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

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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).Social investment[1] plays an important role in the achievement of these objectives. **There are both social and economic reasons in favour of high(er) levels of social investment**.

The case for social investments

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, in two ways, there are inherent economic returns and advantages in social investments:

- 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 maintain positive effects on demand.[2]
- Improved social cohesion prevents tremendous economic costs of inequalities in the long-run. It also generates social and economic returns as it enables people to be more socially and economically productive.[3]

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) do not deliver sufficiently on social projects, and 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. It is true that 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.[4] In practice, however, the application of the clause in favour of social investments has been limited so far.

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[1] 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 in integrated policies that focus on preparing people to confront risks in different stages of the life (such as unemployment, sickness, disability, maternity and parenthood, insufficient income, childhood and old age) instead of repairing their consequences.

[2] European Commission, *Employment and social developments in Europe 2014*, 2014, section 4.4, available at: http://ec.europa.eu/social/BlobServlet?docId=13404&

[3] 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

[4] 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

A two-tier roadmap to bring higher levels of public social investment in all Member States

In the short-term, the European Commission could increasingly highlight the merits and impact of social investment[5] and work towards a 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.

Then, in the medium term, a '**Silver Rule' for public social investment** in the EU economic governance framework could be established to allow and incentivise Member States to have higher levels of social investment policies, focused on the fields in which a strong evidence base exists to justify public social investment from an economic perspective: early childhood education and care, secondary and tertiary education, training and active labour market policies, and the provision of affordable and social housing.[6] In order to ensure a focus not just on a quantitative upscaling but on quality and positive economic impacts too, a mechanism could be developed to supervise and assess which investment initiatives could be pursued under the Rule in the context of the four aforementioned areas, based on concrete indicators and benchmarks. 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.

Promotion through the European Semester

In both stages of the roadmap, **the European Commission could 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 could be given especially to those Member State which face the greatest social challenges.

Which spending pays off?

Removing the blindness of the SGP to productive expenditures

One of the key shortcomings of the Stability and Growth Pact (SGP) in its current form is that it fails to differentiate between productive types of expenditure, which are conducive to economic growth, from unproductive ones. In this paper, we 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.

The first three areas increase productivity directly by fostering human capital and skills.[6] 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.[6] The fourth area reduces risks to health and safety through inadequate housing, which can negatively affect the quantity and productivity of labour.[6] Furthermore, all four areas play an important role in reducing inequality, which negatively impacts both growth and economic stability.[11]

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.

At the same time, **the European Commission could also put additional emphasis on using the European Semester to 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.

Increased public social investments and a sustainable budgetary consolidation would go hand in hand.

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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;

[5] Public social investment could be defined as '*publicly funded spending in human capital which bring lasting positive social and economic returns over time*'.

[6] James J. Heckman, *The case for investing in disadvantaged young children*, 2008, available at: http://heckmanequation.org/download.php?file=Heckman$$$Investing$$$in$$$Young$$$Children.pdf; OECD, *In it together: Why less inequality benefits all*, 2015, p.44, available at: https://www.oecd.org/els/soc/OECD2015-In-It-Together-Chapter1-Overview-Inequality.pdf; European Commission (publisher), *The quality of public expenditures in the EU*, 2012, p.8, available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp125_en.pdf; Eurofound, *Inadequate housing in Europe: Costs and consequences*, 2016, available at: https://www.eurofound.europa.eu/sites/default/files/ef_publication/field_ef_document/ef1604en_0.pdf

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

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.[7]

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. Acording 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 it after 13 years the total gains for the health service would surpass the total investment costs.[8]

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'.[9]

Education

Investing in secondary and tertiary education of students with, for instance, a disadvantaged or immigrant background is essential to break the vicious circle of intergenerational social and income inequalities. The OECD found that students with a disadvantaged or immigrant background show higher risks of low performance by about 21 score points compared to their peers.[10]

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[7] Osservatorio nazionale sulle imprese sociali (2016), *L'impatto sociale delle attività di inclusione lavorativa in Italia. Prima analisi macro-economica sull'impatto sociale*

[8] Housing Europe (2013), *Rethinking investment in homes*

[9] Eurofound (2016), *Inadequate housing in Europe. Costs and consequences,* Publications Office of the European Union, Luxembourg. p. 31.

[10] OECD (2015), p. 45

[11] Dabla-Norris, E. et al., *Causes and Consequences of Income Inequality: a global perspective*, 2015, available at: https://www.imf.org/external/pubs/cat/longres.aspx?sk=42986.0