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Retrenchment, Redistribution, Capacitating Welfare Provision, and Institutional Coherence After The Eurozone's Austerity Reflex

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Essays

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Beyond Value Significance and Positive Neutrality

Since the 1980s, various trends have fundamentally altered the policy environment of European welfare states. Because of greater capital mobility and accelerated European economic integration, fiscal pressures have increased. In addition, population ageing and declining fertility rates, together with a trend towards early retirement of baby boomers, have burdened pension systems. Rapid technological change has reduced the demand for low skill work in advanced economies. The shift towards a post-industrial labor markets has opened up job opportunities for women, but deindustrialization has also come with declining levels of steady lifetime jobs and rising job precariousness. Changing family structures and gender roles, with longer education spells, later child-birth, and lone parenthood, have created new tensions between work and family life and raised new demands for the provision of social care, especially for young children and the frail elderly. Together, "new" risks of social exclusion both within and outside labor markets have triggered growing income polarization between high-skill "dual-earner" families and low skill traditional male breadwinner and single parent households.

Although the drivers behind long-term socioeconomic change are common across Europe, the pressures they create for existing social policy repertoires, together with the policy responses they trigger have varied from country to country. The overriding argument I have tried to convey in my contribution in Socio*logica* is that while some welfare systems have been quite successful in *updating* their policy repertoires to these social transformations, others have fared less well, for various contextual economic, political and institutional reasons, in recalibrating welfare provision over the past two decades. Add to this the differential impact of the global financial crisis, and it is easy to see that European welfare states have entered a new era of flux, of major reform and adaptation to unfolding long-term social changes and short- to medium-term crisis aftershocks, with possibly adverse consequences for democratic governability. High and rising (youth) unemployment, strained pensions, and fiscal consolidation packages, enforced by recent EU agreements, will put enormous pressure on nationally elected politicians in the majority of EU Member States where citizens continue to hold high expectations of social protection from economic uncertainty.

Ugo Ascoli, Jean-Claude Barbier, Jason Beckfield, Giuliano Bonoli, and Joakim Palme have taken the time and intellectual energy to write out some thought-provoking and highly useful comments about urgent questions of early Twenty-first century domestic social policy and its now indissoluble link to European economic governance and sovereign debt crisis management, in response to my essay, for which I am extremely grateful. Their commentaries all bear on the issues of how I conceptualize, empirically research and normatively think about addressing the interconnections – both synergies and conflicts – between economic inefficiency and distributive equity in social policy in early Twenty-first century Europe in the aftermath of the global financial crisis. I am also sincerely thankful that the editor of Socio*logica* has given me the opportunity and ample space to respond to my eminent international colleagues. In my exposition below I wish to comment on five issues of contention.

1. An overriding critical issue, first, concerns some inherent ambiguities in my conceptual understanding of social investment by most commentators, especially Ascoli, Barbier, and Beckfield. I agree, especially, that the empirical categorization and measurement indicators of (non-)social investment spending requires real improvement.

2. A second contention bears on the empirics of policy change, with Ascoli, Barbier, and Beckfield, siding together in their assessment of the dominant trend as one of defensive and destructive social retrenchment rather than one of more responsive and proactive welfare recalibration. Jason Beckfield, most provocatively, even speaks about the "Americanization" of European social policy. Joakim Palme is more nuanced in his assessment, but he too raises deep worries about the negative correlation between growth and education spending and other perverse collective action trade-offs facing European welfare states.

3. As the critiques of Ascoli, Barbier, and Beckfield are backed up by evidence of rising inequality and poverty, I find it important, third, to dig a little deeper into

the extent to which the recent wave of welfare reform across Europe, informed in some places by social investment policy priorities, have come in tandem with negative consequences in terms of income redistribution and relative poverty.

4. A fourth predicament, raised in particular by Giuliano Bonoli and also Joakim Palme, concerns the functional interdependencies and institutional coherence between different areas of modern welfare provision coordinated through different arenas of actor constellations. Under strained finances, this issue of institutional coherence in policy repertoires, where – alas – the devil is in the details, will gain in importance in coming years.

5. My fifth and final response to the commentators addresses the supranational European dimension to contemporary welfare state collective action dilemmas. What economic and political room is there for EU institutions in managing the efficiency-equity frontier in the wake of the Eurozone sovereign debt crisis. Beckfield, Ascoli, Barbier and Palme are not particularly optimistic.

But before I proceed, I owe an intellectual apology to Jean-Claude Barbier. He is right to criticize my rather unprincipled departure from Max Weber's dictum of (axiological) value neutrality – "freedom from value judgements." Positive comparative institutional research, in line with the methodogical canons of Weber, I believe can provide us with practical policy inputs, which I would rather not dismiss for reasons of methodological orthodoxy! Social science contributions to the study of the modern welfare state, from Beveridge and Keynes to the Myrdals, Marshall and Titmuss and Esping-Andersen and many more, have produced a rich "doubly engaged" tradition of positive and normative social policy studies over the past century. Moreover, I do not believe Max Weber's – in his days highly controversial – methodological writings can be easily reduced to a uniform scientific doctrine. Weber himself even acknowledged to have sinned against dictum of distinguishing between empirical statements of facts and value judgements, as meaningful social science always relates to values (*Wertbeziehung*). Without practical and inevitably value loaded perspectives, it is impossible to discover the context of any causation in the unordered chaos of unrelated social phenomena [see also Käsler 1988]. A related lesson from Weber is that for an adequate understanding of social action we need to construct concepts to allow us, as researchers, to delimit what counts are relevant facts. Relying on inter-subjectively constructed policy concepts, such as "activation" and "social investment," we, as social policy researchers, often err to think that the effectiveness of "activation" is easily amenable to purely "value neutral" positive research, whereas the legitimacy of "social investment" can only be derived from a higher-order normative political philosophy, outside of the realm of empirical analysis. Weber's lasting contribution lies in the fact that he incorporated an understanding in of practical reason to causal consequences. As I learned from Fritz W. Scharpf, both policy effectiveness and legitimacy are evaluative concepts. Both *normative orientations* about the "good life," as political inputs into the policy process, and *cognitive orientations*, about effective realization in policy outputs in practice, harbour important causal consequences [Scharpf 1997]. Finally, as long as researchers continue to challenge, elaborate and reformulate (heuristic) concepts-in-use, like "retrenchment," "new social risks," and "social investment," to ever-changing social, economic, and political realities, according to Max Weber, social science progress is made.

When I was approached by Socio*logica* to contribute an essay based on the research done for my forthcoming book *Changing Welfare States*, I asked to venture a normative perspective, especially, given the political tide of EU enforced fiscal conservatism and its, to my mind, dire and unnecessary consequence for social policy continuity and change. The outcomes of the spring 2012 elections in France and Greece, local elections in the UK, and two important regional elections (Baden-Württemberg and North Rhine-Westphalia) in Germany, all testify to a popular backlash against the strict austerity measures promoted by the European Commission, the ECB, and the Merkel-Sarkozy tandem since 2010. Moreover, the political vacuum created by the results of the Greek elections in May brought a Hellenic exit from the Eurozone into the realm of – erstwhile unthinkable – possibilities, with potentially extremely dire contagion escalation effects. To the extent that necessary fiscal consolidation can be matched, as I have argued, with a more realistic (slower) pace of fiscal adjustment, coupled to participation and productivity enhancing social (investment) reforms, informed by readily available insights into the efficiency-equity frontier, the emerging clash between EU technocratic austerity and populist national welfare chauvinism can possibly be avoided. It is not that I am overly optimistic; I just wish to challenge the false necessities of the prevailing *pensée unique*. By taken this explicitly normative position, also to mark my contribution to Socio*logica* from my forthcoming more traditional social science book with OUP, as a political scientist, perhaps I went beyond my proper vocational jurisdiction – with the consent of Socio*logica*'s editorship!

Service-Intensive "Capacitating" and Benefit-Transfer "Compensating" Social Policy

Ascoli, Barbier, and Beckfield all raise important issues of conceptual clarity in my account of social investment progress across Europe. Especially, the distinction between "social investment" and "non-social investment" spending level warrants further conceptual precision and elaboration. It is true that a relatively equal distribution of incomes, reducing as it does dire poverty, should also be recognized as a "productive resources" for individuals, families and the economy at large. Security against the adverse effects of illness, disability, and unemployment, old age, divorce, and child-bearing is of value to citizens who are protected by social policy but also to society and the economy at large, on which the burden of the costs of poverty and social instability would fall if there were no social protection provision. Adequate social protection in terms of income support during periods of short-term unemployment may reduce the search costs for new jobs, fostering more efficient employment matches. Moreover, universal social protection potentially enhances, rather than distorts, labour market flexibility. Similarly, a comprehensive system of collective bargaining permits macro-economically responsive wage setting. Even employment protection, together with legally sanctioned worker participation through works councils, can contribute to competiveness by engaging workers in production and training processes, which are beneficial to both the social climate and productivity. Finally, social protection and budgetary expenditures are powerful stabilizers of economic activity because they help sustain effective demand in times of recession. This kind of Keynesianism through the backdoor continued to prove highly functional in response to the credit-crunch after the Lehman Brothers bankruptcy in the fall of 2008.

In other words, as Ugo Ascoli rightly underlines, the argument of "social policy as productive factor" cannot be singularly applied to active labour market policy, affordable childcare, generous parental leave arrangements, lifelong learning, and care for aged. It should be extended also to a number of "traditional" social protection programs. From this perspective, indeed, a simple dichotomy between "social investment" and "non-social investment" welfare spending categories is perhaps obscure. In thinking through this critique, I would now rather trade the ambivalent concept of (non-)social investment for two alternative dimensions, by distinguishing between "service-oriented" *capacitating* welfare provisions and "benefit-transfer" *compensating* social program categories. Both dimensions are important to address the changing structure of social risks, but they do not overlap, although in terms of their causal effects they really should be studied in tandem. Assessing the level of efficiency of social spending in a cross-country comparison requires performance indicators for both the *capacitating* and *compensating* welfare function, associated with the importance of service delivery and poverty reduction capacities of the welfare state, respectively.

At the core my argument is that social investments programs create important returns. Although comparative welfare regime analysis at the macro level supports the plausibility of this particular claim, cost-benefit policy analyses of social programs only measure the budgetary costs of welfare programs, never really their economic returns. Scholars hardly ever measure the longer term impact of providing high quality education, neither in terms of macroeconomic consequences of competitiveness nor in terms of stratified individual life chances. Likewise, we lack hard policy analysis of the impact of early childhood education and parental leave arrangements in terms of reconciling work and family life, active labour market policy interventions on levels of employment participation and earnings, especially of (married) women, and also the assumed long term cognitive and social skills advantages of high quality childcare. There is a dire need for more dynamic efficiency social policy analysis.

Is Social Retrenchment the Overriding Master Trend in European Social Reform?

According to Barbier, the overall reform momentum since the 1980s, has largely been inspired by considerations of "cost-containment" and "re-commodification," rather than more positive "social investment" priorities. More polemically, Jason Beckfield believes that I really miss the "forest before the trees," which adds up the "Americanization" of the European social model(s). My assessment, in terms of both substantive reforms and policy outputs is more qualified. Again I agree with Ugo Ascoli that overall scope of social reform across the member states of the European Union is more heterogeneous, disparate, and uneven than my overview for Socio*logica* allows for. Central to my empirical argument is that predominant "new politics" of the welfare thesis of protracted *welfare state inertia*, rooted in political constituency constraints of electoral retribution and organized interest obstruction against retrenchment, cannot be generally corroborated. Welfare reform dynamics are difficult to gauge in terms of a crude "black-and-white" dichotomy of more or less retrenchment, depending on the relative strength of reform opposition. On balance, the picture again is more nuanced and colorful. Trajectories of welfare reform in many countries are as much *proactive* and *reconstructive* as merely *defensive* and *deconstructive*, depending in important ways on the institutional capacities of policy systems to generate processes of policy learning that ultimately allow policy makers to enact and implement alternative (effective and legitimate) solutions to (failed) retrenchments. In terms of policy substantive, I argue that social policy reforms have indeed become more "employment-centred." This included a drive towards greater labour market flexibility and strong emphasis on "making work pay" in social insurance provision. I do not believe that employment turn can be equated to social retrenchment tout court, as Barbier and Beckfield seem to suggest. From a purely neoliberal retrenchment perspective, social policy is understood as (passive) "redistribution," with adverse labor market mobility incentives that go at the expense of economic competitiveness. Efficient markets and fiscal prudence are the catchwords in the retrenchment agenda so as to support job growth, private wealth creation, and also to keep future social commitments at bay. There is alternative "employment-centred" reform strategy, based on the notion of (active) "productivist" social policy, serving to increase labor supply and productivity through "capacitating" family, training, and employment services. In other words, conceptually, we can distinguish two pathways to more sustainable employment participation: a "low road" of fiscal austerity, deregulated labor markets, and minimal income protection, and a "high road" of social investment employment creation, supported by affordable child care, work and family reconciliation, skill formation, lifelong learning, and aged care. The available evidence suggests that the "high road," if institutionally available, is able to produce much better, more productive, more competitive and sustainable, job growth, than the "low road" of less productive low-pay and low-quality job growth. A policy strategy based solely on marginal economic incentive effects of unemployment benefits pales in comparison in increasing overall labor supply at higher levels of productivity throughout the life course through capacitating social policy provisions. Turning again to the empirics, as I highlight in my essay, alongside retrenchments, in various welfare regimes there have been deliberate attempts to capacitate individuals, families and institutions more actively in addressing contemporary social risks, associated with intensified international competition, increased life expectancy, gender role and family change, the shift to a service economy, skill-biased technological change, and the de-standardization employment relations. In terms of social spending, we discern a long-term decreasing trend of spending on working age cash benefits relative to GDP, in the Nordic, Anglo-Irish and Continental welfare states. While total spending remained fairly constant, substantial increases in health care and old age spending, to be sure, stand out for reasons of demography. But for the working age population, we find substantial catching-up dynamics in the relative weight of spending on social services in most European countries. This rapprochement between cash-benefit programs and social services, seem to have mitigated processes of job polarization between work-rich and work-poor households in the UK and Ireland. Throughout the past decade, on the other hand, as Ascoli and Bonoli highlight, social service provision remained underdeveloped in Southern Europe, while retrenchment further dualized social protection systems and labor markets. My key point is not that all is well, but that the overall pattern of welfare state change is not one of uniform social retrenchment.

Although Joakim Palme does not take side on this issue, he nonetheless is deeply worried about the negative correlation between economic growth and education spending, which is central to the social investment perspective, as a proportion of GDP [Lindh and Palme 2006]. Although I agree with him that much more could have done to invest in future tax payers through early childhood development, general education, vocational training and lifelong learning, I am not per se convinced that public education spending as a proportion of the GDP is the right indicator for this. The level and quality of future employment relies as much on public as on private spending on human capital resources. More important, demographics need to be factored in. Following my own calculations, public spending per student has in fact gone up over the past decade in most European countries, while private spending on lifelong learning, often supported by the social partners, have also experienced an upward trend in the more competitive Nordic welfare states, but also in the Netherlands, Germany, and Austria. Under conditions of fiscal austerity, there is a future case to be made to invest more in early childhood education and care with public money, while at the same time require higher private contribution in tertiary education, particularly after the bachelor phase.

In a recent unpublished book chapter Frank Vandenbroucke [forth.] has raised another critical caveat with respect to social spending indicators. The relatively economically prosperous periods, from 1994 to 2001 and again between 2004 and 2008, significant declines in unemployment helped some European welfare states to reduce social spending. Spending declines, resulting from economic and employment growth can surely not be equated with social retrenchment. The same logic applies to active labour market policies. With lower levels of unemployment, lower public spending on active labour market policies could easily go with higher spending on individual jobseekers. Vandenbroucke also underscores that the relative success of the employment turn, whether inspired by the "low road" of social retrenchment or the "high road" of social investment, not merely served to reduce working-age households dependency on passive cash transfers. Equally important is that savings enabled the more successful welfare states in this respect to gradually shift resources to pensions and health to better address the economic and social consequences of accelerated demographic ageing.

Given the available qualitative and quantitative evidence, we are well advised to resist easy generalizations about the complex dynamics of changing welfare states. An underspecified polemic of "Americanization" of European social model(s) is particularly unhelpful. According to the former chief economist at IMF, Raghuram Rajan, the lack of adequate welfare provision played a particularly important role in the growing private indebtedness in the US economy since the 1980s. Growing job insecurity and the general stagnation of wages of the American middle class since the late 1970s were compensated by easy credit and subprime mortgages, allowing spending patterns of the squeezed middle to be kept up by reductions in household savings and mounting private indebtedness. In other words, in a free-wheeling "dis-embedded" market environment, access to easy credit and subprime mortgage loans to low-income households seemingly replaced the welfare state as the basis of the American social contract. Weak social safety nets, growing inequality, and increasingly unequal access to education and privatized healthcare have, since the 1980s, as a consequence, deepened the fault lines of the overleveraged US economy, and tempted consecutive American governments and the Fed to pursue extremely risky expansionary fiscal and monetary policies [Rajan 2010]. In contrast, the competitive strengths of Scandinavian economies, before and after the 2008 credit crunch, can be recognized as in part a product of their expensive, active, and capacitating, universal provisions in areas of work, care, and welfare. This evidence surely goes against the argument that all European welfare states are on a general course of American-style social retrenchment. On the other hand, this should not deter us from gaining a better understanding of the welfare-related competitiveness gaps in the Southern Eurozone periphery, especially for Greece and Italy, which seem inherently related to their antiquated passive, pensioner-biased, social contracts and two-tiered labor markets, encouraging job polarization, while inhibiting both quality employment opportunities and adequate social protection and services supports for women, youngsters and single parent households, as Bonoli also argues.

Inequality Revisited

In Jean-Claude Barbier's critique of social investment (as cost-containing and re-commodifying retrenchment) relative poverty increases play an important role. In agreement with recent work of Bea Cantillon [2011], Barbier infers that many welfare states have become decidedly less "pro-poor" in their redistributive profiles. Indeed, the Nordic countries, with their historically low poverty rates, have over the past decade become more inegalitarian. This warrants the question to what extent the "employment turn" and the related "social investment" edifice are not plagued by perverse "Matthew effects," with the middle class disproportionally benefiting from the shift to welfare services as these are generally less redistributive than traditional income programs? To what extent does social investment advocacy, with its emphases on new social risks, gender equality, human capital, activation, and family servicing, renege, perhaps unintentionally, on the classic protective functions and redistributive goals of the modern welfare state? Is it true that by reallocating social expenditure from "passive" social security benefits to "active" capacitating servicing activation, today's poor have been left aside? To the extent to which capacitating services, training and employment supports, parental leave programs and services for the frail elderly, cater after the employed, capacitating services are indeed less redistributive than traditional passive social assistance programs.

We should, however, not overestimate the impact that the welfare state has on income inequality trends per se. Increasing wage differentials and the decreasing redistributive capacity of taxes and benefits are jointly to be held responsible for increasing inequality [Brandolini and Smeeding 2009]. To a large degree the significant increase in equality in the first decades after the Second World War was the result of growing productivity of low-skilled labour that made incomes rise faster at the bottom than at the top. In recent years, globalization- and technology-driven increased demand for (highly) skilled workers has surely contributed to the growing wage disparity between unskilled and skilled workers. In addition, the post-industrialization of the economy, with its stagnating productivity in service jobs, may also be partly responsible for the major U-turn in the progress towards greater equality. Moreover, measures of (relative) inequality are misleading, since they are rather static indicators. When unemployment grows and many people receive benefits, statistically speaking, societies become more equal. By contrast, under conditions of high job growth, even at generous social insurance benefit levels, societies statistically become poorer in relative terms [Atkinson *et al.* 2002; Atkinson 2008]. To estimate redistribution and poverty as outcomes of welfare state efforts, we therefore need better information about the economy, including primary income distribution, before we are able to assess the effectiveness of social policy interventions. The problem is also that the welfare state is always already implicated in the primary income distribution, if only because the welfare state itself is an important employer [Esping-Andersen and Myles 2009, 639].

Can social investments counteract growing inequalities? Phd research by Maria Vaalavoa on family services in Denmark, France, the Netherlands, Slovenia, Spain, and the United Kingdom reveals that the shift towards social investment, in terms of spending, has not adversely disturbed the redistributive character of these welfare states [Vaalavuo 2011; see also Vandenbroucke and Vleminckx 2011]. On the contrary, capacitating social investments in childcare and educational benefits have smoothed the gap in income distribution. Given adequate and efficient minimum income protection, social investment should really be seen as an important precondition for keeping social inequalities at bay. It may be the case that job expansion allows for an increase in wage inequality, but investing in individuals' skills will help them to move into better jobs over time, which in turn reduces the risk of low wages and inactivity traps in turn. As argued by Nelson and Stephens [2012], human capital investment can promote growth in high-end and high-quality service sector employment and shift low-end services from price competition over to quality competition, thereby increasing the value-added (individual and societal) returns of these jobs. By the same token, the costs of a universal daycare policy can easily be reimbursed by working mothers via higher tax payments and social contributions throughout their working lives. As daycare minimizes women's employment interruptions, cumulative lifetime earnings increase, implying higher future tax revenues [Esping-Andersen and Sarasa 2002]. In other words, capacitating provisions can be successfully directed towards single parents on social assistance income support, provided that access to labour market is also available and generally promoted. The goals social policy need to be articulated in relation to how social risk profiles are changing. To maximize life chances, providing services and capacities to families are becoming more important. This should, however, not be mistaken as advocating the abolition of minimum and employment-related income protection.

Managing Social Policy Coherence

Throughout our increasingly heterogeneous life course dynamics a vast array of interdependent institutional arrangements complement each other: family, care and work, industrial relations, social insurance and minimum income protection, training and education, and employment services, pensions and services for the elderly, etc. The changing nature of social risks and strategies of social risk management must therefore be assessed, as Giuliano Bonoli underlines in his important commentary, by how substantive policy mixes of *social protection* and *social investment*, embedded in and supported by what forms of institutional governance, are best able to address and mitigate the (new) social risks concerning welfare, work, schooling, care and family demography. Social risks management today is, therefore, as much about identifying and implementing effective social policy provisions as it is about institutional coordination among social programs and program-specific actor constellations.

Policy choices are never made in institutional isolation. Political objectives, according to Joakim Palme, can only be achieved under highly discrete institutional conditions. Important social policy institutional characteristics relate to how social provisions target risk groups, under what conditions of reciprocity, how they are financed and embedded in tax systems, how they are run by public and/or private actors and monitored by independent agencies. Some existing institutions and policy legacies are far better able to incorporate social investment innovations than others. The comparison of family policy in Flanders and Sweden by Van Lancker and Ghysels [2012] underscores the importance of overall policy coherence, with Swedish care demonstrating that perverse Matthew effects are not inevitable. The Swedish childcare system is considerably more pro-poor thanks to its universality, with childcare slots guaranteed for every child from age one onwards and tariff related to disposable income. But this can only really work if labour regulation encourages female entry, supported by policies of gender equality and parental leave arrangements. It is impossible to study early childhood education and care in isolation from the institutional opportunities of mothers to participate in the labour market and have access to training.

Increasing (female) employment, therefore, should go hand in hand with developing policy mixes that offer broad access and clear incentives to use childcare services. I also concur with Palme that family formation (fertility) has to be taken into the efficiency-equity equation. Welfare states gain an interest in family formation and wellbeing when women are increasingly engaged in gainful employment. Flexible employment relations need to be supported by adequate parental leave arrangements in order to better balance careers and family life.

Institutional "goodness of fit" is not easy to come by. Existing institutions often enable existing clienteles and providers to mobilize defensive shields against path-departing social reforms. Under current crisis conditions, as a consequence, social protection arrangements which continue to guarantee jobs for life and/or high social benefits to labor market insiders, disincentive to lifelong learning promotion and productive employment mobility, as Bonoli argues, with the result of excessive youth unemployment. Tax systems that penalize dual earner couples offset opportunities to raise employment participation for the parents of young children. Labor market divisions between insiders and outsiders reduce the effectiveness of human capital investments in disadvantaged groups which remain confined to labor market segment of precarious work and short terms contracts. In the absence of formal family services, adult family members are expected to provide more informal care at a time which constrains that employment opportunities and, at the same time, reduces tax revenue. In terms of financing, the devolution of social policy responsibilities and financing to firms, employers, and the social partners, can exacerbate "insider-outsider" cleavages in existing welfare programs. While sometimes publicly funded welfare services provided by private firms can improve tailor-made service delivery, they also require additional public monitoring and improved auditing. In terms of administrative capacities, to the extent that welfare states are becoming more service oriented, this requires much improved public administration and professionalization, also with respect improved tax collection and corruption fighting. Especially, the effectiveness of social investments depends on the "capacitating qualities" of the services provided. For contemporary social policy to be successful, the devil, therefore, is in the details of coherence in substantive policy mixes and institutional coordination across social services and transfers, in close connection to labour market governance arrangements.

Overcoming the Political Deficit of Social Europe

Can European welfare states survive the latest stage of the Eurozone's sovereign debt crisis, and, if so, in what shape will they re-appear from the resolution chosen? Joakim Palme is correct to warn against the impossibility of chasing moving targets. But as a starting point, he justly intimates that further economic and political integration can only be successfully achieved if European citizens support these advances, and that this is conditional on popular trust in democratic governments able to handle the social consequences of the crisis. That said: managing crisis consequences is no longer the sole prerogative of the national welfare state. Since the onslaught of the global financial crisis, Eurozone economies have become more deeply connected than ever before. As political leaders have stepped up Eurozone "economic governance" efforts, also their domestic "social citizenship contracts" have become more interdependent. Closer integration implies that welfare policy proficiency (or deficiency) in one country strengthens the prosperity (or stagnation) of the EU economy as whole and vice versa. With public social spending averaging between 20 to 30 per cent of GDP, European welfare states are powerful macroeconomic buffers. On the other hand, macroeconomic policy leeway has been tightly constrained since the outbreak of the Greek sovereign debt crisis. Today EU fiscal adjustment agreements are practically forcing countries in dire straits to give up on the Keynesian "automatic stabilizers" that proved so effective in 2009 after the Lehman bankruptcy induced credit crunch.

Since early 2012, we have witnessed a particularly strong backlash against austerity recipes, in Greece, France, but also in Germany, the United Kingdom and the Netherlands. Betwixt rising anti-austerity national protests and the EU's inquisitive demand for overnight fiscal consolidation, a "political vacuum" has emerged at the heart of the integration project. The more the European Commission steps up austerity, the more European voters, from Greece to France, the Netherlands and Finland, seek refuge with extreme anti-EU left and right populist parties. This trend is not new, however. Already before the near economic meltdown of 2008, middle class fears of falling behind, especially of their offspring, invoked a nostalgic narrative of "golden age" welfare paradise lost, pitted very much against the alleged globalizing ambitions of the EU.

As I write these sentences, Greece may as yet, after two tranches of EU and IMF loans and ECB banking supports, to be forced to exit from the euro currency bloc, despite the fact that 80 per cent of the Greek electorate wish to remain in the Eurozone. While some experts believe that an orderly "Grexit" can be managed; other observers fear an unpredictable cycle of escalating sovereign debt contagion, running from Portugal to Spain, Ireland, and Italy, and possibly even France, triggering the ultimate downfall of the euro. Collectively, EU institutions have all the action resources to contain contagion. In addition, the EU understood as a single economy, is in public debt and deficits in better shape that the US and Japan. Eventually, it is political will that will decide over the fate of Europe's single currency.

An *economic policy regime* failure lies at heart of the Eurozone's political conundrum. The original policy theory of EMU was benignly based on the faulty assumption that a strong ECB mandate on price stability and an equally strong drive towards fiscal consolidation by Member State governments, enforced by the Stability and Growth Pact, would inevitably raise competitive pressures among the Member State economies. Greater competition in financial and product markets, as a consequence, would translate into greater tax and cross-border labor markets competition. But as labor markets and welfare provisions are largely political arrangements, through their commitments to the Stability Pact and the success of EMU, democratic governments would agree to launch incisive reforms in their welfare states and labor markets, if need be by blaming the EU for their inevitability. The architects of EMU, in short, conceived that the new macroeconomic policy regime would naturally trigger "structural" social reforms, resulting in Pareto-optimal economic growth hikes all across the European Union. The Eurozone sovereign debt crisis has critically exposed the weakness of the underlying policy theory, exemplified by the by the high current account deficits in Greece, Spain, Portugal, Ireland, and Italy, housing bubbles in Ireland, the Netherlands, and Spain, and current account surpluses in Germany and the Scandinavian countries. No happy equilibrium has been forthcoming. The introduction of EMU did not trigger path-breaking labor market and welfare reforms. On the contrary, the low interests that came along with EMU slowed down the proactive welfare reform momentum in countries, with passive and insider-biased welfare states and labor markets, which perhaps needed reform the most. At the same time private parties (consumers and banks) took on ever greater heaps of cheap debt, leading to risky asset and housing bubbles. Paradoxically, it was the current account surplus countries, more concerned with competitiveness, such as Germany and the Nordic countries, which intensified the social reform momentum after 1990s.

In the spring of 2010, the EU's political leadership decided to correct earlier mistakes, to wit, on the basis on the same faltering economic policy theory of EMU and the Stability and Growth Pact, to be enforced with much greater vehemence than ever before, through strict EU legislation (the so-called "Six Pack"), forging particularly tough austerity conditions and real sanctions on the alleged profligate economies of the European periphery, reinforced by the December 2011 "Fiscal Compact."

We know from comparative institutional analysis that policy change is largely driven by the political exposure of policy failures, the articulation of alternative policy theories, and practices policy emulation from new successful countries in line with the new policy theory. By exposing policy design mistakes, providing alternative policy theories, and demonstrating new policy effectiveness, policy paradigms change can be promoted, tried and legitimized [Hall 1989; Hall 1993; McNamara 1999]. All these institutional ingredients of policy change are currently gaining in political salience.

1. *Policy failure exposure.* The real economy consequences of pre-emptive austerity are increasingly self-defeating, given the negative growth numbers in Greece, Portugal, Spain, Italy, Belgium, the Netherlands, and France. Moreover, protracted austerity reinforce already existing vulnerabilities, built-up during the first benign phase of currency integration, with, as a consequence, in Europe's national banking systems. Rations of gross public debt to gross domestic product are rising, not falling in distressed economies. As a consequence, real economy divergences between the competitive North, paying close to zero interest rates on moderate public debt and government deficits levels and manageable rates of unemployment, and the uncompetitive South, facing exceedingly high spreads on debt and deficits and two-digit levels of unemployment, with youth unemployment at politically unmanageable rates of close to 50 per cent in countries like Spain and Greece, with Portugal, Italy, and Ireland trailing behind with 30 per cent.

2. *Alternative policy theory articulation.* Practically all leading European economists believe that a fiscal union is essential for the survival of EMU. In the absence of fiscal solidarity, Eurozone economies with unsustainably high interest rates have no room for maneouvre. Belated "structural reform" offers no relief in an asymmetric adjustment process, with countries in difficulties continuing to deflate while countries in better shape refusing to inflate. Many economists agree that in the face of such destabilization, ECB monetary policy can no longer be primarily targeted to inflation to safeguard financial stability across the Eurozone. The Eurozone needs a fiscal union supported by Eurobonds. In addition, the necessary adjustment to past policy mistakes, having built up for over a decade, requires a longer time stretch of policy attention and political effort to correct, for an integrated market cum monetary union to work.

3. *Political mobilization against standard operating policy.* The availability of an alternative policy theory is never enough; its advocates have to be supported by democratic electorates. Political enthusiasm for fiscal austerity is receding rapidly across the European North and South. The election of François Hollande, based on his advocacy to "give growth a chance" is challenging Angela Merkel's "austerity orthodoxy." He has already pressured the German chancellery to give the ECB an additional mandate to restore economic growth. Fiscal consolidation has to be matched to a more realistic pace of "medium term" adjustment and structural reform.

4. *Policy emulation.* Over the past decade, it has become increasingly clear that the high tax / high spend economies in Northern Europe have performed better on most Stability Pact and Lisbon Agenda indicators, than even Germany. This reveals that Europe can afford expansive system of social protection, provided that policy repertoires are designed in a social investment fashion. *Ex negativo*, Southern European uncompetitiveness is inherently related to social investment backwardness.

Both the survival of the Eurozone and the ongoing recalibration of the welfare state, today conjure up a democratic predicament with national as well as European dimensions. The social consequences of the sovereign debt crisis are increasing pressures on national governments in both domestic social policy and supranational economic policy arenas. A Pareto-superior welfare policy mix comes with a comparative advantage for Europe and an orderly resolution to the sovereign debt crisis is a sine qua non for the survival of the welfare state. And to the extent that social reforms are seen as fair, they are likely to gain more political support.

Taxation is of crucial importance. Joakim Palme is however doubtful about the room for progressive taxation in the aftermath of the financial crisis. I am less sanguine. That the crisis has tightened budget constraints 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. There is ample room for a European agreement on minimum tax rates and harmonized EU rules on capital taxation [Scharpf 2009a]. 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 VAT-taxes on luxury goods, which is already a novel trend across EU Member States.

In terms of *political* feasibility, what matters is that European citizens are not ready today to renounce popular national welfare programs, such as pensions, unemployment benefits, labour market protection legislation, and high quality universal healthcare. In terms of *policy effectiveness*, comparative analysis about the costs and benefits of *social austerity* politics and *social investment* policy strategies renders decision-makers crucial evidence that a long-term social investment strategy is imperative in times of demographic ageing. Moreover, the social investment edifice is at least rhetorically in line with Europe's 2020 policy strategy, based explicitly on the commitment to "inclusive growth," aimed at "fostering a high employment economy delivering economic, social and territorial cohesion." To given Europe 2020 more bite, Structural Funds could be granted at fiscally constrained Member States under the proviso that subsidies should be spent on social investment policy priorities.

The political momentum for an orderly reconstruction of the Eurozone's economic governance regime is, however, rapidly fading. At this critical juncture, it is important not to discount the massive achievements of half-a-century of European integration. In the aftermath of World War II, the EU brought peace, prosperity, social fairness and political stability to the largest market in the world. Economic progress and prosperity, combined with decent standards of living for everyone, has produced a model of social capitalism that many other advanced and emerging economies aspire to. Its modus of community integration, moreover, allowed the original European Community of six countries to expand to 27 Member States today. In the process, European integration served to solidly anchor the young democracies of Greece, Portugal, and Spain in the 1980s and 1990s. And after the fall of the Berlin Wall, the EU successfully expanded its geopolitical reach to 10 former communist countries in Central and Eastern Europe. The desire of most former Yugoslavian countries to join continues to testify, even today, to the European Union's attractiveness as a regional bloc of peace, prosperity, and social progress.

The social and economic policy challenge is to make *long-term* social investments and *medium-term* fiscal consolidation mutually supportive and sustainable, under improved economic governance, following the logic of a fiscal union. A more political European Union requires real solidarities in both economic terms and social terms. But these are hard to come by, especially in the current epoch, as Beckfield and Ascoli indicate, also because they have never been politically cultivated and nurtured. Public apathy, low turnouts at European elections is being replaced by Euroscepticism, nationalism, and anti-immigration populism. We also know from comparative welfare state studies that "positive integration" at the EU level should not compete with existing national policy repertoires [Scharpf 2009b]. It is better to launch new initiatives in addition to nationally programs. A "social investment pact," bolstered social investment project bonds, and more generous human capital promoting access to the Structural Funds, discounted in national budget accounts, could be another step towards a Pareto-superior "caring Europe," based on better domestic solidarity and supranational European solidarity supports. The EU has an excellent track record in subsidizing infrastructure and agriculture. It is time to move on to EU social investments up scaling as an inextricable ingredient to European Twenty-first century social capitalism.

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Retrenchment, Redistribution, Capacitating Welfare Provision, and Institutional Coherence After The Eurozone's Austerity Reflex

Abstract: A Reply to Ascoli, Barbier, Beckfield, Bonoli and Palme 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.

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