European welfare states in motion:

From social protection to social investment

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Abstract
This paper examines two decades of welfare state adjustment across EU member states. It observes two 'silver linings' with respect to the daunting question of European welfare state futures, also in the wake of the global financial crisis. First, historically, the analysis reveals that the overall scope of social reform across the member states of the European Union, although varying widely, has been more proactive and reconstructive that is often argued in mainstream comparative studies. Alongside retrenchments, there have been deliberate attempts – often given impetus by intensified European (economic) integration – to rebuild social programs and institutions to accommodate the new economic and social realities of the 21st century. The more prospective, second sign of progressive reorientation is that many welfare states have gradually but quite fundamentally and to some extent also robustly shifted to a stronger *social investment* stance on welfare policy – to considerable extent given impetus by European Union social policy agenda setting. In conclusion, the case is made for a "social investment pact" for Europe, allowing governments to pursue mid-term budgetary discipline *and* long-term social investment reforms in line with new EU economic governance procedures, allowing potentially for a viable balance between 'economic' and 'social' Europe after the crisis.

Key words: welfare reform, social investment, institutional change, financial crisis.

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Introduction

Along with the European Union (EU), the welfare state is perhaps the most important and successful institutional feat of mid-twentieth-century European social engineering. Both the EU and the welfare state now find themselves at a crossroads amidst the turmoil of the Eurocrisis in the aftermath of the global financial crash of 2008. From 1945 to the mid-1970s, the welfare state was extremely successful in fostering both economic and social progress (Castles *et al*. 2010). In the 1980s, long before the 2008 financial crisis, the policy environment of European welfare states began to change. Aging populations, declining fertility rates and early retirement overburdened national pension systems. Technological changes reduced the demand for manual low- and medium-skilled labour. The shift towards post-industrial labour markets opened up job opportunities for women, but deindustrialization has been accompanied by a decline in steady lifetime jobs. Changing family structures and gender roles, with longer periods of education, later childbirth and an increase in single-parent families, have created new tensions between work and family life, resulting in new demands for the care of children and the elderly. The 'new' risk profile of social exclusion has triggered growing income inequalities between high-skilled and job-rich dual-earner families and low-skilled and work-poor single-earner and single-parent households. Simultaneously, the scope for social policy responses to these developments has narrowed. Capital mobility and

European economic integration did not unleash social dumping across Europe, as some observers had feared, but there is no denying that integration and the Stability and Growth Pact have increased fiscal pressures on the member states of the EU since the mid-1990s.

Although the drivers of change are common across Europe, the pressures they create for different welfare systems and the policy responses they elicit vary from country to country. In the rest of this chapter, I first review in Section 2 the challenges presented by the structural changes that swept across the European Union over the two decades prior to the crisis. Next, through a consideration of the rich literature on the ‘worlds’ or ‘families’ of welfare dating back to the late 1980s (Esping-Andersen 1990, 1999; Ferrera *et al*. 2000; Schmidt 2006; Alber and Gilbert 2010), Section 3 contextualizes welfare reform momentum across different clusters of European welfare regimes. Overall, I argue that European trajectories of welfare reform have been far more proactive and reconstructive than is often claimed in academic research and the media (Hemerijck 2013). Since the mid-1990s, in a fair number of EU member states, a so-called ‘social investment’ policy approach has gained influence, seeking to ‘prepare’ individuals and families to confront the ‘new social risk’ profile of the knowledge-based economy by investing in their human capital from early childhood onward, rather than simply ‘repairing’ the damage done through passive social insurance at later stages in life (Esping-Andersen *et*

al. 2002; Morel *et al*. 2012; OECD 2006, 2007, 2008, 2011). Subsequently, Section 4 attempts to establish to what extent different welfare regimes have taken social investment to heart, using descriptive regressions from OECD and Eurostat data. It may be too soon to draw definite conclusions about the future of the European welfare state in the aftermath of the Eurocrisis; however, these questions are among the most pressing of our times. Will the social investment paradigm carry the day in this context of predicament, or will it be sidelines in a new epoch of EU-reinforced fiscal austerity? The concluding Section 5 seeks to identify some tentative answers to these burning questions.

Welfare states under siege

The welfare state of mid-twentieth-century Europe emerged from the economic and political lessons of decades of war and depression. In the 1950s and 1960s, it proved highly successful at protecting workers and families from the vagaries of the market through comprehensive social insurance, without undermining the *modus operandi* of the free market economy. However, ever since the advanced Western economies experienced the stagflation crisis in the 1970s, academic observers, policy-makers and opinion leaders have been permanently engaged in a highly politicized debate over the welfare state in crisis. Ridiculing the so-called 'European Social Model' became a favourite pastime of international business elites, political leaders and economic experts in the 1990s. The

European welfare model was blamed for the region's slow economic growth and lagging competitiveness and technological innovation; these problems were perceived as the consequence of overprotective job security, rigid wage structures, expensive social insurance and employer-unfriendly collective bargaining practices that developed over the post-war period. However, the crisis of stagflation did not result in the welfare state's demise. On the contrary, the remarkable stability of social spending in rich democracies, at about 20–30 per cent of GDP, over decades of neoliberal hegemony is testimony to the staying power of modern welfare state policies across the advanced countries of the EU (Pierson 2011). Taking heed from the classification of welfare regimes introduced almost a quarter century ago by Gøsta Esping-Andersen (see also below), Figure 39.1 shows, public social spending is the highest in the Scandinavian countries and mainland European welfare states, where it ranges between 20 per cent and 30 per cent of GDP. It is lowest in the Anglo-Irish liberal welfare regimes, where spending levels are below 20 per cent of GDP, whereas the new member states hover around 20 per cent. Since the 1990s, the Scandinavian and Bismarckian continental countries have decreased public social expenditures, while the liberal and Mediterranean regimes have increased their social spending efforts. Despite important changes in the overall economic environment, Figure 1 also shows that expenditure on social protection have somewhat increased. At the same time, GDP has

increased across all European welfare states in the meantime (see Figure 2).

Figure 1 about here

Figure 2 about here

The original architects of the post-1945 welfare states could assume stable male-breadwinner families and expanding industrial labour markets; however, this picture of the economy and society no longer holds. Five sets of broad socio-economic changes – exogenous, endogenous, historical, supranational and political – have transformed the policy environment of modern social policy over the past two decades in important ways (Hemerijck 2013: Ch. 3).

1. *From outside*, intensified international competition has come to challenge the redistributive capacity of national welfare states.
2. *From within* European societies, increased life expectancy, declining birth rates, gender and family changes, the shift from an industrial to a service economy, increasingly skill-biased labour markets, the de-standardization of employment relations and the rising demand for healthcare and long-term care services confront the welfare state with 'new social risks' and life-course contingencies in the 'post-industrial' economy.

3. As a *historical legacy*, considerable public resources continue to be directed at ‘old social risks’, including unemployment insurance, sickness and disability benefits and especially old-age pensions. In an era of *relative austerity* and slower economic and productivity growth, prior extensions of welfare entitlements, together with increased fiscal pressure, crowd out the policy space for ‘new’ risks and social policy innovation.
4. At the *supranational* level, the European Union, an institutional innovation of the post-war era (like the modern welfare state), has emerged as a critical intervening variable in domestic processes of welfare state change. It is fair to state that within the EU, we have entered an era of semi-sovereign welfare states.
5. The final challenge relates to the precarious *political context* of early twenty-first-century Europe, which is marked by increased electoral volatility, erosion of party loyalties and a rise in national *welfare chauvinism*, associated with mounting xenophobic populism.

It is popularly claimed that constant levels of social spending indicate that welfare states are *immovable objects*; I argue that this assertion is misleading (see Pierson 1998). As I will show below, behind their constant levels of social spending, all of the welfare states of the European Union have been recasting the basic functional, normative, distributive and

institutional foundations upon which they were originally built in order to meet the challenges of structural change listed above.

Changing welfare regimes

Although the drivers of change are common across Europe, the pressures they create for different welfare regimes and the policy responses they trigger vary from country to country. According to the rich literature on the 'worlds' or 'families' of welfare states, key domestic social policy complementarities have historically produced distinctive clusters of Scandinavian, Conservative Continental, Southern European and 'Anglo-Irish' welfare regimes, which seemingly generate regime-specific policy responses to structural social and economic change (Esping-Andersen 1990; Castles and Mitchell 1993; Ferrera, Hemerijck and Rhodes 2000; Ferrera and Hemerijck 2003; Arts and Gelissen 2010; Hemerijck 2013; see Table 39.2 on the core principles of welfare regime and Table 39.3 on institutional legacies and structures).

Table 1 and

Table 2 about here

The ten Central and Eastern European *new member states* (NMS) that joined the EU in 2004 and 2007 occupy a special place in this scheme. They have undergone two radical changes in the past 65 years: the shift

from capitalism to state-socialism in the 1940s and from state-socialism back to capitalism after 1989 (Cerami 2010). Below, we will more closely examine these five clusters of reform experiences.

Nordic 'dual-earner' normalization

In the *Scandinavian welfare states* (Denmark, Finland and Sweden), social protection is a fundamental right, coverage is fully universal and all citizens are entitled to the same basic guarantees, although this precept has been eroding in recent years. In addition to generous replacement rates, these systems offer a wide array of public social services beyond health and education, together with active labour market programmes that encourage and sustain high levels of both male and female participation in the labour market. The provision of benefits and services is chiefly the responsibility of central and local public authorities. General taxation plays a dominant, though not exclusive, role in financing the welfare state, meaning that taxing and spending levels are high by international standards.

Given the high levels of popular support for inclusive welfare provision (rooted in the *folkhemmet* culture and tradition: the welfare state is the house of the people), the social reform agenda since the 1990s has been politically shaped by a pragmatic, problem-solving approach primarily centred around the issue of cost containment, with no 'grand controversy'

over alternative views or scenarios (Kuhnle 2000; Eitrheim and Kuhnle 2000; Palme 1999). Other than cost containment, the most important *leitmotiv* of the Nordic welfare reform agenda in the 1990s was 'activation', i.e. the modification of social security programmes to provide actual and potential beneficiaries with incentives to find gainful employment (Kautto 2010).

Sweden and Denmark have begun to reduce public-sector employment; however, the tradition and principles of universalism remain largely unquestioned, even though across-the-board cuts in replacement rates (e.g. sickness benefits) and basic guarantees (e.g. family allowances) have occurred. In Denmark, a series of labour market reforms in 1994, 1996 and 1998 gradually implemented both the right and the duty of activation, including mandatory individual action plans in return for job offers within three to five months of unemployment (Goul-Andersen 2007, 2011; Larsen and Andersen 2009). The 'active' turn in the Danish welfare state ultimately gave rise to the now famous 'flexicurity' model that triangulates 'flexible labour markets, generous unemployment benefits, and active labour market policies – all coordinated to reduce unemployment and improve the quality and supply of workers to the labour market' (Campbell and Hall 2006: 30; see also Madsen 2006; Erhel and Gazier 2007). Inspired by the Danish approach, Swedish policy-makers institutionalized a variety of activation measures, including a

youth guarantee in 1998 and an activation guarantee in 2000. Both measures include 'active periods' that require the establishment of individual action plans, close collaboration with supervisors and participation in a variety of job coaching and/or active labour market programmes. Finnish policy-makers, like their Danish and Swedish counterparts, have also intensified their activation policies. As in Denmark, in the sphere of unemployment policy, Finnish municipalities have gradually taken over the implementation of the country's new 'right and duty to activation' strategy (Van Gerven 2008).

Important pension reforms have been undertaken to strengthen the links between contributions and benefits. In 1999, Sweden switched from a defined-benefit to a defined-contribution scheme, whereby each insured employee's contributions are recorded in an interest-earning individual account, typically at a rate tied to wage growth. At retirement, the balance in the account is converted to a life annuity. This important reform was based on a strong consensus on the need for fiscal sustainability spurred by a recession in the early 1990s; agreements were forged first between the social-democrat and centre-right parties and then with employers and trade unions (Schludi 2005). In 2002, although Finnish policy-makers left the statutory retirement age of 65 untouched, they enabled flexible retirement between the ages of 63 and 68. As a consequence of these reforms, pensions are now perceived as financially sustainable and fair,

both within and across generations (Immergut *et al*. 2007; Green-Pedersen 2007; Kangas 2007).

A particularly important feature of Swedish welfare reform in the 2000s has been the reinforced commitment, under more stringent budgetary constraints, to active family support in order to enhance early childhood education and care while enabling citizens to combine parenthood with employment or studies. At pre-school facilities, the fee charged is subject to a maximum capped at a fairly low level. In addition, the new system is topped up with a range of family/children benefits and parental leave in connection to childbirth or adoption. Paid parental leave is granted for a period of well over a year (480 days), and nearly all parents take advantage of the days available (Palme *et al*. 2003). Finland has pushed for a deliberate human capital strategy to ensure a productive workforce in the future (Sabel 2012).

Reversing the Continental 'welfare without work' syndrome

The *Continental group* consists of Austria, Germany, France and the Benelux countries. Here, the Bismarckian tradition, based on a tight link between work position and/or family status and social entitlements, is characterized by occupationally distinct, employment-related social insurance, underpinned by traditional (single-earner) family values (Kersbergen 1995). Only the Netherlands has modified this tradition by

providing a basic public pension. The benefit formulae proportional to earnings and financing through social security contributions largely reflect the logic of insurance, although there are different rules for different professional groups. Benefit replacement rates (i.e. the proportion of previous income) are generous, and benefit duration tends to be long. Spending and taxing levels are therefore high as well.

On the eve of the twenty-first century, the Continental welfare regime was branded the 'sick man' of Western Europe. The root cause of the Continental syndrome lay in the combination of four of its distinct institutional traits: the generosity and long duration of insurance-based income replacement benefits, the chiefly 'passive' or compensatory nature of such benefits, their financing through payroll contributions and high minimum wages (see also Scharpf and Schmidt 2000b; Huber and Stephens 2001; Pierson 2001; Streeck 2009; Eichhorst and Hemerijck 2010). Over the 1970s and 1980s, Continental regimes resorted to disability pensions, early retirement and long-term unemployment schemes to remove older and less productive workers from their labour markets. Governments of various political outlooks preferred increases in social contributions, making labour ever more expensive, over cutting social benefits. Luring people out of the labour market by facilitating early retirement, increasing benefits for the long-term unemployed, lifting the obligation to seek employment for older workers, discouraging mothers

from seeking employment, favouring long periods of leave, easing access to disability pensions and reducing working hours – these policy decisions exemplify the Continental predicament of 'welfare without work' that remained politically popular well into the 1990s (Esping-Andersen 1996; Hemeriijck and Manow 2001).

From the 1990s onwards, the policy of labour supply reduction came to be regarded as a policy failure that, if uncorrected, would undermine the survival of the Continental welfare state and the Rhineland model of 'coordinated market economies' more generally (Hall and Soskice 2001). A novel policy consensus emerged, involving expanding employment levels among women (and perhaps also older workers) as a *sine qua non* for the long-term sustainability of the inclusive welfare states of mainland Europe. Subsequently, the Continental employment predicament engendered a long, complex and cumulative reform agenda, including containment of wages and social spending, trimming of pensions and 'passive' benefits, reductions in payroll charges, the introduction of 'active' incentives, updates to family policies, increased means-testing, labour-market deregulation to overcome insider/outsider cleavages and general financial restructuring (Ferrera and Hemerijck 2003; Palier 2010a).

The Netherlands was the first country to adopt a more encompassing strategic approach to Continental welfare restructuring and employment creation with the revitalization of corporatist negotiations between the social partners and the government beginning in the 1980s. The Netherlands combined wage restraint, cuts in social benefits and first steps towards activation with an expansion of flexible, part-time, service-sector jobs (Visser and Hemerijck 1997; Hemerijck and Marx 2010). In the new millennium, activation programmes based on individual guidance and training opportunities – especially those that target 'outsiders' such as young, female or low-skilled workers – have become especially significant. In the wake of the Dutch reforms, Germany, Belgium and France also targeted stricter activation for recipients of minimum income support and implemented enhanced in-work benefits for low-wage earners (e.g. the French *prime pour l'emploi*) or their employers via exemptions from social insurance contributions. In Germany, the so-called Hartz reforms (2002–5) constituted a definite break with the traditional Continental social insurance legacy of high benefit dependency, low employment, reluctant activation and truncated flexibilization (Seeleib-Kaiser and Fleckenstein 2007). The most radical Hartz IV reform, enacted in 2005, involved the merger of the provisions for unemployment assistance for the long-term unemployed and social assistance for those in need without an employment record into a new, tax-financed 'Unemployment Benefit II' (*Arbeitslosengeld II*) to complement the more

traditional unemployment insurance provision, termed 'Unemployment Benefit I' (*Arbeitslosengeld I*). The introduction of a general assistance scheme for all working-age inactive citizens capable of working, through the merger of unemployment assistance and local social assistance provisions, was complemented by tight eligibility criteria and strong activation requirements for all long-term unemployed citizens (Hinrichs 2010).

In many Continental welfare states, however, labour market deregulation remained biased, in the sense that open-ended contracts for insider groups remained secure, reinforcing the already existing 'dualization' between industrial workers and service-sector employees (Palier and Thelen 2010). In contrast to Germany, the Netherlands and France, Belgium remained ensnared in a vicious circle of ever-higher social spending, higher taxation, labour shedding and mounting public debt and deficits. Attempts to curtail employment protection remained blocked because of disagreement between the social partners (Hemerijck and Marx, 2010; Deken 2011). Austria also maintained its insider-biased social insurance and labour market by restricting access to inactivity benefits. In addition, job subsidies and expanded training measures were introduced to improve the labour market potential of women, the young and older long-term unemployed workers (Obinger and Tálos 2010; Korthouwer 2010).

Pension reform in Continental welfare states has been difficult. Pension contribution rates have risen in Germany and the Netherlands, while in Austria the reference period has been extended as part of a larger package of reforms. Germany has moved from gross to net wage indexation, and France has shifted from wage to price indexation. The Netherlands, France and Belgium have started building reserve funds to sustain pension provision when the baby-boom generation retires (Esping-Andersen *et al*. 2002). Germany has gone the furthest in encouraging savings in private pensions and in the use of state subsidies to support supplementary pension schemes for low-income earners.

Finally, new policies of reconciling work and family life have gained prominence in many Continental countries in the new millennium. Since the 1990s, parental leave schemes have been expanded, in many cases under pressure from EU gender equality directives (Falkner *et al*. 2005; Falkner 2010; Graziano 2011). Governments have increased family spending and pushed for more flexible childcare facility opening hours in order to increase the number of available and affordable childcare places. Whereas the Netherlands has developed a ‘combination scenario’ of childcare through the workplace for mothers working part-time, the Red-Green governments in Germany led by Gerhard Schöder put childcare at the core of its policy platform, with generous tax deductions for parents utilizing childcare facilities in order to stimulate demand, especially

among low-income families. The Grand Coalition of CDU/CSU and the SPD under Angela Merkel then expanded tax reimbursements to cover childcare costs and introduced a new parental leave benefit, while expanding (public) childcare facilities. The Minister for Family, Seniors, Women and Youth Affairs, Ursula von der Leyen (CDU), committed the Grand Coalition to a rapidly expansion of childcare facilities to 750,000 places by 2013 with a subsidy of €4 billion, covering one-third of the costs.

The above social reforms across Continental welfare states, which were once characterized as highly change-resistant, clearly indicates that most mainland European welfare states have been radically transformed over the span of the past two decades (Palier 2010b; Vail 2010).

Southern welfare modernization progress and setbacks

The *Southern European group* of Italy, Spain, Portugal and Greece resembles the Continental family, but there are specific institutional traits that set these countries apart (Ferrera 1996). Benefit coverage reflects a mixed orientation: Bismarckian in income transfers, with especially generous pensions, but Beveridgean in healthcare, with fully universal national health services in both Italy and Spain. The social safety net of basic benefits is not well developed. Social charges (i.e. taxes on employers and employees) are widely employed, but general taxation is

becoming more important in financing social services. The family is still a significant source of care and support and makes up for deficits in the social welfare system. This ‘familialization’ of the social assistance function has given rise to a distinct gender regime, in which women’s roles primarily involve family duties (Saraceno 1994; Trifiletti 1999; Guillén *et al*. 2001). However, Portugal’s high levels of female labour market participation belie this generalization. Finally, inadequate administrative capacities reinforce poor social policy implementation and, in some cases, clientelism.

Under the weight of these institutional legacies, modernizing Southern European welfare states has been problematic. Nonetheless, these states carved out an ambitious reform agenda from the early 1990s onwards, including the attenuation of generous guarantees for historically privileged occupational groups, accompanied by improved minimum benefits, the introduction and consolidation of safety nets (especially through means-tested minimum income schemes), the expansion and improvement of family benefits and social services, measures against the underground economy and tax evasion, reforms of labour markets and modifications of unemployment insurance benefits (Ferrera 2010).

Southern European welfare states entered the 1990s with severe fiscal imbalances. In the shadow of the EMU’s *marche force*, and in view of

their particularly adverse demography, Southern European countries were forced to embark on the politically perilous programme of severe internal restructuring: less generous benefits for insiders in order to cut down debts and deficits and – to the extent that budgetary constraints allowed – to finance new benefits and services for outsiders (Guillén *et al*. 2003; Guillen and Matsaganis 2000).

The Maastricht criteria for EMU membership made pension reform indispensable (Ferrera and Gualmini 2004). Italian pensions were reformed in 1992 and again in 1995, 1997, 2004 and 2007. In the antiquated Italian pension system, the privilege enjoyed by civil servants that allowed them to retire after only 20 years of service regardless of their age (the so-called 'baby pensions') was phased out. Pension rights were accorded to atypical workers, and lower pensions were repeatedly upgraded. Some traditional gaps in social coverage were also filled. The so-called Dini reform of 1995 completely overhauled the pension formula, linking it closely to contributions in a quasi-actuarial fashion (Ferrera and Jessuola 2007). After 2000, however, there were significant setbacks in the momentum of the Italian reform process (Sacchi and Bastagli 2005). The centre-right, led by Berlusconi (2001–6) took over from the centre-left cabinets of the mid- to late 1990s. The Berlusconi government pushed for greater labour market flexibility on the basis of the idea that welfare provision undermined competitiveness and reinforced labour market

distortions (Jessoula and Venan 2011). Because the centre-right government privileged a welfare model based on family and community networks, it drastically cut the funding for social services and family policy and put an end to the experimentation with the minimum insertion income. Subsequently, the rather weak and short-lived centre-left Prodi cabinet (2006–8) preferred not to try to expand childcare, but rather regressively chose to strengthen ordinary unemployment insurance by extending its duration and increasing benefits. These setbacks left Italy unprepared for the 'new social risks' of the mid-2000s and ill-equipped to combat poverty and social exclusion.

The timing of the most significant welfare modernization on the Iberian Peninsula coincided with the period in which Portugal and Spain became full members of the EU. The influence of EU membership has been twofold: First, it constituted a basis for the legitimation of the new democratic regimes, and second, it served to strengthen domestic institutional capabilities, in conjunction with financial support from the European Social Fund (ESF) (Guillén, 2010; Adão e Silva 2011). From the mid-1980s to the early 1990s, the Spanish welfare state in particular underwent major transformation, adopting a national health service, promising universal access to education and pensions and introducing minimum income schemes at the regional level (Guillen 2010). The imperative to curtail public expenditures in order to qualify for the

Maastricht criteria triggered a series of substantial retrenchments in the early 1990s, restricting both eligibility and generosity in the unemployment protection system. Both Portugal and Spain engaged in restrictive pension reforms but also went ahead with improvements in minimum benefits for the elderly, family allowances and the basic safety net. Portugal introduced a pilot national minimum income scheme in 1996, which was adopted nationally in 1997 (Capucha *et al*. 2005). In Spain, the 1995 Toledo Pact agreed upon by the main political parties and later supported by the social partners was of special significance to the country's welfare reform momentum (Molina 2011). Unlike Italy, Spain has progressed towards reducing inequalities in the labour market: In 1997 and 2001, labour laws relaxed protections for core employees and improved the social security rights of irregular and temporary workers (Guillén and Léon 2011). A new social assistance scheme was introduced in 2000, the means-tested *Renta Activa de Inserción* (RAI), or Active Integration Income, targeted at those 45 and over with family dependents who have exhausted their unemployment benefits, coupled with tougher activation and job offer requirements. However, Spain's Achilles' heel remains its high level of unemployment, especially among the nation's youth.

While Italy and the Iberian countries have made headway in updating their welfare systems, Greece has continued to lag behind (Guillen and

Petmesidou 2008). With welfare and (especially) pension provision targeted at a wide variety of interest groups, the expansion of social policy has reinforced a pattern of institutional fragmentation and backwardness. Successive Greek governments employed EU development funds to perpetuate the clientelist structure of the country's welfare system.

What stands out in the Mediterranean social reform experience in retrospect is the impact of the EMU entrance exam and the macro-economic criteria of the Stability and Growth Pact on public spending and deficit financing (Featherstone and Kazamias 2001). In hindsight, however, the EMU has proven to be something of a mixed blessing. Although the entrance exam for the EMU has had clear effects in terms of welfare state modernization, this logic no longer applied as soon as Italy and Greece had secured their full-fledged membership in the Eurozone. Extremely low interest rates allowed these countries to abstain from further reductions in their exceedingly high levels of public debt (close to 100 per cent of GDP). In other words, participation in the EMU took the pressure off, obviating further updates to welfare provision in Greece and Italy.

Anglo-Irish 'Third Ways'

Ireland and especially the United Kingdom (UK) are considered the closest European approximations of a liberal regime-type, characterized by modest levels of social protection, a predilection for targeted provisions and a constrained role for the state (Esping-Andersen 1990). The *Anglo-Irish group*, consisting of the United Kingdom and Ireland, has a system of social protection that is highly inclusive though not fully universal, except for healthcare. Benefits – which are flat-rate – are modest, and social protection programmes reflect an emphasis on targeted, needs-based, means-tested entitlements. Healthcare and social services are financed through general taxation, but contributions play an important role in financing cash benefits, especially pensions. Public social services and family services are less developed than in Scandinavia and the Continental countries; however, as in the Nordic countries, the organization of the welfare state (including unemployment insurance) is highly integrated and entirely managed by the public administration. Although Ireland and the UK historically shared many of the above characteristics, their reform trajectories display an important dimension of recent divergence (Castles 2010).

After 1997, the Blair government embarked on a broad strategy of 'Third Way' reform: fine-tuning benefit rules to neutralize the 'traps' created by welfare-to-work schemes, fighting poverty and social exclusion through increases in the minimum wage and income guarantees, reforming the tax

code, introducing new targeted programmes and launching a campaign against child poverty. Much like the Conservatives before them, New Labour's approach was to minimize regulatory burdens on the labour market, but its 'welfare-to-work' strategy differed substantially from its predecessor's workfare policies. Both Tony Blair and Gorden Brown promoted the notion of an 'enabling' welfare state, contingent upon paid employment (Clasen 2005). Their strong reliance on employment and employability to address poverty, disadvantage and social exclusion essentially rejected the pursuit of greater equality through interventionist policies of income redistribution.

Central to New Labour's ideas about the importance of activation was the emphasis on greater individual responsibility to seek gainful employment, matched by more generous in-work benefits for those who took low-paid jobs, a policy now reinforced by a minimum wage (Schmidt 2002; Daly 2010. Beginning in 1997, the Blair government introduced a series of *New Deals* targeting different sectors of the inactive population (Clegg 2010). In addition, a national minimum wage was introduced in 1999, set at different levels for different age groups, and has been regularly raised ever since (Weishaupt 2011a).

Perhaps the predominant trend of the past decade is that New Labour, across long sequences of policy changes, moved towards the eradication of

many of the differences between various types of out-of-work support (e.g. unemployment, social assistance, disability) for working-age people in the benefit system, both in terms of benefit levels and the expectation of efforts to return to work. The UK's activation and benefit policy has come to focus on working-age people as whole, rather than discrete groups (the unemployed, the disabled, single parents, etc.), resulting in significant benefit simplification (Clasen 2011). An important associated effect of this trend has been a strong 'fiscalization' of British social security and, as a consequence, a more prominent role for Her Majesty's Treasury at the expense of the Department for Work and Pensions (DWP).

Although New Labour's social policy agenda was primarily directed towards anti-poverty and pro-employment policy priorities, it also enacted an impressive range of family policy measures, addressing childcare and children's early education, financial support for families and children, services to improve the quality of family relations in low-income urban areas, parental employment and greater flexibility in work and family life (Daly 2010b).

As in the UK, Irish policy-makers have also focused on the promotion of employment, complemented by welfare reforms. After unemployment reached a level of 18 per cent, cooperation with business and unions (beginning with the National Recovery accord of 1987–91) helped reform

the economy and attract high levels of foreign direct investment, boosting Ireland's rates of output and employment. This successful programme was followed by a series of tripartite accords: the 'Economic and Social Progress' agreement (1991–4), the 'Competitiveness and Work' accord (1994–7) and, finally, the 'Partnership 2000' agreement (1997–2000) (Hardiman 2000). In order to qualify for the EMU, the Irish social partners agreed on a long-term strategy of wage moderation in exchange for tax cuts and strict controls on inflation. This strategy of 'competitive corporatism', together with Ireland's multinational corporation-friendly tax rates, industrial policy and regional development programmes, appeared to pay off: Rates of Irish output and employment growth were the highest in the EU before the onslaught of the global financial crisis, and the nation's public finances were healthy (Weishaupt 2011).

Because policy-makers feared that economic growth would not translate into job growth during the early years of what came to be known as the 'Celtic Tiger', ALMPs were expanded, enabling the long-term unemployed to gain work experience on community projects (Fitzgerald 2005: 129). After the mid-1990s, policy attention shifted to poverty reduction through the National Anti-Poverty Strategy (NAPS) introduced in 1997 and revised in 2002 and 2007. This strategy sought to decrease the long-term poverty rate of the population from 15 per cent to ten and eventually five per cent. As Mary Daly and Nicola Yeates point out, the

NAPS was based on an encompassing understanding of social inclusion that identified the roots of poverty in unemployment and educational and regional (urban vs. rural) disadvantage (Daly and Yeates, 2003: 91). Social support for families with children also expanded dramatically.

In an overall assessment of the social reform agendas pursued in the UK and Ireland before the global financial crash, we can conclude on a positive note that the enlarged scope of 'welfare-to-work' strategies in the two countries has made their welfare systems more inclusive and unified. Both countries have departed from neo-liberal orthodoxy by developing a "social liberal model" of an 'enabling' (in Britain) or 'developmental' (in Ireland) welfare state, optimizing public income and social service support contingent upon paid employment (Clasen 2005).

Welfare system transformation in Europe's new member states

Undoubtedly, the new EU member states in Central and Eastern Europe (CEE) have witnessed the most radical and epochal political and economic transformation of any of the welfare regimes discussed here. Since the fall of the Berlin Wall in November 1989, the scope of social policy change in post-Communist Central and Eastern Europe reflects comprehensive 'system transformation' rather than 'catching up' with the older member states of the EU (Inglot 2008; Haggard and Kaufman 2008; Cook 2007; Nölke and Vliegenthart 2009). In 1989, at the height of the immediate

transition crisis, the functional challenge at hand was to (re)cast and (re)design – practically overnight – welfare provisions in order to support the transition to the modern market economy and pluralist democracy (Stark 1996). This implied a wholesale shift from public to private responsibilities for citizens' life chances and welfare. The decision to pursue a free market economy entailed profound consequences for the institutional capacities of welfare provision, both on the revenue side (including new methods of raising taxes and contributions to mitigate poverty and unemployment) and on the spending side (including new administrative capacities to manage wholly novel programmes of work and welfare) (Cook 2010). Such groundbreaking institutional redesign undoubtedly clashed with remaining popular expectations about employment guarantees, universal social service provision and income equality. But given the countries' (admittedly battered) communist legacy, which involved the state playing the primary role in securing employment and providing social transfers and services, the transition to a market economy would inevitably renege on these long-cherished welfare expectations (Haggard and Kaufmann 2008).

The demise of state-socialism in 1989–91 was accompanied by a deep economic crisis. In 1990–4, economic growth and wages declined rapidly and inflation spiraled, bringing an end to full employment, with job losses ranging from 10 per cent in the Czech Republic to 30 per cent in Hungary.

Initially, the welfare state was used as a buffer to cushion the most dramatic effects of the loss of income through unemployment. In the early 1990s, the Polish, Hungarian, Czech, and Slovakian governments introduced fairly generous targeted unemployment insurance programmes and established basic ‘safety nets’ based on rather lenient eligibility criteria, including expanded pension entitlements and family benefits. On a more structural basis, most CEE countries introduced a minimum wage and income-related social assistance schemes to combat poverty.

With the number of people on pension, unemployment or social assistance benefits increasing dramatically, the financial strain on welfare schemes skyrocketed as GDP contracted. This prompted the next wave of welfare reform in the mid-1990s, bent on cost containment and curtailing welfare dependency by changing incentive structures and governance systems (Keune 2006; Cerami 2006, 2010). In Hungary, social assistance moved from a flat-rate system to a means-tested benefit. In addition, universal family allowances were partially replaced by means-tested benefits for the poor, while universities introduced tuition fees and healthcare was partially privatized. In Poland, the criteria for unemployment insurance were tightened in 1994. In regions where unemployment was high, entitlement duration was cut to six months to incentivize regional mobility. In addition, maternity leave programmes were abolished in 1996,

and families with incomes in the top ten per cent were no longer entitled to family allowances or childcare benefits.

CEE pension systems in particular have undergone radical reforms, specifically through the privatization and individualization of savings, as strongly advocated by the World Bank and the IMF. State-socialist old-age pension systems were largely financed on a pay-as-you-go (PAYG) basis through transfers from state firms to the state budget; direct contributions by the workers themselves were rare (Fultz and Ruck 2001). In the second half of the 1990s, pension reform accelerated in the direction of multi-pillar pension systems, partially privatized, replacing the earlier pay-as-you-go system in the public pillar. A mandatory second tier in old-age pension schemes, run by private funds on the basis of Notional Defined Benefits, was introduced in Estonia in 1994, in Latvia in 1995, in the Czech Republic and Hungary in 1998, in Lithuania, Slovenia and Poland in 1999, in Romania in 2001, in Bulgaria in 2002 and in Slovakia in 2003 (Inglot 2008; Orenstein 2008). These reforms have made pensions more individualized, more heavily dependent on lifetime contributions and life expectancy, and more earnings-related (and thus less redistributive). The Czech Republic resisted the shift to compulsory private co-insurance, mainly because the Czech economy was not in as deep a fiscal crisis as many of the other CEE countries by the mid-1990s.

Throughout the 1990s and the early 2000s, CEE unemployment regimes gradually converged towards a minimal-liberal model, i.e. incomplete coverage and limited level and duration of unemployment benefits, alongside weak active labour market policies. By the mid-2000s, in contrast, the Polish welfare state moved towards a more universal model of social assistance as a stepping-stone in the establishment of a general minimum income guarantee by 2008. Similarly, in the Czech Republic, by the early 2000s, the social assistance minimum was raised, followed by an expansion of family payments in 2004 (Haggard and Kaufman 2008: 326–30; Inglot 2008: 238–50). By 2005, the Czech government came to endorse an explicitly active family policy, motivated in particular by a chronically low fertility rate (at about 1.2 children born to young couples), but also by programmatic initiatives embraced by the EU.

This transition from state-socialist systems to modern welfare states embedded within market economies is without historical precedent. Over the last 25 years of welfare state transformation, the social policy systems of Central and Eastern Europe have evolved towards a mixed or 'hybridized' welfare structure, a combination of Continental 'Bismarckian' elements of social insurance and 'Anglo' market-based pensions and social services, underpinned by basic 'egalitarian-universalist' safety net provisions (Zeitlin and Heidenreich 2009). Of course, these hybrid welfare policy mixes are not stable *per se*, as they

have emerged through intense distributive conflict (Haggard and Kaufman 2008).

On the basis of the survey outlined above, it is fair to conclude that since the mid-1990s, European welfare states have entered a new era of flux, reform and adaptation to unfolding long-term social changes and short- to medium-term economic and political predicaments. This obvious social reform momentum surely invalidates the long-cherished and popular conception of 'frozen' and change-resistant European welfare states (Pierson 1998, 2011). We also observe regime-dependent paths of welfare state adaptation, but in a number key policy areas, there are also definite examples of (regime-contingent) policy convergence in the direction of social investment policy prescriptions.

Towards social investment?

Have European welfare states been recalibrated in accordance with the social investment strategies that gained prominence with the Lisbon Agenda of 2000? And to what extent can we associate the European welfare reform momentum with quantifiable social investment performance indicators?

The philosophy underpinning the social investment approach was given impetus by the publication of a book edited by Esping-Andersen *et al*. in

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

From fighting unemployment to increasing employment

From a social investment perspective, three overarching long-term changes can easily be empirically supported, with important qualifiers.

First, in the majority of EU member states, in line with the general move towards supply-side economics, the overarching social policy objective in the 1990s has shifted from fighting unemployment to proactively promoting labour market participation. Indeed, since the late 1980s, there has been a significant increase in employment in most European welfare states. Spending on active labour market policies in most OECD countries has increased considerably from the 1990s to the mid-2000s, resulting in falling unemployment rates and the mobilization of women, youth, older workers, and less productive workers through early intervention, case management and conditional benefit (Bonoli 2011). With respect to *labour market regulation*, several European countries have moved towards greater acceptance of flexible labour markets. In terms of *social insurance* and *assistance*, the generosity of benefits has been curtailed. Through the weakening of earnings-related benefit provision in particular and by harmonizing benefits across different risk categories, social insurance benefits have become less status-confirming. Today, most countries preside over universal minimum income protection programmes, coupled with ‘demanding’ activation and ‘enabling’ reintegration measures, targeting labour market ‘outsiders’ such as young, female and low-skilled workers (Schmid 2008).

Figure 3 shows the employment/population ratios among the working-age population. What is striking in this figure 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 also notable. Employment in the working-age population in both the Anglo-Saxon and Scandinavian groups was at about 75 to 80 per cent before the global financial crisis. Apart from the Netherlands, most other Continental and Mediterranean European countries lag behind, with employment rates of 60 per cent to 70 per cent. But even there we can see some progress, particularly in Spain and Italy; France and Germany have been more stagnant.

Figure 3 about here

This positive development in employment rates is strongly correlated with a steep rise in female activity. This is the most important life-course transforming trend by far – what Esping-Andersen has called the ‘incomplete revolution’ in the role change of women from homemakers to lifetime employees (2009). Over the past quarter-century, female labour force participation has increased by about 20 per cent. Today, female employment rates in Europe range between 52 per cent in Italy and 73 per cent in Denmark and Sweden (see Figure 4).

Figure 4 about here

The main drivers of increased female labour force participation have been feminist emancipation, educational expansion and the shift to the service economy and the associated labour market flexibility, together with greater opportunities for reconciling work and family responsibilities (Jaumotte 2003).

Since the late 1990s, the employment rate among older workers has also been rising, most strongly in Finland, but also in some Continental welfare states, with the Netherlands taking the lead (see Figure 5).

Figure 5 about here

The across-the-board rise in the employment participation of older workers is consistent with the recent pension reform momentum. Practically all European welfare states have taken steps to reverse the trend towards early retirement policies, together with initiatives to promote longer and healthier working lives. A series of adjustments have fundamentally altered retirement welfare over the past two decades (Bonoli and Palier 2008; Häusermann 2010; Ebbinghaus 2011). A key shift has been the increase in (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 pension benefits and contributions and strong incentives to delay an early exit from the labour market, rewarding those who work for longer (Clark and Whiteside 2003).

Towards capacitating social services

Loosely aligned with the shift towards activation, the development of capacitating social services for dual-earner families also marks a distinct departure from the longstanding male-breadwinner/female-homemaker tradition, especially in continental Europe. Family support, gender roles and particularly childcare have indeed been at the centre of recent social reforms. *Social services* have significantly expanded, especially in the 2000s, to boost female participation though favourable family policy (Lewis 2006; Mahon 2002, 2006; Ungerson 2004; Crompton 2006; Orloff 2006, 2009, 2010). Spending on family services, childcare, education, healthcare and care for the elderly, as well as on training and employment services, has increased as a percentage of GDP practically everywhere in the European Union. Family policy (covering childcare, parental leave and employment regulations, and work and family life reconciliation policies) has undergone profound changes in both scope and substance over the past fifteen years. It is important to underscore here that early twenty-first-century welfare provision now addresses a wider range of social risks with a broader array of policy interventions, far beyond a narrow understanding of social insurance. Europe thus seems to have entered a distinctly new

phase of welfare state development, characterized by an incipient move towards active *service-oriented* welfare states, away from the traditional, passive, *transfer-oriented* systems of the past.

The shift to social services has important implications for the governance and administrative structure of twenty-first-century welfare provision. Juri Kazepov refers to the 'rescaling' of modern social policy in this regard. The most important step has been the attempt to bring social insurance and assistance and labour market policies under one institutional roof in so-called 'one-stop centres', thus ending the previous separation of social security and public employment administration. Ideas of New Public Management and novel concepts of *purchaser-provider* models in public welfare services have been especially instructive with respect to the restructuring of Public Employment Services (PES) since the 1990s (Weishaupt 2011).

From social insurance to (affordable) fiscal financing

The third and final important trend is the overall shift in *welfare financing* from social contributions to general taxation. In general, the Continental welfare states are largely financed through social contributions from workers and employers, following their Bismarckian origins, whereas the Scandinavian and Anglo-Irish social security systems are generally financed by taxes, consistent with the Beveridgean policy legacy. Over the

past two decades, the source of social protection expenditure financing has shifted from social contributions to fiscal financing (see Figure 6). This especially applies to social insurance cost-containment measures, along with the expansion of tax-financed minimum income and activation provisions in many Continental welfare states. The change to tax financing represents a shift from earnings-related employment-based social protection towards more universal service provision (Hemerijck 2013).

Figure 6 about here

This overarching trend is consistent with Sabel's argument about the changing nature of 'new' social risks. According to Sabel, one of the fundamental reasons why the modern 'active' welfare state 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 perfect sense to administer collective social insurance funds for consumption smoothing during spells of demand-deficient unemployment. However, as the risk of unemployment became structural, caused by radical shifts in labour demand and supply, unemployment insurance could no longer function as a reserve income buffer between similar jobs. In order to comprehensively connect social policy with a more dynamic,

competitive, knowledge-based economy and society, citizens must be supported by *capacitating* services *ex ante* – services tailored to meet specific social needs over their life cycle (Sabel *et al*. 2010). As Sabel asserts, the so-called 'new' social risks are essentially 'non-actuarial risks', unforeseeable risks for which it is difficult to establish who should pay how much into an insurance pool for effective risk mitigation over time. When social insurance risk pooling fails, a more effective strategy is often to help risk categories to self-insure against uncertain risks by enabling people to acquire the capacities they need to overcome the social risks they face, with *ex-ante* public support for family services and training programmes (Sabel 2012). As Sabel describes, 'If each of us can acquire, with the support of public training or capacitating services, general skills that make us employable in a wide and changing range of jobs, this employability protects us against labour market risks even when conventional unemployment insurance cannot' (2012: 81).

Social investment synergies

Can the social investment turn be associated with key welfare performance indicators, such as employment and poverty? To tackle this question, building on earlier work (Hemerijck 2013), what is particularly interesting to observe is that higher total budgets for social policies are associated with better outcomes, both in terms of poverty and employment (see Figures 8 and 9). More specifically, countries with higher budgets for

social investment-focused policies fare particularly well in terms of employment, suggesting that social investment is fairly effective in raising employment participation. An elementary regression analysis on employment and social spending data among member states suggests that for every additional 1 per cent of GDP spent on social investment (as defined above), the employment rate is 1.5 per cent higher. Money spent on social protection (narrowly understood) is much less effective, with an increase of only 0.25 per cent. In contrast, a 1 per cent of GDP increase in social protection expenditure is associated with a decrease in the at-risk-of-poverty (AROP) rate of almost 1 per cent (0.88 per cent), which is entirely consistent with the function of social protection provision. At least in the short term, money spent on social investment is not as effective *per se* as social protection more narrowly understood (0.67 per cent reduction in the AROP rate).

Figure 8 and

Figure 9 about here

As Esping-Andersen *et al*. (2002) have suggested, the social protection and social investment functions of the new welfare state should actually be understood in terms of 'institutional complementarities'. A regression based on Eurostat data clearly conveys that an approach that integrates both social investment and social protection functions is optimal for

raising employment participation while mitigating poverty. Social investment can be particularly effective in improving employability; this, in turn, creates the prerequisites for further economic and employment growth, which helps sustain funding for social protection policies, which then serves to reduce poverty risks in hard economic times.

Beyond 'frozen' welfare states

Significant national variation notwithstanding, the wide-ranging welfare reform momentum since the mid-1990s has resulted in a broad, cumulative process of welfare state (self-)transformation across the member states of the European Union (Hemerijck 2002). Even though public social spending levels have been consolidated over the past two decades, practically all European welfare regimes have sought to redesign and reconfigure the basic policy mixes upon which they were founded in the post-war years. It should not be forgotten that the welfare state is a normative concept based on the idea of a social contract with claims on equity and fairness that goes far beyond issues of economic redistribution and insurance to include dimensions of gender roles, the work ethic, child-rearing and intergenerational equity. The policy changes surveyed in this chapter seem to have contributed to a slow redefinition of the very idea of social justice: a shift away from an understanding of fairness in terms of static Rawlsian income equality towards an perception of solidarity and fairness as an obligation to provide due support to the needs of each

individual so as to enable all to flourish, in line with the ‘capability approach’ of Amartya Sen (1999) and Martha Nussbaum (2011). At the normative heart of the social investment edifice lies the reorientation of social citizenship, away from the compensating *freedom from want* logic towards the capacitating logic of the *freedom to act*, under the proviso of accommodating work and family life through social services and a guaranteed rich social minimum enabling citizens to pursue fuller and more satisfying lives.

One of the most important lessons of the past two decades is that domestic welfare reform truly makes a difference in terms of growth, employment and competitiveness. However, despite growing evidence that social investment priorities are being successfully pursued in many European welfare states, we have also observed how certain welfare regimes have been confronted with significant institutional constraints that impede social investment policies. Particularly in the more ‘segmented’ labour markets of Southern Europe, across the new member states and in some Continental welfare regimes, social investment progress has been limited. Tragically, these are the countries that find themselves in dire fiscal straits following the global financial crisis.

It may be too soon to draw definite conclusions about European welfare state futures in the aftermath of the global financial crisis. The question of

affordable social investment is among the most pressing of our times. Between 2008 and 2010, automatic stabilizers were allowed in order to cushion the recession. This response was complemented in a number of EU member states by measures to extend short-term working arrangements, sometimes linked to training and activation incentives. By 2011, the European Union had entered a more critical phase of crisis management, as the impending sovereign debt crises in Greece, Ireland and Portugal began threaten the viability of the euro.

However, the endogenous social changes that prompted many welfare states to turn towards the promotion of investment-oriented social policy have not gone away. If anything, they have become more critical. Demographic headwinds will place social contracts under further duress, especially in countries facing high unemployment and daunting budgetary pressures where long-term population aging and the feminization of the workforce have not been adequately addressed before the crisis. In this respect, the crisis has strengthened the policy saliency of poverty relief, social insurance, macro-economic stabilization and the need for human capital investment. In the current context of fiscal predicament, it is essential not to overlook the long-term growth potential of productive social investment policies. Social investment can no longer be dismissed as a 'fair-weather' policy when times get rough.

In the years ahead, intensifying fiscal pressures will lead many finance ministers to demand scrutiny of social spending. In both employment and social policy, there is a strong compulsion to do more with fewer resources. At the same time, the aftermath of the financial crisis will surely reinforce the need for human capital investment and the importance of poverty relief and social protection. However, short-term fiscal pressures will be intensified, depending on the extent to which long-term societal changes (such as population aging, the feminization of the workforce, immigration and shifts in labour supply and demand) have not been adequately dealt with prior to the crisis.

What makes the Eurozone predicament particularly worrying is that national fiscal and EU monetary authorities have practically no room left for proactive adjustment: Public finances are distressed, and interest rates are close to zero. Politically, governments are caught between Scylla and Charybdis: On the one hand, pressures for deficit reduction constrain domestic social policy space; on the other hand, disenchanted electorates are increasingly unwilling to abide by the austerity promises agreed upon in supranational rescue packages or EU-reinforced fiscal rules. To the Eurozone member countries currently in dire fiscal straits, the social investment message advocated by the European Commission in its February 2013 *Social Investment Package* policy platform is easy to disregard. Fiscal consolidation requires countries to slash active labour

market policies and retrench preventive healthcare programmes, which we now know critically erodes job opportunities for both men and women and thereby limits the capacity of the economy to shoulder the burden of an aging population in the long run. By the same token, cuts in family and childcare services and reconciliation measures hamper future female employment and consequently intensify child and family poverty problems in the most vulnerable economies of the European Union. Moreover, the reinforced 2011 'fiscal compact', 'two-pack' and 'six-pack' agreements, with their overriding emphasis on collective austerity and wage-cost competitiveness, is pressuring Eurozone economies to adopt pro-cyclical and self-defeating welfare retrenchments. EU policy-makers in both European and national arenas have a truly existential interest in addressing prevailing trade and competitiveness asymmetries by forging viable economic adjustment strategies that do justice to the important macro-economic returns of social investment policy reforms. Adverse demographic shifts mean that human capital cannot be allowed to go to waste through semi-permanent inactivity, as was the case in the 1980s and 1990s in many mature continental European welfare states. Social investment considerations must therefore be firmly anchored in Eurozone macro-economic and budgetary governance policies that support durable economic growth and high levels of employment. Room must be created for a more realistic pace of fiscal adjustment (more symmetrical, and for some countries, slower than at first foreseen), associated with a reform-

oriented social investment strategy and anchored in an improved EU financial, budgetary and macro-economic policy framework. The EU needs a ‘New Deal’ between the countries that are in better budgetary shape and have pursued social investment strategies more consistently in the past, and those that have been less consistent with regard to social investment and have therefore experienced dramatic budgetary problems. The macro-economic policy regime that is required is one in which *all* governments pursue budgetary discipline and social investment over the medium and long term and are effectively supported in that regard (Vandenbroucke, Hemerijck and Palier 2011; Hemerijck and Vandenbroucke 2012). In order to convince the larger European democratic public of such a regime’s political legitimacy and consistency with norms of social fairness, this macro strategy should be substantially based on a well-articulated vision of a ‘caring Europe’ – caring about people’s daily lives and future social well-being.

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FIGURES

Table 1 Core principles of welfare regimes

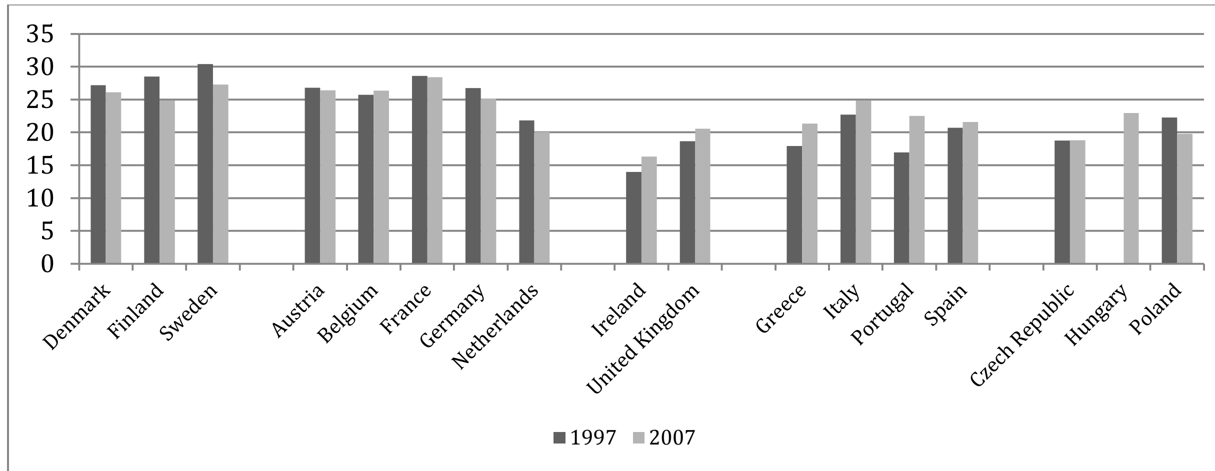
	Nordic	**Anglo-Irish**	**Continental**	**Southern**
Social rights	Universal citizenship rights	Residual entitlements	Employment-based entitlements	Insider-biased entitlements
Core values	Earnings equality (universalism)	Equality of opportunity (needs-based social support)	Status preservation (equivalence principle)	Status preservation and differentiation
Employment	Dual-earner full employment	Full employment	Full male employment	Full male employment
Gender	Dual-earner families (pro-gender equality) to maximize individual family member opportunities	Family servicing as a private matter (neutral)	Nuclear family as the cornerstone of society	Extended family as the core welfare provider
Objective	Equality	Poverty alleviation	Income maintenance	Income maintenance
Claiming principles	Citizenship	Need	Work/family needs	Insider/family needs
Responsibility	Collective	Individual	Collective	Collective

Table 2 Policy legacies, institutions and policy instruments of welfare regimes

	Nordic	Anglo-Irish	Continental	Southern
Social security	Tax-financed high transfers and quality servicing for all	Meager transfers (means-tested and targeted) residual services	Social insurance-financed high (contribution-contingent) transfers (long duration) Separate public social assistance	Social insurance-financed fragmented transfers (long duration) No additional safety net
Labour market policy/ regulation	Active labour market policy	Labour market deregulation	Strong job protection, no active labour market policy	Strong job protection, no active labour market policy
Family support	Active	Neutral	Passive, but generous	Passive, but limited
Beneficiaries	All citizens	Poor	Male breadwinners	Labour market insiders
Core institutions	Central role played by public policy (in the labour market, social security and welfare services)	Central role played by the market in welfare provision (state residual, but with a monopoly over benefit provision and activation)	State is secondary to the social partners (tripartism) and the nuclear family (subsidiarity), intermediary groups	Central role played by the extended family (state rudimentary), voluntary (church) organizations
Industrial relations	Encompassing labour	Decentralized labour	Sectorally-inclusive	Politicized sector- and

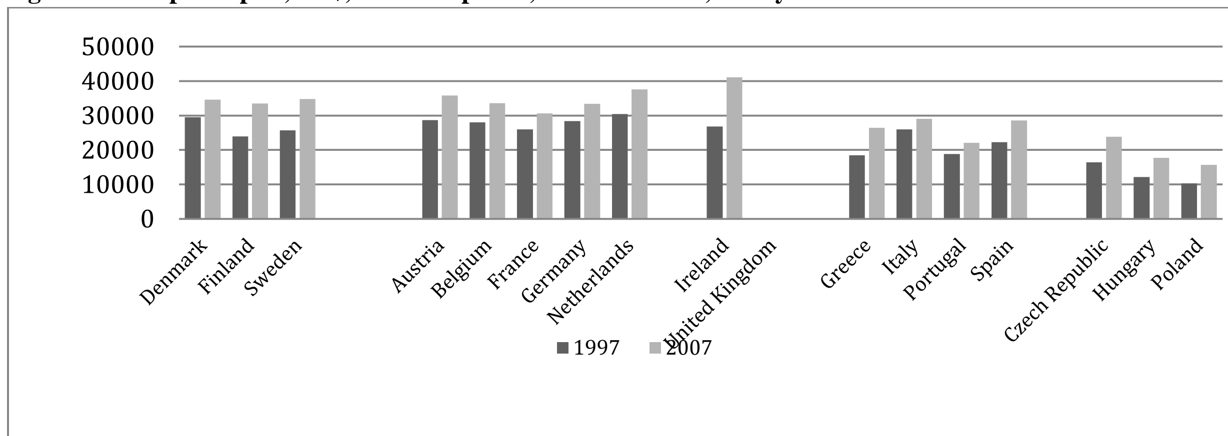
	relations (encompassing coverage)	relations	labour relations (wide coverage)	firm-based labour relations (fragmented coverage)

Figure 1 Gross public social spending (% of GDP)



Source: OECD Social expenditure database (SOCX), extracted October 2012.

Figure 2 GDP per capita, US$, constant prices, constant PPPs, base year 2005



Source: OECD National accounts, extracted October 2012.
Note: PPP is Purchasing Power Parity.

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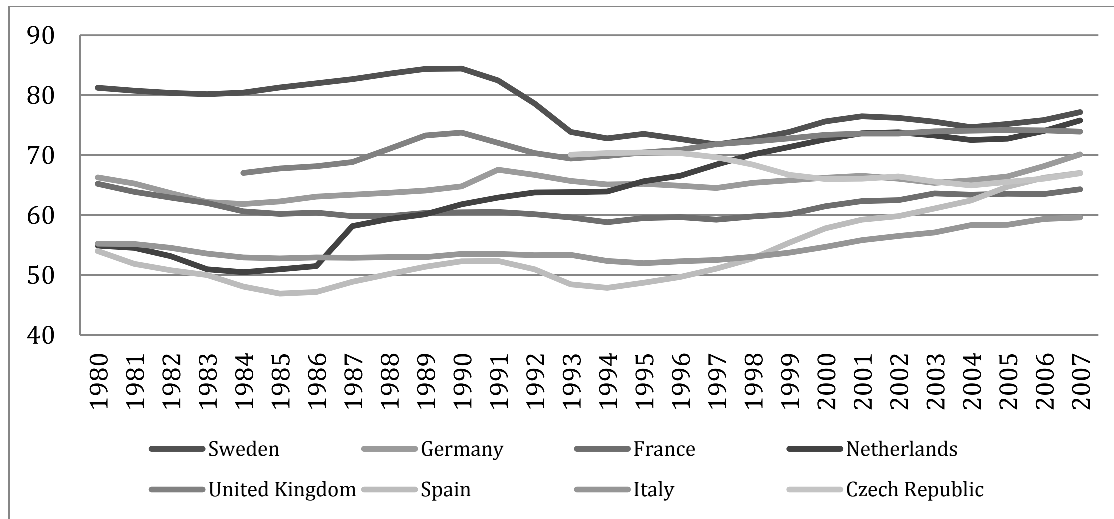
Industrial relations	Encompassing labor relations	Decentralized labor relations	Sectorally-inclusive labor relations	Politicized sector- and firm-based labor relations

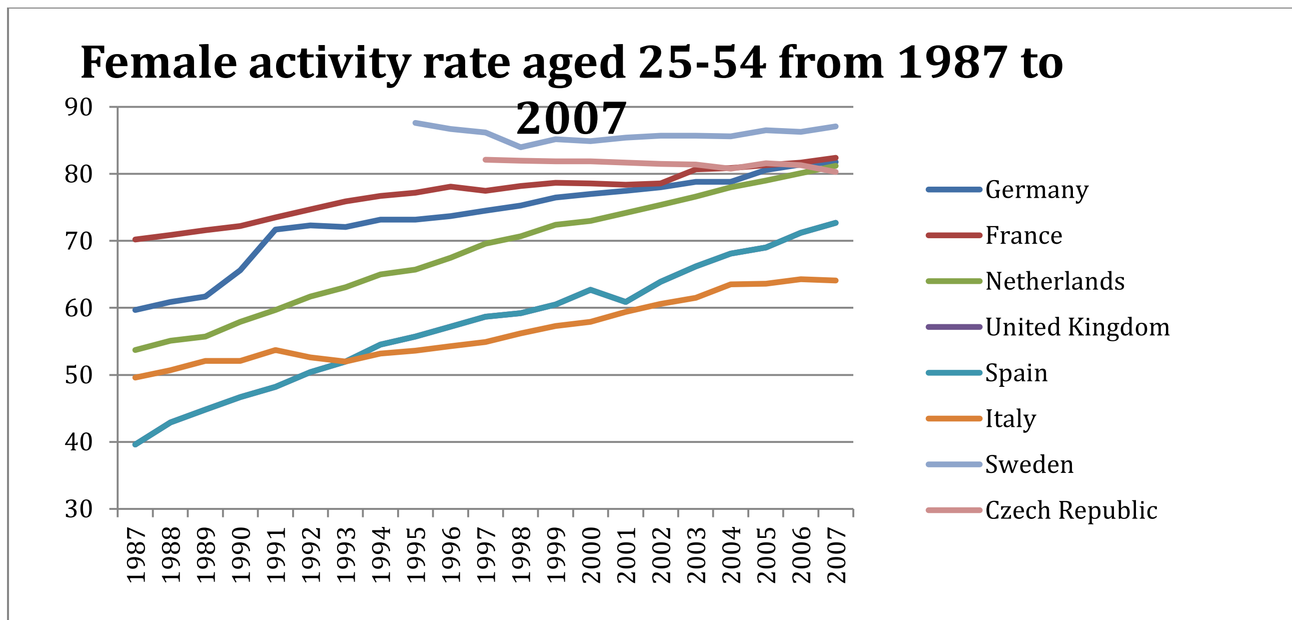
	(encompassing coverage)		(wide coverage)	(fragmented coverage)

Figure 3 Employment/population ratio, 1980-2007



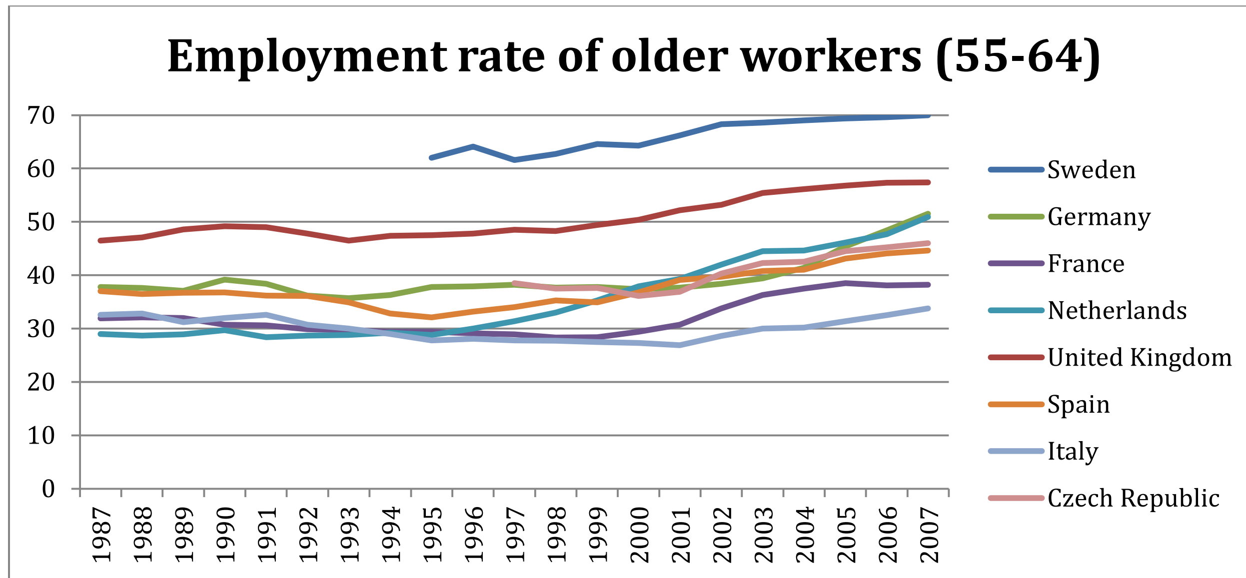
Source: OECD, labour force statistics, extracted February 2012.

Figure 4 Activity rate women (1987-2007)



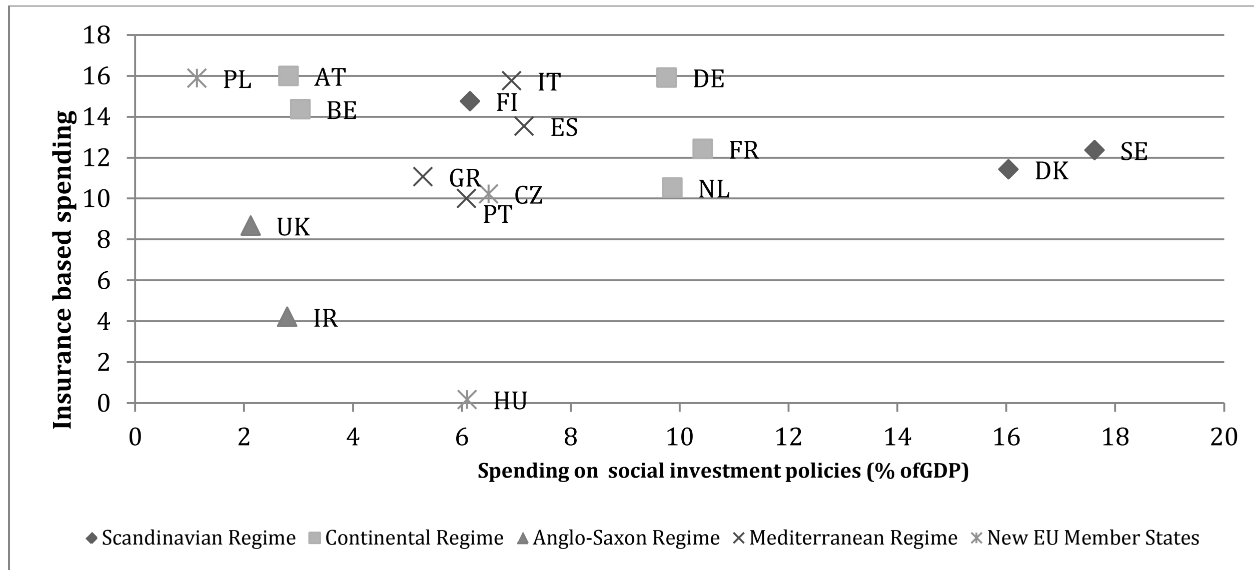
Source: Eurostat

Figure 5 Employment rate of older workers (55-64), 1987- 2007



Source: Eurostat

Figure 6 Social investment spending and insurance based spending in 1997 (top panel) and 2007 (bottom panel), % of GDP


Insurance based spending
18
16
14
12
10
8
6
4
2
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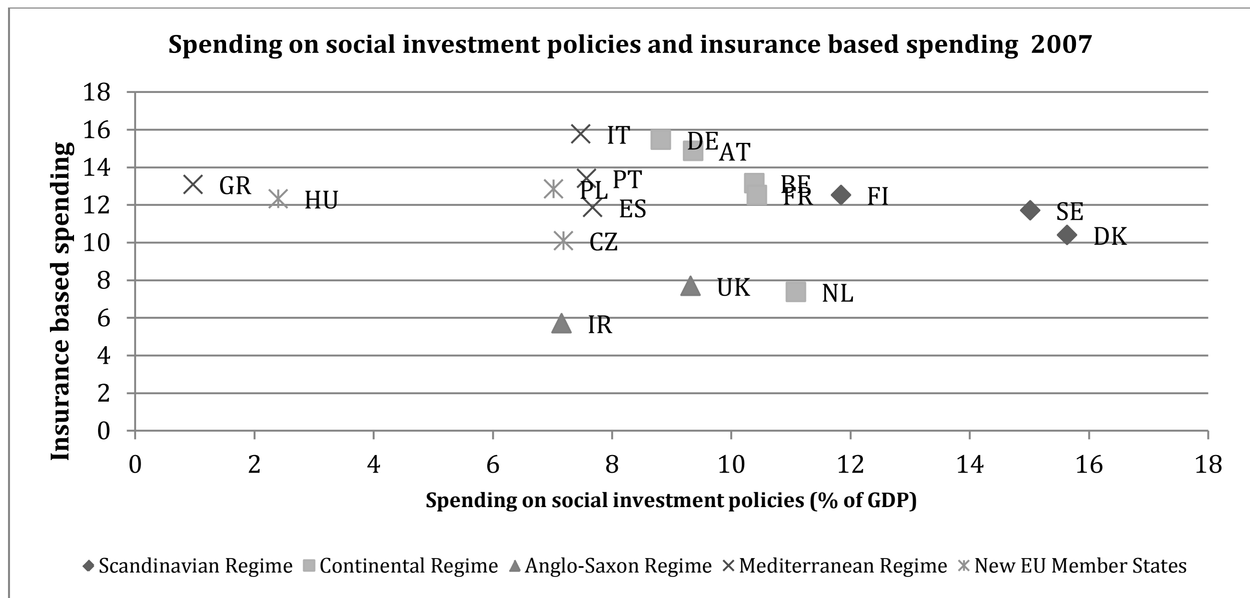
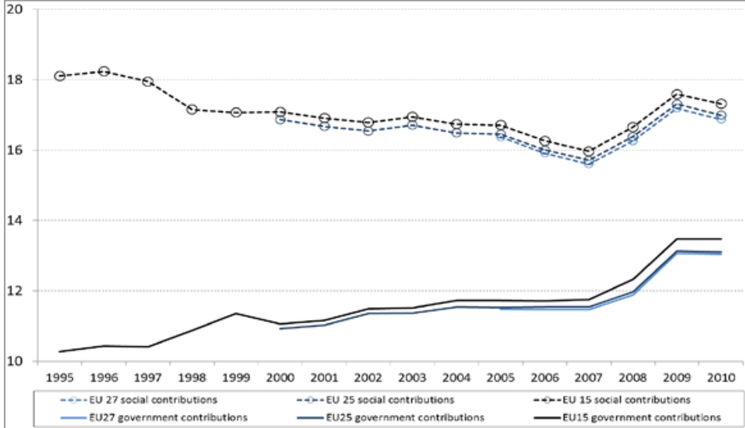
PL
AT
BE
FI
IT
ES
DE
FR
SE
DK
GR
CZ
PT
NL
UK
IR
HU
0
2
4
6
8
10
12
14
16
18
20
Spending on social investment policies (% ofGDP)
Scandinavian Regime
Continental Regime
Anglo-Saxon Regime
Mediterranean Regime
New EU Member States



Source: Own calculations using OECD Social Expenditure Database (SOCX), extracted October 2011.

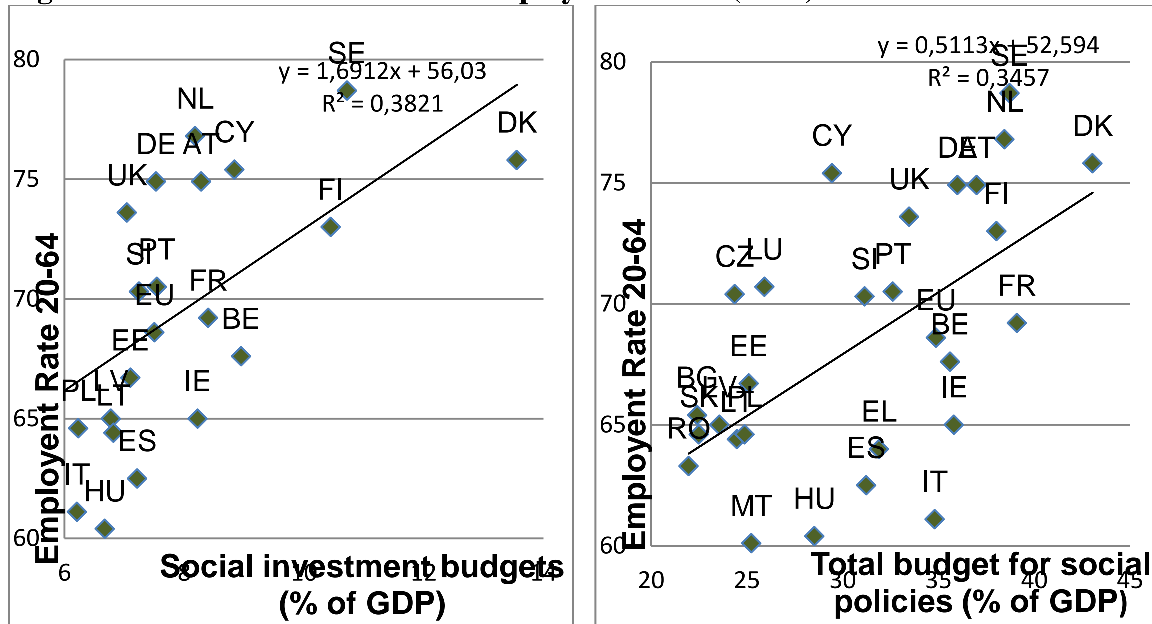
Notes: Spending on social investment policies include childcare, elderly care, education, active labour market policies, and maternal and parental leave; Spending on social insurance based spending includes old-age, survivors, disability pensions, excluding the rehabilitation expenses, and unemployment spending excluding expenses on active labour market programmes.

Figure 7 Trends in social protection financing structures (1995-2010)



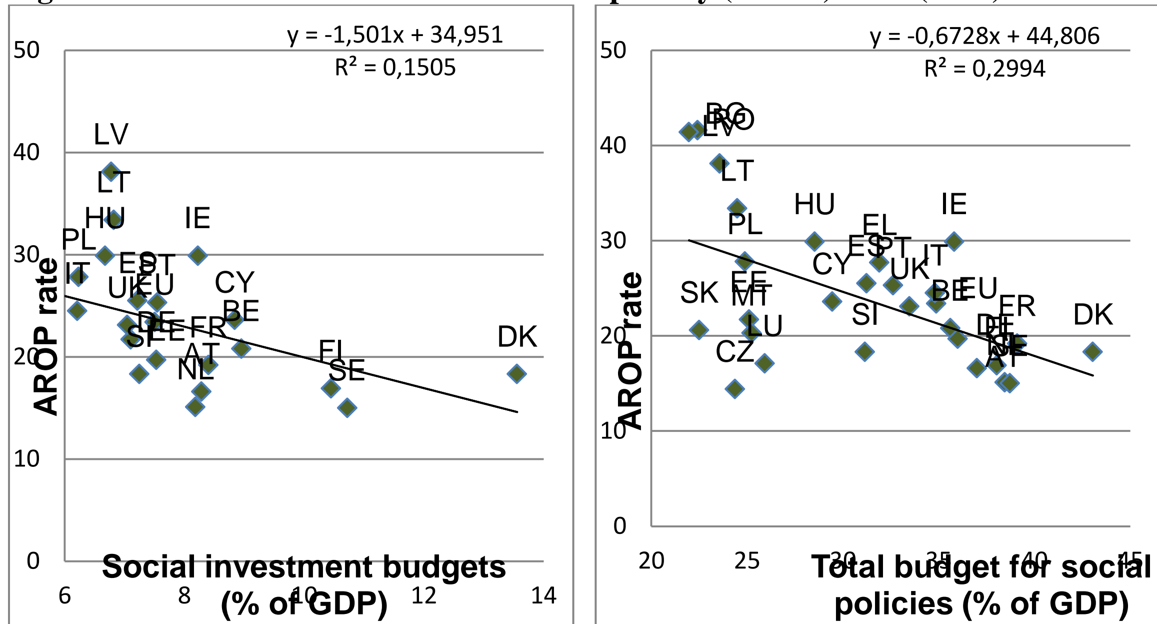
Source: ESPROSS.

Figure 8 — Social investment and employment rates (2010).



Source: Eurostat data, DG EMPL calculations.

Figure 9 — Social investment and at risk of poverty (AROP) rates (2010).



Source: Eurostat data, DG EMPL calculations.