Response Paper
by
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1. INTRODUCTION

First, I would like to thank the members and Directors of the Fondazione Centesimus Annus Pro Pontifice for the invitation to participate in this consultation. I would also like to voice my appreciation to our hosts – the Central Bank of Malta and its governor, Governor Bonnici. It is a personal honor to be invited to join the discussions with such an illustrious group. Second, as a matter of protocol, I would like to emphasize that the opinions expressed herein belong to me. They in no way, shape or form constitute any official or anticipated policy position of the Government of the United States or the United States Department of the Treasury. These views are mine and mine alone.

In his paper, Governor Bonnici has proposed an intriguing concept which speaks to a question of how organizations can better aggregate financial resources to tackle large-scale social issues, foremost among them, rising inequality.

The threat of rising inequality has been debated in academic and applied economics for decades, but has moved into the broader public-public lens of debate following increased popular scrutiny in the wake of the Global Financial Crisis. The renewed interest has no doubt been hastened by recent popular scholarship, such as Thomas Piketty's groundbreaking (and
controversial) *Capital in the 21st Century*. Elsewhere, Oxfam\(^1\) and *The Economist*\(^2\) have jointly noted that 2016 holds the prospect of becoming a watershed moment: for the first time, the richest 1% of the world’s population will enjoy a greater share of global wealth than the other 99% of the population. If unaddressed, this divergence is expected to continue in years to come. Such trends are helping drive an emerging consensus surrounding a key claim of economists such as Mr. Piketty and Governor Bonnici: inequality is undoubtedly on the rise globally, and “inequality discourages investment, and consequently growth, by creating economic, financial, and political instability” in addition to risking a multi-generational disadvantage transmitted down the generations (Bonnici, 6).

It is into this economic environment that Governor Bonnici has proposed the framework for a potential solution: could a voluntary solidarity fund (VSF), undertaken with the aims of Catholic social doctrine and with the imprimatur of the Catholic Church, serve as a vehicle to accumulate financial resources and fund programs intended to combat inequality and build sustainable economic opportunity.

There are other examples of similar mechanisms with narrower scope elsewhere. For instance, in 2002, a European Union Solidarity Fund (EUSF) was established to respond to natural disasters and support emergency response efforts in disaster-stricken regions within Europe. This most recent proposal for a VSF even contemplates adapting strategies which have proven successful for other players in the impact investment community, from foundations (e.g. Gates Foundation, Clinton Global Initiative), to multi-laterals (e.g. the World Bank, The EIB) to traditional banks (e.g. J.P. Morgan Social Finance Unit).

The idea also appears at a fortuitous time in the world of philanthropic and charitable giving. Financial innovations driven by a combination of increased financial literacy, tax policy, declining transaction costs, and technological innovation are transforming the manner by which donors and beneficiaries can interact. So the odds are good that a FCAPP-backed VSF could find an important role in tackling inequality. However, the establishment of a VSF does raise some important questions related to policy and operations.

This paper will explore some of those questions in hopes of seeding future discussions as the idea behind a VSF matures and gains momentum. The questions explored examine three key areas. First, how would a VSF fit into the constellation of charitable entities, and what crowding effect might it create? Second, what would the scope be for the VSF; how would its mission, vision and values shape the projects it undertakes? And finally, how can early seed


capital be leveraged, what might demand look like, and what role could technology play in facilitating capital accumulation from small donors to augment traditional “leadership gifts.”

2. ESTABLISHING & SEEDING THE VSF

“To bring together a number of middle to high net worth individuals, including prominent individuals that embrace the concept of solidarity being propelled by the Foundation.”

– Governor Josef Bonnici

Since the 1970s, the rate of individual and institutional charitable giving has increased dramatically in many developed countries. In 2010, it is estimated that total contributions to charity by individuals, corporations, foundations and through bequests totaled some $296 billion in the US alone (Andreoni/Payne, 6). Meanwhile, the rise of giving over the past few decades has coincided with a proliferation of non-traditional entities as recipients, specifically foundations such as the Gates Foundation, the Clinton Global Initiative, the Buffet Foundation, and others. Between 1999 and 2009, America’s IRS recorded a 54% increase in the number of registered foundations, to more than 120,000 (Andreoni/Payne, 8). Individual givers in the US still account for some 75% of giving; foundation giving has grown dramatically, however, and now accounts for around 12% (List, 160). However, despite still comprising a majority of donations, the share of giving by private individuals has actually declined in recent years while giving to foundations has increased. And foundations also by and large benefit from giving initiated by what in industry parlance are termed high-net-worth (HNW), ultra-high-net-worth (UHNW), and international affluent clientele. As noted by Andreoni and Payne, "The largest recipient of charitable donations are religious organizations. These gifts come largely from the lower income individuals. If one studies individuals that gave more than $1 million [USD], their gifts go mainly to education and health organizations" (Andreoni/Payne, 7). They further suggest that although data is incomplete, this indicates a trend whereby "higher wealth individuals ... choose to first direct their giving to a foundation and then use the foundation as a vehicle for giving to charities" (Andreoni/Payne, 7).

Foundations generally enable givers to dedicate money towards narrow programmatic purposes. The largest announced bequest of 2015 – the Zuckerberg announcement to gift 99% of his holdings in Facebook over time, at what was then an unrealized fair-market-value of $45 billion – has not been publicly allocated to any foundations yet (though the Zuckerbergs have indicated an intent to do so). Other large announcements, however, have been specifically allocated for foundation-based charitable activities. For example, the next-largest gift of 2015
was that of American businessman John Santikos, who left assets and cash worth some $605 million USD to the San Antonio Area Foundation to "create a fund that will support five causes: people in need, especially the elderly and victims of child abuse and disasters; youth and education; public libraries, parks, and museums; health care; and medical research." Such examples validate the long-standing truism that such giving often affords wealthy individuals “substantial tax and other benefits in addition to the satisfaction of knowing they have helped others” (Hallman/Rosenbloom, 453), a phenomenon which social impact economists have dubbed the “warm glow” effect (Andreoni/Payne, 12).

In light of these trends, it seems that a VSF could fill the gap that appears to be emerging between traditional religious charities and foundation-based giving, offering a foundation-backed mechanism which simultaneously aligns with religious doctrinal values. Additionally, the strategy of approaching a coterie of wealthy potential givers to secure so-called “leadership gifts” – gifts which would seed the VSF, build momentum and establish initial credibility – is a common-practice with demonstrable success elsewhere in the world of social-impact investing (List, 158). Notwithstanding, there are some questions which naturally follow from this approach. Foremost among these would be how the VSF would co-exist with other charities.

Governor Bonnici had cited several organizations who today operate in the social impact arena, from the Gates Foundation, to the World Bank, to the European Investment Bank. National governments continue to play a critical role in funding for public goods, a trend which may shift as countries re-balance fiscal portfolios following the Financial Crisis. As the universe of charitable options increases, social impact economists have noted that "crowding out" is a concern when it comes to balancing public- or private charitable giving. Would there be a risk of “crowding out” if a VSF were launched alongside other foundational giving? Would donors to the VSF therefore be less inclined to continue existing patterns of giving to other charitable recipients? And specifically, how would this FCAPP-backed VSF stand in relation to other Catholic-based or religious charities (e.g. Catholic Charities USA, etc.)? Could the VSF be undertaken in such a way that it did not crowd out charitable giving to other entities?

As a counterpoint to the “crowding out” effect, a VSF operating under the aegis of the Catholic Church could present an attractive potential partner for social investment organizations and institutions. There also seem to be areas where a VSF could benefit from agglomeration effects and economies of scope/scale, operating alongside other established players such as the Gates Foundation. Would a VSF backed by the creditworthiness of the FCAPP or the Catholic Church have the potential to “crowd in” charitable giving from other foundations or governments, creating mezzanine financing for programs?

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3. ESTABLISHING SCOPE OF THE VSF

“A solidarity fund on a voluntary basis and motivated by the moral standards of the individual’s conscience, with the central objective of reducing income inequality by enabling individuals to better their capacity to participate in the economy and earn a dignified living through their work.”

– Governor Josef Bonnici

Governor Bonnici has articulated an approach to establish and quickly capitalize a VSF, as well as an overarching thematic mission for the fund. This naturally raises a question which faces “social impact investing” today and which is not dissimilar to a question faced by any investment fund: what types of investments would the VSF consider as part of its portfolio approach? This is driven in large measure by the intended scope of the fund as well as the overall risk appetite for making investments.

Many charities and public institutions have traditionally tended to focus narrowly on grant making. However, the landscape of products and players has changed dramatically in recent decades. Many product offerings from the world of capital markets have been adapted to the world of charitable giving and “social impact investment.” As Lester M. Salamon has noted, this has been primarily characterized by a movement “beyond grants,” leading to the deployment of "a variety of new financial tools for promoting social purposes – loans, loan guarantees, equity-type instruments, securitization, fixed-income instruments, and most recently, social impact bonds.”

Consequently, would the VSF focus be on traditional endeavors such as “vanilla” grants? Or would the VSF aim towards more exotic efforts “beyond grants.” For instance, might the VSF engage in microfinance lending to spur on local development projects as a way to tackle inequality at a grassroots level? Would the VSF engage in a private-equity model akin to the European Investment Bank (EIB) or the International Finance Corporation (IFC), vetting project proposals against mission, funding programs in exchange for an equity position, and providing technical, advisory and compliance oversight to ensure performance? This question of scope is critical. As some scholars have noted, empirical evidence suggests that institutional and wealthy donors have taken a narrow approach to giving vis-à-vis charitable scope. “If one

studies individuals that gave $1 million [USD], their gifts go mostly to education and health-related organizations” (Andreoni/Payne, 7). Would these donors – those most likely to provide “leadership gifts” – be more or less inclined to support a VSF which engaged in more risky capital market-like activities? Or, would there be a bias from this community towards grants, a more conservative approach which minimizes potential losses to the social investment portfolio? The creation of a Competitive Landscape Analysis as part of the VSF “business case” would be valuable towards answering this question and surveying the interest-level of potential donors. And once an appetite for social impact targets and potential programs is determined, it is then about establishing measures for success.

Governor Bonnici has articulated a meaningful thematic mission and vision: to reduce “income inequality by enabling individuals to better their capacity to participate in the economy.” So in this age of heightened transparency and oversight, how would we measure progress towards this objective? How would we measure this “social impact?” These questions must be explored at the initiation of the VSF, since they have significant downstream effects on the guiding framework for how the VSF vets, funds, and oversees projects.

Key Performance Indicators (KPIs) in grant-making have long been a vital tool for measuring success, and various methodologies have evolved over time into various governance and oversight frameworks. In the United States, for example, the Council on Financial Assistance Reform (CoFAR) recently published a wholesale revision to the key governing administrative and oversight framework for grant-making governmental authorities, “2 C.F.R 200: Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance).” In the arena of social impact investing, however, comparable paradigms for performance measurement remain somewhat elusive. As William Burckart has noted in *The Stanford Social Innovation Review*, “impact measurement has arguably become the third rail of impact investing. A solution beyond a focus on metrics has thus far been elusive, raising the risk of counting jobs when the goal is really empowerment or counting houses when the objective is building a community.”

On September 30, 2015, Goldman Sachs hosted a “Talks@GS” conversation in London with the Most Reverend and Right Honorable Justin Welby, the Archbishop of Canterbury entitled “The Role of Religion in Modern Society.” The Archbishop Welby emphasized this point by noting that modern religions really need to focus on prioritizing efforts, on deciding what can reasonably be achieved, but most importantly, they needed to keep their focus on the

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long-term. How the FCAPP defines “inequality” will have a material impact on which types of projects are undertaken and ultimately, how positive outcomes are measured along this line of what can reasonably be achieved.

Traditional views on inequality have emphasized creating employment opportunities, improving access to education, and reforming a more redistributive tax policy as potential solutions. That is not to say, however, that these are not the only potential strategies to tackle inequality. Other potential avenues include microfinance and small-business lending; improving access to basic health-care; improved infrastructure and access to digital platforms; providing additional social safety net programs (e.g. school lunch programs); or even helping support labor mobility (e.g. job training, cross-cultural skills training, up-skilling for aged populations). The VSF might look to fund programs along any of these approaches, particularly ones where existing foundations and charitable endeavors have a limited presence.

Time must also be dedicated to defining what outcomes are being sought by the investment. Who will be the recipient of the funding being provided? What is the intended impact or change desired from this assistance being provided? The VSF also needs to consider its ongoing role to provide oversight, technical assistance, and compliance to ensure metrics are achieved and course corrections are undertaken when needed. Managers of the VSF also should think carefully about what Compliance role it could play to ensure programs implement effective accounting and internal controls to prevent potential malfeasance, waste, fraud, or abuse of VSF resources.

This paper is not an appropriate forum for undertaking all of these time- and thought-intensive tasks. Such scoping requires a wide net of stakeholder feedback and a significant investment of time. But for the purposes of this discussion, suffice it to summarize by saying that the stakeholders and management of any VSF will need to dedicate considerable time defining (1) what “success” looks like, (2) how meaningful data will be gathered, and (3) how social impacts can be quantified and measured in a transparent and compelling manner which benefits both contributors to and beneficiaries of the VSF.

4. LEVERAGING CAPITAL, TRANSPARENCY & TECHNOLOGY

There are a few other concepts which could play a vital role in the success of the VSF. Governor Bonicci has already noted one of these concepts as a longer-term potential goal of the VSF, to “at a future date ... also issue its own bonds rather than rely purely on contributions from individuals” (Bonnici, 9). Historically, institutional investors – for instance, pension funds, insurance firms, etc. - have sought to invest in AAA/aaa rated debt, including sovereign bonds, investment grade private corporation issuances and bonds issued by Government Sponsored
Entities (GSEs) and backed by stable asset classes, such as residential mortgages. Two prime examples of GSEs in the United States have been the mortgage giants, Fannie Mae and Freddie Mac. In the aftermath of the Financial Crisis and post-Conservatorship in the United States, those firms have been reducing the volume of debt issuance, leading to upward price pressure on existing issuances. This has caused institutional investors to seek new sources of stable, highly rated debt for the purposes of portfolio diversification. The market for so-called “supranational” bond issuances has been growing in recent years, particularly as investment authorities seek out AAA/aaa rated bonds that offer limited risk along with stable returns on investment in a low-interest environment. Meanwhile, legal changes have helped facilitate the connecting of debt issuers with a new panoply of institutional investor.

In the United States, as one sample case, legal changes in the State of California have allowed municipal authorities to begin adding "supras" to their investment portfolios for the first time. “Supras” offer an attractive and stable investment vehicle for many portfolio managers, and demand has been robust so far. In 2013, the World Bank raised $30bn USD; in 2014, the European Investment Bank (EIB) raised €61.6bn EUR. There may be obvious differences between traditional “supranationals”* and both the Catholic Church and the FCAPP. However, as an organization with broadly diversified collateral holdings, a global reach, a membership base in excess of 1.2 billion, and a tradition of creditworthiness, there are many good corollaries that would be attractive to this community of institutional investor. Therefore, how appealing would a VSF backed by the creditworthiness of the FCAPP or indeed the Church itself be to such investors?

As Governor Bonnici similarly notes, the approach obviously requires more analysis of potential legal limitations as well as the appropriate organizational structure. It also still remains to be seen what supply and demand would look like in an environment of rising interest rates. However, if the experience of other similar social impact entities is any indicator, properly marketed, this could be an excellent opportunity to tap into capital markets and lever up the “leadership gifts” that seed the initial VSF. And again, transparency will be key for courting investors during the sales and marketing cycle. The ability to articulate programmatic key performance indicators (KPIs) and report on historical program performance will be essential.

Another critical notion will be deciding whether the VSF would have its own proprietary investment strategy for un-deployed capital, thereby maximizing value by generating additional returns. This is a common feature of many public-sector trust funds, and would serve a point raised about putting funds to use instead of “leaving them idle in some bank account or worse stashed in some safety deposit box” (Bonnici, 9). Yet beyond debt issuance and proprietary investing in the capital markets, another potential avenue to tap into vast aggregate giving is the emerging world of social media-based giving.
In the past five years, we have seen the merging of social media platforms with philanthropic endeavors giving rise to a new conduit for charitable giving: so-called “crowdfunding.” There are now dozens of platforms in this space, names that are quickly entering the international lexicon of “social impact investing”: Crowdrise, Kickstarter, GoFundMe, Rockethub, and Indiegogo, to name a few. These platforms cover the gamut of “social” giving, from entrepreneurial investments, to proto-“Angel” investing, to event-driven philanthropic giving, to broader charitable giving. However, the power, symbolism and sheer volume of such examples cannot be denied.

In 2010, for instance, following mass devastation caused by Superstorm Sandy on the east coast of United States, the Red Cross reported that 20% of the millions of dollars collected for storm relief had been raised via SMS messaging, comprised of small, individual pledges of $10 USD. As another example, in 2014, the site GoFundMe processed $470mm USD in social impact donations from a population 6,000,000 of individual givers. And very recently, just on 20 December 2015, a new independent group named “The Compassion Collective” comprised of five (5) women authors with no specific fundraising background, using only Facebook and PayPal, launched an effort to raise $1 million for the Syrian Refugee Crisis. They accomplished their goal in 31 hours by aggregating individual donations of $25 USD or less. The Economist predicts that in 2015 global crowdfunding reached $34 billion USD, “and in 2016 will surpass the annual money committed by investors to venture-capital funds globally.”

The economics of crowdfunding and social media-based giving is still in its infancy. There is also a fundamental difference in acute, crisis-response giving versus more traditional giving patterns. But, these platforms could also provide a third pillar of support to fund the VSF. Such technology platforms may offer promise of lowering the cost of reaching out to potential givers, and lowering the barriers for them to give, thereby lowering the overall transaction cost of donations. Could social media or “crowdfunding” platforms provide a low-

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cost, automated method to tap into the aggregate giving power of smaller contributors, and thereby leverage the flock?

And of course, in addition to all of the above points, national governments are regularly examining tax and fiscal policies in an effort to determine whether there are opportunities to encourage more charitable giving. However, this particular discussion topic warrants a broader investigation with experts better versed and authorized to speak about such potential policy adjustments.

5. CONCLUSION

The concept of an FCAPP-backed Voluntary Solidarity Fund (VSF) presents intriguing ideas about ways to tackle growing global inequality. Underpinning the proposal is a sense that the FCAPP –indeed, the Catholic Church itself – could be best positioned to play key thought leadership and operational roles by adapting the tools of traditional investment finance. This just might be a seminal moment to undertake such an endeavor.

In December 2015, His Holiness Pope Francis, as the ecumenical head of the Catholic Faith, was announced as the 2016 winner of the Charlemagne Prize. In reporting on the prize, The Economist noted that the decision was based largely on the Pontiff’s steadfast emphasis on transcending a normal economic model of human interaction in favor of one more humane, more just, and more dignified. "They cite his oft-stated belief that Europe must be based on ideals, not economic calculation: above all the ideal of the sanctity of human life. For example, the pontiff reminded the European Parliament about a year ago that "at the heart of the (European) project was confidence in man, not so much [in man] as a citizen or an economic agent but in men and women as persons endowed with transcendent dignity."11 The Economist further noted in heralding the win that Europe most needs "strong, job-creating economies."

This vision for a VSF could play a crucial part in that agenda, helping to redress issues of inequality such as expanding access to affordable health care, expanding access to primary and secondary education, even vocation-based training, and tackling issues of infant mortality. As Governor Bonnici has shown, the notion of a VSF is ripe with potential, and as this paper has endeavored to demonstrate, there are multiple avenues worth exploration in order to help bring that vision into reality.

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REFERENCES

