

# **Federalism and Labour Market Policy in Germany and Canada: Exploring the Path Dependency of Reforms in the 1990s<sup>1</sup>**

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## **1 INTRODUCTION**

The 1990s were a decade of considerable political and economic adjustment in both Germany and Canada. In a milieu of increasing competitive economic pressures and severe constraints on public-sector spending, both federations faced periods of high national unemployment combined with strong regional labour market disparities. In both countries labour market policies were seen as inadequate and various reforms were undertaken to ameliorate the efficiency and equity shortcomings of labour market policies.<sup>4</sup> Yet despite similar challenges, as we analyze in this paper, the path and extent of reforms have been noticeably different in the two federations.

In Canada, national and provincial experiments with corporatist measures along the lines of the traditional German model of social partnership were quickly abandoned, followed by drastic and extraordinary decentralization of active labour market policy. In Germany, by contrast, decentralization efforts remained minor and faltering, while corporatist arrangements were rejuvenated by both the national and *Länder* (state) governments. Furthermore, while the Canadian reforms entailed substantial changes to the federal distribution of responsibilities and to the institutional framework of active labour market policy, the organizational and legal basis of

German labour market policy has remained largely intact.

In this paper we begin by analyzing developments in German and Canadian labour market policy over the last ten years (1991-2000). We then examine why the two federations have chosen different reform paths and discuss some of the theoretical implications of our findings. In our conclusion we examine how well the reforms have prepared Germany and Canada for the next recession.

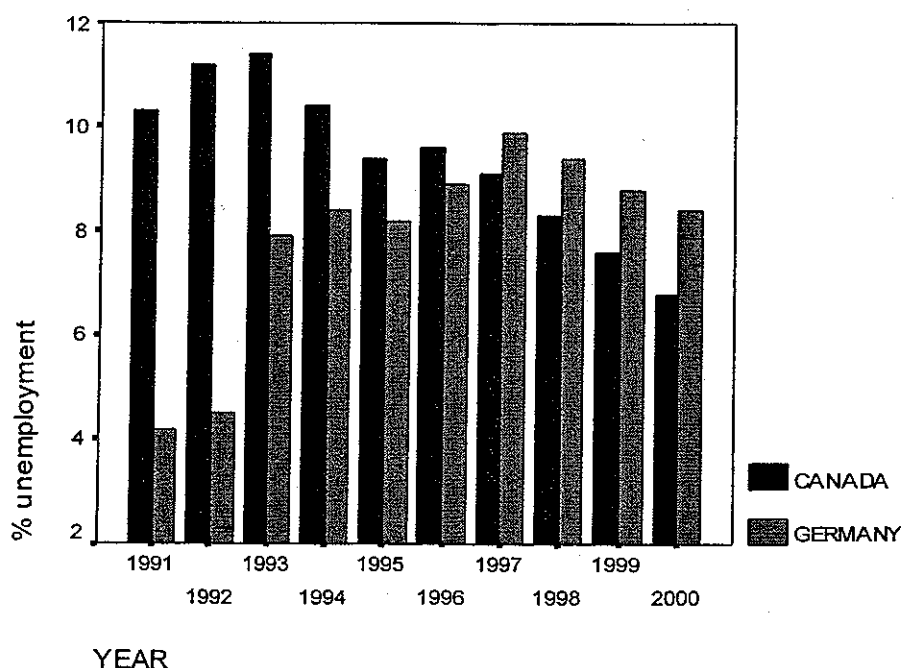
## **2 DEVELOPMENTS IN LABOUR MARKET POLICY**

### **Germany**

In Germany the context of labour market policy during the last two terms of the Kohl coalition government (Christian-Democratic/Christian-Social Union and Liberals, re-elected in 1990 and 1994) and the first two years of the Schröder administration (Social-Democratic Party and Greens, elected in September 1998) was defined by two developments. The first, and most consequential of these, was the reunification of the Federal Republic of Germany and the German Democratic Republic (GDR) in October 1990. The second was the movement towards closer European integration in the wake of the 1992 Maastricht Treaty. Both of these developments exacerbated the processes of economic and labour market restructuring that brought about West Germany's transition from virtual full employment until the 1970s to mass unemployment.<sup>5</sup>

In fact, as shown in Chart 1, national unemployment rates kept growing after 1991 and peaked at almost ten percent in 1997. As illustrated in Table 1, after the short-lived post-reunification boom, unemployment was high and continued to rise even in most West German *Länder*, but was largely concentrated in the East German *Länder*, which were shifting from an outdated, labour-intensive socialist to a capitalist economy. A modest economic upturn

Chart 1 – National Unemployment Rates for Canada and Germany, 1991-2000



Source: OECD standardized unemployment rates.  
Note: Prior to 1993 data refers to Western Germany.

Table 1 – Unemployment Rates (%) by *Länder*, 1991-2000

<i>Länder</i>	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	AVERAGE
Schleswig-Holstein	7.3	7.2	8.3	9.0	9.1	10.0	11.2	11.2	10.6	9.5	9.34
Hamburg	8.7	7.9	8.6	9.8	10.7	11.7	13.0	12.7	11.7	10.0	10.48
Mecklenburg-Vorpommern*	12.5	16.8	17.5	17.0	16.1	18.0	20.3	20.5	19.4	19.0	17.71
Niedersachsen	8.1	8.1	9.7	10.7	10.9	12.1	12.9	12.3	11.5	10.3	10.66
Bremen	10.7	10.7	12.4	13.7	14.0	15.6	16.8	16.6	15.8	14.2	14.05
Nordrhein-Westfalen	7.9	8.0	9.6	10.7	10.6	11.4	12.2	11.7	11.2	10.1	10.34
Hessen	5.1	5.5	7.0	8.2	8.4	9.3	10.4	10.0	9.4	8.1	8.14
Rheinland-Pfalz	5.4	5.7	7.5	8.4	8.5	9.4	10.3	9.7	9.1	8.1	8.21
Saarland	8.6	9.0	11.2	12.1	11.7	12.4	13.6	12.6	11.9	10.8	11.39
Baden-Württemberg	3.7	4.4	6.3	7.5	7.4	8.0	8.7	8.0	7.3	6.0	6.73
Bayern	4.4	4.9	6.4	7.1	7.0	7.9	8.7	8.1	7.4	6.3	6.82
Berlin	10.6	12.4	12.8	13.2	13.6	15.2	17.3	17.9	17.7	17.6	14.83
Brandenburg*	10.3	14.8	15.3	15.3	14.2	16.2	18.9	18.8	18.7	18.4	16.09
Sachsen-Anhalt*	10.3	15.3	17.2	17.6	16.5	18.8	21.7	21.7	21.7	21.4	18.22
Thüringen*	10.2	15.4	16.3	16.5	15.0	16.7	19.1	18.3	16.5	16.5	16.05
Sachsen*	9.1	13.6	14.9	15.7	14.4	15.9	18.4	18.8	18.6	18.5	15.79
STANDARD DEVIATION	2.55	4.18	3.95	3.60	3.13	3.60	4.30	4.56	4.63	5.06	

Source: Bundesanstalt für Arbeit, 2001: *Arbeitsmarkt in Zahlen. Aktuelle Daten - Jahreszahlen 2000 und Zeitreihen*, at: [www.arbeitsamt.de/hst/services/statistik/200012/iiia4/multi/multijz-heftd.pdf](http://www.arbeitsamt.de/hst/services/statistik/200012/iiia4/multi/multijz-heftd.pdf).

\* = Eastern *Länder*.

at the close of the decade has reduced unemployment from 4.8 million workers in early 1998 to about 3.7 by the end of 2000. Nevertheless the unemployment gap between the two parts of the country that emerged soon after reunification has not yet closed, and regional disparities are substantial. The average unemployment rate in the Eastern *Länder* for the decade was 16.6% compared to only 9.5% in the Western *Länder* (excluding Berlin). Also noteworthy is the fact that the standard deviation of unemployment has increased dramatically over the course of the decade. During its first half (1991-1995) the average standard deviation was 3.5, but 4.4 for the second half (1996-2000), reaching its highest level in 2000. At the end of 2000, the average unemployment rate for the Eastern *Länder* was more than twice that of the Western *Länder*.

The Kohl government had made an early political commitment to the quick economic recovery of the former GDR and to the fast expansion of the West German welfare-state regime into the new *Länder*.<sup>6</sup> Yet the revenue shortfall caused by mass unemployment threatened the very foundations of the country's largely social-insurance based income-maintenance system.<sup>7</sup> The sheer magnitude of the labour market problems facing the new *Länder* dictated swift and decisive action. However, the fiscal and monetary stability criteria imposed by the Maastricht Treaty created a countervailing pressure in favour of continuing the neo-conservatively inspired austerity measures that had dominated the government agenda after 1982.<sup>8</sup> As demonstrated in Table 2 and despite reunification, deficits in Germany never reached levels comparable to those in Canada (however, the bulk of reunification costs were covered by German Unity Fund until 1994). As with unemployment rates, the deficit peaked several years after its Canadian counterpart in Germany. Thus it was in 1996 that the country had its largest deficit and even by the end of the decade

it had not yet reached a surplus. Against this backdrop, the bulk of labour market policy reforms implemented until 1998 can be qualified as "emergency" and "containment" measures that reacted to the dramatic situation in East Germany and tinkered with funding problems, but did not substantially alter the organizational and legal basis of the policy field.<sup>9</sup>

In Germany the provision of income support for unemployed workers is a federal responsibility. The UI scheme and a few smaller income-maintenance programs are operated by the Federal Labour Office (FLO), while the less generous and means-tested unemployment assistance is tax-financed by the national government, yet run by the FLO. Most active measures of labour market policy are also financed through UI contributions paid by workers and employers, and administered by the FLO. As a public-law corporation with a strong corporatist element, the FLO enjoys considerable operational autonomy, but is under the supervision of the Federal Ministry of Labour and Social Order. Employers' associations, unions and *Länder* governments are represented in the Central Office that coordinates the unitary provision of services throughout the country, and in its ten regional and 181 local subsidiaries. This merely administrative form of decentralization does not exactly coincide with state boundaries and does not permit substantial regional policy variations (most notably, there are no regional variations in UI eligibility requirements, benefit levels or duration). The *Länder* and municipalities have no legislative or administrative responsibilities with regard to the UI scheme and play only a marginal role in active labour market policy.<sup>10</sup>

The widening gap between shrinking UI contributions and growing demand for services has represented the most immediate and obvious challenge for this institutional framework since 1990. The FLO, which is responsible for

**Table 2 – Surplus (+) or deficit (-) as percentage of nominal GDP 1991-1999**

<b>Year</b>	<b>Canada</b>	<b>Germany</b>
1991	-7.2	-2.9
1992	-8.0	-2.5
1993	-7.6	-3.2
1994	-5.6	-2.5
1995	-4.3	-3.2
1996	-1.8	-3.4
1997	+0.8	-2.6
1998	+0.9	-1.7
1999	+2.8	-1.1

Source: *OECD Economic Outlook* (June 2000, Annex table 30).

approximately 75 to 90 percent of national labour market policy spending, ran deficits and received federal grants throughout the decade. This is in contrast to Canada, where for the second half of the decade the UI account operated with a surplus. The government, in 1991, reacted to these developments by adjusting contribution rates from 4.0% throughout the 1980s to the current 6.5 %. Furthermore, in 1994, it lowered the benefits for the two main income-support programs – UI and unemployment assistance payments – from 68 and 58 percent of the last net income to 60 and 53 percent (67 and 57 percent for persons with children), and tightened eligibility criteria, as well as criteria as to what constitutes "suitable job offers." Together with the economic upturn of the late 1990s, these "containment" measures helped to stabilize and even reverse the quick rise of unemployment compensation related labour market policy expenditures (as percentages of the GDP) that had occurred in the first three years after reunification.<sup>11</sup>

Nevertheless, combined with the growing incidence of long-term unemployment, these measures resulted in more workers relying on social assistance rather than UI or unemployment assistance payments. Social assistance is administered and funded by the municipalities, but regulated by federal legislation. As was the case in Canada as well (with respect to the provincial social assistance programs), spending on unemployment assistance and social assistance increased dramatically, at a rate far exceeding that of UI. Hence the "containment" strategy weakened social-insurance entitlements and strengthened the welfare elements of German income-support programs. It also shifted costs from the UI scheme into other (notably, health and pension) funds.

Like its predecessors since the 1970s, the Kohl government implemented efforts to reduce the labour supply in its "containment" strategy.

These initiatives included: repatriation incentives for foreign workers and a tight anti-immigration policy, qualification programs that keep young people at school for extended periods, uncorrected biases against female employment in the German tax code, and the promotion of early or phased-in transitions to retirement. A final component of the government's labour market policy, efforts to enhance the flexibility of the German labour market, was more in line with its self-proclaimed neo-conservative orientation, but did not go very far. Legislation in the 1980s and 1990s brought only modest deregulation with regard to fixed-term contracts and casual jobs, dismissals and sick leaves, working times and shop-closing hours, while the core principles of German industrial relations and wage bargaining were hardly touched.

In order to achieve full employment and various structural objectives, a broad range of active measures had been established in Germany until the late 1960s, including: (1) job counseling and workforce integration, (2) employment maintenance and job creation, and (3) vocational training and qualification. Most of these instruments were initially granted as legal rights. In the first three years after reunification, these programs were fully used and expanded and new ones were added, in order to cope with the high levels of unemployment and underemployment in the Eastern *Länder*. However, the 1990s confirmed that the joint and largely contribution-based funding of passive and active measures in Germany tends to crowd out the latter in a cyclical fashion. Thus expenditures for active measures (as a percentage of GDP) were highest before 1993, when the first special programs for the new *Länder* were phased out, but sank below the 1991 level in the second half of the decade. In the final years of the Kohl government, a couple of new and improved services were, nevertheless, implemented, but the "containment" strategy ultimately prevailed.

In fact, while active measures had returned to being granted as discretionary privileges years ago, the *Employment Promotion Reform Act* of 1997 no longer mentioned full employment as goal of German active labour market policy.

Quite astonishingly, however, the Kohl government sought in early 1996 to renew, with employers' associations and unions, the corporatist arrangements of the 1970s as part of its fight against mass unemployment. The government encouraged cooperation with and between the social partners and defined an enabling role for the state in the so-called Employment Alliance, linked with the ambitious goal of halving unemployment by 2000. Several *Länder* administrations of different political stripes followed path and established state-wide roundtables and social pacts. Yet the national Employment Alliance did not survive growing tensions between its participants. The government soon also sought to achieve cost savings as part of its initiatives and began a much more confrontational course against the opposition, which controlled the *Bundesrat* (upper chamber of parliament), between 1991 and 1999. In addition to partisan considerations, a majority of the *Länder* feared that the measures advocated by the government would download costs onto them. Moreover, employers' associations clashed with unions as more and more corporations, notably in East Germany, started to renege on the traditional sector-wide collective agreements.<sup>12</sup>

Labour market policy was the focal issue of the September 1998 federal election campaign. Widespread concern about high unemployment and chancellor Kohl's perceived incapacity to curb it played a major role in the ultimately expected, yet surprisingly harsh defeat of his government. Conversely, chancellor Schröder's new administration has unequivocally linked its electoral fate to a single performance indicator: job creation. The coalition agreement pledged to achieve both fiscal consolidation and lower

unemployment rates within the framework of a "social and ecological market economy." In line with its campaign promises, the new government rescinded the liberalized dismissal and tightened sick-leave regulations imposed by its predecessor, re-instated bad-weather payments for workers in the construction industry, and enacted social-insurance contributions for casual jobs and certain forms of self-employment.

Yet the core of the new government's labour market strategy is a revival of the Employment Alliance.<sup>13</sup> Several major initiatives have emerged from this arena since 1998. Among these is a highly successful youth-employment and qualification program that involves the *Länder*, municipalities and social partners, as well as measures that aim to capitalize on the employment potential of the information and telecommunications sector by expanding and improving vocational training geared towards the sector. The (arguably misnamed) "green-card" program, implemented in 2000, is supposed to address the current labour shortage in these growth industries, by offering non-renewable five-year visas to a maximum of 20,000 highly qualified (and paid) specialists. Despite its limitations, the program nevertheless seems to indicate a cautious opening of the debate on immigration policy, and an equally cautious shift from an accent on efforts to reduce the labour supply to measures that increase labour demand.

## **Canada**

In Canada the 1990s began with full-scale constitutional debate initiated by the Conservative Mulroney government culminating in the collapse, in 1990, of the Meech Lake Accord, and the defeat of the Charlottetown Accord in 1992. These events would later in the decade lead to a sovereignty referendum in the province of Quebec, which served as a catalyst for the decentralization of active labour market

policy. With regard to the economy, the decade began with the implementation of the Canada-U.S. Free Trade Agreement, which involved major economic restructuring in the nation's industrial heartland – Quebec and Ontario – followed by the 1993 North American Free Trade Agreement that included Mexico.

The recession of the early 1990s caused national unemployment levels, as illustrated in Chart 1, to exceed 11% in both 1992 and 1993, while provincial social assistance caseloads grew rapidly. For instance in Ontario, the number of individuals classified as “employable” who were on social assistance increased nearly five-fold between 1991 and 1994.<sup>14</sup> Throughout the 1990s another attribute of the Canadian economy were dramatically different unemployment rates in various regions, as illustrated in Table 3. The average unemployment rate of Newfoundland over the decade was 2.7 times that of Saskatchewan, while the standard variation of unemployment between provinces at the start of the decade was lower than at the conclusion of the 1990s. Quebec's unemployment rate was, on average, three percentage points higher than that of Ontario, which contributed to the view of many in Quebec that federal policies ill-served the province.

The early 1990s also marked a period of record and escalating government deficits as shown in Table 2. In 1992, the deficit (as a percentage of nominal GDP) reached 8%, which was nearly twice the 1990 level, and then declined as government expenditures decreased and the economy expanded after 1993. By 1997 a surplus was attained in the general government financial balance, which swelled as the decade came to a close.

The unemployment insurance program was incrementally altered in 1990, 1993 and 1994 to counter concerns that the program was subverting incentives to work and, more

importantly, to reduce costs. In each case, eligibility requirements were tightened, the duration of benefits was reduced, and benefits were lowered. For instance, in 1990 the benefit entitlement was reduced by up to 15 weeks for some workers, while in 1993 the benefit rate was lowered from 60% to 57%. In 1994 the benefit rate was reduced further to 55% and the average period of entitlement to benefits was shortened.

In spite of these changes, the insurance program continued to be viewed by many internal observers<sup>15</sup> as well as external ones<sup>16</sup> as too generous, thereby causing the work ethic to erode. In particular, seasonal workers, especially those in the fishing industry, were seen as unduly reliant on the benefits. Consequently, pressures continued to be placed on the Liberal Chretien government, newly elected in 1993, to further reform the insurance program.

Absent from the policy agenda during the 1990s were attempts to regulate the labour supply. In fact, the federal Program for Older Worker Adjustment, which provided a bridge between permanent labour market displacement and retirement was eliminated in 1996 as a cost cutting measure. Furthermore, immigration rates were extraordinarily high during the early 1990s even as unemployment levels exceeded 11%.<sup>17</sup> Table 4 illustrates the number of immigrants from 1980 to 1999. Between 1990 and 1994, an average of 237,000 immigrants was accepted into Canada each year, while during 1985 and 1989, the annual average had been only 138,000.

At the beginning of the decade, active labour market policy in Canada was being criticized as inadequate in helping unemployed workers to re-enter the labour force.<sup>18</sup> Given that funding for new programs was not available, decision-makers sought to emulate the German corporatist model with regard to training the unemployed. The federal government and most

**Table 3 – Unemployment Rates (%) by Province, 1991-2000**

<b>Province</b>	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	<b>AVERAGE</b>
Newfoundland	18.0	20.2	20.4	20.2	18.1	19.3	18.6	18.0	16.9	16.7	<b>18.64</b>
Prince Edward Island	16.7	18.1	17.6	17.2	15.0	14.7	15.4	13.8	14.4	12.0	<b>15.49</b>
Nova Scotia	12.1	13.2	14.3	13.5	12.1	12.3	12.1	10.5	9.6	9.1	<b>11.88</b>
New Brunswick	12.2	13.0	12.5	12.4	11.2	11.6	12.7	12.2	10.2	10.0	<b>11.80</b>
Quebec	12.1	12.7	13.3	12.3	11.4	11.9	11.4	10.3	9.3	8.4	<b>11.31</b>
Ontario	9.5	10.7	10.9	9.6	8.7	9.0	8.4	7.2	6.3	5.7	<b>8.60</b>
Manitoba	8.6	9.2	9.3	8.6	7.2	7.2	6.5	5.5	5.6	4.9	<b>7.26</b>
Saskatchewan	7.4	7.9	8.2	6.8	6.6	6.6	5.9	5.7	6.1	5.2	<b>6.64</b>
Alberta	8.1	9.4	9.6	8.7	7.8	6.9	5.8	5.6	5.7	5.0	<b>7.26</b>
British Columbia	10.1	10.2	9.7	9.0	8.4	8.7	8.4	8.8	8.3	7.2	<b>8.88</b>
<b>STANDARD DEVIATION</b>	<b>3.55</b>	<b>3.97</b>	<b>3.94</b>	<b>4.23</b>	<b>3.69</b>	<b>4.01</b>	<b>4.29</b>	<b>4.09</b>	<b>3.82</b>	<b>3.77</b>	

Source: Statistics Canada, 2000: Historical Labour Force Statistics 1999, Catalogue 71-201, and (for 2000) Statistics Canada web site.

**Table 4 – Immigration to Canada 1980-2000**

<b>Year</b>	<b>Number of Immigrants</b>
1980	143,135
1981	128,639
1982	121,176
1983	89,188
1984	88,271
1985	84,334
1986	99,325
1987	151,999
1988	161,494
1989	191,493
1990	216,396
1991	232,744
1992	254,817
1993	256,741
1994	224,364
1995	212,859
1996	226,039
1997	216,014
1998	174,159
1999	189,816
2000	226,837



provinces established business-labour training and adjustment boards beginning in 1990 charged with providing advice to decision-makers on labour training and adjustment programs.<sup>19</sup> In Ontario and Quebec these boards were also granted significant powers to design and operate training programs.<sup>20</sup> The reasons these initiatives were undertaken are several-fold. The corporatist bodies were to energize and revitalize active measures by bringing the expertise and objectives of private groups to bear on decision-making and program delivery. The Mulroney government viewed corporatism as a means to begin to privatize labour market policy, or at least to make it more reactive to the concerns of business interests.

Yet, by the mid-1990s it had become apparent that the boards were unable to forge corporatist consensus. The historical animosity of business and labour, along with an unwillingness of state decision-makers to relinquish power and the lack of experience in corporatist bargaining, meant that most boards were unable to influence policies. In any case, given that no new funds were available for training and adjustment programs, the corporatist partners were unable to reach consensus on how to reallocate existing funds. Interestingly, the Quebec corporatist board has been the most resilient supported by the Québécoise culture that fosters a higher degree of business-labour-government cooperation than is found in English-speaking Canada.<sup>21</sup>

Discontented with both passive and active labour market policies, and in the midst of an expenditure reduction battle, the Chretien government sought to reform both active and passive programs in 1995.<sup>22</sup> The fact that the Liberals enjoyed a substantial Parliamentary majority and a divided opposition, and remained popular allowed the government significant room to maneuver. The philosophy behind the changes to passive programs was to reduce the reliance of workers on employment insurance,

thereby achieving further reductions in expenditures. As such, particularly severe adjustments were made to eligibility criteria affecting frequent users of the insurance program, who tend to be concentrated in seasonal occupations such as fishing in the Atlantic provinces. Specifically, 26 weeks of work (910 hours) was required for eligibility rather than the previous 20 weeks, the number of weeks of entitlement was reduced from 50 to 45, and payment levels were decreased.

The various reforms to the insurance program proved very effective, at least in reducing costs. It has been calculated that in constant dollars, \$9,350 of benefits was spent per unemployed worker in 1990 but only \$5,907 in 1997.<sup>23</sup> Furthermore the contributions by employers and employees to the insurance fund in the second half of the decade far exceeded its expenditures, allowing the government to allocate the surplus for other activities.

At the same time, the objective of active labour market measures was shifted, and simplified, via an accountability-for-results framework enshrined in legislation.<sup>24</sup> The success of active measures was to be determined solely by two inter-related measures: (1) the number of EI clients re-employed; and the savings generated to the EI account calculated as the difference between the maximum entitlement of a worker and the actual payout of such benefits. This meant that active programs were solely mandated to move clients into employment as quickly as possible, rather than to make clients as employable as possible in the long term. For example, the accountability framework does not differentiate between an unemployed worker on EI who obtains employment at a higher wage than her former employment, from an individual who obtains work at only half of her previous wage.

As the legislation for the revised active and passive measures was receiving parliamentary

review and ultimate approval, the province of Quebec, governed by the separatist Parti Quebecois, was holding its referendum on sovereignty in late 1995, in which 49.4% of voters favoured sovereignty. As a direct result of the Quebec referendum the federal government offered, in 1996, to transfer responsibility for active labour market policy to provinces, including both funding and federal staff.<sup>25</sup> Table 5 illustrates the asymmetry and the extent of decentralization in terms of both federal dollars and staff transferred to the provinces. The asymmetrical decentralization of active measures, although not accomplished through administrative rather than *de jure* agreements, represent a fundamental shift in Canadian labour market policy.<sup>26</sup>

### **3 EXPLAINING SIMILARITIES AND DIFFERENCES**

In this section of the paper we summarize our findings and analyze the reasons for the similarities and differences in German and Canadian labour market policy reforms during the 1990s. As described above, the central governments of both federations were reacting to the same two major problem areas with regard to labour market policy: (1) rising costs due to periods of high national unemployment rates, aggravated by high government deficits, and (2) considerable regional disparities in unemployment levels.

In both countries, the funding of all, or most, income-support programs for unemployed persons through a UI scheme based on worker and employer contributions led to cyclical revenue and expenditure patterns. For instance in Canada the cumulative UI account balance showed a surplus of \$2.2 billion in 1990 but a deficit of \$5.9 billion in 1993, returning to a surplus in excess of \$20 billion by the end of 2000. In other words, revenues are lowest when spending requirements are highest. Neither in Germany nor in Canada, have federal

governments considered substantial reforms to this funding mechanism, but they rather opted for (politically less demanding) adjustments to contribution rates, eligibility criteria, and benefit levels.

The adjustments to passive labour market policies involved few intergovernmental discussions in Canada. Since a constitutional amendment made in 1940, initially only reluctantly accepted by Quebec, the provision of income support to unemployed workers has been a federal responsibility. As such, the adjustments to policies were solely ones of contribution rates, eligibility criteria, and benefit levels, largely driven in the mid-1990s by the stipulation that expenditures on passive measures be decreased. Although the changes to passive measures did not require, or indeed involve, federal-provincial negotiations, this does not mean that there were no intergovernmental impacts. Historically, many workers who exhausted their (un)employment insurance benefits became eligible for provincial social assistance income support. However, in the 1990s, as the insurance benefits became less generous, so (independently) did the provincial programs. In other words, as more unemployed workers found themselves ineligible for unemployment insurance, they also found themselves more likely than in the past to be ineligible for social assistance.<sup>27</sup> This points to a drawback of Canadian federalism in that there are no intergovernmental mechanisms to ensure the coordination of unemployment insurance income support and social assistance income support.

In Germany, like in Canada, the reforms of the 1990s were largely driven by fiscal considerations, although the fiscal crisis of the state in Germany (high unemployment and deficit) culminated about three years later than in Canada. Most importantly, reforms with regard to passive and even active measures comprised only minor administrative

**Table 5 - Funds and staff transferred to the provinces for active measures, 1997-2001**

Province/Territory	Funds Transferred (\$millions)				Staff Positions Transferred	
	1997/98	1998/99	1999/00	2000/01	Projected	Actual
Newfoundland	-	-	-	-	177	-
Nova Scotia	-	-	-	-	196	-
New Brunswick	66.4	78.0	84.0	90.0	170	124
Prince Edward Island	-	-	-	-	49	-
Quebec	457.3	527.6	561.1	594.4	1 084	1 022
Ontario	No Agreement				1 007	-
Manitoba	46.3	48.7	49.4	49.9	120	118
Saskatchewan	33.5	36.1	37.1	38.5	114	97
Alberta	97.5	106.5	109.2	112.7	204	156
British Columbia	-	-	-	-	470	-
Yukon	-	-	-	-	7	-
Northwest Territories	3.5	4.4	4.8	3.3	24	24
Nunavut				2.0		
<b>TOTAL</b>	<b>704.5</b>	<b>801.3</b>	<b>845.6</b>	<b>890.8</b>	<b>3 627</b>	<b>1 541</b>

Source: Human Resources Development Canada

decentralization within an essentially unchanged organizational and legal framework. In Germany there was no attempt to institute regional differentiation in transfers to individuals or in the availability of services, with the special active measures for East Germany quickly phased out or subsequently made available in the old *Länder*. These modest reforms neither threatened vested interests of the stakeholders represented within the FLO, unions and employers' associations, nor did they necessitate intergovernmental negotiations and changes to the federal distribution of responsibilities. Yet like in Canada, they did have an intergovernmental effect: As discussed, together with a shifting of costs between contribution and tax-financed parts of the welfare-state regime, a downloading of income-support expenditures from the federal level to the municipalities also occurred in Germany. Social assistance does, however, continue to provide a fairly encompassing and generous safety net, and municipalities often use work-creation programs to "recycle" participants for the UI scheme.

But the similarities between Germany and Canada are outweighed by differences with regard to the direction and scope of further reforms in the two countries. With regard to passive measures, the restrictive German approach to the regulation of the labour supply has gone unchallenged until very recently, and the signs of a cautious turnaround – a reaction to labour shortages in specific market segments – have been inconclusive so far. In Canada, by contrast, no attention has been paid to regulating the labour supply, although initiatives along those lines could have been incorporated into the overhaul of passive measures in 1995/96. In fact, during the 1990s immigration levels (which are controlled solely by the federal government) increased in times of high unemployment. This reinforces the view that Canadian governments adopt a more "laissez faire" stance toward controlling the labour supply, and are more

likely to leave active measures the responsibility of individuals.

Table 6 demonstrates that the labour force participation rates in Canada were higher during the 1990s than in Germany. This implies that Germany has indeed been more effective in reducing the labour force rather than in creating new jobs in its efforts to "solve" its unemployment crisis. On the other hand, the higher labour force participation rates in Canada, along with the lower unemployment levels in the second half of the decade, indicate that it has been more successful in creating new jobs. In this regard it should also be noted that from 1991 to 1999 Canada's population increased by 8.1%, while Germany's increase was only one-third as large at 2.6%

Table 7 illustrates that the female participation rates in Germany were less than in Canada, while the male participation rates were fairly close between the two countries. Moreover, the percentage of the long-term unemployed (>12 months) as % of total unemployed was approximately four times as high in Germany as in Canada. This again confirms that job creation has indeed been weaker in Germany than in Canada, and bolsters our argument that the two federations have pursued different labour market policies.

As illustrated in Chart 2 regional disparities in unemployment levels, as measured by the variation coefficients (standard deviation/average provincial and *Länder* unemployment rates) have been high and increasing in both Germany and Canada throughout the 1990s. In Canada the variation steadily increased during the decade. On the other hand, disparities in Germany, after declining from a peak in 1992 immediately after reunification, have been increasing steadily since 1995, so that by the end of the decade they began to approach the Canadian level. The confluence of variation levels in the two nations

**Table 6 - Labour Force Participation Rates in Germany and Canada, 1991-1999**

Year	Labour Force Participation Rates	
	Canada	Germany
1991	77.2	73.9
1992	76.4	73.1
1993	76.1	72.7
1994	76.0	72.9
1995	75.8	72.8
1996	75.6	72.9
1997	75.9	73.4
1998	76.3	73.6
1999	76.9	73.9

Source: *OECD Economic Outlook*, December 2000

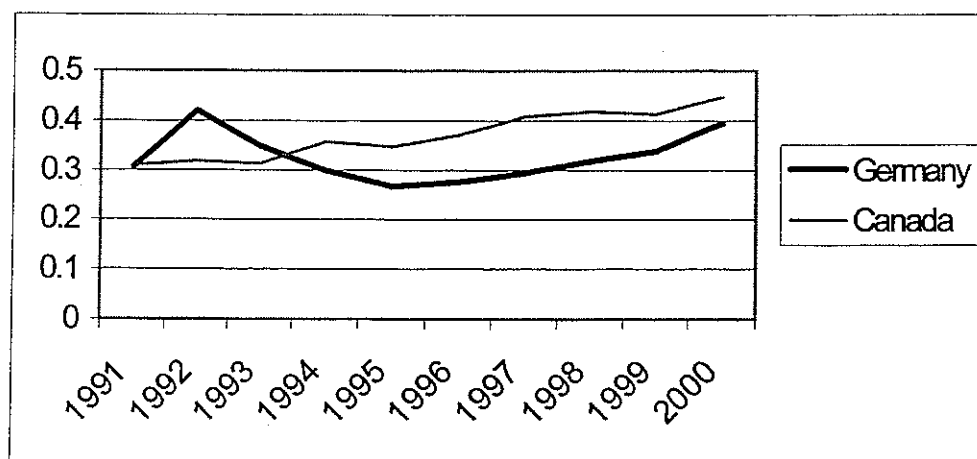
**Table 7 - Male and Female Participation Rates and % Long Term Unemployed in Canada and Germany, 1994-1999.**

Year	% male and female participation rates and % long term unemployed*	Canada	Germany
1994	male participation rate	82.6	80.8
	female participation rate	67.8	61.8
	long-term unemployed	12.5	44.3
1995	male participation rate	n/a	80.1
	female participation rate	n/a	61.0
	long-term unemployed	13.8	48.3
1996	male participation rate	81.7	n/a
	female participation rate	67.9	n/a
	long-term unemployed	12.5	47.8
1997	male participation rate	82.0	80.4
	female participation rate	67.8	62.2
	long-term unemployed	12.5	n/a
1998	male participation rate	83.0	79.6
	female participation rate	69.4	63.1
	long-term unemployed	12.5	n/a
1999	male participation rate	82.2	80.6
	female participation rate	69.6	62.8
	long-term unemployed	11.2	51.7

\* long-term unemployed (>12 months) as % of total unemployed

Source: *OECD Main Economic Indicators* (various years)

**Chart 2 – Variation Coefficients for Unemployment Levels, German *Länder* and Canadian Provinces, 1991-2000**



Source: calculated from Tables 1 and 3.

in the second half of the decade suggests that their respective governments might have been expected to envisage comparable active labour market policy reforms in order to cope with similar regional problems. Yet it is precisely with respect to this policy field that we discovered the greatest differences – or in fact, two divergent reform paths. There is now a growing body of literature, which comes in a market oriented and a community based variant, that suggests a positive correlation between federal decentralization and labour market performance and hence provides a theoretical rationale for the decentralization of active labour market policy and its coupling with structural policy at the sub-national level.<sup>28</sup> But there is also a literature according to which the economic performance of consensus democracy is superior to majoritarian democracy, as demonstrated by corporatist experiments that seem to have been successful at reducing unemployment in countries such as the Netherlands or Denmark.<sup>29</sup> Germany and Canada, then, have drawn on different theoretical inspirations and followed different policy examples during the 1990s.

While Canada has chosen the path of decentralization of active measures (and to some extent also passive measures given the variation in UI benefits across different regions) suggested by much of the recent academic literature, Germany has opted for a renewal of corporatist arrangements. Such arrangements now exist at the sub-national level where they focus on the limited range of labour market issues open to intervention by *Länder* and municipal governments. Yet these sub-national initiatives are dominated by the Berlin roundtable. The Employment Alliance serves as arena for reform discussions and bargaining processes between the government, academic experts and representatives of peak associations on the union and employer side. Discussions are not restricted to active labour market policy, but rather cover a wide range of issues with

potential impact on unemployment, such as industrial relations and wage bargaining or questions of macroeconomic regulation. The outcome of the ambitious Employment Alliance is still in doubt, but there is general agreement among the social partners and federal government that this is the most promising course of action available.

The divergence of reform paths in Germany and Canada is surprising as both countries are federations and were governed during most of the 1990s by administrations that drew, to a greater or lesser extent, on neo-conservative ideas. What, then, explains this divergence? Specifically, why did decentralization never get on the government agenda in Germany, but was implemented with major concomitant organizational changes in Canada? Why did corporatist arrangements fail in Canada, while they now seem well entrenched in Germany?

The contrasting experiences of the two countries suggest that federal institutions do matter, albeit not (only) in the crude sense of contrasts between federal and unitary systems, but also with regard to differences between federal systems themselves. In fact, the reason why authors like Francis Castles<sup>30</sup> have not found a correlation between degrees of decentralization and labour market performance may lie in the scant attention that much of the literature on the presumed advantages of decentralization pays to those latter differences.<sup>31</sup> Canadian interstate and German intrastate federalism tend to be subsumed under the same category in this literature. Yet upon closer examination, the reform paths chosen by the two countries are heavily dependent on their specific historical intergovernmental arrangements. In fact the type of federalism of each country was reinforced rather than weakened by the Quebec crisis and continental market integration in the case of Canada, by reunification and European integration in the German case. As a result, the federalism models

of Canada and Germany have diverged rather than converged during the 1990s, as have their active labour market policies. This finding is consistent with some of the arguments of Stephen Krasner's neo-institutionalist approach to examining path-dependent patterns of decisions.<sup>32</sup>

A reasonably clear and non-hierarchical division of responsibilities between the federal and provincial levels characterizes many policy fields of the Canadian federal regime. This allows the federal government and the provinces to exercise power in discreet fields and pursue their own interests. As a result there are few fora to address federal-provincial (or national) concerns other than the occasional conferences of ministers, resulting in what has been called executive federalism.<sup>33</sup> In the case of active labour market policy, the policy domain has historically been interpreted as a joint federal-provincial responsibility, which resulted in intergovernmental competition. Thus Quebec, believing it was disadvantaged in not having control over labour market policy, sought to obtain jurisdiction over the policy field. In doing so, the province (and others) essentially sought to establish an intergovernmental regime similar to that which exists in other policy fields, such as health.

German intrastate federalism, by contrast, is characterized by joint decision-making and legal harmonization at the national level rather than intergovernmental competition. Hence while the federal level only has a restricted number of exclusive legislative responsibilities and the residual competence formally lies with the *Länder*, there is a broad range of concurrent legislative areas and of fields open to national framework legislation. Therefore, federal legislation has widely indeed preempted state law over the decades. This dynamic is closely linked to a constitutional provision that demands the promotion of equal living standards throughout the country and permits federal

action wherever the legal or economic union of the federation is threatened. Various elements of the *Basic Law*, such as a highly redistributive horizontal and vertical equalization mechanism and instruments of fiscal coordination and co-financing, support this constitutional goal. The *Länder*, on the other hand, play no more than a subordinate role as legislators in their own right, but participate in federal legislation and act as influential collective veto player through the *Bundesrat*.<sup>34</sup>

It is consequently within the logic of German federalism that passive and active labour market policy, like most other fields of social policy, is based on a largely national organizational and legal framework.<sup>35</sup> *Länder* initiatives are restricted to the few areas not covered by national law and the FLO. The provision of most passive and active measures of labour market policy through a national public-law corporation is not only in line with several other branches of the German welfare-state regime, but also means that the federal government does not have to rely much on the *Länder* for administration; this in turn further reduces the influence of state governments (via the *Bundesrat*) on related legislation. The FLO itself operates outside the intergovernmental arena, and its survival is ensured by stakeholder (union and employer) interests; while UI entitlements, like other entitlements, enjoy the status of quasi-property rights. At least one prominent observer, Fritz W. Scharpf, has characterized labour market policy as a field in which the increasingly criticized immobility of the country's political system – due to the logic of the “joint-decision trap” – and its tendency to produce lowest-common-denominator solutions are particularly conspicuous.<sup>36</sup> The deadlock between divergent *Bundestag* (lower chamber of parliament) and *Bundesrat* majorities during most of the 1990s may not suffice to explain why the federal government hesitated to implement more far-reaching reforms, which might have been possible in a strictly



constitutional sense.<sup>37</sup> However, it is clear that a decentralization of the UI scheme and active labour market policy, as proposed by a Bavarian-Saxonian Reform Commission in 1996, would have had to face considerable obstacles, such as the equality-of-living standards principle enshrined in the Basic Law.<sup>38</sup> Thus the peculiar nature of Germany's highly centralized and interlocking federalism with its multiple veto points has, in combination with characteristic elements of its welfare-state regime, so far worked against rather than in favour of substantial reforms like decentralization and policy experimentation by the *Länder*. Indeed, the very nature of German federalism has ensured remarkable institutional stability in the field of labour market policy.

Likewise, federal institutions are embedded in a wider political and societal context in both countries. Canada is far more heterogeneous than Germany, with a constitution that recognizes the linguistic duality of the nation and its multicultural character. Likewise, Canada's size, geography and differentiated labour markets impact on the nature of labour market policies. As such, federalism is primarily a tool for managing, and at times reinforcing, the diversity of the nation, rather than a tool to equalize the conditions of all citizens. As well, in Canada both business and labour is relatively unorganized and fragmented, with no peak organizations.

On the contrary, Germany's intrastate federalism and corporatist arrangements are linked with a high degree of social homogeneity, at least in the Western part of the country. Heterogeneity has increased, more pronounced centre-periphery structures have emerged, after reunification, but the expectation of equal living standards and service levels throughout the country goes unabated. Germany's conflict-averse and statist political culture does not tolerate strong regional imbalances. Hence cooperative federalism is but one, if central,

element of the consensus-oriented "policy of the middle way"<sup>39</sup> that characterizes the "semi-sovereign"<sup>40</sup> German state, its corporatist income-maintenance system and industrial relations, and the "social market economy" writ large. Another element is the tradition of social partnership between centralized, powerful and ideologically moderate unions and employers' associations – key participants in the formulation and administration of German labour market policy. The strong vertical and horizontal integration of the German party system, with the result that party and regional competition in the *Bundesrat* are often conflated, is another key feature of consensus orientation of German politics and society.<sup>41</sup> Furthermore, the German Christian-Democratic Union and Christian-Social Union with their ideological ties to the churches and influential and strong intraparty representation of workers have never adopted the neo-conservative agenda to the same extent Anglo-Saxon parties like the Canadian Liberals and Progressive Conservatives (or even the German Liberals) have.

The historical acceptance in Canada of greater disparity in unemployment rates between regions is one of the reasons that made possible the dramatic decentralization of active measures in 1995/96. In reality, the decentralization is the rational conclusion of a process that had been underway for decades, with federal active labour market field offices granted increasing degrees of independence prior to 1996.<sup>42</sup> Furthermore, since reducing unemployment in Canada is less a political and social priority than in Germany, the decentralization, and its implications, has received little public attention to date.<sup>43</sup>

Hence it would seem that the Canadian and German experiences largely confirm that there are now two basic trajectories of labour market policy reform, which might be called the Anglo-Saxon model of neo-conservatively inspired deregulation and decentralization and the

continental European model. The European model involves cooperation between the state and the social partners' aims at compensating for the social costs of employment strategies that are centred on retrenchment, wage moderation and enhanced flexibility of the labour market.

#### **4 IMPLICATIONS AND CONCLUSIONS**

As we demonstrated above, the German and Canadian labour market policy reforms during the 1990s were highly path dependent and illustrate the significance of federal institutions and their political and societal context. The disparities in labour market policies outweigh the similarities, despite the similar economic forces that operated on both federations during the decade. We now analyze, very briefly, how well – with regard to efficiency and equity outcomes – the reforms have prepared Canada and Germany for more difficult economic periods.

In both countries we find a failure to ensure high levels of regionally balanced employment, and to reduce regional disparities in unemployment rates. Both federations – despite their different reform paths – have so far failed at ensuring high levels of regionally balanced employment, and to reduce provincial and *Länder* disparities in unemployment rates. This is particularly problematic in Canada, which has had declining national unemployment rates since 1993 and a government surplus since 1997.

The announcement in September 2000 by the Chretien government that the most punitive aspects of the reform of passive measures were to be relaxed was political recognition of the increasing discrepancy in unemployment rates.<sup>44</sup> It also recognized that the reforms of the mid-1990s might not be entirely suitable to the 21<sup>st</sup> century. Nevertheless, as unemployment rates increase, it remains to be seen if the experience of the early 1990s – deficits in the UI account

and various attempts to shrink payments to the unemployed – will once again be repeated.

With regard to active measures, the danger is that now that these have been decentralized they will become balkanized, with citizens in different parts of the nation having access to quite dissimilar levels of service. Increases in unemployment rates, along with a concomitant increase in demand for active measures, will place pressure on the provinces, not (as in the past) on the federal government. In other words, now that the provinces have responsibility for active measures there is little enticement for the federal level to increase funding to provinces for these measures. The result may well be that the increase in the discrepancy in provincial unemployment levels apparent in the 1990s will continue to increase. With active labour market policy now largely within the provincial domain, there may be less political pressure on the federal government to seek to minimize regional differences.

Even though the ambitious corporatist initiatives of the early 1990s failed, now that active measures have been decentralized it may be that some corporatist features will flourish at the local level. The ambitious corporatist efforts of the 1990s are unlikely to be duplicated in the foreseeable future, however more modest sectoral and community-based efforts may find some success, especially in those provinces that have a long-term strategy in this regard. The local boards in Ontario bear watching in this regard, as do efforts in Quebec.

Reforms of the UI scheme have had considerably more short-term success in Canada than in Germany. While Ottawa's reforms and cuts, together with the economic upturn of the last couple of years, changed deficits into a surplus, the German FLO is still plagued by deficits in the face of stubbornly high unemployment rates in East Germany. The "containment" strategy of the Kohl government

was partially successful in avoiding a cost explosion in the labour market policy field after reunification, and in cushioning the economic and employment crisis in the Eastern *Länder*. The financial self-sufficiency of the FLO has not been re-established, though, high contribution rates continue to increase the cost of labour, and the flaws inherent in the German funding system have not been touched upon. This explains why there now are two "schools of thought" with regard to the success or failure of labour market policy reforms during the 1990s. On the one hand, Jens Alber has recently argued in line with our own analysis that the "containment" strategy has so far entailed only minor cuts, that spending and benefit levels of the German welfare-state regime continue to be unexceptional in a comparative perspective, and that most programs still have to be considered as remarkably efficient against the backdrop of the reunification shock – findings that suggest the basic viability of "Rhenish capitalism".<sup>45</sup> By contrast, Philip Manow and Eric Seils (2000a) have pointed out that the "containment" strategy has failed to correct the "pathological response pattern" built into German labour market policy, and hence that the flaws of the entire system might be exposed come the next severe recession.<sup>46</sup> Their scathing criticism leads them to the conclusion that "high structural unemployment might be a strategic equilibrium given the incentives of Germany's political and economic order and the interests of the key actors: employers, unions and the state."<sup>47</sup>

The two perspectives measure developments in German social and labour market policy against different benchmarks and hence are not strictly contradictory. While the reunification shock has indeed been absorbed remarkably well in the short term, there is no reason to believe that the tinkering of the 1990s has solved built-in shortcomings in the long term. The modest scope of reforms during the 1990s also illustrates the obstacles that major institutional changes face in Germany. Thus

efficiency and equity concerns remain on the policy agenda. With regard to equity concerns, the "containment" measures of the 1990s came at a price, as they included shifting unemployed persons from UI entitlements to less generous means-tested and welfare programs. The burdens of tightened eligibility criteria, and reduced benefits, were not equally shared by different social groups. While the youth employment situation continues to be relatively favourable if compared with Canada, various other biases (against women, elderly workers, the disabled, non-citizens) have not been reduced much, if at all. The most striking, and politically explosive, imbalances are, however, regional. Whether the latest attempt by the Schröder government to re-energize corporatist arrangements and to use them for the formulation and implementation of consensual answers to labour market challenges will be successful, remains to be seen.

In conclusion, Canadian and German labour market policies of during the 1990s reveal both similarities and divergence. Efforts to reform passive measures in the two federations exhibit more similarities than do initiatives for active measures. With regard to active measures, the two most leading reform paths currently advocated were implemented, one by Canada and the other by Germany. Yet, both federations experienced increasing levels of regional unemployment discrepancy, at the same time as national unemployment rates declined and government deficits were reduced or eradicated altogether. Explaining why the two federations have embarked on different paths requires analysis of the type of federalism that each has historically embraced and developed. The more diverse societal context, a political culture that tolerates more regional disparities, and the blending of interstate federalism with majoritarian institutions seem to have made institutional modifications easier to implement in Canada than in Germany.

## NOTES

1. We thank our colleagues at the Queen's University Institute of Intergovernmental Relations *Social Union Project* for their assistance in conducting some of the background research upon which this working paper is based. We also acknowledge the aid of government officials at the Canadian Human Resources Development department for making information available to us.
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