Building a Sustainable Welfare State
Reconciling Social Justice and Growth in the Advanced Economics

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Escaping the Equality-Efficiency Trade Off

The conciliation of economic growth - with its demanding 'efficiency' imperatives - and social justice - with its equally demanding call for 'equality' - has been one of the most significant achievements of the 'long' twentieth century, now coming to a close. On both sides of the Atlantic, the welfare state (and, more specifically, social insurance) is the main institutional manifestation of this success story. Yet, today it is the object of heated controversy in all of the advanced economies. The 'conciliatory' capacity of the welfare state has been put in serious question, especially in the light of the so-called 'globalisation' process. More and more frequently, efficiency and equality, growth and redistribution, competitiveness and solidarity are referred to as polar opposites that can only thrive at each other's expenses. There is therefore a risk that the new millennium will open under the shadow of a resurrected 'big trade-off', offering only two possible coherent value-combinations and thus virtually only one viable institutional scenario, if functional priorities ('the pie first') are to be respected.

Plausible as it may sound, this trade-off logic is certainly not inescapable. But how can we find a way out of it? The task is one of identifying new value combinations and institutional arrangements that are both mixed (in respect of their normative aspirations) and virtuous, i.e. capable of producing simultaneous advances on all the affected fronts. And the search for these combinations and arrangements must start from an accurate diagnosis of the problems and challenges that are currently afflicting the Western welfare state and are disturbing its delicate relationship with the spheres of economic production and exchange. What exactly lies at the basis of the current welfare predicament? Consequently, what reforms are needed in order to (re)create virtuous circles between social protection and its changed socio-economic context? And finally how can the reform agenda be realised, so that 'old vices' are turned into 'new virtues'?

Globalization Versus 'Internal' Challenges

Let us start with the thorny issue of 'globalisation', frequently assumed to be the basic origin of the predicament. As shown by recent research, there may good reasons for believing that the overall impact of globalisation has been exaggerated, as have its potentially adverse consequences for employment and social standards (see e.g. Garrett 1998). It is important to acknowledge that national economies have neither been wholly absorbed into a new global order nor their governments totally incapacitated. Non-tradables remain important in most European economies and national comparative advantage and specialization remain critical for international competition. Good arguments for the compatibility of large welfare states with internationalization are regularly rehearsed. Welfare states emerged in line with the growing openness of economies and facilitated the consequent process of socio-economic adjustment. Government consumption appears to play an insulating role in economies subject to external shocks.

Unemployment problems and the need for the modernisation of social protection systems should, on the whole, be attributed mainly to other developments (such as the 'post-industrialization' of advanced economies) to which globalisation (e.g. greater trade competition across a growing range of sectors) may make some contribution but cannot on its own explain. We discuss a number of hypotheses concerning the interaction of internationalization with European labour market problems below. Serious attention should be paid, however, to the arguments that financial market globalisation limits government policy-making autonomy, and that market integration and tax competition constrain the capacity of states to engage in redistributive tax policies. While the 'propensity to deficit-spend' has not been constrained by increasing trade and capital mobility (in the EU it has been checked by the construction of economic and monetary unions), financial market integration or capital mobility have potentially a detrimental effect on the policy-making autonomy of Left-Labour governments. They certainly demand that policies prioritise credibility with the capital markets foremost amongst their other objectives. But whatever the extent of the 'globalization effect', which remains debatable, the potential incompatibility between national welfare states and increasingly integrated European markets may be more important than the subjection of the welfare state to punitive global markets. At a time when EMU has forced a reduction in deficits and debts, and rendered competitive devaluation impossible for its member countries, even a 'globalization sceptic' has to accept the constraining nature of these European developments. All European welfare states must become 'competitive' to the extent that simultaneously meeting their fiscal, solidarity and employment creation objectives requires a creative new mix of policies. That said, various types of institutional setting and forms of social, social security and labour market policy may be equally compatible with competitiveness. There is no need for (nor is there much evidence of) convergence on a 'neo-liberal' value combination and institutional model, despite the conviction in certain political circles that such convergence is required.

It should also be stressed that welfare states have generated many of their own problems and these would have created severe adjustment difficulties in the late twentieth century, even in the absence of greater exposure to flows of capital and goods. By helping improve living standards and life spans, welfare states have created new needs that social services were not originally designed to meet. Rising health care costs and pensions provisions have contributed massively to welfare budgets and fiscal strains. Other problems - e.g., the decline in demand for low or unskilled manufacturing workers - stem from the increasingly post-industrial nature of advanced societies. Post-industrial change has created a 'service sector trilemma' in which the goals of employment growth, wage equality and budgetary constraint come increasingly into conflict (Iversen and Wren 1998). Creating private service sector employment entails lower wage and non-wage costs, while generating such employment in the public sector is constrained by budgetary limits. Given the constraints on running high public deficits in the long run, once again there appears to be an inescapable trade off - we either accept high unemployment or countenance greater inequality.

The roots of the current welfare predicament are thus primarily internal - as, of necessity, must be the solutions. The social and economic transformations occurring within affluent democracies are generating mounting pressures on institutional arrangements which not only were designed under very different 'environmental' circumstances, but which have also become increasingly rigid overtime. This syndrome is aptly captured by the metaphor of growth to limits (first used by Flora, 1986/87). In the last couple of decades most of the ambitious social programs introduced during the *trentes glorieuses* (especially as regards pensions and health care) have come to full maturation: they work 'in high gear' and apply to the vast majority of the population. As observed by Pierson (1999a) these extended government commitments produce persistent budgetary pressures and a marked loss of policy flexibility, making even marginal change inherently difficult. The crux of the problem can be construed, as Pierson puts it, in terms of 'irresistible forces' (e.g., post-industrial pressures) meeting 'immovable objects' (strong public support and veto points). Thus, the relative growth of the service sector implies lower productivity growth and entails either greater public spending or increased wage inequality if new jobs are to be created. The maturation of governmental commitments and population ageing demand reforms to health care provision and old age pensions (in 1992 these accounted for 80% of all social protection outlays in the European Union) if costs are not to escalate and employment creation stymied by higher direct taxation and/or payroll taxes. Yet such policies are constrained by the popularity of generous welfare programmes and the commitment of a range of political and vested interests and beneficiaries to defending them. The path forward must of necessity combine creative new policy mixes with new social bargains, woven together with a high degree of political imagination.

Building a Sustainable Welfare State: the Agenda for Reform

If our diagnosis is correct, then the current, persisting problems of the welfare state must be interpreted essentially in terms of an 'institutional maladjustment' between a set of old policy solutions, which are gradually losing both their effectiveness and their flexibility, and a set of new societal problems mainly stemming from internal transformations, but under increased exogenous constraints. The predicament is affecting the various welfare states to varying degrees and tends to be more serious where the principle of social insurance is more firmly entrenched, i.e. in the so-called 'Bismarckian' systems. Here the allocative implications (old risks vs. new needs) and distributive consequences (protected vs. unprotected social groups) of maladjustment have combined to create a widening chasm between a clientele of strongly covered 'insiders' (individuals and households) and growing numbers of under-protected 'outsiders'. In many systems (particularly in Southern Europe) there is evidence of an over-accumulation of benefits on the side of 'guaranteed' workers, with quasi-tenured jobs paralleled by an inadequate (if not total) lack of protection for those employed in the peripheral sectors of the labour market. In particular there seems to be a growing gap between the so-called DINK families (double income, no kids; insider jobs) and the SIMK ones (single income, many kids; outsider job). Though less visible than in the US, an American-style underclass has already formed in some regions of Europe, falling almost completely outside the reach of social insurance.

Of course, the challenges to the status quo and the capacities for adjustment differ widely across countries. Whichever the institutional configuration, the scope for policy innovation seems however to lie between the twin constraints of (1) preserving social justice objectives and (2) solving those fiscal and policy failure problems that undermine economic imperatives - at both the macro and the micro level. At the risk of some simplification, we would like to indicate and discuss some possible broad guidelines for reform in the crucial fields of labour market policy, social insurance and health care.

The Labour Market: From Unemployment Insurance to Employability

Continental European countries have performed poorly in terms of job creation in recent years. Fluctuations in the European economic cycle have left larger numbers unemployed whenever there has been an upturn in the cycle ('hysteresis'). This suggests that employment creation lags behind growth and that the fruits of new growth are not evenly shared between insiders and outsiders (see

Ormerod 1998) - a situation much more acute in some countries than others, created by over-protective regulations for those in full-time, standard employment (see Siebert 1997). In this respect, unemployment shows how different national systems have to face the sometimes adverse consequences of existing social contracts and swallow the bitter pill of reform. Thus, in the Scandinavian countries, the distributional costs of generous social contracts were met by those in employment who have paid high taxes for an over-developed public sector to soak up the potentially unemployed. In continental Europe, governments, employers and labour unions have more or less agreed that the price of adjustment should be shouldered by the unemployed, comprised largely of younger, female and older workers. In southern Europe, an acute 'inside-outsider' problem has developed as a result of the fragmentation and disparities in the income support system for those without work, with large differences in the level of protection given to core and marginal workers.

There has been intense disagreement about the causes of growing unemployment in Europe and the decline in the incomes of the low-skilled and unskilled, but not about the fact that it is occurring. One way or another, there appears to be a relationship between international competition (which for the European countries is primarily with their immediate neighbours in most sectors), technological change and the declining demand for certain types of workers. Freeman and Soete (1987; 1994) argue that the advanced economies are experiencing a shift from an older Fordist 'techno-economic paradigm' - based on energy-intensive production systems and services - to a new 'techno-economic paradigm' based on information-intensive production systems and services. The consequence is far-reaching managerial, organizational and distributive changes, including unemployment among particular categories of workers. Europe is falling behind other regions, however, given an inability to sustain comparative advantage - and therefore widespread employment creation - in the information and communications technology industries. Snower (1997) identifies four critical developments as responsible for greater dispersion of incomes - and a shift in labour demand - between versatile and well-educated workers on the one hand and non-versatile workers and poorly educated workers on the other:

- the reorganisation of firms into flatter hierarchies with a large number of specialised teams reporting directly to central management;
- radical changes in the organisation of both manufacturing and services linked to the introduction of flexible machine tools and programmable equipment, allowing a decentralisation of production and the adoption of 'lean' and 'just-in-time' methods;
- dramatic changes in the nature of products and in seller-customer relations;
- and the breakdown of traditional occupational distinctions and of what is meant by 'skilled' versus 'unskilled' workers at a time when employees are given multiple responsibilities, often spanning production, development, finance, accounting, administration, training and customer relations.

By making jobs less secure, these developments are creating greater reliance on unemployment insurance, public support for education and training and a wide variety of welfare state services. The risk is that this generates what Snower calls 'the quicksand effect' - the phenomenon whereby welfare structures designed for a different era become weighed down and generate negative effects, destroying incentives and making redistributive policies inefficient, while the productivity of welfare services declines and their cost increases.

But the policy conclusions are not all pessimistic. In the labour market, Europe can adapt to the challenges of the information and communications technology revolution, and this revolution can be employment-enhancing in the long-term, if it invests in a new form of flexibility for the workforce (in which occupational patterns and skills profiles are more important than inequality-increasing wage flexibility) and engages in extensive institutional innovation, including a greater attention to the spread of information and communications skills through the education and training systems, as well as substantial investment in telecommunications infrastructure (such as 'information highways'). There also needs to be a co-ordination of supply-side policies across all European countries, focusing on the rapid diffusion of the new techno-economic paradigm throughout the wider socio-economic system.

The implications for the welfare state are wide-ranging, and we address some these broader issues - in pensions, social security and health care - below. To avoid the 'quicksand effect' of traditional welfare policies, a number of options need to be considered. These include incentives to choose between the public or private provision of welfare services; the introduction of elements of voluntary or compulsory savings and insurance into the current tax-and-transfer system and government subsidies for low income groups to help meet equity objectives and the 'activation' of traditional benefits. At the same time there needs to be an expansion of a non-traditional personal, social and environmental services sector to counteract the loss of jobs occurring due to the fact that many traditional services are now exposed to international competition. The creation of a new 'sheltered sector' could be encouraged by tax changes that bring activities that are now frequently in the black economy (e.g. cleaning and repair work) back into the regular economy, while new jobs could be encouraged in education, caring personal services and repair and maintenance. The welfare state's financing and the benefit structure should allow for an expansion of employment at the lower end of the earnings scale - thereby tackling one angle of the 'service sector trilemma' - without creating a class of 'working poor'. High levels of payroll-taxes and social security contributions can be an impediment to the expansion of low-paid/low-skill private-sector service jobs. Social security systems which are financed out of payroll taxes tend to increase labour costs for low-paid employment above the corresponding productivity levels, if wages are sticky downwards. A substantial reduction of social contributions for low-paid workers, as undertaken for instance in the Netherlands and in the United Kingdom, could be part of the strategy to resolve this dilemma.

Certain combinations of incremental reform in labour market rules and social security systems, plus certain policies encouraging a redistribution of work (some forms of work sharing, for example) can help mobilize those sections of the unemployed work force left behind by a return to higher levels of growth. Flexible employment patterns, buttressed by reform of the tax and social security systems, will play an important role in this respect. Otherwise activation policies, designed to help welfare recipients to enter the labour market, while also strengthening obligations to accept suitable work and/or take part in training courses, will fail to tackle the unemployment problem. To facilitate such change, there may have to be some selective deregulation of the labour market to enhance flexible (i.e., part-time or temporary) service-sector employment, and this will form an important part of many continental countries' labour market strategies.

But as Hall (1998) argues, there is no reason that such adaptation will necessarily push Europe's organized, co-operative economies down the slippery slope to Anglo-Saxon style deregulation and inequality. As Nickell (1997) has demonstrated, a number of protective measures that are generally assumed to impede employment creation may in reality have little effect. These include employment protection measures and general labour market standards, generous unemployment benefits (as long as they are accompanied by strict benefit durations and measures to help the jobless back into work) and high levels of unionization and union coverage (as long as they are offset by high levels of co-ordination in wage bargaining). Rather than hampering economic performance because of alleged price distortion, many forms of protective labour market enhance productivity and are beneficial for economic development. Thus, minimum wages pressure firms into finding ways to raise productivity, whether through technological innovation or through training. As long as they are designed so as not to create or accentuate an insider/outsider dualism in the labour market, employment security regulations will improve the worker's commitment to the enterprise, creating trust and enhancing forms of work flexibility.

Moreover, there is no need to shift away from concertation to the unilateral imposition of policy to secure the necessary changes. Indeed, periods of high unemployment and painful restructuring in the trough of the cycle seem to have bolstered the search for consensual solutions in which flexibility is matched by innovations in social security. Of particular importance is the way in which optimal forms of labour market regulation require collaborative industrial relations as well as corporatist bargains to cement them. Selective deregulation, leading to an expansion of part-time employment, has been achieved in the Netherlands, for example, within the context of a broad social pact sustaining co-ordinated wage bargaining, while also, minimizing the impact on real income disparities (Visser and Hemerijk 1997). As we discuss in greater detail below, when discussing how best to bring about reform, the best way of tackling the employment problem institutionally is via negotiation, not the unilateral imposition of looser regulation *à la* Thatcher.

Employment and the labour market thus provide a good example of reform in a sensitive policy area where new techniques and new modes of negotiation have already been and will continue to be critical for policy innovation and policy success. There is now a whole menu of policy measures to choose from: modifying the funding of welfare by shifting the burden of costs, for example, away from pay-roll taxes to general taxation; by removing tax wedges and eliminating poverty traps; by introducing wage subsidies in various forms to employers and 'in-work' benefits (again in all forms including tax credits) as one way of easing the move from benefits and into employment; and, more specifically, via the 'activation' of so-called 'passive' benefits. Examples of radical proposals made in this area are conditional negative income taxes (i.e. negative income tax conditional on, for example, evidence of serious job search by an unemployed person); and benefit transfer programmes (e.g. providing individuals with vouchers that could be offered by the unemployed to firms that would hire them, and reducing correspondingly the amount of public money spent on traditional forms of unemployment benefit) (see e.g. Snower 1997). Denmark and the Netherlands have perhaps gone furthest in experimentation in these areas, and in both cases reforms have been introduced within a general context of policy concertation. Both cases hold lessons for other countries, both in terms of the mix of policies and the consensual process through which such policies are designed and delivered.

Redesigning Social Insurance

As is well known, the institutional core of the welfare state in many European countries is constituted by the principle of social insurance. This comprises a rights-based guarantee of public support in cash and/or in kind against a pre-defined catalogue of standard risks, including old age, invalidity, the death of a supporting spouse, sickness and unemployment (Flora and Alber, 1981). This rights-based guarantee rests in its turn on the compulsory inclusion of large sectors of the population (in some cases the whole population) in public schemes. These are mainly financed from contributions levied on the gainfully employed (with the partial exception of health care and family allowances in some countries). To a large extent, the crisis of the welfare state (especially in Europe) is the crisis of social insurance (especially pension insurance). Are there 'virtuous' ways to redesign this core institution? And, even more fundamentally, should the institution as such be preserved?

A full answer to this latter question would obviously require an extended discussion of the advantages of public/compulsory over private/voluntary insurance in terms of risk pooling, adverse selection, moral hazard, interdependent risks, interpersonal redistribution, etc. From the point of view of positive theory, the justification of public involvement and compulsory membership lies basically in the technical inability of markets to overcome the information problems inherently connected with insuring 'social' risks (Barr 1992). From the point of view of normative theory, the justification lies in the greater capacity of public social insurance to satisfy the fundamental principles of distributive justice (at least in their Rawlsian version), by safeguarding the position of the worst off in society (Daniels, 1995; Van Parijs, 1996). 'Public and compulsory social insurance' is however only a general regulatory principle, which allows in practice a wide range of institutional solutions. Thus, the Italian pension insurance, overwhelmingly centred on state-run, pay-go schemes, with very generous formulae, and the UK pension system, centred on modest 'national insurance' pensions, supplemented by occupational or even personally funded benefits, illustrate the full range of forms which the principle of compulsory insurance can take in practice.

Defending the desirability of this principle - even in its minimal definition - is no trivial matter. The idea of 'dismantling' large-scale compulsory insurance is crops up frequently in political debates around the OECD, opening up the risky scenario of universal systems degenerating into purely voluntaristic and/or localised (and therefore fragmented) systems of social solidarity. But finding 'virtuous' ways of redesigning this core institution - i.e., what kind of compulsory social insurance can be sustained? - raises two sets of issues. The first concerns the basket of risks to be included within the scope of insurance; while the second concerns benefit and funding formulae. We discuss each of these in turn.

What Risks?

As far as the basket of risks is concerned, the standard catalogue drawn up almost a century ago, and which has survived largely due to institutional inertia, now fits poorly with the prevailing socio-economic context. A revision of this catalogue is thus urgent, as regards both the range and the definition of covered risks. Is it still appropriate, for example, to keep in the basket the general risk of 'surviving'? Survivor's benefits represented almost 3% of GDP in the EU on average in the mid-1990s. To the extent that this risk still generates real needs, are there not more effective ways of responding to them? Such needs could more effectively be dealt with via an adequate supply of services (health care, education, training and housing) and/or of targeted transfers (e.g. scholarships or work grants, or benefits for single parents), and more generally through a policy of incentives for the formation of two earner households. Why not leave to the private insurance market the tasks of satisfying the greater demand for security desired by some people in this field? Similar questions could be raised regarding other risks as well. Is it still appropriate to maintain in operation large-scale public schemes for work injury and disability (as distinct from basic invalidity insurance)? Why not transfer the responsibility for compensation directly to the employers (as recently experimented with in the Netherlands, for example)?

But the biggest challenge in the area of risk-redefinition is old age. At the beginning of the twentieth century, surviving beyond the age of 65 was indeed a risk for the bulk of the population. In Germany, France, Italy or England an average male at the age of 20 could only expect to reach the age of 62; if he lived beyond his 40th birthday, he could still only hope to reach the age of 68. Thus remaining alive beyond the official age of retirement was indeed a 'risk' in the strict sense of the concept and the risk definition (old age equals life beyond 65) 'matched' the existing state of affairs. Once formalized into pension rules, however, this notion of old age became a social norm per se, a taken-for-granted principle for the organization of the life cycle, regardless of socio-demographic change. Given longer lifespans, this norm became the subject of contextual redefinition, offering a fertile ground for the social construction of 'retirement' as a distinct phase in people's existence and as a novel collective practice (Kohli 1986).

The notion of old age is thus in need of redefinition. To some extent, this process is already under way. In recent years many countries have indeed raised the legal age of retirement - especially for women and civil servants, who could traditionally retire earlier. In a few cases, the principle of flexible retirement has also been formally introduced, establishing a range of possible ages for exiting from work (e.g. in Belgium, Italy and Sweden). But so far this shift in policy has not proved very effective in actually re-orienting the choices of both workers and employers regarding labour market exit. As recently shown by the European Commission and the OECD, little improvement has taken place in the activity rates of older workers, and early retirement is still being used as a mistaken solution to the unemployment problem. The retirement issue must be integrated with the employment question and the introduction of the 'employability' policies discussed above. It is an objective that must be put forcibly on the reform agenda in all mature welfare states. There are already signs of a reversal of labour shedding strategies using early-retirement, prolonged unemployment, sickness, and disability as easy exit-options. As labour shedding substantially increased the financial burden imposed on the systems of social security, policy actors, most notably in the Netherlands have come to recognize that a robust welfare state requires a high level of employment rather than a low level of open unemployment.

'Dependency', i.e. the loss of physical self-sufficiency, typically connected with the chronic-degenerative pathologies of (very) old age, is a separate issue. There is in fact a range of options available to deal with this most important and growing risk (Oesterle 1999). The issue is debated in many countries, and Germany updated in 1995 this aspect of its social insurance system (Plegeversicherung). But innovation is slow to come about in other countries. Besides long-term care, the updating of social insurance should definitely also address the issues of gender equality and gender equity, neutralizing the indirect penalties suffered by women and all 'carers' in general under traditional insurance regulations. The promotion of more equality and equity across genders is a very important and broad objective which cuts across all sectors of social policy. Social insurance schemes are in urgent need of being 'mainstreamed' in this respect in all countries (Orloff 1999).

What Benefits?

The issue of benefit and funding formulae raises two main questions: a qualitative question (how to compute benefits and how to finance them) and a quantitative question (how much protection?). As for the first question, the emerging trends in most social insurance systems (especially in the EU) are for a rationalization of the inter-personal redistribution implicitly incorporated in benefit and financing formulas and a strengthening of the 'contributory principle'. The elimination of transfers that can be identified as inequitable (because they are not proportional to contributions), outdated (because they are out of step with the structure and distribution of needs) or perverse (because they generate significant work disincentives) appears desirable both for normative and practical reasons. Such a policy also has the advantage of being potentially self-legitimating in political terms, providing an effective solution to the blame-avoidance problems facing 'modernizing' elites (Levy 1999; Pierson 1999b).

In general terms, a closer link between contributions and benefits can be regarded with favour as well - but only up to a point. If nested within the wider logic of compulsory universal coverage, the contributory principle serves two important purposes. The first one is that it safeguards against the possible degeneration of social insurance via the 'inequitable' and 'outdated' transfers mentioned above. Those who think that this is only a minor risk should look at Italian developments in recent decades for evidence to the contrary (France is a parallel case). The second purpose served by the contributory principle is that it strengthens the overall legitimacy of the welfare state, giving to each contributor the feeling that they have a real stake in the system (Rothstein 1999). Even if people are aware that contributory social insurance does not follow strict proportionality rules, they are willing to support a system that 'roughly' balances out burdens and rewards, in compliance with deep-seated norms of 'strong reciprocity' (Bowels and Gintis 1998).

But the contributory principle also has its drawbacks. An objection which is often raised is that in an increasingly flexible and heterogeneous labour market a close link between contributions and benefits will prevent many workers from accumulating adequate benefits - and especially adequate pensions - because of frequent spells out of work. A second drawback has to do with employment incentives. To the extent that contributions tend to be levied essentially on work earnings, they tend to create problems of employment-creation - as already discussed above - especially at the lower end of the earnings spectrum. It is true that these two drawbacks can be partly neutralized by selective reforms of institutional regulations. Incorporating 'equitable' and 'updated' norms in the crediting of contributions for involuntary or socially valued interruptions of work (e.g. training or caring periods) or relieving employers from paying social insurance contributions for low wage workers are both feasible and desirable. But there are limits to such strategy of a political and financial nature, not to mention institutional inertia. The optimal strategy could be one of combining the 'contributory' with the 'fiscal' logic and establishing two layers of benefits. A first layer of pay-go universal benefits could be tax financed, ensuring an interpersonal redistribution based on criteria of 'equity of opportunity' (Rosanvallon 1995); and a second layer of benefits could be linked to income-related contributions. As argued by Scharpf (2000), such a strategy would also maximize the immunity of the welfare state against the challenges of international tax competition.

The actual role that can be played by funding as opposed to pay-go - a thorny issue, hotly debated in many countries and internationally - is highly contingent on the institutional legacy of a particular country. In principle, a combination of the two mechanisms seems a desirable objective: they are in fact subject to different risks and returns (Buti, Franco and Penn 1997). Pay-go systems are good at protecting against inflation and investment risks and in allowing vertical redistribution, but they are also vulnerable to population ageing and rising unemployment. Funding generates fewer distortions in the labour market and may contribute to developing financial markets, in situations in which real interest rates are higher than the rate of growth of employment and real wages. Funded systems can also provide workers with higher returns on contributions. On the other hand, they are vulnerable to inflation and investment risks and are also costly to administer. Regardless of their respective merits and disadvantages, the real problem is that for a given country at a given point in time the options between these two systems are heavily constrained by past choices (Pierson 1999b). Only a few countries have been able to overcome the 'double payment' problem involved in the transition from mature pay-go systems to funded or mixed ones. However crucial for the overall architecture of the welfare state, pension financing is one area in which desirable policy objectives must inexorably yield to the very limited possibilities offered by the institutional status quo.

But what of the 'how much' question? At the abstract level of this paper, there is little that can be said on this question. Two general considerations can however be advanced. The first is that in an age of permanent austerity all 'how much' questions will have to be answered with an 'unpleasant arithmetic'. Thus, 'pluses' (a new benefit, service, or investment) must be balanced against 'minuses' within a highly constrained budgetary context and the opportunity costs of the status quo must be constantly made explicit and carefully assessed (Salvati 1999). A few fortunate countries may be able to escape this logic and savour the pleasantness of surplus politics once again. But most will not - especially in Europe. If this is true (and this is the second general consideration) then the one sector of social protection whence financial resources can be redeployed is pension insurance - especially the generous pension insurance of Continental Europe. In high-income societies where the elderly tend on average to wield considerable economic resources (both mobile and immobile) there is no compelling justification for concentrating public protection on this social group. In the wake of the social and economic transformations illustrated above, income insecurity is increasingly spreading across the earlier phases of the life cycle. This is especially true for women, as a consequence of their continued vertical and horizontal segregation in the labour market. The vulnerability to poverty has visibly shifted from the elderly to other social groups (the young, lone parents, workless households, ethnic minorities, etc.) and within some of these groups, there are also worrying symptoms of social dislocation (crime, teenage pregnancies, homelessness, substance abuse, educational exclusion, etc.). In this new context, a re-calibration of social insurance from 'old age protection' to 'societal integration' seems in order. As is well known, pensions schemes are very 'sticky' institutions: they create long chains of psychological expectations and material interests and thus tend to 'lock' their members into the status quo. But even sticky institutions are not impervious to change. Most European countries have already taken many important steps in the field of pensions in the 1990s. Efforts on this front must definitely continue: pension reform remains the key for solving the allocative and distributive dilemmas of the welfare state, especially in Continental Europe.

Universal, But Not Unlimited Health Care

Considering demographic projections, the efficiency and cost problems inherent in the production of medical services and the 'unpleasant arithmetic' of permanent austerity, the reform agenda for public health systems of advanced welfare states is replete with dilemmas. As in the case of pensions, policy change is politically very difficult in this area, due not only owing to the potential opposition of professionals, but also because the principle of public universal coverage remains extremely popular in OECD countries. Are there virtuous ways for reconciling universalism and sustainability in public health care? This is a complex question that needs to be addressed dispassionately.

Both at the macro and at the micro level, the allocative and distributive priorities of the health care sector have historically been the result of an implicit bargain between the medical profession and the big purchasers, typically large insurance companies, health funds and governments. In all countries, the total amount of resources destined to health care - as opposed to other sectors relevant to people's health status, such as environmental protection or job safety measures - has been defined essentially via 'automatic' criteria (such as past expenditures) or, more recently, based on macroeconomic compatibilities. These methods appear to be less and less effective. A rich empirical literature has shown that:

- there are remarkable variations in the utilisation rate of the various medical treatments and technologies, not only across countries, but also across areas of a single country and even across providers of a single area;
- the correlation between these variations and variations in the main indicators of health status is not strong;
- and health status correlates positively with other indicators, such as the quality of the environment, nutrition and life-style, the safety of transport, etc. (Abel Smith et al. 1995).

The literature also shows that a large degree of the variation in utilisation rates basically stems from clinical uncertainty: from the absence, that is, of reliable and univocal information on the actual effect of various forms of medical intervention. An open debate is therefore in order on the appropriateness of existing care methods and on public strategies of health promotion. Is it possible to identify practices that are really effective? And how can we define the overall amount of public resources that must be mobilised to finance such practices? This latter question has allocative implications that are both inter-sectoral (e.g. how much should go to health care and how much to the environment?) and intra-sectoral (how much to this or that cure or pathology?). It also has clear distributive implications: i.e., how much should go to whom?

The situation of budgetary 'emergency' during the last decade has not allowed the opening of a serious and coherent debate on the dilemmas of inter-sectoral allocation: the prime imperative has been that of cost-containment, wherever and whenever possible. On this front there will be much to discuss in the future. But the most urgent debate concerns the intra-sectoral allocations and distributions: and this is the most interesting aspect for a project of 'sustainable universalism' in health care.

Selecting Users or Selecting Treatments?

The classical doctrine of social security assumed that all full members of a society should have an unconditional right to receive all the forms of care made available by medial progress, with no formalized or fixed restrictions. Since the early 1980s, the first part of this assumption (all citizens unconditionally) has undergone a gradual redefinition. In many countries, the dimension of access (which has remained universal and unconditional - at least in countries with national health systems) has been increasingly separated from the dimension of financial participation: user charges have been introduced in many countries, but differentiated according to need. This 'neo-univeralism' has not, however, significantly altered the second part of the assumption (all forms of care, with no restrictions). It is true that all countries have always had to cope with rationing, especially as regards costly technologies. But the most widespread method of rationing has been de facto that of waiting lists, mainly based on the 'first come, first served' principle. It is also true that some countries have started to introduce restrictions to certain forms of care (usually at the margins of the system: plastic surgery, spa treatments and the like). But rationing has so far remained primarily implicit and marginal. The assumption of 'full comprehensiveness' (the third dimension of classical universalism) has not been squarely addressed. Yet, some limitation of the principle of universalism seems desirable in this respect as well. Considerations of cost-effectiveness are also important, not only to safeguard economic sustainability, but also to encourage a more responsible use of medicine and a reallocation of resources towards the promotion of health from the traditional fight against disease.

But how should universalism be limited in this respect? Is it possible to identify a package of 'essential' and effective forms of care to be maintained under public insurance (even if provided through 'internal markets' or contractual relationships between purchasers and providers)? The main obstacle is of a methodological nature, i.e., what are the relevant criteria for making a selection? The choice has profound implications in terms of both social justice and public finances. Is it appropriate, for instance, to adopt some sort of demographic criterion (limits to the treatment of incurable pathologies among the very old), following the suggestions of the so-called 'ageist' approach (Callahan 1987)? Or should resources be concentrated on the cure of all 'avoidable deaths', i.e. those caused by pathologies that, based on existing clinical knowledge, should not lead to death if a patient is appropriately treated (Holland 1991)? Or should we be more selective and invest only in treatments that promise a reasonable number of 'quality adjusted life years' (QALYs) (Williams 1994)?

However intractable they may sound, these questions have already ceased to be the object of purely academic debates, and are now at the core of the policy making debate. No country has been able so far to adopt formal and explicit rationing criteria in their health systems. But the use of positive and negative lists (e.g. in the supply of pharmaceuticals), of medical protocols, of indicative guidelines, etc. is becoming more and more widespread (Lenaghan 1997). It is obvious that all attempts at introducing greater discipline on this front are bound to meet enormous resistance of an ethical, political and organisational nature. But the issue must be looked at in a dynamic perspective. If it is true that picking among treatments and technologies which are currently utilised is extremely difficult - organisationally and politically speaking - stricter rules can be established for future treatments and technologies. This is where the most difficult rationing dilemmas will occur, because of the huge costs of new medical technology, especially in its early phases, 'natural scarcities' (e.g. organ transplants) or the interval between the experimentation with new treatments and their wider availability. In other words, the definition of priorities now would be useful even if only with regard to future choices, based on cost-effectiveness considerations and forms of procedural equity.

Besides the establishment of some explicit criterion for limiting the content of public entitlements, two other strategies seem promising for making health care universalism more sustainable. One is the introduction of specific incentives at the micro level for practising evidence-based medicine. This is slippery ground, as it interferes with professional 'freedom': but there are compelling normative arguments and possible institutional solutions for making steps along this road (Daniels 1985). The other strategy is that of encouraging patients themselves to become more responsible, allowing them a greater margin of choice on the quantity and type of care that they would like to receive - if appropriately informed. This is the direction followed by the US with the Patient Self-determination Act of 1991 and which some European countries are following as well.

There can be little doubt that the opening of a public debate on the criteria and choices that affect life and death will generate acute moral tensions and political controversies. For the wider public, such a debate may even seem inadmissible. But in a world of scarce resources and characterised by the ultimate unavoidability of death, the health care systems are obliged to confront the issue of allocative and distributive rationing. Ultimately, what will differ among them will the mix between the explicit or implicit, rational or non-rational, deliberate or casual nature of the criteria they employ.

A New Public/Private Mix

One consequence of permanent austerity is that expanding health care and social services through the public budget will remain limited. Restricting universalism through user charges and priority setting will serve to filter demand based on equity and effectiveness considerations. But it will still leave a sizeable (and certainly growing) share of unmet demand. In many countries private expenditure for health care and social services has been rapidly increasing in recent years. Especially in the field of social personal services, the 'third sector' is also becoming increasingly active. But the potential for a further expansion of both the private and the third sector for services has not been fully exploited, despite its positive occupational implications for economies struggling with high unemployment. To some extent (especially in continental Europe) this is linked to the 'inactivity trap' caused by high wage floors, which constrains the development of a labour intensive social services sector (Scharpf 1997). But there are other obstacles as well. The development of non-public forms of provision has traditionally been regarded with suspicion as possible sources of social differentiation and an erosion of welfare state legitimacy. But is this suspicion still well grounded? Can virtuous mixes between the public and non-public spheres be designed to help solve the 'resource' problem without also diminishing both the quality and coverage of care and the legitimacy of public provision?

In contemporary affluent societies, care services are highly valued goods, and the demand for them is not only constantly growing, but is also becoming more diversified, especially among higher income and educated consumers, who are interested in quality, freedom of choice and more personalized provision (Alestalo and Kuhnle 2000). It is unrealistic to expect the state to keep in control of such developments. The emergence of an increasingly specialised private market for health and social services is thus unavoidable. The crucial question is whether there are ways to cater for a significant part of this new demand within the public arena. The advantages for the welfare state of doing so are that public institutions would remain the central locus of care provision and consumption, with no (or little) additional costs and no loss of social cohesion or legitimacy. The success of this strategy depends on two main conditions: the ability of public care services to satisfy 'new' consumer demand (a question primarily of innovation; and the willingness of these consumers to pay fees for services on top of their ordinary taxes and contributions).

In Western Europe, the first condition is essentially a matter of regulation, organisation and management. Here public health institutions have traditionally been and still largely are the centres of medical excellence. In this respect, the European situation is very different from the US, where the long historical delay in the introduction of public health insurance created an early opportunity for the expansion of private markets, creating a twin-track system of socially differentiated provision. The European middle classes trust public hospitals and think rather highly of their clinical quality. It should not be impossible for these institutions to adjust and upgrade their supply of services with a view to attracting fee-paying consumers. The second condition could be met by linking fees to new opportunities. It is certainly true that users of public services dislike and even resent the imposition of charges for what used to be provided free of charge. But their willingness to pay could increase if they are convinced that they have access to a wider array of (new) services and have more options regarding the timing, location and overall context of care. Paying for such high-grade care could be institutionally organised and encouraged, through collective forms of voluntary health insurance, for example. This would be greatly facilitated if it were possible to differentiate between 'essential' and 'non-essential' treatments, along the lines discussed above. The latter could in fact form the object of a second 'pillar' in health insurance.

From the Agenda to Policy: How to Bring About the Reforms?

The third general question raised at the beginning of this paper concerns the more practical problems of how to bring about the reforms. It is important to stress that timely and effective reforms do not simply follow from the pressures of functional problems. They depend most crucially on the ability of relevant policy actors (i.e., national executives, sub-national agencies, and supranational bodies) to correctly diagnose the problem, elaborate viable and coherent policy solutions, adopt them through authoritative and legitimate decisions, and then implement these decisions in accordance with local conditions. Successful reforms depend also - more generally - on the ability of social policy systems to learn from experience, to develop new insights and make good use of relevant information stemming from other policy areas and from foreign experience. Even in the presence of intense functional pressures, welfare states may be unable to respond (or to respond adequately) owing to major institutional deficits with respect to policy diagnosis, communication between policy experts and politicians, political conflict and implementation failures.

At the same time, as the experiences of the 1990s have shown, there are powerful vested interests devoted to defending transfer-heavy welfare states and their traditional redistributive outcomes. Thus, reforms to health care systems, pensions and labour markets all require a careful process of adjustment if social cohesion as a governing principle is not to be sacrificed and if core constituencies and their representatives (welfare professions, social partners, citizens) are not to become hostile opponents of change. On the other hand, some social and political 'forcing' of the status quo is in order for reforms to become effective: changes that are purely marginal and incremental will not be enough to neutralise the old vicious circles. As shown by recent experiences, potential blockages in the process of reform are being avoided in some countries by the creation of new coalitions behind the reform agenda, most notably through new types of concertation and negotiation. But of course, the long-term success of such reform primarily depends on the efficacy of the changes introduced

A successful policy adjustment strategy across the range of issue areas dealt with above requires an identification of the salient policy problems, a sequential strategy of policy reform (in other words a planned an incremental approach rather than a policy 'big bang') and a preservation of social consensus. In some countries (the 'Westminster models' of democracy such as the UK and New Zealand) radical reform strategies of a neo-liberal kind have been implemented in the absence of strong constitutional constraints or coalition partners and have ruthlessly bypassed the involvement of social partners. But these two polities are really the exceptions to the rule amongst the advanced economies. Most continental European economies are 'negotiating systems' with coalition governments, federal arrangements or strong regional actors, and active social partnerships whose involvement in the policy process is a cornerstone of social stability and continued prosperity. Policy reform in such negotiating systems is more likely to be constrained by 'veto power', and as a consequence more likely to follow an incremental pattern of policy change.

An incremental and concerted reform process is not only necessary but can also be more productive than radical and unilateral breaks with the welfare status quo. In the complex and 'organized' economies of continental Europe, the policy areas mentioned above are closely linked and reform in one area will quickly have impacts in others. Often policy-making competencies are shared between state officials and the social partners, which again constrains the political degrees of freedom for the government. Much more so than in the liberal Anglo-Saxon economies, with their predominantly tax-financed welfare systems, it is therefore essential to focus the attention of policy makers and social partners on particular problem constellations (e.g., illustrating the connections between pension reform, social charges and employability) in order to introduce an effective reform sequence. If institutional trust and co-operation are not to be the first casualties of the adjustment process, a social dialogue must be preserved or reinforced. Commonly accepted information, successive rounds of negotiation and the provision of widely acknowledged and coherent sources of expertise all assist in a process of policy 'puzzling' and learning in the search for acceptable and workable solutions.

The implementation of agreed policies also requires the political power to avoid policy blockages and deliver side payments to potential losers. Implementation and legitimising reforms so as to avoid blockage will also require that broader social coalitions are accommodated and aligned with the reform process. Thus, not only does the interlocking nature of European social security and employment systems require simultaneous action on multiple fronts, but broadening and deepening the bargain also compensates for the absence of conventional organizational prerequisites in those countries where the social partners are neither strong nor cohesive. The best way to generalise the process of exchange is to synchronise industrial and structural with social and employment policy and/or extend concertation levels upwards or downwards by making associational strength itself a part of the bargain. This requires a complex and slow process of coalition building, but one that is essential if countries are to succeed in putting the requisite institutions for a co-ordinated adjustment strategy in place.

In Europe, the supranational authorities clearly have an important role to play in this respect. National adjustment strategies and bargains can be reinforced and encouraged in their efforts to tackle existing inequities in welfare cover and introduce new forms of flexible work and social security and tax reform. One specific area where an EU role is required is in helping to ensure that both labour and capital remained linked in national social bargains, for example, given the low exit-costs for these organizations in those countries without a corporatist tradition. This could be achieved by scheduling productivity-linked wage increases and employment creation in line with plans for a return to non-inflationary expansion and growth at both national and European levels. The conclusion of a European employment pact stressing the importance of education and training, as well as setting out the conditions for a co-ordinated strategy of European reflation, would make an important contribution. The Commission could also play a role in diffusing notions of 'best-practice' policy sequencing and linkages. Also of central importance will be the development of new 'soft' instruments for European intervention in the member state economies and labour markets. These are essential if the policy blockage encountered by more traditional European instruments (e.g. social and employment policy directives) is to be avoided. In fact, almost by stealth, during the 1990s the dynamics of European integration have been playing an increasingly important role in shaping social policy developments within the member states.

The European Union, acting as a 'semi-sovereign' policy system, seems slowly but surely to be carving out a distinct 'policy space' regarding social policy - a space which may gradually work to rebalance 'from below' (and 'softly') the structural asymmetry between negative and positive integration. This trend is clearly visible in the areas of gender policy and, since 1997, employment policy. In the area of social protection proper, the relevance and involvement of the EU is less marked and the logic of asymmetry is still predominating: but also on this front the situation is perhaps less desolating and certainly less static than appears. In the field of employment, the turning point has coincided with the launching of the 'Luxembourg process' in 1997 and the new employment chapter introduced in the Amsterdam Treaty. This chapter provides for the co-ordination of national employment policies using a 'management by objectives' approach, whereby EU institutions draw up guidelines and monitor their implementation through an institutionalised procedure. This neither 'binds' the member states in a hard, legal sense, nor foresees possible sanctions as in the case of budgetary policy. Despite its 'softness' this process of co-ordination is acquiring increasing salience for the shaping of public policy at the supra-national, national and sub-national levels. Though specifically focussed on employment issues, the process has crucial implications for other social policies as well. This is so not only because boosting employment performance is, per se, a way of securing the viability of established welfare programmes, but also because of the close link between most recipes for employment promotion and the 'modernization' of social protection systems, as discussed above. Not surprisingly, many of the employment guidelines drawn up so far in the new institutional framework call for an adjustment of various institutional features of existing welfare arrangements.

Conclusion

In sum, the process of welfare state 'recasting' involves a number of dimensions of change in response to a largely domestically generated set of pressures. Globalisation is compatible with several different institutional and normative projects, including those projects that aim at reconciling the imperatives of economic growth with the quest for more cohesion, and solidarity. Recasting implies resetting old instruments, introducing new instruments and changing in some crucial respects the very objectives of the welfare state. Given the rapidly changing nature of advanced economies, in terms of demographics (ageing), patterns of employment and social risks, as well as the apparent permanence of 'austerity', recasting is also likely to be an ongoing process. If Western societies wish to reset themselves on a course of just growth, they will have not only to re-adapt their welfare institutions to the new context, but must increase their adaptability as such, enhancing their social and policy learning capabilities and inaugurating novel institutional combinations between security and flexibility.

Neither outright welfare state retrenchment nor labour market deregulation is necessary for an economy to remain competitive in the 'global era', although realizing particular social policy objectives in an era of 'permanent austerity', and boosting employment creation in the new knowledge-based society, will certainly mean redesigning welfare systems. Nor, it should be added, is there any a priori justification for an all out assault on the public sector as such, even if, as we argue above, there is clear scope for a new equilibrium between the private and public sectors in welfare provision. Efficient public services are an important institutional condition for competitiveness, especially in innovative, high-skilled, and high-value added forms of production and in promoting the transition to an information-based services and production systems. To achieve this goal, social and welfare policies should be part of an institutional ensemble that fosters long-term relations of trust: close links between the state and the social partners; the construction of social and electoral coalitions around programmes of welfare reform; a system of social and labour market regulation that stimulate a longer-term product development strategy, ensure a better educated and more co-operative workforce and make managers more technically competent and willing to invest in generic and company-specific skills.

Finally, although sequential and incremental reforms move at a slower pace than radical change, they are also less likely to endanger the overall stability of the economic and political system. 'Big bang' reforms tend to generate massive uncertainty in the period of transition, and can easily undermine economic performance, at least in the short run, reducing the propensity to take economic risks, and generating social conflict. An erosion of social cohesion, furthermore, is likely to undermine the degree of trust in the economic and political system, which fosters an unstable environment for long-term economic investment, consumer behaviour and policy development

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