The social investment perspective as guiding principle for welfare state adjustment

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Abstract

The European welfare states have undergone a significant amount of change over the last decades. In light of the unresolved tensions resulting from changed macroeconomic conditions, the emergence of new social risks as well as from the consequences of the Great Recession and its aftershocks, more adjustments are needed. The present policy paper investigates the current outlook on welfare state change, retracing the socio-economic drivers of this change and the salient steps that were undertaken to reform welfare states in the last decades. Since the outbreak of the crisis, calls to adopt a social investment perspective on welfare state reform intensified, both in the academic field and at the EU policy-level. Ample space is therefore devoted to the discussion of this perspective, its conceptual background, ambiguities and applications. For a number of reasons, social investment seems the most appropriate approach to frame the objectives that contemporary welfare states have to pursue and to devise a consistent set of policies. The objections which have been moved against the social investment perspective have however to be taken seriously. This concerns the conceptual framework on which the social investment idea is based, but in particular its policy implementation and the relationship between its three central pillars: activation, human capital development and social inclusion.

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Introduction

The historical development of Western European welfare states since the end of WWII presents at least two clear and distinct phases. The first three decades after the war, which are commonly subsumed under titles such as the "Golden Age" and the "Trente Glorieuses", saw the emergence and rapid expansion of encompassing social security systems. This trajectory of expansion reached its peak in the 1970s. After the second oil-shock and with the onset of the 1980s, a new phase began. Momentous changes in social and economic conditions, caused both by internal and external forces, led advanced industrialised – and now post-industrialising – countries to question the size, objectives and priorities of their welfare systems. Size and therefore generosity of the welfare state, its quantitative dimension, came under pressure mainly because of rapid demographic ageing, a reduction in economic growth rates and increased economic and financial internationalisation. Objectives and priorities of consolidated welfare states, their qualitative dimension, were challenged primarily by changes in gender roles and female labour force participation, break-up of traditional household structures and structural changes in labour markets. These social and economic developments were accompanied, and partly facilitated, by a paradigm shift with respect to the dominant policy ideology.

Time has shown that early predictions of an inevitable and quick demise of the European welfare states were wrong. Mature welfare states proved to be very resilient, but particularly since the early 1990s, reform activity and welfare state adjustment became more clearly visible. Countries differed in terms of the timing and extent to which the previous social policy consensus was challenged and changes were introduced. During the highly contended 1980s, policy-makers had come to realise that problems in the social policy field were structural, but also that radical retrenchment was not a viable solution. It was in the 1990s that the new phase on which welfare states had embarked in the late 1970s began to show clearer contours.

In concomitance with a – prevalently moderate – retrenchment, welfare state adjustment increasingly took the form of an – incremental yet substantial – re-orientation of social policy objectives. A number of different analytical categories (such as re-calibration, activation, re-commodification, dualization) have been proposed to investigate and understand this transformational process. The debate is ongoing and it concerns as much the interpretation of past developments as the direction in which European welfare systems should evolve in the next future. Within this debate, the idea of "social investment" as the defining trait of welfare state transformation has gained particular prominence. One reason why social investment has attracted much attention is that it represents both a conceptual framework to understand change and a normative idea to guide policy. In fact, the European Union has played an important role in the articulation of the social investment idea, including its normative and institutional underpinnings (*Hemerijck et al.*, 2013).

Social investment stresses that social policy can – at least partially – defuse the trade-off between equity and efficiency, by focusing on human capital development and employment. In policy terms, the social investment idea advocates to shift resources from protective and passive to preventive and activating policies. This idea however incorporates a degree of ambiguity and lends itself to different interpretations and policy applications. "Activation" can take different forms, depending on the emphasis given to rights, skill-formation and enablement on the one hand or duties and incentives on the other hand. Moreover, the focus on activation and human capital leaves open the question of the relationship between social investment and more "traditional" social policies, such as those geared towards inclusion and protection. In spite of these tensions, the social investment perspective represents a topical attempt to re-cast our understanding of the European welfare states and their objectives. It is not a coincidence that in the last years the social investment idea was at the centre of intensified research and debate. The Great Recession has magnified the long-standing challenges posed by post-industrialisation. Currently, fiscal consolidation, low-growth scenarios and large social imbalances form a formidable challenge for social policy. Against this backdrop, the present paper aims to investigate the following questions: What is the outlook on welfare state adjustment, in light of a "secular" shift in social risk structures but also of the changes resulting from years of crisis? What has the idea of social investment to offer in this respect?

To answer these questions, the paper begins with a concise review of the factors that drive the need for welfare state adaptation (Section 1). Particular emphasis is given to understanding social risk types and to investigate the link between "new" and "old" social risks, because the configuration of these risk structures has important implications for social policy. After a brief discussion of the (quantitative and qualitative) welfare state developments of the past two decades (Section 2), the focus is shifted to the notion of social investment and its implementation (Sections 3 and 4). Social investment represents both a conceptual framework for welfare state analysis and potentially a guiding paradigm for social policy. Here these two dimensions and their interdependence are investigated together and referred to as "social investment perspective" (see *Morel et al.*, 2012). Section 5 discusses how the crisis and its "aftershocks" have affected welfare state adaptation. The final section offers a summary of the findings and draws some policy conclusions.

1. The need for welfare state adaptation

Welfare state objectives

The European welfare states which developed and consolidated in the post-war decades (hereafter the "traditional" welfare states) were characterised by measures to protect against negative events such as unemployment and illness ("old" social risks). In a broader view, the welfare state provided the basis for social citizenship, i. e. a set of social rights to parallel civil and political rights and to attain the level of economic welfare and security necessary to participate fully in society.[1] Analytical accounts of the welfare state stress its insurance and redistribution functions. In his influential work on the role of the welfare state, *Barr* (2001) distinguishes between a "Robin Hood" and "piggy bank" function. The first entails redistributive measures to provide poverty relief, redistribute income and wealth, and reduce social exclusion. The second consists of institutions that "provide insurance and offer a mechanism for redistribution over the life cycle". *Barr* focuses on the role played by social security systems to provide insurance and promote consumption smoothing over the life course. Other accounts of welfare state objectives place greater emphasis on the solidarity component that characterises social policy (see for instance *Cantillon and van Mechelen*, 2013). Redistribution to provide adequate protection and a socially accepted standard of living for those who do not have sufficient means and do not accumulate sufficient entitlement rights in the insurance mechanisms

[1] The notion of social citizenship goes back to the highly influential work of *T. H. Marshall* (1964).

entails *vertical* solidarity. *Horizontal* solidarity from low-risk to high-risk groups, on the other hand, also plays a central a role in social insurance, because of the decoupling of risk and contribution levels. Last but not least, welfare systems are powerful automatic stabilisers and fulfil the Keynesian aim of economic stabilisation over the business cycle.

Shifting risk structures

The literature on welfare state research offers numerous detailed and insightful accounts of the socio-economic trends which, beginning in the 1970s, challenged the consolidated welfare states in affluent democracies (e. g. *Esping-Andersen*, 1996; *Pierson*, 2011; *Hemerijck et al.*, 2013). There are different ways to categorize the long-term trends which generated and continue to generate pressure on mature welfare. In a brief synopsis, we can broadly distinguish two sets of drivers for change: factors that resulted from the increasing economic internationalisation and integration (exogenous factors) and those relating to the internal dynamics experienced by post-industrializing societies (endogenous factors).

First, from the outside, intensified economic globalisation has changed the rules of the game for domestic labour and product markets and exerted a strong influence on social policy constraints. After the fall of the Bretton Woods system, a process of economic liberalization and deep integration was set in motion which has been termed "hyperglobalisation" (*Rodrik*, 2011). Trade integration and the liberalisation of capital flows, with the ensuing processes of relocation and outsourcing, affected the economic position of European workers, with an asymmetrical spin benefitting highly qualified workers to the detriment of low-skilled segments of the labour force. These factors went hand in hand with a tidal change in policy discourse, characterised by an austerity bias in macroeconomic policy and looming tax competition (*Hemerijck et al.*, 2013). In domestic policy terms, these developments led to a substantial shift in "power resources" throughout the OECD area from organized labour to employers (*Pierson*, 2011).[2]

Second, from within, increased life expectancy and declining birth rates, together with changing gender roles, a surge in female labour force participation and the break-up of traditional household structures confronted Europe's welfare systems with new needs (*Esping-Andersen et al.*, 2002); *Bonoli*, 2006). Labour market flexibilization and de-standardisation of employment relations, which have been a salient trait of labour market developments in the past decades, played a dual role: on the one hand they represented a response to the abovementioned exogenous and endogenous pressures. On the other hand the flexibilisation of labour markets and the "precarization" of employment in itself represented a powerful source of insecurity, reinforcing "old" risk dynamics (such as inequality and poverty) and generating new ones (such as working without being entitled to social protection).

Because of the abovementioned exogenous and endogenous long-term trends, the traditional European welfare states have come under pressure both in quantitative and qualitative terms. The increase in numbers affected by risks, coupled with low economic growth, shrinking tax bases and unfavourable demographic trends generated strong fiscal pressure (*quantitative* dimension). The issue

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[2] For evidence on the empirical validity of "power resource theory", see for instance *Bradley et al.* (2003). The power resource theory was elaborated by *Walter Korpi* (1983), a good description can be found in *Häusermann et al.* (2013).

of reduced economic growth rates is of particular importance because the European social protection systems were built on the implicit assumption of enduring high output and productivity growth rates. At the same time, the fluidisation of personal and employment biographies exposed the shortcomings of traditional welfare states in the provision of social security and in the accommodation of new needs (*qualitative* dimension). These developments were accompanied by a broad increase in economic inequality (*OECD*, 2009; 2011). This increase was partly driven by external forces, such as skill-biased changes in labour demand, asymmetric productivity gains and increased economies of scale in some sectors of the economy (notably finance). Labour market flexibilization, decentralisation of wage bargaining processes and intensified use of productivity-related pay schemes contributed additionally to a higher dispersion of wages and earnings. Changes in tax systems represent yet another driver of the rise in inequality. Starting around 1980, a sharp decline in tax progressivity could be observed, as most countries reduced progressive income and inheritance taxes (see *Atkinson et al.*, 2011; *OECD*, 2014). In addition, "in many countries a growing fraction of capital income was gradually left out of the income tax base, so that the progressive income tax has almost become a progressive labour income tax" (*Piketty and Saez*, 2013).

These momentous changes resulted in a shift in social risk structures, which has been framed in terms of the "new social risks" concept (*Bonoli* 2006, 2007; *Taylor-Gooby* 2004; *Pintelon et al.* 2011). The novelty of this shift in risk structures can be summarised in the following points: a) Long-term socio-economic transformations have increased the size of social groups at risk as well as the likelihood of given social groups to be affected by social risks (*Huber and Stephens*, 2006); b) Social risks have become more heterogeneous and therefore fundamentally less predictable and more difficult to insure (*Hemerijck*, 2012b); and c) New social risks have introduced a different type of social stratification with respect to old social risks, because they are more directly related to life course events and to employment (*Cantillon et al.*, 2013).

Determinants and interdependencies of old and new social risks

Following *Pintelon et al.* (2013) we can distinguish between three different perspectives on the evolution of social risk: the notion of the "individualization or democratisation of risk"; the "life course perspective"; and the more traditional "social stratification approach". Given that contemporary societies have become more heterogeneous and biographies more individualized, the role of social class and of its intergenerational transmission as structuring factors of social risk has been questioned. In this view, horizontal life trajectories and lifestyles have become more important than hierarchical determinants of inequality. Social class and other external constraints have lost importance, whereas preferences and individual agency have increased their role. *Hakim* (2000, 2006), for instance, has developed a "preference theory" to emphasize the role of preferences as determinants of women's life choices, arguing that social structural factors and economic environments are of declining importance. There are indeed indications that social stratification matters less than it used to with respect to certain risks, for instance the likelihood of being affected by short-term poverty. On a similar note, unemployment, which in the "Golden Age" of post-war Europe was confined to a small group of the workforce, is today more broadly spread across the population. These observations have prompted some authors to speak of a "democratisation" of risk, arguing that the expansion of flexibility and precariousness as well as a de-standardisation of life-courses led to what *Ulrich Beck* (1986) called the "risk society".

The life course approach shares some common ground with the individualisation perspective, stressing the role played by biographical life events as determinants of welfare. Welfare losses, such as poverty spells can be triggered by life-course transitions (such as family formation and the transition from education to employment), as well as by “risky life-events” such as partner dissolution and health shocks, and have to be understood within this context. Also, problems experienced during any specific life-cycle phase may be either a consequence of earlier difficulties or a precursor of later problems (*NESC*, 2005). The advantage of understanding social risks from a life course perspective is thus twofold: On the one hand, the lens of the life course enables to identify and quantify with greater precision the risk structures faced by the population. On the other hand, the life course approach helps to improve our understanding of the relationships that link aspects such as care for children and the elderly to the rise in female employment and changes in household structures (*Hemerijck*, 2012). As *Pintelon et al.* (2013) point out, both the life-course and the individualization approach emphasise the importance of agency in responding to biographical events.

The fact that “traditional” determinants of social outcomes are less relevant than in the past should not lead to overstating the case for a “democratization” of risk. Social stratification research continues to emphasise the relevance of socio-economic background, gender, ethnicity and social class for numerous outcomes, including poverty duration, unemployment and health (e.g. *Whelan and Maître*, 2010; *Schmid*, 2004; *Tubeuf et al.*, 2012). A string of recent studies that examine the intergenerational transmission of disadvantage in the Nordic countries, clearly shows that, even in a setting with a high level of universalism and low inequality, socio-economic background is a strong predictor of poor outcomes in the following generation. *Wiborg and Møberg* (2010), for instance, examine how social origin affects unemployment risks and social assistance reception over the early life course in Denmark and Norway. They find a stable impact of social background over the life course on the probability of being disadvantaged. Other studies on social assistance receipt of young adults in Norway (*Lorentzen et al.*, 2012) and in Sweden, Norway and Finland (*Kauppinen et al.*, 2014) reach analogous conclusions.

To conclude, social stratification and life-course perspectives should be viewed as potentially complementary, rather than as generating competing hypotheses (*Vandecasteele*, 2011; *Pintelon et al.*, 2013). There is an interdependence between stratifying (“vertical”) and biographic (“horizontal”) elements. For instance, *Layte and Whelan* (2002) and *Whelan and Maître* (2008) show that social class and the life course influence the occurrence of social risks in an interactive manner. A too narrow focus on the individualisation of risk, leads to overlook the asymmetric effects that life course events can have on individuals in different social classes. The same is true of the relationship between “old” and “new” social risks. Deep and ongoing socio-economic changes have shifted the risk and therefore the needs structure of European societies. The transition to post-industrial societies has however not dissolved stratifying structures. Social stratification continues to play an important role, although the degree and also direction of social stratification differs with respect to old and new risk typologies. Risks associated with the combination of work and family life, for instance, are characterized by a clearly different social stratification than (long-term) unemployment, illness or work-poverty (*Cantillon et al.*, 2013). Rather than substituting old social risks, new social risks have added a layer of complexity.

2. Dimensions of welfare state adjustment

Confronting the challenges posed by the transition to "hyperglobalisation" and post-industrialisation, European welfare states have proven to be open for reform, particularly since the early 1990s (*Hemerijck – Eichhorst*, 2009). Welfare state adaptation has taken many forms, depending on national context and institutional path dependencies. Scholarly analyses and debates have accompanied these changes for more than three decades, building an impressive body of evidence (*Huber and Stephens*, 2001; *Taylor-Gooby*, 2002; *Hemerijck*, 2012). Although it is not possible to summarise the findings from this research activity in a few paragraphs, a few facts stand out with clarity, both with respect to the quantitative dimension of change and to the re-direction of policies and institutions to new objectives and priorities.

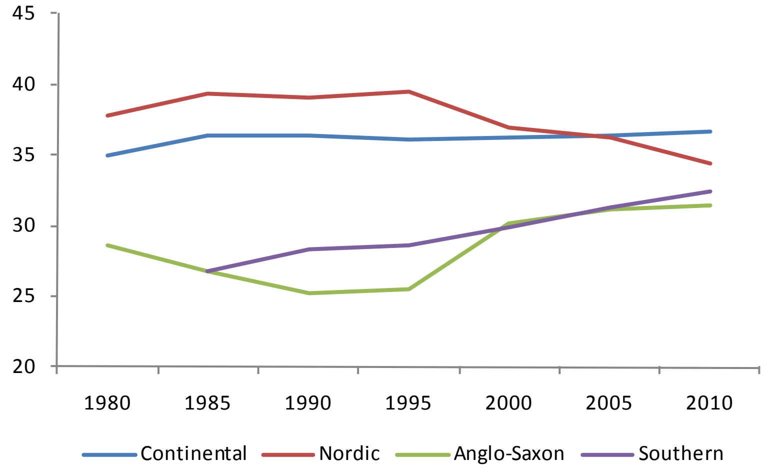
Retrenchment

Pierson (1994) first conceptualised the quantitative dimension of welfare change as "retrenchment", i. e. policy changes "that either cut social expenditure, restructure welfare state programs to conform more closely to the residual welfare state model, or alter the political environment in ways that enhance the probability of such outcomes in the future" (p. 17). This "quantitative" dimension of welfare state development is well-defined and comparatively easy to investigate, as from this perspective change can only take one of two directions (*Bonoli and Natali*, 2012b). In the early days of comparative welfare research following the end of the "Golden Age", concepts such as welfare state "dismantling" were discussed and scholars investigated the possible "decline" or "erosion" of the welfare state (e. g. *Myles*, 1988) Today, there is wide consensus on the fact that almost all European countries reduced the generosity of various transfer programs in the 1980s and 1990s, but in most instances those reductions were relatively limited (*Kenworth and Pontusson*, 2005). Particularly when set against the backdrop of the longstanding, acute demographic and economic pressures, and the decline in power resources of organized labour, the degree of overall welfare state retrenchment was much smaller than what could have been expected (*Pierson*, 2011).

Changes in the quantitative welfare state dimension have however not been uniform across policy areas and countries. Two areas of policy intervention stand out in general: pensions, where financing problems resulting from demographic ageing coupled with low growth dynamics prompted widespread reform in virtually all countries (*Hemerijck et al*., 2013). Parts of these reforms were aimed at reversing the introduction of very generous early retirement schemes and high, non-contributory replacement rates. In most cases changes were gradual and their effects will develop in the future, but it is safe to say that "the state no longer guarantees the same living standard maintained through public pensions for its current, and in particular future retirees, as it did for former retiring generations" (*Ebbinghaus*, 2012). The other area for policy intervention concerns unemployment benefit systems. In numerous and very diverse countries, such as Denmark, Sweden, the UK and Germany, both benefit duration and replacement rates were reduced (*Vandenbroucke and Vleminckx*, 2011; *Cantillon*, 2011). Particularly countries with high benefit generosity, such as the Nordic countries, adjusted their benefit entitlements and levels in other areas too, such as sick pay (*Vis*, 2010).

A descriptive analysis based on the most recent data collected in the Comparative Welfare Entitlement Dataset (CWED; *Scruggs et al.* 2014) shows that the aggregate generosity of welfare state provisions in the three archetypical domains of social security, namely unemployment, sickness and old age, remained fairly stable over the past decades. A closer look, however, reveals that, behind this stable average, we can observe a decline in the generosity of all three welfare state components in the Nordic countries (Figure 1). The reduction in benefit generosity was particularly pronounced in sickness and unemployment insurance. In these countries also coverage rates were lower in 2010 than in the mid-1980s. Coverage rates tended to fall also in the Continental countries, particularly the share of workers covered by sickness and unemployment insurance. At the same time however, Southern European countries completed a catch-up process, with substantial increases in coverage and generosity along several dimension. Interestingly, even in the Anglo-Saxon countries generosity in welfare provision was not scaled back, but did slightly increase since the mid-1980s.

Figure 1: Combined generosity index, by welfare regime group (period 1980-2010)



Note: Data from CWED (*Scruggs et al.* 2014), author's calculations. The Combined Generosity Index is calculated as the sum of sub-indices for the generosity and coverage of benefits in the areas of unemployment, sickness and pensions. For details on the computation see *Scruggs* (2014). The Figure shows unweighted country averages across welfare regimes. Nordic countries: Denmark, Sweden and Finland; Continental countries: Germany, France, Austria, Belgium; Southern countries: Greece, Italy, Spain; Anglo-Saxon countries: Ireland and UK.

These opposite developments suggest a certain degree of convergence in terms of welfare entitlements across Western European countries. The question of welfare state convergence was investigated in numerous studies, which focused on different sets of countries, time periods and also on a range of different policy areas and convergence measures.[3] In general, the findings confirm that, in contrast to some theoretical expectations, there has not been a "race to the bottom". The majority of studies, which apply indicators for absolute and unconditional convergence[4], find only moderate levels of convergence. More recent and methodologically sophisticated studies have however reached the conclusion that welfare state convergence has been much more common than suggested by the earlier literature (*Starke et al.*, 2008; *Schmitt and Starke*, 2011). This is particularly true if we look at conditional (beta) convergence, i. e. once important conditional factors such as the extent of globalisation and the level of unemployment are taken into account. These studies further corroborate

[3] For a concise review of this literature, see *Schmitt and Starke* (2011).

[4] I. e. a reduction in the variance or distribution of the investigated indicators, without taking into account initial levels or controlling for independent variables known to be associated with the phenomenon in question.

the conclusion that, at least until the period before the Great Recession, there was no race to the bottom in welfare state provisions.

Incremental change and re-orientation

The fact that – particularly in an aggregation over countries – we observe only moderate retrenchment, should not lead to understate the degree of welfare state transformation that took place. Institutional change does not have to come by in abrupt way and find immediate expression in expenditure or benefit generosity levels. *Hacker* (2004) has identified different mechanisms through which traditional welfare systems were transformed in recent decades. Examples include instances when formal rules are held constant in the face of major environmental shifts, causing their outcomes to change (drift), when ambiguous rules are re-interpreted to shift ground-level operations in directions at odds with their initial goals (conversion) or when new policies or institutions are put in place atop existing ones without abolishing them (layering). Policy change can thus take place when new institutions and practices gradually hollow out and take over the function of older ones, or when existing institutions are used strategically to achieve new policy goals (*Van der Veen and Yerkes*, 2012). Although institutional change can in principle take a number of different forms, there is reason to think that incremental change, rather than institutional breakdown or replacement, is the dominant mode of transformation in the political economies of advanced post-industrial societies (*Streeck and Thelen*, 2005). In this view, the evolution of the welfare state can best be characterised through forms of change that unfold incrementally but that have transformative effects (*Thelen*, 2009).

In all likelihood, the extent to which processes of layering, conversion and drift led to a transformation of the fundamental welfare state framework was larger in the United States than in Europe. With reference to the US, *Hacker* (2006) argues that a "Great Risk Shift" took place, i. e. a massive transfer of economic risk, both in terms of "old" and "new" social risks, from collective insurance structures to individuals and households. *Gilbert* (2002) takes the US as starting point for an analysis that claims the emergence of a new market-oriented welfare paradigm based on increased activation, selectivity, discipline and privatization. In spite of some parallels in the evolutions across the Atlantic, there remain substantial differences in the extent to which individuals are responsible for managing social risks, particularly those related to old age and health, between the United States and Europe. Nevertheless, reform activity has led to transformational changes in numerous European countries. In Germany, for instance, the well-known Hartz reforms (implemented between 2003 and 2006) deeply transformed the unemployment benefit system. At the same time, starting in 2001 Germany reformed its pension system, introducing significant elements of privatization in old age security and boosting occupational pension plans (*Seeleib-Kaiser et al.*, 2012).

In some cases, transformational changes have gone well beyond single policy areas. A prominent example in this respect is the Dutch welfare state, which underwent a systemic change in the direction of a new welfare settlement based on increased individual responsibility and new policies of reciprocity (*Yerkes*, 2011; *Van der Veen and Yerkes*, 2012). The Netherlands represent a striking example, because the deep reforms in social policies were enacted within and under preservation of a corporatist welfare framework. More nuanced yet possibly paradigmatic shifts have been taking place in Scandinavian countries. *Kvist and Greve* (2011) as well as *Kvist and Harsløf* (2014) find that the Danish welfare state, which has traditionally been viewed as strong example for the universalistic approach of Social Democratic regimes, has seen the emergence of a more multi-tiered system, with a larger role for private health and unemployment insurance. The authors argue that conditionality and selective cutbacks in social welfare policies have gained importance and they suggest that recent developments in Denmark are forerunners of a tendency in the Nordic welfare model towards dual tracks and a differentiation between insiders and outsiders in the labour market.

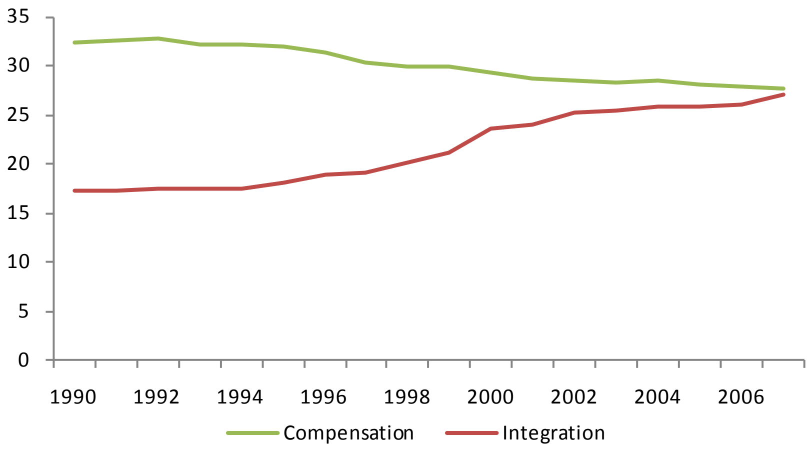
The discussion about the direction and extent of welfare state adaptation has been revolving around concepts such as re-commodification and dualization. Re-commodification essentially involves the effort to restrict the option for securing social insurance to participation in the labor market, either by tightening eligibility or cutting benefits (*Pierson*, 2002). Dualization implies that "policies increasingly differentiate rights, entitlements, and services provided to different categories of recipients" (*Emmenegger et al.*, 2012; p. 10). Both re-commodification and dualization processes have demonstrably taken place in Europe, however the degree of heterogeneity across countries and welfare state regimes is very high. In a recent overview, *Pintelon* (2012) finds only modest overall re-commodification since the 1990s across a sample of 18 OECD countries (in the period 1980-2009).[5] The Scandinavian countries together with the Netherlands are however characterised by substantial re-commodification, whereas Continental countries (with the exception of Germany) experienced only little change. In Ireland and the United Kingdom re-commodification patterns which took place in the early 1980s were partly reversed afterwards. Similarly, behind a general trend towards dualization, *Emmenegger et al.* (2012) detect great variation across countries. A comparison between small countries, for instance, reveals large differences between Austria, Sweden and New Zealand and also leads to reject the hypothesis that different welfare state regimes generate distinctive patterns of insider-outsider dynamics (*Obinger et al.*, 2012).

Arguably, the single concept which applies most consistently to all reform processes in Europe over the last decades is that of the "activation turn", i. e. a more active and employment-centred orientation in social policy. Activation is a focal point of contemporary welfare states for a number of reasons (*Kenworthy*, 2010): firstly, because employment as an alternative to benefit reliance contributes to alleviate the financial strain of social security systems; but also because strategies to support activation are in line with the shift in gender roles and women's professional aspirations, because employment is an unmatched protective factor against poverty, and finally because activation is in line with a new understanding of fairness as reciprocity.[6]

[5] *Pintelon* (2012) focuses on market forces rather than on market participation and defines re-commodification as "changes in regulation whereby governments are less intervening to 'shelter' individuals from the vagaries of the market".

[6] Recent evidence on the role played by reciprocity for welfare state support is provided, among others, by *León* (2012).

Figure 2: „Integration" and „compensation" measures in disability policy.



Note: Yearly average index for 14 European countries. Source: Authors' calculations based on Disability policy typology country scores, *OECD* (2003; 2010). The scores measure the extent of change in disability policy with a typology based on two qualitative policy indicators, each of them consisting of ten sub-components. The first indicator provides an overall assessment of policy features related to the benefit system and the second captures the intensity of integration measures for benefit recipients and those applying for benefits.

Another reason why activation is prominent as defining trait of welfare state transformation, is that it covers a wide range of different policies, with different implications for the mix between rights and responsibilities, support and incentives faced by workers. In its most narrow view, activation is confined to active labour market policies (ALMP). Even in such a narrow definition, activation is an umbrella term that refers to very diverse interventions, which have been tentatively classified using dichotomies such as "offensive" and "defensive" workfare or "positive" and "negative" activation (see *Bonoli*, 2012). A more sophisticated classification of ALMP has been proposed by *Bonoli* (2012), who distinguishes four types of policies based on the extent of human capital investment and of pro-market employment orientation. In a broader perspective, the objective to raise employment can go well beyond ALMP and be associated with a wide range of policy tools (*Kenworthy*, 2010). In this perspective, policies to support the labour participation of women (such as the expansion of child care facilities) are clearly part of an activation strategy. Another policy area which exemplifies with clarity the "activation turn" concerns workers with health problems and disabilities. Since the 1990s, European countries have been reforming their sickness and disability policies, giving increasing weight to activation programs and labour market (re-)integration. Figure 2 shows the evolution of two compound policy indexes for "integration" and "compensation" in disability policy, elaborated by the OECD, for a sample of European countries between 1990 and 2007.

The activation turn can thus be interpreted as a change in terms of welfare state objectives. In a narrow understanding, starting in the mid-1990s the "piggy bank" and "Robin Hood" functions have been complemented by a "public employment service" function. In a broader understanding, activation measures can be defined in a more encompassing way, to include policies that support skill development and the quality of employment (*Kenworthy*, 2010). This tension which underlies the activation concept is carried over to the "social investment" conceptualisation of the welfare state, to which we now turn.

3. The social investment perspective

Defining traits

Since the 1990s, the discussion on welfare state reform has increasingly been guided by the idea that social policy should allocate resources in an "investment" perspective, privileging measures and expenditure categories that provide a long-term return in terms of social and economic benefits. Concepts such as "social investment state" have been used in alternation with similar ones such as "active inclusion", "the enabling state" or "the developmental welfare state" (*Morel et al.*, 2012). The common denominator of these concepts is to underline the productive potential of social policy (the economic rationale for social policy) and to stress that social policies have to fulfil a sort of Copernican Revolution in order to accommodate the dramatic socio-economic changes of the last decades. Instead of being centred on specific risk typologies and to compensate individuals who have been hit by the corresponding negative events, they should first aim at providing individuals with the necessary toolkit to avoid the occurrence of these events and minimize their impact. Rather than to insure and redistribute, and thus largely "compensate" and "repair", social protection systems should pay more attention to "prepare" and "prevent". As noted by *Cantillon – van Mechelen* (2013), social security systems have always included supportive measures with preventive focus, prevention has increasingly been evolving to a pivotal social security objective in its own right.

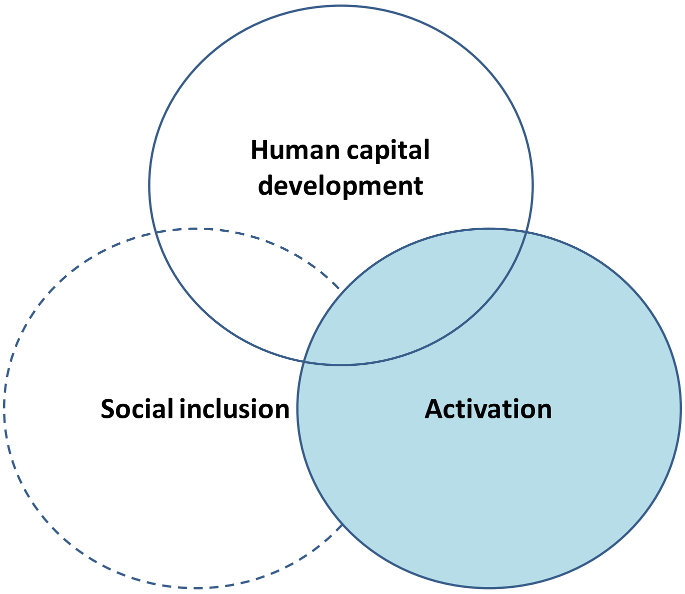
Several aspects can be singled out as characteristic of this understanding of social policy. Human capital formation in all life phases, the interface between family and work life as well as employment relations are the core areas for policy intervention (*Hemerijck*, 2012). Policy interventions are accordingly clustered around the life course phases such as childhood and youth (quality childcare and education), family formation and prime working age (training, measures to reconcile family and work) and old age (rehabilitation and care). In functional terms, the social investment perspective focuses on increasing workforce productivity and activity rates in order to cushion the effects of demographic aging; to support employability as well as the acquisition and retention of skills to empower individuals and prevent (permanent) unemployment; and on long-term strategies starting with early childhood to reduce the risk of poverty and neediness throughout the life course (*Beblavý et al.*, 2014). With respect to the implementation of social policy, the social investment perspective is biased in favour of services against cash transfers (e.g. childcare, all-day school places and care for the elderly).

The intellectual background of this perspective is partly a reaction to the neoliberal prescriptions that dominated the social policy debate in the 1980s and early 1990s. The neoliberal consensus interpreted social policies primarily as a cost factor, focusing on the trade-off between equity and efficiency and advocating strong limits to state intervention. The social investment perspective rejects this narrow view of social expenditure, but it also incorporates the lessons from the "Eurosclerosis" era and partly accepts the neoliberal critique of the traditional welfare state (*Morel et al.*, 2012). Accordingly, labour markets and employment are seen as the cardinal points of a new understanding of the welfare state. Individuals have to be provided with the means to succeed in the complex and dynamic labour markets of the globalized world in order to secure their self-subsistence. Historically, the roots of the social investment approach can be traced to the 1930s in Sweden, when the Myrdals developed the idea that social policy was not only functional to provide social protection and redistribution, but also to achieve economic efficiency (*ibidem*). The theoretical underpinning of this view was strengthened in the 1980s with the development of endogenous growth theories, which firmly placed human capital at the centre of economic growth processes (*Aghion and Howitt*, 1997). With the benefit of hindsight, it does not come as a surprise that towards the end of the "human capital century" (*Goldin and Katz*, 2009), the realization that the economic success of both individuals and nations depends on investment in human capital influenced the welfare state debate. In addition to economic thought, the social investment perspective on social policy has however not been shaped by economic thought only, but also by the advances in social justice theory, most notably Amartya *Sen*'s capability approach.

The different intellectual roots help to explain why, in spite of substantial agreement on its central elements (human capital and activation), the social investment perspective has been invoked using different connotations and placing different emphases. Whereas *Giddens* (1998) and others have associated the social investment idea primarily with activation and human capital development, in a broader understanding this perspective represents an evolution of the social citizenship principle. According to *Jenson* (2010 and 2012, p. 28 ff.), the social investment approach has the ultimate goal to "increase social inclusion and minimise the intergenerational transfer of poverty as well as to ensure that the population is well-prepared for the likely employment conditions [...]". In this broader understanding of social investment, it is underscored that the activation component of social investment cannot fully substitute for social protection: "[A] tendency to believe that activation may substitute for conventional income maintenance guarantees […] may be regarded as naïve optimism but, worse, it may also be counterproductive. … [T]he minimization of poverty and income security is a precondition for an effective social investment strategy" (*Esping-Andersen et al.*, 2002, p. 5). In this understanding a social investment strategy is only productive if a virtuous circle can be created whereby social protection and social investment are mutually reinforcing (*Vandenbroucke and Vleminckx*, 2011).

In essence, we can single out two sources of ambiguity or tension within the social investment perspective: the first is inherent in the activation concept which lies at its core, as activation can entail very diverse interventions, including workfare, work-family policies and measures to support skill development and employability; the second relates to the under-emphasized relationship between activation, human capital development and social inclusion. Figure 3 provides a schematic representation of the pillars of social investment and the tensions that underlie such as strategy.

Figure 3: Pillars of the social investment welfare state



Ambiguities and criticism

Social investment has attracted a considerable amount of criticism, as an analytical concept but particularly as a potential policy paradigm. Objections have been raised, among others, by *Cantillon* (2011) and *Barbier* (2012), and systematic critical reviews can be found in *Morel et al.* (2012) and *Nolan* (2013). A fundamental critique concerns the analytical dichotomy on which the social investment approach is based. The distinction between investment and consumption, capacitating and protective social spending is in fact not dichotomous. No form of social spending is purely an investment, without an element of current consumption. And plausibly also the opposite is true. This raises methodological questions with respect to the measurement of social investment and the policy implications derived from such measurement (*Nolan*, 2013).

The ambiguity associated with the distinction between investment and other forms of social policy expenditure calls for a careful use of the social investment notion, particularly in attempts to quantify the investment component of social policies and to classify expenditure categories accordingly. The overlap between consumption and investment does not however detract from the advantages of conceptualising social spending in view of its contributions to human capital formation and economic growth.[7] More than the theoretical and methodological shortcomings, it is the practical application of

[7] *Nolan* (2013) quotes a seminal work by *Schultz* (1961) to highlight the difficulties associated with quantifying investment in human capital. In fact, Schultz points out that most activities are partly consumption and partly investment, "which is why the task of identifying each component is so formidable and why the measurement of capital formation by expenditures is less useful for human investment than for investment in physical goods" (p. 8). *Schultz* however goes on to say that "despite the difficulty of exact measurement at this stage of our understanding of human investment, many insights can be gained by examining some of the more important activities that improve human capabilities".

the social investment perspective which has attracted concerns. The advocacy of social expenditure focussed on investment has been seen as containing the implicit message that other types of social spending do not generate such a return, and are "only" or "mostly" consumption (*Nolan*, 2013). In this view, the social investment perspective potentially undermines the normative basis of social spending, delegitimizing (other) forms of social spending which – implicitly if not explicitly – are framed only as cost and as lacking the "dividend" associated with social investment. On a similar line, *Cantillon* (2011) and others warn that the social investment strategy might give too little weight to today's poor, and that rechanneling spending from income support to activation might come at the expense of social policies that mitigate poverty and inequality. A second, related tension concerns the bias in favour of a re-commodification of social rights, "at least to the extent that the requirement of greater economic self-reliance is imposed through lower or less accessible benefits" (*Cantillon – van Mechelen*, 2013).

The first point, i. e. the extent to which social investment "crowds out" other expenditure which is explicitly directed at the most vulnerable segments of the population, crucially depends on the actual social policies which are implemented. It relates to the tension, highlighted at the end of the preceding section, between the policy pillars of activation, human capital development and social inclusion. *Vandenbroucke and Vleminckx* (2011) find that, at least up to the years preceding the crisis, "new" forms of spending have not crowded out spending on traditional cash benefit programmes for the poor. The second concern, that the activating, make-work-pay component of the social investment strategy might reinforce pressures for retrenchment and re-commodification in unemployment benefits, thus increasing poverty risks in that segment of the population, is "not easily refuted" (*ibidem*). In fact, as we have seen in the previous section, unemployment insurance systems experienced retrenchment and re-commodification over the last decades, notably in countries with high benefit levels. These reforms are parts of an activation strategy based primarily on lowering reservation wages, and can thus be seen as part of the neo-liberal understanding of social policy. They are however also compatible with a social investment approach to social policy, particularly when the tension within the activation component is resolved in favour of its "workfarist" connotation.

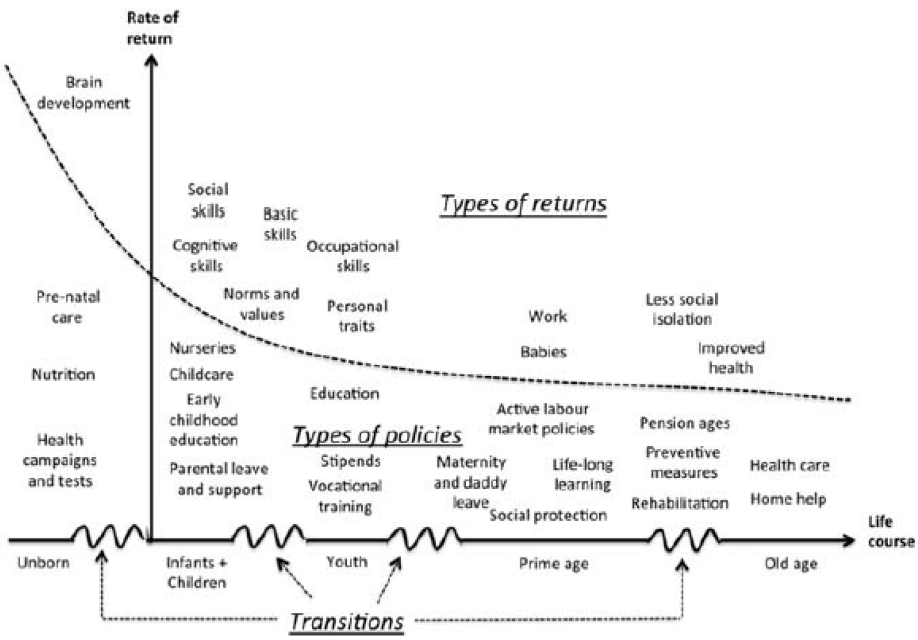
Finally, the social investment agenda has also been associated with potentially regressive distributive effects, because some of its archetypical interventions (such as the provision of institutionalised childcare) are work-related and because its service-orientation might entail weaker redistributive effects than equivalent cash transfers (*Cantillon*, 2011). It is indeed likely that certain activation policies, such as childcare and measures to support the combination of work and family life, initially benefit primarily those who are already participating in the labour process. In the medium and long term, however, they should reach other segments of the population, so that work-related spending increasingly benefits poor or previously poor households. Moreover, the question whether services are less redistributive than cash transfers is not clear-cut, with mixed empirical evidence (*Verbist and Matsaganis*, 2012). In addition, the provision of services can be a very effective way to set quality standards and to avoid common market failures such as information asymmetries and externalities (*Besley and Coate*, 1991; *Blank*, 1999). Ultimately, the redistributive impact of social policies, both in form of cash payments or services, will depend on their design. A shift of social expenditure towards activation and human capital development does not need to have a negative redistributive impact, particularly when a longer time-horizon is considered.

4. The implementation of social investment

Identifying key policies in a social investment perspective

At least since the publication of “Why We Need a New Welfare State” (*Esping-Andersen et al.*, 2002) the social investment idea is strongly linked to the life course as analytical grid.[8] Figure 4 provides a representation of this life course perspective on social investment. As can be seen from the falling returns function, the social investment approach implicitly favors policies that intervene early on in the life course. Early interventions are meant to make a significant impact to address socio-economic inequalities and to increase equality of opportunity. Indeed, policy interventions play a role even before birth, in order to prevent adverse prenatal influences that might have lasting negative effects on individual development.

Figure 4: A life course perspective on social investment policies and their returns



Source: *Kvist* (2014).

Another specific feature of this conceptual framework is the focus on life transitions. Individual biographies have become more fluid and heterogeneous and as consequence also the number of transitions, for instance repeated shifts from education to work or from care to work, is on the rise. The

[8] “The life course framework allows us, first, to connect fragments because welfare conditions at one stage of the life cycle are often directly linked to events earlier in life (and may influence well-being later on in life). [...] Second, as discussed above, it is only via a life course perspective that we can adequately separate momentary (and possibly inconsequential) from lasting hardship. And, third, this is a methodology which does help us take a peek into the dim future. If we know a lot about today's youth cohorts we are in a fairly good position to make informed forecasts about tomorrow's parents, workers, or welfare clienteles” (*Esping-Andersen*, 2002).

welfare state should provide a context within which individuals are able to manage these transitions smoothly, avoiding to get trapped in an adverse equilibrium (e. g. because they are not able to find employment after leaving education or because they exit the labour market too early). Overall, measures to support skill formation and employment play a paramount role in all life stages. Next to policies that increase human capital and that reconcile work with family, health is another prominent dimension addressed by social investment. This has partly to do with the fact that, particularly in aging societies, good health is a keystone of employability and therefore a precondition of any activation strategy. Moreover, health offers a good example to highlight the difference between expenditure aimed at prevention and expenditure aimed at reparation. Table 1 presents a similar conceptual framework as Figure 4, but it gives more space to highlight the existence of three pillars of a consistent social investment strategy, namely human capital development, activation and social inclusion.

These schematic frameworks do not provide answers to many crucial questions that European policy-makers have to face: How should the available resources be allocated to short- and long-term priorities? What should be the relative weight given to the different social policy components, what is the adequate equilibrium between policies that protect, support and compensate and those that set incentives and assign duties? And how should we design the specific policies to achieve their objectives without undermining other goals? These questions cannot be answered in general terms, but must be addressed taking into account national specificities and institutional contexts. Conceptual frameworks do however help to highlight a few guidelines for a social policy strategy with strong investment character: the focus on measures aimed at human capital, skills and employment; the support to individuals and families in managing life course transitions; the bias in favour of policies that favour the youngest cohorts as part of a long-term strategy.

Table 1: Elements of a social investment strategy

	Prenatal period, childhood and youth	**Family formation and working age**	**Old age**
Human capital development	Early childhood education and care (ECEC)		
	Education, training, lifelong learning		
	(Prenatal) health promotion	Health promotion and rehabilitation	
		ALMP – up-skilling, vocational training	
Activation		ALMP – employment assistance, incentives	
		Policies for work-family reconciliation	
Social inclusion	Policies to support pregnant mothers	Insurance (unemployment, sickness, disability)	Pensions
	Safety nets (income assistance)		

How far have we moved in the direction of a "social investment turn"?

We might ask to which extent social investment has already become common practice, informing the welfare state reform processes which have been taking place in Europe. In spite of some serious limitations, data on social spending remain one of the few obvious sources to carry out an empirical analysis on the development of social investment. *Nikolai* (2012) investigates the development of public social expenditure in 21 OECD Member States from 1980 to 2007, with the aim to identify whether a "turn" to social investment can be observed in the social expenditure profile of welfare states. The analysis is based on a distinction between compensatory forms of spending (old age insurance and passive labour market policies) and investment-related social expenditures (ALMP, family policy and education). The findings are mixed, providing only partial support to the claim that "welfare states are moving away from compensatory social policies towards a rechanneling of resources toward social investment" (*Nikolai*, 2012). Only Scandinavian and, to a lesser extent, most of the English-speaking countries have a high share of investment-related social programmes. Continental European countries such as Belgium, France and the Netherlands still show a predominance of compensatory-related expenditure, although they rank high on both compensatory and investment spending. Particularly the Southern European countries were characterised by high levels of spending on compensatory programmes.

Kvist (2013) analyses the social investment content of European social policy before the crisis and its development since the onset of the crisis in 2008. The author defines "social investments" as policies that primarily bring about an increase or an improvement in the formation, maintenance or use of skills. The development of such policies is investigated using small sets of indicators for each of the three life-stages (childhood and youth, working age, and old age). The advantage of *Kvist*'s approach is that it does not rely on expenditure data for his assessment, but on outcome indicators such as the share of NEETs[9] and lifelong learning, as well as a qualitative discussion of pension reforms. The analysis reveals that in many EU countries elements of a social investment have become integral part of social policy strategies. The evidence also indicates that, overall, social investments have been taking a larger role in Europe since the crisis. However, *Kvist* (2013) finds that the crisis impacted countries and policy fields within countries very differently, leading to the conclusion that we are unlikely to see the emergence of "a uniform European social investment model as those countries which are most in need of social investments are also the countries least likely to develop high-quality social investments".

The hypothesis of a "social investment turn" can therefore at best be confirmed very partially. This concerns both cross-country differences, as well as asymmetries in the extent to which different components of a social investment strategy have been implemented. Indeed, in many instances, especially when investment in human capital is concerned, emphasis has been much stronger in discourse than in actual policies (*Bonoli and Natali*, 2012). Empirically the clearest shift in expenditure and the strongest increase in social spending with investment character took place in the realm of childcare service and of policies for the reconciliation of family and work. In this respect, there is a general shift towards a stronger reconciliation of work and care, with Southern European countries still at low levels and Continental countries more rapidly catching up with the forerunners, the Scandinavian countries (*Dräbing, in Beblavý et al.*, 2014). With the exception of a handful of countries,

[9] Young people not in employment and not in any education or training (NEET).

the expansion of childcare coverage was not halted by the crisis and the ensuing fiscal consolidation efforts (*Kvist*, 2013). In other realms progress has however been much more modest and differences across countries have increased, not diminished.

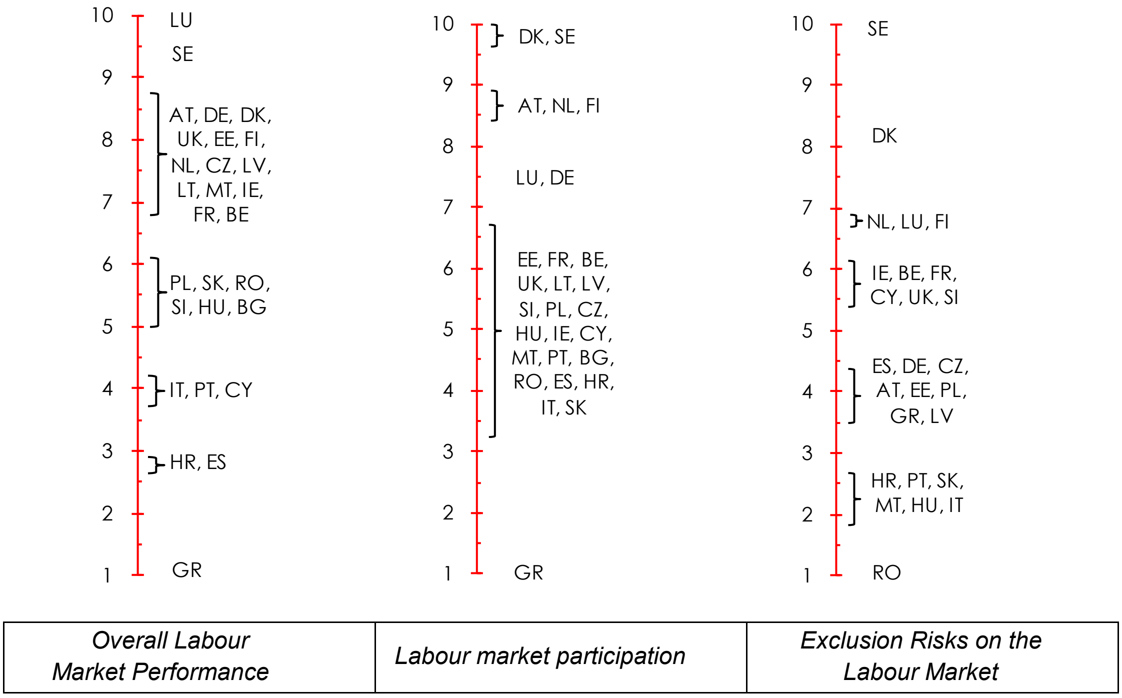
Table 2: Summary statistics for social indicators across EU28(selection) from the MIP scoreboard, 2013 and 2009/2013

	Activity rate (15-64 years)	**Long-term Un-employ-ment Rate**	**Youth Un-employm-ent Rate**	**NEETs**	**People at Risk of Poverty or Social Exclusion**	**At-risk Poverty Rate**	**Severe Material Depri-vation Rate**	**Living in House-holds with Very Low Work Intensity**
				In %				
Mean (EU28)	71.5	5.4	26.3	12.8	25.4	16.3	11.5	10.8
∆ mean (2009/13)	1.5	88.5	24.7	9.0	6.0	1.4	18.8	24.4
				In percentage points				
Range (EU28)	17.6	17.3	50.4	17.2	33.4	14.5	41.6	17.0
∆ range (2009/13)	-3.2	11.4	20.4	1.8	1.2	-3.3	0.8	1.0
Standard deviation	4.9	3.9	12.8	5.0	8.0	3.6	9.6	3.1
∆ stand. deviation	-0.7	2.4	0.9	1.0	0.1	-0.4	0.2	0.0

Source: European Commission; own calculations. Mean refers to unweighted average across countries. In cases of missing data (for Ireland and Croatia), values from the next available year were inserted. NEET refers to young people not in employment and not in any education or training.

To stress this point, we can look at recent data on outcome indicators in the fields of social protection and employment across EU Member States. Table 2 presents summary statistics based on data from the European Commission's scoreboard on (auxiliary) social indicators included in the Macroeconomic Imbalance Procedure (MIP). As we can see from dispersion measures such as standard deviation and range, there is a high degree of cross country variation in all observed dimensions. Overall activity rates have been increasing and the gap between countries (as measured by the range in percentage points) was reduced between 2009 and 2013. This development is primarily due to the increasing labour force participation of women and older workers, areas in which we can observe some catching up of the "laggards" with respect to the "forerunners". At the same time, over the period 2009/2013 unemployment, and particularly youth unemployment, the share of NEETs as well as poverty and deprivation rates were impacted negatively by the crisis. In addition, the crisis led to widening gaps between EU Member States, with an increase in the range between countries with low (high) unemployment and youth unemployment rates. From the viewpoint of the social investment perspective, this is clearly discomforting evidence, particularly when we consider the negative long-term consequences of inactivity on the younger cohorts.

Figure 5: Labour market indexes along different dimensions, clustered representation for EU28 2014



Source: Adapted from *Haas, Huemer and Mahringer* (forthcoming); Eurostat data, WIFO calculations. The numbers on the axes represent the point values of the dimensions (for each index, 1 is the minimum and 10 the maximum value). The countries have been categorized based on differences in point values: a new group starts where the distance to the next group is at least 0.6 points. Within the groups the countries are ranked in descending order of points. Exclusion risks index refers to EU-28 without BG and LT.

Further evidence on the relative position of EU Member States with respect to the objectives addressed by social policy can be obtained by looking at composite measures for specific outcome areas. Figure 5 reports results from a clustering exercise by *Haas, Huemer and Mahringer* (forthcoming), in which the European countries were ranked according to different indexes that capture dimensions of labour market and welfare state performance.[10] The three indexes represented in Figure 5 cover: "overall labour market performance", which is a synthetic measure of seven indicators for employment, unemployment and productivity; "participation", which uses 13 indicators to measure labour market integration of different groups of people as well as active labour market policies; and "exclusion risks on the labour market", which is based on 20 indicators on education, inactivity, child care and health to describe impediments to labour market participation. The countries have been categorized based on the distance to the next group. Within the groups, countries are ranked in descending order of points. We can observe a clear North-South and, partially, a West-East divide along the different synthetic scores. These summary figures indicate that, in light of very diverse starting positions, there is no “one-size-fits-all” approach to welfare state adjustment.

[10] Further details about the computation of these indexes can be found in *Haas, Huemer and Mahringer* (2015).

Social investment – the EU level

Part of the reason why the social investment perspective has gained a prominent position in academic and policy debate, is the increasing popularity it received within the institutions of the European Union. The EU has both pushed in the direction of a new understanding of welfare state framework, for instance by commissioning the "Why we need a new welfare state" study in the early 2000s. And it has been receptive for (parts of) the social investment discourse. The Lisbon Strategy and the European Employment Strategy (EES) emphasised elements of the social investment idea, in particular the positive complementarities between equity and efficiency, and anchored the fight against unemployment firmly within the activation framework (*Hemerijck et al.*, 2013). The focus of the EES and the Lisbon strategy was however clearly only on parts of the social investment idea. The implementation of the EES was biased in favour of labour market flexibility and a narrow ("workfarist") understanding of activation, with little redirection of spending on social investment (*de la Porte and Jacobsson*, 2012). Particularly after the mid-term review of the Lisbon Strategy, a shift in emphasis took place, giving more attention to employment and growth and less to social cohesion (*Lundvall and Lorenz*, 2012). The underlying social policy vision assumed that the goals of economic, employment and social policy are complementary – but this need not necessarily be the case and strongly depends on policy design and the extent to which activation is combined with social inclusion (*Vandenbroucke and Vleminckx*, 2011).

The EU2020 Strategy for "Smart, Sustainable and Inclusive Growth" can be viewed as a more focused and more balanced continuation of the Lisbon Strategy. It is built around central objectives for economic growth, social inclusion and environmental sustainability. At the same time, it suffers from similar weaknesses as the Lisbon strategy, setting priorities and ambitious targets, but failing to provide a clear roadmap on how these objectives can be achieved. This is particularly true from a social investment perspective: The social inclusion objectives include a substantial reduction in poverty and in the number of school drop-outs, a boost in tertiary education and an overall increase in employment rates. The Strategy does not provide a picture of the encompassing and radical reforms that are needed to achieve these goals. Also, the Strategy does not address the fundamental imbalance and tension between hard instruments for monitoring, surveillance and enforcement in the fiscal and monetary realm of the EMU and EU and the soft instruments that are available to implement common objectives in the social dimension. The economic governance structure is built on the Euro Plus Pact, the Stability and Growth Pact and the European Semester, whereas the social dimension continues to rely on voluntary instruments such as the Open Method of Coordination. This institutional imbalance is mirrored in the strong bias towards austerity and short-term goals emanating from European policy in the past years, to the detriment of social inclusion and long-term objectives.

Further steps to advocate social investment and also to strengthen the social dimension of the EU were undertaken more recently. In November 2012 the European Parliament adopted a resolution on "Social Investment Pact – as a response to the crisis", which contains a call for "fight against poverty and social and medical exclusion, with a particular focus on preventive and proactive work" (*European Parliament*, 2012). In March 2013, half a decade since the outbreak of the Great Recession, the European Commission launched the Social Investment Package, a proposal for countries to modernize their social protection system to "benefit individuals' prosperity, boost the economy and help the EU emerge from the crisis stronger, more cohesive, and more competitive" (*European Commission*, 2013). The Social Investment Package can be seen as *the* attempt of the Commission to change the social policy agenda in Europe and shift the balance from short-term measures of fiscal consolidation to long-term and forward-looking goals (*Kvist*, 2013). In the SIP, the European Commission explicitly states that welfare systems have to fulfil three functions: social investment, social protection and stabilisation of the economy. It is stressed that these three functions can be mutually reinforcing and that the protection function represents a precondition to the preservation and further development of human capital. To achieve this goal, the European Commission calls on Member States to prioritise social investment and to modernise their welfare states.

In this case, too, doubts can be expressed with respect to the impact of the Commission's recommendations. Since the SIP is not legally binding and there are no enforcement mechanisms in place, there is no assurance that coming national reforms will follow this blueprint for welfare reform (*Kvist*, 2013). The Commission, or at least parts of it, is however aware of the deficits that are emerging with respect to the social dimension of the European integration project, at least with reference to the EMU. In a Communication from October 2013, the Commission explicitly addressed these deficits, proposing initiatives to strengthen the social dimension of EMU, among others with "reinforced surveillance of employment and social challenges and policy coordination" (*European Commission*, 2013b). The European Council agreed to integrate the social dimension of the EMU into the European Semester and as a result 2014 a new scoreboard to follow key employment and social developments was introduced by the Commission. While this development can be seen as an important step on the way to inform the European Semester by the social investment strategy, the country specific recommendations which were issued in the last European Semester show only partial discontinuity with respect to the recommendations issued in previous years (*Kvist*, 2014).

5. Welfare state adjustment in the post-crisis scenario

In section 1 we discussed changes and long-term trends which have put pressure on consolidated welfare states to adapt. Internal and external forces that have challenged the extent of social protection as well as the traditional set of functions performed by welfare states have not come to rest. In terms of pressures from *within*, demographic change will continue to represent the single most important driver for welfare state adaptation. Demographic dependency rates in mature industrial economies are expected to increase until at least the mid of the century (*Fischer-Kowalski et al.*, 2012). According to the most recent Ageing Report published by the *European Commission* (2014), the demographic old-age dependency ratio (people aged 65 or above relative to those aged 15-64) in the EU as a whole is projected to increase from 27.8% in 2013 to 32.1% in 2020 and to 50.1% in 2060. The deterioration of the dependency ratio will partly be cushioned by increasing participation and employment rates of women and older workers. Therefore the total economic dependency ratio[11], a proxy measure for the financial sustainability of the welfare state, provides a somewhat less gloomy outlook: When calculated on the basis of employment in the age group 20-74, the total economic dependency is initially projected to decrease slightly, from 120% in 2013 to 118% in 2023, before starting to increase again and reach 134% in 2060. The employment rates of women and older workers are projected to rise substantially, reaching 71.2% for women in 2060 (62.6% in 2013) and 67.1% workers aged 55 to 64 (50.3% in 2013). Clearly, these changes in activity rate will maintain

[11] Calculated as the ratio between the total inactive population and employment, gives a measure of the average number of individuals that each employed "supports".

issues such as the reconciliation of family and work and the organisation of care (for both children and elderly persons) high on the agenda of welfare state adjustment.

At the same time, *external* pressure on European economies will continue to induce a high pace of structural change, with sectoral shifts and relocation processes. Although it is early to tell, we might have entered a phase in which trade liberalization and economic integration experience a slowdown. There are indications that many advanced economies are reacting to slow growth with an intensified use of protectionist measures (*Evenett*, 2014). In spite of these signs for a deceleration of economic integration, we can expect that the demand in terms of labour force skills and qualifications will continue to evolve. Technological progress, which has time and again been identified as fundamental component of skill-biased shifts in labour demand (see, for instance, *Autor et al.*, 2008), is likely to continue unabatedly (*Gordon*, 2014) or even to increase in speed (*Mokyr*, 2014). Since part of the technological progress has labour-saving characteristics, the pressure on the workforce to adapt will remain high.[12] The "race between education and technology" (*Goldin and Katz*, 2009) is here to stay: while individuals who possess or gain the right skills are rewarded, others find it difficult to accommodate the demands of fast-changing production processes and risk falling behind. A recent study, which focuses on the potential impact of computerization on jobs delivers an estimate according to which in the United States 47% of jobs could be automated "relatively soon, perhaps over the next decade or two" (*Frey and Osborne*, 2013). Calculations on the basis of the same methodology lead to very similar results for Europe (*Bowles*, 2014).[13] Although these findings must be interpreted with caution[14], they illustrate the perspective that the pace of asymmetric structural change in the labour market will remain high, regardless whether the main driver will be trade or technology.

In addition to these long-standing, secular trends in social and economic circumstances, the financial and economic crisis of 2008/9 has added a new layer of complexity and exacerbated the challenges and trade-offs in the social policy field. After more than seven years since the onset of the financial crisis, it is becoming increasingly clear that "what started as a temporary phenomenon could become an enduring transformation" (*Begg*, 2013). In fact, two intertwined aspects have to be highlighted. On the one hand, the depth of the crisis and the resulting discontinuities caused a level shift in economic output that will continue to be felt in the long-term. A "cohort effect" will occur because a large share of youth is poorer and will have smaller life-income than would have been the case without the crisis (*Kvist*, 2013). On the other hand, due to the length of the crisis we might have entered a period with a new economic equilibrium. According to the most recent projections by the *OECD* (2014), the crisis is estimated to have reduced potential output per capita in 2014 by about 3¼ per cent. The corresponding figure is much larger for some European countries, mainly in the Euro area, with reductions in potential output in 2014 of more than 10%. In its projections on long-term economic

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[12] "Modern technology often leads to winner-take-all outcomes, and the inequality implications in terms of income – though not in terms of access to the good itself – are worrisome. What we gain as consumers, citizens, viewers and patients we may lose as workers" (*Mokyr*, 2014; p. 88).

[13] As an interesting side point, *Bowles* (2014) finds significant cross-country variation in the risks of computerisation for jobs within the EU. In the aggregate the share of jobs with a high risk of computerisation is similar in Europe and in the US (50% and 47% respectively). In a picture disaggregated by country, however, Northern countries - Netherlands, Belgium, Germany, France, UK, Ireland, and Sweden - have considerably lower computerisation risk levels than the Southern and Eastern Member States of the EU.

[14] In addition to the assumptions that underpin the identification of computerisation risks of specific jobs, the authors point out that their analysis is static in nature, i. e. it is based on a snapshot of the current distribution of jobs in the economy and does not take into account dynamic shifts in their composition over time.

growth, the OECD makes the optimistic assumption that in the aftermath of the crisis, within a period of four to five years, output gaps will close smoothly. According to these assumptions, for instance, potential output in the Euro area in the period 2014-2030 will correspond to +1,7% per year, the same rate as for the period 2000-2007. However, it is very likely that hysteresis-type effects resulting from the crisis drag down the level of potential output on a permanent basis, casting a shadow over future economic activity (*De Long and Summers*, 2012).

Although predictions about medium- and long-term economic developments are very fragile, there is a consensus that Europe and particularly the Euro zone is currently facing a non-negligible risk of secular stagnation, i. e. a prolonged period of subdued growth (*Rawdanowicz et al.*, 2014; *Teulings and Baldwin*, 2014).[15] Developments on the labour market lie at the core of such a scenario, both in terms of its causes and of the ensuing consequences. The Great Recession and its aftershocks resulted in a dramatic increase in unemployment, affecting vulnerable groups such as youths, older workers and migrants disproportionally. The long-term unemployment has doubled in comparison to pre-crisis levels (from 2,6% to 5,1% for the whole EU) and this figure has to be interpreted as a lower bound, because labour force statistics do not account for discouraged workers. It is very difficult to estimate the resulting damage in terms of human capital formation and long-term negative employment outcomes. Earlier studies for both Europe and the United States show the existence of persistent earnings penalties of unemployment experienced early in the career (*Arulampalam*, 2001; *Gregg and Tominey*, 2005). These scarring effects can be a consequence of human capital depreciation, foregone human capital accumulation and negative signalling effects of unemployment (*Cockx and Picchio*, 2013). Either way, the high and persistent levels of unemployment affecting the European labour force run the risk to feed into a vicious circle of labour market hysteresis, low potential output and further unemployment, resulting in a "bad equilibrium" that will be difficult to escape.

In terms of policy environment, the Great Recession and its aftershocks had two effects that are of substantial relevance for welfare state dynamics. First, the events since 2008 and the ensuing policy responses magnified social and economic disparities and disequilibria within the EU and particularly within the Euro area. Whereas the Anglo-Saxon and – much more – the Southern European countries underwent a significant amount of welfare state retrenchment, Continental European and Scandinavian countries safeguarded their welfare programmes (*Bonoli and Natali*, 2012). This asymmetric development is particularly detrimental to countries in the Euro zone periphery, as they had gone less far in the transformation of their welfare states before the crisis. They are now even less prepared than others to master the challenges that lie ahead. Second, the crisis profoundly changed the conditions for policy making in the EU. Arguably "permanent austerity" is the over-arching constraint faced by European welfare states since the end of their "Golden Age" and the beginning of the "Silver Age" (*Pierson*, 2002; *Taylor-Gooby*, 2002). Although the period in which the European welfare states face fiscal stress started four decades ago (*Pierson*, 2011), the current constraints due to high public debt and the framework for fiscal coordination embodied in the "six-pack" and the Finance Pact provide a qualitatively different type of constraint in times when the need for social policy interventions is particularly acute. The Euro zone faces the additional limitation that fiscal consolidation is aimed for in a context where monetary policy has no or only limited room.

[15] Secular stagnation can be defined as "a situation when policy interest rates bounded at zero fail to stimulate demand sufficiently, due to low or negative neutral real interest rates and low inflation, and when ensuing prolonged and subdued growth undermines potential growth via labour hysteresis and discouraged investment" (*Rawdanowicz et al.*, 2014).

Accordingly, the policy perspectives for welfare state adjustment have deteriorated: Confronted with recurrent crisis management, long-term transitions and objectives have been downgraded in policy-makers' priorities. In addition, the instruments set in place to improve the functioning of the European Monetary Union have been conceived with a narrow focus on fiscal objectives. The initiatives to address and improve the social dimension of the EU continue to be based on the Open Method of Coordination, with weak surveillance and enforcement (*de la Porte and Hein*, 2015). If there is a silver lining with respect to the current policy environment, it paradoxically consists in the potential for change that results from the extraordinary crisis that we are experiencing. True to its etymological roots, a crisis is a period of intense difficulty in which important decisions have to be made and change takes place. The last few years, which saw the implementation of far-reaching institutional changes at the EU level (such as the Fiscal Pact and the banking union) as well as numerous structural reforms at national level, have proven that policy change in Europe can be fast and effective (*Kvist*, 2013).

Finally, the low growth scenario that we face today has serious implications for the future level and structure of inequality. Even in the case where wage and earnings inequality should not continue to increase, low economic growth will make it more difficult to reduce inactivity and long-term unemployment. Vulnerable segments of the workforce face an increased risk of getting caught in a bad equilibrium characterised by long spells of inactivity and marginal employment. This could reinforce the divide between work-poor and work-rich households. Moreover, *Piketty* (2013) documents the increase in wealth inequality that took place in the last decades. His analysis highlights that low growth rates will lead to a further increase in the capital to income ratios and in the concentration of wealth.

6. Conclusions and discussion

The following points summarize the main results of the previous sections and provide some tentative policy conclusions:

(1) The European welfare states have undergone a significant amount of change over the last decades. There are good reasons to think that we will see, and in fact need to see, further adaptations in the near future. For one thing, there exists large heterogeneity in the degree to which EU Member States adjusted their welfare states to the challenges posed by post-industrialisation and (hyper)globalisation. The shift in the risk structure of European societies commonly captured by the "new social risks" label had been accommodated only partially and with a high degree of cross-country variation before the outbreak of the Great Recession. The crisis and its aftershocks have added a layer of complexity and also urgency to the question of welfare state adjustment. Moreover, the crisis in conjunction with the ensuing policy response, magnified imbalances across the European Union while inequalities *within* countries, which have been on the rise for several decades, risk to be perpetuated and possibly further increased.

(2) "New" and "old" social risks are not substitutes, but potential complements linked by varying interdependencies along the life course. The emergence of the first has not led to the disappearance of the latter. In fact, the crisis and its aftershocks have led to a strong re-emergence of "old" risks, hitting the most vulnerable segments of the population asymmetrically hard. Social stratification continues to be a powerful predictor of risk prevalence, although different risk types are stratified

differently. Life course events, individual characteristics and preferences have gained importance, but they lead to different outcomes in interaction with stratifying socio-economic circumstances. This implies that welfare state adjustment cannot be reduced to a shift in the policy focus from "old" to "new" social risks, nor that risks can be managed either through compensation or through prevention (*Vandenbroucke and Vleminckx*, 2011). Modern social security systems need to combine different functions in a balanced and mutually reinforcing form.

(3) In spite of some weaknesses, both as an analytical framework and as an emerging policy paradigm, social investment seems the most appropriate approach to frame the objectives that contemporary welfare states have to pursue and to devise a consistent set of policies. This for a number of reasons: a) It represents a fruitful synthesis of previous social policy approaches, providing a path to evolve the notion of social citizenship in a context of tight budgets and changed macroeconomic conditions; b) it sets human capital and activation at centre stage and thus addresses key factors to secure high living standards and sustainable development in post-industrialised and rapidly ageing societies; c) it provides a suitable basis to understand and design social security systems that take into account the life course perspective; d) it places great weight on long-term outcomes and is thus conducive to tackle resilient problems such as structural unemployment and vicious circles of (cumulative life course and intergenerational) disadvantage; e) it is consistent with the broader EU strategy aimed at managing the socio-ecological transition.

(4) The objections which have been moved against the social investment perspective have to be taken seriously. Consumption and investment cannot be understood as perfectly dichotomous in the social policy realm. This is of relevance for the conceptual framework on which the social investment perspective builds and for the methodological issues related to policy evaluation. More empirical work is needed to inform the design of policies. A conceptual framework, based on the life course perspective but bringing together interdependencies between life course and stratification as well as between old and new social risks represents a promising theoretical basis for this empirical work. On the macro-level, welfare state adjustment has to be interpreted in a multidimensional way. A useful conceptualisation proposed by *Hemerijck* (2014) differentiates between "flows" (activation and labour market transitions), "stocks" (human capital) and "buffers" (safety nets for social protection). These three components correspond to pillars of welfare state activity dedicated to activation, human capital formation and social inclusion.

(5) The crucial question concerns the way in which the social investment perspective is interpreted and applied in practice. Differences in emphasis can be traced back to ambiguities in the interpretation of "activation" as well as more generally in the relationship between the three pillars of this strategy, social inclusion, human capital development and activation. In a narrow understanding, social investment is centred on activation, with a limited focus on human capital formation and a tendency to scale down social protection. A narrow interpretation and lopsided implementation of social investment entails the danger of overstating the potential for activation and it disconnects social inclusion as a necessary and mutually reinforcing component of a comprehensive long-term strategy. It also entails potentially regressive effects: In a situation where employment growth is either insufficient or not benefitting work-poor households, spending focused on employment-related measures such as the reconciliation of work and family and lifelong learning can tend to accrue permanently to middle and higher income groups (*Cantillon*, 2011). The failure to make substantial progress in the reduction of poverty in the decade previous to the Great Recession, when employment was greatly expanded and

labour market policies incorporated the activation principle, clearly indicates that there are limits to the extent of social inclusion that can be achieved by activation strategies.

(6) So far, the social investment perspective has been implemented very partially, in forms that come close to its narrow definition. There has been a boost of policies to reconcile work and family as well as to expand institutional child care. In other areas, such as unemployment, disability and old age, the focus was mainly on activation in a narrow sense, with stronger emphasis on re-commodification and incentives than on investment in skills and human capital. Investment in the future, be it in form of more education and research or in the reduction of cumulative disadvantage and the increase in social mobility, has been timid. Moreover, across countries and policy areas numerous examples of dualization have been observed, i. e. instances in which policies contributed to separate insiders from outsiders. Complementarity between activation and social inclusion cannot be taken for granted, but it can be achieved through adequate policy design. In order to avoid potential "Matthew effects", i. e. adverse distributional consequences because policies systematically channel resource to comparatively well-off population segments, distributional effects associated with social investment spending have to be carefully monitored. In light of large cross-country differences along many dimensions, welfare state adjustment has to be contextualized to the national situation. The social investment perspective represents a broad and flexible framework that can be adapted to national circumstances depending on level of prosperity, institutional and economic settings and path-dependencies.

(7) Presently, there is a striking imbalance between the needs for welfare state adjustment in European countries and the means that are available to achieve this goal. In light of low growth perspectives and severe constraints on government budgets due to high debt levels and austerity, welfare state adaptation has become more difficult, as has the task to deliver the benefits promised by the social investment strategy. At the same time, the need for social investment has further increased. Social investment targets long-term objectives which in all likelihood need more, not less resources in the short run. Reforms that improve education, enhance skill formation and reduce disadvantage pay-off in the long-run, but they are costly at the beginning. The requirements of a proper social investment strategy contrast with the current policy focus on short-term stabilisation and cost-containment. This is reflected in the tension between the austerity policies and the strong governance instruments in the fiscal area on the one hand and the secondary role and soft governance accorded to the social dimension of the EU on the other. With the social investment package and other related initiatives, the EU institutions have pushed to establish the social investment perspective as overarching European policy paradigm and to raise awareness for the need to target social objectives more stringently. There remains however a wide gap between the stated objectives of the EU2020 Agenda, with its ambitious goals in terms of improving human capital accumulation and reducing social exclusion, and the current policies and macroeconomic governance focused on consolidation rather than on mobilising resources for social investment.

(8) To become a convincing and effective policy paradigm, the social investment perspective thus needs a stronger anchoring within the EU architecture and more co-ordinated commitment from Member States. In addition, it must be clear that welfare state adjustment cannot be achieved by changes in social policy alone. Flanking measures are required to create the conditions for the effective implementation of social investment. Labour market regulations to combat and avoid dualization processes represent one important instance in this respect. Partly, social investment can

be a strategy to bridge the differences between insiders and outsiders (*Emmenegger et al.*, 2012). Conversely, insider-outsider dynamics can represent a stumbling block on the way to deliver the benefits of social investment to those who are most in need of it. The tax systems are another crucial area for reform. Shifts in the taxation mix between capital and labour can reduce the tax burden on labour and therefore stimulate employment. In combination with greater progressivity, they can also generate revenue and help to address the imbalance in wealth and income accrual that we witnessed in the last decades.

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