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The CRESSI project explores the economic underpinnings of social innovation with a particular focus on how policy and practice can enhance the lives of the most marginalised and disempowered citizens in society.

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CRESSI's approach to social innovation: lessons for Europe 2020

By Alex Nicholls and Daniel Edmiston

D1.4 is a CRESSI policy brief based on:

Deliverable D1.3: Report Contrasting CRESSI's Approach of Social Innovation with that of Neoclassical Economics

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Creating Economic Space for Social Innovation

CRESSI's approach to social innovation: lessons for Europe 2020

Policy Brief D1.4[i]

By Alex Nicholls and Daniel Edmiston

Policy Recommendations:

Realising the following actions would come some way towards fulfilling the social targets of Europe 2020 and embedding social innovation in policy and practice:

- Pan-European and domestic policy-makers need to create intellectual, institutional and economic space for social innovation. Public bodies and regulations need to create intellectual space by giving greater consideration to how policy design, implementation and evaluation might better capture, assess and reward the returns on social innovation. Institutional space might be supported through an increased capacity for governance systems and processes to operate within a climate of uncertainty, experimentation and risk. Given the non-monetary and diffuse nature of returns on social innovation, significant public funding and support is needed to support it. Where this is not possible, public bodies should only leverage private sector investment when the diffuse, long-term and non-economic returns on an investment are valued and recognised as the principle objective of social innovation.

- Public policies need to challenge assumptions surrounding self-interested, so-called 'rational' choice. Public deliberation and consultations, such as the public consultation on the Europe 2020 strategy should be extended to identify and give credence to the social and economic commitments that European citizens value.

- The functioning of the social market economy needs to be understood as an intrinsic feature of social innovation - as both a means and end that can give expression to social commitments. Economic growth and the function of the market are the means rather than the end – that is, a 'means to expanding the real freedoms enjoyed by the members of the society'. As such, it is necessary to introduce measures that intervene on markets actors and institutions in real-time to sustainably and meaningfully address the socio-structural dynamics that lead to marginalisation.

Introduction

The European Commission describes Europe 2020 as the European Union's 'ten-year jobs and growth strategy'. The strategy aims to deliver economic growth that is: smart, through substantial investments in research and innovation and improvements in educational attainment; inclusive, by raising employment rates and reducing the number of people at risk of poverty and social exclusion; and sustainable, through a reduction in emissions and an increase in the efficiency and use of renewable energy. European Union and domestic headline targets underpin these ambitions to create the conditions and environment for a thriving *social* market economy. A great deal of political and policy rhetoric has placed social innovation at the heart of realizing the Europe 2020 strategy.[ii] Reflecting on the achievements made, the Bureau of European Policy Advisers (BEPA) suggests that 'a "social innovation" culture has spread in support of the Europe 2020 Strategy and its implementation'.[iii] However, in spite of a range of flagship initiatives, a mid-term review of progress made to date suggests that at the European Union and domestic level, many of the headline targets will not be met by 2020. Targets pertaining to employment, investments in research, development and innovation, energy efficiency, poverty and social exclusion are all unlikely to be met given the extent of progress made thus far.[iv] Crucially, many of the unmet targets represent the social dimension of the social market economy advocated for by the European Commission.

Despite claims that the social and economic objectives of Europe 2020 are interrelated and mutually reinforcing, there appears to be a continuing tendency to focus on 'after-market intervention' rather than socialising the function of the economy to address marginalisation across Europe.[v] This policy brief outlines how an economic sociology of social innovation challenges some of the neoclassical economic assumptions concerning the operation of the market. Whilst many of these assumptions have been subject to debate and revision, the neoclassical economic approach still proves to be influential in mainstream economics. By acknowledging (and addressing) the limitations of neoclassical economic assumptions, it is possible to attend meaningfully to the economic underpinnings of social innovation.[vi] Doing so should make it possible to realise the ambition of social innovation tackling marginalisation as an approach to, and goal of, policy-making.

Neoclassical economic assumptions about growth, innovation and marginalisation

Deliverable D1.3 is a report contrasting CRESSI's approach to understanding social innovation with that of neoclassical economics.[vii] In a number of important respects, neoclassical economics fails to capture accurately the operation and effects of the market, and therein, the means by which social innovation may function and develop to tackle marginalisation.

Perhaps the most crucial weakness of the neoclassical economic (NCE) approach is its supposedly amoral conception of the market and economic growth. In fact, however, the NCE approach is moral, or at least normative, in several respects. According to neoclassical economics, individuals *should* pursue self-interest, because only via this route can the highest possible level of output (maximum welfare) be attained. Both the objectives of the market − maximisation of economic growth − and human behaviour are normatively prescribed in this regard. If economic growth is achieved in ways that create inequality or marginalise people, this is justified in two ways. First, wealth inequality or poverty reflects an individual's marginal productivity. In other words, the causes of marginalisation are conceived on the basis of individual agency with little appreciation of the role of socio-structural dynamics that shape the individual factors of marginal productivity or exclusion (economic or otherwise). Second, higher rates of economic growth thus attained allow society to compensate those who have been less fortunate in the market. Thus, a market may be perfectly efficient and optimal, despite a high degree of marginalisation arising from its operation.[viii] The optimal and efficient functioning of the market may propagate marginalisation, but it also provides the means by which to tackle it through 'after market' intervention.[ix] Any social risks and problems arising out of the market are understood to be legitimate and to some degree necessary to achieve the highest possible general equilibrium level of output. D1.3 finds that such a theoretical framework may be ill-suited to the analysis and development of social innovation in the following ways:

- Within neoclassical economics, individual motivation and incentive structures are rather narrowly conceived as a matter of self-interested rational choice. According to this approach, self-interested rational action not only underpins the efficient and optimal function of the market - it also enhances the welfare and utility of everyone.[x]

The very notion of a *social* market economy challenges the NCE approach by suggesting that economic actors and institutions can and should make social, economic and/or political commitments to others via economic transaction. The NCE approach leaves little conceptual or applied space for ethical individualism or economic actions and motivations rooted in the interests of others. This poses a particular challenge for explaining and scaling social innovation, which principally derives its purpose and character from incentive structures orientated towards the welfare of others.

- A theoretical framework capable of analysing social innovation needs to recognise the plurality and co-dependence of incentive structures. However, it also needs to capture the financial and non-financial capital that contributes towards social innovation. Trust, motivation and commitment are broadly necessary to realise social or economic commitments.
- By its very nature, social innovation involves experimentation, and thus a high degree of uncertainty. The dynamics and processes that enhance or stifle social innovation are subject to socio-structural factors (including institutions) and environments. Any theoretical framework capable of analysing social innovation has to be able to account for these socio-structural dynamics and the attendant uncertainty that comes with it. The NCE approach tends to conceive of markets at a level of abstraction that is rather static and ahistorical. In addition, NCE was not originally developed to deal with innovation, and it can deal with (technical) innovation only when some of its core assumptions – such as perfect competition, and perfect information regarding the costs and consequences of economic transactions − are relaxed. An accurate analysis or effective measure designed to facilitate social innovation must accommodate and account for uncertainty and dynamic efficiency.
- A neoclassical economics understanding of social innovation struggles to reconcile the creation of knowledge and the financial support necessary for its sustained development. When the returns on an innovation are social in nature (i.e. cannot be privately appropriated), how is the creation of knowledge financially supported? This is an enduring challenge for social innovation that seeks to create and disseminate new knowledge. Particularly, when that knowledge supports the development of products, services and processes in a non-exclusive way. Namely, where the benefits of knowledge creation are diffuse (accruing, for example to society generally) and so too are the financial and social returns. This can lead to an under-production of new knowledge necessary for social innovation.
- Similarly, a theoretical framework centred on neoclassical economics is less able to capture the non-economic returns of social innovation. The financial resources and investments available to support innovation tend to be contingent on specified, short-term, private and financial returns. The benefits of social innovation are often long-term, social and non-monetised. Sourcing funds for social innovation designed to tackle marginalisation is particularly difficult in this regard. For example, the fulfilment of capabilities is hard to quantify and the economic returns of such are invariably diffuse. An economic sociology of social innovation is better equipped to account for this.

Creating the means to realise the ends of the Europe 2020 strategy

In certain respects, the Europe 2020 strategy belies an unqualified commitment to a neoclassical economics paradigm. Many of the targets centre on the social and environmental outcomes of the market. This has the potential to problematize the ends and purpose of economic growth and fundamentally challenge the manner in which markets and public bodies operate to tackle marginalisation. However, the majority of the Europe 2020 targets are realised through 'after-market intervention' and therefore neatly fall in line with the NCE approach.

CRESSI's approach to social innovation brings the validity of the Europe 2020 strategy into question – particularly with regards to the means and ends of social and economic targets. By attending to the factors outlined above, it is possible to identify the socio-structural dynamics, motivations and conditions that either stifle or enhance social innovation tackling marginalisation. The European Commission recognises that:

> *"…we lack systematic research about how markets, public sector and institutions (including incentives, norms and legal provisions) work for those groups of society which are marginalised….'*[xi]

This perhaps comes some way to explain why many of the social targets within the Lisbon Strategy and the Europe 2020 strategy are yet to be met. As within domestic contexts, policy-makers can lack the knowledge and tools to make institutions and markets work to the benefit of all and tackle marginalisation. The persistence of the NCE approach obscures the means by which to realise the goals of Europe 2020. As noted in D1.3, neoclassical economic conceptions of market failure pervade EU policy-making.[xii] As a result, many of the existing interventions designed to tackle marginalisation tend to serve an alleviatory role – compensating for the negative effects of what is deemed to be market efficiency and necessity. For example, the Fund for European Aid to the Most Deprived (FEAD) (2014-2020) is providing essential assistance to the most marginalised and disempowered citizens in Europe. However, these interventions do little to disrupt the existing socio-structural dynamics that caused marginalisation in the first instance.[xiii]

Without a significant revision of the NCE approach that has previously dominated intellectual frameworks, institutions and markets in the European Union, little progress is likely to be made. In this regard, there are three key policy recommendations that would help challenge the role, function and effects of the market in a way that disrupts existing socio-structural dynamics causing marginalisation.

Firstly, pan-European and domestic policy-makers need to create intellectual, institutional and economic space for social innovation. This is not only important for actors and organisations engaged in social innovation, but also policy-makers and public bodies. Without it, significant investments in social innovation tackling marginalisation may be wasted. Public bodies and regulations need to create intellectual space by giving greater consideration to how theory building and development, policy design, implementation and evaluation might better capture, assess and reward the returns on social innovation. Similarly, institutional space might be supported through an increased capacity for governance systems and processes to operate within a climate of uncertainty, experimentation and risk. Uncertainty and dynamic efficiency are inherent features of social innovation. Public bodies and markets need to be able to respond accordingly by being open to and investing in measures, organisations, ideas and initiatives where there is little, if any, track record of performance. Given the non-monetary and diffuse nature of returns on social innovation, and as long as these cannot be captured by more comprehensive economic and financial analysis, it seems necessary for public support and intervention to incubate and scale through public finances. Such support should manifest itself in funding and lending instruments but also through a reconsideration of how we think about markets and capital, along with whatever changes to institutions and economic practice such a rethinking entails. Where this is not possible, public bodies should only leverage private sector investment when the diffuse, long-term and non-economic returns on an investment are valued and recognised as a means and end in the process of social innovation.

Secondly, public policies need to challenge assumptions surrounding self-interested, so-called ‘rational’ choice. An economic sociology of social innovation reveals the distributional causes and effects of the market, as well as the role of incentive structures, motivation and commitment in scaling social innovation. Public deliberation and consultations, such as the public consultation on the Europe 2020 strategy[xiv] should be extended to identify and give credence to the social and economic commitments that European citizens value. After all, institutions (the “rules of the game”) and markets are shaped and given legitimacy by the interests and needs of the general public. In addition though, this may help challenge the assumption that self-interested rational choice leads to maximum utility, general equilibrium and/or maximal welfare overall. As a means by which to evaluate and rethink socio-structural dynamics, it is necessary to challenge the idea that market efficiency (according to the NCE approach) is a precondition to subsequently realising social commitments.

Finally, the functioning of the social market economy needs to be understood as an intrinsic feature of social innovation - as both a means and end that can give expression to social commitments. At present, Europe 2020 is a jobs and growth strategy that is complemented by a number of social objectives designed to tackle marginalisation. As previously stated, these objectives are primarily addressed through ‘after-market interventions’. This needs to be turned on its head to recognise that economic growth and the function of the market is the means rather than the end – that is, a ‘means to expanding the real freedoms enjoyed by the members of the society’.[xv] As such, it is necessary to introduce measures that intervene on markets actors and institutions in real-time to sustainably and meaningfully address the socio-structural dynamics that lead to marginalisation. Realising these recommendations would come some way towards fulfilling the social targets of Europe 2020 and embedding social innovation in policy and practice.

[i] This policy brief (D1.4) is based on the findings of the report: Houghton Budd, C., Naastepad, C.W.M., and van Beers, C. P. (Eds.) (2015), *Report Contrasting CRESSI's Approach of Social Innovation with that of Neoclassical Economics*, CRESSI Deliverable D1.3. Both documents, as well as further information about the CRESSI project, are available online at: http://www.sbs.ox.ac.uk/ideas-impact/cressi/publications-0

[ii] http://www.euractiv.com/sections/social-europe-jobs/embed-social-innovation-policy-making-deliver-europe-2020-302256

[iii] BEPA (2011) *Social Innovation: A Decade of Changes*, Bureau of European Policy Advisers, European Commission, Luxembourg, Publications Office of the European Union.

[iv] European Commission (2014) Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth: Annex II: Overview of progress towards the Europe 2020 targets, European Commission, Luxembourg, Publications Office of the European Union: http://ec.europa.eu/europe2020/pdf/europe2020stocktaking_annex_en.pdf

[v] Grusky, D., and Wimer, C. (2010) Can Inequality Be Reduced by Building Better Markets?. In Berger, R., Grusky, D., Raffel, T. Samuels, G. and Winter, C. (eds.) *The Inequality Puzzle: European and US Leaders Discuss Rising Income Inequality*, Berlin: Spring, pp. 211-223.

[vi] Economic underpinnings of social innovation are understood in terms of how different actors gain access to the resources needed to innovate in a general context of scarcity. These resources include not only financial capital, but also manufactured, social, and cultural capital, and natural resources, depending on the context of the innovation. Access to resources raises questions of efficient and effective allocation, as well as of fair distribution and sustainable use.

[vii] Houghton Budd, C., Naastepad, C.W.M., & van Beers, C. (eds.) (2015). *Report Contrasting CRESSI's approach of social innovation with that of neoclassical economics*, CRESSI Deliverable D1.3. Available at: http://www.sbs.ox.ac.uk/ideas-impact/cressi/publications-0

[viii] Sen, Amartya (1970) *Collective Choice and Social Welfare*, Amsterdam: North Holland.

[ix] Paul Krugman, *Washington Monthly*, September 1998 (Book review of *The Living Wage. Building a Fair Economy* by Robert Pollin and Stephanie Luce.)

[x] Hirschman, Albert O. (1997) *The Passions and the Interests. Political Arguments for Capitalism Before Its Triumph*, Princeton: Princeton University Press.

[xi] European Commission (2012) Activity 8.1, SSH.2013.1.1-1 'Economic underpinnings of social innovation' of *FP7 Cooperation Work Programme 2013 Theme 8: Socio-economic sciences and humanities*.

[xii] Houghton Budd, C., Naastepad, C.W.M., & van Beers, C. (eds.) (2015). *Report Contrasting CRESSI's approach of social innovation with that of neoclassical economics*, A deliverable of the project: "Creating Economic Space for Social Innovation" (CRESSI), European Commission – 7th Framework Programme, Brussels: European Commission, DG Research and Innovation.

[xiii] http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=2184&furtherNews=yes

[xiv] http://ec.europa.eu/europe2020/public-consultation/index_en.htm

[xv] Sen, Amartya (2001) *Development as Freedom*, Oxford: Oxford University Press.

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