Department of Social Policy Centennial Lecture

Fault Lines and Silver Linings in the European Social Model(s)

Professor Anton Hemerijck
LSE Centennial Professor, Department of Social Policy

Professor David Soskice
School Professor of Political Science and Economics, LSE

Dr Waltraud Schelkle
Associate Professor of Political Economy, LSE European Institute

Professor David Piachaud
Chair, LSE

Suggested hashtag for Twitter users: #LSEHemerijck
Fault Lines and (too few) Silver Linings in the European Social Market Economy

An essay in possibilism

ANTON HEMERIJCK, VU UNIVERSITY AMSTERDAM, LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE (LSE); COLLEGIO CARLO ALBERTO, TORINO

LSE, 11 June 2014
OUTLINE

1. The politics of policy reform: *Changing Welfare States*
2. Changing social risks *and* *social Investment*
3. Crisis aftershocks and **three fault lines** in E(M)U design
4. A period of transition: **three silver linings** (but too few) on Europe 2020 horizon
5. Competing institutional **explanations** of state we’re in
6. Toward a **currency union of ‘active’ welfare states** – *where there’s a way, there is a will!*
THE POLITICS OF WELFARE REFORM
• Sequel to *Why We Need a New Welfare State* (OUP, 2002) – with Esping-Andersen, Gallie and Myles) – *Social investment agenda setting*

• Do we see *social investment pro- and regress*, and what has the EU to do with it? *Welfare state reform is difficult, but it happens!* Why, how, and to what effect?

• Background assumption: *welfare state is what makes capitalism compatible with democracy!* (pace – Streeck: irreconcilable contradictions in democratic capitalism)
OPEN INSTITUTIONALISM – TWO-LEVEL TRANSFORMATIVE CHANGE

• We live in a world of path-dependent solutions
  • Institutionally dense environments with considerable staying power (including prevailing policy paradigms)

• History does not preclude transformative change
  • *Drift*: slow erosion of existing rules (no deliberate correction) in face socioeconomic change
  • *Recalibration*: proactive enactment of existing rules for strategic re-deployment (with *policy learning* feedback)

• Beyond ‘methodological nationalism’ (Single Market/EMU)
  • Systemic EU rule making – *preserving/accommodating* or *burdening/corroding* (semi-sovereign) welfare state provision (with what economic and political consequences)

• Heuristic room for two level change agency
  • Radical institutional reconfiguration unlikely!
CHANGING RISKS AND SOCIAL INVESTMENT
CHANGING NATURE OF SOCIAL RISKS

The social risks of the life course and the labor market have fundamentally become less predictable – and thus less *insurable* in a strict actuarial sense.

Welfare states in advanced economies are more than ever pressured to raise the quantity and quality of enabling or *capacitating* social services, not easily provided for by markets, to equip and assist people to surmount the increasingly uncertain hazards of the labor market and the life course they face, alongside safety net buffers.
THREE PERIODS OF EU-WELFARE STATE DEVELOPMENT AND THE ROLE OF THE MACRO ECONOMY

1. Great Depression (financial crisis and WWII - demand)
   **Search for Stability** – ‘embedded liberalism’ 50/60
   - compulsory social insurance (Beveridge) as economic stabilization (Keynes) – ‘effective demand affinities’
   (baby boom) in shadow European market integration

2. Great Stagflation (real economy crisis - supply)
   **Challenge of Flexibility** – ‘institutional liberalisation’
   80/90 – stable money/sound budgets/market liberalization (OECD) (last quarter baby boom enter labour market)

3. Great Recession (financial crisis – demand/supply)
   **Resilience Imperative** (adaptive capacities in face of ageing and international economy volatility)
Policies aimed at ‘preparing’ individuals, families and societies to respond to new social risks of the internationalized competitive knowledge economy, by investing in human capital and capabilities from early childhood through old age, such as education and training, active inclusion, and child and elder care, rather than in policies that simply ‘repair’ damages after moments of economic or personal crisis.
1. Raising the quality of human capital ‘stock’ over the life course from the young to the old (cumulative returns)
2. Easing the ‘flow’ of contemporary labour market transitions in line with (gendered) life course dynamics
3. Upkeeping/upgrading strong minimum-income universal safety nets as social (income) protection and economic stabilization ‘buffers’
4. Devil in detail synergy of “institutional complementarities” (child care, labour market regulation, and activation goodness of fit) – different for variegated welfare regimes facing diverse (external and internal) challenges
CRISIS AFTERSHOCKS AND E(M)U FAULT LINES
AFTERSHOCKS

1. Financial crisis – credit crunch – real economy crisis – “fire brigade Keynesianism” to save banks (and jobs)

2. Banking crises triggers sovereign debt crisis – turn to “intrusive austerity” (salvaging policy regime ex ante)

3. Euro crisis – belated recognition that macroeconomic stabilization is more than targeting inflation and deficits (ECB ‘lender of last resort’ OMT and fiscal bailouts)

4. Political (national) and institutional (EU) legitimacy crisis, deepening imbalances in face low growth – little light at end of tunnel provoke perverse narratives (2014 European elections “marker moment”)
THREE FAULT LINES

• **Myopic design EMU**: without a fiscal backstop – internal devaluation only adjustment strategy available (taken more seriously in ‘bad’ than ‘good’ years Greece/Italian entry; FR/DE 2004 - Troika/MoU/Fiscal Compact)

• **Intergovernmental drift**: institutional rule-based minimalism since Maastricht unfit to effectively respond to crisis (18 EMU member and 28 Single Market members) Strong economies take over agenda-setting from Com.

• **Rise of national welfare chauvinism**: economic nationalism in hard times undermine legitimacy European solutions. Muddling-through procrastination deepen imbalances, fueling economic nationalism, further narrow scope supranational crisis management that does justice to systemic EMU interdependency (and SME)
1. EMU theory - **axiomatic** (‘new classical’ supply economics) - gender, family, skill and age blind

2. **Trade-off** between efficiency and equity

3. Primacy of market allocation (**negative state** theory)

4. **Baumol cost disease** (services burden competitiveness)

5. Overriding policy problem – **cost containment** (ageing)

6. Engineer **risk-shift to private sector** preferred response

7. EMU design (**stable money** – **sound finances**, without fiscal/monetary backstop) disciplining **market liberalization** - *retrenchment/privatization/deregulation*

8. **Institutions** as ‘market barriers’ misused by ‘distributive coalitions’ of ‘rent seekers’ (read: trade unions)

9. Political discourse TINA (**European social model dead**)
For Germany and Northern economies as trading partners can no longer devalue, EMU renders favorable context for export-led growth.

For Southern periphery low interest rates set stage for high growth, domestic expansion, easing pressure on public debt/deficits reduction (i.e. reform), encouraged by huge large financial flows from Northern banks on lookout for secure (sic!) investments.

Single Market/EMU inter-governmentalism allow politicians to maintain the pre-crisis illusion of national welfare-state sovereignty and shift easily to post-crisis narrative of “profligate and lazy Greeks and thrifty and industrious Germans”
SOCIAL (UNEMPLOYMENT) IMBALANCES AS CONSEQUENCE SYSTEMIC EMU INTERDEPENDENCY
(Too Few) Silver Linings
PERIOD OF TRANSITION (WHATEVER IT TAKES)

1. **Changing welfare states** (wave proactive welfare reform compatible to currency union and sustainable public finances)

2. **Social Investment Package 2013** Enhancing EU support domestic social investment reform on basis of new institutional settlement (in theory) between European economic governance and active welfare states

3. **Social dimension of EMU rekindled** – political exchange squaring (social investment) supply and (EMU) demand stabilization
PROACTIVE WELFARE RECALIBRATION IN SHADOW OF MONETARISM (MORAL HAZARD MITIGATION)

- Cost-competitive wage moderation
- Selective sobering up social insurance (no ‘dismantling’)
- Activation conditionality and active labour market policy
- Labour market de-segmentation (“flexicurity”)
- Minimum income protection (more universalism)
- Multi-pillar pension reform (life expectancy factored in)
- Dual earner family support (facilitating female employment and early childhood development)
- Human capital (re-)discovered as ‘life course buffer’
- Financial hybridisation (from social insurance to general taxation and private contributions) with spending convergence upward in Southern/NMS before crisis
- Governance change (aligning benefits and services) requires positive macro domestic coordination/local capacitititating service/EU mutual learning by monitoring
EMPLOYMENT/POPULATION RATIO
FEMALE ACTIVITY RATE AGED 25-54 FROM 1987 TO 2007
FEMALE EMPLOYMENT AND FERTILITY 2008

The graph shows the relationship between the participation rate of women in the labor force and the fertility rate across different countries in 2008. The x-axis represents the participation rate of women, and the y-axis represents the fertility rate. The countries are marked with diamonds and include Ireland, France, Belgium, United Kingdom, Denmark, Sweden, Finland, Netherlands, Germany, Austria, Portugal, Spain, Czech Republic, Poland, Slovakia, Hungary, Italy, and Greece. The data points suggest a positive correlation between the two variables.
FEMALE EMPLOYMENT AND FERTILITY 1983

The graph illustrates the relationship between the participation rate of women and their fertility rate across various European countries in 1983. The countries included in the graph are Ireland, Spain, Greece, Portugal, Finland, Sweden, Denmark, Germany, Italy, Netherlands, and Belgium. The graph shows a negative correlation between the participation rate of women and their fertility rate, indicating that as the participation rate increases, fertility rates tend to decrease.
EMPLOYMENT RATE OF OLDER WORKERS

Employment rate of older workers (55-64)

- Sweden
- Germany
- France
- Netherlands
- United Kingdom
- Spain
- Italy
- Czech Republic
EMPLOYMENT, LIFE LONG LEARNING AND EXIT AGE
EARLY SCHOOL LEAVERS
GINI COEFFICIENT

The chart shows the Gini coefficient for various countries in 1997 and 2007. The countries include Denmark, Finland, Sweden, Belgium, Germany, France, Netherlands, Austria, Ireland, United Kingdom, Greece, Spain, Italy, Portugal, Lithuania, Czech Republic, Hungary, Poland, and Slovakia. The Gini coefficient ranges from 15 to 40, with higher values indicating greater inequality.
EMPLOYMENT PROTECTION STRICTNESS (OECD)
KEY TRENDS PRECEDEING FINANCIAL CRISIS

• Upward employment convergence (women/older workers)
• At-risk-of-poverty standstill – erosion redistributive capacity of the welfare state (non-actuarial risk change)
• Polarization ‘work-rich’ – ‘work-poor’ households
• Clear shift towards social investment (ALMP, child-benefits, childcare services, parental leave and life long learning) not “crowding out” competitiveness.

Employment centered (Lisbon) reform success, but growing inadequacy of (passive) social protection for adults and children living in low work-intensity households – Social investment welfare states do better on most if not all economic and social indicators!
COMPETING EXPLANATIONS: INSTITUTIONAL INCOMPATIBILITY OR FAILURES UP FOR CORRECTION?

Hypothesis I: different political economies – one based on export-led growth and another based on demand-led domestic expansion – incompatible with “one-size-fits-(n)one currency union” (Southern Europe now trapped in worst both worlds unable to reflate/forced to retrench)

Hypothesis II (open institutionalism): Contingent convergence with unanticipated consequences (myopic design EMU, cognitive capture Great Moderation, financial globalization, German unification, glass half-full and missed reforms) open to correction through slow policy learning and systemic E(M)U transformation (requiring significant political mobilization beyond “mere unwillingness/inability to give up EMU”)
UNANTICIPATED WELFARE DIVERGENCE UNDER EMU

Nordic (fiscally robust dual earner model)
> Social investments stand the test of the crisis (with lower benefits - normalization)

Continental (beyond “welfare without work” trap)
> Germany and France gradual endorsement of social investment, but depressed demand reinforces dualisation and frustrates service sector (job) growth
> Netherlands procyclical social investment in ‘good’ and retrenchment in ‘hard’ times

Anglo-Irish (genuine social investment not enough to fight inequality)
> Procyclical social investment in ‘good’ and retrenchment in ‘hard’ times – private debt overhang resulting from aggressive financialization

Mediterranean (institutional fragmentation/reform fatigue)
> Low interest rates EMU triggered reform standstill in Greece and Italy (public debt overhang) and house price bubbles in Spain and Portugal. Sovereign debt crisis requiring intrusive ‘internal devaluations’ by Troika/MoU (because of EMU fault lines and intellectual capture) pre-empting (much needed) social investment, most likely leading to more (rather than less) divergence
SOCIAL INVESTMENT PACKAGE
SOCIAL DIMENSION EMU
EU SOCIAL INVESTMENT REINFORCEMENT (BEYOND LISBON LIP-SERVICE)

Without a magic growth driver, sustainable employment best guarantee for growth and social cohesion in ageing European societies: social investment ‘stocks’, ‘flows’, and ‘buffers’ »crowd in« (high family-sensitive [flexicure] human capital utilization) as opposed to »crowding out« private initiative

Positive-sum complementarities for working families:

- Child-centered investment strategy
- Human capital investment push
- Active labour market policies and inclusion
- Reconciling work and family life
- Later and flexible retirement (with permanent adult education)
- Migration (circular) and integration through education and participation
- Minimum income support ‘buffers’ aligned to capacitating social service provision
- Health care: saving lives and costs (by quality learning through monitoring)
SOCIAL DIMENSION EMU: FOUR OPTIONS

1. **Eurobonds** – easy to administer, but vetoed (by Germany), and only address demand (not supply resilience)

2. **European unemployment insurance top up** – difficult to agree in detail, not vetoed, addresses social imbalances (but not per se long term resilience/insider-biased)

3. **Social investment project bonds** – administered on ready experience social and structural funds, *if generous and long-term* can address system resilience, while incentivizing domestic reform ownership

4. **Discounting social investments from SGP rules**
AFFORDABLE SOCIAL INVESTMENT AFTER THE CRISIS
E(M)U democracies are welfare states (like all OECD countries). Without real (social) convergence EMU unsustainable (hunch): existential interest to redress social asymmetries.

Social investment (because of positive macroeconomic effects) must be prioritized and anchored in EU macroeconomic and budgetary governance and financial regulation to support durable and balanced growth. Human capital cannot be allowed to go to waste through semi-permanent inactivity in ageing societies (as in 80s and 90s).

Achieving long-term symmetry by collective action and supranational instruments (Eurobonds/EU unemployment insurance/Project Funds) – in “conditional reciprocity” over realistic social (investment) reforms with stronger (fiscal) monitoring (education as important as pensions).

EMU as political construction must be politically recreated - frame ‘European social model as long gone’ accelerates its demise.

Political bonus: social investment more easily couched in attractive conception of a “caring”, “capacitating” and “competitive” Europe2020, flexible enough to re-launch ‘contingent convergence’.
Policy drift under austerity not only option

- limited evidence insider-biased pension status quo politics: fundamental inter-generational contract change (only in countries that were left of the hook by EMU flaws)
- new social risk policy innovation: significant spending increases on active labor market, family and child policy (despite absent coherent coalitions)

Why so much proactive welfare recalibration?

- Converging family aspirations founded in deep social contract legacy:
  - decent work for everyone and ‘dual earner’ capacitating care provision in reciprocity new E(M)U legitimacy ticket
<table>
<thead>
<tr>
<th>Gradual but transformative reorientation</th>
<th>Social austerity drift (formal unified axiomatic) 2010</th>
<th>Social Investment stabilization (empirical institutional heterogeneity) 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy problem</strong></td>
<td>Cost containment (cuts)</td>
<td>Revenue raising (returns)</td>
</tr>
<tr>
<td><strong>Core policy imperative</strong></td>
<td>Engineer “risk shift” to private sphere (Baumol cost disease)</td>
<td>Maximize employment in open economy (service productivity bonus)</td>
</tr>
<tr>
<td><strong>Policy theory</strong></td>
<td>Trade-off ‘equity and efficiency’ “crowding out” private economic initiative (capital market efficiency/welfare state moral hazard)</td>
<td>Social investments “crowd in” private initiative and competitiveness through higher employment and upskilling across life course (devil in detail)</td>
</tr>
<tr>
<td><strong>Policy instruments</strong></td>
<td>Labour market deregulation, privatization social services, and targeted minimum poverty protection ex post (inequality inevitable/fair in new economy)</td>
<td>Mitigate life (gender sensitive) cycle contingencies ex ante through human capital ‘stock’ upgrading, labour market ‘flow’ desegmentation, with strong universal safety net ‘buffers’</td>
</tr>
<tr>
<td><strong>Macro policy</strong></td>
<td>Procyclical balanced budgets: Fiscal Compact, Troika, MoU, with sanctons (hysteresis best tackled through institutional liberalization)</td>
<td>Economic stabilization is more than fighting inflation and balanced budgets: Sailing - counter-cyclically - against wind) focus on inclusive growth</td>
</tr>
<tr>
<td><strong>Theory state</strong></td>
<td>One-size-fits-all take out market barriers through contracting out, while disciplining low-trust, rent-seeking ‘distributive coalitions’ (trade unions)</td>
<td>Diverse institutions both constraints and resources (public regarding social partners), ‘productive coalitions’ and quality public services help mitigate Baumol disease (local optima)</td>
</tr>
<tr>
<td><strong>Political discourse</strong></td>
<td>TINA (“European social model is dead” – Mario Draghi 2012)</td>
<td>Capacitating, caring and competitive Social Market Economy</td>
</tr>
</tbody>
</table>
Have 2014 EP elections scared the political center strong enough to get their act together on social investment and demand-friendly EMU 3.0 and help them cross the Rubicon towards a Pareto-optimal political union of ‘active’ welfare states – for which a grand coalition Commission and Council is imperative? I hope so! What about the UK?
THANK YOU
Department of Social Policy Centennial Lecture

Fault Lines and Silver Linings in the European Social Model(s)

Professor Anton Hemerijck
LSE Centennial Professor, Department of Social Policy

Professor David Soskice
School Professor of Political Science and Economics, LSE

Dr Waltraud Schelkle
Associate Professor of Political Economy, LSE European Institute

Professor David Piachaud
Chair, LSE

Suggested hashtag for Twitter users: #LSEHemerijck

LSE events