EUROPEAN GOVERNANCE AND POLITICS PROGRAMME

ROBERT SCHUMAN CENTRE

# POLICY BRIEF

## Learning from adversity: towards a European Union of social investment welfare states[1]

### 1. Introduction

Looking back on the long decade of the Great Recession and the COVID-19 health shock, it is undeniable that far from crowding out scarce resources, well-funded and active welfare states are a *sine qua non* to the resilience of liberal democracies, knowledge economies and aging societies. This policy brief intends to provide some useful insights for the important question of the future of the welfare state in the European Union from the perspective of my research at EUI. At the risk of being accused by my colleagues of engaging in a Whig history of our poly-crisis epoch, I will challenge the conjectures of a 'big trade-off' between equity and efficiency and the equally popular 'trilemma' between equality, employment, and fiscal balance, with ample empirical evidence.[2] Drawing on four temporally ordered lessons from the recent past, I raise two supportive cheers for the welfare state, followed by praise for the European Central Bank, and then, last but not least, a compliment for the European Commission. I conclude by making a timely social investment fiscal policy proposal for the EU polity at large.

*Acknowledgements*

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1 This Policy Brief is based on a speech given at the 2023 edition of the EUI State of the Union, Florence, Palazzo Vecchio, 5 May.

2 Okun A.M. (1975) Equality and efficiency: The big tradeoff. Washington DC: Brookings Institution; Iversen, T. and A. Wren (1998) 'Equality, Employment, and Budgetary Restraint: The Trilemma of the Service Economy', World Politics, 50: 507–46.

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## 2. Lesson one: inclusive buffers are indispensable

In times of turbulence and transformation, policymakers and academics are often confronted with the uncomfortable truth that past theories no longer pertain. This is not to be taken lightly, because the hardest part of any learning process is the unlearning of old beliefs. In her address to the World Economic Forum in Davos on 24 January 2013, the then German Chancellor Angela Merkel dramatized the European Great Recession predicament by underscoring that the continent 'represents 7 per cent of the world's population, 25 per cent of the world's GDP and 50 per cent of the world's social spending', implying that such ratios were unsustainable in an era of intensified global competition.[3] As costly bank bailouts drained the public purse, she inferred that fiscal consolidation had to gain primacy in tackling the aftershocks of the global financial crisis, requiring across-the-board cuts in welfare benefits and social services.

From a welfare state perspective, it is important to acknowledge that Merkel's critique was nothing new. The economic and monetary union (EMU) fiscal threshold values of 3 per cent on public deficits and 60 per cent on debt relative to GDP were enshrined in the Stability and Growth Pact and underwritten by the no-bailout clause.[4] The thinking behind these values was premised on the idea that fiscal limits on public spending were key to keep 'wasteful' welfare states in check. Since the stagflation crisis of the 1970s and 1980s, generous welfare provision was believed to crowd out private initiative, and to set the scene for stagnant growth, high levels of unemployment and permanent wage inflation.[5]

Looking back on the long decade since the global financial crisis, it is undeniable that many of Europe's most generous and inclusive welfare states are also among the most competitive economies in the world, including Germany which, under Merkel, preserved social spending and ratcheted up social services for working families with children.[6] What made the Great Recession a 'recession' and not a 'depression' as in the 1930s, was that it was not allowed to persist. Policymakers swiftly launched counter-cyclical monetary and fiscal policies. Compared to the United States, European policymakers were slow to recognize the severity of the crisis.[7] On the other hand, many EU member states presided over far more generous automatic stabilizers in the form of unemployment insurance and minimum income protection transfers, absorbing close to 50 per cent of the unemployment shock, compared to the United States figure of just over 30 per cent.[8] In hindsight, Europe's comprehensive and expensive welfare states, including Finland, France, the Netherlands and Sweden, buffered the Great Recession (and the eurozone crisis) the best. For these countries, income-support mechanisms created for demand-deficient recessions with high unemployment really did kick in: as earnings fell, social benefits were there to mitigate poverty and cushion the macro economy. On the other hand, Greece, Ireland, Italy, Portugal and Spain retrenched social spending pro-cyclically – more on health and education than on pensions – as the economy contracted and unemployment grew.[9] These unfortunate member states were also more constrained by the fiscal rulebook of the 'incomplete' single market and currency union to which I will return later.

3 Merkel, A. (2013) Speech by Federal Chancellor Merkel at the World Economic Forum Annual Meeting, 24 January 2013

4 European Union (1992), Treaty on European Union (Consolidated Version), Treaty of Maastricht, Official Journal of the European Communities C 325/5, 7 February 1992

5 Blanchard, O., and L. Summers (1987) 'Hyteresis in Unemployment', European Economic Review, 31: 288–95.

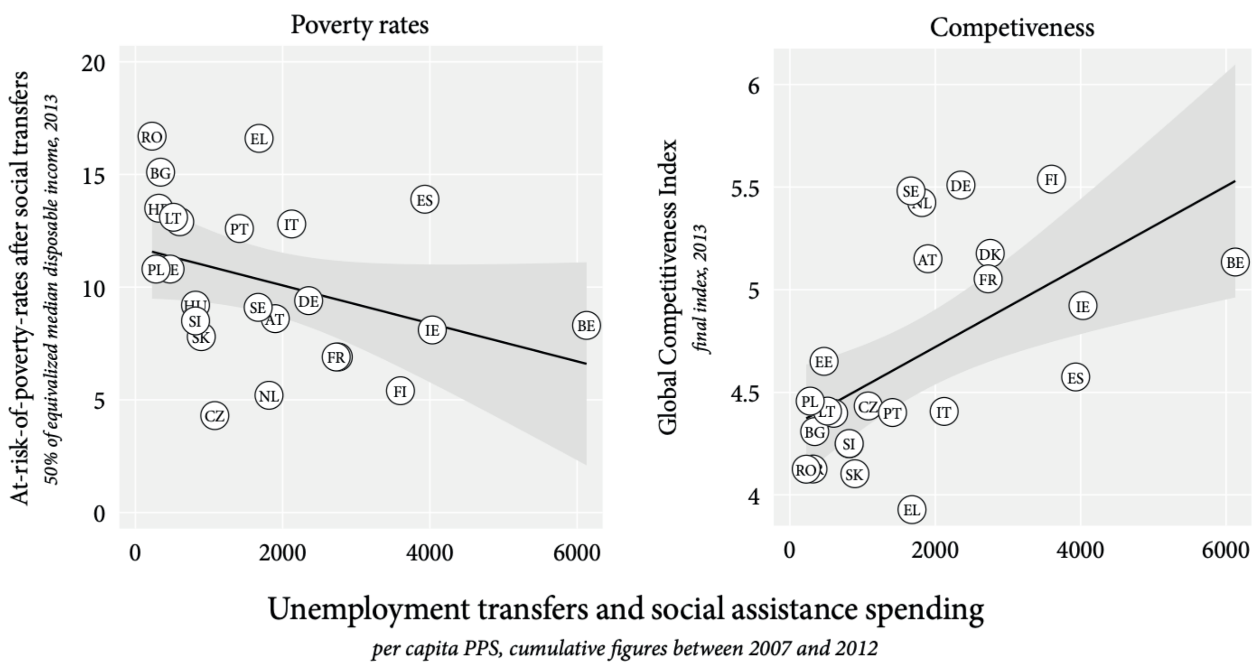
6 Hemerijck, A., and R. Huguenot-Noël (2022) Resilient Welfare States in the European Union, Newcastle upon Tyne: Agenda Publishing.

7 Tooze, A. (2018) Crashed. How a Decade of Finacial Crises Changed the World. New York: Viking.

8 Hemerijck A. and M. Matsaganis (2023) Who's Afraid of the Welfare State Now? Oxford: Oxford University Press.

9 Plavgo I., and A. Hemerijck (2021). The social investment litmus test: Family formation, employment and poverty. Journal of European Social Policy, 31(3), 282–296. https://doi.org/10.1177/0958928720950627

**Figure 1. Social protection spending, poverty, and competitiveness**




Overall, my first lesson is that comprehensive and inclusive social safety nets proved their worth, precisely as John Maynard Keynes and William Beveridge had anticipated in the 1930s and 1940s.[10] As figures 1 and 2 indicate, unsurprisingly unemployment insurance and social assistance outlay are strongly related with lower levels of poverty. More counterintuitive perhaps is that social protection spending is quite strongly correlated with competitiveness.

However, these observations beg the question why Merkel and, no less important, the original architects of the EMU, seemingly discounted the relevance of income buffers and automatic stabilization. My hunch is that, since the 1980s, policymakers, but also many academics, had bought into the promises of economic internationalization and market-making European integration, at the expense of seriously probing for policy vulnerabilities and institutional weaknesses. In that process, important lessons of the Great Depression were unlearned and/or forgotten, and the welfare state came to be narrowly defined in terms of redis tributive economics and politics. This intellectual turnaround began in 1975 with Arthur Okun's idea of a 'big trade-off' between equity and efficiency, arguing that too much redistribution would harm the economy, making everybody worse off. From a different angle, Thomas Piketty in his well-researched books, *Capital in the Twenty-First Century* (2014) and *Capital and Ideology* (2020), underscores how liberalization since the 1980s has greatly contributed to growing inequality. Yet, very much like his neoliberal colleagues, Piketty continues to frame the question of inequality entirely in redistributive terms, from which his preferred solution of progressive wealth taxation to overturn property relations naturally follows.[11]

Political scientists, on the whole agnostic on the equity-efficiency trade-off, have, since the 1990s, come to rely on assumptions of zero-sum welfare politics under fiscal conditions of 'permanent austerity'.[12] Strikingly, this emphasis on distributive economics and politics differs significantly from the productive and problem-solving understanding of welfare provision held by the post-war social engineers and political thinkers. For William Beveridge and John Maynard Keynes, the modern welfare state held out a promise of full employment

10 Keynes, J. M. (1936) [1973] The General Theory of Employment, Interest and Money. London: Macmillan for the Royal Economic Society; Beveridge, W. H. (1944) Full Employment in a Free Society: A Report. London: Allen & Unwin.

11 Piketty, T. (2014) Capital in the Twenty-First Century, Cambridge MA: Harvard University Press; (2019) Capital and Ideology, Cambridge MA: Harvard University Press.

12 Pierson, P. (ed.) The New Politics of the Welfare State. Oxford: Oxford University Press.

(admittedly only for men), comprehensive social safety nets, and universal access to good quality health care and educational opportunities. Over the past decade, the latter function of 'capacitation' through social investment has gained greater prominence in Europe's knowledge economies and ageing societies.

## 3. Lesson two: social investment is key

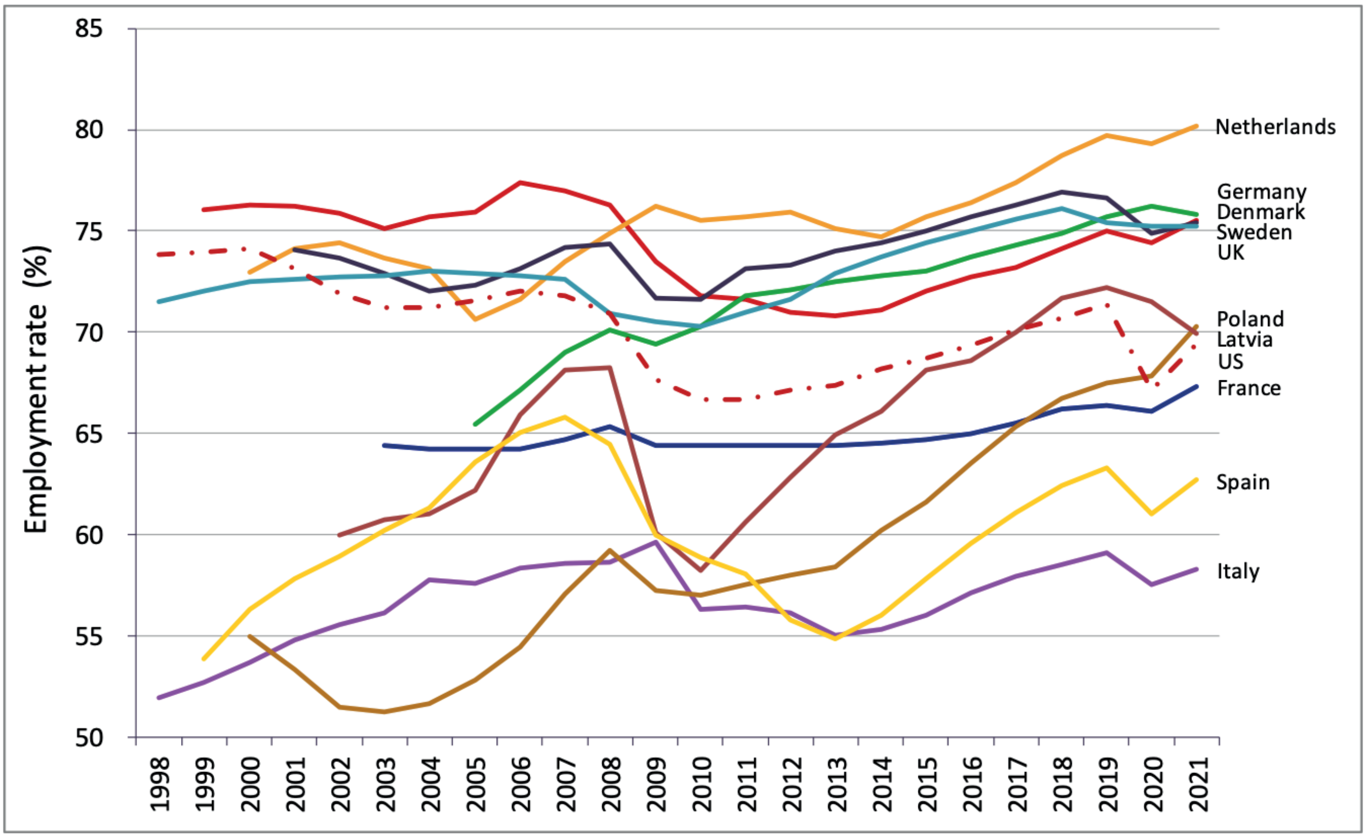
What matters is not the *quantity* or *ratio* of social spending, relative to GDP, but its *composition* and *efficacy*. This is where I would like to raise a second cheer in support of the so-called social investment welfare state. The Great Recession affected different welfare states differently, reflecting their relative vulnerability to shocks and institutional capacities to confront adversity. Beyond financial crisis shock absorption, when it comes to bouncing back in terms of lowering unemployment and raising employment, the active welfare states of northern Europe did much better than their more passive and fragmentary southern counterparts. Not suffering from an austerity panic attack, unsurprisingly it was the Nordic countries (such as Denmark and Sweden) with their strong dual-earner family services, that were able to reinforce high levels of employment in hard times. In addition, these welfare systems also outperformed the United States, as shown by figure 2, although fiscal stimulus and quantitative easing were pursued earlier and far more aggressively across the Atlantic. By contrast, continental countries were more constrained. Yet Germany fast-tracked social-investment reform in childcare and work-family reconciliation in the favourable context of strong export-led growth. Tragically, in the Mediterranean periphery, austerity constrained female employment growth, thereby rendering single-earner families particularly vulnerable.[13]

Under the political pretext of the austerity imperative, the United Kingdom moved away from dual earner family benefits and services, initiated under the New Labour governments of Tony Blair and Gordon Brown, that were successful in lowering child poverty. Meanwhile Poland, largely unaffected by the Great Recession, greatly expanded the welfare state on an old-fashioned male-breadwinner compensatory logic, to consolidate electoral support for the populist radical-right Law and Justice party.[14]

13 Hemerijck, A. and Ronchi, S. (2021). social investment reform in the twenty-first century. The Oxford Handbook of the Welfare State, Oxford: Oxford University Press. pp.112 - 123.

14 Hemerijck A. and M. Matsaganis (2023) Who's Afraid of the Welfare State Now? Oxford: Oxford University Press: chapter 5 and 6.

**Figure 2. Employment trends in the US and in 10 selected European countries (1998-2021).**




*Source: OECD.*

Gradually, in the new millennium the notion of 'social investment' gained purchase as a policy compass for welfare state recalibration. Today, international organisations, from the European Union and the Organisation for Economic Co-operation and Development (OECD) to the World Bank, associate social investment reform with strategies of 'inclusive and sustainable growth'.[15] The objective of social investment-oriented policies is to enhance individuals' opportunities and capabilities to address *ex ante* social risks typical of post-industrial economies, while ensuring the high levels of (quality) employment necessary to sustain the 'carrying capacity' of the welfare state. Early childhood education and care, vocational training over the life course, active labour market policies, work-life balance policies such as (paid) parental leave, lifelong learning, and long-term care – all these policies transcend (but do not replace) the compensatory logic of postwar social security. To the extent that social investment welfare provision is geared towards maximizing employability and productivity, this *ipso facto* bolsters the financial sustainability of the modern welfare state without trampling its commitment to poverty prevention and alleviation in times of need.

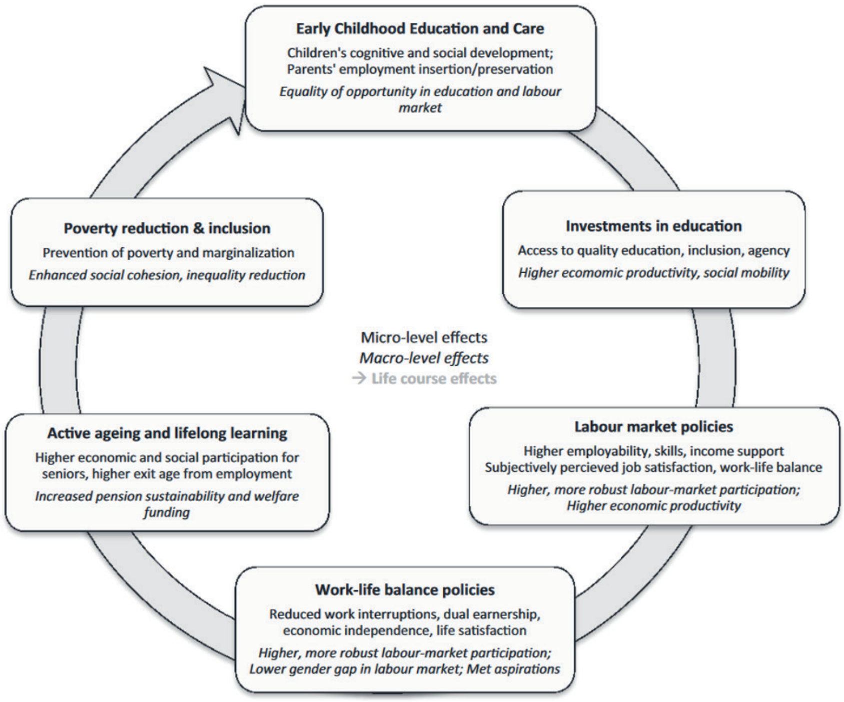
But what is the concrete logic behind welfare state divergence in the wake of the Great Recession? For this we need to adopt a life-course perspective. Fundamentally, retirement in good health correlates with a good childhood, and vice versa. Across the life course, there are moments of transition that can potentially cause (cumulative) disadvantage. In an attempt to overcome the unwarranted opposition between passive, *ex post* compensatory social policies and active, *ex ante* capacitating social policies, I have developed a conception of the welfare state comprising three key functions: first, fostering lifelong development of human capital 'stock'; second, easing the 'flow' of family life-course and labour market transitions; and third, sustaining

15 OECD (2015) In It Together: Why Less Inequality Benefits All. Paris: OECD; OECD (2018) A Broken Elevator? How to Promote Social Mobility. Paris: OECD; European Commission, COM(2013) 83 final – Communication: Towards Social Investment for Growth and Cohesion, Brussels: Publications Office European Commission; World Bank. 2023. Expanding Opportunities: Toward Inclusive Growth. World Bank, Washington, DC. http://hdl.handle.net/10986/39613.

inclusive social protection 'buffers'. Based on the available evidence from my European Research Council Advanced Grant research project WellSIre, an acronym for 'wellbeing returns on social investment recalibration', it is possible to postulate a 'life-course multiplier' mechanism, whereby social investment returns reaped over the life course generate a positive cycle of well-being returns, in terms of employment opportunities and gender equity, with positive results for intra- and intergenerational poverty mitigation (see figure 3).[16]

household well-being (employment and income) and help mitigate social risks later in life through opportunities for skills acquisition and the easing of (gendered) labour-market transitions. At the macro level, the multiplier suggests cumulative societal benefits, ranging from improved productivity, higher employment, and reduced gender gaps to lower poverty, longer careers, and later retirement, all of which are crucial to economic growth and the fiscal sustainability of the welfare state in knowledge economies and ageing societies. The fundamental lesson of our research is that social

**Figure 3. The social investment life-course multiplier at a micro and macro level**




*Source: A. Hemerijck, S. Ronchi, I. Plavgo, Social investment as a conceptual framework for analysing well-being returns and reforms in 21st-century welfare states, Socio-Economic Review, 2022,* https://doi.org/10.1093/ser/mwac035

The social investment life-course multiplier features prominently in the recent report by the High-level Group on the future of social protection and the welfare state of which I was a member.[17]

At the micro level of individuals and households, this multiplier suggests how social investments, from early childhood on, improve material

investment welfare provision potentially contributes to achieving a 'double dividend' of greater and more gender-balanced employment and productivity gains, able to sustain fair, adequate, and sustainable social protection. This indeed is worthy of a second cheer for the active welfare state. Good quality and affordable childcare make it attractive

16 Hemerijck, A., Ronchi, S. and Plavgo, I., 2023. Social investment as a conceptual framework for analysing well-being returns and reforms in 21st century welfare states. Socio-Economic Review, 21(1), pp.479-500.

17 European Commission (2023) High-Level Group Report on the Future of Social Protection and the Welfare State in the EU, Brussels: European Commission

for young couples to have children; whilst active labour market, lifelong learning, and public health policies, enable workers to pursue longer careers.

## 4. Lesson three: a mature currency union to break the spell of unemployment

Despite the growing evidential efficacy of social investment welfare provision, up to the mid-2010s fiscal austerity carried the day within the EU. The eurozone debt and currency crisis laid bare the shortcomings of the architecture of the internal market and monetary union: without a lender of last resort and/or fiscal bailout facility it proved difficult to keep the eurozone together.[18] The Great Recession disrupted the convergence among eurozone countries – both nominal (interest, inflation, and exchange rates) and real (per capita GDP growth and unemployment) – and hindered the steady catch-up of the new member states in central and eastern Europe in employment, wages and economic performance.

The original policy theory of the currency union assumed that the European Central Bank's price stability mandate, together with fiscal discipline enforced by the Stability and Growth Pact, would raise pressures on the member states for 'structural reform'. In other words, the EMU effectively institutionalized a 'disciplining environment' of keeping 'wasteful' welfare states in check, as I alluded to before. In the early years of the euro, Germany undershot the European Central Bank (ECB) inflation targets. At the same time, the Mediterranean countries and Ireland struggled with high inflation amid credit-fuelled growth. Although Ireland and Spain continued to adhere to fiscal conservatism, lower interest rates and easy credit stimulated a construction bubble, financed by a massive hike in private debt, which ultimately burst. For Greece and Italy, with their troubled public finances, a different scenario ensued. After the Mediterranean countries had secured entry into the EMU, however, 'structural reform' incentives waned as public borrowing became excessively cheap. Paradoxically, the euro acted as a 'reform tranquilizer' reducing, rather than reinforcing, pressures to balance the books and make welfare provision more inclusive and capacitating. Moreover, the Brussels-Frankfurt obsession with *public* budgetary discipline caused eurozone policymakers in countries like Ireland and Spain (and the Netherlands) to ignore the destabilizing effects of accumulating *private*-sector debt.[19]

Given the impossibility of currency devaluation in a monetary union, all the troubled eurozone economies were subsequently forced to resort to engineering 'internal devaluations' to try to regain competitiveness. As contagion spread from Greece to the weakened periphery of the eurozone, the no-bailout clause in the Treaty on the Functioning of European Union was cast aside – a breakthrough accompanied by the bitter pill of strict conditionality attached to fiscal assistance. By the summer of 2012, as contagion spread from Greece to the already weakened southern periphery of the eurozone, Mario Draghi, then President of the ECB, broke the ice with his 'whatever it takes' vow to fight rising spreads and deflation. Later that year, International Monetary Fund economists raised questions about the 'multiplier effects' of fiscal consolidation on growth, casting doubt on the viability of the 'expansionary austerity' theory.

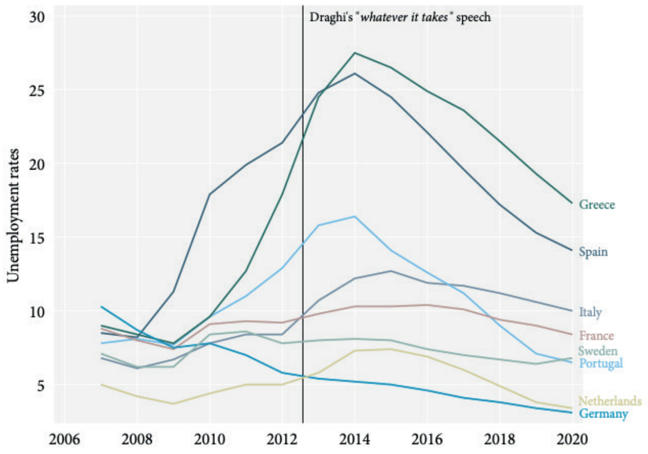
The ECB's introduction of quantitative easing however was not sufficient to transcend the default fiscal-austerity paradigm. By the spring of 2018, Draghi conceded that the monetary union remained incomplete.[20] He felt that the eurozone needed an additional fiscal instrument to maintain macroeconomic stability during large shocks, without over-burdening monetary policy. Draghi conceded that such a fiscal layer for macro-stabilization would be difficult to design consistent with the Treaty, but eventually an instrument of budgetary solidarity would have to play its part in delivering financial stability and economic convergence across the eurozone.

18 De Grauwe, P. (2011) The Governance of a Fragile Eurozone. Leuven: University of Leuven.

19 Hemerijck, A. (2013) Changing Welfare States. Oxford: Oxford University Press.

20 Draghi, M., Address [by Mario Draghi, President, European Central Bank, at SOU2018], The State of the Union Conference, Florence: EUI 2018 - https://hdl.handle.net/1814/67350

**Figure 4. Unemployment decline in the wake of the EBC's 'whatever it takes' vow.**




After Draghi's vow to do 'whatever it takes' to save the euro, a more benign and stable macroeconomic environment ensued, and unemployment began to fall, as can be observed in figure 4. This allowed EMU member states to expand the policy space to more capacity-building and solidaristic reforms. In the troubled economies of Greece and Italy, national minimum-income schemes were introduced for the first time. In Spain, active labour market policies became more robust from 2015. Germany, and to some extent also France and the Netherlands, stepped up efforts to integrate excluded at-risk groups within their social-protection systems.[21] In addition, family services were extended in many more countries. De facto, but not de jure, the ECB – lacking a mandate in relation to (un)employment – started to resemble the US Federal Reserve.[22]

## 5. Lesson four: EU fiscal solidarity to broker social investment reform

By the second half of the decade, it became obvious that the original austerity reflex was both economically flawed and politically untenable. László Andor, the Social Affairs Commissioner in the second Barroso Commission, was the first to reopen the window for a European Union social-investment strategy as a promising, evidence-based, corrective.[23] However, the policy mix of an accommodating monetary policy together with mere lip service to social investment, in the shadow of fiscal rectitude, proved to be an incoherent cocktail. Without EU fiscal backing, social investment reform remained a privilege only for countries with deep fiscal pockets. Barring social investments where they were needed the most, moreover, did little to counter economic divergence within the eurozone. Outside the political mainstream, populist parties, appealing to disenchanted electorates, mobilized against the austerity compromises made in Brussels and Frankfurt.

There were silver linings too. The weakening of the 'expansionary austerity' paradigm gave new impetus to 'Social Europe'. Raising the stakes for a triple-A rated Social Europe, the Juncker Commission launched the European Pillar of Social Rights in 2017, setting out 20 key principles, providing a fine balance of protective and social investment policies for well-functioning labour markets and welfare systems.[24]

Then COVID-19 struck. The early days of the pandemic brought back haunting memories from the eurozone crisis and the migration crisis of the early to mid 2010s when solidarity among member states was in high demand but short supply. While in hindsight the welfare state may be hailed as the unsung hero of the Great Recession, the pandemic ushered in the unthinkable – a truly assertive reappraisal of the European welfare state for the twenty-first century. My first lesson resurfaced with zest. Inclusive welfare states providing broad and well-organised access to sickness and unemployment benefits and to short-time working arrangements for all their citizens – regardless of their employment contract or status, the type of job

21 Hemerijck, A. and Plavgo, I., 2021. Measuring returns on social investment beyond here-and-now redistribution: A commentary on Parolin and Van Lancker's response article. Journal of European social policy, 31(3), pp.309-320.

22 Lucia Quaglia & Amy Verdun (2023) Explaining the response of the ECB to the COVID-19 related economic crisis: inter-crisis and intra-crisis learning, Journal of European Public Policy, 30:4, 635-654, DOI:10.1080/13501763.2022.2141300

23 European Commission (2023) High-Level Group Report on the Future of Social Protection and the Welfare State in the EU, Brussels: European Commission SIP

24 European Commission (2017), Secretariat-General, European pillar of social rights – , Publications Office, 2018, https://data.europa.eu/doi/10.2792/95934

they do or the sector in which they work – swiftly bounced back into good health.[25]

Also at the EU level, the COVID-19 policy response was truly assertive and well-coordinated. The EU intervened to support member states' fiscal efforts in preserving employment, strengthening their health-care systems, and helping to cushion the social consequences of the crisis. European-level action revolved around three pillars: monetary and banking policies; state aid and fiscal rules; and budgetary and financial support measures – in other words – fiscal solidarity. In March 2020, the Commission activated the 'general escape clause' of the Stability and Growth Pact to allow member states to depart from medium-term budgetary objectives. In April, a new quasi-automatic fiscal stabiliser called SURE was created to support member states with short-term work schemes related to the pandemic. Finally, in July 2020 the European Council reached agreement on the NextGenerationEU, including the Recovery and Resilience Facility to mitigate the socioeconomic consequences of the COVID-19 health shock. The €800 billion Recovery and Resilience Facility marks an unprecedented leap in European Union fiscal solidarity, paving the way for a more inclusive, investment-led recovery from the pandemic. This paid off. Employment rose and unemployment quickly fell below pre-pandemic levels. In particular, Mediterranean eurozone economies grew admirably, with debt coming down much faster than across the Great Recession, precisely because of favourable growth dynamics.

In the wake of the pandemic, the current Commission President, Ursula von der Leyen, launched a new Action Plan to implement the Social Pillar by 2030, including a list of EU actions that the Commission is committed to take during the current mandate (until the end of 2024). These include – among the most relevant dossiers – a directive on Binding Pay Transparency Measures, the European Child Guarantee Recommendation, a new Occupational Safety and Health Strategy, the directive on platform work, recommendations on the revision of the Barcelona childcare targets, and on long-term care, and recommendation on minimum income. In May 2021, a European Social Summit was organised in Porto in by the Portuguese Council Presidency, where member states agreed on three EU social targets for 2030: at least 78 per cent of the population aged from 20 to 64 should be in employment, at least 60 per cent of all adults should be in training every year, and a reduction of at least 15 million in the number of people at risk of poverty or social exclusion.

Shaken by the truly existential COVID-19 health shock, compared to the sovereign debt crisis, an important political difference was that the nature of the pandemic could not be framed in terms of sinful debtors and virtuous creditors. The assertive policy response to COVID-19 cannot be understood simply as the result of a symmetric health shock compared to the asymmetric effects of the sovereign debt crisis. I would argue that, in effect, the hard lessons learned from the long decade of the Great Recession critically informed the rapid, assertive, and progressive COVID-19 crisis response. From this perspective, the pandemic was the existential 'tipping point', but the experiential 'game changer' was rooted in the macroeconomic, social and political aftershocks unleashed by the Great Recession.

## 6. Early childhood social investment now

Two cheers for the welfare state, praise for the ECB's courage to engage in heterodox monetary policy, and a final compliment for the European Commission and the member states for mustering EU fiscal solidarity at long last. Besieged by two major shocks – the Great Recession and the pandemic – it is safe to say that adversity has strengthened the policy salience of public health care, poverty relief, social security, macroeconomic stabilization, and secure capacitation in work-life balance, early childhood development, and lifelong learning. The welfare state supported economic resilience during the global financial crisis and provided an indispensable lifeline for firms and families during the pandemic. Ultimately, EU fiscal solidarity, leveraged by SURE and NextGenerationEU and underpinned by the normative principles of the European Pillar of Social Rights, brought into being an EU 'holding environment' where active

25 Hemerijck A. and M. Matsaganis (2023) Who's Afraid of the Welfare State Now? Oxford: Oxford University Press. Chapter 9.

welfare states can flourish.[26] This is a far cry from the erstwhile E(M)U 'disciplining environment' to keep 'wasteful' welfare states in check, as anchored in the Maastricht Treaty of 1991.[27]

As always, in politics and public policy there are many unresolved issues. Faced with high deficits and debt levels, governments will have to increase taxes to foot the bill for the pandemic, health-care and social security expansion. This against the background of Russia's invasion of Ukraine and related inflationary pressures. Most of the new EU instruments are temporary: the general escape clause of the Stability and Growth Pact will be in place until the end of this year, the SURE sunset clause has already been closed, whilst the Recovery and Resilience Facility experiment will run until 2026. But even as temporary instruments, I consider them part and parcel of the EU's new policy toolbox, as they can easily be re-activated under future crises and calamities.

For me, most importantly, the cognitive mindsets and political orientations have been transformed in a manner that makes it difficult to turn back the clock. It was easy for John Maynard Keynes to claim that 'when the facts change, I change my mind'. In practical politics, precisely because preferred outcomes, from equity and efficiency to fiscal balance and environment sustainability, are inherently uncertain, public authorities hold to past policy theories far beyond their evidential expiry date. The fallout of the Great Recession, the pandemic, supply-chain shifts, and the Russian invasion of Ukraine, together with the unexpected resilience of the welfare state, all inspired a painful but sobering learning experience for policymakers. Moreover, these lessons not only gathered momentum among policy elites but also across European publics, as evidenced by the EUI-YouGov survey that we have been running now for six years.[28] When my colleague Philipp Genschel and I started our survey with YouGov in 2018, there was a strong cleavage between Northern and Southern member states. In the wake of Brexit, the pandemic, and the Ukraine war, EU solidarity and trust in EU institutions has progressively grown stronger and the North-South divide has subsided. This indicates that European publics have over the years come to appreciate a more assertive and political crisis management style on the part of EU institutions, opening the space for political leaders to improve EU risk-sharing policies and issue-linkage between salient policy problems and instruments.[29]

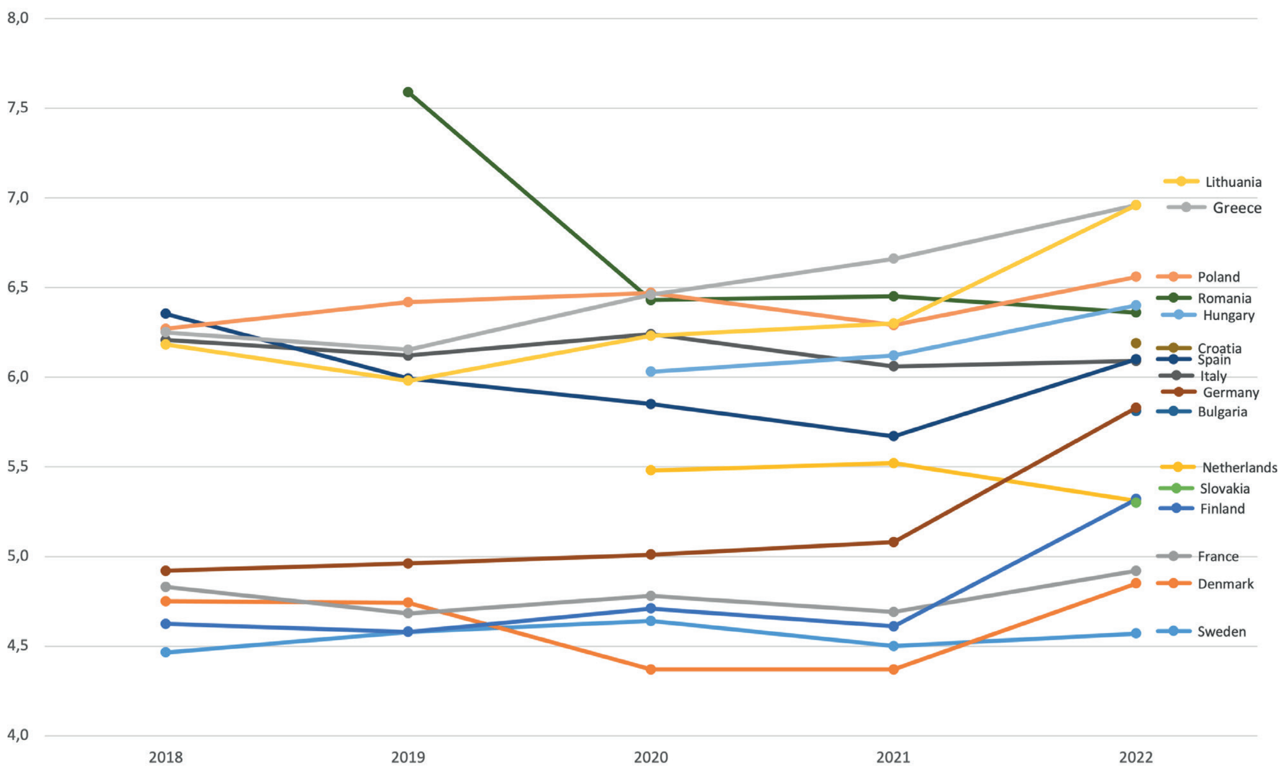
26 Hemerijck, A., 2019. Towards a 'holding environment' for Europe's (diverse) social citizenship regimes (pp. 267-277). Springer International Publishing.

27 Hemerijck, A. (2013) Changing Welfare States. Oxford: Oxford University Press.

28 Hemerijck, A., Genschel, P., Cicchi, L., Nasr, M., and Russo, L., 2021. EUI-YouGov survey on solidarity in Europe trendile and yearly datasets (2018-2021).

29 Genschel, P. and Hemerijck, A., 2018. Solidarity in Europe. San Domenic di Fiesole, School of Transnational Governance, European Univeristy Institute.

**Figure 5: Average support for solidarity across the surveyed countries (2018-2022) (0-10)**




Overall, there is room for optimism. There now is a common understanding that it is better to *improve* rather than *retrench* welfare systems and that durable economic growth is a crucial ingredient for debt sustainability. Today, twenty-first-century evidence shows that generous, inclusive, and capacitating welfare policies are fully compatible with economic growth, high employment and fiscal balance over the economic cycle.[30]

This positive appreciation of social policy as a formidable 'productive factor', I believe, should take pride of place in the debate on the future of EU fiscal and monetary governance. Artificial intelligence will revolutionize the way we work. Demographic headwinds will bring social contracts under further fiscal duress. Climate change requires an even bolder long-term policy effort before it is too late. In essence, there is a need to agree on a stable and equitable inter-generational welfare contract that assures the well-being of the elderly in ageing societies *without* crowding out productive resources for the young to prosper in the dynamic knowledge economy. Rising social needs, especially in long-term care, suggest that the fiscal limits of future welfare provision are real. In other words, the upshot is that twenty-first-century welfare state modernization cannot waste any 'low hanging fruit' policies that will enhance the long-term productive capabilities and opportunities in knowledge-based labour markets to promote and sustain high levels of employment, in order to rein in the fiscal burden of accelerating population ageing.

Endowing future generations with the necessary capabilities to flourish in the knowledge economy forces us to recognize and quantitively appreciate the real returns of social investment in terms of higher levels of employment and gender-balance and productivity, with greater life satisfaction and low levels of poverty and inequality. Existing EMU fiscal rules, expressed in relative monetary values of public debt and deficits, are fundamentally incapable of identifying the real value of social investment. Today, fiscal orthodoxy risks under-investing in tomorrow's economic resilience and social well-being. As mentioned earlier, countries with strong social investment policy profiles generally have lower public debt and deficits and thus borrow at lower costs. In hindsight, they also proved more resilient over the long decade of the Great Recession and the COVID-19 pandemic, by not overburdening the welfare state too much when adversity struck. In the current era of accelerating

30 Hemerijck A. and M. Matsaganis (2023) Who's Afraid of the Welfare State Now? Oxford: Oxford University Press.

technological change and demographic ageing, it is of utmost importance not to squander the long-term resilience that is bolstered by inclusive social protection, gender-balanced employment relations, and a lifelong commitment to human capital development.

If the greatest success of mid-twentieth-century welfare provision was to guarantee economic security in old age, the overriding objective of twenty-first-century welfare provision is to foster strong life chances for the young. In 2021, 19.5 per cent of children were at risk of poverty, compared with 9 per cent of the working-age population, and 16.5 per cent of 20- to 34-year-olds were not in employment, education, or training.[31] Former EU commissioner and Italian prime minister Mario Monti, never a great fan of trade unions, once called the European Union the trade union of the next generation. Well, on that score, it is definitely not doing a good job.

The political conundrum is that discretionary spending on social investments is often sacrificed on the altar of popular transfers for adults and pensioners. Political cynics maintain that as the returns on social investment only materialise in the long run, they inevitably clash with short-sighted electoral competition. Nonetheless, unless we invest in high quality and affordable education and care, governments will soon need to tax shrinking labour forces to fund ailing pensions and healthcare systems. At some point, young dual-earner couples will, against their wishes, effectively give up starting a family. This is already happening in southern Europe and Poland. Because of a conundrum of time-inconsistency, the room for policy mistakes is null.

There is a need for a special EU financing vehicle for public investments with a triple-A rating, and strong positive knock-on effect on long-term growth and debt sustainability. If there ever was merit in having a 'Golden Rule' in EU fiscal governance, early childhood investment is a no-brainer: it's cheap, it immediately creates jobs, it directly reaches out to young families, and it's where the social investment multiplier logic is strongest. It is crucial that early childhood investment does not compete with current expenditures, or, rather, it should be protected from current spending, and this should be anchored in EU fiscal governance. An EU early childhood social investment facility should not be seen as a pro-natalist proposition to ease demographic ageing, but in terms of the normative objective for citizens to pursue fuller and more satisfying lives, which includes facilitating genuine fertility aspirations. Our WellSIRe research reveals higher levels of subjective well-being in countries with good quality and affordable early childhood education and care.[32]

In conclusion, the notion that the EU can advance as a project of market integration and fiscal austerity has been abandoned. In his 1599 play *As You Like It*, William Shakespeare came up with the marvellous line 'Sweet are the uses of adversity'.[33] Over the last 15 years, European welfare states have had more than their fair share of adversity. As a result, we are wiser now, but not sadder. Hopefully, we will no longer hear the false claim that the welfare state is a luxury we cannot afford in hard times. Inclusive and active welfare states make European societies less unequal, their economies more dynamic, and their democracies stronger. But we have no time for complacency: on early childhood social investment, European policymakers must act now!

31 Eurostat

32 Annika Lehmus-Sun (2023), From Making Work Pay to Making Welfare Capacitate
*Social Investment's Promise of Wellbeing.* Draft Dissertation. European University Institute. Department of Political and Social Sciences.

33 Shakespeare, W., 2014. As You Like It: Third Series. Bloomsbury Publishing.

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