Welfare states count among the major achievements of Western industrialized democracies in the twentieth century. Today, however, they face a number of challenges: declining economic growth, unemployment, and demographic aging threaten their financial viability, and the post-industrialization of labor markets and family structures has created new social risks, which are insufficiently covered by the existing social protection schemes. There is a double risk of policy deficiency: welfare states may spend too many scarce resources on old risks while not addressing the most pressing problems of post-industrial society. Given that only effective welfare states can be legitimate, the future of modern welfare states depends not least on their ability to adapt to changing social and economic needs and demands. This book argues that welfare states can be reformed, and it demonstrates the conditions for successful policy change: multidimensional reform politics, coalitional engineering by policy entrepreneurs, and an institutional context that favors negotiation and compromise.

Against both conventional wisdom and recent scholarly research, this book argues that the main question is not just whether welfare states can be preserved or whether they have to be radically dismantled. Rather, the challenge that social policy makers face today is the genuine adaptation of social protection to a profoundly altered economic and social context: modernization in hard times. Modernization refers to the adaptation of existing institutional arrangements to the economic and social structures of post-industrialism: the transition to a (high-skill) service economy, high rates of temporary or long-term unemployment, flexible labor markets, the spread of atypical and female employment, family instability, and mounting demands for individualization and gender equality. The hard times result from the gap between declining resources and the growing (financial) needs that these modernization processes entail. Indeed, lagging growth and massive unemployment undermine the financial basis of welfare states. Similarly, declining birthrates and demographic aging alter the balance between the actively employed and the nonworking population, adding to what Pierson (2001: 410) famously called a context of “permanent austerity.” In addition to undermining
The revenues of welfare states, unemployment and demographic changes also create enormous increases in expenditures: demographic aging causes skyrocketing health and pension costs, and the economic crisis increases unemployment- and disability-related insurance expenditures. Moreover, post-industrial labor markets, a changing family structure, and female labor market participation have given rise to a whole range of new social needs, many of which modern welfare states are poorly prepared to meet. Such post-industrial social needs and demands typically include claims for the welfare coverage of the atypically employed, for gender equality in social insurance schemes, for external child-care facilities, for poverty relief for single parents and – more generally – for minimum income security for people with discontinuous employment biographies. Hence, there is both a strong pressure for retrenchment and a pressure for welfare state expansion. These are the two sides of post-industrial modernization.

Although the foregoing structural changes affect the viability and effectiveness of all modern welfare states, the challenge is clearly paramount in the countries of continental Europe. Continental welfare states combine the strongest challenges in terms of new social risks and economic downturn with social protection schemes, which are ill suited to meet these challenges in at least three respects. First, contrary to Anglo-Saxon and Scandinavian welfare states, in which substantial parts of social expenditure are tax-financed, continental social insurance schemes rely almost exclusively on contribution financing by means of non-wage-labor costs. In times of slower economic growth and increasing unemployment, this not only means that fewer people have to finance growing expenditure but it also raises the costs of labor. In addition, the male-breadwinner institutions of continental Europe have led to both low female labor market participation and low birthrates, two structural characteristics that put additional strain on the financial viability of these welfare states. And finally, continental insurance schemes distribute benefits on the basis of and proportional to contribution payments, which means that people with insufficient contribution records – such as atypically employed or part-time workers, unemployed people, homemakers or single mothers – face specific poverty risks. These new social risks are less salient in Scandinavian welfare states, where social protection schemes are more universalistic and benefits and labor market participation rates are more egalitarian. In summary, continental European welfare states are hard cases for successful welfare state reform: they face both the most urgent need for modernization and the most adverse conditions for that very modernization. This is why the present book focuses specifically on welfare reform dynamics in continental Europe, even though many of the theoretical arguments regarding the dynamics of policy reform travel to other countries, too.

Let us start with a look at the record of welfare state adaptation in the recent past. Over the past twenty years, there have been many modernizing reforms in the continental labor market, in pension schemes, and in family policies. Some of these have dealt with retrenchment and financial consolidation, whereas others have addressed new social needs and demands. A few examples may give a more concrete idea of what I mean by modernizing reforms: several countries have profoundly reformed their labor market and unemployment insurance policies.
For instance, the Dutch labor market was transformed into a part-time economy during the 1990s and has strongly improved the social coverage of atypical workers. At the same time, activation policies have been expanded, and Dutch sickness and disability programs have been cut back significantly (Hemerijck, Unger, and Brisser 2000). Similarly, labor markets have been significantly liberalized in Spain from the mid-1980s onward, a process that allowed the country’s rates of atypical employment – notably fixed-term contracts – to rise to the highest rates in Europe (Guillén 2010). In Germany, several waves of the so-called Hartz reforms – enacted at the beginning of the 2000s against massive public protests – radically lowered long-term unemployment benefits (Clegg 2007). At the same time (and this is far less widely known), the last wave of the Hartz reforms required that the projected long-term savings resulting from this retrenchment be invested in the development of external child-care infrastructure to improve the work-care balance for female workers.

The pension schemes of continental Europe have undergone equally dramatic changes: in several social pacts throughout the 1990s, the legal age of retirement in Italy was raised, benefits were cut, supplementary occupational funds were established, and the rules for public and private sector pensions were harmonized (Ferrera and Gualmini 2000). The Austrian government enacted massive cutbacks of benefits and early retirement options in 2003, balancing them with means-tested benefits for poor pensioners and an increase of educational pension credits (Busemeyer 2005). Similarly, the German pension system was transformed over the course of several reforms from 1992 to 2004, evolving from a typical continental pay-as-you-go scheme to a highly diversified system of old-age income security. Today, this system relies on a combination of minimum pensions, regular insurance benefits, and capitalized funding (Schludi 2005; Schulze and Jochem 2007). During the 1990s and early 2000s, capitalized pension funds have also made their way into the French pension system, alongside a massive reduction of regular pension levels (Palier 2002). Equally important, Switzerland transformed the very structure of its basic pension scheme in 1995 when it increased the retirement age for women and switched from a male-breadwinner regime to a completely individualized insurance system (Bonoli and Mach 2000; Häusermann, Mach, and Papadopoulos 2004).

Finally, family policy has also undergone major transformation in a wide range of continental welfare states. Belgian family policy has become increasingly focused on female labor market participation, with the introduction of parental-leave schemes and massive tax deductions for external-care costs in the 1980s. These reforms were followed by an expansion of external child-care options and part-time work opportunities in the 1990s (Marques-Pereira and Paye 2001). Similarly, France extended its already highly developed family policy regime by adding new subsidies in the 1990s: one of them makes it possible for families to hire child-care helpers, and the other supports low-income families with a generous child-rearing allowance (Jenson and Sineau 2001). In 2004, Swiss women became entitled to maternity insurance, and the parliament decided to support external-care infrastructure in 2003 (Ballestri and Bonoli 2003). In Germany,
reforms centered on the work-care balance have gone even further (Leitner, Ostner, and Schratzenstaller 2004): in 2001, the German government instated a right to part-time employment for both parents and raised the level of educational benefits.

All of these reforms – some restrictive, some expansive – dealt with the modernization of continental welfare states (i.e., with their adaptation to demographic, economic, and social structural change). The very occurrence of these reforms, however, leaves us with at least three unresolved puzzles, which lie at the heart of this book.

The first puzzle deals with the reform capacity of continental welfare states. It has been argued, most prominently by authors like Esping-Andersen (1996: 2), that continental welfare states are sclerotic, “frozen” institutional regimes. From a theoretical perspective, this diagnosis is perfectly sensible: the very design of such welfare states – based on insurance and contribution financing – creates liabilities and vested interests in the existing institutional arrangements, which makes major change risky and highly unlikely from both an electoral and an institutionalist perspective (Pierson 1996, 2001). The focus on policy stability in the welfare literature of the 1990s was also very much in line with the classical approaches in policy analysis, which consider institutional change rare and driven by exogenous shocks (see the idea of punctuated equilibria by Baumgartner and Jones [2002] and the concept of dominant advocacy coalitions in Sabatier and Jenkins-Smith [1993]). Very much in contrast with these expectations, however, the foregoing examples show that there has been ample institutional change in the past two decades. The previously mentioned reforms represent instances of major, if not paradigmatic, policy change not only because many of the cutbacks were very sharp¹ but also because they have, in many respects, transformed the very logic and structure of social insurance schemes. The introduction of means-tested pension minima and capitalized pension funds in France and Germany represents a systemic shift away from the collective insurance principle, which has been at the heart of the continental postwar welfare state. Similarly, the introduction of gender equality in pension insurance, the expansion of external child-care infrastructure, and the support of part-time employment change policies in a direction that is diametrically opposed to the male-breadwinner logic, which traditionally has been a key characteristic of these regimes. These changes are systemic and therefore paradigmatic. How can we explain these surprising reforms? The recent literature has started to acknowledge and describe that institutions are less stable than expected (e.g., Streeck and Thelen 2005; Palier, 2010). However, we still lack an explanation of the politics of change: How are political majorities built? Under what conditions is change possible or even likely?

¹ For instance, the reference period for pension calculation was extended from ten to twenty-five years in France, from five years to the whole duration of the career in Italy, and from fifteen to forty years in Austria. The Organisation for Economic Co-operation and Development (2007) estimates that, after taking their full effect, pension reforms in countries such as France and Germany will lower benefit levels by 10–25 percent.
The mere occurrence of reforms is not the only puzzling aspect about the observed institutional changes, however. The second surprising feature of the reforms is that so many of them seem to go against the interests of the main stakeholders of industrial welfare states. Indeed, the continental welfare regimes are largely the outcome of a class compromise between the organizations of labor and capital from the main industries. Therefore, the standard male employees in the industrial sector (i.e., the insiders) are the early winners of institutional creation and the main beneficiaries of existing insurance plans. People outside this core workforce, by contrast – namely labor market outsiders, the atypically employed, or the non employed – have always remained at the margins of continental welfare states. Neo-institutionalist theory would predict that the institutions have consolidated the power of the insiders over time at the expense of the outsiders. But quite to the contrary, many of the recent reforms have lowered the social rights of insiders to a considerable extent, even in core insurance schemes such as unemployment (e.g., in France, Germany, Switzerland, and Belgium) and pensions (e.g., in Switzerland, Germany, France, Italy, and Austria). To sum it up quite simply, the recent reforms have enacted the very kind of policies we would not expect to occur.

The third puzzle deals with the winners rather than the losers of recent reforms. To a great extent, recent welfare state expansion has been directed toward social groups that are particularly weak in terms of political representation and power. Gender equality in social insurance and educational pension credits, for example, respond to the specific interests of women. Child- and elderly-care infrastructure (and more generally policies on work-care balance) support young families. Social insurance coverage of atypical work and the creation of means-tested benefit minima are reform strategies that benefit mainly labor market outsiders. All these risk groups – notably the low skilled, young, female, and atypically employed – tend to be underrepresented, both in political parties and in trade unions. How did their needs take on such acute political relevance in a context of austerity, which seemingly forecloses any expansion whatsoever?

These three puzzles make it clear that both the scope and the direction of recent continental welfare state modernization are unexpected and need to be explained. This book proposes an analytical model that allows for the understanding of these seemingly contradictory reform trends. The need for such an explanatory model is obvious, as much of the existing literature has just started to acknowledge the actual scope of the recent changes and is still far from explaining it systematically. Furthermore, the most common explanatory approaches found in the existing welfare state literature – functionalism, power resources, and institutionalism – fail to explain the dynamics of post-industrial modernization. Functionalism, the explanation of policy outputs by structural requirements, may be able to account for some cross-regime variation. For instance, gender and family patterns changed earlier in Scandinavia, and deindustrialization started sooner there than in continental Europe. But although this reasoning can shed some light on the more gender egalitarian and universalistic welfare schemes in the Nordic welfare states (Bonoli 2006), it certainly fails to explain the scope
of cross-country differences in reform outputs among the continental countries. Power resources theory, which focuses on the balance of power between labor and capital, falls short particularly when it comes to the expansive reforms mentioned herein. Indeed, the beneficiaries of recent social policy expansion are not the traditional clientele of the labor movement. Rather, they are the politically disenfranchised – the weak. In terms of power resources theory, it is thus difficult to understand why, in a context of financial austerity, countries would expand their benefits for atypically employed, working women, or the poor. It may be more promising to explain recent retrenchment with power resources, interpreting restrictive reforms as the result of a context of austerity that changes the balance of bargaining power in favor of capital (see, e.g., Korpi and Palme 2003). With this argument, however, power resources advocates run aground on the cogent institutionalist claim of path-dependency: over time, the very existence of continental welfare states has extended the ranks of stakeholders in the existing insurance schemes far beyond those of the traditional constituencies of the left, to an extent that makes retrenchment at the expense of insiders politically unlikely (Pierson 1996). Moreover, neo-institutionalism is as unable to explain the recent expansive reforms as is power resources theory. So, if functionalism, power resources, and institutionalism fail, how can we go beyond these approaches?

**Outline of the Argument**

The failure of the existing literature to provide a conclusive explanation for post-industrial reforms results from the fact that most authors tend to adopt too narrow a focus – directing their attention either to a single dimension of the reforms (e.g., retrenchment or new social risk policies or privatization), or to a single explanatory factor (e.g., power resources or institutions or electoral risk or structure). Although each of these theoretical perspectives may explain a part of the ongoing dynamics in continental welfare states, their interrelations are key in accounting for the whole picture. In this book, I propose an explanatory model of institutional change that integrates several theoretical perspectives and conceptualizes different reform dimensions as elements of the same, multidimensional policy space.

The argument goes as follows: the translation of social and economic structural change into actual policy output depends on the *interplay* of structure, institutions, and actors’ preferences and strategies, and it consists of three steps. The first step is the translation of structural change into policy-specific *conflict dimensions*. I argue that structural developments, such as deindustrialization, demographic aging, and family instability, create potentials for political conflict if and only if they challenge the preexisting institutions. Hence, increasing divorce rates, for instance, may not challenge a universalistic and gender egalitarian social-democratic welfare state regime, but they do put a male-breadwinner system into question. Similarly, high levels of unemployment have more dramatic consequences for the financial viability of welfare states that are financed by means of payroll taxes than for those regimes that rely on general taxation. Hence, if such
a clash between evolving structures and stable institutions generates institutional friction (i.e., an institutional misfit), there arises a potential need for the adaptation and reform of institutions. Those who suffer from this misfit are supposed to have a keen interest in institutional adaptation, and those unaffected by it do not or may hold a stronger interest in the status quo. Continental welfare states – built on contribution financing, work-related eligibility for coverage, earnings-related benefits, and decentralized management (Bonoli and Palier 1998) – are particularly at odds with the structural developments of growing austerity and post-industrialization. Therefore, a variety of different institutional misfits emerge, with an ensuing variety of potential reform dimensions.

This variety of potential reform dimensions – and this is the second step – engenders different crosscutting conflict lines, each one splitting social interests in a distinct way. For instance, some conflict lines may oppose the preferences of labor and capital, whereas others are likely to divide social groups according to skill levels or labor market status (insiders versus outsiders). These different risk and preference profiles define a range of potential class and cross-class conflicts at the socio-structural level, and these various socio-structural potentials are spread differently across the constituencies of political parties, trade unions, and employer organizations. Therefore, I expect a plurality of crosscutting conflict lines in the political decision-making processes, giving rise to a multidimensional space in which reform politics unfold.

The third step of the explanatory model deals with the translation of these diverse alliance potentials into actual reforms (i.e., with the determinants of the reform capacity and the actual policy output). To begin with, the multidimensionality of the policy space creates possibilities for political exchange. Rational policy makers can and will strategically exploit such possibilities. In times of austerity and in a context of mature welfare states, the success of welfare reforms depends on the formation of large coalitions supporting them. By combining several conflict dimensions in a single reform package, policy makers may be able to foster such broad cross-class agreements. More specifically, policy makers may try to blur the opposition against retrenchment by compensating cuts with policies aimed to foster cross-class conflict. But the story does not end here, because two (institutional) factors influence the chances of success of such coalitional engineering strategies. First, the more that labor, business, and political parties are fragmented, the more flexible is the reform-specific coalition formation – and the greater the chances for coalitional engineering. By contrast, where economic interests and political parties are concentrated, coalitions are more stable and actors cannot opt in and out of specific and variable reform coalitions as flexibly. In a regime with a high number of veto points – and this is the second factor – such an inability to foster broad cross-class conflict lowers the capacity for reform.

In summary, successful welfare state modernization in continental Europe depends on the capacity of policy makers to build encompassing reform coalitions in a multidimensional policy reform space. And this capacity, in turn, depends on their strategies of coalitional engineering and on the institutional framework within which they deploy these strategies.
The main claim of this book – that multidimensional politics create reform opportunities in hard times – may very well apply to welfare reforms in all regimes and even to policy change more generally (Engeli and Häusermann 2009). In that sense, continental pension reform is just one example of a larger class of phenomena to which this theoretical argument could be applied. But there are reasons why, in this book, I choose to develop and test the argument with regard to pension policy reforms in Germany, France, and Switzerland – three continental pension regimes that share most of the structural and political reform challenges but differ strongly with regard to the institutional framework of decision making that conditions the success of coalitional engineering. Continental pension policy reform is a case of hard testing, because endogenous stabilizers and mechanisms of path dependency are strongest in this prime example of a supposedly inert, frozen policy. Hence, if multidimensional politics and cross-class coalitions allow for adaptation even in pension politics, this is strong evidence for the relevance of these dynamics in the modernization of welfare states more generally.

Contributions of the Book

There is a huge, highly informed, and sophisticated literature dealing with the development of (continental) welfare states and pension policy over the past thirty years. One may ask whether there is a need for another book on the recent pension policy development. If this study focused merely on retracing major reforms, one might well doubt its usefulness, even though the pace of change in today’s welfare states certainly fosters a need for ongoing empirical examination. But that is beside the point. This book deals more generally with the dynamics and determinants of institutional change and policy reform. It makes four theoretical contributions to some of the most vibrant current strands of theorizing and research, and it presents a new empirical and methodological approach to studying policy change over a long time and across multiple countries.

The first contribution is a conceptualization of the coalitional dynamics underlying institutional change. One of the most promising current theoretical attempts to explain recent policy reforms in institutionalist terms is the concept of gradual transformative change, developed by several authors in a volume edited by Streeck and Thelen (2005). Reconsidering the early institutionalist focus on stability and inertia, these authors posit that major change may occur in a series of seemingly minor institutional adaptations, whereby institutional arrangements are gradually undermined, complemented, and/or replaced by new ones. The existing institutions themselves may condition such change by shaping actors’ interests and – given their “inherent openness and under-definition” – by providing “rule takers” with more or less leeway in the implementation (Streeck and Thelen 2005: 15). Hence, although the focus of this new approach has so far been on the conceptualization of the mechanisms of change, it is clear that an actual explanation of gradual transformative change must be based on actors, their preferences, and their behavior and strategies. Thereby, this second-generation
institutionalism must integrate a good deal of agency and power resources variables to gain convincing explanatory power (Mahoney and Thelen [2010] actually go in this direction). Indeed, the authors of this approach insist on the importance of the underlying actor configurations and on the “shifting coalitional basis” of institutions (Thelen 2004: 33). In that sense, the insight that the key to understanding institutional change lies in the plurality of conflict lines and alliance potentials is not new. However, we still lack a conclusive theoretical account of the politics and the coalitional dynamics of institutional change. This is precisely what this book delivers: an explicit theoretical and empirical focus on the multidimensionality of policy reform spaces to explain institutional change.

The second theoretical contribution speaks to the literature on cross-class alliances. So far, this literature has demonstrated the relevance of numerous political cleavages other than class (e.g., Mares 2003; Hiscox 2001; Rueda 2005), and in this sense, it can be read as research on the multidimensionality of politics. To some extent, this book simply provides further theoretical and empirical evidence for the claims that labor and capital are not homogeneous categories and that political coalitions in welfare state reforms are oftentimes built on determinants other than class, such as skill levels, insider-outsider labor market status, or values. But the major contribution I want to make here is with regard to the socio-structural explanation of such cross-class alliances in a post-industrial context. In this book, I argue that conflict lines, which crosscut labor and capital, are inherent in the post-industrial class structure itself. Given the growing share of service sector jobs in the employment structure, female labor market participation, and the spread of higher education, post-industrial labor markets have become so diversified that we must think in terms of a new class schema that divides the workforce into a highly differentiated set of classes. Labor has become an increasingly heterogeneous category that encompasses stark differences in terms of income, chances for mobility, and political preferences. Hence, different categories of labor vary strongly with regard to their risk profiles, interests, values, and – consequently – political preferences. For these reasons, the cross-class alliances that we observe in post-industrial policy making are neither surprising nor accidental nor fortuitous; they are genuinely rooted in the post-industrial class structure. This book shows that the literature on cross-class alliances may benefit greatly from drawing explicit theoretical and empirical links between the socio-structural micro-level of class and the positions of collective political actors in the reform processes.

The third theoretical contribution of this book is to highlight the importance of cultural value divides in post-industrial welfare state reform dynamics. Social policy making is often viewed as a mere distributational struggle between conflicting material interests, and given the fact that welfare states depend on the taxation, distribution, and redistribution of income, this is doubtless a sound focus of the analysis. But there is more to welfare states than preventing poverty and insuring the risk of income loss. Social policy is and has always been a means of regulating social stratification, family patterns, and gender roles by positive and negative incentives, particularly in continental welfare states (see, e.g.,
Van Kersbergen 1995; Orloff 1993; Esping-Andersen 1999). The institutions of the welfare state entail a moral definition of the aspired societal order. Thus, political struggles regarding the design of welfare state institutions are almost always both distributional conflicts and value conflicts. The value aspect of welfare politics is, of course, particularly salient in reforms that deal explicitly with the issues of individualization, familialism, and gender equality. Given the growing misfit between male-breadwinner institutions on the one hand, and the realities of post-industrial family instability, increased female labor market participation, and the spread of discontinuous, atypical employment biographies on the other hand, these value issues have become key topics in welfare state modernization. Therefore, actors’ social policy preferences cannot be understood through their material interests alone. Their positioning on a cultural value divide, in regard to libertarian-progressive versus traditionalist values (Kitschelt 1994), must also be considered. Although the relevance of this value divide may seem straightforward in policy fields such as environmental policy or arts and culture, this book stresses its relevance even to the field of welfare state research. Values are, to be sure, not completely independent of socio-structural characteristics such as skill or income levels. But they can reinforce or hamper the cohesion of interest-based alliances, and they can be a basis for coalition formation in their own right.

The fourth and final theoretical contribution of this book is that it challenges a trend in the current institutionalist literature that consists in downplaying the importance of macro-institutions – such as electoral regimes and consensus democracy – in the explanation of policy reform outputs. Rather, it is argued that welfare regimes’ micro-institutions (i.e., institutional policy arrangements) (Bonoli and Palier 1998) endogenously structure the political decision-making processes (see, e.g., Streeck and Thelen 2005; Palier and Martin 2007). I would agree with this claim when it comes to the substance of the reforms we witness in a particular regime type. Indeed, recent reforms in continental welfare states display striking similarities, despite the very different macro-institutional regimes of these countries. However, one must be careful not to overshoot the mark in criticizing the traditional focus on macro-institutions: electoral systems and state structure may not account for the content of reforms, but this book shows that these institutions remain important in explaining the scope of welfare state reforms. Macro institutions influence the extent to which political parties and interest organizations are willing and able to engage in processes of variable and selective coalition formation. Therefore, these institutions remain relevant to the explanation of intra-regime variation in reform capacities and reform outputs.

Finally, this book proposes a new empirical and methodological strategy for the analysis of policy change, which strikes a balance between large-N regression studies and historical case studies. When analyzing the coalitional dynamics of welfare state change, both of these traditional approaches present specific advantages but also difficulties. Case study research allows for investigating the very mechanisms of political exchange and for tracing actor configurations in detail, but it is difficult to apply this strategy to a large number of reform processes over time. Purely quantitative studies, in contrast, tend to lack precise information...