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Dear Sir/Madam

Social Impact Investing Discussion Paper

The CPSU welcomes the opportunity to make a submission in response to the *Social Impact Investing Discussion Paper* on behalf of our members in the State, Territory, and Commonwealth public services. Please find attached our submission regarding social impact bonds for your consideration.

For further information please contact Clare Middlemas, National Campaigns Officer, on cmiddlemas@spsf.asn.au or 0488 454 003.

Yours sincerely

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Social impact investing discussion paper
CPSU submission

This submission has been prepared by the joint divisions of the Community and Public Sector Union (CPSU), the primary union covering public sector workers in the Commonwealth, State, and Territory governments. The *Social impact investing discussion paper* uses 'social investing' as an umbrella term to include social enterprises, social impact bonds, and social impact investment funds. While there are concerns about a range of forms this type of investing may take, this submission specifically addresses Social Impact Bonds (SIBs).

The CPSU is opposed to the use of SIBs. They are risky and there is no convincing evidence that they work. We recommend that the Australian government not have any role in the social investment market. Instead, the Australian government must invest to promote innovation in the public sector and focus on the deeper structural causes of 'wicked' problems - rather than simply creating a way for venture capitalists to make a quick buck.

Privatisation by another name

Despite the rhetoric around 'social benefit' and 'innovation', SIBs are just another form of privatisation. As Dexter Whitfield explains, SIBs are a 'complex venture capitalist model applied to the provision of social and other public services that relies on the profit motive to get private investors to fund and source the service delivery in order to ensure an agreed social outcome is reached. If the investor is successful, governments pay them a profit of between 15-30%, but if not they do not receive a profit.'[1] At their core, SIBs are 'a government bet tethered to the private advancement of public responsibilities.'[2]

SIBs may lead to further privatisation. Initial SIB success may encourage governments to eliminate the SIB and contract directly with private providers. For example, in the United Kingdom the Peterborough Prison project began constructing interventions using its own direct funding without the need for intermediaries or investors.[3] The financialisation or commodification of social services and results, as well as the intensification of contractual and transactional approaches of them, can undermine and erode reciprocal trust-based relationships and public services ethos. Ideological hurdles also may rise, such as turning-not-for-profits into for-profits through an intermediary.[4]

No evidence

The discussion paper states that 'social impact investing has been growing in popularity both in Australia and internationally. Many early social impact investments have been social impact bonds. The first social impact bond commenced in 2010 in the United Kingdom (UK), with many State and Territory Governments leading on social impact bonds in Australia.' But just because SIBs are popular, does not mean that they are good policy! We contend that there is no compelling evidence that SIBs lead to better outcomes than traditional public service delivery; claims of success are exaggerated and/or inconclusive. In fact, the available evidence points to the failure of some experiments with SIBs. The most well known of these is Rikers Island[5], but other less-than-positive experiences include the New Zealand SIB in mental health[6], and the UK Peterborough Prison SIB[7]. A review of the NSW Benevolent Society Social Benefit Bond, which is widely touted as a success, has shown that the SIB has been no more successful than the service delivered directly by government (see below).

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[1] Dexter Whitfield, "Alternative to Private Finance of the Welfare State: A Global Analysis of Social Impact Bond, Pay-for-Success and Development Impact Bond Project" (Australian Workplace Innovation and Social Research Centre, The University of Adelaide, 2015), i.

[2] Jon D. Michaels, "Privatisation's Progeny" (UCLA School of Law: Georgetown Law Journal, 2013), 29.

[3] V. Kasturi Rangan & Lisa A. Chase, 'The Payoff of Pay-for-Success', Stanford Social Innovation Review, 2015 https://ssir.org/up_for_debate/article/the_payoff_of_pay_for_success

[4] OECD LEED expert seminar, 'Social Impact Bonds: Promises & Pitfalls', 15 April 2015 https://www.oecd.org/cfe/leed/SIBsExpertSeminar-SummaryReport-FINAL.pdf p.13

[5] Donald Cohen and Jennifer Zelnick, 'What We Learned from the Failure of the Rikers Island Social Impact Bond', *NPQ*, 7 August, 2015 https://nonprofitquarterly.org/2015/08/07/what-we-learned-from-the-failure-of-the-rikers-island-social-impact-bond/

[6] Ellie Cooper, 'New Zealand's First Social Bond Falls Through', *Pro Bono News* 13 July 2016, https://probonoaustralia.com.au/news/2016/07/new-zealands-first-social-bond-falls/

[7] 'Can the Peterborough social impact bond be judged a success?', *Civil Society*, 12 August 2014, https://www.civilsociety.co.uk/voices/can-the-peterborough-social-impact-bond-be-judged-a-success-.html

Australian case study - Benevolent Society SIB*

The Benevolent Society Social Impact Bond (SIB) commenced in October 2013, and was the second NSW bond pilot. The $10mil Bond was to provide the Resilient Families Service (RFS), which aims to strengthen family functioning and relationships, and ensure children's safety and wellbeing in order to prevent children entering out-of-home care. Families are eligible for referral to the RFS if they have at least one child less than 6 years old who is living at home and has been assessed by FACS (NSW department of Family and Community Services) as at Risk of Significant Harm (ROSH) but 'safe with plan'. The NSW government believes it will save $66,000 per child not entering foster care. The term of the bond is 5 years ($2million budgeted per annum), and unlike most other SIBs, there is no intermediary organisation.

The success of the program is measured by comparing the performance of the social program against targets agreed upfront with the state government. The progress made by families in the RFS (the 'index children') will be compared against progress made by a similar group of families who have not taken part in the program (the 'control children'). The outcomes of the RFS are measured through the number of:

1. Reports to the Helpline
2. Safety and Risk Assessments (SARAs) commenced by FACS
3. Entries into statutory Out of Home Care.

To the end of June 2015, the actual costs of the program including the start-up period were $3,082,301, compared to a budget of $3,939,999 for the period – this represents 22% less spent than initially planned. The average cost per family was calculated for the 81 families participating in the RFS up to June 2015. This cost was $38,053, which is 52% over the budgeted amount of $25,000. This is partly accounted for by the lower than planned numbers commencing the service. The cost per family may reduce with an increase in the number of families supported, as the majority of costs are largely fixed (staffing costs) and not likely to increase in the same proportion as the number of families. Although the budgeted cost per family for the RFS ($25,000) is much lower than other intensive family support programs funded by FACS, the actual average costs per family for RFS ($35,053) are comparable to budgeted costs of other programs.

The NSW Treasury released an interim report evaluating the RFS in May 2016. The purpose of the report was to evaluate the implementation and outcomes of the RFS over the first three years of its operation, from 2013 to 2016. Eighty six index children (and 86 control children) were involved in the RFS program over the first three years.

Index children in RFS generally showed improvements – however, control children have shown similar levels of improvement. During the measurement period, there were similar improvements in both the index and control group in regards to helpline reports and SARAs commenced. Index children had fewer statutory out-of-home care entries than control children (15 compared to 18 entries), however on closer analysis according to risk level, there is little difference between the two groups, with the majority of entries coming from high-risk families. The interim report states that: 'the population is too small and too short a timeframe has passed for certain improvements to be shown or conclusions to be made at this point.'

The Benevolent Society is claiming the bond is a success: they state that 'using the formula to be applied at the term of the bond, the performance percentage for the first 21 months ended 30 June 2015 is 12%, which would result in compounded returns to investors of 5% per annum for the capital exposed bond holders. While returns will only be paid at the end of the bond term, the results demonstrate a positive trajectory which is encouraging for investors.' (Benevolent Society media statement, 'Social Benefit Bond gives families a secure future', 8 December 2015).

However, the interim evaluation report states that the RFS is 'associated with increased safety and wellbeing for children and their families but is performing relatively poorly under the SBB [Social Benefit Bond] mechanism because decreases seen in the contact with the child protection system for RF families is similar to or less than the decrease seen for control children. This suggests that a FACS [NSW Department of Family and Community Services] business-as-usual response is as effective as the RFS, at least in the short term.'

So as a Social Impact Bond, it is not a success. The Interim evaluation report states that "this is because the control children are experiencing a similar pattern of declining contact with the child protection system as index children,...not because RFS is failing to achieve its stated outcomes. Consistent with the decrease in contact we also see improvements in functioning and wellbeing for index children and their families, but comparative data is not available for the families of control children to see if the same patterns exist."

*Information from NSW Treasury, 'Evaluation of the Resilient Families Service', May 2016,
http://www.benevolent.org.au/~/media/Benevolent/About/SBB/Interim%20Report%20-%20RFS%20Evaluation%20pdf.ashx

Difficult to measure

Social impact is notoriously difficult to measure, and it is difficult to attribute the results of SIBs to the particular mix of interventions, the additional money, or the new financing mechanism itself. The government could end up paying for a SIB that didn't achieve anything beyond what would have been achieved anyway without the SIB but with additional funding.[8] The Centre for Social Impact has previously acknowledged that the 'biggest barrier is likely to be the lack of robust evidence of the efficacy and cost saving potential of programs and policy interventions.'[9] SIBs can only ever look at indicators that are observable, such as age, background, and criminal history. Yet it's often unobservable factors—such as attitude or resilience—that drive behaviour.[10] It is difficult to separate out the 'statistical noise' when examining the results of SIBs: there is a certain amount of random variation between sets of clients, just due to the fact that people and circumstances are different. The trouble is, setting the threshold of success above anything which could be down to random variation, sets an unrealistically high bar.[11] While we don't endorse the methodology or the findings, even a review by Social Finance UK, a body supportive of SIBs, reported in July 2016 that of 60 SIBs just 21 'indicated' positive social outcomes, and only 12 had made outcome payments.[12]

[13]

Outcomes are distorted

As well as being difficult to measure, so-called 'successful' SIBs need to be closely examined. The SIB model is likely to increase the 'cherry-picking' of social needs by focusing on what is most likely to be profitable and may also cause governments to lower a 'target' in order to attract investors instead of identify and implement what may be needed for real improvement. Most social problems are complex and require comprehensive programs and policies that stay the course. A bias toward programs that produce quick, measurable results narrows the public dialogue and waters down findings.

There are also significant concerns about transparency in contract management, particularly the difficulty in measuring outcomes and issues with assessing performance against these outcomes.

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[8] Caroline Fiennes, 'What the First Social Impact Bond Won't Tell Us', *Stanford Social Innovation Review,* 3 April 2013, https://ssir.org/articles/entry/what_the_first_social_impact_bond_wont_tell_us

[9] The Centre for Social Impact, 'Report on the NSW Government Social Impact Bond Pilot', February 2011, http://www.csi.edu.au/media/uploads/Report_on_the_NSW_Social_Impact_Bond_Pilot_-_February_2011.pdf. p.17

[10] Fiennes, 2013

[11] David Ainsworth, 'Six Issues With Social Impact Bonds', *Civil Society,* 27 May 2014,https://www.civilsociety.co.uk/voices/six-issues-with-social-impact-bonds.html

[12] Social Finance, 'Social Impact Bonds: The Early Years', July 2016 http://www.socialfinance.org.uk/wp-content/uploads/2016/07/SIBs-Early-Years_Social-Finance_2016_Final2.pdf

[13] *Ibid.,* p.6.

The role of government should be more than simply a contract manager

The discussion paper suggests that 'the Australian Government could primarily support social impact investing by (i) creating an enabling environment and (ii) by funding (or co-funding with State and Territory Governments) investments which would likely achieve savings to fund the intervention and deliver better outcomes for Australians.' We believe that the role of government is broader than simply an 'enabler', a contract manager, co-funder or 'investment manager'. There are services in the community which have long been delivered by not-for-profits, however there seems to also be an implicit assumption that adding impact investing will improve outcomes. There must be clear connections between the policy development and service delivery arms of public services - to separate these functions by effectively outsourcing public services through SIBs potentially worsens outcomes.

That said, where public servants are managing contracts, they must be properly trained and be provided sufficient resources to ensure that the allocation of public money is being done in the most effective and efficient manner.

Finally, it is unclear what is meant in the paper by the statement that 'social impact investing has the potential to complement (but not replace) the Australian Government's existing role and responsibilities across many portfolios.' It is unclear how SIBs can complement rather than replace roles, except where government has already become simply a contract manager.

Risk transfer and accountability

Rather than improve it, SIBs can worsen transparency and accountability and the use of an intermediary adds another layer between the government and the public.[14] If SIBs are about transferring risk from the government to the private sector, then government will have to pay for both the delivery of the service as well as a premium for the transfer of risk. There are suggestions that given the difficulty of linking the evaluation of a social program to a highly complex contract centred on an outcome payment, the government may actually increase its operational risks in undertaking a SIB.[15]

Investors are unlikely to commit to SIBs unless governments guarantee financial returns –undermining the whole premise of SIBs. Yet the examples thus far are not of returns to investors or savings to government but significant cost to government in establishing SIBs that fail. For example, the New Zealand Government's first planned social impact bond collapsed in July 2016 after three years of work and $29 million spent.[16]

Advocates of SIBs suggest that they remove the risk of failure from the taxpayer and transfer it to the private sector.[17] However this is a likely disincentive for private investors. Indeed, a cited concern of investors has been that there is no guarantee of a return or a guarantee to limit an investors' loss.[18] In the USA, New York City dealt with this problem by getting a philanthropic foundation to guarantee $7.2 million of the private investor's $9.6 million stake. This is hardly a sustainable model. A true test of SIB funding model would mean 100% of the 'at risk' funds would come from for-profit investors.

In truth, SIBs are effectively 'gambling' on the lives of some of the most vulnerable people in society, and there is the potential that investors could 'cut their losses' and shut down a program if it is clear a target won't be reached. Where does this leave the vulnerable populations serviced by a SIB? Or will government have to step in and pick up the pieces?

Costs

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[14] Michaels, 2013, p. 30.

[15] Department of Legislative Services, Office of Policy Analysis, 'Evalutating Social Impact Bonds as a New Reentry Financing Mechanism: A Case Study on Reentry Programming in Maryland, Annapolise, Maryland, 2013, http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013-Evaluating-Social-Impact-Bonds.pdf. p.v

[16] Kate Gudsell, 'Government's first social bond collapses', Radio New Zealand, 6 July 2016, http://www.radionz.co.nz/news/political/308026/government's-first-social-bond-collapses

[17] Rebecca Leventhal, "Effecting Progress: Using Social Impact Bonds to Finance Social Services," NYU Journal of Law & Business 9 (2013): 526

[18] Kate Gudsell, 'Social bond programme stalled by negotiations', Radio New Zealand, 29 April 2016, http://www.radionz.co.nz/news/political/302605/social-bond-programme-stalled-by-negotiations

It is cheaper for government to directly fund programs instead of going through a complex SIB. Advocates of SIBs have acknowledged that a common response from Treasuries is that SIBs are an unnecessarily complex way of financing better social programs. Since governments' costs of capital are significantly cheaper than markets, they should be providing finance. If there really are better approaches to reducing recidivism or unemployment, these should be directly funded by governments, rather than indirectly via SIBs.

In addition, some philanthropists worry that SIBs risk diverting charitable funds to make up for public spending, essentially locking philanthropic money into government agendas.[19]

SIBs are unlikely to save governments money due to the taxpayer having to bear the costs involved in the extensive time and resources to negotiate the SIB contract and pay investors. The KPMG evaluation of the NSW SIB trial, for example, found the number of hours equates to six FTEs working solely on the development of one social benefit bond over an intensive 12 month period.[20]

Innovation

SIBs are premised on the myth that the private sector is more innovative than the public sector. This simply is not the case. As Mazzucato's research shows,[21] the private sector often only finds the courage to invest after an entrepreneurial state has made the initial high-risk investments. The myth of the dynamic private sector vs the lumbering public sector only serves to create an innovation system where the public sector socialises the risk, while the gains are privatised.

There is no evidence that the SIB model is compatible with the general assumption that SIBs encourage improved performance because there is a financial incentive for the investor to improve results.[22] Rather, the very structure of the model is that investors are removed from the day to day operation – and generally payments are fixed – either predetermined targets are met and fixed returns are paid, or they are not.

Innovation could be fostered in the public sector by creating an environment where public servants can take risks in trialling new approaches. Teams of public servants could be given the autonomy to design and trial new approaches to solve 'wicked' problems – this of course will require government investment in the public service to build capacity and capability and provide the space for innovation. Providing the resources for the piloting of new approaches within the public service would logically foster a more innovative approach than a traditional SIB, because the high risk of investors losing their investment due to failure to reach outcomes means investors will stick with safer options rather than innovative and untested ones.[23]

The alternative

It is possible to support a much stronger focus on outcomes while at the same time rejecting social impact bonds. Better monitoring, data collection and evaluation can be done without a SIB. That should the focus, not complex and risky financial products. There is no reason that taking a long-range view of outcomes and employing reasonable and coherent metrics to improve program evaluation and accountability cannot be more broadly applied under government and non-profit auspices. We do need to improve and expand funding for these efforts, but we do not need commercialisation of social services to drive them. If the goal is to solve social problems, not privatise the public sector, we should consider a simpler solution—public investment in schools, jobs, social programs and innovative criminal justice.[24]

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[19] Geoff Mulgan, Neil Reeder, Mhairi Aylott & Luke Bo'sher, 'Social Impact Investment: the challenge and opportunity of Social Impact Bonds', The Young Foundation, March 2011, http://youngfoundation.org/wp-content/uploads/2012/10/Social-Impact-Investment-The-opportunity-and-challenge-of-Social-Impact-Bonds-March-2011.pdf, p.17

[20] KPMG, 'Evaluation of the Joint Development Phase of the NSW Social Benefit Bonds Trial', January 2014, http://www.osii.nsw.gov.au/assets/office-of-social-impact-investment/files/Evaluation-of-the-Joint-Development-Phase.pdf, p.28

[21] Mariana Mazzucato (2013), *The Entrepreneurial State: Debunking Public vs Private Sector Myths,* Anthem Press, London.

[22] Leventhal, p. 526

[23] Jane Lethbridge, "Social Impact Bonds: Investment Opportunities, Not Social Good" (University of Greenwich, UK: Public Services International Research Unit, 2015), 19.

[24] Cohen and Zelnick, 2015.