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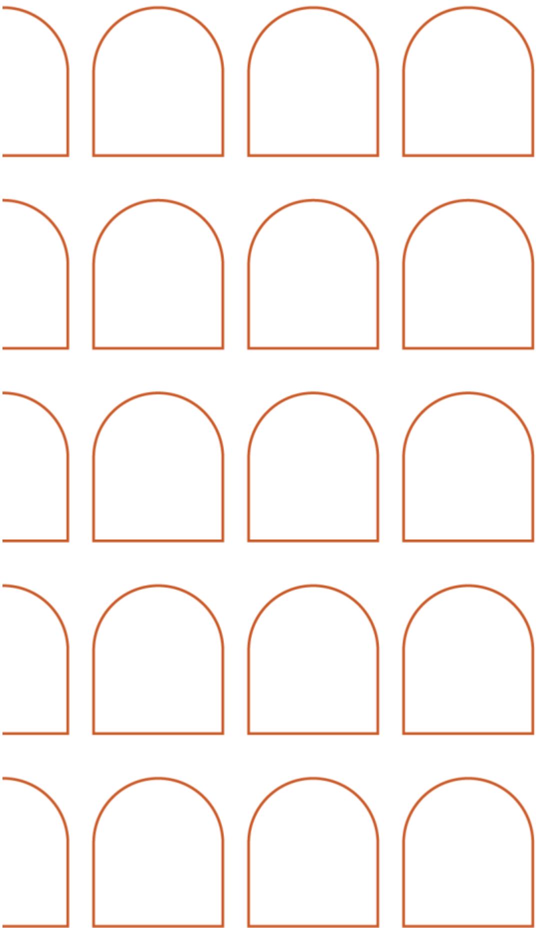

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Regulation & Delegation: Public Sector Wage-Setting Systems and the Two Models of State-led Wage Restraint in Western Europe

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Abstract

Systematic variation in the outcomes of public sector wage-setting (PSWS) persists in Europe. PSWS is generally analyzed as a problem of inter-sectoral wage-coordination in political economy literature. To do justice to PSWS' unique features, this article advances a state-centered theoretical framework which treats PSWS by political employers as fiscal policymaking characterized by the common-pool problem and special-interest politics. Drawing on insights from public economics scholarship, the article thus argues that systematic public sector wage restraint occurs within states where the governance of PSWS is structured according to two models which I term the delegation and regulation models of PSWS. Through a combination of six case studies, elite interviews and archival research, the article shows that variation in PSWS hinges on the various capacity of state institutions to minimize special-interest politics' externalities across countries. These findings advance our understanding of PSWS and the role of the state in public policymaking.

Keywords

Public Sector, Wage-Setting, Neo-corporatism, Political Economy, Europe

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Max Weber Fellow 2020-2021

Introduction

Enacting wage policy for the country's public administration ensures the ongoing operations of the state. In fact, public sector wage-setting (PSWS) is a cumbersome task for state employers, because of the important implications it carries for the country's public finances and economic competitiveness; the state is the single largest employer in advanced economies (Hyman 2013), employing around 20% of total employees (OECD 2019). The wage bill absorbs more than ¼ of governments' current expenditures—an average of 10% of GDP in European countries[1]. As a result, expansionary wage policies in the public sector jeopardize public finances, engender export competitiveness and contribute to countries' current account deficits (Johnston, Hancké, and Pant 2014). It is therefore not surprising that preventing negative spillovers from expansionary wage-setting in the public sector is a crucial concern for governments (Calmfors 1993).

While steady public sector expansion went undisputed during Europe's *Trente Glorieuses* (Rose et al. 1985), since the 1980s there has been a major shift from the active Keynesian state to New Public Management (NPM) and regulatory governance (Hood 1995; Majone 1994). Besides winding back government intervention in the economy, central to this shift was the need to install the market mechanism into public sector employment relations, hitherto mainly subjected to public law status (Bach et al. 1999). Given the secular slowdown of growth and productivity rates, governments have begun containing public sector wage growth to shore up public finances and ensure competitiveness in global markets (Oxley et al. 1991; Oxley and Martin 1991). Despite these common challenges, however, states have not converged toward the neoliberal night-watchman state (Pollitt and Bouckaert 2011); nor have public sector employment relations systems, which remain hardwired into their path-dependent legal and administrative systems (Bach and Bordogna 2011). As a result, cross-country variation in PSWS outcomes persists stubbornly in Europe: some countries feature expansionary public sector wage policies while others systematic wage restraint (Holm-Hadulla et al. 2010; Müller and Schulten 2015). How do we account for cross-country variation in PSWS outcomes across Western Europe?

This question remains relatively understudied in the literature. Drawing on classic neo-corporatist thinking, scholars have largely treated PSWS as a problem of wage co-ordination between exporting and sheltered sectors (Garrett and Way 1999; Hancké 2013; Johnston 2012; 2016; 2011; Traxler and Brandl 2010). This scholarship shows that restrictive PSWS depends on the presence of neo-corporatist wage bargaining regimes, which constrain public sector unions' capacity to extract inflationary wage increases due to centralized bargaining or mechanisms of inter-sectoral wage co-ordination. These insights remain central to our understanding of contemporary wage-setting regimes. However, in this paper I question their applicability to PSWS by showing that neo-corporatist wage-setting regimes are neither necessary nor sufficient institutional prerequisites for public sector wage restraint. Hence, by borrowing insights from public economics scholarship, I advance a new state-centered theoretical framework for the study of PSWS. Instead of a wage co-ordination problem, I posit that PSWS is better comprehended as a classic common-pool problem of public finances (Von Hagen and Harden 1995), characterized by special-interest politics (Persson and Tabellini 2016). Thus, I argue that cross-country variation is better explained by variation in the institutional configuration of PSWS governance systems, which minimize these problems differently across countries.

PSWS is in fact fundamentally different from private sector wage-setting due to the common-pool problem. Public wages are funded by political employers spending general taxpayers'

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1 Calculations based on data from AMECO database.

money on benefits targeted to a specific social group: public employees. Thus, fiscal spending on PSWS generates a clear-cut mismatch between the benefits of public spending, internalized by the public sector groups, and the costs, externalized onto the collectivity. This gives rise to special-interest politics: public sector narrowly-based interest groups are well-organized and have clear incentives to act as "distributional coalitions" (Olson 1986) to appropriate the maximum share of public resources to the advantage of their organizations and their members. Simultaneously, the conflict of interest between capital and labor is absent in PSWS because there is no profit-making motive in the provision of public services. Instead, political employers have strong incentives to grant generous wage increases in exchange for public employees' votes and public sector unions' political support. As a result of these features, PSWS tends to be inherently inflationary because of a mutually-convenient political exchange (Pizzorno 1978) between the parts. Given these general features of PSWS, how do we make sense of cross-country variation?

Taking the cue from public economics scholarship (Hallerberg 2004; Hallerberg and Von Hagen 1997), I contend that cross-country variation in PSWS depends on the presence of state institutions that limit the PSWS in-built common-pool problem. Based on archival material, elite interviews and an original combination of most-similar (France and Italy) and most-different (Germany and Portugal) case studies with shadow cases (Belgium and Greece), I argue that wage restraint occurs in countries where two distinctive institutional configurations govern the conduct of PSWS. I term these the *delegation* and the *regulation* models of PSWS governance. Under the former, wage restraint occurs because the determination of PSWS is centralized under the remits of the finance ministry—the bulwark of the state's fiscal responsibility—or an independent state agency with a mandate and powers to ensure a de-politicized PSWS. Under the regulation model, wage restraint occurs because the determination of PSWS is regulated through *ex ante* rules imposing ceilings to PSWS. In the absence of either governance system, PSWS tends to fall prey to special-interest politics and results in volatile trajectories of expansion and restraint, depending on governments' fiscal capacity.

The paper makes three contributions to comparative political economy scholarship. First, the paper advances our understanding of wage-setting dynamics in Europe. It shows that, differently from standard assumptions held in neo-corporatist scholarship (Di Carlo 2018a), PSWS is often independent from the dominance of export-sector interests and co-ordination institutions. Hence, PSWS should be studied for its own sake; it yields broader insights into the study of countries' fiscal policymaking and distributive politics. Second, the paper advances our understanding of states' role as public employers. It shows that states are neither neutral industrial relations actors—captured by export-sector interests—nor monolithic blocs. Rather, studying intra-state dynamics is important to comprehend the various processes and outcomes of public policymaking in different countries. Third, the paper shows that the state's institutions and practices matter insofar as they shape economic policy outcomes with broader implications for a country's growth model (Baccaro and Pontusson 2016; Hassel and Palier 2021).

The argument proceeds as follows. In the next section, I discuss the shortcomings of the neo-corporatist approach. In the section that follows, I lay out the alternative state-centered theoretical framework of PSWS. In the following two sections I first discuss the logic of case selection to then demonstrate the framework's explanatory capacity through in-depth case studies. Lastly, in the conclusions, I wrap up the findings and discuss the importance of PSWS for burgeoning debates on growth models.

Neo-corporatism: the institutional pre-conditions for public sector wage restraint

The study of PSWS has loosely concerned three different literatures. Labor economists have focused on estimating the wage gap between public and private sector employees in comparable professions (Giordano et al. 2011; Lucifora and Meurs 2006; Postel-Vinay 2015). Industrial relations experts have provided insightful yet descriptive analyses of public sector employment regimes (Bach and Bordogna 2016; Bach et al. 1999). To my knowledge, it is thus mainly the *structuralist* variant[2] of the neo-corporatist scholarship that has investigated the processes and outcomes of PSWS in detail (Crouch 1990; Garrett and Way 1999; Traxler and Brandl 2010).

Neo-corporatist studies have argued that a country's capacity for wage restraint depends on the presence of particular institutional prerequisites, i.e. centralized or coordinated wage bargaining regimes[3] (Scharpf 1991; Soskice 1990). In the former, encompassing unions are forced to moderate their wage claims within confederal agreements because expansionary wage policy across-the-board generates inflation spillovers, thereby jeopardizing their members' purchasing power and export-sector jobs. In the latter, wage restraint pursued by the export-sector—interested in international cost-competitiveness—is imposed on sheltered sectors through institutional mechanisms of inter-sectoral co-ordination.

Drawing on this logic, scholars have thus argued that cross-country variation in PSWS outcomes hinges on the presence of neo-corporatist wage bargaining regimes preventing public sector unions from extracting "unmerited wage increases" (Johnston 2012). These institutional regimes range from pattern bargaining systems of inter-sectoral co-ordination (e.g. Germany), to centralized incomes policies (Finland), wage laws (Belgium) and export-oriented wage co-ordination imposed by the state (France) (Hancké 2013; Johnston 2016; Johnston and Hancke 2009). However, events suggest variation in neo-corporatist wage bargaining regimes cannot fully account for PSWS outcomes. In fact, centralized or coordinated wage bargaining regimes appear neither necessary nor sufficient institutional conditions for public sector wage restraint. To see why, consider these observations.

Germany is the most representative case of inter-sectoral wage coordination through pattern bargaining. Yet, recent scholarship has documented a sharp divergence between the export and public sector's wage trajectories (see Figure 4), which is hard to reconcile with inter-sectoral wage co-ordination (Di Carlo 2020). Marked public sector wage restraint has been imposed by Germany's state employers to shore up public finances in light of Germany's fiscal crisis at the turn of the century (Di Carlo 2019). Therefore, although pattern bargaining may be a sufficient institutional mechanism to generate wage restraint, it is certainly unnecessary in the public sector when governments face budgetary problems. The broader validity of this observation is corroborated by last decade's events. Extant scholarship argues that, before the Eurozone crisis, countries lacking neo-corporatist wage-setting regimes experienced inflationary PSWS (Johnston and Hancke 2009). This is true. However, when the crisis hit, independently of domestic wage-setting regimes, virtually all European governments imposed—unilaterally—wage freezes/cuts in the public sector through their legislative powers

2 The concept of neo-corporatism comes in different theoretical variants (Molina and Rhodes 2002; Streeck and Kenworthy 2005) and empirical applications (Jahn 2014; Kenworthy 2003; Siaroff 1999). In the CPE literature, it describes both a distinctive structure of interest representation (Schmitter 1974) and an inclusive mode of economic governance, i.e. concertation (Baccaro 2003; Grant 1985; Schmitter 1982). While acknowledging this distinction, this paper engages only with the structuralist variant for it is through the institutional features of wage-setting systems that scholars have explained cross-country variation in PSWS.

3 Calmfors and Driffill (1988) demonstrated that fully decentralized wage-setting systems would be functionally equivalent to centralized ones. However, atomistic wage-setting systems are rare in the public sector.

(Bach and Bordogna 2016; Glassner 2010; Vaughan-Whitehead 2013). Thus, neo-corporatist accounts of PSWS fail to explain why similar structures lead to different outcomes over time.

Moreover, consider the Irish and Italian experiences. Ireland entered EMU with a centralized wage-setting regime based on national social partnership, institutionalized since 1987 (Regan 2012). In the early 1990s, Italy adopted a coordinated wage-setting regime based on centralized wage policies anchored to the forecast inflation rate as agreed nationally (Regalia and Regini 1998). Yet, despite this neo-corporatist fine-tuning, both countries experienced a marked trajectory of public sector wage growth well above the private sector (Müller and Schulten 2015). Hence, although certainly helpful, neo-corporatist practices or institutional structures seem insufficient to ensure restraint in the public sector.

In all, the problem with neo-corporatist accounts of PSWS seems to lie in an excessive focus on the institutional structures that best constrain sheltered sector unions' rent-seeking behavior. While insightful, this approach overlooks that PSWS is fiscal policy enacted by political employers (Beaumont 1992). In public sector industrial relations, in fact, the government "occupies two seats" (Hyman 2013). It represents the management side but it is also the state's political and fiscal authority with the capacity to impose its wage preferences via unilateral administrative acts (Traxler 1999). In fact, even where public sector collective bargaining exists, negotiations with the labor counterpart always occur under a "shadow of hierarchy" (Scharpf 1997), where the state maintains the ultimate power to enforce restraint in PSWS unilaterally and does not require neo-corporatist institutional prerequisites. The relevant puzzle in the political economy of PSWS thus becomes why governments fail to pursue restrictive PSWS in good times despite having the powers to do so. This behooves us to adopt an alternative theoretical framework to make sense of PSWS's *sui generis* nature and uncover the conditions under which public sector wage restraint occurs.

Regulation and Delegation: the two institutional configurations for public sector wage restraint

The special-interest politics of PSWS

Moving beyond the neo-corporatist approach, this paper posits that PSWS is better comprehended as a case of fiscal policymaking characterized by the classic common-pool problem of public finance, which gives rise to special-interest politics. The core of fiscal policymaking in democracy is that politicians receive a mandate from voters to spend other people's money. The common-pool problem is thus central to the study of public finance (Von Hagen 2008). It arises anytime politicians can spend general taxpayers' money on policies which are, instead, targeted to specific groups of beneficiaries (Hallerberg, Strauch, and Von Hagen 2007). Since the costs of funding these policies are diffused—i.e. paid by all the taxpayers—while the benefits are concentrated—i.e. enjoyed only by the group members—, there is a mismatch between those who pay for public policy and those who benefit from it. In other words, while a targeted group (e.g. the public sector employees) internalizes the full benefits of spending bids (e.g. on public sector wage increases), the additional burden on the public budgets is externalized onto the collectivity.

This divergence in public spending's net benefits appropriation leads to budgetary expansion and excessive spending due to special-interest politics: narrow-interest groups[4] and the politicians representing them have clear incentives to expand spending bids to appropriate the maximum amount of societal resources from the common pool while bearing only limited costs

4 Mancur Olson famously termed these narrow interest groups "distributional coalitions" (1986).

(Persson and Tabellini 2016; Ch. 7). Fiscal spending for PSWS is particularly prone to special-interest politics because it shares the characteristics of *club goods* (i.e. excludability and non-rivalry) which make spending bids particularly effective for redistributing fiscal resources from the general public to targeted social groups, as characteristic of clientelist exchanges (Hicken 2011; Kitschelt and Wilkinson 2007).

In extreme cases, like in Greece before the financial crisis, politicians may unashamedly exchange public sector wage increases (and other benefits) for clientelist political support by public sector employees and unions (Trantidis 2016). But politicians' use of public money in PSWS implies the in-built logic of budgetary/wage expansion in PSWS remains, even in the absence of clientelism. In fact, it is perfectly rational for office-seeking politicians in charge of PSWS to prefer expansionary wage policies. This is for two main reasons. The standard conflict of interest between capital and labor is absent in the public sector because there is no profit-making motive in the provision of public goods and services, which are not for sale. Second, it is because wage restraint imposes direct and visible costs to a large constituency with high sanctioning capacity. In fact, differently from the private sector, public employees can sanction public employers at the ballot box while well-organized trade unions can disrupt the provision of public goods[5] to the community, causing a broader backlash against the government. Arguably, given the large size of today's public sectors, public sector employees remain a hefty electoral constituency political entrepreneurs cannot easily afford to alienate (Beramendi et al. 2015).

Hence, PSWS tends to be expansionary as a result of a "political exchange" (Pizzorno 1978) between politicians in government and the public sector workers/unions. Expansionary PSWS then creates negative fiscal and inflation externalities (Calmfors 1993). Expansionary PSWS induces higher debt/taxes or cuts in other types of public expenditures. Moreover, it generates inflation spillovers that worsen the country's terms of trade, engender current account deficits and elicit internal or external devaluations (Johnston 2016; 2011; Johnston, Hancké, and Pant 2014). By exchanging political support for generous wage increases, both politicians and public sector groups internalize the full benefits of fiscal spending for PSWS while externalizing its costs on society. However, the extent to which these dynamics occur varies across systems of PSWS governance.

Regulation and delegation: the public sector wage-setting systems for state-led wage restraint

Public economics scholarship shows that fiscal policy's common-pool problems can be mitigated by specific state institutions governing budgetary decisions. Thus, cross-country variation in fiscal policy hinges on variation in these budgetary rules and processes constraining politicians' opportunistic pursuit of special-interest politics (Alesina and Perotti 1996; Poterba and Von Hagen 1999). Among others, two institutional configurations are relevant here (Von Hagen 2008): (1) the centralization of budgetary processes through delegation to the finance ministry and (2) *ex ante* regulations.

First, under the model of centralized delegation, the common-pool problem is minimized by centralizing the ultimate authority on budgetary decisions within a state unit with an organizational mandate to guarantee sound public finance. This is to ensure responsible budgetary decisions be taken in the general interest rather than in response to narrow groups' demands. Within the state's institutional setting, this "fiscal entrepreneur" is the finance ministry whose officials' careers and credibility hinge on their success in enforcing sound budgetary

5 Public employees generally enjoy the right to strike, although limitations may exist for employees with the status of public law civil servants and to guarantee essential services to the community (e.g. law and order, healthcare) (Bordogna 2007).

policies (Jochimsen and Thomasius 2014; Moessinger 2012). Delegation involves the centralization of policy authority within the finance ministry or agenda-setting as well as monitoring and veto powers in the budgetary process. Deviations from this model result in fragmented budgetary decisions, which generate larger deficits. This occurs, for instance, when policymakers other than the finance ministry (e.g. in spending ministries) can use off-budget funds for spending bids targeted at narrow groups without being challenged by the central budgetary authority (Von Hagen 2008). Second, *ex ante* regulation of fiscal policy simply refers to the adoption of predetermined rules mandating numerical constraints on budgetary aggregates (e.g. numerical debt ceilings), which limit budgetary decisions *de jure*.

Drawing on these insights, I theorize equivalent institutional configurations of PSWS governance and distinguish between the *delegation* and the *regulation* models. Table 1 provides an overview of each model's salient traits.

In the delegation model, the conduct of PSWS is centralized under the authority of the finance ministry, which enjoys various institutional mechanisms to ensure responsible PSWS. Here, the conflict of interest between public management and employees is reinstated "artificially" by delegating PSWS powers to a state actor with a vested interest in ensuring the conduct of fiscally *responsible* wage policies in contrast to politicians' temptations to be *responsive*[6] to the demand of public sector groups.

Three configurations of the delegation model can generally be found. One involves the finance ministry acquiring the direct competence for wage negotiations (if collective bargaining exists) or wage determination (if PSWS is based on legislation). Similarly, a second configuration exists where the competence for PSWS is centralized under the authority of an extra-governmental actor, i.e. an independent state agency with a legal mandate to negotiate and/or set wage policy according to "objective" parameters (e.g. inflation targets or private sector wage comparators), thus substituting political decision makers in PSWS (Ozaki 1987). Here, however, the mandate must grant the agency funding authority to disburse fiscal resources for PSWS autonomously. Otherwise, when agencies have only bargaining competences, but politicians control the fiscal resources for PSWS, there remains scope for special-interest politics because wage policy can be expanded by enlarging fiscal funding through additional spending bids, as the Italian case demonstrates (see p.12). Lastly, a third configuration consists of the finance ministry not having the competence for wage determination but holding the power to set *ex ante* budgetary limits for aggregate spending on PSWS and to veto decisions deviating from them.

Thus, I advance the following first hypothesis:

(H1) public sector wage restraint occurs within PSWS systems of governance based on the delegation model where the competence for the determination of public sector wage policy is centralized within the remit of the finance ministry or an independent state agency with funding authority; or where the finance ministry sets ex ante budgetary limits to fiscal aggregates for PSWS.

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6 On the distinction between responsible and responsive governments see Mair (2009).

Table 1: systems of PSWS governance conducive to public sector wage restraint

System of PSWS governance	Features	Mechanism for wage restraint	Example
1. Delegation model			
(1a) Delegation to Finance Ministry	Finance Ministry negotiates with unions and/or sets public sector wage policies unilaterally	Conflict of interest between Finance Ministry and public workers/unions; Finance Ministry conducts responsible PSWS in the general interest	PSWS in German *Länder* & Portugal
(1b) Delegation to independent state agency	Independent state agency negotiates with unions and/or sets public sector wage policies unilaterally	Conflict of interest between independent agency and public workers/unions; agency conducts responsible PSWS according to objective parameters	/
(1c) Agenda-setting or veto powers to Finance Ministry	Finance Ministry sets *ex ante* budgetary limits to fiscal aggregates for PSWS and vetoes deviations	Finance Ministry limits *ex ante* public negotiators' capacity for expansionary wage policy or vetoes expansionary PSWS	PSWS in France
2. Regulation model			
(2) *Ex ante* regulation	Predetermined rules impose ceilings to wage increases	Rules tie public sector wage growth to predetermined objective parameters	PSWS in Belgium

Under the regulation model of PSWS governance, public sector wage increases are tied to binding numerical targets predetermined via regulation. A crucial difference exists between reference targets and mandatory wage ceilings. By the former, I mean targets for wage increases adopted by actors as focal points for wage-setting (e.g. inflation and productivity rates), but which are not legally binding wage ceilings. The latter, in fact, constitute a hard constraint on wage setters while reference targets simply orient their behavior during negotiations.

Thus, I advance the following second hypothesis:

(H2) public sector wage restraint occurs within PSWS systems of governance based on the regulation model where the determination of public sector wage policy is regulated by ex ante rules that mandate specified wage ceilings.

Logic of case selection

I operationalize the outcomes to be explained in the case studies as two alternative trajectories of PSWS: expansionary versus restrictive. Expansionary/restrictive wage policies depend on whether *real* wage growth in the public sector outstrips/lags total labor productivity. Such operationalization is justified on the grounds that real wage growth in line with labor productivity ensures an equitable distribution of national income between managers and workers while simultaneously keeping up workers' purchasing power and preventing wage-setting inflation spillovers (Marglin and Schor 1992).

Based on most-similar and most-different systems designs (Gerring 2006), I have selected two case-study pairs (see Table 2). France and Italy are most-similar cases, sharing weak neo-corporatist structures and pluralist systems of interest representation as well as other important similarities. Yet, in line with H1, the French state systematically pursues restrictive public sector wage policies, under the centralized authority of the finance ministry, within a PSWS governance system based on delegation. Italy, instead, suffers inflationary cycles of PSWS due to lack of either system of PSWS governance described above. Germany and Portugal are most-different cases that, despite substantial differences in industrial relations regimes, state structures and models of capitalism, feature public sector wage restraint thanks to PSWS governance systems based on the delegation model.

Belgium and Greece I analyze as shadow cases to illustrate how, consistently with H2, the Belgian regulation model based on *ex ante* rules is superior in ensuring wage restraint as opposed to both the Italian and Greek systems based on reference targets.

The empirical analysis draws on the triangulation of descriptive statistics, information from archival sources (see Table 3, appendix) and elite interviews with decision makers directly involved in PSWS processes in the different countries (see Table 4, appendix).

Table 2: institutional characteristics of the cases selected for the comparative analysis

	Most-Similar cases		***Most-Different cases***	
	France	**Italy**	**Germany**	**Portugal**
Degree of Corporatism*	Medium-Low	Medium-Low	High	Medium-Low
System of Interest Group Representation°	Pluralist	Pluralist	Corporatist	Pluralist
Model of Capitalism †	Mixed Market Economy	Mixed Market Economy	Coordinated Market Economy	Mixed Market Economy
State Structure	Unitary	Unitary	Federal	Unitary
Role of the State in the Economy ♠	Statist	Statist	Enhancing State	Statist
Predominant Level of PSWS ▪	Centralized	Centralized	Centralized (until 2003) then Organized Decentralization	Centralized
Mode of Public/Private Sector Co-ordination	State-Led	Centralized Wage-Norm	Export-Sector Led Pattern Bargaining	Public-Sector Led Pattern Bargaining
System of PSWS governance	Delegation	Neither Delegation nor Regulation	Delegation	Delegation
Trajectory of PSWS	*Restrictive*	*Expansionary*	*Restrictive*	*Restrictive*

Source: author's own research and elaboration from different sources.

**Based on Jahn (2014)). °Based on Lijphart (2012). †Based on Hall and Soskice (2001), Molina and Rhodes (2006). ♠Based on Schmidt (2002). ▪Based on Bordogna (2007).*

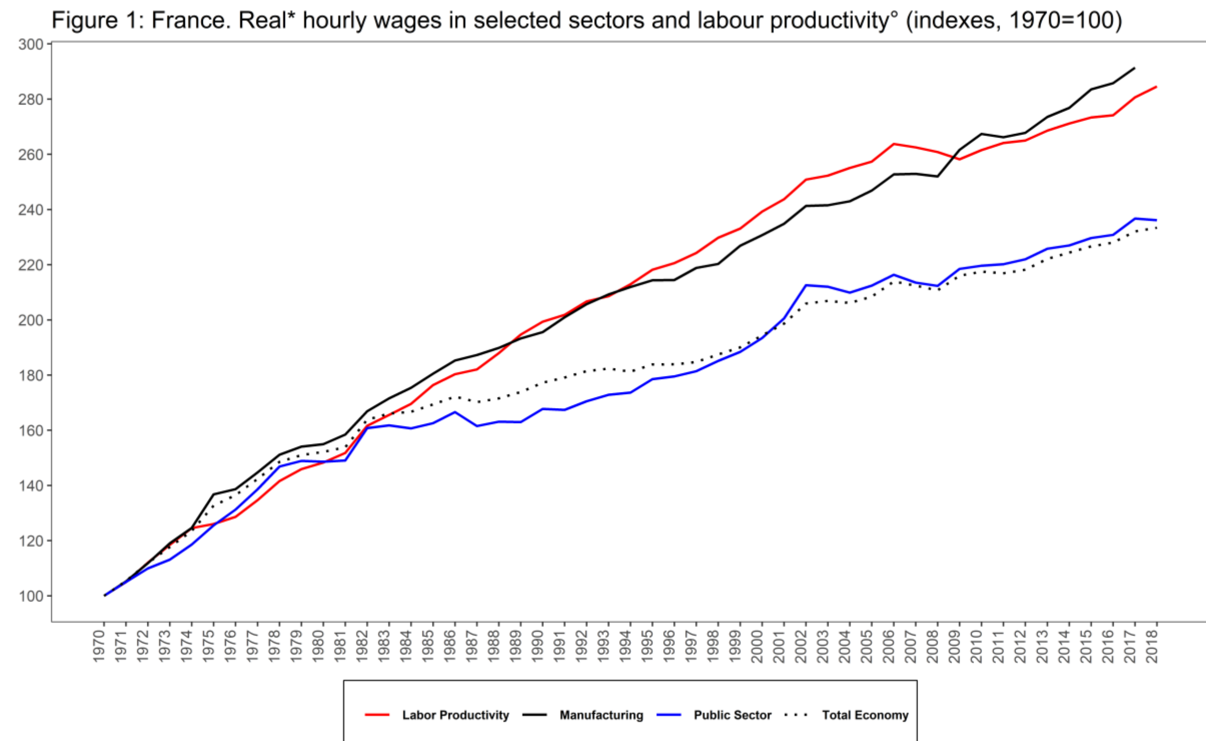
The state-centered political economy of public sector wage-setting in Western Europe

France: from dirigisme to competitive disinflation "in the shadow of hierarchy"

France features a centralized system of PSWS governance based on strong agenda-setting and veto powers governed by the ministry of finance. Collective bargaining in the public sector was introduced in 1983 but agreements lack legal status and do not bind the government (Mossé and Tchobanian 1999). Thus, PSWS occurs predominantly in the "shadow of hierarchy": when unions fail to accept the conditions set by the finance ministry, the government sets wage policy unilaterally through administrative acts. The state is represented in national negotiations with the unions by the civil service minister, but the minister of finance sets *ex ante* the budgetary margins within which the minister operates, monitors the bargaining process and holds a formal veto on all decisions related to the civil service (Document 1). The strength and autonomy of the finance ministry is enhanced further by the presence of an independent senior civil servant as head of the central budget authority. Differently from Italy and Greece, where this figure is a political appointee, the civil servant responsible for the central budget in France is neither changed nor reconfirmed when the government changes (OECD 2012).

Figure 1 shows that such regime based on centralized delegation to the finance ministry is conducive to systematic public sector wage restraint. The figure also points at 1982 as the starting point of this trajectory. This is no coincidence; this governance regime was purposefully engineered by the then Finance Minister Jacques Delors as a central component of the shift from *dirigisme* to competitive fiscal and wage disinflation in the European Monetary System (EMS) (Document 2).

Figure 1: France. Real* hourly wages in selected sectors and labour productivity° (indexes, 1970=100)



Source: author's calculations from OECD Stan (2020 update). °GDP per hour worked in total economy | *Nominal hourly wages deflated by the consumer price index.

Economic governance in France is led by a relatively insulated and hierarchical bureaucracy (Zysman 1977). The plethora of public bodies involved in economic policymaking are coordinated from the top by the finance ministry, which contains the Treasury, the authority ultimately responsible for the country's macroeconomic governance (Hall 1994). In fact, the finance ministry has been a powerful actor within the French state and the ultimate source of power over the direction of the economy (Eck 1986).

Within Bretton Woods, France embodied the dirigiste state capable of centrally steering economic development via industrial policies (Hall 1986; Shonfield 1965; Zysman 1984). The state stimulated growth through deficit spending and lax monetary policy whose inflationary effects were counteracted via competitive devaluations (Levy 2005). The collapse of Bretton Woods, stagflation and the growing internationalization of the French economy made this strategy no longer viable. Reflationary fiscal policies became ineffective and devaluations problematic, insofar as they imported inflation (Hall 1994). In the 1970s, conservative liberals—dominant in the ministry of finance, the Bank of France and the *grand corps*—embraced Germany's model of exchange-rate stability, low inflation, balanced budgets and current account surpluses and backed Prime Minister Raymond Barre's initiative to take France into the European Monetary System (EMS). Participation in the EMS—and EMU later—in turn reinforced the finance ministry's clout over economic policy (Howarth 2001).

In 1981, the strategy of redistributive Keynesian expansion attempted by Mitterrand's socialist government led to a balance of payments deterioration and speculative pressures against the Franc. Mitterrand's decision to keep France committed to the process of European monetary integration led to a U-turn in the country's economic policy. The shift from dirigisme to competitive disinflation and a strong currency (*franc fort*) in the EMS implied public deficit reduction, wage discipline and neoliberal structural reforms to reduce the government's scope in the economy (Amable, Guillaud, and Palombarini 2012; Lordon 1998).

In industrial relations, the French state has historically played a central role to compensate for social partners' fragmentation and weakness. Failed attempts to foster autonomous industrial relations induced extensive state regulation of the labor markets and social protection (Howell 2011). But, while the Auroux Laws fostered private sector wage-setting decentralization and employment flexibility in the 1980s, in the public sector the state moved in the opposite direction: the finance ministry stepped up its unilateral determination of PSWS, imposing restrictive wage policies as the central component of competitive disinflation.

Until the 1970s, it had been unusual for the French government to resort to incomes policies. Under normal circumstances, an index point (*point d'indice*) was used to adjust the wages of French public employees indexing growth to changes in the consumer price index. The first attempts to steer the economy's wage trends through PSWS occurred after the first oil shock when the finance ministry imposed a 2% wage ceiling in the public sector to rein in inflation (Document 3). In 1982, Finance Minister Jacques Delors devised the reform of the indexation system. Against the opposition of the unions, he reconfigured the PSWS system by anchoring wage increases to a future target inflation rate which the finance ministry aimed to achieve, as opposed to past inflation (Document 3). Concomitantly, the finance ministry froze incomes, prices, rents and dividends until the end of 1983 through an emergency act without parliamentary debate. According to Delors, this was necessary "to absorb the full effects of the oil crises" (Document 4). The deindexation of pay and the state's unilateral determination of PSWS started to be hailed as such a success that Finance Minister Balladur, under Chirac's new conservative government, imposed another unilateral public sector pay freeze in 1986. This was seen as a necessary accompanying measure to neutralize the inflationary effects of the 1986 devaluation (Document 5). In the following years, the failure to negotiate collective agreements with the public sector unions led the finance ministry to impose a three-stage 1.7% increase in 1987 (Document 6), 2% in 1988 (Document 7), despite inflation running much

higher. Throughout the 1990s, under the aegis of the finance ministry, various French governments continued the path of *rigueur* in PSWS, imposing pay freezes or very moderate increases below inflation (Document 8).

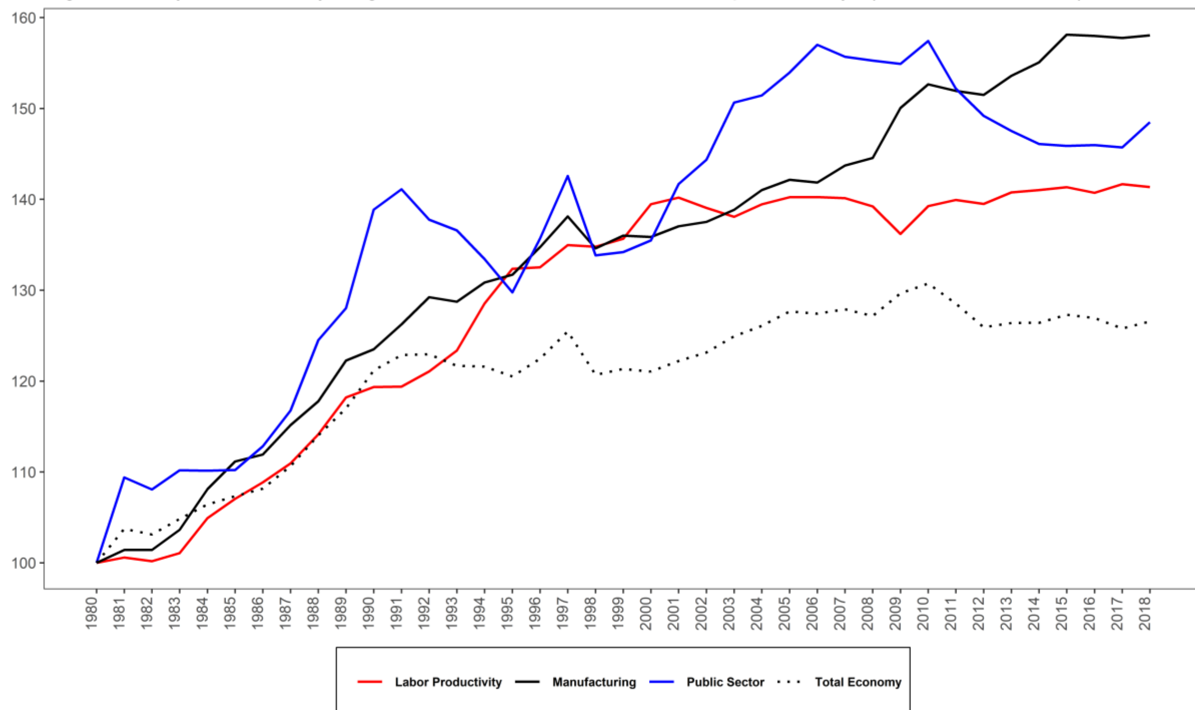
With the advent of EMU, French policymakers have engaged creatively with stringent fiscal constraints to continue to exercise control over the economy (Clift and Woll 2013). In this context, the strategic governance of PSWS to ensure wage restraint through the finance ministry's tight control of PSWS has remained key. Thus, for instance, the government imposed moderate wage increases in both 2001 and 2002 (Document 9). When the financial crisis hit, the government again froze wages unilaterally to curtail budget deficits (Bordogna and Pedersini 2013).

In all, the French system of PSWS governance, organized around the centralized leadership of the finance ministry, has resulted in a steady trajectory of real wage growth below productivity. This has been key support to a strategy of disinflation throughout the process of European monetary integration.

Italy: from clientelism to technocratic disinflation, and back

Italy features a system of PSWS governance characterized by incomplete delegation to an independent agency and lack of binding wage ceilings. As Figure 2 indicates, this peculiar system leads to volatile outcomes. Cycles of opportunistic wage expansions during times of fiscal bonanza (1980s & 2000s) give way to unilateral wage cuts in hard times when technocratic governments become empowered by external constraints (1990s & 2010s).

Figure 2: Italy. Real* hourly wages in selected sectors and labour productivity° (indexes, 1980=100)



Source: author's calculations from OECD Stan (2020 update). °GDP per hour worked in total economy | *Nominal hourly wages deflated by the consumer price index.

In Italy, the public sector has historically been used strategically by politicians; the bureaucracy has long been captured by the political parties that ruled the first republic (1948-1994) (LaPalombara 1966; Ranci 1987). Public employment was expanded strategically to absorb

the large number of unemployed, especially in and from the backward South (Santoro 2014). Uniform national wage increases have served to distribute fiscal resources to the public sector constituency in the South, where living costs are much lower compared to the North (Alesina, Danninger, and Rostagno 2001). In PSWS, virtually all parties had their public sector clienteles to which they unashamedly granted wage increases and other favorable treatments *ad hoc* via legislative interventions in parliament (Ricciardi 2010; Santagata 1995). By the 1980s, public workers' preferential treatment resulted in wage increases so high they jeopardized unity within the trade union confederations: confederal leaders could no longer justify these public sector privileges to workers in exposed manufacturing sectors where these opportunistic choices could not be replicated (Interviews 2, 3).

As a result, before the financial and political crises of the early 1990s, union leaders had formally asked the government to privatize public sector employment relations and "de-politicize" PSWS (Interviews 2, 3). The signing of the Maastricht Treaty, the crisis of the Italian Lira in 1992 and the Bribesville political scandal all forced budgetary restraint and ushered in a series of institutional reforms (Ferrera and Gualmini 2004). During 1993, the technocratic government led by Italy's former central banker Ciampi agreed with the social partners to reform the wage-setting regime; a two-tier system of coordinated wage bargaining was introduced. At the sectoral level wages were set by the social partners but, to ensure centralized inter-sectoral co-ordination, they were to be based on a national reference target: the expected inflation rate as agreed centrally with the social partners ahead of the yearly budget law. A second pillar then allowed for decentralized wage increases based on local productivity levels (Bordogna, Dell'Aringa, and Della Rocca 1999). Collective bargaining was extended to most public sector employees, who lost their public law status as civil servants. The representation of the state in PSWS was delegated to an independent agency (ARAN) with the aim of ensuring wage moderation within a system hitherto plagued by clientelism. Public sector wage freezes were imposed by the technocratic government and wage moderation in collective agreements followed throughout the 1990s (Dell'Aringa 1997), not least because of a general consensus on the need to join EMU at its onset (Regalia and Regini 1998).

Special-interest politics in PSWS returned under Silvio Berlusconi's center-right coalition, in power during the 2000s, and is symptomatic of the broad-ranging flaws of Italy's PSWS governance system. With Berlusconi's consent, deputy Prime Minister Gianfranco Fini orchestrated ways, in liaison with the unions, to circumvent ARAN's independent role in PSWS. After the fall of the Christian Democratic party, Fini's political party (*Alleanza Nazionale*) had found its main electoral constituency in public employees—especially rooted in Southern Italy—and maintained strong ties with the CISL trade union confederation, the most representative in the public sector (Baglioni 2011). Against the will of the then Finance Minister Giulio Tremonti—eventually forced to resign—Fini could exploit loopholes in the newly created system of PSWS governance to his party's and Berlusconi's political advantage.

Under the new system, ARAN received the competence to negotiate with trade unions during the biannual renewals of collective agreements. However, the government maintained for itself the competence to establish the budgetary resources for PSWS, which would have to be earmarked before allowing ARAN to negotiate with the unions. At the same time, no regulations existed to set binding ceilings to wage increases. Legislation only envisaged the social partners anchoring their wage negotiations to the expected rate of inflation. The expected rate of inflation the government aimed to achieve, however, was to be negotiated with the social partners and serve as a focal point for sectoral negotiations. *De facto*, for the public sector this system implied the government would earmark the total resources for PSWS in budget laws before ARAN entered negotiations with the unions. Thus, unions knew the *quantum* of government funding before wage negotiations. ARAN's mandate simply consisted in negotiating how to distribute resources across the various public sector compartments (Talamo

2009). The trade unions, unhappy with the government's initial offers, repeatedly refused to sign collective agreements with ARAN and shifted the negotiating table back to the political arena. By exploiting the already earmarked funding in budget laws as wage floors, they could bid up and push their political referents to grant larger increases in future budget laws (Interviews 3, 4, 5).

Ahead of the 2002-2003 round, for instance, the government had earmarked resources equivalent to a 4.5% increase, despite union demands for 6% (Document 10). The unions refused to enter negotiations with ARAN and called for various public sector strikes. At around the same time, Berlusconi launched a campaign to liberalize the labor market, which had enraged the left-leaning CGIL union confederation and led to sizeable strikes. To divide the unions and prevent a general backlash against the government's agenda, Berlusconi urged a political mediation led by Deputy Prime Minister Fini to exchange larger public sector wage increases for political support. To this end, Fini met privately with CISL's leader Savino Pezzotta during winter 2002 (Interview 6) and worked out an agreement to increase fiscal endowments for PSWS (Interview 7). Eventually, the government met union demands, enlarging resources in the subsequent budget law, and then mandated ARAN to sign collective agreements (Document 11). The CGIL remained isolated in demonstrating against the government and the labor market reform passed at the end of 2002 (Document 12).

A similar dynamic of political exchange occurred in the following 2004-2005 bargaining round. Unions opposed the government's initial offer, circumvented ARAN and, again, managed to extract greater resources for more generous wage increases engineered by Fini's political mediation with the CISL (Di Carlo 2018b). However, while Fini pursued his party's interests via PSWS, ahead of the 2004 European elections, the Finance Minister Giulio Tremonti strongly opposed expensive public sector wage increases. Repeated confrontations between the two resulted in Tremonti eventually resigning in 2004 due to Berlusconi's support for the public sector cause before the elections (Interview 6).

In all, despite the attempted depoliticization of PSWS, incomplete delegation left scope for the return of special-interest politics in national PSWS. Simultaneously, during the early 2000s expansionary wage growth occurred at the decentralized level where local administrations increasingly made use of off-budget funds as top-ups over the national agreements (Bordogna 2002). Decentralized fragmented PSWS, beyond the reach of a central budgetary authority, resulted in inflation spillovers, which contributed substantially to overall public sector wage inflation in the mid-2000s (ARAN 2006). Hence, during times of fiscal availability, PSWS has tended to be inflationary. However, during hard times, finance ministers within technocratic governments have had to rectify previous excesses via unilateral actions. Similar to the 1990s, after the 2008 financial crisis outburst, the then (again) Finance Minister Tremonti imposed a three-year wage freeze in PSWS and cuts for highly ranked civil servants through an emergency package (Bordogna and Pedersini 2013). As the Italian crisis grew into a full-fledged sovereign debt crisis, and Mario Monti's technocratic government came to power, PSWS was frozen for seven years until a 2015 Constitutional Court's sentence instructed the government to restart collective negotiations with the unions.

Shadow cases: Belgium and Greece

Both Belgium and Greece used to have a system of wage-indexation based on price inflation. Under pressure to meet the Maastricht criteria, in 1996 both countries adopted important reforms of the wage-setting system. They make for perfect shadow cases because, at about the same time, Belgium strengthened its model of PSWS governance based on *ex ante* rules, while Greece failed to adopt either a delegation or a regulation system of PSWS governance. As Figure 3a shows, the Belgian model of regulation is conducive to moderate and stable

public sector wage growth, while Greece (Figure 3b)—like Italy—shows cycles of excessive growth followed by wage freezes/cuts unilaterally imposed in hard times.

Figure 3(a): Belgium. Real* hourly wages in selected sectors and labour productivity° (indexes, 1996=100)

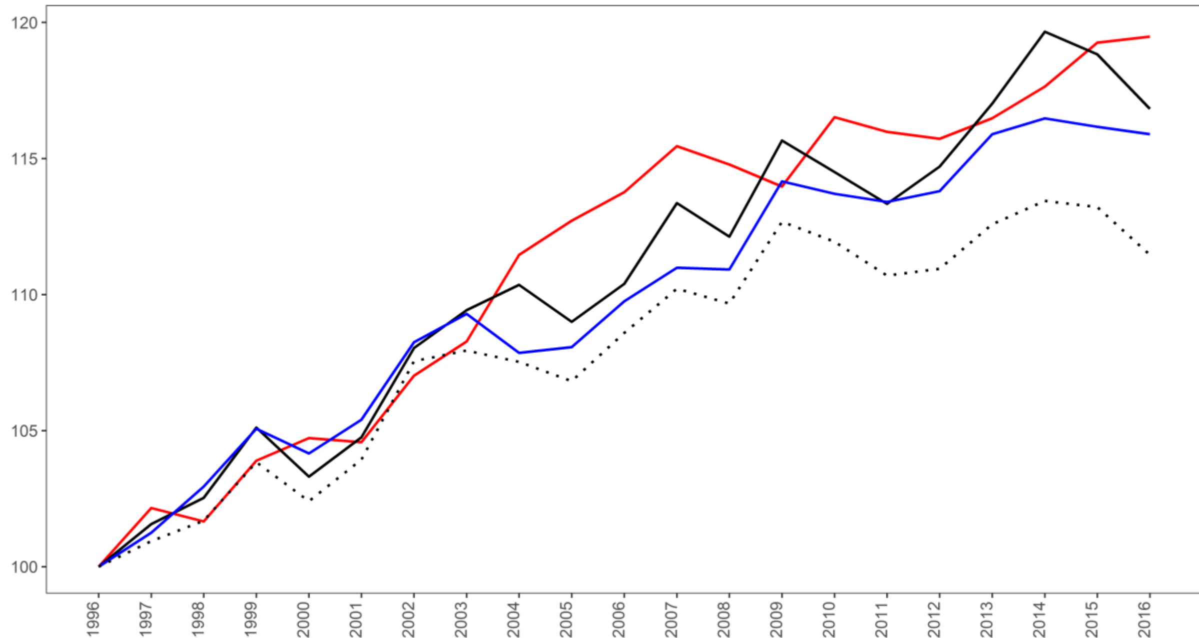
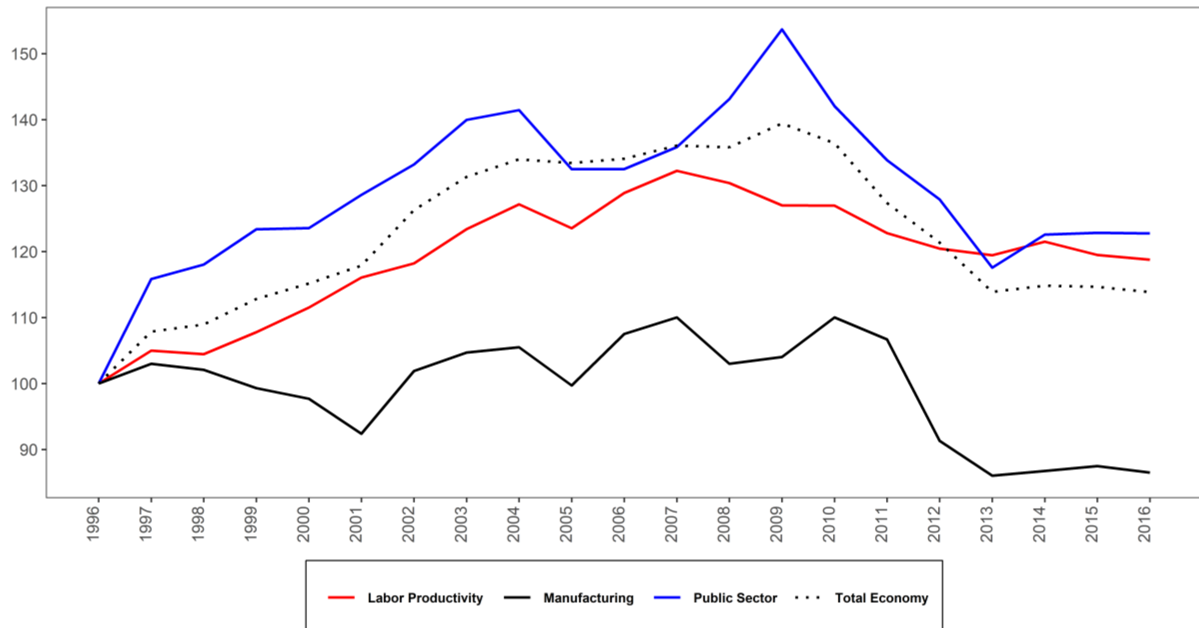


Figure 3(b): Greece. Real* hourly wages in selected sectors and labour productivity° (indexes, 1996=100)



Source: author's calculations from OECD STAN (2018 (for Greece) and 2020 updates).°GDP per hour worked in total economy | *Nominal hourly wages deflated by the consumer price index.

In Belgium, PSWS is centralized at the national level. Three negotiating committees exist, but issues of national PSWS are dealt with in "Committee A", where representatives of the federal government, the communities and regional governments negotiate with the trade unions (Document 13). Wage-setting occurs under "the shadow of the law" (Dorssemont 2019). Already in 1989, the Belgian government had adopted a so-called "law to safeguard the country's competitiveness." Accordingly, after wage agreements had been reached and

implemented, the social partners and the government were mandated to assess the competitiveness of Belgian firms vis-à-vis its seven major commercial partners. In case of competitiveness losses, the social partners had to moderate wage growth *ex post* to realign unit labor costs with those of the seven trading partners. In case of failure to reach an agreement by the social partners on how to proceed, the government would be mandated to act unilaterally to reestablish the country's competitiveness. In 1996, this regulatory model was strengthened further in light of EMU entry (Pochet 2004). To ensure a wage floor, increases would be indexed automatically to the inflation rate, while the upper ceiling for maximum wage increases would be set based on the forecast average pay rises of Belgium's three major trading partners: France, Germany, the Netherlands (Document 14). In this way, special-interest politics in PSWS is ruled out, for wage negotiations occur within predetermined binding wage floors and ceilings. However, given the difficulty of reaching collective agreements in a very fragmented system, PSWS has often been limited to automatic indexation to inflation (Document 13).

In Greece, index-linked wage-setting was introduced in the public sector in 1984, thanks to legislation setting automatic wage adjustments in line with inflation every three months (Document 15). However, the lack of a centralized budgetary authority overseeing PSWS meant the PSWS system was, like in Italy, fragmented and informal. Spending ministries and other units of the public administration could use off-budget funds to grant top-ups above indexed pay increases, beyond the finance ministry's reach (Interview 20). Informal bargaining with employees and unions led to the uncontrolled expansion of wage growth through *ad hoc* administrative acts within the different state units (Ioannou 1996).

Under pressure to meet the Maastricht criteria, in 1996 the social democratic government led by Costas Simitis attempted to rationalize the PSWS system. It consolidated the various ministerial pay levels and allowances into minimum rates applicable to the whole public sector (Document 16). To contain spending and keep the wage bill constant in terms of GDP, it also introduced an informal guideline to anchor PSWS to the growth of real GDP (Interview 20). Yet, the governance of PSWS was neither brought under the full control of the finance ministry, nor was it regulated by binding wage ceilings like in Belgium.

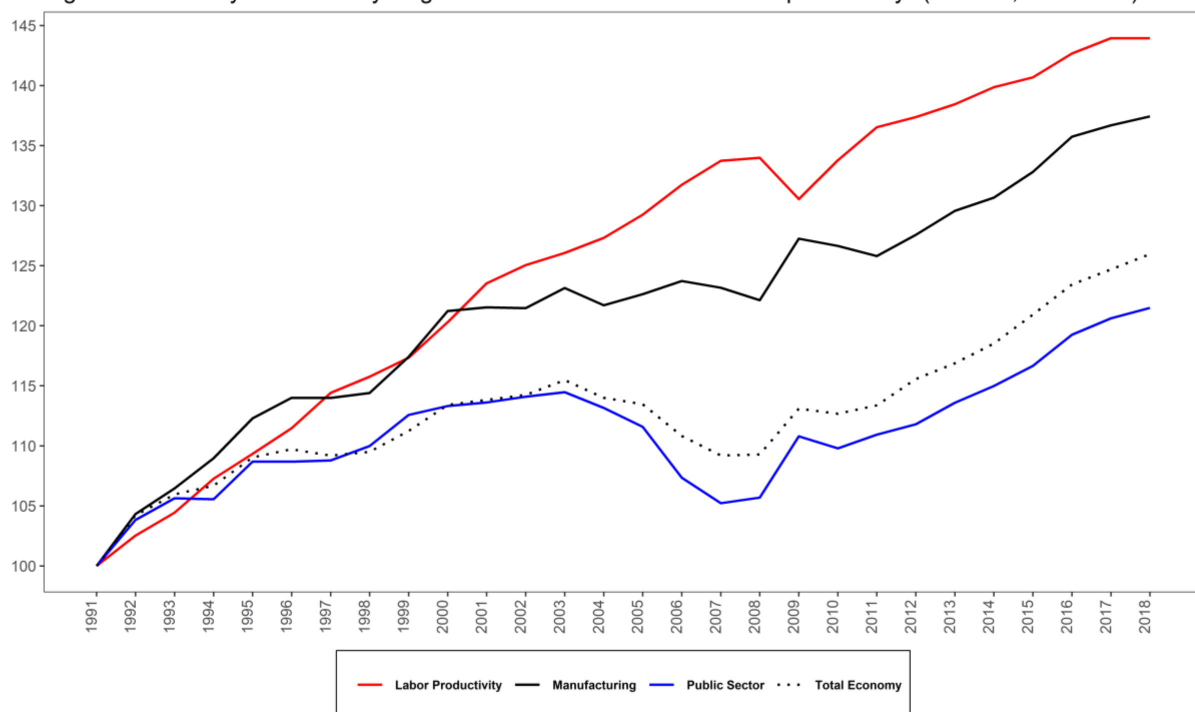
During EMU's first decade, the various public administrations again started employing their own extra funds to expand the public sector and provide top ups to wages and benefits (e.g. pensions), outside the basic wage increases provided in the government's general budget (Interview 20). Until the financial crisis, wage increases were thus granted opportunistically without any economic or financial considerations (Interview 19). When the crisis hit, and push came to shove, the finance ministry "did not even know the exact number of public employees across the Greek public administration, let alone differences in the level of compensation across various state units" (Interview 19). The Troika interventions then led to unilateral wage cuts, major retrenchment in public employee benefits and the introduction of a unified remuneration system for the public sector (Ioannou 2013), which was eventually centralized under the control of the finance ministry (Interview 19).

Germany: from centralization to organized-decentralization and competitive federalism

Germany's federal polity features a hybrid system of PSWS governance where the delegation of key PSWS powers to finance ministers takes place at various levels of the state. Figure 4 shows this model is conducive to systematic public sector wage restraint. However, the peculiar trajectory of remarkable public sector restraint must be understood, considering Germany's post-reunification fiscal crisis.

Given the federal structure, the state is represented in PSWS at three different levels. The federal Ministry of the Interior represents the federal government. The Länder are represented collectively by the Association of German States (*TdL*), grouping together the finance ministers from all the states but Hesse, which pulled out in 2004. Municipal governments are represented collectively by the Association of Municipal Employers (VKA). Until the reforms of the mid-2000s, Germany's PSWS system was highly centralized at the national level and coordinated across the two different employment categories: public employees (*Tarifbeschäftigte*) subjected to collective bargaining and civil servants (*Beamte*) whose wage conditions were set via federal legislation (Keller 1999). Vertical centralization within the state was *de facto* ensured by a bargaining coalition of the three state levels led by the federal Ministry of the Interior. Once contracts were signed with the unions, the ministry would then bring legislation to the federal parliament to extend the collective bargaining provisions to the country's civil servants with a federal law. In this way, employment and wage conditions remained homogenous for both employment categories and across the whole country's public sector.

Figure 4: Germany. Real* hourly wages in selected sectors and labour productivity° (indexes, 1991=100)



Source: author's calculations from OECD Stan (2020 update). °GDP per hour worked in total economy | *Nominal hourly wages deflated by the consumer price index.

In this centralized system, wage restraint was ensured by finance ministers in multiple ways. At the federal level, the Minister of the Interior acts in liaison with state secretaries in the finance ministry who must approve formally the provisions of collective agreements to ensure budgetary restraint (Interview 1). At the states' level, PSWS is the direct responsibility of regional finance ministers who first coordinate horizontally within the *TdL* to reach a unitary position in PSWS, and then coordinate vertically with the federal finance ministry ahead of negotiations with the unions. Overall, until the 2000s it was the federal ministry of finance to have the upper hand in PSWS via its tight control over the Ministry of the Interior. During the 1990s, the Finance Minister Theo Waigel, for instance, steered very restrictive public sector wage increases and even civil servant wage freezes (in 1994) to rein in the ballooning post-reunification budget deficit on the road to EMU. Paradoxically, between 1996 and 1997, Germany risked breaching the Maastricht Treaty's 3% deficit ceiling. To rein in the deficit, he had a savings package adopted that severely curtailed fiscal funding for PSWS during 1996.

Put against the wall, the unions came to accept a moderate lump-sum to avoid other major cuts in sick pay and the extension of working hours (Di Carlo 2019).

Once in EMU, however, the fiscal crisis of the German state deteriorated further (Streeck 2007). Most importantly, Chancellor Gerard Schroeder's tax reform in 2000 dug a hole in subnational governments' tax revenues, forcing subsequent expenditure cuts. In dire straits, the states' finance ministers pulled out of the public employers' bargaining coalition and imposed meagre wage increases, which contributed to the public sector wage deterioration during the early 2000s (Figure 4). Negotiations then began with the unions on how to reform the whole collective bargaining framework. In 2005, the representatives of the federal and municipal employers agreed to continue negotiating collectively with the unions within a new joint collective bargaining framework, i.e. the *TVöD* contract (Interviews 11, 12).

The states, instead, demanded their own bargaining framework to gain independence from the federal level—deemed not restrictive enough—and from the municipal level where unions remained strong and capable of disrupting the provision of local essential services. The reform of the state's collective bargaining framework developed in tandem with negotiations for the 2006 constitutional reform. A double process of institutional and constitutional change thus ensued. In 2006, the states agreed to continue negotiating collectively with the unions within a newly established framework, i.e. the *TV-L* contract. Concomitantly, with the 2006 constitutional reform—under the leadership of rich *Länder* like Bavaria and Baden-Württemberg—the states obtained from the federal level the competence to legislate on the wage and employment conditions of their respective civil servants (Interviews 9, 13, 14).

Ever since, the new system combines elements of organized decentralization in collective bargaining (which now occurs on two main levels) and competitive federalism because each state now sets its civil servants' wage conditions independently. Despite this apparent fragmentation due to Germany's federal polity, wage restraint remains in-built in PSWS thanks to national-level coordination within the public employers' associations.

In states' level collective bargaining (*TV-L* contract), the various regional finance ministers coordinate within *TdL* to reach a unitary position vis-à-vis the unions. This implies consensus-based agreements are only possible if they reflect the interests of all participant finance ministers. For this to happen, the *TdL* must represent the general interest of all states in PSWS and this leaves no room to accommodate the political and electoral interests of states' politicians in PSWS (Interview 8). Moreover, the need to reach negotiated agreements within *TdL* leads finance ministers to converge around the adoption of moderate wage policies. This is because Germany's rich and poor states within *TdL* have very different levels of fiscal capacity and thus financial vulnerability. These differences can hardly be reconciled due to states' lack of fiscal autonomy. In fact, states have very large wage bills due to the decentralization of administrative competencies within the German federal polity. However, they cannot adjust their revenues independently because tax policy is a federal competence to which states participate only jointly via the upper chamber (*Bundesrat*) (Benz 1999). Given the mismatch between high administrative expenditures and constrained fiscal capacity, states' finance ministers (and municipalities) are under constant pressure to minimize the fiscal burden of PSWS (Benz and Sonnicksen 2017). While expansionary PSWS is generally not a problem for rich states (e.g. Bavaria)—with vibrant local economies and higher fiscal capacity—, for poorer states (e.g. Saarland) it becomes instead a matter of financial survival. Thus, negotiated compromises on wage policies within the *TdL* are only reachable if set around the lowest common denominator, i.e. around meagre wage increases poor states can afford to pay (Di Carlo 2019). Otherwise, as occurred in the early 2000s, poorer states would start quitting the employers' association, leading to the collapse of state-level coordinated bargaining.

For analogous reasons, a similar compromise around moderate wage policies must be reached in the *TVöD* contract where the federal and municipal levels bargain collectively. Here, negotiated wage policies are only possible to the extent to which they incorporate the financial concerns of the many cash-stripped municipalities across Germany (Interview 10).

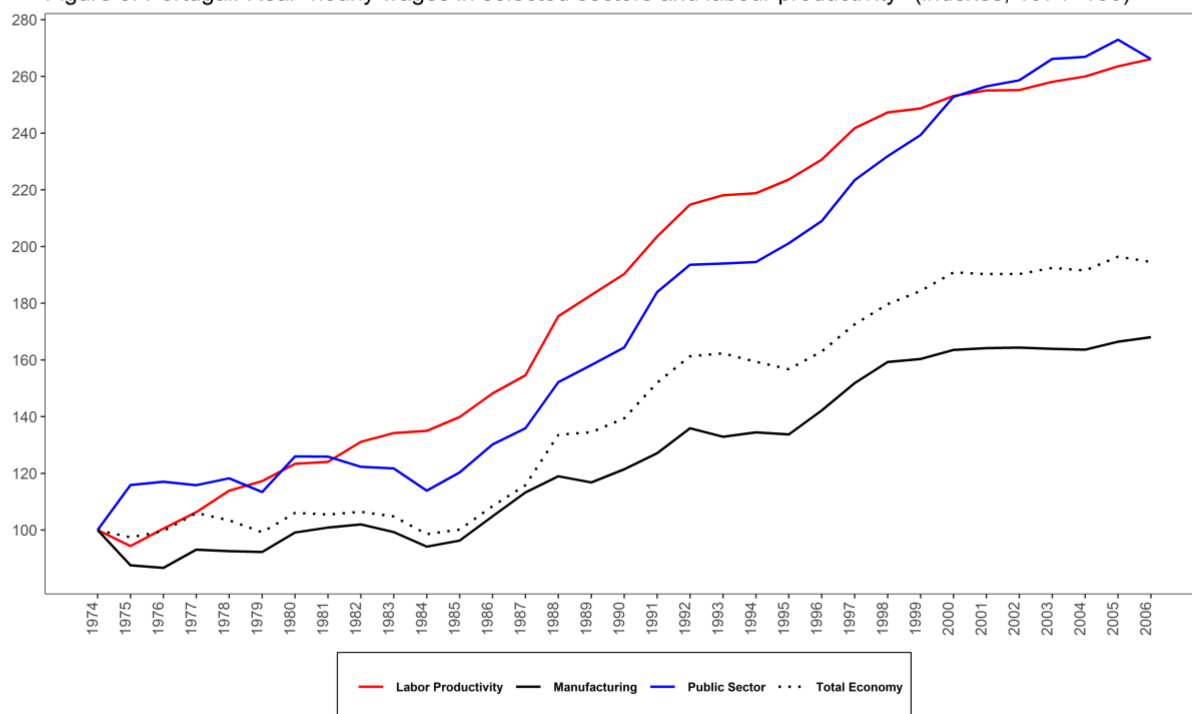
In all, thanks to resilient horizontal coordination within the employers' associations, the reformed system of PSWS in Germany continues to work as a functional equivalent to the previously centralized system of PSWS. Within this new system, based on organized-decentralization, PSWS remains delegated to finance ministers and municipal wage-setters, who coordinate within their respective national employers' associations. The need for negotiated compromises in the members' general interest forces the public employers to conduct fiscally responsible PSWS, leaving no room to accommodate local level political and electoral considerations in PSWS.

Portugal: from authoritarianism to state-led rigor "in the shadow of Europe"

Portugal features a centralized system of PSWS governance where wage-setting is the responsibility of the minister of finance who negotiates nationally within three separate tables based on trade-union affiliation (Document 17). While other ministers do negotiate on various aspects specific to their ministries' employment terms, wage determination is centralized under the sole responsibility of the finance minister who sets PSWS for the whole public sector to ensure coherent incomes policies and sound public finances (OECD 1997, 45). Figure 5 shows that, since Portugal's democratization, this system of delegation in PSWS governance has been conducive to moderate real wage increases below or in line with labor productivity. Like France, the state—through the finance ministry—plays a pivotal role in PSWS. This reflects both Portugal's authoritarian past and the failure to reach negotiated agreements with the social partners within a fragmented system of interest representation.

Until 1974, Portugal was under the conservative authoritarian regime established with Salazar's *Estado Novo*. Within the corporatist system, unions and employers were subdued to the regime, strikes were forbidden, and wage-setting subordinated to the regime's priorities. With the new democratic constitution in 1976, independent trade unionism was established but, until the early 1980s, wage determination continued unilaterally via statutory incomes policies (Document 18). The government decreed national wage ceilings (*tectos salariais*) setting the wage rate across all sectors (Barreto 1998). After 1984, the Grand Coalition government supported by the center-left socialists (PS) and the conservatives (PSD) established the Standing Committee for Social Concertation (SCSC) as a forum to stabilize democratic industrial relations, promote concertation with the social partners and curb inflation in light of Portugal's entry into the European Economic Community (Campos Lima and Naumann 2011). Initially, a series of social pacts were signed covering not only incomes policy but also aspects of social policy and labor market regulation (Dornelas 2010). However, subsequent attempts to reach negotiated pay agreements in the SCSC failed repeatedly, leaving the government no option other than taking the lead in national wage policy (Document 18).

Figure 5: Portugal. Real* hourly wages in selected sectors and labour productivity° (indexes, 1974=100)



Source: author's calculations from EU KLEMS (2011 update). °GDP per hour worked in total economy | *Nominal hourly wages deflated by the consumer price index.

In this context, led by the ministry of finance, the Portuguese state began to use PSWS strategically to govern the process of wage formation across the whole economy. By the end of the year, the finance ministry would set a national pay norm based on the forecast inflation rate as a focal point for negotiations ahead. Soon into the new year, the public sector trade unions filed formal requests for wage increases based on which the finance minister would join negotiations considering the government's budget constraints and other relevant economic considerations (Campos Lima 2008). Generally, no later than February, if no agreement could be reached on the offer advanced by the finance ministry, wage increases in the public sector would be set unilaterally as a reference for wage increases across the whole economy. Although collective bargaining in the Portuguese public sector was then introduced in 1998, the government is not bound to accept the validity of collective contracts, which acquire legal status only after government recognition. Hence, similar to France, PSWS occurs in the shadow of hierarchy because, in case of no agreement, the finance minister defines PSWS unilaterally through an administrative act (Campos Lima 2008).

While this practice of public sector-led pattern bargaining became institutionalized during the 1990s (Document 19), state unilateralism in Portugal's PSWS became particularly pronounced during the 2000s, thanks to mounting budget deficits and the threat of sanctions from the European Council under the Excessive Deficit Procedure (EDP) of the Stability and Growth Pact (SGP). In fact, despite the European Council failing to issue early warnings to Germany and Portugal in 2001, and the EDP for Germany being suspended in late 2003, Portuguese governments still considered the SGP as a hard external constraint (Stoleroff 2007), especially for fear of losing access to Europe's structural funds (Magone 2017, 34). Thus, during the years before the financial crisis, restrictive wage policy in the public sector was repeatedly imposed unilaterally under both the center-right coalition government and the following Socialist majority government.

The socialist government of Antonio Gutierres had fallen in the early 2000s largely because the center-right parties had capitalized on the socialists' failure to counteract the worsening of

the country's public finances (Campos Lima and Naumann 2011). In his electoral campaign, contender José Manuel Barroso openly proclaimed his intention to implement an unpopular liberal platform, centered on fiscal/administrative reforms and tax cuts. Once elected, Manuela Ferreira Leite—known as the iron lady for her hard-headed approach to public finances—was appointed finance minister with a mandate to bring the budget deficit below the 3% ceiling (Document 20).

With the finance ministry committed to push through restrictive PSWS, negotiations with the unions broke down relatively soon (Document 21). Ahead of the 2003 negotiations, unions went on strike, paralyzing the health, education and legal services; the finance ministry ignored union demands and advanced a non-negotiable 3.6% pay rise and a cost-effective rationalization of the civil service. As time went by, lack of agreement led the finance ministry to impose a 2.75% wage increase, below the expected rate of inflation (Document 22). In 2004, despite inflation forecast at around 3%, again the state unilaterally granted a 2% wage increase only to workers in the lower pay grades, while imposing a unilateral freeze for the remaining categories (Document 23).

The situation did not change with the advent of the new socialist government led by Sócrates in spring 2005. During 2005 and 2006 the new government continued with either wage freezes or increases significantly below the forecast rate of inflation. In 2005, with public sector unions demanding between 3.5% and 5.5%, the state initially offered 2.3%, in line with forecast inflation. As negotiations went by, Finance Minister Fernando Teixeira dos Santos, brought the offer down to 1.5% justifying a policy of restraint as a "national imperative" (Stoleroff 2007, 645). Due to budgetary concerns, the state imposed a 1.5% increase in both 2005 and 2006 against the opposition of all the public sector unions.

Overall, despite fierce opposition by the unions, Portuguese finance ministers in charge of PSWS have traditionally pursued a restrictive wage policy for the country's public sector as an instrument of economic governance to shore up public finances and ensure Portugal's continuing participation in the EMU and access to Europe's structural funds. When the sovereign debt crisis hit, pursuant to the Memorandum of Understanding signed with the Troika, the Portuguese government went on unilaterally imposing a combination of further wage freezes and cuts to both civil servants and public companies' employees (Rato 2013).

Conclusions

This paper has argued that PSWS is not primarily a problem of inter-sectoral wage co-ordination between sheltered and exposed industries. In fact, cross-country variation in PSWS cannot be explained fully by the presence/absence of neo-corporatist wage-setting regimes. Although insightful, by virtue of its excessive focus on rent-seeking trade unions, extant literature fails to capture the fiscal nature of PSWS and the political incentives of public sector wage-setters. The state-centered theoretical framework proposed in this paper attempts to make a first step in the direction of taking the specifics of PSWS into account, rather than treating the public sector as a mere satellite of export-sector interests.

Without needing to embrace full-fledged "public choice" accounts of malevolent politicians, highlighting the common-pool problem of PSWS simply helps us focus on dynamics of special-interest politics, which are central in processes of PSWS. I have argued that variation in PSWS can be explained in terms of different PSWS governance systems. In countries with PSWS systems based on the delegation model, wage restraint occurs because the competence for the determination of PSWS ultimately falls within the remits of the fiscally-responsible finance ministry or an independent state agency with powers to ensure the conduct of de-politicized PSWS. In countries with a PSWS system based on the regulation model, wage restraint occurs because PSWS is regulated *ex ante* by mandatory wage ceilings. When neither of these two

governance systems is present, PSWS tends to be inflationary and volatile for it depends on the political employers' fiscal capacity to adopt expansionary wage policies.

These findings yield interesting insights for the burgeoning literature on growth models (Baccaro and Pontusson 2016; Hassel and Palier 2021). In fact, wage-setting regimes shape both the demand and supply side of an economy because they determine workers' incomes (i.e. their consumption capacity) and the emergence of inflation externalities that might jeopardize export-oriented growth strategies (Baccaro and Pontusson 2018). While research on private-sector wage-setting abounds, in the political economy scholarship PSWS is often forgotten. Considering the large size of today's welfare states, it is important to better understand the determinants of public sector wage growth across different countries and shed light on how PSWS governance systems foster or undermine different growth strategies. For example, the case studies clearly indicate that, even within most-similar cases of statist political economies, the state can govern PSWS to prevent negative externalities, like in France or Portugal, or can itself be *the* source of inflation spillovers, like in Italy or Greece. This paper's findings thus suggest the need for political economy scholarship to pay closer attention to PSWS and, more specifically, the role of state actors and states' institutional configurations in shaping growth strategies.

However, this paper does *not* suggest that restrictive wage policies are normatively superior to inflationary wage-setting, as implicit in the neo-corporatist literature. To the contrary, I see trajectories of wage restraint and inflation as equally problematic, for opposite reasons. Systematic wage restraint in the public sector undermines the consumption capacity of large parts of the middle class, weakening domestic demand. Conversely, sustained wage inflation generates inflation and fiscal externalities, which must eventually be redressed through drastic measures, as the Greek and Italian cases demonstrate. Thus, the policy implication of this paper is that states should instead use their sovereign capacity to act as *model employers* in the economy, i.e. making sure that real wages in the public sector grow roughly in line with the economy's total labor productivity. This "golden rule" of wage-setting prevents the emergence of negative externalities and ensures a stable distribution of national income between managers and workers while simultaneously allowing consumption to grow roughly in line with production (Marglin and Schor 1992). Through the proactive governance of PSWS – i.e. pattern bargaining led by the public sector –, states could therefore try to stabilize wage-setting across the whole economy by setting a political wage norm in the public sector which private sector's wage setters will ultimately have to consider during collective bargaining.

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Appendix

Statistical data on wages, inflation and productivity comes from the OECD Stan Database and, whenever unavailable there, from the EU KLEMS Database.

To retrieve specific information on processes and outcomes of PSWS, I have relied on two different archives: the European Industrial Relations Review (EIRR) and the Eurofound's EIRO archives. EIRR consists of a very rich and detailed physical archive containing reports on industrial relations matters on a monthly basis. The archive covers most European countries over the period 1974-2006. The EIRO digital archive covers similar topics from approximately 1997 onwards.

The documents cited in the paper are collected in Table 3.

Table 3: List of archival documents cited

DOCUMENT N.	TITLE	DATE	ARCHIVAL SOURCE
1	France: industrial relations in the public sector	10 December 2008	Eurofound
2	Civil Service Pay	1982, n.99, page 03	European Industrial Relations Review (EIRR)
3	France: news	1974, n.3 page 15	European Industrial Relations Review (EIRR)
4	Pay and Price Controls Continued	1982, n.107, page 25	European Industrial Relations Review (EIRR)
5	France: New Government's Social Programme	1986, n.148, page 03	European Industrial Relations Review (EIRR)
6	France: Public Sector Pay	1987, n. 167, page 4	European Industrial Relations Review (EIRR)
7	France: Strikes Across Public Services	1988, n.179, page 4	European Industrial Relations Review (EIRR)
8	Public Sector Pay Restraint Continues in 1996	1996, n.265, page 06	European Industrial Relations Review (EIRR)
9	Negotiations Fail Over Civil Service Pay Rises	27 May 2001	Eurofound

10	Unions criticise government over 2002 budget plans	2001, n. 333, page 8	European Industrial Relations Review (EIRR)
11	Government and unions reach agreement for public sector	12 March 2002	Eurofound
12	Labour Market Reforms Bill Passed	2002, n.346, page 9	European Industrial Relations Review (EIRR)
13	Belgium: industrial relations in the public sector	10 December 2008	Eurofound
14	Belgium reform of bargaining	1996, n.273, page 16	European Industrial Relations Review (EIRR)
15	Greece: new index-linked increases	1985, n.121, page 5	European Industrial Relations Review (EIRR)
16	Government Unveils New Pay System for Public Sector	1996, n.271, page 8	European Industrial Relations Review (EIRR)
17	Portugal: industrial relations in the public sector	10 December 2008	Eurofound
18	Portugal: industrial relations background	1995, n. 253, page 9	European Industrial Relations Review (EIRR)
19	Public Sector Pay Deal	1999, n. 303, page 18	European Industrial Relations Review (EIRR)
20	New Government's programme	2002, n.342, page 20	European Industrial Relations Review (EIRR)
21	Pay Rise for Civil Servants	2002, n. 340, page 10	European Industrial Relations Review (EIRR)
22	Minimum Wage and Public Service Pay Rise	2003, n.352, page 11	European Industrial Relations Review (EIRR)
23	Civil Service Pay Settlement	2004, n.365, page 11	European Industrial Relations Review (EIRR)

Next to these archival sources, I have conducted elite interviews with key decision makers involved directly in PSWS in Germany, Greece and Italy during the period 2017-2021. However, despite multiple attempts, I have been unable to obtain interviews from policymakers in Portugal and France.

The interviews cited in the paper are collected in Table 4.

Table 4: List of interviews

Interview n.	*Country/Case*	*Institution*	*Position*	*Date*	*Location*
1	Germany	Federal Finance Ministry	State Secretary	10/4/2017	Berlin
2	Italy	The Italian General Confederation of Labor (CGIL)	Former leader of the public sector branch & Senator	20/11/2017	Bologna
3	Italy	National Court of Auditors	High rank official in the top echelons	21/12/2017	Rome
4	Italy	ARAN	Director of Research Department	4/12/2017	Rome
5	Italy	ARAN	President (and former official in the top echelons of the Ministry of Finance)	4/12/2017	Rome
6	Italy	Union of the Centre (Political Party)	Party leader and deputy prime minister	9/1/2018	Rome
7	Italy	CISL (Trade Union)	General Secretary	30/1/2018	Bergamo
8	Germany	Tarifgemeinschaft deutscher Länder, TdL	Official in the top echelons	19/7/2017	Berlin
9	Germany	Economics Ministry, Bavaria	Economic Minister	3/7/2017	Munich
10	Germany	VKA	Head of negotiations	24/10/2018	anonymized
11	Germany	Verdi	Official in the top echelons	11/4/2016	Berlin
12	Germany	Verdi	Joint interview with n. 3 officials in the top echelons	19/1/2017	Berlin
13	Germany	Dbb	Official in the top echelons	7/2/2017	Berlin

14	Germany	Dbb	Official in the top echelons	15/3/2017	Berlin
15	Germany	DGB		4/1/2017	Berlin
16	Italy	Finance Ministry	Official in the top echelons	11/1/2018	Rome
17	Italy	ARAN	Former president	27/11/2017	Milan
18	Italy	ARAN	Former president	7/2/2018	Rome
19	Greece	Finance Ministry	Former Finance Minister	5/3/2018	Anonymized
20	Greece	The Hellenic Federation of Enterprises (SEV)	Official in the top echelons	6/3/2018	Zoom Call