POLICY BRIEF

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Financing social investment for an economy of well-being: Moving from good practices to a paradigm shift

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High levels of public debt, pressure on government expenditures, and existing financial regulations are some of the existing barriers to increasing the level of social investment in Europe. However, given the long-term challenges the European Union (EU) is facing, increased efforts in deploying social investment strategies are needed now more than ever. Such strategies imply investing in people's capabilities and social infrastructures, but also in social innovation and the delivery process of public goods and social outcomes. This is crucial to address current market failures in the social sector and to ensure that existing investment can prompt greater levels of social cohesion and territorial convergence.

Given the long-term challenges the European Union (EU) is facing, increased efforts in deploying social investment strategies are needed now more than ever.

At the centre of such strategies lies the question of financing. Traditional approaches and means of financing (i.e. grants and public transfers) are most likely to fall short. That is why using alternative avenues to deliver social investment is essential. In this regard, the potential of financial instruments and impact finance is key and the EU must lead the way into a new paradigm shift in financing social investment. The EU's upcoming budget period (2021-2027), including the InvestEU programme, offers a unique opportunity to support such a paradigm shift. To achieve this objective the new EU leadership should aim to: (1) ensure that financial regulation is not an obstacle to social investment; (2) support social innovation throughout its entire production chain; and (3) integrate national social investment strategies into the larger European framework.

BACKGROUND: THE CONTEXT OF SOCIAL INVESTMENT TODAY

The idea of social investment entails that social spending is an investment in human and social capital that brings long-term returns, as it enhances individuals' capabilities from an early stage and supports various measures throughout their life. According to the social investment approach, individuals should be enabled to take an active role in society and the economy[1]; the resulting effects are a more competitive economy sustained by a healthy, skilled and resilient workforce, reduced costs on corrective measures and a greater level of economic and social cohesion. This approach is more relevant than ever in the light of ongoing socio-economic transformations. However, it will fail to provide the expected results if this is not coupled with a new financial strategy.

The urgency of social investment

An ageing population, new labour market structures and persisting social issues are some of the socio-economic realities that are currently transforming European societies. Their impact is likely to put further pressure on Europe's social model as well as on its cohesion and convergence objectives. In fact, an ageing population and societal changes will increase the demand for social care and support services. There will be more need for elderly care – the share of people aged 80 years or more is expected to more than double by 2080[2] – and growing female employment (58% in 2001 and 67% in 2017 in the EU)[3] increases the need for early childcare. Additionally, urbanisation will demand more affordable housing in cities. Furthermore, in the current 'knowledge economy', the demand for high-skilled and knowledge-intensive jobs will only rise more.[4] This will require advanced education and, most importantly, continuous learning. Finally, persisting poverty[5], rising economic and social inequalities[6] as well as growing regional disparities need to be tackled thoroughly.

If member states fail to do so, such trends will further reveal the inadequacy of their welfare states to deliver solutions to pressing challenges, which are worsened by the decreased level of public investment.

A decreased level of public investment

Despite a return to economic growth, public investment is yet to reach pre-crisis levels. Government investment in the EU was at a record low in 2016 (2.7% of GDP), with the lowest level (2.1%) in the peripheral and crisis-hit countries (Cyprus, Greece, Ireland, Italy, Portugal, and Spain).[7]

The reduction in public investment has also affected social investment, be it in social infrastructures or intangible assets. All in all, the investment gap in social infrastructures in the EU is estimated to be between €100 and €150 billion every year.[8] Additionally, 35% of EU municipalities report that public infrastructure investment is underfunded, especially in transport and social housing.[9]

All types of social investment have come under pressure due to two main reasons: a decrease in traditional forms of social investment financing, and the limited use of other sources of investment.

Intangible social investment has also suffered. Expenditure in education, for example, has fallen from 5.2% of EU28 GDP in 2010 to 4.6% in 2017. In some countries, the reduction in expenditure is significantly larger than the average. In Estonia for example, education expenditure fell from 7.2% to 5.8% of GDP; in Ireland from 4.7% to 3.3%; and in Romania, from 3.8% to 2.8%.[10]

In a nutshell, all types of social investment have come under pressure due to two main reasons: a decrease in traditional forms of social investment financing (i.e. grants and public transfers), and the limited use of other sources of investment (e.g. financial instruments).

Social investment and financial instruments

What explains the scarcity of private investors in a sector with a large investment gap? Previous research has pointed out some key characteristics of social (infrastructure) projects that deter private investors. First, and despite some exceptions (e.g. hospitals), social infrastructure projects tend to be small compared to others and important investors often prefer to invest in one large project instead of a multitude of small ones. Only 1% of them requires an investment of more than €30 million.[11] Second, social investment funding is often provided to the public authority implementing the project, thus making the likelihood of repayment highly dependent on the regulatory environment. If it is perceived to be unstable, investors will not take the risk. Third, social investment returns have a long-term horizon and are difficult to calculate monetarily. Conversely, investors often require precise estimates of economic returns in the short-term. Fourth, there is a lack of a 'common language' between investors and social practitioners. While the former tend to focus on monetary returns, scalable projects and short-term projections, the latter value long-term societal returns that are obtained through smaller projects and are closer to individuals. Additionally, they lack common experiences. Social service providers traditionally deal with public authorities (i.e. providers of grants) rather than with private investors.

STATE OF PLAY: SOCIAL INVESTMENT AND FINANCIAL INSTRUMENTS IN THE EU – FROM POLICY TO PRACTICE

Growing attention at the EU level

The significant risks that territorial disparities pose to the EU, its economic strength and political viability have already been widely recognised. Significant efforts have been made by the EU to boost its weakest regions, not least by providing support to social policies and investing in people through its structural funds. Most of these funds co-finance social investment programmes through grants, and evidence indicates that they have helped mitigate disparities. However, their size and functioning cannot offset some larger (market) forces that are at work, nor can they eradicate all obstacles to improved convergence.[12] For instance, the limited capacity of certain territories to absorb money and administer impactful, innovative programmes cannot be solved by simply providing additional finance.

The EU has tried to address the general lack of investment in Europe by setting up new mechanisms to attract public and private investors and by making use of innovative financial instruments such as guarantees or equities. The biggest newly-established instrument in that respect is the European Fund for Strategic Investment (EFSI), a guarantee of €26 billion, complemented by a €7.5 billion allocation of the EIB's own capital, which was launched in 2015. The objective for the EIB Group – the EIB and the European Investment Fund[13] – was to unlock additional investment of at least €500 billion by 2020, and facilitate investment in projects with a high-risk profile. Both social infrastructures and projects were defined as one of the EFSI's targeted areas. Several additional relevant instruments – such as the

EUSEF (the European social entrepreneurship funds), EaSI (the EU programme for employment and social innovation), or the most recent pan-European advisory platform for social outcomes contracting – focusing on boosting social innovation and supporting social impact finance have also been part of the EU efforts. However, despite the relevance of such initiatives in facilitating the emergence of new business models, their leverage effect and capacity to mobilise a critical mass to finance social investment cannot be compared with instruments such as EFSI.

EU financial instruments for social investment: What are the lessons learnt?

EFSI achievements have already been widely recognised; the greatest success being to leverage over €398 billion across the EU for investment projects.[14] In addition, social service providers strongly welcomed the reference to social infrastructures and projects in the EFSI regulation,[15] although they expected a bigger impact. Only about 4% of the total EFSI has been devoted to social investment until now, the main reasons being the lack of viable project proposals, the absence of a strong economic model for much of said projects, and their size.

That being said, concluding that financial instruments are inadequate to finance social investment based on the limited impact of EFSI in the social area would be wrong. Even if it remains underfunded, there is a growing interest from policymakers, investors and the banking sector to finance social investment differently. Social investment has been successfully intensified by the EIB in recent years (amounting to more than €8 billion in 2015 and 2016)[16] and is part of the usual business of several financial institutions at the national and regional level.

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More concretely, several social projects have recently received EIB support, showing that social providers, investors and the banking sector can successfully work together and deliver positive social outcomes. For example, the EIB has given a 25-year loan amounting to €160 million to the Swedish municipality of Örebro to support its social investment strategy through several small schemes in the fields of childcare, education, municipal housing and more. This project shows how small social projects can be bundled together under one umbrella investment programme. Another example is the EIF's €10 million investment in a social impact bond scheme together with the private fund manager Epiqus and the Finnish Ministry. The scheme provides training and job-matching assistance for the integration of migrants and refugees in the Finnish labour market. Investors are remunerated when the desired social impact is achieved, creating an alignment between societal and monetary returns. By sharing risks between public and private investors, this innovative instrument shows how to attract more private finance in the delivery of social services. Furthermore, the European Investment Advisory Hub (EIAH), which forms part of the Investment Plan for Europe, has offered advice to several social impact initiatives, such as seventy-five primary health care centres in Austria.

PROSPECTS: TOWARDS A REAL MARKET FOR SOCIAL INVESTMENT

With the new EU's Multiannual Financial Framework (MFF) for the 2021-2027 period currently under negotiation, it is high time to turn good practices into a shared and more widely spread paradigm shift on how to finance social investment. The European Commission's (EC) initial proposal for the next MFF offers a unique opportunity: it suggests launching the InvestEU programme, building on the experience of EFSI and backed by an EU budget guarantee of €38 billion. Social investment and skills feature as one of the priorities of InvestEU and will receive €4 billion of the available budget guarantee.[17] If properly used and accompanied by the right measures, this instrument could be a major catalyst for creating a market for the social economy and for mobilising investors on social impact investment.

However, such a paradigm shift will not happen overnight and without some systemic changes and major preparatory work. More concretely, there is a need for the EU to concentrate on three main tasks: (1) to ensure that financial regulation is not an obstacle to social investment, (2) to support social innovation throughout its entire production chain, and (3) to integrate national social investment strategies into the larger European framework.[18]

Task 1 – Adjust financial regulation with long-term investment objectives

In the aftermath of the financial and economic crisis, the main objectives were to increase stability in the financial system, promote transparency, restore market confidence, and limit risk-taking. A number of European reforms were taken in this direction, while also encouraging pro-cyclical behaviour. For instance, the requirement for solvency capital was raised, favouring immediate liquidity and discouraging long-term investment. In addition, the value at risk of market products is now calculated on a shorter horizon of one year, thus ignoring long-term commitments and returns.

However, long-term investment requires some risk-taking as well as diversification and long-term management of assets. These considerations need to become a central part of financial regulation, which in turn must serve Europe's long-term objectives and social investment needs. It is essential to establish a differentiated regulation for short-term and medium- to long-term investment to make social investment projects more attractive for investors. Changes in financial regulation are therefore crucial to mobilise a diversity of actors around the social impact finance, including the largest investors, and, at the same time, correct the mismatch between the mainstream financial products and the specific needs of the social economy.

Task 2 – Support social innovation throughout its entire production chain

Social innovation follows a long production chain, ranging from the identification of the social issues to be solved, to the set-up of the project methodology, to the access to finance, and the impact evaluation. Despite the existence of good practices in each of these different stages, there is a general lack of knowledge across actors and EU regions. The EU is the ideal entity to bridge the gap. To do so, it needs to start by developing a metrics based on existing successful examples that can provide sufficient guidance on project methodology and calculation of return investment. Such metrics could be developed by the EIAH, while serving the development of other social impact financial instruments that will not get the support of InvestEU. Such metrics needs to be part of a wider capacity-building strategy where the EU helps each individual member state to identify the different actors and investors that could play an active role in the social economy of their country and help build a solid market infrastructure. Such guidance and technical assistance need to be more intense in regions where social issues are the most acute and where the expertise in social impact finance is low. These preparatory work and mapping exercise are essential to complement the provision of access to finance and ensure that the needs of the social economy can be turned into proper market demand.[19]

Task 3 – Integrate national social investment strategies into the larger European framework

Elements of Task 2, i.e. the development of a metrics as well as an EU-wide mapping exercise of social investment needs, should lay the ground for setting up national social investment strategies that InvestEU and other EU instruments, such as the EU structural funds, need to support. Such strategies should clearly demonstrate how a variety of actors come together to address the most pressing social issues faced in each country. Beyond the use of the EU structural funds, it should also outline where and how InvestEU and other financial products could help address member states' weaknesses previously identified in different strategic documents, such as the National Reform Programmes, or the country reports, which, in turn, must be in line with the Sustainable Development Goals and the European Pillar of Social Rights. Lastly, the national social investment strategy needs to be fully integrated into EU cohesion policy and become a central part of the partnership agreements that will be signed between the European Commission and individual EU countries.

To conclude, tapping into the full potential of financial instruments for social investment is imperative. The challenges that ongoing trends pose to European societies will not be solved without the active and large contribution of the private and financial sectors. Both of them need to play a central role in the development of co-creative and impactful solutions for systemic social change. The outgoing Commission has done significant work to prepare the ground for the well-needed paradigm shift, but a lot remains to be done to ensure real changes on the ground and a large-scale impact. It is now up to the next EU leadership to intensify the efforts and make Europe a global champion of the *economy of well-being*. If not, pressing challenges will escalate into real threats to the stability of our societies and the sustainability of the European project.

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1 Claire Dhéret and Lieve Fransen (2017), Social investment first! A precondition for a modern Social Europe, Brussels: European Policy Centre.

2 See Eurostat data.

3 See Eurostat data.

4 Organisation for Economic Co-operation and Development (2017), OECD Employment Outlook 2017, Paris.

5 The persistent at-risk-of-poverty rate is on an increasing trend and was estimated at 11.3% in the EU in 2017. See Eurostat data.

6 Since 2008, income inequality has increased in the majority of member states. See Eurostat data.

7 European Investment Bank (2018), Investment report 2017/2018: from recovery to sustainable growth, Luxembourg.

8 Lieve Fransen; Gino del Bufalo and Edoardo Reviglio (2018), Boosting Investment in Social Infrastructure in Europe: Report of the High-Level Task Force on Investing in Social Infrastructure in Europe, Brussels: European Commission.

9 European Investment Bank (2018), *op.cit.*

10 See Eurostat, General government expenditure by function (COFOG), gov_10a_exp.

11 See event report, Bridging the investment gap in social care and infrastructure: What role for the post-2020 EU budget?, Brussels: European Policy Centre, 19 June 2018.

12 Dhéret, Claire (2017), Achieving social triple A: What role for EU cohesion policy?, Brussels: European Policy Centre.

13 The EIF provides risk financing (including equity and debt) to small- and medium-sized enterprises (SMEs) and mid-caps, and is owned by the EIB, the EU and (in minority) other private and public financial institutions.

14 European Commission (2019), Investment Plan results (accessed 6 June 2019).

15 European Parliament and the Council of the European Union (2015), Regulation (EU) 2015/1017, Brussels.

16 European Investment Bank (2017), EIB Group Support for the Social Sector, Luxembourg.

17 See European Commission (2018), A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, Brussels.

18 Please note that for the sake of space, this paper only focuses on a limited number of recommendations seen as the most significant.

19 Miguel Maduro; Giulio Pasi and Gianluca Misuraca (2018), Social impact investment in the EU. Financing strategies and outcome oriented approaches for social policy innovation: narratives, experiences, and recommendations, Luxembourg: Publications Office of the European Union.

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