DOI: 10.1007/s10272-012-0422-y

The Welfare State After the Great Recession

The economic crisis has given rise to significant challenges to the welfare state. Given that welfare expenses account for a large proportion of all state spending in the member countries of the European Union, reducing government spending means cutting welfare measures. Yet social protection, in particular unemployment insurance benefits and minimum income support, has significantly softened the impact of the crisis for millions of individuals. The global recession calls into question the financial viability of current programmes, and the crisis is being used by some as an opportunity to roll back the welfare state permanently. The present Forum discusses challenges to and opportunities for the welfare state after the crisis.

Anton C. Hemerijck and Frank Vandenbroucke

Social Investment and the Euro Crisis: The Necessity of a Unifying Social Policy Concept

For welfare states in the European Union, where collective coverage of social risks is comprehensive and welfare spending accounts for 16 to 30 per cent of GDP, the repercussions of the financial crisis mark a particularly serious "stress test". The 2008-2012 crisis has already redrawn the boundaries between states and markets. Will its aftermath, like its Great Depression and "great inflation" predecessors, signal a new opportunity to reconfigure and relegitimise social policy? Or are European welfare states becoming a crisis casualty in the cascade of economic, social and political aftershocks of the financial crisis? The deepening of the euro crisis since 2010 reveals how profoundly interconnected the European political economy has become and at the same time how difficult the management of EU institutions is in hard economic times. All solutions that have been put on the table, from strict austerity to aggressive demand stimulation, a banking union, a fiscal union, etc., are highly contested. With national support for European solutions at all-time low, EU indecision leaves a dangerous political vacuum at the heart of the European integration project. We believe that a "joint-decision trap" between EU economic governance and domestic social policy reform can be avoided. There is room for a realistic pace of fiscal adjustment (more symmetrical, and for some countries slower than first foreseen), associated with a reform-oriented social investment strategy and anchored in an improved EU financial, budgetary and macroeconomic policy framework.

We first review the three sequences of policy responses that have been pursued since 2008. Comparing the performance of EU member states during the crisis shows that generous welfare states are no anathema to economic competitiveness; in the second section, we therefore revisit the argument of social policy as a productive factor. The third section addresses the importance of macroeconomic symmetry. We argue that agreement on the meaning of "a social Europe", in the past often viewed as a fair weather product, is rapidly becoming imperative, exactly because of its macroeconomic relevance. The efficiency of social protection and the quality of social investment do matter for the stability of the eurozone. We conclude that the EU needs a social investment pact. The objectives of the Europe 2020 Strategy provide a useful framework for reconciling fiscal consolidation and long-term social investment, provided that EU macroeconomic governance serves social investment.

Three Waves of Crisis Management

European welfare states have gone through three phases of crisis management. In the immediate aftermath of the Lehman Brothers collapse in 2008, the first wave of crisis management exemplified more or less Keynesian policy solutions to a rapid fall in global demand. The crisis pushed fiscal authorities and the ECB into a broad range of interventions, including liquidity and credit-enhancing measures, to help stabilise the besieged eurozone economy. Between 2008 and 2010, automatic stabilisers were allowed to cushion the recession. This response was complemented in a number of EU member states by measures to extend short-term working arrangements, sometimes linked to training and activation incentives.

In December 2009 a second wave of crisis management, punctuated by the Greek debt crisis, took root. After European governments had been forced to bail out systemic banks, the financial crisis was redefined as a crisis of fiscal profligacy, requiring tough and prolonged public austerity. Troubled countries such as Greece, Ireland, Portugal and Spain started pushing through austerity and reform, including labour market deregulation, cuts in civil servant salaries, pension benefit freezes, retirement age rises, and retrenchments in social transfers and services. Only in the United Kingdom under the Cameron coalition government was social retrenchment predicated on an ideological narrative about welfare dependency.

By 2011, the European Union had entered a third, critical, phase of crisis management, as the overhang of the sovereign crises in Greece, Ireland and Portugal came to threaten the viability of the euro. Rising risk premiums for the EU's most vulnerable countries already suggested that the sovereign debt crisis had become systemic. The December 2011 agreement to establish an encompassing "fiscal compact" for the eurozone failed to impress markets and was deemed as yet another "too little, too late" stopgap compromise. Moreover, many observers believed that across-the-board cuts in public budgets set the stage for a double-dip economic recession for 2012. What makes the eurozone predicament particularly worrying is that national fiscal and EU monetary authorities have practically no room left for proactive adjustment: public finances are distressed and interest rates close to zero. Politically, governments have been caught between Scylla and Charybdis. On the one hand, pressures for deficit reduction constrain domestic social policy space. On the other hand, disenchanted electorates are increasingly unwilling to abide by the austerity promises of national political leaders agreed in supranational rescue packages and EU fiscal rules.

Revisiting "Social Policy as Productive Factor"

Long before the financial crisis, the policy environment of European welfare states started changing. Population ageing, declining fertility rates and early retirement have overburdened pension systems. Technological change reduced the demand for routine-based low- and medium-skill work. The shift towards post-industrial labour markets has opened up job opportunities for women, but deindustrialisation has come with declining shares of steady lifetime jobs. Changing family structures and gender roles, with longer education spells, later childbirth and single parenthood, have created new tensions between work and family life and raised new demands for care for children and the frail elderly. The "new" risk profile of social exclusion has triggered growing income polarisation between high-skill and job-rich dual-earner families and low-skill and work-poor male-breadwinner and single-parent households. Simultaneously, the scope for policy responses vis-à-vis these developments became narrower rather than wider. Capital mobility and economic integration did not unleash social dumping across Europe, as some observers feared, but there is no denying that integration and the Stability

Contributors to this Forum

Anton C. Hemerijck, Vrije Universiteit Amsterdam, the Netherlands.

Frank Vandenbroucke, Katholieke Universiteit Leuven, Belgium.

Torben M. Andersen, Aarhus University, Denmark.

Philippe Pochet, European Trade Union Institute (ETUI), Brussels, Belgium.

Christophe Degryse, European Trade Union Institute (ETUI), Brussels, Belgium.

Gaetano Basso, University of California Davis, USA.

Mathias Dolls, Institute for the Study of Labor (IZA), Bonn, Germany.

Werner Eichhorst, Institute for the Study of Labor (IZA), Bonn, Germany.

Thomas Leoni, Austrian Institute of Economic Research (WIFO), Vienna, Austria.

Andreas Peichl, Institute for the Study of Labor (IZA), Bonn, Germany.

Peter Taylor-Gooby, University of Kent, UK.

and Growth Pact increased fiscal pressure on member states.

Although the drivers of change are common across Europe, the pressures they create for existing policy repertoires and the policy responses they trigger vary from country to country. While some welfare systems have been successful in updating their policy repertoires to the social transformations preceding the financial crisis, others have fared less well.[1] Social reform of the past decades is difficult to pigeonhole in terms of a black-and-white dichotomy of more or less retrenchment. Social reform across EU member states has been heterogeneous, disparate and uneven. In terms of policy substance, social policy has become more employment centred across the board, with an emphasis on "making work pay" in social insurance provision and labour market flexibility. However, this turn towards employment has appeared in various guises, which can be situated on a continuum between, on the one hand, social retrenchment and labour market deregulation, and, on the other hand, a "productivist" social policy, bent on increasing labour supply and productivity through "capacitating" family, training and employment services. We do not suggest that "all is well" in northern Europe, but the competitive strengths of the Scandinavian economies, before and after 2008, can be recognised as the outcome of a long-term process of capacitating social policy and reform. By contrast, competitiveness gaps in the southern eurozone interact with two-tiered labour markets and outdated and mainly passive social contracts biased towards pensioners, inhibiting both quality employment opportunities and adequate protection and services for educated women, youth and single-parent households.

We do not wish to confine social policy to merely a "productive input". Yet, social policy programmes can create important returns. Social protection during short-term unemployment can reduce search costs for new jobs and foster efficient employment matches. Well-organised universal social protection potentially enhances rather than distorts labour market flexibility. Similarly, collective bargaining permits macroeconomically responsive wage setting. Even balanced employment protection, together with worker participation through works councils, can contribute to competiveness by engaging workers in production and training processes. Finally, social spending stabilises economic activity because it sustains effective demand in times of recession. This kind of Keynesianism through the backdoor proved functional in the immediate credit crunch after the Lehman Brothers bankruptcy in 2008. Security against the adverse effects of illness, disability, unemployment, old age, divorce and childbearing is of value to citizens – which is important per se – but it is also of value to society at large, on which the burden of poverty and social instability would fall if there were no social protection. It would be naïve to deny tensions between principles of social protection and principles of activation. However, capacitating welfare provision can advance the efficiency-equity frontier, provided that access to labour markets is available.[2]

Social policy today has to factor in far more adverse demographic conditions than during the post-war era of social insurance expansion. The economic sustainability of the welfare state hinges on the number and productivity of future taxpayers.[3] Next to its fundamental mission to protect and care, social policy should contribute to mobilising the productive potential of citizens by mitigating the risks of atypical employment, long-term unemployment, working poverty, family instability and lack of opportunities for labour market participation. Labour market participation and retirement decisions are contingent on the available supply of training, health and care services. Although comparative analysis of welfare regimes supports the plausibility of this claim, the long-term productivity gains from investing in quality child care, education and vocational training are seldom taken seriously in economic cost-benefit analyses of policy options.

The Euro Crisis and the Imperative of Defining "Social Europe"

Policy choices are not made in institutional isolation. Institutions explain how social provisions target risk groups, how they are financed and anchored in tax sys-

1 A. Hemerijck: Changing Welfare State, Oxford 2012, Oxford University Press; A. Hemerijck: When Changing Welfare States and the Eurocrisis Meet, in: Sociologica, No. 1, 2012 (with comments by U. Ascoli, C.-J. Barbier, J. Beckfield, G. Bonoli and J. Palme).

2 G. Esping-Andersen with D. Gallie, A. Hemerijck, J. Myles (eds.): Why we need a New Welfare State, Oxford 2002, Oxford University Press; G. Esping-Andersen, S. Sarasa: The generational conflict reconsidered, in: Journal of European Social Policy, Vol. 12, No. 1, 2002, pp. 5-21; C. Sabel, A.L. Saxenian, R. Miettinen, P.H. Kristensen, J. Hautamäki: Individualized Service Provision in the New Welfare State: Lessons from Special Education in Finland, Report prepared for SITRA, Helsinki 2010; F. Vandenbroucke, K. Vleminckx: Disappointing Poverty Trends: Is the Social Investment State to Blame?, in: Journal of European Social Policy, Vo. 21, No. 5, 2011, pp. 450-471; M. Nelson, J.D. Stephens: Do social investment policies produce more and better jobs?, in: N. Morel, B. Palier, J. Palme (eds.): Towards a social investment welfare state? Ideas, policies and challenges, Bristol 2012, Policy Press, pp. 205-234.

3 T. Lindh, J. Palme: Sustainable Policies in an Ageing Europe: a human capital response, Stockholm 2006, Institute for Future Studies.

tems and how they are run by public and/or private actors. Some policy legacies are better able to incorporate social investment innovations than others. It is, for instance, impossible to assess the impact of early childhood education and care in isolation from mothers' access to training and opportunities to participate in the labour market, supported by policies of gender equality and parental leave arrangements. To the extent that welfare states are becoming more service oriented, this requires professionalisation and improved public administration, also with respect to tax collection.

The importance of institutional complementarities also applies to the relationship between domestic social policy and EU governance. With its undeniable economic success, European integration, from its inception in 1958, has served EU member states to expand their welfare systems. Borrowing Robert Gilpin's phrase, Maurizio Ferrera has aptly captured the post-war institutional compromise as "Keynes at home, Smith abroad".[4] With limited EU-wide macroeconomic governance, high rates of growth stemming from market liberalisation allowed for the "unencumbered" maturation of national welfare systems after 1945.[5] Now, the euro crisis has exposed this earlier division of labour – home-grown social Keynesianism and progressive supranational market integration – as no longer sustainable. Current levels of economic integration, without the possibility of reverting to country-specific strategies based on currency devaluations, imply that welfare policy proficiency (or deficiency) in one country strengthens the prosperity (or stagnation) of the EU economy as a whole and vice versa.

The failure of the economic policy regime lies at the heart of today's conundrum. The original policy theory of EMU was based on the assumption that the ECB's mandate on price stability and an equally strong commitment to fiscal consolidation by member state governments, enforced by the Stability and Growth Pact, would raise competitive pressures among the economies of the member states. Enhanced competition in financial and product markets would subsequently translate into greater tax and labour market competition. This, in turn, would force democratic governments to launch incisive welfare and labour market reform, if need be by blaming the EU for their inevitability. The architects of EMU, in short, conceived that the new macroeconomic policy regime would naturally trigger structural reform. The eurozone crisis has exposed the weakness of this policy theory. No happy equilibrium has been forthcoming. Instead, we have been confronted with destabilising current account deficits in Greece, Spain, Portugal, Ireland and Italy; housing bubbles in Ireland, the Netherlands and Spain; and current account surpluses in Germany and the Scandinavian countries. It is plausible to assume that the low interest rates that came along with the euro have contributed to slowing down welfare reform in countries with passive and insider-biased welfare systems and labour markets. Paradoxically, the current account surplus countries, such as Germany and the Nordic countries, more concerned with competitiveness, intensified the social reform momentum after the 1990s.

Over the past decade it has become increasingly clear that the high-tax, high-spend economies in Northern Europe have performed better on most Stability Pact and Lisbon Agenda indicators than even Germany. This underscores the fact that European polities can afford high levels of social protection, if social protection and investment are both well-organised and efficient. We do not want to suggest simple and one-sided causalities, but it appears that notably Southern welfare states are comparatively inefficient both in terms of social protection and in terms of social investment. Figure 1 summarises an argument developed in Vandenbroucke,[6] leading to the conclusion that, given their level of social spending, Spain, Greece and Latvia are comparatively inefficient with regard to poverty (together with Portugal, Italy and the UK, if we apply less strict criteria to define comparative inefficiency).

Figure 2 maps the average results obtained in the PISA tests for 15-year-old students from 2000 to 2009 and the employment rate in the age cohort of 24 to 29. Figure 3 maps the share of the population in the 25 to 64 age bracket with less than upper secondary education and the global employment rate in the 20 to 64 age bracket.[7]

Figures 2 and 3 not only illustrate the particular deficit of Southern welfare states – compared to other EU15 welfare states – with regard to education and employment; they underscore the huge education agenda confronting the whole EU. More than one in three Spaniards in the 25- to 34-year-old age cohort have no more than lower secondary education; in Germany this applies to less

4 M. Ferrera: Mapping the Components of Social EU: A Critical Analysis of the Current Institutional Patchwork, in: E. Marlier, D. Natali (eds.): Europe 2020: Towards a More Social EU?, Brussels 2010, Peter Lang, pp. 45-68; R. Gilpin: The Political Economy of International Relations, Princeton, NJ 1987, Princeton University Press, p. 355.

5 A. Milward: The European Rescue of the Nation State, London 2000, Routledge.

6 F. Vandenbroucke: Europe: the social challenge. Defining the Union's social objective is a necessity rather than a luxury, OSE Opinion Paper No. 11, July 2012, www.ose.be/EN.

7 As shown in Figure 3, this mapping also illustrates rather different educational legacies in the EU15, on the one hand, and the new member states, on the other hand.

than one in six young people. Vandenbroucke[8] argues that the educational disequilibrium within the eurozone may be as destabilising for the long-term future of the eurozone as the pension disequilibrium. Or, to formulate the argument more precisely, if it is correct to assert that pension ages in all eurozone countries should be tied to life expectancy in a more or less similar manner, for reasons of symmetry across EMU, then the same reasoning holds for educational attainment. If we believe that asymmetry in retirement ages, with Spanish workers retiring earlier than German and Nordic workers, is unsustainable in the eurozone, then the fundamental asymmetry between Spanish and German/Nordic educational attainment should be considered as equally destabilising in the long run. This observation comes with a big if. The extent to which the economic symmetry required for a currency area to be sustainable necessitates convergence in retirement ages (or other social parameters) is disputable. The underlying argument raises complex cognitive and normative issues. But it illustrates the fact that in a currency area a basic consensus is needed on those arguments. In other words, a basic consensus is needed on the social model that is compatible with the EMU and the scope and degree of convergence necessary to sustain it.

Today much attention is paid, and rightly so, to short-term conditions for the sustainability of the EMU, notably the need to establish a degree of banking union. Here we focus on a longer-term perspective. Members of a currency union face interrelated trade-offs between three fundamental economic conditions which determine its sustainability: symmetry, flexibility and the possibility to organise budgetary transfers among members.[9] Symmetry refers to the degree to which output and employment growth are correlated. Flexibility relates to wage flexibility and interregional and international labour mobility, which determine a country's "internal" adjustment capacity in case of an asymmetric shock. Less symmetry necessitates more flexibility. This trade-off between symmetry and flexibility can be mitigated, if budgetary transfers are possible, to support member states facing an asymmetric shock. The aim of such budgetary transfers is temporary stabilisation of the currency union as a whole, not redistribution from the richer to the poorer regions: it is no free lunch to sustain diversion from average economic development across the union for long.

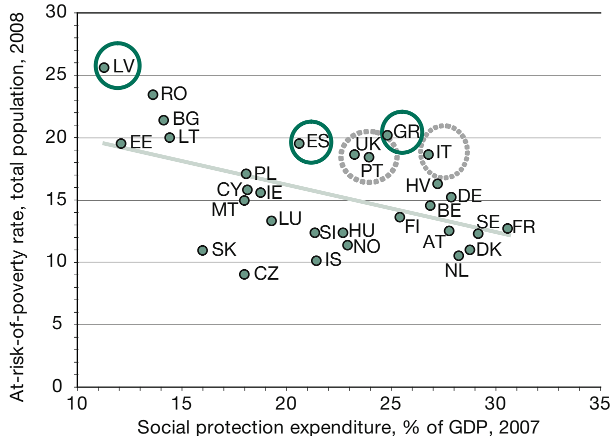
However, the EMU cannot do this under its current institutional mandate. What the eurozone can do is to pursue

8 F. Vandenbroucke, op. cit.

9 P. De Grauwe: Economics of Monetary Union, Oxford 2009, Oxford University Press.

Figure 1

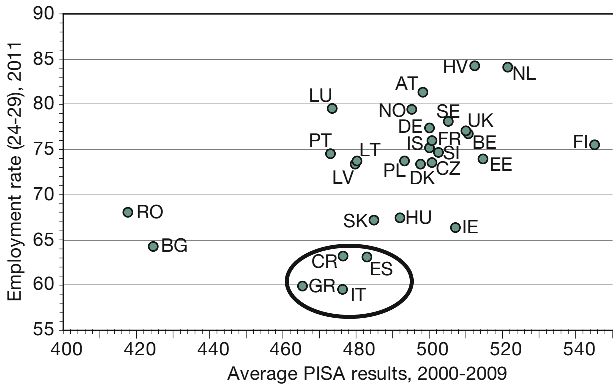
Comparative Efficiency of Social Spending



Source: SILC, Eurostat.

Figure 2

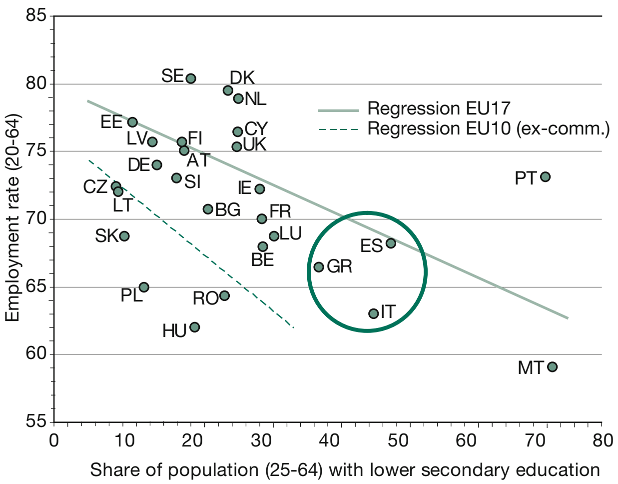
PISA Results and Employment Rate (24-29)



Source: LFS, PISA.

Figure 3

Population with Less than Upper Secondary Education and Employment Rate, 2008



Note: Regression lines are drawn to structure the presentation, not to suggest simple causality; correlation education/employment rate: EU27: -0.39; EU17: -0.66; EU10: -0.47.

Source: Own calculations based on Eurostat data.

a strategy of preventive monitoring of national budgets and wage developments. To the extent that preventive monitoring forecloses asymmetry, there is less need to address economic disequilibria across the currency union via flexibility and/or stabilising transfers. This is what the EU currently tries to achieve through the "six-pack" and the new "fiscal compact". A currency union, in other words, does not per se have to be a unified superstate, but a basic consensus on the trade-off between symmetry, flexibility and the availability of fiscal support is imperative. How strong both supranational and domestic political institutional capacities are to redress destabilising divergences through intrusive monitoring and surveillance, how far member states are willing and able to go in terms of internal flexibility, what kind of flexibility is to be pursued, and under which conditions member states are willing to temporarily support each other through stabilising budgetary transfers – these are by no means politically neutral choices. In the current context they constitute the fundamental choices determining the European social order.

The idea that macroeconomic policy can be determined at the supranational level, while social policy can be left to the national level is presumably naïve and wrong. On the other hand, it is not a priori evident that far-reaching social harmonisation is required to guarantee economic symmetry. There are different avenues through which domestic social policy can support symmetry in macroeconomic outcomes. These complex issues are to some extent open-ended – as is intrinsic to any set of trade-offs. But, however complex and open-ended, these issues cannot remain unresolved. We badly need a Europe-wide consensus on the fundamental cognitive and normative arguments that determine at which point in the trade-off between symmetry, flexibility and transfers European governments would wish to position their welfare states. In other words, we need a consensus on the basics of the European social model. Clarification of what "a social Europe" really means was often viewed as a fair weather goal, but it is rapidly becoming imperative, exactly because of its macroeconomic repercussions.

Admittedly, reaching such a basic consensus is fraught with difficulties. To what extent can "internal flexibility" be married with social securities and capacitating welfare services, in terms of minimum wage, employment relations and migration? Are budgetary transfers effective, or should we fear their misuse by profligate governments delaying structural reform? On which issues do we believe social convergence to be imperative for the stability of the EMU, and to what extent? Moreover, such a shared consensus has to address a complex issue of reciprocity. Jean Pisani-Ferry[10] argues that the issue of adjustment in the Southern countries cannot be treated as a one-sided process. To the extent that there is common interest in successful adjustment, the burden has to be shared. Northern member states should temporarily accept somewhat higher inflation to make price and wage adjustments in Spain realistic, provided that price stability across the eurozone as a whole is maintained and that Spain uses this leniency to continue structural reform. Northern European governments must avoid austerity overkill, according to Pisani-Ferry. They should accept wage settlements significantly above those observed in the first decade of EMU (including higher minimum wages in Germany, we would add). This rational economic policy argument illustrates the need for reciprocity. Reciprocity implies that the burden of economic adjustment – regaining competiveness – is not shouldered by one set of partners only. Economically it is not rational to do that; socially and politically it is disruptive. Pisani-Ferry's reasoning can be extrapolated to a larger set of structural imbalances in the EU. We believe that achieving reciprocity, so conceived, is a fundamental condition for the long-term viability of the Union. We deliberately coined our proposal for a Europe-wide social investment approach "a European social investment pact", not because we are so keen to see yet another "pact" emerging, but because the notion of a "pact" underscores the sense of reciprocity embedded in the proposed strategy.[11]

Conclusions

The social investment approach rests on policies to raise the human capital *stock* (early childhood education and care, vocational training, education and lifelong learning) and *flow* policies serving to make efficient use of human capital (through policies supporting female and single-parent employment, active labour market policy and other activation policies, facilitating access to the labour market for vulnerable groups, and social protection supports that promote flexible security across the life course). In its *flow* dimension the social investment perspective is different – wider – than traditional human capital policies. Moreover, social investment and protection are complementary, as we emphasise elsewhere.[12] Social investment is no panacea for all social ills, and we eschew easy rhetoric about "win-win policies" as if no internal tensions and conflicts arise when pursuing social protection and investment in the

10 J. Pisani-Ferry: The euro-area rebalancing challenge, www.bruegel.org, 22 May 2012.

11 F. Vandenbroucke, A. Hemerijck, B. Palier: The EU needs a social investment pact, OSE Working Paper, May 2011.

12 Ibid.

context of narrow budgetary margins. However, to the extent that deficits in social investment explain, at least in part, the current disequilibria in the EU, we need more social investment, not less. Moreover, together with the intrinsic value of social protection and care, the social investment perspective may offer a substantive definition of the European social purpose, a purpose which must be defined if we are to achieve the long-term sustainability of the eurozone (and thus of the EU). The argument we deployed is macroeconomic, but obviously there is a political corollary. European integration can only be maintained if citizens support it. In Europe this is conditional on popular trust in governments able to handle the social consequences of the crisis in an interdependent world.

Currently we witness a strong backlash against what is seen as "the EU's policies" (as if there were no national governments determining the EU's action), notably in Greece and France, but also in Germany, the United Kingdom and the Netherlands. Between rising anti-austerity national protests and the EU's demand for fiscal consolidation, a political vacuum has emerged at the heart of the integration project. In some countries, such as France, the response to this malaise was democratic alternance, which now opens the possiblility of a broad European compromise between Social Democrats, Christian Democrats and Liberals. In other countries the vacuum may be filled by increasing fragmentation and anti-EU populism. The trend towards anti-EU populism on both the left and the right is certainly not new. Already before 2008, middle class fears of falling behind invoked a nostalgic narrative of a "golden-age" welfare paradise lost, pitted very much against the alleged globalising ambitions of the EU. Again, this underscores the need for another social narrative, adapted to today's challenges and aligning European and domestic perspectives.

In policy terms, the challenge is to make long-term social investments and medium-term fiscal consolidation mutually supportive and sustainable under improved financial and economic governance. In political terms, European citizens need a reformist perspective that gives the social *acquis* they cherish a credible future. At this critical juncture, it is therefore important not to discount the massive achievements of over half a century of European integration and welfare state development. The unprecedented deepening and widening of regional integration from six to twenty-seven member states, creating a community of some 500 million people, was accompanied by the expansion of comprehensive welfare systems, while promoting democracy and securing peace, to an extent barely conceivable at the start of post-war reconstruction. A social investment pact could be an important step towards a "caring Europe", based on a virtuous circle of efficient domestic solidarity and trusted European solidarity.

Torben M. Andersen

The Welfare State and the Great Recession

The purpose of the welfare state is to cushion individuals from economic insecurity, in particular adverse consequences of business cycle downturns. The welfare state implies collective risk sharing to ensure that individuals do not suffer disproportionately large consequences from changes at the macroeconomic level beyond their direct control. In the period prior to the financial crisis, the focus was on the successes of the market economy, and the need for extended welfare arrangements was questioned. At the same time, the scope for the welfare state was challenged, in particular by globalisation.

The financial crisis has shaken belief in markets. The causes of the crisis are attributed to market failures and excesses, and market economies have proven not to be crisis-free. The crisis thus intensified calls for governments to step in. Paradoxically, the financial crisis has also turned into a crisis for the public sector and the welfare state.

The Public Sector – Part of the Solution or the Problem?

Immediately after the onset of the financial crisis, there was a strong focus on both the need to stabilise the financial sector and to pursue a policy to support economic activity and employment. Both monetary and fiscal policy were used very actively. The EU Commission, OECD, IMF and many others spoke of the need for a coordinated expansionary economic policy. As a consequence, the public finances were affected by the banking packages, automatic budget reactions and discretionary measures to boost economic activity. Large and increasing budget deficits in combination with high initial debt levels, however, soon became an independent factor, and concerns about the sustainability of public finances came to the forefront. The financial markets responded, and the yield on Treasury securities rose significantly in several countries. As a result, the discussion in many countries changed from the public sector being part of the solution to being part of the problem. Accordingly, the agenda has been changed to focus on the need for consolidation of public finances. Many countries have implemented or are implementing packages to tighten public finances by a combination of tax increases and savings. The OECD estimates that the planned tightening for 2011-2013 corresponds to about 2% of GDP across the OECD area, of which one-third comes from tax increases and two-thirds from expenditure reductions.[1] Despite the tightening, expected public debt continues to rise. The financial crisis has evolved into a sovereign debt crisis.

What can be inferred about the future of the welfare state from recent developments? Does the welfare state have much less scope than previously recognised? Or do recent developments point to political failures in the management of welfare state arrangements?

The following argues that the welfare state has worked primarily via the so-called automatic stabilisers, including during the financial crisis. It is worth noting that despite the steep decrease in economic activity and increase in unemployment, standard measures of inequality and risk of poverty have remained fairly constant.[2] The welfare state is thus effective in cushioning the economy from shocks and in diversifying these shocks. The ability to perform this task is not unconditional, and several conditions should be met to ensure that this can work. The first is that public budgets should be able to accommodate the changes. In this respect there were severe political errors prior to the crisis. Public finances were not consolidated, and reforms to cope with changing demographics were insufficient. As a consequence, fiscal policies were unsustainable in most countries already before the financial crisis. The crisis has obviously exacerbated the situation and brought the problems into the open. It is worth noting that the direct effect of the crisis – with a few exceptions – cannot by itself explain the sovereign debt crisis. The second crucial condition is that short-term insurance does not become permanent in the form of long-term unemployment or exit from the labour force. Such consequences are a problem both from a social and from a public finance perspective. The financial viability of a welfare model with a large role for the public sector relies on the ability to maintain a high employment rate (in the private sector). A particularly important question is whether an extended welfare state increases the risk that a crisis turns into a permanent reduction in employment.

The Welfare State and the Social Safety Net

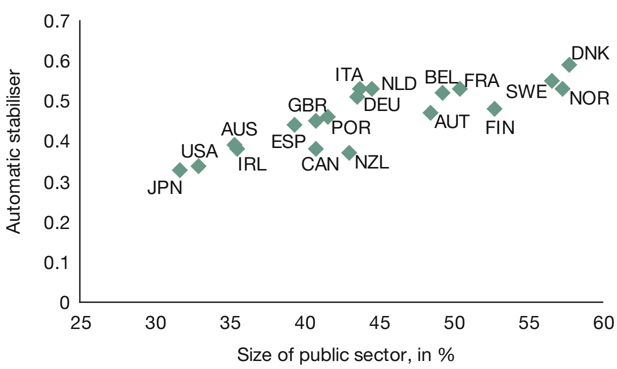
The social safety net is the main channel by which the welfare state cushions shocks. The tax system also plays an important role in stabilising disposable incomes. Both of these mechanisms are important at the individual level, but they are also of significance at the aggregate level in the form of automatic stabilisers.

The term automatic stabiliser is a summary concept for the automatic response of public sector revenues and expenditures to a change in the business cycle situation. These responses arise because revenues and expenditures are contingent on, e.g. income, unemployment, etc. A recession will therefore be associated with a deteriorating public budget position as the consequences are absorbed in the public budget. Thus, for automatic stabilisers to work, it is crucial that public finances are in a position where they can absorb these changes.

There are five important facts about automatic stabilisers worth noting:

I. The size/strength of automatic stabilisers is closely related to the extent of welfare arrangements (see Figure 1); i.e. countries with more extended tax-financed welfare states tend to have larger automatic stabilisers.

Figure 1
Size of Public Sector and Automatic Stabilisers



Note: Public sector size measured by tax burden in per cent of GDP, 2005, and automatic stabilisers by the automatic budget response, i.e. change in budget position relative to GDP to a one percentage point change in GDP.

Sources: www.oecd-ilibrary.org; N. Girouard, C. André: Measuring cyclically-adjusted budget balances for OECD countries, OECD working paper No. 434, 2005.

1 OECD: Economic Outlook 90, OECD Publishing France, 2011.

2 At the EU level there is no change in the Gini coefficient or the share of people at risk of poverty after social transfers between 2007 and 2010. See http://epp.eurostat.ec.europa.eu/portal/page/portal/sdi/indicators/theme3.

II. Automatic stabilisers cushion individual disposable income and therefore serve an insurance function which has a direct positive welfare effect for risk-averse agents. Private alternatives for this type of insurance are highly imperfect and incomplete.[3]

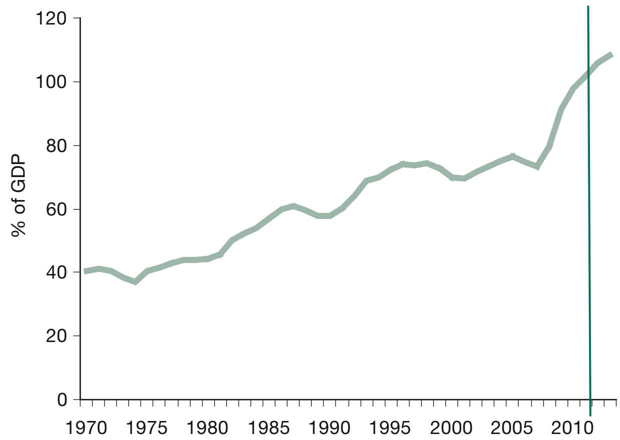
III. Automatic stabilisers contribute to stabilisation of the aggregate economy via their stabilising effect on disposable income and hence on private consumption and aggregate demand.[4]

IV. Automatic stabilisers mute the consequences of economic crises on income inequality.[5]

V. Automatic stabilisers are rule-based, inducing an automatic response to a change in the business cycle situation. Hence, they do not require up-to-date information on the state of the economy, and they do not require any discretionary policy to work.

Figure 2

Public Debt in OECD Countries, 1970-2013



Note: OECD total, data for 2011-13 is the OECD forecast.

Sources: www.oecd-ilibrary.org/statistics, Outlook database 90.

Automatic stabilisers have thus played an important role during the financial crisis. They have the advantage that they work automatically and thus react swiftly to changes in the economic situation. This also implies that they are often overlooked in the public debate, where more attention is devoted to discretionary policy changes. But it is more difficult to time and dose such discretionary changes correctly. Furthermore, the stronger the automatic stabilisers, the less the need for such discretionary changes.

The attractive properties of automatic stabilisers at both the level of individuals (insurance) and of society (aggregate stability, distribution) are a source of renewed interest. In the wake of the Great Recession, it has been widely argued that automatic stabilisers are too weak and that they need to be strengthened. However, the size of automatic stabilisers is not a direct result of macro design but rather a by-product of policy choices in relation to tax, social and labour market policies. The automatic stabilisers are the net outcome of the extent of welfare arrangements in terms of entitlements and financing. Moreover, since policy reforms in recent years have had a strong focus on incentive effects without much concern for the implications for insurance, it may be a consequence that automatic stabilisers have been weakened.[6] Somewhat paradoxically, automatic stabilisers have been praised at the aggregate level but disregarded at the micro level in relation to structural reforms. Accordingly, it is an important policy question how automatic stabilisers can be maintained and possibly strengthened without jeopardising economic performance. Is this at all possible or is there an inevitable conflict?

Policy Errors

A precondition for well-functioning automatic stabilisers is a prudent fiscal policy ensuring consolidation in good times to create absorption capacity in bad times. This is a necessary condition for the public sector to provide a buffer function, muting the consequences of business cycle fluctuations for private actors. This condition has not been fulfilled for most OECD countries.

For the OECD as a whole there has been an upward trend in gross government debt (see Figure 2). In the 1970s and 1980s public debt increased, and in the two decades before the financial crisis, the debt level remained fairly constant at a level around 75% of GDP. It is particularly noteworthy that public debt levels were not reduced over this period in spite of rather favourable economic develop-

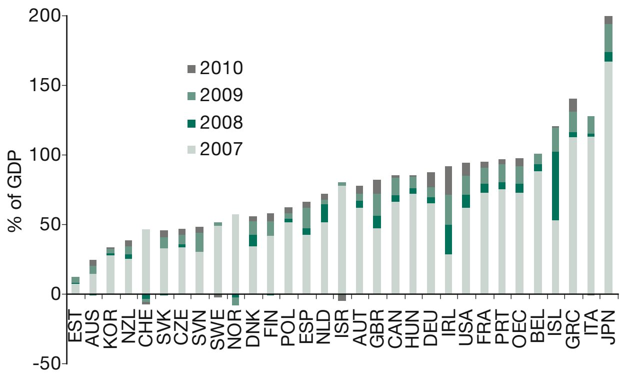
3 T.M. Andersen: The Role for an Active Fiscal Stabilization Policy, in: CESifo Studies, Vol. 51, No. 4, 2005, pp. 511-547.

4 P. Van der Noord: The size and role of automatic stabilizers in the 1990s and beyond, OECD working paper No. 230, 2000.

5 M. Dolls, C. Fuest, A. Peichl: Automatic stabilizers, economic crisis and income distribution in Europe, IZA Discussion Paper No. 4917, 2010.

6 Using OECD estimates of automatic stabilisers, the average size across OECD countries was unchanged between 2000 and 2005, but there seems to be a systematic pattern, since countries with initially weak automatic stabilisers tended to get stronger automatic stabilisers, whereas they have been muted for countries with initially strong automatic stabilisers; see P. Van der Noord, op. cit.; N. Girouard, C. André: Measuring cyclically-adjusted budget balances for OECD countries, OECD working paper No. 434, 2005.

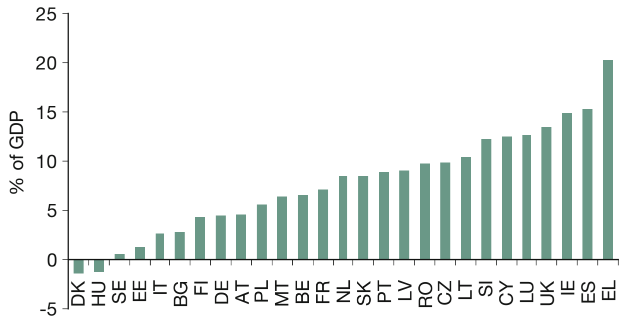
Figure 3
Debt Developments During the Financial Crisis – OECD Countries



Note: Gross debt relative to GDP.

Source: www.oecd-ilibrary.org/statistics.

Figure 4
Fiscal Sustainability Indicator, EU Countries



Note: The sustainability indicator is the so-called S2 indicator. Update of analysis from the EU Commission: The long-term sustainability of public finances in the European Union, European Economy 4/2006, Brussels 2006.

Source: European Commission: Public Finances in EMU, European Economy 3/2011, Brussels 2011.

ment in a number of countries. Due to increased budget deficits and falling GDP levels, the financial crisis has led to further increases in the debt ratio.

The upward trend in public debt reflects an asymmetry in public finances. Budget deficits and increasing debts have been allowed in bad times, but in good times similar budget surpluses have not consolidated public finances. Public finances thus display a tendency to deficit bias; that is, deficits are more frequent than surpluses. This reveals a political bias in the management of public finances which contributed to create a very vulnerable situation prior to the financial crisis.

This point is underscored by considering debt levels before the crisis (2007) and subsequent developments for separate OECD countries (see Figure 3). The debt level was already high before the crisis for a number of reasons, and the crisis has increased it, in some cases to critically high levels. There are two notable exceptions to this, namely Ireland and Iceland, where the debt levels were relatively low before the onset of the crisis. For these two countries, a large part of the debt increase is explained by direct support to the financial sector (for Ireland this corresponds to an increase in the debt level by 42 percentage points and for Iceland by 13 percentage points). For most countries the major reason for the increase in the debt ratio is the fall in economic activity.

The preceding discussion of debt problems and lack of consolidation of public finances is backward-looking. Most OECD countries are, however, facing rather large demographic changes, which will have significant consequences for public finances. The number of elderly is increasing, and in many countries the labour force is shrinking. As a consequence, expenditures on pensions, health and old age care will increase at the same time as tax revenues shrink. This will have severe consequences for public finances, and only few countries have undertaken sufficient reforms to ensure the financial viability of welfare arrangements. For the EU countries, the EU Commission assessed the overall burden upon public finances including both the backward problem arising from debt levels and the forward problem arising from demographic changes. The results of the analysis are depicted in Figure 4 showing the so-called fiscal sustainability indicator. This indicator shows the necessary permanent improvement in the public budget to ensure fiscal sustainability.[7] For two-thirds of the EU countries, the consolidation or reform need corresponds to a permanent improvement of 5% of GDP or more. It is worth stressing that these problems have been known for quite a while,[8] but the policy responses have been lacking or insufficient. The problem is now that the financial crisis has come on top of this, which has produced a very difficult situation for public finances.

It is sometimes argued that if policymakers fail to address problems of fiscal sustainability, then financial markets

7 The sustainability indicator gives the permanent change in the budget balance relative to GDP needed to ensure that sufficient revenue is generated to cover expenditures and the initial debt level, i.e. to ensure that the intertemporal budget constraint of the public sector is satisfied.

8 See World Bank: Averting the Old Age Crisis, Washington 1994; OECD: Ageing in OECD Countries: A Critical Policy Challenge, Social Policy Studies No. 20, Paris 1996; IMF: World Economic Outlook – The global demographic transition, Washington 2004, pp. 137-180; EU Commission: Long term sustainability of public finances in the EU, European Economy, No. 4, Brussels 2006.

will issue warning signals in terms of increasing interest rates; that is, a government which for political reasons may be inclined to push consolidation needs forward, in time, will face increasing interest rates, making this policy both more visible and expensive. However, in the period preceding the financial crisis financial markets did not issue such warning signals, and government bond rates for all EU countries were for practical purposes identical, despite very different levels of public finance solidity (see Figure 4). It was not until after the onset of the financial crisis that financial markets responded, and significant interest rate spreads have developed for the most adversely affected countries. The signals from the financial markets came too late to support consolidation policies and have tended to reinforce the problems by speeding up debt dynamics.

In the context of the welfare state and the crisis, it is worth noting that two countries known for having very expansive welfare states, Sweden and Denmark, had succeeded in consolidating public finances prior to the crisis, and they have also addressed the ageing problem. They show that a prudent fiscal policy is not detrimental to a well-functioning welfare state; rather it widens the scope for the welfare state in a crisis situation. These two countries have thus not faced a debt crisis, and they have had some degree of freedom in economic policy to counteract effects of the financial crisis.

It must thus be concluded that public finances in many countries were in a very vulnerable situation already prior to the financial crisis due to failures to consolidate and undertake reforms to handle changing demographics. Even though the financial crisis has deteriorated public finances, this effect has in most countries not been so large that it itself is the cause of the debt crisis. The sovereign debt crisis has developed because the financial crisis has brought public finances that were already very vulnerable into the critical zone with little room to manoeuvre. Past policy failures are the cause of the paradoxical situation that many countries are forced to undertake consolidation measures in times of low growth and high unemployment.

Persistence and the Social Safety Net[9]

It is a crucial question whether short-term insurance achieved via the social safety net comes at the cost of more sluggish adjustment and hence more persistence in the response to shocks. If so, the social safety net is impairing flexibility and adjustment. This question is particularly important in the wake of large employment decreases following the financial crisis and the discussion both about the need for improvements in the social safety net and the strained public finances. In a welfare state public finances are very sensitive to the employment rate, since lower employment reduces tax revenue and increases expenditures. This is beneficial in coping with temporary changes, but if the employment decrease turns permanent, it puts severe strains on public finances.

This question is made further relevant by the experience of many countries during the period of high and persistent unemployment from the 1970s/1980s onwards. The adjustment in the labour market turned out to be very sluggish, which in itself was a problem, but it also had very large effects on public finances. It is therefore important to establish whether there are any lessons to be drawn from the experience during this period. Moreover, it is particularly important to determine whether a broad welfare state is itself contributing to making the adjustment process more sluggish via its social insurance arrangements and thus strengthening persistence of the slow recovery.

Ljungqvist and Sargent[10] describe a generous welfare state as a "time bomb" in the sense that it may operate efficiently in tranquil times but be vulnerable to turbulence which easily translates into persistent unemployment.[11] The latter is caused by weakened job search incentives and higher reservation wages due to a generous social safety net. In particular, shocks tend to depreciate skills and thus require workers to accept wage cuts to find new jobs, but unemployment benefits dependent on past wages tend to create inertia in the adjustment of reservation wages. As a consequence, the safety net hinders the process of restructuring the economy. It is also asserted[12] that a generous tax-financed social safety net reduces mobility across jobs. This may contribute to reduce frictional unemployment but may induce higher structural unemployment in a turbulent situation.

9 This section builds on T.M. Andersen: Collective risk sharing: The social safety net and employment, Working Paper, Aarhus University, 2012.

10 L. Ljungqvist, T.J. Sargent: The European Unemployment Dilemma, in: Journal of Political Economy, Vol. 106, No. 3, 1998, pp. 514-550.

11 A possibility of multiple equilibria also arises when taking into account the financing of the safety net. Similarly if incentive problems are countered by costly monitoring, the effectiveness of such monitoring is higher at low levels of unemployment reinforcing this situation, and oppositely in a situation with high unemployment.

12 L. Ljungqvist, T.J. Sargent: The Swedish unemployment experience, in: European Economic Review, Vol. 39, No. 5, 1995, pp. 1043-1070.

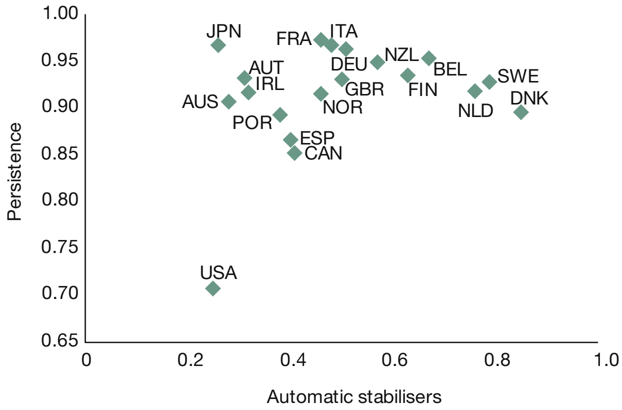
A different explanation of persistence has been advanced by Lindbeck,[13] who points to the role of norms in counteracting the incentive effects of a generous social safety net. A strong norm to be self-supporting counters the economic incentives created by a generous scheme. Allowing for the norm to be endogenous and depending (possibly with a lag) positively on the number of self-supporting individuals implies that a generous social safety net can be maintained if the employment rate is high. However, if employment falls due to, e.g. a severe business cycle downturn, norms may be eroded, and the welfare state would be caught in a situation with persistent non-employment and fiscal problems.

There are several problems involved in assessing the empirical strength of this hypothesis, including the structural unemployment rate and the responsiveness of the labour markets to shocks. The latter involves both the impact effect (volatility) and the adjustment process (persistence). These issues are clearly highly relevant in the current situation where there have been large decreases in employment. It is crucial to minimise the extent to which this translates into persistent reductions in employment.

There is evidence that deep employment crises tend to be highly persistent. Defining a large employment crisis by a fall of three percentage points or more in the employment rate within a three year period, there are 18 such events among OECD countries over the period 1970-2007. All these cases display very strong persistence in the sense that there are no cases where employment recovered to pre-crisis levels within five years and only few instances where this occured within ten years of the onset of the crisis.

The crucial question is whether there are any empirical regularities linking persistence to policy design and institutions in the labour market. This is a difficult endeavour since the metrics of persistence are imprecise and since it is difficult to characterise and summarise policies and institutions in a few simple measures. Figure 5 shows a cross-plot of the strength of the automatic stabilisers as a measure of welfare arrangements and a measure of persistence in the labour market. It is seen that there is no clear relation between the two. If the USA, which is a clear outlier, is removed from the sample, there is weak indication that stronger automatic stabilisers are associated with less persistence. Hence, it is not clear that the welfare state erodes its own foundation. Clearly, this is not independent of policy, and it points to the fact that a crucial task for social and labour market policies is to ensure that the increase in unemployment does not

Figure 5
Automatic Stabilisers and Unemployment Persistence



Note: Automatic stabiliser metrics are from P. Van der Noord: The size and role of automatic stabilisers in the 1990s and beyond, OECD working paper No. 230, 2000. Unemployment persistence is measured by the autocorrelation over the period 1970-2007.

Source: www.sourceoecd.org.

translate to a significant increase in long-term unemployment and marginalisation from the labour market.

Concluding Remarks

The financial crisis has shown that the welfare state serves an important role in providing insurance and thus in cushioning the effects of the crisis for individuals. It has also shown the importance of having sufficient degrees of freedom in public finances to cope with the crisis. Consolidation in good times creates room to cope with bad times. Many countries have neglected this and therefore find themselves in difficult situations where there are no alternatives to severe austerity packages despite low growth and high unemployment. It is a fact that such packages tend to have large social costs, and this further underlines the importance of ensuring the financial viability of the welfare state. The financial crisis has not revealed any flaws in the welfare state model as such, but it does point to management and political economy problems which in some countries have curtailed the welfare state when it is most needed.

In some countries the political economy problems have been worsened during the crisis. Policymakers have attributed the debt crisis to the financial crisis, downplaying the role of policy failures to consolidate in good times and address sustainability problems arising from changing demographics. This blame game is now backfiring since reforms involving core welfare issues like pensions and retirement to ensure the financial viability of the welfare model to ordinary people appear to be arising from a concern solely for the financial sector.

13 See A. Lindbeck: Hazardous Welfare State Dynamics, in: American Economic Review, Papers and Proceedings, Vol. 85, May 1995, pp. 9-15; A. Lindbeck, S. Nyberg, J.W. Weibull: Social Norms Welfare State Dynamics, in: Journal of the European Economic Association, Vol. 1, No. 2-3, 2003, pp. 533-542.

Philippe Pochet and Christophe Degryse*

The Programmed Dismantling of the "European Social Model"

Since 2010 not a week has gone by without one European Union member state government or another announcing major reform plans affecting social legislation, the system of social protection, labour law or collective bargaining.

The arguments put forward by the governments to justify these reforms systematically refer to the crisis, in particular the crisis of public finances. In the construction of these arguments, the role played by the EU institutions cannot be overlooked; not only do we hear a repetition of the standard discourse concerning the need to "modernise" the European social model (in other words, the differing national social models) in order to "save" it (or them) from the crisis; we also witness the creation of various European institutional mechanisms through which the governments attempt to carry out these reforms (the European semester and its arsenal of multilateral surveillance mechanisms, the Euro Plus Pact, the Budgetary Pact, the specific country recommendations, etc.). The convergence of the discourse has recently culminated in a proposal, emanating from the EU Council Presidency, for the establishment of a common policy for the reform of retirement systems.[1]

This article first briefly reviews the reforms adopted in the member states in the fields of labour law and social protection. It covers the whole EU27, thereby providing an overview of the reforms in these areas rather than limiting the picture to the five most frequently mentioned countries (Greece, Spain, Ireland, Portugal and Italy).

In the subsequent section, we will see that these are radical reforms, in that they call into question the very foundations on which labour law and social protection systems have been constructed. What emerges is that, even though the reforms are being launched in countries characterised by quite specific economic and social situations, the measures proposed show a definite tendency towards convergence, thereby suggesting that their inspiration derives from common roots.

In the last section, we will enquire into the reasons underlying these programmes of structural reforms. We will see that the argument whereby the crisis is put forward as the justification for such a programme is hardly convincing. Accordingly, it is necessary to look elsewhere for explanations, and these will be seen to be linked, in the first place, to the constraints of monetary union and, secondly and more prosaically, to a political agenda.

From Social Policy as a Crisis Response to Deregulation as a Prerequisite for New Growth

Today it is possible to gain a good overall view of the labour market reforms conducted in the EU since 2008. Laulom et al.[2] have examined the period 2008-2011 in 11 member states, and the 2010-2012 period has been covered by Clauwaert and Schömann.[3]

While the two studies differ with respect to a few minor details, two convergent elements clearly emerge: the appearance of two distinct periods since the outbreak of crisis in 2008 and the nature of the reforms undertaken.

With regard to chronological sequence, there is a quite noticeable break between 2009 and 2010. During the first period, starting in late 2008, the member state governments used welfare institutions in dynamic fashion in order to protect citizens and workers from the excessively brutal effects of the crisis (unemployment, plummeting purchasing power, firm closures, etc.). Degryse[4] too, in his analysis of the crisis and the new European economic governance, draws attention to the sudden swing in the management of the crisis from the end of 2009, such that the 2010-2012 period came to be marked in virtually all member states by a succession of "structural" reforms.

Upon consideration of the nature of these reforms, it can be observed that all touch upon various aspects of individual and collective labour law. They may be grouped in

* Translation from the French by Kathleen Llanwarne.

1 According to Mr Van Rompuy, all member states should be required to link the statutory retirement age to life expectancy; http://www.lecho.be/actualite/economie_politique_europe/Pensions_toute_l_Europe_doit_reformer_dit_Van_Rompuy.9207088-3323.art?ckc+1.

2 S. Laulom, E. Mazuyer, C. Teissier, C.E. Triomphe, P. Vielle: How has the Crisis affected Social Legislation in Europe?, ETUI Policy Brief, No. 2/2012, Brussels 2012, http://www.etui.org/Publications2/Policy-Briefs/European-Economic-Employment-and-Social-Policy/How-has-the-crisis-affected-social-legislation-in-Europe.

3 S. Clauwaert, I. Schömann: The Crisis and National Labour Law Reforms: A Mapping Exercise, ETUI Working Paper No. 2012.04, Brussels 2012.

4 C. Degryse: La nouvelle gouvernance économique européenne, Brussels 2012, Courrier du CRISP.

Table 1

Announced and/or Adopted Reforms of Industrial Relations/Collective Bargaining Systems and Certain Aspects of Labour Law

	Reform of industrial relations and collective bargaining systems[1]	Changes to individual/collective dismissal rules	Changes to working time legislation	Changes to rules on atypical contracts[2]
Belgium		+	+	+**
Bulgaria	+			+**
Cyprus		+		
Czech Republic		+	+	+*
Estonia	+	+		+
Finland	+			
France	+			+**
Germany			+	+
Greece – MoU[3]	+	+	+	+**
Hungary	+	+	+	+**
Italy	+	+		+**
Ireland – MoU[3]	+			
Latvia		+		+
Lithuania		+	+	+
Luxembourg			+	+**
Netherlands	+			+
Poland	+		+	+*
Portugal – MoU[3]	+	+	+	+
Romania	+	+	+	+/+**
Slovakia	+	+	+	+*
Slovenia			+	+*
Spain	+	+	+	+/+**
Sweden			+	+**
United Kingdom		+	+	+

[1] including decentralisation of collective bargaining; [2] including the creation of new types of contracts (+*), in particular for young people (+**); [3] MoU: countries that have signed a Memorandum of Understanding with the EU, the IMF and the ECB.

Source: S. Clauwaert, I. Schömann: The Crisis and National Labour Law Reforms: A Mapping Exercise, ETUI Working Paper No. 2012.04, Brussels 2012.

four major categories, namely industrial relations, redundancy procedures, working time and employment contracts. Table 1 summarises these developments for the period 2010-2012.

While this table shows only reforms in the field of labour law, another area subject to savage reforms in numerous member states has been social protection. In dealing with this field in the following paragraphs, we will refer, due to space limitations, exclusively to the reform of retirement pensions.

The national pension systems issue was first placed on the European agenda towards the end of the 1990s and, in particular, after 2000.[5] Insofar as this is a topic which is subject to the subsidiarity principle, its eruption at the European level can be explained principally by the fact that, with the finance ministers having tackled the issue in the context of concerns over ensuring sustainable public finances, social actors decided to raise their voices in support of the "non-financial" aspects of the pensions question.[6] Thus, in the decade after 2000, an attempt was made at the European level to construct a balanced discourse dealing both with questions of financial sustainability and with the specifically social questions pertaining to pension regimes.[7]

After a series of parametric reforms during the 1990s and 2000s, the emphasis subsequently came to be placed on the need to make the actual retirement age coincide with the statutory age – in other words, to find ways of ensuring that workers remained in the labour market until they reached the age of 65 (or acquired the entitlement to a full pension).

The reforms that have recently been set in motion over a very short period, namely, the last three years (2010-2012), are aimed at radically altering the basic principle on which retirement systems have been built. It is now no longer a question of setting a maximum age limit but of bringing in other criteria to create a moveable scale and to determine retirement age in accordance with individual factors.

This is what we see in the reforms adopted in 2011-2012 aimed at statutory retirement and linking the retirement age to life expectancy. Such an approach had been, in the past, adopted by the Swedish government alone when it abolished the notion of normal retirement age and intro-

5 A. Math, P. Pochet: Les pensions en Europe: débats, acteurs et méthode, in: Revue belge de sécurité sociale, No. 2, 2001, pp. 345-362.

6 P. Pochet: Pensions: the European Debate, in: G.L. Clark, N. Whiteside (eds.): Pension Security in the 21st Century, Redrawing the Public-Private Debate, Oxford 2003, pp. 44-63, Oxford University Press.

7 P. Pochet, D. Natali: European Networks on Pensions. The Participation of organised Interests in the EU Policy-making Process, in: Revue belge de sécurité sociale, No. 2, 2005, pp. 307-335; D. Natali: Pensions in Turmoil Owing to the Crisis. Key Messages from the EU, in: C. Degryse (ed.): Social Developments in the European Union 2009, Brussels 2010, ETUI, pp. 119-147.

duced a scale ranging between the ages of 61 and 70.[8] Today this approach is becoming virtually the norm, in accordance with EU recommendations to the member states in the framework of the European semester.[9]

The link established – or which, it is argued, "ought" to be established – between retirement age and life expectancy results de facto – because of the introduction of a moving scale – in a gradual increase in the statutory retirement age. Thus the projections for Poland, for example, would lead to an actual retirement age of 71 by 2050. An additional factor in this increase is the desire of ever more governments to promote increasing flexibility as to the statutory age, as a means of encouraging people to remain in work beyond this age.

The conclusion to be drawn from observation of the reforms adopted in the fields of labour law and social protection (the latter here confined to retirement pensions) is that none of the reforms adopted or announced during the 2010-2012 period can be regarded, in any broad sense, as representing an improvement in social legislation.

The Crisis of Labour Law and of Social Protection as We Know It

The original underlying reason for the existence of labour law was recognition of the inequality inherently present in the relationship between the two parties on the labour market. The fact that the position of the employer and the worker is not one of equality in this "market" is what gave rise to the branch of law known as labour law, as distinct from the classic law of contracts.

Trade unions, after protracted struggles, obtained recognition as collective actors and as the employers' "opposite numbers". Collective bargaining gained its structure, resting on a pedestal of rights. The foundation consisted of fundamental social rights, and various higher levels each served only to improve the gains acquired at the previous level.

The situation today, however, looks quite different. The reforms adopted in the different member states indicate a backsliding on the employment contract, which seems to be increasingly equated with a commercial or service contract, as though the two parties to the contract could be regarded as operating on equal footing. As for the trade unions, today their position as collective actors and the official counterpart to the employers is ignored in at least four member states. In other cases (for example, Greece and Portugal), the *erga omnes* extension of sectoral agreements has become increasingly difficult, if not impossible. The new collective bargaining structures authorise an ever greater number of exceptions to or derogations of the rules concerning improvement at each successive level.

In other words, on the one hand, the very nature of the employment relationship is being fundamentally called into question today; on the other hand, the bargaining framework along with the actors and their capacity to impose binding rules – which are extended *erga omnes* – are being dismantled.

With regard to social protection, the changes underway serve to reinstate a twofold differentiation. In the future, there will be, on the one hand, a category of persons in receipt of a private supplementary pension who will enjoy the freedom to choose when to retire from the labour market, and these will be – broadly speaking – the most highly skilled workers and professionals whose life expectancies will also be relatively long. On the other hand, there will be those who have no choice but to go on working, and these will be the lower-skilled workers and all those with precarious terms of employment, whose life expectancies and enjoyment of good health will also be shorter.

Choices will be essentially dependent on additional private sources of retirement income (dependent on qualifications, sector of employment and labour market career). Factors of inequality linked to working conditions and associated life expectancy will no longer be taken into account.[10]

What has changed with the crisis, in reality, is not so much the content or the nature of the reforms advocated by certain economists, the IMF, the OECD and the European Commission, but rather the breadth and the much more radical nature of these new reforms.

How to Explain These Developments?

According to mainstream economists, the developments described above have been generated principally by the crisis, which has become a crisis of public finances that compels governments to adopt measures in the fields of labour law and social protection. This analysis is far from convincing.

8 Observatoire Français des Conjonctures Economiques (OFCE): Les réformes des retraites en Europe dans la crise, Document de travail de l'OFCE, No. 2010-17, Paris 2010.

9 C. Degryse, op. cit.

10 P. Vendramin, G. Valenduc: Métiers et vieillissement au travail. Une analyse des résultats de la cinquième enquête européenne sur les conditions de travail (EWCS 2010), Working Paper, Brussels, ETUI.

First of all, how is it to be explained, in this case, that these structural reforms of the labour market and social security systems were being advocated long before the outbreak of the crisis, during a period when public debts and deficits remained under control?[11] How is it to be explained that the EU was already calling on member states to "reform and reinforce pension, social insurance and health care systems"[12] during a period when the public debt was under control at the European level (59% of GDP in 2007) and when the average EU27 budgetary deficit was 0.9% of GDP? How is it to be explained that the EU, during a period of economic growth, called for wage developments in the member states to be "consistent with a rate of profitability that allows for productivity, capacity and employment-enhancing investment"?[13]

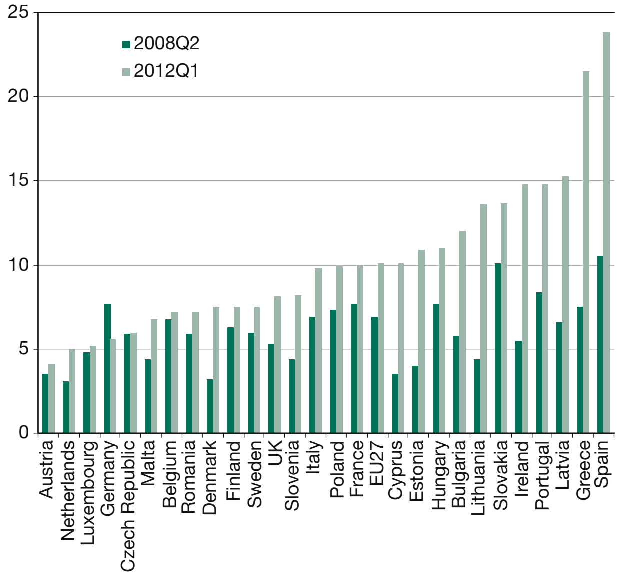
The second reason why this analysis is unconvincing is that any reform of the retirement systems is likely to lead to a positive impact on public finances only in the medium to long term. The time required for the adoption of the reform, for it to take effect – such reforms are generally planned over an extremely long time scale – and for it to result in any impact on the public deficit means that such reform will not cause even the slightest ripple of response in relation to the immediate sovereign debt crisis in Europe.

Finally, in the case of labour market and labour law reforms, it may even be claimed that these would lead Europe in the complete opposite direction of a proper response to the crisis. It has become apparent now that the labour markets of the so-called "Bismarckian" countries are the ones that have proved best able to resist the financial crisis, the economic crisis and the crisis of public finances. This can be seen in Figure 1, which shows EU27 unemployment rates before the crisis and those for the first quarter of 2012.

In terms of unemployment rate development, five countries that stand out as the best performers are Luxembourg, Austria, the Netherlands, Germany and Belgium. Yet in spite of this, in 2012 three of these countries received the gratification of "specific recommendations" relating to their wage formation systems (Luxembourg and Belgium in relation to their wage indexation systems and Germany in relation to its need to take greater account

Figure 1

Unemployment in the EU27 (2008Q2-2012Q1)



Note: Seasonally adjusted data.

Source: Eurostat.

of productivity in wage developments[14]). It is precisely these countries that have received the most criticism from the EU for their failure to introduce reforms;[15] Degryse[16] shows that they received between four (Germany) and nine (Belgium) recommendations in the social policy field in 2011.

A first observation can be drawn from this: performance in terms of efforts to curb unemployment is clearly not the main criterion on which the member states are being judged. Indeed, this criterion even appears to be neglected in comparison with other criteria which are apparently more important in the eyes of the Commission and the governments in the EU Council, such as the existence of an indexation mechanism, unit labour costs, etc.

However, if the reforms proposed (and indeed *imposed* in the case of the countries in receipt of financial assistance) are aimed neither at solving the present crisis of public finances nor at boosting new growth nor at bringing down unemployment, what might their justification be?

These reform programmes reflect the use of the crisis by a series of strategic actors (central bankers, economic and finance ministers, DG ECFIN) as a window of oppor-

11 See, among others, P. De Grauwe: The Governance of a Fragile Eurozone, CEPS Working Document No. 346, Brussels 2011.

12 Council of the European Union: Council Recommendation of 12 July 2005 on the Broad Guidelines for the Economic Policies of the Member States and the Community (2005 to 2008), in: Official Journal of the European Union, L 205/28, 6.8.2005.

13 Ibid.

14 The wage question is deliberately not addressed in this article.

15 B. Palier (ed.): A Long Goodbye to Bismarck? The Politics of Welfare Reform in Continental Europe, Amsterdam 2010, Amsterdam University Press.

16 C. Degryse, op. cit.

tunity for turning the "European social model" into the new adjustment variable within the economic and monetary union. To make EMU work in the absence of genuine economic and economic performance convergence,[17] the adjustments in the euro area (particularly in terms of competitiveness and productivity) must, according to these strategic actors, be achieved via the path of wages, labour law and social security. In other words, what were known as "competitive (currency) devaluations" in the days before monetary union must today be converted, according to these actors, into "competitive wage devaluations", "competitive labour law regulation", and "competitive retirement pension and health care devaluations". The new governing principle has thus become one of domestic devaluation in a range of social policy fields; the application to Greece represents the archetype norm here. This serves to explain, at the end of the day, why Mr Mario Draghi, the President of the European Central Bank, believes that "the European social model is dead".

This overhaul of the very purpose of social policies within the euro area should, according to these powerful and influential actors, have taken place mechanically and would have served to stabilise the monetary union.[18] As things turned out, however, the monetary union that came into being was not an optimum currency area and there was no political government in a position to ensure solidarity mechanisms ("transfer union").[19]

However, if this transformation failed to take place automatically in accordance with their wishes, a major reason is that, in the 1990s, a series of social pacts were concluded among the political, economic and social actors.[20] At the European level, in a political context characterised by a majority of national left-wing or centre governments,[21] two strategies were successively put in place: first, in 1997, the European Employment Strategy, and subsequently the Lisbon Strategy, both of which constituted attempts to balance economic and social goals. Finally, the early 2000s saw the launching of "open methods of coordination" (OMC) in the fields of poverty, social exclusion, pensions and health care, all of which were, in spite of some of their weaknesses, intended as attempts to redress the predominance of the economic "imperatives" promoted by ECFIN.

In two distinct stages, this attempt at attaining balance was broken down. First, beginning in 2004/2005 (particularly with the arrival of José Manuel Barroso as European Commission President), the political context started to change and the social OMCs were eroded in favour of a vision which gradually reinstated the purely economic approach at the heart of public policies and European discourse. This was a development that coincided with the gradual rise of right-wing and centre-right governments in Europe.

It was in this context that the financial crisis of 2007-2008 entered the picture, with all its consequences for the economies and public finances. In 2009-2010, a new medium-term strategy – "Europe 2020" – was put in place to replace the Lisbon Strategy and bring together all the earlier goals under ten priority headings that were collectively subject to the "meta-priority" of the structural stability of monetary union. The route to achieving this priority aim was sought through various documents, legislative initiatives and treaty amendments,[22] the ultimate goal of which was the consolidation of public finances.

From this point on, the path is clear for the ascent of the central bankers who no longer hesitate to dictate to governments the necessary measures they must take (see Mr Draghi's letter to Italy and Spain) and who give public expression to their preference for, in a nutshell, an end to the social model. In a similar manner, the actors busy in the "economic hive" grouped around DG ECFIN no longer hesitate to impose their own version of this preference: social policies are henceforth to serve as adjustment variables for achieving the stability of monetary union. To this end, it is deemed necessary to decentralise collective bargaining, to reduce the weight of collective social actors, to erode solidarity, to privatise the welfare state and so forth.

Conclusion

After responding to the onset of the financial crisis in 2008-2009 with measures to support economic activity and employment, the member states embarked on major programmes to reduce public expenditures and launch

17 M. Sy: Convergence des économies européennes : quel bilan 20 ans après ?, Document de travail, No. 2012-04, Paris 2012, Centre d'analyse stratégique.

18 A. Verdun: An asymmetrical Economic and Monetary Union in the EU: Perceptions of Monetary Authorities and Social Partners, in: Journal of European Integration, Vol. 20, No. 1, 1996, pp. 59-81; A. Martin, G. Ross (eds.): Euros and Europeans: Monetary Integration and the European Model of Society, Cambridge 2004, Cambridge University Press.

19 W. Schelkle: Monetary Integration in Crisis: How well do Existing Theories Explain the Predicament of EMU, (forthcoming).

20 P. Pochet: What's wrong with EU2020?, ETUI Policy Brief, European Social Policy, Issue 2, Brussels 2010, http://www.etui.org/Publications2/Policy-Briefs/European-Social-Policy/What-s-wrong-with-EU2020.

21 P. Pochet: Debate around the Social Model: Evolving Players, Strategies and Dynamics, in: C. Degryse, P. Pochet (eds.): Social Developments in the European Union 2005, Brussels 2006, ETUI-REHS, pp. 79-99.

22 C. Degryse, op. cit.

structural reforms during the second phase of the crisis (2010-2012).

The reforms launched in this context relate, principally, to labour law and social protection. In terms of content, they are very much in line with the usual recommendations issued by mainstream economists who, for the most part, see the European social model as the principal cause of the deterioration of the member states' public finances.

While the content of these reforms is therefore not new, the political context (the Commission and a majority of governments on the political right or centre-right) and socio-economic developments (crisis of the euro, recession, worsening unemployment, etc.) have, contrary to all expectations,[23] opened up a royal road for the imposing of hard-hitting and painful reforms. For the last three years we have been witnessing a coordinated offensive against the foundations of labour law, collective bargaining, social dialogue, wage formation systems and collective actors, including in particular the trade unions, as well as against the principles underlying social protection.

The content of these reforms, though justified in the official discourse by reference to "the crisis", is in no way dictated by the need for responses to temporarily adverse economic circumstances. Their purpose, on the contrary, is to dismantle whole areas of the European social model, even though the best features of this model have proved their worth during the crisis through their effectiveness in averting the full-scale deterioration of the economic situation and the labour market. The countries with the lowest rates of unemployment are precisely those with the strongest welfare institutions and industrial relations systems. Yet the fight against unemployment is quite evidently not what these reforms are about, just as, elsewhere, resolution of the debt crisis is quite evidently not the reason for the long-haul reforms of pension systems so vigorously enacted over the past three years.

The reasons underlying this enthusiasm for dismantling existing gains – "the European social model is dead" – thus need to be sought elsewhere, namely in the current mode of operation of the monetary union. Since Europe has failed to commit its energies to a genuine economic union, i.e. a voluntary process of convergence of economic performance and social cohesion of the euro area states, social policies – in the broadest sense – have today been designated and targeted as the EMU's main adjustment variables. According to the new hegemonic discourse, a range of forms of internal social devaluation (wage, labour law and social protection) will henceforth be called upon in crisis situations in lieu of the monetary adjustments which are now a thing of the past.

23 It was indeed the expectation of progressives that the financial crisis of 2008 and everything that it served to reveal would contribute to a weakening of the neoliberal doctrine and its theoretical underpinnings, as well as to a political strengthening of the advocates of better economic regulation and stricter controls over the operation of financial markets.

Gaetano Basso, Mathias Dolls, Werner Eichhorst, Thomas Leoni, Andreas Peichl*

The Effects of the Recent Economic Crisis on Social Protection and Labour Market Arrangements Across Socio-Economic Groups

The recent economic crisis did not only affect European countries to varying extents; its impact on national labour markets and on specific socio-economic groups in those markets also varied greatly. Institutional arrangements such as employment protection, unemployment insurance benefits, minimum income support, working time flexibility and wage setting played a crucial role in determining to what extent the economic crisis led to higher unemployment, wage cuts or income losses and rising poverty.[1] As the crisis gained momentum, automatic stabilisation mechanisms built into the national tax-benefit and social protection systems were complemented by heterogeneous sets of discretionary policy measures.

* Andreas Peichl is grateful for financial support by Deutsche Forschungsgemeinschaft (DFG). Thomas Leoni acknowledges excellent research assistance by Lukas Tockner. The authors are grateful for comments received at the Second RDW Conference, Geneva, 6-8 July 2011.

1 O. Bargain, H. Immervoll, A. Peichl, S. Siegloch: Distributional consequences of labor-demand shocks: the 2008-2009 recession in Germany, in: International Tax and Public Finance, Vol. 19, No. 1, 2011, pp. 118-138.

While these factors can explain cross-country variation in labour market developments, they also lead to an unequal distribution of economic risks associated with the crisis across socio-economic groups. Accordingly, differences both across countries in their labour market responses to the crisis as well as within countries in the distribution of social and economic risks deserve careful scrutiny.

Theoretical Background

It is beyond dispute that both the magnitude of the economic contraction during the crisis and its effects on labour markets were attenuated considerably by the work of automatic and discretionary stabilisation. Social protection contributed to limit the extent and duration of the recession and to stabilise labour markets and private consumption. The automatic actions of the social protection system on both the revenue and expenditure sides of general government budgets were accompanied in most European countries by discretionary action in the field of social and labour market policy. This included a broad range of measures such as employment incentives, activation policies, higher benefits and increased transfers to low-income households.

Due to differences related to the structure and financing of the social protection system, the degree of automatic stabilisation was bound to vary across countries. Moreover, an economic downturn is bound to affect households very asymmetrically. Job loss leads to a sharp decline in income for the unemployed and their families; at the same time, other social groups are affected only marginally through stagnating real wages. The social policy challenge resulting from these asymmetric effects of the crisis is further enhanced by the presence of in-work poverty.

In terms of social protection, automatic stabilisers have the major advantage of providing income replacement immediately, i.e. when unemployment starts to rise, to those integrated within the benefit systems. They can, however, be ineffective with respect to securing employment and income (replacement) to those at the margin of the labour market. Unemployment insurance systems can be exclusive, as they do not equally protect each type of worker. While means-tested income support is generally available as a basic social security net in most EU member states, income assistance is not easily available, as stringent means-testing obliges households who experience prolonged unemployment first to run down their savings or even sell their home.[2] The extent of unemployment risks and the "quality" of social protection provided to different socio-economic groups do not coincide, and, in general, those most affected are the least protected. The extent of labour market dualism is of crucial importance in this respect, as "both automatic stabilisers and protection against job loss do not operate efficiently when there is a dualism in the labour market".[3]

Institutional Patterns of Unemployment and Employment Protection

Social safety nets provide income security for individuals and households and thereby stabilise national demand in a phase of rising unemployment. Unemployment benefits stemming from unemployment insurance are generally tied to contributions and have to be distinguished from means-tested minimum income support for inactive or long-term unemployed people.

Unemployment insurance benefits provide income replacement in case of redundancies if certain national entitlement and availability criteria are met. Of particular importance is a sufficient employment record in terms of duration and earnings. While fixed-term contracts are often covered by unemployment insurance, holders of these types of jobs may not have a substantial entitlement to unemployment insurance benefits if waiting periods are not fulfilled due to interrupted employment spells. In addition, part-time employees or low-wage workers, while covered by the insurance, may only be able to draw very limited benefits from unemployment insurance due to the close link between earnings-related contributions and benefits.

Apart from the more or less inclusive character of unemployment insurance, the generosity of unemployment insurance benefits is a crucial factor in assessing its role as an automatic stabiliser. To evaluate this, the extent of income replacement and the maximum duration of benefit have to be taken into account. In general, unemployment insurance benefits tend to be generous for those with a solid employment record and substantial earnings. However, unemployment insurance benefits may not be available for vulnerable groups who either do not meet the entitlement criteria or do not have substantial benefit claims and who face higher risk of unemployment due to a more difficult situation in the labour market before and during crises. This concerns particular groups such as (i) employees with fixed-term contracts and short employment records, including labour market entrants, (ii) employees with low monthly earnings and (iii) the self-em-

2 OECD: Employment Outlook 2011, Paris 2011.

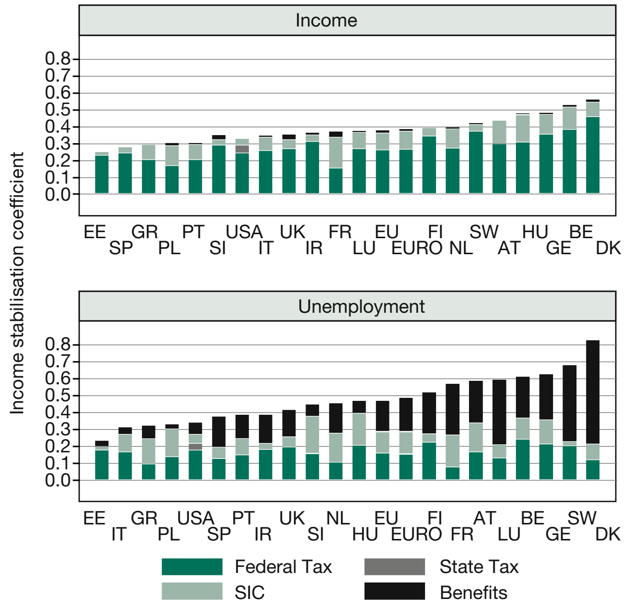
3 T. Boeri, P. Garibaldi: Beyond Eurosclerosis, in: Economic Policy, Vol. 24, No. 59, 2009, pp. 409-461, here p. 445.

ployed. These groups tend to be affected by unemployment more than groups which are better integrated into the unemployment insurance system, but they may not actually have access to substantial insurance benefits in practice. Access to short-time work schemes, which provide an additional safeguard against unemployment, is also biased in favour of the core labour force, i.e. workers with specific skills and substantial tenure.

Minimum income support is a second safety net providing basic social benefits for those not eligible for unemployment insurance. In general, the receipt of minimum income support depends on household-related means testing. It is not time-limited in European countries, but some age restrictions and availability criteria apply. The generosity of minimum income support is more complex to assess, as other means-tested benefits can play a major role, in particular child-related and housing benefits. A reliable measure of basic income support generosity can be calculated as a combination of different relevant benefits available to typical target groups, including housing and child allowances after longer unemployment. However, severe problems in terms of poverty arise if minimum income support is not available or unsuitable in providing poverty relief.

Figure 1

Decomposition of Income Stabilisation Coefficient for Both Scenarios – Country Ranking



Source: M. Dolls, C. Fuest, A. Peichl: Automatic stabilizers and economic crisis: US vs. Europe, in: Journal of Public Economics, Vol. 96, No. 3-4, 2012, pp. 279-294.

Automatic Stabilisation

The tax and transfer system determines the way in which a given shock to gross income translates into a change in disposable income. This section, based on Dolls et al.,[4] compares the magnitude and composition of automatic stabilisation between the USA and Europe. One has to note, however, that this simulation exercise does not take into account prior employment records, instead assuming full benefit coverage and utilisation.

We run two controlled experiments of macro shocks to income and employment. The first is a proportional decline in household gross income by five per cent (income shock). This is the usual way of modelling shocks in simulation studies analysing automatic stabilisers. However, economic downturns typically affect households asymmetrically, with some households losing their jobs and suffering a sharp decline in income and other households being much less affected, as wages are usually rigid in the short term. We therefore consider a second macro shock where some households become unemployed, resulting in an increase in the unemployment rate such that total household income decreases by five per cent (unemployment shock). As our measure of automatic stabilisation, we define an income stabilisation coefficient which relates the shock absorption of the whole tax and transfer system to the overall size of the income shock. We take into account personal income taxes at all government levels, social insurance contributions, payroll taxes as well as transfers to private households such as unemployment benefits. Computations are conducted according to the tax benefit rules which were in force before 2008 in order to avoid an endogeneity problem resulting from policy responses after the start of the crisis.

Our results for the stabilisation coefficient vary considerably across countries, as can be seen from Figure 1. In the case of the income shock, we find the highest stabilisation coefficient for Denmark, where automatic stabilisers cushion 56% of the shock. Belgium (53%), Germany (48%) and Hungary (48%) also have strong automatic stabilisers. The lowest values are found for Estonia (25%), Spain (28%) and Greece (29%). With the exception of France, taxes seem to have a stronger stabilising role than social security contributions. In France, social security contributions are progressive and therefore play an important role in disposable income stabilisation.

4 M. Dolls, C. Fuest, A. Peichl: Automatic stabilizers, economic crisis and income distribution in Europe, in: Research in Labor Economics, Vol. 32, 2011, pp. 227-256; M. Dolls, C. Fuest, A. Peichl: Automatic stabilizers and economic crisis: US vs. Europe, in: Journal of Public Economics, Vol. 96, No. 3-4, 2012, pp. 279-294.

In the case of the unemployment shock, the stabilisation coefficients are larger for the majority of countries. Again, the highest value emerges for Denmark (82%), followed by Sweden (68%), Germany (62%) and Belgium (61%). At the other end of the spectrum, there are some countries with values below the US level of 34%. These include Estonia (23%), Italy (31%) and Poland (33%).

Regarding distributional effects, in the case of the proportional income shock, the stabilisation coefficients are an increasing function of the income quantiles. This result is due to higher changes between market and disposable income for high income groups. In contrast to the increasing stabilisation by income quantile for the income shock, stabilisation results for the unemployment shock follow a somewhat different pattern. Here, with the exception of some Eastern and Southern European countries, we also find high stabilisation for the lowest income groups. As the unemployment shock is modelled through the reweighting of our sample, taking into account individual characteristics of the unemployed, a large number of the newly unemployed come from lower income quantiles. The fact that tax and transfer systems in countries such as Estonia, Greece, Italy, Poland, Portugal, Slovenia or Spain provide only weak stabilisation for low income groups can be explained by rather low unemployment benefits in these countries.

The Contribution of Discretionary Measures

During the crisis, policymakers implemented a number of discretionary reforms to social protection systems. The first phase was characterised by a number of reforms strengthening the current unemployment insurance system, in particular by easing access or improving benefit generosity for non-standard workers. Measures included the reduction of qualifying times for unemployment insurance (e.g. Sweden), the prolongation of benefits entitlement (e.g. Romania) or the increase in replacement rates for specific sub-groups of the workforce that were previously less covered than core workers (e.g. Luxembourg and Sweden). In most countries, social protection was increased beyond the realm of unemployment benefits, with a number of measures targeted at families with children and households exposed to poverty risks. In spite of the many crisis-related measures that were implemented to strengthen income replacement programmes, the crisis exposed significant gaps in the safety nets for the unemployed.[5]

Measures to maintain or facilitate (re-)employment featured even more prominently in labour market packages implemented during the crisis. The most widespread reaction has been to step up efforts to train both employed and unemployed workers and to intensify job search assistance and overall public employment services capacities.[6] 23 out of 27 EU member states took steps to improve job placement and invest in retraining, while 19 countries reinforced activation. Some countries also implemented other types of policy changes or new initiatives, such as increasing incentives for entrepreneurship. This response represents a discretionary component of stabilisation, complementing the automatic stabilisation through mainly passive labour market expenditure discussed in the previous section.

Although overall expenditure on unemployment is highly countercyclical, in the past, significant differences between passive and active measures could be observed, especially as to the proportionality with which spending reacts to changes in the absolute number of unemployed. Estimates based on the historically typical reaction of spending indicate that per person resources for labour market policies in the OECD countries do not raise in proportion to the increase in unemployment.[7] Looking at the cyclicality of more detailed programme categories, the OECD finds that expenditures on training have been totally unresponsive to cyclical unemployment, whereas they represent the category of active measures that has been most responsive to changes in trend unemployment. Conversely, direct jobcreation schemes display the opposite pattern, i.e. a strong correlation with cyclical unemployment and none with trend unemployment.[8]

Another set of policies was geared at encouraging flexible working time, thus enhancing internal flexibility, and more generally at cutting labour costs. Some measures were quite innovative, such as Austria's attempt to encourage further education and skill formation through an attractive educational leave scheme. However, in this area, short-time working schemes to prevent dismissal were the most prominent and by far the most widely used measure. Generosity of the system and ease of access can basically explain the strong variation across countries in interaction with the specific motivation of employers to rely on short-time work. The annual average stock of short-time workers was more than five per cent of all employees in Belgium in 2009 and around three per cent in Italy, Germany and Luxembourg. Apart

5 OECD: OECD Ministerial Meeting on Social Policy, background document session 1: Economic crisis and beyond: Social policies for the recovery, Paris 2-3 May 2011.

6 S. Cazes, S. Verick, C. Heuer: Labour market policies in times of crisis, in: Employment Working Paper, No. 35, Geneva 2009, ILO.

7 OECD: Employment Outlook 2009: Tackling the job crisis, Paris 2009; OECD: Employment Outlook 2010, Paris 2010.

8 OECD: Employment Outlook 2009…, op. cit.

from Belgium's – and, to a lesser extent, Italy's and France's – reliance on short-time work, which predated the crisis, all countries experienced a marked increase from very low levels. In many countries, short-time working schemes were already in place before the crisis but had been used scarcely. During the crisis their attractiveness was enhanced by increasing their flexibility and the amount of public subsidisation.

The impact of discretionary measures in the realm of labour market and employment was not symmetric across the labour force. Numerous measures were explicitly targeted at marginal workers, characterised by a high risk of job loss and by low levels of social protection. Measures to improve the employment outlooks for groups that face high unemployment rates (such as young and old workers) also featured in most labour market packages adopted during the crisis. However, the most prominent measure to support employment – short-time work schemes – did not favour the weaker segments of the labour force.

In principle, incentives to reduce working time represent a way to spread the burden of adjustment more equitably across the work force: whereas reliance on layoffs concentrates the costs of adjustment on a relatively small number of workers, short-time arrangements lead to an adjustment through the hours worked, not the persons in employment. At the same time, short-time work arrangements represent only a partial subsidisation of the costs associated by firms with keeping workers in employment. They are attractive for firms only when the subsidy reduces the costs of employment to the point where they become lower than the costs that would result from a layoff. Accordingly, short-work schemes are most effective for jobs characterised by high search costs (for instance, due to skill shortages in the labour market or a high degree of firm-specific knowledge) or high separation costs (as in the case of high employment protection).

It is thus not surprising that short-time work arrangements were widespread in skilled segments of the labour force and among workers with regular contracts. Low-qualified workers, who are comparatively easy to find in the labour market and who carry out tasks with a low level of firm-specific knowledge, as well as marginal workers with low levels of employment protection did not benefit significantly from the public subsidisation of working time reduction. Cahuc and Carcillo,[9] Hijzen and Venn[10] and the OECD[11] show that short-time work programmes indeed stabilised employment and reduced unemployment. However, the positive impact was limited to workers with permanent contracts, thereby further increasing labour market segmentation.

Unemployment Protection in Dual Labour Markets

Many European countries entered into the recent crisis with a very segmented labour market. A preliminary way to look at this is by analysing the OECD EPL index, a widely used measure of the severity of employment protection legislation based on an assessment of national regulations. The EPL index shows a clear pattern for all European countries. The reforms since 1990[12] have been broadly aimed at reducing dismissal costs, notably in countries that had the strictest standards. Moreover, many European countries carried out EPL reforms involving a change in the overall index exceeding two-thirds of the cross-country standard deviation in the index in 1990. We also observe a converging path: the contemporaneous decline in the average of the overall index for European OECD countries and of the cross-country standard deviation of this indicator.

However, the measurement of dualism is a non-trivial exercise because the two-tier nature of the labour market affects many dimensions, from the share of temporary workers among total employees to the probability of labour market status transitions and, finally, to wage differentials. Going into more detail, we can give a broad idea of what European labour markets looked like in 2008 with respect to dualism. In Figure 2 we plot the share of temporary workers against the level of the EPL regular index (on the left hand side) and then the transition probability against the same EPL index (on the right hand side). Both measures are highly correlated with the level of EPL. In particular, the correlation coefficient between the share of temporary workers and EPL is 0.81, while the transition probability from temporary to permanent positions is negatively correlated with the severity of employment protection legislation (ρ=-0.72).

The share of temporary contracts steadily increased before the 2008-2009 recession in countries with stricter

9 P. Cahuc, S. Carcillo: Is Short-time Work a Good Method to Keep Unemployment Down?, in: CEPR Discussion Paper, No. 8214, London 2011, Centre for Economic Policy Research.

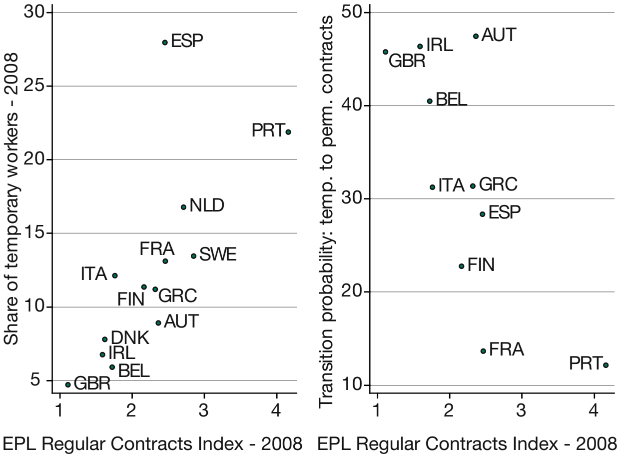
10 A. Hijzen, D. Venn: The Role of Short-Time Work Schemes during the 2008-09 Recession, in: OECD Social, Employment and Migration Working Papers, No. 115, 2011.

11 OECD: Employment Outlook 2010..., op. cit.

12 See W. Eichhorst, M. Dolls, P. Marx, A. Peichl, S. Devisscher, T. Leoni, L. Tockner, M. Marterbauer, S. Ederer, G. Basso, M. Gerard, I. Vanhoren , C. Nielsen: The Role of Social Protection as an Economic Stabiliser: Lessons from the Current Crisis. Report based on a study conducted for the European Parliament, in: IZA Research Reports, No. 31, Bonn 2010, IZA Bonn.

Figure 2

EPL, Temporary Workers and Transition Probability from Temporary to Permanent Positions in Europe



Sources: OECD and Eurostat labour force statistics 2008 (left panel); OECD and EU-SILC 2004-2007 longitudinal component (right panel).

employment protection legislation. However, temporary workers experienced the majority of recession-related job losses, and hence this share has been falling in the recession, according to quarterly European Labour Force Survey data. The most representative country is Spain, where temporary workers declined by 22.9% during the period from the second quarter of 2008 to the second quarter of 2010 (compared with 9.6% for total employment); a similar decline has been observed in Italy (9.6% compared with 2.4%). European Union (15 countries) average reported a 6.2% decline, and Sweden was slightly below the average (5.9%, while total employment dropped by only 1.6%). France experienced a lot of quarterly variation in temporary employment. While total employment loss during the crisis was around 1% (and it slightly changes comparing different quarters), the temporary employment drop was 0.9% in the period 2008Q2-2010Q2, but 8.6% if comparing 2008Q2 with 2010Q1. In the same period Germany outperformed the other countries. As many economists have already noticed (among others, Boeri and Bruecker[13] and the OECD[14]), the German case is quite different: total employment during the crisis period remained unchanged, and no significant change in the share of temporary contracts can be noticed either during or after the crisis.

Table 1 shows the rise and fall and rise again of temporary contracts in some European countries from 2005 to 2011. Most of the countries experienced a drop in the mean share as a consequence of both the recession and of the severity of EPL for permanent contracts. However, once the recession was over, the majority of new hires took place with temporary contracts. This explains the new rise in the share of temporary contracts after 2009.

Table 1

Share of Temporary Workers as a Percentage of Total Dependent Employment

	2005	2006	2007	2008	2009	2010	2011
European Union (15 countries)	14.4	14.9	14.9	14.5	13.8	14.0	14.2
France	13.9	14.8	15.0	14.8	14.3	14.9	15.2
Germany	14.3	14.6	14.7	14.8	14.6	14.7	14.8
Italy	12.3	13,1	13.2	13.3	12.5	12.8	13.4
Portugal	19.5	20.6	22.4	22.9	22.0	23.0	22.2
Spain	33.4	34.1	31.7	29.3	25.5	25.0	25.4
Sweden	15.7	17.0	17.2	15.8	14.9	15.4	15.9

Source: Eurostat labour force statistics.

A main concern regarding the use of temporary jobs is the extent and the coverage of unemployment benefits, especially during recession periods. Some preliminary evidence suggests that the extent of unemployment risks and social protection do not coincide: national benefit schemes hardly cover former temporary workers with unemployment insurance. However, there is little empirical literature so far that covers this topic. Figari et al.[15] have recently analysed the extent of social protection using EUROMOD simulations in five European countries, while D'Amuri[16] has carried out an interesting analysis of the effects of the current crisis on the Italian labour market.

Figure 3 suggests that younger people have much less coverage than older workers both in non-dual and dual countries,[17] but in the latter group the difference be-

13 T. Boeri, H. Bruecker: Short-Time Work Benefits Revisited: Some Lessons from the Great Recession, in: IZA Discussion Paper, No. 5635, Bonn 2011, IZA Bonn.

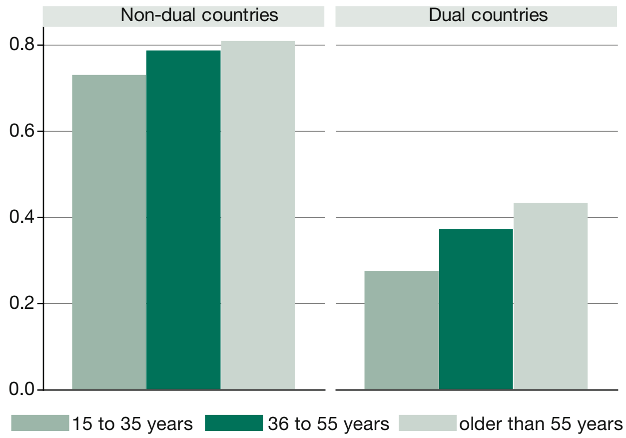
14 OECD: Employment Outlook 2010…, op. cit.

15 F. Figari, A. Salvatori, H. Sutherland: Economic downturn and stress testing European welfare systems, in: Research in Labour Economics, Vol. 32, 2011, pp. 257-286.

16 F. D'Amuri: The impact of the Great Recession on the Italian labour market, in: Research in Labour Economics, Vol. 32, 2009, pp. 155-180.

17 Based on a classification taking into account differences in employment protection, wage premia for permanent contracts and transition probabilities from temporary to permanent presented in W. Eichhorst et al., op. cit., we consider as dual countries France, Greece, Italy, Portugal, Spain and Sweden as a consequence of rankings in the previous table in this section. Non-dual countries are Austria, Belgium, Denmark, Germany, Finland, Ireland and the United Kingdom. European average always refers to the European Union 15 country average, excluding Luxembourg.

Figure 3
Coverage of Unemployment Benefits by Age: Non-dual and Dual Countries



Source: European Survey on Income and Living Condition, 2008.

tween the shares of the young and the middle-aged who are covered is very high (around ten percentage points, from 27.5% to 37.2%). This suggests that younger benefit recipients, who are also more likely to hold temporary jobs, are the most exposed to unemployment related poverty. It is very likely that this problem worsened during 2009.

Conclusions and Policy Lessons

Our analysis finds large variation among EU member states in their use of automatic stabilisers and discretionary fiscal stimuli. Furthermore, it is important to note that some social groups, such as young workers and those holding non-standard contracts, were particularly affected by a deterioration of labour market conditions. At the same time, however, they only had limited access to unemployment insurance. This is particularly problematic if there is no effective minimum income support scheme.

Taking an institutional point of view, we argue that automatic stabilisers inherent in unemployment and minimum income support schemes and progressive taxation can work without a significant time lag and can also lead to a timely phase-out when the economy and the labour market recover. The same holds in particular for public short-time work subsidies which help stabilise employment and a trained workforce and thereby facilitate dynamic economic development after crises. Hence, automatic stabilisers are of particular importance and should be developed, not in a uniform way, but taking into account the specific national economic and institutional context. Establishing a proper system of automatic stabilisers reduces the need for further discretionary action and avoids time lags inevitable in case of discretionary fiscal stimuli.

Furthermore, policymakers should prepare social protection schemes for the future and overcome present inequality in social security. It is particularly important to ensure that non-standard workers, those with fixed-term contracts or only short employment records, in particular young people, have access to sufficient social protection so that social exclusion is prevented. One element for achieving this is the creation of general minimum income schemes for all working-age people. This should, of course, be based on a careful assessment regarding the appropriate benefit level and not lead to work disincentives. In order to avoid long-term benefit dependency through exclusion from work, proper activation measures have to be put in place including job search assistance and training. It should be evaluated whether and how access to unemployment insurance benefits can be made more general, in particular by assessing the role minimum employment or contribution conditions play in the case of young people, other labour market entrants and, in general, people on non-standard contracts.

Discretionary action should be well-targeted and timely, but also temporary. Hence, there is a need for a clear exit strategy in order to avoid the risk of ineffective spending of public resources through prolonged subsidisation and eventually pro-cyclical impacts. Growing fiscal constraints will otherwise hamper the capacity of governments to counter future economic uncertainties. As temporary measures quite often tend to be prolonged, it is important that policymakers assess the need for discretionary measures carefully and regularly check the justification for their existence. A more rule-driven, quasi-automatic approach to discretionary action could be helpful in this respect, i.e. by referring to objective indicators when deciding on the introduction or maintenance of fiscal stimuli, in particular temporary social measures. A rule-based approach to discretionary spending could refer to the development of (non-subsidised) employment, to unemployment rates or to GDP – both current and forecast data.

Finally, labour market dualisms can only be overcome if the regulatory divide between different types of employment such as open-ended contracts, fixed-term jobs and agency work is mitigated, in particular with reference to models of a “unified employment contract” which would provide for a progressive amount of employment protection according to tenure.

Peter Taylor-Gooby

Beveridge Overboard? How the UK Government Is Using the Crisis to Permanently Restructure the Welfare State

The UK government's current strategy combines radical cuts in public spending with a restructuring of most areas of public provision to reduce costs, expand the role of non-state – especially for-profit – providers, increase local diversity of provision, tighten work incentives and dismantle redistributive programmes to focus welfare on defined groups among the poor. This has a bearing on two issues of broader interest concerning the best future trajectory for government policy and social spending as social investment.

First, if a combination of radical spending cuts and wholesale restructuring is associated with a return to secure growth in the UK, this may reinforce the argument that social provision is best seen as a burden on the productive economy and not as social investment that helps to provide the basis for growth and builds solidarity. Those who point to Canada and New Zealand as examples of countries which have imposed radical cuts and restructurings of welfare systems when faced with economic crisis and have succeeded in restoring growth and sustaining spending at lower levels support this argument.[1] Figure 1 gives some evidence on government spending and growth for the two countries following the crises in New Zealand in the 1980s and in Canada in the 1990s. Government spending fell and broadly stabilised in both countries after radical changes, and debt fell sharply until the recent crisis.

The second issue concerns the European social model. If there is a commonality among European welfare states embodied in the "social investment" logic of Lisbon 2000, the spillover from the Maastricht Treaty onto social provision, the concern with quality as well as quantity of jobs, and the open method of coordination (OMC) process in social exclusion and the Europe 2020 social exclusion target, current UK policies represent a departure from that approach. Taken together with the cuts in benefits, public services and public sector employment that the austerity packages entail, most strikingly in Ireland and Mediterranean countries, this may signal the end of the ambition of creating a "social Europe".[2]

This paper sets out developments in UK policies, paying particular attention to the restructuring of the welfare state currently underway and discusses how far the government is succeeding in embedding a permanent change of direction in British social policy.

Public Spending

The stated objective of UK government policies, as set out in the first sentence of the June 2010 Emergency Budget, is to deal "decisively with our country's record debts ... and to set the country on the course for recovery".[3] The programme totals £110.3bn in tax increases and spending cuts.[4] The cuts are equivalent to about 13 per cent of 2010 public expenditure, larger than any retrenchment since the 23 per cent cut of 1921-1922, apart from the exceptional restructuring of some 43 per cent when the economy moved from command to market after the Second World War.

The main cuts are in three areas:[5]

Non-pension benefits, particularly housing benefits and benefits for disabled people. Housing benefits are cut by about 20 per cent and targeted more closely. Child benefit is frozen for two years and removed from higher rate taxpayers, and tax credits are cut. Benefit indexation is reduced by a change in the index used. A restructuring of benefits for disabled people is intended to save one-fifth of current spending in this area. Overall, the benefit cuts will reduce benefit spending by about 15 per cent

1 For a discussion see H. Obinger, P. Starke, J. Moser, C. Bogedan, E. Obinger-Gindulis, S. Leibfried: Transformation of the Welfare State, Oxford 2010, Oxford University Press; P. Starke: Radical Welfare State Retrenchment, Basingstoke 2008, Palgrave; P. Taylor-Gooby: Root and Branch Restructuring to Achieve Major Cuts: The Social Policy Programme of the 2010 UK Coalition Government, in: Social Policy and Administration, Vol. 46, No. 1, 2012, pp. 61-81.

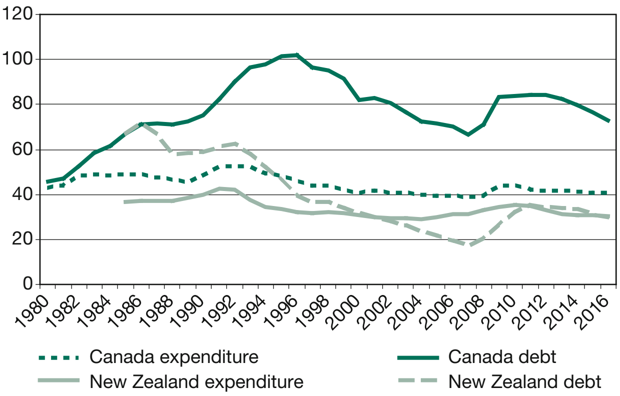
2 B. Vis, K. van Kersbergen, T. Hylands: To what extent did the financial crisis intensify the pressure to reform the welfare state?, in: Social Policy and Administration, Vol. 45, No. 4, 2011, pp. 338-353.

3 HM Treasury: Chancellor's Budget Speech June 2010, http://www.hmtreasury. gov.uk/junebudget_speech.htm (accessed 28 May 2011).

4 Ibid.; HM Treasury: Spending Review, Cmnd 7892, October 2010, http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf.

5 For full details see P. Taylor-Gooby, G. Stoke: The Coalition programme, in: Political Quarterly, Vol. 82, No. 1, 2011, pp. 4-15; N. Yeates, T. Haux, R. Jawad, M. Kilkey (eds.): In Defence of Welfare, Social Policy Association, London 2011, http://www.social-policy.org.uk/downloads/idow.pdf (accessed 28 May 2011).

Figure 1
General Government Expenditure and Gross Debt in Canada and New Zealand
in % GDP



Note: IMF staff estimates from 2010.

Source: International Monetary Fund: World Economic Outlook Database, September 2011, http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/index.aspx.

over four years. There is also a tax increase for those earning over £150,000 a year (about two per cent of taxpayers) and an increase in VAT from 17.5 to 20 per cent. The most authoritative estimate of the impact of tax and benefit cuts indicates that the top decile and bottom deciles will lose about four per cent of income, with less impact on intermediate groups. Older people are relatively protected, and families with children will lose some six or seven per cent of income in these groups.[6]

Cuts in public services. The spending plans maintain expenditure on the National Health Service (NHS), schools and overseas aid in cash terms, and they impose sharp cuts elsewhere, roughly equivalent to one-fifth of the total spending in these areas. However, existing plans for four per cent annual efficiency savings in NHS spending are retained, and education services for pre-school children, those over the school-leaving age of 16, and universities and colleges are cut. Local government, responsible for social care, social housing and other community services, is cut most sharply, losing 27 per cent of central support over four years.

Cuts that impact on public sector workers. In addition to the local government cuts, central government departments are required to make staff cuts of between 20 and 40 per cent. Since the state sector employs a higher proportion of women, these cuts contribute to the rapid increases in unemployment, especially among entrants or recent entrants to the labour market and women.[7] Unemployment rates for men currently stand at 9 per cent and for women at 7.4 per cent. For 18- to 24-year-olds the equivalent figures are 21.4 per cent and 16.4 per cent, all on a rising trend.[8]

How far these cutbacks are likely to become permanent, shifting the UK towards a more frugal welfare system, is unclear. Current government policies envisage a reduction in spending as a proportion of GDP by nearly a fifth between 2012 and 2017, so that the UK would be the lowest state spender among the G7, falling below the USA and Japan for the first time in its history.[9] It would in principle be possible for a future administration to reverse the cuts if money became available. The government has committed itself to reversing the tax increases on a number of occasions. Two factors imply that the spending reductions may be hard to maintain: firstly, opposition parties, trade unions and, perhaps more significantly, the junior coalition partner are beginning to voice more or less forceful resistance as growth projections are revised downwards.[10] Secondly, the cuts are the largest and most precipitate since those imposed in the early 1920s in the crisis after the First World War. The package introduced then led to a general strike and the first Labour government. Various later episodes of cutback are listed in Table 1. In all cases governments failed to achieve lasting cuts, and spending reverted to the longer-term trend level within five to eight years. A programme which hopes to succeed where previous attempts failed is ambitious.

These points suggest that the striking cutbacks in the UK may only prove to be a temporary episode, and that spending will eventually revert to the rising trend of the past decade, driven mainly by demography. However,

6 C. O'Dea: Who loses most from public spending cuts?, Institute for Fiscal Studies, London 2010, http://www.ifs.org.uk/publications/5313 (accessed 28 May 2011); J. Browne: Distributional analysis of tax and benefit changes, Institute for Fiscal Studies, London 2010, http://www.ifs.org.uk/publications/5313 (accessed 28 May 2011); Institute for Fiscal Studies: Green Budget, London 2011.

7 Y. Cooper: Women bear brunt of budget cuts, 2010, http://www.yvettecooper.com/women-bear-brunt-of-budget-cuts (accessed 28 May 2011); Women's Budget Group: The Impact on Women of the Coalition Spending Review, London 2010.

8 Office for National Statistics: Labour Market Statistics October, 2011, Tables A02, A06, http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-222441 (accessed 27.10.2011).

9 Office for Budget Responsibility: Economic and Fiscal Outlook, March 2012, Cmnd 8303, Chart 4.4., http://budgetresponsibility.independent.gov.uk/fiscal-sustainability-report-july-2011/; IMF: World Economic Outlook Database, April 2012, http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx.

10 Trade Union Congress: Call for a Day of Action, 2011, http://www.tuc.org.uk/economy/tuc-20184-f0.cfm; N. Clegg: "Interview with Financial Times", Financial Times, 22 May 2012, http://www.ft.com/cms/s/0/7ab1d982-a42c-11e1-84b1-00144feabdc0.html#axzz1vgcp3QH7.

Table 1

Episodes of Retrenchment in the UK, Current Expenditure, 1921-2010

	Planned (%GDP)	Achieved (%GDP)	Outcome	Comment
1921-2 Geddes Axe	8%	5% by 1925	Local govt spending up 4.6% by 1929	Central cuts out-weighed by 1930
1931 National Government	4%	2.5% by 1933	Made up by 1936	Cost pressures centrally and locally
1975 IMF Loan	5%	1.5% by 1979 (mainly local govt)	Made up by increases during 1983 recession	Mainly local govt
1980-90 Thatcher	"Rolling back the state" 8%	5.4% by 1990	3% made up by 1993	Election spending and 1991 crisis
1993-9 Major/New Labour	3.8%	4% by 1997	Further 1% in New Labour's first years	Made up under New Labour by 2005
2007-10 Brown	1.4% (efficiency savings)	0.4% by 2009	Two-thirds of these service cuts not efficiency savings	Overtaken by stimulus pack-age and coalition programme

Sources: A. Peacock, J. Wiseman: The Growth of Public Expenditure in the UK, 1890-1955, London 1967, Unwin; A. Dunsire, C. Hood: Cutback Management in Public Bureaucracies, Cambridge 1989, Cambridge University Press, C. Hood, C. Emerson, R. Dixon: Public Spending in Hard Times, Oxford 2010; C.H. Feinstein: National Income, Expenditure and Output of the United Kingdom, 1855-1965, Cambridge 1972, Cambridge University Press, http://www.ukpublicspending.co.uk/uk_art19_derivation_of_uk_public_spending_for_1900_1950.html (accessed 28 May 2011); Institute for Fiscal Studies: Green Budget, London 2011, p. 153.

the changes take place alongside a restructuring of provision in health care, education, local services, the employment services, cash benefits and, perhaps more significantly, in the principles that underlie public provision. This is the most substantial series of changes to the structure of welfare provision in the UK since the period of reform following the Second World War. It will make the new system more difficult to unravel for two reasons: any return to the previous framework will be expensive (and that cost will increase over time); also, the changes will empower new stakeholders in provision so that the balance of forces in welfare politics will shift.

Restructuring

Welfare state restructuring in the UK is incomplete, but the main features of the new framework are emerging. These include a deeper division between those of working age and pensioners with regard to entitlement to cash benefits; a move towards much greater use of private (and in some cases third) sector for-profit providers, with the objective of improving cost-efficiency, shifting some responsibility for services away from the state and expanding the sphere of individual responsibility; and a move towards more variegated patterns of provision within the universal services that remain, so that greater differences in levels of service for different groups in different areas become accepted. These changes may undermine solidaristic support for the welfare state.

Cash Benefits

Under legislation currently in process and virtually certain to be passed, pensioners are treated favourably. The first-tier state pension remains universal and protected from cuts and will be uprated by the highest of price or wage indices or 2.5 per cent. This will involve increases in spending on this largest group of cash benefit recipients, partially offset by reduced spending on means-tested support for the poorest pensioners and retirement age increases to 66 by 2018 and then to 67. This reform is expected to reduce the proportion of pensioners below the 60 per cent median income poverty line from 16 to 10 per cent by 2025.[11] Existing plans to introduce voluntary state subsidised private second-tier funded pensions will be continued. Employees will automatically be enrolled into schemes by employers but may opt out.

Reforms to other benefits contrast with pension reforms in their extensive use of means-testing and their emphasis on paid work. From 2013 all cash benefits apart from pensions will be combined into a new Universal Credit in order to produce a simpler means-tested scheme. This includes Job Seekers Allowance, Employment Support Allowance, Housing Benefits, Tax Credits for those of working age and other provisions, but not child benefit. The new benefit will have a lower withdrawal rate against earned income to generate stronger work incentives. Entitlement will be limited to one year for those of working age. Projections by the Institute for Fiscal Studies (IFS) indicate that some 2.5 million families (mainly in the

11 Pension Policy Institute: The Implications of Government Policy for Future Pensioner Poverty, 2011, https://www.pensionspolicyinstitute.org.uk/uploadeddocuments/Events/2011events/20110711_PPI_AgeUK_Pensioner_Poverty_Seminar_writeup.pdf.

bottom six deciles of the income distribution) will gain, 2.5 million will see no change and 1.4 million will lose.[12] This comparison takes as its starting point the stringent cuts in benefits noted above. In addition, the new benefit (as with all benefits apart from first-tier pensions) will be uprated by the consumer price index rather than the retail price index. CPI ignores housing and local tax charges and is highly likely to lower the rate of increase in comparison with average living costs. More recent IFS work indicates that Universal Credit will not offset the increase in poverty resulting from slow growth and the uprating changes. Poverty rates (at the 60 per cent median line) will rise from 19 to 24 per cent for children, 17 to 20 per cent for working age parents and 15 to 18 per cent for working age single people between 2010 and 2020.[13] The emphatic work orientation is reflected in current proposals to require two years in a job to acquire protection rights and imposing fees for access to the industrial tribunal system which adjudicates unfair dismissal.

Disability benefits will be restructured to target resources towards the most severely disabled and channel others into paid work. The Work Capability Test is tightened and contracted out to for-profit agencies, with the intention of removing one-fifth of claimers and saving about £1bn.[14] The Employment Support Allowance is being limited to one year so that those deemed capable of some employment will be moved into work.

Universal Services: Contracting Out to For-profit Providers

The Prime Minister has signalled a "presumption" of "all public services being open to outside providers".[15] The Open Public Services White Paper sets out the principles for the reform: greater choice, decentralisation of provision, competition and the presumption that "wherever possible, public services should be open to a range of providers competing to offer a better service" with fair access and accountability procedures.[16] In practice, policies follow a variant of the new Public Management that involves the contracting out of services to "any willing provider" (in some cases "any qualified provider") with a bias towards commercial providers and a relaxation of responsibilities for government to secure a particular range or standard of provision.

The NHS reforms, currently before Parliament, follow this pattern. The main providers of health services will be local GP practices, run as small business, and managing a devolved £80bn budget to meet health needs within an overall regulatory framework but with many fewer targets to direct their practice. Despite repeated denials by the government, the Minister's responsibility to meet national health needs appears to be removed. The future shape of the service is unclear. There are currently moves by commercial providers, including the provision arms of the large multinational medical insurance firms and European competitors, to sub-contract from GPs. One possibility is a more variegated service with different levels and ranges of provision and priorities between areas. Much will depend on the level at which government is prepared to commit resources to meet the continuing demographic and other pressures.

In education, decentralising school reforms, initiated by the previous government but now massively expanded without funding, are being vigorously pursued. These reforms have the object of achieving a system which effectively takes all schools out of local government control and gives them greater powers to choose among students. Private providers are being encouraged to enter the market. Regulation of curriculum has been reduced, and regulations of teachers' pay, qualifications and conditions of service is also being relaxed in some schools. While school spending has been maintained in cash terms (inflation for 2011-12 was 5.5 per cent), spending on other areas of education has been cut sharply. As a result of relaxation in regulation, which allows hard-pressed councils to divert the money to other uses, funding for the main pre-school programme, Sure Start, has fallen by about half. The same applies to 16-19 college education outside schools. The national scheme of cash benefits to encourage low-income students to continue schooling and training beyond the minimum age (16) has been abolished, and any continuation depends again on the locality. Government funding for higher education has been cut by 80 per cent with the assumption that increased fees of up to £9,000 a year will make up the difference. Current indications are of a ten per cent fall in applications overall (slightly higher among women) and of market pressures forcing radical changes at the less prestigious institutions.

12 M. Brewer, J. Browne, W. Jin: Universal Credit, IFS Briefing 116, 2010, p. 3, http://www.ifs.org.uk/bns/bn116.pdf.

13 M. Brewer, J. Browne, R. Joyce: Child and Working-Age Poverty from 2010 to 2020, IFS Commentary C121, 2011, p. 2, http://www.ifs.org.uk/comms/comm121.pdf.

14 E. Grant, R. Woods: Disability Benefits, in: N. Yeates et al. (eds.): In Defence of Welfare, Social Policy Association, 2011, p. 29, http://www.social-policy.org.uk/downloads/idow.pdf (accessed 27 October 2011).

15 D. Cameron: Public sector revolution, 20 February 2011, http://www.telegraph.co.uk/news/politics/8337237/David-Cameron-promises-public-sector-revolution.html (accessed 28 May 2011).

16 Cabinet Office: Open Public Services, cmnd 8415, 2011, p. 9, http://www.cabinetoffice.gov.uk/sites/default/files/resources/open-public-services-white-paper.pdf.

Non-Universal Services: Cuts and Contracting Out

The most severe spending cuts are directed at local government. These will reduce central support to local government by 27 per cent over four years, affecting pre-school and 16-19 college education, the careers service, local housing and transport, youth work, public health, social housing and, most importantly, care for frail and older people and for children. The communities' budget that supports social housing was cut by 68 per cent.[17] The local government cuts impact most sharply on poorer authorities, so that, in the first year, total spending power will fall by 8.4 per cent in the most deprived decile of single tier authorities, but only by 2.2 per cent in the least deprived. For shire districts, corresponding figures are 8.6 and 5.4 per cent.[18] Price Waterhouse Coopers' modelling shows that the policies will have an overall "negative" impact by region and sector.[19] These shifts have led to service cuts, mergers of provision by councils and much greater use of contracting to private contractors.[20]

The recently completed restructuring of the employment service contains an interesting variant on the use of the for-profit sector. Direct state provision is replaced by contracted private commercial agencies. The contracts pay mainly by results, so that the bulk of the money depends on the claimer holding a job for a minimum period of three to six months. This system is also being trialled in overseas aid contracts. If this method of regulation succeeds, it will open up a new approach to public management in which outcome targets rather than provision standards are key. Whether the contractual obligations will be enforceable in a difficult labour market is unclear.

The distributional impact of these changes is hard to calculate. Welfare state services impact differently on richer and poorer groups, and it is not obvious that their worth is equivalent to the cost of providing them. The official Treasury estimate uses this approach but only includes one-tenth of local services for technical reasons[21] and judges the impact as roughly the same for all income groups. An IFS estimate which includes a much greater range of services suggests that they are highly regressive, doubling the loss to the poorest deciles to about seven per cent over four years as opposed to four per cent for other groups.[22] This compounds the poverty problem mentioned earlier.

The emphasis on the market, for-profit providers and local variation has been offset in presentation by references to the role of the voluntary sector, the value of local people having control over their services and the Big Society: "a broad culture of responsibility, mutuality and obligation".[23] In practice, voluntary activity is small compared with state services, concentrated in particular areas, generally the richer areas of the country,[24] focussed on particular needs (health care and research, schools and youth clubs, religious groupings and overseas aid)[25] and depends in any case on state support.

The third sector is enormously diverse. The five areas of provision closest to the government services which are now being cut back (employment and training, law and advocacy, education, housing and social services) receive more than half their income from government through contracts.[26] In most cases local government is reducing spending on these contracts and on other support.[27] The capacity of the third sector to substitute for government in the current context appears to be limited.

The Restructuring Is Now in Progress

The cash benefit, NHS and education reforms have passed into law and are now being implemented. Local government cuts, employment service and pension changes are achieved by ministerial decision. It appears likely that the moves towards decentralisation and the much greater use of contracts and shifts of responsibility away from ministers for outcomes in services like the

17 Institute for Fiscal Studies, op. cit., Figure 6.4.

18 House of Commons Library: The Local Government Finance Settlement 2011-13, Research Paper No. 11/16, 2011, Tables 4 and 5, http://www.parliament.uk/briefingpapers/commons/lib/.

19 Price Waterhouse Coopers: Sectoral and Regional Impact of the Fiscal Squeeze, London 2010, pp. 2-3.

20 Local Government Association: Funding Settlement Disappointing, 2011, http://www.lga.gov.uk/lga/core/page.do?pageId=16647103 (accessed 28 May 2011).

21 HM Treasury: Spending Review…, op. cit., Table B6.

22 C. O'Dea, op. cit.

23 D. Cameron: The Big Society, Hugo Young lecture, November 2009, http://www.conservatives.com/News/Speeches/2009/11/David_Cameron_The_Big_Society.aspx.

24 F. Lyon, L. Sepulveda: Mapping social enterprises: Past approaches, challenges and future directions, in: Social Enterprise Journal, Vol. 5, No. 1, 2009, pp. 83-94; J. Mohan: Mapping the third sector, Third Sector Research Centre Working Paper No. 62, 2011, p. 7, http://www.tsrc.ac.uk/LinkClick.aspx?fileticket=izLuarcAwMs%3D&tabid=500 (accessed 28 May 2011).

25 National Council for Voluntary Organisations: The Big Society and Sustainable Funding, London 2011, http://www.ncvo-vol.org.uk/sfp/bigsociety (accessed 28 May 2011); D. Scott: "The Role of the Voluntary and Community Sectors", in: J. Baldock et al. (eds.): Social Policy, Oxford 2007, University Press, p. 322.

26 HM Treasury: Spending Review..., op. cit.

27 K. Wilding: Voluntary and community organisations, in: N. Yeates et al. (eds.): In Defence of Welfare, Social Policy Association, London 2011, http://www.social-policy.org.uk/downloads/idow.pdf (accessed 28 May 2011), pp. 32-33; National Council for Voluntary Organisations, op. cit.; C. Woodhouse: Cameron's Big Society takes another hit, in: Evening Standard, 7 February 2011.

NHS will lead to greater diversity in provision. In health care, GPs will be able to decide on priorities and spend state resources to promote them to a much greater extent than at present. Local state schools constituted as separate semi-autonomous agencies will vary in curriculum, staffing and admission policies. Local government services, especially in social care, will depend on different local resources.

Taken together, the reforms constitute a major restructuring of state welfare in the UK and one which would take considerable sums of money and a secure parliamentary majority for a considerable period to reverse. The changes in indexation of working age cash benefits will mean that the extra cost of a restoration to previous levels will increase each year. Perhaps more importantly, the new system introduces a range of new stakeholders into the struggles over state spending. The national and international firms winning contracts for provision of health and social care, employment, education and local government services constitute a powerful lobby. Unravelling the decentralisation of powers would provoke opposition from many party workers spread out across the country and from the firms who will provide the new services locally. Any attempt to reverse the contracted-out system in provision across all services would generate further problems if open market competition law is held to restrict government's capacity to intervene through subsidies which are not equally available to all players. Only an exceptionally strong government with a substantial majority could embark on reversing the current restructuring, and it is unclear how much it would be able to do in the life of one Parliament.

Conclusions

It is unclear at the time of writing how much of the UK government's package or precipitate cuts plus wholesale restructuring will be effectively implemented. The cuts are established policy, and the legislation for restructuring has largely been passed. The questions that now remain are political: how far will opposition to the cuts, as they continue to bite, lead the government to change direction? Poverty and homelessness are increasing, unemployment and part-time working are also rising, and many people feel insecure. The voluntary sector is losing substantial government support. While some businesses are gaining contracts to provide the privatised services, others are losing out as the range of services contracts. More generally, the retail and service sectors are hard hit by the collapse in demand. Beveridge is in process of being abandoned. Whether he can be rescued is at present unclear.