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Curiosity, Caution and Social Impact Bonds

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There is an increasing interest in the *Social Impact Bond (SIB),* or as some are preferring to call them, *Pay for Success*. The latter name is being used by some in response to the criticism that SIBs are not bonds as these are normally understood to be. *Pay for Success* implies that government only pays when interventions are successful. For the purpose of this paper the reference will be to SIBs given that it is the name most widely used.

The concept behind SIBs is that private investors will contract with both government authorities and service providers to achieve specified and measurable social outcomes. The first of these arrangements was established in the United Kingdom (UK) as part of the Big Society agenda. The conservative UK government was happy to support a SIB projected to minimise the recidivism rate at a prison in Peterborough. The program was expected to cost $US8 million over six years. The most recent information is that the program is struggling to meet its outcomes.

The number of SIBs in the world is still relatively small. The most recent figures, according to international social development group *Instiglio*, as at January 2016, show that there are 31 SIBs in design stage and 48 at implementation stage. The UK and the United States (US) account for 66 percent of the total number of SIBs in both the implementation and design stages. The number drops rapidly in Eurasia with only 15 SIBs and South America with only five. Australia has two in implementation stage and one in design phase. *(Instiglio 2016)*

SIBs arose primarily in response to the economic downturn and financial stress that resulted from the world financial crisis that began in 2008. Not for profits struggling to attract donors to their causes and cash impoverished governments looked for alternative sources of funding.

> *Cash-strapped governments quickly became sold on the concept that they can use private money from investors for preventive social programs -- money the government will have to pay back only if the programs produce the desired measurable outcomes. (Farmer 2015)*

Given the lack of 'safe' investment options worldwide such arrangements were also attractive to investors that could potentially make returns from 7-15 percent. The Rikers Island Prison SIB mentioned below was intended to provide the investor, Goldman Sachs, with a 22 percent return.

The idea of forestalling expenditure of money on social programs and only paying for those that achieve predetermined results is very attractive to governments. Government entities in the US were quick to want to imitate the Peterborough experiment. The city of New York launched an extensive program at its Rikers Island Prison intended to reduce the amount of reoffending once prisoners were released. Success would be determined by a reduction in recidivism of 10 percent over four years. The initiative was primarily funded through Goldman Sachs with a $US9.6 million investment. It had been convinced by academic evidence that the program would work. A preliminary report three years later showed that the program had no effect and Goldman Sachs moved to rescind the contract one year ahead of time.

Recently the New South Wales (NSW) Government announced that its *Newpin* SIB had successfully achieved its desired outcomes. *Newpin* is a service that provides intensive support to improve parenting and thereby reduce the number of children taken into care and retain family cohesion.

> *It is a program with a solid evidence base and track record of successfully restoring children to their families. (NSW Premier and Cabinet 2016)*

The government announced that the *Newpin* program had achieved a cumulative restoration of 61.6 percent compared to a baseline of 25 percent. Consequently, the investors would receive a 7.5 percent return in the first year and 8.9 percent in the second. NSW has also established a $10 million Benevolent Society Bond to be delivered over a five year period.

An attempt in NSW to establish another SIB in regards to recidivism was abandoned.

> *The decision not to proceed was based on the aggregate challenges and risks of the proposed model, including the evolving nature of the justice and corrective services policy environment. (NSW Premier and Cabinet 2016)*

For supporters of SIBs, the model is seen to be a new way of funding social services as it has the capacity to attract new capital for programs. They argue that by making outcomes the basis for financial reward, greater efficiency is achieved. It is widely perceived that SIBs provide the impetus for innovation and achieve greater effectiveness due to the pressure to attain specified results. These perceived attributes are reflected in the reasons given by the NSW government for its involvement with SIBs.

The government believes that SIBs will:

- *Shift the focus onto outcomes rather than outputs*
- *Direct additional resources towards early intervention*
- *Encourage innovation*
- *Improve the evidence base*
- *Ensure accountability and transparency (NSW Premier and Cabinet 2016)*

Non-Government Organisations (NGOs) may see SIBs as an opportunity to attract new funding streams, especially at a time when donations are down and government funding is questionable. The possibility of long term contracts of five or more years is also an attraction. The financial risk to NGOs appears minimal as it is the investor's money that is at risk if outcomes are not achieved.

A number of governments are interested and keen to promote the concept, especially at a time of budgetary constraint, as they see it as a way of attracting private investment into an area that has been traditionally their responsibility to fund. They may see such funding as ultimately replacing their involvement in large tracts of social expenditure and help to achieve 'small government'. It's also a funding strategy that precludes immediate outlays of money. The fact that they only repay the investors' outlay with an additional interest payment, if agreed outcomes are met, is an additional attraction. There is another upside for government in that even if agreed outcome levels aren't achieved some social services are likely to have been delivered.

On first glance there would appear to be good reasons to support SIBs. However, SIBs are not as simple as they may at first appear and their effectiveness and relevance to the delivery of long-term social programs are not as clear as one might expect. Their promise to governments of a cheaper and more effective alternative to traditional means of social service delivery is also yet to be confirmed. The desirability and effectiveness of SIBs is viewed by many as questionable with the outcomes publicised by their proponents being highly suspect and backed by little evidence.

The hope that such programs will be a cheap and relatively simple option for governments is dubious. If the SIB successfully reaches its outcome targets the government will need to repay the investor outlay with an additional return which, as has been mentioned above, can be substantial depending on contractual arrangements. In the event that outcomes are not met there is the expectation that government will pay nothing. However, the reality is that contractual arrangements of this type are often complex, with some contracts being as long as 200 pages, and a legal minefield. To expect that investors will simply walk away from such contracts without making every attempt to argue for the return of some if not all of their investment is stretching credibility. RAND Europe, in its independent evaluation of the Peterborough SIB, found that in regards to the contractual content:

> "…*the SIB raises some complex contractual issues and involves many different stakeholders…complexity in some instances meant that the actual transfer of risk is not clear." (RAND Europe 2011)*

Governments and service providers need to be cautious in entering such arrangements.

> *"…these endeavours in financial creativity may become expensive experiments that leave governments with the ultimate risk and providers with broken and contested contracts." (McKay 2013)*

Added to the possibility of governments needing to pay, with an additional return to investors, for successful SIBs are the indirect costs of such agreements. The NSW Government spent two years, at substantial cost, establishing the contract related to the *Newpin* SIB. Federal Minister — Scott Morrison, when he was minister for Social Services, stated that the Australian Government intended investing $20 million to develop a framework for SIBs. In addition to Government's costs are those of both private investors and service providers as they prepare and negotiate such complex deals.

The administrative and legal expenses associated with establishing these projects, along with the cost for independent assessors and ongoing bureaucratic monitoring, are largely hidden and raise questions as to how advantageous to the taxpayer SIBs actually are. Kyle McKay, a policy analyst with the US State of Maryland's General Assembly, recommended against the establishment of a SIB in regards to prisoner recidivism. His analysis concluded that *"the costs (of the SIB) did not stack up.*" He believed that if the benefit of SIBs could not be justified in the area of justice then it was unlikely that they would be of value in regards to other, more unpredictable, areas of social need. *(McKay 2013)*

The attractive idea that SIBs bring additional, new capital for social programs is highly questionable. The reality is that governments will ultimately be funding any program that proves to be successful and pay an additional premium in the process. Consequently, this is not adding 'new money' but simply creating a new process through which government pays for services. That it doesn't pay for an unsuccessful program is little consolation as the ultimate aim of governments becoming involved with SIBs ought not to be to save money or engage in a funding experiment but to create effective and efficient social services. Saving money from ineffective service delivery is a waste of resources and time. The following quote in regards to SIBs in Latin America speaks to their deficiency in this area:

> *"It's a problem, because it doesn't resolve the underlying issue," Martha Juárez, an activist with the Consortium for Parliamentary Dialogue and Equity Oaxaca, which works for women's rights in southern Mexico, told IPS. "There are no real savings and there are doubts about efficiency. That money should be used by public institutions to directly address problems." (Godoy 2013)*

That SIBs will provide capital for innovation is not supported by the facts. In every instance where a SIB has been implemented it has been based on the existence of an already proven, effective program. Investors are very unlikely to risk their money on unproven and 'blue sky' ideas. The NSW Government provided investors involved in the *Newpin* project with attractive conditions to allay their reluctance to invest.

> *The Newpin SBB (Social Benefit Bond) will pay a minimum coupon of five percent per annum over the first three years. The Newpin SBB also provides the benefit of a degree of capital protection; during the first four years any loss of principal will be limited to 25 percent and after the fourth year principal loss will be limited to 50 percent. (SVA 2013)*

These are not typical conditions for SIBs where investors are not generally guaranteed protection of their investment, irrespective of outcome. One can only presume that the NSW

Government was willing to underwrite these benefits to ensure the establishment of their first SIB. This raises the issue of how far a government would be willing to go to make SIBs attractive to investors. Governments are equally very cautious of taking on uncertain ventures. The NSW Government did not proceed with the proposed recidivism SIB (already mentioned) because of the uncertain environment in which it was to be established.

Most NGOs would need substantial seeding money to be able to create new service responses that are proven enough to attract SIB investment. This is likely to mean that SIBs will remain primarily an avenue for funding for those few organisations strong enough to garner research and development money. Social interventions that have rigorous evidence of their effectiveness, enough to convince investors, government and service providers to engage in a complex contractual arrangement, would seem ripe for traditional government funding that avoids the difficulties and additional costs invariably associated with SIBs.

There is a presumption underlying all SIBs that they, of their very nature, are likely to be far more efficient and effective than current forms of funding. Supporters of SIBs propose that the involvement of private financiers seeking to protect and gain from their investments will create the conditions for efficient and productive service delivery. However, there is little hard evidence that this is so. The privatisation of childcare and the disastrous failure of ABC Learning Centres in 2007 demonstrates that successful and sustainable service delivery is not always associated with commercially backed social initiatives. Over the years, there have been numerous research papers and reports that have shown the economic savings of government sponsored social programs. However, these have been unsuccessful in convincing treasury departments to adequately fund much needed social services. Programs that are directed by government can be equally efficient and effective as those delivered by private enterprise.

> *People often claim, with or without supporting evidence, that governments are always poor at doing their assigned jobs…but when economists study the ways private and public enterprises carry out the same tasks they often find negligible difference. (McAuley & Lyons 2015)*

The claim made by SIB advocates of greater cost efficiencies and better service results than current services have no credibility unless there is evidence through rigorous comparison with existing, effective government/philanthropically funded programs. Without such a thorough cost/benefit analysis there is no reason to believe that SIBs provide any financial and/or service advantage to taxpayers. What is interesting to note, is that while traditionally some governments have largely emphasised the cost of the social programs they fund, these same governments are keen to assert the savings made by SIB social interventions. This is all the more remarkable given that many of the programs established through SIBs are similar to existing services funded through government or other means. It suggests that those governments keen to promote SIBs may be willing to emphasise their positive aspects and underplay their shortcomings.

There are other questions that need to be raised in regards to SIBs. These relate to the nature of the relationship between government, investor(s) and service providers. In a transaction that often involves many millions of dollars a number of pressures are likely to exist. In such an environment it is possible for government officials to accept proposals that are presented as being in the public interest but are designed for self-interest.

> *My experience in government suggests that those who hold positions of power want to believe that they are doing the right thing – that they are pursuing the public interest. But their beliefs are at least malleable enough for them to be convinced by "special interests" that what they want is in the public interest, when in fact it is in their own interest to so believe. (Stiglitz 2012)*

Service providers have the responsibility of providing the best service possible to their clients while being mindful of the need to meet their contractual obligations. These expectations are likely to have substantial pressures associated with them given the fact that significant amounts of capital are at risk. The issue arises as to what extent service providers can remain focused on the qualitative aspects of service delivery when such high stakes are in the balance. Experiences with Job Services Australia has shown how pressure to achieve financial returns based on designated outcomes can negatively impact on program innovation, creativity, quality and focus. *(Considine et al. 2011; Considine et al. 2014; Eardly 2003)*

The role of the independent evaluators associated with SIBs will also be under intense pressure as their assessments are crucial to the financial outcome for all involved, especially investors. Evaluators often find themselves in difficult positions as they attempt to make assessments based on inadequate data or information that is difficult to validate. At last year's Australian Evaluation Society International Conference, speakers told of the difficulties that were often inherent in meeting their professional expectations and that of government and non-government bodies especially in regards to the reliability of the metrics associated with particular appraisals.

In an article on SIBs in the Non Profit Quarterly, Jon Pratt used the following quote when referring to their transactional nature.

> ….. Campbell's Law (after Donald T. Campbell): *"The more any quantitative social indicator is used for social decision-making, the more subject it will be to corruption pressures and the more apt it will be to distort and corrupt the social processes it is intended to monitor." (Pratt 2013)*

The question of the impact of the above pressures on the quality and integrity of the SIB process and product need to be kept in mind when assessing their effectiveness, relevance and function within the broader social service system.

In examining SIBs it becomes apparent that they are open to the vacillations associated with government policy direction and investor interest. The latter can change rapidly when return on investments in other areas outperform those that may be gained through SIBs. The case of Goldman Sachs, (discussed previously) demonstrates how quickly investors end a SIB when their investment is at risk. In an event such as this, the negative consequences for service providers and their clients could be significant. Governments seeking to adjust social policy directions can find themselves locked into contractual arrangements that are not as amenable to change as current funding agreements. The consequence of this, are either that governments are straightjacketed by previous arrangements or that they can only disentangle themselves by paying substantial amounts of money. Social programs based on market mechanisms are open to the negative consequences of market failure. In the event of such a failure, service providers, their clients and government can be left in a very difficult position due to the complexity of SIB contracts.

Finally, how are we to understand the place of SIBs in a country's social service system? For now there are few examples of successful SIBs and it is too early to know whether or not they can play a significant role in the delivery of social programs. There are considerations for government as SIBs have the potential to create additional costs for taxpayers than current funding regimes without necessarily achieving better outcomes. There would appear to be risks for government, investors and service providers due to the convoluted nature of SIB contracts and the complexity of social interventions. It may be that SIBs at best, are suitable for programs that are easily controlled and quantifiable. Some have referred to these as the low hanging fruit of social services. However, it is difficult to see how SIBs could be used as a basis on which to build long-term, integrated and coordinated responses to societal needs.

Given the specific and individual nature of SIBs, it is possible that a reliance on them as a means to achieve social change can further fragment a service system that suffers from significant compartmentalization. Governments have for many years, and for good reason, sought to better integrate and coordinate services. SIBs would appear to run counter to this intent. While SIBs may be able to occupy a niche in the full suite of social service approaches, there needs to be a high degree of caution in seeing them as a means to achieve social reform and development.

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