Commentary

Outcomes, Not Process: Towards a New Model for European Funding in an Age of Austerity

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Abstract

In October 2010, the European Commission presented its initial results of the four year-long EU Budget Review. This came as all levels of government from the local up over, attempted to address shared challenges with static or decreasing resources as a result of the economic crisis. This commentary explores how Social Impact Bonds can potentially lead to greater impact for EU funds at the local level, meaning substantial financial savings in the future due to decreased draws on public services.

Keywords

European Union; Budget; Funding; Local government; Innovation; Social

EUROPE FACES A SERIES OF CHALLENGES THAT ARE SHARED VERTICALLY BETWEEN governance levels, and horizontally across geographical boundaries. "Regions 2020 – An Assessment of Future Challenges for EU Regions" (European Commission 2008) first provided a long term vision of these issues. It argued that globalisation, climate change, demographic change and energy would be the key strategic challenges facing the European Union (EU) in the next 10-15 years. Failure to adequately address these could have severe social, economic and financial implications for the EU.

These issues are not cheap to address, nor will they be overcome through unilateral action. The capacity of many individual Member States to intervene alone is reduced by budget cuts linked to the global economic crisis (*e.g.* HM Treasury 2010). Similarly, many local authorities relying on national grants and local tax receipts for income have reported substantial reductions in their budgets, undermining their capacity to drive change (Eurocities 2010). Given these fiscal restraints and the interdependent nature of key societal challenges, a pan-European approach seems a logical approach, with the European Commission coordinating efforts where possible.

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In 2009, President Barroso indicated that this was the objective, declaring that the European Commission would be "leading on climate change, developing new sources of sustainable growth and social cohesion, [and] advancing a people's Europe" (Barroso 2009: 17). This was followed by the Europe 2020 Strategy, replacing the economic-centric Lisbon Strategy with a broader, cross-thematic approach to growth (European Commission 2010a). This provides the core of Europe's policy focus, indicating where the Commission will focus future financial support post-2013 (European Commission 2010a: 20). Focusing on smart, sustainable and inclusive growth, it represents an integrated approach to European politics.

The European Commission's EU Budget Review report confirmed and reinforced the centrality of Europe 2020, arguing that the entire post-2014 EU budget "should be designed as one of the most important instruments to help deliver the Europe 2020 Strategy" (European Commission 2010d: 5). EU funding will support the delivery of five headline targets that set the benchmark for all Member States, with seven Flagship Initiatives covering policy and interventions in areas from digital technology to social inclusion.[1] These five targets are fixed at the EU level, but are adaptable at the national level to reflect different starting points:

- Raising the employment rate of the population aged 20-64 from 69 per cent to 75 per cent;
- Raising research and development (R&D) investment to 3 per cent of the EU's gross domestic product (GDP);
- Meeting the EU's "20/20/20" objectives on greenhouse gas emission reduction and renewable energies;
- Reducing the share of early school leavers from 15 per cent to under 10 per cent and making sure that at least 40 per cent of youngsters have a degree or diploma;
- Reducing the number of Europeans living below the poverty line by 25 per cent.

How to pay for success: outcome vs. process

The broad nature of these objectives presents a challenge to the EU, however. In the wake of the recession, how can it continue to meaningfully support such diverse thematic activities without substantial increases to funding levels? As far back as 2006, it was recognised that the EU budget was stretched and lacked focus. The EU budget review was launched to determine "how the budget can already be shaped to serve EU policies and to meet the challenges of the decades ahead" (European Commission 2007: 2). The results of this process were released in October 2010, at a time when "the global economic crisis [...] put public spending at the heart of political debate in European countries" (European Commission 2010d: 2). As all levels of government negotiate spending cuts across the EU, there is little prospect of future additional resources for the European budget, regardless of the pressing nature of shared challenges. As a result, "prioritisation, added value and high quality of spending" (European Commission 2010d: 2) must be the basis for effective activities.

The challenge of stable (instead of increasing) budgets is compounded by criticism over the effectiveness of EU spending in the past. Although interventions are most often

[1] The Flagship Initiatives were delivered on a staggered timescale: Digital Agenda in early summer 2010, Youth on the Move and Innovation Union in late Summer 2020, followed by New Industrial Policy, New Skills and Jobs, and Platform Against Poverty late 2010, and finally Resource Efficiency early 2011.

delivered by local authorities with excellent knowledge on true local need and opportunity, process has often been prioritised over outcomes. "Controls have […] had a tendency to assess programmes on the basis of inputs rather than performance, reducing the incentives for effective results" (European Commission 2010d: 4). As a result, local authorities have emphasised management procedures and outputs, as opposed to innovation and outcomes when delivering projects aimed at common challenges. For example, local projects aimed at improving labour market conditions are more likely to measure outputs such as the number of people put in training, rather than outcomes such as the number of people in sustainable employment six months after training.[2]

This is replicated in many transnational funds as diverse as the 7th Framework Programme and the Lifelong Learning Programme, as well as finance mechanisms such as JESSICA and JEREMIE. Indeed, around 90 individual budgets and budget lines distribute EU monies to local interventions (European Commission 2009a), with many having no real requirement to link funding with measurable outcomes. This benefits neither local authority end-recipients nor the European Commission. In such a process-driven system, the former have no pressing driver to achieve excellent outcomes through innovative interventions, and may instead rely on models of intervention that have delivered in the past.[3] This subsequently means that the European Commission fails to maximise the impact of its finite financial resources. If projects produce only average or even poor outcomes despite meeting process targets, the challenges they seek to address will continue to increase in intensity at a time when available funding is not able to rise.

If challenges are to be addressed in a long term context of financial uncertainty, there is a need for a new approach. The local level must remain at the centre of EU activity, intervening in ways that support the public good, informed by local knowledge and capacity (Santos and Neheider 2009: 4). But outcomes and impacts must be the focus, and not process and management. The European Commission has acknowledged this, raising the prospect of "payment on the basis of results" (European Commission 2010: 5) post-2014. As a principle, this shows a willingness to use EU funds in a targeted, proactive fashion. Yet a shift towards outcome-based funding will not be simple, and will go against a generation's worth of process-focused thinking. This challenge is highlighted in the 2010's Fifth Cohesion Report, which emphasises the need to link funding with strategic policy objectives, yet discusses outcome measurement as a means to evaluate programmes rather than determine financial support (European Commission 2010f).

Social Impact Bonds and outcome-based EU funding

Europe has a history of pilot programmes, encapsulated in Urban and Urban II that looked at local development. This approach of testing new approaches within the limits of major EU funding programmes may be suitable to testing new outcome-based approaches top financing interventions. One potential model to test is Social Impact Bonds (SIBs), developed in the UK. These are tools to support innovative responses to key challenges, using outcome-based payments and outsourced intervention delivery to promote maximum impact. Sitting within an "invest-to-save" methodology, the model lends itself to funding preventative measures that will lessen the need for future public expenditure (Freud 2007) and provide benefit for society (Young Foundation 2010: 5).

The core of the model is that the public sector identifies a challenge that could be addressed through proactive, preventative measures. The public sector is traditionally poor at developing such interventions (Social Finance 2010), so a call is opened for an

[2] Senior EU Programme Officer, Newcastle City Council, October 2010.
[3] Senior Policy Officer, London Borough of Haringey, October 2010.

external organisation to develop and implement a new project or set of projects instead. The activities of the organisation are paid for by monies placed in a bond by investors. If the intervention meets pre-set outcome targets, then there will be immediate and long-term societal improvements, and a reduced drain on future public sector services and budgets.

A proportion of these public sector budget savings are then used to provide bond investors with a dividend as a reward for their financial backing, and also to provide a financial bonus to the delivery organisation as a reward. If the targets are missed by any amount, no reward payments are made to either the investors or delivery organisation (Social Finance 2010: 47). A key benefit for the public sector commissioner is the elimination of financial risk, as it does not issue payments for either the intervention or unsuccessful projects. The approach creates an incentive structure for long-term preventative and proactive government expenditure. Rather than reacting to the consequences and costs of poor public service provision, an outcome-driven payment system fosters a "race to the top" ensuring that the most effective service providers win out (Social Finance 2009: 11).

Rolling out the SIB model across European funding streams would undoubtedly prove difficult. Yet there is particular potential for their effective use in urban areas where "some of Europe's greatest assets lie" (Hahn 2010), but where even city representatives recognise that "the side effects of social and economic concentration […] require management" (Eurocities 2009: 4). By promoting preventative interventions in these areas of greatest concentration, significant progress could be made in achieving both savings and shared objectives.

A European Social Impact Bond model

A first step would be for linkages to be reinforced between funding programmes, overarching Europe 2020 targets, and Flagship Initiative targets. This process is kicked off in 2010's Budget Review documentation, where an emphasis is placed on "the effective targeting of policy priorities" (European Commission 2010d: 5) with European funding. Indeed, taking inspiration from Lisbon Strategy earmarking for 2007-2013 cohesion spending, the Commission argues that "the Europe 2020 strategy provides both a clear set of common priorities, and a clear framework for identification of funding priorities" (European Commission 2010d: 12). In practice, this could see each funding programme explicitly linked to specific headline targets, for example, the European Social Fund (ESF) tied to poverty, education and employment targets, as well as sub-targets within the European Platform for Poverty. Therefore any ESF-funded projects would have to demonstrate an outcome linked to these targets before receiving funding.

The next challenge is to determine specific issues that SIBs would have most impact on. Using the UK model as a basis, a series of requirements must be met (Social Finance 2010: 54), including the identification of:

- A robust outcome metric;
- A clearly defined target group;
- Evidence-based interventions;
- Clarity on the intervention costing less than the savings through lower long-term public sector interventions.

This will require a step change in the way that all levels of government think when addressing strategic targets, for example, "Reducing the share of early school leavers from 15 per cent to under 10 per cent and making sure that at least 40 per cent of youngsters have a degree or diploma". An SIB approach could be to reject a traditional emphasis on creating costly new courses or vocational programmes, and instead work with children from an early age to change perceptions of education. If over a period of time this approach reduced the number of early school leavers, it would have been a success, contributing to strategic targets and reducing public sector costs in the long term. Close analysis by the European Commission, Member States and local authorities would allow the identification of target areas where this shift towards preventative actions would be viable.

This process would mirror the development of a menu of thematic priorities envisaged by the EU Budget Review to link future cohesion funds and Europe 2020 (European Commission 2010d). Each major EU funding programme would then have a portion of its financial resource ring-fenced to fund SIBs in these "ideal-type" issue areas. Calls for proposals would ultimately invite local authorities to tender for an SIB, on the basis that they can demonstrate clear potential for a localised intervention that would fulfil necessary criteria. The Commission has already pointed to the possibility of "ring-fencing expenditure for […] experimental approaches" (European Commission 2010f: 4) in the Fifth Cohesion Report, demonstrating a willingness to support the use of EU funds in new ways such as this.

Implementing an SIB

In those instances where a clear link can be drawn between potential local outcomes and EU targets, the Commission could agree to support an SIB. There are two main potential models. First, an *ex-ante* funded SIB, and second, an *ex-post* funded SIB. Both see EU and local indicators used as a starting point to agree a detailed "challenge" in the form of an outcome target to be achieved. This challenge would then be laid out in the form of a local tender to deliver interventions, with any organisation free to bid. Applications would have to demonstrate how their intervention or interventions would meet the specified outcome target, and what reduction in public service need this would lead to in the future. This would form the basis of the outcome contract between the EU, local authority and delivery agent.

In the *ex-ante* model, the SIB pot fund could comprise European monies from the appropriate EU programme, as well as local authority match funding. This would be used to pay for the costs incurred by the delivery agent(s) for carrying out the agreed intervention(s). If the intervention is successful and the agreed outcome is achieved, then the Commission could present both the local authority and delivery organisation with a reward grant. This would be a proportion of the savings calculated to be a local, national and EU consequence of the successful actions paid for by the SIB. If outcomes are not achieved in this model, there is no real impact on the local authority as they will simply have followed a traditional match funding approach to local projects. The emphasis is therefore on the public sector to value potential financial reward enough to drive forward excellence in local activity.

The *ex-post* funding model removes this reliance on "additionality" and moves funding more directly to "conditionality", with all EU funds withheld until results are measured, with local authorities solely responsible for the interim funding of the SIB. Local administrations could be free to attract finance from any source, and all funding parties would enter into an outcome-based contract with the EU Commission. If the intervention achieved set outcome targets, the EU Commission would reimburse the SIB funders whatever money they invested in the SIB, and could pay an additional reward depending on the levels of future savings brought about. This model strongly emphasises outcomes as the basis for any EU funding, and in turn presents local authorities with a risk-reward calculation - if innovative, successful interventions are delivered, they receive substantial EU funding, yet if average or poor interventions are put in place, they receive no financial support at all.

The benefits of an EU-Local SIB

There are several interrelated drivers and benefits for an SIB that links European policy and funding with local level outcomes. At the European level, there is the need to use funds in as focused a manner as possible, supporting excellent interventions that tangibly contribute to the strategic targets laid down as the future focus for the EU. In many areas such as public health, employment or social inclusion, the vast majority of public funds at all levels support interventions that merely cope with problems, instead of attempting to prevent future problems (Social Finance 2009: 2). A well-designed SIB will have outcomes leading not only to immediate and long-term societal benefits, but also a reduction in future public sector expenditure.

An SIB model could also help tackle problems associated with match funding EU programmes. The global recession has placed national and in turn local government in dire financial straits, with many city administrations reporting real budget cuts that would affect the ground activities (Eurocities 2010). In an era where such cuts will have a long-term effect on the financial capabilities of many local authorities, it is possible that some would struggle to provide traditional match funding for EU projects. Indeed, this has already been reported as an issue for some local authorities (LGA 2009). An SIB that provides local authorities with the potential for financial reward subject to outcome attainment may provide a risk-reward ratio that local government will find tempting.

The organisations acting as end delivery agents would also benefit from SIBs. These could be private or third sector organisations, such as community groups or small businesses. Again, these have been and will continue to be affected by a dramatically altered economic landscape. Many small businesses must restructure and refocus if they are to keep pace in the modern economy, yet financial support is often hard to come by (European Commission 2010e). The opportunity to act as a delivery agent in major projects would provide sustainable incomes and allow their market repositioning. Similarly, many charities and other third sector organisations have been in receipt of public funding that is threatened due to public sector cuts (Cook 2010). SIB funding can provide these organisations with a lifeline and the opportunity to potentially develop new business models.

SIBs and local innovation

Another important potential benefit of outcome-based funding through SIBs could be increased support for innovation, one of the Commission's strategic objectives. Market-type innovation with its emphasis on R&D, the private sector and universities, has long been understood and supported by the EU. Yet a focus on profit and economic growth is unlikely to foster the innovations needed to achieve Europe 2020 targets such as increasing education levels or tackling poverty. EU supported interventions must therefore be based on different types of innovation that have the potential to provide real societal benefits.

Public innovation is one model of innovation that SIBs could promote. This can be understood as "new ideas that work at creating public value" (Mulgan 2007: 6). The public sector, comprising large organisations with substantial human, physical and economic resources, is a key actor in this element of innovation. Cities, regions and other forms of government or public sector organisation are constantly innovating in order that they can provide better services, achieve targets across all policy areas, tackle challenges and take advantage of opportunities in areas as diverse as child poverty and climate change adaptation.

Although there are numerous examples of successful public innovation, such as the UK's National Health Service, or road charging policies, there are still barriers. Local authorities face a dichotomy between short-term targets and long-term objectives that inhibits risk taking. Ambitious attempts to achieve long-term goals may lead to fears that "standard", immediate services are somehow ignored. Other hurdles include public sector organisational cultures that shun innovation as being a private sector concern, or lack of experience in learning from outside organisations (Mulgan 2007). If the key challenges facing the EU are to be addressed, such obstacles must be negotiated, as "innovation is as important to the delivery of healthcare and education as it is to industries such as manufacturing, retail and the creative economy" (DIUS 2008: 4).

In its Innovation Union Flagship Initiative, the Commission has committed to developing a benchmark for public innovation across the EU (European Commission 2010c: 21), yet measurement will not be enough. By actively incentivising the achievement of high outcomes through SIBs, the Commission would in turn promote local authorities to support new and untried approaches delivered by external agencies that could lead to valuable public innovations.

Another aspect of innovation that SIBs could support locally is social innovation. Put simply, this refers to "new ideas, institutions or ways of working that aim to fulfil unmet social needs or tackle social problems" (Young Foundation/NESTA 2007: 6). Whereas market innovation relies on research institutes, universities and private enterprise, social innovation is "predominantly developed and diffused through organisations whose primary purposes are social" (Mulgan *et al.* 2008: 8).

By using SIBs to actively support the actions of the third sector as delivery agents, EU-Local SIBs would act as catalysts for this social innovation. Innovation Union does bring social innovation into the EU's policy lexicon for the first time, with the promise of a research programme to explore the issue (European Commission 2010c: 8). Yet exploration will not deliver tangible changes at the local level where new interventions can have most impact, so SIBs could prove valuable catalysts for growing this area of innovation across the EU.

Conclusion

2010 saw the beginning of "real" discussions over the future shape of the European budget and its associated funding programmes. In an era of economic uncertainty and growing austerity, the Commission has committed to linking EU funds to the objectives outlined in Europe 2020. Importantly, there has also been an acknowledgement that if funds are to be used in the most effective and efficient manner, the future emphasis should be on outcomes (as opposed to processes) and outputs.

This presents a major challenge to decision-makers overseeing complex budgetary and policy processes, yet the overall framework of the EU budget does not need to be entirely rejected. A clear linking of specific funding programmes with strategic EU targets will provide the basis for outcome-based funding as the objectives of EU support are made clearer than ever before. The Fifth Cohesion Report provides an insight into the thoughts of at least DG Regio, which seems to embrace an outcome-based approach. Yet, its suggestion to use outcome indicators as a tool for evaluating programmes would do little to guarantee high-quality results from supported interventions.

Social Impact Bonds present a workable model for actually basing the allocation and award of EU funding on agreed outcome targets. This mechanism would involve the agreement of local outcomes, which would form the basis of an open tender for delivery interventions. If outcomes are achieved, local authorities and delivery organisations receive EU funding and financial reward, yet if interventions fail to achieve success, EU funding is withheld.

The potential value of such a model at the European level is substantial, and extends far beyond that of merely a financial mechanism. First, by emphasising preventative rather than reactive interventions, SIB-related activity could lead to significant future savings for the public sector, as well as more immediate impacts on shared challenges. Second, by moving the delivery of interventions out of the public sector's control, SIBs could support a variety of organisations that are currently threatened by the impacts of the recession. And finally, by incentivising outcomes and promoting the use of divergent delivery organisations, the Commission could drive forward social and public innovation for the first time.

There is little doubt that this is an approach that challenges the norms of European policy and funding. Yet given the Commission's repeated commitment to changing existing ways of working, it presents a viable approach that can be applied in all geographical areas of the EU, across all policies and funding programmes.

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