Anton Hemerijck

When Changing Welfare States and the Eurocrisis Meet

(doi: 10.2383/36887)

Sociologica (ISSN 1971-8853)
Fascicolo 1, gennaio-aprile 2012

Ente di afferenza:
()

Essays

When Changing Welfare States and the Eurocrisis Meet

by Anton Hemerijck

doi: 10.2383/36887

1. European Welfare States As Crisis Casualties?

The welfare state has people worried in the aftermath of the deepest economic crisis since the Great Depression. For member states of the European Union, where collective coverage of modern social risks is comprehensive compared to other geopolitical regions, the long-term social and economic consequences of the 2008-2011 financial crisis mark a serious "stress test" for Twenty-first century welfare provision. The global economic crisis has fundamentally redrawn the boundaries between states and markets. Will its aftermath, like its Great Depression and "great inflation" predecessors, mark a new opportunity to reconfigure and re-legitimize social policy? Or, are European welfare states in danger of becoming a *crisis casualty* in the cascade of violent economic, social, and political aftershocks, unleashed by the first crisis of Twenty-first century global capitalism?

Initially, the financial crisis altered the picture of dysfunctional welfare states. In the immediate wake of the bankruptcy of Lehman Brothers investment bank, practically all advanced political economies intervened with Keynesian stimulus measures for ailing banks through monetary easing and temporary social policy expansion, in order to sustain effective demand and save jobs and skills. Speaking at the World Economic Forum in Davos in 2009, German Chancellor Angela Merkel asserted that the days of low trust "laissez faire" capitalism of the Washington Consensus had come to pass. Blaming unbridled Anglo-American capitalism for the economic mess, Merkel openly endorsed the European "social market economy" – a free market tempered by a generous welfare state, consensus-building politics, and labour relations – as a "best practice" model for the future. The 2009 Lisbon Treaty officially endorsed the EU's normative commitment to a (highly competitive) "social market economy, geared toward employment and social progress." To underscore the realism of these commitments, the more comprehensive welfare states of the EU, the more comprehensive European welfare systems, such as Germany and Sweden, proved most resilient in the wake of the 2008 credit crunch. Near-universal social security benefits acting as robust automatic stabilisers, together with high quality social services, effectively ensured that workers on short-term unemployment benefits could maintain their human capital.

Since 2010, a more conservative macroeconomic policy platform took root, bent on bringing down budget deficits and public debt. The Greek sovereign debt crisis punctuated the turn towards pre-emptive austerity across Europe. Costly bank bail-outs, automatic stabilization, tax cuts, and other initial stimulus measures, however, drained the public purse, resulting in a double bind of rising social protection expenditures and declining government revenues. The Greek sovereign debt crisis confronted the European economy with a new and challenging crisis aftershock as contagion fears spread across the weaker periphery of the euro zone. The EU ultimately came to the rescue of Greece and other weak economies with a general bail-out package, worth up to 750 billion. Next, Greece, Spain, and Portugal staged impressive fiscal consolidation programs, including significant welfare retrenchment and labour market reform. Soon after, conservative governments in Germany, France, Italy, the UK, and the Netherlands launched austerity measures, and moved away from the post-Lehman Keynesian crisis management moment. When sovereign debt contagion spread from the periphery to the eurozone heartland of Spain and Italy by mid-2011 the crisis transfigured into a systemic crisis of the twelve year old currency union.

The long-term social repercussions of the crisis are truly dramatic. Considerable employment growth across the EU, achieved through intelligent social reforms over the past decades, has been wiped out consequent to the banking crisis. Especially, the prospects of finding employment for young people have worsened dramatically. Massive increases in fiscal deficits and public debt, required to pre-empt a more dramatic economic meltdown, are forcing policymakers to (re-)consider cuts in welfare services, including health, education, and social transfers to the poor, the unemployed and pensioners, in order to shore up public finance solvency and economic stability.

Three years since the bankruptcy of the Lehman Brothers investment bank, the aftermath of the global financial crisis is riddled with wrong-headed policy temptations. This is especially true for Europe, where short-sighted fiscal austerity is endangering the very objectives – economic growth and social stability – it set out to achieve. Moreover, the manner and extent to which burden of austerity is being distributed within and across member states will have important implications both for the political legitimacy of EU-level macroeconomic agreements and domestic social reform. Pro-cyclical fiscal restraint in Europe's most distressed economies is sure to generate domestic political conflict and frustration if there no light at the end of the tunnel in exchange for painful sacrifices. As many governments are struggling to garner domestic support for new rounds of unpopular welfare reform, any new "fiscal compact" must be balanced with growth and social cohesion enhancing measures, if the European project is to survive. To put together joint EU macroeconomic governance and domestic social reform packages that can stabilize public finance without hurting recovery, and that are the same time seen as sufficiently equitable and legitimate for democratic publics, is a tall order. For Europe to live to its full economic growth and social wellbeing potential, the hesitant and halfway re-conversion to the economic teachings of John Maynard Keynes in the wake of global financial crash sorely needs to be complemented with a forceful updating of the welfare legacy of William Beveridge, to Twenty-first century economic and (geo-)political conditions.

It is perhaps too soon for any academic to draw policy conclusions from the momentous crisis of Twenty-first century global capitalism, but given the stakes at play, it is imperative to at least try to explore some of the contours of what lies ahead for social policy provision and EU cooperation. While the crisis is putting severe strains on welfare and European institutions, this can engender positive consequences. Deep economic crises are often moments of political truth, so the history of the Twentieth century teaches us. In the wake of credit crunch of late 2008, both social policy concerns and EU economic governance predicaments have resurfaced on top of the political agenda in practically all member states. Citizens and policy makers once again realized how important social protection is for mitigating social hardship and how critical the EU, especially ECB, is in fostering a minimal degree of economic stability.

In addition, and contrary to conventional wisdom, it should not be forgotten that the past three decades have been ones on intense social reform. Some countries, most notably the Nordics, have in the process been able to re-establish new virtuous mixes of equity and efficiency, by enlarging, on the one hand, the scope for markets in the sphere of production while, on the other hand, complementing income protection with active and capacitating social services. Also elsewhere, notably in a number of Continental welfare regimes, such as the Netherlands (social activation), Germany (support for dual earner families), and France (minimum income protection), but also in Britain (fighting child poverty) and Ireland (improved education), and Spain (negotiated pension reform) welfare policy and labour markets have been re-oriented towards "social investment," with higher levels of employment for both men and women as a result. Social service innovation and expansion, it is true, have been accompanied by benefits of shorter duration, increased targeting and sanctioning in passive welfare benefits. Only a small minority of European countries, among which Greece and Italy, have continued to resemble the purported general caricature of change-resistant passive welfare states. But, by the early 2000s, their antiquated, fragmented and insider-biased, social policy systems had become the exceptions to the more general rule of (self-)transformative welfare state change in most other regions on the European continent.

The overriding purpose of this contribution is to assess and contextualize the prospects for social investment in early Twenty-first century European welfare capitalism [Vandenbroucke *et al.* 2011]. Will the social investment paradigm carry the day, or revert to marginality, now that the calls for immediate deficit and debt reduction, based on the mantras of balanced budgets and disinflation, have taken pride of place? The years ahead will differ markedly from the past two decades when the social investment paradigm was launched after the mid-1990s [Morel *et al.* 2012]. To be sure, the current tide of pre-emptive austerity, the resurgence of national populist old-style welfare chauvinism, and declining popular support for solution including European Union institutions, are all anathema to a much needed rethinking of a productive welfare state. Below I wish to examine what is needed to rescue the social investment perspective from one-sided and pro-cyclical austerity policy orientations. This, however, without denying however the importance of fiscal consolidation. Given Europe's adverse demography, it is my contention that the social investment imperative is more acute than ever. The key policy challenge is to make long-term social investment and short-term fiscal consolidation mutually supportive, both economically and politically.

The rest of the article is organized as follows. First, section 2 takes critical stock of a number of several significant qualitative changes in the makeup of European welfare states over the past two decades. Section 3 summarizes how social investment ideas and policy practices have taken root across different welfare regimes and to what effect. The section also elaborates in a number of concrete policy recommendations so as to substantiate social investment policy synergies. Section 4, in turn, addresses the critical role of the EU. As social investment is necessarily a supply side strategy, it cannot be a substitute for macroeconomic governance and sound financial regulation. The eurozone sovereign debt and currency crisis critically exposed the shortcomings of the too "loose coupling" of "hard" EMU governance and "soft" Lisbon Agenda.

A deliberate strategy of affordable social investments, therefore, needs to be solidly embedded in a regime of macroeconomic governance and budgetary monitoring at the EU level. The final section touches on the embattled politics of social progress in early Twenty-first century Europe. As today EU citizens have as little faith in the state as they have in the market, a fundamental reimagining of the role of public authority in the economy is imperative. Elected national politicians and EU officials must re-establish the terms upon which welfare provision can be seen as normatively legitimate and economically efficient [Hall 2009].

2. Welfare Reform Is Difficult, But It Happens

From the early 1990s to the mid-2000s, total public social spending as a proportion of GDP absorbed between 25 and 30 percent of GDP [Castles 2004; Begg *et al.* 2008; OECD 2008]. High and constant social spending is often taken as an indicator that comprehensive welfare states are largely unable to adapt to environmental change. Paul Pierson, a leading scholar in comparative welfare state research, has characterized contemporary welfare states as *immovable objects* – impossible to reform because of the immense popularity of mature social programs, in an era of *permanent austerity* [Pierson 1994; Pierson 1998; Pierson 2001; Pierson 2004; Pierson 2011].

Behind stable government social spending, however, the policy repertoires of advanced European welfare states have experienced profound transformation over the past two decades. From a public policy perspective, modern welfare regimes are best conceptualized as complementary packages of interdependent social policy programs [Hemerijck and Schludi 2000]. Over the past three decades, many European welfare states have – with varying degrees of success – have made important efforts to redirect economic and social policies by pushing through adjustments to macro-economic policy, industrial relations, social security, labor market policy, employment protection legislation, pensions and social services, and welfare financing and governance, contingent on various institutional conditions across different regimes.

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 and Featherstone 1999; Scharpf 1999; Eichengreen 2007; Lindvall 2010]. Especially, EMU restrictions on monetary and fiscal policies 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 between the trade unions, employer organization and government, often linked with wider packages of negotiated reform that have made taxation, social protection, pension and labor market regulation more "employment friendly." In the 1990s, the EMU entrance exam played a critical role in national social pacts in the so-called hard-currency latecomer countries, such as Italy, Spain and Portugal [Pochet and Fajertag, 2000; Dølvik 2004; Baccaro and Simoni 2008; Avdagic *et al.* 2011].

In the area of *labor market policy*, in the 1990s the new objective became maximizing employment. Spending on active labor 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 [Eichhorst *et al.* 2008; Bonoli 2009; Bonoli 2012; Clasen and Clegg 2011; Van Vliet 2011; Kenworthy 2010]. Bonoli [2011] convincingly argues that the novelty of the new approach lies in the combination of investment in human capital and stronger work incentives. In all countries (except Italy) we see a general convergence towards *employment first* approaches in active labor market policies, although some countries stress human capital investment (the Nordic countries and France), while others emphasize labor market re-entry (The Netherlands, Germany, the United Kingdom).

With respect to *labor market regulation*, several European countries have moved towards greater acceptance of flexible labor markets. It was the introduction of these "active" elements into the Danish labour market, mentioned above, gave rise to the "flexicurity" model [Campbell and Hall 2006]. Flexicurity entails the view that social policies and labor market regulation should simultaneously augment labor market flexibility to address the needs of firms while expanding social policies to enable workers to find employment [Wilthagen *et al.* 2004]. Flexicurity triangulates flexible labour markets, generous unemployment benefits, and active labour market policies, so as to reduce unemployment and improve the quality and supply of workers to the labour market, with the aim of correcting the imbalance between an inflexible labor market for core workers and precarious work for the growing contingency workforce. It builds on the concept of the "transitional labor markets" [Schmid 2006; Schmid 2008], which underscores the need to adjust the qualifying criteria for social policies to accommodate more frequent transitions in and out of employment. The Danish arrangement of easy hiring and firing, generous unemployment benefits and active labor market policy, was hailed by the European Employment Strategy (EES) as an *example par excellence* for simultaneously enhancing flexibility and security in the labor market, reconciling employers' need for a flexible work force with workers' preference for employment security. Meanwhile, governments in many European countries have increased the scope for temporary work and fixed-term contracts.

In terms of *social insurance* and *assistance*, the generosity of benefits has been curtailed. There have been reductions in benefit levels and benefit duration, the eligibility criteria of social provisions have been tightened, and the coverage of benefits have been limited. Through the weakening of earnings-related benefit provision and by harmonizing benefits across different risk categories, social insurance benefits have become less status confirming [Bahle *et al.* 2010]. As income replacement policies have been curtailed, activation and active labor market policies have expanded significantly [Kenworthy 2008; Kenworthy 2010; Eichhorst *et al.* 2008; Bonoli 2011; Bonoli 2012]. Access to social insurance for inactive able-bodied persons has become progressively conditional on participation in training and counseling programs and behavioral requirements, such as job search obligations [Van Gerven 2008; Weishaupt 2011]. Clasen and Clegg [2011] observe a trend towards benefit homogenization, suggesting a reduction in variation and conditions of entitlement across different tiers of social protection, such as unemployment insurance and social assistance in countries like the UK, the Netherlands, Germany, Denmark, and Belgium. In the Netherlands, reforms increased the employment requirements of the disabled, single mothers and older workers [Hoogenboom 2011]. Conditionality and job search requirements have been tightened in Denmark and Sweden [Goul Andersen 2011; Sjöberg 2011]. Similarly, successive Labour British governments have departed from the liberal path since 1997 by developing an enabling welfare state that makes most of its provisions contingent upon paid employment [Clasen 2005]. In addition, policymakers have strengthened minimum income protection, coupled with more "demanding" activation and "enabling" reintegration measures. In countries like Belgium, France, and the Netherlands, activation programs based on individual guidance and training opportunities, primarily targeting 'outsiders' like the young, female or low-skill workers, have gained momentum over the past two decades.

Old age pensions are often seen as the most resilient artefacts of the post-war welfare state, "least likely" to confront profound reform. Financing problems due to population ageing and lower growth prompted widespread reform. Steps have been taken to reverse the trend towards early retirement policies, together with initiatives to promote longer and healthier working lives. A string of adjustments, however, have fundamentally altered retirement welfare over the past two decades [Ebbinghaus 2011; Bonoli and Palier 2008]. 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 labor market and award those working longer [Clark and Whiteside 2003; Hauserman 2010]. Many countries have shifted from defined benefits to defined contributions [Ebbinghaus 2011]. Virtually all European countries have introduced fiscal incentives to take up supplementary private pension insurance. In addition, measures to combine work and retirement, with tax allowances and partial pension benefits, have been introduced in Denmark and Finland. One of the most profound pension reforms was enacted by Sweden in the mid-1990s, introducing a small mandatory funded element and transferring an important part of the risk associated with aging onto (future) retirees, by way of indexing future benefits to the life expectancy and net wages, while at the same time ensuring a universally guaranteed pension for low-income pensioners [Palme 2005].

Social services have significantly expanded, especially in the 2000s, to boost female participation though active family policy [Kautto 2002; Lewis 2006; Mahon 2002; Mahon 2006; Ungerson 2004; Crompton 2006; Orloff 2006; Orloff 2009; Orloff 2010]. Spending on family services, childcare, education, health, and care for the elderly, as well as on training and employment services, has increased as a percentage of GDP in practically everywhere in the European Union [Jenson 2006; Jenson 2009; OECD 2007; OECD 2011]. Family policy, covering child care, 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 [Daly 2000; Daly 2010]. Traditional "passive" cash measures were complemented with 'activating' services, such as childcare and parental leave schemes, to help reconcile work and family life, also to foster higher levels of female employment, reflecting a change in orientation towards the norm of dual earner households [Lambert 2008; Bradshaw and Finch 2010; Plantenga *et al.* 2012]. A core feature concerns new provisions to resolve dilemmas associated with women's new career preferences [Gautier 1996; Hakim 2000; Orloff 2006; Esping-Andersen 2009]. The available evidence suggests that many countries have moved towards the expansion of policies to facilitate work-life reconciliation. Pioneers in the such reconciliation policies include the Nordic countries and France, followed by the "path-shifters" of Germany, the Netherlands, and the UK and finally slow reformers including Austria, Italy and Spain [Morgan 2008; Morgan 2012]. Leave arrangements have been expanded, in terms of both time and scope of coverage, including the frail elderly.

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. Although a straightforward privatization of social risks has remained a marginal phenomenon across European, except for pensions, we do observe an increase in user financing is social services – childcare, school education, medical care, old-age care. Especially, private provision of publicly financed services has increased substantially. In parallel, market-oriented administrative practices have also become more widespread. In addition, most countries have reviewed the incentives of their tax/benefit systems in order to make them more "employment-friendly." This development has been motivated by competitiveness concerns, but also by the wish to neutralize the vicious spiral of "welfare without work" generated by "contribution-heavy" Continental social insurance systems [Palier 2010b]. While many observers feared that tax competition would come to under-finance the welfare state [Sinn 1990; Steinmo 1993; Tanzi 1995; Rodrik 1997; Swank 2002; Swank 2006; Swank and Steinmo 2002], Philipp Genschel and Peter Schwartz [2011] observe that a "race to bottom" through competitive tax cutting does not stand up to empirical scrutiny.

A final overarching reform concerns the changes in the territorial organization of social policies and the related *administrative reforms*, or the "rescaling" of social policies, as Yuri Kazepov [2010] puts it. Most important has been the attempt to bring social insurance and assistance and labor market policies institutionally under one roof in so-called "one-stop centres," thus ending previous separation of social security and public employment administration being organized at different territorial levels but bringing about more complex multilevel arrangements. Beyond important substantive policy innovation in social security, labor market and social service provision, many policy changes also implied important reforms in the governance structure, towards more decentralization, marketization and competition, inter-agency cooperation, and new public management [Berkel and Borghi 2008; Berkel *et al.* 2011]. Ideas of New Public Management (NPM) 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]. The general shift from income maintenance programs to services in welfare provision, moreover, has been accompanied by individualization and customization of new public-private mixes in capacitating local social servicing, requiring high quality institutional competencies for policy administration and discretionary implementation in career guidance, (re-)training and rehabilitation services, and child and elder care provision adjusted to the specific needs and capabilities of individual clients. In short, the division of labor in welfare provision between family responsibilities, commercial market social services, and public provision has been thoroughly redrafted [Le Grand 2007; Pollitt 2003; Pollitt and Bouckaert 2004; Weishaupt 2010a].

Welfare reform is difficult, but it happens. The result has been a highly dynamic process of social reform, marked not by half-hearted retrenchment efforts and political stalemate in the face of entrenched interests, as conjectured in the "new politics" of the welfare state literature, but by comprehensive trajectories of "welfare recalibration." Since the late 1980s, all welfare states of the European Union have been recasting the basic functional, normative, distributive and institutional underpinnings upon which they were based. Initially, across Western Europe, social and economic policy adjustment primarily revolved around issues of economic competitiveness, including the decisive shift towards cost-competitive wage bargaining alongside labor market deregulation. When the European Economic and Monetary Union set limits to deficit and debt financing, domestic policy makers became more willing to adopt measures of cost-containment, in conjunction with more active labor market policies. Eventually, new values of work, family, gender relations, distributive fairness, and social integration, triggered the adoption of an active welfare state edifice, reinforced by dilemmas of ageing populations, de-industrialization, changing family roles in labor markets and households. In order to maximize employment, promote activation, restrain early retirement, reconcile work and family life, in the process, a great number of welfare regimes have decisively moved away from the traditional male breadwinner and female caregiver household models of the 1960s to embrace the norm of dual-earner households. Welfare reform has been accompanied by social conflict, but in many countries important reforms received broad consent from opposition parties, trade unions and employer organizations. The shift to social pacts, activation, active ageing, basic pension guarantees, gender mainstreaming, childcare and parental leave expansion, alongside labor market "flexicurity," moreover, fundamentally transcend the traditional neoliberal retrenchment, deregulation, and negative incentive recipes of the 1980s and 1990s.

3. Five Important Lessons

The wide-ranging welfare reform momentum, with significant domestic variation, sketched out above, adds up to a broad, cumulative process of welfare state (self-)transformation across the member states of the European Union [Levy 1999; Ross 2000; Ross 2008; Hemerijck 2002; Hemerijck *et. al.* 2006; Clasen 2005; Huo 2009; Lindvall 2010]. There have big policy changes, many of which apply to the allegedly most "inert" and "locked-in" German and French Bismarckian welfare systems [Vail 2010; Eichhorst and Kaiser 2006; Stiller 2010; Palier, 2010a; Weishaupt 2010b]! Especially since the mid-1990s, the welfare state has been in a constant state of flux. In their attempt to quantify reform intensity across the OECD, the economists Duval and Elmeskov [2006] reached the conclusion that, over the period between 1994 and 2004, the propensity to enact welfare and labor market reforms has been greater in the EU15 countries in comparison to a number of OECD countries outside the EU. Similarly, based on alternative indicators from 1995 to 2005, Bertola *et. al.* [2001] and Boeri and Garibaldi [2009] observe a strong acceleration of social reforms, with eurozone member state significantly intensifying the reform momentum over the period of the establishment of EMU.

I would like to draw five important lessons from the recent experience of comprehensive welfare recalibration.

a) *Welfare state futures are not foreordained.* Country-specific recalibration efforts have not been guided by some grand design or carefully thought out master plan, from which successful policy responses then ensued. European trajectories of welfare recalibration were paved with many contingencies, major recessions, multiple policy failures and regime-specific pathologies, political gridlock, severe coordination, implementation deficits, and also setbacks. Institutionally-bounded recalibration and innovation in the welfare state required hard-won changes, interrupted policy experiments, and both fast and slow learning processes, increasingly also at the level of European tiers of governance. At the same time, the boundaries of national welfare states have been significantly redrawn as a consequence of intensified EU integration. This has resulted in the transition from sovereign to semi-sovereign welfare states, and the creation of a "multi-level" polity, within which national and supranational economic and social policy makers interact more strongly than before. Intensified interdependencies between European economic integration and national welfare states have prompted many governments to reinforce recalibrations in their welfare social protection systems.

b) *We live in a world of path-dependent solutions.* Although the drivers behind changing European welfare states are common, internal and external challenges have manifested themselves in terms of divergent problem loads from one welfare regime to the next. As a result, policy adjustment has been regime specific, cautiously accommodating new benefits and services into existing institutional contexts. This even applies to the new EU member states, whose revolutionary social policy transformation revealed novel layerings of Bismarckian and egalitarian policy legacies, inherited, respectively, from late Nineteenth and Twentieth century social insurance provision and from the state-socialist period between 1940s to the late 1980s, together with novel market-liberal advocacy inputs from the IMF and the World Bank. As prevailing employment and social policy regimes, on various occasions, ran into severe problems of sustainability, such predicaments triggered processes of *renovation* and *re-casting* current policy legacies and institutional structures so as to achieve a better "fit" with prevailing societal challenges, all this with considerable time lags and difficulties in overcoming political resistance. In hindsight, the era of relative austerity since the 1980s up to the onslaught of the global financial crisis, should reframed as an epoch of permanent and unprecedented social reform. Given the differential impact of the aftermath of the global financial crisis, it is easy to see that European welfare states have entered a new era of flux and diversified social and economic policy adjustment.

c) Credit is due to supranational social policy agenda setting. In this respect, the EU has been critical in the articulation of the social investment paradigm, including its basic functional, normative and institutional underpinnings. Guided by the Lisbon Agenda of 2000 and European Employment Strategy (EES) of 1997, the EU has (indirectly) become an effective agent of welfare reform. It helped to redefine the European employment predicament away from *managing unemployment* toward the *promotion of employment*. After the EU, also other supranational organizations have jumped on the epistemic bandwagon of social investment, most notably the OECD, which has established itself through studies like *Babies and Bosses* [OECD 2007] and *Doing Better for Families* [OECD 2011] as the new cheerleader of social investment [Jenson 2012].

d) But the nation-stated remains of vital importance throughout the past decades of structural social and economic change. European citizens are *politically* not ready to renounce their national identities in favour of a stronger EU social policy space [Berger 2009]. On the contrary, the prevailing narrative of welfare paradise lost, rhetorically poised in contrast to the perceived present-day heartless world of global competition, has negatively framed the sentiments of national publics to EU policymaking – a sentiment that has been reinforced by the 2010 sovereign debt and 2011 currency crisis and its political mismanagement.

e) Changing welfare states defy easy explanation. Welfare states are complex systems, whose goals, functions and institutions change over time, however slowly and incompletely. For this reason, it is imperative to study the politics of changing welfare states, not as models, but, more dynamically, as open systems caught up in processes of path-dependent evolutionary social and economic reconfiguration. Welfare state change is work in progress, leading to patchwork mixes of old and new policies and institutions. But this should not surprise us. The post-1945 modern welfare state was also not built from scratch. The common denominator of European welfare reform momentum of the past two decades can be captured in terms of a *search for a new welfare edifice*, a search process that remains incomplete, resulting from the institutionally bounded and contingent adaptation to new and evolving social and economic realities. Therefore, any attempt to analyze social policy change has to abide by a differentiated approach which takes count of the complex character of welfare states – their normative and ideological foundations, their distributive portent, the institutional structures of social programs, and the division of labor of welfare provision and administration between public institutions, markets, families and civil society.

4. Social Investment Welfare Transformation

Without proper substantive contextualization any list of profound social reforms remains unsatisfactory. Since many of the above policy reforms were made before the onslaught of the recent recession, it is worthwhile to take stock of the general direction of profound social policy transformation.

a) *From fighting unemployment toward raising labor market participation*. Different policy provisions have been brought into new institutional relationships with each other through important redefinitions of salient policy problems. In line with the general shift to supply side economics, the overarching social policy objective has shifted from fighting unemployment to promoting labor market participation. As income protection remained the key function of social insurance policy, it has been increasingly complemented by employment activation and reintegration measures, evident in augmented conditionality for unemployment insurance of social assistance benefits and supported by active labor market policy measures.

b) *Capacitating and family-friendly social services*. Loosely aligned with the shift toward activation, the development of capacitating social services of dual-earner families marks a clear departure from the longstanding male breadwinner/female homemaker legacy, especially in continental Europe. Family support, gender roles, and childcare have moved to the center of recent social reform. One of the fundamental reasons why the "active" welfare state today must provide enabling and capacitating social services is inherently related to the erosion of the effectiveness of the social insurance principle, upon which the post-war transfer-biased male breadwinner welfare state was based. When the risk of industrial unemployment was largely cyclical, it made sense to administer collective social insurance funds for consumption smoothing during spells of demand deficient unemployment. When unemployment becomes structural, however, unemployment insurance can no longer function as a reserve income buffer between jobs in the same industrial sector. For the effective mitigation of *new social risks*, such as skill depletion and tension between work and family responsibilities, the new welfare state must provide capacitating services tailored to particular social needs. Such services in fact better protect citizens against new labor market risks than conventional unemployment insurance.

c) *From "freedom from want" to "freedom to act."* We have entered a distinctively new phase of welfare state development, characterized by an incipient move toward active *service-oriented* welfare states, and away from the traditional passive, *transfer-oriented* systems of the past. Today, the highest levels of employment are found in the Nordic countries, which have been able to hold on to generous social welfare systems. The recent reform momentum represents a *Gestalt switch*, from an orientation on social compensation to citizenship empowerment with state-provided or regulated investment in human capital and social quality.

The welfare state, it should not be forgotten, is a normative concept based on the image of a social contract, with claims on equity and fairness, and goes far beyond issues of economic redistribution to include dimensions of gender roles, the work ethic, child rearing, and intergenerational equity. The changes listed above have contributed to a slow redefinition in the very idea of social justice: a shift away from understanding fairness in terms of equality toward an understanding of solidarity and fairness as an obligation to give due to the needs of each individual, so as to enable all to flourish. At the heart of the new welfare state lies a re-orientation in social citizenship, away from the compensating *freedom from want* logic toward the capacitating logic of *freedom to act*.

The turn towards raising employment, supported by capacitating social servicing to encourage the freedom to act, intellectually, has been pioneered by leading experts and intellectuals like Gøsta Esping-Andersen [1999] and Anthony Giddens [1998], was advocated in terms of a determinate departure from the institutional and ideological foundations of both the postwar male breadwinner, social insurance, welfare state, and its 1980s neoliberal successor of labor market deregulation and welfare retrenchment. The philosophy underpinning the social investment perspective was given more substance by the publication of a book edited by Esping-Andersen and others, *Why We Need a New Welfare State*, commissioned by the Belgian presidency of the EU in 2001, endorsed the view that "the single greatest challenge we face today is how to rethink social policy so that, once again, labor markets and families are welfare optimizers and a good guarantee that tomorrow's adult workers will be as productive and resourceful as possible" [Esping-Andersen *et al.* 2002, 25]. The key idea, in terms of policy, was to "prepare" individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the development of new social risks, population ageing and climate change, instead of simply "repairing" damage after passive social policies prove inadequate [Morel *et. al.* 2012].

Already in the 1990s it became evident that the more active, universal and service-oriented welfare states were in a stronger position than the more passive, selective, and transfer-oriented systems. In the new millennium, some of the most generous welfare states, with large public sectors devoted to human capital formation, active labor market policy, early childhood education and care, and work family reconciliation arrangements, clearly outperform the more passive and liberal welfare state. Especially, the Nordic countries have produced the strongest evidence base for Pareto-optimal solutions to the challenges of structural social and economic change, by matching, in the words of André Sapir [2006], "high efficiency" in the economy with "high equity" in the distribution of life chances. But in their wake, also other welfare regimes have moved to more active and service-oriented welfare provision. This holds true for the Netherlands, Germany, France, the United Kingdom, Ireland, and Spain [Morel *et al.* 2012]. All in all, we are able to discern a relative shift from the *social protection function* of the welfare state towards a greater emphasis on the *social promotion function* of social and economic policy as an essential ingredient of resilient knowledge-based economies. Elsewhere I have been able to establish that the social investment impetus correspond with high levels of male and female employment participation over the life cycle, high productivity, low inflation and budget surpluses, without massive hikes in inequality [Hemerijck 2012]. A large public sector is not necessarily an inhibition to competitiveness; that there is a positive relationship between fertility and higher levels of female employment; and that high numeracy and literacy rates can be achieved with educational policies that abide by the principles of equal opportunities and high quality public provision [see also Lindert 2004; Kenworthy 2004; Kenworthy 2008; Kenworthy 2011; Pontusson 2005; Esping-Andersen *et al.* 2002; Esping-Andersen 2009; Bernard and Boucher 2007; Begg *et al.* 2008; Hemerijck and Eichhorst 2010; Eichhorst and Hemerijck 2010; Eichhorst *et al.* 2012]. *Ex negativo*, many Southern European countries, excepting Spain, stand out as having declined to pursue explicit social investment policy strategies, with continued underinvestments in services together with overspending in passive benefits. This in part also explains their continuing high levels of inequality, low levels employment for women and older men, high long-term and youth unemployment, and more troubled public finances, together with lower fertility, in especially Italy and Greece.

4.1. *Employment*

Over the past three decades, there has been a significant increase in employment virtually all European welfare states whereas the new member states experienced a transformation crisis. Figure 1 describes the employment/population ratios among people in the working age population. What is striking is, first, the long-term increase in employment in most countries and, second, some persistent differences in the overall share of people in gainful employment across countries and families of welfare states. The convergence over time within the EU is striking. Now, both the Anglo-Saxon and the Scandinavian countries have about 75 to 80 percent of the working-age population in employment. The same level is also achieved by the Netherlands after an impressive increase in employment over the last two decades. The other Continental and Southern European countries are still behind with employment rates of 60 to 70 percent. But even there we can see some progress, in particular in Spain and Italy while France and Germany have been more stagnant.

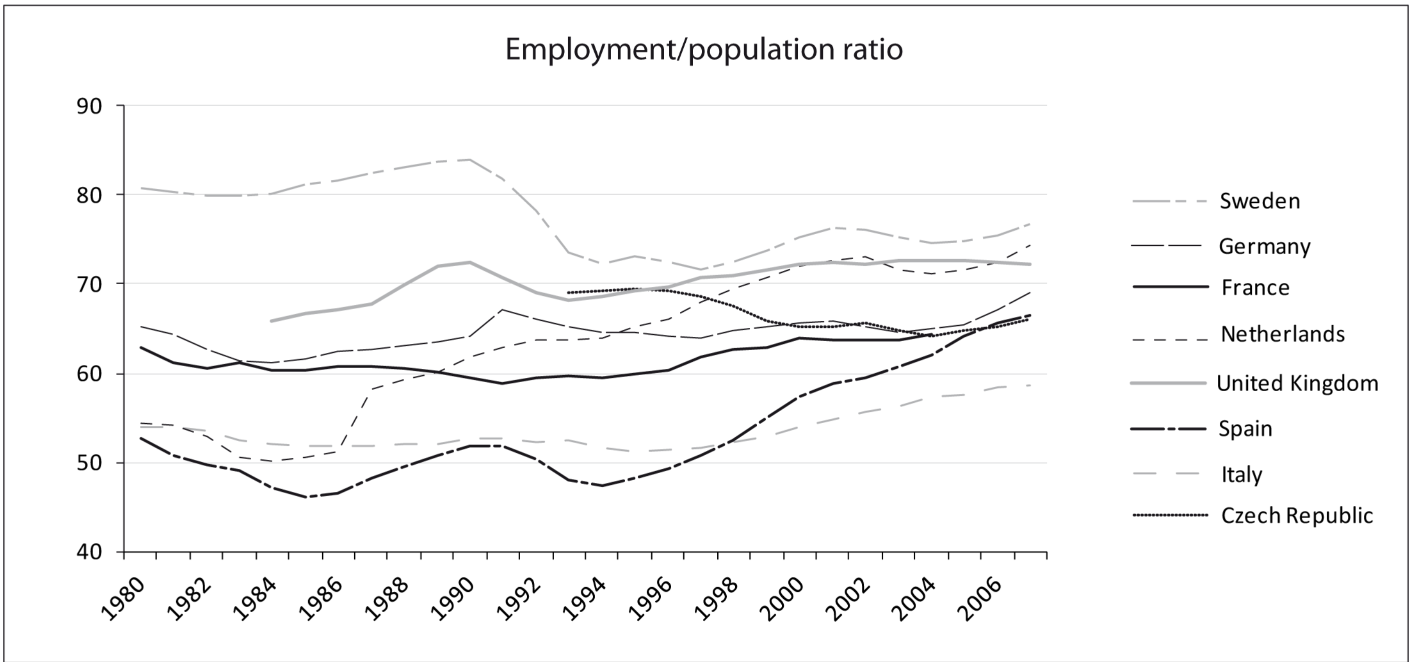

FIG. 1. Employment/population ratio (1980-2006).
Source: OECD, labour force statistics.

The activity rates for females aged 25 to 54 based on Eurostat data reveal that female activity rates between 1987 and 2007 ranged from 89% (2003) in Lithuania and 87.1% (2007) and 39.6% (1987) in Spain and 41.6% (1987) in Ireland, as shown in figure 2. For the female activity rate, a strong increasing trend for the Mediterranean and Continental countries is visible. In Spain (39.6% to 72.7%) and Ireland (40.6% to 71.9%) the female activity rate has nearly doubled between 1987 and 2007.

There exists much greater variation across welfare regimes regarding the employment rates of older workers, women and the low-skilled (see figure 3). Differences in the extent to which these three groups are integrated into the labour market basically determine differences in the overall employment rate. With respect to the 55-64 age cohort Belgium has the lowest employment rate of the EU-15 (32%) while Sweden has the highest (almost 70%). Since the end of the 1990s, the employment rate among older workers has been increasing strongly in Finland, but also in some Continental welfare states, with the Netherlands taking the lead.

For the average exit age from the labor force differences between regimes continue to persist. The Anglo-Saxon countries, the Netherlands and Sweden show in general the highest average exit age for men and women (64.7 for women in Ireland, 64.2 for men in Sweden and the Netherlands in 2007) while the other regime types reveal lower levels. However, the Continental regime and the new member states show an increase in average exit age which is less the case for the other regime types. The biggest increase has been in Belgium especially for women from 55.9 to 61.9. Spain is the only country of the Mediterranean regime with a rise in female exit age of more than 2 years between 2001 and 2007 (Eurostat).

On average, employment rates are highest in the EU countries with low government debts (see figure 4). This suggests that achieving balanced budget and high employment rates is possible. As the graph indicates, the Scandinavian and Anglo-Saxon countries as well as a few Continental countries display rather low debt levels and high employment rates.

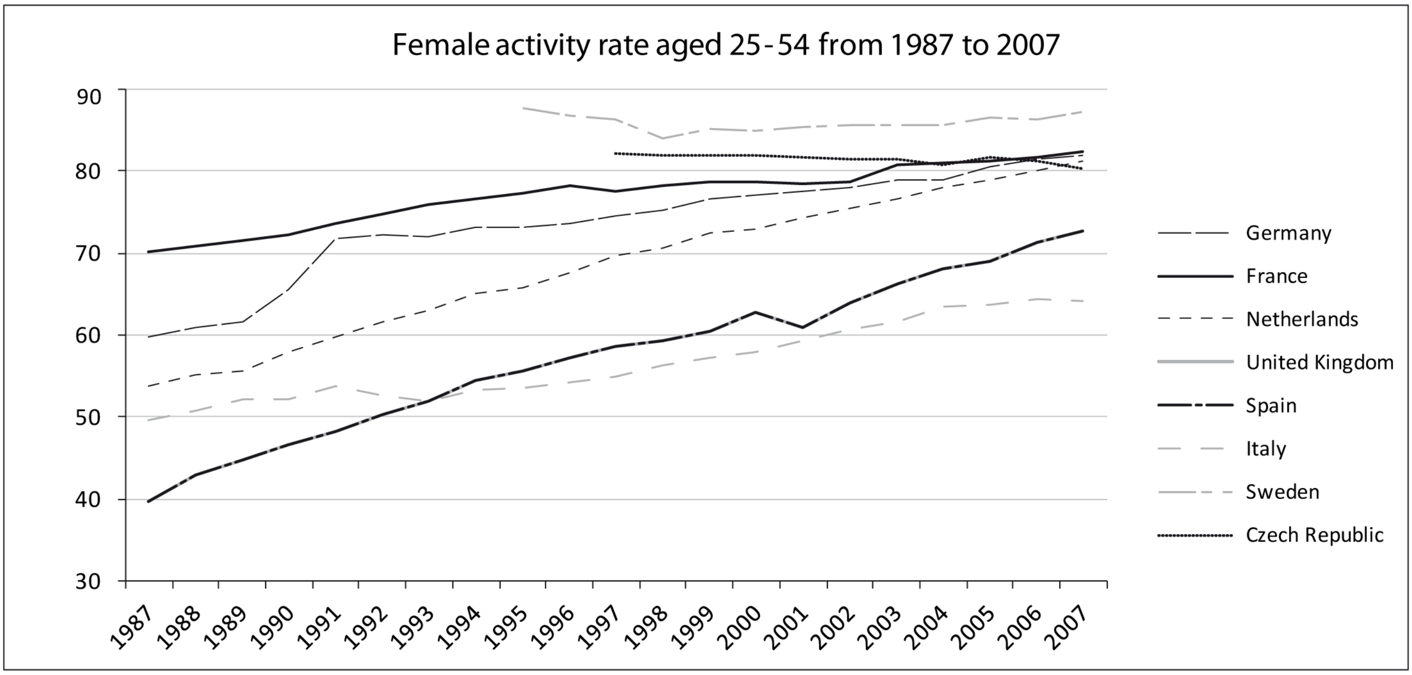

FIG. 2. Activity rate women (1987-2007).
Source: Eurostat.

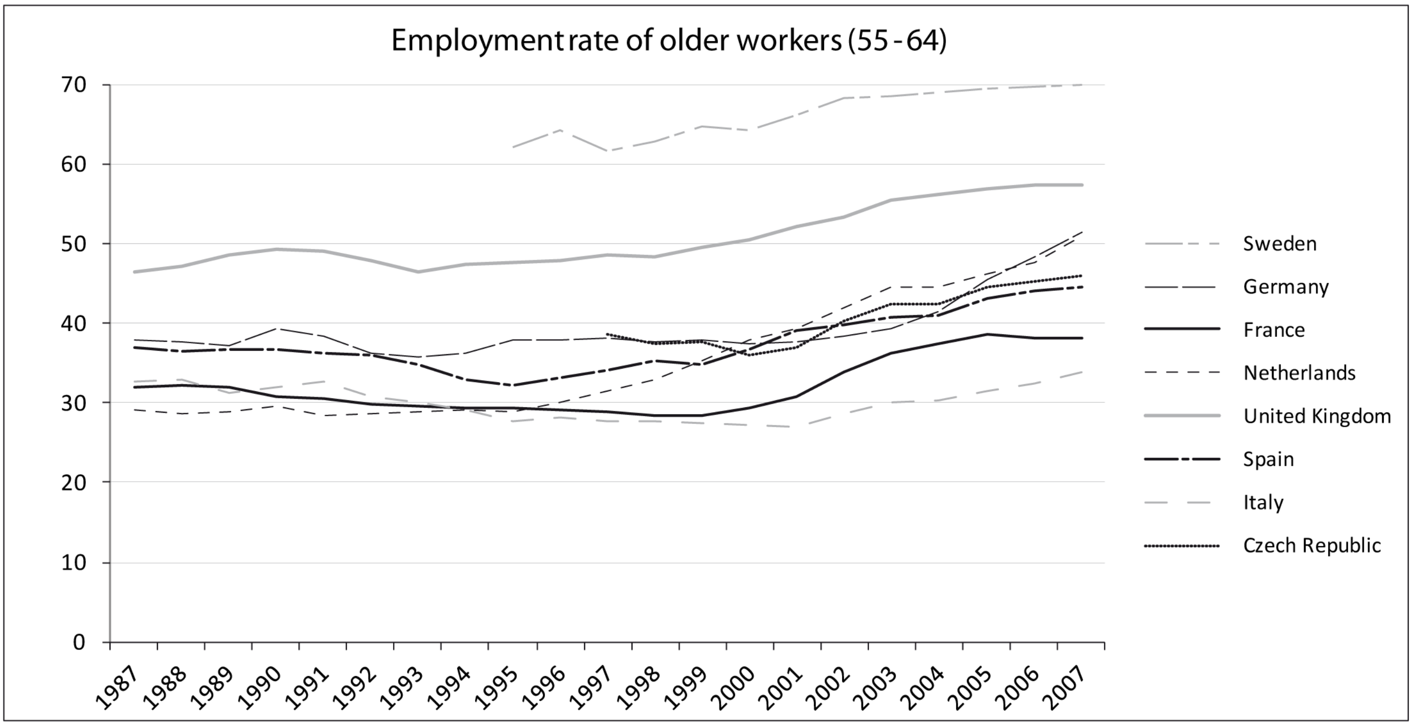

FIG. 3. Employment rate of older workers (55-64), (1987- 2007).
Source: Eurostat.

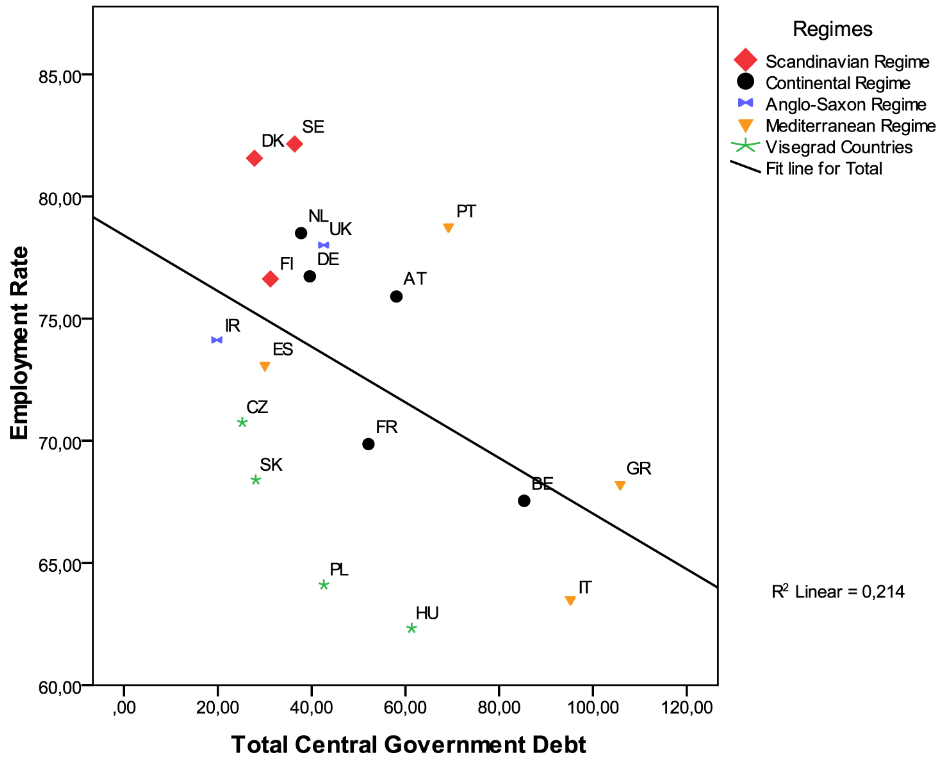

FIG. 4. Total Central Government Debt and Employment Rates.
Source: OECD.

4.2. *Social investment spending*

There is no agreed to definition of social investment spending. I view social investment spending to refer to spending on active labor market programs, child-care, education, research, and the rehabilitation of the disabled. Hereby I wish to distinguish social investment spending from non-social investment welfare spending, which encompasses expenses on old-age, survivors, disability pensions, excluding the rehabilitation expenses, and unemployment spending, excluding expenses on active labor market programs. As we can observe from figure 5 Scandinavian countries are big social investment spenders, but in the decade leading up to financial crisis they have sobered the social investment content of their welfare states somewhat. But while social investment spending has decreased in Scandinavia, it increased in the Anglo-Saxon and the Netherland, Spain, and Portugal.

Also non-social investment welfare spending has been stable from 1997 to 2007 (see figure 6). Countries with high social investment spending are generally also committed to high non-social investment spending while countries with low social investment expenditure usually spent less in general. Italy is an exception with high non-social investment welfare spending and low social investment spending levels. Similar trends manifest themselves for social investment spending in relation to net public social spending. Only Germany, France, Italy and the Netherlands diverge from this tendency. While the first show high net pubic social spending and low social investment spending in 2007, the Netherlands displays an opposite spending pattern.

The differences in the allocation of public resources to either social investment policies (such as education and training) or to compensating policies such as social benefits and passive and active labour market policies are most evident in figure 9 which represents public spending on education and social expenditure combined. While there is a general positive association between both areas of public spending, some countries, in particular the Scandinavian ones, but also Belgium and France, combine above-average spending on social policies with above-average spending on education. Germany and Italy, in contrast, devotequite a lot on social protection but are relatively close on educational expenditure. Many new EU member states devote few resources to social policies, but some achieve the European average in terms of educational spending such as Poland, Hungary and the Baltic states.

Investment in human capital takes place in the early stages of life, but due to rapidly changing work environments, people need to keep investing in their human capital throughout their life cycle. Measuring the extent in which the population invests in its human capital, looking at both initial education as well as lifelong learning is necessary. For the exit age of older employees from work and life-long learning, it is visible that although countries such as Greece, Portugal and Denmark do not follow the general pattern countries with a higher exit age depict on average a higher participation in life-long learning.

4.3. *Distribution*

Finally, distributive performance can be assessed with different measures, for instance by comparing the ratios of income quintiles or deciles to each other as to see how equal the distribution of income is or using the Gini coefficient. A score of 0 on the Gini-index means that income is equally distributed among the population, 100 is the most unequal score. Concerning the European welfare states, there does not seem to be one common pattern in the distribution of income. The Anglo-Saxon countries and the Mediterranean countries have much more unequal income distributions than the Continental and Scandinavian countries. The best performers in 1997, the Scandinavian countries, experience a slight increase in inequality, while the Continental countries seem to decrease inequality somewhat.

Turning child poverty, OECD figures based on the 2011 report "Doing Better for Families" reveals that countries investing more per child aged 0 to 17 reveal lower child income poverty rates. Here again, Continental and Scandinavian countries spend most and show lower child poverty rates.

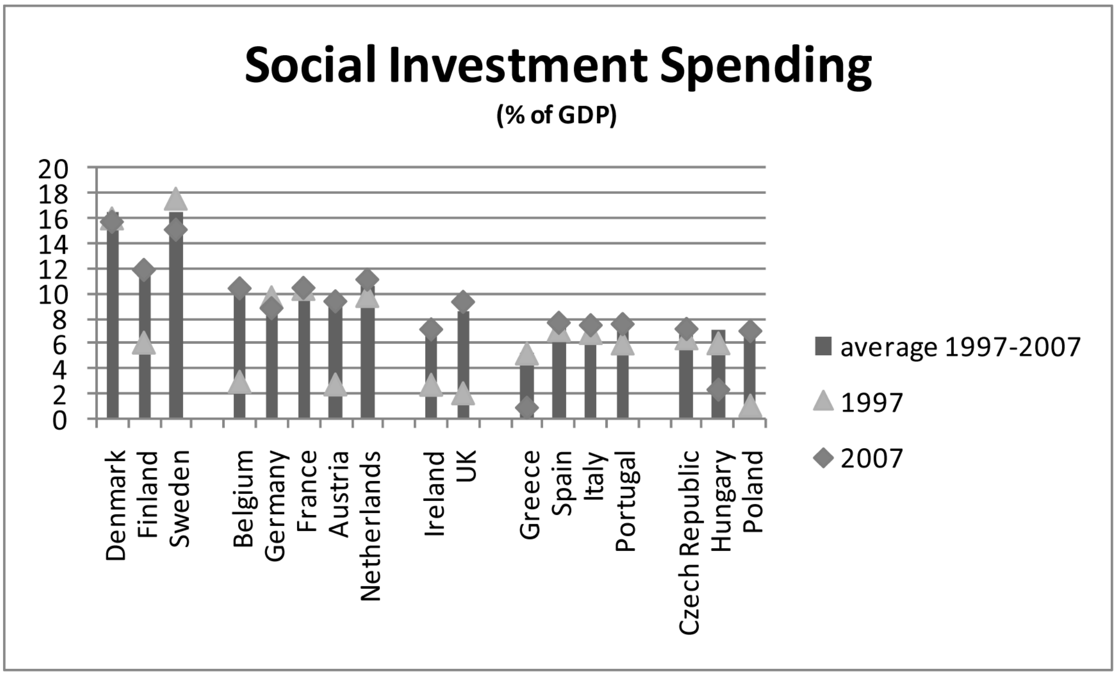

FIG. 5. Social investment spending.
Source: Calculated with OECD data.

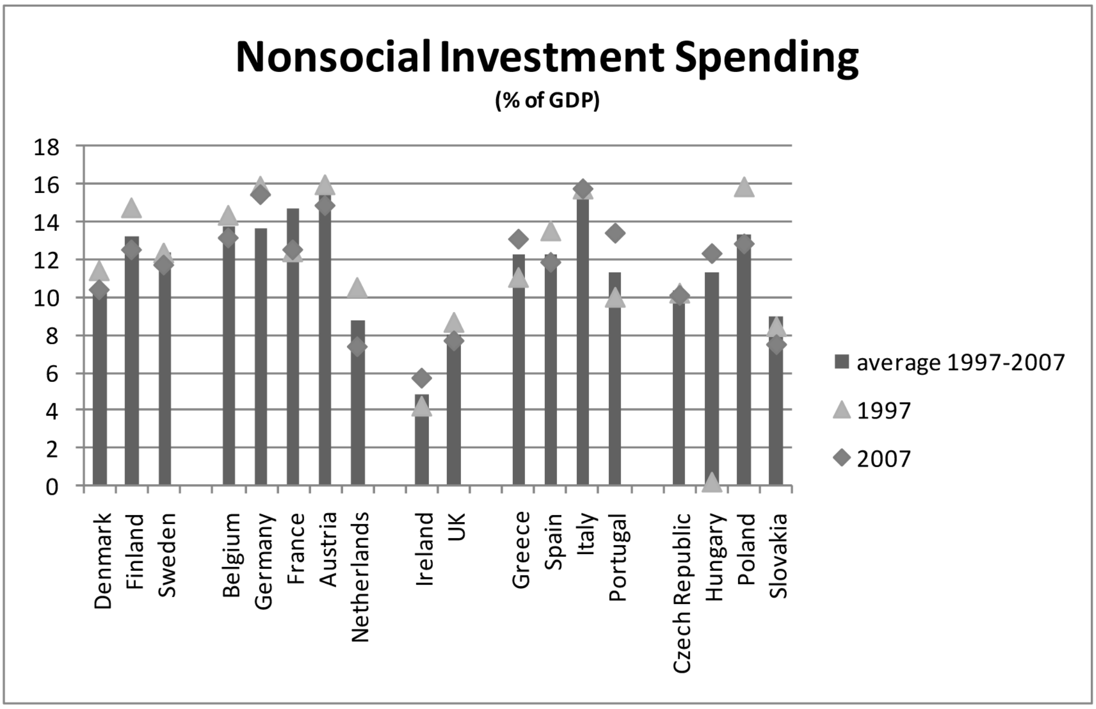

FIG. 6. Non-social investment spending.
Source: Calculated with OECD data.

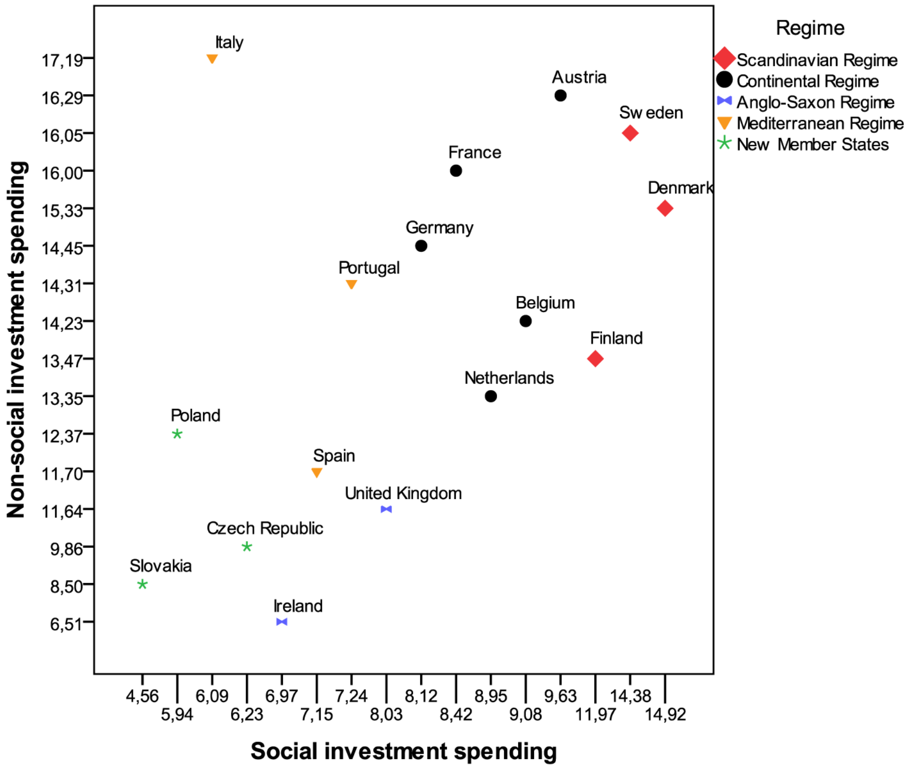

FIG. 7. Social investment spending and Non-social investment spending
Source: Calculated using OECD data.

Aggregate welfare performance speaks to important accomplishments of the social investment turn, already before the onslaught of the global financial crisis. This brings us to the important question of whether the fallout of the financial crisis since 2008 will reinforce or undermine the promise of social investment in terms of its triad of high life course employment participation and productivity, distributive justice and sustainable economic growth. In 2009 and 2010, Keynesian crisis management, in combination with short-term work or temporary lay-off schemes and strong human capital initiatives, were largely consistent with social investment priorities. Without much exaggeration, we can therefore infer from the empirical evidence of long run social policy change that the translation of the social investment paradigm into new welfare provisions has been largely successful.

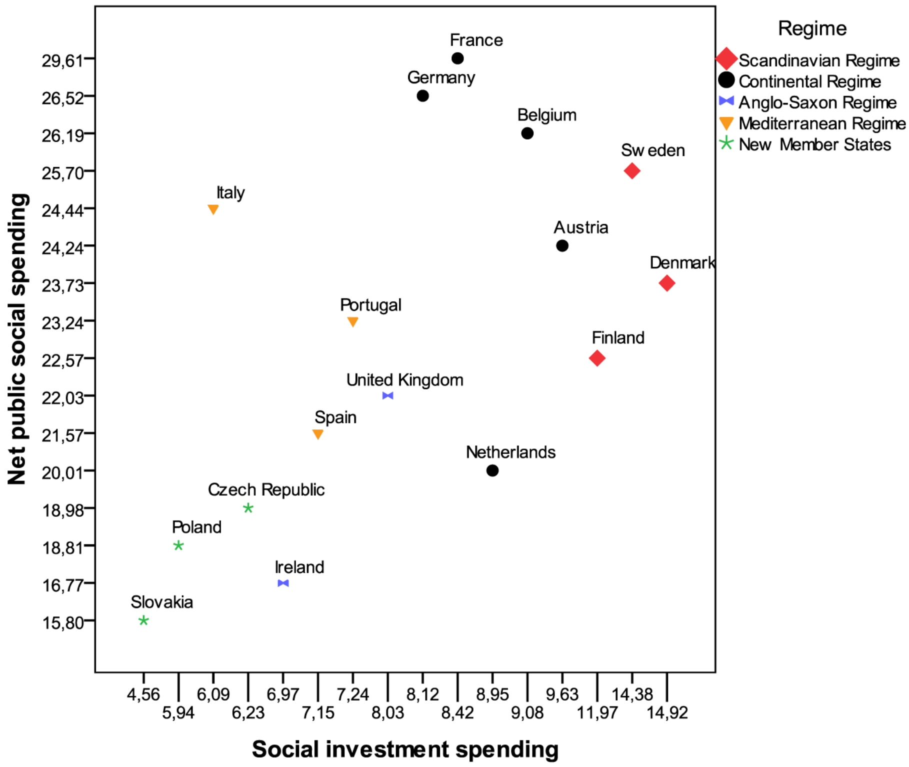

FIG. 8. Social investment spending and net social spending

Source: Net public social spending (OECD), Social investment calculated using OECD data.

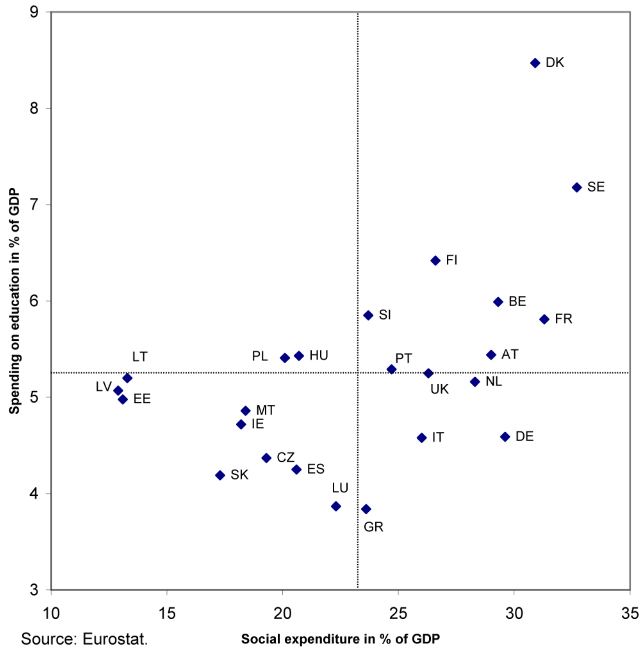

FIG. 9. Public social expenditure and spending on education in percent of GDP, 2004.
Source: Eichhorst and Hemerijck 2010.

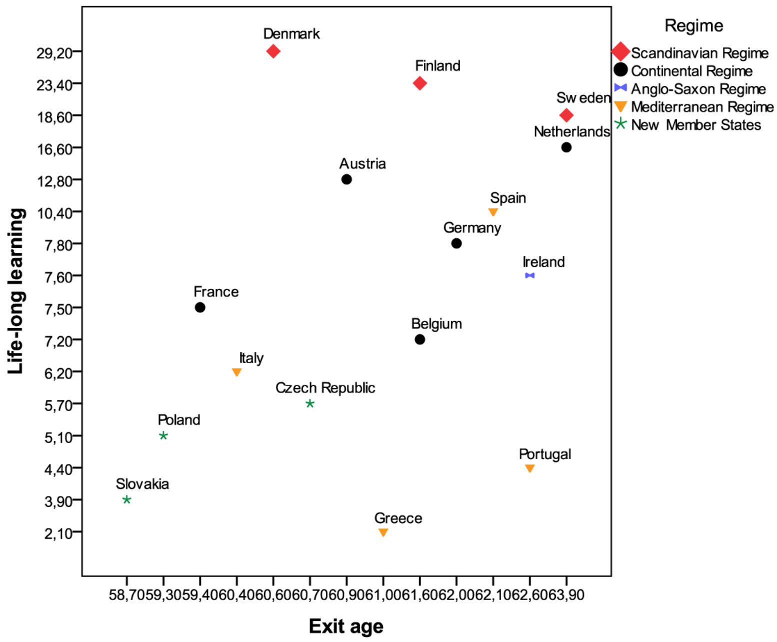

FIG. 10. Life-long learning and exit age 2007.
Source: Eurostat.

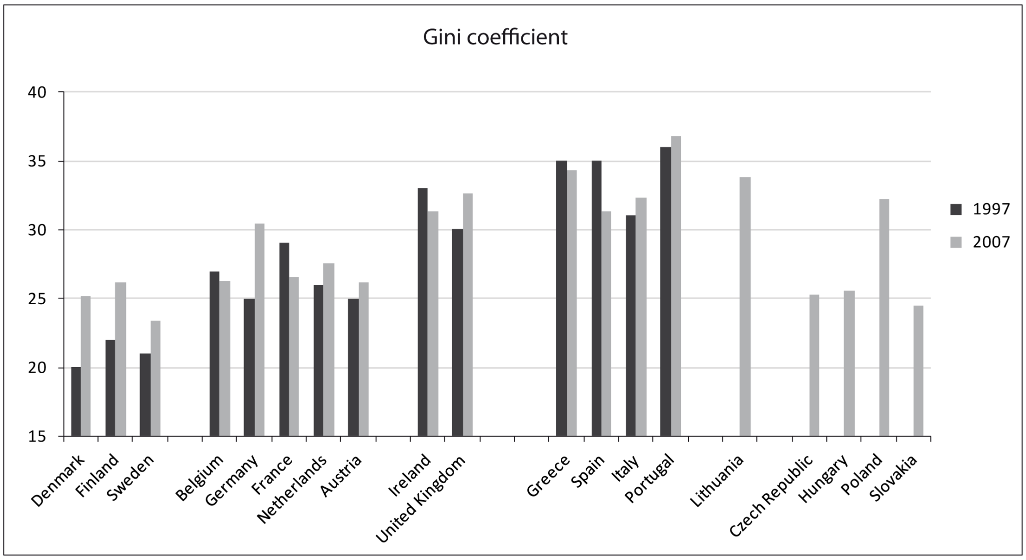

FIG. 11. Gini coefficient, 1997, 2007.

Source: Eurostat.

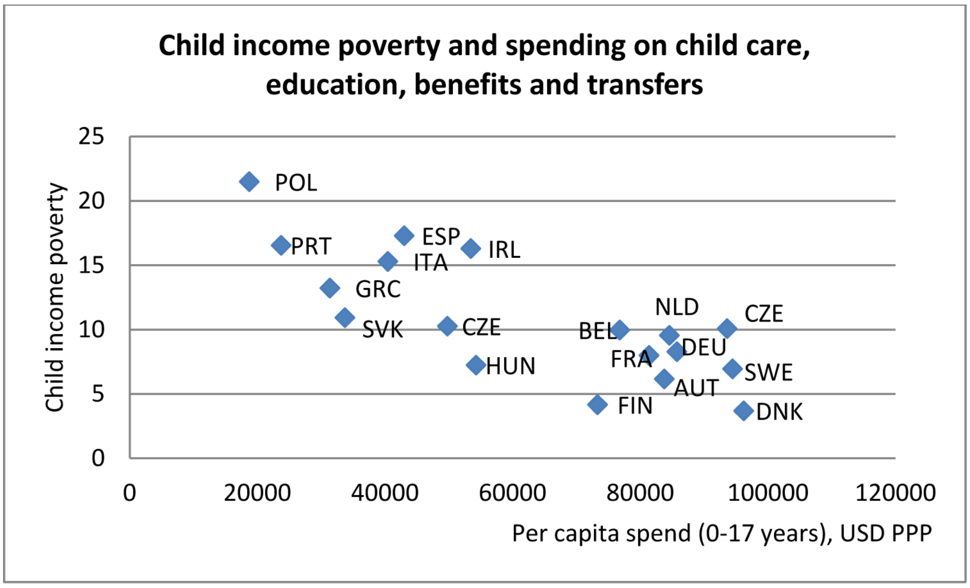

FIG. 12. Child income poverty and spending on child care, education, benefits and transfers.

Source: OECD Doing better for Families 2011.

5. Social investment imperatives in the financial crisis aftermath

The fundamental societal trends that necessitated a social investment perspective are as relevant and important today as they were ten years ago, perhaps even more so, because of adverse demography and skill-biased economic change. With fewer active persons supporting ever more dependents, low labor market participation is simply no longer affordable. There is no denying that a social investment strategy generates tensions and trade-offs between various social policy preferences in the short term, but it is important to emphasize is that social investment is a long-term strategy *par excellence* with potentially very high rates of economic returns and social rewards, in an era where human capital is swiftly becoming a scarce resource. There is great potential for employment and productivity growth, if people are skilled for the new jobs and families are supported by good quality child care and work family reconciliation arrangements. High lifetime labor force participation at high levels of productivity is the single most important macroeconomic prerequisite for maintaining living standards while sustaining inclusive welfare states, and thereby citizen well-being. The task of employment and social policy systems should foremost support the development of each person, with measures tailored to people's capabilities and needs, and thereby enabling them to reach their full potential. The key challenge is to devise policy portfolios that not only address "new" and "old" social risks adequately, but equally important is to connect such an endeavor fully with the dynamic knowledge-based economy. On the other hand, social investment should not be mistaken as a celebration of economic dynamism as an end in itself, but in terms of a framework for citizens to pursue fuller and more satisfying lives. At the heart of the social investment edifice lies in the idea that each welfare system consists of three overlapping spheres of public policy: income supports, capacitating regulation and social services to address new needs. In concrete policy practice, social investment bears on reforming these three elements by linking them more close to one another, in ways suited to welfare contexts. Delivering on social investment requires policy action across a large array of policy areas, in effective combinations that maximize employment and productivity in a manner consistent with deeply anchored values of social fairness, that are difficult to achieve through the market alone.

Central to the social investment edifice is that social services, in childcare, education, elder and health care, and employment services, are of critical importance to improving social protection today. Social services have a triple function in supporting people in employment, redressing the marginal position of social disadvantaged groups and according autonomy and respect to people in need of institutional care. In addition, a life-cycle approach provides the most adequate framework for advancing a social investment strategy. This allows us to distinguish between different life-cycle cohorts – children, young adults, people of working age, pensioners and persons reliant on care, while asking what combination of social services, income support, and enabling regulation is necessary to achieve better social protection and promotion and through what governance methods. In order to guide the social investment policy measures in a broader perspective on competitiveness, below I suggest a series of highly relevant priorities.

a) Child-centred social investment strategy. Since life chances are so over-determined by what happens in childhood, a comprehensive child investment strategy with a strong emphasis on early childhood development is imperative. Access to affordable quality childcare is a sine qua non for any workable welfare state. Childcare demands cannot be adequately met via commercial care market. And the dangers of inadequate childcare are immense. The emphasis on early-childhood education and development goes *beyond* the idea that childcare is necessary to allow mothers and fathers to reconcile work and family life. A "child-centred social investment strategy" is needed to ensure that children become lifelong learners and strong contributors to their societies. More children, educated to perform in a knowledge economy, are required in order to keep that economy going, given the demands of a retiring baby boom generation with increasing care needs. Only high quality early childhood education and care services are contribution to higher short-term labour force participation and long-term productivity increases. Hence, there is need to go further than the quantitative targets of Barcelona 2002 (90% of children between 3 and the mandatory school age and at least 33% of children under 3) to add figures such as number children in early childhood care and education per adult. The prime objective of Twentieth century welfare provision was to guarantee economic security in old age; the prime objective of Twenty-first century welfare provision must be to promote fair life chances to the young.

b) Human capital investment push. In the new, knowledge-based society, there is an urgent need for investment in human capital throughout the life course. Considering the looming demographic imbalances in Europe, we cannot afford large skill deficits and high educational dropout rates. As inequalities are widening in the knowledge economy, parents' ability to invest in their children's futures has becoming increasingly unequal. If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, surely they assume the role of a "productive factor." Equality of opportunity must be guaranteed by compulsory primary and secondary education with universal quality standards, together with increased access to grant and state-guaranteed loans in tertiary education, and quality post-secondary vocational training. Cross the board increased investments in education, preventing early exit from formal education and training, and facilitating the transition from school to work, in particular for school leavers with low qualifications, are imperative. Hence the crucial importance of the early school drop-out target set in the *Europe 2020* agenda. It is crucial not to allow human capital to be depleted at a time of intensified international competition and demographic change. But as important is a focus on life-long training, beginning with more streamlined cooperation between education and training institutions and the world of work. Learning and work time, interrupted by leave support, increasingly overlapping and becoming much more closely integrated. Technology and advanced learning methods should be applied in enabling young people to combine studies and working. In the knowledge economy, human resources, developed at an earlier stage, easily lose their value again by lack of practice and/or structural change. For this reason, a longer life span increases the relevance of these investments to compensate for depreciation processes across the life course. Further education and training measures ought to become a regular component of employment relations and collective bargaining process. Lifelong education and training are in the process of becoming regular components of gainful employment. For the acquisition of skills over the life course it is important that vocational education and training are made certifiable and transferable. Learning can form linkages, not only between individuals' different occupational activities, but also between work, family and retirement. The fact that the unemployed are predominantly unskilled and that vacant jobs require high skills, suggests that, in these times of "crisis aftershocks," we need to complement demand-side measures with supply-side instruments that go beyond the deregulation of labor markets, lowering of labor costs and provision of incentives for the unemployed to take poorly paid jobs. We should up-skill especially the young unemployed by providing them with necessary learning capacities.

c) Flexicure labor markets for all. The interaction between economic performance and the welfare state is largely mediated by the labor market. It is crucial to place employment at the center of welfare provision. Quality employment is the best guarantee against poverty and inequality. This presupposes: enhancing the labor force participation of women and assuring enduring employment for various disadvantaged groups, including the disabled, the under skilled and the long-term unemployed; making employment attractive by fighting poverty traps; activating benefit recipients; subsidizing decent low-skilled and low-productive work; implementing active labor market policies as well as labor market reform. The majority of Europe's mature welfare states are confronted with the phenomenon of labor market segmentation between "insiders" and "outsiders." Most likely, labor markets will become ever more flexible. While the boundaries between being "in" and "out" of work have been blurred by growth in atypical work, low-wages, subsidized jobs, and training programmes, one job is no longer enough to keep low-income families out of poverty. Post-industrial job growth is highly biased in favour of high-skilled jobs. Additionally, however, increased labour market flexibility, together with the continuous rise in female employment, will also encourage sizeable growth of low-skilled and semi-skilled jobs in the social sector and in personal services. The policy challenge that presents itself is how to mitigate the emergence of new forms of labour market segmentation through what might be referred to as "preventive employability," combining increases in flexibility in labor relations by way of relaxing dismissal protection, while generating a higher level of security for employees in flexible jobs, including (un)paid (parental) leave, life-course policies, childcare, care for the frail elderly, and gender equality. Better unemployment protection of entrants and flexible workers is better than strict re-regulation of labor law. In addition, the effectiveness of employment services, active labor market policies and training schemes of youths and unemployed persons should be pursued in the common framework of the EES. With the rise of long-term unemployment and extremely high levels of youth unemployment, there is the augmented risk of hysteresis, of jobseekers falling permanently out of the labor market. At the same time, as a consequence of demographic ageing, withdrawal from the labor market is accelerating, possibly reinforcing a structural mismatch between labor supply in terms of jobseekers and demand in terms of unfulfilled vacancies in the near future. To remedy this looming mismatch, skill enhancement and geographic mobility support, together with balanced "flexicurity" policies can help workers move across jobs and the borders of sectoral and territorial labor markets.

d) Reconciling work and family life. Promoting female employment is good for growth and robust families. It is also in line with women's aspiration and increased educational attainment. High female employment does not hamper fertility. On the contrary, they go together, provided policy supports which improve the compatibility of gainful employment and family care responsibilities. For this, labor markets have be organized around the principle of gender equality. Social policies must encourage the formation and meet the needs of "dual carer" families, in which both partners share work and family responsibilities. There is a clear relation between the ratio of part-time jobs and female employment growth. Flexible working conditions are often part and parcel of family-friendly employment policy provisions. But the ability of part-time employment to harmonize careers with family life also depends very much on employment regulation, on whether part-time work is recognized as a regular job with basic social insurance participation, and on whether it offers prospects of career mobility, thus serving the achievement of higher rates of women's labor force participation. With more improved work-life reconciliation policies for younger two-job couples with children, employment relations based on dignity at work principles, fostering new combinations of security and flexibility that allow workers from all age-cohorts to make the best of their abilities and talents, recalibrated employment relations are part and parcel of the new social investment imperative. Maternity leave programs and employment opportunities should be complemented with by appropriate qualification programs that can already begin during the first phase of leave.

Many of the so-called "new social risks," such as family formation, divorce, old-age care dependency, declining fertility rates, and accelerating population ageing, bear primarily on young people and young families, signifying a shift in social risks from the elderly to the young.

e) *Later and flexible retirement.* Late entry into the labor market by youngsters, early exit by older workers, combined with higher life expectancy, confronts the welfare state with a looming financing deficit. To ensures pension sustainability and adequacy, there is need to realign pension policy to increased life expectancy. From a macroeconomic perspective, increased participation of older people in gainful employment is essential for future prosperity. Two trends justify a change in our thinking about delaying retirement: a) the health status of each elderly cohort is better than that of the last. And, b) the skill gap between old age and education is rapidly narrowing, so that, in the future, old people will be much better placed than they are today to adapt through retraining and lifelong learning [Esping-Andersen *et al.* 2002]. The education gap between the old and the young will begin to close as the baby-boomers approach retirement. Beyond the development of multi-pillar, including pay-as-you-go and funded schemes, in the area of pension policy, the challenge lies in how to allocate the additional expenditures that inevitably accompany population ageing [Myles 2002]. Of crucial importance remains a general revenue financed first tier pension guarantee with a price index guarantee for the next generation of flexible labor market cohorts. Sustainable pensions will be difficult to achieve unless we raise employment rates of older workers and raise the retirement age to at least 67 years. Delaying retirement is both effective and equitable. It is effective because it impacts simultaneously on the nominator and the denominator by combining more revenue with lower spending. It is inter-generationally equitable because retirees and workers both sacrifice in equal proportions [*ibidem*]. People are getting healthier and more educated with each age cohort. Flexible retirement and the introduction of incentives to postpone retirement could greatly alleviate the old-age pensions burden. If older workers remain employed longer than they typically do today, then household income will increase substantially and the pensions system would be better preserved. Labor market needs to be designed for second careers jobs – making work also attractive for older workers. This can be done by changing the relative competitiveness of older workers in comparison to younger people by replacing steep seniority wages with pay-for-performance components and agreements on repayment clauses if the employer invests in further education, thus also making it easier to take up so-called "second careers." From the employee's perspective, the choice of longer employment crucially depends on workplaces that match their competences. If workplaces can be made more attractive for older staff, the trend toward an exodus into retirement will wane.

Social investment policy in this respect goes beyond capacitating public services and leave provisions. Above of this means enabling re-employment as well as slow and continuous phased withdrawal from employment. Such a phased withdrawal would mean that part-time work is combined with partial pension benefits. An increase of the average length of working life, a partial privatization of the provision for old age, and an extension of minimum security in the pension system are politically feasible. The renewal of the post-war intergenerational contract necessitated by demographic change must not trample with the achievement of eliminating poverty in old age.

f) Migration and integration through education and participation. More than before, priority should be given to the issues of participation and integration on the part of migrants and non-EU nationals, whose rates of unemployment are on average twice that of EU nationals. Integration and immigration policy should occupy a central place in the debate on the future of the welfare state, something policy makers have failed to acknowledge in the past. In our ethnically and culturally diversified ageing societies, the welfare state faces the major challenge of ensuring that immigrants and their children do not fall behind. Specific effort in education, training and labour market integration should be targeted towards migrants and their children in order to narrow the gaps between them and the rest of society. The positive impact of migration and better integration should be reconsidered. The overriding imperative is in the face of demographic ageing and in the light of a declining work force, nobody can be left inactive (for long)!

g) Minimum income support and capacitating service provision. Social insurance guarantees are increasingly connected to *capacitating* social services, customized to individual needs caused by the new life-course contingencies of skill depletion, family breakdown, career and caring contingencies. We cannot assume that early childhood development, human capital push, together with high-quality training and activation measures will remedy current and future welfare deficiencies. Hence, in the medium term, it is impossible to avoid any form of passive minimum income support unless we are willing to accept rising household welfare inequalities. An unchecked rise in income inequality will worsen citizens' life chances and opportunities. Greater flexibility and widespread low-wage employment suggests a scenario of overall insecurity for a sizeable group. It is therefore necessary to have an even more tightly woven safety net for the truly needy. Minimum wages do not hamper job creation and access to the labor market for the young and the low skilled if set at a moderate level and evaluated closely. Access to social assistance should be designed so as to avoid labor market segmentation and the emergence of insider/outsider gaps. Basic minimum income guarantees must therefore be complemented with *capacitating* public services, customized to particular social needs caused by life-course contingencies and empowering children and adults with a view to create real equality of opportunity. And since it is difficult to privately and/or collectively insure new social risks, and as capacitating social services are not self-evidently supplied by private markets, it is imperative for public policy to step in and provide effective protection against such risks. The movement away from passive income compensation, through social insurance, to more active social policy support and servicing is critically informed by the mounting evidence, collected over the past decades, of the enormous social cost of early failure and (too) late policy intervention across the life course. Early school dropout and youth unemployment massively narrow life chances in later life, both individually and collectively. Therefore, an inclusive anti-poverty strategy must provide resources to those most in need but also opportunities for them to (re-)gain individual autonomy and integrity. Social safety net must incorporate incentives for social and occupational insertion (including in-work benefits) and for personal development through learning activation.

h) *Sustainable financing and taxation.* The past decades have revealed that growing levels of inequality are not only socially disruptive, but also economically wasteful and destabilizing. Temporarily at least, a more progressive tax system is imperative in order not only to pay for growing numbers of beneficiaries, but also to smooth the business cycle. To reverse the trend in redistribution, and hence contribute to sustaining aggregate demand in the medium-to-long term, it is also necessary to fight tax heavens and tax evasion. A broad political agreement is required to improve supranational cooperation to mitigate tax competition. Other potential sources of income could come from introducing and raising taxes of luxury goods and expenses. As the crisis has tightened budget constraints, this makes it difficult for governments to trade short-term revenue losses for long-term competitiveness gains through selective tax rate reductions. Growing inequality and rising unemployment add to political resistance to low capital and corporate taxation. Given these financial and political constraints, Philipp Genschel and Peter Schwartz [2011] expect greater tax coordination across countries and even tax harmonization, including a tax on financial transactions, to emerge with a vengeance in the aftermath of the global financial crisis.

i) *Reinforcing institutional capabilities.* In the knowledge-based economy, employees and their families require public supports to navigate them through their increasingly uncertain employment careers, while improving their resilience to economic adversity. This implies greater investments in education, jobs skills, and more generous and portable unemployment insurance, health care plans and pension benefits. In terms of institutional capabilities, the quality of social services, in childcare, education, training and active labor market and leave policies, is probably the most important prerequisite of effective social investment. Social services should be genuinely capacitating. High-quality childcare can produce a long-term impact on children's capacities and successes, and help reduce social inequalities. By the same token, poor-quality activation services produce poor results in participation and productivity. In other words, equality of opportunity is both a precondition for a successful social investment welfare state and an important outcome of social investment policies. Hence, the need for a balanced approach, with a social "promotion" and a "protection" as the axial pillars of active welfare states.

j) The imperative of social investment policy coherence. Today, there is widespread agreement about social investment imperatives for sustaining European welfare state. Nonetheless, there are a number of important caveats to make social investment happen on wider scale than the more advanced welfare systems. Creating virtuous circles of participation and productivity, prevention, inclusion and emancipation, require social investments to be, in the first place, mutually consistent, and secondly, sufficiently ambitious. In terms of mutual consistency, social investment strategies are really about coherent policy mixes. The social investment perspective is based on a life-chance/life-course perspective, and this suggests that policies can be effective only if the whole chain is maintained, from early childhood education and care to lifelong training and active ageing. Partial implementation may at best deliver partial success. High unemployment benefits of short duration, coupled to strong activation incentives and training obligations, if supported by vigorous active labor market policy services, are most successful in lowering unemployment and raising productivity. The disincentive effects of high replacement rates cannot be considered in isolation from employment protection legislation. Expanding child care without taking into reconsideration labor market barriers to female employment can be extremely expensive. By the same token, raising the retirement age without opening up the job market for second careers and improving employment relations, is likely to generate few savings. Working mothers cannot profit from inclusive family services in dualized labor markets. Good practice policy mixes, moreover, are to be found in countries where lifelong learning, welfare-to-work programs, activation and other social services, are provided by highly competent, client-friendly, and professional frontline personnel. Institutional capacities matter significantly in the shift towards more service-oriented welfare states. There are no magic bullets. The devil of social investment effectiveness in fairness is in the details of concrete policy complementarities.

k) Social investment as a common language. An important advantage of the social investment perspective is that it provides a common language for discussing the link between economic and social development across the 27 member states of the EU. Social investment policy can be contextualized to different national contexts, applicable to countries at different levels of prosperity, and also to various welfare regime architectures, ranging from highly-developed universal welfare systems to less developed, more family and voluntary systems, which are now faced with a need to build more robust and equitable systems to mitigate old and new social risks. Throughout, the social investment perspective plays close attention to link between economic, social and family development across the life course, and asks that close attention be paid to specific economic structures and specific social deficits in each country. In each case, this will involve a different combination of, integrated, policy reform in income support, social services and public regulation to address new needs.

6. Embedding Social Investment in EU Economic Governance

The fundamental insight that (re-)emerged from the global financial crisis is that economic markets are not self-regulating, self-stabilising, and self-legitimising [Rodrik 2011]. While this important lesson is certainly not new, a whole generation of policymakers and private economic actors seem to have forgotten the basic truth that the benefits of global economic interdependence rely heavily on robust and equitable social and political institutions. In the larger context of macroeconomic global and intra-European imbalances, social investment cannot substitute growth-supporting macroeconomic governance and prudential financial regulation, because social investment largely serves the supply side of the economy. Any social investment strategy must therefore be embedded in a macroeconomic policy framework that supports durable and inclusive growth. The key European policy challenge in the wake of sovereign debt and currency crisis, therefore, is to make *long-term* social investments and *short-term* fiscal consolidation mutually supportive. As macroeconomic policy largely falls within the jurisdiction of the EU, the EU has a critical role to play in making social investment durable and sustainable. This is the argument Frank Vandenbrouck, Bruno Palier and I made when we issues a call for an "EU social investment pact" [2011].

Although the social investment paradigm promises high rates of return on investment, in terms of higher employment, rising productivity and more robust families, social investments do not come cheap with immediate budgetary savings. Implementing a successful transition to fully-fledged social investment strategies, while at the same time addressing rising needs in healthcare (and pensions), will inevitably require additional resources. Short-term budgetary pressures, on the other hand, cannot be wished away. The erosion of the tax base and the imperative of budgetary austerity constrain the scope for any social investment strategy. But then again, fiscal discipline must not nip in the bud long-term returns on social investments. Additional (temporary) tax revenue is perhaps necessary to overcome the current crisis without destroying long-term employability in ageing societies. At the same time, budgetary costs of ageing must be contained so as to retain leeway for improvements in preschool care for poor children and investments in youth more generally.

In terms of economic governance, the financial crisis has fundamentally exposed the limits of institutional decoupling rules-based single market and monetary integration from domestic social and labor market reform under the ill-fated *subsidiarity* principle. Over the 1980s and 1990s, a genuine EU Social Space has emerged, able to catalyze national social reforms and cushion single market infringements. Rather, it is the EU's economic space that has not been able catch up with the incremental maturation of the EU's social policy space and evolving internal eurozone macro-imbalances, which are now causing "bad equilibria' across an increasing number of eurozone members experiencing dramatic budgetary situations. Tragically, in hindsight, is that extremely low interests rates, allowed ineffective bureaucracies, especially in Greece, to postpone necessary welfare recalibrations to better address the pressures of economic competitiveness, demographic ageing, gender and family change, and labor market shifts in the knowledge-based service economy.

To add insult to injury, the December 2011 "fiscal compact," with its overriding emphasis on collective austerity and wage-cost competitiveness, is pressing all eurozone economies to adopt pro-cyclical and self-defeating welfare retrenchments. It cannot be forgotten that the current crisis originated in the behavioral accesses in deregulated financial markets and not in excess welfare spending. Moreover, it is 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, which is need of correction. In their cognitive biases to perfect the internal market and the monetary union, EU economic policymakers, from the Commission, the Council of Ministers and the ECB, were in hindsight never able and willing ever really take seriously the Lisbon Strategy's importance in terms of real "productivity-enhancing," "participation-raising," "employability-friendly," "family-capacitating" social and labor market reforms, for the greater good of the macro-economy of the EU!

That a currency union presupposes a minimal "fiscal union" is finally commonly accepted. The eurozone must find effective ways of engineering internal adjustments for distressed member state economies, by putting them on some form life support to restore resilience, while allowing the stronger members of eurozone and the rest of the world economy to grow, in order to compensate for the decline in domestic demand in economically vulnerable regions. Therefore, the EU needs to find a more flexible approach to macroeconomic governance, akin to its social space, able to take account important differences among member states' growth and competitiveness potentials, while address specific weaknesses at the macro and micro levels.

To manage the intricate interface of the EU social and economic spaces, and to realign domestic economic liberalization and social reform, a return to the spirit of "embedded liberalism" is required. But in contrast to the Bretton Woods era that was based on the proviso of Smith "abroad" and Keynes at "home," there a need to give more reign to Keynes at the EU level, including countercyclical fiscal policy and prudential financial regulation, in combination with accelerated social investment initiatives at the supply side of domestic social policy systems.

The policy conundrum is complex. Walking the fine line between protecting domestic social policy (semi-)sovereignty, while supporting supranational market integration, is difficult. In the years ahead, intensifying fiscal pressures will lead many finance ministers to demand uncompromising scrutiny on public spending. In both employment and social policy, there will be strong pressures to do more with fewer resources. Moreover, short-term fiscal pressures will be intensified by the extent to which long-run societal change, ranging from population ageing, the feminization of the work force, immigration, and shifts in labour supply and demand, have not been adequately dealt with prior to the crisis. At the same time, the aftermath of the crisis will surely reinforce the need for human capital investment and the importance of poverty relief and social insurance. The (social investment) quality of spending under constrained public budgets is crucial therefore.

6.1. *Three macro-economic instruments*

In our policy paper calling for an "EU social investment pact," Frank Vandenbroucke, Bruno Palier and myself put forward three macroeconomic instruments which would incentivize better alignment between eurozone stability and domestic social investment reform. These are: *a)* the issuing of "Eurobonds" to remedy the systemic fragility of the Eurozone; *b)* making existing policy portfolios more supportive of social investments; and *c)* adjusting the Stability Pact so to make it social investment enhancing.

a) *Eurobonds.* Although the joint issue of Eurobonds is a controversial idea, the argument put forward by Paul De Grauwe and Jean Pisani-Ferry and many other leading economist and policy makers, is forceful: it would allow *all* members of the Eurozone to find themselves in a much better equilibrium, significantly decreasing the interest burden on their budgets, and reduce a collective risk with which the whole Eurozone is confronted, whilst taking on board concerns regarding moral hazard. In a proposal put forward by Paul de Grauwe public debt servicing could be separated into two tiers. For the first tier, countries would be able to participate in the joint Eurobond issue, guaranteed by all EU member states. This would cover public debt up to the Maastricht benchmark of 60% of GDP. This tier of "blue bonds" would thus receive triple-A rating. Anything above 60% threshold, the second tier of "red bond" would have to be issued in the national bond market. The "red" tier would face higher a risks premium, which in turn creates a powerful incentive for the government to reduce their debt levels. Lower average borrowing costs for trouble economies with higher marginal costs. The "blue" tier makes it easier to service the debt; the "red" provides strong incentives towards reducing the level of debt and thus reduces reduce moral hazard and profligacy. Lower average interest rates help shield countries from being pushed into a bad equilibrium. Eurobonds up to 60% of GDP would ensure that the European Stability Mechanism can remain within reasonable limits while providing liquidity support to larger vulnerable member states. The European Parliament has already endorsed the idea of issuing Eurobonds. A joint issuing of Eurobonds will send a strong message to capital markets that the euro is indeed "not negotiable!" as German Federal Chancellor Angela Merkel underlined at the 41st World Economic Forum Annual Meeting in January 2011.

b) Structural funds to support social investment. The European Structural Funds, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) could also become more supportive of specific social investment policies. Eurobonds could also be issued to fund specific European projects in the realm of social investment, from which member states that pursue credible social investment policies may benefit. In this way, the EU could substantiate a real "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 experience dramatic budgetary policies.

c) Towards social investment public accounts. Consistent delivery of the social investment objectives requires, in the third place, that they be embedded in the reinforced Stability Pact macroeconomic and budgetary surveillance of the EU. Thus far the Stability Pact has declined to distinguish between public investments with estimates of real returns, from consumption expenditures. All the available evidence suggests that investments in childcare and education will, in the long-run, pay for themselves. Besides education and training, there are a number of social policies that are easy to identify as investments in individual productivity and collective wealth creation, such as family services, building life-long learning opportunities, and activation programs. In addition, all spending on child welfare has a high potential pay-off in terms of financial security and preventing child poverty. The central idea behind social investments is that policies which serve to raise participation and productivity should not be seen as a drain on the public purse but as productive factors which can contribute to economic progress – in other words there a real return for economy and society from investing in people. Therefore, there is a strong case to be made to distinguishing between current and capital accounts in welfare state spending, just as private companies do. As Esping-Andersen [2005] has advocated before, a new system of EU public finance surveillance is needed that would allow finance ministers to *a*) identify real public investments, and *b*) examine the joint expenditure trends in markets and governments alike. For this, the EU could establish a new social investment in national accounting to separate investments for future and current expenditure, including differentiation between both types of expenditures in macroeconomic surveillance. It could then be possible to exempt social investments for the constraints of fiscal austerity. Considering the long-term return on social investments for the European economy and society, there is ample reason to count social in early childhood care, training and education and family services, not as public expenditure but rather be seen as public investment in a way that the EU could stimulate and allow all member states to pursue ambitious social investment strategies, so as to accelerate productive reforms and dynamic social innovation. To the extent that economic returns from social investments will lead to higher participation and productivity, in turn, reducing the need for corrective social insurance, this surely justifies raising social investment expenditures even when public finances are tight.

It is important to emphasize that all three proposals contribute to enforcing an institutional dynamic whereby *all* governments pursue budgetary discipline and social investment, and are *supported* therein in tangible ways by the EU. Such a reform-oriented, forward-looking strategy may contribute to creating a real sense of "reciprocity" in the EU. Reciprocity presupposes an intelligent balance between discipline and assistance, between strict conditionality and perspective on progress, or, to put it in yet other terminology, between "stick" and "carrot." What we know to be true for individual activation policies in labour markets is also true for the overall architecture of EU governance. Investment in human capital, life time employment and productivity are perhaps the most important factors to EU-wide macroeconomic stability and growth in the longer term. The worst performing countries are those struggling most in the current situation, and they are unable to invest additional money into training, education, and skills. The EU should consider how to help the worst performers as human capital is the single most important growth factor, which, if fixed, could put the EU on track for achieving the targets of more sustainable, inclusive growth. Low labor market participation is then simply no longer affordable with the demographic changes taking place and it has to be addressed as a matter of urgency. "Helping" means, in this context, putting in place a productive combined macroeconomic and budgetary surveillance and social investment incentive structure. Delivering on the above priorities offers a far more convincing response to stabilize financial markets than the one-size-fits-all collective austerity, which only reinforces recessionary pressures.

7. Embattled Social Progress

The imperative of a more fiscal union cannot be separated from the need for minimum of a shared vision on social Europe. However, when it comes to steering the *overall* orientation of *social* policy in the Member States, there is no real alternative to "governance by objectives" approach based on the broad contours of social investment in respect of diversity. Setting common social investment goals, while leaving the precise implementation of social and employment policy to the member states will be the name of the game in the foreseeable future, facilitating policy learning through the toolkit of the open method of coordination. Although the fiscal room for manoeuvre is restricted, as I have argued also in chapter 8, the objectives formulated in the Europe 2020 Strategy can provide a receptive – by no means perfect – framework to anchor a more positive EU social investment policy strategy in closer pro-growth budgetary and monetary macroeconomic surveillance and financial regulation. *Europe 2020* and the Lisbon Treaty (which anchors the EU's normative commitment to (a highly competitive) "social market economy" in article 3 and the "horizontal clause" in article 9) enable real governance improvements, potentially leading to a more balanced approach to market integration. When competitiveness becomes a key indicator for multilateral surveillance, then countries would be submitting social and labour market policies to EU scrutiny, which would give the OMC in effect far more bite! A related important question in this respect is whether the National Reform Programmes of the Member States will credibly pursue *all* the integrated guidelines and headline targets of Europe 2020, and whether or not the European Council will be as strict in assessing the National Reform Programmes and in monitoring sustainability, education and social targets as it promises to be strict on budgetary and competitiveness indicators. In this respect, the credibility of the Europe 2020 ambitions will depend on the credibility of the link and hierarchy between the reinforced macroeconomic and fiscal surveillance to which the EU now committed. I strongly believe that the objectives formulated under the *Europe 2020* strategy can provide a framework for reconciling those short-term and long-term considerations, if the social investment strategy is embedded in budgetary policy and financial regulation, i.e. if short-term macroeconomic governance serves long-term social investment. Again, what is sorely required at the cognitive level is a wider understanding of macroeconomic stability which takes social investment equity and efficiency gains seriously.

Because national political leaders have in the recent declined to honestly explain to their citizens how EMU and the single market have made life chances across Europe ever more interdependent, they now suffer huge losses in popular legitimacy. As a consequence, EU crisis resolutions are perceived as threats, rather than as opportunities to better help European citizens manage old and new social risks. While political leaders have stepped up their efforts at political integration and eurozone "economic governance" over the past three years, their domestic constituencies, by contrast, have shifted their allegiance away from further EU political integration. Public disenchantment with the EU, moreover, is accompanied by an ill-conceived, but discursively highly persuasive, narrative of welfare paradise lost to the perils of global competition and large-scale immigration. Growing support for the populist right (and left) inevitably puts pressure on centre-right government in power in most EU member states to keep moves towards a closer political union at a distance. In the medium term, more forward-looking political leaders have plenty of self-interested political reasons to go beyond austerity-biased "negative integration" and proceed, explicitly, visibly and credibly, to articulate a positive vision on a more growth oriented "caring Europe" as a shared and credible political purpose. If expectations of fairness in hard times of reform and retrenchment are unfulfilled, the fundamental "social citizenship contract" and, hence, the democratic legitimacy of both the national welfare state and the European integration project will be put into jeopardy.

Rahm Emanuel, President Obama's first chief staff, is purported to have said "You never want to let a good crisis gone to waste." Four years after the credit crunch, many political commentaries seem to believe that the post-crisis moment for extraordinary politics and fundamental institutional transformation has long passed. Although pendulum swing historiography is highly suggestive, contemporary history proceeds in a far more gradualist and layered fashion, with smaller incremental and large path-deviating changes cumulatively transforming social orders, as we know from Wolfgang Streeck and Kathy Thelen [2005]. Contemporary history is made by recasting existing institutions rather than by designing new ones from scratch. The depth of global financial crisis and the cascade of aftershocks it has unleashed are going to be with us for many years to come. It is mistake to think that the policy responses that are currently on offer will continue to set the scene. Fast-moving financial markets and unfolding political events will surely bring about additional institutional changes in our economic and social policy repertoires. Cumulative steps undertaken as the crisis deepened after 2009, have already fundamentally recalibrated the responsibilities of member state government, the European Council, the ECB and the European Commission. What has been achieved may not guarantee the survival of the 17-member eurozone, but important strides in the direction of a closer fiscal and political union have been taken. The joint issuing of Eurobonds, underpinned by stringent fiscal coordination, possibly supervised by a fully-fledged EU Ministry of Finance, is no longer a political taboo.

The more political role of EU cannot be limited to punitive fiscal discipline. To the extent that, as I firmly believe, enhanced eurozone political integration is inevitable, a more political EU must rise to become a reliable defender of the genuine interests and normative orientation on the part of European citizens in a "caring" EU. As the Europe is in dire need of a narrative of social progress, capable of restoring its legitimacy in hard times, social investment is a highly credible candidate. Empirically, there is plenty of evidence for Pareto-optimal social policy improvement to expand and enhance human capacities throughout the life course, combining elements of flexibility and security, bent on removing social barriers for labor market entry, discouraging early exit, making labor market transitions less precarious, and providing real equality of opportunity in education, without reneging of decent minimum income protection and basic social insurance. More normatively, surveys reveal that the wider European publics aspire to live in harmonious societies, where income and wealth is distributed fairly, with the well off payer high taxes to help governments fight poverty. But they also understand that a well-functioning economy is the foundation on which well-being hinges, and that as public debt rises, social security, pensions and health care commitments should fall under augmented scrutiny. As a consequence, large majorities prefer available public expenditures to be devoted to employment, as employment participation is not only a *sine qua non* for economic security, health and learning, but also for psychological health and social cohesion. Finally, when asked to prioritize welfare spending, most respondents choose universal and affordable access to public services, especially in education, as a first priority [EPC 2011]. These findings are highly consistent with the normative core of the social investment perspective.

Politically, it is important to reiterate that the social investment imperative is rooted in an argument that a strong economy requires a strong state. After three long decades of loss of faith in public action, the downfall of the neo-liberal efficient-market hypothesis is, in this respect, no guarantee for the acceleration of welfare state renewal following the strictures of social investment policy analysis. Saving social investments from ill-conceived pre-emptive retrenchment in the near future will continue to be an uphill political battle of injecting common sense into the current economic and political debates. Time is perhaps the scarcest resource. Policymakers and larger publics need time to see the aftershock repercussions of the sovereign debt and currency crisis and the most appropriate policy responses in a different light and to adapt their ideas and policies. From the literature on policy learning we know that giving up deep beliefs is extremely difficult [Hall 1998; Hall 1993; McNamara 1998]. We are also aware that EU decision-making time is extremely tardy compared to the volatile cascade of crisis aftershocks on the wing of financial markets. Both the welfare state and EU, two major feats of mid-Twentieth century of institutional engineering, have at critical times been able to reinvent themselves, showing the ingenuity, dynamism, flexibility and the stamina and resilience needed to overcome the challenges and institutional contingencies they faced up to – although not always been in sync with another. Given time and courage, together with ample policy intelligence and political creativity, based on the empirical record of positive social investment performance, we should therefore be able to turn the current tide of inward-looking pessimism about welfare state futures into renewed political efforts at forward-looking "social pragmatism."

References

Avdagic, S., Rhodes, M., and Visser, J.

2011 *Social Pacts in Europe: Emergence, Evolution and Institutionalization.* Oxford: Oxford University Press.

Baccaro, L., and Simoni, M.

2008 "Policy Concertation in Europe: Understanding Government Choice." *Comparative Political Studies* 41: 1323-1348.

Bahle, T., Pfeifer, M., and Wendt, C.

2010 "Social assistance." Pp. 448-461 in *The Oxford Handbook of the Welfare State*, edited by F.G. Castles, S. Leibfried, J. Lewis, H. Obinger and C. Pierson. Oxford: Oxford University Press.

Begg, I., Draxler, J. and Mortensen, J.

2008 *Is Social Europe Fit for Globalisation? A study of the social impact of globalization in the European Union*. Brussels: European Commission, Centre for European Policy Studies.

Berger S.

2009 "Troubleshooting Economic Narratives." Pp. 93-102 in *Aftershocks. Economic Crisis and Institutional Choice*, edited by A. Hemerijck, B. Knapen and E. van Doorn. Amsterdam: Amsterdam University Press.

Berkel, R. van, and Borghi, V.

2008 "Introduction: The Governance of Activation." *Social Policy and Society* 7: 331-340.

Berkel, R. Van, de Graaf, W., and Sirovátka, T.

2011 "The Governance of Active Welfare States." In *The Governance of Active Welfare States in Europe*, edited by R. Van Berkel, W. De Graaf and T. Sirovátka. Basingstoke: Palgrave Macmillan.

Bernard, P., and Boucher, G.

2007 "Institutional competitiveness, social investment, and welfare regimes." *Regulation and Governance* 1: 213-229.

Bertola, G., Boeri, T., and Nicoletti, G. (eds.)

2001 *Welfare and employment in a United Europe.* Cambridge MA: MIT Press.

Boeri, T., and Garibaldi, P.

2009 "Beyond Eurosclerosis." *Economic Policy* 24: 409-461.

Bonoli, G.

2009 "Varieties of Social Investment in Labour Market Policy." Pp. 55-66 in *What future for social investment?*, edited by N. Morel, B. Palier and J. Palme. Stockholm: Institute for futures studies.

2011 "Active labour market policy in a changing economic context." In: J. Clasen and D. Clegg (eds.), *Regulating the risk of unemployment.* Oxford: Oxford University Press: 318-332.

2012 "Active labour market policy and social investment: a changing relationship." In: N. Morel, B. Palier and J. Palme (eds.), *Towards a social investment welfare state? Ideas, policies and challenges.* Bristol: Policy Press: 181-204.

Bonoli, G., and Palier, B.

2008 "When past reforms open new opportunities: comparing old-age insurance reforms in Bismarckian welfare systems." Pp. 21-39 in *Reforming Bismarckian Welfare Systems*, edited by B. Palier and C. Martin. Oxford: Blackwell.

Bradshaw, J., and Finch, N.

2010 "Family benefits and services." In: F.G. Castles, S. Leibfried, J. Lewis, H. Obinger and C. Pierson (eds.), *The Oxford Handbook of the Welfare State.* Oxford: Oxford University Press: 462-478.

Campbell, J.L., and Hall, J.A.

2006 "The state of Denmark." Pp. 3-49 in *National identity and the varieties of capitalism: The Danish experience*, edited J. L. Campbell, J. A. Hall and O. K. Pedersen. Montreal: McGill-queen's University Press.

Castles, F.G.

2004 *The Future of the Welfare State: Crisis Myths and Crisis Realities*. Oxford: Oxford University Press.

Clark, G.L., and Whiteside, N.

2003 *Pension Security in the* 21st *Century*. Oxford: Oxford University Press.

Clasen, J.

2005 *Reforming European welfare states: Germany and the United Kingdom compared*. Oxford: Oxford University Press.

Clasen, J., and Clegg, D. (eds.)

2011 *Regulating the Risk of Unemployment. National Adaptations to Post-Industrial Labour Markets in Europe*. Oxford: Oxford University Press.

Crompton, R.

2006 *Employment and the family: the reconfiguration of work and family life in contemporary societies.* Cambridge: Cambridge University Press.

Daly, M.

2000 *Gendering Welfare States.* Cambridge: Cambridge University Press.

2010 "Families versus states/markets." Pp. 139-151 *The Oxford Handbook of the Welfare State*, edited by H. Obinger *et. al.* Oxford: Oxford University Press.

Dølvik, J.E.

2004 "Industrial Relations under EMU: Are Renationalization and Europeanization Two Sides of the Same Coin?" Pp. 278-308 in *Euros and European. Monetary Integration and the European Model of Society*, edited by A. Martin and G. Ross. Cambridge: Cambridge University Press.

Duval, R., and Elmeskov, J.

2006 "The effects of EMU on structural reforms in labour and product markets." *ECB Working Paper,* no. 596.

Dyson, K., and Featherstone, K.

1999 *The road to Maastricht: negotiating Economic Monetary Union.* Oxford: Oxford University Press.

Ebbinghaus, B. (ed.)

2011 *The varieties of pension governance. Pension privatization in Europe*. Oxford: Oxford University Press.

Eichengreen, B.J.

2007 *The European Economy since 1945: Coordinated Capitalism and Beyond.* Princeton: Princeton University Press.

Eichhorst, W., and Hemerijck, A.

2010 "Welfare and employment: A European dilemma?." Pp. 201-236 in *United In diversity? Comparing Social Models in Europe and America*, edited by J. Alber and N. Gilbert. Oxford: Oxford University Press.

Eichhorst, W., and Kaiser, L.C.

2006 "The German labor market: still adjusting badly?" *IZA DP* 2215.

Eichhorst, W., Hemerijck, A., and Dräbing, V.

Forth-coming "Beyond the service sector trilemma: towards a better understanding of social investment policy synergies," unpublished paper.

Eichhorst, W., Kaufmann, O., and Konle-Seidl, R.

2008 *Bringing the jobless into work?: experiences with activation schemes in Europe and the US.* Berlin/Heidelberg: Springer.

EPC

2011 "Well-being 2030 - A new vision for 'Social Europe.'" *Issue Paper* 65.

Esping-Andersen, G.

1999 *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press.

2006 "Putting the horse in front of the cart: towards a social model for mid-century Europe." WRR-Lecture 2005, Amsterdam: Amsterdam University Press.

2009 *The Incomplete Revolution: Adapting to Women's New Roles*. Cambridge: Polity Press.

Esping-Andersen, G., Gallie, D., Hemerijck, A., and Myles, J.

2002 *Why We Need a New Welfare State*. Oxford: Oxford University Press.

Gautier, A.H.

1996 *The State and the Family: A Comparative Analysis of Family Policies in Industrialized Countries*. Oxford: The Clarendon Press at Oxford University Press.

Giddens, A.

1998 *The Third Way: The Renewal of Social Democracy*. Cambridge: Polity Press.

Genschel, P., and Schwartz, P.

2011 "Tax competition: a literature review." *Socio-Economic Review* 9: 339-370.

Goul Andersen, J.

2011 "Denmark: ambiguous modernization of an inclusive unemployment protection system." Pp. 187-207 *Regulating the risk of unemployment*, edited by J. Clasen and D. Clegg. Oxford: Oxford University Press.

Hakim, C.

2000 *Work-Lifestyle Choices in the 21st Century: Preference Theory.* Oxford: Oxford University Press.

Hall, P.

1989 *The Political Power of Economic Ideas: Keynesianism across Nations*. Princeton: Princeton University Press

1993 "Policy Paradigms, Social Learning, and the State: The Case of Economic Policy Making in Britain." *Comparative Politics* 25: 275-296.

2009 "The Significance of Politics." Pp. 93-102 in *Aftershocks*, edited by A. Hemerijck, B. Knapen, and E. van Doorne. Amsterdam: Amsterdam University Press.

Hausermann, S.

2010 *The Politics of Welfare State Reform in Continental Europe: Modernization in Hard Times*. Cambridge: Cambridge University Press.

Hemerijck, A.

2002 "The self- transformation of the European social model(s)." Pp. 173-213 in G. Esping-Andersen with D. Gallie, A. Hemerijck and J. Myles, *Why we Need a New Welfare State*, Oxford: Oxford University Press.

2012 *Changing Welfare States*, Oxford: Oxford University Press

Hemerijck, A., and Eichhorst, W.

2010 "Whatever happened to the Bismarckian welfare state? From labor shedding to employment-friendly reforms." In: *A Long Goodbye to Bismarck? The politics of welfare reform in Continental Europe*, edited by B. Palier. Amsterdam: Amsterdam University Press.

Hemerijck, A., Keune, M., and Rhodes, M.

2006 "European Welfare States: Diversity, Challenges and Reform." In *Developments in European Politics*, edited by P. Heywood, E. Jones, M. Rhodes and U. Sedelmeier. Houndmills, Palgrave.

Hemerijck, A., and Schludi, M.

2000 "Sequences of Policy Failures and Effective Policy Responses." Pp. 125-228 in *Welfare and Work in the Open Economy: From Vulnerability to Competitiveness* (Volume I), edited by F.W. Scharpf and V.A. Schmidt. Oxford: Oxford University Press.

Hoogenboom, M.
2011 "The Netherlands: two tiers for all." Pp. 75-99 in *Regulating the risk of unemployment*, edited by J. Clasen and D. Clegg. Oxford: Oxford University Press.

Huo, J.
2009 *Third way reforms: social democracy after the golden age.* Cambridge: Cambridge University Press.

Jenson, J.
2006 "The European Social Model: Gender and Generational Equality." Pp. 151-170 in *Global Europe, social Europe*, edited by A. Giddens, P. Diamond and R. Liddle. Cambridge: Polity Press.
2009 "Lost in translation: the social investment perspective and gender equality." *Social Politics* 16: 446-483.
2012 "Redesigning citizenship regimes after neoliberalism: moving towards social investment." Pp. 61-90 in *Towards a social investment welfare state? Ideas, policies and challenges*, edited by N. Morel, B. Palier and J. Palme. Bristol: Policy Press.

Kazepov, Y.
2010 *Rescaling Social Policies: Towards Multilevel Governance in Europe*. Farnham: Ashgate

Kautto, M.
2002 "Investing in services in West European welfare states." *Journal of European Social Policy* 12: 33-65.

Kenworthy, L.
2004 *Egalitarian Capitalism: Jobs, Incomes and Growth in Affluent Countries*. New York: Russell Sage Foundation.
2008 *Jobs with equality.* Oxford: Oxford University Press.
2010 "Labour market activation." Pp. 435-447 in *The Oxford Handbook of the Welfare State*, edited by F. G. Castles, S. Leibfried, J. Lewis, H. Obinger and C. Pierson. Oxford: Oxford University Press.
2011 *Progress for the poor.* Oxford: Oxford University Press.

Lambert, P.A.
2008 "The Comparative Political Economy of Parental Leave and Child Care: Evidence from Twenty OECD Countries." *Social Politics* 15: 315-344.

Le Grand, J.
2007 *The other invisible hand.* Princeton: Princeton University Press.

Levy, J.D.
1999 "Vice into Virtue? Progressive Politics and Welfare Reform in Continental Europe." *Politics & Society* 27: 239-274.

Lewis, J.E.
2006 *Children, changing families and welfare states.* Cheltenham: Edward Elgar.

Lindert, P.H.
2004 *Growing Public: Social Spending and Economic Growth since the Eighteenth Century*. Cambridge: Cambridge University Press.

Lindvall, J.
2010 *Mass unemployment and the state.* Oxford: Oxford University Press.

Mahon, R.

2002 "Child care: toward what kind of social Europe." *Social Politics* 9: 343-379.

2006 "The OECD and the work/family reconciliation agenda: competing frames." Pp. 173-197 in *Children, changing families and welfare states,* edited by J.E. Lewis. Cheltenham: Edward Elgar Publishing.

McNamara, K.

1998 *The Currency of Ideas: Monetary Politics in the European Union*. Ithaca: Cornell University Press.

Morel, N., Palier, B., and Palme, J.

2012 *Towards a Social Investment Welfare State? Ideas, Policies, Challenges.* Bristol: Policy Press. In text: 2011

Morgan, K.J.

2008 *Working Mothers and the Welfare State: Religion and the Politics of Work-Family Policies in Western Europe and the United States*. Stanford: Stanford University Press.

2012 "Promoting social investment through work-family policies: which nations do it and why?" Pp. 153-180 in *Towards a social investment welfare state? Ideas, policies and challenges*, edited by N. Morel, B. Palier and J. Palme. Bristol: Policy Press.

Myles, J.

2002 "A New Social Contract for the Elderly." Pp. 130-172 in G. Esping-Andersen with D. Gallie, A. Hemerijck and J. Myles, *Why we Need a New Welfare State*, Oxford: Oxford University Press.

OECD

2007 *Babies and Bosses. Reconciling Work and Family Life.* Paris: OECD.

2008 *Growing Unequal.* Paris: OECD.

2011 *Doing Better for Families.* Paris: OECD.

Orloff, A.S.

2006 "From Maternalism to "Employment for All": State Policies to Promote Women's Employment Across the Affluent Democracies." Pp. 230-270 in *The State After Statism: New State Activities in the Age of Liberalization*, edited by J. Levy. Harvard: Harvard University Press.

2009 "Gendering the comparative analysis of welfare states: an unfinished agenda." *Sociological Theory* 27: 317-343.

2010 "Gender." Pp. 252-264 in *The Oxford Handbook of Comparative Welfare States*, edited by S. Leibfried *et al.* Oxford: Oxford University Press.

Palier, B.

2010a *A Long Goodbye to Bismarck? The Politics of Welfare Reforms in Continental Europe*. Amsterdam: Amsterdam University Press.

2010b "Continental Western Europe." Pp. 601-615 in *The Oxford Handbook of the Welfare State*, edited by F.G. Castles, S. Leibfried, J. Lewis, H. Obinger and C. Pierson. Oxford: Oxford University Press.

Palme, J.

2005 "Features of the Swedish pension reform." *The Japanese Journal of Social Security Policy* 41: 42-53.

Pierson, P.

1994 *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment*. Cambridge: Cambridge University Press.

1998 "Irresistible Forces, Immovable Objects: Post-Industrial Welfare States Confront Permanent Austerity." *Journal of European Public Policy* 5: 539-560.

2004 *Politics in Time: History, Institutions, and Social Analysis*. Princeton: Princeton University Press.

2011 "The Welfare State over the Very Long Run." *ZeS-Working Paper* 02/2011.

Pierson, P. (ed.)

2001 *The New Politics of the Welfare State*. Oxford: Oxford University Press.

Platenga, J., Remery, C., and Takacs, J.

2012 "Public support to young families in the European Union." In *Work, Family Policies, and Transitions to Adulthood in Europe*, edited by T. Knijn. Basingstoke: Palgrave Macmillan.

Pochet, P., and Fajertag, G.

2000 *Social pacts in Europe: new dynamics.* Brussels: ETUI.

Pollitt, C.

2003 "Joined-up government: a survey." *Political Studies Review* 11: 34-39.

Pollitt, C., and Bouckaert, G.

2004 *Public management: a comparative analysis.* 2nd ed. Oxford: Oxford University Press.

Pontusson, J.

2005 *Inequality and Prosperity: Social Europe versus Liberal America.* Ithaca, NY: Cornell University Press.

Rodrik, D.

1997 *Has globalization gone too far?* Washington, D. C.: Institute for International Economics.

2011 *The Globalization Paradox: why global markets, states and democracy can't coexist.* Oxford: Oxford University Press.

Ross, F.

2000 "Beyond left and right: the new partisan politics of welfare." *Governance* 132: 155-183.

2008 "The politics of path-breaking change: the transformation of the welfare state in Britain and Germany." *Journal of Comparative Policy Analysis* 10: 365-384.

Sapir, A.

2006 "Globalization and the Reform of European Social Models." *Journal of Common Market Studies* 44: 369-390.

Scharpf, F.W.

1999 *Governing in Europe: Effective and democratic?* Oxford: Oxford University Press.

Schmid, G.

2006 "Social risk management through transitional labour markets." *Socioeconomic Review* 4: 1-33.

2008 *Full employment in Europe: managing labour market transition and risks.* Cheltenham: Edward Elgar.

Sinn, H.-W.

1990 "Tax Harmonization and Tax Competition in Europe." *European Economic Review* 34: 489-504.

Sjöberg, O.

2011 "Sweden: ambivalent adjustment." Pp. 208-231 in *Regulating the risk of unemployment*, edited by J. Clasen and D. Clegg. Oxford: Oxford University Press.

Steinmo, S.

1993 *Taxation and democracy.* New Haven: Yale University Press.

Stiller, S.

2010 *Ideational Leadership in German Welfare State Reform: How Politicians and Policy Ideas Transform Resilient Institutions*. Amsterdam: Amsterdam University Press.

Streeck, W., and Thelen, K.

2005 *Beyond Continuity: Institutional Change in Advanced Political Economies*. Oxford: Oxford University Press.

Swank, D.

2002 *Global Capital, Political Institutions, and Policy Change in Developed Welfare States*. Cambridge: Cambridge University Press.

2006 "Tax policy in the era of internationalization: explaining the spread of neoliberalism." *International Organization* 60: 847-882.

Swank, D., and Steinmo, S.

2002 "The New Political Economy of Taxation in Advanced Capitalist Economies." *American Journal of Political Science* 46: 642-655.

Tanzi, V.

1995 *Taxation in an Integrating World.* Washington DC, Brooking Institution.

Ungerson, C.

2004 "Whose empowerment and independence? A cross-national perspective on 'cash for care' schemes?" *Ageing and Society* 24: 189-212.

Vail, M.I.

2010 *Recasting Welfare Capitalism: Economic Adjustment in Contemporary France and Germany*. Philadelphia: Temple University Press.

Gerven, M. van

2008 *The Broad Tracks of Path Dependent Benefit Reforms: A Longitudinal Study of Social Benefit Reforms in Three European Countries, 1980-2006*. Studies in Social Security and Health. Helsinki: Social Insurance Institution Finland.

Vliet, O. van

2011 *Convergence and Europeanisation. The political economy of social and labour market policies.* Leiden: Leiden University Press.

Vandenbroucke, F., Hemerijck, A., and Palier, B.

2011 "The EU needs a social investment pact." *OSE Paper Series*, Opinion Paper No 5.

Weishaupt, J.T.

2010a "A silent revolution? New management ideas and the reinvention of European public employment services." *Socio-Economic Review* 83: 461-486.

2010b “Germany after a decade of social democrats in government: the end of the Continental Model.” *German Politics* 192: 105-122.

2011 *From the manpower revolution to the activation paradigm. Explaining institutional continuity and change in an integrating Europe.* Amsterdam: Amsterdam University Press.

Wilthagen, T., Tros, F., and van Lieshout, H.

2004 “Towards ‘flexicurity?’ Balancing flexibility and security in EU member states.” *European Journal of Social Security* 23: 113-136.

When Changing Welfare States and the Eurocrisis Meet

Abstract: The aftermath of the global financial crisis of 2008 certainly marks a "stress test" for European welfare states. Massive increases in fiscal deficits and public debt, required to pre-empt a more severe global meltdown, have since forced policymakers to consider deep cuts in welfare services, including health, education, and social transfers to the poor, the unemployed and pensioners, in order to shore up public finance solvency and economic stability. The crisis has affected different economies differently, as a result of their relative vulnerability to endogenous and external economic shocks and also because of the differing institutional capacities they were able to mobilise to address the economic duress. Policies with a social investment flavour (activation, childcare) have been somewhat more resilient in the face of fiscal austerity in the early days of financial crisis management. But will the social investment carry the day as 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. In the current context of fiscal predicament, it is crucial not to overlook the growth potential of productive social policies. This contribution examines what is needed to rescue an affordable social investment impetus from the one-sided short term policy orientations triggered by the financial and fiscal crisis at both the level of the European Union and its member states. Questions of institutional design today encompasses two, tightly interconnected, dimensions. Any long term resolution to the crisis has to be both effective and legitimate at level of the EU as well as at the domestic level of the national politics. At the level of the EU, the task is to devise a stable macroeconomic regime for the euro-zone, which is able to better accommodate and discipline the diverse needs of different member economies. Domestically, institutional change requires recalibrating the welfare state by combining capacitating social policy supports with a fair distribution of life chances. The key challenge is to make *long-term* social investment and *short-term* fiscal consolidation mutually supportive at both the EU level and in the Member States. The critical challenge lies in redirecting the broad political support for the welfare state in most EU member countries toward designing a new model of welfare state that is able to equip European citizens and societies to face endogenous social change and growing global competition.

Keywords: Economic crisis, welfare state, fiscal austerity, social investment, institutional choice, EU.

Anton Hemerijck (1958) is Dean of the Faculty of the Social Sciences an Professor of Institutional Policy Analysis at the VU University Amsterdam. Between 2001 and 2009 he was the Director of the Netherlands' Scientific Council for Government Policy (WRR). In that period he also held a chair in Comparative European Social Policy at the Erasmus University Rotterdam. He studied economics at Tilburg University and obtained his doctorate (DPhil) in Social Studies form Oxford University in 1993. Between 1997 and 2000 he was a senior researcher at the Max-Planck-Institute for the Study of Societies. He publishes widely on issue of comparative social and economic policy and institutional analysis. He has also been involved in drafting reports on social policy for the Portuguese (2000; 2007), Belgian (2001), Greek (2003), Finnish (2006), and German (2007) Presidencies of the EU. Important publication include *'A Dutch Miracle'* with Jelle Visser (Amsterdam University Press, 1997) and '*Why We Need a New Welfare State*' with Gosta Esping-Andersen, Duncan Gallie and John Myles (Oxford University Press, 2002). Forthcoming is his monograph *'Changing Welfare States'* (Oxford University Press, 2012). Email: a.c.hemerijck@vu.nl