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SOCIAL FINANCE AS A PUBLIC POLICY INSTRUMENT

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Abstract

We address the high social impact household savings could generate if channeled (at least, partially) into social impact investments in a win-win formula for both households and society as a whole. More specifically, we focus on two financial products which both have a monetary return along with a well-defined social impact: Social Bonds (SB) and Social Impact Bonds (SIB). While social bonds reduce the net return in favor of setting up a social program, social impact bonds are a breakthrough concept that combines traditional investment, be it risky or risk-free, with a social connotation in a unique public/private partnership.

Introduction

In Italy, recent decades have been marked by the need to cut public spending, resulting in a shrinking welfare system (Ascoli 2011) together with institutional readaptation processes that can be seen as forms of "subtractive recalibration" (Ferrera 2012). Prolonged austerity leaves little room for cross-fertilizing innovations that can make public policy-making processes open to new social investment approaches (Ascoli, Ranci & Sgritta 2015), to the point where social investment in Italy has been called a "mission impossible" (Kazepov & Ranci 2017). It is precisely the scarcity of economic resources available for investment in socially oriented businesses (even if they have high social returns) and the difficulties that actors in the social economy have in accessing traditional banking channels that increase the potential of the new "social finance" instruments, which have both been lauded as a means of leveraging private capital for the public good in a new frontier of philanthropy (Salamon 2014), and accused of being yet another encroachment of NPM precepts in social program delivery (Warner 2013).

Social impact investment consists of providing financing to public organizations and local communities for initiatives that are expected to have a significant social return in the area concerned. The investment is explicitly intended to deliver a financial return, though the extent of the return is proportional to the outcomes of the program thus financed. Social finance combines elements of both philanthropy and financial investment. Though an apparent contradiction, impact investments are thus "investments to do good"[4].

These investments have trended steadily upwards over the last decade, reaching approximately 6.6 trillion dollars in 2015 (Busch et al. 2016), with a flurry of experiments that, starting from the UK and the USA, have in a few short decades come to involve a highly dissimilar range of countries[5], with varying results.

From their beginnings in the English-speaking world, these instruments have slowly gained ground in Italy, where their

[4] The term impact investment was coined in 2007 at a Rockefeller Foundation conference in Bellagio.
[5] For a map of these experiments, see: www.socialfinance.org.uk.

potential[6] has been recognized despite the many doubts that have been raised (Italian National Advisory Board Report to the Social Impact Investment Task Force, 2014). The Italian legal system[7], for instance, is not particularly ready for these instruments, and introducing them in Italy would call for a more balanced attention to demand as well as to the supply of capital (Pasi 2015). With the exception of the UBI social bonds[8], Italian experience with social finance instruments has been chiefly limited to the level of planning and feasibility studies, as in the case of the Naples Bond[9], which was never actually launched. In this connection, the Trentino Bond described in the conclusion of this paper can be an example of an innovative theoretical construct put into practice.

Though the SIB market has intriguing prospects from the supply standpoint, it is by no means clear what its potential on the demand side might be, partly because of the lack of empirical data. Whether the project is feasible hinges entirely on the appeal that the program selected together with the public administration has for the community of savers, encouraging demand from small investors in a new form of participatory savings.

The paper is organized as follows. The first section will explore social finance instruments from a sociological standpoint, discussing their potential in terms of social innovation and the risks of reproducing inequalities. The second section will focus attention on social bonds and social impact bonds, describing their operation and how returns are calculated, while the third section will analyze the viability of an Italian experiment, examining advantages and potential problems.

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[6] In the Introduction to the Italian National Advisory Board Report to the G8 Social Impact Investment Task Force (2014), the board's chair Giovanna Melandri refers to social value as the "third dimension" of investment decisions, as well as to a "paradigm shift" and the "impact revolution".

[7] Italian commentators concentrate in particular on the legal framework for public contracts and public finance, as well as on the public administration's more general oversight of instruments whose institutional design is particularly complex. These issues will be further discussed in our concluding section.

[8] For the UBI social bonds, see the URL, https://www.ubibanca.com/Social_bond.

[9] This was an interesting proposal for a bond intended to solve Naples' waste disposal problem, and at the same time create job opportunities for the area's unemployed.

1. Social finance for public policies: potential for innovation and risks

Italy’s fascination with social finance instruments could be dismissed as the latest in an endless series of infatuations with fads that have swept through other, and often very different countries, or as yet another attempt to put a neo-managerial stamp on public service delivery. But it can also be an opportunity for rethinking the issues involved in order to shed light on the potential for innovation, without losing sight of the risks and consequences that could arise in a country as markedly heterogeneous and unequal as Italy. We are not referring here only to the well-known North/South divide, borne out by a historical series of economic indicators, but rather to the differing institutional capacity to design, govern and – often – even simply to implement public policies at the local level, where the outcomes are always uncertain in terms of the results that can be obtained and the effects that will be produced. In the broad spectrum of public policies, social policies are perhaps the lens that the literature has most frequently trained on the fragmented geography of decision-making processes and the risk of outcomes that are paradoxically prone to reproducing existing inequalities (Madama 2010, Saraceno 2013).

This section starts with an exploration of the innovation potential that social finance instruments offer for public policies, where innovation (in processes, programs or products) is seen as a change in the “basic routines, resource and authority flows, or beliefs of the social system” (Westley & Antadze 2010, 2). From the vantage point of structuration theory (Giddens 1984), innovation can be regarded as a complex but constant process of changing the rules and relationships that govern society, which can take place in different ways and involves different areas of the structure simultaneously. The change in how public policies are financed, which belongs to the sphere of relationships of domination, is this closely connected to the transformations that occur both in the dimension of signification and in the dimension of legitimation. On the cultural/legitimation level, social innovation evokes a recovery of the reciprocity of relationships and the essence of what it means to be a society, present for example in Touraine (2010) or in Rosanvallon’s “communalité” (2011), moving from citizenship to the broader concept of “co-citizenship” based on “shared information, knowledge,

communication, initiatives, experience, acts of solidarity, feelings of usefulness, places, interests and public goods" (Ascoli & Sgritta 2014, 519). From this perspective, there can be no doubt that the ties between social finance and social innovation are extremely close, so much so that "social finance is both a product of existing social innovation processes (part of a new capitalism *zeitgeist*) and, simultaneously, a part of the enabling conditions for the further development of social innovation and transformative change" (Nicholls, Moore & Westley, 2012, 126-127). This connection offers a number of interpretive tools we can bring to bear on understanding social finance instruments in the light of sociology.

Social innovation is at the heart of the European social model's modernization strategy (Maino 2013), which stands on two conjoined pillars: the ability to meet social needs more effectively, on the one hand, and the creation of new social relationships and collaborations on the other (BEPA 2011). Effectiveness is not simply a question of finding alternative solutions to acknowledged social needs that are not addressed by established state or market mechanisms, especially in a climate of austerity and public budget cuts. Rather, it means fielding new and better ideas for taking social action that favor prevention and empowerment over protection by means of sustainable programs tailored to the local areas where they are implemented and which can produce lasting benefits. In the dimension of relationships, what is needed is to build new public/private partnerships, promoting new forms of governance that can stimulate participation and the sense of belonging to the community and thus bolster social cohesion[10].

Taking our cue from Pirone (2012), we could say that while the first definitions of social innovation show an inherent recognition of the central part in promoting innovation played by the third sector and social enterprises, later thinking about social finance instruments presents a larger cast of actors who are acknowledged to have an important role in innovating public polices, thus moving closer to the definitions of social innovation that emphasize the social aims of the action in terms of furthering the public good, as can be seen in the work of the Stanford group. Welfare programs are now staged by a troupe that includes banks, pension and social security funds, banking foundations, insurance companies, for-profit

[10] The accent on social cohesion and solidarity as dimensions that cannot be divorced from economic growth and environmental sustainability pervades many recent EU documents and much of the literature on the move towards a civil economy (Bruni & Zamagni 2004), seen as a remedy to the debacle of the neoliberal model.

associations, philanthropic groups and private investors of all sizes and thus, albeit indirectly, households and individual savers. The action of such an extended system of actors and the emergence of new forms of public/private partnership necessarily has consequences on program governance and on the more complex role of government oversight in public programs. As has been pointed out, whether we are discussing social finance (Pasi 2015) or social innovation (Nicholls & Murdock 2012), we are no longer dealing only with the consequences of the interaction between actors motivated by different approaches, but with the emergence of new, hybrid forms of action where combinations of traditional public, private and civil society approaches are grafted onto the provision of welfare services.

Though the multitude of definitions of social innovation offered in the literature has, as Pirone (2012) notes, overstretched the term, focusing on social finance instruments reveals a number of areas where the management literature has made its influence felt on the sociological literature. Whereas in the first case innovation is synonymous with guaranteed effectiveness, efficiency and sustainability, the second puts a more nuanced emphasis on the need for innovation to be considered successful once the dust has died down, and for innovation's impact on society to be long-lasting. In the literature on social finance instruments, the prime focus is on maximizing the quality and effectiveness of welfare programs, gauging social impact by the yardstick of performance-based contracting arrangements. The new social finance instruments present us with a win-win game[11], where the investor earns the right to a return on capital (or lower future expenses), the program participant meets an initial need (for employment, health, education, etc.) and members of the local community benefit indirectly from the reduction in future public spending for the aided categories and from the "consequences of the consequences" (Bezzi 2010) of the program, which in the medium to long tem triggers virtuous circles of development and social cohesion. Clearly, if all this is to occur, the program must in fact work, and its success must be certified by an

[11] This is the stance taken by Delrio, who in the preface to the Italian National Advisory Board Report (2014) describes these instruments as "designed to bring about a rethinking of the economy where, for once, everyone wins, or rather, everyone benefits".

independent evaluator and demonstrated by a robust metric[12], as is now done in calculating the return on more traditional financial instruments. Measuring programs' social impact is the most under-investigated issue in the literature, not just because of the reliance on experimental evaluations alone, but also because of the risks of gaming the data or creaming the population that is most likely to benefit from the program in order to guarantee its success.

By this point, it should be sufficiently clear that the effective potential for innovation and success of social finance instruments depends to a large extent on the resources that can be fielded at the local level, in terms of activation and governance of local networks, as well as of the specific skills needed to administer programs that are particularly complex because of the sheer number and heterogeneity of the actors involved. The capacities of local institutions must then be set against the scale and amplitude of the needs that the innovation hopes to meet: however self-evident this may be, it should nevertheless be emphasized that no social finance tool is capable of tackling very widespread social issues and massive numbers of beneficiaries. It is thus no accident that the Italian experiment discussed in the last section of this paper got its start in Trentino rather than elsewhere. The fascination with these tools must be tempered by the pragmatic recognition of the danger that they may drive a wedge between different local areas and undermine the sense of social citizenship, which is already very much at risk in Italy. The fact remains that the potential of social finance instruments rides largely on their institutional design, which we believe must guarantee public oversight of the program and investment in innovative prevention programs that aim for quality – without attempts at cream-skimming the most promising beneficiaries – while giving voice to the individual, in an approach stressing community participation and accountability.

2. Social finance and household investments

According to economic theory, the financial portfolio of small investors, i.e., of households, reflects the risk-return nexus, whereby

[12] In cases such as that of Naples, the problem of metrics can be readily solved by measuring the cost at market price of waste disposal before and after program introduction.

higher returns are expected to result from taking higher risks: savers' goal is to maximize returns for a given level of risk they are willing to take. The desired risk exposure depends on preferences, or the degree of risk aversion/risk tolerance, which varies from individual to individual. Economic theory states that, given these parameters, the saver will decide how much to put into risky investments (like stocks) as opposed to risk-free investments (such as bonds)[13]. Where does social finance tie in with savers' optimal investment?

Social finance brings new yield prospects to the financial returns offered by traditional investment mechanisms. The returns are no longer exclusively monetary, but include other outcomes that mean that the investment has a social impact (Nicholls et al. 2012).

In the conceptual framework provided by economic thinking, the investors' utility function is enriched by an ethical component which, together with the degree of risk aversion, determines their portfolio of investments, including those made with a social intent.

Social investment seeks a blended return that balances the expectations of financial gain with the benefits produced in the social realm.

The new financial instruments attract a new kind of investors, who no longer passively channel their savings into securities offered by financial intermediaries, but are active and attentive, willing to use their savings only if the investment fits their set of values, and demanding greater openness and information about the investment's purpose. The desire for greater involvement and more voice concerning the social benefits of one's investments is making inroads in many quarters, particularly among highly educated, low-wealth young people (Bauer & Smeets 2015, Rossi et al. 2016).

In our view, social bonds and social impact bonds are the two major categories of financial instrument that can combine social and financial returns. The two products' common denominator is that both reflect a will to take action regarding a social issue that needs additional investments, be they public or private. Social bonds are ordinary bonds, except they come at a penalty with respect to market rates of return, and the forgone returns go into a fund which finances a project defined at the time of subscription. Example of projects that can be financed wholly or in part by this means include expanding the services offered by a hospital in the community where the subscriber lives, or a job training program for the unemployed.

[13] See, for example, Calcagno & Rossi (2011)

Though from an economic standpoint the product is an investment and, at the same time, a charitable donation, the more it is connected with a program that the community believes in, the easier it will be to place on the market. Indeed, placements of this type of bond have been quite successful (as witnessed by the UBI case), demonstrating that the demand for such products is anything but negligible. The drawback of these bonds is that they have a modest impact, in the sense that the monies devolved as forgone interest amount to only around 1% of the invested capital. On the other hand, the financial-social inclusion aspect is excellent: subscribers are well informed and whole-heartedly involved in the project, to the point of feeling that they are, in a way, active protagonists.

By contrast, social impact bonds (which are bonds in name only, as they involve a risk) are a form of public/private partnership that entails no devolution of any kind. Essentially, they place a bet on the outcome of a socially-oriented program with a high potential impact on welfare, whose success would mean savings for the community. The private capital – dormant capital, in many cases – attracted by the bonds is invested in a social program that public resources would be unable to cover.

Social impact bonds or SIBs are a very recent instrument, but they have grown apace: the first social impact bond was launched 2010 with the Peterborough experiment for prisoners in the UK, and though the project has not yet been completed, its effect so far has been positive in reducing recidivism. Thus, the empirical evidence is necessarily as scanty as the potential is wide-ranging.

The idea of the social bond is to generate a yield linked to "social" performance. For example, if the investment program's purpose is to help ex-prisoners return to the job market, the interest paid to subscribers will depend on the program's success in reaching a target defined beforehand, such as reducing the reconviction rate by a predetermined percentage. In developing a social bond, it is thus crucially important that the projects be evaluated by an independent entity.

In the case of SIBs, the program's success generates higher returns for the private investor who benefits from a welfare program that has proven effective in producing savings for the public administration.

What do social impact bonds and social bonds have in common, apart from the term "bond"? Both pursue a social aim, though they do so in different ways. Social bonds devolve for this purpose, while SIBs rely on the potential yield on a social investment. The former

are "disposable funds", as it were, whereas the latter seize hitherto unexploited profit opportunities. SIBs are very much a frontier product carrying significant risks. At this early stage, their target is not the small saver, but institutional investors who can spur the public sector to tackle potentially high-impact social issues. SIBs see the public/private partnership as a possible solution to social problems that have been intractable because of a lack of funds, but could be highly fruitful for the community. Precisely because the returns – should the public investment prove successful – would accrue entirely to the public, or in other words to the community as a whole, the private investor would see no reason to sink his own money into the initiative. SIBs thus act as a bridge, as they envisage that the public administration will return the capital and the interest on it when the program is successful, thus breaking even. Though the two products differ in intent, they can be seen as complementary means of attacking an array of chronic social problems that call for targeted courses of action, but have been neglected as a result of the lack – or indeed, the total absence – of resources for dealing with latent structural problems: women's low participation in the job market, for example. With an SIB, when an investment intended to reduce youth unemployment is successful, the interest is returned to investors in a market-based approach.

We believe that the two products are complementary without encroaching on each other: though their scope is quite different, they both fill a gap for private capital invested in social programs, with non-negligible yields. SBs, by their very nature, collect a small amount of capital which is willingly donated. Given this limit, only a much more massive initiative could reach the scale of a program capable of delivering major social repercussions. To achieve this, the public/private partnership opens up to actors of the level and caliper of the public administration and private institutional investors. This does not mean that small savers are excluded from SIBs, rather, they may indeed find that these products are an additional vehicle for their investments, though SIBs' capital requirements are such that most of the money must necessarily come from large investors. In this scenario, small savers will have a new opportunity: to participate in implementing a program that benefits the community they live in by investing in risky or risk-free financial products.

3. Advantages and potential problems of an experiment: a Trentino Bond linked to active labor market programs.

Now that we have outlined the aims and instruments of social finance, and illustrated the prospects they offer for additional, non-monetary returns, we can attempt to single out the minimum conditions for an experiment, and then examine the advantages together with the potential problems that bcan arise.

Italy's dwindling public budgets are no match for its ballooning need for action on the social plane. The current situation thus demonstrates the urgency of developing working criteria – in territory that is largely unexplored by public actors and others involved in program design and implementation – for innovative instruments for tapping and managing financial resources with the greatest possible participation by private investors. In setting up architectures of this kind, it is imperative not to lose sight of the specific content of the projects that the financial instruments are intended to serve. Nor must we lose sight of these instruments' added value, which consists first and foremost in the ability to throw light on the link between private investments, socially-oriented projects and public control – whether direct or otherwise – over every stage of the project as a whole. From this standpoint, it seems undeniable that social finance should strive for connections that can move beyond past investment methods in how they intertwine public support and modernization of the welfare system.

A connection that is indeed innovative – and the first of its kind in Italy – is that underlying a project launched in Trentino during 2017, where social finance tools support active labor and employment initiatives, or in other words, special regional-level job policy programs.

A few words are in order concerning the area where the idea was conceived and is taking concrete shape, and some of the conditions it offers which could in our opinion prove favorable in driving the growth of the new social finance instrument. Trentino boasts a long tradition in labor policies, thanks to its longstanding administrative efforts with the participation of employers and worker's representatives. It is a region with a strong sense of independence and sociotypical traits that make it a breeding ground for innovations that often anticipate and spark developments on the national scene. Specifically, the Self-Governing Province of Trento is the only province in Italy where oversight of the job market falls to a

public agency, essentially a one-stop shop. The agency is responsible for a set of wide-ranging active and passive labor market policy measures, and administers a continuum of services that provide transitional assistance to people in difficulty.

The experiment thus takes place in a setting that offers at least three features in its favor: a robust system of public governance for labor policies; a single entity (the province's Labor Agency) in which responsibility for implementing these policies is vested; and, lastly, a true employment policy plan, in the shape of a so-called working document on employment policy measures, which details the initiatives for re-employment of the jobless, transition to the labor market, work-life balance and continuing education.

The current employment policy plan contains a number of guiding principles and a set of measure whose aims include the idea of changing the welfare model. For the Province of Tento, this change is essential not only in order to make efficient use of resources, but also with a view to providing answers for new dimensions of vulnerability, which is increasingly affecting segments of the population that were once relatively secure. In recent years, moving towards active welfare has meant reinforcing the public administration's ability to respond to new needs, with synergistic services for re-employing people who are out of work, facilitating entry to the job market, helping workers balance job commitments and family responsibilities, and providing lifelong education opportunities. In concrete terms, from the standpoint of employment policy governance, it means using social plans or integrated projects as a basis for setting up personalized routes for exiting from situations of difficulty by planning and delivering active labor market policy programs that match the types of orientation, training, and support for re-entering employment.

Against a background of highly structured social and labor market policies, the Trentino experiment thus aims at identifying specific ways of supporting active welfare in the province through social finance. For a number of reasons, contingent and otherwise, the initiative has focused on the cooperative enterprises and cooperative system in the area. The problem to be solved involved multiple facets, one of which concerned the employment difficulties that have recently begun to plague a number of consortiums and several large cooperative enterprises in Trentino.

It was first necessary to gauge the actual feasibility of deploying the more exacting forms of social finance such as social impact bonds, instruments that – according to some – can both generate

economic returns and produce social value. Here, it must be stressed that social impact bonds are a type of "pay for success" investment, where the returns for the investors depend on the positive impacts of a certain social activity, usually involving partnerships between local governments, other stakeholders, third sector organizations, financial intermediaries and so forth. In this connection, then, Trentino's strong history of public involvement in the social and labor markets was and still is undoubtedly an important springboard for the project.

It must also be borne in mind that what little experience has been gained in these matters has been in English-speaking countries, whose institutions and markets are very unlike Italy's. Thus, "exporting" these instruments to an Italian setting – and to Trentino in particular – calls for careful evaluation from a theoretical standpoint as well as in terms of their concrete practicability. This means weighing the advantages and risks of designing innovative instruments of this kind in an area – Trentino – and in a sector such as that of cooperative enterprises where other instruments – that are substantially similar to social impact bonds but in many respects have a greater resemblance to social bonds – could prove more effective.

In any case, one of the primary goals of the experiment is to find new ways of providing private support in revising and applying public policies, and in particular the "active welfare" measures for finding work for the jobless or those who are risking unemployment. This goal can be pursued by shining a theoretical light on the strong points and drawbacks of the various social finance instruments used internationally and nationally, concentrating on an analysis of the alternative public/private financing models which have been found to perform best and can be concretely applied to the Trentino cooperative system (and specifically, at least at the initial stage, to consumer cooperatives). In detail, the experiment's objective is to develop instruments that can be instrumental in strategically reorienting employment policies to meet the need for innovation in managing and financing services, ensuring that the social benefits are larger than the public outlays incurred to achieve them.

The project thus combined theoretical analysis and a feasibility study with the concrete deployment of methods of raising private funding (from the cooperative system and possibly from sources outside it) for special employment policy programs that can potentially have a significant impact in the Trentino area. These methods and programs are now poised for implementation under the

direction of the most important actors and policy makers in this particular field (viz., the Trentino Federation of Cooperatives and the Labor Agency of the Self-Governing Province of Trento). Essentially, they consist of "taking charge" (through ad hoc training and reintroduction to the workforce) of people who are or risk becoming redundant to the cooperative enterprises' production processes, doing so with the participation of the local community in a spirit of mutual aid.

While the possible role of the Labor Agency has been discussed above, the partnership with Trentino Federation of Cooperatives is also important. As it represents the cooperative enterprises in the area, the Federation's involvement is essential in developing instruments for raising private investment in order to pursue programs that will have a social impact on the cooperative system. Accordingly, the Federation, like the Labor Agency, can play an active part in the initial planning stage as well as in project implementation. Its participation will make it possible to fine-tune the theoretical apparatus and deployment to the needs of the area's cooperatives.

In limiting the social repercussions of employment difficulties, the Federation, together with the enterprises it represents, can lead the way in providing support – and not only economic support – in staking out effective pathways for retraining, outplacement and reemployment of people who have been caught up in restructuring processes. These programs' contractual architecture and operational design will be set up together with the area's institutions, and will draw on the findings of the researchers involved in the project to help ensure that each program is targeted and effective.

Lastly, it should be emphasized that from the standpoint of their structural design, both social bonds and (to an even greater extent) social impact bonds are extremely articulated and complex. If the project is to find its legs, it will be essential to analyze the identity and role of each party involved in the operation.

With social impact bonds in particular, a plurality of interconnected contractual relationships is created whose ultimate purpose is two-fold, viz., for the public administration, to achieve the planned social outcome, and for the private investors, to regain their principal plus interest (Arena M., Bengo I., Calderini M., Chiodo V., 2015). As indicated earlier, these initiatives are *contractual public/private partnerships* that are not readily classified as either ordinary public procurement contracts or as service concession agreements.

Similar effort will be required in drawing up the main contract around which the entire operation revolves, or in other words the agreement between the public administration and the financial intermediary. As we have said, despite its name, a social impact bond is not a bond in the strict sense, but is a structured security containing a product – the so-called underlying component – which is linked to the performance of the planned social impact activity and thus generates a variable return. On the other hand, the nature of a social impact bond is such that the instrument will not only be placed along with others linked to initiatives tax benefits, but also and, currently, above all among complex financial products.

More generally, then, the reflection on the contractual "technology" to be employed must tie in with a reflection on the public administration's use of innovative approaches to providing a multitude of welfare functions and assessing their efficiency. The experiment can provide an eminently concrete opportunity for testing the feasibility of a model for action that, while reaffirming public institutions' responsibility for certain tasks, recasts the approaches to them in forms that are better able to achieve market-based success.

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