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New development: Private finance over public good?

Questioning the impact of social and environmental impact bonds

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Abstract

Social impact bonds (SIBs) have emerged as an alternative mechanism for financing projects with an explicit social purpose. This article contrasts the proposed benefits of SIBs with the more mixed performance of initial projects, and reviews the early literature, revealing a similar divide between initial optimism and subsequent critique. Despite this, SIBs continue to receive high-level support, whilst expanding their reach through controversial new 'development' and 'environmental' impact bonds. This situation deserves more scrutiny in the accounting literature.

Keywords

Impact bonds, third sector, outcomes-based performance, accountability.

Reductions in public spending since the 2008 financial crisis have intensified demands to better allocate public resources. This challenging fiscal climate has led to an increasing policy focus on the potential benefits arising from the outsourcing of welfare and other social services. One area of particular interest is the greater involvement of third sector organisations, especially where they already work alongside the public sector in service delivery settings. The move has been accompanied by the outsourcing of funding for services, this time through the involvement of the private sector. To provide sufficient incentives to attract private capital and ensure successful outcomes in the service being delivered, Social Impact Bonds (SIBs hereafter) have emerged as an alternative mechanism for financing welfare projects and enterprises that have an explicit social purpose. Two additional variants of this approach, Development Impact Bonds and Environmental Impact Bonds, have also been introduced more recently, and are considered later in this article.

While referred to as a bond, the use of such a term is misleading: instead, SIBs are better understood as a type of performance or outcomes-based contract, involving a public-private partnership. Rather than funding and delivering services directly, government agencies use a commissioner to broker an arrangement between private investors and third sector service providers. Investors provide upfront funding for a project, with the initial investment plus a further return being repaid to them if a set of pre-defined outcome targets are met by the service provider. This basic arrangement is attractive for the government agency, not least because the investor (rather than the government) is expected to provide the upfront investment and bear the outcomes risk. In addition, the focus on measurable outcomes (rather than outputs) may improve accountability of service provision, by setting clearer expectations of what is to be achieved. A further feature of SIBs is an emphasis on preventative forms of intervention, such as reducing recidivism, homelessness or youth unemployment. If successful, such interventions are expected to generate additional cost savings by avoiding the remedial spending incurred, including costs of policing, prisons, the justice system and state benefits. A share of these potential cost savings is then set aside as the additional return given to investors, but only if the agreed outcome targets are met. Otherwise, investors can stand to lose out.

Since the first SIB was launched in 2010 at Peterborough prison in the UK (Disley *et al.*, 2011), the number of projects had grown to 32 in the UK, and 60 internationally by the beginning of 2017 (Social Finance, 2016). Whilst this level of growth is substantial, the overall value of the SIB field is still comparatively small, with the investment element of each SIB (in the UK) typically less than £2 million (Big Society Capital, 2016). As the number of projects has grown, the results of early SIBs have begun to emerge. However, the picture appears to be rather mixed. For example, the pioneering project at Peterborough prison, which was intended to reduce recidivism amongst prisoners, appears to have worked well initially, but was much less effective in its later stages, leading to the early closure of the scheme (Disley *et al.* 2011; Ogman, 2016), while a similar project at Rikers Island Prison in New York (the first of its kind in the US) was widely regarded as an outright failure (Rudd *et al.* 2013).

Despite these mixed results, successive UK governments have continued to back the idea enthusiastically, providing significant financial resources, policy measures and institutional arrangements to further encourage and facilitate its adoption (Cabinet Office, 2016; Big Society Capital, 2016; Social Finance, 2016). The ongoing high-level endorsement of SIB as a funding mechanism has in turn encouraged the establishment of a variety of think-tanks, consultancies and others involved in promoting and operating SIBs. The 'grey literature' produced by these organisations, in the form of commentaries, reports, toolkits and so on is extensive. A recent comprehensive review of the extant SIB literature (Fraser *et al.*, 2018) found it comfortably exceeds the volume of published academic research on SIBs to date. More importantly, it also suggested that the grey literature on SIBs is largely devoted to presenting a variety of reformist narratives aimed at the key parties involved in the contractual process. Firstly, a 'public sector reform' narrative targets government agencies and the third sector, and typically advocates the use of private sector management methods to drive greater innovation and alleviate what are presented as inherent flaws in non-profit styles of service delivery and accountability. At the same time, however, a 'private sector reform' narrative is also deployed to an investor audience, in which potential providers of capital are encouraged to consider SIBs as a commercial opportunity which can also grow private sector involvement with the public sector and pursue (and allow investors to obtain legitimacy from) socially responsible business practices. As Balboa (2016) argues, these narratives together present a seemingly perfect scenario of a 'win-win-win' for investors, government agencies and the public. However, is this carefully constructed, utopian solution simply too good to be true?

Perhaps given the intrinsic complexity of SIB contracts, efforts to develop and improve them from a practitioner-focused perspective have been generally well-received (Fraser *et al.*, 2018). These efforts involve further consideration of the practical issues around outcomes measurement and reporting as well as the difficulties arising from the long contractual timescales of SIBs (see, for example, CIPFA, 2012). However, the largely positive and constructive tone of the grey literature may be contrasted with a more cautious and critical narrative emerging from recent academic studies on SIBs (Fraser *et al.*, 2018). Even where this literature shares a concern to develop more robust outcomes measures and contract designs, academic studies have stressed the underlying complexities of social problems, and argued that they cannot be reduced to simplistic cause-and-effect modelling (McHugh et al, 2013). Beyond this, the academic literature has extended its theoretical analysis to develop a more wide-ranging and profound critique of the impact of financial sector interests on the structure, regulation and underlying agenda of SIBs and on the delivery of the public services involved (Clifford and Jung, 2016). Rather than the seductive 'win-win-win' narrative emanating from institutional actors and networks directly involved in the development and delivery of SIBs, academic studies tend to frame the emergence of the funding mechanism as "represent(ing) the worst of both [private financial and social services] sectors" (Fraser *et al.*, 2018, p. 5).

A number of specific themes and issues may be identified from a review of these studies. For some, including Warner (2013), McHugh *et al.* (2013) and Balboa (2016), the structure of impact bonds dilutes and compromises accountability relationships between governments and services, by outsourcing the services themselves and the process of service commissioning. These studies also argue that impact bonds can negatively affect accountability relationships between service providers and local communities, by pressuring the third sector to grow and amalgamate to achieve 'investment-readiness' and obtain sufficient working capital to deliver large projects. The weakening of accountability is also associated with questions about governance within the SIBs, in terms of potential shortcomings in government oversight and control over service delivery (McHugh *et al.*, 2013), and a lower quality of provision compared to a publicly-provided service (Mullins *et al.*, 2011). At the same time, as Balboa (2016, p.40) argues, SIBs also introduce a form of accountability bias that favours "financial outcomes, prioritising financial accountability for future projects before they are even created".

The bias towards financial accountability is related to a deeper concern expressed within academic studies, surrounding the way in which private sector norms and practices are being promoted as a solution to social problems and introduced into the third sector. For some, this is symptomatic of an underlying ideological shift within government towards the neo-liberal restructuring of public services (McHugh *et al.*, 2013; Lake, 2015; Ogman, 2016; Dowling, 2017; Rosamond, 2016; Cooper *et al.*, 2016). In this context, SIBs are viewed as another manifestation of what has been termed the 'financialisation' of valuation in public policy (Chiapello, 2015), whereby social and welfare objectives are subordinated to financial sector interests. As Dowling (2017, p.306) argues, "financialisation is not a simple process of allocating resources […]; it imposes a set of disciplinary measures that shape the social processes they affect, in turn privatising gains and socialising risks and costs". Insights from major case studies into the negative consequences of SIB projects as solutions to social problems are also now beginning to emerge. For example, Cooper *et al.* (2016) critically examine the use of SIBs to deliver homelessness services in London, and argue that:

> the SIB is thoroughly neoliberal in that it is constructed upon an assumption that there is no such thing as a social problem, only individuals who fail. The SIB transforms all participants in the bond, except perhaps the homeless themselves, into entrepreneurs. The homeless are instead "failed entrepreneurs" who become securitized into the potential future cash flows of investors. (p.63)

While the focus of the grey and academic literature has been on the development and implementation of SIBs to deliver social and welfare services in developed economies, it is also important to briefly highlight the emergence of two further versions of impact bonds, which essentially apply the same model but within quite different settings. Development Impact Bonds (DIBs) (Development Impact Bond Working Group, 2013) follow the same basic approach of seeking private investment for social programmes, but in this case, investment is directed into developing countries, with private investors are typically remunerated by donors rather than host-country governments, who may lack the necessary resources to fund services. In seeking to improve the quality and efficiency of public services in developing countries, DIBs are increasingly being viewed as a potential way of mobilising the huge investment required to meet the Sustainable Development Goals (Aldiss, 2016). However, the role of wealthy 'philanthrocapitalist' donors in acting on behalf of host governments in developing countries is controversial. Indeed, according to Kish and Leroy (2015) it represents a further unwelcome expansion of the territorial boundaries and limits of financialisation, containing implicit overtones of racial oppression and slavery.

The emergence of Environmental Impact Bonds (EIBs) is another recent development as a means of financing environmentally sustainable initiatives. EIBs operate along similar lines as SIBs and DIBs, but it is important to emphasise that this also means they are quite different to the larger and more established market in green and climate bonds. These are financial instruments which have been issued by large financial institutions and corporations and which generally function much like conventional debt-securities (Climate Bonds Initiative, 2016). By contrast, EIB development is at a much more nascent stage, with the first proposals emerging in 2013 (Clark and Nicola, 2013; Nicola, 2013) and initial experimentation currently limited to two US-based projects, in urban stormwater management (Gonella, 2017) and forestry conservation and resilience (Yonavjak, 2016; Blue Forest Conservation, 2016). One of the suggested advantages of EIBs over other varieties of impact bond is the potential for measurable and quantifiable characteristics of the desired outcomes. Whereas SIB metrics are often developed from scratch, many standardised metrics already exist that may be directly applicable within EIBs (Clark and Nicola, 2013). While there appears to be some enthusiasm for the potential of EIBs to solve environmental problems, many of the underlying accountability and governance problems associated with the involvement of private capital remain (Balboa, 2016). More broadly, the important role of both green/climate bonds (as well as EIBs and other forms of ecosystem payments mechanisms) in driving the expansion of private investment in what is becoming known as 'natural capital' remains highly controversial, leading to a further expansion of the process of financialisation into nature itself (Sullivan, 2014).

To conclude, while enthusiasm for impact bonds as a financing mechanism to solve social and environmental problems continues unabated amongst governments and their networks of supporting organisations, wider opinion on the merits of impact bonds is far more divided. The academic literature has been slower to catch up and respond to the issues at stake, but this is now changing, although it should also be noted that most studies continue to be published outside, rather than within, the accounting literature. The scope and depth of the critique emerging from this literature suggests that the claims being made about the potential role of impact bonds in addressing fundamental societal, developmental and environmental problems are often exaggerated. While there may be circumstances in which specific interventions can deliver benefits to both public and private sectors, the expansion of impact bonds into areas of social dislocation and poverty, especially in the developing world, as well as into the natural environment, is clearly controversial and deserves much greater scrutiny. Further critical examination, including within case study settings (see, for example, Cooper *et al.*, 2016) is needed, especially in the accounting literature.

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