RECASTING EUROPE'S SEMI-SOVEREIGN

WELFARE STATES AND THE ROLE OF THE EU

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1. Introduction

European welfare states are in urgent need of reform. Both external economic conditions and internal societal dynamics pose severe strains to mature welfare states at the beginning of the 21st century. *From without*, international competition and intensified European economic integration are challenging the redistributive scope and de-commodifying power of the national welfare state. *From within*, ageing populations, changing gender roles in labour markets and households, and new technologies in the organisation of work, engender sub-optimal employment levels, new inequalities and exclusion (Esping-Andersen, 1999). While the welfare state must find new ways to manage the adverse consequences of economic internationalisation and post-industrial differentiation, it is still obliged to honour standing social policy commitments in the areas of unemployment and pensions. This trilemma of increased economic exposure, post-industrial risk differentiation, under conditions of mature welfare commitments, seems to have ushered in a period of *permanent austerity* (Pierson, 2001). Hence, we face the challenge of a path-breaking strategy to recasting the welfare effort in order to retain Europe's normative commitments to social justice in a truly competitive knowledge economy. The European Union is made up of highly diverse welfare systems, each with distinct policy legacies and institutional structures. Consequently, their ability to respond to international economic and endogenous social pressures will vary accordingly (Scharpf/Schmidt, 2000).

A core feature of today is that national systems of social protection are becoming increasingly embedded in practices and EU regulation and coordination. The national welfare state reached its full development in the post-war decades, when advanced industrial democracies were still in full control of their national economic boundaries. This is no longer the case. It is fair to say that we have entered an era of *semi-sovereign welfare states* in the early 21st century. Issues of work and welfare since the mid-1980s become ever more intertwined with the Single Market and EMU. Many observers believe that as a result of intensified European economic integration, the basic 'market correcting' functions of Europe's highly diverse national welfare systems are negatively affected. With integrated markets and a single currency, adequately functioning labour markets with proper social protection is no longer a matter just for national governments. The question therefore is not *whether* the European Union has to play a role in social and employment policy, decided by some simple-minded "subsidiarity" test, but *how* it can make an effective and legitimate contribution to the ongoing process of reform in Europe's increasingly semi-sovereign welfare states.

In this contribution, I deliberately focus on the adaptive capacity of the semi-sovereign welfare state. Over the past two decades, under the shadow of accelerating European integration many European states have taken measures to respond to the challenges ahead. Welfare reform is guided by far more than path-dependency, entrenched policy legacies and political inertia. I will highlight (bounded) policy innovation as pervasive features of Europe's semi-sovereign welfare states. The focus on institutional heterogeneity also suggests an altogether more positive view of the prospects for cross-national policy learning than most scholars in the tradition of political institutionalism would have it (Zeitlin, 2003).

My argument is built up as follows. First, Section 2 takes issue with the dominant picture of policy inertia and political immobilism which plagues mainstream comparative social policy. Surely welfare reform offers an example of path-dependent policy change. It is difficult, but it happens. Next, in Section 3, I will try to delineate the problem space of the contemporary welfare edifice, by delineating the twin challenge of economic internationalisation and post-industrial differentiation. After the problem policy implications of economic internationalisation and post-industrial differentiation have been specified, Section 4 turns to stipulating the policy agenda of feasible and fair policy responses in an era of permanent austerity. Next, section 5 highlights the critical contribution the EU can and should play in ongoing processes of recasting Europe's semi- sovereign welfare states. Section 6 subsequently touches on the social policy consequences of the accession of 10 Central and Eastern European countries to the EU. Finally, the closing section offers a normative perspective on the social policy reform agenda in the first decade of the 21st century.

2. Beyond institutional determinism

The welfare state, in the shape and form in which it developed in Western Europe in the second half of the twentieth century, represents a unique historical achievement. Never before in history, as Fritz Scharpf puts it, "has democratic politics been so effectively used to promote civil liberty, economic growth, social solidarity and public well-being" (Scharpf, 2003). Protecting the vulnerable and preventing the disadvantaged from becoming vulnerable lied at the heart of the normative underpinning of the post-war welfare state. This implied, among other things, the expansion of mass education as an instrument for equal opportunities, access to high quality health-care for everyone, together with the introduction of a universal right to real income, in the words of T. H. Marshall, 'not proportionate to the market value of the claimant' (Marshall, 1950: 110). Social citizenship was institutionalised as the key organising principle of the European welfare state, holding out, in the words of T.H. Marshall, a promise of the enlargement, enrichment and equalisation of people's 'life chances' (Marshall, 1950: 107).

Toward the late 1970s, after two decades of expansion, the celebration of the welfare state's economic, social and political success gave way to doubts over the long-term viability of Europe's now mature welfare states. The final quarter of the 20th century has oftentimes been captured as the epoch of the crisis of the welfare state. Since the oil price shock of 1973-74, keywords in the political debate became 'fiscal overload', 'ungovernability', and 'unsustainability'. In the 1980s, with levels of unemployment not seen since the 1930s, the 'prospects for survival' of the welfare state was recognised as poor. Economists singled out the accumulation of perverse labour-market rigidities produced by the welfare state, impeding flexible adjustment, blocking technological innovation, and hampering employment and economic growth in an integrating world economy (OECD, 1981; 1994).

Notwithstanding the dire predictions of the breakdown of the welfare state, which today seems to experience something of a revival, the welfare state survived the recession-prone 1970s and 1980s, suggesting that social security and employment protection were apparently not much susceptible to 'necessary' and 'radical' reforms. Despite the 'irresistible forces' urging for reform, ranging from the new rules of global competition, intensified European economic integration, the new shape of working life, the predicament of demographic ageing, and changing family structures, the European welfare state proved to be, as one leading scholar put it, an 'unmovable object' (Pierson, 2001). As a consequence, students of comparative social policy turned towards explaining the resilience of the welfare state in terms of institutional path-dependency, entrenched policy legacies and political inertia (Esping-Andersen, 1996; Pierson, 1998). Central to this analysis is that reform is difficult because of 'policy feedback' generated by the expansion of social policy commitments (Pierson, 1994). The argument put forward was that social policy areas over the course of post-war era have been captured by pressure groups who, given their institutional self-interests and those of their clienteles were increasingly in a position to resist reform. As these policies shape politics in times of austerity, popular resistance and collective action capture turn the welfare state, in spite of the 'irresistible forces' calling for change, into an 'immovable object' (Pierson, 1998: 541).

Despite their analytical elegance, the empirical foundations of welfare state inertia are shaky. Welfare reform offers an example of path-dependent policy change. It is difficult but it happens. Looking at employment insurance, employment protection and pensions, Tito Boeri (2001) counted nearly 200 reforms in unemployment insurance, employment protection and pensions in Western Europe between 1985 and 1995. Most of these reforms were unpopular, but a fair amount occurred with the consent of opposition parties and trade unions. Surely welfare reform is problematic, because, as Freeman (1995: 17) suggests, 'changes in one aspect of a highly interactive system alter the efficiency of other parts' (Freeman 1995: 17). Rather than 'long-jump adaptation', which are 'impossible to bring about except in a politician's promises' (idem, p. 20), reform involves intelligent sequencing of measures in different policy fields and trade-offs between different interests (Bonoli and Palier 2000; Hemerijck and Schludi 2000; Natali and Rhodes 2003). Going beyond Boeri's attempt to quantify reform endeavours, far more important is the extent that, over the final quarter of the 20th century, developed welfare states of the European Union have been substantively transforming the basic architecture upon which their national welfare states were built after 1945. If we interpret the welfare state more broadly than the mere complex of social protection, it is possible to paint a broad process of self-transformation of the European social model(s) across at least five closely related policy shifts in macro-economic policy, wage bargaining, taxation, social security, and labour market policy.

- In *macro-economic policy*, up to the late 1970s, Keynesian macro-economic policy priorities were geared toward full employment. After the period of stagflation - i.e. the combination of high inflation and rising unemployment - the Keynesian order gave way to a stricter macroeconomic policy framework centred around economic stability and hard currencies.
- Low and behold, the responsibility for employment shifted away from macro-economic policy towards adjacent areas of social and economic regulation. In the field of *wage policy* a reorientation took place from the 1980s onwards in favour of market-based wage restraint.
- Next, as a result of intensified competition across the European Union, in the field of *taxation*, from which the welfare state is in part financed, a change took place. Many member states started to pursue a combination strategy of lower statutory tax rates and a broadening of the tax base. This implies a policy shift away from a focus on vertical redistribution between rich and poor citizens, but not per se, as a consequence base broadening, at the expense of standing welfare commitments.
- Within the sphere of *social security*, the changes in macroeconomic management and wage policy have resulted in a shift from passive policy priorities aimed at income maintainance towards a policy geared towards the activation and reintegration of vulnerable groups. Initially, to this end, benefits were reduced, access to social security was made more selective and social rights increasingly became conditional in nature, based on reciprocal obligations between citizens and the government.
- With respect to *labour market policy*, in due course the new objective became maximising employment rather than induce labour market exit, and this implied new links between employment policy and social security. The new philosophy, with strong

historical roots in Scandinavia, is that the greater the number of people participating full-time and part-time in the labour market, the greater the contribution they make towards maintaining the affordability of adequate levels of social protection.

- Institutionally, the welfare state's state-centric paradigm has given way to the emergence of new forms of "*governance*" beyond the traditional territorial state. Publicly mandated private provision and civil society delivery structures have gained in importance. With this evolutionary change of co-production beyond traditional 'command-and-control' steering, public institutions, like states and EU-regulation have increasingly come to focus on laying the institutional ground rules and social principles shaping multi-level governance.

In brief, welfare reform has over the past three decades become an ongoing concern among all member countries of the European Union. Multiple recessions, critical EMU entrance exams, German unification, and the impending pension crisis in especially continental countries, have been among the more significant triggers behind welfare reform broadly understood. The political image of welfare inertia and political immobilism cannot be corroborated by the available empirical evidence (Scharpf/Schmidt, 2000). As prevailing employment and social policy ran into severe problems of sustainability since the late 1970s, this triggered a dynamic of policy learning and *re-casting* current policy repertoires so as to achieve a better "goodness of fit" with new external economic constraints and edogenous social pressures. The precise policy mixes that have ensued from these reform experiences have not only been critically shaped by past policy legacies and institutional structures of decision-making, but also and more in particular by policy makers' capacity for *innovation*, intelligently using the institutional constraints and policy resources at their disposal (Crouch, 2001).

If we really wish to understand the dynamics, obstacles, and widows of welfare reform, we therefore need to go beyond the limits of mainstream institutional analysis. Traditional political institutional explanations miss out on two crucial dimensions of policy development. First, and irrespective of policy design and prevailing institutional capacities (and power resources), the adoption of substantive reforms is still an act of creative policy choice. Second, policy innovation is often triggered by substantive pressures and vulnerabilities. It is my contention, social learning processes must have an important place in the comparative study of welfare reform (Hemerijck/Visser, 2003). By so doing, we need to bring in the (changing) cognitive frames and normative orientations of policy actors (and the electorate) in their evaluation of mounting internal and external pressures in the policy environment of the welfare state (Scharpf, 1997b).

In most definitions of social learning , the emphasis is on widening of repertoire of potential behaviour, not per se actual behaviour, through information processing, geared 'to detect and correct errors, and thereby to improve the functioning of systems' (Olsen en Peters, 1996: 4). Heclo (1974: 306) defines 'policy oriented learning' as 'relatively enduring changes in thought or behavioural intention that result from experience and/or new information concerned with the attainment or revision of policy objectives'. Hall (1993: 278) broadens 'intention' to 'attempt' in his definition of policy learning as 'a deliberate attempt to adjust the goals of techniques of policy in the light of the consequences of past policy and new information. Learning is indicated when policy change is the result of such a process'. I define learning operationally as a change of ideas or beliefs (cognitive and/or normative orientations), skills or competences as a result of the observation and interpretation of experience. Such ideational changes should be 'relatively enduring' (Heclo 1974:306) in order to count as instances of policy learning (Anderson 1995:4).

For Peter Hall, the principal contribution of a policy learning perspective is that it allow for the study of the role of ideas in politics and policy making. It reminds us that responses to policy problems cannot be adequately explained by pressures on existent institutional structures and policy repertoires. Policy development is shaped by the flow of ideas at the interface between problems and policy responses. Fundamental to the idea of learning is information processing. Information feedback on performance and impending policy problems stimulate processes of policy learning (Hall, 1993). Reform is not simple and instantaneous. Actors need time to update their cognitive orientations and normative views in response to new insights and information. Before policy alternatives are placed on the political agenda, the status quo must be considered unsatisfactory. In real crisis problems can no longer be ignored by decision-makers.

Policy learning perspectives presume actors to boundedly rational solve problems, actively searching for information, gathering new ideas and insights, so as to improve policies or solve policy problems. The world of policy and politics, it is argued, however, hardly satisfies the ideal conditions of a 'learner friendly environment'. Especially, the collective nature of politics, the institutional density of policy making, power asymmetries and the complexity and opacity of politics and policy issues create serious problems for self-corrective policy learning (Pierson, 2000). In an instructive comparison of private and public organizational learning, LaPalombara (2001) stresses the normative dimension that pervades public sector organizations. In the public sector, 'messiness' abounds: purposes are multiple, accountability is dispersed and autonomy is contested. This sets limits to the feedback mechanisms of learning. Policy-makers tend to base their experience on the interpretation of the latest crisis, from which they at best draw the lesson not to repeat the errors they manage to recall from the previous one. Much political learning is of an ever more short-run character, due to, among other things, electoral and budgetary cycles. Finally, when problem spaces are ill defined, solutions tend to be ideologically pre-packaged. Following the logic of the "carbage can", solutions then start to define the problem (Cohen/March/Olsen, 1972).

On the other hand, as politics embodies strife over ideas and best courses of action, a form of learning is always present. Although the indicators of success and failure are often ambiguous and variable, as Bryan Jones puts it:

> Democratic governments clearly respond to information. Elections are the mechanisms than enforce that responsiveness. So long as politicians are "ambitious"- so long as they want to retain office or go on to higher effective office – they will have motive to attend to information flows. Moreover, since most judgements of politicians by voters is retrospective – an evaluation of how things have gone while they are in office – elected leaders have a strong motive to solve problems before they fester and grow (Jones, 2001: 170).

Strong electoral competition, media exposure and citizen participation may contribute to processes of social learning (Dorf and Sabel 1998), since proponents of rival policies will be self-interestedly motivated to find fault with existing policies. And, because re-election is always an uncertain business, politicians have an incentive to pay attention to all sources of information, not only media coverage and the last opinion poll, but also to expert 'policy analysis' and reports from 'think tanks'. The French government has its Commissariat du Plan, the German government receives official forecasts on the economy from five competing wizards, the Netherlands has separate forecasting institutions for economic, social and cultural, and demographic affairs. The European Union habitually works with ad hoc expert committees and so-called 'High-Level Groups' in order to analyse particular policy problems and recommend solutions. Policy analysis takes pride of place in the routine operations of international organizations like the OECD or the World Bank.

Thus far learning dynamics and the role of policy analysis have not been sufficiently integrated in mainstream comparative welfare studies. Both rational choice theory, which dismisses motivation beyond fixed rational self-interests, and institutional analysis, which ignores the dynamics of institutional change beyond sticky regime-dependent scenarios, have shied away from understanding learning dynamics. Taking inspiration from Hugh Heclo

(1974), I see policy making as the outcome of puzzling—diagnosing the nature and magnitude of the problems at hand, setting priorities and identifying potentially effective solutions—and of powering—organising the political and societal support for the selection of particular solutions. Policy reform is not merely ‘a contest for power’ but depends also on ‘playing with ideas’, the extent to which policy actors agree over the cognitive definition of policy problems, and the normative benchmarks for effective policy solutions.

In order to bring social learning back in to the comparative study of the welfare state, surely requires a rigorous understanding of the institutional environment within which puzzling and powering over alternative policy responses, take place. The cognitive reception and the political adoption of novel ideas into policy-making is shaped by various institutional conditions: the strength of societal and political coalitions supporting policy innovations; state traditions and legacies of social concertation; the public status of policy analysis in political decision-making; and the organisational capacities of public agencies to translate ideas into feasible policies.

Two varieties of social learning are especially relevant to the study of welfare reform: domestic trial-and-error lesson drawing and international benchmarking. Domestic trial-and-error lesson drawing, with its roots in post-Weberian organization theory under conditions of bounded rationality, is primarily a corrective, and somewhat insular *inner-directed* exercise, triggered by nationally specific problems of adjustment, based on sharing experience and gaining knowledge among domestic actors. International benchmarking, on the other hand, inspired more by pragmatist social thought, suggests a more exploratory *other-directed* form of the joint observation and scanning of cross-national experience, beyond traditional problems of bounded rationality. International benchmarking has gained in importance and popularity in recent decades, mainly because the pace of adaptive pressures and the scope of international interdependence have intensified dramatically over the past two decades. And with the shift from sovereign to semi-sovereign welfare states in Europe, surely a combination of domestic trial-and-error lesson drawing and learning through international benchmarking is what is called for. The expansion of the repertoire of policy alternatives through international benchmarking can inspire domestic policy makers to reflect on their own policies in new ways. But first we turn to defining the problem space of today’s semi-sovereign welfare states, by isolating the relevant challenges facing Europe’s systems of social protection and employment regimes.

3. The trilemma of economic internationalisation, post-industrial differentiation and permanent austerity

To contend that Europe's mature welfare states are not per se immobile is not to say that they are in good shape. They are not. Both external economic conditions and internal societal dynamics pose severe strains to mature welfare state at the beginning of the 21st century. *From without*, international competition and intensified European economic integration are challenging the redistributive scope and decommodifying powers of the national welfare state. *From within*, ageing populations, changing gender roles in labour markets and households, and new technologies in the organisation of work, call for a path-breaking effort to further recalibrate prevailing national and European policy repertoires.

The constraints of economic internationalisation

Many academic observers believe that the rapid process of economic internationalisation - the increase in cross-border competition in the markets for money, goods and services – has substantially reduced the room for manoeuvre of national governments (and social partners) with respect to its 'market correcting' and stabilisation functions of social protection and labour market policy. In the wake of the liberalisation of capital markets in the second half of the 1980s, the regime of so-called 'embedded liberalism' (Ruggie, 1982) gave way to the integration of international product and capital markets, whereby which capitalist firms have increasingly been able to escape from national political control. High level of international economic exposure is believed to create serious pressures for cutting social expenditures. Moreover, the internationalization of capital markets since the early 1980s have made national governments particularly fearful of capital flight to less taxing regions.

Under the spectre of the intensification of economic internationalisation since the early 1980s, domestic economic borders have become more open. In the EU, the introduction of the European Monetary Union (EMU) has taken away the instruments of national exchange rate and interest rate adjustment. Moreover, the Stability and Growth Pact (SGP) forced member states to commit to budgetary discipline within the constraints of 3% for the deficit and 60% for the debt (as % of GDP). While the Monetary Union inaugurated a more stable economic environment, and has led to a more closely synchronised EU business cycle. For national governments presiding over expensive welfare states, European economic integration increased the difficulties of managing the national economy, regulating production processes, and financing social transfers and public services.

In the wake of the 2004 enlargement of the EU with 10 Central and East European (CEE) countries there is a common fear that low living standards and high unemployment in the CEE member states may lead to increasing migration flow to the old EU-15 member states, which is likely to destabilize the proper functioning of labour market in the West and hamper economic growth in the East. Several EU-15 member states have implemented temporary restrictions against free labour migration from the CEE member states.

The leading comparativist Fritz W. Scharpf fears that increased economic efficiency brought about by economic internationalisation will, following the pervasive logic of 'market-making', undermine the 'market-correcting' functions of national welfare states. There is, for one, the danger of tax competition in the open economy, leading to an under-provision of public goods (Genschel, 2001). In order to attract and preserve capital, countries like Ireland may feel pressed to provide advantageous taxation and/or regulation for internationally mobile firms. Other countries will follow suit, which in the end will cause a lower level of taxation and regulation than was previously found appropriate. Such developments would in the long severely jeopardise current systems of social protection (Tanzi, 1998). And there is also a real danger that competition between companies could lead countries into perverse forms of policy competition between the member states, like unfair 'beggar thy neighbour' labour-costs competition, with particularly adverse consequences for those member states with high standards of labour market regulation and social protection.

The challenge of post-industrialism

Many scholars who study the viability of the welfare state from the angle of the constraints imposed upon mature welfare states by economic internationalisation and European economic integration economic internationalisation, tend to ignore the fact that a great number of new social policy problems are endogenously created in our post-industrial societies. The leading Danish political economist and sociologist Gosta Esping-Andersen places great weight on internal pressures, ranging from skill-biased technological change, innovation in work organisation, the rise of the service economy, changing gender roles in labour markets and households. population ageing and declining birth rates (Esping-Andersen, 1999).

The post-war welfare state catered after the industrial risks of unemployment, sickness, disability, and old age largely through social insurance, based on an intimate tie to standard employment relationships. Today, however, the conventional type of household with a male breadwinner has become an anachronism and the one-and-a-half earner household the new norm. Post-industrialism has given rise to new and increasingly more differentiated social risks, varying from skill deficits and career breaks. Technological innovation and changes in the organisation of labour have contributed towards more flexible labour patterns. Those most in need of education and training, the elderly and poorly educated, receive the least and consequently end up even more exposed to the risk of (long-term) inactivity and poverty.

Many of the so-called 'new social risks', like family formation, divorce, the elderly becoming dependent on care, declining fertility, and accelerating population ageing, it should be emphasized, have little to do with the labour market contingencies. According to Esping-Andersen, the most important reason why the existing systems of social care have become overstretched stems from the weakening of labour markets and family households as traditional spheres of welfare. Families are becoming smaller and people grow ever older, while taking earlier retirement and consequently drawing more heavily on pension arrangements and healthcare. Citizens are also more often, and for longer periods, going through life by themselves (in some cases with children). The heightened instability of the traditional family has increased the risk of child poverty, while increased labour force participation by women means less care in the family.

Traditional post-war social policy was predominantly concerned with income transfers, less so with social services. The welfare risks of the post-industrial economy are, however, based around a growing need for family services (child care and care for the elderly) rather than income compensation: not only because the income position of the elderly is nowadays relatively good and secure, but because ageing and longevity make demands on professional care that working families cannot or are no longer able to meet. Despite women's new biographies, the driving force of service employment growth, social policy programs in many European welfare states remains encapsulated in the breadwinner model designed in the post-war decades (Daly, 2000). Women continue to bear most of the burden of reproducing and caring for the next generation and the older generation (Orloff, 2002). Future welfare state sustainability continues to rely on women's willingness to reproduce the next generation and have children. With double earner households increasingly becoming the new norm, this may however create greater family instability and perhaps also provoke an undesirable low-fertility equilibrium.

A new social risk that deserves special attention is child poverty – which, together with lone motherhood, is on the rise in many countries of the European Union. Child poverty, unlike poverty among the aged, has long-term negative consequences as it often translates into less education and inferior cognitive skills, with the likely effect of low pay and high vulnerability to unemployment in post-industrial economies. In short, the new social risks of family and working life bear primarily on young people and young families, signifying a shift in social risks from the elderly to the young.

The predicament of permanent austerity

As economic internationalisation and post-industrialism have largely come in tandem, it is difficult to measure the relative weight of these two sets of external pressures and internal challenges. Both are associated with a profound shift in the problem load of the welfare sate today. Together, the twin challenge of post-industrial differentiation and economic internationalisation seem to have ushered in a period of *permanent austerity* (Pierson, 2001). Ever since the early 1980s, fiscal and budgetary pressures have lead to numerous reforms and reorganisations in welfare state arrangements. Ongoing changes in the world economy, the large standing commitments of mature social programs, in the face of the new social needs of working families, generate immense fiscal stress. The maturation of welfare commitments, policies put in place to cater after the social risks associated with the post-war industrial era, crowd out the available policy space for effective policy responses to new post-industrial social risks. The popularity of old programs, the requirement to maintain international competitiveness, under conditions of fiscal pressures, hinder more pro-active reform endeavours in an age permanent austerity. Even when policy makers recognize the need for more fundamental processes of welfare recalibration, the broad popularity of standing programs and interest group capture make substantive reform highly unlikely, as this will be met by fierce popular and professional resistance (Pierson, 1998). This spectre of permanent austerity is not likely to subside. If anything, austerity is likely to intensify in the face of population ageing.

4. From diagnosis to policy responses

When we move the debate on the future of the European welfare state from the role of problem diagnoses into the realm of the policy implications, it is crucial to emphasize at the outset that any recourse to patent policy solutions, like reducing labour supply via early retirement and disability pensions, is utterly misguided. On the other hand, European welfare states continue to retain deep reservoirs of popular support. In the face of conditions of permanent austerity, many observers agree that this tug of war between popular expectations and harsh economic realities will privilege “a politics of blame avoidance in which cutbacks can take place only through incremental and surreptitious mechanisms of retrenchment or during moments of extraordinary fiscal stress and political consensus”, in the wake of severe social conflict across Europe in first decades of the 21st century (Clayton/Pontussen, 1998: 68). By the same token, however, reasoning from a boundedly rational learning perspective, the combined pressures of economic exposure, new social risks, and fiscal duress, could just as likely positively destabilize deeply held policy paradigms and institutionalized rules of procedure, with the result of progressively opening up new ideas over work, welfare and sustainable social inclusion. By intelligently banking on the large support basis for inclusive social policy, ideational change could in turn stimulate more pro-active search processes for a more viable, fair and feasible, new welfare architecture in times of economic internationalization, post-industrial differentiation, and permanent austerity. From this perspective, the crucial challenge is ultimately one of *agenda-setting*. Here I summarize a policy agenda for recasting Europe's semi-sovereign welfare states along seven priorities (Hemerijck/Schludi, 2000; Ferrera/Hemerijck/Rhodes, 2000; Esping-Andersen et al, 2002):

- Robust but flexible macroeconomic policy;
- Responsive wage bargaining;
- Social inclusion through employment;
- Investing in skills;
- Flexicure labour markets;
- Later and flexible retirement;
- Active servicing.

Robust but flexible macroeconomic policy

Price stability and budgetary discipline have become key elements of any sustainable macroeconomic policy in open economies. In an environment of free capital movement, low inflation and budgetary discipline have become necessary, but not sufficient, background condition for a stable economy. Persistently high public deficits and inflation rates are undesirable in themselves and incompatible with global financial markets. Moreover, high public deficits increase the debt burden of the state. As a result, the room for fiscal manoeuvre may become seriously constrained as interest payments on public debt rise. This is why I believe that the EMU fixed exchange rate regime is not necessarily incompatible with welfare state sustainability and may indeed enhance it. EMU, far from being a threat, as Ton Notermans (2000) argues, has provided European countries with a favourable institutional set up for avoiding in the future the main problem that threw their welfare states into crisis in the 1970s and 1980s – their inability to prevent inflation in tight labour markets. In principle, this allowed social democratic parties, back in power in most European countries in the second half of the 1990s, to underpin a new growth-oriented macro-economic policy with a new redistributive bargain, without the fear that this project would be undermined by uncontrollable wages and price spiral which western Europe experienced in the 1970s. In addition, a relatively strict fiscal policy helps to bring down interest rates, which (over time) may stimulate the economy, reduce the public debt burden, and strengthen the confidence of consumers and potential investors in the economy. This has already happened in some of the most chronically indebted European states, of which Italy is the prime example

(Ferrera/Gualmini 2000). Moreover, if the structural budget deficit is low on average there is more leeway, like in a number Scandinavian countries, to activate the stabilizing function of fiscal policy in periods of low economic growth.

This is not to say that the framework of EMU and the Stability Pact already provides for a stable macro-economic regime for the European economy. There are in fact two (let us hope temporary) flaws in the architecture of EMU which become visible in adverse economic times. European Monetary Union and the Stability Pact came about in a situation of strong economic growth in the European member states during the 1990s. Under the Growth and Stability Pact, an unduly limited budget deficit threshold of 3 percent of GDP (for three successive years) was adopted for the purposes of national fiscal policy. The Pact furthermore stipulated that the members of the Euro-zone were not allowed have a government debt of more than 60% of GDP. The key problem is that regime of EMU and the SGP does not do justice to the differences in economic circumstances across the member states. The European Central Bank (ECB) set interest rates in accordance with European-wide averages and development in the trade cycle, rather than nation-specific shocks. The architects of the SGP rightfully wished to discipline spendthrift governments, taking a free ride of EMU's low interest rate policy, thus punishing countries with sound fiscal policy with relatively high interest rates.

Today, five years after the introduction of the euro, in Germany, France and Italy, the agreements to which the member states committed themselves under the Stability Pact are being observed less strictly than agreed to in the mid-1990s. Although fiscal discipline is in the self-interest of member states, it is nonetheless understandable (and up to a certain point even advisable) for governments to resort to anti-cyclical fiscal and budgetary measures when faced by a severe economic headwind. Inconsiderate and bold reforms of labor market regulation and social protection in a downturn stifle the market and is likely generate social unrest. And once a recession hits it is already too late to tinker with employment regulation and social protection. Then again, it should not be forgotten that social security provisions like unemployment benefits have specifically been designed to act as an automatic anti-cyclical economic stabilizers in a downturn. The policy lesson that can be drawn from the recent experience with the EU's macroeconomic policy regime is that domestic fiscal policy should resume to play a key role in the economy. Stability is a must, but a little more flexibility is called for, with possibly higher country-specific deficit thresholds. Perhaps new rules should be targeted more at the structural deficit and/or the pace of debt reduction.

Responsive wage bargaining

Since the early 1980s, wage restraint resumed importance as a requirement for successful adjustment by facilitating competitiveness, profitability, and - as a second-order effect - employment. As it lowers wage costs, wage restraint not only helps to boost competitiveness in the exposed sector, it also creates room, albeit indirectly, for job growth in private services. The remarkable resurgence of social pacts began in the Netherlands with the 1982 'Wassenaar' accord, followed by the 1992 'New Course' agreement and the 'Flexicurity Accord' of 1996. Denmark established more informal norms of wage moderation under the D-Mark zone in 1987. Finland followed suit with the 'Stability Pact' of 1991. Ireland embarked on a series of tripartite accords in the late 1980s, beginning with the 'National Recovery' accord in 1987 through to the 'Partnership 2000' agreement reached a decade later (Hardiman, 2000). In Italy, the first pact was the 'National Agreement' on the *scala mobile* in 1992, followed by the pension reform in 1995 and the 'Social Pact for Growth and Employment' of 1998. In Portugal a number of agreements were reached throughout the 1990s (without consent from the largest union). In Spain important agreements include the 'Toledo Pact" of 1996, and the 'Stability of Employment and Bargaining Pact' of 1997 (Rhodes, 2001).

The new generation of social pacts in Europe, aimed both at strengthening national competitiveness and the promotion of social cohesion, have extended the scope of collective bargaining and industrial relations in at least four respects. First, most social pacts agreed to over the 1990s have been linked in recent years with wider packages of negotiated reform to labour market regulation, adjustments social security and pensions and taxation. The rediscovery of a jobs-intensive growth path in the Netherlands, Ireland and Denmark, by way of social pacts, played a significant part in shaping the political conditions for social security and labour market policy reform to 'make work pay' together with the introduction of mandatory contributions to occupational pensions.

Second, the introduction of EMU has played a critical role in the resurgence of national social pacts aimed at ensuring welfare state sustainability (Fajertag and Pochet, 2000; Ebbinghaus and Hassel, 1999). Especially for hard-currency latecomers, like Italy and Portugal, and Greece, the EMU entrance exam helped to rekindle co-operative, positive-sum solutions (Cameron, 2000). While the architects of EMU expected in theory that monetary integration would offer legitimacy to labor deregulation and welfare retrenchment, in practice EMU reinforced the need to co-ordinate the rewards to be gained from monetary integration. Forced to abide by the euro-zone, in the face of widely varying levels of productivity and external liabilities, domestic labour market organisations capable of providing minimal co-ordination at national level have proved to be vital. European monetary integration thus seem to have rekindled the urge to find co-operative, positive-sum solutions to the predicament of adjustment – among which initiatives to make taxation and social protection more 'employment friendly' have figured prominently. Social pacts thus provided, as Colin Crouch infers, 'a functional equivalent of devaluation when the latter in no longer available' (Crouch, 2002).

Third, the new generation of social pacts rely on two-tier wage bargaining process: general agreements at the central level and special agreements at the decentralized level. This means that wage moderation is combined with the establishment of parameters within which decentralized collective bargaining can be conducted at firm, industry, region, or even individual plant. The Danish, Dutch, as well as the Austrian experiences suggest that two-level wage bargaining systems, placing sectoral or decentralized negotiations within the confines of a broader national framework accord, are comparatively successful in combining macroeconomic objectives with micro-level flexibility.

Fourth, in terms of substance, the resurgence of social pacts in two-level systems have allowed sectoral bargainers to strike decentralized deals over productivity, training, and job opportunities for less productive workers (Pochet, 1999). The old corporatist exchange logic of the Keynesian era more or less relieved employers to a large extent of the responsibility to invest in human capital. Under the new generation of social pacts, firms seem to be assuming a greater responsibility for human resource management, employability concerns and changing employee preferences require flexible working-time arrangements, including periods during which work can be combined with training, education, or family care. Decentralized bargaining under the spectre of central agreements is increasingly focusing on the these qualitative conditions. Hereby the related income risks are being internalized through collectively agreed risk management arrangements, for instance training or pension funds.

Social inclusion through employment

With the erosion of the 'standard labour contract', the borders between gainful employment and other (productive) activities have become increasingly blurred. The erosion of the standard employment relationship is reflected in the increasing diversity of working times and in the increasing variability of employment relationships. The immediate impact of the growing number of dual-earner families is the combined pressure of paid and unpaid working time, especially among women. Raising female participation in the labour market is not merely an issue of gender equality, but also of social justice and economic effectiveness

(Orloff, 2002). The best response to child poverty is for mothers to work, which is coupled with a greater need for childcare.

Contemporary policy fashion emphasises gainful employment as the axial principle of effective citizenship (Clasen, 2000). This is also the key message of the report *Jobs, Jobs, Jobs* of the report of the Employment Taskforce, established by the European Commission and chaired by the former Dutch prime-minister Wim Kok (2003). The new objective is to maximise employment rather than induce labour force exit, and this implies new links between employment policy and social security. Often captured in terms of a shift from a 'passive' to an 'active' welfare state, we observe a shift from an emphasis on *protection from the market*, providing people with a replacement income in the case of old age, unemployment, childcare, illness, and so on, towards an emphasis on *labour market (re)integration* in an open, skill-biased, economy on the supply side. Increasingly, the underlying normative philosophy is one of reciprocal obligations. Welfare recipients must be obliged to accept employment or training in order to receive benefits, while the state has the obligation to enhance the employability of benefit claimants (Lødemel-Trickey, 2000).

Offering personalised services to the unemployed at an early stage, with the help of local partnerships, is crucial. For this reason, public employment services (PES) across the EU have lost their placement monopoly in almost all countries, and although private placement agencies have still not gained much market share, they have at least pushed the PES further towards modernizing their service delivery. More special attention, however, should be given to labour market problems of migrants and non-EU nationals, whose rate of unemployment is on average twice that of EU nationals. Skills, cultural and language barriers together with discrimination call for real improvement in integration policies, including access to social citizenship.

Flexicure labour markets

The future world of work requires not only 'making work pay' but also – and maybe even more crucially – 'making transitions pay'. Transitional labour market theory suggests that risks should be classified according to the critical transitions that occur during the life course. A mutually supportive system of social protection and employment policies, therefore, would have to find institutional responses to five types of risks. To institutionalise a broad opportunity set of mobility for both men and women in order to maintain employability in critical phases of the life cycle. Reasoning from a life-course perspective, Schmid and Gazier, identify five labour market transitions that should be supported with specific policies: (1) transitions between education/training and employment; (2) transitions between part-time and full-time dependent employment, or between dependent employment and self-employment, or combinations of the two; (3) transitions between (usually unpaid) private or family-based activities and paid work; (4) transitions between unemployment and employment; and (5) transitions between periodic incapacity for work and employment, as well as flexible transitions from work into retirement. The institutionalization of 'transitional labour markets' establishes stable 'bridges' linking all forms of productive activity and facilitating mobility through, for instance, special drawing rights (Gazier/Schmid, 2004).

The open economy and post-industrial societies require more labour market flexibility in terms of work patterns, wages and working time. Flexible working hours are often a requirement for family friendly employment, and there is a clear relation between the ratio of part-time jobs and female employment growth. But the ability of part-time employment to harmonize careers with family depends very much on regulation, whether part-time work is recognised as a regular job with basic social insurance participation, and whether it offers possibilities for career mobility. Part-time solutions may promote a better use of human resources within firms, but also welfare improvements for workers and their families. An effective employment policy must reconcile flexibility with minimal precariousness. There is no inherent contradiction between the objectives flexibility and security. To the contrary, acceptance of flexible labour markets is enhanced if matched by strong social guarantees. This is the essence of the idea of flexicurity, combining flexible labour market regulation with basic security for flex- workers, while relaxing employment protection for core workers (Barrell/Genre 1999). The promotion of greater gender equality and equity and the development of 'flexicure' labour market based on diverse household arrangements, lifetime working patterns and career changes is however central to the strategy of social inclusion through employment.

For the same reason, while systems combining restrictive dismissal protection with meagre unemployment benefits essentially cater to the interests of insiders, systems based on minimal job protection but offering decent standards of social protection for the unemployed bridge the gap between insiders and outsiders more easily. In this respect the Danish and Dutch strategies are clearly superior to their functional equivalent in the Mediterranean countries. Lower standards of protection against dismissal affect overall employment levels only a little, since a more rapid rise in employment during an economic upswing is likely to be outweighed by a faster cutback in jobs during a downturn. But long-term unemployment with its highly undesirable hysteresis effects might well be kept at a more modest level than in countries with high and rigid standards of employment protection (OECD 1999).

Investing in skills (is necessary but not enough)

There is a marked tendency of large scale shedding of low-productivity work, resulting in an ever widening resultant gap between 'insiders' with stable jobs, and 'outsiders' who become ever more dependent on the provisions of the welfare state. If Europe wishes to be competitive in the new, knowledge-based society, there is an urgent need to invest in cognitive capacities. Everyone's favourite solution is of course education. Cognitive skills and competencies are becoming more important in the open post-industrial economy. The notion of the 'knowledge society' fits in neatly with all sorts of political images spanning the full political spectrum. If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, they can assume the role of a 'productive factor'. The revitalisation of the Irish economy is in part based on increased investments in education. The same is true for Finland. However, in other countries the consensus over life long learning however begins to weaken as soon as it comes to practical problems of funding, implementation and the division of roles between the public and private sectors (Crouch et al, 1999). In theory, a significant investment programme in human capital could both improve economic efficiency and help narrow the gap between the well educated and the poorly educated.

Although there has been an increase throughout Europe in the percentage of firms offering training and the percentage of employees being given training, most of the training is concentrated on younger employees who have already had some or considerable training (Esping-Andersen, 2002). The human capital push will always arrive too late for the present cohorts of the poorly educated: it takes years, if not a generation, for investments in education to bear fruit. However important the knowledge economy may be for the preservation of high-grade employment and competitiveness in the open sectors, in terms of employment growth no miracles are to be expected of the 'learning society'. Already there is a growing group of children and poorly educated employees who find themselves at a disadvantage, due for example to the lack of day-care facilities, the lack of support for young families and school dropout. Education at a later age is unable to compensate for these deficiencies.

If employment is taken as the primary objective of government policy, the education and training offensive will need to be supplemented by policies aimed at the growth in demand for unskilled and semi-skilled labour in the social sector and in personal services. Demand for low skilled workers can be raised by extending work-conditional benefits and/or reductions in social security contributions. Different strategies are appropriate to different welfare states. In the United Kingdom, where income guarantees and unemployment benefits are modest, individual tax credits to support low-wage workers and their families are very popular. In Continental Europe, the main problem is that heavy social contributions price less productive workers out of the market. Hence, reducing fixed labour costs is an appropriate way to stimulate jobs. Targeted wage subsidies are seen as a means to spur job growth without, at the same time, accepting American style inequalities. In the face of demographic ageing, everyone is needed.

Recasting the generational contract

Increasingly it is understood that demographic ageing constitutes one of the most pressing policy problems throughout the European Union (Clark/Whiteside, 2003). In the area of *pension policy*, the challenge lies in how to allocate the additional expenditures that inevitably accompany population ageing. In the 1990s, a number of countries, notably the Netherlands, France, Portugal, Ireland and Belgium, have started to build up reserve funds in order to maintain adequate pension provision when the baby-boom generation retires. A variety of measures have been adopted in Finland and Italy and elsewhere in order to strengthen the actuarial link between contribution and pension benefits. Also changes in indexation rules have helped to reduce pension reliabilities. In Southern Europe, restriction have gone hand in hand with attempt to upgrade minimum pension benefits, as evidenced in the Spanish ‘Toledo Pact’, mentioned above.

There is almost unanimous agreement that pension reform must be coupled to employment policy (Schludi, 2001). Discouraging early retirement is crucial. Sustainable pensions will be difficult to achieve unless we raise employment rates of older workers. Two trends justify an adjustment in our thinking about retirement: a) the health status of each elderly cohort is better than that of the last; at present a man aged 65 can look forward to a further 10 healthy years. And, b) the gap between old age and education is rapidly narrowing, so that old people in the future will be much better placed than now to adapt in the coming decades with the aid of retraining and lifelong learning. In this respect, the termination of the tax incentives favouring early retirement and pre-retirement schemes is necessary first step.

Policy makers now advocate ‘active ageing’ as an alternative to early retirement. The idea is to keep older people in the work force by measures that make it possible to combine work and retirement, with tax allowances in Denmark, partial pension benefits in Belgium, and the promotion of work ability and employability in Finland. In the light of the growing demand for lifelong learning and the growing tension in harmonising work and family commitments, and given also the greater risks of career breaks, a combined strategy would logically also provide for more flexible leisure arrangements in the course of people's careers. Examples might include actuarially-neutral ‘leave’ entitlements, giving people the right to make use of time saved up in the course of their active career. Flexible retirement and the introduction of incentives to postpone retirement could greatly alleviate the pension burden.

Since the adoption of several action programs in the 1990s (notably the 'Respect for the Ageing' program and the 'National Age Program'), Finland has developed policy approaches directed towards improving occupational health, work ability and well-being of ageing workers, in order to keep older workers in the workforce as long as possible (Ilmarinen, 1999). In November 2001, the Finnish social partners came to an agreement on an far-reaching reform of statutory earnings-related pensions, including flexible retirement, allowing workers to retire on an old age pension between 62 and 68 years of age. This plan includes substantive incentive to postpone retirement: if taken at the age of 62, the old-age pension will be reduced, whereas a substantial bonus is introduced for those who retire beyond the age of 63 (Gould/Saurama, 2003). Still, most welfare states have thus far abstained from more proactive policies to raise the employability of older workers and to counter widespread age discrimination of employers. Many studies show that the ideal of gradual or flexible retirement currently faces many impediments. Although there has been a slight increase of part-time work among the elderly, and although it has been shown that part-time work and participation rates among older people are positively related (European Commission, 1999), there is still little systematic and comprehensive policy activity to enhance the variable opportunity set for older people. If the goals agreed upon at the Lisbon summit (2000) in terms of labour force participation, for the year 2010, were to be realised, this would have beneficial effects on the long-term financial sustainability of Europe’s pensions systems with lower scores on income inequality and poverty.

From income compensation to servicing welfare states

Within the EU, there is extensive unmet demand due to budgetary constraints in health, childcare, eldercare, and education. Recently the quality of *(public) social services* – e.g. education, health care and public housing – has become the subject of political attention in an ever-growing number of countries in the European Union. Greater differentiation in household and employment relations, as a result of economic internationalisation, skill-biased technological change and post-industrial differentiation, increases the demand for diversity in the delivery of public services in housing, child care, education, health care and employment services, and so on. And while economic internationalisation increases the costs of welfare taxation, ageing is likely to raises the demand for public provided social services, especially in health care, in a period with slower projected economic growth. Together tight budgets and diversified demand make it increasingly difficult for governments to apply typical uniform rules and procedures and regulations to welfare provisions. The inevitable failure to deliver diversified public goods and services in turn triggers popular discontent with the public sector. Popular discontent with the overall quality of public social services and the mismatch between supply and demand for publicly provided goods in most European welfare states is threefold: First, too little is invested in public services, it is agued, in part due to permanent austerity constraints. Second, administrative processes in public service provision are hopelessly old-fashioned, particularly when compared with private service management. Third, the level of provision does not measure up to the diversity of needs of individual citizens in Europe's increasingly multicultural societies. Heterogeneity raises the demand for diversity, which traditional public sectors fails to deliver. Hence, the need for policy change and innovation and experimentation with new forms of public and private service provision in child care, education and training and professional care for the elderly.

As women still form a labour reservoir in most European countries, especially on the continent, family services should be assigned the highest priority as the basic point of departure for policy. The best strategy for guaranteeing the sustainability of pensions in the long run is to increase labour force participation (Hakim, 2000). This is after all a win-win strategy: the welfare of families is strengthened, the costs of ageing are kept under control and the productive and financial base of the economy (including the tax base for welfare state) is consolidated. Europe has seen an enormous increase in the leisure time enjoyed by its citizens, the bulk of it concentrated in old age. Flexible retirement expands individual freedom of choice as to when to stop work, but postponed retirement presupposes less leisure.

Of major importance is of course intensive training for those lacking education. Poverty, uncertainty and the lack of opportunities in large families are significant obstacles towards the development of children and their future productive capacities. Social services needs to ensure that resources for children enable them to maximise their learning capacities. The emphasis on early childhood development goes *beyond* the idea that childcare is necessary to parents to reconcile work and family life. It strongly suggests that quality childcare is needed to ensure that children will be life-long learners and strong contributors to their societies. But this is not enough. Stimulating of the demand for low skill jobs is perhaps equally important.

In Scandinavia the expansion of services to families began in the 1970s in tandem with the rise in female labour supply. It was in large part this policy of 'de-familialization' of caring responsibilities which catalysed the dual-earner norm. In most other European countries, female employment growth has come somewhat later. In Southern Europe it is only during the past decade that we see a sharp rise. Recent policy in the Netherlands seeks to expand childcare through the organisations where parents are employed. The Netherlands now has the highest rate of firm-provided and privately subsidised day care. While this shows that childcare does not necessarily need to be provided by the government, the problem is that private provision is generally limited to high skilled and full time workers. The ambition of the so-called National Childcare Strategy in the UK, on the other hand, is to establish childcare facilities in every neighbourhood. Workers receiving Working Family Tax Credits (usually low skilled and low paid workers), are credited 70 per cent of their childcare costs.

Investing in social services has a price. However, medium-term gains very likely outweigh the initial costs. For one, it should not be overlooked that investment in (public and private) social services provides additional job opportunities, especially for women, while raising the quality of the work force. New jobs, second, support economic growth and bring in additional tax revenues, and thereby contribute to sustainable welfare policies. Third, the availability of good childcare facilities is essential to early childhood cognitive development, with positive effects throughout the life cycle.

5. The contribution of Social Europe

The democratic legitimacy of the European welfare state states is closely associated with the historical achievements of national social policy. The national welfare state reached its full development in the post-war decades, when advanced industrial democracies were still in full control of their national economic boundaries. This is no longer the case. Issues of work and welfare since the mid-1980s become ever more intertwined with the Single Market and EMU. With integrated markets and a single currency, adequately functioning labour markets with proper social protection is no longer a matter just for national governments. As such, the European Union is no longer a “single purpose” economic intergovernmental institution. The question therefore is not *whether* the European Union has to play a role in social and employment policy, decided by some simplistic “subsidiarity” test, but *how* it can make an effective and legitimate contribution to the ongoing process of recasting Europe’s now semi-sovereign welfare states.

The new policy environment of the internal market, EMU and the Stability and Growth Pact, require EU social policy coordination. This is not a simple matter of compensating for the functional loss of sovereignty of the national welfare state through European social policy integration. Social and economic policy coordination can be broadly characterized along two dimensions. First, there is the relevance of cross-border risk pooling through binding legislation against unruly competition. Second, in its central role as an agenda setter, the EU can help diagnose the nature and magnitude of the fundamental challenges and new social risks facing European citizens and help identify of potentially effective policy solutions to the twin challenge of economic internationalization and post-industrial differentiation. Although the relationship between these two dimensions of EU policy coordination goes beyond mere overlap and co-existence, in the academic debate over the future of "social Europe" these two forms of policy coordination are more often than not seen as *alternatives*, rather than *complements*. Moreover, a majority of EU social policy scholars claim that "hard" legislation and cross-border risk pooling, is superior to more open-ended 'agenda setting' forms of policy coordination. Lacking real sanctions, soft agenda setting is deemed to be futile. Even worse, soft law is believed to eventually crowd out hard policy coordination. I take issue with this widespread scepticism against more open-ended, agenda setting forms of governance in the area of EU social and employment policy. Recent advances of social Europe along the tracks of institutional flexibility, I contend, should be welcomed as a *complementary layer* of EU institutional design.

The double bind of social Europe

Many leading scholars, most notably Wolfgang Streeck (1995), and Fritz Scharpf (1999; 2001), have argued that the Single Market, the introduction of EMU, in the wake of successive rounds of enlargement, are exemplar of an overall tendency of 'uneven growth' between the EU's economic and social policies. The latter, market-correcting 'positive integration' has been unable to keep up with the market-expanding logic of 'negative integration' - "the removal of tariffs, quantitative restrictions, and other barriers to trade or obstacles to free and undistorted competitions"(Scharpf, 1999: 50-52). Already with the loss of national exchange rate and interest rate policies from EMU and the accompanying budgetary restrictions of the Stability and Growth pact, member states have seen their capacity to maintain the high levels of social protection severely curtailed. In a more indirect manner, European regulation in the sphere of the internal market (competition; free movement of persons, goods and services) are increasingly applied to the management of welfare provision in the field of health care and education, forcing member states to distinguish more clearly between government and market solutions, thereby further limiting the room for manoeuvre of member states in managing social programs. In the longer run, Scharpf and others argue, European economic integration is likely to undermine the basic foundations of Europe's mature national welfare states. From this pessimistic reading, European economic integration creates a problem-solving gap for Europe's now semi-sovereign welfare states (Scharpf, 2001). Similarly, Stephan Leibfried and Paul Pierson argue that European integration erodes both

> (...) "the sovereignty (by which we mean legal authority) and autonomy (by which we mean de facto capacity) of Member States in the realm of social policy. National welfare states remain the primary institutions of European social policy, but they do so in the context of an increasingly constraining multi-tiered polity (Leibfried/Pierson, 1995: 44).

Inasmuch as national welfare states are running up against the limits of their institutional capacities in the transformed circumstances of the single market and EMU, EU social policy solutions enter the picture. However, unable to reach agreement at the level of the European Union over these sensitive policy issues due to conflicts of interest and of ideological preferences across member governments, national policy makers will more likely find themselves increasingly engaged in a vicious cycle of deflationary 'beggar-thy-neighbour' strategies of internal devaluation, 'social dumping', 'social tourism' and a 'race to the bottom' processes of competitive welfare retrenchment. Eventually, through the backdoor, European economic integration will forge a fully-fledged "disembedded" neo-liberal European political economy.

From this pessimistic reading, European welfare states face the predicament of a "double bind". On the one hand, Member States are unlikely to shed their welfare-state obligations, as this would jeopardising the political bases of their legitimacy. On the other hand, EU Member States have, since the mid 1980s, become irreversibly committed to a pervasive program of European economic integration. In the face of this "double bind", national policy makers cannot want to shed their welfare-state function without jeopardising the territorial bases of their political legitimacy, while at the same time they cannot want to reverse the process of economic integration which increasingly exposes their now semi-sovereign welfare states to regulatory competition. The double bind confronts national and EU-levels policy makers with a thorny dilemma: common European solutions are desirable, but not feasible nor effective on account of national interests, political sensitivities and the immense diversity of social security systems in the EU (Scharpf: 2001: 362).

The imperative of double engagement

There is no denying the logic of the "double bind" contains important elements of truth. Thus far, however, the empirical evidence suggests that tax competition has so far been limited. Firstly, there has been no decrease in total taxation levels across Europe. And there is also no clear indication of a shift from taxing mobile to immobile factors (Garrett, 1998; Swank, 2001). Arguing from a more voluntarist standpoint, the "double bind" with its associated spectre of competitive welfare retrenchment, can serve as a critical trigger (and thus intellectual resource) for progressive EU- and domestic policy makers, encourage them to constructively recalibrate national welfare regimes and the European social policy agenda. In the process, through the 'bounded' conversion of prevailing domestic institutions arrangements and the invention of (complementary) institutional devices at the level of the EU, policy actors may thus turn the "double bind" into a "double engagement". This as a consequence of "political", rather than "functional", spill-over effects of European economic integration.

Students of the Europeanization of public policy have thus far captured only one sequence of the overall dynamic of Europeanization, in their relatively narrow focus on domestic policy change caused by European (economic) integration (Börzel, 1999; Marks/Hooghe, 2001; Raedelli, 2003). The political impact of European integration, however, does not stop with incorporation of EU-initiatives in domestic public policy. As a second order effect, domestic adjustment problems, resulting from economic integration, can trigger another round of European policy initiatives, so as to mitigate the unintended consequences of earlier rounds of European policy formation. To be sure, with the intensification of economic integration, political elites have in the recent past come to realize that in order to maintain popular support for the European project, the EU must present itself to its citizens as a credible institution of social protection, and certainly not as a threat to established industrial and social rights (Offe, 2003). In other words, the consequence, both benign and less so, of accelerating economic integration seemed to have triggered a *political* spillovers from the nation state upward to the level of the EU, which seems to have created the need, the momentum and the political space for raising social policy considerations to the level of the EU.

The remarkable resurgence of "social pacts" across the European Union in the 1990s is exemplar of the logic of "double engagement" at the domestic level. With the benefit of hindsight, the margins for national monetary and budgetary of policy under EMU and the Stability Pact can be viewed of as 'beneficial constraints', a concept coined by Wolfgang Streeck (1997), laying down established limiting conditions that encourage national policy-makers to engage in reforming and modernising industrial relations, labour market regulation and social security on the supply side of the labour market. The extent to which the external commitment to a consistent and independent monetary policy has in fact meant a liberation from national and international macro-economic political dilemmas is clearly demonstrated by the re-emergence of *social pacts* in diverse political economies like the Netherlands, Ireland, Spain, Portugal and Italy, and other more employment-friendly reforms in social security across Europe in the 1990s under the shadow of the introduction of

EMU. Following this line of reasoning, Maurizio Ferrera and Elisabetta Gualmini (2000) go as far as to claim that EMU in effect *saved* the Italian welfare state from complete ungovernability. The success of EMU in triggering legitimate and effective domestic policy reform, is not to say that the framework of EMU and the Stability and Growth Pact (SGP) already provides for an optimal macro-economic regime for the European economy. The key problem is that regime of EMU and the SGP does not do justice to the differences in economic circumstances across the member states. It is undeniably true that uniform macroeconomic rules of the Stability and Growth Pact (SGP) pact do create problems of adjustment for countries whose growth prospects, inflation rates, and fiscal conditions that differ from the European average. In countries with above-average rates of growth and inflation this leads to overheating, while in low inflation/low growth countries recessionary tendencies are reinforced, with the result of aggravating swings in the business cycle. As a result, real interest rates in the low-growth countries are too low to stimulate the economy and too high in high-growth countries to rein in inflation. It is notable that a number of countries that did well in the 1990s, such as Ireland, the Netherlands, Portugal and Finland, have run into inflationary problems, whereas the ECB's low interest-rate policy was still insufficient and came too late to drag the German economy - the motor of the European economy - out of the mire. Surely these negative spillovers are not solved by the unduly limited deficit rules of the SGP, which punishes low growth without doing anything towards disciplining overheating during an upturn.

Through institutional flexibility

The European Union is primarily a community of rights which acts essentially by law-making. EU laws apply throughout the territory of the Union. They take precedence over the national laws of the Member States. The prevailing EU social and employment policy profile consists of three key components (Ferrera/Hemerijck/Rhodes, 2000). First, on the level of *constitutional principle*s, Article 2 EC explicitly mentions the promotion of high rates of employment and social protection, equality of men and women, high standards of living for EU inhabitants, and social cohesion and solidarity between Member States as tasks of the Union, as core *normative principles* guiding Community action.

Secondly, *binding community legislation* (regulations and directives), following the logic of the Community method by which the Commission has the exclusive right of initiative, the Council decides (preferably by qualified majority) with participation of the European Parliament (ideally co-decision), subject to jurisdiction of the European Court of Justice, is now in place in many areas of social policy. The Treaty of Rome’s market-compatibility requirement (largely related to the free movement of workers) lies at the heart of an elaborate set of supranational rules and jurisprudence ensuring the transferability across Member States of nationally defined entitlements and promoting the interpenetration of national social security systems. Equal-treatment and gender-opportunities directives – spurred by ECJ case law deriving from them – have consolidated a binding set of rights for men and women across national borders. Various aspects of EU citizenship left their imprint on the Maastricht Treaty in 1992 (TEF Art. 17-22). The Charter of Fundamental Right 'approved' of during the Nice Summit in December 2000 is now incorporated in the new draft Constitution.

Third, a number of *institutional complementarities,* next to the traditional 'community method', have in recent decades emerged to promote Member States cooperation on the politically sensitive aspects of social security and employment policy. It is important to emphasize that the 1980s, when the legal framework of the single market was established, was a relatively conservative decade. In 1985, seven out of 10 prime ministers were either Christian Democrats or Conservative. After the mid-1990s Social Democracy regained political office (Manow/Schäfer/Zorn, 2004). In the wake of the Single European Act, it became overwhelmingly clear that accommodating so many policy legacies, systems of finance and administration, and decision-making styles was no longer feasible on a pan-European basis. This stimulated the development of more innovative, flexible institutional solutions in the 1990s. First, the Social Charter was adopted in 1989. Despite being a non legally binding declaration, the Social Charter represented a considerable step in a new direction. With this compromise over "enhanced cooperation" between eleven countries, excepting the UK, acceptable to all twelve Member States, it was possible for the group of eleven to impose guidelines concerning labour conditions, consultation of employees, and equal opportunities for men and women by a qualified majority. The agreement reinforced a tendency towards "variable geometry" in processes of European intergration.

A second institutional innovation that sprang from the Social Protocol pertains to the formalisation of the European social dialogue between the social partners at the community level. The Social Protocol allows the European social partners to sign collective agreements. Ultimately the social dialogue was introduced into the body of the Treaty (new Articles 138 and 139) at Amsterdam in 1997. This new status of the social partners is an example of 'horizontal flexibility'.

From the second half of the 1990s we are witnessing a veritable *quality leap* towards flexible EU employment and social policy initiatives, trampling the received wisdom of market-making supremacy , ECJ-orthodoxy of negative integration, and political immobilism at the level of EU decision-making. It is important to emphasize, that, at the time of the European Council in Amsterdam, June 1997, no fewer than 13 out of 15 Member States had social-democratic or socialist governments, giving the Europeanisation of social policy a vital impulse (Manow/Schäfer/Zorn, 2004). The introduction of a separate employment chapter in the Treaty of Amsterdam is thus best understood not so much as a 'functional' spillover, but as an effect of 'political' spillover of EMU. Social democrats in power wanted to show that Europe was about more than just 'a market and money', and that its social dimension is also important to the average European citizen. In a political sense, then, Amsterdam can therefore be seen as a political 'correction' of Maastricht.

The European Employment Strategy was accepted on condition that no national authority would be transferred to Brussels, there would be no extra cost, and EMU rules would be fully respected. The central aim of the EES was to raise the level of employment participation throughout the European Union, allowing for different national strategies to contribute to this aim. Every Member State agreed to develop an annual National Action Plan (NAP) for employment to translate the common guidelines into clear-cut national policy measures, supplemented by – often multi-annual – policy goals. Based on evaluations of the EES we are able to draw a few tentative conclusions with respect to the effectiveness of the open method of coordination (Best and Bossaert 2002; Zeitlin 2003; GOVECOR, 2004; Zeitlin/Pochet, 2005).

In terms of outcomes, in the late 1990s and 2000, the European Union experienced slightly higher annual rates of employment growth while unemployment decreased somewhat. In terms of agenda-setting, we clearly observe the increased political salience and ambition to increase employment rates, rather than reduce levels of unemployment, with a strong emphasis of activation, lifelong learning, gender mainstreaming, active ageing, inclusive labor market integration, through integrated partnership approaches. At the Cologne summit, in June 1999, raising employment was singled out as Europe's "most important objective of economic and social policy". Ministers and civil servants are being kept alert, and an activating approach towards social policy is diffused. In the process, national ambitions have been raised and translated in a large number of concrete targets concerning employment, education and training. Much more attention is paid to activation, and there is a strong focus on increasing labor participation (rather than subsidizing inactivity) and better preventive adjustment between work and household responsibilities in young families. In committing the Union to become the "most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth and more and better jobs and greater social cohesion", the Council set a concrete target for the overall employment rate in the EU (about 63 per cent at the time) at a figure as close to 70 per cent and it stated that the employment rate for women should increase from the current 53 per cent to more that 60 per cent by 2010. At Stockholm in 2001, the Council added a target employment rate of 50 per cent for workers aged 55-64 from the current low of 35 per cent. The widespread adoption of the above priorities reflects a broad shift in policy ideas in a fair number of countries where activating ambitions were rather weak before, like in most Continental and Southern European welfare states. Practically everywhere, we can observe much improved horizontal coordination of interdependent policy areas of social protection, labor market policy and regulation, collective bargaining and macroeconomic steering. Also the integration of various 'stakeholders' in processes of open coordination has been much improved. This, in turn, seems to have led to enhanced awareness of (similar) problems and (different) policy responses in other member-states across the Union. As a consequence, domestic policy makers increasingly use European frames of references rather than being exclusively bogged down by national preoccupations.

In 2003, the employment guidelines were revised. In June 2003, the Council invited the Commission to establish a European Employment Task Force, headed by former Prime Minister Wim Kok of the Netherlands, in order to re-energize the Employment Strategy. In Novermber 2003, the Employment Taskforce, echoing the title of its report – "Jobs, Jobs, Jobs" – Kok reported that the Union was in danger of missing its employment targets. Creating more and better jobs was the most urgent issue facing the member states.

Since the first employment experiments began in Luxembourg, OMC has quickly spread to other social policy areas. It is now used, for example, in social exclusion (Lisbon, 2000), the modernization of pension provisions (Gothenburg and Laeken 2001), and the implementation of framework directives on lifelong education and teleworking. The European Council at Lisbon on 23 and 24 March 2000 formally recognized OMC as a legitimate form of European governance. OMC practices are far from perfect. Especially, its degree of 'openness' to national political arena's should be questioned. Open coordination, especially the EES, is widely viewed as an opaque and technocratic process, dominated by a new class of high civil servants and EU officials. Also because OMC practices are poorly integrated in domestic policy processes, public awareness, media coverage, and parliamentary overview are poorly developed.

Policy making under a "veil of constructive ambiguity"

The open method coordination is often seen as a second best alternative to hard legislative directives, meant to facilitate policy-making in areas where EU competencies are relatively weak and where regulation by law is unachievable and impractical. Under conditions of uncertainty and complexity, however, 'soft law' agenda setting policy instruments can be far more effective than overly precise legislative directives. Sometimes it is imperative to leave things open to get things going. Acting in the absence of complete knowledge, soft law initiatives may secure attention by way of an agreement to agree on urgent common concerns, to be followed by progressive incremental decisions on more concrete courses of action, which in the meantime neutralizing defection and mitigating short termism. This is what Diane Gibson and Robert Goodin call "policy making under a veil of vagueness". I prefer the more positive term "constructive ambiguity".

The key question is how creative joint decisions can be arrived at in complex decision-making situations, by reconciling competing interests, rather than letting outcomes to imposed by the *force majeure* - in the case of European social and employment: the primacy of "negative integration". And this in the absence of a clear arbiter or referee. Agenda setting processes under the veil of constructive ambiguity proceed, at the most general level, by way of a rather broad agreements that something should be done. By deliberately suppressing detailed particularities at the outset, the veil of constructive ambiguity facilitates policy-makers to pay attention to the big picture of urgent policy problems. As a result, policy makers are better able to see basic structure of pressing problems, define common concerns, and get a better grip on the effects of alternative solutions. This in a way would not have been possible if they were to try to negotiate more detailed package deals right from the start. Moreover, policy making under a veil of constructive ambiguity opens up opportunities for mutual learning through comparative exploration of alternative solutions to common problems; solutions which are enhanced rather than diminished by the breadth of variation among the participants because of the wider range of experiences and perspectives on which they can draw. The fundamental idea is that, having secured agreement at this broader level, the veil of constructive ambiguity deliberately masks the overall cost and benefit calculation of ultimate policy choices, exactly because it obscures the details of implementation. At a later stage it will be easier to secure agreement on detail.

Once concluded, agreements made under the veil of constructive ambiguity take on a life of their own. Starting with deliberately vague and general agreements, on either substance or process, the veil of vagueness process progressively refines, clarifies and specifies in ever more detail what is required under the terms of those earlier agreements. At first, participant actors in these agenda setting processes begin probing each other's intentions and their room for maneuver, exchanging information and refining the agenda of what is to be discussed and among whom. In this context, a first step is often to invest in relevant and consistent date collection. In due course, participants become socialized into accepting both the procedures and their products. In the process participants become socialized into accepting both the procedures of peer review and their products, action plans, new guidelines, and concrete targets. In the case of the EES, the commitment to proceed, at first without quantifiable target, eventually brought about increasingly more concrete ambitions: an overall employment level of 70 per cent (60 per cent for women) by 2010 (endorses at the 2000 Lisbon Council) and a target employment rate of 50 per cent among older employees (55–64 years of age) in 2010 (agreed to at the 2001 Stockholm Council).

Institutionally, policy making under a veil of structured ambiguity gives rise to autonomous policy networks, above and beyond the nation state, of policy institutions and committees, such as the Social Protection Committee, the Employment Committee, the Economic Policy Committee, the Social Affairs and Labour Council (Falkner, 1998; Ferrera, Hemerijck, Rhodes 2000; De la Porte and Pochet 2001). In due course, other actors, like domestic trade union and administrative officials, start framing their own plans actions around the assumption, legitimated by the ongoing process of open coordination. The mutual reliance of actors to perform as promised gives rise to moral obligations. The veil of constructive ambiguity, in short, takes the form of an agreement to agree, on terms yet to be specified in an engaging bootstrapping policy process (Sabel, 2004). As such, it serves as a kind of precommitment to common concerns. Hereby policy makers are set of a course independently of momentary urgencies of high politics, eventually to serve long term interests. The idea is that, having agreed to the generalities in earlier stages of the process, actors will see themselves committed and bound to the elaborations that emerge in the course of subsequent rounds, is fundamentally optimistic. That is to say that, the strategy presumes that some adequate way will eventually be found to transform broad agreements into implementable action plans. And all that is required for the veil of constructive ambiguity to work is that (1) the same institutional actors participate repeatedly, and that (2) the representatives of these institutionalized actors feel an obligation to own and to honour the agreements of their predecessors. In short, the veil of constructive ambiguity is not a garbage can privileging ideologically prepackaged solutions. On the contrary, it privileges problem solving strategies rather than fudging solutions, as a way of promoting the public good rather than perverting it (Gibson and Goodin, 1999).

To be sure, the success of agenda setting under a veil of constructive ambiguity is highly contingent on the extent to which national policy makers see themselves as pursuing convergent or parallel goals. Without substantive consensus or common concerns, together with a sense of urgency for cross-national problem-solving, there is indeed a danger that open coordination ends up in a ritual of 'dressing up' existing policies (Ferrera, 2002). Nonetheless, it is important to note that with the shift to the conservative right in recent years, employment ambitions have not been watered down.

Within the EU, the appreciation of shared problems seems to have opened up new possibilities for procedures of identifying promising policy responses or good practices through open coordination, which in turn could well facilitate domestic reform processes. The open method of coordination constitutes a powerful stimulus for policy learning and innovation. Through open coordination, persistent heterogeneity may be exploited for purposes of experimentation and innovation. Ongoing reforms in the member countries provide ample opportunity for the EU to further learning processes, particularly suited to policy innovation. The success of OMC, respecting national political traditions and policy legacies, could enhance the legitimacy of the EU as a social union. Policies may even gradually converge in a process of multi-level diffusion as the experience with new policies accumulates. Taking learning seriously highlights the importance of ascertaining the possibility and the willingness to experiment beyond existing routines. Ex post monitoring and international benchmarking encourages national actor to take each other's experiences, best practices but also pressing problems, seriously. Open coordination combines two types of learning: learning from others, with a large element of domestic lesson-drawing, based on the observation of trial-and-error experiences in other countries; and learning with others, or 'interactive learning', based on joint processing of information, insight and experience.

Beyond federalism and intergovernamentalism

The pace of change in European employment policy during the 1990s clearly rebuts the bias towards negative integration and the pathology of 'joint-decision traps'. However, the majority of scholars in the tradition of historical institutional analysis, reasoning as they do from the vantage point of robust and formerly self-contained national welfare states, remain profoundly sceptical about the prospects of somehow engaging social policy and economic regulation at the level of the EU. To be sure, redistributive social policies on the European level cannot be expected. The EU will continue to focus of a "regulative" social policy. However, the introduction of a new layer of institutional flexibility to the EU employment and social policy profile suggests an altogether different and more positive and quite realistic view of the prospects for "doubly engaging" cross-national learning processes. And as community legislation has inevitably become more difficult upon the accession of ten new Member States in 2004, social progress will have to rely more on horizontal EU social dialogue and 'soft law' processes of the open method of coordination so as to balance common concerns and *legitimate diversity*. In the process, European integration has the potential to become more of a doubly engaged enterprise.

One of the surprising advantages of the open method of coordination is that subsidiarity ceases to be a zero-sum relation between member states and EU institutions. It helps both *substantive* EU objectives for welfare and employment *and* more ambitious national reform strategies. The tussle between federalism and intergovernmentalism over the interpretation of the subsidiarity principle over the 1990s seems to have created the political space for an alternative solution of a novel sort that neither the advocates of federalism nor the proponents of intergovernamentalism foresaw. The intergovernamentalists hoped that the subsidiarity principle would keep governing decisions firmly in the jurisdiction of the traditional nation-states. The federalists hoped that the subsidiarity principle would free spillover problems from ineffective nation-state solutions by licensing the EU to pursue more centralized community based policy responses. Especially, the emergent battle between re-nationalization and European centralization over the politically salient issues of work and welfare in recent years triggered an alternative dynamic by adding, through the introduction of OMC, a new level of engagement to the European menu of policy coordination. Processes of open coordination, with its emphasis on continuous feedback, facilitates the creation and coming together of networks of engagement, animating social and economic actors to search for common ground at the level of the EU, deepening policy networks beyond nation-state boundaries, while continuing to expedite reform strategies and policy implementation within the jurisdiction of the member states, on the condition of continuous open feedback on performance.

6. The challenge of enlargement

Is the mixture of hard community legislation, social dialogue, and 'soft' law forms of open coordination, established in the late 1990s, capable of coping with the new social policy challenges of an EU of 25 Member States in the first decade of the 21st century? How much system diversity can effectively be 'absorbed' through processes of the OMC? Are peer reviews and benchmarking feasible in a Union of 25? The entry of so many new members with significantly less sturdy social protection systems and labour market regimes clearly is a daunting challenge for the European Union. At issue is whether the outlook for social policy will be affected by the impending enlargement in a predictable and manageable way.

The 2004 accession of ten countries to the European Union is the largest in the history of the EU. The enlargement of the EU to 25 Member States has implied a growth of the population of about 20%, but in terms of GDP only a modest increase of 5%. As a consequence, Eastward enlargement is not very likely to have a big impact on the economies of the “old” member states. By and large, the poorest “new” member states have over the past decade grown the fasted. When we take account of the specific social problems that confront CEE countries, the accession states face a much greater economic-development challenge than their predecessors. State socialist social policy contained a number of distinct and internally consistent qualities, sufficient to warrant the attribution of a particular type of “service heavy” and “transfer lean” welfare regime, practically the opposite of the Continental welfare regime, from which most of the CEE countries originally descended (Manning, 2003). Hospitals and schools were run by the central state, income support was handled by trade unions, and the majority of housing was allocated by industrial enterprises to its own (and other) favoured workers. Unemployment did not officially exist because the constitution guaranteed work for all, and social care (of small children and older people) was heavily institutionalized. Since the government controlled almost all of domestic production, taxation was unnecessary.

The social problems of the countries of Central and Eastern Europe are definitely more intense, but not wholly different from those of current Member States (Clark-Dageville 2002: 123). Persistent unemployment in an unfavourable macroeconomic climate, pension systems overburdened because of an ageing population, health problems, and increasing social inequality also figure prominently on national and European policy agendas elsewhere. In addition, the particular kind of social gender equality has disappeared in the process, with women increasingly taking on the double burden of paid work and family responsibilities (Manning, 2003). Ageing of the population because of its demographic profile is a well-documented trend that will simultaneously increase the proportion of the traditionally vulnerable elderly in the population and lower the tax-paying base of working individuals.

The transition from state socialism to the market economy caused tremendous social hardship. Under the pressure of tight public finances, there was little room for generous social policy. Most CEE countries have had to deal with severe problems of ‘jobless growth’, that is, high structural unemployment alongside relatively robust economic growth. The CEE unemployment crisis has its origins in extensive economic restructuring (Stark/Bruszt, 1998). There is an exodus of labour from the public to the private sector and from heavy industry and agriculture to light industry and services. In the fight of unemployment growth, many CEE governments in the 1990s introduced passive labour market measures such as early retirement and disability payments, thus putting even more pressure on employment. As a result, many workers have withdrawn from the job market (to the shadow economy). As a result, the employment rate of the new EU-10 is significantly lower than the old EU-15. Poverty and inequality have increased significantly in the course of the 1990s.

The lack of an effective social safety net under state socialism implied that the introduction of social assistance was among the first reforms in CEE countries. Shortly after, new legislation introduced minimum wage regulation. With respect to unemployment insurance, CEE countries by and large opted for contribution financed social insurance systems with relatively modest replacement rates. And with respect to pension, towards the late 1990s, many countries opted for the three pillar system, with strong elements of private funding, as recommended by the World Bank, again with relatively low replacement rates.

During the transition period, the EU has been a relatively weak transnational actor, in comparison to the IMF and World Bank. CEE countries have at first been keen to pursue neo-liberal reform strategies, especially in pensions, in return for support from the IMF and the World Bank. More recently, many governments have begun to resort to more active labour market instruments, such as special programmes for education and training, and subsidised employment for the disadvantaged, more in line with EU policy ambitions. As part of the EU accession process, many CEE countries have been shadowing the European Employment Strategy (Keune, 2003). The so-called *National Action Plans for Adoption of the Acquis* require them to develop long-term strategies in preparation for the more detailed annual action plans to be developed within the framework of the EES. In an attempt to guide this process and to 'socialise' the Member States' policy-makers, the Commission is drawing up so-called *Joint Assessments of Employment Policy* (JAP) in cooperation with the candidate countries. In countries like the Czech Republic, Bulgaria, Estonia, Poland, and Slovenia, employment policy is also increasingly modelled on the EES. This allows them to experiment with policy innovations that match their own labour market challenges, both among themselves and in the company of more 'experienced' EU Member States. A similar positive picture emerges from the CEE policy experiment modelled after the EU social inclusion OMC process. There is certainly room for criticism. The JAPs report minimal involvement of the social partners in Central and Eastern Europe. Not only are trade unions usually politically weak and employers' organisations slow to develop, but there is often also a paternal attitude on the part of governments and a lack of preparedness on the part of employers to organise and represent themselves collectively.

The majority of empirical studies dealing with enlargement and social policy highlight deficient institutional capacities for effective employment and social policy as the single greatest weakness facing the CEE welfare states (Wagener, 2002). A robust institutional framework, able to channel, enforce, and implement, the much needed consensus over welfare reform in post-communist societies, is lacking (Standing, 1996). This is especially problematic with respect to the social dialogue. While the social partners as the European level have virtually become legislators, many studies reveal that the social partners in CEE countries have been largely marginalized by their national governments (Lendvai, 2003). In the face of weak governance capacities, conflicting conflicts of economic integration and social disparities, could easily become explosive.

Economic internationalization, adverse demography, and permanent austerity, are also in CEE countries the most dominant parameters, causing an urgent need to recast the welfare state in Central and Eastern Europe. In this respect the enlarged EU faces similar challenges irrespective of "new" or "old" membership, of which declining employment and population ageing are the most prominent. The direction in which the CEE welfare states will develop cannot be foreseen so shortly after their accession to the EU. On the one hand, harking back to policy legacies rooted in the 1930s, they figure similarities in terms of policy development with the continental welfare states (Germany and France). Social policy today is largely financed by workers' premiums and contributions. Furthermore, a multi-pillar pension system is rapidly being implemented (Denmark and the Netherlands). Labour market regulations show many similarities with the most flexible job markets in Western Europe (United Kingdom and Ireland). Trade unions and employers' organisations are in general poorly represented in the new private sectors. These policy developments suggest that welfare state models are becoming increasingly mixed or 'hybridised' (Zeitlin, 2003). Nonetheless, institutional fragmentation hinders the development of an effective social dialogue and much required political consensus over necessary reforms. In this area of institution building, EU can step in with support.

7. The normative basis of social pragmatism

Practically all European welfare state are in the process of recasting the terms of the post-war social contract. Welfare reform has become an ongoing concern which is unlikely to subside in the near future. The future of the welfare state is not pre-ordained. The doomsday scenario of the demise of European of social citizenship, predicted in the 1980s, inevitably leading at some critical juncture to immanent collapse, is not been borne out by the recent European experience. In the 1980s, social security provisions have become more austere. During the 1990s, we observe a manifest convergence of employment and social policy objectives, encouraged by the EU social policy agenda, with much greater attention to proactive strategies, a marked focus on increased labour force participation for women and older workers, and improved coordination between employment and social protection. To some extent this shift reflects a shift in ideas on the European left from the Keynesian interventionist and de-commodifying welfare state towards more supply-side oriented, employment and social policies, with new combinations of flexibility and security, geared towards new priorities of facilitating women to accommodate work and family life and fighting child poverty, managed by new forms of multilevel governance in support of the welfare state (Esping-Andersen *et al*, 2002). While this policy agenda for a new welfare architecture is today broadly accepted by domestic policy makers and EU-officials alike, the national stakes of social policy reform, especially in the area of pensions, have remained dominant.

The majority of member states of the European Union continue to associate the welfare state with a strong normative preference for solidarity with the most vulnerable; a cognitive orientation towards social policy as a productive factor; and an institutional style marked by political negotiation and social consultation. In retrospect, neo-liberalism failed to obtain any grip on these three deeply entrenched normative, cognitive and institutional legacies. It is highly questionable whether the tide of neo-conservatism since 2000 will succeed where neo-liberalism failed in the 1980s. It is striking how many domestic reforms have been enacted in the past decade and how little they followed the textbook neo-liberal prescriptions (Martin/Ross, 2004).

At the level of the EU, employment and social policy initiatives have had to come to terms with the increasing diversity of national welfare states with each wave of enlargement. Although social policy is deeply entrenched in national politics, the social dimension of the European Union no longer merely holds a 'Cinderella status' of good intentions (job growth, social dialogue), high principles (improving living standards, working conditions, solidarity and adequate social protection), but little action. In the past, it was generally believed that that enlargement would enfeeble the prospects for deepening, especially in politically sensitive employment and social policy areas. With the benefit of hindsight, the idea that widening goes at the expense of deepening of the EU, cannot be upheld. This is not to say that reaching consensus over issues fiscal, social, and employment policy will become more difficult in the more heterogeneous Union of 25 Member States. Today, the EU finds itself at an important constitutional juncture. Accession of 10 more states to the European Union in May 2004 has brought about an enormous increase in the economic and social heterogeneity among Member States. It is fair to conclude that, as a result, agreement over binding social and labor standards will be even more difficult to achieve. At the same time, the social policy consequences of European economic integration will become more poignant. If community legislation is more difficult, social progress will have to rely more on horizontal EU social dialogue and ‘soft law’ processes of the open method of coordination, where state policy makers remain the central actors embedded in a larger European economic and social policy space.

Domestic reform experiments and EU social policy innovation of the 1990s already mark a distinctive, and sometimes successful, response to the dual policy challenges of economic internationalisation and post-industrial societies under the pressing fiscal and budgetary stress. The big if is whether this momentum is to continue in a radically different political climate across Europe since 9/11. There are signs that European social policy ambitions have been toned down and shoved back unto Europe’s semi-sovereign domestic welfare systems, which could very well reinforce regime-specific institutional conservatism, and thus widening the social policy problem-solving gap. But this is a matter of political choices and conjunctural circumstance. What I have tried to show is that, over the longer term, Europe is not immanently ‘sclerotic’, that we have been witnessing a dynamic and distinctly “European” type of reform process. In the 1990s, social policy initiatives at the EU-level have all been couched in terms of the idea of “social protection as a productive factor”. The European social model (social market economy/social market democracy) has always been characterized by institutional arrangements that gave losers a fair chance of a share in national wealth to become winners themselves. Social policy is considered both a productive factor and an effective buffer against hardship of advanced capitalist societies. The future of the European social model depends crucially on its remaining inclusive and thus contain the tendency towards segmentation and discrimination. Still, at the Barcelona Summit in 2002, when the EES was up for review, the Council endorsed ‘full employment’ as the overarching objective of European employment policy.

Domestic reform strategies are is replete with contingencies, policy failures, co-ordination and implementation problems and, obviously, shifts in the balance of political and economic power. The ‘trial and error’ nature of European social policy reform implies that attempts to solve problems in one particular policy area are likely, through a dynamic of spill-over effects, to create problems in neighbouring policy areas. New social risks trigger yet another search for new solutions, both horizontally (across policy areas) and vertically (between different layers of governance) (Zeitlin, 2003). Since the mid-1970s, macroeconomic instability stimulated a learning process through which the hard currency EMU was established. The imperatives of monetary integration put pressure on systems of industrial relations, leading to new adaptations in wage setting. New bargaining procedures, in turn, encouraged a search for more active labour market policies, as well as ‘activating’ social security provisions. And with the rise of female employment occurred a reorientation in public and private services.

Last but not least, steps are being taken to make pension systems fair and sustainable in the face of population ageing. Politically, most of the steps in path-dependent policy innovation were outcomes of lengthy processes of (re-)negotiation between political parties, governments and often also the social partners.

Spillover problems associated with European economic integration have shaped the employment and social policy agenda of the European Union. Persistently high unemployment in the run-up to the EMU raised the urgency of a common European strategy. In the second half of the 1990s, aided by the presence of centre-left governments, we see a deepening of Social Europe through open coordination. All the member states are explicitly dedicated towards raising employment, promote social inclusion, invest in the productivity and skills of future workers, and enhance innovation in the pursuit of a competitive knowledge-based economy. Institutionally, welfare reform has served to redefine the role of the state from 'government' to 'governance', a change in direction that cannot be simply equated to the move from centralization and decentralization, from regulation to deregulation or from public to private provision. These dichotomies do not adequately reflect to complex relationships that characterize the multilateral exchange mechanisms and bargaining processes in governance structures, which operate both 'horizontally' between specialized actors in different policy areas, and 'vertically' between different administrative jurisdictions at local, regional, national, and the EU-levels of policy making, without however the withdrawal of political oversight (see Ferrera et al, 2000; Ferrera and Hemerijck, 2003; Esping-Andersen et al, 2002). In the process, the state is at once withdrawing, while at the same reaffirming its role as the guardian of the 'goodness of fit' of economic competitiveness and social solidarity. Striking features in this respect is the resurgence of 'social pacts', agreed to by functional organized interests and domestic policy makers, and the widening the scope of a *governance by objectives* approach at the level of the EU, epitomised by the social dialogue, and more so by the open method coordination in the areas of employment, social exclusion and pensions, which also – albeit at a distance – engage the social partners, with parliaments engaged in the monitoring of these learning practices.

Alongside the search for effective solutions in the face of the dual challenge associated with associated with economic internationalisation and post-industrial differentiation, under conditions of permanent austerity, a particularly pressing issue is to give new expression to the normative underpinnings of social pragmatism. Effective reforms only stand any chance of success if they are brought into line with widely shared, accepted norms of social justice as well as greater efficiency. Each revision of the *status quo* must be seen as just. A Rawlsian view of social justice (named after the political philosopher John Rawls) is most consistent with the dominant values and social priorities in the European Union. Following Rawls, any departure from the principle of equal distribution is admissible only if it is to the greatest benefits of the least advantaged (Rawls, 1971). As the new social order will probably generate greater uncertainty and inequality, this is only problematic if it takes the form of long-term exclusion. A number of policy analysts today advocate 'dynamising' Rawls' theory of social justice (Ferrera et al, 2000; Esping-Andersen et al, 2002). They suggest a shift from a static notion of distributive justice, focused on greater equality in the here-and-now, towards a dynamic notion of equality of opportunity, emphasising equality of life chances, while advocating modern social policies as societal investments rather than as income-replacing consumption. Preventive social protection would maintain employment relationships for as long as possible. From this perspective, temporary inequalities, low wages, and poor jobs are less of a problem than long-term poverty and inactivity traps. They become problematic when they negatively affect opportunities for future life chances. For this reason basic social security provision as a right of social citizenship remains essential. But against the backdrop of economic internationalisation and post-industrial differentiation, there is a growing need to re-conceptualise social citizenship rights in terms of effective guarantees against social exclusion and/or entrapment. This implies a re-orientation in social citizenship, away from *freedom from want* towards *freedom to act* while continuing to guarantee a *rich social minimum*.

Under the current tide economic internationalisation and post-industrialism, the *minima moralia* of the rich social minimum should not only provide a minimum income guarantee and a 'health/health promotion' guarantee, but also a 'human capital guarantee'. Mature welfare states have become ever more dependent on high levels of employment in order to bolster the financial base as effectively as possible in an increasingly open world economy. Female employment is doubly beneficial as it contributes to a broader tax base plus higher fertility. The proportion of citizens who are dependent on social security needs to be curtailed. This does not provide any place for an indiscriminate austerity policy discouraging vulnerable groups from the labour market - groups for which we will have a pressing need for to safeguard pensions. Active participation (in employment) is of crucial importance, not merely because of the imperative of economic internationalisation, but also because 'participation in social life is crucial for gaining respect from others and self-respect, the opportunity to participate actively in society is one of the basic opportunities that should be the right of everyone' (Vandenbroucke, 2002). In contradiction to earlier predictions that in affluent post-industrial societies, work would become a marginal part in our lives, gainful employment today is central to the quality of life in dual- earning families. The normative focus of social policy therefore should be more on *ex ante employability* than on *ex post redistribution*.

In an dynamic perspective, and instead of mitigating flexibility, the social safety net should become a springboard to support ‘job-to-job’ employability with portable social rights, notably with respect to pensions, between jobs. This then also implies that welfare recipients or social program participants adopt an entrepreneurial attitude towards their own employability. New employment policies are only effective if they maintain and enhance individual employability. High employment rates, high productivity and work that provides income security are the most reliable way of providing social protection. Flexicurity, along the same lines, is all about joint risk management through the provision of new forms of intertemporal, intergenerational, and interregional forms of solidarity, encouraging people to accept more risks, with the beneficial externalities for society. The normative justification of ‘flexicurity’ may be argued as follows: in moral terms it is no more than just to reduce the protection of the ‘insiders’ and to allow greater flexibility and a wider distribution of incomes if this generates greater opportunities for work for those who are worst off, i.e. ‘outsiders’.

The elaboration of a new normative framework is particularly urgent in the field of old age policy. The demographic predicament calls for a normative benchmark for reforming pension systems in a financially sustainable and socially adequate manner, touching on norms of intergenerational equity and intragenerational justice. Intergenerational equity implies that the transition costs associated with population aging be proportionately shared by both young and old. The principle of intragenerational justice reflects the Rawlsian benchmark, suggesting that any change of the status quo should turn to the advantage (or the least disadvantage) of the worst off within both the working and the retired population (Myles, 2002).

Rawlsian ideas are primarily pertinent for market inequalities: and one of the fundamental normative roots of social protection is precisely to compensate for many of these inequalities, thus re-establishing conditions of social ‘fairness’. But are we sure that the institutions currently in place actually achieve this outcome and are themselves internally ‘fair’? Poverty research reveals the resilience of perhaps the greatest possible Rawlsian injustice: seriously disadvantaged individuals and groups who are trapped by perverse social security provisions and employment protection regulation. It is vitally important to continue to counter social exclusion for those who remain trapped in circumstances of under-privilege as the result of social policy inertia. Otherwise, a significant shift in policy discourse is called for: from a market failure perspective to one of emphasizing the productive double bind between social cohesion and economic competitiveness and from a static notion of equality, centring around material resources (income) and means of compensation towards a more dynamic and service-intensive notion, based on capacities, opportunities and empowerment.

Turning finally to the role of the EU, we observe how over the past two decades, the 'hard' social *acquis* has surely 'deepened', more recently new, 'softer' forms of EU involvement, such as the social dialogue and OMC, have become institutionalised so as to balance common concerns and *legitimate diversity*, i.e. respect for institutional differences of formerly self-contained territorial welfare states. However, multi-level Europe continues to depend on democratic legitimacy derived from and mediated through national legislatures, which remain the primary focal point of political identity in Europe and the cornerstone for further policy integration. Less-binding and non-legal modes of governance such as the social dialogue and open coordination should, therefore, not be viewed as *alternatives* to the Community method but as necessary, indispensable "doubly engaging" *complements*. It is arguably a sign of good health that 50 years of European integration has thrown up such a wide range of modes of governance for European cooperation (Best, 2003). Indeed, the introduction of new layers of institutional flexibility to the EU employment and social policy profile suggests an altogether different and more positive and quite realistic view of the prospects for "doubly engaging" cross-national learning processes. And as community legislation will inevitably become more difficult upon the accession of ten new Member States, social progress will have to rely more on horizontal EU social dialogue and 'soft law' processes of the open method of coordination so as to balance common concerns and *legitimate diversity*. In the process, European integration has the potential to become more of a doubly engaged enterprise. In the process, the EU will transform into a regulatory forum which helps to substantiate common ground for multilevel action by way of coordinating polycentric interaction among a range of public and private policy actors, of which the nation-state surely is a leading player. Ultimately then, the principle of subsidiarity ceased to be defined in term of a zero-sum relation between member states and EU institutions. The EU's primary role, as Jeremy Rifkin puts it, will become in large "orchestral" (Rifkin, 2004: 215).

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