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Irresistible forces, immovable objects: post-industrial welfare states confront permanent austerity

Paul Pierson

ABSTRACT The welfare states of affluent democracies face severe budgetary strain, increasing policy rigidities, and growing political controversy. Although these developments are often attributed to shifts in the global economy, three post-industrial transitions have been at least as important: the relative growth of the service sector, the maturation of governmental commitments, and population aging. These transitions create an environment of ongoing austerity, but the strength of support for public social provision in most countries makes the dismantling of the welfare state highly unlikely. Instead, successful reform is likely to be based on compromise and to take the form of restructuring and modernization of the social contract. The article concludes by outlining a research agenda for the investigation of this reform process.

KEY WORDS Deficits; globalization; social pacts; social policy; welfare state.

Long recognized as a defining feature of advanced industrial democracies, the welfare state currently commands greater attention than ever. Demands for austerity have intensified, and have in turn provoked heated controversy and widespread unrest. During the past few years, announcements of welfare state cutbacks in Germany, the Netherlands, and Italy prompted the largest demonstrations in three decades. In the United States, the Republican attempt to alter core elements of national social policy led to a fierce clash between Congress and President and an unprecedented three-week shutdown of 'non-essential' government services. In France, the conservative government's bid for an electoral endorsement of its austerity plans led to a stunning defeat at the polls. Throughout the ranks of affluent democracies, the welfare state is at the center of political discussion and social conflict.

Analysts frequently portray these conflicts as fundamental struggles between supporters and opponents of the basic principles of the post-war social contract. They often emphasize that these conflicts are played out against the backdrop of a transformed global economy which has undercut the social and economic foundations of the welfare state. While containing elements of truth, such portrayals distort crucial characteristics of the contemporary politics of the welfare state. Changes in the global economy are important, but it is primarily social and

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economic transformations occurring within affluent democracies which produce pressures on mature welfare states. At the same time, support for the welfare state remains widespread almost everywhere. In most countries, there is little sign that the basic contours of social policy face a fundamental political challenge. The contemporary politics of the welfare state centers on the renegotiation, restructuring, and modernization of the terms of this social contract rather than its dismantling. I develop this argument in three stages. The first examines the primary sources of strain on the contemporary welfare state, the second considers its enduring sources of political resilience, and the third offers some propositions about the reform process given these formidable but conflicting pressures.

I. IRRESISTIBLE FORCE: POST-INDUSTRIAL PRESSURES ON MATURE WELFARE STATES

Welfare states everywhere face considerable strains. For many observers, especially in the popular press, the principal source of this new state of affairs is the rapidly changing world economy. The basic outlines of this new conventional wisdom are well known. 'Globalization' has undermined the capacity of nation states to control their own affairs. Integration of financial markets, increasing capital mobility, and the rise of competition from newly industrialized countries (NICs) have rendered the generous social provision characteristic of advanced industrial societies an unaffordable luxury. There is a widespread sentiment that this new global environment threatens a 'race to the bottom', or at least convergence on the much more modest level of social provision characteristic of 'liberal' welfare states like the United States or the United Kingdom.

Skeptical evaluation of this globalization scenario is spreading as many of its core claims are subjected to more intensive scrutiny (Garrett 1998; Swank 1998). Rather than directly examining the causal arguments associated with the globalization thesis, however, this essay takes an alternative tack. It focuses on trends within the major industrial economies which constitute potential sources of the strains generally attributed to globalization. Welfare states indeed face unprecedented budgetary stress, but this is primarily related to endogenous processes of social change, as the economic profiles of affluent societies have become increasingly 'post-industrial' and as their welfare states have matured and their populations have grown older. These important shifts are related only loosely, if at all, to the changing international economy. To focus on globalization is to mistake the essential nature of the problem.

Why is the globalization thesis widely accepted if the direct evidence supporting it is at best weak? The answer is straightforward. What makes the globalization thesis so convincing to many is the undeniable difficulty that governments now face in funding their social policy commitments. Austerity has been on the agenda throughout the advanced industrial world, and the intensity of fiscal pressures is clearly growing. Governments appear increasingly unable to respond to new demands. The correlation in timing between globalization, on the one hand, and mounting demands for austerity and indications of lost policy-making capacity, on the other, has lent credence to claims of a causal relationship between globalization and a weakening nation state.

In evaluating such causal claims, however, social scientists have recently become more conscious of the need to make counterfactuals explicit. Arguing that 'A caused B' implies that 'if A had not occurred, B would not have occurred' (Fearon 1991). It is the counterfactual of the globalization thesis which I wish to assess. The available evidence casts doubt on the claim that in the absence of growing economic integration welfare states would be under dramatically less pressure, and national policy-makers markedly more capable of addressing new public demands.

In addition to growing global linkages, three profound transitions have been taking place as the advanced industrial economies become post-industrial ones: the slowdown in the growth of productivity (and consequently economic growth) associated with a massive shift from manufacturing to service employment; the gradual expansion, maturation and 'growth to limits' of governmental commitments; and the demographic shift to an older population. Each element of this 'triple transition' to post-industrialism represents a powerful and continuing source of pressure on the welfare state.[1] Globalization is essentially unrelated to the second and third transitions; its links to the first transformation are at best quite modest. In short, my counterfactual runs as follows: the slower economic growth and related problems associated with rising service sector employment, the tremendous expansion of governmental commitments, and the fiscal demands stemming from population aging in countries with mature social programs would, by themselves, have generated much of the current turmoil around the welfare state. Had economic openness remained constant over the past quarter-century, governments would nonetheless face increasing inflexibility and intense fiscal pressure, including tendencies towards deficit spending and demands for program cutbacks and policy reform. Globalization *accompanied* these transitions; it has undoubtedly accentuated and modified the pressures on welfare states in important respects. Yet it is the triple transition itself that has made the real difference.

Slower productivity growth, the rise of the service sector, and welfare state strain[2]

The first transition, to slower growth of productivity, is now so taken for granted that we forget what a profound impact it has had on the workings of advanced economies. Over time, productivity improvements are the key to sustaining economic growth. It is this slowdown in growth that lies behind much of the turmoil in Organization for Economic Co-operation and Development (OECD) economies. If 3–4 percent economic growth had continued over the past quarter-century, many of our current economic problems would never have materialized.

It is hard to see how this slowdown in productivity growth can plausibly be linked to increasing international exchange. There is, in fact, a broad consensus among economists that such exchange should be efficiency-enhancing – that it facilitates the allocation of resources to their most productive use and therefore should increase productivity growth rather than retard it. Thus the sources of slower productivity growth appear to be largely endogenous rather than exogenous to national economies.

While there remains uncertainty concerning the full explanation for declining productivity growth, a central culprit almost certainly has been the massive shift in employment from relatively dynamic manufacturing activities to generally less dynamic service provision. William Baumol long ago pointed out that service industries were generally unable to match the productivity increases typical of manufacturing, and that this would be especially true when services were particularly labor-intensive (e.g. in education, child care, and many aspects of health care) (Baumol 1967). In many services, it is essentially the labor effort itself that we wish to consume. Such activities are resistant to the processes of standardization and replication that are central to efficiency gains in manufacturing. It is extremely difficult in most services to generate the large, continuous increases in productivity typical of manufacturing. Table 1 reveals a large and consistent gap in productivity increases between services and manufacturing from 1960 to 1994 in the OECD.

The limited capacity for productivity improvements in services has a number of implications. Relative prices of manufacturing goods are likely to fall. If, however, demand for services is price inelastic – remaining high despite rising relative prices – then the relative weight of services in employment will increase.[3] Given stable relative demand for services and manufactures, large gaps in productivity will mean fewer and fewer workers in manufacturing, and more and more in services. Indeed, there has been a massive, steady shift in the employment structures of all advanced industrial economies, away from increasingly efficient manufacturing and towards relatively stagnant service provision (see Figure 1). Over time, more and more workers are engaged in service provision, where possibilities for productivity improvements are more limited. Inevitably, the consequence will be a slowdown in overall productivity growth, and, all other things being equal, slower economic growth (Appelbaum and Schettkat 1994; Rowthorn and Ramaswamy 1997; see also Iversen and Wren 1998).

It is important to stress that this first post-industrial transition to massive service employment is fundamentally endogenous to domestic economies, based on crucial differences in the possibilities for efficiency improvements in different economic activities. As Robert Rowthorn and Ramana Ramaswamy put it:

Table 1 Industrial countries: growth of output and employment

	1960–70	*1971–94*	*1960–94*
Output			
Manufacturing	6.3	2.5	3.6
Services	5.3	3.3	3.8
Output per person employed			
Manufacturing	4.6	3.1	3.6
Services	3.0	1.1	1.6
Employment			
Manufacturing	1.7	−0.6	0.0
Services	2.4	2.2	2.2

Source: Rowthorn and Ramaswamy (1997).

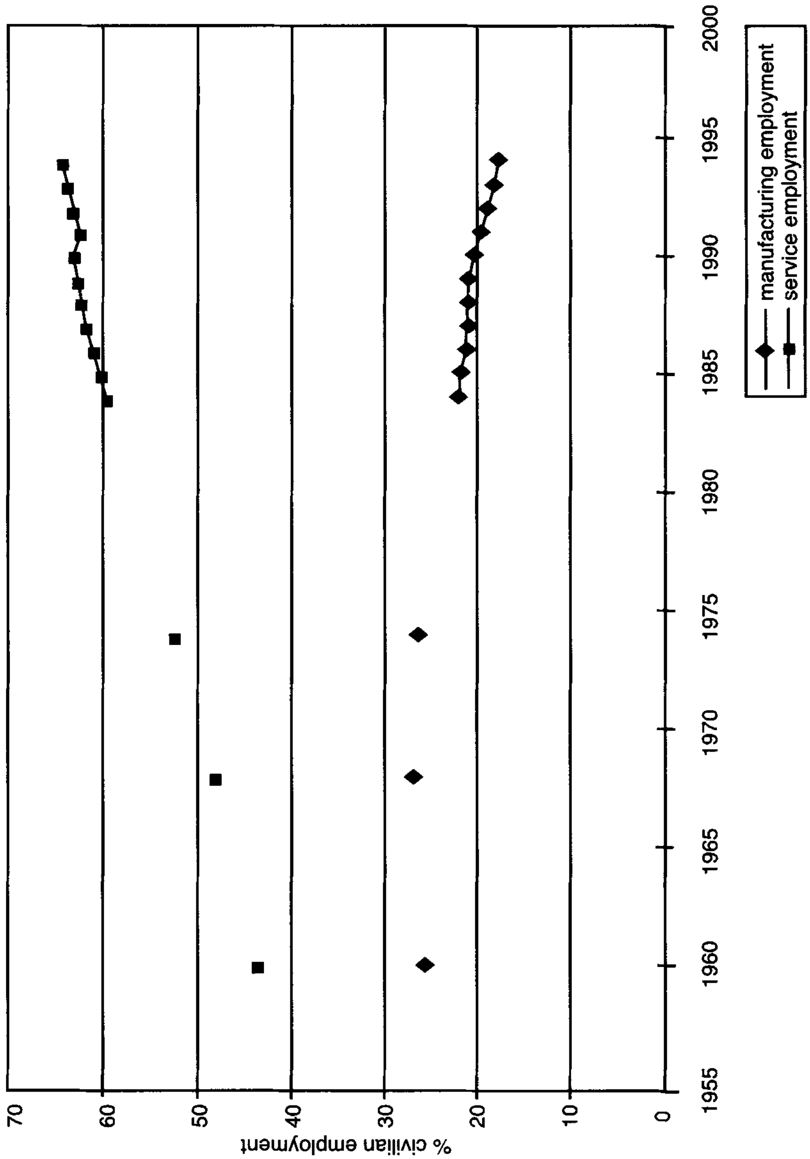


Figure 1 Manufacturing and service employment 1960–94 (% civilian employment, OECD average)
Source: OECD (1993).

'deindustrialization is simply the natural outcome of the process of successful economic development, and is, in general, associated with rising living standards' (Rowthorn and Ramaswamy 1997: 14). That being said, the lower productivity growth associated with expanded activity in services generates acute problems for welfare states. Most directly, slower overall economic growth impedes the growth of wages and salaries, on which the revenues of the welfare state heavily depend. One can see this clearly in an examination of pension costs. With benefits indexed to prices (at least after retirement), high real wage growth provides an expanding base for financing pension payments. As the growth of real wages slows, however, higher payroll taxes are required to finance higher benefits. In Sweden, for instance, sustained 2 percent real growth would necessitate payroll tax rates of 23.3 percent in the year 2025 to meet existing pension commitments. If instead the growth rate were to be 1 percent, the payroll tax rate would have to rise to 33.1 percent (Anderson 1998: 13). Thus low growth has a direct impact on the sustainability of the welfare state. In addition, if slower growth contributes to higher unemployment (e.g. because of labor market rigidities), it further retards revenues while forcing up expenditures.

Nor are the implications of this post-industrial transition limited to simply slower economic growth. Esping-Andersen (1996), Scharpf (1997a), and Iversen and Wren (1998) have highlighted the contribution of the shift towards service employment to many of the central challenges facing post-industrial political economies in general and welfare states in particular. In Iversen and Wren's elegant formulation, with this post-industrial transition, governments face a 'trilemma of the service economy', in which the goals of employment growth, wage equality, and budgetary constraint come into increasing conflict. Service sector employment, prone to productivity stagnation and often low-wage, can be generated in only two ways: through the private sector, at the price of increased wage inequality, or through the public sector, at the cost of increased budgetary pressure. Alternatively, countries that manage to hold the line on wage equality and budgetary restraint are likely to see little service sector employment growth and hence rising unemployment.

Strikingly, the three typical responses to this trilemma largely mirror the three regimes (Christian Democratic, Social Democratic, and Liberal) identified in Esping-Andersen's *The Three Worlds of Welfare Capitalism* (Esping-Andersen 1990). Welfare states in each regime face problems associated with the rise of the service economy, but the nature of the problem depends upon regime type (Esping-Andersen 1996; Iversen and Wren 1998). Social Democratic welfare states have expanded employment without worsening wage inequality by expanding the public service sector. The budgetary costs of this strategy, however, are increasingly stiff. For the Christian Democratic societies of continental Europe, public service employment is limited and labor market regulations and high fixed costs impede private service sector employment growth. The dominant problem is lagging employment, with increasingly disturbing implications. In the liberal welfare states, the problems of lost budgetary restraint and unemployment have been avoided through policies which encourage the expansion of low-wage private sector employment. In these countries, the costs include mounting poverty and inequality, along with a host of associated social problems.

Here we have a slow-moving but inexorable social process with major ramifications. Less dramatic and exotic than globalization, the shift to services nonetheless represents a profound social transformation. By themselves, the stagnation of service sector productivity and the related decline in overall economic growth after 1973 probably go a long way towards explaining the current predicaments of welfare states. Equally important, as the work of Esping-Andersen and Iversen and Wren demonstrates, a focus on this post-industrial transition allows us to zero in on the distinctive predicaments facing different welfare state regimes.

The expansion of governmental commitments and welfare state maturation

A second source of pressure is simply the transition to mature welfare states and an expanded set of governmental commitments which has occurred throughout the industrialized world in the post-war period (Klein and O'Higgins 1988). Welfare states grew at a remarkable pace from 1945 to 1973, far faster than the (very rapid) growth of real gross domestic product (GDP). Countries adopted new programs, 'filling in' their coverage of social risks associated with industrialization. In addition, they expanded eligibility and increased the benefits of existing pensions, disability, and unemployment insurance programs. Although the pace slowed down considerably after 1973, most welfare states continued to grow. The wide scope of established governmental commitments is a defining feature of affluent, post-industrial democracies. By themselves, these expanded governmental commitments have generated persistent budgetary pressure and a pronounced loss of policy flexibility (Rose and Davies 1994).

By far the most important components of this expanding array of governmental commitments are health care provision and old age pensions. In the European Union, they accounted for just over *four-fifths* of total social protection outlays in 1992 (Eurostat 1996: 135), and amounted to over ten times the share devoted to unemployment (including expenditures on job creation). Pensions alone consumed roughly 45 percent of expenditures on social protection. As will be discussed below, this is partly related to population aging, but it also reflects the steady expansion and gradual maturation of public pension programs.

Throughout the OECD, pension benefits are considerably higher than they were forty years ago, not just in real terms but as a percentage of average wages. Almost everywhere, rising outlays in the post-1973 period stem in significant part from more generous benefit provisions, expanded program coverage, and the gradual maturation of systems in which benefits depend on contributions over a full working life. In the United States, for example, median social security benefits increased from 33 percent of average male wages in 1950 to 55 percent by 1980 (Smolensky *et al.* 1988: 44). Over the same period, the percentage of elderly Americans receiving social security increased from 16 percent to 90 percent (Ball 1988: 28). Benefit increases were enacted in most countries in the 1960s and 1970s.

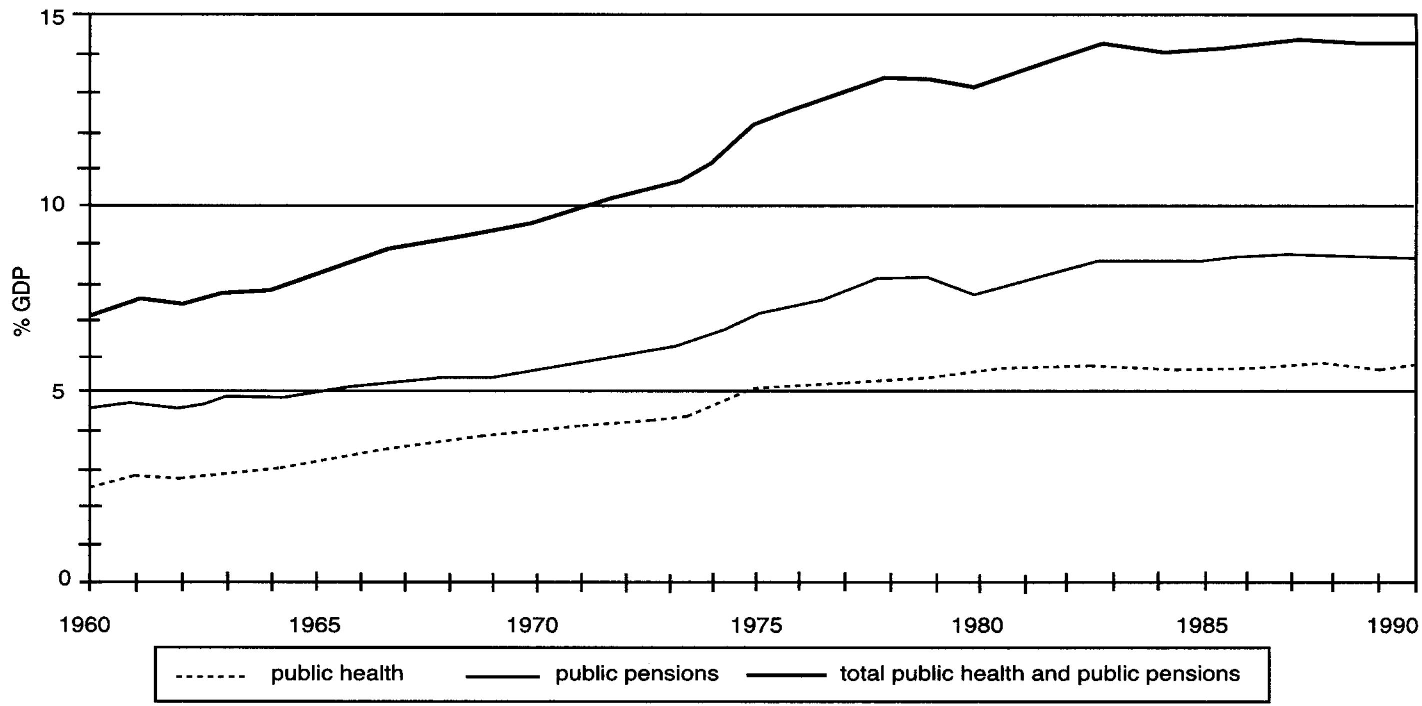
In part at least, governments used promises of pension improvements to purchase labor peace while deferring the costs (Myles 1988). In combination, these trends in benefit levels, program maturation, and pensioner populations have led to major increases in pensions spending in most OECD countries. Between 1960 and 1990, public expenditures on pensions increased from 4.6 percent to 8.5 percent of GDP (see Figure 2).

Health care represents the other massive social commitment of OECD governments. Again, both the coverage and scope of health care systems expanded dramatically in the post-war period, as governments extended their promises in this critical area of social provision. In addition, the costs of health care have risen inexorably (in part because of the relative price effect in service provision discussed above). As with pensions, this consolidating governmental commitment to health care provision has led to dramatically higher spending. Between 1960 and 1991, average public spending in the OECD on health care increased from 2.5 percent to 6.0 percent of GDP.

Between them, health care and pensions – neither linked in any fundamental way to globalization – account for a large share of the increased fiscal demands on the welfare state over the past few decades. As a share of GDP, combined public spending on health care and pensions doubled between 1960 and 1990, rising from 7.1 percent to 14.3 percent. The expansion and maturation of these commitments are thus a central source of budgetary strain in OECD countries – larger in its direct budgetary impact than either the fiscal costs associated with higher unemployment or rising inequality in earnings.

These governmental commitments also have an important secondary effect, contributing to higher unemployment through the intense pressure they place on the taxation of labor (Scharpf 1997a). In Germany, for instance, there is widespread concern about the employment effects of increasing social insurance charges, which rose from 24.4 percent of gross wages in 1965 to 41 percent in 1996. Of this increase of 17.6 percent of gross wages, only 4.5 percent is for unemployment insurance. The remaining 13.1 percent is accounted for by rising contribution rates for pensions, health insurance, and the new long-term care insurance program (Manow 1997: table 3).

Welfare states matured between 1960 and 1980. For three reasons – none of which has anything to do with globalization – this maturation process was bound to lead eventually to increased budgetary stress, a loss of policy flexibility, and political controversy. First, as social provision accounted for a growing share of the economy, the opportunity cost associated with further expansions rose (Klein and O'Higgins 1988). If social expenditure grows at twice the rate of national income, the cost in foregone resources is much greater when social spending is 30 percent of GDP than it was when that share was 15 percent of GDP. Second, the pain of taxation has grown over time as rising social expenditures required government officials to reach further and further down the income distribution in search of revenues. Mature institutional welfare states require a heavy tax burden on average and even below-average income households, which necessarily produces growing political tension. Finally, as maturing welfare states gradually expanded, the costs (e.g. the impact on work incentives) of increased generosity were likely to grow.



Countries: Australia, Austria, Belgium (pensions: 1971–), Canada, Denmark, Finland, France, Germany, Greece, (pensions: 1962–89), Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal (pensions: 1962–; public health: 1970–), Spain (pensions: 1967–), Sweden, UK, US. Pensions data contain 1980 break in series.

Figure 2 Public spending on pensions and health 1960–90 (% GDP, average for 20 OECD countries)
Sources: OECD (1994) *New Orientations for Social Policy*, Paris: OECD, OECD (1998) *Reforming Public Pensions*, Paris: OECD.

Many welfare states have failed to address new (or newly recognized) social risks associated with changing family structure, gender relations, and the spread of atypical work. In traditional domains such as health care, pensions, disability and unemployment, however, welfare states are often working at the margin – that is, they have grown to limits. As replacement rates for unemployment insurance or early retirement approached 100 percent of wages, the case for stopping expansion, or for rolling back some instances of overreach, was bound to become stronger.

All these correlates of maturing welfare states help to account for a heightened sensitivity to the costs of social provision. There is nothing surprising about any of these tendencies – and certainly no need to invoke globalization to account for them. Rather, they are simple consequences of a core transition of modern affluent societies: the more complete institutionalization of governmental commitments.

A closely related phenomenon is perhaps less 'natural' but nonetheless highly significant: the decline of fiscal slack associated with years of extensive government borrowing. As Figure 3 indicates, government debt and associated interest payments have risen considerably over the past two decades (Tanzi and Fanizza 1996). For the industrial countries as a group, spending on interest payments rose from roughly 2 percent of GDP in 1970 to over 5 percent of GDP in 1994. This increase is roughly equal to the rise in spending directly associated with higher unemployment in Europe. Part of this historically unprecedented growth in peacetime debt resulted from miscalculations about the possibilities for reflation in the late 1970s, but it also reflects the willingness of elected officials to defer painful choices and the relentless logic of compound interest. As Joseph Cordes puts it,

> increased reliance on deficit finance in the late 1970s and 1980s temporarily allowed lawmakers to simultaneously honor growing prior commitments to spend on entitlement programs, maintain existing programs, and add new ones, but at the price of having to confront these trade-offs in starker form in the late 1980s, 1990s, and into the next century.
>
> (Cordes 1996: 107)

The large budget deficits of the past quarter-century mean that more fiscal resources are pre-committed. Governments have fewer revenues to use for current activities, because more must be allocated to cover interest payments. In extreme cases, governments such as Italy must run sizable surpluses in their primary budgets in order to keep debt/GDP ratios from worsening. It is worth emphasizing these implications of high debt burdens in part because in Europe the pressures for constraint which they generate will often be attributed to the Maastricht criteria associated with monetary union. Economic and monetry union (EMU) is likely to have considerable consequences, exacerbating and channeling pressures for fiscal retrenchment. Yet it is essential to realize that the broad constraint on government debt/GDP ratios, and the implications of rising interest payments, would exist in a world without EMU.

The vast array of governmental commitments which has accumulated over time is a fundamental feature of the affluent democracies. There is tremendous cross-national variation in the scope and character of these commitments, but they have

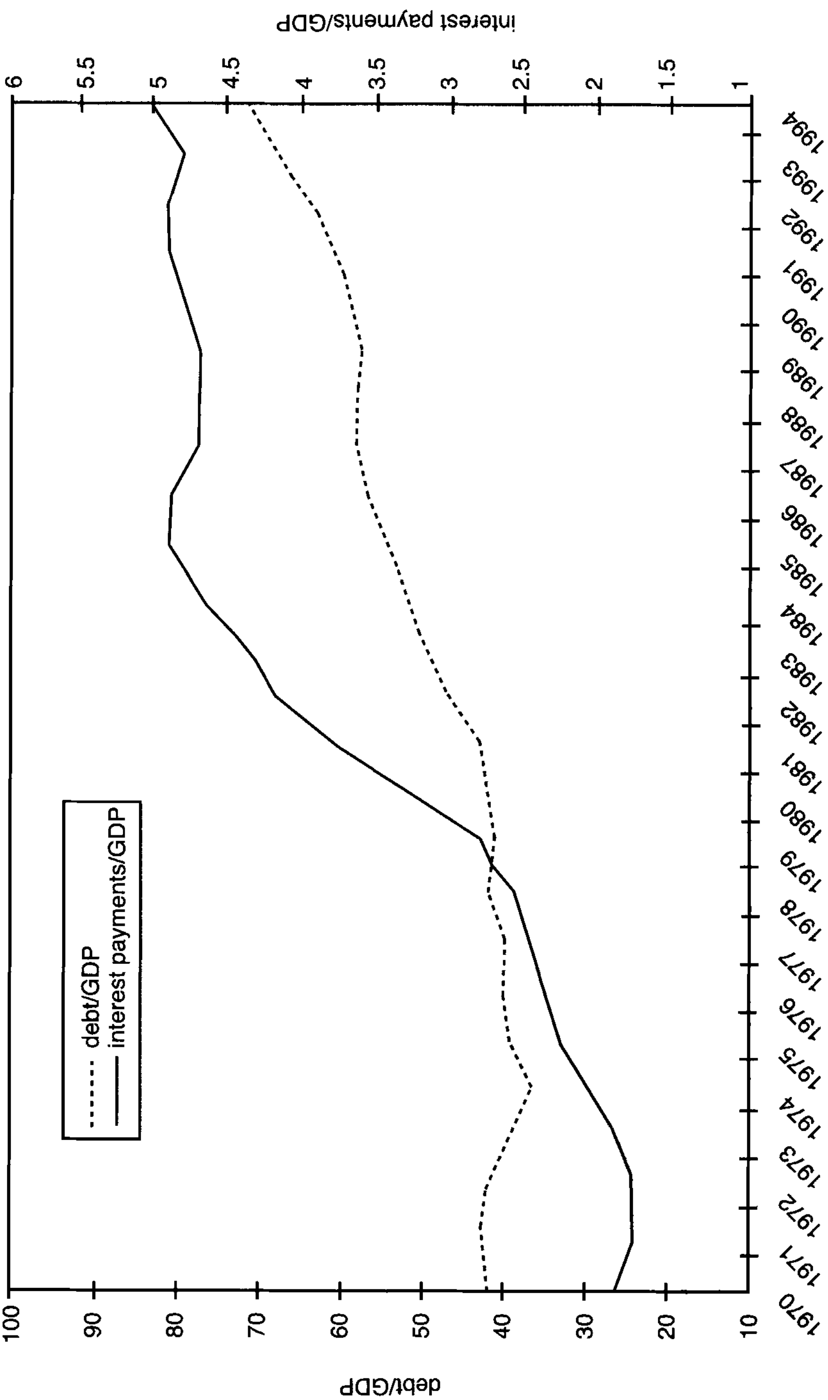


Figure 3 Debt/GDP and interest payments/GDP: G7 countries 1970–94
Source: Tanzi and Fanizza (1996).

expanded everywhere. Pensions and health care, perhaps the sectors of the welfare state least connected to processes of globalization, have been at the core of this transformation. This second post-industrial shift and its ripple effects (such as the possible impact on unemployment and the implications of efforts to defer important parts of the bill for meeting these commitments) are central to the growing sense of budgetary stress and loss of policy control which characterizes the affluent democracies.

Population aging

The third critical post-industrial transition is demographic or, more accurately, the evolving interaction between demography and mature social programs. The populations of the advanced industrial democracies have been aging, both because birth rates have fallen and because people are living longer. In the OECD, the share of the population over 65 rose from 9.4 percent in 1960 to 13 percent in 1990 and is projected to reach 13.9 percent by the year 2000 (OECD 1988: 12, 22). This represents a very considerable shift – a 50 percent increase in the elderly's share of the population – with clear implications for public expenditures, since all welfare states are heavily tilted towards the elderly.

And yet this demographic transition is still in an early phase. The increase since 1960 accounts for roughly one-third of the projected total growth in the elderly's share of the population, which is anticipated to eventually reach 23 percent of the population. In most OECD countries, the bulk of this demographic transition will occur between 2010 and 2035 (OECD 1995). In a more fundamental sense, even a greater proportion of the demographic transition lies ahead. Over the past few decades, the fiscal impact of population aging has been muted by the very large 'baby boom' cohorts following the current elderly through the life course. Because these large cohorts are in their peak earning years, they provide a solid foundation for financing social benefits for the elderly. The situation will be quite different when these large baby boom cohorts move into retirement and must be supported by a workforce made up of the considerably smaller cohorts which follow them. In the OECD, the ratio of the working-aged (15–64) to those over 65 fell by a third between 1960 and 1990 (from 7.5 to 5.0), but it is expected to fall by half between 1990 and 2040 (5.0 to 2.5) (Scherer 1996).

Associated fiscal pressures are beginning to mount. Under current policies population aging will produce an additional increase in pensions spending of 3.9 percent of GDP across the OECD between 2000 and 2030. Particular countries such as Japan (6.3 percent), Italy (7.7 percent), and the Netherlands (6.9 percent) face much larger increases (OECD 1996: table 12, p. 25). Given the high levels of taxes in many of these countries, and the other sources of fiscal pressure already discussed, these looming increases in pension outlays are attracting considerable attention. Unfunded pension liabilities should be seen as an additional set of commitments, similar to public debt but less visible, which limits the flexibility and responsiveness of public officials.

Population aging is an important factor at work in another area where the welfare state faces strains: the provision of health care. Because the elderly are the biggest consumers of health care, population aging leads directly to higher health costs. Between 2000 and 2030, population aging alone is expected to add 1.7 percent of GDP to health care expenditure in the OECD (OECD 1996: 25). In combination with pensions, this suggests an *average* increase in outlays of 5.6 percent of GDP in the OECD attributable to population aging alone.

The demographic shift underway is profound, and its effects are felt precisely in the most expensive areas of the welfare state. This is thus a central source of fiscal pressure on national welfare states. Like the other two transitions of slower economic growth and the maturation of governmental commitments, the phenomenon of population aging is slow-moving and undramatic, but it has fundamental consequences over time.

Once again, population aging draws our attention back to endogenous processes – the gradual transition from an industrial to a post-industrial society. In contrast to common variants of the globalization thesis, the current analysis suggests that the affluent democracies have been changing not in one big way, but in many ways. To complete my original counterfactual: the fundamental symptoms of declining governmental capacity and fiscal strain would clearly be with us even in the absence of trends associated with globalization. This is not to suggest that increasing economic integration is unimportant, or to dismiss the linkages between international and domestic developments. Such links, however, are likely to be more modest, complex and bi-directional than is commonly suggested. At the same time, we need to pay more attention than has recently been the case to social transformations that are essentially domestic in character. Societies are becoming more service-based, with a consequential decline in productivity growth. Extensive social programs have grown to maturity. Populations are getting older. These trends, which can be loosely lumped under the label of post-industrialism, explain most of the strain facing the welfare states of affluent societies.

II. IMMOVABLE OBJECT: THE SOURCES OF WELFARE STATE RESILIENCE

Underlining the severe pressures confronting mature welfare states does not imply that the expected result is a collapse or radical retrenchment of national welfare states. Major policy reform is a political process, dependent on the mobilization of political resources sufficient to overcome organized opponents and other barriers to change. The welfare state's opponents have found it very difficult to generate and sustain this kind of political mobilization.

I have developed this argument elsewhere (Pierson 1994; Pierson 1996) and present only a drastically condensed version here. The sources of the welfare state's political strength are diverse, but are of two basic types: the electoral incentives associated with programs which retain broad and deep popular support and the institutional 'stickiness' which further constrains the possibilities for policy reform. Together, these features have created tremendous resilience in the face of two decades of welfare state 'crisis' (Stephens *et al.* 1998).

Electoral incentives

In market democracies, voters play a crucial role. Implementing and sustaining policy reforms over time generally requires electoral vindication. Voters, however, remain strongly attached to the welfare state. The broad public support consistently revealed in polls stems from several sources. As the welfare state has expanded, so has the size of its constituencies. As Peter Flora has noted, 'including recipients of [pensions,] unemployment benefits and social assistance and the persons employed in education, health and the social services, in many countries today almost half of the electorate receive transfer or work income from the welfare state' (Flora 1989: 154).[4] Furthermore, the welfare state retains considerable legitimacy as a source of social stability and guarantor of basic rights of citizenship. In most countries, popular support appears to extend well beyond the confines of narrow economic self-interest.

Popular support for the welfare state is intense as well as broad. Intensity of preference matters because it is associated with higher rates of political mobilization and with voters' actual choices among parties. The intensity of support for the welfare state stems from two factors. First, while the benefits of retrenchment for welfare state opponents are generally diffuse and often uncertain, the large core constituencies for the welfare state have a concentrated interest in the maintenance of social provision. Huge segments of the electorates of advanced industrial societies rely on the welfare state for a large share of their income. It is one of the few basic axioms of political science that concentrated groups will generally be advantaged over diffuse ones.

The second source of intensity stems from the fact that welfare state supporters are in the position of fighting to sustain already existing benefits. Students of electoral behavior and political psychology have found that voters exhibit a 'negativity bias' – they react more intensely to potential losses than to commensurate potential gains. Thus, the welfare state's electoral base is not only enormous, but primed to punish politicians for unpopular initiatives.

One additional part of the electoral calculus deserves mention: the short time-horizons of most elected officials. Given that politicians generally want to win reelection, they may heavily discount any long-term benefits of reform. Yet any payoff from welfare state cutbacks will often be well in the future, while the adverse effects are frequently felt immediately. The asymmetrical political role of short-term costs and long-term benefits tilts the incentives of politicians still further against efforts at radical retrenchment.

Institutional 'stickiness'

Those seeking policy reform must confront not only the potential opposition of voters and program beneficiaries but the stickiness of existing policy arrangements. By stickiness I have in mind two features of developed polities that reinforce the electoral obstacles to radical reform: 'veto points' within formal political institutions and 'path dependent' processes which in many cases tend to lock existing policy arrangements into place. The impact of veto points is straightforward. Most political systems contain arrangements that make policy reform dependent on more than a simple 51 percent majority, allowing minorities (including in some cases quite small ones) opportunities to block reforms. Examples of such arrangements include federalism, a strong judiciary, bicameralism, use of referenda, requirements of super-majorities, and coalition-based governments.[5] Difficult as it is to create a majority coalition in favor of restructuring the welfare state, even that may not be enough. The multiplication of veto points can hamstring efforts at policy change, frustrating even an ambitious and aggressive reform coalition such as the Republican congressional majority in the United States after 1994, or an enduring conservative coalition such as the one governing Germany since 1982.

A second major source of stickiness is more complex. Recent research on path dependence has demonstrated that certain courses of policy development, once initiated, are hard to reverse. In adapting to complex policy arrangements, organizations and individuals may make commitments that render the cost of change (even to some alternative that might have been more efficient if adopted initially) far higher than the costs of continuity. Existing commitments lock in policy-makers. Pension systems provide a powerful example (Pierson 1994). Most countries operate pensions on a pay-as-you-go basis: current workers pay 'contributions' that finance the previous generation's retirement. Once they have been in place for a long time, pay-as-you-go systems may face incremental cutbacks and adjustments, but they are highly resistant to radical reform. Shifting to private, funded arrangements would place an untenable burden on current workers, requiring them to finance the previous generation's retirement while simultaneously saving for their own. Indeed, a comparative examination of pension reform in the OECD demonstrates that even partial privatization has generally proven possible only in the relatively few countries lacking extensive and mature pay-as-you-go systems (Myles and Pierson 1998).

Similar if less severe path-dependent effects are likely in areas of social policy where complex sets of institutions and organizations have 'co-evolved' over extended periods. In health care provision and many aspects of labor market systems, social actors need to co-ordinate their activities, and they invest resources in line with the incentive structures of their existing environment. This probably helps to explain why employers, for instance, have often been more half-hearted and internally divided over policy reform than many theories of political economy might have anticipated (Thelen 1998).

III. THE POLITICS OF RESTRUCTURING THE WELFARE STATE

Welfare states face severe strains, but also retain deep reservoirs of political support. For political analysts, the central question can be put as follows: What happens when the irresistible forces of post-industrialism meet the immovable object of the welfare state? Acknowledging the strength of both sides of this collision generates several important implications for investigating the politics of reform.

There are strong grounds for skepticism about the prospect of any radical revision of the welfare state in most countries. Almost nowhere have politicians been able to assemble and sustain majority coalitions for a far-reaching contraction of social policy (Stephens *et al.* 1998). The reasons have already been outlined. The broad scale of public support for social provision, the intensity of preferences among program recipients, the extent to which a variety of actors (including employers) have adjusted their practices to the existing contours of the social market economy, and the institutional arrangements which favor defenders of the status quo combine to make a frontal assault on the welfare state politically suicidal in most countries.

Yet the pressures associated with post-industrialism, intensified in some respects by globalization, also indicate that sustaining existing policy arrangements without adjustment is an increasingly unrealistic option. Continuing low growth coupled with the challenges of creating service sector employment, population aging, and the overcommitments of existing policies are already generating intense pressures. Tax levels strain public tolerance. Payroll tax burdens and their possible adverse impact on employment and wages create increasingly severe tensions within the traditional support coalitions of the welfare state, particularly in the ranks of private sector unions (Visser and Hemerijck 1997). Barring an extremely unlikely return to an era of high economic growth, fiscal pressures on welfare states are certain to intensify. While tax increases may contribute to closing the gap between commitments and resources, it is difficult to imagine that in many European countries changes in revenues alone could be sufficient to maintain fiscal equilibrium. Thus even strong supporters of the welfare state increasingly acknowledge that sustaining basic arrangements will require significant reforms. It is a context of permanent austerity.

If the welfare state indeed faces permanent austerity, this alone is likely to transform political conflicts over the restructuring of policy. Welfare state conflict is often portrayed as a clash between those wedded to the status quo and those eager to dismantle basic social protections. In countries where aggressive advocates of neo-liberalism have been in power, such as New Zealand and until recently the United Kingdom, this has not been too inaccurate a portrayal. Yet in a climate where social trends make pressures on budgets intense and unrelenting, political cleavages are likely to become more complex. Those advocating restructuring will include many who wish to preserve and modernize key elements of the social contract, but seek to do so in a manner which does not create unsustainable budgetary burdens, contributes to economic performance, and gives emerging social demands some chance of competing for public attention and resources with well-established ones. In the current climate, restructuring must be distinguished from retrenchment or dismantling.

The central contention of the first two sections of this article was that neither the alternatives of standing pat nor dismantling are likely to prove viable in most countries. Instead, as in many aspects of politics, we should expect strong pressures to move towards more centrist – and therefore more incrementalist – responses. Those seeking to generate significant cost reductions while modernizing particular aspects of social provision should be in an advantageous position. In Claus Offe's words, the objective for those likely to wield the balance of electoral power in most countries will be 'smooth consolidation' (Offe 1991).

A useful framework for fleshing out this situation is a simple version of the pivotal politics argument suggested in recent studies of American politics (Krehbiel 1998; Brady and Volden 1998). In any collective choice situation where policy preferences can be arrayed on a single continuum, there is a pivotal actor whose vote determines whether an initiative moves forward or is blocked. This pivotal voter is likely to wield disproportionate power, and policy outcomes should generally gravitate toward that location. *Pivotal* voters need not be median voters. A great deal turns on the institutional environment governing choice. Depending on the significance of multiple vetoes and super-majoritarian systems, the pivotal voter will generally be closer to the status quo than the median voter – often much closer. In the United States, for instance, if a President is prepared to veto legislation, the pivotal voter in the legislature is not the one generating a bare majority, but the one producing the two-thirds majority required for a veto override.[6]

In practice, the political vulnerability of those seeking to modify popular social welfare programs is such that they will often seek relatively broad consensus on reform rather than a 'minimum winning coalition'. Broader consensus legitimates the claim that policy change is necessary, and intended to sustain rather than gut the program under review; it thus provides essential political cover. The desire to make reform durable generally points in the same direction. Especially with large, complex, and deeply institutionalized programs like health care and pensions, social actors are likely to place a high value on predictability and continuity in policy. Reform is not enough; powerful interests seek reasonable assurance that the new policies can be sustained. This again encourages the assembly of grand coalitions. Such coalitions, often informal and issue-specific, extend the range of actors with a stake in the reform outcome, and enhance expectations that the next election will not overturn the new initiatives.

In other words, the pivotal actor in practice will generally be closer to the status quo than the actor identified by a formal analysis of the institutional preconditions for minimum winning coalitions. In a wide range of countries, the coalitions engaged in the restructuring of welfare states have been far broader than minimum size, incorporating key interest organizations as well as political parties outside the current government. What is purchased by such a broadening is the increased legitimacy and potential durability of enacted reforms. Most often, the price is a more incremental adjustment than would have been possible with a smaller coalition.

A final, related factor in pushing the 'pivot' towards the status quo is the possibility that the governments capable of enacting reform at a limited political cost will be those possessing the greatest credibility with voters on the issue (Ross 1998). Following a 'Nixon goes to China' logic, it will often be those governments with reputations of support for the welfare state that have the greatest room to maneuver. Yet the very factors that produce such credibility (past commitments, ideological orientations, and the nature of a party's core constituencies) make it unlikely that the favored party will use this enhanced maneuverability to dismantle established social policies. Again, political incentives point towards more moderate, modernizing reforms.

Of course, students of comparative public policy have long recognized the role of positive-sum bargaining among crucial organized interests and political parties. In most advanced industrial democracies the new economic and fiscal environment has transformed, but not undermined the conditions for consensus-oriented policy-making based on political exchange. What has changed is the 'currency' for such exchanges. Traditionally, labor's contribution to consensus was wage restraint. Even following the demise of Keynesianism this contribution remains important. Yet reformers also require credibility and legitimacy, particularly in the eyes of voters. Left and center-left parties generally need to be brought into reform coalitions to make the restructuring of welfare states politically sustainable. In some cases (e.g. Italy and the Netherlands) unions have been active partners in these agreements, but in other cases (e.g. the recent Swedish pension reform) they have been largely excluded.

The implications of this discussion can be seen in Figure 4. Depicting policy reforms on a continuum from the status quo (q) to a full-fledged neo-liberal agenda of radical retrenchment (r), one would expect the median voter (m) to be a considerable distance from (r). The need to surmount institutional veto points pushes the government reform agenda back to (v), and the desire to gain legitimacy-enhancing and stability-inducing consensus promotes a further move to (c). My argument is thus that in most advanced industrial democracies the viable reform space will be, at a maximum, in the region (c)–(v). Reform thus entails a substantial shift from (q), but it is a long way from (r).

This is, of course, an extremely stylized treatment of reform politics, restricted by both space constraints and the state of current research on welfare state adjustment. A more satisfying account would need to complicate the analysis in several respects. Indeed, each of these complications represents an important part of the current agenda for research on the politics of the welfare state.

First, in many countries, the electoral/partisan arena is not the only or necessarily even the most important domain in which policy reform occurs. Particularly in 'co-ordinated market economies', where corporatist-style arrangements create powerful interlocuters with distinct incentives and longer time horizons, a focus on voters, public opinion, and party coalitions will fail to capture important political dynamics. Instead, policy reform involves a complex two-level game, incorporating both an electoral arena and a corporatist arena (Visser and Hemerijck 1997).[7]

In key respects, however, focusing on the corporatist arena reinforces the basic argument advanced here. With organized labor's traditional sources of bargaining power in decline, the need to legitimate welfare state reform may empower labor in these corporatist bargains. Indeed, this has helped to expand the prominence of 'social pacts' in a number of countries, such as Italy, where corporatist forms of interest intermediation have traditionally been weak (Locke and Baccaro 1996; Rhodes 1998). Corporatist arrangements provide a forum for continuing dialogue

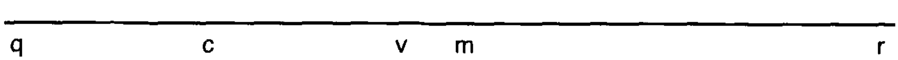


Figure 4 Identifying the viable space for policy reform

and social learning (Visser and Hemerijck 1997) about both the need for serious adjustment and the limits of politically feasible change, which serves to channel reform efforts along consensual tracks.

A second ambiguity concerns the content of welfare state reform. 'Restructuring' is an even more awkward concept than retrenchment. One of the major barriers to cumulative research on contemporary welfare state reform is the absence of clear and compelling conceptualizations of the dependent variable. Esping-Andersen's categories of commodification/decommodification provided a powerful framework for analyzing welfare state expansion, and for measuring the extent to which the welfare state has been rolled back (Esping-Andersen 1990). Yet the mixed motives of contemporary reformers mean that 'recommodification' is only part of the story. The single continuum of reform depicted in Figure 4 is unlikely to adequately capture the restructuring efforts of viable reform coalitions.

With cost reductions a priority, many initiatives will indeed involve fairly straightforward cuts of existing benefits (e.g. delayed retirements or lower replacement rates). Others, however, will involve efforts to address inefficiencies in service provision, eliminate obviously perverse incentives in transfer programs, improve human capital formation, or seek lower-cost mechanisms to combat unemployment and poverty traps. Precisely because serious reform of the welfare state requires broad consensus, there will be strenuous efforts to fashion 'positive-sum' reforms which seek to increase the compatibility of economic and social goals. Reforms may incorporate some programmatic expansions in exchange for cutbacks elsewhere, rather than simply dismantling social benefits. Consensual reform efforts will often focus on redesigning particularly problematic aspects of welfare states rather than eroding social provision across the board (Levy 1998). Major targets of reform are thus likely to vary considerably across countries (e.g. pensions in Germany and Italy, unemployment insurance in Canada, health care in the United States, disability programs in the Netherlands), as a consequence both of distinctive national program designs and the distinctive 'post-industrial' pressures facing particular systems.

Third, a major limitation of Figure 4 is that it is static rather than dynamic. 'c' and 'v' are not fixed points over time; they respond to a variety of changes in the political, social, and economic environment. The operation of EMU could heighten pressure for austerity. Initial, moderate policy reforms could feed back into the political process by shifting incentives, slowly eroding support coalitions for the status quo or expanding the ranks of those with a stake in radical reform. Persistent austerity could gradually undermine public support for the welfare state. The need to view the politics of reform dynamically is unquestionable, but it should be stressed that, almost without exception, two full decades of austerity have yet to create such a downward spiral or tipping process. Stabilizing dynamics (such as the continuous expansion of a retirement population which has high expectations about its pension benefits) are evident as well as destabilizing ones.

Finally, one needs to acknowledge the possibility that efforts to reach a consensus over restructuring may fail. Bargaining breakdowns, disagreements about the magnitude or character of required reform, short-term opportunistic behavior on the part of key actors, or the lack of institutions and organizations facilitating long-term, positive-sum exchanges, may result in an impasse (Scharpf 1997b: ch. 6).[8] Failure to adapt in a timely manner could exacerbate the severity of pressures on the welfare state, increasing the prospect for a more radical and more conflictual process of policy change in the long run. Thus a critical issue for current researchers concerns the circumstances which facilitate or impede the negotiation of substantial and timely adjustment.

Change is coming to the welfare states of the affluent democracies. For the most part, however, it is coming neither for the reasons (shifts in the international economy) nor along the lines (radical market-oriented reform) suggested in popular accounts. A better appreciation of the true pressures and actual politics surrounding the contemporary welfare state remains a precondition for more satisfying analyses of the future prospects for social provision.

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NOTES

1 To link these transitions together as 'post-industrial' is slightly awkward, but just as the term globalization serves to highlight a range of distinct international processes, post-industrialism focuses attention on important domestic transformations.
2 This section owes a considerable debt to the work of my colleagues, Torben Iversen and Anne Wren.
3 In fact, manufacturing's share of output has been relatively constant over time. The relatively low income elasticity of demand for manufactures appears to have roughly offset the falling relative prices resulting from manufacturing's higher productivity (Rowthorn and Ramaswamy 1997).
4 Some have argued that new support for the welfare state has emerged owing to increases in labor market risk, associated with globalization (Garrett 1998; Rodrik 1997) or the transition from manufacturing to services (Iversen 1998). If true, these arguments would bolster the analysis developed here.
5 Veto points may also be policy-specific. The Canada Pension Plan (CPP), for example, cannot be reformed without a large super-majority among provincial governments.
6 More precisely, it is the voter producing a two-thirds override majority in the House or Senate whose vote is closest to the status quo.
7 It is worth stressing that Visser and Hemerijck's stimulating analysis makes clear that the social partners acted 'in the shadow of the state' – that is, with an awareness that political actors were prepared to move forward with restructuring if unions and employers did not take the initiative themselves.
8 Recent French politics is perhaps the best exemplar of this scenario.

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