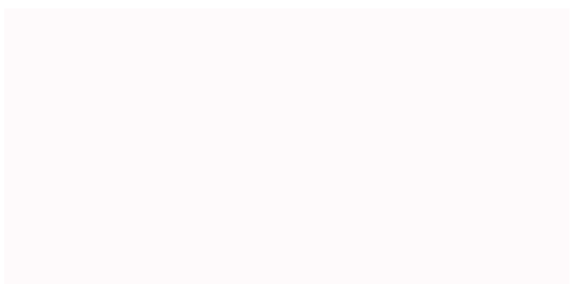




Australian Treasury Discussion Paper on Social Impact Investing
Submission from the South Australian Government
February 2017



Introduction

The South Australian Government welcomes the opportunity to provide feedback to the Social Impact Investing Discussion Paper issued by the Australian Treasury in January 2017.

South Australia strongly supports the development of social impact investment, and recently launched the first social impact bond in the state – the first in Australia to be brought to market with a specific target to reduce homelessness.

Specific responses to selected questions in the Discussion Paper are provided below.

Benefits and Challenges

Q1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?

A necessary and defining feature of social impact bonds – as articulated in the ‘Value for Money’ principle raised in the discussion paper – is that the costs of the bond (including returns to investors) need to be offset by benefits to government in the form of savings through avoided future service delivery costs.

Quantifying the extent of these benefits is often a complex task, particularly where the savings would accrue to different levels of government and/or multiple government agencies. Even deriving the cost to government of service use for an existing cohort is not straightforward, where this involves analysis of data across various non-integrated customer management and financial data systems across government. There is also some inherent uncertainty about the extent to which savings are “cashable”.

The negotiation of social impact bonds involves a significant commitment of time and some up-front costs for government, intermediaries and service providers. A practical limitation to the broader adoption of social impact bonds is that the potential benefit (reduction in future crisis end service delivery) needs to be sufficiently large, quantifiable, and attributable, in order to justify the transaction and costs and time required to develop the bond. From the South Australian Government’s perspective, relatively few focus areas have been identified to date that meet these criteria – particularly where the bond costs are fully borne by the state. Uncertainty around the future of Commonwealth funding to states under national agreements complicates this further.

All parties in a social impact bond require a level of maturity and capability to be able to negotiate a successful service model and financial structure that represents value for money outcomes for all concerned. A necessary precondition for social impact investment to be successful is that this capability needs to be built, within non-government service providers as well as within government.

Q2. What do you see as the future for social impact investing in Australia: for example, can you foresee the development of new structures for social impact investing?

The South Australian Government is closely following the progress of existing social impact investment products in New South Wales, and also those currently under development in other Australian states.

While the number of investment products that have been brought to market to date remains small, there has already emerged some significant variation in the contracting structures and financial terms. Of interest is not only the details of the financial products, but also the evidence that is being built around new intervention programs, and the methodology used in different jurisdictions to establish baseline measures and measure outcomes.

South Australia is also interested to explore different models for impact investment, particularly those that might be suited to address social problems through trials on a smaller scale.

Social impact investment allows scope for greater involvement of investors and program providers in designing interventions, and assessing their likelihood of success.

To date in Australia, social impact investment has involved a partial move towards governments paying directly for outcomes. In an ideal scenario where governments could reliably estimate (and publish) the unit costs of a social problem – and the value to government of the achievement of a social outcome – service providers and investors would have greater flexibility to propose programs that achieved those outcomes – with government payment even further tied to the achievement of those outcomes.

A key issue in the coordination of programs between governments and others is to ensure that metrics for success are well thought out and not perverted by changes to policy at one level of government or another.

Role for the Australian Government

Q4. What do you see as the role of the Australian Government in developing the social impact investing market?

Interventions to improve workforce participation and productivity would substantially benefit both Commonwealth and state/territory and local levels of government. The Productivity Commission has estimated the split of benefits across different levels of government to be 60% to the Commonwealth, and 40% to state/territory and local government.¹

The Australian Government could support the viability of new social impact investment products across Australia through:

- Providing **funding** for new investment products (either alone or in conjunction with state and territory governments).
- Providing improved **access to Commonwealth data** to understand the scale of the problem, establish the viability of a new impact investment product, and also to measure the outcomes for the intervention cohort (participants on programs financed by social impact investment).

To date in Australia, state-led social impact bonds have been fully funded by state governments, although it is expected that substantial benefits would also flow to the Commonwealth as a result of a successful employment outcome and reduced reliance on

¹ Productivity Commission 2006, Potential Benefits of the National Reform Agenda, Report to the Council of Australian Governments, Canberra, page 56.

welfare. As identified in various studies² an avoided welfare benefit payment over a number of years would constitute a highly 'bankable' saving to the Commonwealth. In such cases, a funding contribution from the Commonwealth would help to improve the business case for a social impact investment product that might otherwise be more marginal.

Such an approach, through a shared understanding of the nature and scale of the problem, would also support better articulation between programs funded by different levels of government. This in turn would support a more rigorous understanding of the value that governments might place on the achievement of better social outcomes – and as a consequence, how much governments might be prepared to pay for the achievement of those outcomes.

Additionally, the Commonwealth could assist the development of the market and new investible products by building capability and expertise in universities, so that proponents and governments could access technical skills to develop proposals. Overseas examples of this include the Government Outcomes Lab at Oxford University in the United Kingdom, and the Government Performance Lab at Harvard University in the United States.

Some of the development costs associated with specific impact investments are able to be costed into the financial product itself (this includes costs borne directly by parties to the transaction). Nevertheless, public investment in broader capacity-building is more properly considered a core role for government, in line with the broader responsibility of government to be always looking at ways to achieve better public value and social outcomes through programs that are ultimately taxpayer-funded.

Q5. Do you see different roles for different levels of government in the Australian social impact investing market? For example, the Australian Government as co-funder with State and Territory Governments continuing to take the lead in developing social impact investments?

The South Australian Government would welcome the active involvement of the Commonwealth in defining and quantifying the social problem to be addressed – and also in the identification of specific cohorts where new interventions might be trialled. (See also response to question 9, below.)

Q6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?

A social investment framework requires explicit consideration of objectives and outcomes. Traditionally, knowledge of program effectiveness is often limited by a focus on reporting and measurement of outputs and inputs, rather than outcomes. Greater focus on outcome measurement for government and non-government service providers allows for greater collaboration and flexibility in service design.

In addition, social impact bonds allow governments to share some of the risk associated with funding a program where the outcomes are unknown. This risk is shared with

² See for example:

Baldry, E. et al (2012), *Lifecourse institutional costs of homelessness for vulnerable groups*, Canberra: Department of Families Housing, Community Services and Indigenous Affairs.

Zaretsky, K. and Flatau, P. (2013) *The cost of homelessness and the net benefit of homelessness programs: a national study*, AHURI Final Report No. 218, Australian Housing and Urban Research Institute Limited, Melbourne.

investors who may have a higher appetite for risk than government – and may be better placed to price that risk. If the intervention is not effective, government’s exposure under a social impact bond is limited and will likely be significantly lower than if the program had been funded directly (through a grant or conventional procurement). On the other hand, if the intervention is effective, financing it through a social impact bond will probably involve a higher cost to government than funding it directly.

In many cases, there are already government-funded programs in existence to target the social problem, but they are not considered to be effective, or not effective for all groups of clients (in particular those with more complex needs) as traditional government procurement tends to favour lower cost per case intervention models.

The South Australian Government’s view is that the benefits of social impact investment as a financing mechanism are particularly apparent in cases where:

- A new intervention model is being trialled, where there might be insufficient evidence (at least in the Australian context) of effectiveness, to justify funding through a grant or conventional procurement of services.
- A new intervention is being used to address a ‘wicked’ policy problem – in particular, a more intensive, higher cost-per-case intervention – and the government wishes to understand how much more effective it is than previous approaches.
- Rigorous collection of data is needed to build the evidence base of program effectiveness, to answer questions such as not only “does it work”, but also “why does it work”, “does it seem to work better for some people than others”, and “for those who do less well, if certain elements of the program are tweaked, does it improve the outcomes for those people”.

Social impact investment may also potentially be more effective in cases where:

- Government lacks the appetite to take a risk on an early intervention program without being confident that it will cut future service demand (or that the additional benefits of a more intensive intervention, will be sufficient to justify the cost).
- Robust investor oversight of program service providers can replace government-run input controls on service providers.

Nevertheless, the South Australian Government is not of the view that social impact investment is a panacea for all social problems, and strongly advises the Commonwealth against any wholesale jettison of grant funding programs such as the National Affordable Housing Agreement, in favour of social impact investment.

Potential Areas of Opportunity for the Australian Government

Q7. What Australian Government policy or service delivery areas hold the most potential for social impact investing? Are there any specific opportunities you are aware of?

In most areas of social disadvantage, reducing the level of disadvantage would benefit multiple levels of government. The South Australian Government suggests that Commonwealth consideration of social impact investment be based first and foremost on

the nature of the problem to be solved, and the viability of financing an intervention using social impact investment, rather than attempting to consider a social problem as being primarily the responsibility of one or other level of government.

Q8. Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?

The South Australian Government would welcome Commonwealth involvement in discussion around social impact investment in areas such as out-of-home care (including improved transition to independence for young people leaving care), reducing recidivism, interventions to reduce inpatient demand for acute health and mental health facilities, and improved workforce participation for disadvantaged groups (including through a focus on adult literacy and numeracy).

Data Sharing

Q9. What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can the Australian Government do to address these challenges?

South Australia has participated with other states in a cross jurisdictional data linkage project led by the Commonwealth Department of Human Services to understand the differences in longer term welfare dependency for young people who were in out-of-home care as children, compared to the general population. Projects such as this can deliver valuable insights into the scale and nature of problems which state and federal governments have a shared interest in addressing.

Data insights are critical to inform where social impact investment might be applied, as well as an understanding of the benefits that might accrue from a successful intervention. Administrative data (in aggregate form) could also be used for reliable measurement of outcomes for participant cohorts in programs financed by social impact bonds.

Q10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?

The South Australian Government strongly supports the broader Commonwealth agenda to make better use of administrative data – and has recently introduced legislative reforms at the state level to make it easier to share and link data between state agencies.

The South Australian Government also supports the work undertaken by the Commonwealth Department of Social Services (DSS) to develop the Australian Priority Investment Approach to Welfare – noting that this actuarial assessment and analysis in this approach is currently limited to datasets held by the Commonwealth.

A broad-based, genuine partnership between Commonwealth, state and territory governments in terms of data sharing would recognise the equally legitimate interest of states and territories in defining and pursuing the agenda for analysis. It would involve not only states and territories supplying data to be linked and analysed by the Commonwealth, but also the Commonwealth providing de-identified unit record level data to the states, so that appropriately qualified state officers (with the necessary tools and security clearances)

could use it to develop state-level actuarial analysis to ensure rigour in the selection of focus areas and cohorts for new interventions, as well as measurement of results.

The Trusted Access Model ('5 safes') adopted by the Australian Bureau of Statistics and DSS (based on international best practice) provides a framework through which Commonwealth data could be made available to states for the purpose of this analysis.

Principles for Social Impact Investing

Q11. We are seeking your feedback on the four proposed Principles for social impact investing.

The South Australian Government supports the four principles articulated in the Discussion Paper (value for money, robust outcomes-based measurement and evaluation, fair sharing of risk and return, and a deliverable and relevant social outcome).

On the question of standing charges, the rationale for the inclusion of these in social impact bonds is to balance the sharing of risk between governments and investors. A standing charge can serve to reduce the downside risk for investors (which might otherwise need to be compensated by significantly higher upside returns, at higher cost to government, for successful outcomes).

Where standing charges are used, careful thought needs to be given to the amount and timing of standing charge payments, with regard to the desired risk allocation and required level of upside investor returns, in order to ensure that the financial product will appeal to investors (taking into account the perceived level of risk associated with program success). It is noted that there is no 'golden rule' to follow in this regard. Governments contemplating standing charges need to be assured that they represent value for money outcomes under all performance scenarios (compared to the cost of conventional funding). As the market for impact investing in Australia develops and matures, the expectations of the investor market in relation to acceptable risk and return are expected to become clearer.