Toward Institutional Innovation in US Labor Market Policy: Learning from Europe?

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What keeps US labor market institutions from more effectively helping the nation cope with the current economic crisis and secure its future prosperity? What is the scope for politically feasible innovation in US labor market policy? These are crucial policy questions. As a result of the global financial crisis, the US unemployment rate climbed into double digits and has remained higher than in many European countries. The US is experiencing the highest level of unemployment for a generation and the highest rate of long-term unemployment for more than half a century. American families are suffering from financial hardship without any fault of their own, and many of the currently unemployed will find it hard to re-enter the workforce during the recovery. Nor is the government easily able to use current programs to help those seeking work. Even though policymakers have launched new initiatives during the past year, the US remains almost uniquely weak among advanced industrialized democracies in its lack of policy programs to support the populace in successfully engaging with the labor market.

US policymakers have long had little interest in learning from the experiences of other countries, considering the American institutions to be both innately superior to foreign ones, and better suited to American culture. Policymakers have been especially disdainful of the supposedly rigid and stifling labor market institutions of continental Europe. Such comments are misguided. With per-capita rates of economic growth in the US and Europe over the past decades at similar levels (Hartwig 2006, Krugman 2010), the empirical evidence provides no reason to believe that European labor markets are inferior to their US equivalent under normal economic conditions. In a crisis, the labor market institutions of some European countries are arguably much better suited than their US equivalents to help families deal with economic dislocation, to cushion a recession's impact on individuals' livelihoods and to support workers in their adaptation to new economic conditions. Furthermore, different European countries have very different labor market policies. Not all European approaches are incompatible with the US emphasis on individual autonomy and freedom as skeptics would argue.

In any event, the recent crisis has demonstrated that a deregulated economy is not self-sustaining. Hands-off economic policies do not only undermine markets over the long term, they impose enormous and increasing costs on society. This has become as evident in the worldwide financial markets as in the domestic market for labor. American labor market policy has withered under laissez-faire, suffering both from deliberate rollbacks (Weir 1992) and from institutional drift as it fails to respond to new social and economic needs (Hacker 2004). This has left the United States without the internal collective resources to address today's large-scale socio-economic challenges. Unless the US takes active steps to shore up its labor market policy, it is likely to drift as it has in the past, creating major long-term problems with unemployment and/or poverty. This would come with serious repercussions for the stability of the American economy and society.

In this paper, we move beyond the typically narrow US-centric nature of domestic policy debates in Washington to expand the horizon of policy possibilities for the United States. By examining other countries' experiences with labor market policy and policy reforms, we provide a new way of looking at the tasks and options for US labor market policymaking. Moreover, by rooting our argument securely in the political science of institutional change, we can avoid making unrealistic or impossible claims. As we will discuss with respect to both labor market *policy* and the *policy process*, US policymakers could draw inspiration from other democracies' experiences and implement (albeit with difficulty) new institutions that build upon lessons from abroad. If the US is ever likely to learn from other countries, it is now.

In particular, we argue for an approach to labor market policy that borrows extensively from the Danish model. Over the last three decades, Denmark has embraced a more coordinated and active labor market policy. Combining generous temporary support and intensive worker training with a strong emphasis on getting workers back into the labor force as quickly as possible, the country's labor market policy has helped produce desirable market outcomes. While there are admittedly many differences between Denmark and the United States, including the two countries' respective sizes, the US could build on the ideas underlying successful policy programs in Denmark. Today, all industrialized nations face essentially the same basic policy constraints and share common goals: For instance, they have all struggled with reducing unemployment and simultaneously encouraging the provision of good jobs that pay decent wages. Moreover, they all seek to increase labor market flexibility, both with regard to particular employment relationships, as well as more broadly in terms of encouraging national workforce adaptability in the face of increased labor market uncertainty.

Beyond providing inspiration for new policies, developments in Europe could also provide US policymakers with a valuable comparative perspective on the processes through which labor policy can be enacted. Here the German experience is particularly relevant, because the country has a complex political system like that of the United States, in which complicated relationships between the federal states and the national government create a tendency towards stasis. Yet Germany has shown real signs over the last several years of changing its labor market policy. By critically appreciating Germany's successes and failures, Washington policymakers could find inspiration for how to plot a plausible pathway to major reforms in the United States. In the German example, they could see how "layering" – building new institutions to supplement older ones rather than immediately replacing them – can help circumvent blockages in the legislative processes *and* lead to transformational change. While layering reforms might appear relatively insignificant at first, grafting *new* elements onto *old* policies can engender a reform *dynamic* in which a compromise between old and new slowly turns into the defeat of the old (Streeck and Thelen 2005). Thus, if American policymakers were to find their attempts to emulate Denmark blocked, they might consider pursuing a layering approach in order to deliver the more supportive and capacity-building types of labor market institutions that many Americans have long desired.

In this paper, we will elaborate on one potential opportunity for layering-oriented policy reform in the United States, which may open up as Washington starts to examine seriously the United States' position in the global economy. With policymakers now widely recognizing that imbalances in the United States' economic relationship with other countries around the world may precipitate a new financial crisis, they face the daunting prospect of weaning the country off foreign borrowing and boosting US export performance. This will be difficult – even before the financial crisis, Americans had grown increasingly skeptical of globalization. In this context, the significant expansion of the small federal Trade Adjustment Assistance (TAA) program might help address hot-button issues and build a broad pro-reform coalition beyond entrenched interest group conflict and bitter political partisanship. Making TAA a much more prominent part of US labor market policy could plausibly attract broad support, address domestic worries about globalization and improve the nation's export capacity. While TAA reform would not drastically change US labor market institutions in the short term, it could serve as a nucleus for a *gradual* but *transformative* process of institutional change in the US labor market over the long run.

The paper is divided into five major sections. Section one discusses potential ways of addressing contemporary challenges in labor market policy. Section two reviews American labor market institutions, chronicling how neglect throughout most of the 20th century has led to institutional drift. A third section illustrates how Denmark sustains impressive labor market outcomes through coordinated activation policies. The fourth section turns to Germany, Europe's largest economy and a country with political institutions that were partially modeled on American ones after World War II. The fifth section examines how US policymakers could build on European experiences.

Section 1: Labor Market Policies for the Global Era

Labor is often treated by economists as a simple production input, no different from land and capital. It is anything but. Creating well-functioning labor markets is a political process, in which governments try to resolve the needs of the market with the social and physical needs of the workforce. Given that there exists no optimal labor market structure, politics plays a substantial role in determining outcomes (Offe 2010). Labor market policy helps legitimate market governance by making compatible the diverging goals of capitalism and of democracy, ranging from "passive" policies that help attenuate the consequences of market rule, to "active" measures that intervene in the labor market to help the unemployed gain employment and labor laws that regulate diverse aspects of the employment relationship.

Not only is there room for labor market policies to make employment more attractive and increase job satisfaction, it can actually increase economic performance, e.g. by underpinning labor mobility from less productive sectors to more productive ones (Schulze-Cleven et al 2007). Moreover, policies may also encourage workers to invest in firm- or sector-specific skills (Estevez-Abe et al. 2001) or to become entrepreneurs, secure in the knowledge that they have a safety net if they fail. The logic here is essentially the same as in the set-up of limited-liability companies: Limiting downside risks encourages beneficial risk-taking.

Importantly, the changing terms of international competition and domestic socio-economic transformations present new challenges for labor market policies. The “doubling of the global labor market” in the wake of the economic opening of the former Soviet Block, China and India (Freeman 2005) and the arrival of “knowledge-based” competition leave skills as countries’ scarcest resources (Mayer and Solga 2008). In all advanced democracies, the number of well-paying, manufacturing-based jobs has shrunk; employment opportunities have become increasingly concentrated in services at the two ends of the labor market, i.e. both in knowledge-intensive and cost-sensitive segments. While this new economy provides more opportunities and freedom for highly skilled professionals, it also increases the levels of vulnerability and risk for broad sections of the workforce (Azmanova 2004). This change is expressed in the cross-national trends towards unemployment of increasing duration, slower wage growth, rising income inequality and higher earnings volatility.

Most commentators agree that labor markets need to be flexible in this environment, both to allow companies to stay competitive internationally, and to allow countries to reach sustainable macro-economic conditions. But how can flexibility be best achieved? For conservatives and neo-liberals, achieving “flexibility” involves removing labor market “rigidities” (Siebert 1997). In practice, this involves weakening unions and removing social protections. However, this simplistic approach fails to conceptually appreciate how these “rigidities” may be necessary parts of a well-functioning labor market; it should thus not surprise that the approach holds little empirical water (Nickell 1997). A more realistic and sustainable approach seeks to identify "flexible rigidities," i.e. durable institutions that provide social protection in such a manner that encourages and supports structural adaptation (Streeck 2005).

By understanding the importance of flexible rigidities, we can see how best to update social protection to today's global era. Contemporary policies should be dependable and inclusive, with people being able to access them when in need and policies providing help to all, and particularly to those individuals without other sources of support. Moreover, policies should help workers adapt to changes in a manner that is sustainable over the long term. Given existing funding constraints, it is important that social protection policies do not simply finance consumption but have a strong investment-component, i.e. rather than only compensating individuals in line with their past efforts, policies should help them re-engage in new activities.

In our view, these general considerations point particularly – although not exclusively – to the need to maintain incomes when the labor market cannot support individuals and to the importance of strengthening training (or lifelong learning) opportunities. Financial support during periods of unemployment is the most basic element of a social safety net, in that it reduces the risks posed to workers by global competition and domestic improvements in production. Strengthening continuing education as a means towards creating human capital is the best answer to the problems of technological change. Continuing training more effectively harnesses workers' productive potential over their entire life course. Moreover, while continuing education has never been – and will never be – able to wholly substitute for other mechanisms of protection (such as income maintenance), improved training programs are an important weapon in the arsenal of flexible social protection policies. First, more than any other policy tool, training is investment-oriented. Second, it is versatile in that it can support both unemployed and employed workers: By helping unemployed workers update their skill profiles, such programs can play an important role in allowing these workers find suitable re-employment. As lifelong learning programs, they sustain continuous capacity-building for current employees so that they can effectively contribute to their workplaces. As we will now discuss, the United States entered the economic downturn with labor market policies that performed remarkably poorly by these criteria.

Section 2: The Pathologies of American Labor Policy

Many of the United States' contemporary programs, both those for income support and training, are inadequate to underpin real flexibility. For instance, restrictive eligibility criteria leave more than 60 percent of unemployed people without assistance from the country's unemployment insurance. The current system tends to leave the most vulnerable part of the workforce – contingent workers on temporary and part-time jobs – completely exposed to the risks of job loss. Moreover, the funding for federal employment and training programs is at its lowest in almost 45 years, having fallen from a peak of 0.46 percent of GDP in 1978 to 0.05 percent a few years ago (Rosen 2008a, 9). Rationalized by the questionable pop-economics of pundits such as Thomas Friedman (1999, 2005), American policymakers have failed in updating the country's social protection system to changing demands. Thus, while American workers are increasingly exposed to risk, they are not reliably protected from it either by unemployment insurance (which is inadequate) or by continuing education and training policies (which are unsuited to the needs of the modern economy).

Unemployment Insurance

The patchwork system of US unemployment insurance (UI), which is administered by the states according to federal and state guidelines and financed through a complex mix of federal and state payroll taxes, offers only low standards of income protection. The state schemes fail to cover the majority of the unemployed and pay lower benefits for less time than systems in other advanced countries. No state except Hawaii meets the initial goal of replacing half of the previous wage level. The average national replacement rate is only a little more than a third of former wages, with almost all states limiting benefits to a maximum between $200 and $500 a week (Kletzer and Rosen 2006).

Benefits are only regularly disbursed for up to 26 weeks in most states (Montana and Massachusetts are slightly more generous). Because the average time spent in unemployment has increased, about a third of UI recipients exhaust their benefits before they are able to find new employment. While there is a system of automatic triggers in place to extend benefits during cyclical downturns, rapid changes in the economy have rendered it ineffective. In turn, Congress has sought to pass emergency extensions during recessions, sometimes with great difficulty. Not only have these temporary stopgap measures politicized unemployment assistance, they also introduced a strong element of randomness into the level of protection enjoyed by the workforce, because extensions usually only applied to those workers who had not yet exhausted their benefits.

The federal government’s failure to continually adapt the UI program to new needs is probably best illustrated by the insufficient adjustment of the wage base on which federal unemployment taxes are levied. Originally set at $3,000 in 1939, the taxable wage not only remained completely fixed for the first 32 years, but has stayed at $7,000 since 1983, which translates into a fall in the ratio of taxable to average total wages from 98 percent to 33 percent over six decades. Simply indexing the taxable wage to inflation (not to mention historically higher wage increases) would have led to a taxable wage of $45,000 today. Currently, the highly regressive federal taxation system only collects a maximum of $56 from each covered worker, leaving the states to finance 83 percent of the UI program's regular expenditures (Kletzer and Rosen 2006).

Training and Education Policy

Neither political party has paid the systematic attention to labor market policy and social protection for workers that they have to changing retirement provisions. Moreover, the joint federal/state system of unemployment insurance makes it extremely difficult to adapt programs to new needs. One result is that publicly funded training initiatives are not well integrated either with unemployment insurance, or with each other. Efforts to create more cohesive policy – such as the Workforce Investment Act (WIA), which established "one-stop" career centers across the country – have been undermined by meagre funding (the WIA received only $3.2 billion in 2008, a decline of ten percent over 2002). Even the conservative Economist magazine (2009) writes that funding levels remain much too low to handle the career centers' rising caseload effectively and that public expenditures on training – about 40 percent of WIA's funds – are insufficient.

The higher education system – which is supposed to provide post-secondary education and training – is also falling short of expectations. While the historical achievements of the country's higher education system have continued to have extremely positive effects on the country's economy to this day – the postwar baby-boomers were the best-educated generation in the country's history – tuition is rising sharply, and public support is not keeping up. For instance, in 1976, Pell Grants for low-income students covered 72 percent of the average cost of a four-year state institution; by 2003, they covered only 38 percent (Delbanco 2009). This is particularly a problem for the children of immigrants and for first-generation college attendees, as the increasing cost of higher education squeezes many of them out of the market. According to Andrew Delbanco (2009), "a great many gifted and motivated young people are excluded from college for no other reason than their inability to pay, and we have failed seriously to confront the problem."

Admittedly, the American "learning system" (Samuelson 2006) has long excelled at offering opportunities for workers to obtain qualifications later in life, but it is struggling to adjust to changing student demographics, learners' time constraints and students' greater interests in more vocational courses. These days, little more than one out of every six college students fits the traditional profile of full-time residential students aged between eighteen and twenty-two (Delbanco 2005). Indeed, "non-traditional" students now make up 73 percent of all enrollment in US colleges and universities, and 40 percent of college students are 25 and older (UCEA 2009). One in three American undergraduates now works full-time, and a majority attends college part-time, tending toward majors that promise immediate utility, such as accounting and computing (Delbanco 2005). Community colleges – traditionally the most accessible providers of higher education – have been systematically neglected at a time when an increasing number of jobs require the skills and knowledge typically obtained in some form of post-secondary education (Merisotis 2009). Because of demographic change and weakening commitments to accessible higher education, the new generation of workers replacing the retiring baby-boomers in the labor market will on average have lower educational credentials

(Callan 2009). As such, a wide gap has opened up between policymakers' inclination to preach the importance of education and learning, and the sobering messages of experts about the contemporary state of the national education system.

More broadly, not only does America help workers less than other countries, but these workers face higher levels of social risks and barriers to security. Today, Americans live in a country that features the OECD's highest income polarization and does worse than many European countries in supporting the "American dream": upward income mobility (Sawhill and Morton 2008, Solon 2002).

As union strength has declined, Congress has paid less attention to the expressed preferences of the majority of Americans. Instead, corporations and wealthy individuals that tend to bankroll policymakers' campaigns have gained in influence (Hacker and Pierson 2010). Developments in the area of labor and employment law illustrate this well: Reform attempts under Presidents Carter and Clinton have come to nothing due to business resistance (Osterman 1999), and companies now even openly flout those laws that actually are on the books (Bernhardt et al 2008). This gives firms some short-term flexibility – but at the expense of social damage on a wide scale. Over the long run, such behavior undermines itself by destroying the incentives for companies to provide training and by de-legitimating market governance.

Already, the mismatch between higher risk and inadequate protections has led to greater calls for protectionism. Workers fear that they could be made worse off by competition from abroad as well as by the introduction of new production techniques at home. These are reasonable concerns, since the international reorganization of economic activity over the last few decades has been associated with American companies off-shoring and outsourcing many activities that they previously sourced domestically. In the United States, off-shoring now hits well-educated middle-class workers (e.g. software programmers), as well as blue-collar workers in manufacturing. While the country has benefited from globalization overall, the gains have been highly unequally distributed. Indeed, international economic integration has negatively affected many people, and it has strongly increased the level of uncertainty that American workers face in their daily lives. In our view – and indeed in the view of pro-free trade economists like Jagdish Bhagwati (2009) – the provision of more dependable and effective mechanisms of social protection to help workers deal with higher uncertainty would go a long way toward making global markets more legitimate.

Denmark and Germany provide important lessons about how the United States might do things differently. Denmark shows that social protection mechanisms, such as well-managed income replacement programs and continued training programs, are not only compatible with flexible markets, but can indeed enhance them. The German case points to a reform strategy that might be feasible in the US context. Taken together, the two countries' experiences demonstrate how more dependable and effective social protection mechanisms in labor market policy are both practical and achievable.

Section 3: Toward Labor Market Utopia? The Danish Case

Over the last few years, Denmark's institutional arrangements have received both increasing journalistic and scholarly attention in the United States (e.g. Stinson 2006, Stokes 2006). Having selectively displaced old institutions and converted others to new uses over the past two decades, the Danes built labor market arrangements that provide "flexicurity," combining the promotion of labor market flexibility with the guarantee of social security. The country's institutions support a unique system of "protected mobility," where job mobility levels match those of the United States and the social safety net is one of Europe's most effective. Social security is provided through generous income replacement schemes rather than regulation. For instance, the Danish unemployment insurance offers up to 90 percent replacement of the previous wage for low-income earners and about 60 percent of previous wages for a skilled metalworker. Importantly, unemployment insurance benefits are only granted unconditionally for a limited time, with continued payment linked to the recipient's compliance with an activation plan, which includes either an offer for further training or an employment position. This helps Denmark sustain very high rates of labor market participation.

Denmark sees itself as a "learning society" and is the leading provider of continuing worker training among the OECD countries. The country features participation rates in continuing training activities at about twice the average of the EU-25 and almost twice the average of the EU-15; in a recent survey, 56.2 percent of Danish respondents reported that they had participated in some form of education or training during the last year (Cedefop 2003, 18). While Danish workers at all skill levels participate in lifelong learning programs, the degree of participation by people with low levels of formal education, i.e. those who are most at risk from economic change, is especially striking by international standards. For instance, according to data from the mid-1990s, 42.3 percent of all "blue-collar low-skilled" workers in Denmark participated in adult education and training during the preceding year, but only 22.4 percent of Americans workers in the same category did so (Desjardins et al 2006, 59-62). Even though, as in other countries, the levels of participation in lifelong learning increase with the level of prior education, the differences in participation rates between highly educated workers, skilled workers and formally unskilled workers are very low in Denmark (Kailis and Pilos 2005). Thus

Denmark’s continuing education and training system plays its part in sustaining a more equal distribution of competences in the population than exists in other OECD countries.

The international market success of Danish companies indicates how much they have benefited from the labor market arrangements in their country. Be it as independent operators in niche markets or as valuable subsidiaries of multinational corporations, they have proven very adept at playing “global games” by using domestic institutions to their competitive advantage (Kristensen and Zeitlin 2004). Danish firms can grant workers more autonomy than their foreign competitors, leaving them with more discretion for decision-making unconstrained by hierarchical supervision systems (Dobbin and Boychuk 1999). This provides the basis for effective decentralized knowledge management and organizational flexibility within firms (Lorenz and Valeyre 2005). By facilitating close collaborations between companies’ customers, production workers, and engineers, work organization in many Danish companies facilitates continuous experimentation in support of incremental product and process innovations.

Of course, Danish-style labor market policies do not come cheap, particularly if one takes into account the generous state grants for companies with workers in continuing training. Denmark is a leader among OECD countries in public investment in education and spending on labor market programs. However, these resource commitments seem to have directly positive effects: Arguably, they have helped create a population that is highly open to change and new economic opportunities, with 77 percent of the population seeing globalization as an opportunity and only 16 percent perceiving it as a threat (Eurobarometer 2006). These figures make Denmark the most trade-friendly country in Europe.

So, what general lessons could US policymakers take away from the Danish experience? First, policymakers should recognize that it is possible to set up comprehensive social security and continuing training systems that work and play an active role in sustaining upward social mobility. Second, they can interpret Danish arrangements as evidence of the importance of public-private cooperation in job training: Danish companies enjoy considerable leeway in shaping training programs to meet their local needs (Kristensen and Zeitlin 2004), and they participate in active labor-market and social programs with the explicit goal of gaining access to a more highly skilled labor supply (Martin 2004, 41).

While the Danish case is instructive about what kinds of policies might be possible, if one were working from a blank slate, the United States is not a blank slate. Any institutional changes in the US would have to build on current institutions. Here, the experience of Germany – which similarly had to introduce labor market reforms in a politically inflexible system – can be instructive. Developments in Germany illustrate that policymakers can change the character of an institutional system through introducing new elements rather than directly attempting broad institutional reform.

Section 4: Policy Change through Layering – The German Case

Having become a “fallen superstar” (Steingart 2004), Germany was long seen as needing to overhaul its labor market policy with the goal of introducing more flexible mechanisms of social protection. It was widely accepted that the rules governing and the social welfare programs supporting the “standard employment relationship” (Normalarbeitsverhältnis) had left the country stuck in the “continental dilemma” (Scharpf 2000) of providing “welfare without work” (Esping-Andersen 1996). For instance, while expenditures for social protection were high, they went largely into compensatory measures, with much less use made of education as preventive social policy (Allmendinger and Leibfried 2003). According to one assessment, the country needed nothing less than a transformation of its competitive infrastructure (Silvia 2003, 2). However, the policy process was stuck.

The country eventually overcame its long-running “reform gridlock” through a strategy of institutional layering: Rather than delivering fundamental changes through the displacement of old institutions, the government under Social Democratic Chancellor Schröder pursued a strategy of selective deregulation that effectively layered new institutions on top of those that already existed.

Following what amounted to a path of least resistance, the government built a “second-tier” system of labor contracts by changing the country’s rules for non-standard types of employment. Almost no changes were made to the rules governing the “first-tier” standard employment relationship, which grants workers an impressive array of employment rights that leave Germany ranking second in a composite index of employment protection among the OECD countries (Estevez-Abe et al 2001, 165). Instead, the government liberalized temporary agency work by removing the limit that had restricted the employment of temporary workers by any one employer to a maximum of one year. Moreover, the government reformed the regulation of part-time jobs, which service-sector companies have been particularly keen to use.

As will become evident, these reforms are in many respects highly problematic, when compared to the Danish model. They give employers greater flexibility in hiring decisions but come with lower levels of social protections for the least securely employed workers. Given that there exist some substitution effects between job categories, the reforms have most likely led to a net loss in social protection overall. Clearly, a strategy of more broadly reforming inherited institutions would have been more in line with the progressive ideology of the governing coalition. However, not only would such a strategy have required a far higher degree of political leadership on convincing the population about the need for broader reform (Cox 2001) as well as a clear break with inherited norms, it would have also run into the institutional constraints of the German economic and political order. Among some of the features of Germany's political institutions that acted as constraints were numerous state and regional elections serving as referenda on the reforms, resistance within the governing parties and the labor movement, as well as an opposition majority in the upper house of the federal parliament that was keen to protect its own constituents. Schröder himself stressed how narrow he perceived the window to be for his overall reform program by emphasizing that "when you examine what we are trying to achieve, then it is a path, that *under the political and power conditions in this society*, I hold for optimal" (Camerra-Rowe 2004, 25, italics added).

Following the changes in the law, the extended menu of non-standard forms of employment was widely embraced. Indeed, the rapidity of the increase in employment of "atypical" workers in Germany is without any parallel in Europe. Between March 2002 and May 2006, when German businesses shed well over one million first-tier jobs, they simultaneously created almost exactly the same number of second-tier jobs. In 1968, first-tier jobs still accounted for 65 percent of all employment; however, today, their share is down to less than half of total employment (Benoit 2006). In 2004, a good third of dependent workers and over 54% of female workers were employed in atypical employment relationships (Keller and Seifert 2006, 236). So, while Germans continue to refer to jobs with "standard" labor contracts as "typical" jobs, they have become both significantly less standard and typical.

The booming category of non-standard employment includes a variety of different types of contracts: First, the number of positions in fractional employment (*geringfügige Beschäftigung*), most notably "mini-jobs," has risen from 2.6 million at the beginning of 2003 to

6.7 million in mid-2005. Part-time contracts now account for 24 percent of all jobs, double the level of 1991. Second, after the liberalizing reforms, temping agencies have dramatically expanded; while the labor market was shrinking during 2003-05, the number of temporary workers shot up by about 250,000 to nearly one million. Third, the number of workers on fixed-term contracts (of six months to two years) has increased from 3.2 percent of total employment in 1982 to 10.8 percent in 1991 and 14 percent in 2005 (Benoit 2006).

More recently, the proliferation of second-tier employment prompted further reforms. In the spring of 2009, the government expanded the legal basis through which it can set sector-specific work conditions – minimum wages and rules about holiday provisions, as well as health and safety regulations – to protect non-standard workers. In the past, such moves would have been politically infeasible, and would have been criticized widely as improper government meddling in what should be "free" wage determination in society. Only the initial reforms opened up the political room for this break with long-standing principles.

We emphasize that these reforms' lesson for American policymakers is one of *process* rather than *content*. German policymakers succeeded in overcoming stalemate by circumventing domestic opposition from entrenched interest groups and political veto players. They did not attack the existing system head on, but instead sought to layer a new system, with a quite different employment relationship, on top of it. This suggests that one path to institutional change in a system involving many veto points can be through the creation of new programs rather than wholesale efforts at institutional re-engineering. While layering approaches are likely to have only moderate success in the short term, they may, if carefully designed, unleash longer-term processes of institutional change. Over time, new programs can – if they prove successful – be expanded, or they may trigger further adaptation as happened in Germany. However, given the uncertainty of a layering strategy's long-term effects, policymakers should think long and hard about the mechanisms through which layering might lead to further reforms. If they can identify mechanisms through which changed program dynamics could move overall policies and institutions closer to (rather than further away from) the broader intended outcome, then layering might be a viable strategy to consider in situations where efforts at more direct reform are blocked.

Section 5: Toward Institutional Innovation in the US

In 2009, many hoped that the Obama administration could seize on the economic crisis to overcome the complexity of the US federal system and push New Deal-style comprehensive, system-changing reforms of US labor market policy through Congress. After all, FDR's legislative initiatives seemed to provide evidence that a crisis provided an incoming administration with opportunities for institution-building that might not exist during more steady times.

These hopes were never very realistic. The New Deal too was the result of unsatisfying political compromises. Moreover, it is much easier to build new institutions where there are no old ones to displace than to build such institutions in an environment where there are existing institutions, each with its own entrenched interest groups. While the Roosevelt administration was able to build new institutions on a relatively clean slate, the Obama administration is constrained by a plethora of feedback effects from past institution-building and policymaking (Pierson 2004). As well as having to fill a far higher number of staff positions in the administration (a task that remained to be completed more than one year after Obama's taking office), the new administration needs to handle the well-organized constituencies of existing government programs and devise policy solutions that take into account current policies' implicit future commitments. Add to that the high level of partisanship in contemporary American politics, which increasingly produces "legislative gridlock" (Binder 2003), and efforts at broader institutional reform look far less promising. It is no wonder that many experts in employment policy have long believed that significant progressive reform in labor market policy will only be driven from the local level (Osterman 1999, Weir 1998).

Nevertheless, some important changes in labor market and education programs have been made. For instance, the American Recovery and Reinvestment Act (ARRA) included temporary extensions of – as well as small increases in – UI benefits, expanded tax credits for college attendance from low-income families, job training funds for "green jobs," increases in the size of Pell Grants, and fiscal transfers to the states that were geared toward preventing cuts in education. In addition, the Obama administration has sought to make the recipients of unemployment benefits eligible for Pell Grants and change many states' restrictions that have kept benefit recipients from enrolling in college classes. While such initiatives carry the promise of improving the US social protection and workforce development systems, it remains to be seen whether they can produce long lasting structural changes. Given the depth of the crisis, they have not prevented capacity losses in community colleges. Moreover, Congress has sent a sobering message when its recent student-loan bill appropriated only two rather than the twelve billion dollars the administration had proposed for long-term investment in the capacity of community colleges (Basken 2010).

Ultimately, political opposition can hinder legislative initiatives at many points in the policy process. Given that a significant share of Washington policymakers tends to view labor market adjustment policies as "welfare" (Destler 2005) and that the Republican Party seems bent on non-cooperation (Crook 2010), there exist many barriers to emulating Danish employment policies. Moreover, while the Democrats have the option of unilaterally pursuing reforms through their majorities in both Houses of Congress, their own difficulties in coalition-building – quite apart from the threat of a Republican filibuster – make that unlikely.

Having considered the strategic options for overcoming the roadblocks to a "flexicurity"-type policy approach in the United States, we raise the possibility that US policymakers could consider using the trade debate to both reframe the issues of labor market policy in the context of international integration and to implement layering-oriented policy reforms. By making the expansion of the federal government's Trade Adjustment Assistance (TAA) program a constitutive part of the discussions on trade matters, "institutional entrepreneurs" (Crouch 2004) could assemble a broad social coalition in support of a legislative agenda that both sustains international cooperation on trade and converts a small backwater program into an important element of US labor market policy. Over the longer run, the resulting forms of institutional "bricolage" (Campbell 2004) in labor market policy could raise demands for further policy coordination. Down the line, potential attempts at newly systematizing labor policy programs could then open up further chances for more ambitious labor market policy reforms, including potentially de-coupling TAA from trade policy altogether.

Upcoming Challenges in Trade Policy

After a long silence on trade policy during much of Obama's first year in office (Bergsten 2009), Washington has started to talk about the topic again. For instance, in his 2010 State of the Union address, the President prominently mentioned his intention to shape the continuing Doha round of trade negotiations and stressed his commitment to strengthen bilateral trade relations, such as with South Korea, Panama and Colombia (i.e. countries, with which the Bush administration had negotiated free trade agreements that remain to be passed by Congress). Moreover, Obama announced a National Export Initiative, with which he hopes to double exports over the next few years. Of all the strategic options open to policymakers for shrinking the gap between what the United States produces and what it consumes (the US trade deficit had grown to more than five percent of GDP just before the crisis), export promotion is certainly one of the best and least painful for the population (compared to inflation and depreciation, or austerity packages and expenditure reductions). However, a crucially important condition for export promotion to work is that protectionist pressures are contained at home; without an open global trading system, there will be few foreign markets for the US to export to.

Pursuing any type of trade agenda in the post-crisis environment will be politically challenging. While businesses' calls for protectionism have largely died down over the last few decades, popular dissatisfaction about globalization's impact has increased. Organized labor has not supported Washington's trade liberalization efforts since the early 1960s, and policymakers' recent strong emphasis on laissez-faire policies has prompted more fervent opposition from labor. The unions feel that trade has severely hit good-paying jobs, first in manufacturing and more recently in white-collar services, and replaced "them with jobs with lower wages and reduced benefits"; for organized labor, trade has "become *the* hot button for the debate over the economic divide" (Stern 2006, 138-139, italics added).

Congressional support for deepening trade relations, particularly within the Democratic Caucus in the House, has also fallen as the trade share of GDP increased over the years. While Republican lawmakers are clearly more supportive of free trade than Democrats, they too have noticed that their constituents are often unenthusiastic. Without the necessary Congressional majorities to renew it, the President's Trade Promotion (formerly Fast Track Negotiation) Authority lapsed between 1994 and 2002, and it has again become defunct since July 2007.

Most of the major federal trade bills have been accompanied by reforms of Trade Adjustment Assistance (TAA). Originally introduced in 1962 and building on an idea from the President of the United Steelworkers, TAA seeks to help workers who have lost their jobs as a result of foreign trade. Today, TAA provides job training, income support, job search and relocation allowances, a tax credit to help pay the costs of health insurance, and a wage insurance supplement to certain reemployed trade-affected workers aged 50 years and above.

Over the course of its existence, the TAA program has gone through significant changes. Following its expansion in 1974, program expenditures grew rapidly in the late 1970s, with outlays of about $1.6bn dollars and as many as half a million workers being supported during one year in 1980 alone. Under the Reagan administration, however, the program was cut back to less than ten percent of its peak size. For instance, the amount of income maintenance was reduced, and income support was made conditional. While the program continues to be amended (most recently under ARRA), it has never grown back to its pre-Reagan size. During the 1980s and 1990s, it averaged around 30,000 recipients per year.

Since the Trade Act of 2002 merged "regular" TAA with the separate NAFTA-TAA, TAA's eligibility criteria include not just workers laid off at companies directly affected by increases in imports but also "secondary" workers, i.e. people who were let go at suppliers or downstream producers of firms that faced increased import competition, and those who were displaced due to shifts of production to countries that have bilateral free trade agreements with the United States. Under ARRA, eligibility was further expanded to workers in companies that supply services. Worker eligibility is established through a petition process to the Department of

Labor, with between 1,086 and 3,095 petitions being filed per year (2003-2007), of which between half and two-thirds were approved.

As TAA is currently practiced, its positive effects are severely hampered by the typical problems of targeted programs. Few know about the program, so that it has very low take-up rates, with only about ten percent of the estimated group of potentially eligible workers having received assistance between 1974 and 2002 (Kletzer and Rosen 2005, 317). Even from among those 117,904 to 197,264 workers, which were determined eligible through the petition process each year between 2003 and 2005, only an average of 62,444 received income support and 46,103 received training (Rosen 2006, 89; 2008b, 3). Furthermore, the program's administration is contentious, with regular union complaints about "improper denials" of assistance (AFL-CIO 2004) and US court criticism of the program's poor implementation. Finally, even after recent reforms in ARRA, the program leaves workers who lose jobs in export-oriented industries ineligible, let alone those who are displaced due to non-trade-related reasons.

Toward A New Social Compact on Trade

Given the shortcomings of US labor market policies in socializing the substantial costs that come with the process of trade liberalization, observers of US trade policy have long noted the need for a new social compact to maximize both the country's overall gains from globalization and the share of the population that participates in these gains. One suggestion comes from trade policy expert I. M. Destler (2005) who stressed that such a compact should 1) broaden TAA eligibility for stipends and retraining to all Americans displaced from their jobs by economic change, 2) make wage insurance broadly available without current restrictions, and 3) provide employers with incentives to invest in human capital by offering on-the-job training to displaced workers. For both *political* and *substantive* reasons, Destler saw such a compact as the most *plausible* means of overcoming partisan divisions on trade policy in Washington.

In our view, the post-crisis political-economic context (of the population in stronger economic pain and threats to social cohesion mounting) makes a Destler-style social compact even more necessary. Free traders skeptical of domestic compensation should take note that there is nothing natural about global capitalism and that it has collapsed once before in the interwar period when domestic conflict spilled over into international protectionism (Frieden 2006). If designed well, a revised TAA could become a cornerstone in a broader national strategy for responding to economic dislocation (Rosen 2008a). By including training programs and increased support for firms as well as communities, it could also play an important role in helping to increase American companies' export capacities. While the US current account deficit has fallen in the current crisis (Baldwin 2009), this drop is likely to be merely temporary, and there is political will for the US to boost its exports (Rosen 2009). Finally, even those free trade advocates who disdain the intellectual merits of export-boosting policies should not ignore their potential to create a new compact on trade.

Recent reforms of TAA under ARRA certainly go in the right direction, but they remain an inadequate foundation for a new social compact on trade. They have not changed the character of the program, including such long-standing issues as the burdensome petition process and the challenges for Department of Labor outreach. Here policymakers would need to go further. Importantly, they can build on a variety of detailed suggestions that policy scholars have made over the years for reforming the program (e.g. Brainard et al 2005, Kletzer and Rosen 2005).

This is not the place to cover these proposals in detail; rather we wish to indicate that this broad approach could be a winning idea for a majority of Americans. With the US population being far less polarized than Washington politicians (Hacker and Pierson 2005, Fiorina et al 2005), one should not solely focus on either the partisan rancor between Republican and Democratic, or the stark opposition on trade between such groups as the US Chamber of Commerce and the AFL-CIO. Citizens' preferences on trade do not line up with class boundaries (Hiscox 2002), and there exist broad majorities for the proposed policies among the underlying social groups. Pre-crisis opinion polls have shown time and time again, first, that Americans tend to believe that globalization is beneficial for the US, second, that they worry about globalization's negative effects on domestic job security, and third, that they would like to see government do more to help workers who suffer from globalization-related job loss. Deeply committed to Ronald Reagan's vision of the United States as an "opportunity society" (Haskins and Sawhill 2009), Americans are increasingly dissatisfied with rising economic inequalities that undermine relative equality of opportunity (McCall and Kenworthy 2009). We believe that – with the right framing by institutional entrepreneurs – the existing majorities in society are large enough to force Washington insiders' hands. Moreover, among other organized interests, many larger pro-globalization businesses would likely come on board; in contrast to smaller companies, they have long supported human capital investment policies and broader social policy interventions (Martin 2000).

Looking into the Future

To be clear: the proposed strategy of institutional layering does not provide an immediate solution to many of the challenges that the United States faces in its labor market policy. Indeed, the immediate impact on the social security of the average American might be quite small; certainly, it would not initially move the country very far towards the more broadly "shared prosperity" (Faux 2007) that many on the political left hope for. Substantial progress in that direction will require far more, including paying serious attention to enforcing and updating labor and employment laws.

Moreover, coordinated political initiatives to pursue "market-shaping" policies seem necessary to improve the number of "quality jobs" in the US labor market (Kochan 2010) and to promote innovation in work organization at the company level (Applebaum et al 2008, Schulze-Cleven 2006). Finally, there is a strong need for finding new ways through which working middle-class people can make their voices heard, both at the workplace and in politics, so that they can provide a counterweight to more narrow economic interests. To this end, it seems particularly important for Congress to allow unions to stop their membership hemorrhage by passing a modified and reframed Employee Free Choice Act (EFCA). However, immediate progress on such policies does not look likely in the current US political climate, and any progress will likely require significant political leadership over a sustained period of time.

Layering a significantly converted TAA program onto US labor market policy would not preempt such broader reforms. Instead, it could be the start for a process of institutional change that could lead to more substantial structural policy changes over time. As such, it could contribute to putting the country on a more sustainable – and equitable – path of economic growth and job creation than the financialization boom of the last decade. It would also be in line with Americans' expressed preferences for *indirect* (e.g. education-based) rather than *direct* (i.e. redistributive) mechanisms of addressing rising income inequality (McCall and Kenworthy 2009).

Earlier in the paper, we mentioned further demands for policy coordination between TAA and other labor market programs as one potential mechanism for future broader institutional change. The extension of TAA-type assistance to all displaced workers would certainly make necessary further reforms in the UI system. But this is only one of many possible mechanisms of institutional change that could be set in motion. Another one could be domestic policy learning. Research has already shown that some displaced-worker adjustment programs have been quite effective in the US (Kletzer and Koch 2004). Washington policymakers have continued to ignore these findings; however, if they are forced to address them, we might see significant shifts.

As it stands, any larger-scale policy shifts will require changes in US politics, US institutions, or both. The current relationship between an increasingly polarized US party system and a political system that effectively requires inter-party cooperation to achieve change has undermined the country's ability to prepare for the future. Either the two political parties will begin again to respond to the incentives to get things done rather than merely to oppose each other's policy proposals, or legislative institutions (including the "semi-universalization" of the filibuster) will have to change. When change occurs, new policy options may open up to political entrepreneurs. In the interim, a strategy based on layering and coalition-building on trade policy seems worth serious consideration for overcoming entrenched opposition.

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