THE REFORM OF SOCIAL PROTECTION SYSTEMS IN MIXED MARKET ECONOMIES

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RÉSUMÉ / *ABSTRACT*

Cet article analyse la réforme des systèmes de protection sociale dans deux pays méditerranéens, prenant comme point de départ le modèle des variétés du capitalisme. Son but est de démontrer l'intérêt d'une méthode intégrant les différentes approches à l'étude de l'État providence. Prenant comme point de départ la capacité limitée des théories existantes pour expliquer la dynamique de réforme des économies de l'Europe du Sud, l'article déploie une analyse sur deux niveaux pour rendre compte de la dynamique et de la direction du changement en Espagne et en Italie. L'intégration des conclusions provenant du modèle des variétés de capitalisme et de la littérature scientifique sur l'évolution de l'État providence nous aident à mieux comprendre les mécanismes du changement dans les économies hybride de l'Europe du sud. À cette fin, nous analysons l'interaction entre régime de production et de protection sociale. Parmi les variables clefs de cette analyse se trouvent : la fragmentation organisationnelle des associations collectives, les types de coalition de réforme, ainsi que les caractéristiques des systèmes politiques.

This paper reviews the reform of social protection systems in two Mediterranean economies in the light of the Varieties of Capitalism theory. Far from providing an exhaustive and detailed explanation of change in all areas of social protection, the paper aims to show the need to integrate insights from different approaches to welfare reform. The starting point is the limited capacity of existing approaches when it comes to explaining reform dynamics in southern European economies. The paper uses a two-level analytical framework in order to understand the dynamics and direction of change in Italy and Spain. The integration of insights from the varieties of capitalism and the politics of welfare reform literature helps to achieve a better understanding of mechanisms underlying change in the Southern European hybrid political economies. The interactions between production regimes and protection systems are analysed extensively. The organizational fragmentation of collective associations, the type of reform coalitions as well as the characteristics of the political system stand as important variables to explain change in social protection models of these countries.

MOTS-CLÉ / *KEYWORDS*

Espagne, Italie, réformes, politique sociale, variétés du capitalisme
Italy, reform, Spain, social policy, varieties of Capitalism

Introduction

Changes observed in the institutions governing the wage-labour nexus and social protection systems of Italy and Spain have attracted the close attention of scholars for more than a decade (Adam and Canziani, 1997; Perez, 2000; Cebrian et al., 2001; Molina, 2005; Molina and Rhodes, 2007). These analyses have tried to answer a series of puzzling developments: the achievement of macroeconomic stability allowing EMU entry despite apparently intractable initial imbalances; the consolidation and re-organization of collective bargaining systems that have resisted pressures for decentralisation notwithstanding a gradual loss of trade union strength; the resurgence of tripartite concertation and social pacts between employers, unions and governments (Rhodes, 2001; Hancké and Rhodes, 2005; Regini, 2003; Royo, 2002; Molina, 2006); and the renegotiation of welfare states and social protection systems without delivering across-the-board retrenchment and substantial cuts in benefit entitlements.

Even though the two countries have been subject to similar exogenous pressures, a closer inspection of their protection systems reveals the existence of some differences in the form and extent of institutional reaction. Two approaches in the welfare reform literature try to account for these differences. First, the work of Pierson (2001) around the politics of retrenchment highlighted the importance of political institutions, veto points and trade unions as purposive political actors (Bonoli, 2001). On the other hand, Huber and Stephens (1999) placed a stronger emphasis upon the interaction between production and protection systems. Following a similar approach, the Varieties of Capitalism literature argued that companies and employer organizations play a key role in explaining welfare state expansion and retrenchment (Hall and Soskice, 2001). According to the Varieties of Capitalism argument, business and their competitive requirements play a central role as the protection system affects not only labour costs, but also workers' decisions to invest in skills.

This paper approaches the analysis of change in Italy and Spain by drawing on insights from the Varieties of Capitalism (VoC) literature (Soskice, 1999; Hall and Soskice, 2001) but complementing it with elements of the politics of retrenchment theories. The starting point of the paper are the limitations of the Varieties of capitalism theory: the little attention paid to the role of the state, the over simplification of national models and ideal-types, an excessive concern for institutional stability and deterministic change, and finally, the difficulties to explain cases that fit uneasily within the two ideal-types of Coordinated or Liberal Market economies (Crouch, 2005; Molina and Rhodes, 2007). The familist character of the welfare state, characterized by the pivotal role of the family as care giver, a specific configuration of gender relations and a limited provision of public care services, suggests distinctive forms of adjustment to exogenous pressures as well as interactions between production systems and protection models different from those in the CME (Coordinated Market Economies) or LME (Liberal Market Economies) ideal-types (Leibfried, 1992; Castles, 1994, Ferrera, 1996; Naldini, 2002).

Italy and Spain fit uneasily into the existing theoretical frameworks. For that reason we build on the insights of other recent contributions (e.g.: Amable, 2003; Schmidt, 2002) in our search for explanations of changes and institutional reforms in Mixed Market Economies (MMEs). We propose a two-tiered framework for analysing change in MMEs and address theoretical issues concerning institutional change and the role of complementarities. The nature of the micro-foundations of MMEs and instances of fit and misfit between the protection and production systems of these economies are examined. Differences in the organization of economic interests and the degree of state intervention in the economy determine the mix in micro forms of coordination and regulation, the behaviour of actors (for instance, investment in specific assets) and help to explain the emergence and characteristics of coalitions. But this micro approach has to be complemented with the analysis of the macro political structures that determine the success of reform coalitions in transforming demands and preferences into policies and institutional innovation. Accordingly, the paper brings politics and power relations shaped by political institutions (the macro tier) into the explanation of change, thus complementing the VoC focus on the micro tier in order to explain policy recalibration.

The paper shows how the organizational capacities of actors and the degree and form of state intervention (and retrenchment) contribute to explain forms of coordination and interaction and the character of reform coalitions. The fragmentation of social partners has been a hindrance for the development of new forms of autonomous or associational coordination and provision of protection in response to the changing role of the state (Trampusch, 2007). The nature and power of coalitions hinge on the organizational and political power of interest associations, and these depend in turn on the institutional configuration of the respective [macro] models of socio-economic governance (Menz, 2003, p. 536). The recalibration of links between production systems and protection regimes has been carried out through complex processes of exchange involving negotiation in several policy arenas in order to weaken the resistance of veto actors. Overall, the paper concludes that institutional change under the exogenous pressures of EMU in Italy and Spain has not been driven so much by positive feedbacks generated from the bottom-up (as we would expect in CMEs) or the dynamics of market-oriented environments for firms (as in LMEs). Instead the experience of MMEs in the 1990s has been characterized by the search for new forms of domestic coordination before exogenous shocks, conditioned by the existing organizational capacities of socio-economic actors, the coalitions they create and their respective veto powers.

The paper is organized in three sections. Section I contains a review of the Varieties of Capitalism literature. More specifically, we look at the treatment of Southern European economies within the theory. Section II analyses the adjustment process protection systems of Italy and Spain in the last two decades. Section III concludes.

Southern Europe and Varieties of Capitalism

The political economy debate around changes in welfare states has begun to address in recetn years the relationship between production systems and protection regimes (Esping-Andersen, 1999; Ebbinghaus, 1998; Hall and Soskice, 2001). Soskice (1990) and Hollingsworth and Boyer (1997) drew attention to institutional spillovers within economic systems influencing economic and employment performance. These spillovers suggest the existence of a series of institutional complementarities and positive feedbacks between protection (the welfare state and labour market regulation) and production regimes (the dominant form of competition among firms, systems of corporate governance and forms of specialization in international market competition). Two ideal-typical cases, liberal market economies and coordinated market economies (LMEs and CMEs), emerge from this analysis. In each case, protection and production sub-systems seem to be coherent and their institutions tightly coupled.

Each of these two ideal-types is characterized by a different logic of interaction and coordination between actors. In LMEs the market is a major source of regulation, guides interactions at a micro-level and coordinates the activities of socio-economic actors across the spheres of production and protection. In countries belonging to this cluster (the US, UK, and Ireland) institutions (and formal regulations) create a market-friendly environment where actors are negatively «constrained» to enter into arms' length relations with each other. By contrast, actors in CMEs use diverse forms of strategic coordination relying on a dense network of corporate institutions and associations. Actors are positively «constrained» to interact within a well-defined set of formal and informal rules and take account of each others' objectives, strategies and power resources.

The pitfalls of this theory become apparent when we face the analysis of economies that fall outside the boundaries of the two ideal-types of CMEs and LMEs. In the case of Southern Europe, relationships are much more complex of what has been suggested for the other two ideal types. Thus for instance, production systems tend to be characterized by a higher degree of diversity and fragmentation between small and large companies, public and private sectors as well as between regions.

Moreover, several forms of interaction and coordination between actors exist thus making it difficult to identify a single coherent production model with a well-defined and strong comparative advantage. On the other side, social protection models and welfare states are significantly different from the traditional liberal or social-democratic / bismarckian models (Leibfried, Naldini, Moreno, Crouch, 2001). Some authors defend their inclusion into a third Mediterranean group (Castles, 1994) characterized by fragmentation in programs, a high degree of clientelism, the mix of bismarckian (pensions) and liberal (health) features and last but not least, the critical role of the family providing protection and care.

It is accordingly necessary to innovate along two lines the theory of VoC in order to be able to extend some of its arguments to the mixed models of Southern Europe. First, it is indispensable to shed further light into the complex relationship between production systems and protection models and the implications regarding complementarities. Secondly, new analytical lenses to the relationship between the political and economic spheres are necessary in order to be able to accommodate the deviant cases of Southern Europe into VoC.

Production systems and protection models of Southern Europe

Recent analyses of the relationship between production regimes and welfare systems have concentrated on the degree of fit between them. Huber and Stephens (2001, p. 119) have argued that 'within each country, certain –though not all– aspects of its welfare state and production regimes do «fit» each other'. They specifically refer to the need of pay and benefit levels to fit, and for labour market and social policies to be aligned in such a way that they do not create perverse incentives on economic actors. They go on to argue that protection regimes and production systems go together in ways that enhance the performance of firms and the efficiency of the national political economy, thereby contributing to comparative institutional advantage.

VoC has conceptualised this relationship in terms of institutional complementarities, whereby the efficiency of one institution increases when it coincides and interacts with another (Aoki, 1994). One would expect the potential for *misfit* to be especially acute in those economies that do not conform closely to the LME or CME ideal types for, in theory, their sub-systems should be less well calibrated. This perception lies behind the reasoning of Hall and Gingerich (2004) for whom «hybrid» systems – such as those of southern Europe – will *ceteris paribus* under-perform «purer» types. A number of authors have warned against the risks of this rather functional assumption (see for instance Crouch, 2005), and have instead suggested that complementarities across policy domains with different rationales can also be detected. In a similar vein, Boyer (1998) also points out to the potentially positive effects of hybridization when national architecture is heterogeneous and loose. If we accept institutional heterogeneity as a valid – and logically possible – source of institutional complementarities, then it is also possible for mixed economies to find their own forms of coordination and fit in line with the needs of their respective production systems (Rhodes, 2005).

Other authors using a VoC lens have sought to confirm the hybridity = dysfunctionality equation. Amable (2003) argues that MMEs lack the pre-conditions for the existence of beneficial complementarities and positive spillovers found in the pure ideal-typical cases. Hence, the southern European model is characterised by strong employment protection, low levels of social protection that deter investment in specific skills, hence preventing the development of high value-added activities. Limits to competition created by product market regulation and state intervention allow for the maintenance of stable bank-industry relations that explain, in turn, the underdevelopment of financial markets. Together, these features lead to a pattern of industrial specialization based on small firms competing mainly on price and make it difficult to move on to a higher-wage/higher-skills development path.

Another central question when we deal with the relationship between production and protection systems is change. VoC finds it difficult to explain institutional change that is not path-dependent, incremental, exogenously-induced and employer-driven[1]. This is because institutional change in VoC is supposed to be driven by (i) firm-individual preferences determined by their types and levels of asset-specific investments and (ii) the capacities of actors in the system to establish durable forms of coordination in order to preserve complementarities. According to an asset-specific logic, actors are likely to become more committed to the continuation of an activity where those assets are present (O'Neil and Pierson, 2002, p 13). Applied to the realm of socio-economic institutions, actors that have invested in a certain institutional arrangement are more likely «to protect their investment by opposing change» (Gourevitch, 2000) or to pursue incremental changes that maintain a high return on these investments[2]. Nonetheless, the capacity to defend these specific investments is determined to a large extent by the organisational characteristics of domestic interest groups, and more specifically trade unions and employer organizations (Menz, 2003). Hence, in CMEs well-organised employer associations and well-articulated union organizations have created institutional arrangements that deliver a series of collective goods and help to protect specific asset investments (Crouch and Streeck, 1997).

1. VoC puts a strong emphasis on institutional equilibriums and their resilience. To the extent that it enters into the explanation of institutional development, it remains unclear which logic dominates in each of the two ideal-types equilibriums, LMEs and CMEs.
2. Similarly, as pointed out by Lake (1999), institutions to a large extent determine the type and degree of investment in specific assets. This means that causality runs in both directions.

A case in point is the role of industry collective bargaining frameworks in providing training and skills in the German industrial relations system (Thelen, 2001). As a consequence, reform coalitions in CMEs are more likely to be cross-class as both employers and employees share a common interest in protecting their comparative institutional advantage and associated complementarities. They will accordingly oppose attempts at neo-liberal de-regulation entailing the erosion of the industry-level industrial relations institutions. By contrast, in LMEs employer organizations lack strong and well-organized associations and trade unions are either weak or fragmented, hence making it difficult to deliver the collective goods or autonomous forms of coordination required to support investment in specific assets. In the case of LMEs, complementarities seem to come from the less visible disciplining effect of market-driven regulation across policy arenas. Competitive forces are accommodated through an institutional setting where coalitions favourable to higher levels of institutional regulation struggle to find support. Given the weakness of trade unions at company level, reform is likely to be driven by a market-making logic. Instead of intervening to protect the specific investments and collective goods produced autonomously by employers and employees (as in CMEs), the state will be much more permeable to exogenous pressures and producer lobbies pushing for liberalization and de-regulation.

In the context of the above discussion, MMEs would lie somewhere in between. While unions and employers have stronger organizational structures than in LMEs, they are more fragmented and less well articulated than in CMEs. Moreover, even though they are unable to deliver the same collective goods or create autonomous frameworks of coordination in collective bargaining, they do have sufficient political power to veto change. This coordination failure within a veto-heavy system has triggered a higher degree of state intervention seeking to provide an alternative form of coordination (Schmidt, 2002). Processes of adjustment are therefore strongly dependent on the state's gate-keeping role and the capacities of interest organizations to veto initiatives for change. Schmidt (2002) points to a third type of capitalism - state capitalism– in addition to the LME and CME ideal types. An important question in the context of the VoC literature is whether the state is capable of generating the kind of complementarities that exist in LMEs and CMEs. Crouch (2005) has strongly suggested that the state can act as a compensatory mechanism for introducing, extending and consolidating complementarities between institutions in countries that are considered «hybrid cases». But this is also true of CMEs, for as argued by Mares (2003, p. 237), state social policies act as a guarantor of employers' investments in workers' skills. This means that, depending on the form and the degree of state intervention, the benefits from protection systems for employers can outweigh the costs they incur from state policies, corporate taxes and employers' contributions.

Thus, in MMEs, where the role of the state is pervasive in both the production and protection systems, the absence of complementarities is related more to the degree and form taken by state intervention than to its presence *per se*. This has important implications for the analysis of complementarities and change in MMEs, where the recalibration of relations between production and protection systems has come along a re-configuration of the state's role. Changes in the regulatory environment have been characterised by attempts to colonize arenas of state regulation with markets and/or autonomous regulation.

The implications of the above paragraphs for the analysis of the character and type of complementarities in MMEs are clear. First of all, the importance of the state arena has triggered the politicization and organizational centralization of social partners, hence hindering the development of strong forms of associative regulation and coordination at micro and meso levels. Social partners have invested in political power through strong alliances with political parties and clientelistic relations. As a consequence, industrial relations have traditionally been an arena for dealing with conflicts rather than providing protection, produce collective goods or achieve a better fit between production and protection systems. Moreover, adjustment processes depend to a large extent on the state; its willingness to intervene and the direction of this intervention. Finally, clientelism together with an active role of the state compensating coordination failures has led in many occasions to exchange subsidies for cooperation, hence leading to an excessive fragmentation in programs (Aparicio, 2002).

Institutional stability in these countries can very easily degenerate into sclerosis, hence perpetuating institutional conflicts and a permanent lack of complementarities between production and protection systems. Additionally, state regulation contributes to long-term inefficiencies as it perpetuates collective action problems. The lack of adequate mechanisms for the autonomous provision of collective goods together with state inability to cope with pressures of organized groups will make even more difficult to achieve mechanisms of autonomous coordination between organized actors. In the realm of the protection system, the difficulties to undertake a structural reform of the system together with the families' inability to face the new demands for protection tend to increase the recourse to market solutions (Da Roit and Sabatinelli, 2005).

In the context of the reform of social protection systems in some European countries, Trampusch (2007) has developed a similar argument. According to her, the consequences of welfare state retrenchment not only depend on the politics of bargaining reforms, but also on the capacity of social partners to develop autonomous mechanisms of coordination and welfare provision. A high degree of coordination will ceteris paribus facilitate new forms of solidarity and protection trough associational self-regulation of those groups affected by new social risks. This serves to highlight the importance of alternative coordination mechanisms in the realm of industrial relations that compensate for the structural rigidity of Mediterranean welfare states based on the extended family.

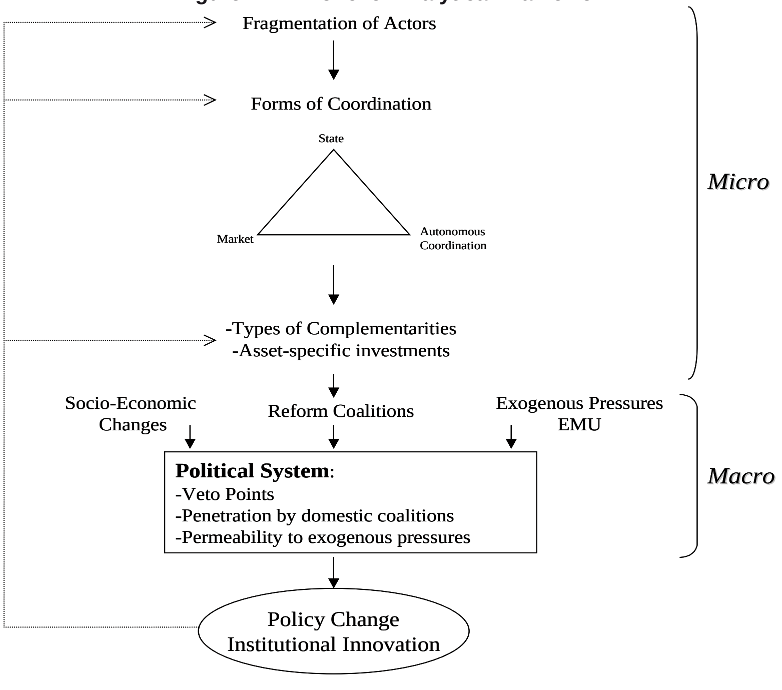
Bringing politics back in: A two-tiered framework for analysis

The interaction between micro (company – local production) and macro (political system) levels in VoC is important to the extent that the latter determines (i) the propensity of economic actors to invest in specific assets as well as (ii) the possibilities of actors and coalitions to intervene in the policy-making process. Asset specificity is positively correlated with the capacity of political systems to make credible the maintenance of certain lines of policy and to diminish the probabilities of radical departures from them. This is because sharp swings in policy make specific-asset investments risky, while stable policies protect them (Hall and Soskice, 2001).

Institutional complementarities and asset specificity in the VoC approach supposedly spur the mobilisation of corporate actors and reform coalitions that contribute to perpetuating the core features of the system. Nonetheless, reform paths and the possibilities for change are also determined by certain features of the political system. Political systems with many veto points diminish the risk of radical policy change, a risk that is much higher under majoritarian systems that magnify the impact of small shifts in votes, thus allowing large swings in policy to occur (Hall and Gingerich, 2004). Political frameworks define the authority of government within an institutional system and hence its leeway for reform. They also determine which actors can influence policy and to what extent. LMEs or shareholder systems are typically characterised by majoritarian systems where power is a concentrated in the hands of the executive and social actors are by and large excluded from policy-making. CMEs typically have consensus-based systems where both the parliament and the executive share power. Moreover, strong and articulated social partners enjoy *de facto* (and some times *de jure*) veto influence in many policy arenas (Iversen and Soskice, 2007; Iversen, 2005). Dedicated assets between interest groups and parties (the union as a transmission belt of a political party) are more likely in proportional and/or consociational systems, as electoral losses are less likely to erase the value of the investment. Westminster systems, where winners monopolize payoffs, limit incentives to create assets dedicated solely to one political party (O'Neil and Pierson, 2002, p. 20).

It follows from the above paragraphs that a two-level approach provides useful insights into the dynamics of institutional change in different models of capitalism and the factors underlying fit (complementary relations) and/or misfit between protection and production systems (see Amable, 2003, p 34-35, and Aoki, 2001 for similar ideas). This framework expands the (single-level) perspective predominant in most of the VoC literature. The two-level perspective's heuristic utility rests on the separation of two spheres of action, the micro and the macro, whose interaction determines change. Even though some authors in the VoC tradition have also pointed to the possibility of different logics of behaviour in upper (macro-political) and lower tiers (Hall and Gingerich 2004), this insight has not been developed to date for the analysis of policy innovation and institutional change.

Figure 1: A Two-level Analytical Framework



The framework we propose is illustrated in figure 1. This framework allows us to examine the mechanisms whereby lower-level demands are negotiated at the macro political level. At this level, the relevant dimensions to examine are the permeability of the state to domestic vetoes (Gualmini, 1996) and the impact of exogenous pressures (Olsen, 2002). While state intervention and the fragmentation of corporate actors serve to explain some of the differences between countries in terms of coordination and interaction, the features of the political system become critical when it comes to explaining the *dynamics* of systems, i.e., policy and institutional change. 'Domestic permeability' will depend on the involvement of interest associations in socio-economic governance and the character of political institutions and reform coalitions. 'Exogenous penetration' will depend on the goodness of fit between domestic conditions and the exogenous requirements.

The Spanish and Italian Mixed Market Economies

In the Italian and Spanish MMEs, the fragmentation of industrial relations institutions and welfare programmes is related to the structural constraints placed by the production systems on capacities for collective interest organization. Nonetheless, because these countries share with the European continental CMEs a social insurance-based welfare system, protection and production are *a priori* much more closely coupled than in LMEs. This occurs first through the wage-labour nexus that links protection and production via the industrial relations system (Ebbinghaus and Manow, 2001, p. 13; Ferrera et al., 2003) – which, in turn, is linked to corporate governance practices (Gospel and Pendleton, 2005); and second, through the character of social protection delivered via labour market policies (Martin and Swank, 2004). Fragmentation also impedes the development of autonomous non-market and non-state mechanisms of coordination across sectors and levels (Martin and Swank, 2004, p. 593), and augments centrifugal pressures from particularistic demands. Fragmentation therefore profoundly shapes the nature of reform coalitions and their mobilisation as it is obstaculises the formation of strong and stable cross-class coalitions.

On the other hand, the possibilities of single actors or coalitions to intervene in the policy-making process depend on the structural characteristics of the political system. There is disagreement in the literature as to the consociational or consensual character of Italian democracy (Lijphart, 1999; Powell, 2000; Zucchini, 1997), but at least during the so-called (pre-1992) «First Republic», political parties and the executive regulated conflict through compromises and mutual concessions. Changes in the 1990s have given a more majoritarian flavour to the system. Spain, however, is unambiguously associated with a competitive type of democracy where party competition exerts a disciplining role in the system. Developments in the two countries in the 1990s took different directions. While the role of parliament was strengthened in Spain in 1993-2000 (Pérez Díaz, 1999), developments in the early 1990s' Italy initiated a transition from consensual to competitive democracy, thus strengthening the executive's role. The Italian political system contains many veto points and constraints on the political behaviour of the government, which exacerbated by «*partitocrazia*» (La Palombara, 1987) has been a strong impediment for institutional change (Molina and Rhodes, 2007a). Gourevitch and Shinn (2005) provide a similar view of these countries: Spain ranks very high in terms of political cohesion (close to pure majoritarianism) whilst Italy ranks very low (close to consensual). The political framework structures actors' interactions by determining the number of veto players within constitutional structures (Tsebelis, 2002) as well as partisan influences, electoral pressures and practices of co-determination (Frege and Kelly, 2003, pp. 16-17) and, by extension, also shapes the contents of public policies and domestic responses to exogenous challenges (Schmidt, 2002).

Based on the above insights, we can conclude that even though MMEs will exhibit some distinctive traits in their micro logics of change and adjustment compared to CMEs and LMEs, the outcomes of change might also differ due to the differences in the political system. In the case of LMEs, change will occur more rapidly due to a smaller number of veto points. On the contrary, institutional change would proceed more slowly in CMEs where it is necessary to include a large number of actors in the decision-making process in order to guarantee institutional coherence across sub-systems. There is a bottom-up logic driving change in CMEs whereby, given the high levels of cooperation and coordination between actors as well as their capacity to produce collective goods at micro-level, political actors will have incentives to include them in the policy process.

By contrast, a weaker relationship between production and protection spheres, together with fragmented corporate actors, leaves MMEs more exposed to the disrupting effects of external shocks and less equipped to follow a negotiated adjustment path. The high levels of conflict that have for many years afflicted industrial relations in Italy and Spain are a reflection of their low capacity to build autonomous forms of coordination at micro levels, which impede bottom-up dynamics of cross-class negotiation and incorporation. Accordingly, MMEs are characterized by a top-down logic of institutional governance; governments in these countries are forced to rely on punctual political exchange at national level with social partners in order to find a negotiated solution to the conflicts generated at micro level (Molina, 2005). The fragility of coordination mechanisms both at macro and micro levels impedes the formation of stable cross-lass coalitions, hence making it difficult the institutionalization of neo-corporatist systems and consensus-based forms of adaptation. Sporadic concertation has proved to be an effective «crisis governance» mechanism, enhancing governability and compensating partially for the lack of stable mechanisms of autonomous coordination.

Spain: state retrenchment, weakly organized capitalism and market liberalization

Under the Franco dictatorship, the Spanish production system was characterised by high levels of protection and pervasive state intervention. After the industrial crisis of the early 1980s, the industrial structure became more polarised and entered a period of profound transformation. The changes experiencing the production system, together with the organizational fragmentation of employers and trade unions contributed to high levels of social and industrial conflict (Rigby and Marco, 2001). Weakly organized employers' organizations followed a confrontational approach to union militancy. The CEOE employers' federation lacked the negotiating authority that might have been expected to follow from its monopoly of employers interest representation. This is explained by the difficulties CEOE experienced in gaining access to policy-making under the Socialist government, its own incoherent organizational architecture and the increasingly important role of MNCs investing in Spain that developed their own lobbying channels (Heywood, 1995, pp. 255-6). Even though, the centralization of industrial relations in the early 1980s contributed to democratic consolidation and macroeconomic adjustment, it frustrated any possibility of strengthening autonomous bottom-up coordination by social and economic actors as an alternative to either state intervention or the extension of market forms of regulation. Although sectoral industrial relations frameworks soon developed at national and provincial level, they took the form of narrow collective bargaining mechanisms subordinated to the dictates of peak-level union officials, rather than company-based regulatory frameworks facilitating the provision of collective goods for companies and workers such as vocational training.

The state's role consisted in providing passive forms of assistance to both workers and firms (state aids to industry, early retirement, the extension of unemployment benefits) and the externalization of the costs of adjustment on to workers (wage moderation, labour market flexibility) and to a lesser extent companies. Due to the absence of micro and meso-level mechanisms of regulation and strategic coordination, the policy of state retrenchment followed since the mid 1980s – but which accelerated during the 1990s – left a vacuum filled very often by liberalization and the extension of market principles. The strategy of economic recovery based on Foreign Direct Investment inflows followed by the Socialist government in the mid-1980s opened the door to a liberalizing agenda and left the state more vulnerable to the objectives of foreign capital.

The state assisted the extension and consolidation of a residual and fragmented welfare state[3] where unemployment subsidies and early retirement schemes expanded significantly in the 1980s and worsened the government's budgetary position. From the late 1980s on, we can talk of a liberalizing bias in the Spanish welfare system and a shift away from its original conservative-corporatist character, its high level of protection and channeling of massive resources into the «competitive rationalization» of industry, towards an emphasis on creating new employment through active labour market policies (Moreno and Sarassa, 1992, p. 15). Nonetheless, the extent to which there has been a real activation of the social protection system has been conditioned by the weak capacity of employers and unions to engage in joint coordination. Even though active labour market policies (ALMPs) have increased since the 1980s both in terms of funding and number of initiatives, the weakness of local structures of social partner representation – as demonstrated, for example,

3. The Spanish welfare state can be understood as a via media with respect to other welfare systems as it incorporates elements of both the breadwinner-centred continental model and the citizenship-centred liberal model (Moreno, 1997).

by the disappointing outcomes of attempts to draw up local employment agreements – have limited the extension of these policies (EIRO 1997). The most important problem is the lack of organisation among small businesses with paternalistic labour relations that dedicate little resources to technical innovation and vocational training. Muñoz (2002, p. 50) also invokes these reasons to explain the poor connection between the state-financed vocational training system and the world of work.

Activation policies have also been obstructed by flexibility in the entry to the labour market and the rapid extension of atypical forms of employment. This has coincided with a shift from state-guaranteed employment protection towards looser regulation and the extension of more individualized, fragmented and diverse employment conditions (Encarnacion, 1999, p. 33). Under the Socialist government, employment policy initiatives – such as a the Rural Employment Plan – focused on maintaining income levels rather than on the development of training schemes and skills enhancing plans. Thus subsidised employment has been an important active measure in Spain (Fravega, 2004). As a consequence, there has been a reduction in overall protection due to a progressive rupture of standard employment transitions triggered by increasing temporary employment, self-employment and the reduction of firing costs (Lopez and Verd, 2004).

The 1984 labour market reform established a two-tiered model of labour market segmentation leading to a sharp increase in fixed-term contracts (Adam and Canziani, 1997; Polavieja and Richards, 2001). Most of the jobs created in the late 1980s' expansion were temporary and this helped to reduce unemployment. However, the perverse effects of this policy became clear right afterwards, when the recession of the early 1990s was accompanied by massive lay-offs of temporary workers, as well as a substitution of indefinite by atypical contracts; the Spanish economy relied upon these contracts as a mechanism of adjustment (Rhodes, 1997b; Saint-Paul, 2000). Other negative effects of the extension of atypical forms of employment and the frequent recourse to fixed-term contracts was the little incentives workers and companies alike had to invest in specific skills and the concomitant impact on productivity levels.

Reliance upon external or quantitative mechanisms of labour market flexibility has been more widespread in the case of SMEs as large firms could more easily resort to internal forms of flexibility. Thus the reliance on temporary employment further accentuated the low-wage, price-based, medium-low technology production system in Spain. SMEs found it cheaper to adopt labour-intensive strategies at a time of relatively high interest rates, rather than to invest in new equipment and technology. A cost-based competitive strategy with a low-skilled labour force led employers to pay less attention to on-the-job training, thereby reducing the sunk costs incurred by firms on hiring and minimising the incentives to keep employees in the firm in the case of a negative shock. The fact that workers in Spain have been burdened with the lion's share of costs derived from economic and institutional adjustment poses the question of reform coalitions at play. With few exceptions, the relations between labour unions and employer organisations as class-based organizations have been characterized since the transition to democracy by conflict. The sporadic negotiation of social pacts or bipartite agreements hasn't meant the existence of a cross-class coalition, though the degree of collaboration and cooperation between unions and employers has improved significantly in the last fifteen years. Employers have been able to build two parallel coalitions in order to pursue their agenda.

First, the existence of a similar specialization pattern in large and small companies has allowed Spanish employers to build a class coalition before the trade union movement. As a consequence of membership losses as well as divisions between confederations, trade unions adopted a defensive position of insiders' interests which in the medium and long run proved to be self-defeating. This situation led to high levels of industrial conflict and an increasing weakness of trade unions with respect to employer organizations which had a clear reflection in the character of reforms. Already in the 1990s, trade unions adopted a different approach based on social dialogue and cooperation with employer organizations as a result of which several pacts were signed. The objective of this change in trade unions' attitude was to improve the government of labour relations as well as to introduce negotiated changes in the employment protection system.

In addition to this, employers were also able to create in the 1980s a coalition between large domestic companies and multinationals investing in Spain. The objective of this coalition was to accelerate the process of economic liberalization of product, labour and capital markets as well as to move towards privatization of state holdings (Arocena, 2004). The political weakness of a trade union due to the erosion of the direct channel with political parties and the ensuing loss of political leverage, contributed to the above capital coalition to achieve the objectives. On the other hand, the privileged relations between the economics ministry and the banking system in the early years of democracy explains a more liberal economic policy compared to unions' demands.

Italy: state resilience and the struggle for reform

In spite of their structural similarities as members of a Mediterranean variety of capitalism, the Italian economy differed in some important respects from the Spanish system by the end of the 1980s: the existence of a more developed and consolidated industrial structure (at least in the centre and northern regions), better organized corporate actors with a comparatively higher level of penetration at the local / company level, stronger national-sector collective bargaining frameworks, a more developed social protection system, and the greater resilience and pervasiveness of state regulatory intervention in several arenas of the production and protection systems that according to Della Sala (2004) determined a «dysfunctional state capitalism».

These and other differences that we will comment in the next paragraphs have determined a distinctive pattern and speed of adjustment in the Italian production regime and protection systems compared to Spain. Following a decade of policy and institutional hysteresis, the 1990s have been characterized by a series of negotiated reforms which have nonetheless occurred in a sporadic and chaotic way (Lodovoci, 1999). What distinguishes the Italian experience compared to Spain is the deeper involvement of trade unions in the negotiation of change and their capacity to veto certain policy decisions thanks to a instable political system which has required social partners to assume policy-making roles. This in spite of the membership loses since the early 1980s and inter-confederal divisions. The convulsions of the system following the Tangentopoli affair leading to the dissolution of the existing political parties and the establishment of technocratic governments in the early 1990s, forced parties and governments to seek union support in order to pass reforms in the areas of labour market and social protection. As a consequence of this, several social pacts were signed which set the foundations for macroeconomic adjustment and Italy joining the Euro.

Italian unions have taken advantage of their position in order to engage into a strong pulse to maintain the rights and privileges of their members (mostly employers with indefinite contracts as well as pensioners). Employment protection and the pension system play «de facto» the role of a security net in the Italian welfare system due to the weakness of counter-cyclical social benefits like unemployment subsidies, employment services and active labour market policies. Moreover, the solidaristic wage policy promoted by trade unions in the collective bargaining system behaves like a redistributive mechanism by maintaining the wage income of workers in Southern regions (Ferrera, 1997; Rostagno and Utili, 1998). Government inability to shift financial resources from old-age pensions to other social protection programs in order to cover the risk and uncertainty underlying labour market transitions of other groups, most notably young and women, is to a large extent due the trade unions' defence of their traditional membership. This position has had a series of negative consequences, like for instance increasing labour market segmentation and a welfare system focused on the fordist male-breadwinner worker on one side, and pensioners on the other. Public sector employment in southern regions has acted as a substitute for social transfer in regions affected by high unemployment levels. It has been shown how around half of the wage paid to public or private employees in the Mezzogiorno corresponds to various kinds of subsidies (Alesina et al., 2001). All together, this explains why some issues which fall within the field of autonomous bargaining between unions and employers in the industrial relations system assume a wider political dimension in Italy, hence complicating the whole adjustment process.

The characteristics of the Italian employment regulation system have exacerbated a dualism between the conditions and degree of protection of employees in small and large firms, hence explaining the existence of radically different policy preferences of workers. The 1970 Workers' Statute established an intricate system of employment protection for companies above fifteen employees, hence leaving large protection gaps for employees in smaller firms. Similarly to what has been said in the case of Spain, the difficulties to establish long-lasting forms of autonomous coordination between actors in the industrial relations system has limited the incentives and capacities of individual actors to invest in specific assets necessary in order to sustain complementarities between company needs, workers' demands and the protection system.

The shift towards activation in labour market policies has been slow, with only some significant measures being introduced in the 1990s. There are two main impediments to the consolidation of ALMPs. The first is related to the weak coordination capacities of trade unions and employers, while the second has to do with the incentives for keeping passive forms of state assistance in operation. A case in point is the *Cassa Integrazione Guadagni* (CIG), through which the state maintains the wages of workers of companies engaged in restructuring. The CIG was created after an agreement between unions and employers in the northern regions and reflects the propensity in the Italian system for the state to internalize costs in the production system. From the 1980s on, large firms in crisis have asked for CIG help in company-specific restructuring (Franzini, 2001). The use of early retirement schemes and subsided employment schemes (especially for youths) is also widespread (Fravega, 2004). Contrary to Spain, where new forms of flexibility and policies of adjustment in the labour market have entailed a reduction in social protection for workers, in Italy these new instruments have guaranteed comparatively higher levels of social protection accompanied by a significant increase in labour costs[4].

Reliance upon CIG in order to maintain wages during restructuring processes has remained significant in the 1990s (Franzini, 2000). Even though it is an onerous program from states' finances point of view, trade unions have defended it as an instrument to minimize conflict in processes of change and restructuring of large companies. In this vein, a fragmented cross-class coalition of unions and large companies in declining sectors has developed in favour of a compensatory state. Divisions within the employer side reflecting the fragmented nature of the financial and production sector together with the lower presence of multinational companies hindered the formation of a broad capital

4. According to Fravega (2004) so-called «Co.co.co.» – *collaboratori coordinati e continuativi* – contracts (with lower costs and dismissals protection) have created an intermediate space of protection between self-employment and standard work. Other forms of subsided employment (*credito d'imposta, sgravio triennale*) have effectively subsided firms since the cost reductions are a reward for creating new jobs.

coalition as happened in Spain in the 1980s. This explains why small companies are more distanced from large companies' preferences in Italy. As they have a restricted access to mechanisms like CIG , they have been more favourable to policies of labour market flexibility and de-regulation. However, and given their lower degree of influence over the policy-making process, they have been forced to build their own responses to the adaptation needs posed by changing economic conditions. This would explain for instance the development of industrial districts where stakeholders of small companies have joined forces in order to provide a series of collective goods like training or protection that neither the industrial relations system nor the state could provide.

The introduction of labour market flexibility and de-regulation, has by far been more limited than in neighbouring countries. Ferner and Hyman (1998, p. 464) refer to this as a process of «articulated de-regulation». Moreover, it has been characterised by consensus and concertation (Regini, 2000). Until the mid-1980s, there was a cross-class consensus on the model of flexibility and its limits. Collective bargaining governed the extension of flexibility in hiring practices, working hours and wages. Unions allowed greater internal flexibility in exchange for a limit on the extension of external numerical flexibility (Regalia and Regini, 1995). From then on the positions of unions and employer associations have diverged and the introduction of flexibility has followed a case-by-case approach preventing both employers and the government from implementing the more comprehensive reforms required to generate positive complementarities (Coe and Snower, 1997; Belot and van Ourst, 2004). Self-employment has provided an alternative form of flexibility in response to the restrictive labour market regulations imposed by unions on hiring and firing costs (Bertola 1990), though firms also obtain some flexibility through sub-contracting (Ozaki, 1999, p. 10)[5]. But self-employment also increased exit from the regular sector (covered by collective bargaining) at both ends of the skill distribution: highly skilled workers left to seek higher returns to self-employment, while the less skilled were forced into the more precarious underground economy (Erickson and Ichino, 1995, p. 302).

Finally, a distinctive feature of the Italian experience has been its greater capacity to experiment with innovative forms of autonomous coordination. This reflects the stronger associative capacity of Italian interest associations at lower levels compared to Spain. But it is also a response of employers to some weaknesses of the industrial relations system, and in particular the uncertainty created by shop-floor militancy and high levels of industrial conflict. These two features have determined employers' long-term decisions with respect to their workforce, negatively affecting the propensity of companies to invest in the training of strike-prone workers (Genda et al., 2001). On the other hand, they have also

5. Nonetheless, the 1990s have witnessed a significant increase in atypical forms of work such as temporary, fixed-term and part-time contracts.

favoured the appearance of new forms of coordination at the margins of the official collective bargaining system, such as the extension of firm-level negotiations to create a more favourable bargaining environment and escape from the constraints imposed at higher levels – what Regini (1999) has called «micro-corporatism». A second mechanism is the development of industrial districts, that is, geographical areas with homogenous production structures, solid vocational training institutions, high mobility of technicians, large flexibility in the organization of production, a strong capacity for adaptation to demand, and very close relationships between users and upstream producers of specialised machinery.

As pointed out by Visintin (1999), even in the area of corporate governance and the relationship between banks and firms, the situation in industrial districts differs from the economy in general, as cooperative relationships between firms and banks are more frequent and stable. More recently, the extension of forms of local and regional concertation under the mechanisms of *programmazione negoziata* has provided the Italian local social system of production with another form – though one that is limited in scope – of autonomous coordination.

Concluding Remarks

This paper has argued that change in protection systems of MMEs is subject to conflicting, and often contradictory trends due to the fragmented nature of class coalitions and a long tradition of class conflict. Part of the reason for this lies in the difficulties in relying upon and sustaining mechanisms of autonomous coordination, cooperation, and regulation at micro levels that could deliver collective goods and provide the foundations for macro forms of cooperation and negotiated regulation. At the same time, the lack of strong micro-foundations is explained by the fragmentation of interests as well as the historically strong role of the state in the economy, which hindered the development of autonomous mechanisms of regulation in the labour market, and more generally, the protection regime.

These similarities justify their inclusion within a MME type, which possesses clearly delimitated adjustment mechanisms compared to the LMEs or CMEs. The distinctiveness of Mediterranean countries had already been highlighted by analysis of labour markets, welfare states, etc. This article has moved one step further by trying to understand the dynamics underlying change and the existence of common trends in the two countries analysed. Regarding change, the article has proposed a two-level analytical framework where strategic interactions at company level are explained and interpreted within the broader macro framework of the political system. The relationship between the two tiers is one of mutual inter-dependence and causation. The forms of interaction at company level have determined the incentives individual actors face and by extension, the type of coalitions that will emerge in the face of shocks to the system. The capacity of these coalitions to advance their demands for change and/or stability will depend on the spaces opened up by the political framework.

By contrast to the argument underlying varieties of capitalism, according to which institutional change is dictated by the requirements of the production system, the analysis of the Italian and Spanish cases serves to highlight the importance of politics and power relations to understand diverging change in countries that lie outside the boundaries of CMEs or LMEs. The fragmentation of collective actors has in both cases impeded the formation of stable cross-class alliances and by the same token, of complementarities at micro and meso levels. At the same time, state intervention has not only contributed to the perpetuation of coordination problems, but has also led to the politicization of collective interests, hence explaining the key role of politics in determining the form and degree of adjustment.

The analysis of changes in protection systems of Italy and Spain following the analytical framework proposed above confirms the importance of adopting a micro-macro perspective to understand change. Only by incorporating insights from the micro Varieties of Capitalism approach as well as from the politics of welfare reform literature we can explain the different directions followed by protection systems. Thus, whilst in both countries there has been a movement towards retrenchment, privatisation and the liberalization of goods and services markets (including factor markets such as labour), this process has been faster and gone farther in Spain, particularly with regard to the liberalization of social protection, labour markets and financial markets (Martinez Lucio and McKenzie, 2004). The differences in the capacity of economic actors to fill the vacuum left by these changes, has determined the nature of the shifts in the regulatory triangle between state, associations and market, with a stronger bias towards market regulation in Spain[6].

These changes are important for understanding the nature of complementarities between the production and protection systems in these two countries and the extent to which there has been a regime shift over the last two decades. In Spain, where the production system is characterized by a specialization in labour intensive, low-skill, low-technology intensive strategies, waves of liberalization and state retrenchment have reinforced sub-system complementarities in the direction of an LME-type equilibrium. The comparative institutional advantage of Spain would seem to rely on the flexibility of easy «hire and

6. In this respect, the experience of Spain resembles in many ways that of France,as depicted by Hancké and Goyer (2005), who argue that the «non-involvement» of French labour allowed firms to push through changes over the last twenty years that brought them closer to their Anglo-Saxon counterparts.

fire», the expansion of low-paid service sector work and the increasing role of 'impatient' capital. Nonetheless, Spain is still a long way from becoming a pure LME as its more developed welfare system, a relatively well-organized collective bargaining system and a protective labour market regulation provide many instances of non-market regulation. On the other hand, recent developments in the 1990s have indicated a search for enhanced coordination in the collective bargaining and vocational training systems that also distance Spain from the LME ideal type. The picture is different in Italy where only recently have there been real attempts to liberalize markets and undertake a real retrenchment of the state business sector. As has been shown, state resilience has meant the maintenance of a wide range of instruments – both regulatory and financial – of non-market, state coordination. As a matter of fact, the institutional incongruence and misfits found in the Italian production-protection nexus have not been substantially modified over the last twenty years.

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