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The EU Needs a Social Investment Pact

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Introduction

In this Opinion Paper, we argue that *long term*-goals of social and economic policy in the EU must not fall victim to *short-term* policy orientations prompted by the banking crisis that hit the global economy in 2008 and the subsequent financial and fiscal problems affecting the Eurozone and the EU at large. We capture these long-term goals with the notion of a 'social investment imperative'. Social investment is not a new idea *per se*. We first revisit the social investment perspective as proposed towards the end of the 1990s and draw some lessons from past experience. We maintain that a social investment impetus, given Europe's adverse demography, is today more acute than ever before. Subsequently, we examine how a renewed social investment perspective can be rescued from one-sided policy orientations prompted by the economic crisis ([1]).

Over the past three years, Europe has experienced three interconnected crises: a banking crisis in 2008, followed by a severe economic recession in 2009, which in turn invoked a fiscal crisis of the state, most dramatically in Greece, Ireland and Portugal, potentially threatening the long-term viability of the project of European integration. The long-term repercussions of the financial crisis are far from benign. Considerable employment growth across the EU, achieved through intelligent social reforms over the past decade, was instantly wiped out consequent to the financial crisis. From next year, the European working age population will start to shrink. In 2009, the employment rate fell to 69 per cent. Employment will have to grow by more than one per cent every year until 2020 to reach the 75 per cent headline target. Many of the jobs lost in the 2008-2009 crisis will not come back. New jobs will require more qualifications. Skill mismatches will grow: by 2015 there will be a shortage of 700,000 ICT specialists, together with many unfilled vacancies in health care. These are among the many reasons why social and labour market policies will have to be strengthened, rather than weakened. Public deficit and debt have soared, necessitating tough austerity measures. On the other hand, in the new context of fiscal predicament, it is essential not to overlook the growth potential of social investment policies. Furthermore, the social impact of the crisis may be expected to underline the need for poverty relief, social insurance and macroeconomic stabilization, and to rekindle the social investment imperative.

It is important to emphasize that the current challenge is as much political as it is policy-related. The overall political sentiment across Europe is conservative. Middle-class fears of falling go hand in hand with greater electoral abstention and growing support for populist anti-EU parties. At the same time, the debate on 'EU economic governance' has been largely confined to a rather narrow

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1. This policy brief has benefited greatly from discussions at a conference organized by Policy Network (with the Wiardi Beckman Stichting and FEPS) in London, on 30 March – 1 April 2011, from a seminar organized by the European Social Observatory on 6 May 2011. The authors wish to thank a variety of other friends for their precious comments on earlier drafts.

view on competitiveness (inspired by discussions on a so-called ‘Competitiveness Pact’) and strict budget rules in the new Stability Pact; lacking substantive social policy orientation, it can only be perceived as technocratic. Both populist welfare chauvinism and technocratic fiscal orthodoxy are anathema to social investment.

The key challenge is to make *long-term* social investment and *short-term* fiscal consolidation mutually supportive at both the EU level and in the Member States. We believe that the objectives formulated in the Europe 2020 Strategy can provide a framework to achieve this, *on condition that* an “EU social investment pact” is anchored in pro-growth budgetary policy and financial regulation. In other words, the new macroeconomic and budgetary surveillance at the EU level must be compatible with and accompanied by a “Social Investment Pact”, as we will substantiate in the final section of this policy paper.

1. The social investment imperative

Social investment is not a new idea. It emerged gradually as a social policy perspective in the 1990s in response to fundamental changes in our societies. The social investment perspective was developed with the dual ambition of i) modernizing the welfare state, so that it would better address the new social risks and needs structure of contemporary societies; and ii) ensuring the financial and political sustainability of the welfare state, while upholding a different, knowledge-based, economy. Central to the social investment perspective is the attempt to reconcile social and economic goals. In policy terms, the focus is on public policies that ‘prepare’ individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the emergence of new social risks, population ageing and climate change, rather than on simply generating responses aimed at ‘repairing’ any damage caused by market failure, social misfortune, poor health or prevailing policy inadequacies. By addressing problems in their infancy, the social investment paradigm stands to reduce human suffering, economic instability and environmental degradation, while enhancing social resilience.

In 2000, the Portuguese presidency of the EU raised the social and economic policy ambitions of the EU by putting forward an integrated agenda of economic, employment and social objectives, thereby committing the Union to becoming the ‘most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’. The so-called Lisbon Strategy was strongly influenced by the social investment paradigm, although the political translation of the concept may have been more ambiguous than one might have wished. Lisbon certainly represented an attempt to re-launch the idea of the positive complementarities between equity and efficiency in the knowledge-based economy by way of 'investing in people and developing an active and dynamic welfare state'. In addition to the objective of raising employment rates throughout Europe, the Lisbon Agenda placed human capital, research, innovation and development explicitly at the centre of European social and economic policy. This broadened the notion of social policy as a productive factor beyond its traditional emphasis on social protection, extending it to social promotion by improving quality of training and education. The Lisbon Strategy also prefigured a re-focusing of equal opportunity policies with an explicit view to raising employment rates among women and elderly workers.

The philosophy underpinning the social dimension of the Lisbon Strategy was given further substance by the publication in 2002 of a book entitled *Why We Need a New Welfare State* under the editorship of Esping-Andersen ([2]). At the core of this publication lies the argument that the prevailing inertia in male-breadwinner welfare provision fosters increasingly sub-optimal life chances in labour market opportunities, income, educational attainment, and intra and intergenerational fairness, for large shares of the population. Esping-Andersen and his co-authors argued that the staying power of 'passive' male breadwinner policies is frustrating more adequate responses to 'new' social risks in the post-industrial economy, including rapid skill depletion, reconciling work and family life, caring for frail relatives, and inadequacy of social security coverage. These 'new' social risks adversely affect low-skilled workers, youth, working women, immigrants, and families with small children. Most troublesome is the polarization between work-rich and work-poor families. Top-income households are increasingly distancing themselves from the middle as a result of rising returns to skills, exacerbated by marital homogamy, i.e. family formation by spouses with similar educational backgrounds. At the bottom of the pyramid, less educated couples and especially single-mother families face (child) poverty and long-term joblessness. And as inequality widens, households' capacity to invest in their children's future will grow, consequently, increasingly unequal.

As the new social risks weigh most heavily on the younger cohorts, Esping-Andersen et al. explicitly advocate a reallocation of social expenditures towards family services, active labour market policy, early childhood education and vocational training, so as to ensure productivity improvement and high employment for both men and women in the knowledge-based economy. There is, however, no contradiction *per se* between an explicit welfare effort towards privileging the active phases of life and sustainable pensions: "good pension policies – like good health policies – begin at birth". It should also be noted that Esping-Andersen et al. emphasize – *contra* the Third Way – that social investment is no substitute for social protection. Adequate minimum income protection is a critical precondition for an effective social investment strategy. In other

2. Esping-Andersen, G., Gallie, D., Hemerijck, A., Myles, J. (eds.) (2002), *Why we need a new welfare state*, Oxford University Press, Oxford.

words, 'social protection' and 'social promotion' should be understood as the indispensable *complementary* twin pillars of the new social investment welfare edifice.

The social investment paradigm makes a virtue of the argument that a strong economy requires a strong welfare state. Social protection expenditures remain powerful stabilisers of economic activity at the macro level as they consolidate effective demand during recessions. The experience of the early days of the 2008-2010 financial crisis brought to the fore that this kind of Keynesianism through the back door is in fact still operative. Government anti-cyclical budgets are important achievement in the developed world as they reinforce greater business cycle stability and improve social welfare, shielding people from the harshness of the booms and busts in capitalist economies.

Basic minimum income protection serves to reduce poverty and inequality. Dire poverty and high levels of inequality are bad for any economy, especially when passed down the generations, permanently excluding disadvantaged groups from economic progress, wasting human capital, undermining social cohesion and making capitalist economies highly volatile to panics of boom and bust.

Moreover, institutions of social partnership guide wage setting and welfare reform towards the general interest at the macro level, and encourage employers and trade unions to jointly invest in vocational training programmes, thus contributing to competitiveness through human capital upgrading at the meso-level. As today’s organization of knowledge-intensive production relies heavily on realising gains from cooperation, social partnership at industry level is a prerequisite at the meso-level, in addition to channelling industrial conflict in periods of structural adjustment at the macro-level.

Social insurance, compensating workers and families who contribute to the common economic good by exposing themselves to periodic market contingencies, encourages private initiative and risk-taking. But the devil is in the detail. High unemployment benefits of short duration, coupled with strong activation incentives and training obligations, supported by active labor market policy services, are most successful in lowering unemployment and raising productivity ([3]). Effective policy mixes of this kind, in addition, harbor a moderating effect on wage developments.

Extensive comparative empirical research has, since the turn of the century, revealed that there is no trade-off between macroeconomic performance and the size of the welfare state. The cases of Nordic countries, always considered as amongst the most competitive economies (notably in the Davos forum), demonstrate that the presence of a large public sector does not necessarily damage

3. Blanchard, O. (2002), European unemployment: the evolution of facts and ideas, *Economic Policy,* Vol.21 No.45, pp. 5-59.

competitiveness; there is a positive relationship between fertility and high levels of female participation in most Scandinavian countries, as well as in France; and finally, high numeracy and literacy rates can be achieved with educational policies that abide by the principles of equal opportunities, as OECD PISA studies show for Finland in particular.

Social investments today generate private and public dividends in the mid- to long-term. Statistical analyses show that social investment policies (such as early child education and care, equal opportunity education, active labor market policies) make a difference not only in raising employment level, but in allowing the development of highly skilled quality jobs ([4]). Central to the notion of social investment is that the economic sustainability of the welfare state hinges on the number and productivity of future taxpayers. From this reading, social policy should contribute to actively mobilising the productive potential of citizens in order to mitigate new social risks, such as atypical employment, long-term unemployment, working poverty, family instability and lacking opportunities for labor market participation, resulting from care obligations or obsolete skills.

It is important to spell out the reasons why the welfare state today must be 'active' and provide complementary enabling social services alongside more traditional social insurance. When the risk of industrial unemployment was still largely cyclical, it appeared sufficient to administer collective social insurance funds for consumption-smoothing during spells of Keynesian demand-deficient unemployment. However, when unemployment becomes structural and is caused by radical shifts in labour demand and supply, intensified international competition, skill-biased technological change, the feminization of the work force, family transformation, and social and economic preferences for more flexible employment relations, then traditional unemployment insurance no longer suffices. Basic minimum income guarantees must therefore be complemented with *capacitating* public services, customized to particular social needs caused by life-course contingencies and empowering children and adults with a view to create real equality of opportunity([5]). And since it is difficult to privately and/or collectively insure new social risks, and as capacitating social services are not self-evidently supplied by private markets, it is imperative for public policy to step in and provide effective protection against such risks. The movement away from passive income compensation, through social insurance, to more active social policy support and servicing is critically informed by the mounting evidence (collected over the past decades) of the enormous social cost of early failure and (too) late policy intervention across the life course. Early school dropouts and youth unemployment massively narrow life chances in later years, both individually and collectively.

4. Nelson, S. (2011), 'Do social investment policies produce more and better jobs?', in Morel, N., Palier, B. and Palme, J. (eds.), *Towards a Social Investment Welfare State?*, Policy Press.
5. Sabel, C., Saxenian, A.L., Miettinen, R., Kristensen, P.H. and Hautamäki, J. (2010), Individualized service provision in the New Welfare State: Lessons from special education in Finland, report prepared for SITRA, Helsinki.

Increasing unemployment risks for the unskilled are a fundamental trend in contemporary societies. As the European Commission's "New skills for new jobs" report underlines, employment rates vary greatly according to qualification levels. The employment rates across Europe as a whole in 2008 for those with high skills was 83,9%, that for medium skill levels was 70,6%, and that for low skill levels was only 48,1%. In fact, between 2007 and 2010, the number of jobs employing people with high skills has increased in Europe, while the number of low-skill jobs has decreased ([6]). This goes to show that in today's economy, qualifications are more important than ever, especially in view of the increasing needs in new sectors of employment, such as 'green jobs', advanced technologies, and the digital economy which lie at the core of the new economy.

The fact that the unemployed are predominantly unskilled and that vacant jobs require high skills, suggests that, in these times of 'aftershock', we need to complement demand-side measures with supply-side instruments that go beyond the deregulation of labour markets, lowering of labour costs and provision of incentives for the unemployed to take poorly paid jobs. We should upskill the unemployed by providing them with the necessary learning capacities.

The more fundamental and contentious unifying tenet of the economics of the social investment perspective bears on its theory of the state. Distancing themselves from neo-liberalism's 'negative' economic theory of the state, social investment advocates view public policy as a key provider for families and labour markets. They do so, in the first place, on the basis of a far less sanguine understanding of efficient markets. Two economic rationales are at work here. The first relates to information asymmetries. Because citizens often lack the requisite information and capabilities to make enlightened choices, many post-industrial life-course needs remain unmet because of the market failures of service under-provision at too high a cost. Because it is difficult to privately and/or collectively insure new social risks, and as capacitating social services are not self-evidently supplied by private markets, it becomes imperative for public policy to step in for effective protection against new social risks.

In terms of substance, three areas of public policy stand out in the social investment perspective: bearing on human capital improvement, the family's relation to the economy, and employment relations. In an ageing economy with widening inequalities, raising the quality and quantity of human capital is imperative to sustain generous and effective welfare states, beginning in early childhood. One period of education at the beginning of one's life is no longer a good enough basis

6. European Commission (2009), New skills for new jobs. Anticipating and matching labour market and skills needs, Luxembourg: Office for Official Publications of the European Communities; European Commission (2010) "New skills for new jobs: action now", a report by the Expert Group on New skills for new jobs prepared for the European Commission.

for a successful career. In economics, the case for human capital enhancement goes back to endogenous growth theory of the 1980s, suggesting that long term growth is determined more by human capital investment decision than by external shocks and demographic change. The case of high-quality early childhood intervention is most powerfully argued by the economic Nobel laureate James Heckman. Since cognitive and non-cognitive abilities influence school success and, subsequently, adult chances in working life, the policy imperative is to ensure a 'strong start', (i.e. investment in the training of young children) ([7]).

As female participation is paramount to sustainable welfare states, and parenting is crucial to child development, and thus to the shape of future life chances, policy makers have many reasons to want to support robust families, which under post-industrial economic conditions implies helping parents find a better balance between work and family life. The economic reasoning of the OECD in their 2007 *Babies and Bosses* studies is that when parents cannot realize their aspiration in work and family life, including the number of children they aspire to, not only is their wellbeing impaired, but also economic progress is curtailed through reduced labour supply and lower productivity, which ultimately undermine the long-term fiscal sustainability of universal welfare systems ([8]). To the extent that low levels of education in less well-off groups depress productivity, underinvestment in education will engender stunted economic growth and decreased tax revenue. Overinvestment by work-rich families in their offspring offers little compensation for this fundamental market failure.

In the post-industrial context of new social risks, flexible careers and life expectancy gains, the goal of full employment has come to require far more differentiated employment patterns over the life course. In the aggregate, maximizing employment, rather than fighting formal unemployment, should be the prime policy objective. A new model of employment relations is in the making whereby both men and women share working time, which enable them to keep enough time for catering to their families. Higher employment of women typically raises the demand for regular jobs in the areas of care for children and other dependents as well as for consumer-oriented services in general. If part-time work is recognized as a normal job, supported by access to basic social security and allows for normal career development and basic economic independence, part-time jobs can generate gender equality and active security of working families. Accommodating critical life course transitions thus reduce the probability of being trapped into inactivity and welfare dependency and thus harbour both individual and economic gains ([9]). The issue is not

7. Heckman, J.J. (2000), ‘Policies to foster human capital, *Research in Economics,* Vol.54, No.1, pp. 3-56; Heckman, J.J. and Lochner, L. (2000), ‘Rethinking myths about education and training: Understanding the sources of skill formation in a modern economy’, in Danziger, S. and Waldfogel, J. (eds.), *Securing the Future: Investing in Children from Birth to College,* Russell Sage Foundation, New York, pp. 47-83.
8. OECD (2007), *Babies and Bosses*, Organisation for Economic Co-operation and Development, Paris.
9. Kok, W., Dell’Aringa, C., Lopez, F. D., Eckström, A., Rodrigues, M.J., Roux, A. and Schmid, G. (2003), Jobs, jobs, jobs: Creating more employment in Europe: Report of the European Commission’s

maximum labor market flexibility or 'making work pay'. Instead, the policy imperative is for 'making transitions pay' over the life cycle through the provision of ‘active securities’ or ‘social bridges’, ensuring that non-standardized employment relations become ‘stepping stones’ to sustainable careers.

The explicit re-appraisal of the role of the state as a key social investor questions the way public spending is monitored in the Stability and Growth Pact. While all the available evidence suggests that investments in childcare and education will, in the long-run, pay for themselves, existing public finance practices consider any form of social policy spending only as pure consumption. This may be true for the modus operandi of the post-war welfare state, which was indeed income-transfer biased. Today, as the welfare state is in process of becoming more service based, there is a clear need to distinguish social investments from consumption spending. A new regime of public finance that would allow finance ministers to (a) identify real public investments with estimated real return, and (b) examine the joint expenditure trends in markets and governments alike, has become imperative. This would be akin to distinguishing between current and capital accounts in welfare state spending, just as private companies do.

We believe that the fundamental societal trends that necessitated a social investment perspective, so conceived, are as relevant and important today as they were ten years ago, perhaps even more so because of adverse demography. With fewer active persons supporting ever more dependents, low labour market participation is simply no longer affordable with the demographic changes now taking effect across the EU. Social investments especially in older workers, which allow for combinations of flexible retirement while continuing working, together with investments in life-long learning and training, incur positive macroeconomic effects far beyond the current crisis. There is great potential for employment growth, if people are skilled for the new jobs and families can get the quality child service they need. This cannot be overstated.

Employment Taskforce, European Commission, Brussels; European Commission (2006), Implementing the renewed Lisbon Strategy for growth and jobs: A year of delivery, COM (2006) 816 final, Brussels, Part I; European Commission (2008), Renewed Social Agenda: Opportunities, access and solidarity in 21st century Europe, COM (2008), 412 final, Brussels.

2. What can be learned from past social investment experience?

Between 2000 and 2010, the Lisbon Strategy was highly instrumental in enhancing the social dimension of EU policy and in promoting greater social and economic policy coordination. Below we examine a number of substantive issues concerning the social investment turn, followed by a short reflection on aspects of EU governance.

Substantive policy issues

Since the 1990s, the majority of European welfare states have – with varying success – pushed through reforms in macroeconomic policy, industrial relations, taxation, social security, labour market policy, employment protection legislation, pensions schemes, social services, welfare financing and social policy administration. Even if public social spending has been consolidated, practically all advanced European welfare states have been reconfiguring the basic policy mixes upon which they were built after 1945. It is also fair to say that, in hindsight, European welfare reforms over the past two decades have *not* singularly followed the social retrenchment and labour market deregulation recipes of the 1980s, but that they have also embraced notions such as competitive social pacts, activation, active ageing/avoidance of early retirement, part-time work, lifelong learning, parental leave, gender mainstreaming, labour market 'flexicurity', and the reconciliation of work and family life. In the process, innovations and additions in some policy areas have been accompanied by subtractions in others. The novelty of the recent epoch lies in the simultaneous and complementary application of both *positive* incentives of active and investment-oriented labour market policies, including employment subsidies, training measures, individualized counselling, and childcare provision, and the *negative* incentives of retrenched welfare benefits of shorter duration, increased targeting and sanctioning.

As the jury is still out, judgments on the extent to which the social investment paradigm has been put into practice diverge. The countries that display the strongest social investment profile are the Nordic countries, but we can also observe changes towards a more active welfare state in countries like the Netherlands, Germany, France, the United Kingdom, Ireland and Spain in the period leading up the current crisis([10]). The Southern European countries (Italy, Greece, Portugal, but not Spain), together with the East European New Member States seem to have shied away from making social investments.

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10. Morel, N., Palier, B. and Palme, J. (eds.) (2011), *Towards a Social Investment Welfare State?*, Policy Press.

With regard to the substantive issues raised by the social investment experience, we think there may nevertheless be agreement on the following points:

1) Creating virtuous circles of inclusion and emancipation presupposes that policies are **sufficiently ambitious and mutually consistent**. The social investment perspective is a ‘package’, and partial implementation may at best deliver partial success. The social investment perspective is based on a life-chance/life-course perspective, and this suggests that policies can be effective only if the whole chain is maintained, from early childhood education and care to lifelong training and active ageing.

2) Although the social investment paradigm has not 'crowded out' traditional welfare programmes over the past two decades, a social investment strategy is not a cheap option that allows substantial budgetary savings, especially not in the short run. Simultaneously responding to rising needs in healthcare (and pensions) and implementing a successful transition to fully-fledged social investment strategies **will require additional resources**. The erosion of the tax base and the imperative of budgetary austerity in the wake of the economic crisis of 2008-2010 is a dangerous threat to the social investment strategy. Budgetary discipline must not destroy the social investment perspective: additional tax revenues may be a necessity for overcoming the current crisis without destroying social investment. Simultaneously, and for the same reason, we will have to convince public opinion that the budgetary cost of ageing must be contained, in order to retain leeway for investment in youth: working longer (combined with labour market reform) is imperative.

3) Equality and Quality. **The quality of social services** is part and parcel of the social investment strategy. In order for social investment to be a driver in virtuous circles of inclusion, the investment function itself should be egalitarian: rather than to exacerbate background inequalities, the impact of childcare and education should be to reduce inequality in society. Social services should be genuinely capacitating. Only high-quality childcare can produce a long-term impact on children’s capacities and successes, and help reduce social inequalities. Quality of childcare is essential to making a difference and reaching the goals of social investment perspective.

By the same token, activation that aims merely at driving people back to the labour market to accept ‘any job’ is not producing good results. Active labour market policies can be seen as elements of social investment only if conceived as an instrument of social promotion. Poor-quality activation services produce poor results.

Education reform, with a view to enhancing real equality of opportunity, ought to be on the agenda in many a European Member State.

In other words, **equality** is both a precondition for a successful social investment welfare state and an important outcome of social investment policies. We know that egalitarian societies are more successful in implementing social investment policies. The fact that it is a precondition urges us to remember the merits of traditional social protection and anti-poverty programmes, and suggests that reducing income inequality should remain high on the social investment agenda. Hence, there is a **need for a balanced approach, with an 'investment strategy' and a 'protection strategy' as complementary pillars** of an active welfare state. Half-baked social investments will make it impossible to turn vicious intergenerational circles of disadvantage into virtuous circles of capacitation, inclusion and emancipation.

4) Finally – and very importantly – a social investment strategy is a (necessary) **supply side** strategy; it cannot be a substitute for macroeconomic governance and sound financial regulation. Considerable progress in EU employment rates has been wiped out by the crisis occasioned by financial deregulation and economic mismanagement. The social investment strategy must be **embedded in macroeconomic governance and financial regulation that support durable and balanced growth in the real economy**.

There is no denying that a social investment strategy generates tensions and trade-offs between various social policy goals in the short term, but most important to emphasize is that social investment is a packaged long-term strategy *par excellence* with high rates of economic returns and social rewards. This especially in an era where human capital is swiftly becoming a scarce resource.

Governance issues

At EU level, the social investment perspective was associated with a specific policy methodology, known as the Open Method of Coordination (OMC). The merits and weaknesses of this approach have been the subject of debate in a vast literature, which we will not discuss further at the present moment ([11]). Very succinctly put, our viewpoint may be summarized as follows: **open coordination is no doubt as weak as it is 'soft', and one should not entertain too rosy a picture of its effectiveness. On the other hand, it has been instrumental in reorienting employment policies and – albeit to a lesser extent – social policies in Europe**. The European Employment Strategy, embodied in the Lisbon strategy, helped to redefine the European employment issue away from *managing unemployment* and toward the *promotion of employment*, fostering the diffusion and acceptance of a new mental framework for employment policy re-

11. Zeitlin, J., Pochet, P. and Magnusson, L. (2005), *The Open Method of Coordination in action. The European Employment and Social Inclusion Strategies*. Peter Lang New York.

direction (rather than concrete policy recommendations). The pro-active reorientation from managing unemployment to increasing labour market participation - on the basis of social investment priorities of activation, active ageing/avoidance of early retirement, part-time work, lifelong learning, parental leave, gender mainstreaming, 'flexicurity' (i.e. balancing flexibility with security), and reconciling work and family life - has certainly been important to the overall improvement in quality of employment and a significant decline in unemployment across most European countries over the decade. However, in the policy areas of social inclusion, the Lisbon process has failed to adequately address structural inequalities. This is due to the fragmentary thinking that has been so characteristic of EU social and economic policymaking. The primary focus on the integrity of the single market, low inflation and sound public finances, anchored in the Stability and Growth Pact, precluded EU macroeconomic policymaking from taking social policy seriously as a productive factor. The Lisbon Strategy certainly represented the first attempt to rectify this lopsided economic thinking, but beyond employment it has failed to achieve prominence over the past decade. **When it comes to steering the *overall* orientation of *social* policy in the Member States, we see no alternative to 'governance by objectives'; no alternative, that is, to setting common goals and leaving the precise implementation of social and employment policy to the Member States. Hence, the crucial question that presents itself is how to make 'governance by objectives' deliver more consistently in the new era of Europe 2020, as the latter was sketched in June 2010**.

Consistent delivery of the social investment objectives requires that they be embedded in the macroeconomic and budgetary surveillance of the EU, as we will further emphasize below: that is the first lesson from past experience ([12]). Simultaneously, the EU has to address two other lessons from recent experience. First, the macroeconomic regime of EMU and the Stability and Growth Pact is inadequate: by singularly focusing on inflation and, rather ineffectively, on public deficit and debt levels, the EU has overlooked worrying divergences in the real economy across the Eurozone. Second, the members of the Eurozone have become more vulnerable vis-à-vis financial markets, and have lost much of their capacity to apply counter-cyclical budgetary policies: countries in a monetary union such as today's Eurozone can be forced into a 'bad equilibrium', characterized by deflation, high interest rates, high budget deficits and a banking crisis, as Paul De Grauwe argues ([13]).

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12. Apart from the necessity to have social investment policies embedded in macroeconomic and budgetary regulation, an issue which we deem crucial, more needs to be said about the prospect of the Open Coordination on Social Policy itself. We consider it important to maintain a process of open coordination on social policy. For a discussion on this topic, we refer to Marlier, E. and Natali, D. (eds.) with Rudi Van Dam (2010), *Europe 2020. Towards a More Social EU?*, P.I.E. Peter Lang, Brussels.
13. De Grauwe, P. (2011), The governance of a fragile eurozone, discussion paper, April 2011, (http://www.econ.kuleuven.be/ew/academic/intecon/Degrauwe/PDG-papers/Discussion_papers/Governance-fragile-eurozone_s.pdf).

Addressing some of these issues will take us beyond (soft) governance by objectives (without abandoning soft governance on the overall orientation of social policies proper), as will become clear below. But before we turn to solutions, we want to highlight the risks the EU is confronted with.

3. Social investment in jeopardy?

Will the social investment paradigm, which gained credit before the onslaught of the 2007 economic crisis, carry the day, or will it revert to marginality and be left orphaned in the new epoch of austerity? While public support for the welfare state remains high across Europe, and has even grown somewhat in the immediate aftermath of the crisis, the repercussions of the financial downturn are not benign for the politics of the welfare state. Inevitably, demographic headwind and drained public finance will bring social contracts under duress, especially in countries facing high unemployment and immediate budgetary pressures, where long-run population ageing and the feminization of the work force were not adequately dealt with in the era prior to the crisis.

The associated political problem is that while confidence in free markets is at an all-time low, skepticism about the ability of governments to manage economies, let alone help to foster social progress, is at its peak. In many countries, the middle classes are increasingly fearful their offspring will be affected by downward mobility. At the same time, the economic position of the very rich has improved over the past two decades. Middle-class fears of falling behind have gone hand in hand with stronger electoral abstention and growing support for populist parties, particularly of the right. The overall political sentiment across Europe is conservative and creates a 'double bind': national welfare chauvinism and a belief in one-sided, short-term austerity. The internal contradictions in this double bind risk paralysing both the EU and much needed domestic social reform.

Politically, even before the 2008 financial meltdown, the EU became the scapegoat of choice for anti-immigrant and Eurosceptic voices. Although populist anti-EU as well as anti-immigrant parties may not muster the strength to take office in most countries, their growing support will put pressure on existing governments to protect national welfare programmes and limit their commitments to European integration. Mario Monti aptly speaks of 'single market fatigue' in his important report on the future of European economic integration in the wake of the crisis. While populism surely fails to offer credible – future-proof - social policy alternatives, it is becoming increasingly difficult for pro-European mainstream social democratic, Christian democratic and green-left parties to support, defend and claim credit for much needed domestic welfare recalibration based on social investment alternatives, which are to be consistently anchored in pan-European macroeconomic solutions to the crisis.

Concurrently in EU economic policy circles, technocratic fiscal orthodoxy reigns supreme. The debate on 'economic governance' has been largely confined to new budget rules, complemented with a selection of macroeconomic issues. It is perplexing how quickly the neo-liberal 'blame-it-on-the-state' narrative resurfaced at the centre of the debate after the Greek sovereign debt predicament of early 2010. Within the span of a single year, many EU policymakers seem to have forgotten that the financial crash originated in behavioural excesses in financial markets and excessive faith in those markets, and not in excess welfare spending per se. The Annual Growth Strategy (AGS), published by the European Commission in February 2011, marks a return to social retrenchment and deregulation, reminiscent of the OECD jobs study of the mid-1990s. The Commission once again identifies fiscal profligacy, overregulated labour markets, overgenerous welfare states, excessively strong trade unions and rigid wage bargaining institutions as the main barriers to European growth and competitiveness. The AGS thus calls for ‘a rapid reduction in unemployment through labour market reform’, as part and parcel of an aggressive fiscal consolidation package. By insisting that EU actions do ‘not require large public investments’, the AGS is fundamentally at odds with empirical evidence of the proficiency of social investment responses to the crisis.

Between 2008 and 2010, many European countries implemented short-term work or temporary lay-off schemes, combined with existing programmes of unemployment compensation alongside further training initiatives. The aim was to enhance the resilience and adaptability of workers and hence the competitiveness of enterprises through skills development, often based on tripartite agreements with the social partners at regional, sector or company level. It is fair to say that many of these preventive measures were consistent with both demand stabilization and new social investment priorities. Some of the most generous welfare states, with large public sectors devoted to human capital formation and family services, have outperformed many of the most liberal political economies in the wake of the crisis. In other words, an ambitious, generous and active welfare state, with a strong social investment impetus, has proved to be an asset rather than a liability after the onslaught of the Great Recession of the early 21st century.

Notwithstanding significant social investment policy successes over the past decade, the 'double bind' of welfare chauvinism and EU austerity could easily nip the social investment imperative in the bud, fuelling nationalism in macro-economic policy and xenophobia and welfare chauvinism in social policy in the coming years.

4. Taking Europe 2020 seriously

There are grounds for scepticism towards Europe 2020, the successor to the Lisbon Strategy. The policy methodology may be considered as intrinsically weak, given its reliance on 'governance by objectives' (or, as some would point out, given its reliance on *intergovernmental* management by objectives, rather than a more traditional 'Community' approach). Like its predecessor, Europe 2020 remains at the level of 'headline targets' with not much in the way of a policy theory underlining the importance of these targets for economic stability and social progress and the measures and policy instruments to realistically achieve them. The five headline targets are: 1) an employment rate of 75%; 2) spending on R&D amounting to 3% of GDP; 3) the reduction of greenhouse gas emissions by 20%; 4) the reduction of secondary-school drop-out rate by 10% and to achieve 40% of graduates from higher education. The fifth target, on social inclusion, is based on a combination of three indicators: the number of people at risk of financial poverty, the number suffering from severe material deprivation and the number living in jobless households. The ambition is to reduce the total living in one or more of these conditions by 20 million by 2020.

While certainly not perfect, the social objectives of Europe 2020 translate a social investment ambition which merits full support. For that reason, they should be taken very seriously. The question then becomes whether the National Reform Programmes of the Member States will credibly pursue *all* the integrated guidelines and headline targets of Europe 2020, and whether or not the European Council will be as strict in assessing the National Reform Programmes and in monitoring sustainability, education and social targets as it promises to be strict on budgetary and competitiveness indicators. The **June European Council** will provide a **first testing ground** in this respect.

In the coming years, the credibility of the Europe 2020 targets and guidelines will depend on the credibility of the link between the latter and the macroeconomic and fiscal surveillance which the EU is due to launch. The quality of spending under constrained public budgets will be crucial in this respect.

We believe that the objectives formulated under the Europe 2020 strategy can provide a framework for reconciling those short-term and long-term considerations, *if* the social investment strategy is embedded in budgetary policy and financial regulation, i.e. if short-term macroeconomic governance serves long-term social investment. The crucial question is how **long-term** and **short-term** policy considerations will interact, both at EU level and in individual Member States. The policy conundrum is complex. On the one hand, short-term austerity pressure is intensified by the extent to which long-run societal change, ranging from population ageing, the feminization of the work force, immigration, and shifts in labour supply and demand, was not adequately dealt with in the era prior to the crisis in a number of Member States. One cannot simply wish short-term budgetary pressures away. On the other hand, the continuing pressures of those societal changes in the aftermath of the current crisis will only strengthen both the need for human capital investment and the importance of poverty relief and social insurance.

In June 2010, the EU launched its Europe 2020 strategy, and today it is in the process of establishing a new system of macroeconomic and budgetary surveillance. Meanwhile, the political momentum and the substantive orientation have been dominated by the so-called 'competitiveness pact'. **Wrong-headed austerity policies and a one-sided emphasis on wage-cost competitiveness** (important though it is) **will jeopardize the social investment perspective. In order to guide the budgetary austerity policies towards long-term ends and to frame wage-cost considerations in a broader perspective on competitiveness, the EU needs a true “Social Investment Pact”. Such a pact should, moreover, have as much bite and clout as the forthcoming macroeconomic and budgetary surveillance.**

In April, the European Parliament’s Committee on Economic and Monetary Affairs defined its position vis-à-vis the European Commission’s six legislative proposals on the new macroeconomic and budgetary surveillance. Negotiations will now start with the Commission and the Council. Some of the concerns that we here express, have been incorporated in the amendments proposed by the Parliament’s Committee on Economic and Monetary Affairs. For instance, the budgetary surveillance is made more realistic, by taking into account cyclical effects on national budgets (such as increasing unemployment expenditure in a downturn); the scoreboard used in macroeconomic surveillance may be broadened to include social protection and social investment indicators; some ideas of the Monti report have been included, with a view to maintain a correct balance between economic policies and fundamental social rights. The Parliament endorses the idea of issuing Eurobonds, a proposal to which we return briefly below. In its considerations, the Parliament also refers to the quality of spending and the role of investment, but no hard, operational proposals are made to sustain social investment in the framework of budgetary surveillance. Hence, the current negotiations may to some extent improve what has been tabled by the Commission and the Council ([14]).

However, we remain deeply worried about the political momentum that has been created by the discussions in the Council on the so-called “Competitiveness Pact” (notwithstanding the fact that the latter has been turned into a more nuanced “Euro-plus Pact”). There is a very real risk that the

14. On the improvement of the EU's macroeconomic and fiscal governance and its link with Europe 2020, a number of proposals have been tabled over the last 12 months, which we cannot all discuss here. See for instance, Estella, A. and de Sola, M. (2010), 2020 Strategy: from growth and competitiveness to prosperity and sustainability, Discussion Papers 10/2010, Foundation IDEAS; and Delors, J., Fernandes, S. and Mermet, E. (2011), The European Semester: only a first step, Policy Brief No. 22, Notre Europe, February 2011.

balanced set of objectives, written down in the Europe 2020 strategy, will be definitely lost, and that the social investment perspective will vanish. **The coming weeks will be crucial in this respect.**

As already said, we do not want to suggest that one can wish short-term budgetary pressures away, and we do not want to sound naïve with regard to the current situation in a number of Member States. The question is how the EU can help Member States experiencing dramatic budgetary problems (such as Ireland, Spain, Portugal and Greece) to simultaneously cut deficits and maintain a credible social investment perspective in the longer term. Therefore, it is important to consider two types of measures. First, the systemic fragility of the Eurozone has to be remedied. Although the joint issue of Eurobonds is, today, in the European capitals a controversial idea, the argument put forward by De Grauwe and others in favour of Eurobonds is forceful: the joint issue of Eurobonds would allow *all* members of the Eurozone to find themselves in a 'good equilibrium', significantly decreasing the interest burden on their budgets, and reduce a collective risk with which the whole Eurozone is confronted, whilst taking on board concerns regarding moral hazard. Second, the European Structural Funds, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) could also become more supportive of specific social investment policies. Eurobonds – taking the form of earmarked project bonds – could also be issued to fund specific European projects in the realm of social investment, from which member states that pursue credible social investment policies may benefit. In this way, the EU could substantiate a real 'deal' between countries which are in better budgetary shape and have pursued social investment strategies more consistently in the past, and countries which have been less consistent with regard to social investment than one may have wished and experience dramatic budgetary policies. **The political deal the EU needs is one wherein *all* governments pursue budgetary discipline and social investment, and are *supported* therein in a tangible way by the EU. Such a reform-oriented, forward-looking deal may contribute to creating a real sense of 'reciprocity' in the EU.** Reciprocity presupposes an intelligent balance between discipline and assistance, between strict conditionality and perspective on progress, or, to put it in yet other terminology, between 'stick' and 'carrot'. What we know to be true for individual activation policies in labour markets is also true for the overall architecture of EU governance.

Such a deal would be fully consistent the overall need to raise competitiveness, and the need to reduce disparities in competitiveness among EU member states. Investment in human capital, life time employment and productivity are perhaps the most important factors to EU-wide macroeconomic stability and growth in the longer term. The worst performing countries are those struggling most in the current situation, and they are unable to invest additional money into training, education, and skills. The EU should consider how to help the worst performers. It is the single most important growth factor, which, if fixed, could put the EU on track for achieving the targets of more sustainable, inclusive growth. Low labour market participation is simply no longer affordable with the demographic changes taking place and it has to be addressed as a matter of urgency. 'Helping' means, in this context, putting in place the combined macroeconomic and budgetary surveillance and social investment perspective we have sketched.

Such a deal would not only constitute a relevant follow-up to the effort the EU invested in social policy. It would also be a true response to legitimate expectations created by the EU over the last few years ([15]).

5. Substantiating the Europe 2020 Social Investment Pact

Macroeconomic growth and stability needs to be supported by productive social investments. One of the key merits of Van Rompuy's Task Force on economic governance has been to reconnect real economy competitiveness, including issues of trade imbalances, asset bubbles, oversized banks, and macroeconomic surveillance. As such, Van Rompuy's wider interpretation of macroeconomic performance creates an important window of opportunity to take real economy social investment efficiency gains seriously more than ever before.

It is crucial to articulate a political perspective on the interdependent roles that the EU and the Member States should play, combining short-term fiscal crisis management with room for domestic reform to pave the way for the longer-term social investment priorities. This should be accompanied by a strong social narrative of a 'caring Europe' as one of the founding principles of European cooperation. In his important report, Mario Monti rightly states that the single market and social policy priorities are in dire need of 'appropriate reconciliation'. It seems that the old division of labour between EU institutions and domestic policy making, with the former concentrating on market liberalization, while the latter retaining near monopoly over domestic social policy and labour market governance, has reached a cul-de-sac, both politically and economically, in the aftermath of the crisis. The critical challenge lies in redirecting the broad political support for the welfare state in most EU Member States towards the design of a new welfare state model that will better equip the citizens and societies of Europe to face up to social change and global competition. An explicit 'EU social investment pact', based on a clear vision of 21st-century social progress, could be helpful in these challenging times in restoring the EU's legitimacy. That legitimacy has been discredited in some quarters, as the EU role was perceived as a mere custodian of free market competition. Today, Europe 2020 and the Lisbon Treaty (which

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15. See, among other publications, the EU's Joint Report 2010 on Social Protection and Social Inclusion; and the assessment the Social Protection Committee published in 2009 on the social dimension of the Lisbon Strategy.

anchors the EU's normative commitment to a highly competitive 'social market economy' in article 3 and a ´horizontal social clause´ in article 9) enable real governance improvements, potentially leading to a more balanced approach to market integration.

The social and economic challenges out of which the social investment perspective emerged in the first place remain as relevant and important today as they were ten years ago. The aftermath of the current crisis and adverse demography can only underline the need for human capital enhancement and employment growth, as well as the importance of poverty relief and social insurance. On the other hand, short-term budgetary pressures cannot be wished away. Although the social investment paradigm promises high rates of return on investment, in terms of higher employment, rising productivity and more robust families, social investment does not come cheap. Additional tax revenues may be a necessity to overcome the current crisis without destroying long-term labour productivity and participation in ageing societies. In order to guide the budgetary austerity policies towards long-term ends and to frame wage-cost considerations in a broader perspective on competitiveness, the EU needs to supplement its strengthened budgetary and macroeconomic surveillance with an effective "Social Investment Pact". Using a life-course perspective on social progress, we can best substantiate what this means.

Child-centred social investment strategy

Since life chances are so over-determined by what happens in childhood, a comprehensive child investment strategy with a strong emphasis on early childhood development is imperative. Access to affordable quality childcare is a sine qua non for any workable future equilibrium. The emphasis on early-childhood education and development goes *beyond* the idea that childcare is necessary to allow mothers and fathers to reconcile work and family life. A 'child-centred social investment strategy' is needed to ensure that children become lifelong learners and strong contributors to their societies. More children, educated to perform in a knowledge economy, are required in order to keep that economy going, given the demands of a retiring baby boom generation with substantial care needs. As underlined, only high quality early childhood education and care services are performing. Hence we propose to go further than the only quantitative targets of Barcelona 2002 (90 percent of children between 3 and the mandatory school age and at least 33 percent of children under 3) to add figures such as number of adult per children. Considering the return on such investments for societies, we propose that investment in early childhood education and care should not be counted as public expenditure but rather be seen as public investment, and that the overall economic governance of the EU should stimulate member states to pursue such investment.

Human capital investment push

If Europe wishes to be competitive in the new, knowledge-based society, there is an urgent need for investment in human capital throughout the life course. Considering the looming demographic imbalances, we surely cannot afford large skill deficits and high educational dropout rates. As inequalities are widening in the knowledge economy, parents' ability to invest in their children's futures is also becoming more unequal. If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, surely they assume the role of a 'productive factor'. Increased investment in education, preventing early exit from formal education and training, and facilitating the transition from school to work, in particular for school leavers with low qualifications, are imperative. Hence the crucial importance of the early school drop-out target set in the Europe 2020 agenda. But as important would be a focus on life-long training. A more streamlined cooperation between education and training institutions and the professional world is called for as the worlds of learning, work and leisure are increasingly overlapping and becoming much more closely integrated. Lifelong education and training are in the process of becoming regular components of gainful employment.

Reconciling work and family life

The interaction between economic performance and the welfare state is largely mediated by the labour market. Quality employment is the best guarantee against poverty and inequality. This presupposes: enhancing the labour force participation of women and assuring enduring employment for various disadvantaged groups, including the disabled, the under skilled and the long-term unemployed; making employment attractive by fighting poverty traps; activating benefit recipients; subsidizing decent low-skilled and low-productive work; implementing active labour market policies as well as labour market reform. The majority of Europe's mature welfare states are confronted with the phenomenon of labour market segmentation between 'insiders' and 'outsiders'. Most likely, labour markets will become ever more flexible. While the boundaries between being 'in' and 'out' of work have been blurred by growth in atypical work, low-wages, subsidized jobs, and training programmes, one job is no longer enough to keep low-income families out of poverty. Post-industrial job growth is highly biased in favour of high-skilled jobs. Additionally, however, increased labour market flexibility, together with the continuous rise in female employment, will also encourage sizeable growth of low-skilled and semi-skilled jobs in the social sector and in personal services. The policy challenge that presents itself is how to mitigate the emergence of new forms of labour market segmentation through what might be referred to as 'preventive employability', combining increases in flexibility in labour relations by way of relaxing dismissal protection, while generating a higher level of security for employees in flexible jobs, including (un)paid (parental) leave, life-course policies, childcare, care for the frail elderly, and gender equality. Flexible working conditions are often part and parcel of family-friendly employment policy provisions. There is a clear relation between the ratio of part-time jobs and female employment growth. But the ability of part-time employment to harmonize careers with family life depends very much on employment regulation, on whether part-time work is recognized as a regular job with basic social insurance participation, and on whether it offers prospects of career mobility.

Later and flexible retirement

Many of the so-called 'new social risks', such as family formation, divorce, old-age care dependency, declining fertility rates, and accelerating population ageing, bear primarily on young people and young families, signifying a shift in social risks from the elderly to the young. Late entry into the labour market by youngster, early exit by older workers, combined with higher life expectancy, confronts the welfare state with a looming financing deficit. Two trends justify a change in our thinking about retirement: a) the health status of each elderly cohort is better than that of the last. And, b) the gap between old age and education is rapidly narrowing, so that, in the future, old people will be much better placed than they are today to adapt through retraining and lifelong learning. The education gap between the old and the young will begin to close as the baby-boomers approach retirement.

In the area of pensions policy, the challenge lies in how to allocate the additional expenditures that inevitably accompany population ageing. Delaying retirement is necessary. This is both effective and equitable. It is effective because it impacts simultaneously on the nominator and the denominator by combining more revenue with lower spending. It is inter-generationally equitable because retirees and workers both sacrifice in equal proportions. People are getting healthier and more educated with each age cohort. Flexible retirement and the introduction of incentives to postpone retirement could greatly alleviate the old-age pensions burden. If older workers remain employed longer than they typically do today, then household incomes will increase substantially and the pensions system would be better preserved.

In order to reach this goal, one needs to go beyond changing pension calculation rules (the so-called parametric reforms) and also aim at improving working conditions and implementing lifelong training schemes for all workers. Social investment policy in this respect goes beyond capacitating public services and leave provisions. With a more active older work force and work-life reconciliation problems for younger two-job couples with children, employment relations based on dignity at work principles, fostering new combinations of security and flexibility that allow workers from all age-cohorts to make the best of their abilities and talents, recalibrated employment relations are part and parcel of the new social investment imperative.

Migration and integration through education and participation

More than before, priority should be given to the issues of participation and integration on the part of migrants and non-EU nationals, whose rates of unemployment are on average twice that of EU nationals. Integration and immigration policy should occupy a central place in the debate on the future of the welfare state, something we have failed to acknowledge in the past. In our ethnically and culturally diversified societies, the welfare state faces the major challenge of ensuring that immigrants and their children do not fall behind. Specific effort in education, training and labour market integration should be targeted towards migrants and their children in order to narrow the gaps between them and the rest of society.

Minimum income support and capacitating service provision

Social insurance guarantees are increasingly connected to capacitating social services, customized to individual needs caused by the new life-course contingencies of skill depletion, family breakdown, career and caring contingencies,. We cannot assume that early childhood development, human capital push, together with high-quality training and activation measures will remedy current and future welfare deficiencies. Hence, in the medium term, it is impossible to avoid any form of passive minimum income support unless we are willing to accept rising household welfare inequalities. An unchecked rise in income inequality will worsen citizens' life chances and opportunities. Greater flexibility and widespread low-wage employment suggests a scenario of overall insecurity for a sizeable group. It is therefore necessary to have an even more tightly woven safety net for the truly needy.

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We know that the current situations in the EU Member States, from which we have to start, are very diverse, with some Member States already experiencing dramatic budgetary pressures. Priorities may therefore diverge among Member States, and – as already mentioned – a European-wide Social Investment Pact should support Member States that wish to pursue social investment, despite their budgetary difficulties. Without being naïve, and taking into account the existing diversity, we are convinced that a Social Investment Pact will in the longer term impact positively on public finances, on the basis of the employment and productivity growth that social investment induces. Without a Social Investment Pact of growth in fairness, fiscal consolidation is unlikely, due to both wrongheaded economics and the political conflict it is bound to ultimately unleash. Let us hope that, sooner rather than later, more policy creativity and political imagination will encourage EU and national policymakers to turn the current tide of inward-looking pessimism about the EU's future and the sustainability of European welfare states into a renewed and much needed political effort at forward-looking 'social pragmatism'. Social investment means reform, and the political question finally is how the public opinion and social actors can be convinced of the necessity to reform. In order to convince, social investment strategies should not only be embedded in sound macroeconomic and budgetary policies, but also embedded in an attractive perspective of social progress, based on a shared notion of fairness and the political willingness to fight growing inequalities in our societies.