# Social investment ‘stocks’, ‘flows’ and ‘buffers’

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***Abstract***

This paper examines two ‘silver linings’ with respect to the daunting question of European welfare state futures in the wake of the global financial crisis. First, historically over the past two decades, the analysis reveals that the overall scope of social reform across the member states of the European Union, although varying widely, has been more proactive and reconstructive that is often argued in mainstream comparative studies. Alongside retrenchments, there have been deliberate attempts – often given impetus by intensified European (economic) integration – to rebuild social programs and institutions to accommodate the new economic and social realities of the 21st century. The more prospective, second sign of progressive reorientation is that in the aftermath of global financial crisis, *social investment is no longer dismissed as “fair weather” policy*, as epitomized by the launch of the *Social Investment Package for Growth and Social Cohesion* by the European Commission in 2013. In terms of social investment policy analysis, the paper distinguishes between three interdependent policy supports: (1) easing the ‘flow’ of contemporary labour market transitions; (2) raising the quality of human capital ‘stock’; and (3) upkeeping strong minimum-income universal safety nets as social protection and economic stabilization ‘buffers’, viewed interactively through the lens of the life course contingencies of modern familihood. In conclusion, the case is made for a “social investment pact” for Europe, allowinggovernments to pursue mid-term budgetary discipline *and* long-term social investment reforms in line with new EU economic governance procedures, potentially allowing for a viable balance between ‘economic’ and ‘social’ Europe after the crisis.

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

**1 A bias for hope**

The European welfare state, one of the most successful feats of mid-twentieth century European social engineering, find itself at a crossroads in the aftermath of the global credit crash of 2008. Good news is that by 2013 economic growth returned to Europe, five years after the global financial crash of 2008 put many Eurozone economies – notably in the southern periphery – in acute fiscal straits. While the emergence from the double-dip Great Recession is surely welcome, many observers believe Europe’s nascent recovery is far too feeble to seriously overcome the dramatic social crisis that Europe is confronted with today. 24 million Europeans are out of work and youth unemployment approaches catastrophic rates of over 50 per cent in countries like Greece, Portugal and Spain. Moreover, rising inequality and widespread poverty render the Europe 2020 strategy, conceived in 2009 as an ‘inclusive growth strategy’ in serious jeopardy. A rapidly growing cohort of youngsters neither in education nor in employment leaves another urgent Europe 2020 ambition, to push the share of early school leaving down and to raise tertiary educational attainment, wide of the mark. In other words, now that the existential crisis of the Euro has abated, the novel policy imperative for the European Union and its member states is to effectively manage the social aftershocks of the global financial crisis.

While the aftermath of the financial crisis is putting severe strains on national welfare states and EU institutions, this could also engender positive consequences as unsettling beliefs sometimes inspire path-breaking social and economic policy innovations. Deep economic crises are often moments of political truth, so the history of the twentieth-century teaches us. The Great Depression of the 1930s and World War II in its aftermath were the brainchildren of the post-war Keynesian welfare. The Great Stagflation crisis of the 1970s ushered in a reform momentum of institutional liberalization, constraining the scope of social protection provision, to be sure, but not per se triggering the demise of the welfare state. In the wake of the Great Recession, social policy resurfaced at the centre of the debate. Citizens and policymakers once again realized how important social security is for mitigating economic hardship, while fostering social cohesion in hard times.

Still, there are many reasons to be pessimistic about the prospects of a new era of proactive sovereign welfare states restructuring, but for the remainder of this contribution I wish to highlight two ‘silver linings’ for effective future welfare provision. Based on earlier research, the first bias of hope is that *welfare state futures are not foreordained*. The expectation of ‘policy drift’, incipient institutional decay slowed down by past-policy lock-in, special interest capture and fear of electoral retribution, effectively incapacitating policy makers to adjust, adapt and update their welfare programs in a timely manner to the new rules international competition, the new shape of family demography, and the new flexibility of the labour market, has been the exception rather than the of rule of post-stagflation social policy evolution since the 1980s (Pierson, 1998; 2001; 2011; Hacker and Pierson, 2010). In *Changing Welfare States* (2013) I have argued that the wave of social reform that has swept across Europe over the past three decades reveals trajectories of welfare adjustment that are reconstructive than is often argued in mainstream academic research (and the media). Alongside retrenchments, there have been deliberate attempts – also given impetus by intensified European (economic) integration – to rebuild social programs and institutions and thereby accommodate welfare policy repertoires to the new economic and social realities of the 21st century, including the critical impact of the global financial crisis. Welfare state change is work in progress, leading to patchwork mixes of new and old policies and institutions on the lookout perhaps, for greater coherence. Unsurprisingly, that search process remains incomplete, resulting from the institutionally bounded and contingent adaptation to challenges of economic globalization, family and gender change, adverse demography, changing political cleavages, and crisis induces fiscal austerity.

The second silver lining of progressive reorientation is that in the aftermath of global financial crisis and its European correlates of the sovereign debt and Euro crisis, *social investment is no longer dismissed as “fair weather” policy* when times get rough. The notion of social investment emerged as a policy perspective round the turn of the century with the ambition to modernize the welfare state and ensure its sustainability (Ferrera et al., 2000; Esping-Andersen et al., 2002). Social investment implies policies that ‘prepare’ individuals and families to respond to new social risks of the competitive knowledge society, by investing in human capital stock from their early childhood on, rather than simply to ‘repair’ damage after moments of economic or political crisis. The 2000 Lisbon Strategy, committed the EU to become the ‘most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth and more and better jobs and greater social cohesion’, was indeed strongly influenced by the ‘social investment’ perspective. However, by 2005, the mid-term review criticized the Lisbon Strategy for lack of strategic focus and the multiplication of objectives and coordination processes. As a consequence, the social investment perspective took a backseat in the re-launched Lisbon Strategy, pushing for more labour market flexibility and social insurance savings. In the face of the raging Euro crisis, social investment ideas have made a strong comeback in the *Social Investment Package for Growth and Social Cohesion*, launched by the EU Commissioner for Employment, Social Affairs and Inclusion László Andor in February 2013 (European Commission, 2013). Through the Social Investment Package, Commissioner Andor has been able to create room for a critical – evidence-based – policy agenda of improving the effectiveness of Europe’s variegated social protection systems as productive and stabilizing forces, in terms of the common EU-wide urgency not to allow human capital to go to waste through semi-permanent inactivity, as was the case in the 1980s and 1990s in many mature continental European welfare systems, in the face of accelerated demographic ageing.

In the aftermath of the Euro crisis, social policy makers all over Europe are engaged in deep processes of social learning and political soul-searching. Important breakthroughs in additional EU funding for youth employment guarantees, associated with the Social Investment Package, together with the rekindling of the debate about a genuine ‘social’ dimension of EMU conjures up the image of a period of transition, embedded in a wider critical appraisal of the legacy of the neoliberal era of market-oriented reform in the foregone period. The overriding purpose of the rest of this contribution is to underscore and further develop the two ‘silver linings’ about European welfare state resilience and the potential positive contribution that social investment can play to anchor future national social policy provision in line with the prerequisites of economic efficiency and social equity. For the rest of the article, I first review the wave of social reform that has swept across Europe over the past decades ex ante the economic crisis. Next, in Section 3, I expand earlier work on social investment policy analysis by distinguishing between three interdependent policy supports: (1) easing the ‘flow’ of contemporary labour market transitions; (2) raising the quality of human capital ‘stock’; and (3) upkeeping strong minimum-income universal safety nets as social protection and economic stabilization ‘buffers’, viewed interactively through the lens of the life course contingencies of modern familihood. Section 4 concludes by rekindling the idea of a “social investment pact” for Europe, based on earlier publications with Frank Vandenbroucke and Bruno Palier as co-authors, incitinggovernments to pursue mid-term budgetary discipline *and* long-term social investment reforms (Vandenbroucke et al, 2011; Hemerijck and Vandendenbroucke, 2012).

**2 Changing welfare states**

With the benefit of hindsight, it is possible to conceptualize the evolution of European welfare state from its immediate post-war “Golden Age” to the recent emergence of social investment in terms of a sequential evolutionary model in which social policy change can be portrayed as moving relatively coherently through three phases of adjustment in response to new economic and social realities (Hemerijck, 2013). These are: first, the phase of social rights universalism driven by Keynesian economics and Beveridgeian social insurance; second, the neoliberal era of deregulation, privatization and budgetary retrenchment; and third, the social investment turn in response to intensified economic internationalization and accelerated European (economic) integration, and, especially, the feminization of European labour markets, pressed by adverse demography.

The welfare state of mid-twentieth-century Europe emerged from the economic and political lessons of the World War II and the Great Depression, founded on the objective of managing structural change in such a way that modern social policy could help to widen and equalize the social benefits of structural change while minimizing its social and economic costs. In this respect, the post-war welfare state represented a unique achievement in civil liberty, economic growth, social solidarity and public wellbeing. The defining feature of the post war welfare state is that social protection came to be firmly anchored on the explicit normative commitment to grant social rights to citizens in areas of human need. This implied the expansion of mass education as an instrument for equal opportunities, access to high quality health-care for everyone, together with the introduction of a universal right to real income, in the words of the British sociologist T. H. Marshall’s seminal work, *Citizenship and Social Class* (1992), ‘not proportionate to the market value of the claimant’ (Marshall, 19992: 110). Marshall regarded the institutionalisation of universal social rights, following the guarantee of civil liberties, such as ownership rights and freedom of contract, in the 18th century and the introduction of political rights, including universal suffrage, in the 19th century, as the culmination of modern citizenship. Marshall described social rights as: *(…) the whole range from the right to a modicum of economic welfare and security to share to the full in the social heritage and to live the life of a civilized being according to the standard prevailing in society* (Marshall, 1992: 74)*.* Among the successes of the post-welfare national welfare state are full employment, a high standard of living, universal access to education and health care and a right to an income for those who are elderly, ill, disabled, unemployed and poor. The post-war era was a period of innovative institution building, with the state acting as the overriding countercyclical makeweight, seeing to aggregate demand stabilization in important based on the expansion of social insurance funding. Keynesian priorities remained prevalent until the late 1970s, with full employment as the principal objective of macroeconomic management. Full employment and the welfare state made way for a viable strategy for growth and redistribution. The welfare state, however much innovative in conception, it is important to emphasize, was the sobering product of a search for political ‘stability’ on the part of post-war policy elites. The painful memories of the Great Depression and the turmoil of World War II remained ever present on their minds, creating a felt need for stability based on a strong *visible hand of the (welfare) state*.

Signs that European welfare states are on shaky ground are not new. When advanced Western economies ran into the predicament of stagflation in the 1970s, academic observers, policymakers, and opinion leaders have ever since been engaged in a highly politicized debate over the welfare state in crisis. Numerous publications have argued the dismantling of generous social policy provision in the age of globalization. Ridiculing the so-called ‘European Social Model’ became a particularly favourite pastime of international business elites, political leaders, and economic experts in the 1990s. From the 1980s onwards, the European welfare state system took the blame for the region’s slow economic growth, lack of dynamism, lagging competitiveness and technological innovation, as a consequence of overprotective job security, rigid wages, expensive social insurance, unemployment ‘hysteresis’ and employer-unfriendly collective bargaining that developed over the post-war period. At the juncture of the worrisome crisis of stagflation, a whole set of new institutional innovations were introduced, centred on the primacy of the *invisible hand of the market*. From a revamped neoclassical perspective, the overall conclusion was that the European ‘social market economy’—a free market tempered by a generous welfare state, consensus-building politics, and cooperative labour relations, based on the firm’s accountability to a diversity of stakeholders beyond shareholders, such as unions and local communities—had become an anachronism in the world of intensified global competition, premised on quicksilver capital movements. Important qualifications notwithstanding, the neoliberal moment of the 1980s can be viewed as a quest for (labour market) ‘flexibility’ in the shadow of hard currency and balanced budget macroeconomic regime, in the hope to curtail ‘moral hazard’ and ‘adverse selection’ dilemmas in social insurance provision. The landmark intellectual contribution, in terms of policy analysis, behind the new wave welfare retrenchment and labour market liberalization is to be found in the OECD’s *Jobs Studies* of the 1990s, strongly advocating the removal of job protection barriers to employment growth, while lowering the tax burden on labour (1997). Consistent with the shift to supply-side economics, macroeconomic policy gave way to a stricter rule-based fiscal and monetary policy framework centred on economic stability, hard currencies, low inflation, sound budgets, and public debt reduction. The overarching social policy objective in the 1990s shifted from fighting unemployment to proactively promoting labour market participation. In the field of *wage policy*, a significant reorientation can be observed in favour of market-based wage restraint in order to facilitate competitiveness, profitability, and employment growth, prompted by the new rule-based macroeconomic policy prescription. Since the 1980s, wage moderation in many countries was pursued through social pacts among the trade unions, employer organizations, and government, often linked with wider packages of negotiated reform that have made taxation, social protection, and pension and labour market regulation more “employment friendly.” The EMU entrance exam of the mid-1990s played an especially critical role in national social pacts in the so-called hard-currency latecomer countries, such as Italy, Spain, and Portugal, as an alternative to straightforward labour market deregulation and collective bargaining decentralization (Avdagic et al., 2011). In terms of *social insurance* and *assistance*, the generosity of benefits was curtailed. In the process, social insurance benefits have become less status confirming. Today most countries preside over universal minimum income protection programs, coupled to ‘demanding’ activation and ‘enabling’ reintegration measures, targeting labour market ‘outsiders’ like the young, female or low-skill workers (Clasen and Clegg, 2011). The ‘dark side’ of the era of institutional liberalization and market-oriented reform perhaps pertains less to the weakening of the welfare state, but more pertinently to finance and banking. In hindsight, it is the neoliberal model of financial deregulation and associated ‘moral hazards’ that ultimately brought the global economy to the brink of collapse in 2008.

Since the 1990s, various trends have once more fundamentally altered the policy environment of Europe’s modern welfare states (Esping-Andersen et al., 2002). Under moderate economic growth levels, fiscal pressures have increased, not least because of greater capital mobility and accelerated European economic integration. In addition, population ageing and declining fertility, together with a trend towards early retirement of baby-boomers, severely burdened pension systems. Rapid technological change, together with accelerated economic internationalization, meanwhile reduced the demand for low-skill work in advanced economies. While the shift towards post-industrial labour markets opened up job opportunities for women, deindustrialization has come with declining levels of steady lifetime jobs and rising job precariousness. Changing family structures and gender roles, with longer education spells, later childbirth, and lone parenthood, created new tensions between career and family life. As a consequence, rising levels of female labour-market participation raised new demands for the provision of social care, especially for young children and the frail elderly. The new risks of social exclusion both within and outside the labour market, in addition, triggered growing income polarization between highly skilled, dual-earner families and low-skilled male-breadwinner and single parent households. To effectively respond to these ‘new’ social risks, Esping-Andersen et al. advocated a ‘social investment’ renewal of the welfare state to secure improved social resilience over the family life course. The overarching imperative became the preparation of citizens and families, and to pre-empt new risks, by way of combining income support and capacitating social services, rather than to repair damage at too high a social cost of old risk unemployment insurance. Prototypical social investment policies are gender-related child and elderly care, family-friendly labour market regulation, allowing especially women to move back and forth between full-time and part-time employment in relation to evolving informal care responsibilities. Since the 1990s, *social services* significantly expanded to boost female participation though family policy (Lewis, 2006; Orloff, 2010). Spending on family services, childcare, education, health, and care for the frail elderly, as well as on training and employment services, increased as a percentage of GDP in practically everywhere in the European Union. Family policy, covering childcare, parental leave and employment regulation, and work and family life reconciliation policies, experienced profound change in both scope and substance over the past decade and half. Another plank of the social investment imperative concerns employment-related training and education to improve life course employability, particularly for labour market outsider**s**, including better job security under more flexible employment relations. In tandem, spending on *active labour market policies* in most OECD countries increased considerably from the 1990s and the mid-2000s, mobilizing women, youth, older workers, and less productive workers through early intervention, case management and conditional benefits (Bonoli, 2013). With respect to *labour market regulation*, several European countries have moved towards greater acceptance of flexible labour markets with new elements of security being introduced for labour market outsiders (Schmid, 2008). In the process, the EU took on a pro-active role as a social investment policy agenda-setter. The Lisbon Strategy, adopted by the European Council in 2000, is exemplary of the EU’s new commitment to catalyse domestic social reform in the direction of ‘active welfare states’. With respect to employment the Lisbon Agenda was very successful. Over the Lisbon term from 2000 to 2010, employment rates in Europe have risen by an impressive 8 per cent, including a massive increase of female employment. To be sure, the level of success varied across the Member States (European Commission, 2009). But in the domain of social inclusion, the Lisbon process failed to address structural inequalities and rising (child) poverty.

Even though public social spending was consolidated at levels reached in the 1980s, practically all advanced European welfare states have been recasting and reconfiguring the basic policy mixes upon which they were built after 1945. The overall sequence of post-war welfare state up to the present has been fundamentally ‘layered’, in the sense that earlier policy legacies continue to exist alongside the new additions, rather than past policy portfolios being gradually displaced by novel arrangements. In this process of sequential layering, to a term introduced by Wolfgang Streeck and Kathy Thelen (2005), older legacies were reconfigured into new policy directions, with novel linkages to new and complementary layers, such as the re-alignment between (old risk) social insurance and (new risk) activation and human capital upgrading. The overall scope of change varied widely across the member states of the European Union. In some cases welfare state change was accompanied by deep social conflict, while in other instances unpopular social reforms received broad consent from opposition parties and the social partners. With their tradition of high quality child care and high employment rates for older workers, the Nordic countries performed particularly well throughout the past quarter century, both in terms of efficiency and equity, but we also observe reconstructive change in countries like the Netherlands (social activation), Germany (support for dual earner families), France (minimum income protection for labour market outsiders), the United Kingdom (fighting child poverty), Ireland (much improved education) and Spain (negotiated pension recalibration) in the period leading up to the financial crisis. The abortion of the 1990s reform momentum in the pension-heavy and segmented welfare systems of Southern Europe, after their successful entry into EMU, can be associated with far too low real interest rates – a financial market failure *par excellence* – up to the onslaught of the financial crisis. This mistake gives reason to believe that the poorly performing – economically uncompetitive and socially deficient – Greek, Italian, Portuguese and Spanish welfare states, now facing high extremely high levels of youth and long term unemployment, are not per se structurally incapable of social reform and effective welfare recalibration.

**3 Social investment policy analysis**

The philosophy underpinning the social investment approach was given impetus by the publication of a book edited by Esping-Andersen et al. in 2002, *Why We Need a New Welfare State* (Esping-Andersen et al., 2002), commissioned by the Belgian presidency of the EU in 2001. Central to *Why We Need a New Welfare State* is the argument that male-breadwinner welfare inertia increasingly fosters suboptimal life chances in labour market opportunities, income, educational attainment, and intra- and intergenerational fairness, for large parts of the population.

*Stocks, flows, and buffers*

An emphasis on the ‘productive function’ of social policy stands out as the distinguishing feature of the social investment perspective. Social investment is in essence an encompassing human capital strategy with an explicit focus on helping both men and women balance earning and caring. There is a deliberate orientation toward “early identification” and “early action” targeted on the more vulnerable new risks groups. By raising employment and citizens’ long-term productivity the financial sustainability of the welfare state is best guaranteed. If successful, social investments relieve dependence on passive social insurance provision, without having to further retrench existing benefits. The social investment perspective strongly focuses on the regenerative or promotional side of social policy, including education, health, innovation, and sustainability, based on a general diagnosis that many of these not-for-profit policy provisions are key to high productivity economies, have suffered from tremendous underfunding during the neoliberal moment of the 1980s and 1990s.

Social investment policy analysis is based on three central interdependent and complementary policy functions: (1) easing the ‘flow’ of contemporary labour market transitions; (2) raising the quality of human capital ‘stock’; and (3) upkeeping strong minimum-income universal safety nets as social protection and economic stabilization ‘buffers’ in ageing societies. With respect to the function of safety net ‘buffers’ of critical importance is both the level of income protection and the scope of social security. In increasingly flexible labour market, basic social protection from a social investment perspective should be universal at high levels of (short-term) benefits. Employment-related social insurance, most common in Continental and Mediterranean welfare regimes, providing high social protection for labour market insiders is a recipe for labour market dualisation, with outsider increasingly bearing the brunt of limited social security. The social investment function of labour market ‘flow’ should not be mistaken for one-dimensional labour market deregulation. The function of ‘flow’ has to be understood in terms of helping to bridge critical life course transitions from schooling to the first job, during the crunch hour of making a career while raising children, taking up additional training and lifelong learning to prepare for later adult life while taking care of a frail family, etc. The ‘stock’ function of high quality training is the sine qua non of social investment. ‘Buffer’, ‘stock’ and ‘flow’ functions have to be viewed interactively through the lens of the life course contingencies of modern familihood. Over the life course, social investment policy efforts are progressively associated with lower economic and social returns. In early-childhood, childcare and pre-school education the expected pay-off is highest. There is a ‘double dividend’ at work. First, early childhood care raises the long-term human ‘stock’ by improving the cognitive and social skills of youngsters. Second, by easing labour market ‘flows’, access to daycare allows parents – especially women – to pursue uninterrupted careers. Next, for youth, primary, secondary and tertiary education provides for general and specific human capital ‘stock’ development. Below average PISA-scores and high levels of high school drop out comeat a price of low across the board employment. At working age, childcare and elderly care and long-term care for frail relatives become important for reconciling work and family life in terms of labour market ‘flow’ without penalizing demographic reproduction. Today high female employment participation is correlated with high and stable fertility under the proviso of universal access to childcare (‘stock’), formal leave arrangements (‘flow’), and family cash transfers (‘buffers’). In the recent past, European welfare states have experienced a wave of pension reforms, bent on raising the retirement age while at the same time making pensions more actuarially neutral by factoring in life expectancy. Life-long learning and active labour markets policies are ever more pertinent in ageing societies. High investment in life long learnings is associated with higher older worker employment participation and a higher average exit age. In late career, further education, lifelong learning and flexible retirement provision allow for upkeeping a scarce human capital ‘stock’, together with a more effective use of flexible labour market ‘flow’ in ageing societies. Throughout, it is important to acknowledge that the social investment edifice is in essence a supply side strategy and therefore cannot serve as a real alternative for an effective macro-economic policy. Equally important to add here is that — *contra* the British Third Way approach — social investment is no substitute for social protection. Adequate minimum income protection is a critical precondition for an effective social investment strategy as a ‘buffer’ helping to mitigate social inequity while at the same time stabilizing the business cycle. This kind of Keynesianism through the back door is still operative today, as we have experienced from the early days of the 2007–2010 financial crisis. In other words ‘social protection’ and ‘social promotion’ should be understood as the indispensible twin pillars of the new social investment welfare edifice.

*Institutional complementarities*

Social investment protagonists hold the relationship between substantive social policy and economic performance to be critically dependent on identifying institutional conditions, at the micro-, meso-, and macro-levels, under which it is possible to formulate and implement productive social policies. The economic and institutional policy analysis of social investment hereby relies heavily on empirical data and case-by-case comparisons. It is therefore crucial to consider the “fine” structures of variegated welfare regimes. Social policy is never a productive factor per se. One cannot turn a blind eye to the negative, unintended, and perverse side effects of excessively generous social security benefits of long duration, undermining work incentives, raising the tax burden, and contributing to high gross wage costs. By the same token, rigid forms of dismissal protection making hiring and firing unnecessarily costly can also result in high levels of semi-permanent inactivity. But this also holds true for increased job insecurity, which can depress domestic demand through unnecessary precautionary savings on the part of precarious workers and their families. In the absence of early childhood education and care provision in combination with generous parental leave arrangement, young women with good employment prospects defer from having children, while women with children are reluctant to return to the labour market, thereby reinforcing an adverse low-fertility/low-employment equilibrium.

A fundamental unifying tenet of the economics of the social investment perspective, finally, bears on its theory of the state. Distancing themselves from the neoliberal “negative” economic theory of the state, social investment advocates view public policy as a key provider for families and labour markets. Neoclassical economic policy analysis, based on perfect information and market clearing, theoretically rules out the kind of social risks and market failures that the welfare state seeks to address. Two economic rationales theoretically support the proficiency of public social investment. The first rationale for public intervention harks back to the original economic rationale for collective social insurance, countering market inefficiencies caused by asymmetric information, and to the economic rationale for social policy interventions related to the problems of imperfect information and the framing of choice in a more general sense. This is what Nicholas Barr has coined as the “piggy-bank” function of the welfare state (Barr, 2001). Because citizens often lack the requisite information and capabilities to make enlightened choices, many post-industrial life-course needs remain unmet because of the market failures of service under provision at too high a cost.

The second, perhaps most fundamental, reason why the welfare state today must be “active” and provide enabling social services is inherently bound up with the declining effectiveness of the logic of ‘old social risk’ insurance. When the risk of industrial unemployment was still largely cyclical, it continued to make perfect sense to administer collective social insurance funds for consumption smoothing during spells of Keynesian demand-deficient unemployment. However, when unemployment becomes structural, caused by radical shifts in labour demand and supply, intensified international competition, skill-biased technological change, the feminization of the labour market, family transformation, together with changing social and economic preferences for more flexible employment relations, traditional unemployment insurance can no longer function as an effective reserve income buffer between jobs (in the same industry). Basic public income guarantees, therefore, have to be complemented with *capacitating* public services ex ante, a term coined by Charles Sabel (2012), tailored to particular social needs caused by life course contingencies. What then matters at the level of policy execution and administration is that, as welfare states become ever more service-oriented, local service provision by highly qualified professional care workers help their clienteles to make timely choices in areas of childcare placement, job search and training, and elder and family care.

The imperative of capacitating service provision harbours important consequences for the prevailing poor economic understanding of (public) service sector productivity, often associated with so-called ‘Baumol cost disease’, named after the American economist William Baumol (1967). The overall gist of the Baumol cost disease is that productivity improvements in, especially, labour-intensive services like health and education, consistently lag behind productivity improvement in competitive industry, whereby productivity in services is typically understood as the relationship between the output of a particular service (such factors as numbers of students taught in classes) and the input (the money and other resources spent), taking account of changes in quality (measured by factors such as patient satisfaction, waiting times and examination passes). When public service pay increases, moreover, follow wage developments in the more dynamic capital-intensive private sector, this surely makes low productivity services increasingly more expensive. Assuming that social services are publicly funded, also the tax share of GDP rises, which then in turn comes to burden and eventually undermine competitiveness in the dynamic sector through ever higher taxation. From this it follows that countries are well advised to keep stagnant public services at bay. A significant empirical problem is that the Baumol cost disease does not stand up to the evidence of the competitive success of the Nordic service-intensive welfare states. This is because the reasoning behind the Baumol cost disease largely ignores the important indirect effects of high quality labour-absorbing and employment-intensive public services in health and education contributing in decisive ways to productivity growth in the dynamic private sector by providing them with high quality human capital input.

*Social investment political support*

It should, finally, not be forgotten that the welfare state is a normative concept based on the image of a social contract, with claims on social justice and fairness that go beyond issues of economic efficiency and effective insurance, to include dimensions of gender roles, the work ethic, child-rearing, and inter- and intra-generational equity. The policy changes surveyed above seem to have contributed to a slow redefinition in the very idea of social justice: a shift away from understanding fairness in terms of static Rawlsian income equality (1973) towards an understanding of solidarity and fairness as a right and an obligation to give due support to the needs of each, individually, so as to enable all to flourish, in line with the ‘capability approach’ of Amartya Sen (1999) and Martha Nussbaum (2011). At the normative heart of the social investment edifice lies a reorientation of social citizenship, away from the compensating *freedom from want* logic towards the capacitating logic of *freedom to act*, under the proviso of accommodating work and family life through social servicing and a guaranteed *rich social minimum* enabling citizens to pursue fuller and more satisfying lives.

It has been argued that social investment policy innovations are politically difficult to pursue because ‘new social risks’ affect different groups in a variegated fashion across the life course. Especially Paul Pierson (2001) considers new social risk heterogeneity to severely narrow and almost pre-empt the political support basis behind social investment reforms. In short, social investment policy lacks a coherent political coalition or class base, reminiscent of organized labour behind the male breadwinner post-war social insurance state. It is true that new social risks, ranging from skill depletion and difficulties in balancing work and family life, affect people at variegated episodes over the (family) life cycle. Nonetheless, the empirical record reveals significant spending increases on childcare, elder care, pre-schooling, reconciling work and family life, and active labour market policies, suggesting that social investment reforms must have been supported by the European political mainstream. Giuliano Bonoli has drawn attention to what he calls opportunities of ‘affordable credit claiming’ behind social investment reforms in less expensive policy areas, such as day and elder care; vocational education and training; family-friendly employment conditions, for which political credit can be claimed, particularly from younger cohorts, who by and large bear the brunt of the new social risks (Bonoli, 2012).

Peter Taylor-Gooby (2013) believes that political support for social investment is much wider than suggested by Bonoli and Pierson, who continue to reason from past institutional structures and their insider-prone support bases. European electorates increasingly treat redistributive welfare provision with suspicion. As citizens generally think that they reallydeserve their market incomes, attacking inequality through selective social investment policies may incur less political resistance. Taylor-Gooby suggests that the proliferation of ‘new social risks’ of skill erosion, balancing work and family life, insufficient social insurance coverage, associated with augmented job insecurity and higher labour market flexibility, may in effect provide a window of opportunity for broad constituencies of support for inclusive provision, far beyond new risks groups and cohort. New social risks allow for a broad normative redefinition of benefits and services in terms of support for work and family responsibility, consistent with mass middle-class aspirations, which today revolve around the desire of adult men and women to work and raise children, social objectives shared by low-income and middle-class groups alike. The strong focus on family support, especially for children, who cannot be held responsible for their fate, Taylor-Gooby intimates allows for a less stigmatizing mainstream political discourse of benefit claimants as contributing working parents. Converging family aspirations founded in decent work for everyone and ‘dual earner’ capacitating care provision in reciprocity can become the new ticket of electoral success. Efforts to mitigate poverty and inequality by improving ‘predistributive’ assets, think of high-quality health and child care and good education, such policies, which do contribute to a more egalitarian *market* distribution of incomes, are perhaps treated with less suspicion (Carlin, 2013).

Like Giuliano Bonoli, Peter Taylor-Gooby believes social investments are potentially able to address (new) social needs without making major demands on public spending. Social investments do *not* come cheap. Although the social investment paradigm promises high rates of return on investment, in terms of higher employment, rising productivity, and more robust families, social investments do not incur immediate budgetary savings. Implementing a successful transition to fully-fledged social investment strategies, while at the same time addressing rising needs in healthcare (and pensions), will inevitably require additional resources. To wit, social investments will inevitably miss out on protecting the most vulnerable groups in an era of deepening inequalities. For this reason, adequate minimum income protection remains a critical precondition for any inclusive social investment welfare state.

The empirical turn towards social investment reform across Europe contains two important lessons. First and foremost is that social investment should be understood in terms of ‘packages’ of interdependent policy initiatives across the various dimensions of ‘stock’, ‘flow’ and ‘buffers’. The available evidence before and after 2008 clearly shows that notably service-intensive “institutional complementarities” are associated with high employment rates and lower long-term unemployment, in contradistinction to the Baumol cost disease argument (Hemerijck, 2013; Eichhorst, & Hemerijck, 2010; Kenworthy, 2008; 2011; OECD, 2008; 2011). Second, as everyday life needs of working families have moved up the political agenda, social investments presents a new source for political mobilization behind a socially inclusive and economically effective and efficient welfare state.

**4 Towards an EMU social investment pact**

European policy makers are confronted with a truly existential – economic, political and social – interest in addressing prevailing economic asymmetries and social imbalances by forging viable economic adjustment strategies that do justice to the important macro-economic returns of the social investment perspective. Without a long-term strategic focus on employment opportunities, easing labour transitions for working families, and improving human capital, the EU risks becoming entrapped in a permanent economic depression. In the difficult years ahead, demographic headwind will bring social contracts under further duress, especially in countries facing high unemployment and the daunting budgetary conditions. Will the social investment paradigm carry the day in this context of predicament, or will it revert to marginality and be left orphaned in the new epoch of reinforced fiscal austerity? Politically, governments have been caught between Scylla and Charybdus. On the one hand, pressures for deficit reduction constrain domestic social policy space. On the other hand, disenchanted electorates are increasingly unwilling to abide by the austerity promises of national political leaders agreed in supranational rescue packages and new rules of enhanced economic and fiscal coordination, especially for the Eurozone. An orderly resolution of the sovereign debt crisis and is a *sine qua non* for the survival of the welfare state and vice versa. The social and economic policy challenge is to make social investments and fiscal consolidation mutually supportive and sustainable, through improved macroeconomic governance. To this end, a more realistic (slower) pace of fiscal adjustment should be coupled with productivity-enhancing social investments. With Frank Vandenbroucke and Bruno Palier I have argued that the EU needs a New Deal, a political exchange based institutional confidence in the future of the euro, between countries which are in better budgetary shape and have pursued social investment strategies more consistently in the past, and countries which have been less consistent with regard to social investment than one may have wished and therefore experience dramatic budgetary situations. The macro-economic policy regime that is required is one wherein *all* governments pursue budgetary discipline and social investment over the medium and long run, and are effectively supported therein (Vandenbroucke, Hemerijck, and Palier, 2011; Hemerijck and Vandenbroucke, 2012). The European imperative is to develop an adjustment strategy that is both economically viable and socially fair. A conditional ‘social investment pact’, bolstered perhaps by Euro bonds or specially designed ‘social investment project bonds’, based on generous access to structural funds (discounted in national budget accounts) could be an important step.

Given the political salience of the issues at stake, any sustainable social investment pact must answer to the democratic dimension of the European project. The ‘no’ vote in the 2005 French and Dutch referendums over the draft constitution, and the rise of neo-nationalism and populist xenophobia in the aftermath of the global financial crisis, have exposed the limits of market-based economic integration by ‘stealth’. Now more than ever political leaders, as Claus Offe intimated long before the onslaught global financial crisis, need to realize that in order to maintain popular support for the European project, the EU must be able to present itself to its citizens as a credible institution of protection against economic insecurity, and certainly not as a threat to care, cohesion and solidarity (Offe, 2003). To convince the larger European democratic publics, consistent with norms of social fairness written down in the Lisbon Treaty, such a EU ‘social investment pact’ should be tangibly based on a well-articulated vision of a ‘caring and capacitating Europe’, caring about people’s daily lives and future social wellbeing.

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