Vision Europe Summit

The Welfare State in Europe
Visions for Reform

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Contents

Preface

In all the countries of the European Union, the welfare state has come under intense scrutiny as a result of budgetary pressures and wider societal developments. The Vision Europe initiative has chosen to focus this year on the future of the welfare state, and aims to develop innovative policy recommendations on how to ensure the long-term sustainability of national welfare systems in Europe. This introductory paper is designed to set the scene for the challenges currently facing the welfare state in Europe. Specific facets of welfare state policy are being reviewed in more detail in three project working groups. All these issues will be examined in the first Vision Europe Summit, which is due to take place in Berlin on 17–18 November 2015.

Vision Europe Summit is a consortium of think-tanks and foundations that came together in 2015 to address some of Europe's most pressing public policy challenges. Through research, publications and an annual summit, it aims to provide a forum for debate and a source of recommendations for improving evidence-based policy-making at both national and EU levels.

Participating Organizations:

- Bertelsmann Stiftung (Gütersloh)
- Bruegel (Brussels)
- Calouste Gulbenkian Foundation (Lisbon)
- Chatham House (London)
- Compagnia di San Paolo (Torino)
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Summary

- For many in Europe, the values and norms that underpin the continent's social model are at the heart of what it means to be European.

- Welfare states perform a number of redistributive functions and protect the vulnerable. Contrary to negative portrayals, welfare states also invest in human and social capital. All European citizens both use and contribute to the welfare state at different stages of their lives.

- Pressures on public finances, and the burden that social spending imposes on the 'productive' parts of economies, raise questions about whether European countries can still afford their welfare states.

- Welfare systems first designed 50 or more years ago need to be recast to confront today's challenges. They must accommodate the extensive societal transformations associated with population ageing, closer global economic integration and the spillover effects of climate change.

- Welfare states will also have to adapt to new social risks resulting from the changing nature of European economies, especially evolving patterns of work and employment. They will have to use resources more efficiently and make the most of relevant technological advances, without unduly sacrificing key principles such as solidarity.

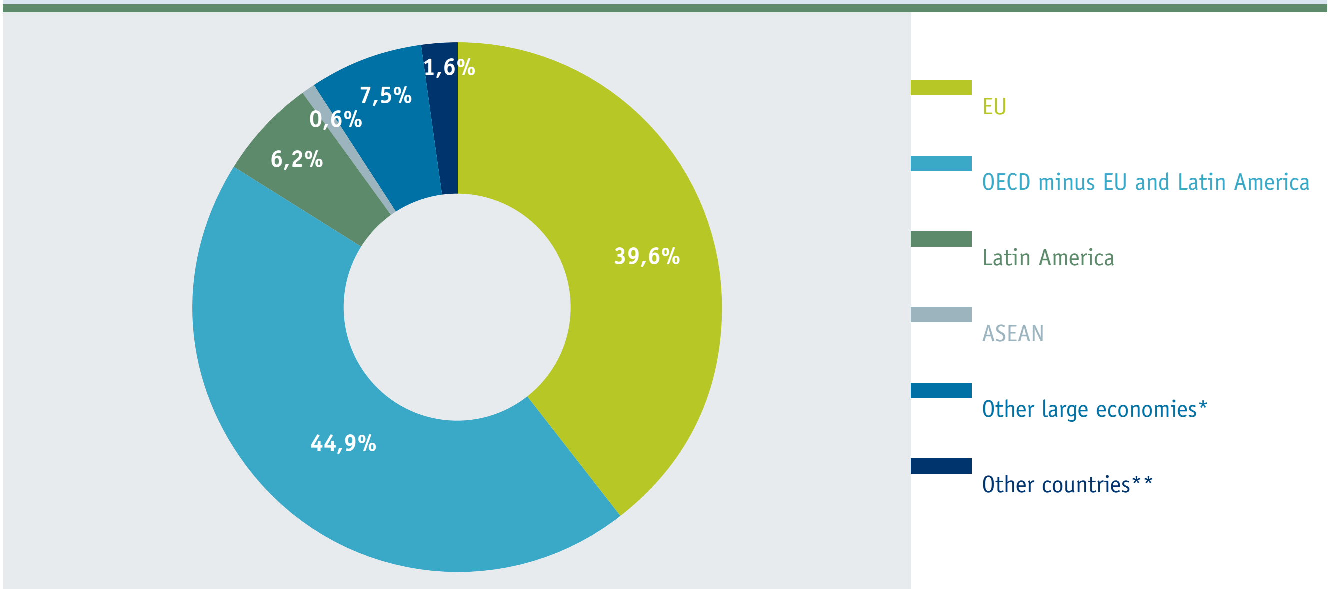
- A number of dilemmas about appropriate forms of decision-making and democratic oversight surround efforts to reform welfare, but there are reasons to be optimistic about the future of the European social model. Well-designed welfare states can promote sustainable growth in Europe and be a competitive asset.

Introduction

There is a growing sense that the European social model is unsustainable and in need of reform. As the German chancellor, Angela Merkel, is fond of claiming, the European Union (EU) accounts for roughly 7 per cent of the world's population and 25 per cent of its GDP, but over 50 per cent of its welfare spending. The implication is that Europe's welfare states are not only generous in comparison with provisions elsewhere, but will become unaffordable without major recasting. They undeniably face a range of demographic, fiscal and other pressures, exacerbated by weak economic growth or recession since the 2008–09 financial crisis. Changing work patterns and competition from emerging economies with lower labour and social welfare costs are also raising fundamental questions that Europe's leaders have struggled to answer. These include dilemmas about the extent of the state's responsibility to its citizens and, specifically, whether governments can or should maintain comprehensive welfare systems in the future.

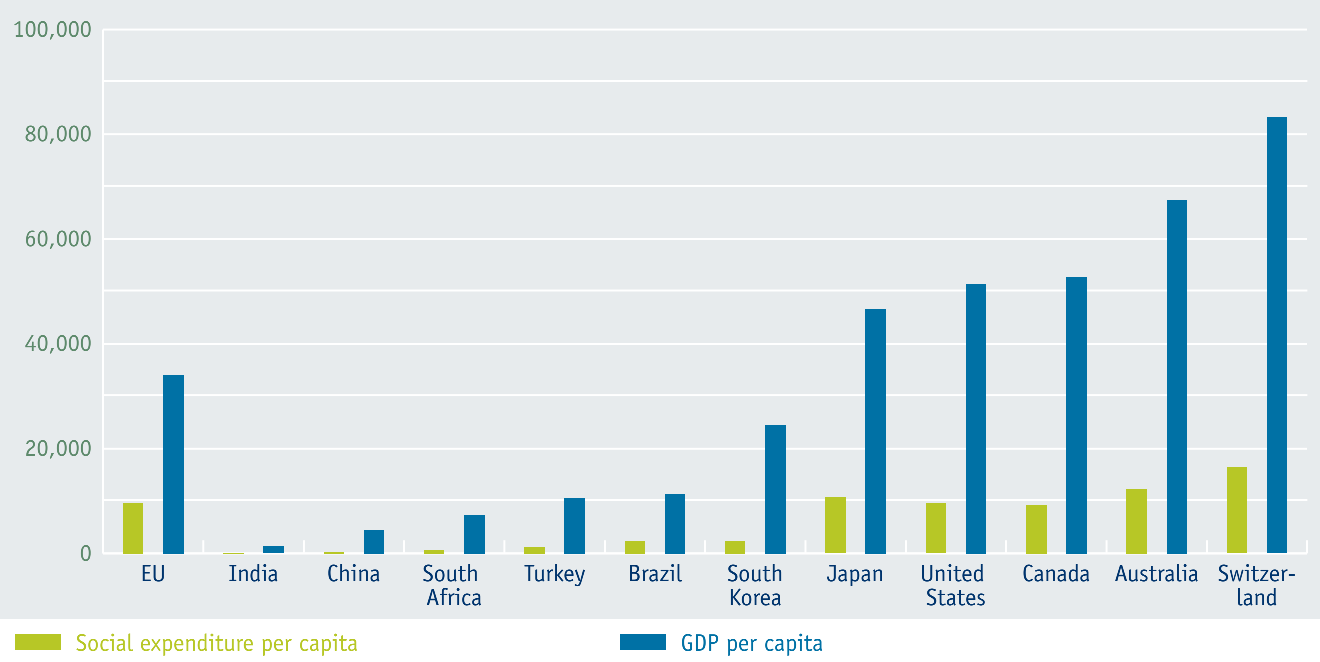
In fact, Merkel's data are somewhat inaccurate. The EU's welfare spending was 40 per cent of the world total in 2012 (see Figure 1), while its share of nominal world GDP in 2014 was 24 per cent (at current prices and current exchange rates, and thus

Figure 1 | Global social protection expenditure aggregates, 2012 or latest (% of total)



* Large economies are China, Egypt, India, Nigeria, Russia, Saudi Arabia, South Africa, United Arab Emirates.
** Other countries exclude American Samoa, Andorra, Bermuda, Cabo Verde, Cayman Islands, Channel Islands, Comoros, Curaçao, Djibouti, Faeroe Islands, French Polynesia, Gabon, Greenland, Guam, Haiti, Isle of Man, North Korea, Kosovo, Liberia, Liechtenstein, Macao, Malawi, Micronesia, Monaco, Montenegro, New Caledonia, Northern Mariana Islands, Palau, Puerto Rico, Republic of the Congo, Romania, San Marino, Serbia, Sierra Leone, St Martin (Dutch and French parts), Somalia, South Sudan, Suriname, Syria, Taiwan, Timor-Leste, Tonga, Turkmenistan, Turks and Caicos Islands, Tuvalu, Virgin Islands (US), West Bank and Gaza.
Sources: EUROSTAT (for social expenditure in EU member states); OECD SOCX database (for social expenditure in non-EU OECD countries); ILOSTAT (for social expenditure in non-EU non-OECD countries); World Bank Data (for GDP and population data).

Figure 2 | Social protection expenditure and GDP per capita in EU and selected countries, US$, 2012 or latest



Sources: EUROSTAT (for social expenditure in EU member states); OECD SOCX database (for social expenditure in non-EU OECD countries); ILOSTAT (for social expenditure in non-EU non-OECD countries); World Bank Data (for GDP and population data).

making no allowance for differing price levels).[1] In addition, as Figure 2 shows, per capita spending on social protection in the United States and Japan was broadly the same as in Europe, higher in Switzerland and Australia, and very slightly lower in Canada.

The real gap in social spending is between the 'old' industrial economies and the emerging markets, including China, India, Brazil and South Korea. For these countries, social spending is a small fraction of that in the more advanced economies, but it is likely to rise as their prosperity increases and they seek to strengthen welfare provision. As a result, the EU's share of global social spending can be expected to fall simply because the share accounted for by the rest of the world will rise. It is already clear, for example, that China will soon have to take steps to deal with its rapidly ageing population by introducing higher social support to maintain the incomes of older people.

1 An alternative means of measurement, converting national data using 'purchasing power parities' (reflecting differences in price levels), would lower the EU's shares of global GDP and social protection spending by about 20 per cent, and push up the corresponding shares of emerging market economies.

While Merkel's point is that something will need to 'give' in Europe's approach to its welfare model, the affordability of the welfare state is a tricky concept. The linked concern that high welfare spending is undermining European competitiveness has to be looked at with care, even if it is accepted that adjustments need to be made. Today's political and economic context for such an adjustment is not benign. In the wake of the financial crisis and a protracted recession in parts of Europe, national politics is fragmenting in both the more and less wealthy members of the EU.

Populist parties are on the rise, as seen in the results of the 2014 European Parliament elections and several national elections since then. There is a pervasive concern that neither national governments nor the EU as a whole will prevent globalization from further constraining median wages while widening income inequality.

This paper aims to lay out the scope of the challenge ahead. It starts by describing the core functions of the welfare state. Second, it outlines the evolution of particular welfare models across Europe and introduces the concept of social investment. Third, it assesses the ways in which socio-economic change threatens welfare state sustainability. It then considers the dilemmas for the welfare state and the potential for recasting the welfare model to cope more effectively with the challenges it faces.

Three areas for deeper research are suggested. These will form the basis of an additional series of papers, focusing on the economic, social and governance dimensions of the welfare challenge. These papers will suggest changes in strategy and specific policy approaches to welfare provision, with the aim of enabling European countries to achieve sustainable welfare systems for the coming decades.

What Is the Welfare State?

European countries developed their welfare systems during a period when the region's benign demographic profile could support extensive social spending and when solid economic growth made it affordable. The political economy of Europe has been defined since the 1950s by the development in each European country of a more or less comprehensive welfare model, whereby the state has taken a central role in providing a range of social benefits, the most costly of which are pensions, support for the poor, social housing and healthcare. In parallel, all EU countries have sought to regulate labour markets and ensure a fair deal for workers. One of the most complex challenges currently facing European governments and societies is to reconcile these commitments to welfare provision, which are widely supported politically, with pressures that may make them unsustainable economically.

Purposes and design

The European 'welfare state' eludes concrete or universal definition. Its principal purpose, however, has been to help governments reconcile the often competing dynamics of capitalism, equity and democracy. Free-market economies have an inherent tendency towards income inequality and distribute economic power unequally, while democratic government seeks to distribute political power more evenly and to promote notions of social equality.[2] In relation to European integration, the underlying challenge can be seen as a variant on Dani Rodrik's 'trilemma', in which there is mutual incompatibility between global economic integration, the nation state and democracy.[3] In his analysis, only two out of the three can simultaneously be sustained.

2 See Colin Hay and Daniel Wincott, The Political Economy of European Welfare Capitalism (Basingstoke, Hampshire: Palgrave Macmillan, 2012).

3 Dani Rodrik, The Globalization Paradox: Why Global Markets, States, and Democracy Can't Coexist (New York: W.W. Norton, 2011).

The result is that much of the debate about designing a welfare state and judging the pros and cons of its different components is influenced by political ideology. For some, the state should play a central role in income redistribution in order to sustain welfare budgets. For others, the capacity to deliver social welfare is a by-product of a less interventionist approach to economic governance. Inevitably, the particular political outlook then influences the methods by which a government seeks to deliver welfare policies.

A good example lies in healthcare. In the United States, the political consensus long held that this should principally be a private responsibility, leaving the state to provide support only to those unable to afford private health insurance. The deeply politicized and increasingly contested nature of this settlement was exposed by the difficulties that President Barack Obama faced in passing the Affordable Care Act. In the United Kingdom, the prevailing political consensus is that the state should have principal responsibility for healthcare, providing universal coverage through the central government budget and thereby avoiding the market failures that have long blighted the US system.

Welfare state functions

Overall, the welfare state fulfils three analytically distinctive functions:[4]

- **The 'Robin Hood' function** of redistributing in various ways from better-off members of society to those faced with material or other deprivation or subject to higher social risks. Welfare states comprise institutions and mechanisms designed to protect against these risks by delivering poverty

4 Drawing on, and extending, Nicholas Barr, The Economics of the Welfare State (5th edition, Oxford: Oxford University Press, 2012).

relief, providing social housing, redistributing income and reducing social exclusion. Labour market regulations protect against unfair dismissal and ensure rights for temporary workers. Social risks have evolved over time and now include aspects such as one-parent families and the isolation of old-age pensioners from their families.

- **The 'piggy bank' function** through which the welfare state enables citizens to insure themselves against social hardship and to spread their income more securely over their lifetime, with pensions being the main element.

- **The social investment function** that enables the state to invest in the nation's human and (harder to define) social capital.[5] This includes kindergarten care, state education from primary level through university, out-of-work training and various types of work-related tax benefits.

In macroeconomic terms, state welfare budgets serve as 'automatic stabilizers' against the effects of economic disruption at the individual and national levels. More specifically, they address a number of policy priorities, including those listed below.

Macro- and microeconomic efficiency

A welfare state reacts to market failures wherever there are deviations from optimal outcomes, in particular uninsurable risks. Government intervention is therefore justified, even in the most libertarian systems, because it increases economic efficiency over time. Improving aggregate as well as individual economic efficiency lies at the heart of most aspects of welfare provision.

5 See Anton Hemerijck, Changing Welfare States (Oxford: Oxford University Press, 2012).

Consumption smoothing

Through the provisions of cash benefits for pensioners and for families with young children, a welfare state allows individuals to smooth out their financial expenditure and consumption over their lifetime.

Pension schemes allow individuals to redistribute income from their younger to their older selves in a secure manner. Student loans enable students to consume more than their current income allows through claims on their future income. Child benefits allow families with young children to consume more than they could otherwise at a financially constrained point in their lives.

Risk-sharing

The welfare state provides insurance against unexpected and unacceptable changes in individuals' living standards, through mechanisms such as unemployment and disability benefits. At the same time it has to guard against eliminating incentives to take well-judged risks that offer rewards for individuals and society alike. An example would be overly generous unemployment benefits that discourage the search for new employment. Different modes of risk-sharing are:

- Actuarial insurance: individuals pool risks to be insured against losses from certain events. Benefits from actuarial insurance are strictly related to one's own contributions. There is no systematic redistribution from rich to poor but rather from 'lucky' to 'unlucky', i.e. from those people who pay for the insurance but never suffer from the insured loss to those who do.

- Social insurance: the same pooling principle as actuarial insurance, but typically with compulsory membership, perhaps justified because the market would not insure against the risks in question.

- Redistribution from rich to poor: risk-sharing mechanisms can entail redistributive elements, such as pension schemes that provide higher benefits relative to paid contributions for lower-paid than for higher-paid workers.

Relieving poverty

An essential objective of the modern welfare state is poverty relief, with nearly all EU countries offering some form of minimum income guarantee and many undertaking to offer basic shelter. Whether this entails elimination of poverty or alleviation of poverty is subject to political decisions and depends on a number of factors.

Reducing inequality

Reducing inequality entails both vertical redistribution (from rich to poor households through progressive taxation) and horizontal redistribution (ensuring that households with similar characteristics, such as age, family size etc., are treated equivalently).

Addressing social exclusion

Addressing social exclusion is a broader and more normative objective of the welfare state. It includes increasing social solidarity and the dignity of welfare clients by delivering benefits without unnecessary stigma.

Box 1 | How do governments distribute social benefits?

Cash benefits

_ Social insurance: entitlements to benefits are based on past contributions, with payments triggered by specific contingencies (e.g. unemployment, retirement or ill health). Examples include replacement incomes for the unemployed, pensions and disability allowances.

_ Non-contributory benefits: benefits available to all, without any obligation to contribute or means-testing (e.g. child benefit in many countries).

_ Social assistance: means-tested benefits for those in poverty.

Benefits in kind

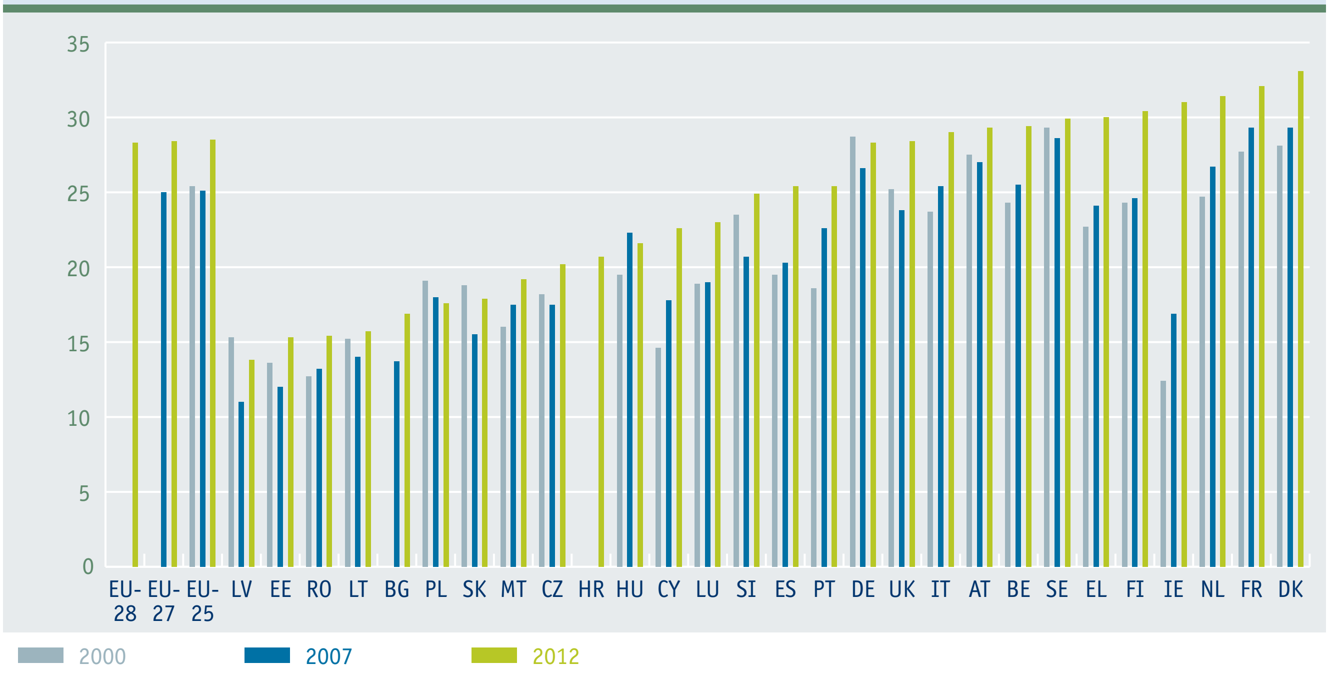
_ Benefits in kind provide welfare through the free provision of services, such as healthcare, social housing (either free or at rents below market levels) and education. The three main issues that policy-makers need to address are how these benefits are financed, how they are delivered and how quality can be assured.

_ In most countries healthcare is financed to a large degree through the state, since the market for healthcare does not conform to the principles that are expected of a well-functioning market (being subject, for example, to imperfect information or incomplete provision of insurance that can deny protection to many of the most needy).

_ This explains why the United States, which relies heavily on private finance, spent almost twice as much (16.2 per cent of GDP) on healthcare in 2012 as the average for other OECD countries (8.8 per cent of GDP). By contrast, the figures were 8.9 per cent for the United Kingdom, 9.1 per cent for Sweden and 10.9 per cent for Germany. The mode of delivery, on the other hand, varies in different countries (from mostly public to mixed forms to mostly private) since it interferes less with efficiency.

_ For similar reasons, school education is predominantly both financed and delivered publicly in most countries, while the provision of university education is more diverse.

Figure 3 | Social protection benefits – all functions (expenditure as % of GDP)



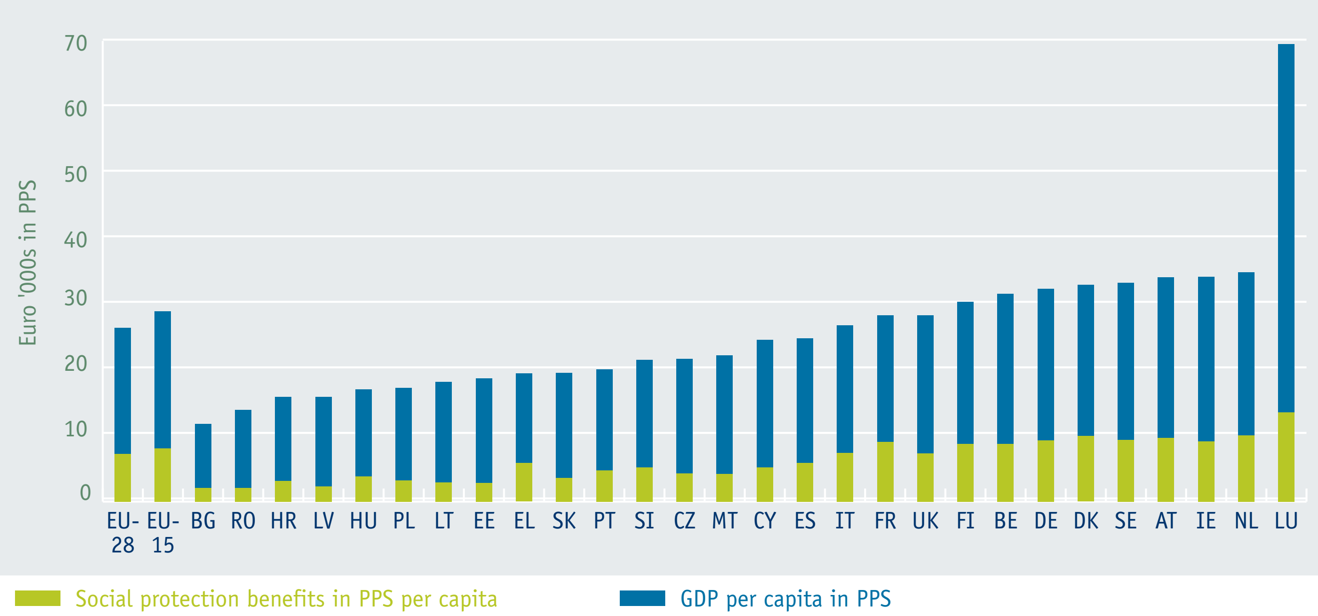
Source: EUROSTAT.

Welfare spending in Europe

It is clear from recent data that governments continued to allow spending on social protection to increase before and after the financial crisis, whether because it played its automatic stabilizing function or in order to protect particular segments of the population for political reasons, and that all of this occurred despite the pervasive 'austerity' narrative (see Figure 3). More generally, it is hard to cut or even restructure social benefits for the simple political economy reason that those who lose out protest loudly. This leads many governments to opt instead for less conspicuous cuts in public investment when public finances are under pressure.

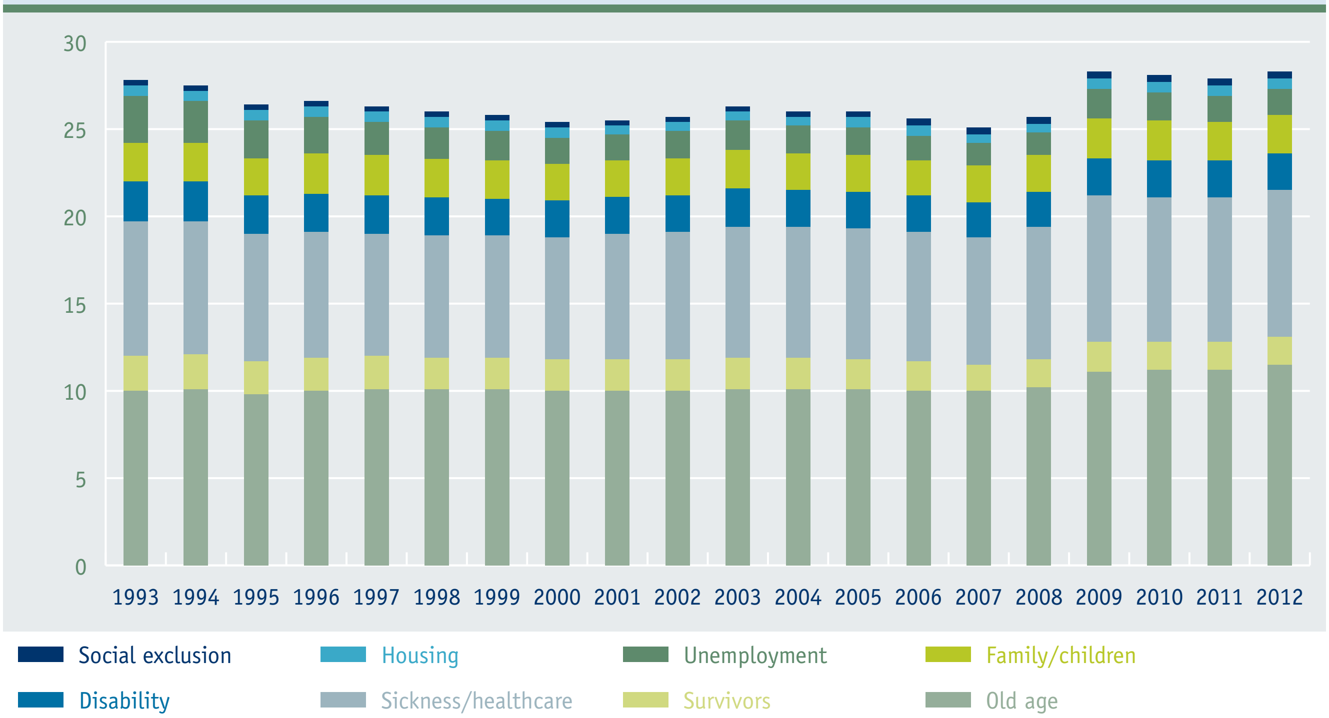
Some of the differences between EU countries can be discerned from considering the scale and mix of welfare spending (see Figures 4 and 5). These differences partly reflect national traditions and preferences, but also the differing economic conditions in countries. Per capita spending on welfare is lower as a share of GDP in the lowest-income EU countries, but clearly higher in France than in the United Kingdom, two countries with similar levels of GDP. Yet it is also noteworthy that per capita spending levels are similar across the northern European countries. Among the headings of welfare spending, it is striking just how stable the shares of old-age outlays were up to the crisis and how they appear to have been protected (and have indeed increased) since 2008. Healthcare, similarly,

Figure 4 | Expenditure on social protection benefits – all functions (PPS* basis per capita, relative to GDP per capita, 2012)



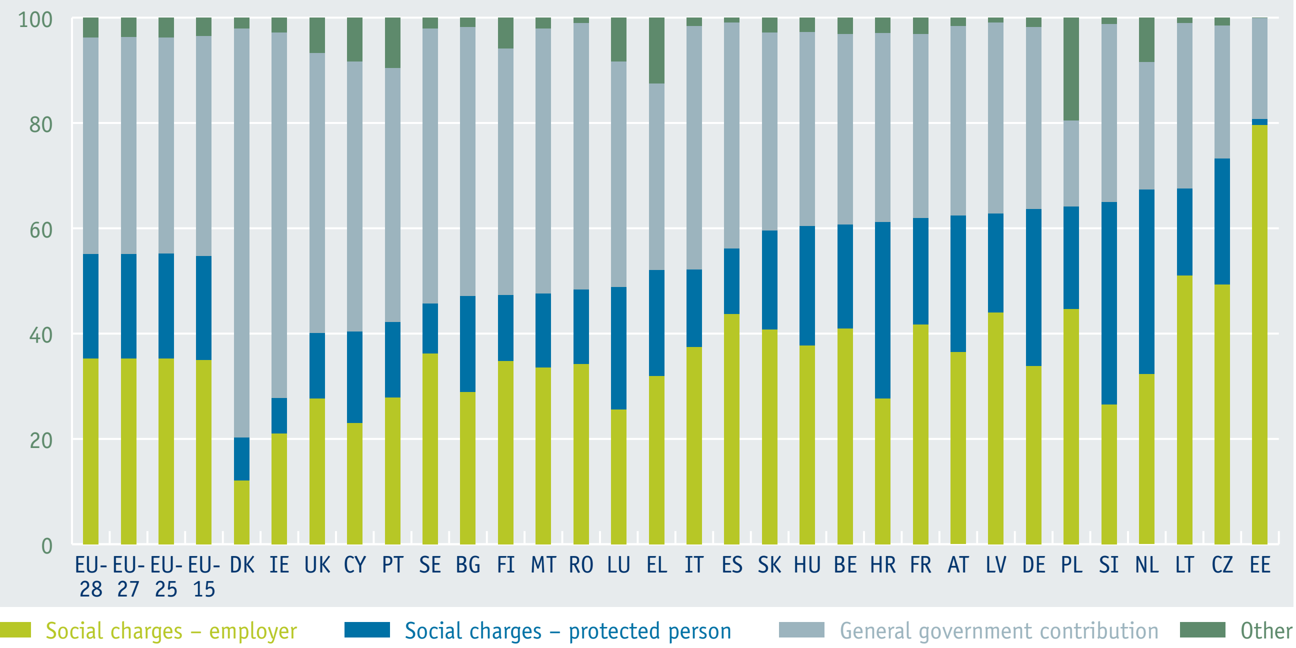
* Purchasing power standard.
Source: EUROSTAT.

Figure 5 | Expenditure on social protection benefits – by function (as % of GDP in EU*, 1993–2012)



* EU is taken as EU-15 for 1993–99, EU-25 for 2000–04, EU-27 for 2005–07, EU-28 for 2008–12.
Source: EUROSTAT.

Figure 6 | Social protection receipts – by type (% of total receipts in 2012)



Source: EUROSTAT.

has been gently increasing its share. The share going to unemployment benefit, albeit small, jumped after 2007 as the number of unemployed people rose. Overall, as a share of GDP, social spending has varied less than might be expected, only jumping in 2009 when GDP, the denominator of the ratio, fell sharply.

Governments across Europe raise the revenue needed to meet their welfare commitments from a mix of explicit social charges levied on employers and employees, general taxation and some charges for specific benefits (see Figure 6). Even in the United Kingdom, for example, 'free at the point of need' healthcare includes a flat charge for some drug prescriptions and various fees for dental care. With public finances under pressure, how to fund welfare states will be an increasingly delicate governance issue.

The main differences between EU countries are in the proportion of revenue raised from explicit social charges, the consequence of which is that general taxation has to make up the difference. At one extreme, Denmark generates only a fifth of the income through charges on employers and workers, whereas in Estonia the proportion is four times as high. Differences between the share paid by workers as opposed to their employers are also noteworthy, with Slovenia and Germany among those asking workers to shoulder more of the burden.

Evolving European Models of Welfare States

Welfare states in Europe were largely constructed in their present form following the Second World War, but reflect longer-term national traditions and accommodations. Despite considerable diversity in the core values of the respective national welfare systems in Europe, many norms are common across the continent. It is reasonable, therefore, to speak of a distinctive European social model, often most easily defined in terms of what other parts of the world lack. Pascal Lamy has referred to the model as embodying 'a European way of life' and described it as 'a civilized version of globalization'.[6] Its key features include protection of workers and a commitment to social protection of the vulnerable and to limiting inequalities. There are, indisputably, components of national social provision which have special status: to Britons, the National Health Service has totemic status; in France the word 'solidarity' is central to welfare politics; and citizens of the Nordic countries set great store by a broad definition of equality.

Welfare systems in the postwar socio-economic paradigm

Welfare states in Europe were a key component of the postwar economic management paradigm, in what is sometimes referred to as a golden age of economic growth up to the early 1970s. Among the attributes of this paradigm were reconciling democracy and capitalism, allowing high growth and investment, and at the same time significantly reducing insecurities (poverty, unemployment, inadequate healthcare, etc.) for the working population. Full employment was an underlying objective. Welfare systems also contributed to the legitimization of the nation state in the postwar era, as explained by Alan Milward in a seminal book.[7] What transpired was a division of labour between the European 'project' (providing economic integration and fostering growth) and the nation state (providing social welfare and ensuring that the benefits of higher growth were equitably distributed among different social groups).

From the oil shocks of the 1970s onwards, the conjunction of rising inflation and slowing growth – what came to be known as 'stagflation' – called into question the prevailing economic orthodoxy, leading to what is sometimes called neoliberalism. This was characterized by renewed reliance on market mechanisms, and a belief in the need for smaller government and sound money (balancing fiscal budgets, low inflation, etc.). In subsequent decades, the paradox emerged of there being consistent pressure on, and questioning of, public spending on social policies while surprisingly stable amounts of money were spent on social protection systems.

'Worlds of welfare'

Nevertheless, differing welfare models evolved over this period. In parallel with work on 'varieties of capitalism', these models have been categorized in various ways by academics, with perhaps the best known being Gøsta Esping-Andersen's 'worlds of welfare capitalism'.[8] He identified three distinct models of welfare state within Europe, marked by levels of 'decommodification' (i.e. income support for those outside the labour market), 'stratification' (i.e. the effects of welfare policies on social class and mobility) and the different providers of welfare (i.e. public, private, etc.). Later a fourth, southern

6 EurActiv, 'Lamy: Social model distinguishes Europe from the rest of the world', 4 February 2014, http://www.euractiv.com/eu-elections-2014/pascal-lamy-interview-interview-533239.

7 Alan Milward, The European Rescue of the Nation-State (2nd edition, London: Routledge, 2000).

8 Gøsta Esping-Andersen, The Three Worlds of Welfare Capitalism (Princeton, New Jersey: Princeton University Press, 1990).

Box 2 | 'Worlds' of welfare capitalism*

Social-democratic/Scandinavian model

- Prevalent in Denmark, Sweden.
- Generous replacement of market earnings through the state.
- Stratification of universal social citizenship/social welfare as a universal right.
- State as main provider of social welfare.
- Characterized by high social expenditure, active labour market policies and increased public-sector employment.

Corporatist/Continental model, sometimes also known as 'Bismarckian'

- Northern-central Europe, typified by Germany and France.
- Varying degrees of decommodification and stratification, preserving the status of workers.
- Main provider of welfare is the family, but contributory principle ties many benefits to employment history.
- Basic security supplemented with contributory benefits (pensions, unemployment, etc.).
- Opening up jobs through earlier retirement.

Liberal/Anglo-Saxon model

- United Kingdom, Ireland.
- Minimal decommodification; stigmatizing stratification.
- Seeks to increase demand for labour through liberalization and wage flexibility.
- Mostly private forms of insurance.
- Benefits comparatively low and linked to means-testing.
- Poverty relief through minimum wages, but less of a focus on equality.

Southern model

- Spain, Italy, Greece, Portugal.
- Insider-based entitlements.
- Extended family as core unit.
- Income maintenance.
- Strong jobs protection – favouring, for example, full-time over temporary workers.

* Based on concepts developed by Gøsta Esping-Andersen and Maurizio Ferrera.

European 'world' was added based on work by Maurizio Ferrera.[9] (See Box 2.) It is a moot point whether the systems put in place in the course of the transitions from socialism of the countries of central and eastern Europe constitute a fifth model.

The 'worlds of welfare capitalism' approach sets out 'ideal-type' models rather than being a precise description of welfare approaches in specific countries. However, it has had an enduring influence, even though the reality is more nuanced and substantial changes have occurred over the past quarter of a century in many countries. Developments since the seminal work of Esping-Andersen was published often belie easy categorization, as the examples of France and Germany show, given that they display very different characteristics in their welfare regimes, despite being part of the same 'world'. Germany, in particular, has undergone extensive welfare reforms since reunification; these have facilitated a much increased employment rate compared with France.

Social investment as a new European model

Since the mid-1990s, a shift in welfare provision towards social investment has become evident. Although the term allows for different interpretations,[10] the 'social investment state' can be understood as a concept in which the state tries to foster adaptability, flexibility, security and employability. It has many roots, including the activation policies already prominent in Sweden from as early as the 1930s and the notion of social protection as a productive factor that became prominent in Belgium, the Netherlands and Luxembourg in the 1990s. It can also be regarded politically as a means of legitimizing

9 Maurizio Ferrera, 'The "Southern Model" of Welfare in Social Europe', Journal of European Social Policy, 6:1, 1996, pp. 17–37.

10 Frank Vandenbroucke and Koen Vleminckx, 'Disappointing poverty trends: is the social investment state to blame?', Journal of European Social Policy, 21:5, 2011, pp. 450–71.

the welfare states in a context of taxpayer resistance to the rising cost of programmes perceived (however inaccurately) to be predominantly redistributive. What distinguishes the social investment approach is that its focus is much more on 'capacitating' interventions than on those which compensate. In this sense, social investment is about raising human and social capital to prevent future problems that could require costlier interventions.[11]

An interesting way of looking at this stronger role of the state is that it provides an active approach to the challenges posed by many long-term socio-ecological transitions. Ageing needs to be managed, as does climate change or societal evolution. 'Active' labour market policies that enhance human capital, rather than the more traditional passive income support for the economically inactive, can equip an economy to meet challenges such as decarbonization or the growth of the knowledge economy, and help to provide the workforce with the new skills required.

Some critics of social investment point to its correlation with what has become known as the 'Matthew effect', deriving from verse 13.12 of the Gospel of Matthew in the Bible, which states: 'for whosoever hath, to him shall be given, and he shall have more abundance: but whosoever hath not, from him shall be taken away even that he hath'.[12,13] They argue that too many of its benefits accrue to middle-class citizens, examples being increases in childcare support or favourable treatment for private pensions. The wider concern expressed by bodies such as the European Anti-Poverty Network is that by putting work at the heart of social policy, the social investment approach discriminates against those in the most dire need and undermines the principles of protection and solidarity that are central to European welfare policies.

11 Nathalie Morel, Bruno Palier and Joakim Palme (eds), Towards a Social Investment Welfare State? Ideas, Policies and Challenges (Bristol: Policy Press, 2012).

12 For example Bea Cantillon, 'The paradox of the social investment state: growth, employment and poverty in the Lisbon era', Journal of European Social Policy, 21:5, 2011, pp. 432–49.

13 King James Bible, Authorized Version (KJV).

Drivers of Change

While Europe's governments have developed an elaborate system of social protections and incentives for their citizens, its welfare states are now under threat from a number of directions. Principal among these are demographic change, the pressures at national level from economic globalization, the increasingly explicit EU-level requirements for national budget discipline, and the changing nature of work. Dealing with climate change is also widely recognized as a core challenge, likely to generate new social risks that welfare states are ill-equipped to manage. An obvious example is fuel poverty resulting from rising energy prices. But there are also opportunities; targeted energy efficiency measures (better insulation of the European housing stock, for example) would help to reduce carbon emissions and address fuel poverty. The many dimensions of 'sustainability' are, therefore, also germane to the future of the welfare state.

Demographic change

Population ageing will affect all European countries, albeit at different rates and times. The populations of Finland and Germany are already starting to decline and are projected to fall sharply up to 2050, with ramifications for the labour market and the financial sustainability of each country's welfare state. The German workforce, for example, is projected to shrink by between 11.1 per cent and 18.7 per cent (depending on the scenario) by 2030 compared to today,[14] while the country's old-age dependency ratio (the ratio of elderly dependents to the working population) is expected to rise to about 0.45, from 0.31 in 2010.[15] Ireland is at the other end of the spectrum, but will still have to deal with ageing before long. Overall, the proportion of the population aged 65 or over in the EU28 is projected to rise steadily from 18.9 per cent in 2015 to 23.9 per cent in 2030 and 28.1 per cent in 2050.[16]

The challenge this presents for the welfare state has several dimensions. The first relates to the simple arithmetic of the 'piggy bank' function: more pensioners, living longer increases the financial burden unless countervailing action is taken. Provision of care, sheltered housing or other social services adds to the financial challenges, while also requiring suitably qualified labour. In appraising the costs, it is important to note that the distinction between fully capitalized funding (through which pension funds own the assets from which the income flows pay pensions) and pay-as-you-go systems (which rely on raising revenue from today's taxpayers and social charges) may affect the details, but does not fundamentally alter the arithmetic of a falling working population having to support a growing dependent population. However, it does raise governance questions around fairness, mechanisms, legitimation and transparency.

Immigration can mitigate the impact of the demographic shift, particularly if migrants are predominantly younger working-age people who are motivated to work. However, the difficulties European countries have had in coping with would-be migrants crossing the Mediterranean illustrate the political and social obstacles to higher immigration across the EU, even in Germany which has been more receptive to migrants than many other EU countries. Moreover, there have been instances of specific problems associated with integrating immigrants and resulting tensions. The evident problem here is that the blurred boundary between, on the one hand, those trying to come to Europe as economic migrants and, on the other, refugees

14 Mathias Dolls, Karina Doorley, Hilmar Schneider and Eric Sommer, Demographic change in Europe: The labor market and fiscal effects in 2030, NEUJOBS Working Paper D 10.8, January 2014, http://www.neujobs.eu/sites/default/files/publication/2014/10/D10.8_final%20version_.pdf.

15 Alari Paulus, Sebastian Siegloch and Eric Sommer, Increasing the Retirement Age to Counter Population Aging? Evidence from the EU27, NEUJOBS Working Paper D 10.10, June 2014, http://www.neujobs.eu/sites/default/files/publication/2014/10/NEUJOBS_D1010_revision.pdf.

16 EUROSTAT, EUROPOP2013 projections, http://ec.europa.eu/eurostat/data/database?node_code=proj.

fleeing oppressive regimes has inhibited rational debate about the potential role of immigrants in countering the ageing of populations.

Globalization

Globalization is reducing European governments' ability to sustain or reform welfare institutions and arrangements independently. For example, currently elaborate and often expensive welfare provision is frequently funded by requiring European employers to pay a labour tax or social charge for each worker employed. At a time of mobile capital and a global race to attract foreign investment, European countries with relatively high welfare charges find domestic companies moving increasing proportions of their operations to locations with lower labour costs, whether inside or outside Europe. Similarly, restrictions on firing workers as a means of minimizing the social exclusion caused by unemployment can lead to companies taking employment 'offshore'. Remedies include shifting the tax base, e.g. to environmental taxes (part of the attraction lies in taxing 'bads' rather than 'goods' such as labour), but care is needed not to create new problems as a result of unintended consequences. A poorly designed carbon tax, for instance, could aggravate fuel poverty for poor households and damage competitiveness by raising energy costs, particularly if European standards are out of step with those in other Western economies and emerging markets.

In several European countries high unemployment has been exacerbated by the tension between restrictive labour markets and the pressures on companies to earn high returns on capital. Restrictive labour regulations can undermine the demographic dividend for European countries that comes from taking in younger immigrants, by making it hard to integrate newcomers into the labour force. Instead of finding work quickly, thereby contributing to the funding of the welfare system, immigrants can end up placing additional burdens on it.

European integration

Public debt has risen significantly across the EU to a weighted average in a range around 90 per cent of GDP. While some of the blame for this can be attributed to the need for certain governments to bail out parts of their financial sectors following imprudent lending in the lead-up to the 2008–09 financial crisis, sustaining welfare commitments at a time of declining economic competitiveness in an increasingly open world economy has also contributed to the rise. A further significant rise in debt levels would become unsustainable.

Given the integrated nature of European economies through the single market, reducing government deficits and debt has become a central priority for European governments and the EU as a whole. Although the mix of welfare expenditure in each EU member state is driven by national politics and policies, coordinating reform responses at the EU level has become, in many cases, the only way for national governments to overcome domestic vested interests that seek to protect specific aspects of welfare. Past examples of such coordination included the convergence criteria established in advance of the Maastricht Treaty to determine which countries would join the single currency, and the Stability and Growth Pact agreed at the launch of monetary union in 1999. More recently, the EU's economic governance has been deepened to embrace the 'semester' process through which the European Commission now scrutinizes member states' economic policies and, for the euro area members, annual budgets.

One consequence of the creation of a single market in the EU allowing free movement of goods, services and capital was the need for free movement of labour. In theory, this provides a means of absorbing economic shocks affecting only part of the EU, because workers will be attracted to the more dynamic countries and regions, rather than languishing in unemployment. Free movement of labour then led to the concept of a European welfare model, enshrined in the EU's Social Chapter, which stipulated EU-wide rights for workers – ranging from rights to holidays to limits on the number of hours someone can be obliged to work. However, a frequently heard academic argument is that the market-making associated with European integration (referred to in the literature as 'negative integration') has long been politically easier to achieve than common social regulation aimed at curbing market excesses (known as 'positive integration'). In the European context, Fritz Scharpf has argued that member states converge towards an integrated liberal market economy model which at the same time substantively obstructs the embedding of a strong social dimension in EU policies.[17]

Changes in the family structure/societal change

EU welfare states are facing reform pressures from societal changes that create new demands for social provision while affecting the basis for welfare funding. In particular, the significant increase in the participation rate of women in the labour force in large parts of Europe over the past two to three decades (see Figure 7 for the evolution in Germany) has raised demand for publicly funded childcare. It has also led to calls for a rethinking of entitlements. The shift away from the male-breadwinner model is still a work in progress, even though it is increasingly essential at a time when Europe's overall workforce is shrinking as the population ages. As this process unfolds, certain aspects of the welfare model, such as the provision of public support for childcare or child benefit, will increase in importance.

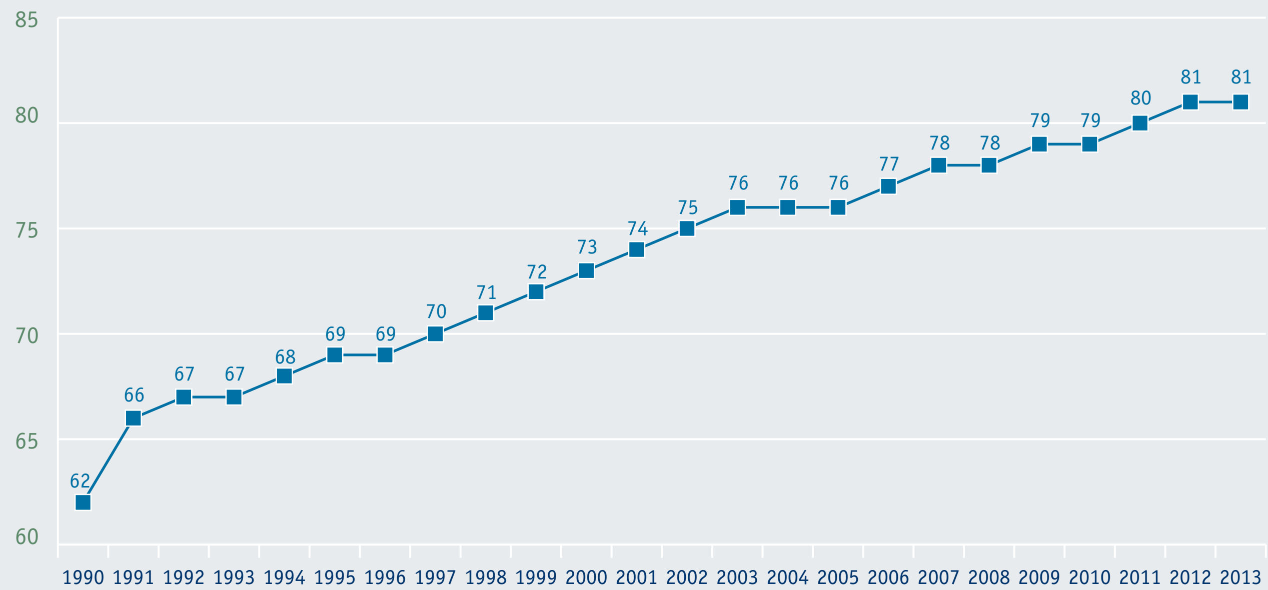
The general need for increased immigration to compensate for ageing populations and the reality of growing numbers of migrants coming from and through the Middle East and North Africa are posing additional challenges to European welfare states. Local services, from schools to hospitals, have to cope with more young people entering primary public education and more elderly people requiring public support. In some EU countries, there is evidence of immigrants' families suffering social exclusion. Nevertheless, EU agreements in areas such as pension portability can at least underpin intra-EU migration and allow EU residents to take advantage of opportunities to move freely, whether for work or retirement.

Technology, innovation and the changing mix of jobs

New technologies and structural changes in economies are bound to affect the welfare state and the nature of jobs. Productivity growth is at the heart of economic growth and generally to be welcomed, but in a period of slow growth there can be a tension between maintaining jobs and introducing labour-saving innovations. Fears that jobs will disappear, leading to pervasive unemployment, often prove to be misplaced. But periods of transformation undeniably create winners and losers. In all EU countries, the trend has been for the share of service activities in the economy to grow and that of industry to decline, with implications for the types of jobs that are

17 Fritz W. Scharpf, 'The Asymmetry of European Integration or why the EU cannot be a "Social Market Economy"', Socio-Economic Review, 8:2, 2010, pp. 211–50. His characterization of the newly evolving European model draws on the work of Gøsta Esping-Andersen, The Three Worlds of Welfare Capitalism (Princeton, New Jersey: Princeton University Press, 1990), as well as on Peter A. Hall and David Soskice (eds), Varieties of Capitalism: The Institutional Foundations of Competitiveness (Oxford: Oxford University Press, 2001).

Figure 7 | Labour force participation rate (female–male ratio)*, Germany



* Ratio of female to male of proportion of a country's working-age population (ages 15 and older) that engages in the labour market, either by working or actively looking for work, expressed as a percentage of the working-age population.
Sources: UN Development Programme; Key Indicators on the Labour Market (7th edition, Geneva: International Labour Organization, 2013).

created or lost. There is also some evidence that 'green' jobs are increasing, albeit from a low base, raising questions about the skills and associated training that such a shift may require. Both the European Centre for the Development of Vocational Training (CEDEFOP), which analyses skills needs for the EU, and the OECD stress the importance of 'transversal' green skills – that is, skills applicable to a broad range of environmental tasks – rather than occupation-specific ones.[18]

For European countries, one of the issues that surfaced during the crisis years was how to maintain employment levels. The very different rates of unemployment among them testify to the divergence in their ability to achieve this objective. In Germany and the United Kingdom, low unemployment rates are at least in part attributable to the way job preservation was stressed (belying the 'hire and fire' image of the latter), although critics argue that this was only possible because of resort to precarious forms of employment, such as 'Kurzarbeit' in Germany or 'zero hours' contracts in the United Kingdom. In other countries, such as Spain, job losses were substantial. These differences also reflected the incidence of the recession. Ireland and Spain suffered big downturns in construction, a sector less likely to retain employees when demand falls.

18 OECD and CEDEFOP, Greener Skills and Jobs (Paris: OECD, 2014).

The European Commission, just prior to the crisis, had espoused 'flexicurity' – an approach combining flexible labour markets, fairly generous social protection, and activation policies – as its favoured model. In a number of countries this was criticized as an anti-worker policy. Germany, however, offers an example of the successful application of this approach, having undergone significant deregulation of its labour market following reunification. This is in contrast to what happened in France, where the scope for creating 'non-standard' jobs as a means of averting higher unemployment proved more limited.[19]

The European welfare model is also challenged by polarization in the labour market. Europe continues to generate a healthy number of high-skilled jobs. It also has steady demand for lower-skilled jobs in areas such as care and other personal services. However, there is evidence of a hollowing-out of jobs in the middle of the range of skills distribution. This is largely as a result of technological change, although the pattern varies among member states.[20] An increase in high-skilled jobs has most recently given way to renewed growth at the lower end of the skills distribution. An associated trend is an upsurge in part-time jobs, which raises challenges for states that base entitlements to various forms of welfare provision on full-time work.

19 Christian Dustmann, Bernd Fitzenberger, Uta Schönberg and Alexandra Spitz-Oener, 'From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy', Journal of Economic Perspectives, 28:1, 2014, pp. 167–188; Wendy Carlin, Anke Hassel, Andrew Martin and David Soskice, 'The transformation of the German model', in Jon Erik Dolvik and Andrew Martin (eds), European Social Models from Crisis to Crisis (Oxford: Oxford University Press, 2014).

20 Eurofound, 'Upgrading or polarisation? Long-term or global shifts in the employment structure', European Jobs Monitor 2015 (Luxembourg: Publications Office of the European Union, 2015).

Dilemmas for the Welfare State

Economic concerns

Given the drivers of change examined above, a frequently expressed view is that Europe can no longer afford the welfare state that was one of the mainstays of its social models during the postwar period. The 'Merkel formula' that 7 per cent of the world's population producing 25 per cent of global output cannot sustain 50 per cent of global social protection spending implies that European welfare states have become unaffordable. The message is that by continuing to accept such a burden, European economies are rendering themselves uncompetitive in global markets and that welfare states have to change (and would have needed to do so even without the squeeze on public finances of recent years).

The other side to the story is that well-designed welfare states can promote sustainable growth, potentially increasing the size of the overall welfare 'pie' in addition to determining how it is sliced. This prompts the question of whether current provisions in Europe, most of which are mediated through the public sector, are appropriate. Some welfare arrangements in Europe manifestly need recalibration or even wide-ranging reform, but others can be shown to be necessary and efficient.

In his work on the economics of the welfare state, Nick Barr is critical of the woolly thinking that fails to distinguish between the objectives and the means of delivery of different welfare state provisions.[21] In many European systems, the right to healthcare, social provision and so on is often conjoined with the idea that it must be produced by the state. There are certainly sound arguments that public risk-pooling can be better and more efficient than private provision, as noted by the prime example of the vastly expensive US healthcare system. However, care is needed to identify why market failures arise and when government failures might be just as bad, if not worse.

Moreover, the social risks against which welfare states provide insurance or support arise everywhere; if they were not dealt with by the welfare state, they would have to be resolved by other means. For example, the growing difficulties in financing pay-as-you-go pension systems have led many policy-makers to advocate a transition to funded pension schemes, not least to benefit from the high returns on investments that capital markets yield. But as noted above, both systems are equally sensitive to demographic change. In a funded scheme individuals acquire claims on future consumption over their working lives, accumulated in pension funds. Upon retiring, those claims will be realized, and the nominally accumulated assets or monetary funds used for consumption. Since overall output, however, does not increase, the burden shouldered by the economically active population is the same as in a pay-as-you-go system.

There are potentially even more intractable challenges associated with the increasing demands that ageing populations, who are also living longer, are imposing on stretched public healthcare and long-term care systems. New medical breakthroughs, which are obviously good news for individual health and welfare, often result in substantial additional costs, while expectations of care provision can rise. The conjunction of an ageing society and the higher probability that older people will vote, and campaign for higher public spending that favours them, raises difficult questions around democratic decision-making in relation to the welfare state.

Although a long-term solution to ageing costs could involve policies to increase fertility, it cannot improve matters before the next cohort enters the labour market. Moreover, more children may create an additional burden of dependency. Unless

21 Barr, The Economics of the Welfare State.

the systems change, the decline in the number of people paying into the pension system and the increase in those drawing on it could lead to growing pressures on public budgets. There are, nevertheless, approaches to stabilizing outlays on pensions, for example by linking them to GDP growth, such that the cost of pensions is prevented from rising excessively. Over a 10- to 20-year horizon, therefore, there are four possible solutions for easing the cost of ageing. These are:

- Increasing the effective age at which 'piggy bank' benefits become payable by altering the balance between the working lifetime and the projected period of inactivity (noting that, as in the recent German pension reform, fairness dictates that years worked, as well as the official retirement age, have to be taken into account). Early-retirement schemes favoured for reasons of providing jobs for young entrants into the labour market have proved in the past to be a mistaken policy response.

- Reducing the generosity of payments and services offered to the elderly.

- Raising additional revenue from the working population, including by boosting the latter's size by attracting immigrant workers.

- Investing abroad to generate a future flow of income, emulating the example of Norway's massive sovereign wealth fund.

Social concerns

An underlying dilemma is that many of the core assumptions on which welfare states were constructed are no longer tenable. Longer life expectancy, much improved health, the emancipation of women and the virtual elimination of absolute poverty are rightly celebrated as achievements. Although the 2008–09 financial crisis has resulted in the return of poverty and mass unemployment in the worst-affected countries, and increased use of food-banks in others, three of the five 'giant evils' listed by William Beveridge in his 1942 report that laid the basis for the postwar UK welfare state – disease, squalor and ignorance (the others were want and idleness) – are no longer endemic in European societies as they were in the early postwar years. Instead, the new social risks have to be summed up with a different array of watchwords, such as exclusion, inequality, lack of opportunity, frailty and transitions over the life-course. It can also be argued that while advances in healthcare have largely eradicated many of the diseases, such as tuberculosis and polio, that afflicted European societies in Beveridge's day, new healthcare challenges have to be confronted. Obesity, lifestyle-related cancers, mental health problems and the growth of age-related dementia are among the contemporary health concerns reshaping demands on welfare systems, often for chronic rather than acute care.

To the extent that welfare states with a mix of family, retirement and survivor benefits were designed for a typical working-life pattern, it was that of the full-time male manual worker as the principal breadwinner. In many welfare states, especially in southern Europe, the family remained a key part of the model, providing care and shelter for younger, older or incapacitated members. Greater social mobility, changing gender roles and rising expectations of public services have all contributed to an evolving societal model which is reshaping social policy demands.

As a result, new risks have to be confronted and new expectations of welfare states recognized. The new issues include various forms of social exclusion, dealing with single parents where family structures fail to cope, new vectors of poverty and various dimensions of equality. In some cases, increasing segmentation of the labour market is leading to concerns about how to ensure that 'outsiders' are fairly treated, but also about whether supposedly standard models of employment fit the new context. A link with environmental sustainability has been posited by a number of authors, but the consequences for policy choices remain to be clarified.

Governance concerns

In all these areas, there are governance issues to resolve. A first is the balance between public and private provision in some of the most costly components of social policy. Even though the economic crisis of the past few years has been profound and has lasted longer than previous cyclical downturns, European societies (with obvious exceptions, such as Greece) are richer than they have ever been.

None the less, a narrative of the unaffordability of the welfare state has taken hold. In this regard, a distinction has to be made between the short-term imperative of restoring the sustainability of public finances and the much more contentious question of limits to the size of the state. Equally, the public/private dichotomy concerns the choices for individuals about how much they have to save, when they spend it and how their welfare entitlements are determined.

An associated question is how to organize welfare provision. In some EU countries, the state is the prime actor, while others delegate to specialist executive agencies or assign responsibility to social partners, such as employers' organizations and trade unions. National tradition is, plainly, central to what is done, but there may also be reasons to break with established norms: does the 'long goodbye to Bismarck'[22] signal that the time is ripe to rethink the fundamentals of welfare states based on the contributory principle? Yet as Esping-Andersen observes, there is no clear direction for where Bismarckian welfare states go next, although he notes the general trend towards the introduction of a basic safety net through some variant on minimum income.[23] A related issue is whether, despite the continuing resistance of many member states, closer economic integration may warrant an EU-wide (or at least eurozone-wide) unemployment insurance scheme of the sort mooted by the former European commissioner, László Andor.[24]

In a relatively closed economy with stable employment, funding the welfare state through social charges shared between employers and employees is viable, but with intensifying global competition, what labour economists describe as the 'wedge' between labour costs and wages becomes a difficulty. Where, as in certain EU countries, the wedge is half or more on top of wages, it can have a debilitating effect on competitiveness, over and above the cost in terms of the share of GDP. Ageing compounds the problem, if it means a rising welfare burden alongside a shrinking contributory base, even if more welfare spending comes out of general taxation rather than from a tax on labour.

More efficient delivery of welfare state provisions ought to be uncontroversial, and there is undoubtedly scope, in particular, for more and (crucially) better use of information technology in this regard.

22 Borrowing the phrase from Bruno Palier, A Long Goodbye to Bismarck: the Politics of Welfare Reform in Continental Europe (Amsterdam: Amsterdam University Press, 2010).

23 Gøsta Esping-Andersen, 'Foreword', in Palier, A Long Goodbye to Bismarck.

24 For example László Andor, 'Basic European unemployment insurance: Countering divergences within the Economic and Monetary Union', speech at the Vienna University of Economics and Business, Europa Press Release, 29 September 2014, http://europa.eu/rapid/press-release_SPEECH-14-635_en.htm.

Resistance is often substantial, partly for the familiar reason that disruptive technological change will mean that some jobs will be lost and that established models of managing activities have to be reformed. Equally, there is a growing body of evidence on new and experimental approaches that can be transformative. For example, Sitra (a Finnish public fund and one of the partners in this project) has examined a range of innovations and suggested how they could be implemented in improving approaches to government functions.[25] In a world of increased short- and long-term pressures on public finances, it will be incumbent on decision-makers to accelerate the adoption of such innovations.

25 Yves Doz and Mikko Kosonen, Government for the Future: Building the Strategic and Agile State, Sitra Studies 80, 2014, https://www.sitra.fi/julkaisut/Selvityksi%C3%A4-sarja/Selvityksia80.pdf.

Visions for the Welfare State and Strategies for Achieving Them

The welfare state is a defining feature of European societies, and the values which underpin it are deeply embedded in them. Differences between European countries are small compared with the gulf between Europe and many other parts of the world, and what Europe has is widely envied. Those contemplating reforms of social models and policies should not overlook the abiding strengths of European welfare states, even if it is accepted that major challenges arising from the drivers of change discussed above have to be confronted.

Moreover, as John Hills explains, the welfare state's influence is pervasive and affects opportunities for all strata of society, not just those currently claiming particular benefits. Hills finds that for most income groups, what they receive over their lifetimes from the welfare state broadly matches what they contribute. Only the top decile of the income distribution makes relatively lower (though still sizeable) demands on welfare systems, while the bottom decile receives relatively more.[26] In this sense the welfare state in all EU countries has to be seen as part of the fabric of society and not as an overblown and costly liability.

Transformation of the welfare state cannot, however, be avoided, so it is pertinent to ask towards what, for whom and how? It is worth stressing, first, that austerity and the aftermath of the financial crisis are largely short-term considerations. Certainly, welfare states need to be fiscally sustainable. Countries that have allowed social spending to race ahead of fiscal capacity will have to rein in the excesses. Equally, however, the proposition that welfare spending needs to decline sharply as a proportion of GDP is a false one.

The welfare state offers a comprehensive response to social risks which, if not covered by the state, would still arise.[27] Critics often overlook the fact that the welfare state deals with these risks efficiently.[28] Instead, the question Europeans need to answer, not least in pondering the 'Merkel formula', is whether the costs of 'non-social' responses would be lower.

New employment patterns are an acknowledged, if often insufficiently understood, part of the picture. As noted above, the median worker today is no longer a man employed in a factory, but is as likely to be a woman as a man, working in an office, hospital or care service. Careers evolve and may be subject to sharp changes of direction. Work–life balance is an objective that can have pronounced effects on welfare arrangements. In the light of these transformations, the answer may be to reinforce moves already apparent in some EU countries towards a system in which entitlement is based on citizenship rather than employment history.

A more pessimistic scenario of the future of European welfare states follows the argument of Fritz Scharpf mentioned above that, due to the inherent bias towards negative integration, the formation of a European social market economy with a strong social dimension is impossible. Instead, EU member states will converge towards a liberal welfare model, entailing retrenchment of the welfare state, especially in the social-democratic countries (following the Esping-Andersen conceptualization).

26 John Hills, Good Times, Bad Times: the Welfare Myth of Them and Us (Bristol: Policy Press, 2014).

27 Iain Begg, 'Rethinking the Social Dimension of the EU: The Costs of Non-Social Policy', in Alexandra Baum-Cesig and Anne Faber, Soziales Europa? Perspektiven des Wohlfahrtsstaates im Kontext von Europäisierung und Globalisierung [Social Europe? Prospects for the Welfare State in the Context of European Integration and Globalization] (Wiesbaden: VS Verlag für Sozialwissenschaften, 2005).

28 Eloi Laurent, Le bel avenir de l'Etat Providence [The bright future of the welfare state] (Paris: LLL, 2014).

Choices have to be made, and the means by which decisions are taken invites examination, particularly where new demands (e.g. for enhanced childcare provision) can only be met if other spending is reduced. It is well known that welfare states are 'sticky', in the sense of being politically resistant to change – if only because losers from reform are bound to shout louder than new winners. Politicians apprehensive about losing elections find it easy to shy away from necessary reforms.

Nevertheless, as Anton Hemerijck, taking issue with some of the more negative assessments, asserts: 'both the welfare state and EU, two major feats of mid-twentieth century institutional engineering, have at critical times been able to reinvent themselves'.[29]

29 Hemerijck, Changing Welfare States.

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