

Social Impact Bonds for Youth Employment in Morelia, Mexico: A New Approach to an Old Problem

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Abstract - Social Impact Bonds have received attention across the world and in Mexico. In order to address the challenges that youth faces, the municipality of Morelia has decided to explore this innovative mechanism of financing social development.

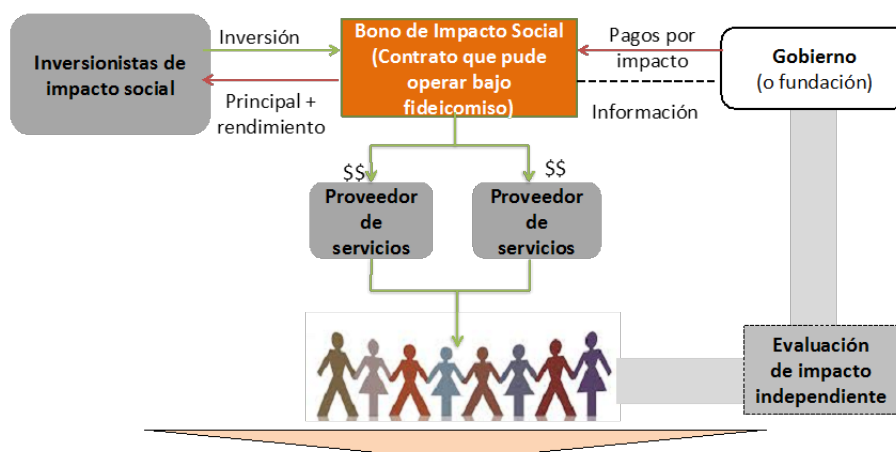
What is a Social Impact Bond (SIB)?

Social Impact Bonds are financial instruments that involve an association in which foundations and impact investors assume the risk to finance a solution to a social problem (Levey, et al. 2015). In that sense, the Government does not assume the risk of proving a new policy and only pays for success. The British organization Social Finance implemented the first SIB in 2010 to work with Young offenders coming out of prison in order to achieve their social reintegration. That SIB turned out to be very successful given that it reduced reincidence and it implied savings for the British government. The savings allowed the British government to pay the principal to investor plus a return on investment. SIBs are important financial innovation tools to the international aid system and development, because they seek to reward successful social in-

terventions (Pay for Results) and consequently encourage public and private money used for social improvement of the community to be used effectively and efficiently.

A basic model for a SIB implies that the government hires the provision of social services through a private sector intermediary. The government makes payments to investors according to the achievements. An independent evaluator measures achievements using rigorous methodologies. If the intermediary fails to achieve the minimum target the government does not make the agreed payment.

The broker obtains funds to finance operating costs through private investment funds, foundations and non-governmental organizations, which provide capital upfront in exchange for a percentage of the payments that the government will make. Similarly, the broker uses these



- Si la(s) meta(s) acordadas se cumplen, los inversionistas reciben el principal invertido más un retorno a la inversión
- Se están desarrollando más de 80 BIS a nivel mundial y Jalisco podría ser pionero en México y en América Latina en el uso de BIS

Figure 1: Operational Scheme of SIB
Source: Prepared with data from FOMIN and SF

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funds to hire service providers to deliver the interventions required to meet performance goals (Azemati, et al., 2013). It is then expected that the SIB will lead to a more efficient investment of public resources and contribute to improvements in the living conditions of the group targeted for the intervention.

When is it worth using a Social Impact Bond?

It is important to analyze when a SIB is worth implementing; the structure involved in a SIB is highly complex and thus should be used when the situation really requires it. For instance, a SIB can be considered when the prevailing policy has important constraints and does not achieve its' purpose and is expensive compared to other possible options. It is also worth exploring a SIB whenever there are policy alternatives offered by non-governmental actors and with proven results. In most cases these Payments for Success (PFS) interventions cannot scale-up due to the operator's lack of resources and thus bringing investors to the table can prove very effective.

What makes recent PFS initiatives distinctive is that they are focused not simply on creating additional financial incentives for contractors to produce better outcomes, but more broadly on overcoming the wide set of barriers that are hindering the pace of social innovation. For sure, these barriers include a lack of performance focus and outcome measurement, but they also include political constraints that prevent government from investing in prevention, the inability of nonprofits to access the capital needed to expand operations, and insufficient capacity to develop rapid and rigorous evidence about what works. In some of these new models, the amount of performance risk shifted from taxpayers to those on the hook for producing the outcomes is much greater than under traditional performance contracts, requiring the participation of socially-minded investors to make the projects feasible (Azemati et al.)

When is a Social Impact Bond feasible?

There are several criteria that have to be met in order to determine if a SIB is feasible:

1) **Clearly identifiable and traceable beneficiaries for the intervention.** The targeted population has to be identifiable along the whole program, which can in many cases last for several years. It is fundamental to be able to evaluate the beneficiaries' conditions and the performance of the program throughout the years.

2) **Robust measurable results metrics.** A rigorous impact evaluation is very important in these cases given that it defines payments from governments to investors and determines what success looks like.

3) **Programs with rigorous impact evaluation.** Providers of social services should have evaluations about their interventions and prove successful results. In that area that are still a lot of work to be done to professionalize non-governmental-organizations that are not accustomed to this kind of requirements.

4) **Priority topic for investors.** In order to be able to obtain the initial investment, the problem that the SIB wishes to address has to be considered as a priority for the social the impact investor community, as well as other more traditional financial entities.

5) **Priority topic for governments.** Governments need to be involved to increase the probability of success of a SIB so it becomes vital for the bond that the problem to be tackled is considered relevant and significant.

6) **Effective cost benefit program.** SIBs need to imply savings for governments and ultimately taxpayers. The idea is to have a better, proven and cheaper intervention. The returns to investors will then come from the savings that the bond has allowed. In many situations the business case for the SIB can address preventive actions, rather than remedial.

The evidence of employability Bonds

More than 10 SIB on employment for Young people in the world have taken place, mainly in the UK. One of the most successful SIBs took place in London to address young people with high risk of unemployment and school dropout. An investment of £900,000 targeted 950 young persons. The SIB began in January 2012 with a 3-year duration and a return on annual investment of 3% at the end of the program.

The department of work and pensions developed proxy metrics to measure the increase and sustainability of future employment. Metrics included attendance and school performance, behavioral changes, improvement in abilities, learning of skills and employment. The Department of work and pensions established payments for each percent increase obtained and declared at the end of the project that they had saved £40,000 per student.

Overall the results were quite successful. Among them, 91% of the young that participated in the program have

a job or are in an employment training, 85% improved their behavior and scholar attendance, 72% reached good grades in standardized tests, 21% obtained a job through the organization ThinkForward who was in charge of the intervention and finally 24% got admitted to higher education.

The issue in Morelia and the case for a SIB

The city of Morelia is the capital of Michoacán, a federal state of Mexico which has been in the international headlines because of the problems of organized crime and violence for the last 15 years: Human heads dumped at public places, grenade attacks, armed self-defense groups claiming to liberate their communities from organized crime, public video revelations about the infiltration of organized crime in the local public administration. Meanwhile atrocities of executions, murder, kidnappings and forced disappearances of persons continue.

In response to the unfolding security crisis, the federal government in coordination with the military set up a special commission which has coordinated police operations and social and economic programs throughout Michoacán with considerate progress. These efforts contributed to the significant decline of the intentional homicide rate in Morelia, Michoacán's capital which dropped from 27.3 per 100,000 inhabitants in 2013 to 19.8 in 2015 .

Other incidences of violence and crime have also been in decline. According to the Consejo Ciudadano de Seguridad Pública y Justicia Penal, in 2012 Morelia was leading national crime statistics on extortion and kidnapping. Three years later, it appears that Morelia is recovering from those situations (Figure 2).

Figure 2: Crime reports in Morelia (2000 – 2015)

	2000	2006	2013	2015
Crime reported to the authority	8,376	12,076	13,662	10,676
Burglary and robbery	3,468	6,634	7,910	6,116
Injuries	1,350	1,210	1,150	1,364
Intentional homicide	33	77	199	152
Extortion	25	25	85	6
Kidnapping	17	54	96	7

Source: Elaborated with data of Morelia Como Vamos and Secretariado Ejecutivo del Sistema Nacional de Seguridad Pública (2016)

According to official data, the most affected population group by the violence has been young men between 15 to 39 years old. Over the past 10 years, an average of 34.7% of young men between 15 to 29 years were deprived of

their life by homicide (Figure 3).



Figure 3: Homicide registered in Morelia (2005-2015)

Source: Prepared with data for INEGI (2016)

Besides the public safety crisis, Morelia has undergone significant urban governance transformations and has faced economic development setbacks, which have especially impacted its youth. Between 1975 until 2000 the surface of the city has been growing 91.6% (Alvarez 2011). The population has been doubled from 353,055 in 1980 to 729,279 in 2010 (INEGI 1980, 2010). The age group of 15 to 29 years old has increased about 35.2% over the past 25 years. This added social and economic pressure on the city.

From 2002 to 2013 Morelia suffered a severe economic downturn which has impacted in employment opportunities and the business community. Based on Mexican Statistics Office' macroeconomic data, the total value added of Morelia's economy crashed from 29 billion pesos in 2003 to 14.22 billion pesos in 2011. With regard to the labor market, only 51.4% of the economically active people has a formal fulltime job. The unemployment rate increased from 4.2% (2005) to 5.19% (2016) (INEGI, 2016). According to national estimations by INEGI, the unemployment rate of youth between 15 and 19 years and those between 20 to 24 years has been around 8.6% and 8.3%, respectively. INEGI also estimates that 68.1% of the young people in Mexico works in the informal sector – exposed to minimum wages, lack of social security and labor exploitation.

Besides all those vulnerabilities, we identified in a recent study that youth of Morelia is eager to have their own commercial ventures. 8 in 10 young people would like to have their own business in the future. They consider that they have the ideas and skills to do so. We also asked for the motives of starting their own business. On one hand they referred to the necessity of an extra income and difficulties to find a job. On the other hand they emphasize their need to be independent and search for opportunities to apply

their skills and knowledge. With regard to their vocational orientation, more than 23.1% of the interviewed young people would like to be a trained professional with an undergraduate degree (Vorndran, 2016).

Outlook

The Mayor of Morelia, Alfonso Martínez Alcazar, has set out employment and young people as a priority of its administration. Aware of the federal, state and local budget restraints he has approached national experts and Tec de Monterrey's School of Government to explore new mechanisms of financing social development based on concrete results. After an initial capacity building of his cabinet members about SIB and analyzing its pros and cons, his administration decided to proceed with the development of an initial concept about youth and employment in order to study the feasibility of an SIB.

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