

Globalisation, Competitiveness, and the Social Democratic Model

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For a long time, the discussion about the impact of economic globalisation on the full employment/generous welfare state policies pursued by social democratic governments was characterised by doom and gloom. Glib neo-liberal arguments about the impossibility of maintaining social democratic policies, that were presumably hindering competitiveness through excessive wages and taxes in the new international environment were difficult to counter, because social democrats could not resort to an equally elaborate and internally consistent economic doctrine that could substitute for evidence, and the evidence was not yet in to counter these arguments on empirical grounds. Recently, careful and comprehensive comparative studies have provided evidence that, despite undeniable problems posed by economic internationalisation, social democratic welfare states and employment regimes have proven to be highly resilient (Scharpf and Schmidt, 2000; Huber and Stephens, 2001). Indeed, some kinds of traditional social democratic policy, such as an emphasis on labour mobilisation through active labour market policy and social services that make it possible to combine labour force participation with raising children, and an emphasis on human capital formation have facilitated adaptation to the new economic conditions. Moreover, newly available data on skill distribution (OECD/HRDC, 2000) and income distribution (LIS) suggest that the egalitarian thrust characteristic of social democratic policy has made an important contribution to raising literacy skills at the bottom, which in turn facilitates the integration of the entire labour force into productive activities that are competitive in high-quality markets.

In what follows, we will focus on the experience of Sweden, Norway, Finland, and Denmark, countries where social democracy has most profoundly shaped the welfare state and production regimes, and we will make five arguments. First, the neo-liberal assertion that high wages and high taxes necessarily make economies with social democratic welfare states uncompetitive in liberalised world markets is mistaken. The export sectors of the Nordic countries (like those of Germany for that matter) have maintained their competitiveness. Second, liberalisation of markets for goods and capital and the process of European integration have deprived social democratic governments of policy tools they used to rely on. Demand-side measures have become virtually impossible to use, and even many supply-side measures are no longer feasible. Third, the key to maintaining competitiveness in the short and medium run is the wage bargaining system. In countries where labour is strong, it is crucial that the structure of wage bargaining makes wage restraint possible. Fourth, human capital formation assumes an ever-more central role to maintain competitiveness in the longer run, and human capital formation is related to the redistributive character of the welfare state. Finally, labour force activation is important to sustain a strong tax base, and measures to facilitate the combination of work and child rearing are an essential part of this.

Social democratic welfare states

Social democratic welfare states are very generous and highly redistributive (see table 1, columns 1, 2, 7). Christian democratic welfare states are very generous also, but they are structured differently and effect less redistribution; liberal welfare states are significantly less generous (Bradley *et al.*, 2001). Social democratic welfare states are characterised by universal coverage of the population for a wide variety of social risks, by a combination of basic security and income security with comparatively generous benefits for lower-income earners, and by the public provision of a large array of free or subsidised services (see columns 5 and 7).¹ Universal coverage is achieved by incorporating people into standard, unified programs, not differentiated by occupational category. Basic security is provided through universal flat-rate benefits, and income security through the addition of earnings-related benefits. In the area of social services, social democratic welfare states provide not only health care but also care for children and the elderly, rehabilitative services for the disabled, and retraining and relocation assistance for those losing their jobs or having been separated from the labour market for a while (see column 5). Neither Christian democratic nor liberal welfare states provide any of these kinds of services; at best, they finance a limited array of privately provided services for the needy. These services, along with generous child allowances, make the social democratic welfare states women-friendly (Hernes, 1987; Sainsbury, 1996) and encourage female labour force participation (see column 6). On the financing side of the welfare state, separate taxation makes female labour force participation financially attractive. Social services and basic transfer benefits are typically financed by general revenue, whereas earnings-related benefits are financed by earnings-related social security contributions. The total tax burden necessary to finance the generous transfers and services is high (see column 8).

Co-ordinated production regimes

Social democratic welfare states are embedded in a mutually supportive relationship with co-ordinated production regimes.² In co-ordinated production regimes, both employers and labour are organised in centralised associations, and they engage in frequent negotiations and co-operation with each other and with the government. Kitschelt *et al.* (1999) draw a distinction between sectorally and nationally co-ordinated production regimes, the latter being the ones related to social democratic welfare states.³ In nationally co-ordinated production regimes, wage bargaining is or was centralised at the national level and tended to have a strong solidaristic component leading to compressed wage differentials (columns 3 and 9). Employers, labour, and the government cooperate in labour force training and retraining. The government plays or played a significant role in promoting long-term growth through investment, research and development, and human capital formation, and in counteracting economic cycles through fiscal and monetary policies.

During the Golden Age of post-war capitalism, under Bretton Woods, governments were allowed to control capital movements. With the exception of Denmark, the Nordic welfare states did maintain capital controls and thus could manipulate both their exchange rates and their interest rates.⁴ Accordingly, social democratic governments could and did resort to periodic devaluations to shore up the competitiveness of their

Table 1 Characteristics of welfare state and production regime, c. 1990

	1	2	3	4	5	6	7	8	9
	Post-Tax & Transfer Gini	Reduction in Gini due to taxes & transfers	Wage dispersion	Literacy Score 5th percentile	Public HEW Employment*	Female Labor Force Participation	Decommod- ification index*	Total Taxes	Bargaining Centralization
<i>Social Democratic Welfare States</i>									
Sweden	20	43	2.1	216	20	80	39	63	0.31
Norway	22	29	2.0	207	15	71	38	56	0.58
Denmark	21	38	2.2	213	18	78	38	56	0.37
Finland	19	34	2.4	195	9	73	29	51	0.44
Mean	21	36	2.2	208	16	76	36	57	0.42
<i>Christian Democratic Welfare States</i>									
Austria	21				4	55	31	47	0.44
Belgium	21	40	2.3	161	6	52	32	49	0.29
Netherlands	26	26	2.6	202	4	53	32	52	0.35
Germany	30	23	2.5	208	4	57	28	43	0.32
France	32	24	3.3		7	58	28	47	0.10
Italy	29	12	2.4		5	46	24	42	0.14
Switzerland	31	11	2.7	150	5	60	30	34	0.25
Mean	27	23	2.6	180	5	54	29	45	0.27
<i>Liberal Welfare States</i>									
Australia	29	24	2.9	146	7	63	13	35	0.47
New Zealand				157		63	17		
Canada	28	26	4.2	145	7	75	22	42	0.07
Ireland	32	32		145		69	23	39	
UK	33	23	3.3	145	8	65	23	40	0.12
USA	33	18	4.9	133	5	69	14	32	0.07
Mean	31	25	3.8	145	7	67	19	38	0.18

* 1980 data. Data definition and sources: See appendix.

exports, while maintaining differential interest rates and particularly low ones for productive investment. Subsidies, sometimes on a massive scale, were used temporarily to support declining industries and facilitate industrial restructuring. While economic downturns were countered by deficit spending, it is important to recognise that these were primarily supply-side models. The budget was targeted to yield a surplus across economic cycles and many counter-cyclical measures, such as Sweden's investment funds or Norway's public sector investment, were supply side. Again with the exception of Denmark, Nordic governments subordinated central banks to governmental authority and used their authority over monetary policy to fight cyclical unemployment and set interest rates at a low level across economic cycles. Finally, immigration of foreign labour was strictly controlled.

Though the Nordic models depended on capital controls, these countries had few restrictions on trade and with their small domestic markets were highly dependent on trade (Katzenstein, 1985). Indeed the whole economic model was predicated on trade competitiveness, and the interest of workers in the export sector can be characterised as the pivot of the economic and social policies of these regimes (Huber and Stephens, 1998, 2001).

The recent OECD/Statistics Canada study on literacy skills demonstrates conclusively for the first time the effectiveness of social democratic welfare states in developing human capital (figure 1) (OECD/HRDC, 2000). This is the first study which presents comparable measures of actual skills of the adult population based on the testing of random samples of working-age adults on a battery of tasks designed to be as strictly comparable as possible given the differences in language and culture. The figures in figure 1 are the average literacy skills scores on the three tests, prose, document, and quantitative, of the 95th, 75th, 50th, 25th, and 5th percentiles of the adult population. We would contend that human capital formation is only partly a product of a nation's educational system, for young people in the form of traditional schooling and for working-age people in the form of continuing education and retraining opportunities. In fact, school enrolment of the school-age population up to 16 looks very similar across advanced industrial democracies, with virtually everyone being in school. However, the quality of formal schooling up to that point varies considerably, as do the opportunities for continuing education after that, particularly for working adults. The OECD/HRDC (2000) study shows a marked dispersion across countries, greater at the bottom of the skill levels than at the top (figure 1). The average score on the test achieved by the bottom 25 and bottom 5 percent of the adult population varied markedly between countries. This variation is not random but relates systematically to type of welfare state and production regime. The Nordic social democratic welfare states and the Christian democratic welfare states of Germany and the Netherlands show higher skill levels at the lower end of the distribution than Belgium, Switzerland and any of the countries with liberal welfare states.

We contend that this is not due to differential expenditure on education. Indeed, neither total public expenditures on education, nor total public and private expenditures on education are notably correlated with the percentage of the adult population scoring at level three or above in the three tests (what the study defined as necessary to function well in the information economy), or with the mean scores achieved by the bottom 25 or 5 percent in the countries in figure 1; none of these correlation coefficients exceed 0.22. The crucial factor is the degree of poverty and inequality, which in turn is a result of the

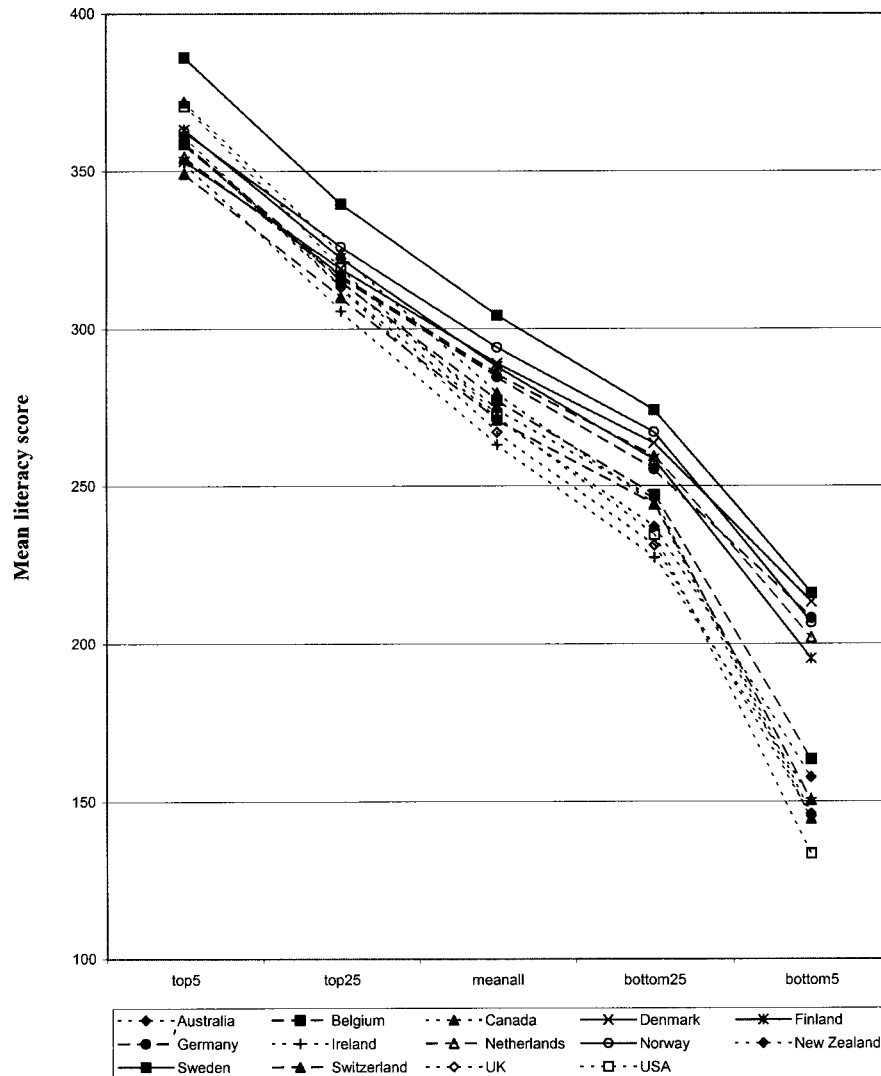


Figure 1. Mean Literacy Score at Selected Percentile Levels.

redistributive character of the welfare state. It is a firmly established fact that children from poor backgrounds on average have lower educational achievements than middle-class children and above. They simply do not have the same supportive home environment. Thus, we would expect lower rates of poverty and inequality at the societal level to be correlated with higher achievement levels at the bottom. Indeed, the cross-sectional correlation between the percentage of the adult population scoring at level three or above and inequality (post-tax and transfer Gini index of income distribution)⁵ is negative 0.84, and the correlation with post-tax and transfer poverty among the working-age population is negative 0.77. The correlations between inequality and skills at the mean,

25th, and 5th percentile are also negative and very large (−0.74 to −0.85). In other words, countries that reduce poverty and inequality through their taxes and transfers get higher return on their investment in education and end up with a labour force with higher literacy skill levels and thus a greater capacity to meet the requirements of the information economy. It is important to emphasise that there are no levelling costs here; that is, average scores at the top are not any lower for the countries with higher scores at the bottom; if anything, slightly higher.

Of course, the sceptic will immediately raise the chicken and egg problem. Lower skill dispersion will result in lower wage dispersion and thus lower pre-tax poverty and inequality. That is certainly true, but in our analysis of LIS data we could conclusively show that the social democratic welfare states further reduce poverty and inequality, starting from a more favourable base line which is the result not only of skill distribution but also of the collective bargaining system and union organisation (Bradley *et al.*, 2001). Therefore, our argument is not weakened. Social democratic welfare states and co-ordinated production regimes sustain a virtuous circle where redistributive tax and transfer systems produce lower levels of poverty and inequality which in turn help those at the lower end achieve higher skill levels which in turn contribute, along with centralised bargaining, to lower wage dispersion which in turn reduces the burden on the tax and transfer system to sustain low rates of poverty and inequality.

The impact of 'globalisation' on the social democratic welfare states and production regimes

As we noted in our opening paragraph, neo-liberals have been quick to attribute the difficulties which the Scandinavian welfare states were experiencing in the early 1990s to 'globalisation'. Though we find that the neo-liberal argument is almost entirely wrong in its details, we will argue that there is a certain amount of truth to the contention that economic internationalisation has made the task of social democratic governments more difficult because it has deprived them of a number of policy tools which they used in the past to stimulate growth and employment.

In the dark days of 1994, with Swedish unemployment at 9 per cent and Finnish at 19 per cent, proclamations of the end of the social democratic model understandably met with some resonance. But, as we have explained in detail elsewhere, the Finnish and Swedish predicaments were products of economic policy mistakes of these governments along with austerity stemming from the policies of the German Bundesbank in the wake of German reunification and the criteria for EMU membership contained in the Maastricht treaty. In addition, the collapse of the Soviet trade was a serious setback for the Finnish economy (Huber and Stephens, 1998, 2001).

In hindsight the flaws of the neo-liberal argument seem obvious as they focus on the uncompetitiveness of the export sector. As we just pointed out, the Nordic welfare state and production regimes were built upon trade competitiveness. Moreover, the increases in trade openness in the post-Bretton Woods period in these countries have been quite modest, if only because their economies were very open in the first place. Total trade as measured by exports plus imports as a percentage of GDP increased from 58 per cent in 1960–73 to 63 per cent in 1990–94 (Stephens 1999). Export competitiveness had little to do with the Finnish and Swedish problems, and this can also be seen by the fact that, at the height of the unemployment crisis in 1994–95, the export sector in both countries

was booming. By the end of the decade, with unemployment down to 9.4 per cent in Finland and 5.4 per cent in Sweden and even lower in Denmark and Norway (4.7 per cent and 3.5 per cent respectively), and with the budgets of all four countries in surplus, the obituaries of social democracy issued a few years earlier seemed premature.

In contrast to the analyses of the neo-liberals which now appear to be totally off base, the analysis of the *OECD Job Study* (1994), which comes to similar policy conclusions, must be taken more seriously. The OECD links the poor record of employment growth of European countries to compressed wage differentials; generous welfare state benefits, especially for the healthy working-age population; high taxes, especially payroll taxes; and employment protection legislation. However, unlike the neo-liberals, the focus here is not on the employment performance of the exposed sector, but rather on total employment performance. In fact, as Scharpf (2000) points out, none of these factors are strongly associated with exposed sector employment. By contrast, both Scharpf (2000) and Iversen and Wren (1998), who are hardly sympathetic to neo-liberalism, argue that there is evidence that some of the factors pointed to by the *Job Study* do impede employment growth in the private social services. In the private service sector with its concentration of personal service jobs, productivity is low and productivity growth is slow, thus these jobs are very sensitive to labour costs. As a consequence, the factors pointed to by the *Job Study*, all of which arguably affect labour costs, may retard employment growth in this sector.

Nonetheless, it seems to us that the primary concern should be with total employment and that the best measure of employment performance is the proportion of the working-age population that is working. A pooled time series analysis, by David Bradley (2000), with the employment level as the dependent variable shows little support for the *OECD Job Study* hypotheses.⁶ Employment protection legislation and wage dispersion are not related to employment levels. Social security taxes are negatively related to employment levels but total taxes are positively related to employment. There is a straightforward interpretation to this finding: high levels of total taxes are necessary to finance public sector employment, while social security taxes impede the growth of private service sector employment. Bradley also finds, more tentatively, that high short-term (one year) replacement rates in unemployment benefits, characteristic of social democratic welfare states, are positively related to employment levels, while long-term (five year) unemployment benefits, characteristic of Christian democratic welfare states, are negatively related to employment levels. We return to these findings in our closing remarks on recent and possible future reforms of social democratic welfare states.

We do not mean to imply that globalisation has had no effect on the ability of social democratic governments to stimulate employment growth. As we outlined in the previous section, the Golden Age social democratic model was predicated on open trade markets but closed financial markets. In contrast to the very modest increase in trade, the change in terms of both capital controls and capital flows in the social democratic welfare states has been dramatic. By the early 1990s, the Nordic countries had eliminated all capital controls, a process begun before the decision to seek European Economic Area membership in Norway, Sweden, and Finland. Capital flows increased exponentially; for example, outward direct foreign investment increased 11 fold from 1960–73 to 1990–94 and borrowing on international capital markets increased eight fold (Stephens, 1999).

Removal of capital controls made it impossible to set interest rates and exchange

rates at the same time. Thus, the low, often negative real interest rate policy could only be pursued with the cost of a constantly depreciating currency. At the same time, devaluation, a tool used periodically by all of the Nordic governments in the post-Bretton Woods period and constantly by Finland in the whole post-war period, became increasingly costly as open capital markets forced countries with devaluation histories to pay interest premiums. The increased opportunities for arbitrage in open capital markets made targeting of cheap credit to business borrowers more problematic and EU regulations made preferential treatment of national businesses illegal. With the development of the EU and then the EMU, all four countries moved toward greater central bank independence, non-accommodating monetary policy, and increasingly targeted macro-economic policy on inflation rather than unemployment. It is not that the governments abandoned their commitment to employment but rather they increasingly came to see inflation as a cause of unemployment. In order to reduce interest rates, it is now necessary to pursue a policy of stable exchange rates (or, in the case of Finland, actual entry into the EMU). In this environment, inflation-induced wage inflation will translate into job losses in the exposed sector or to profitability losses in the sheltered sector and thus declining investment sources. Stimulation of the economy through deficit spending was made less effective not only because of the modest increases in trade openness but more importantly by the fact that open capital markets made budget deficits a much greater liability due to the aversion of international currency traders to deficits. Finally, EU regulations made it impossible for governments directly to stimulate investment and support employment through subsidies to industry.

Globalisation has not been the only challenge facing social democratic welfare states in the post-Bretton Woods period, of course. Changes in the occupational structure – the decline of industrial employment and rise of service employment, the expansion of public sector employment, increased non-manual employment, and the decline of Fordist production and rise of post-Fordist, skill-differentiated diversified quality production – have complicated wage bargaining, putting particular pressure on the highly centralised systems of economy-wide bargaining and the policy of inter-skill wage levelling characteristic of the Nordic countries. These pressures certainly contributed to the end of centralised bargaining in Sweden and with it the wage-levelling policy. Demographic and family structure changes – the ageing of the population and the increase in single parent and dual income households – posed new challenges for the transfer systems. Fortunately, the gender egalitarian policies which allowed women to combine work and family enabled the social democratic welfare states to avoid the low fertility trap experienced by the Christian democratic welfare states, which threatens those systems with a future demographic time-bomb (Esping-Andersen, 1999). More and more women began to work, and since Christian democratic welfare states offer no public support for childcare, many of these women decided not to have children. Thus, whereas the fertility rate for e.g. Sweden was 2.0 in 1991–95, it was only 1.3 for Italy. Thus, the demographics are much more favourable for the maintenance of generous welfare states in the countries with social democratic welfare states than in the countries with Christian democratic welfare states.

The new social democratic model and future reforms

In sum, while events have proven neo-liberal predictions that globalisation would bring

an end to the social democratic model to be incorrect, there is no doubt that the free flow of capital across borders and European integration have constricted the range of tools social democratic governments once used to stimulate growth and employment, while promoting equity through the tax and transfer system. Indeed, under the present conditions, a tremendous burden is carried by the wage bargaining systems and the systems of human capital development and utilisation. The task of short-term economic adjustment falls very heavily on the wage-bargaining system. The bargaining system must produce wage increases within the European norm. Any error in bargaining, including wage drift unanticipated by the bargain, will be immediately translated into decreased competitiveness and job loss in the exposed sector. Since job losses lead directly to loss of tax revenue and to increased expenditure on transfers, any serious error threatens to set in motion a vicious circle of deficit spending, higher interest rates, decline of investment, job losses, declines in tax revenue, higher spending on transfers, etc.

With possibilities for stimulating investment in physical capital via state subsidies or low interest rates greatly restricted, the capability of social democratic welfare states to produce economic growth and employment growth over the long term depends on their ability to produce high levels of human capital investment and high levels of labour utilisation. Fortunately, they have proven track records of performing at a high level in both of these tasks in the past. Moreover, the evidence presented above indicates that it is precisely the class and gender egalitarian features of social democratic policy that account for its success in promoting human capital development and high levels of labour utilisation.

Clearly, sustaining such redistributive welfare states requires a strong tax base. Given the limitations on taxing mobile assets, high employment levels assume a crucial role in strengthening the tax base. It is here that social democratic welfare states have a significant advantage over Christian democratic welfare states. Active labour market policy has always been an integral part of the social democratic model. High replacement rates for the unemployed were linked to assistance for retraining and relocation. Early retirement and disability schemes were not used as major tools to reduce labour supply, as they were in some Christian democratic welfare states.

The foregoing should not be taken to suggest that the social democratic welfare states have not experienced significant changes in recent years or that they could not be reformed in the future to improve employment performance. In all four Nordic countries, there has been a marked trend toward increasing even further the already strongly active profile of labour market measures. There have been some modest cuts in unemployment replacement rates, though these are still high by international standards. More concerted efforts have been made to limit duration of passive benefits and to retrain and place the unemployed in work. The statistical results mentioned above indicate that this profile of high short-term passive benefits and active measures should encourage high levels of employment. Moreover, there are efforts to further improve the human capital base by supporting new opportunities for life-long learning. The statistical results on total taxes and social security taxes also indicate another possible path for reform that has been discussed in the Nordic countries: Shift the tax burden from social security taxes to other taxes which do not raise the direct labour costs of employers. This pattern of taxation has been long characteristic of Denmark and it is arguably the reason why Denmark has been more successful than the other Nordic countries at creating employment in small and medium enterprises.

Appendix: Data definition and sources

Post-Tax and Transfer Inequality: Post-tax/transfer Gini index of income inequality among households with a head aged 25–59: #

Reduction in Inequality: per cent reduction in inequality effected by taxes and transfers $[(1 - \text{post-inequality/pre-inequality}) \times 100]$ #

Wage dispersion: 90–10 ratio, the wages of a full-time employee at the 90th percentile of the wage distribution as a multiple of one at the 10th percentile (OECD, 1996)

Literacy score: Average literacy skills score on the three tests in the OECD/HRDC study, prose, document, and quantitative, of the 5th percentile of the adult population of OECD/HRDC (2000)

Public HEW Employment: Public health, education, and welfare employment as a percentage of the working-age population (WEEP•). Canadian figure provided by John Myles on the basis of Statistics Canada data.

Female labour force participation: Percentage of women aged 15–64 in the labour force (HRS, OECD)

Decommodification index: Indicates degree of transfer entitlement generosity (Esping-Andersen, 1990: 52)

Total Taxes: Government revenue as a percentage of GDP (HRS*, OECD°)

Bargaining Centralisation: Degree of centralisation of wage bargaining (Iversen, 1998)

* Data from the Huber, Ragin and Stephens (1997) data set.

° Original data source is OECD, various years.

• Data from the Welfare State Exit Entry Project, Science Centre, Berlin see Huber, Ragin and Stephens (1997).

From Luxembourg Income Surveys.

Notes

1 The literature on types of welfare states, or welfare state regimes, has grown tremendously since the publication of Esping-Andersen's (1990) path breaking book. See e.g. Huber, Ragin and Stephens (1993), Castles and Mitchell (1993), van Kersbergen (1995), Sainsbury (1999), Hicks (1999), O'Connor, Orloff and Shaver (2000), Huber and Stephens (2001).

2 We build on Soskice's (1999) concept of production regimes but use it more broadly. His focus is primarily on business behaviour whereas we include labour and the government as key actors in production regimes.

3 Germany is the prototype of a sectorally co-ordinated economy, with a Christian democratic welfare state.

4 This characterisation of Nordic macro-economic policies does not apply to Denmark which had relatively open capital markets. Danish economic policies were demand-side-oriented and not nearly as successful in producing full employment as its Scandinavian neighbours (Esping-Andersen 1985).

5 The results were the same for inequality measured in the entire population and the working-age population only. Poverty and inequality measures are from the Luxembourg Income Studies website: <http://www.lis.ceps.lu/>.

6 This analysis is part of Bradley's Ph.D dissertation in political science at the University of North Carolina, Chapel Hill. Preliminary reports can be found in Bradley (2000).

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