Introduction: The sovereign debt crisis, the EU and welfare state reform

Introduction: The sovereign debt crisis, the EU and welfare state reform

Elke Heins[a,*] and Caroline de la Porte[b]

[a] School of Social and Political Science, University of Edinburgh, 15A George Square, Edinburgh EH8 9LD, UK.

[b] Department of Society and Globalisation, Roskilde University, Demark.

[*] Corresponding author.

Key words: European Union; sovereign debt crisis; unemployment; welfare state reform; economic crisis

This Special Issue focuses on the European Union's (EU) responses to the sovereign debt crisis and analyses the impact these have had thus far on welfare state reforms. EU austerity policy, although preventing default and re-assuring the financial markets in the short term, may lead to substantial policy, institutional or paradigmatic change in the welfare states in the longer term (Hall, 1993) and thus deserves thorough analysis. The global financial crisis which started in 2007 and the ensuing 'Great Recession' has already sparked a number of publications analysing the responses of governments to the far-reaching global recession as well as the impact these responses have had thus far on welfare states. Some of the recent literature highlights distinctive features of the on-going recession, including, first, the international origins and global impact of the crisis (Farnsworth and Irving, 2011; Bermeo and Pontusson, 2012; Greve, 2012), but the role of the EU in crisis responses has not per se been in the spotlight. Second, while the fiscal response to the crisis in the 1970s primarily involved increases in government spending, in the current recession, governments have relied predominantly on tax cuts to stimulate the economy and on spending cuts to achieve fiscal consolidation (Bermeo and Pontusson, 2012). The patterns of response thus follow recent paths of institutional welfare state change, although

Keynesian crisis responses were adopted to some degree following the immediate outbreak of the crisis (Vis et al., 2011; Hemerijck, 2012). These new paths include the development of employment at the margins, which re-enforces patterns of labour market dualization, toughening access to unemployment and other benefits, as well as curtailing public expenditure in the areas of health care, pensions and education (Bermeo and Pontusson, 2012; Bonoli and Natali, 2011; Emmenegger et al., 2012; Greve, 2012; Hemerijck, 2012). Third, mainstream theory – e.g. the ’Varieties of Capitalism’ and ‘Worlds of Welfare’ literature - does not sufficiently account for these institutional welfare state developments or for variation in responses to the crisis, let alone the different responses to this recession compared to previous economic downturns.

The Great Recession has hit the Eurozone’s soft spot, that is, the interdependent, yet asymmetric economies which have pooled monetary policy while fiscal policy remains decided at national level (Scharpf, 2011). The EU’s response to this situation – first and foremost fiscal consolidation - and the impact this is having on welfare state reform deserves more in-depth analysis. This Special Issue analyses how EU policy has developed throughout the crisis and the mechanisms through which EU instruments have affected welfare state reforms in the Member States most severely hit by the crisis. These countries, mainly in the European periphery, have seen soaring rates of public debt, leading to a sovereign debt crisis in which it became difficult or impossible to re-finance public debt without the assistance of the EU and the International Monetary Fund (IMF).

The scale of the crisis and the EU response to it

In order to understand the EU responses, it is important to recall the severe crisis context in which these new tools of EU governance were developed. Starting off as a ‘sub-prime’ mortgage and banking crisis in the US in 2007, the crisis quickly became global and also spread to the European financial sector. The first countries affected by the crisis were countries where financial regulation was weak (Bermeo and

Pontusson, 2012). These include liberal market economies, but also the southern EU countries and some central and eastern European countries. From autumn 2008 onwards, the effects of the financial crisis on the real economy became apparent as economic growth was declining and unemployment was rising in Europe. By 2009/10, the average unemployment rate in the EU stood at 9 per cent and reached peaks of as high as 20 per cent (in Spain and Latvia) with youth unemployment climbing over 20 per cent throughout the EU (and even over 40 per cent in Spain) (Eurostat data). With rising unemployment levels, the pressure on national welfare budgets increased while at the same time fewer resources were available due to negative economic growth and declining tax revenue, rapidly shifting the fiscal balance into deficits. In combination with large rescue packages to prop up the banking sector to prevent a collapse of financial institutions and a wider economic meltdown, many euro area countries breached the deficit rule of the EU's Stability and Growth Pact (SGP) (stipulating a maximum public deficit of 3% of GDP) and had soaring rates of public debt.

As a consequence, international credit ratings agencies considerably downgraded the credit status of several euro zone countries, sometimes to as low as 'junk', sparking fears of individual member states' bankruptcy with a potential domino effect on other countries in the Euro area (Scharpf, 2011). The biggest fear was that if there was a precedent of Euro exit, investors would become too nervous to lend to other Eurozone countries with the result of a substantial increase in interest rates that would, in turn, bring further troubled Eurozone economies to the brink of bankruptcy with the ultimate threat of other countries leaving the Eurozone and a break-up of the common currency altogether. To prevent such contagion and to restore confidence in the Euro, joint and swift action became indispensable.

The EU and the ECB, together with the IMF offered full or partial financial rescue packages to the most-troubled countries through loans and other types of conditionality (Sacchi, in this issue), starting with a bailout of Greece in Spring 2010. Ireland required financial assistance in late 2010 and Portugal in Spring

2011. They are the only three countries that have signed Memoranda of Understanding (MoUs) that require radical austerity measures and structural reforms, monitored intensely, in exchange for financial support. In late 2012, Spain sought a nearly €40 billion rescue package from the EU to stabilise its struggling banking sector, but avoided a full state bailout. The latest country to seek financial assistance from the EU was Cyprus in April 2013. At around the same time new fears were sparked that Italy could no longer repay its public debt. As a response to that, the ECB bought up Italian government bonds on secondary sovereign bond markets, but on the condition to implement a strict course of action, including welfare reforms, to promote growth and to balance the budget by 2013, (Sacchi, in this issue; de la Porte and Natali, 2014). At EU level, several decisions were taken rapidly that aimed at strengthening the SGP and thus correcting existing economic imbalances, while also preventing future debt crises. These put indirect, but strong pressure on welfare states with an emphasis on structural reforms. The articles in this Special Issue examine to what extent changes have taken place due to the particular crisis conditions at the European Union and national levels.

Contributions to this Special Issue and their main findings

In the article "A new era of European Integration? Governance of labour market and social policy since the sovereign debt crisis" , Caroline de la Porte and Elke Heins develop a typology of EU integration to capture with what objectives and through which surveillance and enforcement mechanisms new instruments affecting labour market and social policy have been developed throughout the crisis. It is shown that the governance of the EMU has been altered via a process of institutional 'layering' whereby new mechanisms are grafted onto the pre-existent institutional frameworks. Through these alterations, the nature of EU intervention into domestic welfare states has changed, with an enhanced focus on fiscal consolidation, while other aims such as social equity have only recently re-gained attention on the EU agenda via softer governance methods. Furthermore, this new style of EU intervention in welfare states is associated with increased surveillance and a higher degree of enforcement, which represents a radical alteration in EU integration.

The article by Sotiria Theodoropoulou entitled **"**National social and labour market policy reforms in the shadow of EU bail-out conditionality: The cases of Greece and Portugal**"** scrutinizes the intrusive role of the EU and the IMF in pensions, labour markets and collective bargaining in Greece and Portugal. In both cases financial assistance was provided conditionally, as detailed in MoUs, in exchange for structural reforms. The two cases show that despite very high intrusiveness of MoUs due to tough conditionality and active surveillance in both countries, there were notable differences, with more radical policy intervention and more far-reaching reforms in Greece than in Portugal. The comparative analysis shows that the policy agenda embodied in the MoUs was to enhance fiscal consolidation via radical reforms under conditions of pervasive austerity, which has led to radical retrenchment of the Greek and Portuguese welfare states.

The article “From austerity to permanent strain? The EU and welfare state reform in Italy and Spain” by Emmanuele Pavolini, Margarita León, Ana Guillén and Ugo Ascoli analyses the altered impact of the EU on the two largest Southern European welfare states in the wake of the crisis. While the two countries avoided a formal bail-out, they nevertheless came under the shadow of conditionality. A longitudinal analysis across different policy areas highlights that both were following different paths pre-crisis, with Spain having made more investments to meet new social risks, while in Italy such reforms were envisaged but not enacted. From mid-2010 onwards, mounting pressure from the EU led to reforms adopted rapidly, which represents a retrenchment phase in both welfare states. The authors conceptualise this reform dynamic as a new ‘age of permanent strain’, characterized by extreme haste, intense tensions, growing anxiety among the population and growing public unrest.

The article “Conditionality by other means: EU involvement in Italy’s structural reforms in the sovereign debt crisis” by Stefano Sacchi focuses on the altered nature of conditionality in the Italian case. He argues that conditionality, although informal, can be extremely strong in terms of policy specificity as well as surveillance, but weak along the enforcement dimension. He convincingly shows that market forces are the important causal factor intervening in enforcement of policies prompted by the EU. The article also shows the use of ad-hoc informal conditionality empowered the economically-oriented actors, especially the Directorate General of Economic and Financial Affairs and the European Central Bank.

Fiona Dukelow in her article “’Pushing against an open door’: reinforcing the neo-liberal policy paradigm in Ireland and the impact of EU intrusion” argues that austerity measures demanded by the EU/IMF in return for large-scale financial support were drastic, but that they did not constitute a change in social policy direction in Ireland. She shows that the recommendations made through the MoUs were welcome by political elites and representatives of business and that paradoxically the EU-IMF induced reforms even strengthened the neo-liberal paradigm that has been underpinning the Irish welfare state for decades. The empirical evidence is striking and the theoretical contribution highlights that paradigms can be re-enforced under crisis circumstances, rather than being altered.

The article “Still the sound of silence? Towards a new phase in the Europeanization of welfare state policies in France” by Patrick Hassenteufel and Bruno Palier analyses the EU influence on welfare reforms in France. Through a longitudinal perspective the authors find that reforms in the areas of pensions, health care and labour markets are increasingly taken in line with EU prerogatives. The authors argue that there are changes compared to before the crisis since the need for deficit reduction is now explicitly integrated into French political discourses and policies and the EU is able to demand evidence of reform. The authors also show that France has maintained leverage regarding the timing and content of the reforms. However, overall, the implication is that the EU is much more involved in welfare state reforms than before the crisis.

In “A Framework for Social Investment Strategies: Integrating generational, life course, and gender perspectives in the EU social investment strategy” Jon Kvist argues that the Social investment strategy developed at European level holds the promise of renewing the European Social Model in the aftermath of the crisis although the gender dimension has been overlooked in this context. Kvist offers a comprehensive life-course perspective on social investment that shows how the strategy is based on a generational contract combined with horizontal redistribution. The life course perspective also focuses attention to the dynamic and multi-dimensional nature of social investments and cumulative effects over time. In an illustrative comparative study combining the life-course perspective with a gender perspective on social investment, Kvist points to some of the key gender dimensions that need to be addressed by appropriate policies to optimize the formation, maintenance and use of human capital in both economic and non-economic spheres by men and women.

Despite (soft) EU pressure to reform welfare states in line with social investment policies it is doubtful, however, that all countries can afford and implement all the necessary institutional reforms to harvest the long-term returns. As the contributions in this issue demonstrate, some of the countries most in need of welfare reforms are worst positioned to undertake such reform due to the impact of the crisis on these countries.

Notes

The idea for this Special Issue emerged at the annual ESPAnet conference in 2012, where first drafts of many of the papers were presented. A subsequent workshop in May 2013, supported by the Department of Political Science, University of Southern Denmark, gave us the opportunity to discuss all of the papers. We would like to thank various colleagues for their valuable comments, in particular Jonah Levy, Nathalie Morel and Joakim Palme.

References

Bermeo, N. and Pontusson, J. (eds.) (2012) *Coping with Crisis: Government reactions to the Great Recession*, New York: Russell Sage Foundation.

Bonoli, G. and Natali, D. (eds.) (2012) *The Politics of the New Welfare State*, Oxford: Oxford University Press.

Emmenegger, P., Häusermann, S., Palier, B. and Seeleib-Kaiser, M. (2012) *The Age of Dualization: The Changing Face of Inequality in Deindustrializing Societies*, Oxford: Oxford University Press

Farnsworth, K. and Irving, Z. (eds) (2011), *Social Policy in Challenging times: economic crisis and welfare systems*, Policy Press.

Greve, B. (ed.) (2012) *The Times they are Changing? Crisis and the Welfare State*, Chichester: Wiley-Blackwell.

Hall, P. (1993) Policy paradigms, social learning and the state: the case of economic policy making in Britain. *Comparative Politics* 25(3): 275-95.

Hemerijck, A. (2012) 'Stress-testing the new welfare state', in G. Bonoli and D. Natali (eds), *The Politics of the New Welfare State*, Oxford: Oxford University Press.

Scharpf, F. (2011), "Monetary Union, Fiscal Crisis and the Preemption of Democracy", Working paper, Max Planck Institute for the Study of Societies

Vis, B., van Kersbergen, K. and Hylands, T. (2011), 'To What Extent Did the Financial Crisis Intensify the Pressure to Reform the Welfare State?', *Social Policy & Administration* 45(4): 338-353.

Word count: 2508