

## Towards Convergence?

### New Labour's *Third Way* and the SPD's *Agenda 2010* in Comparative Perspective

Christian Schweiger<sup>1</sup>

#### Abstract

This article provides a comparative analysis of the 'third way' economic and social policy approach of New Labour in the United Kingdom and the *Agenda 2010* reform programme implemented by the SPD under Gerhard Schröder in Germany. The study tries to show that a substantial degree of policy-learning can occur between countries if national policy-makers share the same programmatic positions in a policy area and domestic institutions at the same time fail to produce efficient outcomes. The post-2005 renewed divergence between New Labour's focus on further welfare reforms and the SPD's role as the guardian of the domestic welfare status quo however reinforces the importance of domestic path-dependent institutional constraints for policy outcomes.

*Zusammenfassung: Auf dem Weg zum Konsensmodell? New Labour's „dritter Weg“ und die „Agenda 2010“ der SPD in vergleichender Perspektive*

Der vorliegende Artikel enthält eine vergleichende Studie zwischen dem wirtschafts- und sozialpolitischen Ansatz des „dritten Weges“ unter New Labour in Großbritannien und der von der SPD unter Bundeskanzler Schröder entwickelten *Agenda 2010*. Die Studie versucht zu zeigen, dass signifikante Lernprozesse zwischen den politisch Verantwortlichen über Ländergrenzen hinweg möglich sind, falls übereinstimmende programmatic Ansätze vorliegen und bestehende nationale Institutionen sich als nicht effektiv zur Lösung anstehender Probleme erweisen. Die sich seit 2005 erneut abzeichnende Divergenz zwischen der Fortentwicklung arbeits- und sozialpolitischer Reformen unter New Labour und der Rückbesinnung der SPD auf ihre Rolle als Partei des sozialstaatlichen Status Quo macht jedoch deutlich, dass etablierte institutionelle Hindernisse im nationalen Kontext weiterhin von zentraler Bedeutung für die konkrete Ausgestaltung von Politikwandel sind.

The British and German economic models have been at the core of the *Varieties of Capitalism* distinction between liberal and coordinated economies with each possessing its own specific comparative advantages. In the case of the former this manifests itself in a culture of free market competition while the latter has developed a distinctive set of institutions, which allow cooperation between actors outside the realm of the market (Hall/Soskice 2001: 19). Using Esping-Andersen's welfare state typologies, liberal economies tend to be associated with welfare states that provide a rather modest and short-term level of basis assistance for the unemployed which is strictly means-tested, while the corporatist welfare states of coordinated economies like Germany tend to be orientated towards high levels of income replacement during unemployment. Incentives for the unemployed to return to work in the liberal economy are therefore high, while they remain low in the corporatist welfare states (Esping-Andersen 1993: 26–27 and 224).

This article provides a comparative empirical analysis of the economic and social policies of New Labour in the UK and the SPD in Germany which aims to show that, in spite of a number of substantial reforms which both parties introduced in recent years, the intrinsic institutional path-dependency of the British

<sup>1</sup> Ich danke den Gutachtern des Sozialen Fortschritts für die wertvolle Kommentare.

and the German economy has in both cases survived the introduction of a set of substantial policy reforms. In the German case the welfare reforms implemented under the *Agenda 2010* showed substantial elements of policy learning from New Labour's 'third way' welfare-to-work approach. This was supported by the combination of the political correspondence between New Labour under Blair and the SPD under Schröder and the general encouragement to adopt best practice from other member states under the EU open method of coordination. In this respect New Labour managed to successfully upload its 'third way' welfare-to-work political approach, which it had previously adopted from the New Democrats under president Bill Clinton in the US (Gould 1998: 235–236), to the EU policy framework level. The priority for welfare targeted at bringing people back into work consequently became the heart of the EU's Lisbon Strategy and the attached mechanism of best-practice benchmarking of national employment figures under the open method of coordination. Based on its remarkably good record of job creation since 1997, the New Labour government was self-confident in promoting its welfare strategy as a role model for the rest of the EU. Peter Mandelson even claimed in 2005 that 'New Labour is inspiring Europe'<sup>2</sup>.

New Labour's ideological influence became apparent in the 2005 revision of the Lisbon targets, which now prioritise 'jobs and growth' (European Commission 2005). The 'third way' priorities of targeted activation of the unemployed through a mixture of compulsory active labour market policies based on investment in education, training and work-orientated tax credits subsequently became the core of the European Employment Strategy. The EES monitors national labour market performance on the basis of overall targets and country-specific policy recommendations (Büchs 2007: 48).

The path-dependent approach developed by historical institutionalists such as Pierson assumes that national actors are reluctant to change the domestic institutional setting in which they have been socialised due to expectation that these will continue to produce 'increasing returns' in terms of policy outcomes. Pierson emphasises that these 'increasing returns' occur in the form of 'self-reinforcing or positive feedback processes' resulting from existing institutions and policies, which makes it less likely that policy-makers consider alternatives (Pierson 2000: 252). Following this approach it is obvious that processes of policy learning usually only occur when these returns are no longer deemed to be sufficient or at least when it is assumed that the cost of change may be smaller than the cost of continuing to stay on the same path. Substantial change to public policies and in some cases even institutions are therefore most likely if substantial crises, which Pierson describes as fundamental junctures or 'exogenous shocks' (Pierson 2000: 266) emerge. These shocks reveal shortcomings of established policies or institutional practices which in turn leads domestic actors, albeit often reluctantly, to prioritise change over the continuation on the established path-dependent course.

The expectation amongst political decision-makers that changes to either the established set of policies, or more fundamentally, the underlying established institutional framework may produce short-term results in terms of producing a political advantage for themselves make it more likely that they will decide to steer away from the previous pathway (Pierson, 2000: 261). Yet policy change tends to be easier to achieve than attempts to alter the established institutional setting in which these policies are implemented (Pierson, 2000: 259). The historical institutionalist approach is crucial in highlighting the importance of intrinsic national economic and welfare state traditions when determining the preferences of domestic actors. The weakness of the path dependency concept lies in its assumption that, other than in the economic sphere, in politics the review of policies and institutions does not occur on the basis of more sophisticated learning processes which go beyond a simply domestic 'trial and error fashion' (Pierson 2000: 261). This ignores the increasing importance of new transnational mechanisms of pol-

icy-learning like the EU open method coordination, which encourage the horizontal dimension of policy-learning between countries on the basis of a comparative rational choice analysis ('benchmarking') of existing domestic path-dependent policies (Borrás/Jacobsson 2004: 195). As a number of studies have shown, mechanisms like the open method of coordination, are effective in encouraging the shift from the established status quo, even if they are hardly the only causal factor for these changes and usually only act as a catalyst for existing domestic reform pressures on the basis of crisis 'tipping points' (Dyson/Padgett 2005: 116), which usually stem from economic pressures (Hough/Sloam 2007: 31).

The comparative case study in this article attempts to show that the processes of policy learning which lead national actors to consider policy choices in other countries continue to take place in a predominantly path-dependent domestic context. Even after the decision to change policies or individual institutions has been made, these changes are frequently confronted with fundamental obstacles. The latter manifest themselves as opposition from domestic vested interests who try to defend the previous status quo and also existing institutional veto players. This is most prominent in the 'semisovereign' German political system, where the federal government needs to seek consensus with regional governments in the Federal Council in a wide range of policy areas and the Federal Constitutional Court acts as the final referee in case of disputes about substantial policy changes (Green/Paterson 2008: 184).

The nature and the pace of the change that occurs is strongly determined by the domestic institutional setting of the country involved and is most likely to take considerable time to take effect (Pierson 2000: 261). Even if a country faces significant reform pressures and a rational analysis of the circumstances would indicate that this should almost inevitably result in profound reforms of the status quo, the perspective for change ultimately depends on the willingness of national actors and institutions to abandon the path-dependent route (Turner/Green 2007: 16). The institutionalist acknowledgement of the effects of national path-dependent institutional particularities on policy outcomes makes it very distinctive from the perspective of the convergence thesis put forward by some economists (Barro/Sala-i-Martin 1991; Parker 1998; Sinn 2004). While the latter assume that external economic pressures inevitably push national economies towards the adoption of a deregulated liberal convergence model, the historical institutionalist perspective emphasises that even if countries apply similar policies to solve common pressures (such as unemployment), the outcome of these policies are likely to be distinctively different in each national context. Hay has developed this perspective even further by emphasising that one cannot assume that the convergence of policies between countries will automatically result in a convergence of outcomes. He points out that 'if we assume the path dependence of institutional and cultural dynamics, then the same policy is likely to have different institutional and cultural consequences (over whatever time-horizon) in different institutional and cultural environments' (Hay 2000: 514).

In this context national governments tend to influence and subsequently use the OMC as a means to strengthen the case for reform against opposition at home on the basis of 'invited dutifulness' (Büchs 2008: 27). In the case of the German Hartz labour market reforms outlined in this article, which mainly emerged on the basis of expert advice from a Commission led by the former Volkswagen executive Peter Hartz, the influence of the OMC on the domestic level of policy-making can clearly be detected. The Hartz Commission was installed by Chancellor Schröder to overcome opposition within his own political ranks and amongst the opposition parties used the OMC to embed their reform proposal into the wider European employment policy context (Büchs 2007: 75 and 2008: 29). The OMC and

<sup>2</sup> The Guardian (2005) 'New Labour is inspiring Europe, says Mandelson', 3 February.

European employment targets did however hardly feature in the public discourse on the Hartz reforms in Germany (*de la Porte/Nanz* 2004: 277). This shows that while OMC encourages new forms of national decision-making in the area of social policy which broadens the participative discourse, it tends to do so at the expense of the traditional parliamentary route (*Borrás/Jacobsson* 2004: 200). This usually occurs by enhancing the influence of non-governmental networks of policy experts rather than the general public.

The problematic aspect of this is that these experts are not directly accountable to the national parliament and the electorate, which opens the OMC to the accusation that it is encouraging the establishment of a new sphere of elite-driven policy-making based on 'expert deliberation' beyond the public realm (*de la Porte/Nanz* 2004: 283; *Benz* 2007: 515). The process of policy learning in the case of New Labour and the SPD was facilitated by the existence of a wider policy network between centre-left governments in Europe and also the US, which had initiated a debate on policy options for a reformed European Social Democracy in the late 1990s. Substantially influenced by New Labour's 'third way' approach, European centre-left governments held a number of progressive governance network conferences in 1999, which included Tony Blair, Gerhard Schröder, US president Bill Clinton and the Dutch prime minister Wim Kok, who later became the head of the expert commission on the revision of the Lisbon Strategy. The first communiqué issued by the network in Berlin on June 3<sup>rd</sup> 2000 reflected the emerging consensus on New Labour's 'welfare to work' employment strategy and set the direction for the OMC as a method of 'best practice' learning that would be applied in the EU Lisbon Strategy (Policy Network 2000).

Parallel to this a joint paper on the future of Social Democratic governance in Europe (Blair-Schröder paper) had emerged in 1999. It resulted from intense discussions between the close confidants of both leaders, Blair's special advisor Peter Mandelson and Bodo Hombach, Schröder's chief of staff in the German Chancellery. As will be outlined in this article, this now largely forgotten paper has to still be regarded as the reflection of a political consensus on economic and social policy priorities between the top leadership of New Labour and the SPD at the time, even if it had initially seemed as if Schröder was not fully supportive of the substance of the paper. This was due to his cautiousness with regard to the implementation of the 'welfare to work' strategy into concrete policy reform.

The incremental bias against radical reform which is at the heart of the German polity explains why the Hartz labour market and welfare state reforms introduced by the Schröder government were mainly targeted towards policy reform rather than trying to achieve a substantial overhaul of the core institutional foundations of the German model, such as the system of collective bargaining, the right against unfair dismissal, works councils and the industry-wide general wage agreements. In spite of these rather modest changes, the Hartz reforms continue to be fundamentally unpopular amongst the German public and substantially contributed to the failure of Schröder to be re-elected in 2005.

The EU's open method of coordination approach in the area of economic and social policy has promoted increasing levels of policy-learning between member states in the European Union, particularly in the development of active labour market policies (*de la Porte* 2007: 31). National policy-makers adopt these processes with the aim of preserving the comparative advantage of their respective national political economy by trying to achieve more efficient ways of interaction between its central economic actors (*Hall/Soskice* 2001: 45). In the case of New Labour and the SPD the political consensus and the process of policy-learning occurred during a limited period, at a time when New Labour's Third Way approach was able to successfully promote itself as the best practice model for economic growth and job creation in the EU on the basis of the stable post-1997 boom.

This allowed Schröder to use the 2002 unemployment crisis to push through his own preference for the Third Way's 'welfare to work' approach by using expert advice which promoted the introduction of the principle into the German employment system as a way to stabilise rather than to undermine the core institutional setting of the German social market economy.

### 1. The Blair-Schröder Paper: A Basis for Policy Learning

The joint Blair-Schröder paper on *The Way Forward for Europe's Social Democrats*, published in June 1999, remains a crucial but rather surprisingly a widely neglected source for the analysis of socio-economic policy correspondences between the SPD and New Labour. Due to the internal divisions in the SPD over the party's economic policy in the aftermath of the 1998 election victory, these however only became apparent later on and for a limited period, from around 2002 until the run-up to the early 2005 general election in Germany.

Schröder quickly moved away from the common reform agenda with Blair due to strong opposition within the SPD against the proposals made in the joint paper. His critics, particularly his main inner party rival, party leader and finance minister Oskar Lafontaine, had dismissed the ideas set out in the paper as substantially neo-liberal and therefore contradictory to traditional Social Democratic values (*Lafontaine* 1999:185). The paper subsequently almost completely disappeared from public awareness, especially in the United Kingdom. Schröder only returned to the core ideas of the paper in 2002, when Germany's worsening employment figures forced him to consider labour market reforms which were seen as relatively radical in the German domestic context.

The resulting *Agenda 2010* reform programme, in particular the substantial reduction of financial support for the unemployed under the Hartz IV labour market reforms reflected the principles which the Blair-Schröder paper had originally set out (*Funk* 2007: 129). Schröder himself explicitly conceded this in his political memoirs in 2006 (*Schröder* 2006: 276). The incorporation of core principles of the Blair-Schröder paper into the red-green coalition's 2002 *Agenda 2010* was a manifestation of Schröder's deep-seated sympathies for New Labour's 'Third Way' economic approach, especially the essential *welfare-to-work* principle.

This had already become obvious during the run-up to the 1998 general election campaign when Schröder tried to present himself as a reformed Social Democrat, who would represent '*Die neue Mitte*' (the new middle ground). He concentrated on the concept of an 'activating state' and categorically rejected calls for large-scale Keynesian public spending programmes (*Schröder* 1998a: 39). Once elected as Chancellor, he clarified that his policy of the 'new middle ground' would be aimed at activating the individual responsibility of each citizen in his first official declaration to the German parliament (*Schröder* 1998b).

The concept of the '*Neue Mitte*' with its emphasis on self-responsibility and the notion of an activating state had clearly been inspired by New Labour's 'Third Way' philosophy. Tony Blair called it a new pragmatic left-of-centre approach which would go beyond the dogmas of the traditional left and right and create a new relationship between government and business (*Blair* 1995a). At the heart of the 'Third Way' is the redefinition of the notion of modern, active citizenship and individual responsibility, where the role of the state is transformed from a provider of all-encompassing care for its citizens to that of a facilitator of individual potential (*Blair* 1995b). State supervision of individual need in the form of rigid means testing hence becomes the norm and benefit recipients are expected to accept state assistance to get back into work. Anthony Giddens, who provided New Labour with the conceptual framework for this new middle-of-the-way policy concept, described his 'third way' approach as a new Social Democratic agenda which would break down the traditional boundaries of left and right. He called on

the new left to create a “society of ‘responsible risk takers’” (Giddens 1998: 100).

Tony Blair’s and Gerhard Schröder’s shared admiration for this approach was expressed in their joint position paper. The paper was mainly the result of intense consultations between their two senior advisors, Peter Mandelson and Bodo Hombach. The Blair-Schröder paper emphasised the need to adopt a pragmatic and facilitating role for government, based on the encouragement of ‘individual achievement and success, business spirit, personal responsibility and a sense of community’ (Blair/Schröder 1999: 2). Schröder was hampered in his efforts to put these principles into concrete policies by his finance minister Oskar Lafontaine, who dismissed the paper as a modern form of Thatcherism, which in his opinion belonged in the ‘waste basket’ (Lafontaine 1999: 190). Lafontaine blocked any attempts by Schröder to introduce structural reforms of the labour market and the welfare system and unexpectedly resigned as finance minister and SPD leader in March 1999, following a row with Schröder over his Keynesian spending plans.

Schröder reform aspirations nevertheless faced the biggest hurdle in the structural constraints of the German polity, which is characterised by a weak executive and the existence of a multiplicity of veto points and players on the federal, regional and local level. In an institutional setting which Katzenstein distinctively characterised as *semi-sovereign* (Katzenstein 1987), swift and radical policy change is very difficult to achieve. The German system forces the federal government into a constant process of consensual bargaining with a variety of veto players (coalition partners, the *Bundesrat*, the Federal Constitutional Court). The two major parties are consequently forced to enter a constant informal grand coalition if they want to avoid political stalemate (Saalfeld 2006: 250; Strohmeier 2006: 234). The scope for either the SPD or the CDU/CSU to implement the core agenda of their individual election manifestos with one of the smaller parties therefore remains substantially limited. This has become even more noticeable in the domestic political setting of the unified Germany, which is characterised by a greater diversity of interests and a decline in electoral support for the larger parties (Sieberer 2006, 67). Schröder attempted to overcome the domestic German institutional constraints by using expert advice in the form of commissions as a means to weaken the authority of the political opposition against his government’s agenda. The first phase of this ‘government by commission’ approach (Dyson 2005: 288) was the consensus-orientated *Bündnis für Arbeit* (Alliance for Jobs), established in the aftermath of the 1998 election victory. It assembled employers, trade unions and the government at a round table. The Alliance for Jobs forum was an attempt on the Chancellor’s part to weaken the influence of the traditionalists within his own party and to manage opposition from vested interests effectively (Streeck/Hassel, 2004: 114). The failure of the Alliance to produce concrete consensual proposals for structural reforms confirmed the public perception of Schröder as a rather weak reformer, which was strengthened when he characterised his style of governing as ‘the steady hand’.

The situation for Blair’s New Labour government was fundamentally different. The decisive executive powers granted to the government in the British polity, combined with the small number of veto players, who have only a limited influence on the government’s legislative agenda allows swift and profound policy changes, provided the government has a sufficient majority in parliament. Blair’s two landslide victories in 1997 and 2001 provided him with a clear mandate to introduce radical reform in Britain. New Labour consequently swiftly pushed through changes to the tax and benefits system, which were aimed at the concrete implementation of the ‘welfare to work’ principle. Straight after its 1997 general election victory the government introduced a welfare-to-work budget, which was mainly financed by a windfall tax on excess profits made from privatised utilities. As set out in its election manifesto, New Labour aspired to eradicate poverty and exclusion in Britain on the basis of the notion of a ‘stakeholder economy’. It was aimed at

achieving full employment by making it an obligatory choice for the unemployed to either take up work or to opt for further training (Labour Party 1997: 19). The ‘welfare to work’ ethic of New Labour is based on the notion that in an age, where life-long employment in one job is increasingly becoming the exception, ‘government has a vital role in equipping individuals to prosper’ (Blair 1996: 9). This rests on three elements: Government-funded ‘welfare-to-work’ programmes, a tax system which provides incentives to work and investment in skills and training. Between 1997 and 2001, the government introduced compulsory ‘New Deal’ programmes for all 18–24 year-olds who are out of work for more than six months and also for those over 25 who had been out of work for more than 18 months. Voluntary programmes were introduced for the long-term unemployed, single parents and recipients of disability benefits. At the end of 2000, the latter were also developed for people over 50 years of age and anyone living with an unemployed person. The compulsory programmes make it obligatory for anyone who registers as unemployed to attend work-focused interviews with an individual advisor at one of the new *Jobcentre Plus* service centres. Jobseekers are able to choose from one of the available options: Six months subsidised employment or employment in the voluntary sector, or alternatively 12 months of further education and training (Finn 2003: 117).

During its second term in government, New Labour supplemented the work activation programme of the ‘New Deal’ with major tax reforms which are designed to favour those who are in employment, particularly families with children. Already in 1999 the government had introduced tax credits for low-income working families with children, for childcare and for the disabled. This was supplemented by the introduction of the national minimum wage at £ 3.60 per hour, which has in the meantime risen to £ 5.73 for all workers aged 18 and over and £ 3.53 for those under 18. In 2003 this was followed by the introduction of a working tax credit for low-paid workers without children, a child tax credit, which is based on family income and includes a wider range of families than the WFTC, and also a child trust fund, which gives every newborn child in Britain £ 250 as a starting capital in a savings account.

## 2. Towards Convergence?

### *The Agenda 2010 and the Brown Spending Spree*

On the German side, after a substantial period of a lack of reform activity, Schröder was finally forced to take drastic action when unemployment in Germany hit the four million watershed in the run-up to the 2002 general election and his re-election was more than uncertain. Schröder attempted to strengthen his political standing by abandoning efforts to integrate veto players such as employers associations and the trade unions and initiating a new phase of commission government, in which he relied exclusively on expert advice.

In February 2002, Schröder asked Peter Hartz, the chief human resources executive of the German car manufacturer *Volkswagen* to chair a commission to develop proposals for the reform of the labour market. In November the economics professor Bert Rürup, was commissioned with the task of examining the reform of the welfare system, including health and pensions. Both commissions reported their findings shortly before the September 2002 general election. This allowed Schröder to pursue a double-edged strategy. Adopting the slogan ‘*Innovation und Gerechtigkeit*’ (innovation and social justice) as the basis for his election campaign, Schröder announced that he would introduce an ambitious structural reform programme immediately after his re-election, based on the recommendations of the two commissions. The traditional wing of the SPD and the trade unions were pacified by Schröder’s flamboyant promise to defend the core of the *Rhenish* social market economy. He described this as ‘*der deutsche Weg*’ (the German way), which he contrasted with the neo-liberal forces of Anglo-American global ca-

pitalism that are promoting deregulation and a drastic reduction of state influence on the economy.

After his red-green coalition had won the 2002 general election with a slim majority, Schröder embarked on the implementation of what he called the *Agenda 2010* reform programme. It was supposed to equip the Germany economy for the forthcoming challenges of the global economy in the next decade. The core of the *Agenda* was the controversial *Hartz* legislation which reformed German employment policy, based on the recommendations made by the commission led by Peter Hartz, formerly head of personnel at the German car manufacturer *Volkswagen*. The government had already previously emphasised its preference for a strategy of Anglo-Saxon 'support and demand' towards the unemployed in its 2002 national action plan which it issued in response to the recommendations of the European Commission under the European Employment Strategy. The Commission recommendations had called for the deregulation of the German employment system (German Federal Government 2003: 14). The core objectives of labour market flexibility and activation emphasised in the EES, which had been substantially influenced by the UK employment policies of New Labour, became an integral part of the Hartz commission's report on the reform proposals for the German employment system (Büchs 2007: 75).

The red-green coalition passed the Hartz reforms in four stages. Hartz I, which came into effect on 1 January 2003, created personal service agencies to reduce the level of red tape and to assist jobseekers in finding temporary work more quickly. Hartz II, which also came into effect on 1 January 2003, introduced new regulations for part-time employment. Part-time work became exempt from taxes and social insurance contributions below a salary of € 400 for the employee, while the employer pays a flat rate of 30 per cent (12 per cent if it is part-time work in a private household). For part-time employment with a salary of more than € 400 ('*Mini Jobs*'), social insurance contributions rise in stages for the employee, while the employer has to pay the full standard rate. It is also possible to take up part-time work in addition to full-time employment. The foundation of self-employed personal joint-stock companies ('*Ich-AGs*') was encouraged through state subsidies of € 14,400 in total over a three-year period (€ 600 per month in the first year, € 360 in the second year and € 240 in the third year). This has since been limited to nine months and substantially reduced to the level of the new unemployment benefit plus an additional € 300.

The German labour offices (*Arbeitsämter*) were merged with social security offices in an attempt to reduce administrative costs and to offer a single point of call to the unemployed. Hartz III, which came into effect on 1 January 2004 transformed the Federal Labour Office (*Bundesanstalt für Arbeit*) into the new Federal Labour Agency (*Bundesagentur für Arbeit*) with regional branches. The *BA* is supposed to be a modern service provider focused on the individual needs and circumstances of each jobseeker. At the same time with its introduction the Schröder government adopted the concept of a single point of call which combines all services for jobseekers which New Labour had previously introduced in the form of the *Jobs Plus* Centres in the UK (Kemmerling / Bruttel 2006: 104).

The most controversial part of the package, Hartz IV, radically reformed the system of unemployment benefits and income support. Both were merged into a basic subsidy for people who are unemployed and do not qualify for the more generous first category of unemployment benefit (*Arbeitslosengeld I*). The ALG I entitles recipients to unemployment benefits which amount to 60 per cent of their original salary (67 per cent for claimants with one child). The precondition for receiving ALG I is that the claimant has previously paid social insurance contributions for at least twelve consecutive months. In February 2006, the Hartz reforms generally limited the receipt of ALG I to a maximum of 18 months (12 months for those under 55). The SPD has since

pushed for an extension of the periods an unemployed person can receive ALG I. As a result the grand coalition under Chancellor Merkel put into effect changes to the regulations on January 1<sup>st</sup> 2008. Those unemployed over 50 are now able to receive the ALG I for a maximum of 15 months (18 for those over 55 and 24 for those over 58). The maximum period an individual claimant is able to receive ALG I under the new regulation yet depends on how long he or she has paid social insurance contributions during the previous five years.

The new second unemployment benefit ('*Arbeitslosengeld II*') is a tax-funded merger of the former unemployment benefit and income support, which covers all those who do not qualify, or who have exceeded the maximum period during which they can receive ALG I. The rates for ALG II were deliberately set at the level of the former income support to encourage people to subsidise themselves with additional part-time work or minor forms employment. As the following *Table* shows, the grand coalition under Merkel has since slightly increased the level of payment for all categories and introduced a single rate across the whole of Germany in July 2008. The ALG II was increased again on July 1<sup>st</sup> 2009, particularly for children in the household, who are now also recognised in the age group of under six years of age (see the following *Table*). Additional support is granted for rental payments and heating costs and to pregnant women, single parents and disabled people.

**General monthly rates for recipients of '*Arbeitslosengeld 2*' (ALG 2)**

Before 1 July 2007					
	Single Person	Partner (aged 19+)	Child (under 14)	Child (15–18)	
West	€ 345	€ 310,50	€ 207	€ 276	
East	€ 331 (100%)	€ 298 (90%)	€ 199 (60%)	€ 265 (80%)	
New unitary rates across Germany since 1 July 2008					
	Single Person	Partner (aged 18+)	Child (under 14)	Child (14–25)	
	€ 351 (100%)	€ 316 (90%)	€ 211 (60%)	€ 281 (80%)	
Increased rates since 1 July 2009					
	Single Person	Partner (aged 18+)	Child (0–6)	Child (7–14)	Child (15–25)
	€ 59	€ 323	€ 215	€ 251	€ 287

Source: Federal Ministry for Employment and Welfare (2009).

Like welfare benefits in the UK, the ALG II is rigorously means-tested. Individual claims are assessed by the regional branches of the Federal Labour Agencies, which took over this task from local authorities. The Hartz laws determine that anyone who can at least work for three hours a day, which includes people who are temporarily off work to raise children, is considered to be 'capable of gainful employment' (Federal Labour Agency 2008A6: 32). The only groups who are currently excluded from this are the chronically ill and the disabled.

The means-testing for ALG II does not only take into account the individual circumstances of the claimant, but considers everyone in the context of a 'household community' ('*Bedarfgemeinschaft*'). Personal savings and possessions of the claimants and anyone living in the household are therefore considered for means-testing. This includes parents, spouses, non-married partners and children under 25. Recipients of ALG II are encouraged by their personal advisor in the Federal Labour Agency to take up available employment. This often occurs in the form of 'Mini Jobs' with an income of less than € 400 per month or the 'one euro jobs', which are free from social insur-

ance contributions for the employee. The latter are jobs in the community sector which are compulsory for ALG II recipients if offered by an employment agency and are based on a very small salary or other forms of compensation paid in addition to the standard government transfer as ALG II subsidies. Those who receive the ALG II unemployment benefit and earn between € 100 and € 800 get a tax-free allowance of 20 per cent of their income (Federal Labour Agency 2008■: 37). In addition, young people who receive ALG II are generally expected to enter training programmes or any other form of employment to avoid falling into the trap of welfare dependency.

An essential part of the reform package was the attempt to achieve slightly greater flexibility in the German employment system by allowing opt-outs from general wage agreements (*Flächentarifverträge*) for individual companies. However, in each case they have to be strictly consensually agreed between employers and trade unions, and by modestly relaxing the protection against unfair dismissal (*Kündigungsschutz*) for smaller companies (with less than ten employees). It was hoped that this will encourage more employers to offer at least temporary jobs to the unemployed, which in fact did occur to a certain extent as a result of the reforms as recent data by the BA demonstrates (Federal Labour Agency 2008■).

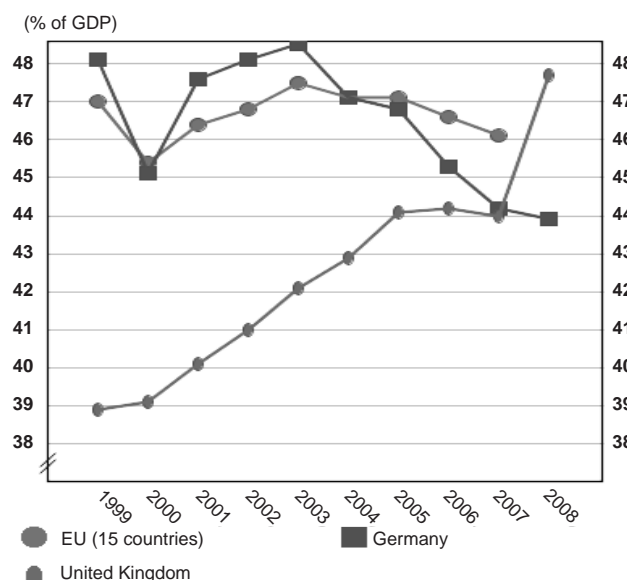
While *Hartz IV* has certainly modified the institutional foundations of the German employment model, it can be argued that the reforms were not radical enough that they could be classified as having substantially altered the nature of the German social market economy (*Haucap/Pauly* 2007). This is however the subject of a continuous debate in Germany, which is spearheaded by the party *Die Linke* which argues that *Hartz* fundamentally undermined the solidarity principle of the German welfare state. The *Hartz IV* labour market reforms have indeed weakened the Bismarckian welfare state principle of 'life standard guarantee', which amounted to a state-guaranteed protection against social descent and poverty through high levels of wage replacement (*Clasen* 2005: 32; *Seeleib-Kaiser* 2001: 112). This had previously established a German welfare state culture where the unemployed were predominantly administered and provided with little incentives to actively look for employment as they received benefits above the wage level offered in many jobs (*Czada* 2005: 167–169). Since the steep increase of unemployment to over two million in the mid-1980s and the increase of social insurance contributions to over 30 per cent of the individual gross income (*Steingart* 2004: 97) the German welfare system became trapped in an increasingly vicious circle of steadily rising social insurance contributions for a decreasing number of people in full-time employment. This amounted to what some classified as 'a functional equivalent of the Keynesian reflation state' (*Streeck* 2005: 146). For critics of the *Hartz* package the reforms represent a decisive break with the traditional German welfare culture by severing the link between former earnings and unemployment benefit (*Kemmerling/Bruttel* 2006: 96). This poses the risk of increasing levels of poverty particularly amongst older workers who become dependent on the low support offered under ALG II if their efforts to return to employment remain unsuccessful. By introducing the 'welfare-to-work' principle into the German welfare state, the *Hartz* reforms have substantially reduced the responsibility of the state to provide income maintenance for the unemployed. The German welfare state culture has therefore indeed incorporated elements of the culture of individual responsibility which are usually found in liberal economies like the UK. If this was accompanied by even more radical reforms of the German employment systems under future governments, the *Hartz* laws could indeed in retrospective still be considered as the first wave of a gradual systemic change towards a more liberal economic model.

The *Hartz* labour market reforms have also led to a higher level of vertical disintegration in the German industrial relations system, which has led to an increase in the outsourcing of jobs to the low-wage sector of smaller companies, which tends to not be covered by collective agreements. Consequently only around

50 per cent of East German employees and less than 70 per cent of West German employees are currently covered by collective wage agreements (*Bosch* 2008: 17). This certainly reflects a trend towards a greater diversity in the German industrial relations system. At this stage however one cannot detect an overall strategy amongst employers to try eradicate the system of collective bargaining (*Doellgast/Greer* 2007: 71). In spite of the changes described above the fundamentals of German industrial relations predominantly continue to follow the traditional patterns of 'centralisation and coordination' (*Funk* 2007: 128).

The red-green coalition's delayed introduction of labour market reforms coincided with a fundamental shift in New Labour's budgetary policy. While the New Labour government had strictly kept to the tight limit on public spending limits set out by their Conservative predecessors during its first term in office, Chancellor Gordon Brown announced a new spending plan for public services for the period up to 2006 in his first budget following New Labour's second landslide election victory in 2001, which meant a large increase in real terms. Total public spending in the UK has hence consistently risen from around £ 362 billion in 2001 to around £ 575 billion in 2008, with the biggest ever post-war increase in health spending in Britain. NHS spending has almost doubled between 2001 and 2008, from £ 53 to £ 102 billion in 2008<sup>3</sup>.

Under New Labour public spending gap between the UK and the rest of the EU-15 has consequently substantially narrowed since the late 1990s, which is particularly noticeable when comparing the UK and Germany, where British government expenditure has even been higher than in Germany since 2007 (see *Figure 1*). These changes distinguish New Labour's economic approach noticeably from the Thatcherite culture of 'rolling back the state' under previous Conservative administrations, which rejected the notion that taxpayers should be burdened with the funding of public services. Some scholars even detect distinctively Keynesian elements in New Labour's policy approach, concentrating mainly on the 'willingness and capacity to pursue deficit finance in appropriate circumstances' (*Clift/Tomlinson* 2007: 52) with the overall goal of fighting unemployment.



Source: EUROSTAT.

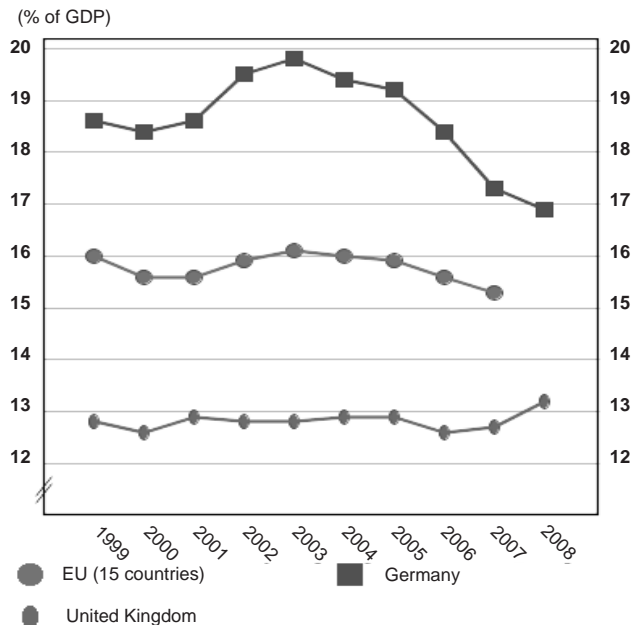
Figure 1: Total general government expenditure

In spite of the sustained public investment program introduced by New Labour, the UK nevertheless still spends substantially less on social benefits than the EU-27 average, particularly less

<sup>3</sup> Source: HM Treasury Public Expenditure and Statistical Analyses (2009), [http://www.hm-treasury.gov.uk/pesa2009\\_tables.htm](http://www.hm-treasury.gov.uk/pesa2009_tables.htm).



than continental welfare states like Germany. Figure 2 illustrates that in spite of the lower welfare payments in the wake of the Hartz reforms and slightly lower overall spending on welfare benefits, it is noticeable that Germany maintains a relatively high level of welfare spending. The UK remains below the average EU-15 levels on welfare spending, which at least in this area points to the persistence of the Thatcherite legacy of a rather individualistic welfare culture, where the political debate continues to be dominated by an 'image of taxpayers versus (fraudulent) benefit claimants' (Clasen, 2005: 32).



Source: EUROSTAT.

Figure 2: Social benefits (other than social transfers in kind) paid by general government

The concrete effects of New Labour's social policies show that a certain level of criticism is justified, particularly as the record level of economic growth and job creation over more than a decade since 1997 has not resulted in noticeable socially cohesive outcomes. In the comparative European context, New Labour's approach has yet to prove that it can produce levels of social cohesion that are equal to those of continental welfare state models. The risk of remaining trapped in poverty after receiving social transfers, measured on the basis of remaining below the threshold of 60 per cent of the national median disposable income, has persistently remained at the level of 18 (lowest) and 19 (highest) per cent since 1997, whilst the EU-15 average tends to fluctuate around 16–17 per cent. In contrast, the German welfare state continues to be more efficient in preventing poverty, even though the effects of persistently high levels of structural unemployment in the East since reunification and more recently also the reduction of welfare benefits under Hartz IV described in this article have led to a rise in poverty levels. In comparison to the UK this increase is yet still relatively modest, from 12 per cent in 1997 to the up until now highest level of 15 per cent in 2007.<sup>4</sup> It had fallen afterwards due to the positive effects of the upswing in 2008 which however ended in the same year.

New Labour still faces the challenge to convincingly defend its 'third way' approach against accusations that it represents a rather managerial cost-cutting exercise (Hutton 2003: 118), a point that has also been put forward by critics of the *Agenda 2010* reforms in Germany (Bosch 2004: 16). Whilst both the UK and Germany face a growing problem with income inequality and resulting poverty, a particular concern for New Labour has to be the fact that the level of income inequality between those at the top and the bottom end of the income scale today is actually higher than under earlier Conservative administrations.

New Labour's post-1997 economic and employment boom largely benefitted the middle class and those at the top of the incomes scale (Deacon 2003: 138). The ratio between the equivalised disposable income of the 20 per cent highest earners and those of the 20 per cent at the bottom of the income scale is less favourable than in Germany and amongst the EU-25 average. The ratio has risen from 5.0 in 1997 to 5.5 in 2006, which contrasts unfavourably with the EU-15 average of 4.7 and the German average of 4.1<sup>5</sup>. It is nevertheless noticeable that since the introduction of the Hartz IV laws, income inequality has also risen in Germany and under the conditions of the current global economic crisis it is likely to increase further in the future.

This generally raises the question if the very strong focus of the 'third way' approach on the rapid creation of employment is in practice able to support the logic of the EU Lisbon strategy that high employment rates result in rising levels of social cohesion. A substantial section of the jobs created in Britain and Germany in recent years are failing to provide adequate earnings, particularly for people on medium and lower incomes. The 2008 Institute for Fiscal Studies report on poverty and inequality in the UK highlights that real income growth for the poorest income quintile group in the period between 2004/05 and 2006/07 was negative (minus 1.1 per cent), with just minor improvements for middle incomes (between 0.1 and 0.6 per cent) and substantial above zero growth only amongst the top earners (plus 1.2 per cent) (Brewer et al. 2008: 22). The overall increase in income inequality under New Labour is shown in the increase of the Gini coefficient from 0.33 to a record 0.35 (Ibid: 27). In terms of the general debate about rising poverty in the UK, the IFS observes that, in spite of general declining levels of poverty since 1997, New Labour's welfare policies have in recent years failed to stop a trend which sees a rise in poverty amongst children and pensioners and even amongst working people with our without children (Ibid: 37). When considering the British case where poverty has not been substantially reduced in spite of a decade of continuous employment growth, the logic that work itself can be regarded as a universally effective anti-poverty measure hence has to be questioned.

### 3. Conclusion

The comparative analysis of the economic and social policy reforms in the UK and Germany since the late 1990s illustrates that processes of policy learning are possible between governments in fundamentally different domestic socio-economic pathways, if they are facilitated by certain conditions. In the case presented in this article these were visible in the (if only temporary) correspondence in political preferences between the top leadership of New Labour and the SPD, combined with a substantial level of domestic reform pressure in Germany and consequently the opportunity for Chancellor Schröder to sideline institutional veto players and to implement the *Agenda 2010* reforms.

Since the 2005 general election the policies of the two parties have started to develop into noticeably different directions. This reinforces the view that in spite of the ability of national actors to make choices about changes in the direction of policies, they are usually unlikely to substantially alter the essential path dependent culture of existing domestic institutions. As could be expected, New Labour hence abided by the inherent domestic culture of scepticism towards state welfare provision and has recently pushed its welfare reforms towards a more radical direction. The Department of Work and Pensions has hence followed the recommendations made by the Freud report (Freud 2007) and is now including the most inactive societal groups, particularly single mothers and less severely disabled people, into com-

<sup>4</sup> Source: EUROSTAT (2009), Living Conditions and Welfare: At risk of poverty rate after social transfers by gender.

<sup>5</sup> Source: EUROSTAT (2009), Living Conditions and Welfare: Inequality of income distribution.

pulsory labour market activation programmes. (Department of Work and Pensions 2008: 12).

In contrast, the SPD responded to increasing public hostility and the institutional resistance in many German regions towards the detailed implementation of the *Hartz* reforms (Kemmerling/Bruttel 2006: 106) by promoting itself as the guardian of the German social market economy against more radical reform proposals put forward by the CDU/CSU and the FDP during the 2005 general election campaign. In the subsequent grand coalition government with the CDU under Merkel, the SPD has since wavered between general support and criticism of Schröder's *Agenda* reforms. The mounting public opposition against the *Hartz* labour market reforms have led to a surge in support for the SPD's left-wing political rival, the *Linkspartei* spearheaded by former SPD leader Lafontaine, even in the Western part of the country. Due to the electoral unpopularity of the *Hartz* laws, the SPD is now emphasising the need to increase the ALG-II tariffs on a regular basis in order to prevent 'the unemployed from descending into poverty' (SPD 2009: 20) and also continues to campaign for the introduction of a general minimum wage and additional wage subsidies for those on low incomes.

The parameters for national policy reform have undoubtedly been altered dramatically as a result of the ongoing global economic recession following the collapse of parts of the financial industries in the United States in 2008. Future comparative analyses of socio-economic transformation will need to assess the impact of this crisis of global capitalism on the varieties of national economies and social models, particularly in respect of the changes within the British model as a result of the unprecedented level of government interference and the part-nationalisation of the banking industry under prime minister Gordon Brown. These developments and a greater focus on rebuilding the domestic manufacturing industry could in the future significantly alter the core of Britain's liberal economic model.

Similarly the effects of the global recession could in the long run lead towards a new reform debate in Germany, particularly if the country's economic performance continues to decline in future years. Currently Germany's traditional anti-reformist climate is once again dominating the domestic political discourse (Green/Paterson 2008: 192). The fact that the global recession had its origins in the relatively unregulated financial industries of the liberal economies in the United States, Britain and Ireland has made it less attractive for German policy-makers to promote the further deregulation of the German social market economy. The SPD is using the current economic situation to praise the institutional foundations and the focus on high-quality manufacturing of the German model as a competitive advantage against its more liberal competitors. This accompanied by a clear criticism of New Labour's overreliance on 'services and the financial sector' (Steinmeier 2009).

The policy trends in Britain and Germany following the publication of the Blair-Schröder paper consequently illustrate that national responses to the challenge of globalisation remain distinctively diverse in terms of policy detail and speed of implementation as a result of prevailing institutional and cultural differences. This reinforces the importance of the historical institutional view that in spite of the common challenges national economic models are facing in the increasingly interdependent global economy, policy change continues to occur on the basis of established path-dependent institutional cultures. Instead of pursuing a one-size-fits-all deregulated convergence model, national policy-makers are hence trying to increase the comparative advantages of their economies on the basis of 'development through adaptation of competitiveness-enhancing modes of intervention sensitive to institutional and cultural specificities' (Hay 2000: 519)

Future comparative analyses of socio-economic transformation will nonetheless increasingly have to take into account the growing importance of actors and processes which occur outside

the established domestic institutions of individual economic models (Allen 2006: 147). These include transnational forms of policy learning and also new mechanisms of domestic governance, like the use of expert commissions. It remains to be seen if these processes, particularly if they increasingly involve actors from outside the national institutional culture, will in the long lead to new forms of policy transfer and ultimately towards greater convergence between existing models.

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