

Stress Testing the Welfare State

Anton Hemerijck

Dean, Faculty of the Social Sciences,
Free University, Amsterdam

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Outline

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1. DEEP CRISES AS MOMENTS OF INSTITUTIONAL TRUTH



Three crises

1. Great Depression (financial crisis) – *Embedded Liberalism* : welfare state and EU institution building – *politics against markets*
2. Stagflation 1970s/80s (real economy) – *Institutional liberalisation* welfare state and eurosclerosis as *problems* – *politics for (single) markets*
3. Great Recession (financial crisis) early 21st century: Welfare state and EU as *crisis casualties*?





WELFARE STATE

2. CASCADING AFTERSHOCKS AND CRISIS DIAGNOSIS



Aftershocks

1. Deglobalisation (financial re-nationalisation)
2. Unemployment crisis (could last long)
3. Pension crisis (also due to ageing)
4. Fiscal crisis (higher deficits -6% is perhaps doable, but not -12%)
5. Long period of low growth – *systemic* (**private + public**) *debt* and no obvious growth driver (BRICS)
6. Sovereign debt crisis (current account deficits)
7. Accelerated power shift to China, India, and Brasil
8. Currency war between China and US
9. Social unrest, globalization fatigue, and political disenchantment (EU)
10. Negative (and positive) feedback – uncertainty

Diagnosis

- Transformation role and size (international) financial markets
- Academic failure (efficient markets, politics as distortion, silo disciplines, mathematics)
- Fragmentary financial regulation
- Lenient (US) and single-minded (EU) *procyclical* macro policy
- China's rise as world's largest exporter and US as largest debtor economy
 - Profligate lending (privatized Keynesianism)
 - World economy disbalance (*perfect storm*)
 - Danger of *tipping point* heart attack (Lehman)

Fragmentary EU integration

- EMU regime blind to current account competitiveness imbalance and private debt
- Macro stability is more than inflation targeting and budgetary discipline
- Complete divorce between negative rule based macro stability and social investment
Lisbon Agenda (2005 narrow growth/jobs)
- **A failure of regime/thinking**; not a failure of enforcement (Greece – yes, but not Spain, Ireland, Portugal)



3. WELFARE STATE CHANGE BEFORE CRISIS



Profound welfare reform (1)

Macroeconomic shift to moderate
monetarism and Europeanisation

Cost competitive *wage bargaining*

Active labour market policy with significant
labour market deregulation (bridges for
outsiders – ‘*flexicurity*’)

Activating *social insurance*, selective
retrenchment with universal minimum
income protection (closing early exit)



Profound reform (2)

Multi-pillar *old age pensions*, higher retirement ages, public safety nets

Dual earner *social service* support (child care and elderly care, parental leave)

Human capital investment lagging behind

Hybridization of *financing* motivated by incentive and competitiveness concerns (broaden basis taxation). Less public

Governance change (NPM – PES), public-private mix, local servicing, social pacts, issue linkage, EU boundary restructuring.



Social investment (gender/family friendly) codification?

- **Scandinavia:** full-fledge shift to social investment (robust)
- **Continental:** U-turn away from labour supply reduction, timid social investment turn (but gaining momentum Germany)
- **Anglo:** social investment in orientation, but not enough (fiscal/tax support)
- **Southern:** institutional inertia and political resistance (except Spain)
- **NMS:** hybridization



4. TWO PHASES OF CRISIS MANAGEMENT

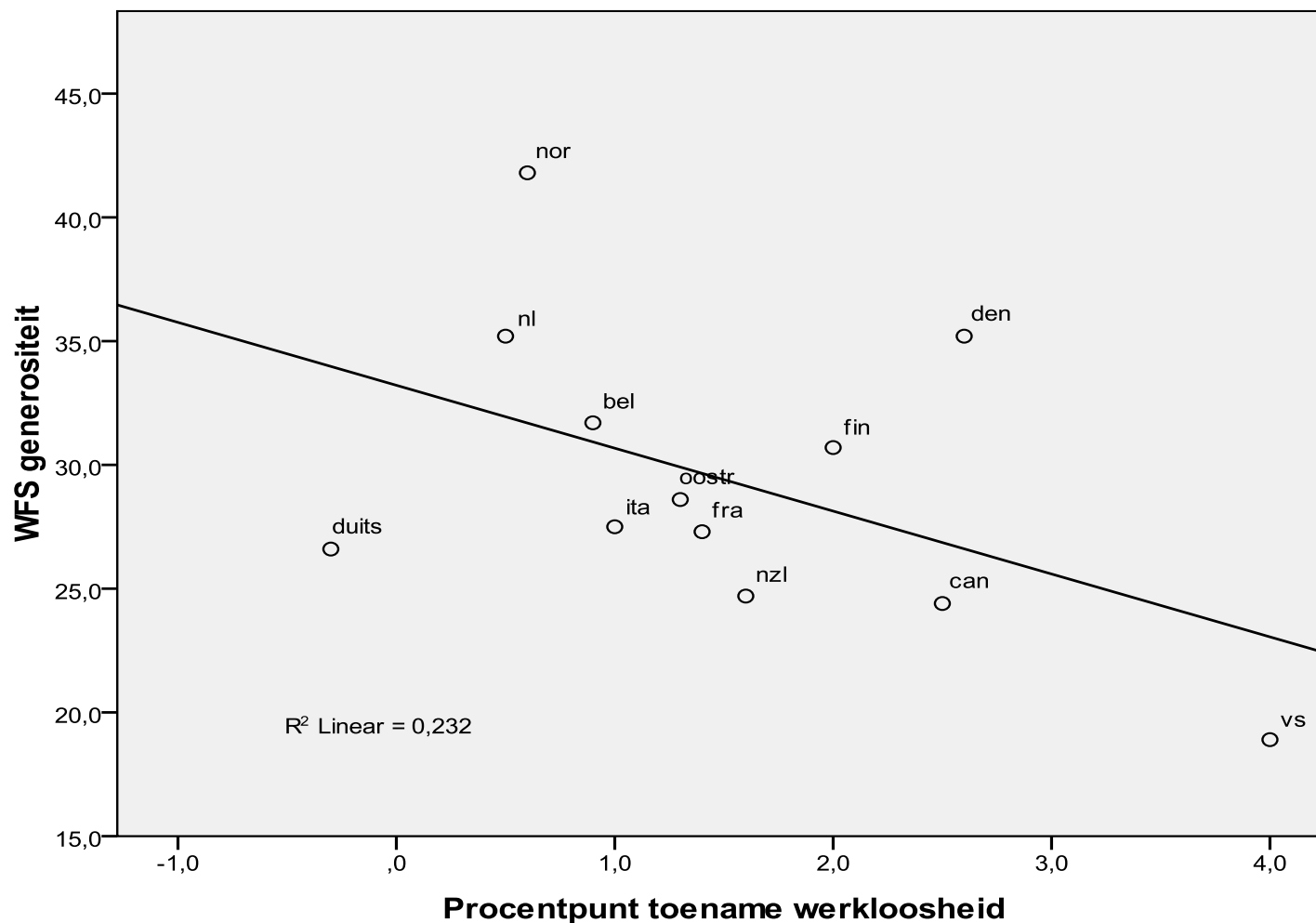


I: September 2008 – December 2009

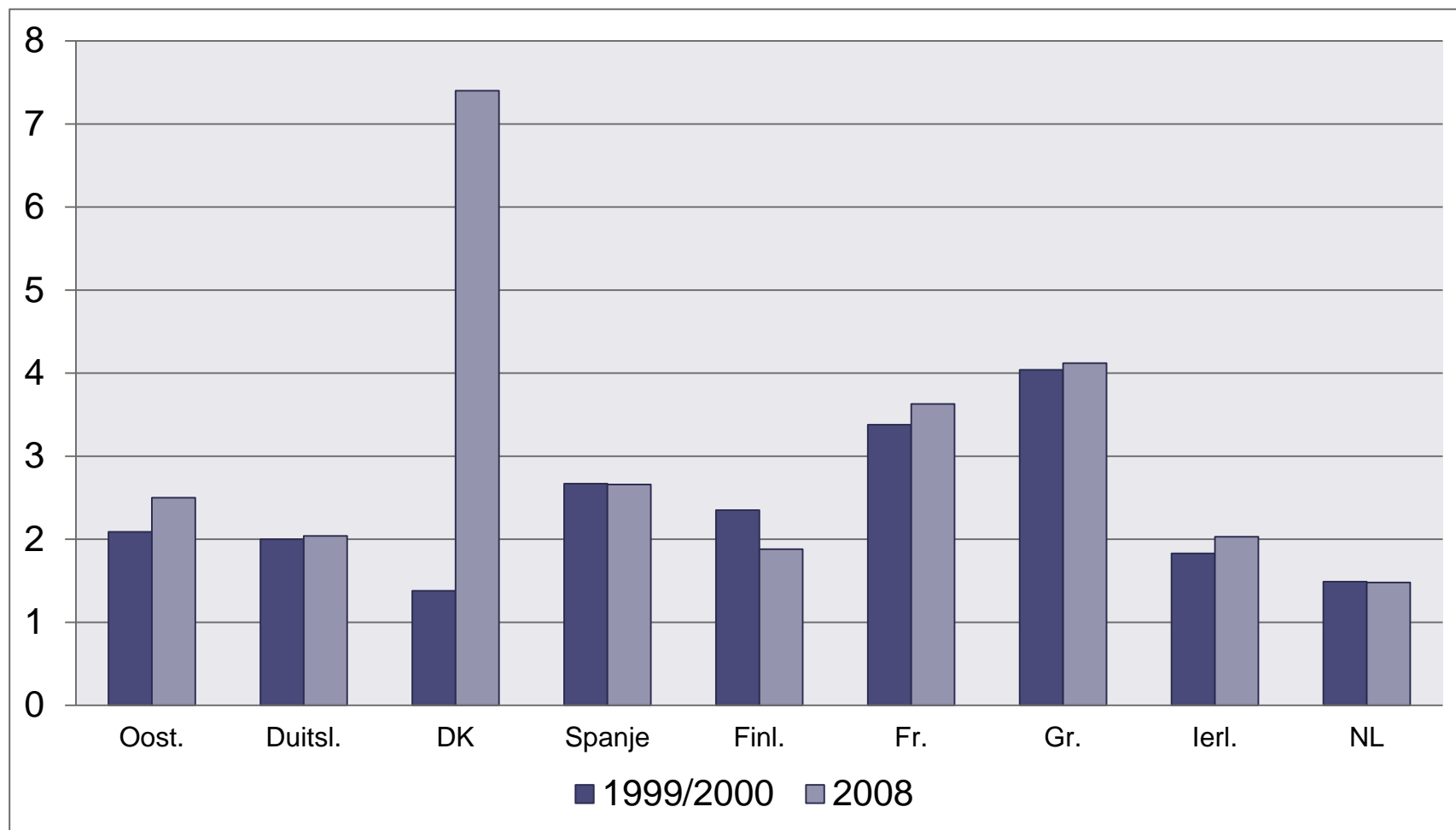
- Domestic (automatic) stabilization + mild fiscal stimulus (coordinated by Commission)
- ECB very effective under Trichet (quantitative easing)
- Core European labour markets more resilient than expected (especially Germany)
- Generous EU welfare state, with robust safety nets in place, do rather well!
- Keynesian crisis management aligned with clear social investment priorities (social partnership)
- Hyperactive government (without *positive* theory)



Generous welfare states, less dramatic rise in unemployment



Rising popularity social protection



Sources: EVS 1999/2000 & 2008.

II: December 2009 – 2011 (*Greek sovereign debt crisis*)

- Sovereign debt problems in Greece, Spain, Ireland, and Portugal (shift to austerity)
- Fear of currency contagion early 2010
- Too late and, therefore, too costly € 750 billion bail-out (postponement problem?)
- Commission invisible (subsidiarity prevails)
- ECB shift to buying weak member states' government bonds + quantitative easing
- 2nd Shift to fiscal austerity by UK, NL, G
- Background currency war between China and US



5. WHAT ROOM FOR SOCIAL INVESTMENT UNDER NEW AUSTERITY?



- **Sweden:** no need for regime overhaul (nurturing recent reforms), strengthen work first, general compulsory unemployment insurance (universalisation)
- **Denmark:** unchanged social services, cuts in child benefits, reduction duration unemployment insurance, indexation suspended



- **Germany:** Piecemeal retrenchment, workfare, investment in education, training, and research. Welfare state must remain effective and affordable
- **Netherlands:** xenophobic austerity complete anathema to social investment. Slow rise retirement age, insider-biased labour regulation untouched, massive social assistance retrenchment, cuts in education



- **UK:** cuts in childcare and education, alongside retrenchment and tax credit freeze, workfare,
- improved pensions, more education for disadvantaged children (countering Matthew effects: more targeting)
- **Ireland:** major retrenchment: public sector pay cuts, reduction minimum wage, workfare, job placement, pension retrenchment while broadening access, higher age retirement, aware of Matthew effect in family and social assistance



- **Greece/Spain/Portugal:** severe retrenchment: public sector pay cuts, pension freeze, labour market desegmentation, activation and training, raising retirement age, (higher) tax modernisation , farewell to “clientelism”
- **Italy:** old welfare inertia
- **France:** milder version of above
- **Hungary/Czech republic:** new labour market and family demography understanding, higher taxes



Lisbon Agenda lessons (not) learned

- Shift from “banking crisis” (phase 1) to “crisis of the state” (phase 2)
- 2020 strategy incoherent (thus far)
- Return to SGP primacy over employment and social inclusion (status quo ex ante)
- Suggestion childcare, education, family servicing as pure consumption (like pensions). Private sector building spree better?!?!
- Intergovernmentalist stalemate (Germany)



6. PRECARIOUS POLITICS OF EARLY 21ST CENTURY CRISIS MANAGEMENT



Restaurative political forces

- Back to stability oriented 1980s single market “**negative integration**” (ignoring social and economic consequences crisis)
- Back to “**cosy welfare state**” of 1950s (populist left and right and traditional cleavages political center) not on the basis of solidarity, but group egotism!

Those days are over!

- Recent growth illusory, wasteful, and unequal
- EMU/SGP/Lisbon Agenda ill conceived ‘fair weather’ projects
- Cosy welfare state a ‘myth’



Institutional predicament

- **Nation–state:** increasingly “incomplete” in regulatory coverage (semi–sovereign)
- **State capacity:** massively constrained after neoliberalism and shadow new austerity (intellectually and real budget limits)
- **Polity:** isolationist populism (jealous of supranational policy integration)
- **Electoral de–alignment** (erosion class)
- **Political climate** distrustful of markets *and* states



Therefore no appetite for a more *political* European Union

- Paradox of globalisation: interdependence increases domestic pressures on politicians to shelter citizens (no bailout for *Club Med*)
- EU since collapse communism an enterprise of *political choice* rather than *necessity*
- *Alleingang* Merkel (and Sarkozy)
- EMU no longer accepted as '*community of fate*' (subsidiarity champions – revenge of the nation state, pressed by xenophobia)



7. EUROPEAN WELFARE STATE FUTURES



Macro uncertainty

- Oderly fiscal consolidation with growth in fairness (austerity in turn)
- Discretionary EU economic governance
- Macro and growth strategy more in balance with raising *participation* and *productivity* (real social investments)
- With improved enforcement and monitoring (learning) framework, including wages, labour markets and social policy



Uncertain welfare futures

- Real fiscal pressures demanding sizeable cuts in public (social) spending (contra Matthew effect)
- Long-run societal change not adequately dealt with before crisis predicaments (ageing, family change, labour market transformations)
- Severity of social consequences (unemployment, poverty, inequality) requiring “fairness” in policy responses (**blaming victims not credible**)
- Shifts in labour supply and demand in medium term (health care) – return to full employment?
- Resilience of social policy with severe resource constraints in face of anti-immigrant welfare chauvinism (**fearful middle class**)



Glass half full

- Taming and re-regulation no dirty words
- Renewed attention to demand side economy
- Re-legitimation social policy (demand and supply)
- ***Social investment not aborted !***
- Growth contingent on other substantive objectives (Sen/Stiglitz/Fitoussi)
- State theory: countervailing, enabling, anti-cyclical, political responsibility economy
- Welfare here to stay! (but not as we know it)
- Layered institutional change
- Where is Europe?



8. THEORETICAL AFTERTHOUGHT



Welfare state theory

- **Strong economy** requires a **strong welfare**
- Focus on **supply side** (*participation* and *productivity* contribute to competitiveness)
- Social promotion *with* social protection (strong social minimum)
- **Active welfare states**: large public sector, allocated to human capital and family servicing, outcompete liberal regimes
- **Availability of capacitating social services** for jobs, equity, efficiency and social cohesion under post-industrialism



- **Information asymmetries:** many post-industrial life course needs remain unmet because of market failures of service underprovision at too high cost ('**piggy bank**' function collective welfare provision)
- **Declining effectiveness** of traditional **social insurance** since 1980s. Social risks no longer cyclical because radical shifts labour demand and supply, feminization labour market, life course contingencies, new health risks, in ageing societies)



To rise from the crisis

- **Participation** to 80% prime age (flexicurity and active ageing)
- **Productivity** human capital enhancement from pre-school to life long learning
- **Gender/family friendly social investment imperative** in absence other growth drivers.
- **Need for a new (EU) public finance regime:**
 - Able to identify public investments with real returns (in terms of participation/productivity)
 - Examine joint public and private social protection/promotion expenditure trends
- **IN FAIRNESS!**

