

## Towards more public social investment in EU economic governance: Which way forward?

*Discussion paper*

*European Confederation of Independent Trade Unions (CESI), Eurodiaconia, Social Platform*

*June 2016*

According to the Treaties, the EU shall combat social exclusion and promote social justice and protection (Art. 3 TEU) and has as objectives the promotion of employment and improved living and working conditions (Art. 151 TFEU). Although social investment<sup>1</sup> plays a key role in the achievement of these objectives, current levels are low across Member States.<sup>2</sup> This paper argues that increasing the fiscal space for social investment constitutes a necessary step to overcome this impasse.

### The case for social investments

Social investments pay off both socially and economically. Firstly, such investments help create more social justice. The recent financial and economic crisis has resulted in a social crisis, with sharply rising socioeconomic inequalities in Member States across the EU. Higher levels of social investments are needed to build more converging societies: they contribute to the provision of affordable and social housing, the fight against persistently high unemployment rates, the integration of refugees as well as the promotion of social inclusion and social cohesion for all.

Secondly, there are inherent economic returns and advantages in social investments. On the one hand, economies with a higher degree of social investment have shown to be more resilient to shocks and perform better in crises. Adequately resourced social protection systems can work as automatic stabilisers and yield positive effects on demand.<sup>3</sup> On the other hand, improved social cohesion prevents the tremendous economic costs of inequalities in the long-run. It also increases future productive capacity, which in turn gives a boost to currently low growth rates.<sup>4</sup>

### Limitations in the EU economic governance framework

Regrettably, while levels of social investments have been persistently low across the EU during the last years, **the EU has so far failed to facilitate substantive increases in the Member States**. EU-level funding tools such as the European Fund for Strategic Investments (EFSI) are aimed at stimulating private investment but do not deliver sufficiently on social investment. Furthermore, the Stability and Growth Pact (SGP) prevents, in many instances, Member States from engaging in social investments themselves because necessary investments in human capital and housing as well as in social, health, and education services often mean a breach of the SGP's deficit rules.

Significantly, there is a so-called investment clause to the SGP, set out in point 2.2 of the European Commission's Communication COM(2015) 12 of 13 January 2015 'Making the best use of the flexibility within the existing rules of the Stability and Growth Pact' grants Member States, based on Article 5 of Regulation 1666/97. This clause grants Member States the possibility to deviate temporarily, under the preventive arm of the SGP, from their medium term objective (MTO) or adjustment path towards it to accommodate investment if a number of conditions are met.<sup>5</sup> In practice, however, this clause has failed to provide adequate leeway for social investment. The current governance framework allows flexibility only to a

<sup>1</sup> Referred to, here, as 'Spending in human capital which brings lasting positive social and economic returns over time'. In its 2013 Social Investment Package (COM (2013) 83), the European Commission defines social investment as policies designed to strengthen people's present and future skills and capabilities and to support them to participate fully in employment and social life. Social investment consists of integrated policies that focus on preparing people for different social realities they might come to face (such as unemployment, sickness, disability or insufficient income), taking a preventive approach by aiming to reduce risks rather than repair their negative impact at a later stage.

<sup>2</sup> According to Eurostat, government investment in the euro area has declined substantially with its ratio to GDP falling from 3.6% in 2009 to only 2.7% in 2014. Cutting public investment has been a common response of European governments during the crisis, despite various studies highlighting the detrimental effects on growth.

<sup>3</sup> European Commission, *Employment and social developments in Europe 2014*, 2014, section 4.4, available at: <http://ec.europa.eu/social/BlobServlet?docId=134048>

<sup>4</sup> OECD, *Income inequality and labour income share in G20 countries: Trends, impacts and causes*, 2015, pp.2-3, available at: <https://www.oecd.org/g20/topics/employment-and-social-policy/Income-inequality-labour-income-share.pdf>. And: European Commission, *Towards social investment for growth and cohesion – including implementing the European Social Fund 2014-2020*, pp.1-2, available at: <http://ec.europa.eu/social/BlobServlet?docId=9761&langId=en>

<sup>5</sup> The following references must be met: The Member State's GDP growth must be negative or its GDP below its potential; the deviation must not lead to an excess over the 3% deficit reference value and an appropriate safety margin must be preserved; investment levels must be effectively increased as a result; the deviation must be compensated within the timeframe of the Member State's Stability or Convergence Programme; eligible investment must be national expenditures on projects co-funded by the EU under the Structural and Cohesion policy, Trans-European Networks and the Connecting Europe Facility or national co-financing projects also co-financed by the European Fund for Strategic Investments;

very limited extent, due to the risk of abuse by Member States who want to break deficit limits by presenting excessive spending as (social) investment.<sup>6</sup>

### A roadmap to stimulate higher levels of public social investment in all Member States

This paper contends that it is possible to effectively boost social investment across Member States through increased fiscal flexibility whilst minimising the risk of abuse. To realise this goal, the following steps should be taken into consideration:

1) The European Commission currently has defined social investment as "strengthening people's current and future capacities", which "have lasting impacts by offering economic and social returns over time, notably in terms of employment prospects or labour incomes."<sup>7</sup> However, a clearer delineation of the term is needed to prevent potential abuses by Member States in the framework of the SGP. Therefore, **the European Commission should carry out a more in-depth assessment of which types of spending can definitely be considered as social investments** (see Box and Annex).<sup>8</sup>

2) In the short-term, the European Commission should increasingly highlight the merits and impact of social investment and work towards a broader and more systematic **application of the investment clause 2.2 referred to in COM(2015) 12 on the SGP** in relation to social investment. This would not require any changes to legislative texts of the EU.

3) In doing so, **the European Commission should systematically promote public social investment in the framework of the European Semester**, especially through the thematic coordination and the Annual Growth Surveys, Country Reports and Country Specific Recommendations, continuously reminding all Member States of the added value of promoting more public social investment. Special attention should be given especially to those Member States which face the greatest social challenges. Using the European Semester, the Commission should also incentivise Member States to reform their revenue and expenditure regimes in a socially inclusive and sustainable way in order to increase financial margins available for public social investment.

4) Even though it is highly plausible that many expenditures in areas such as early childhood education and care, primary and secondary education, further training and social housing have positive returns, the impact of social investment is difficult to quantify because it is social as well as economic. Therefore, **a measurement framework should be developed and recognised to allow for a reliable assessment of short/medium/long economic and social returns generated by social investment**, and to allow for comparison with the outcomes of other spending areas. It should be the task of the European Commission to facilitate the creation of such a framework.<sup>9</sup> An independent institution such as the European Fiscal Board could be tasked with applying this framework and assessing whether specific types of public spending count as social investment.<sup>10</sup>

#### Defining social investment

One of the key shortcomings of the Stability and Growth Pact (SGP) in its current form is that it fails to stimulate sufficient levels of productive social expenditure, which is conducive to economic growth. **The authors of this paper argue that there are at least four areas of public social expenditure which are productive and should be considered for exemption from the corrective and preventive arm of the SGP:** 1) early childhood education and care, 2) primary and secondary education, 3) training and active labour market policies, and 4) affordable and social housing. They are growth-friendly because they both increase labour productivity and reduce societal inequality, and often they generate savings in public budgets in the medium and long run.

The first three areas increase productivity directly by fostering human capital and skills.<sup>6</sup> Interventions at the earliest stages of the lifecycle, in particular, yield high economic returns, as they are less costly and can tackle societal disadvantages at their source.<sup>6</sup> The fourth area reduces risks to health and safety through inadequate housing, which can negatively affect the quantity and productivity of labour.<sup>6</sup> Furthermore, all four areas play an important role in reducing inequality, which negatively impacts both growth and economic stability.<sup>11</sup>

**Whilst short-term savings can be achieved by cutting spending on these areas, this will cost more and challenge social cohesion in the long term.** Cuts to these services make it difficult to put in place preventative measures and to prepare for future needs. Allowing greater budgetary flexibility for public social investment in the above-mentioned areas is viable both socially and economically.

<sup>6</sup> Fabian Zuleeg/Jan David Schneider, *What role for social investment in the new economic governance of the Eurozone?*, EPC Policy Brief 10 November 2015, p. 2.

<sup>7</sup> European Commission, 2013. 'Towards social investment for growth and cohesion – including implementing the European Social Fund 2014-2020.'

<sup>8</sup> Fabian Zuleeg, *Economic policy coordination in the euro area under the European Semester. In-Depth Analysis provided at the request of the Economic and Monetary Affairs Committee*, November 2015, p. 16.

<sup>9</sup> Ibid., p. 16.

<sup>10</sup> Fabian Zuleeg/Jan David Schneider, *What role for social investment in the new economic governance of the Eurozone?*, EPC Policy Brief 10 November 2015, p. 3.



5) Building on the above, in the longer term, a **‘Silver Rule’ for public social investment in the EU economic governance framework should be established to allow and incentivise Member States to pursue higher levels of public social investment**, focused on the fields in which a strong evidence base exists to justify social investment from both a social and an economic perspective. This includes, most notably, early childhood education and care, primary and secondary education, further training and social housing. Realising a Silver Rule for public social investment might require the Commission to adapt the investment clause or preferably a revision of Article 5 of Regulation 1466/97. Ideally, the Silver rule should, in the longer term, be enshrined in a new Protocol on Investment attached to the Treaties by means of the simplified revision procedure.

## Annex: Short case studies of positive economic impacts of public social investments

### A) Active labour market policies

In Italy social cooperatives of type B have as their mission the social and professional integration of people in vulnerable situations.

The social impact produced in 2016 by social cooperatives employing 67.134 people in vulnerable situations is estimated to be equal to 716.364.855€, against an investment of 373.856.159€, thus amounting to a total of 342.508.696€ net value of the investment. Each 1€ invested in the work integration of people in vulnerable situations generated an economic return of 1,92€.

The economic return includes increased income for people in vulnerable situations, increased tax revenues, better work-life balance, and less costs for hospitalisation and medicines. The social return that cannot be quantified in monetary terms includes the improvements of the relationship with the family and the local community, an increased perception of security, reductions in prejudice, a greater willingness to solidarity, and reduced rates of crime recidivism.<sup>11</sup>

### B) Social and affordable housing

Investment in social and affordable housing produces social and economic returns for different reasons.

Public policies aiming at increasing energy efficiency in housing reduce energy bills. According to the UK Department on Energy and Climate Change, by 2020, the national average household’s dual fuel bill could be expected to be £1,496 without government policies and £1,331 with energy-saving policies.

These policies also have an impact on health expenditure and other areas. For instance in Northern Ireland, the estimated cost of eliminating or renovating the most energy consuming houses would be of nearly 600 million Euros. At the same time the estimated annual savings to the Health Service would be 40 million euro per annum, which means that after 13 years the total gains for the health service would surpass the total investment costs.<sup>12</sup>

Living in inadequate housing increases risks to health and safety and negatively affects well-being. Sickness and disability cause school or work days to be lost, which has an impact on skills, education, and personal income. The UK Audit Commission (2009) stated: ‘Every £1 spent on providing housing support for vulnerable people can save nearly £2 in reduced costs of health services, tenancy failure, crime and residential care’.<sup>13</sup>

<sup>11</sup> Osservatorio nazionale sulle imprese sociali (2016), *L’impatto sociale delle attività di inclusione lavorativa in Italia. Prima analisi macro-economica sull’impatto sociale*

<sup>12</sup> Housing Europe (2013), *Rethinking investment in homes*

<sup>13</sup> Eurofound (2016), *Inadequate housing in Europe. Costs and consequences*, Publications Office of the European Union, Luxembourg. p. 31.