The Re-orientation of European Social Policies toward Social Investment*

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Western European countries have their own »social model,« one that that differentiates them from other industrialized countries. The basic foundation of the European social model, which was established during the boom period after 1945, was shared. It included the pursuit of full employment and Keynesian policies to stimulate demand. It also guaranteed social welfare and social rights that were more or less independent of the relationship to the labor market. All Western European countries, however, also adapted this framework by introducing their own policy compromises, approaches, and institutions for social protection tailored to their own needs and context. Consequently, the European social model can be subdivided into five types, or regimes: British, Nordic, Continental, Mediterranean, and Eastern.

Since the middle of the 1970s, this model has been in crisis and much reformed. Some people even suggest that a new social model for Europe is needed. This paper seeks to isolate the major trends that are re-shaping social policies. A comparison of the reforms implemented in a number of European countries reveals common trends. In the decade from 1990 to 2000, social policies previously formulated in Keynesian terms had to adjust to a new economic framework characterized by the domination of neo-classical, supply-side policies and conservative budget practices. Beginning in the late 1970s, new economic conditions altered the operation of social protection mechanisms and convinced many governments that they should reconsider their social policies. Out of this process have come two general trends that characterize all the policies implemented in European countries: the desire to limit government social expenditures and to redefine the role of the state (section 1), and the re-alignment of social

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programs with employment needs (section 2). It seems, then, that all reforms are trying to re-align social policies to supply-side macroeconomic policies (section 3). However, one can also see the emergence of a new social model, compatible with the new economic environment, and capable of promoting social justice and progress (section 4).

Limiting Growth in Spending and the Role of the State: The Era of Retrenchment

Whereas from the 1950s to the 1970s social protection policies extended and increased social security coverage, the late 1980s and the 1990s were characterized by retrenchment policies, that is, by reductions in social spending levels. These changes marked a transformation in the economic role of social protection, a change in the way the state's role was formulated, and the end of Keynesian compromises between the economic sphere and the social sphere. The 1970s brought increased demand for social assistance, due in part to the economic downturn; the latter in turn reduced tax revenues and payroll taxes. The deficits created by this drift toward higher expenditures and lower revenues became a central problem for European governments, challenging among other things their macroeconomic analysis.

Within the framework of Keynesian policy, temporary government deficits provided a vehicle to boost consumption, which in turn facilitated economic recovery. The recovery would culminate in an increase in tax receipts that were supposed to enable governments to rapidly make up the deficits. In several European countries, however, Keynesian intervention in the late 1970s did not generate these effects and ended in traumatizing economic failure. For example, the two attempts at economic recovery based on increases in social security benefits, tried in France in 1974/1975 and 1981/1982, did not have the expected results. To be sure, they boosted consumption, but primarily consumption of imported goods and thus did not generate a national economic upturn nor increase tax receipts. The result was that government deficits and the trade balance deteriorated, there was an exodus of capital, and exchange rates worsened. To tackle these problems the French franc was devalued several times and taxes were increased. However, both greater inflation and unemployment accompanied these measures, generating »stagflation.« Eventually, France abandoned its Keynesianism in the early 1980s. The British Labour government faced its own difficulties with Keynesian strategies. Having carried out a policy of recovery based on increases in social security benefits, it was obliged in 1979 to borrow from the International Monetary Fund (IMF) in order to reimburse a level of public debt that had become intolerable.

Such anomalies raised doubts about the overall framework of government intervention. From that point forward, new macroeconomic policies gradually became the norm in Europe. They emphasized budgetary rigor, wage restraint, monetarism, and corporate competitiveness. There was a growing demand for the role of the state to be downgraded, since it was perceived as too costly and inefficient, and for a reallocation of social responsibilities towards other social forces, such as the market, the family, or community associations.

The state's role and economic objectives were modified. Full employment was no longer a direct objective of macroeconomic policy. It was conceived instead as the future payoff of a virtuous chain of events triggered by the new policies. This chain of events included: a slowdown in price and wage increases; gains in competitiveness and productivity; a rise in corporate profit margins and in value added not redistributed in wages; and investment and job creation. An expression often used in the 1980s – »today's profits will be tomorrow's investments, which will create the jobs for the day after tomorrow« – captures the idea that battling unemployment had become of secondary importance in the state's economic policy objectives. Government spending, and in particular spending on social programs, was less important than private investments that were supposed to create jobs. In this macroeconomic thinking, social policies no longer played a central role in ensuring economic well-being.[1] In this view, social expenditure had become a cost rather than a stimulator of economic growth or a promoter of political and social stability.

Given this new attitude, cost reduction became a priority for most European governments, beginning in Margaret Thatcher's United Kingdom.[2] Since then, comparative studies[3] have demonstrated that, beyond

1. See especially OECD, *The Welfare State in Crisis*, Paris: OECD (1981); Hugh Heclo, »Toward a New Welfare State,« in: Peter Flora and Arnold Heidenheimer (eds.), *The Development of Welfare States in Europe and in America*, London and New Brunswick, NJ: Transaction Books (1981), pp. 383–406.
2. Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher and the Politics of Retrenchment*, Cambridge: Cambridge University Press (1994).
3. Vic George and Peter Taylor-Gooby (eds.), *European Welfare Policy – Squaring the Welfare Circle*, London: Macmillan (1996). See especially Chapter 1.

the institutional differences and diverse social policies applied in various European countries over the last fifteen years, all have tried to cut back the Welfare State.

While the primary objective of these policies was to reduce social expenditures,[4] they also affected overall approaches to social protection in two ways. First, to the extent that they frequently reduced public spending, they had an impact on the division of responsibilities among the state, the family, the market, and civil society. In most cases, this involved the partial privatization of social protection functions. Second, retrenchment indicated that social spending was no longer seen as an underpinning of economic growth, but as a cost factor that needed to be reduced. Retrenchment signaled the end of Keynesian compromise, thereby setting the stage for finding a new economic role for social protection.

It would be a mistake, however, to assume that these changes have ushered in an outright dismantling of European welfare regimes. Radical neo-liberalism was not on the agenda, and institutional and political resistance reflected the attachment of Europeans to their »social model.« This opposition has brought a kind of reform that focuses on being »employment friendly.« In this way, social policy is again seen to have a constructive economic function.

The Emphasis on Employment in Social Protection Reform[5]

Whatever the social protection system, maintaining it has seemed to depend on preserving or returning to high levels of employment. The result is that the objective of social protection reforms gradually changed, focusing on both increasing the employment rate *and* decreasing the unemployment rate.[6] Three main sets of reforms – all giving priority to employment – are undertaken: (i) reforms in the way social protection was

4. This objective was met in part. Following a rise in the early 1990s that was linked to the economic recession in Europe, social expenditures stabilized in most European countries, although they often increased again in the early 2000s.
5. This section continues work carried out in collaboration with Christine Daniel, and published as Christine Daniel and Bruno Palier (eds.), *La protection sociale en Europe. Le temps de réforme*, Paris (2001) (La Documentation Française), Chapter 1.
6. This change in objective represented a major turning point for many countries, including France, the Netherlands, and Germany, which had initially responded to the rise in unemployment in the 1980s by removing certain categories of persons

funded; (ii) the introduction of stricter conditions for training (or other occupation-related activities) in return for benefits, and (iii) increased public services designed to increase the rate of female labor force participation.

The first set of reforms tackled funding based on the belief that the predominant method in continental Europe, payment of social contributions, penalizes employment. Consequently, several countries are moving to funding from general revenues or taxation, thereby broadening the funding base. These methods were employed in France which in 1991 introduced a new form of social protection funding, the General Social Contribution (Contribution sociale généralisée, or CSG). Germany too focused on the burden of payroll taxes, while in 1998 it created a new type of ecological tax levied on polluting activities with revenues earmarked for social expenditures.

The second set of reforms of European social policy involves the introduction of stricter controls on training (or on other occupation-related activities) requirements in return for benefits. These involve, among other things, setting out new requirements for training or job search for recipients of unemployment insurance or social assistance. Policies of this type are found in all social protection systems.

The Nordic countries sought to recapture the basic aim of a »working society.« For these countries, this meant that everyone who was able to work, should work. For example, in Denmark, so-called activation policies played an important role. These involved reforming the employment policies introduced in 1994. The reform was in three parts, and involved increasing eligible categories for leave and time-off (this, of course, was of benefit only to the employed), restrictions on compensation, and strengthening the requirement to participate in activation schemes. In 1997, Denmark also reformed its social assistance policy, placing even greater emphasis than unemployment insurance did on the requirement to participate in work-oriented activities organized by municipalities.

Activation policies also involved developing types of employment that were less standard than those found in full-time work contracts. In the Netherlands, this approach was implemented in several ways. First, part-time work: although the country had a weak preschool system, this type

from the labor market in order to lower the unemployment rate, while providing relatively generous replacement income to individuals who, as a result of this policy, had lost their jobs.

of work enabled women to gain entry to the labor market. Second, the government placed certain restrictions on benefits paid to individuals of working age, especially in the case of disability benefits, but also of unemployment benefits.

In the United Kingdom, the incentives were of a more restrictive or conditional type, somewhat resembling Workfare. The slogan of British Conservative governments had been to »make work pay« by creating or increasing income tax credits, and by greatly reducing social security benefits to levels that were well below the lowest wages. In addition, Conservative governments increasingly made benefits conditional upon training or job search activities; in 1996, unemployment compensation was replaced by the Job Seekers' Allowance, which could be cut off if the recipient refused several job offers. Since 1997, the Labour government has not radically changed this overall approach in employment policy. However, it did shift the emphasis somewhat, accepting the need to improve training for job seekers, while continuing, within the framework of the New Deal launched in late 1997, to subject training and job search programs to effective monitoring. It has also created a lot of new public jobs.

In continental Europe, the incentives were more timid. In most cases, employment policies were paradoxical. Governments would continue to apply labor-shedding measures (especially early retirement), even as they provided claimants with incentives to return to work. The incentives included reforming unemployment compensation systems (increasing the compensation given to claimants who agreed to undertake training or pursue other occupation-related activities: see the unemployment insurance reforms in France in 2001, or the Hartz 4 reforms in Germany), increasing training expenditure, and creating subsidized jobs.

The third set of reforms designed to encourage work is based on a very different kind of approach. It does not aim to restrict access to monetary benefits but rather to facilitate access to services designed to balance work and family life (personal social services for children, the elderly, the disabled, and so on). First, this strategy is seen to have an effect on employment rates, in two ways. Women are more readily available for work, thanks to child care and services for taking care of vulnerable seniors. Second, such services are themselves sources of jobs. In addition, this strategy has been identified as one likely to foster higher birth rates. Women wishing to work but without access to social services often give up the idea of having children, as the situation in southern Europe seems to indicate. Third, such services combat child poverty. Women's labor force participation is one of the best defenses against child poverty, whether involving lone-parent families or couples. Levels of poverty are lower in families with employed parents.

This third set of reforms was adopted in different ways across Europe. Social services, which were already highly developed in Nordic countries, stayed at a high level, while labor market participation by women increased. On the other hand, only a minority of southern European countries were fully committed to this approach. However, we will see that this approach can serve as a basis for a renewed European social model, in a new macroeconomic context.

The Shift toward Supply-side Policies

The establishment of a single European market, which guarantees free competition among all European firms, and the criteria set out by the Maastricht Treaty and the Stability and Growth Pact (to ensure the stability of the euro), which present a coherent economic policy (reduced public debt and deficit, controlled inflation, and fixed exchange rates), were signs that, in the area of macroeconomic policy, Europe was collectively adopting a new paradigm very different from its Keynesian predecessor. The new paradigm involved supply-side policies (monetarist, neoclassical) promoting free competition (deregulation, labor flexibility) and was based on conservative budget practices (reduced debt and deficit, low interest rates, reduced levels of inflation). Although this shift in Europe had started in the late 1970s and had been implemented throughout the 1980s in various European countries' economic policies, social policy continued for a long time to operate according to the Keynesian logic of the past. Social policy was thus in crisis because of its incongruity with the new global economic logic.

There are three reasons for the persistence of this discrepancy throughout the 1980s and 1990s. First, institutional constraints and the influence of the past made fundamental reform difficult. Second, many countries used traditional social policies as a buffer to mitigate the social effects (especially higher unemployment) of changes in economic policies associated with tight budget and wage policies and industrial restructuring. Third, while economic policy was increasingly defined at the European level, particularly following the introduction of a single currency, social policies remained within the jurisdiction of national governments, thereby making it more difficult to collectively define social policies that were consistent with Europe's dominant economic policies.

Towards the end of the 1990s, faced with this growing incongruity between the trend in economic policy and the general orientation of social policy, a global challenge characterized reform of social policy, namely the need to adjust social policy to make it compatible with the new economic standards.

Following studies carried out by numerous economists – backed up first by reports published by the OECD and then the European Union – new standards for social protection began to circulate in Europe. They revolved around adapting social protection systems to supply-side rather than demand-side policies. The reforms were supposed to make social protection systems more conducive to employment by reducing their cost (especially the mandatory employment-related costs, which are a burden on employment) rather than by increasing social spending. Another general principle of the reforms, consistent with the need to control spending, was to direct government intervention towards individuals who needed it most, instead of promoting universal social policies. Ultimately, this would entail calling on everyone who played a role in social protection – not only the state but also the private sector, families, and community associations – to promote a system of social protection that would be more efficient and closer to the individuals affected than that delivered by governments alone.

Social programs too were supposed to be more employment friendly and to link benefits to incentives that made it preferable to work rather than to receive social security benefits for doing nothing. We have already noted that this trend toward the activation of social expenditures arose in every European country. Employment policies and social policies were increasingly based on wage restraint, limited increases in social expenditures, growth in non-standard jobs (low-skilled, poorly paid, or part-time jobs), and the restructuring of benefits to make them employment friendly.

By the end of the 1990s, there was increasing evidence that social policy reforms were driven by a desire to restructure social spending patterns and not simply to retrench or cut them back. Despite the diversity of the reforms and the processes leading to them, the reform objectives (more than on their outcomes) exhibited several common trends. In the various European countries, they reflected an attempt to adapt welfare regimes to new macroeconomic norms, putting more emphasis on the market and sounder public finances, less on public spending, and so on.

For example, in the area of old-age pension reform, and despite using different paths to get there, most European countries are now developing a multi-pillar system, one that includes both pay-as-you-go and fully-funded schemes, with an emphasis on the tight link between pension level and amount of contribution paid. This is a particularly important change for regimes that were based on social insurance and pay-as-you-go, as the continental countries have been. For their part, in health care systems, the introduction of managed competition seems to be spreading to all national health systems; it has also penetrated health insurance systems through competition among insurers. Employment policies founded on the concept of activation are also widely shared, as is the general principle of activation, despite the fact that there are still big differences in the ways these policies are implemented.

As a consequence of such efforts to address challenges to strategies for ensuring retirement and employment income, ways to increase the employment rate have become a generalized response. This trend implies important changes in Bismarckian welfare regimes, which in the 1980s adopted a strategy sometimes termed »a welfare state without work.« But it is not only the continental welfare regimes that have been challenged, the institutions of the European Union have been challenged to promote their own responses as well.

This picture, albeit a very general one, is interesting because it presents us with the emergence of new concerns and foundations for welfare policies. Nowadays, all national European governments, as well as the European Union, seem to recognize that welfare states should become compatible with international competition. They should become »employment friendly« by reducing their costs (especially non-wage costs) and by offering benefits that do not function as disincentives to employment. Hence the emphasis on activation and »making work pay.« Targeting spending on those who »really« need (and deserve) it has also become a norm. So too has the notion that welfare should not rely on public intervention alone; other actors contribute – and ought to contribute – to the welfare mix. The family, NGOs, and firms are receiving more attention.

These measures brought about fundamental reforms in social protection, inasmuch as they involved not only modifying existing parameters and instruments of social policy, but also changing the intent, overall logic, and orientation of established social protection. It was not only a question of retrenchment, but also of creating a fundamentally new foundation for social protection. Regardless of whether these policies were totally new or simply reformed existing policies, they were based on a new approach to social protection whose function was no longer to protect individuals against risk, but to change their behavior. This was frequently referred to as changing social protection expenditures *from a passive to an active form*. Less emphasis was placed on providing replacement income than on providing incentives (in a more or less coercive fashion) for a return to the labor market. It was a question of moving from a guarantee of replacement income outside the market (decommodification) to a strategy of providing incentives designed to promote a return to employment and of bringing people back to the labor market (recommodification).

In Europe, many denounced this return to the market, since it often embraced neo-liberal workfare policies. Other views, however, advanced an alternative and more positive interpretation (from a social policy standpoint) of these trends, since they signaled a transition from compensatory, passive, and corrective action to prevention, putting less emphasis on the elderly (less expenditure on pensions) and more on investing in the future.

Toward a Social Investment State

When trying to re-orient social policies, to think of them more in terms of investment than of compensation, investments should be designed to help children and women (policies to combat child poverty, education policies and orientation training, policies to reconcile family life and working life). This alternative outlook has been summed up by slogans such as »re-channel social expenditures toward social investments.«[7] In this new perspective, social policies should focus more on prevention and social investment than on compensating for immediate difficulties.

7. See, for example, Gøsta Esping-Andersen, in collaboration with Duncan Gallie, Anton Hemerijck, and John Myles, *Why We Need a New Welfare State*, Oxford: Oxford University Press (2002); and Jane Jenson and Denis Saint-Martin, »New Routes to Social Cohesion? Citizenship and the Social Investment State,« in: *Canadian Journal of Sociology* (winter 2003).

While current systems of social protection are spending more and more on seniors, new social policies should invest in children. Rather than fighting social exclusion once it has occurred or trying to retrain long-term unemployed older workers, for example, numerous experts (such as Esping-Andersen) advocate prevention, centred on childhood. Given the observation that the deepest poverty among adults is found among those who grew up in poor and unemployed families, reducing child poverty and providing good quality early childhood education and care are ways of preventing social exclusion, as well as of ensuring a well-trained, skilled, and flexible labor force. To achieve these goals, two programs seem crucial, as demonstrated by Esping-Andersen and his colleagues: (i) providing a basic income to all families by increasing benefits in those countries where social assistance is still a residual benefit and therefore leaves recipients in poverty; and (ii) developing public programs of early childhood education and care that will guarantee a solid socialization and promote school-readiness, so that people both in school and after will be adaptable and flexible, characteristics needed by a knowledge-based and service economy.

Public services for all dependent and vulnerable persons, as well as early childhood education and care, seem also to be the appropriate means of addressing the issue of increasing women's labor force participation and gender equality. Early childhood education and care and other services create jobs for women and also allow mothers of young children to work for pay and enable families to balance work and family life. Increasing women's labor force participation obviously responds to women's desire for economic autonomy but it goes beyond that. It also helps reduce child poverty, because poverty is always lower when two parents are employed, and it increases the employment rate, such that revenues are higher for states and for insurance-based social programs. Policies »for women« have to do more than simply allow a work–family balance; they must also provide gender equality and equality of opportunity. This means, in other words, changing men's trajectories as well as women's and altering the gender division of labor within the household.

This is, in other words, a program for changing both work and family life. Such analyses by experts as well as that of the Commission itself have fed the efforts of the European Union to forge a virtuous circle of interaction among macroeconomic, employment, and social policies. Indeed, a new principle emerged in the framework proposed in the various texts on social policy adopted by the European Union, »quality.«

As Jane Jenson has shown,[8] putting the accent on quality builds on the premise that »social policy is a productive factor« rather than a drain on the economy. Good social policy is a necessary feature of a well-functioning modern economy, particularly one that hopes to position itself well in a high-stakes knowledge economy. In part, this is because it helps, as the Stockholm European Council Conclusions put it, to ensure security in times of change. Such security enables people to take risks and invest in their human capital as well as that of their children, and so on.

For the European Union, promoting quality in employment and social policy is a key element in reaching the goals of building more and better jobs, creating a competitive and cohesive knowledge-based economy, and ensuring a positive mutual interaction between economic, employment, and social policies. As such, quality goes hand in hand with improving efficiency, especially as far as public finances and labor market incentives are concerned. Social policies are not simply an outcome of good economic performance and policies but are at the same time an input and a framework. In this context, the modernization of the social model means developing and adapting it to take account of the rapidly changing new economy and society, and ensuring the positive mutually supportive role of economic and social policies. We can expect many aspects of the modernization of the social model to have a positive impact on the quality of work – including both social investments and social transfers. Hence the pursuit of more and better employment and higher levels of economic performance cannot be separated from the overall aims of modernization of the European Social Model.

8. The European Social Model. Seeking a Roadmap for Gender and Generational Equality, paper prepared for the Policy Network/London School of Economics in the context of the UK Presidency of the European Union (June–December 2005).