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**Article**

Making Social Investment Happen for the Eurozone

Intereconomics


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Half a decade after the euro crisis, the European Union is in dire need of a growth strategy that is economically viable, politically legitimate and seen as socially fair. The United Kingdom’s fateful choice for Brexit has given new urgency to this imperative. While it is deplorable to lose a strong political force behind the internal market, Britain’s decision to leave the EU does create a window of opportunity for taking the Union’s “social market economy” ambitions, as laid down in Articles 2 and 3 of the Lisbon Treaty,1 more seriously than before. British governments have in the past been fairly dismissive of Europe’s “social dimension”. So as not to upset the Brits, Commission presidents, ever since the days of Jacques Delors, have been rather silent about Europe’s social acquis. This lukewarm stance has run its course. Current Commission President Jean-Claude Juncker conjured up a breath of fresh air with his pronouncement to the European Parliament when presenting the new Commission in November 2014: “I want Europe to be dedicated to being triple-A on social issues, as much as it is to being triple-A in the financial and economic sense.”2 Likewise, the public consultation on the so-called European Pillar of Social Rights that was launched by the Commission in March 2016, prioritising investment in human capital based on equal opportunities, effective social safety nets and open access to European labour markets, is another welcome change.3 The European Pillar of Social Rights initiative is, however, not without risks. How will the Juncker Commission see to the credible enforcement of its new social discourse?

Meanwhile, the deep economic imbalances, high unemployment, poverty and inequality that have coincided with a rather timid economic recovery are becoming the breeding grounds of xenophobic anti-EU populism. The inability to deliver on economic prosperity and social progress puts national governments and EU institutions under enormous pressure. All in all, electorates continue to hold national politicians accountable for socio-economic (mis-)fortune. With political accountability bound up with popular welfare states, it is particularly difficult to renego on established social contracts in hard economic times. In addition, the failure to resolve the euro crisis at the supranational level has increasingly been met by rising eurosceptic domestic pressures to water down ruling governments’ commitments to European solutions, especially in the politically sensitive policy areas of welfare provision. Betwixt the EU’s inquisitive austerity reflex and anti-establishment populism, unsurprisingly, a “political-institutional vacuum” has emerged at the heart of the European project. More than ever, the social dimension has to assume pride of place. Social progress is of existential importance to the eurozone, as the single currency bars the option of restoring economic growth and social order through currency devaluation. How can Europe move forward?

There is no need for treaty changes. As intimated above, Article 3 of the Treaty of the European Union already obliges the Union to combat social exclusion and promote social justice, gender equality and solidarity between generations. Moreover, Article 151 proactively commits the Union to the development of human capital with a view to attaining high levels of employment,4 while Article 153 states that the Union must complement national policy in the areas of occupational health and safety, social protection and the integration of persons excluded from the labour market.5 More concretely, the Europe 2020 strategy aspires to raise employment rates to 75% by 2020, to reduce early school

* This article extensively builds on the analysis originally advanced in the monograph A. Hemerijck: Changing Welfare States, Oxford 2013, Oxford University Press and in my more recent articles on the euro crisis and the economics of social investment. Comments by Gerda Falkner, Maurizio Ferrera, Frank Vandenbroucke and Simon Vydra are gratefully acknowledged.

1 Art. 3 of the Treaty of the Function of the European Union (TFEU) states that “The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment.”

2 J.-C. Juncker: Setting Europe in Motion: President-elect Juncker’s Main Messages from his speech before the European Parliament, Strasbourg, 22 October 2014.


4 Article 151 TFEU: “The Union and the Member States, having in mind fundamental social rights such as those set out in the European Social Charter signed at Turin on 18 October 1961 and in the 1989 Community Charter of the Fundamental Social Rights of Workers, shall have as their objectives the promotion of employment, improved living and working conditions, so as to make possible their harmonisation while the improvement is being maintained, proper social protection, dialogue between management and labour, the development of human resources with a view to lasting high employment and the combating of exclusion.”

5 See Article 153 TFEU (1).
leaving to below ten per cent and to lift 20 million people out of poverty.\(^6\)

With levels of social spending in member states hovering between 16 and more than 30 per cent of GDP, the EU at face value is best understood as a union of national welfare states.\(^7\) In the current context, the appropriate role for the EU is to function (better than ever before) as a tenable “holding environment”, within which active welfare states can prosper. The good news is that there is ample scope for moving into this direction, thanks to the maturation of the social investment perspective in recent years.\(^8\)

**The growth potential of social investment “stocks”, “flows” and “buffers”**

The so-called Social Investment Package, published by the European Commission on 20 February 2013, already advocated forward-looking welfare policies to “prepare” individuals and families to respond to the social risks of the competitive knowledge society by investing in human capital stock from early childhood on, rather than to simply “repair” damage after economic misfortune strikes.\(^9\) Consistent with the impressive series of recent OECD studies on family policy and gender-friendly employment relations, skills and education, and rising inequality,\(^10\) the Social Investment Package compiled strong empirical evidence of positive returns to economic growth, employment creation and (child) poverty mitigation through social investment provisions of high quality childcare, generous parental leave, assertive activation and active labour market services, training and education, alongside adequate (universal) minimum income protection, consistent with long-term budget consolidation.

Social investment is quintessentially a strategy to promote and protect human capital for working families over the life course. Three complementary policy functions make up social investment:

- improving the “stock” of human capital
- easing the “flow” of labour market and life transitions
- maintaining strong universal safety nets and economic “buffers” in support of high levels of employment in ageing societies.\(^11\)

The buffer function alludes to securing adequate and universal minimum income protection, thereby also stabilising the business cycle and cushioning economic shocks. The stock function has to do with productivity and is focused on developing and maintaining human capital from early childhood all the way through lifelong learning. The flow function refers to the easing of labour market transitions to achieve a more efficient and optimal allocation of labour over the lifespan. In policy practice, there is significant functional overlap among the policy functions of stocks, flows and buffers.

This point of “institutional complementarity” is most persuasively brought to the fore by the recent OECD report *In It Together. Why Less Inequality Benefits All.*\(^12\) According to the OECD, one of the main transmission mechanisms between inequality and reduced growth concerns human capital. While there is always a gap in education outcomes across individuals with different socioeconomic backgrounds, the cognitive divide is particularly wide in high inequality countries where disadvantaged households disproportionately struggle to gain access to quality education for their offspring. Any reduction of inequality between rich and poor citizens thus requires the mobilisation of a whole range of policies, from turning female employment into good quality careers (flow) to proactive early childhood development as well as youth and adult training policies (stock), and the expansion of effective and efficient activating tax-and-transfer systems (buffers) in times of dire need.

Effective combinations of stock, flow and buffer policies “crowd in” employment, productivity and economic growth, following the logic of a “social investment life course multiplier”.\(^13\) Greater numbers of disadvantaged children will then have access to early education and high quality primary and secondary education. Consequently, overall levels of skill attainment improve, resulting in higher employment.

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\(^8\) See also F. Vandenbroucke: The Case for a European Social Union: why we need it; what it means, in: Rivista Italiana di Politiche Pubbliche, 2013, No. 2, pp. 221-247.


\(^12\) OECD: In It Together. Why Less Inequality Benefits All, Paris 2015.

and labour productivity and more upward social mobility. Quality childcare and preschool programmes, alongside effective parental leave arrangements and other family benefits and services – and supported by appropriate tax and benefit incentives, active labour market policies, and vocational rehabilitation programmes – enable more parents to engage in gainful employment without lengthy (gendered) career interruptions. There is plenty of research that shows that early childhood interventions massively improve life chances, labour market opportunities and capabilities, and health conditions later in life. However, social investment policy reaches far beyond early childhood education and care. Of exemplary importance today are active labour market policy programmes based on assertive counselling and job search requirements.

To the extent that social investment multi-functional policy portfolios promote longer and more productive working lives over the life course, they effectively contribute to more sustainable welfare provision in Europe's ageing societies. The more parents – especially mothers – work, the broader the tax base, with even a positive effect on fertility. Dual-earner families often use additional household income to achieve work-life balance by relying more on public and private services to ease their chore load, thereby creating extra jobs, further boosting economic output. Longer working careers with fewer interruptions incur lower gender gaps. Higher maternal employment rates are associated with lower rates of child poverty. Over the mature phases of the life course, lifelong learning and active ageing policies help secure older workers' employment participation, resulting in a high exit age and, by implication, lower outlays for unemployment, pensions and health care buffers. Work-life balance reconciliation flow measures, workplace organisation and active ageing policies that enable and encourage men and especially women to pursue flexible working careers with few interruptions encourage labour force participation at advanced ages. To the extent that social investment policies help defer retirement, actively employed men and women are able to qualify for fully remunerated old age pension buffers. Concurrently, effective unemployment buffers protect human capital and can improve labour market matching. The ideal-typical social investment multiplier effect is illustrated in Figure 1.

A social investment turn thus implies a complex reform agenda of interrelated policy interventions. The analytical taxonomy of stocks, flows and buffers conjures up a fairly parsimonious and integrated framework, representing three core social investment policy functions, rooted in strong theoretical priors on possible synergy effects in term of citizen life course chances through interrelated policy portfolios. Social investment life-course synergy effects hereby emerge from the complex interaction between the social investment functions that operate across institutionally differentiated policy areas of human capital stock formation, maintenance and recuperation; social security and minimum income protection.


18 Since the 1990s, fertility is positively associated with female employment, suggesting that prospective mothers decide to form a family when they have secured their position in the labour market. In A. Hemerijck: Changing Welfare States, op. cit. I have been able to plausibly convey that social investment strategies, based on readily available statistical data from the OECD and Eurostat, do support rising levels of (female) employment participation, together with, more indirectly, labour productivity growth and higher fertility, thus raising the long-term fiscal carrying capacities of generous and active welfare states.


buffers; and employment flow regulation, ranging from active labour market policies, hiring and firing legislation, health and work-life balance policies, and workplace organisation. A subsidiary aim is to counteract declines in labour supply resulting from a shrinking working age population in most European societies.

Of course, there is no such thing as an unequivocally optimal social investment policy mix. National welfare states with their varied policy legacies and diverse institutional capabilities require different combinations of stock, flow and buffer policies to foster economic progress and social well-being in tandem. To date, little research has been carried out that explicitly focuses on the life-course interplay of the social investment functions of stocks, flows and buffers under varied institutional contexts with the central aim of identifying and selecting effective policy mixes. What is required is a layered methodological approach that integrates quantitative macro- and micro-level analysis together with a qualitative institutional analysis so as to gain rich and actionable insights regarding which particular social investment policy portfolios work best under different economic and institutional conditions.21 This methodological point carries enormous political weight: where social policy budget allocation is merely informed by isolated and short-term policy intervention trials, longer, interdependent and cumulative well-being returns of social investment policy portfolios will remain under-examined and, as a consequence, under-developed in policy practice, due to an ingrained reluctance to query alternative insights in an age of “evidence-based” policymaking.


EMU and social investment: friends and foes

In the span of a mere decade, the social investment perspective matured from an intuitively appealing metaphor of “social policy as productive factor” to nothing less than a paradigmatic rethink of active welfare provision for 21st century knowledge economies in theory and practice.22 Although the 2013 Social Investment Package marked the EU case for “capacitating” welfare provision, its policy recommendations have not really latched on. An important reason for this is policy inertia. The Single European Act of 1986 and the Economic and Monetary Union (EMU) of 1999 were negotiated at a time when the supply side revolution in micro- and macro-economic theory was riding high.23 EMU originated from the stagflation crisis of the 1970s and early 1980s as a natural complement to the single market freedoms of goods, services, capital and people and was firmly grounded in a rejection of Keynesian demand management, capital controls, progressive taxation, corporatist wage bargaining and the use of deficit fiscal spending to counter economic recessions and mitigate social hardship. The architects of EMU generally believed that the single currency would force member states to adopt liberalising structural reforms, such as breaking down job protection, retrenching welfare benefits, cutting taxes, privatising pensions and deregulating capital markets. From this perspective, the architecture of EMU would ideally act as a “disciplining device” for participating member states to hold their “wasteful” welfare states in check by fast-forwarding market-conforming economic convergence. What happened?24

The unforeseen but welcome social investment turn

Alongside retrenchments, deliberate attempts across Scandinavia, Ireland, the UK, Austria, Germany, the Netherlands and Slovenia have successfully accommodated policy repertoires to the new economic and social realities of the knowledge-based economy. With respect to social insur-
ance and assistance, the majority of EU welfare states progressed towards more universal minimum income protection programmes, coupled with fairly “demanding” activation and “enabling” reintegration measures. The area of employment policy saw considerable increases in public spending on active labour market policies, training and education services to improve life course employability. Several Northern European countries experimented with greater acceptance of flexible employment relations, with new elements of security for labour market outsiders. Family policy, covering childcare, parental leave and work-life balance policies, experienced the most profound transformation. For pensions, finally, key shifts have been the raising of retirement ages coupled with initiatives on active ageing and the phasing out of early retirement schemes, together with the growth of (compulsory) occupational and private pensions and the development of multi-pillar systems, in an attempt to extend working lives and factoring in rising life expectancy.

Particularly noteworthy is the (belated) turn towards social investment in Germany, a country that at the turn of the century was deemed the “sick man of Europe”. Difficulties in abiding by the Stability and Growth Pact (SGP) inspired the Agenda 2010, a radical liberalisation of German labour markets and welfare provision. However, in the wake of the infamous Hartz IV reforms, the archetypical Bismarckian German welfare state also moved decisively in the direction of social investment. The first Merkel administration adopted a new parental leave scheme with strong incentives for women to return to work and for fathers to take up care leave, while significantly expanding childcare provision, anchored in a new universal right to childcare. Next, the grand coalition government constitutionally committed Germany to maintaining a balanced budget from 2010, but consistent with the social investment approach, it wisely exempted lifelong education and research from fiscal retrenchment.25

Unsurprisingly, coming from a deep policy legacy of Christian democratic male-breadwinner and female-homemaker welfare provision, the German social investment turn remains uneven. Childcare provision is layered with a more traditional transfer program, the so-called Betreuungsgeld, whereby parents can receive €150 per child and per month if they look after their children themselves and do not use childcare facilities. This is surely contrary to the logic of social investment and may engender quite regressive consequences for the cognitive and social development of children from more disadvantaged backgrounds. Furthermore, the debt brake, the coalition government’s agreement to reduce public debt to zero, will very likely result in drastic reductions in near-term social investment spending on education by the Länder, which are responsible for education, at a time when interest rates on public debt are close to zero.

All in all, however, the overall vector of change is in the direction of social investment.

EMU as an unintended “reform tranquilliser”

While the eurozone seemed fairly stable in the aggregate over its first decade, with moderate deficit and public debt levels and an external account in balance, imbalances underneath this smooth façade festered and grew. At low levels of economic growth, Germany undershot the ECB’s inflation target around the turn of the century. By contrast, the Mediterranean countries and Ireland struggled with higher inflation at fortuitous levels of catch-up growth. Although Spain and Ireland continued to adhere to fiscal conservatism, lower interest rates and easy credit stimulated excessive asset-based inflation, as Spanish and Irish households took on massive private debt to buy property and construct or renovate homes. For Italy and Greece, with their highly indebted public finances, a different scenario unfolded. After they had secured safe entry into EMU, “structural reform” incentives waned as public borrowing grew excessively cheap. Paradoxically, EMU entry reduced rather than reinforced pressures on debt-ridden countries to implement structural reforms to bring their fiscal houses in order. As a result, structural welfare reform came to a halt where it was needed the most – in countries in the Southern periphery, with their rigid insider-biased labour markets and pension-heavy male-breadwinner welfare states.26

Exempting human capital stock investments in eurozone fiscal governance

Post-eurocrisis management continues to be riddled with deep ambiguities. While the fiscal rectitude of the Six-Pack, Two-Pack, the Fiscal Compact, the Excessive Deficit Procedure and Troika bailout programmes may have been justified to restore the immediate credibility of EMU vis-à-vis capital markets after 2009, now that the single currency is on safer (but not secure) ground thanks to the ECB’s heterodox intervention, it is imperative to anchor the social investment progress more thoroughly in the eurozone economic governance framework and the European Semester. Proud as Europe should be of the unparalleled historical economic and social feats of inclusive welfare states and progressive governance,


regional economic integration, Europe will only prosper politically and economically if it improves on its own social model.

The challenge is to design a governance framework which contains supranational fiscal discipline in sync with the imperative to ramp up social investment across the eurozone’s semi-sovereign and economically highly interdependent welfare states. In this context, intensified EU fiscal surveillance can no longer ignore and dismiss the growth potential of social investment and the need to counter wide economic and social imbalances across the eurozone. Domestic welfare reform ownership is crucial. National policy actors are not and have never been the blind followers of policy fashion. In the majority of EMU welfare states, policy actors incrementally – through trial and error – turned to social investment as an inclusive proactive reform in times of intensified economic competition and adverse demographic trends. A different approach is in order. What is required is no less than a transformation in the modus operandi of EMU: away from an intrusive top-down welfare state “disciplining device” towards a more positive “holding environment” for sustaining social investment welfare states.

Unsurprisingly, the available evidence suggests that social investment-oriented welfare states reach levels of employment participation of close to 80% of the working age population. This is a result of high levels of investment in human capital stock formation and training across the entire life course, proactive labour market policy and regulation, reinforcement of family-friendly labour market flow for both job seekers and employers, and the maintenance of comprehensive income stabilisation buffers, which reinforce greater macroeconomic resilience during times of crisis, in combination with an effective tax and activating transfer system with a strong track record in countering inequality and skill atrophy.

Empirical evidence, including from the OECD, increasingly shows that the gains from improving educational standards across the life course are positively correlated with significant productivity and wage increases, employment and GDP growth, and lower levels of inequality. Thus, a low-risk proposal with tremendous upside is to discount social investments from the deficit rules in the reinforced SGP, so as to let the social investment life course multiplier do its work. As a leftover legacy of the stagflation era, standard public accounting procedures continue to report education and active labour market policy spending as current expenditures – in other words, as “unproductive”. But even in the Keynesian perspective, social protection, like pensions, at best allows for “consumption-smoothing”. Beyond cushioning economic shocks and stabilising demand, it is taken for granted, even in Keynesian economic theory, that welfare provision does not generate medium- or long-term positive economic dynamics and impact. This is old economics!

Granting more fiscal room for manoeuvre (within bounds) to countries that experience excessive social and macroeconomic imbalances would enable them to secure sustainable financing of education and skill upgrading before the ageing predicament becomes truly burdensome. Thus, reducing economic and social imbalances is in the collective eurozone and EU economic interest. Exemptions to SGP requirements are best confined to human capital stock intervention across the three social investment policy functions of stocks, flows and buffers. Exempting such investments from SGP deficit requirements would render greater fiscal space to member states that opt for social investment reform, without trampling on eurozone fiscal rules.

Discounting social investments should definitely come with conditions. The current framework, based on the Commission’s Communication of 13 January 2015, has thus far not lived up to expectations because of its opaque rules, cumbersome procedures and overall conditions of macroeconomic uncertainty. The same bureaucratic logic applies to Juncker’s even more ambitious €315 billion Investment Plan for Europe. Making social investments eligible for ex-

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29 Similar ideas have been advanced by F. Zuleeg, J.D. Schneider: What role for social investment in the new governance of the Eurozone?, European Policy Centre Policy Brief, 10 November 2015; and A. Truger: Reviving EU Fiscal Policy: 10 Ways to Strengthen Public Investment, www.socialeurope.eu, 9 March 2015.


emptions from the SGP and Fiscal Compact deficit procedures should be confined to lifelong training and education, as promoting and protecting human capital is the lynchpin of any effective social investment strategy. There should also be an upper limit to such social investment exemptions. For example, with an added one per cent of GDP in human capital investment for a decade or so, preferably matched by domestic public finances, the added advantage at the macro EU-level would be a more synchronised business cycle at a higher level of aggregate demand.

Special attention should be paid to low-hanging fruit. We know full well that a three-month long summer break is harmful to the social and cognitive development of disadvantaged children. Redesigning the school calendar to create a better distribution of school holidays is practically costless. In the future European Semester process, member state governments should present their reform ambitions in a comprehensive fashion across stock, flow and buffer policies as they put in their proposals for greater fiscal leeway on specific human capital stock investments. Italy and Spain could opt for the creation of immediate (and primarily female) jobs by making huge investments in high quality childcare centres. France could pursue a radical improvement of its system of vocational education and training based on the Finnish and German examples, while Belgium, the Netherlands and Slovenia could ramp up their rather regressive lifelong learning arrangements. Effective monitoring of social policy reform trajectories, under the European Semester exercise, requires a wider ambit of policy interventions than evaluating isolated human capital stock investments. We need more “contextualised” information about what kind of policy mixes of preventive stock, allocative flow, and corrective buffer policies are needed for people to realise their full potential throughout the life course. The focus should be on the alignment of stocks, flows and buffers using a layered empirical methodology for policy evaluation with an emphasis on how different policies work together to achieve the desired outcomes in terms of growth and wellbeing, and country-specific recommendations should be articulated accordingly.

Although human capital stock exemptions from SGP rules can be enacted without a major overhaul of the EMU governance framework, it is of political importance to give the eurozone social investment turn great visibility. To this effect, a Social Investment Pact to complement the Fiscal Compact would represent an important political signal that the eurozone is in the process of taking seriously the “holding environment” function for the active welfare state to prosper, with an assertive willingness to bid farewell to the fiscal austerity welfare disciplining function. The current schizophrenia of the eurozone as the austerity headmaster, on the one hand, and the global social investment cheerleader, on the other, has run its course. An assertive double commitment to rule-based medium-term budgetary discipline and sustained social investment, moreover, is fully consistent with the Europe 2020 policy strategy of “smart, inclusive and sustainable growth”.

The turn towards social investment can be couched in a non-partisan normative discourse of “capacitating” and family-friendly welfare provision. It places manageable demands on forward-looking political leadership to build broad support for social investment welfare provision, consistent with widely held normative and economic aspirations of ordinary EU citizens and working families. A number of immediate gains in the areas of early childhood development, female employment, improved work-life balance and reduced levels of early school leaving can be foreseen.

Finally, in terms of political feasibility, it has to be emphasised that exempting human capital stock investment from the SGP and Fiscal Compact is broadly in line with the prevailing general preference for an intergovernmental, rather than a supranational, approach to European integration. Over the medium term, positive economic and social returns from exempting human capital stock investments could set the stage for the introduction of a Golden Rule for social investments under a new EMU governance framework, anchored within an explicit social investment “pact”.

Economic history teaches that new ideas only gain institutional portent if they provide answers to salient political problems. Two fundamental political challenges loom large. First, there is the overarching conundrum of keeping EMU afloat and ultimately regaining its attractiveness among citizens of EU countries which are not yet EMU members. The related second conundrum is the populist temptation of national welfare chauvinism and market closure. An honest recognition of the economic, social and political limits of austerity, combined with the highlighting of the positive track record of social investment reform, are *sine qua non* for constructing a policy consensus in the political centre of a currency union – one based on a macroeconomic holding environment friendly to human capital, employment and families and that allows EMU and active European welfare states to prosper in tandem.

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