



# The European Semester in the North and in the South: Domestic Politics and the Salience of EU-Induced Wage Reform in Different Growth Models\*

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## Abstract

Macro-economic policy coordination remains a challenge in the EU. The European Semester was designed to help facilitate more coordination. In the area of wage policies, it encourages Germany and the Netherlands to support stronger wage growth, while Italy and Portugal have been told to exercise wage restraint. This paper analyses how domestic interest group politics influence how EU recommendations are received. Reflecting on the different growth models that underpin these four countries, we find that country-specific recommendations meet country-specific obstacles – independent of whether recommendations aim at increasing or reducing wages. Specifically, we observe that domestic actors successfully mobilize against EU recommendations that go against the interests of their constituencies, but are less effective in mobilizing for recommendations aligning with their interests. Hence, we submit that high salience of EU influence poses an obstacle for EU-induced reform in the South while low salience limits EU influence in the North.

**Keywords:** Country-Specific Recommendations; domestic politics; European Semester; growth models; macro-economic policy coordination

## Introduction

Macro-economic policy coordination remains a challenge in the EU. Following the euro area crisis, the European Semester was created to serve as a mechanism to coordinate better member state policies and prevent macroeconomic imbalances in the European Union (EU), especially within its Economic and Monetary Union (EMU). Based on soft modes of governance, the Semester framework makes annual Country-Specific Recommendations (CSRs) for national economic and social policies to improve macroeconomic stability in the euro area. Structural differences among member states are therefore reflected in heterogeneous reform recommendations.

The academic literature on the European Semester has not paid much attention to the fact that different reforms are demanded of different member states. Earlier literature on ‘Europeanization’ and related studies on implementation focused on how different domestic actors and institutional structures adjust to directives (Falkner *et al.*, 2005; Graziano and Vink, 2013, p. 36). Existing research focuses on the European Semester from a bird’s-eye perspective, discussing its overall effectiveness, its democratic legitimacy, or questions about a general change in direction of its CSRs (see Verdun and Zeitlin, 2018). In-depth

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case studies, by contrast, analyse how the European Semester interacts with domestic politics in one or several specific domains of reform and often hone in on a single country case (for example Bursens and De Blauwer, 2018; Eihmanis, 2018; Louvaris Fasois, 2018; Mariotto and Franchino, 2020; Karremans, 2021).

While country-specific and policy-specific studies tend to focus on particular determinants of national reforms, the macro-perspective typically emphasizes common trends and generalized characteristics of the European Semester process rather than systematic differences across countries. Our article adds to this literature by advancing an understanding of how policy coordination at the European level is received at the domestic level by key domestic actors and interacts with macroeconomic policy trajectories. We examine in particular whether recommendations are treated differently by selected member states with current account surpluses (colloquially 'Northern' states in an EU economic governance context) and those with current account deficits (colloquially 'Southern' states) (Johnston, 2016). This examination speaks in part to the earlier Europeanization literature, which acknowledges a lack of clarity on causality when describing differences among member states' response to EU recommendations (Radelli and Exadaktylos, 2010; Graziano and Vink, 2013). Our findings here within suggest that CSR implementation depends on the country setting, the power of the domestic actors, and the circumstances of domestic institutions.

Reflecting the goal of preventing and correcting macroeconomic imbalances, member states receive highly different recommendations (Haas *et al.*, 2020, pp. 334–6). To examine how recommendations are treated when they are different in orientation, we take as our point of departure the emphasis on labour costs. We take from the growth model perspective (Beramendi *et al.*, 2015; Baccaro and Pontusson, 2016) the need to differentiate between export-led and consumption-led growth models. Given the importance of labour costs across growth models, member states are likely to receive wage-related CSRs that seek to rebalance current account surpluses versus deficits. In the former, member states may receive recommendations to increase wages and labour conditions; in the latter, there may be a downward pressure on wages to support competitiveness. These recommendations, however, are unlikely to be implemented if met with contestation by powerful domestic actors.

We identify the micro-foundations of these models to be the expected behaviour of organized interests in these economies. By micro-foundations we mean those actors and structures that play a role in the domestic environment and influence the interaction among players. These include collective actors such as trade unions, employers' associations, and government agencies, as well as institutional structures such as established frameworks for wage negotiations. Export-led growth models assume wage moderation; domestic demand-led growth models assume high minimum wages and public sector pay (Avlijaš *et al.*, 2021, p. 384). Hence, we expect trade unions and employers' organizations to support recommendations which are in line with their preferences: CSRs encouraging wage growth for unions, and CSRs encouraging wage moderation for employers.

As member states receive differentiated reform recommendations, the Semester CSRs are likely to be perceived rather differently in different groups of member states. For example, domestic interest groups (social partners) and political parties (left-leaning and right-leaning) are likely to take opposing positions when EU recommendations interfere with their economic interests. Critics have expressed concerns in particular with the

downward pressure on wages and interventions in the labour market (for example Scholz-Alvarado, 2021). Yet obstacles might also occur for CSRs that focus on increasing internal demand through higher wages. Recent literature has examined how financial adjustment might serve as a driver of change in growth models (Spielberger and Voss, 2021). In this paper we analyse to what extent different reform profiles lead to different domestic politics, focusing on the micro-foundations (as defined above) underlying countries' existing growth models.

We explore this question here by focusing on EU-induced wage reforms in four EMU member states with highly differentiated reform profiles (see Section II) and, specifically, on the role that domestic actors and structures play in their response. In this context, our research question examines how opposing prescriptions on wage reform – a policy area deeply intertwined with national regulations, social partners, and issues of regional disparities – are perceived across member states. The data for this exploration, gathered from primary document analysis, policy reports, and interviews with similar key informants in each case study, suggest that the effects of the European Semester on domestic growth strategies vary according to the interpretations of the CSRs by entrenched domestic actors. Altogether 35 semi-structured interviews were conducted over the period 2018–21 for a larger study on the European Semester. This paper utilizes 16 of those interviews, selected on their relevance for wage policies. They were held with representatives from the national governments, trade unions, employers' associations and European Semester officers in each of the four cases.

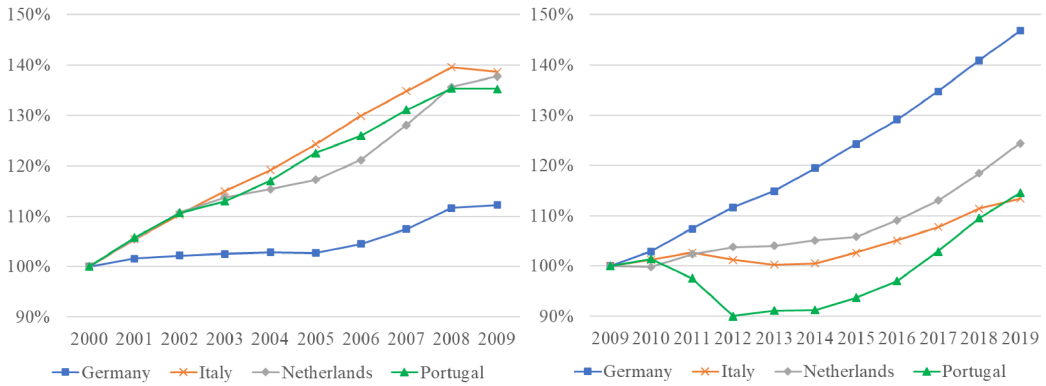
The next section provides a brief summary of the literature on the European Semester's institutional design and the content of CSRs. We also include here a concise overview of the prescriptions made to the four member states studied in this paper (Germany, Netherlands, Italy, and Portugal) as well as their respective reform records. The subsequent section focuses on the domestic perceptions and preferences in the four country cases based on secondary literature and policy reports as well as interviews with officials and stakeholders. We conclude by highlighting the limitations of soft governance for producing path-breaking reforms.

## **I. The European Semester and Heterogeneous Wage-Setting Regimes within EMU**

The literature highlights the varied and multi-faceted character of the European Commission's reform prescriptions. The tailored, country-specific recommendations (CSRs) can be seen as resembling a double-edged sword: in some cases, they are accepted as exerting pressure from the supranational level on member state governments; in other cases, they provide momentum for governments to enact reforms that have previously proven difficult to undertake (Copeland and Daly, 2018; Eihmanis, 2018). The non-uniform character of CSR content is at the same time an asset for adaptability in dynamic domestic contexts (Bekker, 2018), and a source of uneven strength behind the force of recommendations when comparing economic recommendations to social policy prescriptions (Maricut and Puetter, 2018).

One key debate on the nature of the European Semester concerns the political 'direction' of its policy recommendations. While some scholars argue that the Semester has increased its focus on the social dimension in process and content over time (Zeitlin and Vanhercke, 2018), others observe a stagnation of 'pro-social' policies at a relatively high

Figure 1: Employee Compensation in Wages and Salaries in Selected EMU Countries between 2000 and 2009 (100 = 2000) and 2009 and 2019 (100 = 2019) *Source: Eurostat. Note: Compensation of employees (at current prices) – annual data. Code: tipslm13. [Colour figure can be viewed at wileyonlinelibrary.com]*



Source: Eurostat

Note: Compensation of employees (at current prices) – annual data. Code: tipslm13.

level (Haas *et al.*, 2020) or a continued dominance of economic policies and actors (Copeland and Daly, 2018; Crespy and Vanheuverzwijn, 2019). Regarding specific labour market policies, a recent analysis of CSR content finds a generalized trend toward reducing protections for labour market insiders and increasing opportunities for labour market outsiders, but also important country-specific differences in labour market reform profiles (Haas *et al.*, 2020). This literature on the European Semester connects with long-standing debates about the compatibility of a single monetary policy with heterogeneous wage regimes (Soskice and Iversen, 2001; Johnston, 2016; Johnston and Regan, 2016; Höpner and Lutter, 2018).

Comparative Political Economy (CPE) scholars have argued that labour markets and wage developments were a key determinant in the development of EMU’s sovereign debt crisis. Johnston (2016) demonstrates that divergent unit labour cost in Northern and Southern EMU member states led to large current account imbalances across the euro area.<sup>1</sup> The ‘North’, was able to restrain wage increases through their coordinated wage-setting institutions supporting an export-led growth strategy (see Figure 1). In the ‘South’, wage setting was less coordinated and generally more adversarial, making coordinated wage restraint less likely (Johnston and Hancké, 2009; Hancké, 2013; Iversen *et al.*, 2016; Johnston, 2016). Various scholars have underscored that financial assistance programmes during the sovereign debt crisis explicitly focussed on reforming labour markets to increase price competitiveness (Hermann, 2014, 2017; Theodoropoulou, 2015). EU members that did not receive financial assistance within an adjustment programme

<sup>1</sup> Johnston (2016: 26) uses the terms ‘North’ and ‘core’ interchangeably and also ‘South’ and ‘periphery’. Johnston also places in the former category the following countries: Austria, Belgium, Finland, France, Germany and the Netherlands, whereas the latter category she places Greece, Ireland, Italy, Portugal, and Spain.

also experienced reform pressure as they were encouraged to increase wage flexibility (Sacchi, 2015; Schulten and Müller, 2015; Theodoropoulou, 2018), mirroring scholarly contributions that argue EMU favours export-led growth models (Johnston and Regan, 2018). Hence, focusing on the *policy directions* of the European Semester and the *domestic obstacles* it is likely to encounter, gives us the opportunity to research the differentiated impact of European economic governance on wage-setting institutions across the euro area.

## II. Case Selection

Our analysis focuses on a systematic comparison of EU-induced wage reform in Germany and Netherlands as two ‘Northern’ cases, and Italy and Portugal, representing the ‘South’. Whereas Germany and the Netherlands are well-known as surplus-countries that rely on export-led growth, Italy and Portugal, although running small current account surpluses since 2013, have long been characterized as deficit countries, particularly during the height of the euro area crisis. While this has been an obstacle to export-led growth, negative labour market effects during the sovereign debt crisis have also hindered consumption-led growth in these Southern economies.

We use these four country cases to explore the domestic politics of coordinated structural reform efforts in the context of the North–South divide in EU economic governance. We focus on EMU members only because the macroeconomic spillovers of wage policies are particularly salient among countries which share the single currency. Given the idiosyncrasies of industrial relations in other member states – Scandinavian welfare states or Central and Eastern European countries, for example – our cases are not necessarily representative for the entire universe of cases within the EU. It is not our intention to generalize from these cases to all EU member states. Instead, we aim to contribute to theory-building efforts that emphasize the domestic obstacles to EU policy coordination via soft governance. For further analyses on these cases, see the other papers in this special issue (Bokhorst, 2022; Hennis, 2022; Vanhercke and Verdun, 2022).

While the annual Semester cycle includes reform recommendations that touch upon a great number of issues across a variety of policy areas, we list four reasons for focusing on wage policies. First, CSRs focusing on wage developments have been continuously included over time and across countries. Second, wages are a key determinant in adjusting macroeconomic imbalances between member states as they have a strong influence on growth models and are relevant for the objectives of the Semester. Third, while sector-specific reform projects typically concern only a small subset of political actors and domestic groups, wage developments are a major concern for social partners. The interaction between these actors provides the micro-foundations for comparative political economy models of capitalism. Fourth, wage CSRs have continuously differed in ‘direction’ between Northern and Southern member states, focusing on increasing domestic demand through higher wages in the North, while aiming at keeping wage-increases under control to improve price competitiveness in the South.

Southern European member states have predominantly received CSRs that closely resemble the internal devaluation template, where budgetary restraint and structural reforms typically aim at increasing price competitiveness through wage moderation, thus fostering export-led growth. Italy and Portugal have repeatedly received recommendations to

Table 1: Sample Country Specific Recommendations (CSRs) for Each Case Study

<i>Germany</i>	<i>Netherlands</i>	<i>Italy</i>	<i>Portugal</i>
<ul style="list-style-type: none"> <li>• Create the conditions for wages to grow in line with productivity (2012)</li> <li>• Sustain conditions that enable wage growth to support domestic demand (2013)</li> <li>• When implementing the general minimum wage, monitor its impact on employment (2014)</li> <li>• Create conditions to promote higher real wage growth, respecting the role of the social partners (2017)</li> </ul>	<ul style="list-style-type: none"> <li>• In consultation with the social partners and in accordance with national practice, allow for more differentiated wage increases by making full use of the existing institutional framework (2014)</li> <li>• Create conditions to promote higher real wage growth, respecting the role of the social partners (2017)</li> <li>• Create conditions to promote higher wage growth, respecting the role of the social partners (2018)</li> </ul>	<ul style="list-style-type: none"> <li>• Reinforce the implementation of the new wage setting framework in order to contribute to the alignment of wage growth and productivity at sector and company level (2012)</li> <li>• Ensure the effective implementation of the labour market and wage setting reforms to allow better alignment of wages to productivity (2013)</li> <li>• Evaluate, by the end of 2014, the impact of the labour market and wage-setting reforms on job creation, dismissals' procedures, labour market duality and cost competitiveness, and assess the need for additional action (2014)</li> </ul>	<ul style="list-style-type: none"> <li>• Maintain minimum wage developments consistent with the objectives of promoting employment and competitiveness (2014)</li> <li>• Promote the alignment of wages and productivity [...] Ensure that developments relating to the minimum wage are consistent with the objectives of promoting employment and competitiveness (2015)</li> <li>• In consultation with social partners, ensure that the minimum wage is consistent with the objectives of promoting employment and competitiveness across sectors (2016)</li> <li>• Together with social partners, ensure that minimum wage developments do not harm employment of the low-skilled (2017)</li> </ul>

*Source:* Authors' own compilation from CSR data available at the European Commission website on 'EU Economic Governance: Monitoring, Prevention, Correction > The European Semester': [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/eu-country-specific-recommendations\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/eu-country-specific-recommendations_en).

implement labour market and wage-setting reforms that promote cost competitiveness (see Table 1). In the short run, such internal adjustment strategies often lead to higher unemployment and lower wages and threaten the foundations of electorally popular welfare state provisions. Given the Semester's limited array of sticks and carrots until 2020,<sup>2</sup> it should not come as a surprise that Semester CSRs have often led to relatively meagre results in terms of reform progress in this policy area (Bokhorst, 2022; Hennis, 2022).

The reform profiles for 'Northern' countries suggest different political obstacles. Germany and the Netherlands, for instance, have been told to support domestic demand through both fiscal and structural policies, including explicit calls for public investment and higher wages, at least for vulnerable groups which would increase consumption-led growth (see Table 1). While such recommendations are likely to be supported by labour and left-leaning parties, we expect them to meet the opposition from business groups and conservative parties.

### III. Case Studies

#### *Germany*

Germany's growth model was in a unique position in EMU over the last two decades, capitalising on export-led growth through internal wage moderation. Framed as 'the sick man of the Euro' (The Economist, 1999), Germany entered EMU with comparatively high unemployment numbers and slow economic growth, partly caused by long-term effects of Germany's reunification process. To reduce unemployment, several initiatives were put forward from the mid-1990s onwards to increase employment, particularly through wage moderation in combination with reforming and retrenching unemployment support systems. The reforms of the 2000s ('Agenda 2010') were the culminating point of this development and led to the establishment of Germany's large low-wage sector (Hassel and Schiller, 2010, pp. 85–106; 184–228). German labour markets were characterized by strong wage restraint from 2000 to 2010 (see Figure 1) and high current account surpluses against fellow EMU member states, facilitating its role as an export-led growth model. German wages started to increase after the global financial crisis, thus partially rebalancing its current account against other EMU members (Di Carlo, 2018). However, wage increases evolved unequally across German industrial and service sectors (Höpner, 2019; Di Carlo and Höpner, 2020). In addition, Germany experienced record high employment numbers throughout the last decade.

With these labour market developments in mind, the Semester country reports for Germany focus extensively on improving Germany's unequal wage structure.<sup>3</sup> Key issues are Germany's large low-pay sector, wage-related macroeconomic imbalances, and Germany's lack of equal opportunities in the labour market due to low wages, precarious

<sup>2</sup>The newly created Recovery and Resilience Facility (RRF) offers non-repayable grant as reform incentives, embedded in the European Semester (see Fabbrini, 2022; Vanhercke and Verdun, 2022).

<sup>3</sup>This paper draws from Country-Specific Recommendations for all four cases from the years 2012–20, inclusive. All country reports can be found from the European Commission website on 'EU Economic Governance: Monitoring, Prevention, Correction > The European Semester', which we include here for space considerations: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/eu-country-specific-recommendations\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/eu-country-specific-recommendations_en).

work environments, and negative tax incentives for second income earners. Ultimately, the CSRs aim at strengthening the role of consumption-led growth components in Germany's export-led growth model. Germany's minimum wage, a key, long-fought labour market reform of the German government (Bosch, 2018), became a central discussion point in the country reports as an important tool to increase wages in low-pay sectors and reduce in-work poverty.

The country reports focus on three central aspects of a statutory minimum wage. First, its hourly compensation. Whereas in 2013 and 2014, the country reports feared job-losses in case the minimum wage was set too high, the reports are less concerned with potential job losses in subsequent years. Second, income developments as a consequence of the minimum wage. In 2015, the report argued that the minimum wage could have positive income effects on low-wage earners and potentially lead to reductions in income supplementation. While the reports highlight that low-wage earners indeed benefitted and received higher hourly wages, its effect on in-work poverty was limited as a result of negative interactions with taxation and social benefits. Third, long-term effects on industrial relations. The reports focus on potential support for collective bargaining and general wage increases, but highlight that the minimum wage only had limited effects on collective bargaining and wage developments in different sectors.

Germany's highly selective responsiveness to the criticism of slow wage adjustments can be accounted for by the institutional setting of German wage-setting in general and the minimum wage in particular. The German constitution guarantees social partners independence in wage bargaining. However, there are legal instruments, such as the statutory minimum wage, that set boundaries to collective bargaining or aim at higher bargaining coverage. While German trade unions have become more appreciative of such instruments than employers' associations, social partners generally reject governmental interference. The German minimum wage is set by a politically independent commission.<sup>4</sup> Every two years, social partners have to reach compromise, which lead to slower adjustments (Bruttel *et al.*, 2017). The minimum wage only had smaller effects on rate of pay in low-pay sectors with existing collective agreements, as their pay levels were already slightly above the minimum wage (Bispinck, 2017). However, it showed stronger effects on negotiation strategies, pay levels for sectors without collective agreements, and low-pay wage dynamics in collective agreements (Bundesministerium für Arbeit und Soziales, 2020).

The German Trade Union Confederation (DGB) and the Confederation of German Employers' Associations (BDA), both peak-level organizations, engage in consultations with the German government and the European Commission about the European Semester (Interviews 12 and 13). They voice their opinions regarding the recommendations on a regular basis, but remain critical of the consultation process (Kraemer, 2020, p. 13). The German employers are appreciative of the European Semester process in general but not necessarily its focus on wage increases (Interview 13). Most of the employers associations' engagement with the Semester relies on the BDA. By contrast, German trade unions are more appreciative of CSRs that focus on stronger wage growth in low-pay sectors and higher bargaining coverage. However, based on experiences during EMU's

<sup>4</sup>The minimum wage commission is composed of nine people: one president, three trade union representatives, three representatives of employers' organizations, and two non-voting scholars. A single majority wins the vote, but the president does only participate in voting after no compromise was possible.



sovereign debt crisis, they are more sceptical about European economic governance objectives in general (Interview 12). Furthermore, they rely on the DGB to engage with the European Semester (Kramer, 2020, p. 5). The European Semester meets strong obstacles in Germany. The micro-foundations of the German growth model – its institutional setting as well as the position of veto-players – make it less likely to produce immediate results and thus strengthen the German path of export-led growth, despite visible gradual changes.

### *The Netherlands*

Export-led growth has been a key component of the Netherlands' growth strategy. Starting in the 1980s, the Netherlands has created increasing trade surpluses over the last 40 years. Keeping wages low and making the labour market more flexible has in part also resulted in increased employment levels in the last two decades of the 20th century (Hemerijck and Visser, 2000). Relationships among the social partners are generally amicable and social pacts have been the usual path for cooperation between employers' associations and trade unions (Visser and van der Meer, 2011). Yet following the emergence of macroeconomic imbalances, the Dutch have been encouraged to increase real wages. Contrary to the German case, the EU country reports in the case of the Netherlands do not focus on the minimum wage as a means to increase wages, because the Netherlands has had an official minimum wage for 50 years (CBS, 2019). Instead, the focus is on relative wages. The Commission reports particularly focused on encouraging the Dutch government to find ways to address low wage traps (see also Visser, 2013; Son, 2020).

Various disincentives to work repeatedly found their way back into the recommendations: 'Due to this high burden and the relatively high benefits, low-wage traps, inactivity traps and unemployment traps, including for a second member of a couple, are higher than the EU average, pointing to the existence of financial disincentives to work.' (European Commission, 2015, p. 33). Furthermore, major differences persist between the average wages of those with a permanent contract compared to those on a temporary contract, with the Netherlands having a higher rate of workers on temporary contracts versus fixed positions compared to other member states. By 2015 the Dutch government embarked on a major reform aimed at reducing those differences. The CSRs also point to the earnings of the self-employed in relation to the minimum wage. Bennaars *et al.* (2016) as well as Houweling *et al.* (2016) found that the Government labour law reforms of 2015 had mixed results. In subsequent years the Dutch government embarked on some tax measures that had the effect of encouraging higher disposable real incomes of households.

A frequent insight offered by Dutch interviewees was that the issue of wages was not being addressed, in part because there was not a shared perspective on the idea that the Netherlands, being a surplus country, should be forced to increase wages (Interviews 1, 2 and 16). Domestic actors have accepted the recommendations that some of the self-employed are in overly precarious financial situations and that regulations ought to be put in place to protect them. When trade unions do call for higher wages, they typically do not make the connection to the CSRs or the European Semester but rather to matters about competitiveness within the Dutch context. The Social-Economic Council reinforced that view of the responsibility for a fair wage being for national authorities and in

particular national social partners (SER, 2019). More recently the understanding has emerged that not only wages, but also various subsidies and supplements, may contribute to inequality. In other words, there is an increasing awareness that wage traps are a concern.

Wage and labour-oriented recommendations have been difficult to achieve in full in the Netherlands. For example, the CSR in 2018 stated: 'Create conditions to promote higher real wage growth, respecting the role of the social partners' (European Commission, 2018, p. 16). Although the government acknowledged the importance of an increase of real wage growth, there was not much done, outside of a small increase in expenditure on teachers' salaries. CSR 2 in 2019 recommended reducing the incentives to use temporary contracts and to create conditions that would promote higher wage growth. Here again there was some progress. The assessment identified that negotiated wages increased by 2.1 per cent in 2018, with public sector wages growing at a faster rate.<sup>5</sup>

However, since 2020 there has been a bit of a change – unions have started to make wages a more salient issue and have started to make a clearer link to EU calls for higher wages (FNV, 2020). In spring 2021 trade unions and employers' organizations agreed to some reforms that would reduce flexible work, get rid of contracts at zero hours, and would restrict temporary employment to three years. The agreement also set a relatively high level of wages for self-employed without employees (at 35 euros) and called for higher minimum wage (SER, 2021; Trouw, 2021). However at no point was any reference made to the European Semester or CSRs.

What we find in this context is that Dutch domestic actors are less focused on the European Semester as such. They realize that the topics are of importance, but they are not given much specific individual attention, and have not been made very salient. Trade unions rarely utilize EU reports and recommendations when campaigning for higher wages. Therefore, the micro-foundations of the Dutch export-led growth model prevent a stronger utilization of CSRs to strengthen consumption-led growth components.

### *Italy*

Italy, as a consumption-led economy, has experienced slow economic growth for a long period as a result of reduced domestic demand and insufficient export-led growth to balance out its overall economic performance (Baccaro and Pontusson, 2016, p. 176). The share of contracts covered by some form of collective bargaining is among the highest in the EU despite union membership being on the low side; this is due to the practice of collective contracts applying to both unionized and non-unionized workers, and the enforcement of such contracts outside the sector where they are negotiated (Tomassetti, 2017). A series of intersectoral agreements introduced after 2012 made some minor adjustments to organized bargaining within Italy, but did not modify the basic feature of wage indexation to forecast inflation in accordance with the notion of using industry-wide agreements to preserve the purchasing power of pay (Leonardi and Pedersini, 2018, p.17). There has been some movement towards this decentralization over

<sup>5</sup>In 2018 wage agreements were reached in various government sectors (for example a nominal increase of 7 per cent in two years for all civil servants in central government). Additional funding has been made available for teachers' salaries. Fiscal measures included in the 2019 budget support disposable household income.

time, but the results within some sectors are mentioned as not being immediately apparent within subsequent Commission reports and CSR assessments. The entrenched nature of the sectoral level of bargaining in Italian industrial relations is a relatively rigid constraint against the potential introduction of firm-level wage variation (Devicienti *et al.*, 2019). The CSRs address issues with Italian economic growth in the fields of wage-related policies and collective bargaining.

The most specific areas of wage-related policies in the CSRs for Italy concern wage levels and collective bargaining. With regard to wage levels, the earlier years of Commission reports (2012–15) emphasize the need to reduce unit labour costs in order to keep wages more congruent with productivity growth, particularly when growth is low. The summary assessments of earlier CSRs highlight a very gradual reduction, or at least stagnation, in wages vis-à-vis growth over this period, as well as the temporary freezing of public sector wages. Later Commission reports and CSR assessments do not emphasize this as much; by 2019–20, Commission reports instead note that while wage levels are no longer exacerbating the deficit, there is instead a different concern of ‘in-work poverty’, particularly in the Mezzogiorno region, due to low wages.

With regard to collective bargaining as it pertains to wage dynamics, the CSRs for Italy repeatedly provide the prescription to move wage negotiations from entrenched sectoral levels and multi-employer collective bargaining institutions to company- and firm-levels. For the public sector, the recommendation is to decentralize from the national level towards different categories of employment. The interaction between wage levels and collective bargaining is central for CSR prescriptions speaking to the need to link wages to growth. Wages appear to be a central focus of EU reports and recommendations for the Italian case of high debt and deficit levels, presumably because they offer a quicker corrective factor to the ongoing situation of low productivity. However, domestic perceptions in Italy of such recommendations vary enormously between actors; while all interviewees were well-aware of the language of the CSR prescriptions, the specific opinions of what utility the CSRs offered diverged between unions, employers’ associations, and national governmental officials, highlighting the complexity of the micro-foundations of macro-economic growth models.

Representatives from Italy’s largest trade union confederations stated that despite the frequent consultations between Brussels and the Italian social partners, the recommendation to centralize collective bargaining was unhelpful and irrelevant given that the relative size of Italian enterprises was less than 15 employees. They also offered that most Italian firms are very small and cannot offer second-level bargaining, and would actually benefit more from national level bargaining. However, the perceptions offered were that the European Semester was a strong tool that offered more potential contact points between the Italian social partners and the EU-level (Interview 10).

By contrast, interviewees from the Italian employers’ federation stated that while the CSRs frequently offered prescriptions that were sound and favourable but ultimately unrealistic due to political obstacles, the utility of the recommendations was in building public consensus about proposals that might have otherwise been seen to stem from employers’ interests alone. The prevalence of small firms in Italy have made employers less amenable to full-scale decentralization of collective bargaining than perhaps some of their counterparts in northern European economies, as the centralization of bargaining is perceived as limiting wage competition among firms (Interview 8). An Italian

government representative offered a different vantage point, stating that the content of CSR prescriptions was less of a salient factor for levels of response than whether the orientation of the government of the day was pro-European or not. The perspective here was that government stability is a key obstacle to structural reform in Italy, as reform priorities change with each new governmental formation (Interview 9); as well, that some social partners more than others were prepared to enter into discussions with the Ministry of Finance on the basis of actual reform.

The micro-foundations of the Italian growth model – the critical role of small firms and related interests – help to make the issues of wages and decentralized collective bargaining less polarized among labour–employer lines. Similarly, it appears that the interviewees' stated perceptions of the EU's CSRs were less divided in terms of acknowledging the *utility* of the European level, even if the recommendations were perceived differently. The Semester played a visible role both in clarifying the dynamics of wage-setting processes in Italian collective bargaining institutions and in sharpening the focus on decentralization as a means to tailor wages to productivity.

### *Portugal*

Portugal's growth model was strongly characterized by consumption-led growth, particularly prior to joining EMU. Since the introduction of the euro, wage developments in Portugal have gone through three stages. Following a period of steady wage growth until 2008, average wages saw a long period of nominal reductions until 2014, when wages gradually started to recover again (see Figure 1). Due to the Economic Adjustment Program (EAP) 2011–14, European influence on these developments is sizable and heavily politicized – particularly regarding Portugal's national minimum wage. While previous demands to freeze the minimum wage under the Stability and Growth Pact (SGP) had been repeatedly refused by the Portuguese government, such a freeze emerged as a *conditio sine qua non* for the disbursement of financial aid during negotiations with the Troika (Moury and Freire, 2013, p. 45). The national minimum wage was consequently frozen in 2011, while Portuguese negotiators successfully took the option of reducing it off the table (Moury *et al.*, 2020, p. 147). Portuguese demands to increase the minimum wage were however rejected for the duration of the EAP, implying that the freeze only ended after 'the Troika left town'.

The salience of the national minimum wage only increased during this period. While one in ten dependent workers received the minimum wage in 2010, this share doubled to nearly one in five by 2014 when Portugal exited the EAP and began receiving recommendations under the Semester. By 2016, 36 per cent of all new contracts were set at the minimum wage (Afonso, 2019). The national minimum wage also constitutes a key lever for the government to directly influence wage developments across the income distribution because it serves as a reference point for wage negotiations between unions and employers. Wage-related recommendations under the Semester reflect this key role of the national minimum wage, continuously warning of 'excessive' increases. According to the Commission's country reports, such recommendations were mainly driven by concerns about competitiveness and job creation. Hence, CSRs demanded minimum wage developments to be aligned with productivity (2014 and 2015), to promote employment and competitiveness (2014 to 2016) or, finally, to safeguard employment at the lower

end of the skill spectrum (2017). Hence, we observe a gradual weakening of the Commission's language on this issue over time, until the annual minimum wage recommendations were dropped entirely in 2018 (see Perista and Perista, 2019).

Two developments are key to understand this development: a political shift to the left and a relatively strong economic recovery offering benign conditions for labour policies. First, the General Elections of 2015 brought an end to the conservative PSD-CDS alliance, which lost disproportionately among low-income voters and the unemployed (Fernandes *et al.*, 2018). This paved the way for the Socialist Party (PS), which had campaigned on the promise to 'turn the page on austerity'. Bolstered by the support of two radical left parties, the PS attempted to use its time in office to win back traditional constituencies through the (partial) reversal of the previous labour market reforms (Afonso and Bulfone, 2019; Bulfone and Tassinari, 2020). Unsurprisingly, this coalition met the suspicion of Northern governments and EU officials, whose fears about a complete reversal of the economic adjustments of 2011–14 informed the direction of Semester CSRs from 2014 onwards. Yet, Portugal's solid recovery made it increasingly difficult for EU officials to make the case for restrictive policies.

Both developments strengthened the position of Portuguese unions in their fight for higher wages. Importantly, their main adversary in this fight was neither the government nor employer associations, but EU officials. Social partners agreed on a steady increase of the minimum wage, reflecting employers concerns about low levels of domestic consumption (Interview 6) – and showing that social partners could reach an agreement 'even if this agreement was not in line with [EU] recommendations' (Perista and Perista, 2019, p. 22). Consequently, Portuguese unions engaged with Commission officials directly in the Semester process – and the national minimum wage remained the key topic in these discussions (Interview 6). Their arguments only gained currency, however, once it became increasingly clear that the downside risks of higher wages never materialized. The gradual shift in tone by the Semester documents thus does not reflect that EU officials were persuaded by the tripartite consensus in Portugal but rather by economic data following the wage increases enacted by the Costa government – against EU recommendations.

This, eventually, shifted the balance of power in favor of the Portuguese government *and* trade unions vis-à-vis the European Commission (Moury *et al.*, 2020, p. 106). The 2019 re-election of the Costa government was based on broad support for 'sound' budgetary policies combined with popular pledges, including the promise to further increase the minimum wage by 25 per cent to €750 over four years (Wise, 2019). It is against the backdrop of this general political shift to the left and benign macroeconomic conditions that the domestic politics of structural reform have played out after 2014.

EU influence on Portuguese wage policies is also heavily politicized due to the long shadow of the EAP. While this makes Portugal a special case, high levels of contestation of what is perceived as inappropriate European interference in national competences characterize other post-programme countries as well. Here, labour organizations successfully utilized public discontent to mobilize against EU recommendations for wage restraint. The recommendations on the minimum wage specifically were met with broad opposition from the government, employers, and unions alike, which all supported higher minimum wages for different reasons: to support domestic consumption, to increase productivity (Interview 19), or to combat rising poverty rates (Interview 3). In short, EU

recommendations were perceived as undue attempts to continue 'bossing the country around' (Perista and Perista, 2019, p. 22). Facing such broad opposition, the Commission eventually admitted defeat. It 'ran into a wall and out of arguments' (Interviews 4 and 5) and consequently dropped its warnings against higher minimum wages from the annual list of recommendations.

## Conclusion

This paper analyses how EU recommendations on wage policies are addressed in Northern and Southern member states, which have different growth models. While the recommendations differ markedly, our case studies – with attention to CSRs, wage-setting institutions, and social partners in Italy, Portugal, Germany, and the Netherlands – yield a consistent picture of domestic institutional resilience to EU recommendations. While the varied content of CSRs logically follows from the Semester's stated objective of reducing macroeconomic imbalances across heterogeneous political economies, it is less straightforward to decipher the domestic constraints that EU recommendations face.

We find that country-specific recommendations meet country-specific obstacles. As domestic actors have invested in domestic institutions, this element of path dependence poses an obstacle to effective EU macroeconomic policy coordination based on soft governance. More specifically, we observe a pattern of asymmetric mobilization: while domestic actors have a tendency to mobilize *against* EU recommendations that are perceived to go against the interests of their constituencies, they are less effective in mobilizing resources to *support* recommendations which one would assume would align with their interests.

The case studies point to the importance of longstanding political traditions and practices in each member state, which constitute the micro-foundations of the relative growth models. The institutional setting of German wage-setting systems, the detachment of Dutch domestic actors from European Semester recommendations, the established sectoral wage-bargaining mechanisms in Italy, and the partisan shifts in Portugal over time, all support the general contention that EU influence is perhaps identifiable only when it corroborates existing domestic preferences. Our findings indicate that the path-dependence of domestic institutions is critical. These domestic idiosyncrasies underscore the limitations of using quantitative indicators to examine the effectiveness of the European Semester process. Yet we have also observed that in the medium-run, national preferences and the recommendations that countries receive shift somewhat over time, albeit to varying degrees. In cases with high levels of contestation of EU influence (Italy and Portugal), for instance, recommendations have gradually shifted closer towards domestic actors' stance. Hence, we submit that high salience of EU influence poses an obstacle for reform in the South, while low salience limits EU influence in the North.

The study further emphasizes the value of examining micro-foundations of models of capitalism in order to get a better grasp of policy change in member states. This also implies that path-breaking changes require much more than predominantly soft forms of governance, especially when addressing complex forms of governance with long traditions such as national wage-setting systems. Overcoming hard domestic obstacles for

reforms focused on both wage restraint in the South and wage increases in the North are thus likely to require more potent coordination tools, including sticks and carrots.

The insights of this study may rekindle the debate on Europeanization, which has subsided somewhat in recent years. Radaelli and Exadaktylos suggest that it is ‘absolutely conventional and obvious’ to expect that domestic actors and settings would influence implementation of EU suggestions for policy change (2010, p. 209). They emphasize that unions and parliament would ordinarily block changes in policies, but also that it is difficult to find causal mechanisms that would work in most cases when we see change occurring (2010, pp. 191–2). The present study suggests that we may want to reconnect with these debates, in order to examine what kinds of micro-foundations might be likely to effect more or less visible changes, and whether any carrots and sticks will help encourage policy change.

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## Interviews

- Interview 1. European Commission Official, The Hague (14 May 2018).
- Interview 2. European Commission Official, The Hague (14 May 2018).
- Interview 3. Government Official, Lisbon, Portugal (17 May 2019).
- Interview 4. Commission Official, Lisbon, Portugal (20 May 2019).
- Interview 5. Government Officials, Lisbon, Portugal (21 May 2019).
- Interview 6. Trade Union Representatives, Lisbon, Portugal (22 May 2019).
- Interview 7. Trade Union Representative, Rome (12 November 2019).
- Interview 8. Employers' Association Representative, Rome (12 November 2019).
- Interview 9. Ministry of Economy and Finance Official, Rome (15 November 2019).
- Interview 10. Trade Union Representative, Rome (18 November 2019).
- Interview 11. Policy Think Tank Representative, The Netherlands, via Zoom (9 June 2020).
- Interview 12. Trade Union Representative, Berlin (4 December 2020).
- Interview 13. Employers' Association Representative, Berlin (4 December 2020).
- Interview 14. Parliamentary staff, The Netherlands, via Zoom (9 December 2020).
- Interview 15. Legal Expert, The Netherlands, via Zoom (15 December 2020).
- Interview 16. Former Senior Government Official, The Netherlands, via Zoom (26 January 2021).

*These interviews are part of a larger research project in which a larger corpus of interviews have been conducted. To secure the anonymity of the review process, no further information will be given at this stage.*