

## **From good to growth. Promoting social investment and public good to stimulate the European economy<sup>1</sup>**

*Fiorenza Lipparini, Seva Phillips, Filippo Addarii, Indy Johar / March 2015*

*“Just as it took the New Deal and the European social welfare state to make the Industrial Revolution work for the many and not the few during the 20th century, we need new social and political institutions to make 21st century capitalism work for the many and not the few.”*

Center for American Progress, Report of the Commission on Inclusive Prosperity, 2015

### **Summary**

This paper makes the case for using the new €315bn European Fund for Structural Investment to foster investment into: (i) human capital development programmes (“social investment”); (ii) projects which achieve both financial and social returns (“public good”) and (iii) multi-stakeholder partnerships which systematically address entrenched social issues (“systemic social innovation”). Together, these will stimulate economic growth across the European Union.

We have made this case because it is clear that austerity alone cannot put Europe back on the path to growth. Through a comprehensive literature review and discussion of case studies we illustrate the power of collaborative approaches between the public, private and third sectors.

We argue that a multi-stakeholder approach is essential properly to respond to the complexity of social needs. We show that public funds have the potential to leverage private capital, providing the resources to create social change.

### **1. Setting the scene: inclusive economic growth**

Seven years after the beginning of the global financial crisis, it is clear that it will take more than austerity measures alone to put Europe back on the path to growth. In this paper, we argue that if we want to leave the crisis behind it is necessary to stop thinking of economic and social policies as two separate entities. We need not only to invest more in social protection and public goods and services, but also to involve the private sector and civil society, (that is businesses, civil society organizations and citizens) in this effort.

In this chapter, we outline how pervasive inequality is a barrier to economic growth, set out existing EU social policy initiatives that have an impact on inequality and reflect on the opportunity presented within the European Commission’s new investment package.

---

<sup>1</sup> The present chapter has been written in the context of the EU funded project DOLFINS – *Distributed Global Financial Systems for Society*, coordinated by Prof. Stefano Battiston from the University of Zurich. The project aims at making the financial system better serve society by placing scientific evidence and citizens’ participation at the centre of the policy process in finance. It investigates with a multidisciplinary approach how to achieve financial stability and facilitate the long-term investments required by the transition to a more sustainable, more innovative, less unequal and greener EU economy. The chapter is based on the research paper “Making impact real. Why the role of social infrastructure and public good investment are key to stimulating the European economy and how we can encourage them”, undertaken by the Young Foundation’s EuropeLab/SmallWorldLabs in the context of a broader research project on “Growth and Investment in the European Union”. The project was led by the European Policy Centre and sponsored by Unipol Financial Group. The research paper is based on a wide bibliographic review and on data and insight collected through semi-structured interviews with members of the project’s Advisory Board and expert practitioners. We are thankful to Nicolas Bearelle (Re-Vive), Fiammetta Fabris and Maria Luisa Parmigiani (Unipol Group), Filipe Santos (INSEAD/Social Innovation Portugal) and Simone Santi, Duncan Pelham and Iain Smith (Lend Lease) whose contributions were used to write this chapter.

## 1.1 Growing inequality & its economic impact

The heavy social consequences of the financial crisis in terms of rising inequality and unemployment put the spotlight on the limits of 20th century capitalism, highlighting how most of the free-market democracies that achieved the highest GDPs across the world after the Second World War failed to raise the living standards equally across their populations. The gap between rich and poor is today at its highest level in most EU countries in 30 years, and, since the 1980s, productivity growth has not translated into a commensurate increase in incomes for the bottom 90% of earners<sup>2</sup>. Redistribution policies have not kept pace with rising market-inequality<sup>3</sup>. To make matters worse, income inequality deepens inequality of wealth and implies inequality in accessing essential services like healthcare, education and, even more disturbingly, translates into unequal life-expectancy<sup>4</sup>.

Income inequality though, is not only unfair and politically undesirable, it has also sizable negative effects on economic growth.

According to a recent OECD report<sup>5</sup>, an increase in inequality by 3 Gini points – the average increase registered in the OECD area over the past 20 years – means a cumulative loss in GDP of 8.5% over the same time period. If we look at the performance of single countries, we find that rising inequality has knocked nearly 9 percentage points off growth in the UK, Finland and Norway and between 6 and 7 points in Italy and Sweden.

OECD also finds that “the biggest factor for the impact of inequality on growth is the gap between lower income households and the rest of the population. The negative effect is not just for the poorest income decile but for all of those in the bottom four deciles of the income distribution”<sup>6</sup>. The consequences on consumption levels are increasingly apparent. As shown by Cynamon and Fazzari<sup>7</sup> in the United States, the share of disposable income consumed by the top 5% of households in the 1989-2008 period was substantially below that of the bottom 95%. The limited borrowing possibilities for lower income households due to the financial crisis caused a strong contraction in the consumption of goods and the overall demand, slowing the recovery process.

---

<sup>2</sup> See Centre for American Progress. *Report of the Commission on Inclusive Prosperity*, 2015 and Furman J. (2014). *Global Lessons for Inclusive Growth*. Dublin: The Institute of International and European Affairs: “In the United States to a greater degree, and in other OECD countries to varying degrees, the bigger source of the failure to generate sustained gains in middle-class incomes has been the fact that productivity growth has not translated into a commensurate increase in incomes for the middle class. The gap between aggregate productivity growth and the measure of middle class income growth (...) is particularly stark in the United States, United Kingdom and France”.

<sup>3</sup> Cfr. OECD, *Society at a Glance 2014: OECD Social Indicators*, OECD Publishing, 2014: “today the richest 10% of the population in the OECD area earn 9.5 times the income of the poorest 10%; where the ratio was 7:1 in the 1980s. While over the 20 years leading up to the crisis, average real disposable household incomes increased everywhere – on average by 1.6% annually -, in three quarters of OECD countries income at the bottom grew much slower during the prosperous years and fell sharply during the downturns, resulting in widening income inequality. (...) Differences in the pace of income growth across household groups in the pre-crisis period were particularly pronounced in most of the English-speaking countries but also in Israel, Germany and Sweden. The picture changes when looking at the post-crisis period (i.e. the years from 2007 through 2011/12) as average real household income stagnated or fell in most countries, particularly – by more than 3.5% per year – in Spain, Ireland, Iceland and Greece. In almost all countries where incomes fell, those of the bottom 10% fell more rapidly. Similarly, in about half of those countries where incomes continued to grow, the top 10% did better than the bottom 10%.

<sup>4</sup> See Centre for American Progress (2015).

<sup>5</sup> Cingano, F., *Trends in Income Inequality and its Impact on Economic Growth*, OECD Social, Employment and Migration Working Papers, No. 163, OECD Publishing.

<sup>6</sup> OECD, *Focus on Inequality and Growth* - December 2014.

<sup>7</sup> Cynamon and Fazzari, *Inequality and Household Finance during the Consumer Age*. Levy Economics Institute of Bard College, Working Paper No. 752, 2013.

Based on the longitudinal analysis of cross-country data sets, it is clear that there is a strong negative correlation between the level of net inequality and growth in income per capita, while redistribution has an overall pro-growth effect.<sup>8</sup> Moreover, inequality has a statistically significant negative relationship with the duration of growth spells: a 1 Gini point increase in inequality translates into a 6 percentage point higher risk that a growth spell will end in the next year.

In conclusion, “it would be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable. And second, there is surprisingly little evidence for the growth-destroying effects of fiscal redistribution at a macroeconomic level.”<sup>9</sup>

## **1.2 The European context and the new European Commission Investment Plan**

### **1.2.1 The European context**

The idea of boosting economic growth by using social policy to tackle inequality – in addition to purely economic approaches – is not new in European policy.

The European Semester process, introduced in 2010, has encouraged European Member States to further deepen the coordination of their economic and budgetary policies with the aim of reaching the agreed Europe2020 targets for employment, innovation, education, poverty reduction and climate/energy<sup>10</sup>. This means that for the first time the EU is considering social policies as part of the economic governance process so that they can be effectively discussed and monitored at EU level. The social impact assessment that will accompany fiscal sustainability assessments for countries in Excessive Deficit Procedures is another step in the process of bringing together social and economic policies, while – also thanks to the European Parliament’s input<sup>11</sup> – Member States not complying with the Commission’s Country Specific Recommendations will be increasingly under pressure to justify such actions.

The importance of involving civil society, social entrepreneurs and businesses in the process of reconciling economic progress and social impact has been acknowledged in a number of European policies. These are outlined below.

The central role given to social innovation in the Innovation Union Flagship Initiative has resulted in a wide number of regulatory and non-regulatory actions, from the Social Business Initiative to the European Social Entrepreneurship Funds (EuSEFs) Regulation to the new directive on public procurement which integrates social considerations into contracting procedures.

The Social Investment Package launched in 2013 fully recognized the importance of both ensuring adequate and sustainable social protection and promoting social investment across Europe. It called for a more efficient and effective use of member states’ social budgets and made the case for the modernization of welfare systems.

---

<sup>8</sup> Jonathan D. Ostry, Andrew Berg, Charalambos G. Tsangarides, *Redistribution, Inequality, and Growth*.

<sup>9</sup> Ibidem.

<sup>10</sup> Namely: 75% of 20-64 year-olds in employment by 2020, 3% of the EU’s GDP to be invested in RDI, early school leaving rates below 10%, 40% of 30-34-year-olds with third-level education, 20 million fewer people in or at risk of poverty and social exclusion, reduction of greenhouse gas emissions at least 20% lower than in 1990; 20% of energy from renewable sources and energy efficiency.

<sup>11</sup> See in particular Art. 62 to 76 of the EP Report on the European Semester for economic policy coordination: implementation of 2014 priorities, chaired by Philippe de Backer MEP.

In addition, EU funding to help member states achieve smart, sustainable and inclusive growth is being disbursed through a number of programmes directly managed by the Commission (as Horizon2020 and EaSI), but especially through the EU Cohesion Policy, which will make available up to €351.8 billion to Europe's regions and cities by 2020.

In spite of this rich policy context, the practice of taking into account social impact is not yet mainstreamed within the criteria presiding financial decisions for the allocation of EU funding. This is a missed opportunity, because, as we will see in the next chapter, the business sector is more up to the challenge than is normally assumed. In this regard, Juncker's Investment Plan offers a formidable opportunity.

### **1.2.2 The opportunity of the European Fund for Strategic Investments**

The Juncker's Investment Plan for investment was launched in November 2014 with the aim of catalysing private investment into the European economy. Indeed, EU firms still have great investment capacity (according to McKinsey<sup>12</sup>, EU listed companies had cash holdings in excess of €750bn in 2011); the idea is to make investment in the real economy more attractive than financial speculation by providing EC/EIB backed guarantees, a pipeline of credible projects and a favourable and predictable regulatory framework.

The focal point of this plan is the newly established European Fund for Strategic Investments (EFSI), capitalised with €21bn of EU funds. According to the Commission's calculations, the fund will mobilise at least €315bn of public and private investment over the next three years (2015 - 2017). The fund will mainly invest in strategic infrastructure (digital and energy investments in line with EU policies), transport infrastructure in industrial centres, education, research and innovation, SMEs, environmentally sustainable projects and Research and Innovation, and it will do so either directly or through intermediaries. More precisely, the Commission plans to invest up to three quarters of the resources to support private fund structures such as the European Long-Term Investment Fund (ELTIF), set up by private investors and/or National Promotion Banks (NPBs).

#### **EFSI in practice**

Establishing a pipeline of viable projects and making sure that they are compliant with all relevant regulatory and administrative requirements is essential to attract private investment. For this purpose, a Task Force has been set up by the EC and EIB, together with the Member States to screen potential projects according to four key criteria:

1. EU added value (i.e. projects must be consistent with EU objectives)
2. Economic viability and value (projects with high socio-economic returns will be prioritised)
3. Maturity (projects should start within the next three years)
4. Potential for leveraging other sources of funding

Projects should also be of reasonable size and scalability (differentiating by sector/sub-sector), even if this can take account of the bundling of smaller investments. The pipeline will be transparent and open, meaning that member states, including regional authorities and NPBs, European institutions and private investors will be able to contribute to the pipeline by presenting or sponsoring projects.

---

<sup>12</sup> Roxburgh, C. et al, *Investing in growth: Europe's next challenge*, McKinsey Global Institute, 2012.

Selected projects will then be assessed by a dedicated independent investment committee made up of experts that will have to validate every project from a commercial and societal perspective and based on what added value they can bring to the EU as a whole.

### **The opportunity**

The assessment of projects' "societal value" presents an unparalleled opportunity to change the way to invest in Europe. We argue that it has the power to bring about a new phase of economic growth and democratic participation. To capitalise on this opportunity, we suggest that:

- All projects, including "hard" infrastructure projects (for instance in the transport, digital and energy domain) are assessed for their social investment dimension (for instance in terms of local work-force upskilling or RDI activities) or for the social impact they want to achieve (for instance in terms of jobs created or goods/services of public general interest made available);
- Projects specifically targeting social investments or investments in public good should be included in the projects pipeline as ends in themselves and not only as a complementary investment to hard infrastructure; for instance by ensuring that impact investment funds such as the EIF backed Social Impact Accelerator are among EFSI's investment options or by encouraging impact investors and third-sector organizations to present and sponsor projects in the pipeline alongside public and private investors.

In the next chapter, we will show through a series of concrete examples how social investments and investments in public good, are not only desirable from a macro-economic perspective - because of their contribution to restraining inequality and enhancing long-term sustainable growth – but can also be economically rewarding in the short-medium term for private investors.

## **2. Private capital for social investment and investment in the public good: why (and how) it works**

To develop the right conditions for sustainable growth we need to reduce inequality. To pave the way for possible approaches, this chapter explores the rationale for social investment and public good investment, in themselves and for each, provides examples of how collaborative approaches between the public and private sectors can foster these. In the conclusions we will recommend how these collaborations can be encouraged through the EFSI package.

### **2.1 Social investment**

#### **Definition**

In line with the Commission Communication *Towards Social Investment for Growth and Cohesion*<sup>13</sup>, we define social investment as those social policies and initiatives that contribute to the prevention of social problems and the enablement of individuals to be more in control of their lives. It involves strengthening people's current and future capacities.

#### **2.1.1 The consequences of inadequate social investment**

The facts speak for themselves: countries with high levels of public spending on social protection and social services such as the Scandinavian countries have performed better in economic terms in the

---

<sup>13</sup> European Commission, *Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund 2014-2020*. COM(2013) 83 final: "Social investment involves strengthening people's current and future capacities. In other words, as well as having immediate effects, social policies also have lasting impacts by offering economic and social returns over time, notably in terms of employment prospects or labour incomes. In particular, social investment helps to 'prepare' people to confront life's risks, rather than simply 'repairing' the consequences".

last decade compared to most other industrialized countries and have been less affected by the crisis. In fact, as highlighted by Hemerijck “extensive comparative empirical research has since the turn of the century revealed that there is no trade-off between macro-economic performance and the size of the welfare state”<sup>14</sup>. On the contrary, there is a positive correlation between a large public sector, high rates of employment (particularly of women’s employment), high fertility rates, reduced poverty (and particularly child and in/work poverty) and general economic competitiveness.

Fiscal consolidation efforts required by EU member states in the framework of the Stability and Growth Pact have led to dramatic cuts in public spending, which could lead to increased poverty and inequality and could therefore jeopardize the efforts undertaken so far to re-ignite growth.

According to OECD projections<sup>15</sup>, expenditure cuts will account for more than two-thirds of the planned consolidation efforts between 2011 and 2015, and welfare services and infrastructure are likely to be the most affected. It must also be considered that increases in social spending have been lower in the EU member states more severely hit by the crisis, with some countries already experiencing a decline (for instance in Greece social spending fell from 24% of GDP in 2009 to 22% in 2013). Furthermore, the mix of welfare spending in the crisis years has changed, with cuts affecting mainly those services that strengthen people’s current and future capacities throughout their lives, preparing them to confront risks rather than simply repairing the consequences. So, while old age and unemployment benefits kept growing in most EU countries even after 2012, active labour market and work-life balance measures, health disease prevention, education (including early childhood education and care) and training, have been subject to massive cuts.

The consequences are clear: not only will cuts to preventative social policies translate into reduced economic growth and tax revenues, but they are likely to increase reactive social policy spending too. Indeed, since the Commission’s pioneering report on the *Cost of non-social policy*<sup>16</sup>, scholars and practitioners across the world have collected highly compelling evidence showing the enormous costs of late policy interventions compared to preventive and early interventions across citizens’ lives. Early identification of social risks and early action targeted at the more vulnerable groups contributes to providing citizens with the tools necessary to successfully face the most common social risks (such as atypical employment, poor health, long-term unemployment, working poverty, family instability and poor or obsolete skills).

### **2.1.2 Specific social investment policies and their macroeconomic implications**

We have built the case for the general benefits of social investment at the macroeconomic level. The body of empirical and theoretical evidence with regard to specific programmes and interventions has been growing over the decades. We explore this in three areas – childhood education and care, vocational training and apprenticeships.

#### **Childhood education and care**

---

<sup>14</sup> Hemerijck Anton 2012: “Two or three waves of welfare state transformation?” in N. Morel, B. Palier and J. Palme (Ed.), *Towards a social investment welfare state?* Policy Press, Bristol.

<sup>15</sup> OECD, *Policy responses to the economic crisis: stimulus packages, innovation and long-term growth*. DSTI/IND/STP/ICCP(2009)1/ADD/FINAL, 2009  
<http://era.gv.at/object/document/398/attach/OECD0509StimulusPackagesInnovationLongTermGrowth.pdf>

<sup>16</sup> Fouarge Didier 2008: *Cost of non-social policy: towards an economic framework of quality social policies – and the cost of not having them*. Report for the Employment and Social Affairs DG

Affordable childhood education and care (CEC) provides children with the cognitive abilities which will determine their future participation in the labour market and allows mothers to participate in paid work, which, as demonstrated by Esping-Andersen<sup>17</sup> with reference to the Scandinavian countries, is the most effective way to reduce child-poverty and in-work poverty. Chetty et al.<sup>18</sup> demonstrated how the quality of a child's kindergarten teacher and educational environment influence people's probability of college attendance, future income and home ownership.

In fact, CEC and education policies are strictly related to active employment policies: "activating or retraining adults is profitable and realistic if these same adults already come with a sufficient ability to learn"<sup>19</sup>. According to Ciccone - de la Fuente<sup>20</sup> every additional year of schooling increases European students' future wages by around 6.5%, while a year of training leads on average to a 5% salary increase. Furthermore, from a macro-economic perspective, an extra year of intermediate level education increases aggregate productivity by about 5% immediately and by a further 5% in the long term. According to Hanushek-Woessmann<sup>21</sup> improving educational standards up to the level of the top performer (Finland) in the EU28 would lead to a 16.8% increase in GDP.

### **Vocational training**

The capacity of a country's workforce to continually update its skills is perhaps the most important factor for future competitiveness in the current globalized learning economy. As demonstrated by Lundvall-Lorenz<sup>22</sup>, there is a strong positive correlation between the number of high quality jobs and firms' investment in continuing vocational training, while the correlation between high quality jobs and tertiary education or scientific education is weak at best. Even more strikingly, the comparative analysis of statistical data across EU countries shows how there is a fairly positive correlation between high levels of unemployment protection and frequency of high-quality jobs. Finally, income distribution is more equal in countries with high frequency of organizational learning supported by social investment in education and training (as in the Netherlands and Scandinavian countries). Similarly, Nelson-Stephens<sup>23</sup>, based on the analysis of data across 17 OECD countries from 1972 to 1999, show that there is a positive correlation between the use of active labour market policies, levels of employment, number of high quality jobs and general economic growth.

Life-long learning and in-job training should be considered an important part of active employment market policy: according to the Commission, "the transition rate out of unemployment to employment is 6 points higher for those having had some lifelong learning opportunities (37 % vs. 31 %), as also mirrored in a lower persistence rate in unemployment (44 % vs. 49 %)"<sup>24</sup>.

### **Apprenticeships**

---

<sup>17</sup> Esping-Andersen Gøsta, *Why we need a new welfare state*. Oxford University Press, Oxford, 2002.

<sup>18</sup> Chetty and al., *How Does Your Kindergarten Classroom Affect Your Earnings? Evidence From Project STAR*. BER Working Paper No. 16381, 2011. <http://www.nber.org/papers/w16381>

<sup>19</sup> Esping-Andersen Gøsta (2002).

<sup>20</sup> Ciccone A. and Á. de la Fuente, *Human capital in a global and knowledge-based economy. Final report for the European Commission*. 2012.

<sup>21</sup> Hanushek Eric and Ludger Woessmann 2012: "Do better schools lead to more growth? Cognitive skills, economic outcomes, and causation" in *Journal of Economic Growth*, Springer, vol. 17(4): 267-321.

<sup>22</sup> Lorenz, E. and B. Lundvall "Accounting for Creativity in the European Union: A multi-level analysis of individual competence, labour market structure, and systems of education and training," *Cambridge Journal of Economics*, Oxford University Press, vol. 35(2), pages 269-294.

<sup>23</sup> Nelson, M. and J. D. Stephens 2012: "Do social investment policies produce more and better jobs?" in N. Morel, B. Palier and J. Palme (Ed.), *Towards a social investment welfare state?* Policy Press, Bristol.

<sup>24</sup> European Commission, 2013.

In the same way, apprenticeship programmes are very effective for the development of human capital. According to Center for American Progress “researchers have found that U.S. workers who complete an apprenticeship make about \$300,000 more than comparable job seekers over their lifetimes. People who complete a British apprenticeship have been found to make a gross weekly wage 10 percent higher than those who have not. A Swiss study found that employers spend around \$3.4bn annually training apprentices but earn \$3.7bn each year from apprentices’ work during training. In Canada, researchers found that employers receive a benefit of \$1.47 for every dollar spent on apprenticeship training. In the United Kingdom, the Department for Business, Innovation and Skills and the National Audit Office determined that for every pound spent by the government to support apprenticeship, the country gets a return of between 18 pounds and 28 pounds”<sup>25</sup>.

This brief overview demonstrates that social investment can create substantial future savings and earnings for the state, which would explain its frequent association with public or philanthropic investment.

### **2.1.3 Private capital in social investment**

Is there a case for involving private investors along with public investors in social investment? On the one hand, certain social investment activity is more closely related to the private sector, contributing to its competitiveness. For instance, private investors could be interested in human capital development (upskilling/requalification of workers, better matching between education and work-market needs etc.), and especially considering that, according to a recent PWC survey of Global CEOs, the number one concern of business executives across the world is the inability to find enough skilled workers.

The costs of non-intervention for the safety and health of workers can be very high. According to the ILO, costs of work-related accidents and diseases are estimated to range between the 2.6% and the 3.8% of EU GDP, while for every euro invested in occupational safety and health there is a return of €2.20.

But emerging evidence<sup>26</sup> demonstrates how public-private partnerships for investing in social infrastructure, such as schools or hospitals, can generate significant social and financial returns too, both for public and private partners, in line with the Social Investment Package recommendations.

#### **Romanian National Health Insurance Fund<sup>27</sup>**

In 2004 in Romania, the National Health Insurance Fund (NHIF), advised by the International Finance Corporation, contracted four international private dialysis operators to take over the renovation and management of renal services at eight different public hospitals across Romania in order to make the facilities compliant with EU standards. The government paid the private partner a flat fee (€100) per hemodialysis treatment and an annual fee (€11,000) per peritoneal patient. Patients accessed the dialysis services for free. The private partners are responsible for the complete renovation, fitting-out and management of all centres as well as for the recruitment and training of all local staff, and for delivering all services. At the start of the contract, all centres were located at the public hospitals and the facilities were leased to the private partners. The contract covered an initial four years and was extendable up to seven years, but only if the private partner

<sup>25</sup> Center for American Progress, 2015.

<sup>26</sup> See for instance OECD, *Infrastructure Investment: Links to Growth and the Role of Public Policies*. ECONOMICS DEPARTMENT WORKING PAPER No. 686, 2009 and OECD, *Regions Matter: Economic Recovery, Innovation and Sustainable Growth*, 2009.

<sup>27</sup> See IFC, “Contracting-Out Dialysis in Romania: What Was the Impact?”, Monitor, 2008 and IFC, *IFC Support to Health Public-Private Partnerships*, 2010.



relocated to a new facility within two years of the tender award. Each bidder was restricted to two centres to increase competition and limit concentration.

Between 2005 and 2008, the private partners invested over €28.6m to renovate and equip the facilities; additionally, two new facilities opened, with 17 more clinics to be constructed in the future. Further to upgrading its services to EU standards and re-training the workforce employed in the facilities, the government saved €2.9m between 2005 and 2008 as a result of this partnership.

## 2.2 Investment in public good

### Definition

We define public good as all those goods or services that create social as well as economic value and have a positive impact on a given community. It is already possible to identify a growing body of successful private or public-private investments. Social housing, renewable energy, waste and water management, open-source technology – these are all cases where social impact can be associated with positive financial returns.

### 2.2.1 The case for public good investment

Leading businesses recognise that positive social and environmental impact is not only compatible with making profits, but, in the medium term, is a *pre-condition* of them. They are recognising that they cannot continue to view value creation narrowly, optimising short-term financial performance while ignoring the broader influences and risks that determine their longer-term survival. As Donaldson and Dunfee<sup>28</sup> remind us, while in the 1950s enterprises were basically expected to produce goods and services at reasonable prices, now they're considered responsible for a wider range of issues involving fairness and quality of life across their ecosystem of operation.<sup>29</sup> Further than adjusting to a changing social contract, companies are increasingly aware of the fact that they cannot overlook the loss of natural resources vital to their operations, the viability of supply chains, or the economic distress of the neighbourhoods in which they produce and sell, without undermining their future activities. The availability of talent, intellectual property protection, rule of law and neighbourhood levels of employment might be external to the company's perimeter of action, but will have a material impact on its performance in the medium to long term. As KPMG Global Chairman Yvo de Boer has said, achieving positive economic and social impact is not a philanthropic act, but "is essential to convince investors that your business has a future beyond the next quarter or the next year"<sup>30</sup>. These considerations are leading towards increasingly sophisticated business strategies allowing to associate economic performances to positive social impact.

On the other hand, impact investing is increasingly becoming a privileged choice for all those citizens, philanthropists and third sector organisations who choose to create positive social outcomes as well as financial returns.

---

<sup>28</sup> Donaldson, T. and Dunfee, T.W. (2002): "Ties that bind in business ethics: Social contracts and why they matter". *Journal of Banking and Finance* 26 (9): 1853-1865.

<sup>29</sup> Although of course this not always the case, and deregulation has allowed opportunistic behaviour by companies. On the topic see Sangheon Lee and D. McCann (eds), *Regulating for Decent Work. New directions in labour market regulation*, Palgrave Macmillan, 2011.

<sup>30</sup> *The KPMG Survey of Corporate Responsibility Reporting 2013*.

Of course the risk is that large companies, driven by a mixture of self-interest and regulation, will identify sustained profitability with the management of external social risks, and take measures to engage the political environment. The public and third sector will need to identify and denounce opportunistic behaviours and, by encouraging transparency, help companies to validate their results and demonstrate genuine attempts to achieve social impact. In this respect, the forthcoming Commission strategy to combat tax fraud and evasion will be key. On the same line, social impact is not always achievable through economically self-sustaining business models, and it is important to make sure that impact investing won't take away vital resources from the third sector.

In spite of these concerns, corporate social responsibility and impact investment are indeed contributing to create a new market where private and public interest are aligned, and financial and social returns go hand in hand.

## 2.2.2 Public good investment in practice

### Impact investment

One specific category of investment in public good is impact investing, which we define as the field of investment that takes into consideration social impact, financial return and trade-offs between them in any investment opportunity. Over the last decade, it has become a new driver of investment in the public good through the actions of charitable foundations, ethical banks, individual philanthropists and specialist impact investment funds. Not only has impact investment brought new funds into organisations targeting social and environmental objectives, but it has also led to the creation of innovative public-private models of investment and has attracted the attention of policy makers across Europe and beyond.

#### Global Health Investment Fund<sup>31</sup>

The \$108m Global Health Investment Fund (GHIF) was launched in 2012 by the Bill and Melinda Gates Foundation and Grand Challenges Canada with the aim of accelerating the development of drugs, vaccines and diagnostics for diseases that disproportionately affect developing countries.

The fund has received direct investments on a pari-passu basis from foundations, high net worth individuals, government supported bodies and corporates. The Gates Foundation, together with the Swedish International Development Agency (SIDA), has substantially reduced the risk for investors making direct commitments to the fund by providing a first loss guarantee and a risk share (investors are provided with a loss protection of up to 60% of the fund's capital, the first loss guarantee covers up to 20% of invested capital, with investors covering 50% of any subsequent losses on a pari passu basis).

The Gates Foundation has also leveraged its network and expertise to assemble support from a range of global health and finance experts: representatives from GlaxoSmithKline and Novartis, two of the world's leading pharmaceutical companies, and former leaders in the field of finance from Goldman Sachs and MPM Capital are serving as members of the board of directors and scientific advisory committee.

Funding is provided through mezzanine debt and repaid via a combination of milestones and royalties on the new products created. So far, \$5m has been committed to support the final stages of product development for a new oral cholera vaccine.

Data on the size of the impact investment market, on the risk profiles of investments and on financial and social performance is hard to find and even harder to compare<sup>32</sup>. Work to increase

<sup>31</sup> See <http://ghif.com/>.

<sup>32</sup> OECD, *Social impact investment. Building the evidence base*, 2015.

transparency and data comparability continues. Interest from investors is growing. According to JP Morgan the market was worth \$12.7bn in 2014 and is growing fast. As an indicator of the rise of impact investing, Black Rock, the world's largest asset manager, has announced that it will soon launch "BlackRock Impact" to help clients invest in products with clear environmental and societal goals<sup>33</sup>.

### **Social impact as business as usual**

The idea of creating social impact is increasingly important for large businesses' principal activities and financial decisions. As highlighted by Michael Porter and Mark Kramer<sup>34</sup> in their seminal work *Creating shared value*, the "generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems (...) effective research, analysis and evaluation of ESG [environmental, social and corporate governance] issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term, and (...) should inform asset allocation, stock selection, portfolio construction, shareholder engagement and voting."

A few examples showing both how social considerations are influencing financial decisions in the corporate sector and how investment in public good can be financially rewarding can be found in the urban regeneration field.

#### **Lend Lease: urban regeneration**

Lend Lease is currently investing £1.6 bn in a regeneration project covering more than 28 acres across three sites at the heart of Elephant & Castle, in what is one of the last major regeneration opportunities in central London. By 2025, the regeneration project foresees the creation of almost 3,000 new homes, over 50 new shops, restaurants cafes and bars, as well as significant improvements to transportation links. The approach adopted by Lend Lease is innovative both at environmental and social levels.

From an environmental perspective, Lend Lease's sustainability approach is long term and aims to enable sustainable behaviours, such as enhancing biodiversity, improving public transport and cycle networks, and maximise the energy-efficiency of buildings. The plan was influenced by community consultation so that many of the existing trees on the site could be kept to help form a brand new park in the centre of the development. Many more new trees are then being planted in and around the development, and the diversity of tree species chosen will help create balanced ecosystems that are more resilient to extreme weather as well as encouraging nature to flourish. In addition, Lend Lease seeks to ensure that all the wood used on the project is FSC certified and all homes on the scheme will achieve Code for Sustainable Homes Level 4.

The high-standards adopted in terms of sustainability are further proved by the fact that the Elephant & Castle regeneration is one of 18 founding projects from across the world to be part of the C40 Cities Climate Positive Development Programme (both Lend Lease's Barangaroo South and Victoria Harbour are also included). As part of this programme, Lend Lease has submitted a roadmap demonstrating how the project will be Climate Positive, or net carbon neutral, by 2025. A key part of this commitment to being Climate Positive, is Lend Lease's plans to deliver an on-site combined heat and power energy centre, which will help ensure a low carbon energy solution for the project. By demonstrating climate-positive strategies, the project aims to be a model for large-scale urban regeneration projects of the future.

As for social considerations, the commitment of the firm is demonstrated by the fact that in the time lapse between the award of the contract to Lend Lease and the granting of outline planning approval, £2m was invested into community-engagement activities. A strategic stakeholders group was set-up with key public

<sup>33</sup> See <http://www.reuters.com/article/2015/02/09/us-blackrock-impact-exclusive-idUSKBN0LD18W20150209>

<sup>34</sup> Porter, M. and Kramer, M. (2011). "Creating Shared Value". HBR. January 2011.

authorities such as Transport for London and the Greater London Authority, as well as local universities and other developers in the area in order to ensure a coordinated approach through the opportunity area.

A thorough assessment of local social issues (unemployment, low-income, mental health, obesity, children's health) served as a basis for the project's social sustainability strategy. A key part of this strategy is the delivery of construction jobs for the local community and the project is already achieving great success. Since construction began in July 2013, 322 local residents have been employed on the project, of whom 147 were previously unemployed. Among them, 55 have been in sustained employment for more than 6 months. Furthermore, in 2012, a community fund to be managed by a local NGO was set-up to provide grant-funding for local community groups looking to run projects in the area; the fund is now in its fourth year and has awarded over £125,000, benefitting 6,950 people.

#### **Re-Vive: the Ekla project**

In Brussels, the Ekla project aims to decontaminate and redevelop a 6,200sqm former industrial zone in Molenbeck, next to the city's West station, to become one of the three most important intermodal hubs for public transportation in Brussels. Belgian company Re-Vive, specialized on urban brownfield sites development, has allocated €32m to build 45 apartments for affordable housing (to be built by the public local supplier Citydev), 39 apartments for social housing, 50 student housing units suited for students in need of financial support, a primary school, day nursery, retail spaces and a social innovation hub and offices. Once completed, the buildings will be sold to end investors (impact investors or social funds). To this end, Re-Vive has been working together with regional investment agencies and funds such as Citydev (Brussels) on the affordable housing front, or Vlaamse Gemeenschapscommissie (Flanders) for the school.

The neighbourhood is characterized by both poverty and unemployment, with a large immigrant community; however, its inhabitants are also young and very entrepreneurial: the social innovation hub will build on this potential by offering not only office space, but also business support. The use of the building as a hub for cultural events and exhibitions before the opening of the construction-site allowed Re-Vive to establish a trusted relationship with local artists, who acted as intermediaries with the local community, which was instrumental to attract the attention and support of local authorities. The buildings are designed with sustainability in mind: maximising the use of renewables and reducing energy consumption.

The Lend Lease and Re-Vive examples illustrate two key success factors in their implementation: strong relations with local authorities and strong partnerships with local communities and stakeholders.<sup>35</sup> In the Re-Vive case for instance, City councils and local authorities have been instrumental in fostering projects' economic sustainability by facilitating swift zoning of the areas concerned from industrial to commercial or residential use. Furthermore, in response to the projects' strong social and environmental aspects, more building density has been allowed than usual, granting increased revenues. Re-Vive's approach aligned well with most local authorities' policies for open development, and contributed to further growing policy-makers' ambitions in the urban re-generation field. Residents of the neighbourhoods targeted by both development projects were involved at very early stage in order to take into accounts their needs, views and aspirations. Before being refurbished, buildings were used as temporary meeting centres, in order to engage with the local population and explore its cultural and creative strengths through a series of events. Local partners (including public authorities) are always involved when social housing programmes are foreseen.

---

<sup>35</sup> Of course this leads to a risk of collusion, for this reason transparency in tendering procedures and community engagement all along regeneration projects are key. On the topic see Anna Minton, *Ground Control*, Penguin Books, 2012 and the seminal work of Jane Jacobs, *The Death and Life of Great American Cities*, New York: Random House and Vintage Books, 1961.

In both cases, economic reasons fully justify a socially responsible approach: in fact regeneration projects strongly impact the cost of housing: mutated costs of leaving can mean raising inequality, compromised social cohesion and, therefore, increased systemic risks for the value of assets. Creating a community instead of a series of buildings, and making sure that regeneration brings advantages to the local population, means reducing the project risk while ensuring the long-term value of the real estate. In addition, it creates interest, and therefore market for future buyers and users of the new buildings and facilities.

### **3. A glimpse to the future: Investment in systemic social innovation**

#### **Definition**

We define systemic social innovation as the collective effort to face entrenched social issues through the coordinated action of the public, private, third sector and of citizens at large<sup>36</sup>.

Today most social issues (for instance poverty, social exclusion, quality of health care) and macro challenges (such as aging, climate change, the sustainability of welfare systems) interlink with one another and drive a cycle of deprivation. Social ills cannot be faced one at a time, in isolation, by adopting single points of intervention. For instance, if we want to increase educational attainment in a neighbourhood – or in a country – the question is not simply one of whether more funding should be allocated to public schools or to private schools. It is necessary to map and intervene in multiple factors affecting education in the area, such as investing in prenatal nutrition, establishing breakfast clubs to increase children's' attention spans, setting reading clubs to mentor pupils, mums' associations to support young mothers, youth circles to provide peer support and developing new tech to facilitate communication between parents and teachers.

This means that we need a new approach, where the public, private and third sector and citizens at large can come together to understand how to face entrenched social issues in the most effective way by co-designing, co-funding, co-delivering and co-evaluating innovative solutions.

The case studies in the preceding chapter show us that the most successful experiences – both financially and socially speaking – are those where a strong partnership has been created between the public and the private sector (including third sector organizations) and involving the wider community; not only in terms of the funding model but also in terms of the design, delivery and evaluation of the good/services produced. In this chapter, we argue that – complementing the need to apply a more social lens to initiatives like EFSI – all social stakeholders would do well to adopt a collaborative approach to drive innovation in society at a systemic level. We illustrate this approach with case studies and an outline of the current work of EuropeLab/SmallWorldLabs.

#### **3.3.1 The partnership of public and private**

If we look at what is happening across Europe, we will find that increasingly member states are looking with interest at how to create better welfare services (especially on the social investment front) by actively collaborating with the private sector, the third sector and citizens at large. In

---

<sup>36</sup> Social Innovation has been mostly intended as new services or products answering unmet social needs, and often identified with social enterprises. This is for instance the case of the Commission's EuSEFs regulation, where social entrepreneurship funds' investees need not only to be social enterprises, but also have to serve particular "deprived groups" instead of the wider population. We call instead for system innovation, i.e. for a comprehensive approach taking into account positive and negative feedback effects and non-causal relations across fields and sectors.

contrast to what was observed in the 1970s when, following Hemerijck<sup>37</sup>'s classification, in the wake of oil shocks, Europe entered a period of welfare retrenchment and of slimming down the state, the aim today cannot be about the outsourcing of key services – instead it must be about collaborative shared value creation.

The awareness of the tremendous social and economic challenges facing most European countries, together with the awareness – accelerated by the financial crisis – that the public sector is unlikely to have the resources necessary to meet these challenges, has galvanized efforts which were already on-going within the private and third sectors.

The rise of impact investing, the growth of social enterprises, the professionalization (concerning forms of governance, management and ways of production) of third sector organizations and a growing community of traditional businesses committed to making a positive difference to their social and environmental surroundings has led to the creation of a complex ecosystem of actors committed to using their different skills and networks to overcome entrenched social issues.

#### **Unisalute**

In Italy UniSalute – a specialist company owned by Unipol Group, the biggest Italian insurance group for number of clients served and the second in terms of premium disbursement - is working to set-up a local fund in the Emilia Romagna region with a specific focus on Long Term Care (LTC). The idea is to pool resources from the public sector (allocated locally by the National Health Fund), the private sector and from single insured citizens in order to create synergies allowing the successful meeting of social needs by extending to all citizens LTC services already provided by the insurer to its existing clients.

The growing demand for long-term care services in Emilia Romagna has not been met by the national health sector, and in 2011 for the first time public funding for the elderly in the health sector was cut by 2.4% compared to the previous year, with home-care services particularly affected by the cuts (-7.9%). The situation is quickly becoming unsustainable, and especially if we consider that around one third of the total expenses for elderly-care in Italy is already paid for by families. Furthermore, LTC services are currently provided by a plethora of municipal, regional and local authorities, with little coordination and without certainty regarding the availability of services, as public budgets can vary widely over the years. This translates into a situation of uncertainty for people in need of assistance, who therefore will in most case access emergency services, leading to unnecessary hospitalisation and increased costs for the public sector.

A local, or even better regional fund targeting people in need of assistance who could be treated at home and covering in a coordinated way all their socio-sanitary needs, pooling resources from the private and public sector and integrating the different services needed while coordinating the various service providers, would allow this challenge to be addressed in a sustainable way.

The fund would be built pooling public resources (co-funding for low-income households or fiscal deductions) and private resources (work insurance or private insurance), and the insurance company would grant services' continuity over the years. By allocating part of the funds available for people in need of constant assistance to the fund, the public sector would transform current expenses into an insurance investment, granting coverage continuity and allowing the fund to reach the critical mass necessary to extend services to everybody (including the unemployed or people not enjoying insurance coverage negotiated by employers and trade unions).

The model put forward by Unisalute would allow considerable savings for the public sector: against an initial fixed investment the insurer will grant universal assistance to all citizens in need, irrespectively of their number. Citizens would also benefit from the partnership, given that at the moment about one third of the

---

<sup>37</sup> Hemerijck, 2012.

total expenses for LTC are borne directly by families. The model is sustainable for the private partner too, thanks to efficiency gains allowed by its negotiating power on the market: Unisalute can already count on a network of over 4.669 structures specialized in providing assistance to non-autonomous people, meaning that it can ensure highly convenient tariffs by purchasing packets of services instead of single services (which is not the case either for the public sector or families).

Most importantly, the quality of the service provided would be higher. The private insurer would not only manage the fund but would also exercise a pro-active role in coordinating services delivery. Building on its existing network, Unisalute would act as a single entry-point for beneficiaries through a network of in-house case managers, developing individual assistance plans (IAP) for the beneficiaries and their families which would take into account their medical, social and economic needs. The network of case managers, distributed on the territory, will ensure coordination between service providers and constant monitoring of the quality of service through regular contact with the assisted person and her/his family.

The public sector will maintain ultimate control on the service's quality and cost-effectiveness, through audits and a relationship of total transparency with the private partner.

The capacity of national authorities to direct and coordinate these efforts varies hugely. The strategy recently put in place by the UK government to promote impact investing is particularly interesting. By collecting and publishing the costs of social issues (as violence on women, re-offending or hospitalization), the government is encouraging third parties to come up with new and more cost-effective solutions in determinate fields.

New forms of commissioning too, such as payment-by-results (or pay-for-success), allow the testing of new services – for instance, those that the public sector would be unlikely to fund independently and by itself but which, if proved effective, could become part of mainstream services. In this case third sector and private organizations can offer services to address unmet needs.

### **3. 3.2 Systemic social innovation in practice**

There is no single institution or policy that can effectively address social ills, which is why a collaborative and systemic approach is needed. EuropeLab/SmallWorldLabs is already piloting this approach in several European countries. Our starting point is the recognition that citizens – as well as private organizations and institutions - are both a repository of collective common wealth (or assets) and of common liabilities (current and future), and that both are largely quantifiable in terms of current and future value and related costs, savings and returns. Mapping the different issues affecting a specific community, their various components and often interdependent relations, the stakeholders concerned and the possible solutions which can be put in place, means organizing new inter-sectorial and inter-organisational partnerships, developed around shared outcomes. We call these partnerships “collective outcomes partnerships”. Assessing the value of available goods and services of public interest for all the stakeholders involved in the partnership, as well as the costs associated to maintaining, scaling-up, adjusting or replacing those same goods/services as required by a changing situation, allows-us to build new funding and action models to drive systemic development. We call these ‘Townhall Models’ because the underlying approach puts civic engagement at the centre of local and national development, building on systems financing and accelerators. The public sector plays a key role in promoting the creation of these complex partnerships, as in the case of the Portugal Social Innovation Initiative.

In Portugal, the Council of Ministers launched in early 2015 a Social Innovation Initiative which will make available €150m from European structural funds to promote and disseminate innovative solutions to tackle social problems leveraging creativity, entrepreneurship and civic participation in the country. The initiative was created with an ambitious agenda to modernise the country's social protection, education and regional development systems and promote sustainable and inclusive growth through the growth of social innovation projects.

Incentives are being put in place to reward those investments that provide social and environmental returns as well as being able to generate revenues and financial surpluses, while citizens, businesses and communities are called to experiment innovative solutions and, in so doing, renew public policies. Four strands of financing instruments are being set-up: 1. a fund of funds providing guarantees and low cost-funding, both for lending and quasi-equity investments in high- impact potential projects that can generate revenues; 2. a social impact bonds fund to develop and validate the payment-by-results approach in Portugal and so doing fostering collaboration between public, private and social sectors and serve as an engine of innovation for public services delivery; 3. a "partnership for impact program", providing co-financing grants to philanthropic investors willing to fund the most innovative social impact initiatives using a venture philanthropy approach; and 4. A social investment readiness program to build capacity and grow the pipeline of projects for the other three instruments

Quoting a recent interview to Luis Miguel Poiras Maduro<sup>38</sup>, Minister in the Cabinet of the Prime Minister and for Regional Development and promoter of the initiative, Social Innovation Portugal aims at overcoming austerity and fiscal consolidation policies by sustaining the creation of a "true civic economy", focused on achieving social impact while reaching economic sustainability across sectors and geographical and organisational boundaries. The idea is to turn "public costs" into shared investment for the common good, encouraging the shift from the provision (or the purchase) of social services by the public sector or – to a lesser extent - philanthropic entities, to the co-design, co-financing and co-delivery of social outcomes agreed by all the stakeholders involved.

In this case, public funding is being used not only to catalyse private funding in order to find effective solutions to entrenched social issues but, most importantly, to build "collective outcomes partnerships" in which co-funding is accompanied by co-design, co-delivery and joint monitoring of the good and services which are instrumental for achieving the agreed outcomes. We believe that this new model of public-private funding will be instrumental in tackling inequality and re-establishing long-term growth in Europe. For this reason we recommend the Commission to make sure that not only impact investing funds are considered eligible under EFSI (on an equal footing with European long-term investment funds), but also that their scope is not limited to funding social enterprises and encompasses more ambitious "systemic social innovation" projects to be undertaken in partnerships with local, regional and national authorities and all interested parties.

### **Conclusions. Growing social and public good investment: recommendations for EFSI**

Evidence shows that unless we are able to reduce inequality and invest adequate resources to enhance and modernise European welfare systems, we will not be able to re-ignite long-lasting growth.

As we have started to see, there is not necessarily a trade-off between social and environmental impact and economic performance. Taking into full consideration projects' "societal" returns would certainly contribute to make EFSI's investments more valuable for society at large, while not undermining their profitability and therefore their attractiveness to private investors. Most

---

<sup>38</sup> See Cadarin, L., Impact Investment. La sostenibilità necessaria. Corriere della Sera Economia – Dossier. 23 March 2015.



importantly, the new Commission investment plan could induce positive change in the way investors take decisions and projects' proposals are structured, leading to more socially and environmentally sustainable financial markets. To achieve this, investments in public good, systemic social innovation and social investment should be promoted under EFSI, and every project funded, including "hard-infrastructure" projects, should be evaluated also for their social impact.

In order to achieve this, we recommend the following:

**1. "Societal value" in the new investment strategy has to be clearly spelt out, aligned with consolidated practice, and implemented in every investment decision.**

a) Ensure that the "societal value" is properly weighted in the projects' evaluation grid (e.g. by assessing infrastructure projects' also in terms of local work-force upskilling, new jobs created, related RDI activities, smart specialization, partnerships with local actors etc.)

b) Ensure that at least one member of the Independent Expert Committee has specific expertise in evaluating social impact and that each member of the Independent investment Committee is provided with detailed information on the importance of taking into account the "societal dimension" of every project.

c) Ensure that the Investment Advisory Hub includes social investment and impact investing experts to provide guidance on how to evaluate societal impact and build effective public-private partnerships for social investments and investments in public good.

d) Ensure that a share of the available funding resources are allocated for social investments and investments in public good as ends in themselves and not just as a complementary investment to hard infrastructure. This can be achieved by ensuring that the "Investment Task Force" in charge of identifying strategic investment projects across member states includes experts in social investment and investments in public good.

**2. Public and private funding streams have to be aligned within the new investment framework.**

a) EuSEFs funds and other impact investment funds such as the EIF backed Social Investment Accelerator (SIA), recently re-capitalized with €610m (and a further €300m is in discussion with the EC) should be among EFSI's investment options and on an equal footing with ELTIF funds. Broadening the scope of the definition of social undertakings under the EuSEF regulation review (due in 2017) will be of the utmost importance in order to ensure the take-up of the label by impact investors and the quality and ambition of projects funded.

b) Private impact investing funds should be considered investible vehicles, and projects dealing with systemic social innovation should be encouraged with higher scores in the "societal value" assessment.

c) Impact funds capitalized through structural funds such as the recently launched Portugal Social Innovation Initiative and the Key Fund already operating in the North East of England offer viable opportunities to align the new strategy with cohesion policy, leveraging structural funds.