in structural reforms: one focused on investment in productive capacities (to increase the country's competitiveness); the other on protection (see Table 2).[11]

Table 2 shows four ideal-types of structural reform. In line with the literature on welfare and economic reforms – Hausermann (2012) and Thelen (2014), as well as Starke *et al.* (2013) – we first identify the two polar opposites. We refer to *social standards devaluation*, in cases of a set of measures aimed at cutting spending and consolidating public finances and with an overall decline in social rights (for example, deregulation,

11. The distributional consequences of structural reforms constitute another analytical dimension of considerable interest. In the following sections we do not refer to this, but other contributions in the literature have focused on the issue (see Almendinger and von den Drieschs 2014).

the decentralisation of collective bargaining and so on). Social standard devaluation is based on the idea that the deliberate deflation of domestic wages and prices through cuts to public spending and deregulation is designed to reduce a state's debts and deficits, increase its economic competitiveness and restore what is vaguely referred to as 'business confidence' (Blyth 2013). This is the case of countries more affected by the crisis, in which a combination of economic recession, fiscal stress, speculative attacks in the financial markets and social tensions have led to a systematic decrease in social rights and protection, while cutbacks have hit investments as well. This reminds us of the 'low road' to economic competitiveness based on cost-cutting, conflictual labour relations and a narrow set of social programmes (Millberg and Houston 2005).

At the opposite end of the spectrum we see *social standards improvements*: this consists of increased spending in order to improve a country's growth potential. This is also the type of policy pursued in the first years after the emergence of the *Great Recession*, when policymakers aimed to bail out the European economy, to implement 'Keynesian' policies and, some said, to take the opportunity afforded by the crisis for a 'paradigm shift' (Degryse and Natali 2011). Beyond an increase in social protection and consumption, the social standards improvement scenario consists of increased investments in the country's productive capacity through skills formation, R&D, education and innovation policies and so on. This is the 'high road' to economic competitiveness, with innovation based on cooperative labour relations and generally stronger and more centralised labour unions, high quality production and higher wages and costly welfare programmes (Millberg and Houston 2005).

As stressed in Table 2, we add two intermediate reform paths. On one hand, there is the (*selective*) *investment path*, based on cost-containment in the field of 'non-productive' spending and an expansion – in parallel – of specific growth-oriented policies (Kolev and Matthes 2013). The aim is to set up effective consolidation programmes that foster long-term growth and minimise the potentially negative short-term effects on economic activity. Comprehensive expenditure reviews are used to single out spending items that can be reduced without significantly endangering the effectiveness of government spending. Countries with sufficient fiscal space should aim at a gradual fiscal adjustment, while improving long-term growth prospects by moderately increasing public investment and education expenditures. Social investment can be part of this strategy of investments in human capital and knowledge to support

labour market participation, or to confront new social risks (Morel *et al.* 2012). A more selective investment strategy is the so-called 'Schumpeterian Workfare State' based on 'the promotion of product, process, organisational, and market innovation; the enhancement of the structural competitiveness of open economies mainly through supply-side intervention; and the subordination of social policy to the demands of labour market flexibility and structural competitiveness' (Jessop 1993: 9).

On the other side, we refer to *socio-economic protectionism*, where reforms tend towards strengthening social protection, while investment is sacrificed. Here the priority is to address the resulting social and economic difficulties. This does not involve an overall increase of public spending, but rather the definition of a strong network of protection and the promotion of social rights through the rationalisation of some public spending. A high level of public spending contributes to internal demand and consumption. This reform path aims at improving growth through domestic demand and at safeguarding social peace, for instance, through the segmentation if not dualisation of welfare recipients and the labour force (Hausermann 2012). This is also the case of populist forces that have a reform agenda consistent with the protection of domestic firms and the increase of social protection spending (for example, pensions) at least for native citizens.