3. 21st Century European Social Investment Imperatives[22]

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1 Beyond frozen welfare states

Europe finds itself at a crossroads amidst the turmoil of the Euro crisis in the aftermath of the global financial crash of 2008. It needs a growth strategy that is both economically viable and socially fair. Without a long-term strategic focus on employment opportunities, easing labour transitions for working families, and improving human capital, the EU risks becoming entrapped in a permanent economic depression. This is the central message of the *Social Investment Package for Growth and Social Cohesion* launched by the European Commission in February 2013 (European Commission, 2013). The notion of social investment emerged as a policy perspective round the turn of the century with the ambition to modernize the welfare state and ensure its sustainability (Ferrera et al., 2000; Esping-Andersen et al., 2002). Social investment implies policies that 'prepare' individuals and families to respond to new social risks of the competitive knowledge society, by investing in human capital stock from their early childhood on, rather than simply to 'repair' damage after economic misfortune strikes. Because of adverse demography, alongside expected sluggish growth, social investments in productive human potential and capacitating social servicing are more relevant than ever.

Over the past two decades, European welfare states have, with varying success, pushed through reform. In a fair number of countries trajectories of welfare reform have been more proactive and reconstructive than defensive or destructive. With their tradition of high quality child care and high employment rates for older workers, the Nordic countries display the strongest social investment profile, but we also observe change in countries like the Netherlands (social activation), Germany (support for dual earner

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families), France (minimum income protection for labour market outsiders), the United Kingdom (fighting child poverty), Ireland (much improved education) and Spain (negotiated pension recalibration) in the period leading up to the financial crisis. Alongside retrenchments there have deliberate attempts – often given impetus by intensified European (economic) integration – to rebuild social programs and institutions thereby accommodate policy repertoires within the new economic and social realities of the 21st century. *Ex negativo*, the pension-heavy welfare states, with their segmented labour markets and low active labour market policy spending, of Southern Europe are confronted with high levels of youth unemployment, long-term unemployment, low female employment participation, and perverse fertility trends, thereby aggravating not only ageing predicaments, but, by implication, also reinforcing existing trade imbalances and deepening social divergences across the Euro zone (Hemerijck, 2013).

In the wake of the global financial crisis, costly bank bailouts, automatic stabilization, tax cuts, and other initial stimulus measures, drained the public purse. This resulted in a "double bind" of rising social protection expenditures and declining government revenues. In the spring of 2010, the Greek sovereign debt crisis confronted the European economy with a new and challenging crisis aftershock, and contagion fears spread across the weaker periphery of the Euro zone. The European Union (EU) and the European Central Bank (ECB) ultimately came to the rescue of Greece and other weak economies with general bail-out packages, monetary easing and lender-of-last-resort interventions. In exchange for support, Greece, Spain, and Portugal staged impressive fiscal consolidation programs, including significant welfare retrenchment and labor market reforms.

In the face of the raging Euro crisis, social investment can no longer be dismissed as a "fair weather" policy when times get rough, as was the case during the Lisbon era. European policy makers are confronted with a truly existential – economic, political and social – interest in addressing prevailing trade and competitiveness asymmetries by forging viable economic adjustment strategies that do justice to the important macro-economic returns of the social investment perspective. Because of ageing, human capital cannot be allowed to go to waste through semi-permanent inactivity, as was the case in the 1980s and 1990s in many mature continental European welfare states.

It is important to emphasize that the social investment imperative is a supply side strategy and thus cannot serve as a real alternative for an effective macro-economic policy regime. To the Euro zone member countries of the Mediterranean in dire fiscal straits today the social investment message, therefore, is easily lost. Fiscal consolidation requires them to slash active labour market policies and retrench preventive health care programs, which we know, in the long run, critically erodes job opportunities for men and women and thereby the capacity of the economy to shoulder the ageing burden. There is a real risk that a balanced set of objectives, laid down in the Social Investment Package, will be lost in the drive for front-loading (pro-cyclical) austerity in times of large-scale public and private deleveraging, conjuring up a spectre of a lost decade for Europe, worse than the one experienced by Japan since the early 1990s.

The EU is in desperate need of a New Deal between countries which are in better budgetary shape and have pursued social investment strategies more consistently in the past, and countries which have been less consistent with regard to social investment than one may have wished and therefore experience dramatic budgetary situations. The macro-economic policy regime that is required is one wherein *all* governments pursue budgetary discipline and social investment over the medium and long run, and are effectively supported therein. To convince the larger European democratic publics, in terms of political legitimacy, consistent with norms of social fairness, such a macro strategy should be tangibly based on a well-articulated vision of a 'caring Europe', caring about people's daily lives and future social wellbeing.

For the rest of the chapter, I first discuss the welfare reform momentum of the past two decades across different European welfare clusters. Next, in section 3, I will explicate the economic logic of social investment', "crowing in" growth prospects by helping to 'prepare' individuals and families to confront the 'new social risk' profile of the knowledge-based economy (Esping-Andersen et al., 2002; Morel et al., 2012). It may be all too soon to draw definite conclusions about European welfare state futures in the aftermath of the Euro crisis since 2011. But this is perhaps the most pressing question of our times. Will the social investment paradigm carry the day in this new context of predicament, or will it revert to marginality and be left orphaned in an epoch of intrusive EU-led austerity? Section 4, in conclusion, tries to draw some tentative answers to this burning predicament.

2 A short history of profound social reform

Welfare states are multidimensional policy systems, made up of interdependent social and economic policy repertoires with different dimensions. For an adequate understanding of overall social risk mitigation, it is necessary to consider how macroeconomic policy, labor market regulation, social insurance, and taxation work together to reduce the risks of poverty, unemployment, and social and labor market exclusion across time. Drawing on an expanding literature of comparative welfare reform, I propose to briefly look at some key changes across the following policy domains: (1) macroeconomic policy (including fiscal, exchange rate, and monetary policy); (2) wage bargaining and industrial relations; (3) labor market policy; (4) labor market regulation; (5) social insurance and social assistance; (6) old age pensions; (7) family and social servicing; (8) welfare financing; and (9) governance and social policy administration. I concentrate on the recent social reform momentum in the older EU15 Member States of the European Union (see for a more encompassing EU27 overview, see Hemerijck, 2013).

In *macroeconomic policy*, Keynesian priorities were prevalent until the late 1970s, with full employment as the principal goal of macroeconomic management. After 1980, macroeconomic policy gave way to a stricter rule-based fiscal and monetary policy framework centered on economic stability, hard currencies, low inflation, sound budgets, and public debt reduction, culminating in the introduction of the European Monetary Union (EMU) (Dyson & Featherstone, 1999; Eichengreen, 2007). EMU restrictions on monetary and fiscal policies, in addition, led many policymakers across Europe to bring social and employment policy to the center of welfare state adjustment over the 1990s.

In the field of *wage policy*, the 1980s saw a reorientation in favor of market-based wage restraint in order to facilitate competitiveness, profitability, and employment growth, prompted by the new rule-based macroeconomic policy prescription. Wage moderation has in many countries been pursued through social pacts among the trade unions, employer organizations, and government, often linked with wider packages of negotiated reform that have made taxation, social protection, and pension and labor market regulation more “employment friendly.” The EMU entrance exam played

an especially critical role in national social pacts in the so-called hard-currency latecomer countries, such as Italy, Spain, and Portugal, as an alternative to straightforward labor market deregulation and collective bargaining decentralization (Avdagic et al., 2011).

In line with the general shift to supply side economics, the overarching social policy objective in the 1990s has shifted from fighting unemployment to proactively promoting labour market participation. Spending on *active labour market policies* in most OECD countries has increased considerably from the 1990s and the mid-2000s, in the context of falling unemployment rates, mobilizing women, youth, older workers, and less productive workers through early intervention, case management and conditional benefits gained sway (Bonoli, 2013). With respect to *labour market regulation*, several European countries have moved towards greater acceptance of flexible labour markets with new elements of security being introduced for labour market outsiders (Schmid, 2008). In terms of *social insurance* and *assistance*, the generosity of benefits has been curtailed. In the process, social insurance benefits have become less status confirming. Today most countries preside over universal minimum income protection programs, coupled to 'demanding' activation and 'enabling' reintegration measures, targeting labour market 'outsiders' like the young, female or low-skill workers

(Clasen and Clegg, 2011).

A string of adjustments, however, have fundamentally altered *pension policy* over the past two decades (Häusermann, 2010; Ebbinghaus, 2011). A key shift has been the growth of (compulsory) occupational and private pensions and the development of multi-pillar systems, combining pay-as-you-go and fully funded methods, with relatively tight (actuarial) links between the pension benefits and contributions, with strong incentives to delay early exit from the labour market and award those working longer (Clark and Whiteside, 2003).

Social services have significantly expanded, especially in the 2000s, to boost female participation though family policy (Lewis, 2006; Mahon, 2006; Orloff, 2010). Spending on family services, childcare, education, health, and care for the frail elderly, as well as on training and employment services, has increased as a percentage of GDP practically everywhere in the European Union. Family policy, covering childcare, parental leave and employment regulation, and

work and family life reconciliation policies, has been subject to profound change in both scope and substance over the past decade and half.

With respect to the *financing of the welfare state*, policies have been sought to relieve public finances and to shift some of the responsibility for welfare provision to individual workers or the social partners, and to reduce charges of business and labor. Over the past two decades the source of social protections expenditure financing has shifted from social contribution to fiscal financing. Although a straightforward privatization of social risks has remained a marginal phenomenon across Europe, except for pensions, we do observe an increase in user financing in social services—child care, school education, medical care, old-age care.

A final overarching reform trend has been *administrative reform*. Yuri Kazepov speaks of a fundamental 'rescaling' of modern social policy. Most important has been the attempt to bring social insurance and assistance and labour market policies institutionally under one roof in so-called one-stop centres, thus ending previous separation of social security and public employment administration (Kazepov, 2010). Ideas of New Public Management and novel concepts of *purchaser-provider* models within public welfare services have been especially instructive with respect to the restructuring of Public Employment Services (PES), since the 1990s (Weishaupt, 2011).

These are big policy changes, executed in a sequence of incremental, but cumulative transformative, steps. Even though public social spending has largely been consolidated, practically all advanced European welfare states have been recasting and reconfiguring the basic policy mixes upon which they were built after 1945. Especially since the mid-1990s, the welfare state has been in a constant state of flux.

3 The economics of social investment

Without proper contextualization any list of intense social policy changes remains unsatisfactory. The emergence of the so-called "social investment perspective" in the second half of the 1990s can serve as a benchmark for gauging substantive social policy redirection. Have European welfare states been recalibrated in accordance to the teachings of the social investment edifice?

The philosophy underpinning the social investment approach was given impetus by the publication of a book edited by Esping-Andersen et al. in 2002, *Why We Need a New Welfare State* (Esping-Andersen et al., 2002), commissioned by the Belgian presidency of the EU in 2001. Central to *Why We Need a New Welfare State* is the argument that male-breadwinner welfare inertia would foster increasingly suboptimal life chances in labour market opportunities, income, educational attainment, and intra- and intergenerational fairness, for large proportions of the population. The new social risks of social segmentation, skill erosion, and structural poverty dynamics in the knowledge-based service economy, pressed by demographic ageing, make traditional passive, employment-related, social insurance provision extremely expensive and ultimately unsustainable. Instead, the emergence of 'new' social risk mitigation underlines the importance of early childhood development, training, education and lifelong learning, and family reconciliation policies. It is important to add here that Esping-Andersen et al. emphasized—*contra* the Third Way—that social investment is no substitute for social protection. Adequate minimum income protection is a critical precondition for an effective social investment strategy. In other words 'social protection' and 'social promotion' should be understood as the indispensable twin pillars of the new social investment welfare edifice.

An emphasis on the productive function of social policy stands as the distinguishing feature of the social investment perspective. From this perspective, social investment is essentially an encompassing human capital strategy with an explicit focus on helping both men and women balance earning and caring. There is a deliberate orientation toward "early identification" and "early action" targeted on the more vulnerable new risks groups. By raising employment and citizens' long-term productivity the financial sustainability of the welfare state is best guaranteed. If successful, social investments relieve dependence on passive social insurance provision, without having to further retrench existing benefits.

Social investment protagonists hold the relationship between substantive social policy and economic performance to be critically dependent on identifying institutional conditions, at the micro-, meso-, and macro-levels, under which it is possible to formulate and implement productive social policies. The economic and institutional policy analysis of social investment hereby relies heavily on empirical data and case-by-case comparisons. It is crucial to consider the "fine" structures of the welfare state. Social policy is

never a productive factor per se. One cannot turn a blind eye to the negative, unintended, and perverse side effects of excessively generous social security benefits of long duration, undermining work incentives, raising the tax burden, and contributing to high gross wage costs. By the same token, rigid forms of dismissal protection making hiring and firing unnecessarily costly can result in high levels of inactivity. Beyond these caveats, in agreement with Keynesian economics, the social investment paradigm makes a virtue of the argument that a strong economy requires a strong welfare state. Social protection expenditures are powerful stabilizers of economic activity at the macro-level, because they consolidate effective demand during recessions. This kind of Keynesianism through the back door is still operative today, as we have experienced from the early days of the 2007–2010 financial crisis.

A fundamental unifying tenet of the economics of the social investment perspective bears on its theory of the state. Distancing themselves from the neoliberal "negative" economic theory of the state, social investment advocates view public policy as a key provider for families and labor markets. Neoclassical economic policy analysis, based on perfect information and market clearing, theoretically rules out the kind of social risks and market failures that the welfare state seeks to address. Two economic rationales theoretically support the proficiency of social investment. The first rationale for public intervention harks back to the original economic rationale for collective social insurance, countering market inefficiencies caused by asymmetric information, and to the economic rationale for social policy interventions related to the problems of imperfect information and the framing of choice in a more general sense. This is what Nicholas Barr has coined as the "piggy-bank" function of the welfare state (Barr, 2001). Because citizens often lack the requisite information and capabilities to make enlightened choices, many postindustrial life-course needs remain unmet because of the market failures of service under provision at too high a cost.

The second, more fundamental, reason why the welfare state today must be "active" and provide enabling social services is inherently bound up with the declining effectiveness of the logic of social insurance ever since the 1980s. When the risk of industrial unemployment was still largely cyclical, it made perfect sense to administer collective social insurance funds for consumption smoothing during spells of Keynesian demand-deficient unemployment. However, when unemployment becomes structural, caused by radical shifts in labor demand and supply, intensified international

competition, skill-biased technological change, the feminization of the labor market, family transformation, and social and economic preferences for more flexible employment relations, traditional unemployment insurance no longer functions as an effective reserve income buffer between jobs in the same industry. Basic public income guarantees, therefore, have to be complemented with capacitating public services, a term coined by Charles Sabel (2012), tailored to particular social needs caused by life course contingencies. In order to connect social policy more fully with a more dynamic competitive knowledge-based economy and society, citizens therefore have to be supported by *capacitating* services ex ante, tailored to particular social needs over the life cycle. When social insurance risk pooling fails, a more effective strategy is often to help risk categories to self-insure against uncertain risks by enabling to acquire the capacities they need to overcome the social risks they face, with ex ante public supports in family services and training provisions. What matters at the level of policy execution is that, as welfare states become ever more service-oriented, local service provision offers highly qualified professional care workers, able to help clients to make timely choices in areas of childcare placement, job search and training, and elder and family care.

The empirical turn towards social investment contains some important lessons. First and foremost is that social investment should indeed be understood in terms of 'packages' of interdependent policy initiatives across various areas. Positive returns in terms of economic growth, employment opportunities, and (child) poverty mitigation depend on complementary sets of provision, ranging from quality childcare, parental leave arrangements, training, education and activation services, alongside adequate (universal) minimum income protection, rely on strong elements of "goodness of fit" between various policy provisions. Quality childcare services, alongside effective parental leave arrangements, supported by appropriate tax and benefit incentives and active labour market policies, enable more parents to engage in gainful employment, creating additional job opportunities for especially mothers, while helping their offspring to a 'strong start', allowing them to develop their cognitive and social skills to make them successful later in life (Esping-Andersen, 2009). The available evidence before and after 2008 clearly shows that effective "institutional complementarities" are associated with high employment rates and lower long terms unemployment (Hemerijck, 2013; Eichhorst, & Hemerijck, 2010; Kenworthy, 2008; 2011; OECD, 2008; 2011).

4 A growing Europe is a social investment Europe

It should in the final analysis not be forgotten that the welfare state is a normative concept based on the image of a social contract, with claims on social justice that go beyond issues of economic efficiency and effective insurance, to include dimensions of gender roles, the work ethic, child-rearing, and inter- and intra-generational equity. The policy changes surveyed in this chapter have contributed to a slow redefinition in the very idea of social justice: a shift away from understanding fairness in terms of static Rawlsian income equality towards an understanding of solidarity and fairness as an obligation to give due support to the needs of each, individually, so as to enable all to flourish, in line with the 'capability approach' of Amartya Sen (1999) and Martha Nussbaum (2011). At the normative heart of the social investment edifice lies a reorientation of social citizenship, away from the compensating *freedom from want* logic towards the capacitating logic of *freedom to act*, under the proviso of accommodating work and family life through social servicing and a guaranteed *rich social minimum* enabling citizens to pursue fuller and more satisfying lives.

Reasoning from the popular 'new politics' of the welfare state perspective, it has often been argued that social investment recalibration is extremely difficult to pursue under economic conditions of relative austerity. Paul Pierson, the leading advocate of this approach, has in various publications advanced the conjecture that welfare states have in recent decades become exceedingly change-resistant, despite irresistible social, demographic, economic, and fiscal pressures (1998; 2001). Because social investments are contingent on highly heterogeneous risks at play over different stages of the life cycle, it is argued from a 'new politics' perspective that social investment policies may fail to muster political support from cohesive social movements, reminiscent of organized labor from the male-breadwinner manufacturing era, which stood at the basis of the post-war welfare state (Pierson, 2011). The 'mirror image' of the expected lack of support for social investment reform is the impossibility of far-reaching old-age pension reform, because this would trigger large-scale interest based opposition from highly organized clienteles and mainstream parties. It is true that new social risks, ranging from skill depletion and difficulties in balancing work and family life, affect people at variegated episodes over the (family) life cycle. But the empirical record is less

sanguine than the ‘new politics’ welfare immobilism conjecture. Despite incentives of ‘blame-avoidance’, in effect, most European countries have embarked on thoroughgoing pension reform so as to respond to demographic challenges and fiscal pressures. As a result, future pension commitments in the EU have been reduced by almost a quarter since 1990s, making pension costs far more manageable than ever before. On the other hand, significant spending increases on childcare, elder care, pre-schooling, reconciling work and family life, and active labor market policies, suggest that social investments are supported by mainstream parties and interest groups. Interestingly, moreover, is that social investment policy reforms have been enacted and defended by both conservative and progressive coalitions across Europe, even in economically hard times. Apparent support for social investment, I believe, is rooted in the evolution of the aspirations of modern family hood over the past two decades, which has come to converge on the desire of adult men and women to work and raise children, an aspiration shared by low-income and middle-class groups alike. Of course, social investments will inevitably miss out on protecting the most vulnerable groups in an era of deepening inequalities. For this reason, adequate minimum income protection remains a critical precondition for any inclusive social investment welfare state.

In the difficult years ahead, intensifying fiscal pressures will lead many finance ministers to demand scrutiny on social spending. In both employment and social policy, there is a strong urge to do more with less resources. At the same time, the aftermath of the financial crisis will surely reinforce the need for human capital investment and the importance of poverty relief and social protection. Demographic headwind will bring social contracts under further duress, especially in countries facing high unemployment and the most daunting budgetary pressures, where long-run population ageing and the feminization of the workforce have not been adequately dealt with before the crisis. Social investment can no longer be dismissed as a “fair weather” policy when times get rough. Will the social investment paradigm carry the day in this context of predicament, or will it revert to marginality and be left orphaned in the new epoch of reinforced fiscal austerity? What makes the Euro zone predicament particularly worrying is that national fiscal and EU monetary authorities have practically no room left for proactive adjustment. Politically, governments have been caught between Scylla and Charybdus. On the one hand, pressures for deficit reduction constrain domestic social policy space. On

the other hand, disenchanted electorates are increasingly unwilling to abide by the austerity promises of national political leaders agreed in supranational rescue packages and EU reinforced fiscal rules.

The global financial crisis, it should not be forgotten, originated in the behavioural excesses in deregulated financial markets, not in excess welfare spending. The fundamental insight that (re-)emerged from the crisis is that economic markets are not self-regulating, self-stabilising or self-legitimising (Rodrik, 2010). While this important lesson is certainly not new, a whole generation of domestic and EU policy makers and academic economists seem to have forgotten the basic truth that the benefits of global economic interdependence rely heavily on robust social and political – both domestic and supranational – institutions. The EU's original sin of pushing for rapid market and currency integration to let the social-political-institutional underpinnings of European economic integration catch up later is in dire need of correction. In their cognitive bias of further liberalising the internal market through monetary integration, EU economic policy makers, from the European Commission to the ECB, declined to really appreciate the Lisbon Treaty's macroeconomic importance in terms of 'productivity-enhancing', 'participation-raising', 'employability-friendly', 'family-capacitating' social investments for the greater good of a more prosperous, equitable and caring Europe.

A social investment strategy is not cheap, especially not in the short run. Simultaneously responding to rising needs in health-care (and pensions) and implementing a successful transition to fully-fledged social investment strategies will require additional resources. European integration can ultimately only be maintained if citizens support the political project at stake and trust governments to handle the social consequences of the crisis fairly.

While all the available evidence suggests that investments in child care and education will, in the long-run, pay for themselves, EMU public finance constraints take all forms of public social policy spending as pure consumption, "crowding out" private economic activity. This may have been true for the modus operandi of the post-War social insurance welfare state, which was indeed income-transfer biased. Today, as social policy is in the process of becoming more service based, there is a clear need to distinguish social investments from consumption spending. A new regime of public finance that would allow finance ministers to, in the first place, identify real

public investments with estimated real return, and, second, examine the joint expenditure trends in markets and governments alike, has become imperative. This would be akin to distinguishing between current and capital accounts in welfare state spending, just as private companies do. There is even an argument to be made that public deficits and debt wisely spent on social investment in education and family support, can help stabilize the macro-economy. This in two ways: first, by depriving financial institutions of excess liquidity for short-term speculation, and, second, by nourishing sustained job and productivity growth with social progress.

Because of adverse demography, human capital cannot be allowed to go to waste through semi-permanent inactivity, as was the case in the 1980s and 1990s in many mature continental European welfare states.

To Euro zone member countries in dire fiscal straits today the social investment message, advocated by the European Commission in February 2013 *Social Investment Package* policy platform, is easily lost under the current macroeconomic regime. The reinforced 2011 “fiscal compact”, “two-pack” and “six-pack” agreements, with their overriding emphasis on collective austerity, labour market deregulation and wage-cost competitiveness, are pressing Euro zone economies to adopt pro-cyclical and self-defeating welfare retrenchments and labour market reforms.

Both the survival of the Euro zone and the imperative to recalibrate welfare provision in the knowledge-based economy conjure up a democratic predicament of national and European dimensions. The EU can no longer advance as a mere project of market integration and fiscal austerity. A Pareto-superior social investment policy mix, as I have argued in this chapter, comes with a comparative advantage for Europe and an orderly resolution of the sovereign debt crisis and is a *sine qua non* for the survival of the welfare state and vice versa. The social and economic policy challenge is to make social investments and fiscal consolidation mutually supportive and sustainable, through improved macroeconomic governance. To this end, a more realistic (slower) pace of fiscal adjustment should be coupled with productivity-enhancing social investments, in part funded through Euro bonds and project bonds.

The EU needs a New Deal between countries which are in better budgetary shape and have pursued social investment strategies more consistently in

the past, and countries which have been less consistent with regard to social investment than one may have wished and therefore experience dramatic budgetary situations. The macro-economic policy regime that is required is one wherein *all* governments pursue budgetary discipline and social investment over the medium and long run, and are effectively supported therein (Vandenbroucke, Hemerijck, and Palier, 2011; Hemerijck and Vandenbroucke, 2012). An EU social investment pact implies significant burden sharing. In terms of budgetary policy, Northern European governments should avoid austerity overkill, as part and parcel of a mutual effort. The competitive north could tolerate higher levels of inflation so as to make price and wage adjustments in the Mediterranean south realistic, provided that Greece, Italy and Spain use leniency to continue with structural social (investment) reforms. A 'social investment pact', bolstered by Euro bonds and special social investment project bonds and more generous human capital promoting access to structural funds (discounted in national budget accounts) could be an important step towards a Pareto-superior 'caring Europe', caring about people's daily lives and future social wellbeing, based on much improved national solidarity and supranational European cohesion.

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