Italian discussion paper

The challenge of Social Impact Bond: the state of the art of the Italian context

Abstract

This paper aims to explore the opportunities and challenges posed by the Social Impact Bond, as a specific social finance tool able to involve various stakeholder groups in generating social value. The paper structure is designed to conduct a reconnaissance of the logical model of SIBs and their significance in this historical period, with a specific focus on the Italian context. The questions we will try to answer are:

- What logic configuration do the SIB have and how could this be useful in this particular historical period in the Italian context?
- What are the conditions for the experimentation and dissemination of SIBs in the Italian context, in the light of the workshop held in Turin on 6 November 2017?
- What opportunities and limitations have emerged during the workshop regarding the Public Administration perspective?

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The challenge of Social Impact Bond: the state of the art of the Italian context

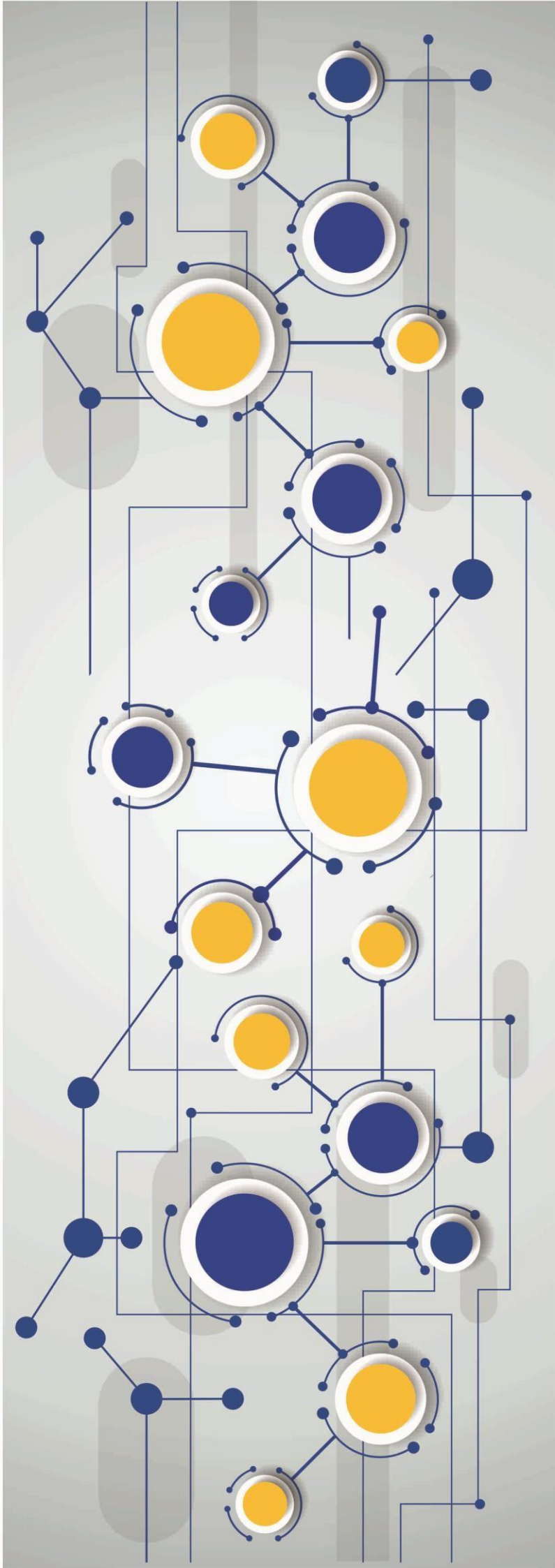
Luigi Corvo; Lavinia Pastore - University of Rome Tor Vergata

1. Introduction: Scenario of Economic and Democratic Crisis

The '900 was the century marked by dichotomies. The main dichotomy in the socio-economic field concerned the relationship between state and market, which reflected a geopolitical context. On one side – the West – where market oriented logic prevailed and the other side – Eastern countries – where a state oriented model was established. Europe has produced unique solutions in terms of balance between state and market. The European approach, called social democracy in terms of political framework and welfare state, concerns the redistribution of value in goods and services to balance inequalities.

This balance is based on a complex network of relationships and exchanges among the three major players in the socio-economic system: the State, the for-profit enterprises and the organizations of civil society.

The ability to earn profit from business has been (and largely still is) the mechanism to create value at the base of Capitalism. The value generated by enterprises is shared with society by the State. In fact, the State, through taxation, recovers the resources to implement redistributive policies through welfare. On the other side, though labour, citizens participate in



value creation and in return are compensated by wages.

The crisis of 2007-2008 has altered this mechanism of value creation and distribution. In fact, the crisis has generated a sharp drop in profit ability (especially for non-financial companies), and this has created a downward spiral that has affected other sectors. The reduced share of value taken by state taxation has altered the balance of public finances and pushed up public debt. This has reduced the capacity of the welfare state to redistribute value through public policies and services, and this has clashed with the growth in demand for assistance, protection and social services. At the same time, it has reduced the share of companies involved in the production processes. Therefore, the unemployment rate has grown and, along with it, the need for social welfare and unemployment benefits from the state.

This spiral has prompted the OECD to publish the recommendation "to do more with less" (OECD, 2010), focusing on the potential effectiveness and increasing public sector efficiency to reduce the gap between demand and supply of public goods and services. This approach does not seem to have been sufficient.

At this moment, governments are trying to find sustainable solutions to a very dangerous tackle:

- on one hand, the difficulty of controlling public finance balances, stressed by the impressive growth of public debt between 2008 and 2016;
- on the other hand the growing mistrust of citizens towards institutions, ultimately due to the inability of public administrations to respond to growing social needs.

Figure 1 and Figure 2 (see last page)

Assuming the Italian context as a focus, we can observe how the quantitative balances on the share of GDP spent in public spending are in line with the average of other European countries. Likewise, by analysing the breakdown of that expense (net of interest on debt), no significant deviations are noted.

What deserves further attention, it is not the data regarding quantity of expenditure (neither in its aggregate nor in its distribution) but, its qualitative composition, in terms of the expenditure logic and the processes that compose it.

The ever-increasing scarcity of public resources due to the economic crisis has resulted in innovation in public relations between private bodies and private organizations: public subsidies and funding, specific projects and specific achievements have come from, or still through public-private partnerships based on the level of performance achieved (payment by results).

The OECD has devoted a report on "New Investment Approaches to Meeting Social and Economic Challenges" (Wilson, KE, 2014) where the topic of Social Investment is addressed and the impact of investing as the evolution of the relationship between finance and philanthropy, or as the third way to reallocating private resources in strategic and general interest areas. This reconfiguration confronts us with the challenge of a hybrid market with unexplored potential involving financial intermediaries and local authorities, SMEs and large companies, non-profit organizations and civil society.

Precisely with reference to this analysis, there is an interesting reflection on the role that SIBs can play in redesigning the public sector intervention logics, with the aim not to

rationalize spending as much as its logical qualification and configuration in order to significantly improve the ability to respond to the needs of the community.

2. SIB and the Italian context

In the post-crisis 2008-2009 context there was a large process of revaluation of impact finance, as a way to restart of the economic cycle and for the protection and enhancement of public and common goods. The important aspect that distinguishes traditional finance from impact finance is the intention to generate a measurable impact on the social- environmental dimensions. The new impact finance tools are characterized by the ability to consider the investment compared to a double bottom line logic, this means putting the economic and social nature of the initiative on the same level in order to favour interventions that are economically sustainable over time and in able to create advantages for the territory and for the communities.

The increasing scarcity of public resources, due to the economic crisis, has led to an innovation in economic relations between public bodies and private organizations: we have thus moved from subsidies and public funding, to interventions dedicated to specific projects and specific results achieved, and to public-private partnership based on the level of performance achieved (payment by results).

The OECD has dedicated a report to the "New investment approaches to meet the social and economic challenges" (Wilson, KE, 2014) where the issue of Social Investment is tackled. Impact investing is declined as an evolution of the relationship between finance and philanthropy, or as the third way that favours the reallocation of private resources in strategic sectors of general interest. This reconfiguration confronts us with the challenge of a hybrid market, with unexplored potentialities, involving financial intermediaries and local bodies, SMEs and large companies, non-profit organizations and civil society.

Social Impact Bond is one of the main impact finance tools and is born in the UK impact market investing following the establishment of the Government's Social Investment Task Force. The so-called Social Impact Bond (SIB) is configurable as a partnership between different actors aimed at raising private capital to promote social initiatives in the public and non-profit sectors. SIBs are therefore obligations that arise essentially for two reasons:

1) on the one hand the difficulty, accentuated by the current financial crisis, on the part of the public sector and non-profit organizations to access the resources they need to finance projects with a social impact;

2) on the other hand the demand of savers who wish to have responsible and transparent investment instruments.

The essential elements of social impact bonds are:

- A program of interventions in the social field capable of generating a social impact and saving public expenditure;

- An investment with return of principal and remuneration only if the program is successful.

It is important to point out that the recipients of the investment can rely on certain resources for a period (from a minimum of 3 to a maximum of 10 years) considerably longer than that foreseen by traditional programs (ranging from 1 to 3 years). Therefore, they are relieved of the worry of continuously seeking sources of funding and can thus concentrate on the social impact to be produced (Mento, Human Foundation 2016). Like other forms of payment by results, the SIB is a financing mechanism in which the return for the investor is determined by the positive impacts generated by a certain social activity.

The performance of the SIB is in fact variable as the price of an action, which changes according to the performance achieved by the social enterprise. In this case, the remuneration is linked to the results of the activity financed in terms of value created for the company.

It is a sophisticated financial instrument that is born to promote social innovation. The complexity of the tool in this case is not linked to the difficulty of being able to predict the success or failure of an investment, but to the network of relationships among the actors involved in the process.

Typically the actors involved are:

- Public Administration (municipal, regional, national);

- Service providers, typically non-profit organizations;

- Social investors;

- Specialized intermediaries and,

- Independent evaluator who measures the result and certifies the achievement of the objective.

These actors are linked by a partnership, also recognized under the contractual profile, where to the variable "financial risk" of a traditional investment is added the variable "trust" between the partners who take part in the game. The assumption at the basis of SIBs are:

- The investor believes in the ability of a certain social service provider to achieve a certain result;

- the Public Administration believes that the innovative service has value also in economic terms;

- all the actors trust in the validity and certainty of the statistical surveys, carried out by an independent third party, necessary to measure the performance of the service.

In the Italian context, SIBs are in an embryonic state of study and experimentation. As of today, it is not possible to report a complete SIB initiative, but only signs of interest coming from different experiences that are still not systemic.

First, it is worth mentioning the work that *Human Foundation Innovating and Giving* is doing. On the one hand, Human Foundation is building institutional awareness and on the other hand is promoting experimentation, aiming at creating the context conditions for the implementation of SIB initiatives.

Another significant experience is that of the Sardinia Region, which used a part of the Regional Operative Plan funds to create a Social Impact Investing fund of 8 million euros.

Banca Prossima is investing in SIB linked to the rethinking of the waste cycle in the Municipality of Naples. Also other banks, such as *UBI* and *Banca Etica*, have developed social bonds and are interested in tools such as the SIBs.

However, apart from these sporadic experiences, a systemic implementation activity of the SIB tool is not present in the Italian context.

1. The Italian Workshop: The challenge of Social Impact Bond

This contribution was developed following the workshop "The challenge of the Social Impact Bond" organized by *Finpiemonte* and the Municipality of Pordenone, with the support of the University of Rome Tor Vergata (Government and Civil Society Research

Group)[1] as part of the European project Alp Sib.

The meeting of October 26, 2017, held in Turin, was a moment of deepening and reflection with the aim of increasing the awareness of policy makers with respect to the SIB tool and identifying the main opportunities and challenges encountered by the various actors called to collaborate in the process of introduction of this tool (PA, Third Sector, and Finance).

The organizing partners according to the following criteria selected the workshop participants:

- Policy makers and top PA managers involved in areas of possible application for SIB (welfare area), with particular attention to the representatives of the Alpine regions (given that the AlpSib project is an EU interreg project);

- Homogeneous representation between local and central Pa;

- Inclusion also of non-public but strategic actors (with a privileged perspective on the SIB theme)

In total, 90 subjects were selected throughout Italy and invitations were sent one month before the event. 32 people participated in the workshop:

- 20 policy makers, managers and officials of the PA, of which
    - 4 Regions: Piedmont, Friuli Venezia Giulia, Valle d'Aosta, Puglia - 2 representatives per region, almost all managers except 1 policy maker from the Valle D'Aosta region.
    - 2 Cities: The Metropolitan city of Turin (2 representatives, 1 political 1 technician) and the city of Pordenone (2 representatives, 1 executive and 1 official).
    - 1 representatives of the Regional Agency for Social Housing (Piedmont Region).
    - 1 consultant (private company) for the Public Administration on European structural funds.
    - 1 official of the Cohesion Agency.
    - 1 official from the Ministry of Labor.
    - 2 representatives of the ANCI / IFEL
- **5 expert** speakers of the theme coming from the *Università della Svizzera Italiana*, from the University of Rome “Tor Vergata” and from Human Foundation Giving and Innovating.
- **7 representatives** of 3 **Alp Sib project** partners: *Finpiemonte* (4 participants) and Next Level Association (3 participants) as well as the Municipality of Pordenone (already listed).

The program of the day was divided into two parts: the morning was dedicated to in-depth study by a panel of experts while the afternoon was a moment of confrontation between the various representatives of Public Administrations and experts.

[1] Faculty of Economics, University of Rome "Tor Vergata" http://economia.uniroma2.it/ - Department of Management and Law http://economia.uniroma2.it/dmd - Government and Civil Society research group http://gcs-group.it/

The questions we tried to answer during the workshop were the following:

- Is the Italian ecosystem mature enough to seize opportunities and tackle the challenges posed by impact finance?

- What are the main difficulties that slow down the development of instruments of social and financial innovation? What are the possible solutions?

3. Findings

Starting from these ideas, the debate of the Turin workshop brought out three key aspects of the Italian ecosystem:

- There is a strong interest from the regions to the SIBs (as evidenced by the prevailing participation in the meeting). Therefore there is a willingness to experiment from a certain PA that has a direct contact with the effects of the economic and democratic crisis that Italy, like other OECD countries, is going through;

- A diffidence regarding the preparation of the other actors involved in an SIB. The concern has emerged that not only the PA is not suitable for managing complex processes, but also that the third Italian sector and social finance are still unsuitable.

- Government-government relations have been indicated as the main factor of difficulty and obstacle, not only to the development of SIBs but of any process that has a complex governance. The discrepancy between the directives of various public bodies creates a sense of loss and insecurity and, in fact, hinders the implementation of innovative tools such as the SIBs. In particular, it has emerged that the ANAC[2] directives and the decisions of the Court of Auditors are not, to date, consistent with multi-stakeholder intervention models and with a medium-long term economic-financial perspective, basic elements of the SIBs.

The issue of government-government relations does not stop at a conflict between local administrations and some central bodies, but it is a much broader debate concerning the complexity of the public system and all the roles that a PA is called upon to cover.

Following the workshop, it was tried to cluster the categories of analysis with respect to the roles that a PA can have, very often simultaneous, on which the problems of government-government relations depend. The analysis of the roles of the PA refers to the possible application of an SIB, although it could also be extended to other contexts.

The role of PA: not just a payer

In order to grasp the role of PA in a SIB process, it is necessary first to analyse the value chain of the underlying project/service that will be recipient.

The first important distinction concerns the willingness to pay the recipients of the project / service. Where there is no willingness to pay or where such availability is limited, by not allowing the project / service investment to be remunerated, the role of the PA becomes central to ensuring economic and financial sustainability.

In case of willingness to pay recipients, however, the PA assumes a different role, aimed at enabling the initiative and facilitating it in order to grasp the useful ideas to replicate the initiative in other areas.

[2] ANAC - National Anti-Corruption Authority

The initiative of a SIB, generally, concerns more than one type of process within the PA and in this, we find the root of the complexity we discussed during the Turin workshop.

To such complexity, that we could define “multifunction”, is added the complexity of the different areas of institutional competence between central and local PA. This second complexity we call "multilevel".

The first element of orientation is marked, as anticipated, by the willingness to pay the recipients. The willingness to pay creates a fundamental bifurcation that determines a different intensity of the PA's intervention.

The first question that must be asked, therefore, is: does the considered SIB concern a project / service for which the recipients have (or not) willingness to pay? Who can remunerate the investment?

Because of this differentiation, we can understand the role that social finance investors have in the specifics of that Sib.

As emerged explicitly during the Workshop, the main critical issue that limits the development of SIBs in the Italian context is determined by the weakness of the coordination mechanisms between different public actors that respond to different functions / roles that the PA assumes in an SIB initiative.

Summarizing the analysis of the processes, we report 3 basic roles that the PA assumes in an SIB process:

A) as producer-investor

B) as regulator-controller

C) as enabler-facilitator

(A) <u>The PA as producer-investor</u>

The PA plays a role in producing and delivering services where it is considered that the value (in its plural sense) generated by the direct intervention of the State is higher than the value that the market would be able to generate. In many direct intervention areas, service beneficiaries do not have the economic viability to pay for the service. Therefore, Public service is crucial to re-balance the distribution of value among citizens through resources collected by general taxation. In this case, SIBs are an important tool for redesigning public spending towards "outcome-based commissioning" approach.

(B) <u>The PA as regulator-controller</u>

The PA also (we should say above all) has a role in regulating social relations in order to ensure compliance with shared rules and conditions of social cohesion. A particularly important aspect emerged during the workshop: the risk of fracture within the public system. Indeed, several actors involved and regional policy makers referred to the major criticalities of SIB experimentation on the difficulty of dialogue with other actors, which, in the specific case of Italy, are the Court of Auditors[3] and the ANAC[4]. During the debate, it appeared as if these two bodies were not part of the same public governance system as the regions involved, as if they were talking about entities separate from them.

This dynamic indicates ineffectiveness in public governance systems and draws attention to the need not only to understand not just "society-government" relations but above all government-government relations.

To this end, the topic of the governance arrangements needed to enable SIB experiments has been introduced.

[3] The Court of Auditors (*Corte dei Conti*) is a constitutionally important body, envisaged by Articles 100 and 103 of the Italian Constitution, which includes it among the auxiliary bodies of the Government. It is a body with advisory, controlling and judicial functions.

[4] ANAC - National Anti-Corruption Authority.

SIBs, by their nature, require a very significant shift in the regulation and control function. To simplify, for the effective management of a SIB, the regulatory function should be accompanied by a significant programming capability and the control function should be guided by an important evaluation capability.

Both steps refer to a shift first cultural, and therefore managerial. It is necessary to move from a perspective oriented to the formal (accounting-administrative) aspects to an outcome-based management perspective. The outcome-based management should be integrated from the moment of programming and up to the evaluation phase.

(C) The PA as enabler-facilitator

In the Italian context, the least considered function is that of PA as enabler-facilitator. As an enabler, the PA should simulate new relationships that can experiment with innovative projects, including SIBs.

The PA, in fact, is not only a party who funds initiatives or decides the legitimacy of an initiative. PA is primarily the subject that works to generate value, so it has an intrinsic interest in all projects that can generate social impact.

This aspect, which can be technically defined as PA's multiple outcome governance and impact, is the basis for the PA's enabling role.

However, regardless of the ability of a PA to support – from a financial point of view - a Social Impact Bond, it is necessary to understand whether that same PA is primarily concerned with Social Impact.

Too often, in fact, we concentrate almost exclusively on the demand for social impact assessment, ignoring the first lever of the process, that is, the significance of the impact that we are going to generate with the proposed SIB initiative.

This step is crucial to creating the necessary commitment conditions to stimulate a multifaceted and complex governance.

The Italian case shows that such a passage is often overlooked and this creates a rebound in terms of the continued emergence of interventions related to the socio-environmental dimension. Suffice to observe how that commitment becomes automatic because of dramatic events (earthquakes, hydro-geological disasters that create obvious damage and casualties, collapse in cultural sites, poverty rate data, etc.).

The assumption of an enabling role therefore responds to the need to have a direction that coordinates the SIBs, since:

1. the public entity is intrinsically concerned with the generation of social and environmental impacts, because they contribute to the achievement of the institutional goals of the PA itself.
2. the role of the institutions is re-qualified, responding to a crisis of trust evident and well-measured by various observers, including the OECD.
3. Enhances the poorly utilized assets of the PAs and could favour the generation of positive impacts (public assets, common assets at large).

3.1 Limitations in implementing SIBs in the Italian Context

Afterwards the workshop, it was decided to divide the weaknesses / limitations of the Italian context into two categories:

A. Objective (or systemic) limitations:

- Poor flexibility of the formal legal framework.

Focus on formal aspects inhibits the possibility of experimenting with SIBs. An example of inconsistency is the concept of *Public Utility* described in the Procurement Code. According to the Code *Public Utility* is the ability to generate accounting savings in the same year of the project. Therefore, for the implementation of a SIB, it should be able to demonstrate *Public Utility* and not the ability to generate positive impacts in a broader, albeit measurable and quantifiable sense.

- Short-term orientation

The short-term tension imposed by public finance constraints is in radical contradiction with the SIB philosophy. Social impact, by its very nature, manifests its ability to create value and recalculate spending on medium-term horizons. Linking it to the ability to generate savings in a short-term horizon is a limitation that greatly reduces the potential of SIBs, also considering a contradiction between this trend and the norm requiring PAs to plan multi- annual economic and financial cycles.

- Lack of process management procedure

Considering both a partnership for innovation and co-planning and direct negotiation, there is some confusion about the device to be used to implement an SIB. Therefore, there is a lack of guidelines able to guarantee to all the subjects involved, including the Court of Auditors, a shared procedure.

- Poor integration of the SIB process into the economic-financial planning cycle.

In the post-2008 crisis, continuous logics of cutback management were applied (calling them spending review and using the term Anglo-Saxon improperly), making only linear cuts in spending. In Italy, the logic of basing decisions on public spending (and on spending reviews) on the impact of spending, and not on immediate savings, is still far away. For this reason, it is difficult to implement innovative tools that have as their logical matrix the outcome based commissioning and payment by results.

B. Subjective (or cultural) limitations:

- Weak managerial skills in the PA: from strategic planning to performance management (impact management). While on the one hand (objective limitations) it is true that the PA provides for a formal control of spending and short-term performance it is also true that there is a lack of managerial skills within the PA. There is a lack of critical mass within the PA itself that can put pressure on transforming the PA and make sure that impact management, outcome-based commissioning and payment by results are adopted.

- Poor financial literacy in the PA and in the TSOs: this leads to scepticism and fear in relations with financial players.

- Difficulty in governance of multi-stakeholder processes. There is a tendency to fragment the processes and to lose the overall vision, the PA do not feel able to manage complex processes in terms of actors involved, times and risks. This aspect is partly linked to the objective lack of tested and safe devices and administrative procedures and combines with a strong

aversion to the risk of public administration, avoiding the role of directing that should characterize them.

- Weakness of leadership, partly due to a lack of overall political strategy. The lack of leadership is reflected in the lack of coordination mechanisms, and therefore in the inability to manage complex processes, this aspect is closely linked to the previous point.

The set of elements mentioned above does not facilitate the meeting with investors and other stakeholders who, in this context, do not feel guaranteed by a weak and contradictory public interlocutor.

3.2 Opportunities through implementing SIBs in the Italian context

The workshop, however, brought out opportunities that should not be underestimated.

First, as a first positive element, the interest shown by the participants in the Workshop, which, as mentioned, are important public organizations. In particular, regional representatives, engaged in a dual role of coordination (upwards with European and national policies, downwards with the municipalities) expressed interest in SIBs and expressed their willingness to better understand the possibilities of implementation in their contexts.

Furthermore, the following aspects of the Italian context emerged as an opportunity:

- Availability of the ethical finance system: the banks whose purpose is to support the development of the social economy have shown a strong interest in SIBs and, more generally, for the various impact investing instruments.

- The Third Sector Reform (2016) which pushes the Third sector organization (TSO) to change its approach. During 2017 the decrees implementing the Reform were issued, which introduced important changes with respect to the methods of financing social enterprises and the logic of interaction between these and the public administration.

- Birth of networks and centres of expertise that create greater awareness (see role Foundations). In Italy, there are more and more centres of expertise, often born around Universities or other Research Institutes, which aim to create conditions of greater awareness about financial instruments linked to social innovation processes.

4. Recommendations and Conclusions: the evolution of the Italian scenario

Following the discussion of the workshop, and many other opportunities for debate on the subject with experts and key players in the Italian context, we have come up with four areas of recommendation for the Italian scenario to develop and actually take shape:

1. Create a knowledge management system on SIBs accessible to public administrations: it consists of an open source platform in which it is possible to simulate each step of the SIB process, with tutorials explaining how to overcome any possible obstacle;

2. Create a process format with accompanying tools for the replication of trials: in addition to the platform, it is necessary to create a support and empowerment team of the PAs who intend to start an SIB. The mechanism

is similar to that which characterized the function of Incubators with respect to the birth and development of start- ups;

3. Allocate a portion of the funds available from public financial institutions (for instance Cassa Depositi e Prestiti[5]) to SIBs, borrowing virtuous experiences and matching the logic of SIBs with the purpose of institutional programs (Urban Regeneration, Promotion of active labour policy instruments , fight against educational poverty and more);

4. Promote the creation of networks of third sector organizations (TSO) that can drive the development of SIBs by acting in synergy even in different territorial contexts.

The Italian scenario seems to take the first steps towards the adoption of financial tools oriented to the social impact and this is confirmed by the approval of an Innovation Fund with the Budget Law 2017. This fund has a total budget of 25 million euro and it will finance feasibility studies and support activities for public administration to access impact investing tools.

If we add to this the important result of the financial collection carried out by banks and financial companies for social impact purposes, we can conclude that in the coming years we might face a scenario that opens up the possibility of continuing the work of raising awareness and experimentation on this issue.

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Figure 1. General government gross debt as percentage of GDP 2007,2009,2015,2016. Source OECD

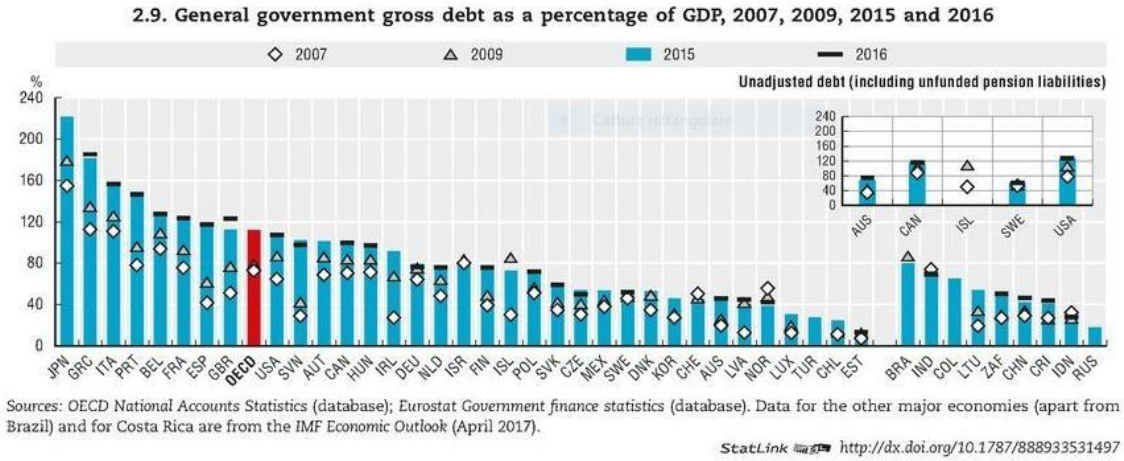

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Figure 2. Correlation between confidence in national government (2012) and public debt (2011). Source OECD.