Department of Social Policy

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

Dr Waltraud Schelkle

Associate Professor of Political Economy, LSE European Institute

Professor David Soskice

School Professor of Political Science and Economics, LSE

Professor David Piachaud

Chair, LSE

Suggested hashtag for Twitter users: **#LSEHemerijck**

LSE events

CPD CERTIFIED
The CPD Certification Service

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

VU VRIJE UNIVERSITEIT AMSTERDAM
Faculteit der Sociale Wetenschappen

- 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

VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

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** ecomomy crisis - **supply**)

Challenge of Flexibility – 'institutional liberalisation' 80/90 – stable money/sound bugets/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)

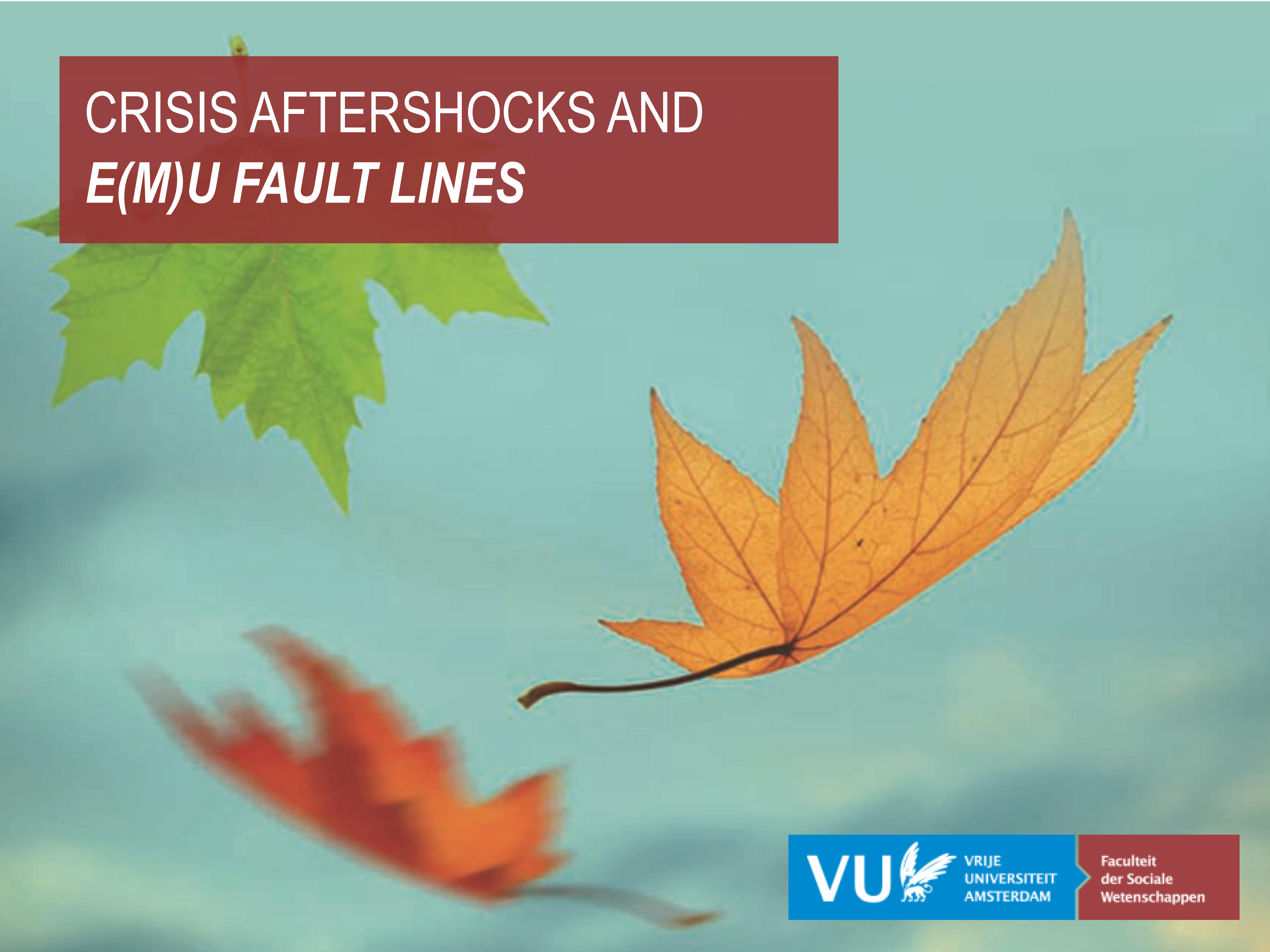
SOCIAL INVESTMENT

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.

CONCEPTUAL OPERATIONALIZATION: **STOCK, FLOW, AND BUFFERS IN INSTITUTIONAL COMPLEMENTARITY**

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*



VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

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)

BEHIND EVERY MACRO ECONOMIC REGIME THERE IS A THEORY OF THE (WELFARE) STATE

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***)

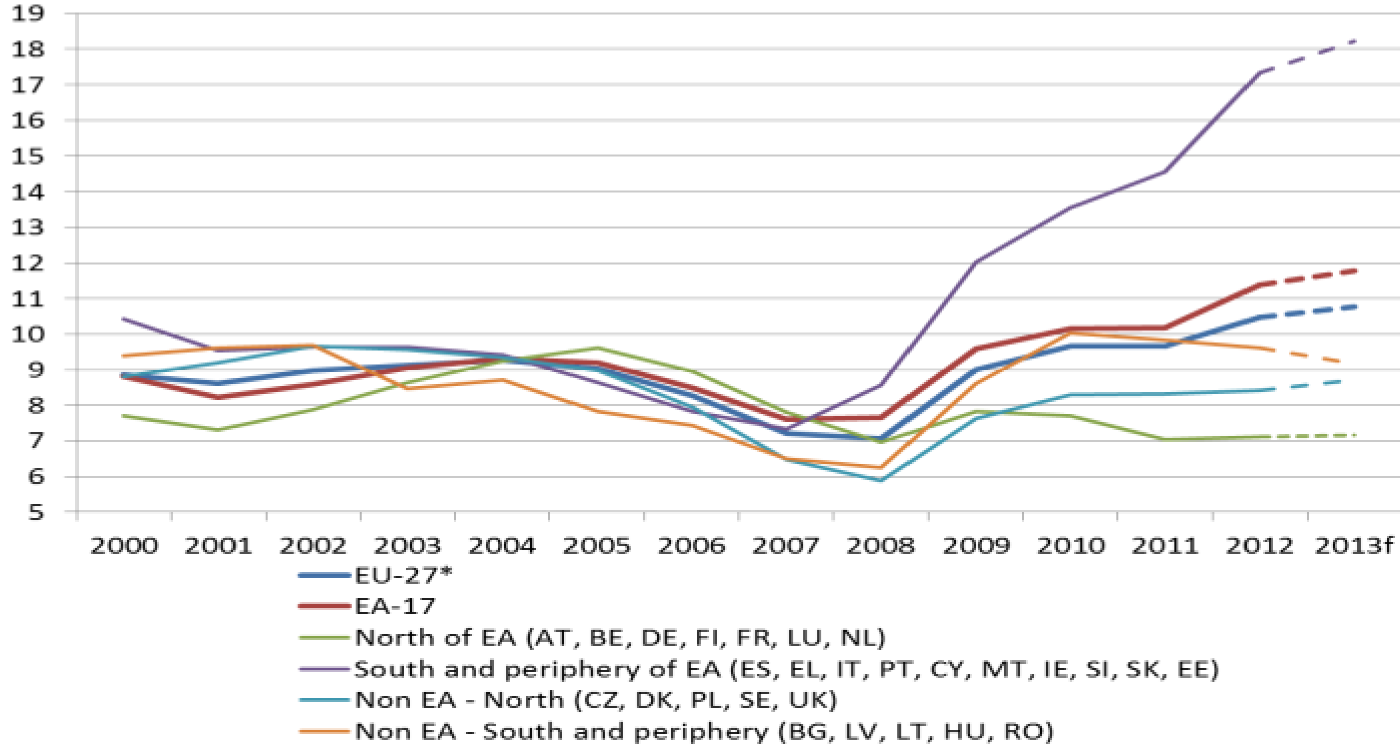
FAULT LINES DEEPLY EMBEDDED IN ECONOMIC STRATEGIES AND INTERESTS (ALBEIT UNSUSTAINABLE)

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

VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

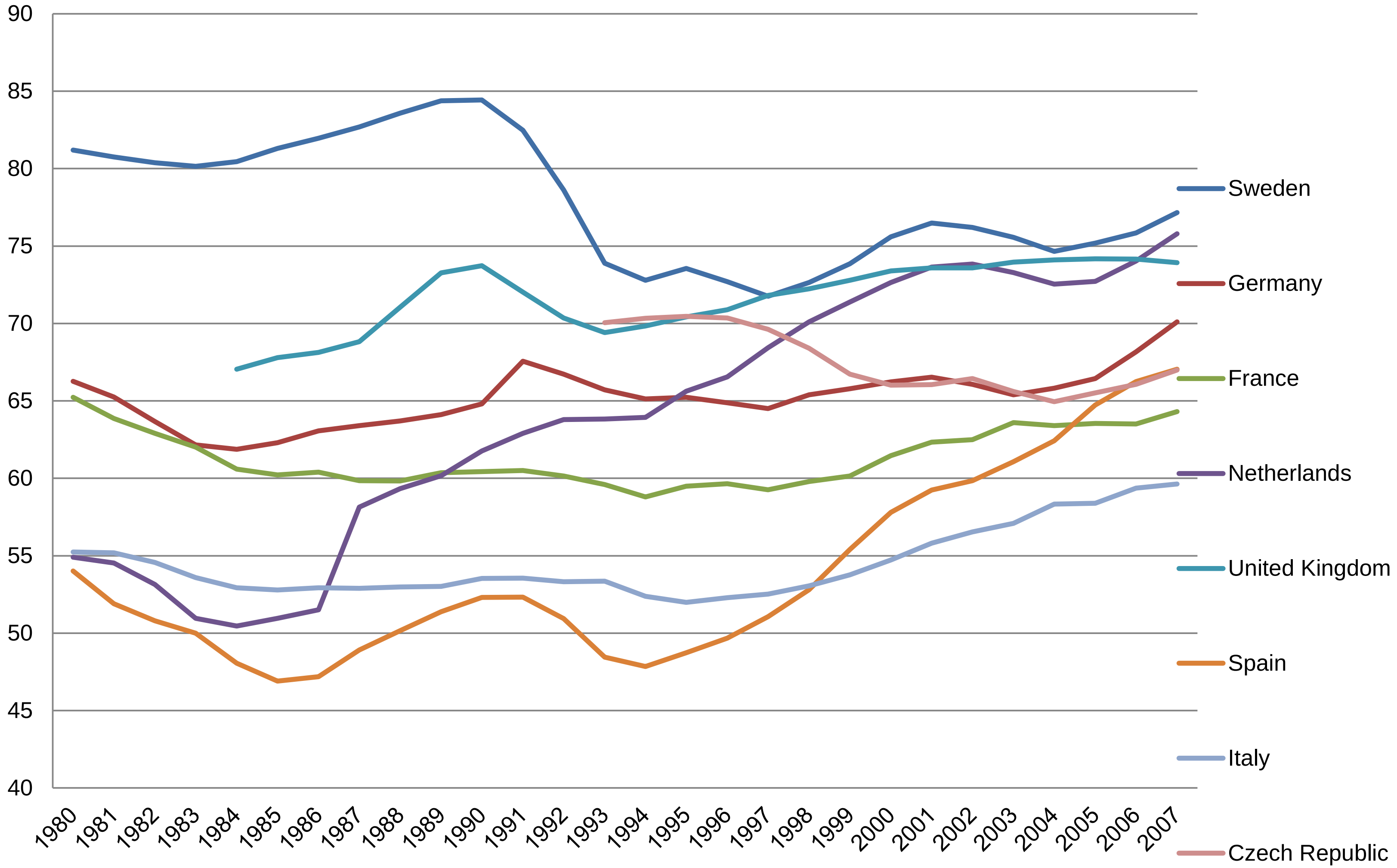
PERIOD OF TRANSITION (WHATEVER IT TAKES)

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*

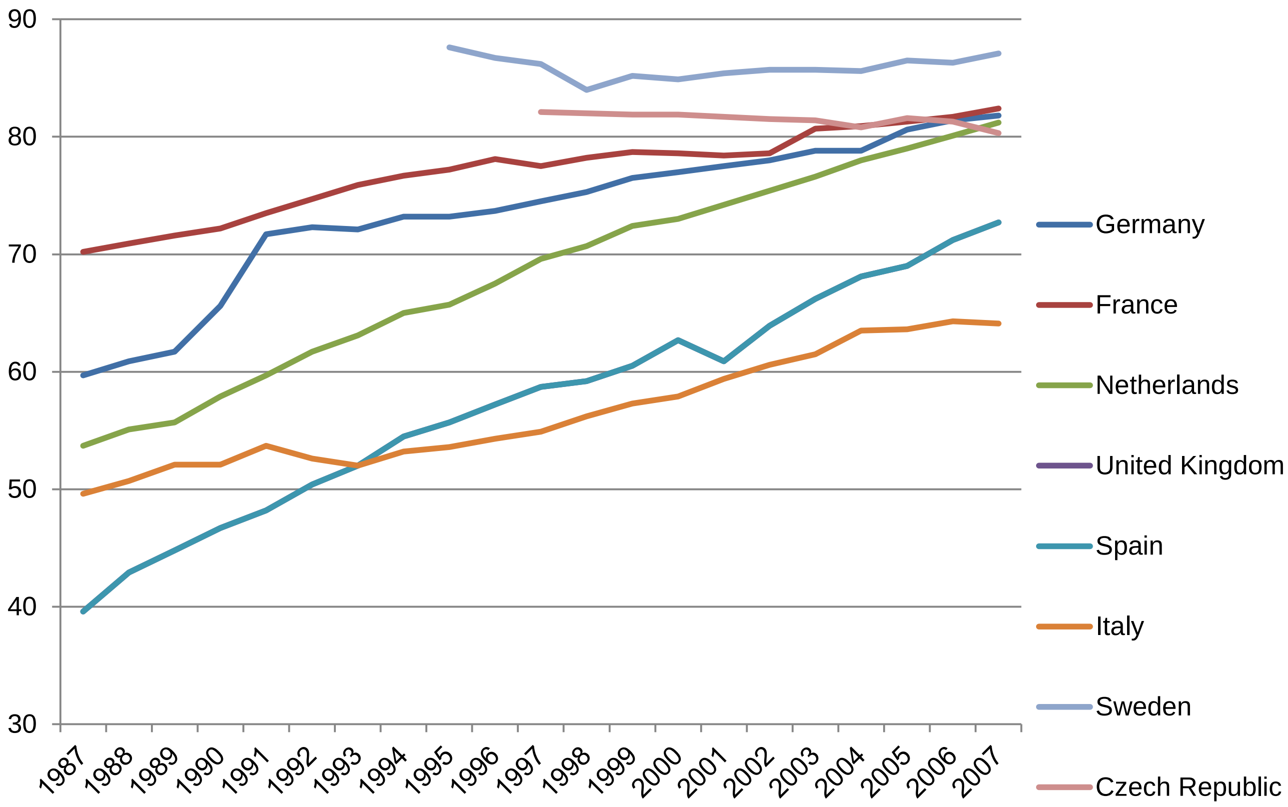
PROACTIVE WELFARE RECALIBRATION IN SHADOW OF MONETARISM (MORAL HAZARD MITIGATION)

- 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 capacititating service/EU mutual learning by monitoring

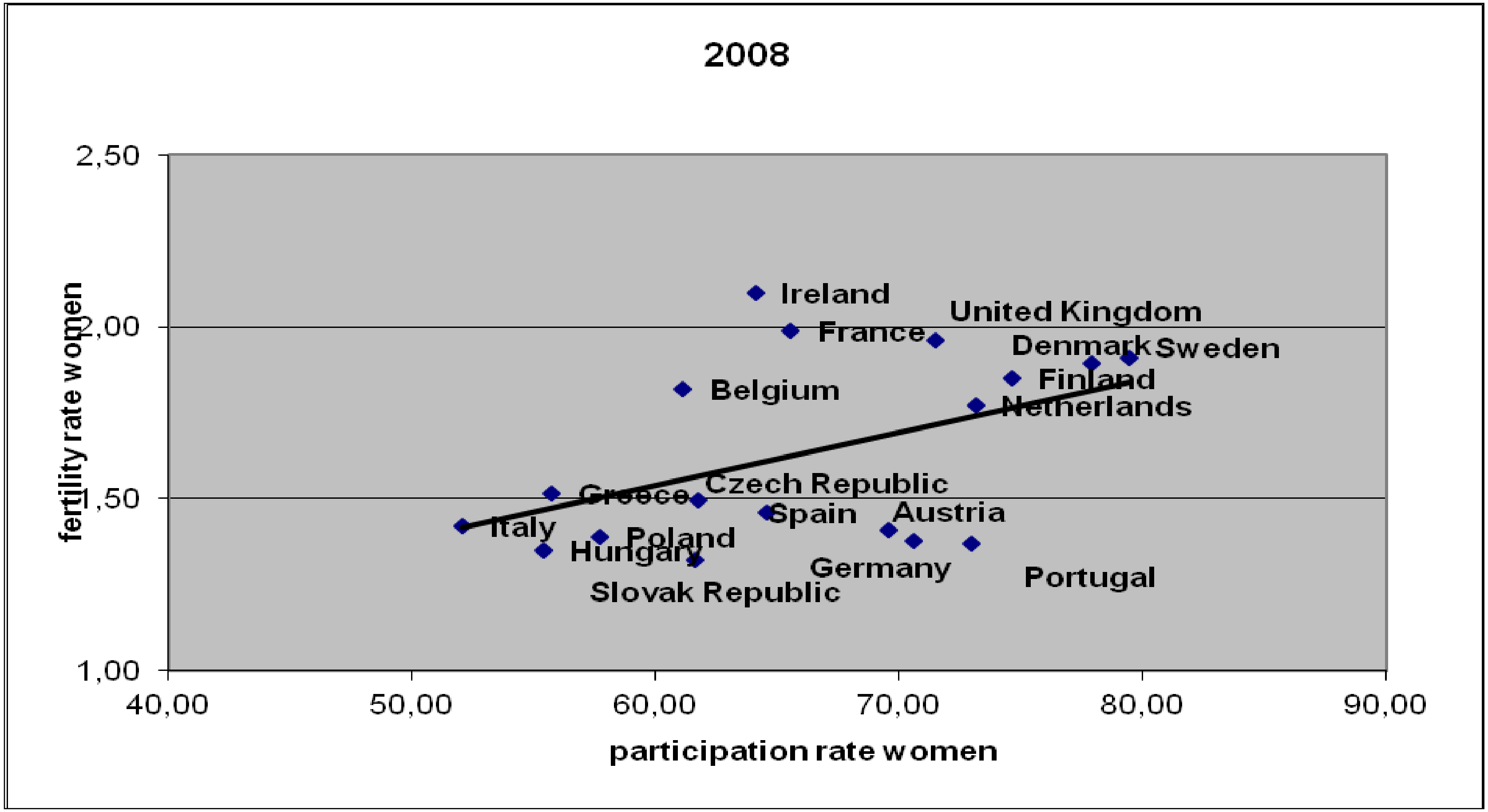
EMPLOYMENT/POPULATION RATIO



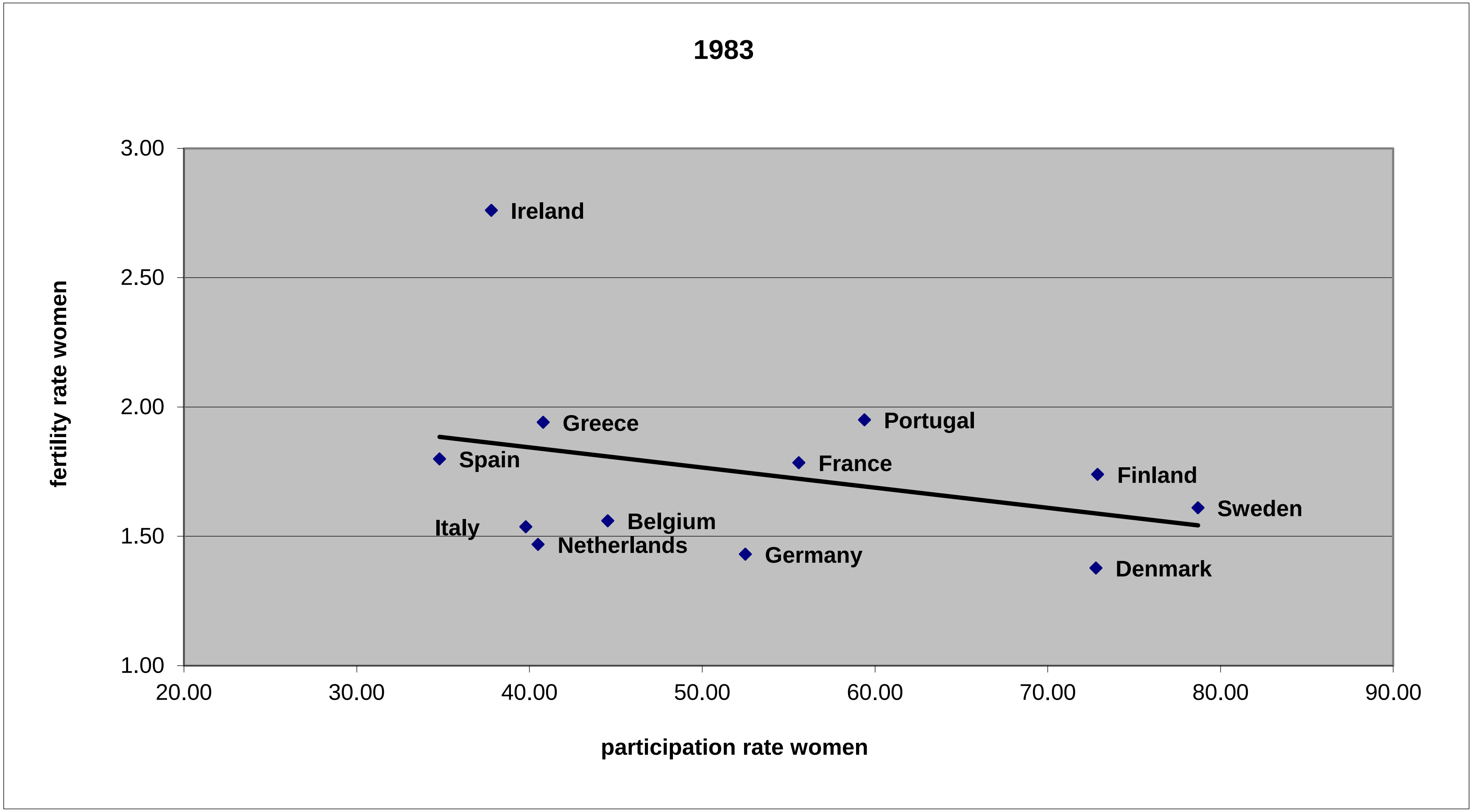
FEMALE ACTIVITY RATE AGED 25-54 FROM 1987 TO 2007



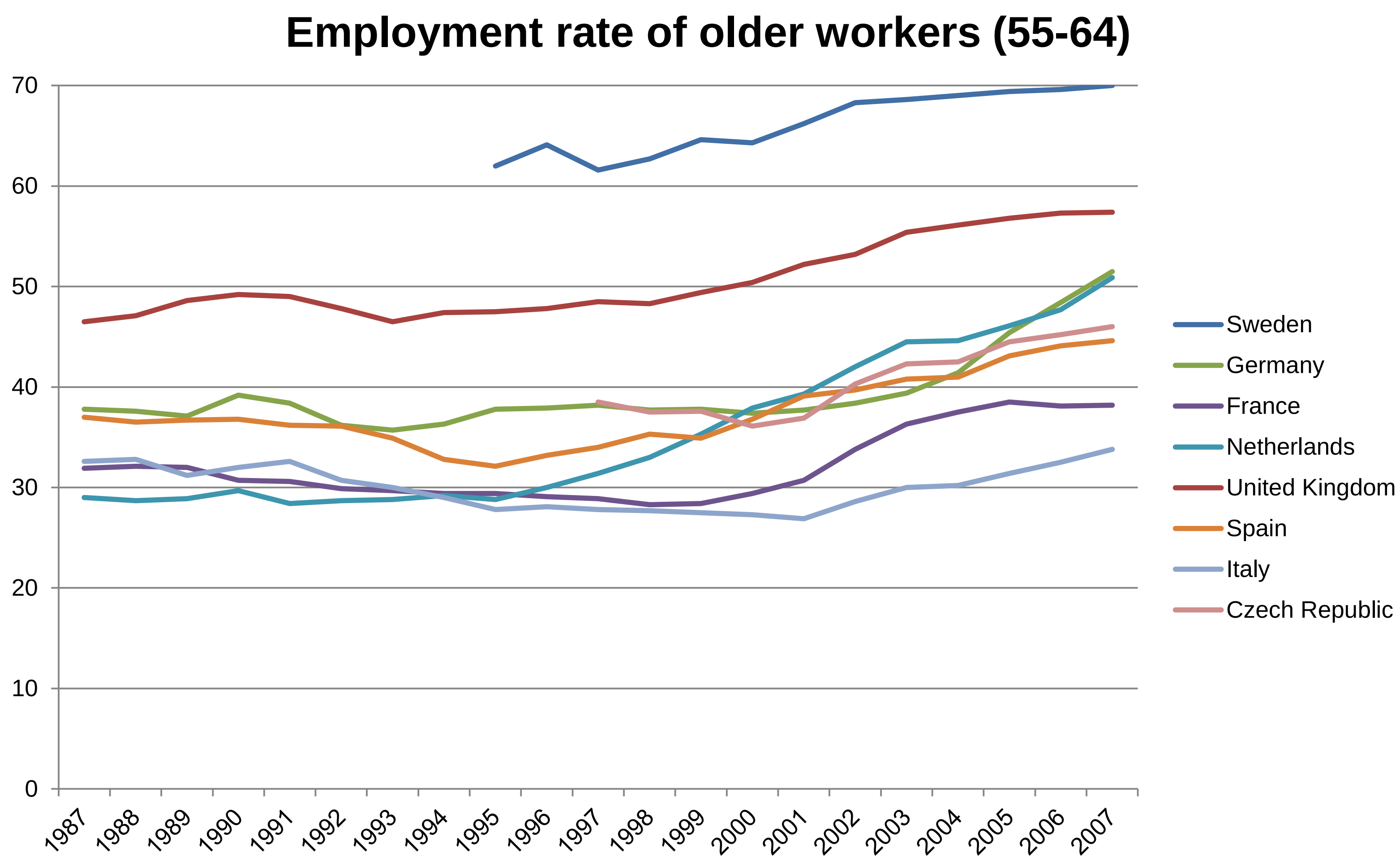
FEMALE EMPLOYMENT AND FERTILITY 2008



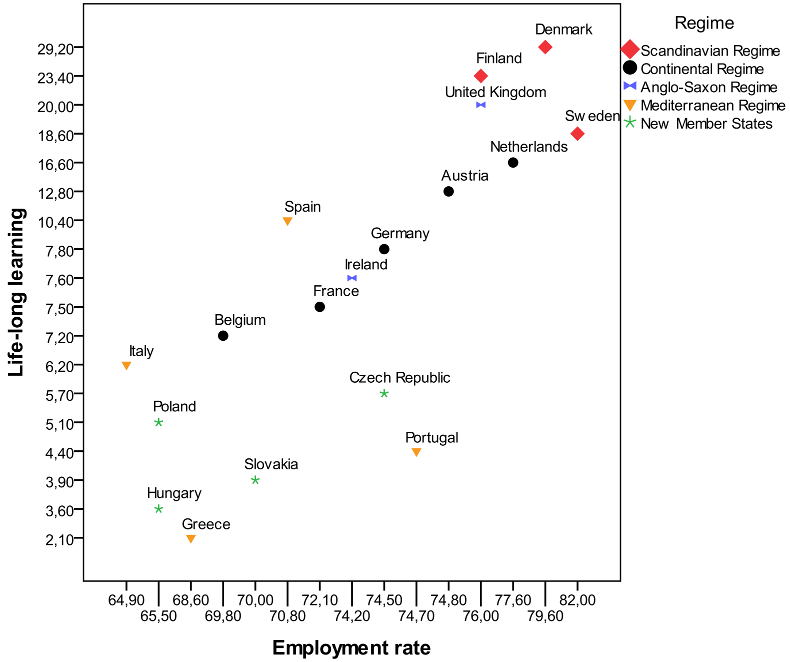
FEMALE EMPLOYMENT AND FERTILITY 1983

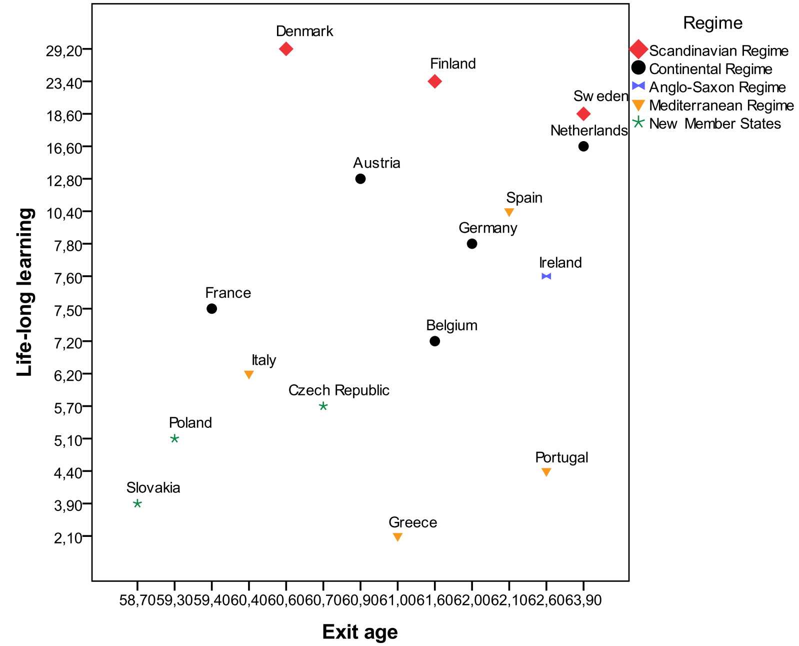


EMPLOYMENT RATE OF OLDER WORKERS

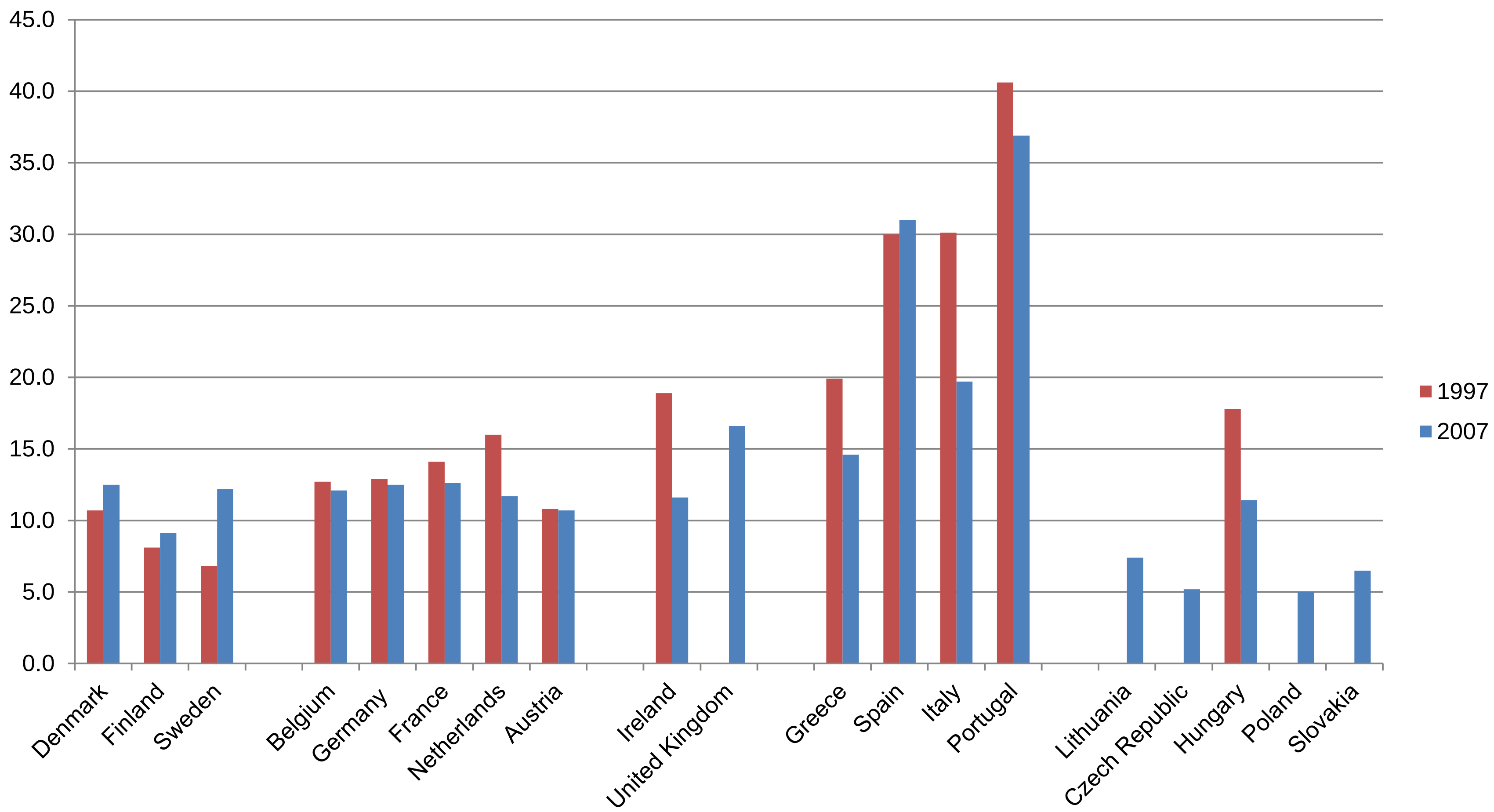


EMPLOYMENT, LIFE LONG LEARNING AND EXIT AGE

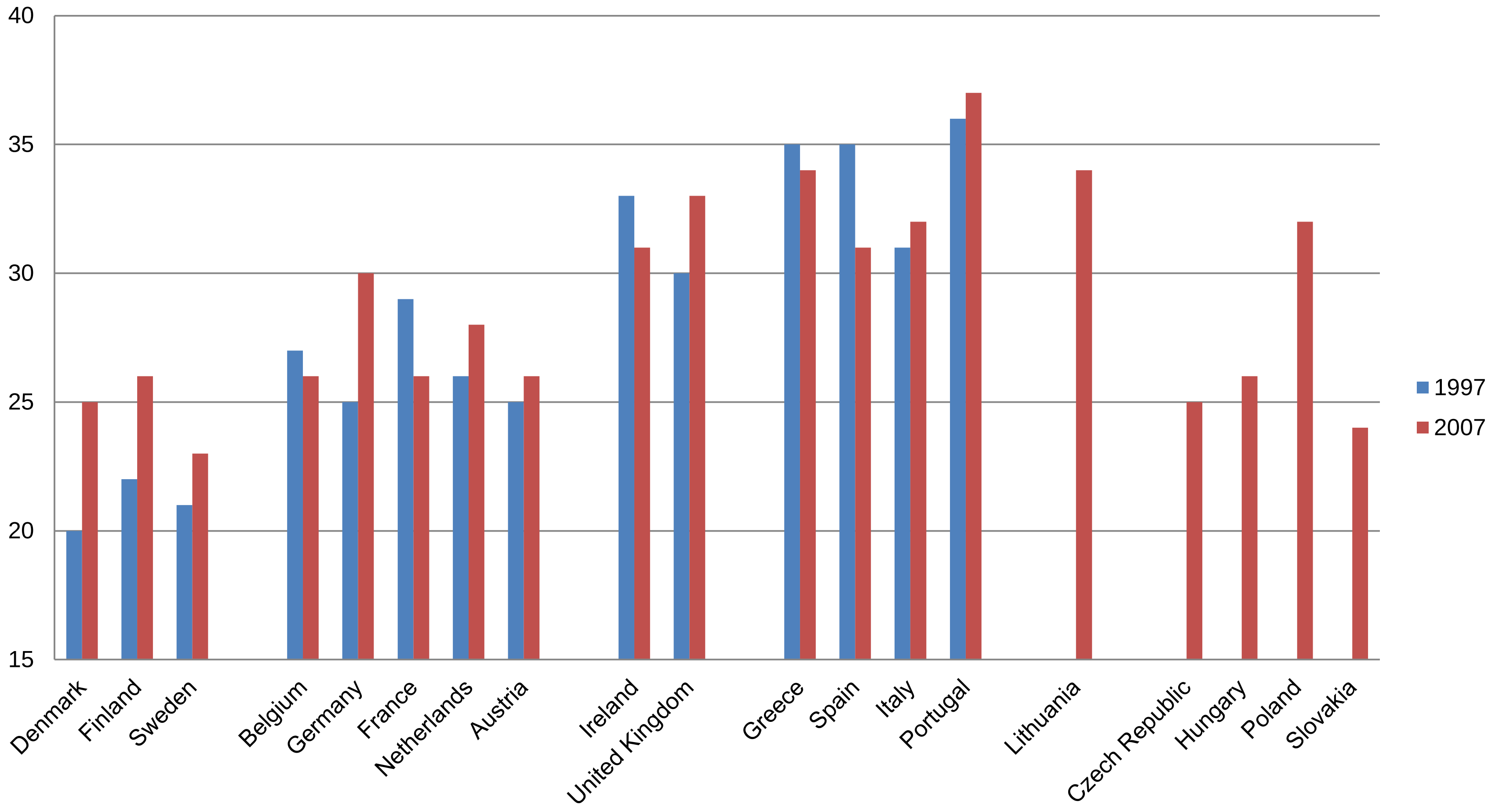




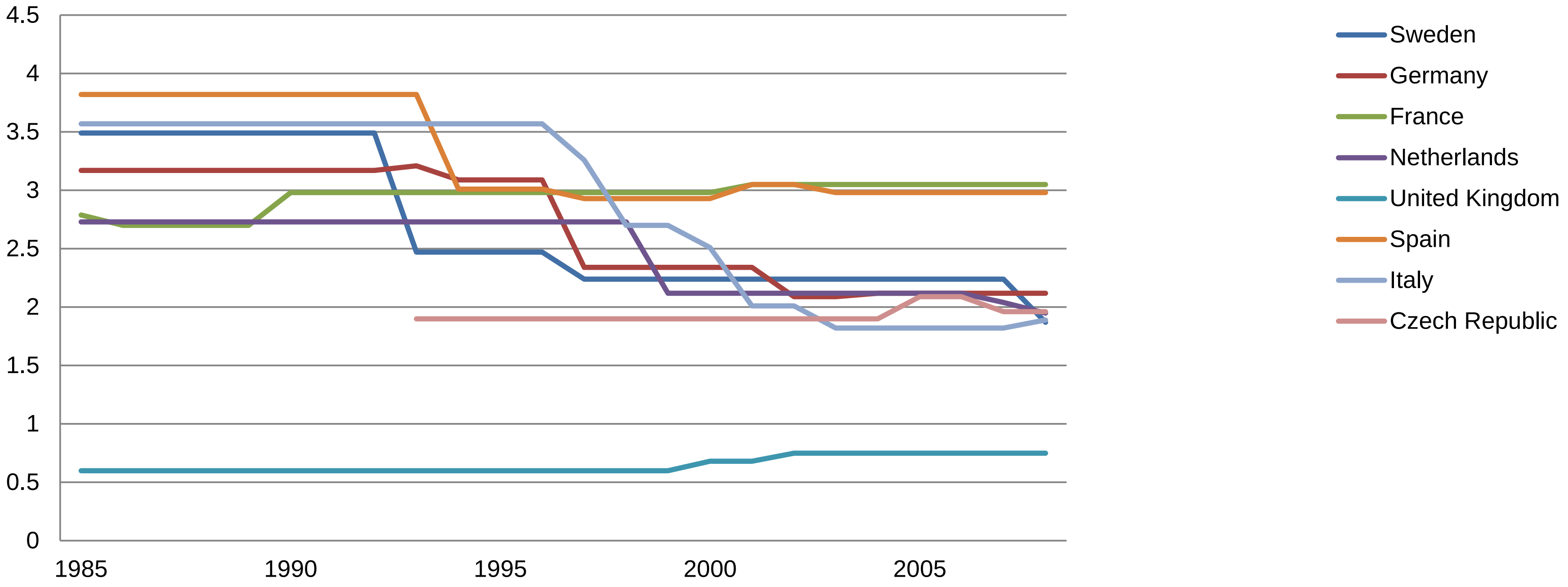
EARLY SCHOOL LEAVERS



GINI COEFFICIENT



EMPLOYMENT PROTECTION STRICTNESS (OECD)



KEY TRENDS PRECEDING 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 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
INTERMEZZO

VRIJE UNIVERSITEIT AMSTERDAM
Faculteit der Sociale Wetenschappen

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

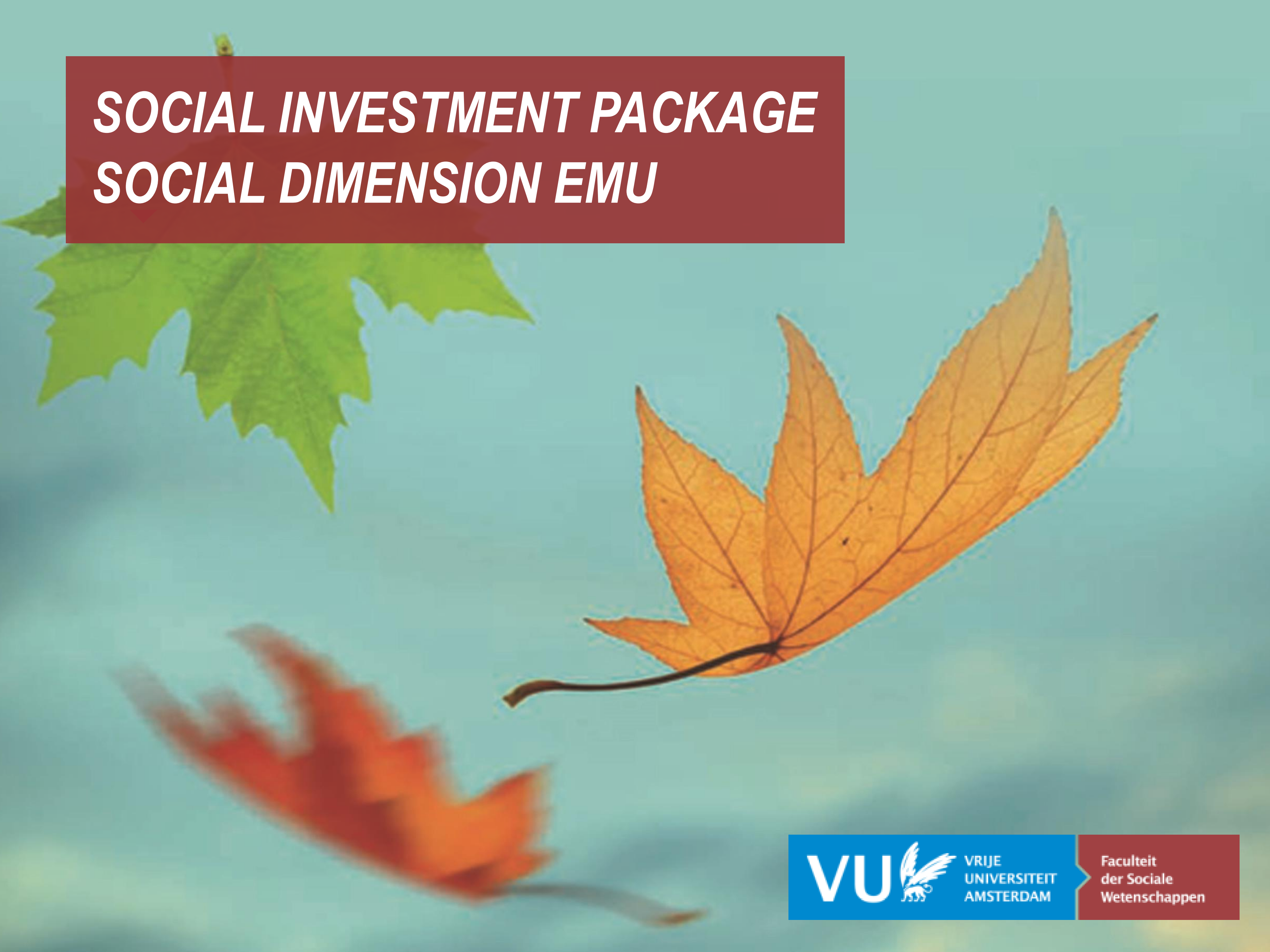
Anglo-Irish (genuine social investment not enough to fight inequality)

- 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



VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

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

VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

TOWARDS CURRENCY UNION OF "ACTIVE" WELFARE STATES

- 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 socieities (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'.

BEFORE CRISIS

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

Gradual but transformative reorientation	**Social austerity *drift*** (formal unified axiomatic) 2010	**Social Investment *stabilization*** (empirical institutional heterogeneity) 2014
Policy problem	**Cost containment (cuts)**	**Revenue raising (returns)**
Core policy imperative	Engineer **"risk shift" to private** sphere (Baumol cost disease)	**Maximize employment** in open economy (service productivity bonus)
Policy theory	Trade-off 'equity and efficiency' **"crowding out"** private economic initiative (capital market efficiency/**welfare state moral hazard**)	Social investments **"crowd in"** private initiative and competitiveness through higher employment and upskilling across life course (**devil in detail**)
Policy instruments	Labour market **deregulation**, **privatization** social services, and targeted minimum poverty protection *ex post* (inequality inevitable/fair in new economy)	Mitigate life (gender sensitive) cycle contingencies *ex ante* through human capital **'stock'** upgrading, labour market **'flow'** desegmentation, with strong universal safety net **'buffers'**
Macro policy	**Procyclical balanced budgets**: Fiscal Compact, Troika, MoU, with sanctons (hysteresis best tackled through institutional liberalization)	**Economic stabilization is more** than fighting inflation and balanced budgets: Sailing - counter-cyclically - against wind) focus on inclusive growth
Theory state	*One-size-fits-all* **take out market barriers** through contracting out, while disciplining low-trust, rent-seeking 'distributive coalitions' (trade unions)	Diverse institutions both ***constraints*** and ***resources*** (public regarding social partners), 'productive coalitions' and quality public services help mitigate Baumol disease *(local optima)*
Political discourse	TINA (**"European social model is dead"** – Mario Draghi 2012)	**Capacitating, caring and competitive Social Market Economy**

BACK TO THE EUROPEAN POLITICAL PREDICAMENT

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

NEUJOBS

EUROPEAN COMMISSION
European Research Area

SEVENTH FRAMEWORK PROGRAMME

Funded under Socio-economic Sciences & Humanities

stichting instituut gak

VU VRIJE UNIVERSITEIT AMSTERDAM

Faculteit der Sociale Wetenschappen

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

Dr Waltraud Schelkle

Associate Professor of Political Economy, LSE European Institute

Professor David Soskice

School Professor of Political Science and Economics, LSE

Professor David Piachaud

Chair, LSE

Suggested hashtag for Twitter users: **#LSEHemerijck**

LSE events