

THE STATE OF THE ART

The politics of employment-friendly welfare reforms in post-industrial economies

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The transition to post-industrialism has generated a range of new tensions between welfare arrangements and labour market performance, which confront today's welfare states with new challenges for employment-friendly recalibration, such as flexicurity, activation and work-care conciliation. Hence, the question of whether, how and to what extent current welfare states are able to adapt to the conditions and needs of post-industrial labour markets has become a major issue in recent welfare state research. This article identifies and discusses key debates in this literature on the politics of employment-friendly reforms. It first focuses on the general capacity for reform in mature welfare states and then discusses regime-specific reform politics, since post-industrialism confronts different welfare regimes with very different challenges. For each regime, the article proposes a range of research frontiers and open debates which we consider particularly relevant and fruitful avenues for future theorizing and research.

Keywords: institutional change, labor markets, public policy, welfare state

JEL classification: I31 general welfare, I38 government policy; provision and effects of welfare programs, J50 general labor–management relations, trade unions, collective bargaining

1. Introduction: goals and outline

This article identifies and discusses key debates in the literature on the *politics of employment-friendly welfare reforms in post-industrial economies*. The literature on the relationship between welfare institutions and labour market performance has shown that welfare states are not necessarily detrimental to economic

performance.¹ If welfare institutions and labour markets are complementary, the effects may rather be positive. However, the welfare institutions that enhanced labour market performance in the industrial age may weaken this performance in a different, post-industrial context. Ample literature indeed shows that the transition to post-industrialism has generated a range of new tensions between welfare arrangements and labour market performance, which confront today's welfare states with new challenges for employment-friendly recalibration. Hence, one of the major questions in the political science welfare state literature of the past decade or two has been whether, how and to what extent current welfare states are able to deal with these challenges and to adapt to the conditions and needs of post-industrial labour markets. This literature is the subject of the present article.

The goal of this article is twofold: on the one hand, we present our reading of the literature on employment-friendly reform politics in mature welfare states. Both these politics and the literature that theorizes and analyses them are evolving dynamically. Therefore, our discussion of the literature cannot be an exhaustive presentation of the topic, but rather provides an interim overview of the major research in this area. The second goal is to propose and discuss a range of current research frontiers and open debates which we anticipate will be crucial topics on future research agendas dealing with employment-friendly welfare state reforms.

This article is structured as follows. Section 1 reviews the post-industrial challenges to mature welfare states and labour markets: globalization, de-industrialization and demographic changes. We then review a range of typical, post-industrial welfare-employment tensions resulting from these challenges. This provides us with an understanding of what the current literature defines as employment-friendly policy reforms: flexicurity, activation, work-care conciliation and social investments in human resources and skills.

The bulk of the article then reviews our reading of the literature on the politics of these employment-friendly welfare reforms, focusing on actors, preferences and institutions. In Section 2, we focus on the prominent institutionalist literature that deals with the general capacity for reform in mature welfare states: Can industrial welfare states be reformed in an employment-friendly way?

¹The early Keynesian literature (Keynes, 1937; Weir *et al.*, 1988) argued that welfare states are actually a precondition for efficient economies and labor markets. Both capitalists and workers need certain guarantees in terms of stability, job and earnings security to work productively in the long run. More recent and specific studies focus on the effect of the total welfare effort on job performance (see, for example, Atkinson, 1995; Kvist, 2002), on the effects of wage coordination and wage moderation on employment (e.g. Calmfors and Driffill, 1988; Pontusson and Swenson, 1996; Mares, 2006) and on the impact of the mode of welfare financing on job performance (e.g. Palme, 1998; Deakin and Parry, 2000).

What are the conditions for the implementation of unpopular ‘commodifying’ reforms, and what are the factors that explain the success or failure of post-industrial recalibration? In Section 3, we focus more closely on the regime-specific reform politics, since post-industrialism confronts different welfare regimes with very different challenges. In this section, we review literature on the respective agendas, politics and reform determinants in Scandinavian, liberal and continental welfare regimes. For each regime, we then propose a range of research frontiers and open debates which we think address key topics regarding the politics of employment-friendly welfare reforms. Our main focus will be on continental regimes, since their employment-friendliness is the most strongly challenged in the post-industrial context, whereas the Nordic and liberal regimes are rather successful with regard to their employment performance. In the concluding part of the article, we summarize major axes for future theorizing and research.

2. A new context: the transition to post-industrial economies and societies

The linkages between labour markets and welfare state policies depend on the economic and social context. This context has changed profoundly over the last 30 years. Since the 1970s, the industrial economies have developed into very different post-industrial employment patterns. Hence, welfare policies that may have been employment-functional in an industrial era may become employment-dysfunctional in a post-industrialist era. More generally, the linkages between welfare policies and labour markets must be contextualized.

2.1 Multiple pressures on post-industrial labour markets: globalization, de-industrialization and demographic changes

While there is wide agreement in the literature that the economic and social context of Western welfare states has changed dramatically over the last 30 years or so, there is still much ongoing controversy concerning the actual *sources* of these changes. In the following, it is argued that there are three main post-industrial developments—globalization, de-industrialization and socio-structural change—that challenge national labour markets and welfare states.

The economic literature conceptualizes *globalization* mostly in terms of growing trade openness (see, for example, Scharpf and Schmidt, 2000), capital market openness (e.g. Garrett and Mitchell, 1996; Garrett, 1998) or increased global competition in terms of price levels (e.g. Crotty, 2003), wages (e.g. Esping-Andersen, 1996) or taxes (e.g. Tanzi and Schuknecht, 2000; Steinmo, 2002). Intriguingly, both the hypotheses on and the existing evidence for the

impact of economic globalization on labour markets are mixed and not conclusive. Different authors expect either a strengthening of the specificities of national production regimes (e.g. Hall and Soskice, 2001; for early forerunners, see Katzenstein, 1984 and Gourevitch, 1986) or a growing convergence of national labour markets and (liberalized) welfare states (Mishra, 1999). Similarly, the empirical results so far have been inconclusive. It is rather uncontested that the processes of globalization have contributed to de-industrialization and the economic downturn in Western economies after the 1970s. However, whether these developments lead to particular policy responses, notably in the direction of deregulation and retrenchment, is far from obvious. A large body of literature doubts that globalization eclipses national (welfare) state capacity (see, for example, Garrett, 1998; Boyer and Drache, 1996; Evans, 1997; Leibfried and Rieger, 1998; Castles, 2004; in a different vein, see Mishra, 1999). Similarly, empirical studies (Garrett and Mitchell, 1996; Burgoon, 2001) find no or only very weak evidence for a direct negative impact of trade openness on social spending in the OECD (for an extensive annotated bibliography on globalization, see Rieger and Leibfried, 1995). Hence, it is indeed generally agreed that increasing openness leads to a more volatile economy and thus challenges contemporary labour markets, but it is an open question as to how welfare states should or do react to these challenges.

Iversen and Cusack (1998) challenge the globalization literature head-on. In their words, they 'believe that the main sources of risk [in the labour market] are to be found in domestic economic processes' (p. 10), more precisely in the structural transition from an industrial to a service economy, driven by technological change, progressive market saturation and shifting patterns of demand. *De-industrialization* is indeed the second major source of labour market changes that is often mentioned in the literature (see, in particular, Esping-Andersen, 1993, 1999 and Iversen and Wren, 1998 on the 'service sector trilemma'). The literature in this field argues that de-industrialization has profound impacts on the functioning of the labour markets. A service economy provides ample labour demand for very highly skilled and unskilled work, but fewer job opportunities for middle-level skills (Wright and Dwyer, 2003). Furthermore, the rise of service sector jobs and changing production modes goes along with the spread of atypical and flexible work contracts. These changes pose forceful challenges to the industrial welfare states.

In addition to globalization and de-industrialization, the *social modernization* since the 1960s (see, for example, Esping-Andersen, 1999; Pierson, 2001) is a third structural trend that transforms the pre-conditions for employment-friendly welfare states. Two major trends are particularly relevant for labour markets and welfare states: demographic ageing and changing gender roles. An expanding body of literature (see, for example, Castles, 2004; Myles and

Clement, 1994; Esping-Andersen *et al.*, 2002) documents demographic ageing and its twofold consequences in terms of labour markets: on the one hand, the lack of workers of a younger generation will prompt a need for an additional supply of labour. On the other hand, the wealth produced by the active generation needs to finance an ever-growing non-active population. The change in gender roles is partly linked to declining fertility rates. In addition, both higher education levels among women and family instability contribute to the growing demand of women for participation in the labour market (see, for example, Orloff *et al.*, 1999; Orloff, 2006). The implications for labour markets are evident and manifold: a spread of discontinuous and atypical employment curricula, demands for gender-equal arrangements in the workplace, and a growing need to either redistribute or professionalize care work.

The three trends of *globalization*, *de-industrialization* and *social modernization* create a new post-industrial labour market characterized by lower stability, different skill-level requirements, pressure for financial sustainability and a redistribution of work between men and women. These new labour markets clash with welfare states that are designed to match industrial employment patterns.

2.2 *A growing tension between post-industrial labour markets and industrial welfare states*

Post-industrial labour markets have become more precarious, more feminized, more unequal and older (Sarfati and Bonoli, 2002). The fit or misfit between welfare state institutions and labour markets has thus become a prominent issue in the literature on the welfare state (see, for example, Esping-Andersen, 1999; Huber and Stephens, 2001; Sarfati and Bonoli, 2002). The following list presents a selection of some of the major post-industrial developments that challenge the employment-friendliness of welfare states in specific ways:

- *Massive unemployment* since the 1970s: high rates of structural unemployment and labour-shedding strategies, such as early retirement (Ebbinghaus, 2006a), have dramatically reduced the labour market participation rate, especially in continental Europe. The low labour market participation rate becomes a particularly threatening problem for those countries that rely on employment for the financing of the welfare state, i.e. the continental regimes. In addition, the shift from industry to service as the major sector of employment puts into question the existing educational and skill regime that was designed to enable workers to participate in the industrial economy (see, for example, Iversen and Cusack, 1998; Estevez-Abe *et al.*, 2001; Hall and Soskice, 2001; Thelen, 2004). Educational and training systems need to be adapted to provide employees with adequate skills and re-qualification. The literature on *active labour*

market policies and *activation* (see, for example, Clasen and Clegg, 2006; Schmid, 2002) deals with this first category of employment-friendly reforms.

- *Difficulties for outsiders trying to enter the labour market:* Labour markets and standard employment are strongly protected in the continental welfare states. It can be argued that this arrangement was functional for the efficiency of a coordinated market economy in the industrial age (Estevez-Abe *et al.*, 2001; Iversen, 2005). In the current context characterized by structural unemployment and the growth of the demand for the participation of women in the labour market, however, strong employment protection may become particularly harmful to job creation and may drive a wedge between the interests of labour market ‘insiders’ and ‘outsiders’ (Rueda, 2005; Saint-Paul, 1996). In this respect, an employment-friendly welfare state is likely to pursue specific policies to support *outsider activation* and *employment for younger workers* (Schmid, 2002; Wilthagen and Rogowski, 2002).
- *Spread of atypical/precarious work:* De-industrialization and the entry of women into the labour market have led to the spread of atypical employment (see, for example, Talos, 1999; Ferrera *et al.*, 2000). The spread of flexible work raises welfare state issues: employees in atypical employment relations face a greater risk of low income and poverty. In addition, the spread of flexible employment challenges certain welfare arrangements that penalize non-standard employment. Hence, an employment-friendly welfare state would tend to *encourage such forms of labour, but also provide new protection for these new types of jobs*. Denmark and the Netherlands have probably become the most prominent examples of such a ‘flexicurity’ strategy (Visser and Hemerijck, 1997; Ferrera *et al.*, 2000; Wilthagen, 2002, 2003; Bredgaard *et al.*, 2005; Klammer, 2005; Sperber, 2005).
- *Rising income inequality:* As outlined above, the spread of post-industrial jobs leads to an increasing focus on particularly high- and low-skilled employment profiles (Wright and Dwyer, 2003). Scharpf and Schmidt (2000) and Iversen and Wren (1998) stress a similar point when arguing that full employment in a post-industrial economy necessarily comes at the price of greater income inequality. The trend towards rising inequality is likely to become most pressing in the Nordic and liberal worlds of welfare. In the Nordic welfare state, the new production structure may clash with the tradition of wage equalization (Pontusson and Swenson, 1996; Clayton and Pontusson, 1998). In the liberal world, the major problem is the rise in the number of ‘working poor’ (Esping-Andersen, 1999; Simmons, 2004). An employment-friendly welfare state, i.e. a welfare state that supports full employment and well-functioning labour markets, must provide adequate instruments for *poverty prevention* among the working population and/or adapted instruments of wage equalization.

- *Feminization of the labour force*: The entry of women into the labour force hits different welfare regimes in different ways (Esping-Andersen, 1999; Huber and Stephens, 2001). In the industrial age, women's labour market participation rates were already much higher in the liberal and Nordic welfare economies than in continental Europe, where the employment rates of women tend to be significantly below 60% (Gornick *et al.*, 1996; Gornick and Meyers, 2003). This low rate of female labour market participation was perfectly functional in the industrial era: it ensured full (male) employment (Iversen and Wren, 1998) and allowed the preservation of the social and normative ideals of a male breadwinner society (Lewis, 1993; Naumann, 2005). In the post-industrial era, however, the male breadwinner institutions clash with both economic needs and normative values. An employment-friendly welfare state favours policies that allow the *conciliation of work and care obligations* for parents by means of family and labour market policies in order to increase the labour market participation of women (Gornick and Meyers, 2003; Estevez-Abe, 2006).

From the 1980s onwards, the welfare states thus have confronted the need for employment-friendly recalibration (Ferrera *et al.*, 2000; see, for example, Esping-Andersen *et al.*, 2002) and new social risk policies (see, for example, Taylor-Gooby, 2004; Bonoli, 2005; Armingeon and Bonoli, 2006) in the areas of *activation* (including transitional labour markets, outsider activation, youth activation, etc.), *flexicurity*, the *conciliation of work and care* and *poverty relief for the working poor*. At the same time, however, resources have become scarce, so that all welfare states start (highly unpopular) attempts at financial consolidation and retrenchment (Pierson, 2001). Hence, post-industrial welfare states are confronted with these two contradictory pressures: (a) there are demands for expansive welfare reforms, and (b) there is a pressure for financial austerity. In this difficult context, the *politics* of post-industrial reforms become the focus of much of the research on the welfare state: The primary question is not what needs to be done, but whether reform is possible at all. What are the relevant conflict lines? Who will be the key actors of post-industrial welfare reform?

The literature on these questions can be divided into two strands: the first focuses on the more general *reform capacity* of institutionally mature welfare states (Section 2), whereas the second strand deals with *regime-specific politics* (Section 3).

3. The new politics of the welfare state: can mature welfare states adapt to post-industrialism?

The need for employment-friendly welfare state reforms in a context of austerity has fostered the development of a wide and influential body of literature on the question of whether mature welfare states can be reformed at all. At first, this 'new

politics of the welfare state' literature (Pierson, 1996, 2001) dealt almost exclusively with the question of welfare retrenchment, which is not the core of this paper. But the literature on retrenchment does have some relevance in this paper since much of the more recent literature points to the *link* between retrenchment and expansive employment-friendly 'recalibration'. The argument of the early literature on 'new politics' was that over time, welfare reforms become increasingly difficult since the mature welfare states themselves create the constituencies that are likely to oppose such restructuring. Welfare state institutions thereby endogenously transform the politics of reform over time. The new politics of the welfare state (Pierson, 1996) would thus differ from the 'old' pattern of class politics, in which left-wing welfare supporters opposed right-wing liberals. In the new context, it was argued, the ever-increasing ranks of welfare beneficiaries would mobilize for their acquired rights and create a cross-class coalition of defenders of the status quo almost impossible to surmount in democratic regimes. A wide body of literature subsequently analysed these obstacles to reform (e.g. Esping-Andersen, 1996; Myles and Pierson, 1997; Pierson, 2001; Hacker, 2002). In response to the 'new politics' argument, two main answers appeared in the literature: first, a strand of literature close to power resources argues that the basic pattern of class- and party-led reform orientations still holds (Korpi and Palme, 2003; Green-Pedersen, 2001). Secondly, a more recent strand of literature specifies the conditions under which even highly unpopular reforms may indeed take place in advanced welfare states (Hacker, 2002; Streeck and Thelen, 2005). This second strand of literature deals more directly with the politics of welfare state transformation and recalibration.

In this *debate on welfare state restructuring and recalibration*, we identify two areas of research in which many open questions on the emerging patterns of politics still persist.

- *What are the conditions for the implementation of 'unpopular' reforms?*

Unpopular reforms include the retrenchment of benefit levels, but they also refer to employment-friendly reforms such as re-commodification and labour market flexibilization. Many of these reforms have been implemented in Western Europe over the past few decades, and they challenge the neo-institutionalist claim of stasis and path dependency. Several explanations exist, but they have not yet been tested systematically and explicitly against each other. Pierson himself (1996, 2001) argues that restrictive reforms can only be implemented by political leaders against the constituencies of beneficiaries if the consequences of the reforms are non-transparent or obfuscated. However, there have been many very significant reforms over the past few years, many of them covered in detail by the media and heatedly debated in the public arena. Alternative explanations for these reforms have appeared in the literature: Bonoli and Palier (2007)

argue that structural changes are based on the accumulation of a series of reforms in which retrenchment reforms strategically exempt particular groups from negative consequences (e.g. pensioners).

Somewhat similarly, Bonoli (2001), Levy (1999) and Häusermann (2006, 2007) argue that retrenchment reforms tend to be strategically tied packages ('modernizing compromises', Bonoli, 2001) that divide the (potential) opponents of a reform by providing them with selective compensations. Finally, Kitschelt (2001) argues that 'unpopular' reforms are implemented by governments who face little 'electoral threat', i.e. they have no competitor who might credibly defend a pro-welfare position. This last argument comes close to the 'Nixon goes to China' logic, developed by Fiona Ross (2000). Hence, many hypotheses are on the table, but there has been no explicit testing of these hypotheses against each other and no conclusive evidence on the determinants (political parties, ideas, etc.) of unpopular reforms, such as retrenchment or labour market flexibilization.

- *The politics of recalibration*

A different strand of reform analyses the politics of employment-friendly reforms more directly, i.e. without referring to the wider context of austerity and retrenchment. What are the politics of welfare state recalibration in the direction of activation, flexicurity and work–care conciliation? One idea—which is similar to the argument on 'modernizing compromises' in the literature on retrenchment—can be found in the literature on 'social pacts' (Ebbinghaus and Hassel, 2000; Rhodes, 2001). These authors observe that corporatist policy-making had not collapsed in the 1990s (as some had expected; see, for example, Schmitter and Grote, 1997), but quite contrarily had re-surfaced in several European countries such as Italy, the Netherlands and Ireland (Regini, 2000; Rhodes, 2001; Ferrera and Hemerijck, 2003), bringing about activation, flexicurity policies and wage restraint in several countries. How could this happen? Generally, this literature argues that the recent social pacts do not follow the same patterns as earlier corporatist pacts. This means that trade unions and employers are no longer the key actors because they are no longer able to come to agreements through self-restraint and compromise. Rather, this literature argues that the new social pacts of labour market and welfare recalibration are the result of EMU pressure (Rhodes, 2001, 2003; Hancké and Rhodes, 2005), stronger state unilateralism (Rhodes, 2000; Ross, 2000; Hassel, 2003), and/or new types of concertation and negotiation (Ferrera and Gualmini, 2000; Hemerijck and Visser, 2000). Hence, the open question with regard to Western welfare states' capacity for recalibration is whether employment-friendly recalibration is the result of rare and contingent favourable circumstances (such as EMU pressure and a technocratic government) or whether these pacts represent a new mode of policy-making in the post-industrial era (Avdagic *et al.*, 2005).

With regard to employment-friendly family-policy recalibration, rather similar questions have surfaced and remain on the agenda. Reforms aimed at balancing work and family life have gained momentum in many Western European countries since the 1990s, and it has been observed that the politics of work–care conciliation do not correspond to the ‘old’ patterns of class conflict. Rather, these policies give rise to new coalitions of parties, employers and civil society organizations, and they are backed by EU legislation (Jenson and Sineau, 2001; Ferrarini, 2006; Häusermann, 2006; Orloff, 2006). However, it remains unclear so far whether these new coalitions are selective or whether they reflect a pattern of politics that is going to last.

Overall, there remains a range of unresolved questions in the literature on recalibration: Mainly, it is unclear whether these reforms are exogenously induced by supranational legislation, whether they are the result of strong governments and unilateral reforms, or whether they result from a new pattern of preferences and power relations among traditional political actors.

In this section, we have briefly reviewed two strands of literature that deal with the politics of welfare state restructuring and recalibration. From very early on, however, a wide body of literature has pointed out the fact that the post-industrial challenges to welfare states and labour markets will differ between the regimes (Huber *et al.*, 1999; Kitschelt *et al.*, 1999; Scharpf and Schmidt, 2000; Pierson, 2001). Consequently, the politics of employment-friendly reforms also differ across these regimes, and the literature must be analysed and discussed separately.

4. Different reform agendas, different politics

Comparative research published in the early 2000s has shown that each welfare and labour market regime has its specific vulnerabilities, in particular for maintaining employment (Scharpf and Schmidt, 2000). If the challenges vary, so do the solutions: We can identify three approaches to reform, each of them reflecting the distinctive historical and institutional challenges of a particular social protection regime. Paul Pierson argues that the agenda of each regime is dominated by one type of welfare and labour market reform: in liberal regimes, reform is based on re-commodification; in social democratic regimes, reform is based on cost-containment; and in continental regimes, reform is based on recalibration, which adjusts social programmes to new risks and needs (Pierson, 2001, Conclusion).

Here, we will focus on the politics of employment-friendly welfare reforms. The discussions of the politics of reform in the three regime types are structured similarly. We start with the identification of the key issues on the agenda of employment-friendly reforms before reviewing some major open research debates on specific aspects of these reforms.

4.1 *Nordic welfare states: reinforcing a successful regime*

The Nordic welfare states are characterized by high levels of social expenditure and taxes and by low levels of poverty, as well as low income and gender inequality. Therefore, they have been portrayed as ‘big and fat’ welfare regimes (Kautto and Kvist, 2002, p. 191). However, one of the keys to understanding Nordic welfare states is the very *high employment rate*, which is partly the result of large public sector and activation policies. The high level of activation provides the means for the large scope of tax-financed welfare. Hence, since the welfare policies of the Nordic regimes aim at ensuring full employment of all adults by means of activation, work–care infrastructure and public sector employment, they can roughly be seen as the ‘employment-friendly pioneers’, which may inspire many of the employment-friendly reform attempts in other countries, notably the continental welfare states.

Nevertheless, there is a recent trend in the literature towards discussing the *sustainability* of the employment performance in Nordic regimes. In the 1990s, the Nordic model became strongly challenged through a macroeconomic downturn. Unemployment rates in Sweden and Finland increased almost fivefold between 1990 and 1993 (Kautto and Kvist, 2002), and the employment performance also declined in Denmark and Norway. In this context, some authors asked whether the Nordic welfare states would remain sustainable, or whether we should expect a race to the bottom, i.e. a downward convergence with the smaller welfare states in continental Europe and the Anglo-Saxon countries (Lindbeck, 1997; Mishra, 1999; Steinmo, 2002; review in Kautto and Kvist, 2002; for a sceptical viewpoint on these challenges, see Huber and Stephens, 1998). Indeed, some indications of major change in politics have become visible, e.g. when Swedish employers temporarily left the administrative boards of social policy governance (Pontusson and Swenson, 1996; Pestoff, 2002). So far, however, the convergence thesis has received very little support. In a large research project, Kautto *et al.* (2001) show (a) that there is a clearly recognizable Nordic model, (b) that parallel developments with other (continental) countries remain limited and (c) that there is no dismantling of the Nordic welfare states (Kautto *et al.*, 2001). Quite the contrary, the Swedish employment-centred welfare state has become a reference point not only for the EU and other Nordic states developing activation further (Kvist, 2003), but also for the continental welfare regimes seeking to implement employment-friendly reforms.

Hence, there is wide agreement that after a short crisis in the 1990s, the Nordic regimes basically have stuck to their traditional road of welfare and even intensified it. However, several questions about the politics of reform are still debated in the literature. We identify three major questions about Nordic reform politics: (a) what accounts for the strength and spread of activation policies? (b) what are the main conflict lines in Nordic welfare reforms? More precisely, what is the role of

the trade unions in the recalibration of welfare regimes towards employment-favouring policies? and (c) how sustainable is the Nordic model actually?

- *The spread of activation policies in the 1990s*

While Sweden has always been a pioneer in terms of activation policies (Dropping *et al.*, 1999), these employment-centred reforms (here understood as active labour market measures) spread massively in the other Nordic countries in the 1990s. At the end of the 1990s, Denmark and Finland had even overtaken Sweden as the frontrunners in activation, with Denmark being particularly innovative and successful (Kvist, 2003a). In terms of employment-friendly welfare reforms, the key question is, of course, how we can explain these reforms. The jury is still out on the question of whether these policies are the result external constraints and problem load (Dropping *et al.*, 1999), the particularities of the industrial structure (Goul Andersen, 2007), ideational leadership by international actors (Hvinden *et al.*, 2001) and/or other political factors such as coordination capacity and state strength (Martin and Thelen, 2007).

- *Trade unions: new sectoral cleavages or encompassing 'modernized' unions?*

The second major debate in the literature on the development of Nordic welfare state politics deals with the relevant cleavages for policy-making and—more specifically—with the role of trade unions. Much of the literature of the late 1990s (Pontusson and Swenson, 1996; Iversen and Wren, 1998) pointed to a growing intra-labour divide between economic sectors sheltered from international competition (mainly the public and private service sectors) and the economic sectors exposed to growing pressures for competitiveness (mainly the large manufacturing industry). The decline in Swedish corporatism in the 1990s (Pontusson and Swenson, 1996; Pestoff, 2002) points in a similar direction because the employers of the large firms temporarily withdraw from the negotiation table. Similarly, other observers also point to newly emerging conflict lines that may divide the interests of labour (see Sainsbury, 1996 on gender conflict; Steinmo, 2002 on the erosion of worker solidarity). However, the more recent literature points to the renewed success of the Nordic model, with reforms agreed upon by all major actors, including the union movement and the state (Martin and Thelen, 2007).² How can we explain persisting labour cohesion in the Nordic regimes? How did the Nordic trade unions manage to remain encompassing organizations in the context of post-industrialism? These are important questions, especially in the light of the growing intra-labour divides that are present in the continental regimes.

²In addition, Ebbinghaus (2006b) shows that the Nordic union movement is still much more encompassing and representative in terms of skill levels and gender than the continental unions.

- *The sustainability of the Nordic model*

Iversen and Wren, in their article on the service sector trilemma (1998), point out the fact that low income inequality and full employment in a service economy may only come at a very high budgetary and fiscal cost. Therefore, Iversen and Wren expect that the Nordic model may place the interests of the high-productivity private sector against the interests of the low-productivity (public) service sector and thus lead to attacks on the high tax levels. Steinmo (2002) answers this debate by closely examining Swedish tax policy since the 1980s. He finds that Sweden indeed deeply reformed the tax system in the early 1990s, but in a way that did not dismantle the system, rather broadening the tax base while at the same time lowering marginal tax rates for both workers and firms. Overall, the reform made the system less progressive, and it could be seen as a threat to the Swedish welfare model. However, as Scharpf and Schmidt (2000) argue, the problem of sustainability is as much economic as political: the main question is whether citizens in the Nordic states are—and will remain—sufficiently satisfied with public services to consider the high tax levels legitimate.

4.2 *Liberal welfare states: from welfare to workfare*

In the wake of Pierson's contributions (1994, 1996), much of the literature on liberal welfare states in the 1990s focused on the issue of reform capacity against institutional stability. Pierson had shown that even the right-wing governments in the US and the UK were unable to implement radical retrenchment in times when they faced, in principle, very favourable political conditions to do so (i.e. a context of crisis, right-wing ideology, firm majorities and weak unions). Hence, the focus of the literature was mostly on the reform (in)capacity of liberal regimes and on institutional stability (Myles and Pierson, 1997). With the development of the 'third way' in the UK from 1997 onwards, however, the liberal welfare states—especially Britain—became the forerunners of 'employment-friendly welfare reforms'. The whole welfare state was largely reoriented towards extensive workfare schemes, intended to raise employment rates and to replace compensation by activation. With regard to the politics of workfare and the third way, Taylor-Gooby (2001) shows that they were clearly the result of the major political convergence of the Conservative and Labour parties. Equally clear is the apparent 'success' of these employment-focused policies in the sense that the liberal countries managed to achieve very high levels of activation (for a critical view on the third way's effectiveness, see Clasen and Clegg, 2004).³

³However, workfare and liberal labor market policies increased job performance, but they mostly produced jobs at the higher and very low ends of the income distribution, squeezing out the middle classes (Wright and Dwyer, 2003).

The orientation of liberal welfare states towards activation and social investment raises several important issues on the politics and consequences of this employment-focused strategy. We discuss two of them in the following.

- *Third way workfare policies aim ideally at a social investment state. What are the politics of social investment?*

Third way politics insist on individual opportunities and responsibilities instead of on rights. The underlying idea is what Lister (2004) calls a ‘social investment state’, i.e. a state that enables citizens to care for themselves, rather than caring for them. The idea was most strongly developed in the ‘New Deal’ of the Blair government, providing jobs, education and training for unemployed people as a condition of receipt of benefits (‘workfare’). However, the ‘make work pay’ programmes widen the gap between those in and out of work, because more means-tested support is directed to low-income families in work, while benefits are minimal for those out of work. What are the politics of social investment? The ‘Welfare to Work’ programme of the Blair government was supported by British employers, while they opposed the minimum wage. Is the third way activation strategy only a different sort of neoliberal policy, framing retrenchment as an increase of individual responsibility and opportunity? Or is the social investment state a new *left* strategy to reconcile financial austerity with some sort of equality? Is it a way to ‘turn vice into virtue’ (Levy, 1999)? And will it become a larger paradigm for policy reform all over Europe, now that the EU has adopted the strategy and discourse (Jenson and Saint Martin, 2006)? (On this debate, see also Lewis and Surrender, 2004 and—more generally—Green-Pedersen *et al.*, 2001.)

- *Workfare in the liberal welfare states has the problematic side effect of raising wage inequality, working poverty and precarious jobs. What are the politics of making workfare socially sustainable?*

Somewhat in contrast to the ‘neoliberal’ convergence between the left and the right on the third way, Taylor-Gooby (2001, 2004) nevertheless shows that New Labour in Britain did increase provision for low-paid workers and low-income families (see also Taylor-Gooby and Pernille Larsen, 2005). Labour also increased the less visible taxes for higher income groups and introduced a minimum wage. This resembles the ‘classic strategy’ of a liberal welfare state, i.e. a reliance on means-tested minimum benefits for particularly vulnerable groups. What is particularly notable in terms of politics is that these improvements of redistribution are ‘granted’ rather than achieved by the beneficiaries themselves. As Taylor-Gooby (2001) points out, the victims of these trends are unable to gain a political voice within the institutional framework of decision-making in the UK.

4.3. *Continental welfare states: the politics of regime transformation*

Continental welfare states are the most challenged of all regime types because they are most severely hit by the ‘welfare without work’ problem. In terms of Iversen and Wren’s (1998) service sector trilemma, continental welfare states have long privileged wage equality and budgetary stability over full employment. Hence, employment levels in continental welfare states have become particularly low. Continental welfare states also display particularly low levels of female activity and an early ‘de facto’ retirement age, due to extensive early retirement schemes and low labour market opportunities for the elderly.

To a large extent, continental welfare states thus present an accumulation of all the typical problems of a post-industrial society (Esping-Andersen, 1996): Social security is mostly provided through insurance schemes, which are financed by payroll taxes. Hence, low labour market participation undermines the stability of the welfare state. In addition, and in spite of the low female labour market participation rate, fertility rates are lowest in continental Europe, a situation which also undermines the long-term stability of the PAYG-pension schemes. Furthermore, the policy implications of the male breadwinner model (lack of care infrastructure, derived instead of individualized rights, etc.) are in plain contrast to the changing values and needs of a post-industrial society. Moreover, the social insurance architecture of the continental welfare state focuses on standard employment and fails to provide adequate social provision to ‘new risk’ groups, such as the atypically employed, young families, etc. And finally, low female employment and strong horizontal and vertical gender segregation of the labour market negatively impacts the economic performance of these countries. This list of the major strains on continental regimes indicates that the lacking employment opportunities are at the core of most of the problems of these welfare states. Hence, the questions as to whether, how and to what extent employment-friendly policies—activation, work–care conciliation, flexicurity—can be implemented is key.

Much of the literature has argued that the continental welfare states are ‘frozen’, i.e. particularly difficult to reform (Esping-Andersen, 1996; Pierson, 2001). This is due to the very institutional architecture of these states, building on insurance, which not only is very legitimate in the eyes of the contributors, but also reinforces the power of the beneficiaries of existing schemes (Bonoli and Palier, 2000; Pierson, 2001). Since all contributors are stakeholders in the insurance regime, they will have an interest in preventing change, so that reforms should be particularly difficult. In addition, activation and employment-friendly policies often target outsiders and new risk groups, which are particularly marginalized in continental welfare states (Clegg, 2007). Consequently, much of the literature stresses the strong problem-load in continental Europe and the particularly

problematic circumstances for employment-friendly reforms (see, for example, Esping-Andersen, 1996, 1999; Scharpf and Schmidt, 2000; Huber and Stephens, 2001; Armingeon and Bonoli, 2006).

Despite all these rather pessimistic, yet highly plausible, explanations for inertia, a growing body of literature has emerged since the end of the 1990s documenting far-reaching changes in continental welfare states (see, for example, Palier, 2002; Bleses and Seeleib-Kaiser, 2004; Clasen, 2005; Streeck and Thelen, 2005; Palier and Martin, 2007). Not only did most of them massively scale back existing rights in core policy fields such as pensions and unemployment benefits (Schludi, 2005; Clasen and Clegg, 2006), but most of them also expanded employment-friendly policies by strengthening active labour market measures, flexicurity for atypical workers and external care infrastructure for working women (see, for example, Levy, 1999; Hemerijck *et al.*, 2000; Rhodes, 2001; Gornick and Meyers, 2003; Bleses and Seeleib-Kaiser, 2004; Leitner *et al.*, 2004; Clasen, 2005). All these reforms seemed highly unlikely in the context of continental regimes. Consequently, they have triggered a large and growing body of literature on the change of political dynamics and politics in continental welfare states. In this literature, many different explanations of recent political dynamics exist, but most debates remain unsettled so far. In the following paragraphs, we give an overview of the state of several selected debates.

- *Which are the relevant conflict lines in post-industrial continental welfare politics: class, insider/outsider status, gender, values? Are these newly observable conflict lines ephemeral or do they reflect a deeper restructuring of the patterns of policy-making?*

There are several tentative explanations of the recent, highly unlikely reform profile of continental welfare states. Some authors refer to the mere problem-load and to the ideational leadership of governments, convincing people of the need for cuts (see, for example, Kitschelt and Streeck, 2003; Stiller, 2007). Others refer to exogenous factors, notably pressure from the EU (Ferrera and Gualmini, 2000a). However, many observers also note that the *conflict structure* in continental European welfare politics has changed. The recent reforms tend to be implemented by highly ‘unlikely’ (cross-class) coalitions of actors. Several hypotheses exist with regard to the nature of these new conflict structures: Häusermann (2007) shows that labour unions and political parties tend to become more and more split with regard to insider/outsider status, skill levels and value orientations. A progressive, highly skilled, left-wing constituency parts company with the rather conservative blue-collar workforce, the main clientele of the trade unions. Kitschelt and Rehm (2005) emphasize this finding by showing that the left (Social Democrats and trade unions) in continental Europe increasingly relies on an electorate with extremely heterogeneous

welfare preferences. Rueda (2007) also stresses the importance of insider–outsider politics in employment policy reforms. Insiders claim employment protection, whereas outsiders claim active labour market policies. Hence, outsiders may become an ally of forces who want to reduce employment protection. Rhodes' (2001) argument on social pacts goes in a similar direction. Outsider policies have the potential to divide labour. In sum, employment-friendly reforms in continental regimes may divide labour—and more generally the left—and open new avenues to cross-class alliances. An additional open question is whether these new alliances correspond to punctual 'ambiguous agreements' (Palier, 2005), which are highly unstable and ephemeral (Ballestri and Bonoli, 2003), or whether they reflect a deeper reconfiguration of the underlying class structure (Kitschelt and Rehm, 2005; Oesch, 2006; Häusermann, 2007).

- *Who are the winners and losers of the recent employment-friendly reforms (such as flexible labour markets, activation, flexicurity, and female labour market participation)?*

Is the growing focus of the continental welfare states on outsider activation and new risk protection actually a welfare state expansion (Riedmüller *et al.*, 2000; Bleses and Seeleib-Kaiser, 2004; Bonoli, 2005; Häusermann, 2007), or are these policies merely minor sweeteners to a trend towards retrenchment, growing inequality and precariousness (Palier, 2002; Leibfried and Obinger, 2003; Clegg, 2007)? This question about the winners and losers of recent recalibration is at the core of a debate on the effects of recent reforms in terms of social stratification. Indeed, even though most continental welfare states have developed and extended their welfare support for the social groups most at risk (low-skilled workers, low wage earners, young families, etc.), in the end they may still not be better off than people with similar characteristics 10 to 20 years ago. This debate relates, of course, to the question of welfare reform measurement (Clasen and Siegel, 2007). It is relevant to the understanding of recalibrating politics, because the distributional effects of these reforms feed back into subsequent reform processes.

- *What is the role of corporatism in continental welfare state reforms? Has it turned from an advantage into a liability? And why have the trade unions in some countries become 'reformist' and inclined to employment-friendly policies, whereas in other countries, they oppose these same reforms?*

For a long time, corporatism was seen as an integral part of the continental welfare states, ensuring reform capacity and social peace, especially in small states (Katzenstein, 1984) and in times of crisis (Gourevitch, 1986). More recent studies, however, question the role of trade unions. Several studies (Ebbinghaus and Hassel, 2000; Rhodes, 2001; Kitschelt and Streeck, 2003;

Häusermann, 2005) show that in various cases of employment-friendly policies, they have even become a major impediment to reform. Quite in contrast, however, trade unions have been at the heart of the employment-focused reforms in the Netherlands (Visser and Hemerijck, 1997). There is an unresolved debate on the role and strength of labour in these recent reforms. Why do they play such different roles in different countries? What factors does their position depend upon? There are some hints in the literature. Ebbinghaus (2006*b*) points to the selective representation of trade unions in continental Europe: women and service sector workers are strongly underrepresented, as compared to the Nordic states. And Trampusch (2004) shows for Germany that the ties between party and union elites are becoming weaker. This may also contribute to the changing role of unions. Moreover, Ebbinghaus and Hassel (2000) argue that trade unions only cooperated in social pacts where the state was strong enough to threaten unilateral intervention in the case of the failure of negotiations.

5. Conclusion

The transition to post-industrialism has generated a range of new tensions between welfare state arrangements and labour market performance, which confront today's welfare states with new challenges for employment-friendly recalibration. In this article, we have discussed a wide range of literature that deals with the capacity of welfare states to adapt to these challenges and the political determinants of this adaptation process. The overview of this dynamically evolving literature shows that—contrary to the expectations of stasis and inertia that dominated the neo-institutionalist literature in the 1990s—there have been far-reaching changes in most welfare regimes, in the direction of employment-friendly policies such as flexicurity, activation, work–care conciliation and social investments. The Nordic welfare states are the champions of these policies, and their success in terms of both employment performance and social welfare also turns the spotlight on the politics of employment-friendly reform strategies in the liberal and continental regimes. However, both the reforms themselves and the research that analyses their determinants are evolving rapidly, and most research debates have not yet been solved. Therefore, we have outlined and discussed a range of research questions that we consider to be particularly relevant and to be fruitful avenues for future theorizing and research. The following conclusion is a brief summary of these questions.

The literature on recalibration in a context of financial austerity shows that most re-commodifying and employment-friendly reforms in the 1990s and early 2000s were the result of political dynamics and coalitions that differ from the old patterns of class politics (e.g. Rhodes, 2001; Ferrera and Hemerijck, 2003). Divided trade unions, selective cross-class alliances and new party

dynamics characterize these reforms. However, there remains disagreement on two issues: on the one hand, there are competing hypotheses as to whether these 'new politics' are the result of external pressure, stronger unilateral state intervention or underlying electoral dynamics. And on the other hand, we still do not know whether the new alliances and coalitional dynamics represent a stable new pattern of recalibrating policy-making or whether they are ephemeral and selective. Qualitative comparative research, and a stronger focus on the link between the changing socio-structural constituencies and actor positions in the policy process, could take this debate further.

In addition to this general debate on recalibration capacity, we proposed and discussed more regime-specific debates. The Nordic welfare states have so far been the most successful regimes in terms of employment-friendly policy reforms. Activation, flexicurity and work-care policies spread massively, particularly in Sweden and Denmark, throughout the 1990s (see, for example, Kautto *et al.*, 1999, 2001; Kvist, 2003a), and the blooming job performance in these countries makes policy-makers and researchers in other regimes turn their eyes on the factors that explain the capacity for adaptation of these welfare states. In terms of politics, it is striking to see that most of these reforms were adopted by large coalitions of state actors, parties, employers and encompassing trade unions (e.g. Kvist, 2003a; Martin and Thelen, forthcoming). The literature so far provides different explanations for this coordination capacity, referring notably to state strength, external pressure and the strategies of trade unions. Future research may put a focus on the interrelation and relative impact of these factors in order to provide valuable lessons for the future and for other regimes.

Employment-friendly reforms took a particular form in liberal welfare states, relying first on workfare and later on a more encompassing approach of social investment, especially in the UK (e.g. Taylor-Gooby, 2001, 2004; Lewis and Surrender, 2004; Lister, 2004). In contrast to other regimes, these policies correspond to government strategies, rather than negotiated compromises. Given that the current policies feed back into future reforms, and also given that the EU is adopting a similar 'social investment' policy orientation, it is important to assess the nature and distributional implications of these reforms, in particular for low-income groups. Is the social investment strategy a new way of overcoming the equality-efficiency trade-off, or does it widen the gap between the highly skilled workforce and the—politically voiceless—unskilled workers?

Continental welfare states struggle most with the reorientation of their welfare states towards post-industrial labour markets. Employment-friendly reform politics not only deviate from the established logic of insider-oriented, male breadwinner welfare states, but they also blur established conflict lines. A wide body of literature shows that recalibrating reforms follow different logics of political

division than 'old' social insurance reforms (e.g. Rhodes, 2001; Bonoli, 2005; Kitschelt and Rehm, 2005; Häusermann, 2007; Rueda, 2007). In this respect, the salience of the insider–outsider divide is certainly an important open research debate that should receive attention in the future. The literature is still scarce on showing who advocates insider and outsider interests, under what conditions they can be heard and how recalibration affects the balance of power between them. This is a key issue not only for explaining reform opportunities, but also for assessing the distributional implications of these reforms. In this respect, particular attention should be given to the role of trade unions in organizing and advocating the interests of different constituencies of insiders, outsiders, women and the service sector workforce. A comparison with the encompassing union movement in the Nordic welfare regimes tends to suggest that the future of the work–welfare nexus in continental welfare states will depend strongly on the internal reform capacity of continental trade unions.

Finally, and this has not been the topic of our article, future research should pay particular attention to the distributional implications and effects of employment-friendly welfare reforms because they bear very strong relevance for subsequent reforms. Indeed, reform processes are heavily influenced by policy feedback and learning processes. Hence, theories of policy reform dynamics must build on a deep understanding of the determinants and effects of preceding reforms.

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