DISCUSSION PAPERS

THE DYNAMIC STATE BEFORE AND AFTER THE ECONOMIC CRISIS

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1
Introduction[1]

The debate as to the role of the State in the economy is as old as economic science itself. Every great economist, sociologist and political scientist since the Industrial Revolution has contributed his or her own perspective on the issue. The success of Keynesian policies in the emergence from the Great Depression in the 30's legitimated the role of the State as an economic agent, while after World War II the State was recognized as having a strategic role to play in the industrial sectors which were to prove central to the economic recovery of those countries which were most hit by the conflict.

The inability of Keynesian formulae to help advanced countries out of the oil crises of the 70's and unanimity with economists of rational expectations discredited the effectiveness of public action in the longer term, opening up a new period during which policies aimed to maximize the benefits of the market and minimize the problems created by the State. From this point onwards, the role of the State as an economic actor became minimized, both for center-right governments and, progressively, for center-left administrations. In the early 90's, no political party with aspirations to govern in the countries of the Organisation for Economic Cooperation and Development (OECD) gave the State any role other than that of resolving market shortcomings and working towards social cohesion through public policies associated with the Welfare State.

However, the scale of the Welfare State itself, and the distortions which it generated through benefits and sources of funding were the subject of considerable attack in the late 1990's. The problems of Europe's competitiveness in comparison with the United States and Japan, along with the process of the inexorable aging of the old continent highlighted the need for the social model developed in most European countries to be reformed.

Political leaders followed this academic debate from a distance during the 90's, but by the outset of the current century it had been placed very much on the continental political agenda. For the first time in the year 2000, within the context of the launch of the Lisbon Strategy in Europe to turn it into the most competitive region in the world, European leaders tackled this question.

1 This article draws some sections from Chapter 4 of the forthcoming book entitled "El Estado Dinaminzador: nuevos riesgos, nuevas políticas y la reforma del Estado de Bienestar en Europa" (Editorial Complutense, 2009).

The position at the time was optimistic, and they chose to put out a message of the sustainability of the European social model (in all its versions), fully compatible with the economic reforms to be tackled in the shift towards what was at the time referred to as the "knowledge society".

In 2005, Europe's leaders met once again, at Hampton Court in the United Kingdom, reaching a much less positive conclusion. Five years had gone by, the necessary reforms had barely been undertaken, while the global horizon revealed increasingly powerful competitors among the emerging economies. This time around, the message was more guarded. Europe's Welfare States would be sustainable only if they converged towards a point mid-way between the broad-based provisions of the Scandinavian model and the more skimmed Anglo-Saxon version. In all cases, the question would be one not of scale but of operational logic. Europe's social model required reform in order to turn the Welfare State into a more active agent, with a greater focus on individuals rather than groups, developing skills and free of prejudice as to public and private sectors. The model would focus on the provision of quality public services to achieve compatibility between efficiency and the fairness to which European societies aspire.

The 2008 financial crisis and the subsequent economic downturn have shifted the debate about the sustainability of the Welfare State, as contextualized by the renewed Lisbon Strategy, once again establishing it as a major political issue. The vast public intervention in the financial markets which took place following on from the collapse of Lehman Brothers in September 2008 made it clear that the State could not act only at times of personal difficulty (providing benefits in the event of unemployment, illness or old age), but was required to intervene when the economic system as a whole was in danger of falling apart due to a lack of credit and confidence. Subsequently, in 2009, the most powerful world economies in turn followed suit in providing large-scale fiscal stimuli to underpin domestic demand and hold back the devastating recession unleashed by the financial crisis. Most analysts celebrated the return of Keynes, highlighted the renewed role of the State as economic player and no longer talked of the crowding-out effect which public action could have on private investment, instead praising the drag-along effect which public investment would have on private funds at times of economic uncertainty.

Now, as the first signs that the worst has been overcome begin to appear on the horizon, the debate as to the role of the State in the economy must once again gradually be put in its rightful place. The structural challenges faced by the Welfare State before the crisis remain. Now, however, the State is being asked not only to protect against market failures and provide welfare insurance for citizens, but to play a role as leader and to find a way to make the economy function once again. This is an enormous challenge, and the first steps are still barely being taken.

Within this context, this paper focuses on the debate as to the modernization of the Welfare State, and its transformation into a Dynamic State. The following section clarifies the debate as to the policies which represent what have become known in the literature as the "pillars of welfare". Section 3 turns to the new pillars of the Welfare State. Section 4 defines the Dynamic State, while Section 5 examines its application in Spain. Section 6 draws the article to a close with a reflection which goes beyond the debate as to the modernized Welfare State, championing the idea that the Dynamic State could additionally have clear strategic applications in the renewal of the economic model of advanced countries in a shift towards more balanced and sustainable production models.

2
The Traditional Pillars of the Welfare State

Numerous studies have attempted to differentiate the welfare models of advanced democracies. From Esping-Andersen (1990) up until the more recent work by Sapir (2006), these classifications have been based on the level of efficiency and fairness generated by the different models, along with the level of intervention by the public sector in the economy, and the type of employment relationships to be found in each model. Despite the differences which may be observed between the different welfare models in each country, there is a series of common elements shared by all, allowing one to identify the Welfare State with a system of public cover for the involuntary risks to which citizens are prey.

2.1 Traditional Risks

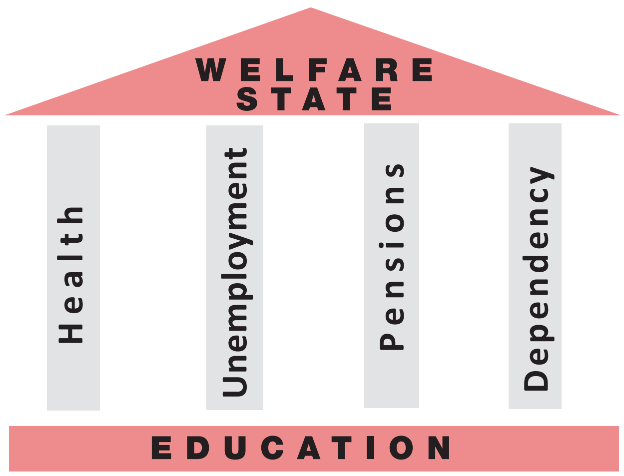
The three risks traditionally covered by the Welfare State are those which prevent a human being from employing his or her capacity for labor as the sole means for self-sufficiency, and hence freedom. They are: the risk of falling sick; the risk of unemployment; and the "risk of aging", in the sense of uncertainty as to the point at which age will ultimately undermine the physical and/or intellectual capacities which are the basis for an individual's gainful employment. If these risks were not covered by health insurance, unemployment insurance and a pensions system, individuals subject to the emergence of any of these risks would be subject to exclusion and marginalization.

Public sector cover for these three risks was the principle behind the creation and consolidation of the Welfare Stated in the past century, and they represent its three main pillars, subsequently added to by a fourth pillar: cover for the risk of being born or becoming disabled.

This grouping of Welfare State pillars typically, and mistakenly, includes education. However, strictly speaking, the public provision of universal education has nothing to do with cover for any risk, but rather the preference for equality of opportunity typical of progressive thinking. From this progressive perspective, social inequalities are not the result of unavoidable fundamental differences between individuals, as conservative thought would claim, but can be resolved because they have a social origin connected with the family, intellectual and educational environment within which we grow up.

Consequently, from this point of view, the Welfare State could be metaphorically defined as a complete building (see Figure 1) with educational foundations and four pillars serving to support each citizen's potential for full realization, since these pillars provide public sector cover for the risks to our employment to which we are all involuntarily exposed.

Figure 1. The four pillars of the Welfare State



Source: produced by the author.

2.2 Public Cover against Risks

Public cover against these risks and their involuntary nature are two important aspects requiring explanation, especially in light of the volume of public expenditure they generate. As may be seen in Table 1, European countries spend an average of 23.4% of their gross domestic product (GDP) on financing the traditional pillars of the Welfare State, and above all on health and pensions (the proportion rising to almost 30% if we include education expenditure).

Given the volume of resources employed, the first question we must address is: why should universal cover against these risks be public? It would at first glance seem reasonable to suppose that the risk of unemployment, illness, aging and disability could be covered by means of private insurance policies using market mechanisms, just as our motor insurance covers us against the involuntary risk of having a traffic accident. However, and quite apart from the moral connotations which they all share, the four risks referred to above are subject to market shortcomings which make private cover unprofitable for companies in the case of certain social groups who would thus be left unprotected, as happens in countries such as the United States (where 15% of the population has no medical insurance).

These market shortcomings vary depending on each pillar of the Welfare State.

- **Healthcare:** the classic shortcoming generally mentioned in this regard is that of adverse selection, which would lead private insurers to cover only those individuals with a good state of

Table 1. Public expenditure on the traditional pillars of the Welfare State (% of GDP)

Public Expenditure Welfare	All Pillars	Healthcare	Unemployment	Pensions	Dependency	Education
Austria	26.1	5.1	1.0	12.8	2.6	5.2
Belgium	26.5	7.2	3.3	7.2	2.3	5.9
Czech Rep.	21.1	6.8	0.7	7.8	2.9	4.4
Denmark	27.6	5.6	3.3	7.2	4.2	6.7
Finland	22.5	5.7	2.1	5.8	3.5	6.0
France	28.7	7.6	1.9	10.5	1.7	5.8
Germany	27.3	8.0	1.8	11.3	2.0	4.4
Greece	21.3	5.0	0.4	11.5	1.0	4.0
Hungary	22.7	6.0	0.5	7.5	3.0	5.5
Ireland	15.9	5.6	1.0	2.9	1.5	4.1
Italy	24.2	6.2	0.4	11.4	1.8	4.7
Luxembourg	22.2	6.2	0.9	4.5	3.6	5.2
Netherlands	20.7	5.8	1.6	5.4	3.9	4.6
Norway	25.1	6.5	0.7	7.0	5.4	6.5
Poland	22.9	4.5	0.8	11.4	3.4	5.8
Portugal	23.5	6.7	1.1	8.8	2.6	5.8
Slovakia	17.3	5.2	0.3	6.4	2.2	4.3
Spain	20.3	5.2	2.2	7.9	2.4	4.2
Sweden	31.3	7.1	1.2	10.1	6.0	6.6
United Kingdom	20.6	6.7	0.3	5.9	2.5	5.1
UE-Average	23.4	5.9	1.1	6.9	2.5	5.2

Source: OECD Social Indicators (2008). Most recent data available for 2006.

Note: The data in the pensions column are drawn from the "Old Age" section, and those for dependency from the "Disability" section. The data for education are not considered within the total for social expenditure under OECD principles.

health, leaving citizens with chronic illnesses without cover (or prohibitive premiums). There are in addition problems of natural monopoly (health services with cutting-edge technology which, because of the scale involved, are too expensive and complex for the private sector). And of course there are problems of negative externalities on the public health of the community (in the case of epidemics), which can be addressed only by the State.

- **Unemployment:** the market shortcomings justifying the public provision of unemployment insurance are similar to those for health. On the one hand there is a potential problem of adverse selection in the case of private insurance, and meanwhile an added problem of credit restriction, credit which is very necessary when the information is incomplete and a period of time is required to seek out the most appropriate position. Lastly, the negative externalities which could be caused by unemployment giving rise to indigence are self-evident.

- **Pensions and Dependency:** in both cases the problems of adverse selection are particularly relevant, especially in the latter case, since if disability occurs and is maintained with a degree of probability over time, private insurance policies would drive citizens with permanent disabilities out of the marketplace. Likewise, both old age and dependency require permanent care, normally provided by relatives, who are prevented from leading a fully active life, with the negative externalities which this has for them and for society as a whole.

- **Education:** in the case of basic education intended to guarantee equal opportunities, the risk that needs to be insured (that of being born into a family lacking in resources) requires action for which no market even exists. This is combined with an initial problem of credit restriction, since no private insurer would extend educational credit until a child had demonstrated his or her positive capacity to generate future returns with which to repay the loan. For this reason, educational loans exist only for university studies, while for the initial stages of education the role must be played by the State. Final mention must once again be made of the negative externalities of a political and economic nature generated by illiterate societies with no democratic culture or the capacity to accumulate human capital.

In short, these market shortcomings would give rise to unprotected groups if cover were limited to private insurance, and it is our collective preference for universality in such cover that demands this insurance to be public.

Another important question to answer is: why cover against only these four involuntary risks? Why not extend the Welfare State to protect people against other risks entered into voluntarily? The answer is clear: if the State were to provide cover against risks which could be avoided, then everyone would take on levels of risk above the norm and the system of prices and incentives in our economies would collapse. That is the reason why there is no public insurance to cover against the possible debts of citizens risking their savings on the Stock Exchange, or those who lose their homes having taken out variable-rate mortgages when they could themselves have insured against this by means of a fixed-rate loan.

The reality is that the possible attachment of liability in the event of an unfavorable situation places a limit on the level of cover of the Welfare State in order to avoid incentives to fraud becoming part of social provision[2]. And in those countries where this limit has not been respected, Welfare States have become unsustainable, ineffective and have led the population to lose faith in the public sector.

2 Such incentives occur when an individual is guaranteed the right to receive a social benefit irrespective of the reasons allowing that status as a beneficiary to arise. For example, receiving unemployment benefit irrespective of whether or not the layoff was involuntary, or if the individual is doing everything possible to find a new job, could lead to distortions requiring a change in the rules and methods for ruling such benefits.

3
The New Pillars and New Policies of the Welfare State

3.1 The New Risks

For at least a decade now, the traditional Welfare State, with its foundations and its four pillars, has been faced with **new social risks** (such as multiple entries to and exits from the labor market faced by young people, or the obsolescence of skills and long-term unemployment suffered by older citizens), along with new realities generating **new needs** (such as an aging population, the proliferation of single-parent families, or the definitive incorporation of women into the world of work)[3]. The ability to deal with these new needs and face up to new social risks is, however, restricted by the process of worldwide economic globalization (tending to make countries with more rigid Welfare States less competitive), and the paralysis of certain traditional public institutions.

3.2 New Policies or New Pillars? Both at Once

Given the emergence of new social risks, two options exist: to take the opportunity to liquidate the traditional Welfare State, or to reform it in order to allow it to remain a valid instrument in reducing inequalities and generating economic growth.

Within such a reform process, Welfare States must, in turn, balance two parallel processes: on the one hand, policies associated with the traditional pillars of the welfare system (education, healthcare, pensions, unemployment and disability) must be transformed to cover new areas and to make them more agile and dynamic. And on the other, new pillars require development in areas where up until now no cover existed.

There are countless examples of the adaptation of the traditional pillars. For example, globalization and technological change have forced education systems to modify their curricula and teaching methods in order to train students to deal with permanent change. Other changes connected with globalization, such as an increase in the mobility of individuals and the extension

3 For an analysis of the new risks affecting European societies, see Liddle and Lerais (2006).

of the migratory phenomenon, have also had an effect on educational systems and healthcare systems. The latter have sustained a substantial impact through the progressive aging of the population in the advanced democracies, leading them to shift their traditional emphasis on curing illness towards policies based more on prevention. Likewise, the exposure of our societies to new, rapidly spreading global pandemics as a result of the increased mobility of individuals around the planet is calling for additional resources in healthcare coordination which would until recently have been unthinkable. Efforts to adapt are also being seen in what are clearly new areas, such as those connected with illnesses caused by climate change.

Although such changes in education or healthcare are important, up until now the most significant adaptations to dynamize the traditional pillars of welfare policy have been seen in the field of the labor market. The most well-known are Welfare to Work policies (involving a reduction in the taxes or in Social Security contributions of companies hiring long-term unemployed) and Make Work Pay policies (providing loans to set up new businesses and recycle knowledge, with the aim of making it more attractive to work than to claim a benefit). This type of process has also been seen in the field of business. For example, all policies intended to promote micro-businesses, self-employment, a return to work by women and the elderly, and to reconcile work and family life, belong to the same philosophy. Likewise, support for innovative Small Medium Enterprises (SMEs), venture capital firms and finance for entrepreneurs have a dynamic nature, as do policies to incentivize training sabbaticals at companies and programs for study and work at universities.

Alongside these efforts to adapt the traditional welfare pillars to the new social risks, we have seen the emergence of policies which are as yet unconnected, but which could little by little go to shape a new pillar of the Welfare State.

This new pillar would serve to cover against a new risk, that of becoming entrapped by constant change, of being unable to adapt to the unstable economic and social dynamic resulting from globalization, technological changes and the replacement of traditional social values.

An increasing number of individuals work in many different jobs over the course of their professional career, do not have their life focused on a stable nuclear family, have exchanged their stable circles of friends for bilateral relationships which change over time, living in different countries and travelling on a regular basis. Such individuals are no longer the elite of advanced societies, but represent an increasing proportion of the global middle class. And in such a situation, these individuals are exposed to the new risk of becoming trapped in one of these processes of change: the risk of being unable to find yet another new job; the risk of becoming isolated and psychologically affected by the absence of ties of family or friendship, above all at a more advanced stage; the risk of having to bring up a child without the help of a partner; or the risk of not being able to fly the nest despite being a well-educated young person.

Social policies intended to assist single-parent families, the independence of young people, elderly people at risk of exclusion and the long-term unemployed are taking up an increasing volume of resources and attracting the media and electoral attention of Europe's societies. These are policies which in some countries did not exist, or were at the fringes of their welfare systems, but which are now taking on added importance through rental assistance programs, basic independence salaries for young people, life-long training programs and even new socialization activities intended for the broadest range of segments of society.

If we were to group together all these initiatives in accordance with the risk they aim to cover against (that of becoming entrapped by change), and in accordance with the shared formula which connects them (that of providing or equipping the individuals affected by this risk with education, financial and social resources), it would be no exaggeration to claim that we are looking at a new pillar of the Welfare State. A pillar which, in the light of static entrapment, aims for the dynamic re-inclusion of individuals within the social and productive cycle, as the only way of guaranteeing that they will be fully able to exercise their individual liberty within a context of permanent change.

In response to these new social risks, then, Welfare States are undergoing two simultaneous transformations: on the one hand they are adapting and dynamic their traditional pillars, and on the other they are developing new policies which will soon constitute a new pillar of welfare: the pillar of emancipation, or of social re-inclusion in the event of situations of entrapment.

And these efforts are now being reflected in figures for public expenditure on new social policies. As may be seen in Table 2, policies connected with the renewal of the traditional pillars (such as active employment policies) or the development of new pillars (such as policies to support the family, housing and other social assistance), now account for as much public expenditure as any of the old pillars.

Table 2. Public expenditure on the new policies and new pillars of welfare (% of GDP)

Public Expenditure Welfare	Employment activation	Housing	Family	Inclusion and Subsistence	Other	All new policies/ pillars
Austria	0.6	0.1	3.1	0.4	0.4	4.6
Belgium	1.2	0.0	2.7	2.1	0.5	6.5
Czech Rep.	0.2	0.1	1.9	0.2	0.5	2.9
Denmark	1.6	0.7	3.9	0.0	1.0	7.3
Finland	0.9	0.3	3.0	0.6	0.6	5.4
France	1.1	0.8	3.0	1.8	0.3	7.1
Germany	1.1	0.2	1.9	0.4	0.5	4.2
Greece	0.2	0.6	1.3	0.8	0.4	3.3
Hungary	0.4	0.5	3.5	1.1	0.1	5.6
Ireland	0.7	0.5	2.5	0.8	0.5	5.0
Italy	0.7	0.0	1.2	2.5	0.0	4.4
Luxembourg	0.3	0.1	4.1	2.0	0.5	7.0
Netherlands	1.1	0.3	1.6	0.4	0.6	4.0
Norway	0.8	0.2	3.4	0.3	0.6	5.4
Poland	0.2	0.0	1.5	1.0	0.0	2.8
Portugal	0.7	0.0	1.6	1.6	0.3	4.3
Slovakia	0.3	0.1	1.9	0.2	0.8	3.2
Spain	0.7	0.2	1.0	0.6	0.2	2.6
Sweden	1.3	0.6	3.5	0.7	0.7	6.8
United Kingdom	0.5	1.4	2.9	0.2	0.2	5.3
UE-Average	0.6	0.3	2.1	0.8	0.5	4.3

Source: OECD Social Indicators (2008). Most recent data available for 2006.

4
From the Welfare State to the Dynamic State

4.1 A New Operational Logic

In addition to the new social risks facing citizens as referred to in the above section, globalization and permanent economic change have forced traditional Welfare States to embark on a type of reform connected not with their scale but their operational logic and the type of programs which are implemented in line with the pillars which each country has chosen to maintain. In fact, those countries with the most developed Welfare States, in Scandinavia, reformed their models in the 90's, introducing the same logic as the Labor Party in Britain, with a Welfare State around half the size. In both cases these reforms are putting into place more agile and more modern Welfare States, with similar results in terms of efficiency and competitiveness, although still with different outcomes in terms of equality, where the former comes out on top (Sapir, 2006).

The logic to which I refer is the logic of the Dynamic State, a definition of which I will now give. The Dynamic State is a new type of Welfare State which has seen two simultaneous transformations: (1) A change in means and procedures: this is an internally dynamic state in its administrative operation, and is externally dynamic in its relations with other economic and social agents; (2) A change in ends: the ultimate aim is that of a state of dynamic (active) citizens, where equal opportunities are guaranteed as the sole means allowing individuals fully to exercise the freedom of each citizen to develop in accordance with personal expectations and imagination. This State of active citizens will combine their social protection with the active and dynamic participation of citizens in the economy and in society.

In line with this logic, the Dynamic State could be characterized as one which foresees and anticipates new social demands and risks (rather than simply reacting when the risks of unemployment, illness or disability have already materialized). The Dynamic State likewise serves to catalyze economic and social change; it is based on the participation and mobilization of citizens (rather than simply providing compensation and income support); it is dedicated to social investment in education and the comprehensive training of its citizens throughout every stage of their lives; it fosters the creativity and ambition of economic and social agents, and above all mobilizes all inactive social resources (young people, women and the elderly), turning them into economically and socially useful citizens, whereas the traditional Welfare State was passive, disincentivized work and gave rise to groups dependent on benefits.

In order to achieve its goals, the Dynamic State needs responsible and committed citizens, but through its policies it promotes social mobility and inclusion, and guarantees the actual sustainability of the welfare model within the aforementioned new context.

The Dynamic State meanwhile adopts new functions which the Welfare State did not fully provide for, such as support for the creation of new markets and their proper operation in terms of access and competition. It also coordinates private investment activities, promotes strategic sectors and assists in the consolidation of competitive sectorial advantages.

Lastly, in the new relationship which the administrators of this new state must establish with their citizens, the dynamic logic is crucial: initiatives for transparency of information, disclosure of data and public funding processes, the elimination of overlaps between different levels of government and e-administration or electronic identity cards are some of the typical measures for the purpose of this transformation.

4.2 A New Funding Logic

Processes such as globalization, demographic change and technological change have generated not only new risks for citizens to be covered by reformed or completely new policies, but have also generated considerable upward pressure on social expenditure, and placed a limit on the tax burden which productive factors can withstand. As a consequence, alongside the new internal and external operational logic, the transformation of the Welfare State into a Dynamic State has also involved a new funding logic.

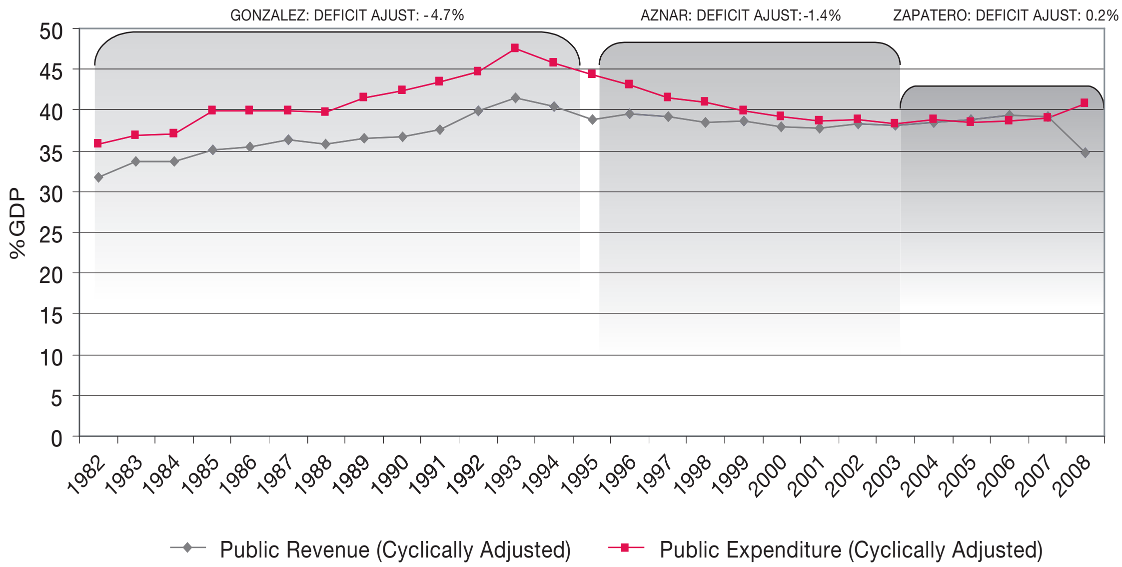
In order to explain this new logic, I will turn to an example close at hand, the case of Spain. Let us imagine that a recently elected government wishes to implement the new social programs called for by citizens in order to deal with one of the new social risks (for example, the new dependency policies in Spain). It then has four options, which I will classify in accordance with the Spanish experience in its process of consolidating the Welfare State.

First, that chosen by the early González governments: increase public expenditure (led by the initial development of the Welfare State) at a faster rate than the rise in public revenues, thereby bringing about a deficit situation which stood on average (in cyclically adjusted terms) at -4.7% during the 13 years that González was in power (see Graph 1). Meanwhile, public investment remained, in terms of overall public expenditure, at an average level of 8.9%, a figure which would have been higher if, at the end of his last mandate, social expenditure and public consumption had not clearly imposed themselves on the investment efforts made during the previous period (see Graph 2).

Secondly, the approach of the Aznar governments: reduce taxes, maintain revenue steady and reduce public investment by the same (limited) extent as the increase in expenditure on a visible social program. This allowed the government to maintain a much lower deficit, although at the expense of freezing public investment as a percentage of overall public expenditure (see Graphs 1 and 2).

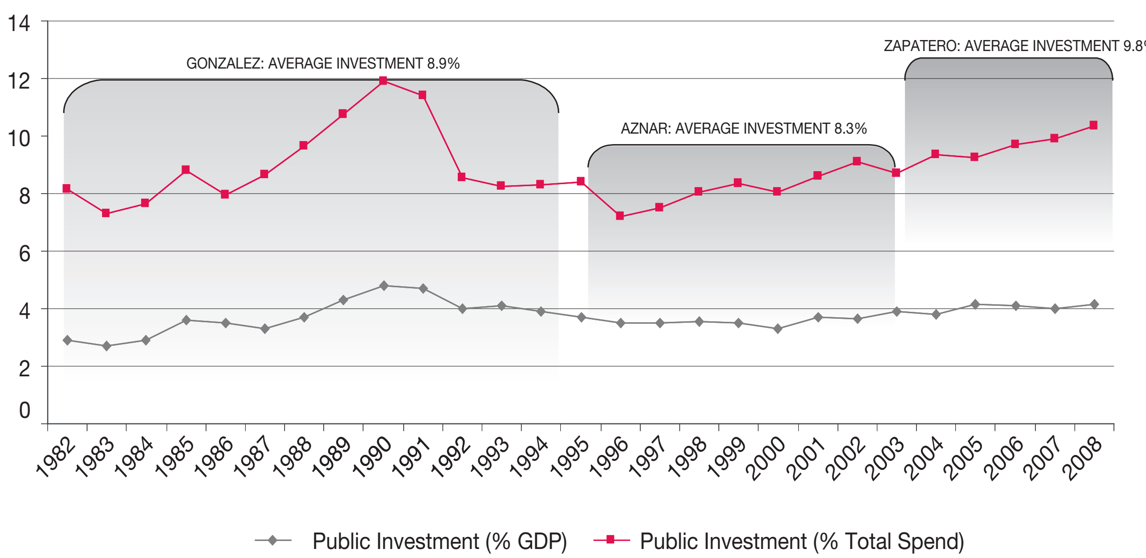
Thirdly, the policy of Zapatero's first term: increase public expenditure (led by a renewed impulse in welfare policies and public investment) on the basis of even higher growth in public revenue, thereby leading to a budget surplus (a surplus of an average 0.2% over the period, which would

Graph 1. Public Revenue and Expenditure in Spain: 1982-2008



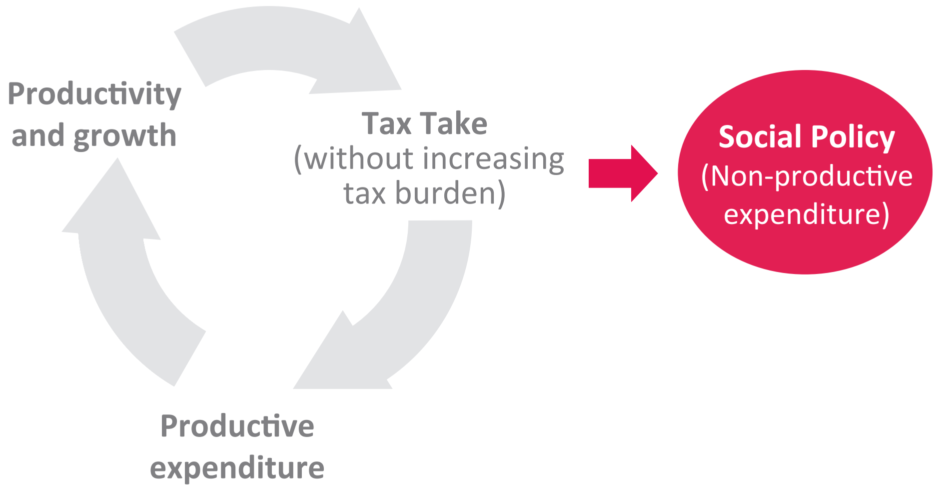
Source: produced by the author.
Note: Data with cyclical adjustment based on potential GDP drawn from AMECO, Eurostat.

Graph 2. Public investment in Spain: 1982-2008



Source: produced by the author.
Note: GFCF data drawn from AMECO, Eurostat.

Figure 2. The virtuous circle of the Dynamizing State



Source: produced by the author.

have been greater had it not been for the fiscal stimulus policies adopted in order to deal with the economic crisis which began in 2008).

Lastly, the fourth possibility would be the option based on a dynamic logic (rather than static, as in the three previous cases), which would focus on spending first on productive investments (strictly speaking, physical, human and technological capital, or in broader terms activation, inclusion and efficiency policies) in order to multiply economic growth and the additional revenue required, before turning to the funding of new social programs. In any case, the growth in expenditure associated with these new social programs would not be in excess of the rise in GDP over the course of the cycle. As may be seen in Figure 2, this dynamic logic would be self-sustaining, making economic growth compatible with the (absolute, rather than relative) expansion of welfare spending.

As may be seen in Graph 2, the first Zapatero government applied a part of this philosophy as set out in its 2004 electoral manifesto, providing renewed impetus for Public Investment (at an average level of 9.7% of overall public expenditure, far above the figures for González and Aznar). The aspect of the philosophy not fulfilled is that the increase in social expenditure was higher than the rise in GDP, hence the fact that the proportion of the economy as a whole dedicated to public expenditure once again increased (as had been the case under González, although in a much more timid manner).

If we focus on a comparison of the last two expenditure philosophies (purely expansive, and dynamic) we evidently come up against a question of preferences in terms of the scale of the Welfare State. Both options are equally rigorous, in that they finance their expenditure and maintain a balanced budget; and both options generate economic growth, because they are both committed to rates of growth in productive investment above the level of increase in social expenditure. However, the strategy applied during Zapatero's first term increased the State's stake in the economy (because the percentage of public expenditure and revenue rose as a proportion of GDP), whereas the option contained in the electoral manifesto would have allowed for absolute growth in social expenditure while maintaining the relative scale of the Welfare State in terms of GDP.

In this second term it is still too early to draw any conclusions as to what will be the chosen strategy. Social expenditure will clearly increase over the initial years, as a result of the political decision taken by the socialist government to maintain social cohesion during the economic crisis. Almost simultaneously, though, and with increased relevance following the introduction of the Sustainable Economy Act (*Ley de Economía sostenible*), public investment should once again take on a more prominent role. In economic terms, the current climate demands that aggregate economic demand be maintained, hence the desirability of preserving State expenditure (and also current expenditure) and transfers to citizens (through benefits, rebates and pensions) in order to allow them to continue consuming. However, the aggregate level of supply in the economy must shortly begin to pick up. And in a situation of uncertainties such as that generated by the financial crises, restricted access to credit and considerable corporate debt, the dynamic role of public investment will play a crucial role. In this regard, governments should not be worrying so much about the annual deficit figures as the balance between the debt taken on and the assets acquired. If the investments are sound, they will end up by producing economic growth which will in turn increase the tax take, wiping out the deficit and paying off the debt built up during the period in question.

Leaving economic reasoning to one side and returning to the political focus, the reality is that the scale of the Welfare State must in each country reflect collective preferences as to the role which the public sector is to play in the provision of services and cover against risks. In Spain, these preferences are insufficiently clear, since CIS (Spanish Center for Sociological Studies) sociological surveys indicate that while citizens call for more and better public services, they applaud tax cuts and state that they do not want the State to spend beyond its revenue. It is a circle which cannot be squared, and hence represents a debate which must be fostered, with the aim of resolving some of these inconsistencies and providing a clear political mandate. This casts a particularly positive light on the recent exercise in transparency and political responsibility undertaken by the socialist government, which has finally positioned itself clearly in support of a rise in taxes in order to maintain the social provisions of the current system from 2010 onwards.

5
The Dynamic State in Spain

Having reached this point, and in the light of all the concepts raised in the previous sections, the article will end by focusing in more detail on the most significant dynamic measures seen in Spain over recent years.

The Spanish story is a particularly relevant one since it is unique in Europe, with an aspiration to converge with the welfare provision in other European countries coinciding with the need to provide cover against new social risks and to dynamize the operation of a welfare system still under construction.

The development of the Welfare State took its greatest steps forward during the terms served by the socialists governments of Felipe González, from the second half of the 80's onwards. The undeniable aim at that time was to provide universality of basic rights not previously guaranteed (such as education and health), while also extending the cover and provision of the existing pensions and unemployment benefits. European benchmarks were always to the fore, with the lead being provided in most cases by France and Germany, and only for some programs the Nordic countries. During the 90's, and especially during the conservative Aznar governments, this process of convergence of the social model became frozen.

From 2004 onwards, the first term of the socialist Zapatero took up the baton and once again focused social policies on a precise strategy to underpin and extend the Welfare State in four aspects.

- First, by working to shore up the aging foundations of equal opportunities through a clear commitment to public education (through substantial increases in funding per student and school grants), within a context of considerable sociological and demographic change. This strategy to improve education also had a substantial productive component, since it was confined not only to more basic levels, but also those stages connected with the direct development of human capital. These efforts were combined with a considerable boost for investment in physical and technological capital, in order to resolve the problem of low productivity without which any structural expansion of the Welfare State would become unsustainable.

- Meanwhile, attempts were also made to consolidate the first three pillars of the Welfare State, improving non-contributions-based pensions, reinforcing the mobilizing nature of unemployment policies and extended public health cover (e.g. help in giving up smoking and oral hygiene).

- A commitment was also made to extending the Welfare State with a fourth pillar to provide for care for the disabled and dependent, an area which had previously been substantially underdeveloped, with major disparities between regions.

- Lastly, Zapatero implemented a number of major initiatives which could serve as the core of a fifth welfare pillar, in particular schooling for children aged between 0 and 3 years, the introduction of income supplements to help young people set up home independently, within the context of a new rental housing plan.

All these priorities had a very considerable impact on the budget, as may be seen in the enclosed table. And in all cases they were implemented with clear expectations of a dynamic effect, in terms both of their positive impact on economic activity and employment and through the consequences expected in terms of the activation and inclusion of the old, the young and women.

The three sub-sections which follow detail the dynamic expectations with which investments in physical and technological capital were made, the aim thereby being to increase the potential for economic growth in order to provide sustainability for the creation of a fourth and fifth pillar of the Welfare State in the medium term. Similarly, the two most important elements of these new pillars, the national dependency care system and the universalization of kindergarten schooling, respectively, were also planned in the expectation that a part of the investment required would yield positive economic returns, and above all a major impact on the active employment of women (this being one of the most significant gaps which still exists between Spain and the rest of Europe).

Table 3. Public Expenditure Priorities (in millions of euros)

	Budget 2004	Budget 2008	Variance € M	2008-2004 Δ%
Productive Expenditure	**22,576.74**	**34,821.50**	**12,244.76**	**54.2**
Civil R&D	2,903.77	7,767.60	4,863.83	167.5
Education	1,524.66	2,932.62	1,,407.96	92.3
Infrastructure	18,148.31	24,121.28	5,972.97	32.9
Social Expenditure	**114,211.04**	**158,843.87**	**44,632.83**	**39.1**
Housing	663.02	1,378.40	715.38	107.9
Basic pensions	906.35	2,106.35	1,200.00	132.4
Dependency	0.00	870.99	870.99	- -

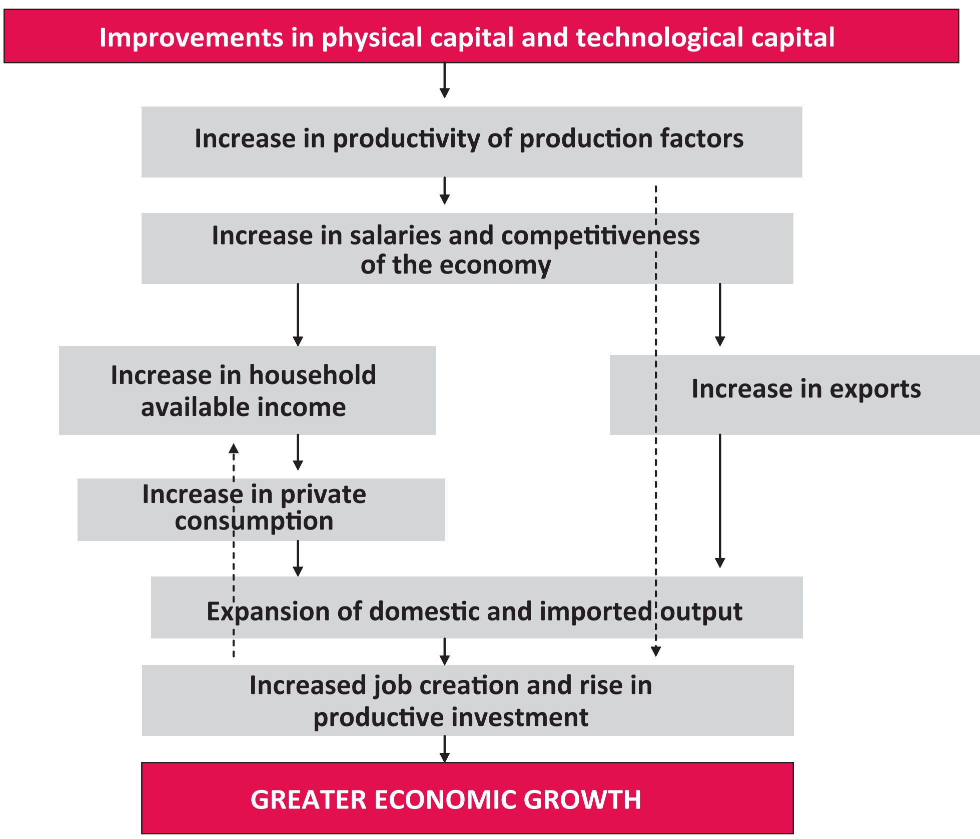
Source: White Paper, General State Budget (2008): p. 15.

5.1 The Dynamic Effects of Investment in Physical and Technological Capital

5.1.1 Improvement of Physical Capital

When the Zapatero government approved the Strategic Transport Infrastructure Plan (PEIT) in 2005, it committed to major flows of public investment up until 2020. The approach adopted in this regard is that the public sector invests in physical capital (essentially infrastructure) because this improves the productivity and competitiveness of the productive apparatus of the private sector. As a result, these investments have a permanent multiplying effect on the economy, as they increase the efficiency of production factors. In specific terms, an increase in the overall productivity of factors provides consumers with greater resources, which increases their demand for consumption, while companies see their competitiveness increased, and so export more. This increase in demand must be satisfied through domestic output and imports, hence the need to employ more workers and expand the stock of productive capital. If demand increases less than supply, this will reduce inflation (see Figure 3).

Figure 3. Dynamizing mechanisms through investment in physical and technological capital



Source: produced by the author.

Assuming that for each additional point by which public physical capital increases, productivity rises by 0.1%, the potential product of the economy would, by 2012, be 1.1 percentage points higher than would be the case had the PEIT not been fully implemented. Observed GDP, meanwhile, rises at a slower rate, as there is a degree of lag before the increase in potential product is fully incorporated by agents in their expectations. Inflation then falls once again. In any case, in order to satisfy the increase in demand, employment levels would have to rise by around 84,000 new jobs (these would be in addition to those directly involved in the construction of the infrastructure, which are incorporated in the central scenario), thereby reducing the unemployment rate by two decimalt.

5.1.2 Improvement in Technological Capital

Just as in the development of infrastructure, the socialist government justifies the importance of this type of investment on the basis that it significantly increases the productivity of the economy's production factors. The mechanisms by which the multiplying effect would be passed on are the same as in the previous case, although there is no direct impact on investment in construction as seen in investment in physical capital (see Figure 3).

These effects have been calibrated by means of elasticity in the productivity of the stock of technological capital of 10% in the medium term, while it has also been assumed that there will be a small-scale drag-along effect on private R&D+i investment. As may be seen in Table 5, the long-term level of economic output would increase by 0.61 percentage points by 2012, while demand would have risen by only 0.36 pp. As a result, there will be a slight fall in inflation, while 63,000 extra jobs would be created, leading to a fall of two decimal points in the unemployment rate compared with the central scenario.

5.2 The Dynamic Effects of Dependency Care

Investment in physical and technological capital belong to a strategy whereby economic modernization was intended to allow Spain to meet the greatest challenge it has taken on in recent decades in terms of its Welfare State. This challenge involved recognition of the universal

Table 4. Multiplying effects of the PEIT Infrastructure Plan

	Potential Product	Actual GDP	Employment	Number of Jobs	Unemployment Rate	GDP deflator
2008	0.14	0.07	0.07	12100	-0.03	-0.02
2009	0.52	0.20	0.16	30395	-0.08	-0.09
2010	0.74	0.32	0.22	42472	-0.11	-0.13
2011	0.93	0.45	0.31	60880	-0.15	-0.15
2012	1.11	0.61	0.43	84100	-0.21	-0.15

Source: Mulas-Granados (2009).
The figures reflect deviation levels from the central scenario.

Table 5. Multiplying effects of the National R&D+i Plan

	Potential Product	Actual GDP	Employment	Number of Jobs	Unemployment Rate	GDP deflator
2008	0.22	0.05	0.04	7740	-0.02	-0.05
2009	0.37	0.13	0.11	21293	-0.06	-0.07
2010	0.48	0.19	0.17	32424	-0.08	-0.09
2011	0.56	0.27	0.24	46976	-0.12	-0.09
2012	0.61	0.36	0.32	63426	-0.16	-0.07

Source: Mulas-Granados (2009).
The figures reflect deviation levels from the central scenario.

right to care of dependent persons, through the introduction of a new national system. Other European countries provided cover for the risk of being or becoming disabled/dependent, but in Spain this had been dealt with only in a few of the country's autonomous regions, and in all cases to a very limited extent[4]. The initial design was crucial, since within the context of the progressive aging of the Spanish population and potentially rising demand, recognition of a universal right of care could lead to an unsustainable burden on the public budget in the long term. This new pillar was therefore introduced in accordance with an activating philosophy: co-payment for services and a design intended to generate direct employment and release family members, allowing them to become professionally active once again, providing the design of the system with a dynamic profile which sets it apart from other similar systems in Europe.

The Spanish Personal Autonomy and Dependency Care Act was passed in 2006, establishing a new right on the part of citizens guaranteeing attention and care for dependent persons (the elderly and those with a serious disability). Under the terms of the Act, which is still under development, the State will guarantee people who cannot take care of themselves access to social services in accordance with their degree and level of dependency. The National Dependency System will prioritize the provision of services (home help, day-care centers, remote assistance, technical aids, residential places, etc). In those cases where this may prove impossible, beneficiaries can receive financial benefits linked to services purchased on the private market. Family carers may receive financial Compensation and will be included in the Social Security system.

The law which was passed established a gradual roll-out of the system, first dealing with dependent persons with serious disability (those requiring assistance in order to perform basic daily tasks such as getting out of bed, washing, eating, etc.). According to the data in the Dependency White Paper, it is calculated that Spain is home to 1,125,000 people suffering from serious and severe dependency.

Until the Act was introduced, these people were above all cared for within the family, the burden being borne in particular by women (who account for 83% of family carers), and who would in most cases find it impossible to perform any form of paid work.

4 According to the Dependency White Paper (Libro Blanco de la Dependencia), up until 2005 care was provided by public authorities through the health system and the field of social services, with cover being plainly inadequate and subject to major variations across autonomous regions, and between urban and rural areas. In Spain only 3.14% of those aged over 65 had any home help service, 2.05% received remote assistance, and 0.46% had a place at a day-care center.

Funding for the system was devised in order to place an equal burden on the central state authorities, the autonomous regions and, where applicable, local councils. The aim is to increase the level of 0.33% of GDP currently dedicated to dependency to more than 1% by 2015. In order to achieve this, according to the report on the Act, the central state authorities would provide over 12.638 billion euros up until 2015 in order to guarantee provision and services under the new National Dependency System The forecast costs for the first eight years, to be borne by the central state authorities break down as follows.

The Act highlighted the fact that in addition to its social benefits, the creation in Spain of the National Dependency System would represent an efficient investment in terms of its impact on society, the economy and employment. In fact, according to the Dependency White Paper and the FEDEA (Foundation for Applied Economic Studies) report, by 2015 some 300,000 jobs will have been created, while the effect on Spain's GDP could constitute an additional 1.56% by 2010, which would in turn represent an additional actual annual cumulative growth rate of 0.28% over the course of the entire period. Likewise, the overall fiscal return, through general taxation and Social Security contributions, would cover as much as two thirds of the expenditure associated with the roll-out of the National Dependency System (SND) (see Table 7).

5.3 The Dynamic Effects of the Universalization of First-Cycle Infant Education (0-3 Years): 300,000 New Kindergarten Places

At both the 2004 and 2008 elections, the Socialist Party committed to the universalization of first-cycle infant education. While during Zapatero's first term this development was postponed until after the implementation of the Dependency Care System, a public commitment was issued at the start of the second term for its introduction by 2012.

Under the terms of the initiative, 75% of the cost of each of the infant education places created (estimated at around 5,000 euros per place) would be funded by the public authorities, and the

Table 6. Cost for the central state authorities of the National Dependency System

Year	Cost in euros
2007	400,000,000
2008	678,685,396
2009	979,364,617
2010	1,160,330,812
2011	1,545,425,613
2012	1,673,884,768
2013	1,876,030,564
2014	2,111,571,644
2015	2,212,904,397
Total	**12,638,197,811**

Source: produced by the author.

Table 7. Estimated job creation through introduction of the SND

Methodology	2005	2006	2007	2008	2009	2010
TOD Spain 2000						
Current expenditure	7,031	36,847	69,370	112,648	150,925	174,464
Capital expenditure	9,242	37,210	39,115	49,813	42,394	25,264
Total:	16,273	74,057	108,485	162,461	193,320	199,728
HERMIN Model-Spain						
Current expenditure	5,699	35,731	69,689	111,671	148,433	169,855
Capital expenditure	3,260	15,238	29,249	38,549	34,859	20,273
Total:	8,959	50,969	98,939	150,220	183,292	190,158
Macroeconomic assessment						
Current expenditure	8,016	40,078	76,641	96,188	144,283	160,314
Release of employment (a)	4,350	- -	- -	- -	- -	96,485
Dependency White Paper						
Current expenditure (b)	10,588	55,490	104,469	169,643	227,287	262,735

Source: Fedea Report (Labeaga, Sosvilla, Ortega and Herce , 2006). Included in the Dependency White Paper (Chapter X, p. 27), Tables 3, 9, 14 and 15.

(a) In effective terms, as the National Dependency System is introduced over the period (2005: 5%; 2010: 100%). These jobs cannot be assimilated under any of the other remaining categories in the table. They are presented for the purpose of the subsequent discussion in the main text.

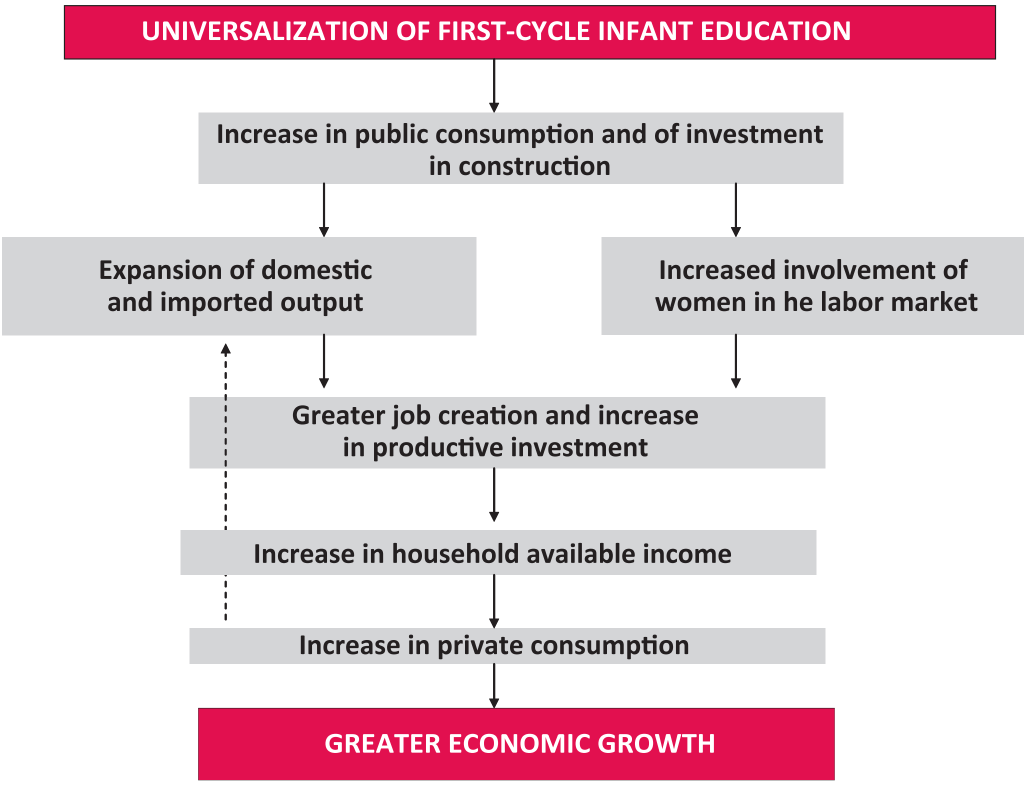
(b) The White Paper does not assess the capital resources applied to dependency, but does so rather in terms of treatment capacity (residential homes, day-care centers), and so does not provide an estimate of the jobs associated with the necessary capital formation, which in no case would be jobs within the sector. This line can therefore only be compared with the lines of the same name under the remaining methodologies, and not the overall lines.

remainder (25%) by the parents. As a result, this measure would involve an immediate increase in public consumption (to recruit teachers) and investment in construction (to build kindergartens).

As in the case of dependency, the measure would have a clear multiplying effect on the economy by increasing the involvement of women in the labor market. In specific terms, according to the Opinion Poll Survey (EPA) employment survey data for 2007, the probability of a mother with children aged under 3 (and with a partner) being actively employed was 60.8%, considerably below the figure for a woman of similar characteristics but without children (84.4%). It is estimated that the creation of a National Kindergarten Network would serve at least to halve the gap between the two probabilities. This would lead to a greater supply of labor, increasing the productive potential of the economy.

In addition, the construction of schools and recruitment of teachers would increase the income available to households and their private consumption. In the event that this latter increase in demand were below the rise in productive potential, there would be a reduction in inflationary pressures (see Figure 4).

Figure 4. Dynamizing mechanisms of age 0-3 schooling



Source: produced by the author.

According to the quantitative estimates set out in the economic report published by the Socialist Party prior to the 2008 election, the creation of 300,000 new kindergarten places would allow at least 70,000 more women to join the labor market. As a result, the potential product of the economy by 2012 would be 0.35% higher than forecast (see Table 8). Meanwhile, the increase in demand by 2012 would be slightly lower, meaning that prices would fall. Lastly, in order to satisfy this increase in demand, at least 58,000 new jobs would be created, and the unemployment rate would not be affected.

Table 8. Multiplying effects of age 0-3 schooling

	Potential Product	Actual GDP	Employment	Number of Jobs	Unemployment Rate	GDP deflator
2008	0.00	0.04	0.04	7749	-0.04	0.01
2009	0.09	0.10	0.11	19928	-0.02	0.00
2010	0.18	0.15	0.17	31842	0.00	-0.01
2011	0.27	0.20	0.22	43156	0.02	-0.02
2012	0.35	0.27	0.30	58478	0.02	-0.02

Source: Mulas-Granados (2009).
The figures reflect deviation levels from the central scenario.

6
Conclusions: the Economic Crisis and the Dynamic State

In light of the evidence presented, it would be fair to state that prior to the economic crisis which has been ravaging Spain since 2008, the socialist government was taking the initial steps along a complex path intended to extend the provisions of the country's Welfare State, while also attempting to make it more dynamic in every aspect.

The onset of the crisis has for the moment halted this process. When the issue at stake is the need to shake off paralysis and reset the economic system as a whole, processes to reform the social model take a back seat.

No one would dispute that the 2008 crisis is now having profound and immediate economic consequences, although its most lasting effects will probably be on the political and institutional fronts, in both Spain and the other advanced countries.

Unlike in previous financial and economic crises, the role of the public sector has emerged stronger in all countries. In fact, during the recent crisis, the State has everywhere reclaimed a central role in at least four areas:

- As the guarantor of sustainability in the banking system and as a lender of last resort.
- As the provider of a social safety net for citizens and companies affected by the economic crisis generated by the restriction in credit caused by the financial crisis.
- As a regulatory and supervisory body for financial markets in the future.
- And as almost the only catalyst for activity in a paralyzed economy, through large-scale fiscal and monetary stimuli.

What is interesting is that the responses of the State to the crisis have dedicated equal attention to the role as guarantor and as dynamizer. In the first two cases, the states of the most advanced nations worked to avert the collapse of the economic system and to alleviate the social consequences. In the latter two cases, meanwhile, the State is simultaneously playing a substantial active role in the recovery of economic activity and in establishing new regulations to prevent further future crises.

The 2008 financial crisis demonstrated the harmful potential of the first of the "megatrends" for change which I referred to at the start of this paper. Globalization, in its financial aspect, generates individual risks, but also collective risks of systemic instability. In response to the former, the Dynamic State reacts by increasing the skills, training and mobility of its citizens. Faced with the collective risk, however, the same State must demonstrate its full capacity to perform three specific tasks: an underpinning task (cushioning the loss in revenue caused by the collapse); a dynamic task (stimulating demand for products and services in order to catalyze the reactivation of the private sector); and lastly a regulatory task, abandoning the paradigms of market self-regulation and assuming the role which the Dynamic State also has in generating stable, transparent and trustworthy markets.

These are the three roles which we will see the Dynamic State playing in the near future, while continuing to promote the transformation of the social models of the most advanced countries with the aim of maximizing their capacity to generate social justice and freedom.

Against this background, I would like to conclude with a personal reflection. I believe that in this regard Spain could take its Dynamic State still further, through two actions which would be simultaneous and would necessarily feed off one another.

First, the State must play a strategic role in the economic recovery. Massive investment to improve our country's stock of physical, human and technological capital will guarantee us the means required in order to transform our economic model. However, definitive transformation depends not only on the quantity of the investment but must also be accompanied by regulatory changes to increase competition in the markets for goods and services and to improve the productivity of the labor market. Only through simultaneous action in the fields of expenditure and legislation will we succeed in transforming the spent model of today into a sustainable and cutting-edge economy.

Secondly, and as the change in the economic model beds in and Spain emerges from the crisis, the government must continue with the process begun in welfare policy. This will be the time to develop a fifth pillar serving to cover for a new, fifth involuntary risk, the risk of becoming socially entrapped. When the world moved slowly, staying in the same job and the same social and professional stratum formed part of daily reality. Today, the certainty of having to deal with recurrent professional turnover throughout one's life goes hand-in-hand with the viability of less stable family models and the accelerated geographical mobility of individuals. A world where the individual is taking on increasing importance, to the detriment of social classes, trade associations and families, and where change is permanent, leads to the risk of becoming entrapped within one of these transitions. As in the case of the four traditional pillars, the State must play a role in providing cover for this risk through programs to re-skill and re-launch individuals towards the next stage.

In Spain, this fifth pillar should first focus on the economic emancipation and independence of those groups which currently find this most difficult to achieve, since such emancipation would generate productivity gains for the entire economy, would allow us to pay for the additional public services we require, and would make very important sectors of society more equal and more free. These groups are essentially young people, who become independent at a very late stage because of restricted access to housing and the limited purchasing power of the salaries they earn, who do not travel abroad or speak other languages because of a lack of resources, who cannot balance lifelong learning and employment, and who find it difficult to have children and maintain a professional career because they cannot find free infant schools, home help or out-of-school activities for their children. This risk of entrapment is particularly great for women of all ages, when they separate or when they are forced to choose between their family and professional lives.

In all cases, new public services and a commitment to lifelong training would resolve most of the problems. In summary, with or without a fifth pillar, the transformation of the traditional Welfare State into a Dynamic State has taken only its first few steps in Spain. The crisis has postponed some reform processes in the field of modernizing social policy, but has served up a renewed opportunity in the field of transforming the economic model into a more sustainable, equitable and lasting system. The debate as to build upon this great opportunity has only just begun.

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THE DYNAMIC STATE BEFORE AND AFTER THE ECONOMIC CRISIS

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