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Focus on Disability

Social Impact Bonds in Criminal Justice:

from interesting idea to business as usual

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History

Interest in Social Impact Bonds (SIBs) and tools for developing new investment approaches to address social problems has grown in recent years. There is extensive evidence of potential financial returns on investment in early years programmes and preventive measures which reduce demand on the justice system and save money.

Turning the merits of preventative programmes into concrete proposals for investment has proved challenging. However, there were numerous developments which accelerated thinking during the early 2000s. For example, there were steady advances within government in methods for assessing the impact of public investments on human capital, and for bringing more systematic analysis of the link between spending and social outcomes such as crime reduction or health improvements.¹ There was also widespread experience of private finance initiatives and public private partnerships, which helped advance the range of tools available to investors and contractors. Markets for carbon reduction developed, prompted by the Kyoto Treaty and the EU, which encouraged greater confidence in the potential to invest in social gains. There was also experimentation in health around initiatives such as advanced market commitments, in which a payer guarantees a market will be available for breakthroughs such as vaccinations for malaria.

The current spending squeeze in the UK means that there is more interest than ever in such tools to achieve greater value, and to tap into new sources of finance for social goals, particularly in the field of criminal justice. The Comprehensive Spending Review 2010 announced a reduction on public spending of £81bn by 2015. The Ministry of Justice has the task of reducing spend by £2 billion, 23 per cent of its budget by the end of 2015. The UK needs a strategy to reduce crime while saving money at the same time — Social Impact Bonds present such an opportunity.

Work on their design and implementation has been in train since early 2008, when the City Leader's Group (led by banker and Young Foundation

Chairman Peter Wheeler) began work to identify new types of investment vehicles for social outcomes. Some of this work was taken forward by a new organisation called Social Finance, which agreed the first SIB in the final days of the Labour government in early 2010. The Young Foundation coined the term 'Social Impact Bonds', and fed into Social Finance's work while also developing alternative models of SIBs, all of which shared the goal of turning social outcomes into investments to encourage ways of creating more good for less money.

The concept has also gained traction internationally. In Australia, New South Wales is implementing a Social Impact Bond to work with young offenders and President Obama's administration recently announced \$100 million for Social Impact Bond pilots in the US, terming them Payment for Success Bonds.

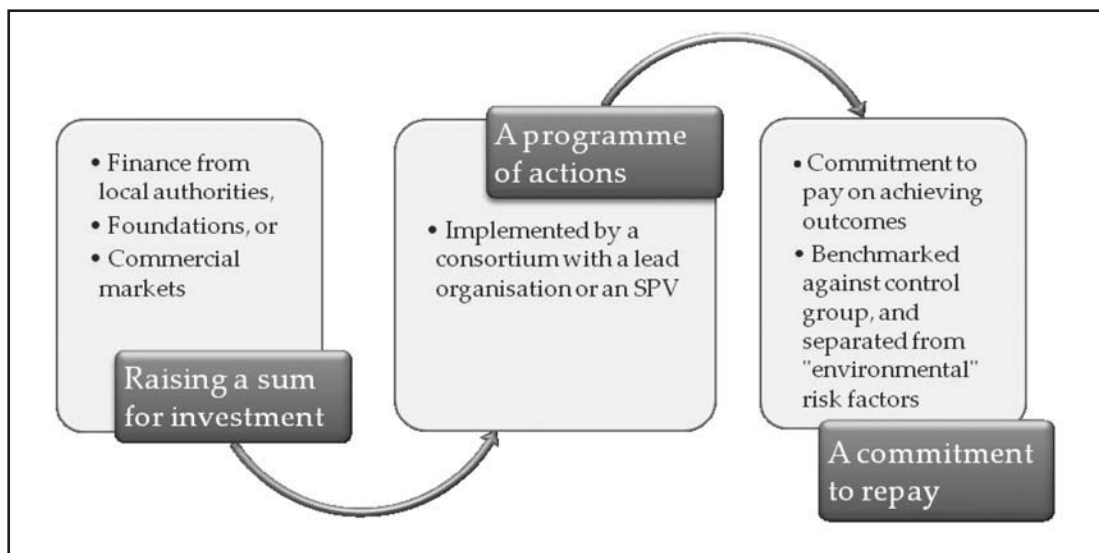
What is a Social Impact Bond?

Social Impact Bonds (SIBs) are funding mechanisms which invest in social outcomes. They have three elements:

1. Monetary investment
2. A programme of actions to improve the prospects of a group
3. Commitments by local or national government to make payments linked to improved social outcomes achieved by the group

Under a SIB, a payer (usually Government) agrees to pay for the measurable improved social outcomes of a project. This prospective income is used to attract the necessary funds from commercial, public or social investors to offset the costs of the activity that will achieve those better results. This approach is possible where better outcomes lead to tangible public financial savings. When agreed milestones are achieved (eg a specific percentage reduction in re-offending compared to a control group) the investor will be re-paid their original funding, with a return on investment, complimented by the knowledge that they have saved the government money, reduced crime and made our society a safer place.

1. For example see the recently launched journal *Evidence & Policy: A Journal of Research, Debate and Practice*.



There is interest and excitement surrounding SIBs, however they are one of a number of payment by results mechanism available to governments. Recognising this, Chancellor George Osborne has called for better commissioning, streamlined procurement and payment by results to deliver radical improvements to public services. The Ministry of Justice's Green Paper on offending and rehabilitation: *Breaking the Cycle: Effective Punishment, Rehabilitation and Sentencing of Offenders*, reaffirms this commitment.² The government has committed to carry out at least six new payment by results projects across the UK and the MOJ has stated that it is committed to adopting innovative approaches to reduce reoffending.³

SIBs offer the potential to align the incentives of service providers and central government, bring attention to the merits of preventive action, and importantly tap into new funding streams for civil society which faces deep cuts in governmental funding. They are potentially a powerful instrument for creating change and improving existing services. As research highlights, innovation often happens due to financial pressures.⁴

SIBs take the 'Justice Reinvestment' (JR) approach one step further. JR is a data driven approach widely used in the US for reducing corrections spending, reinvesting savings in strategies that can decrease crime and strengthen communities. SIBs can create real savings for the Ministry of Justice through reduced re-offending, and these savings can be reinvested in preventative action to reduce further crime and improve the system as a whole. Social Impact Bonds present an exciting opportunity in the UK to end the cycle of offending, help reduce the prison population and prevent the waste of human

potential. If implemented properly they could even halt and reverse the trend of hyperincarceration.

Yet SIBs are unlikely immediately to be able to meet all of the expectations being placed on them, and there are risks and challenges for all associated parties. This paper seeks to outline the case for adopting SIBs in a criminal justice framework, highlighting the merits and potential of rehabilitative and preventative programmes, while outlining the advantages and challenges of SIBs.

Why Social Impact Bonds?

Despite high levels of spending, increasing availability of alternatives to custody and a reduction in offending, the UK prison population rose from 20,000 in the 1900's, to over 40,000 in the mid 1990's and then only took another 15 years to double again. The 21st century saw this figure surpass 80,000 for the first time. Infamous political rhetoric underpinned this rise in the population, from Michael Howard's notorious claim that 'prison works,' to Tony Blair's New Labour pledge 'tough on crime, tough on the causes of crime.'

Yet many questioned whether building more prisons is the key to reducing criminal activity and reoffending. Despite Lord Carter's 2007 Prison Report recommendations to secure the long term availability of prison places, and build up to three new 'Titan' prisons,⁵ past rhetoric has began to change. Justice Secretary Kenneth Clarke has signalled a departure from the 'prison works' orthodoxy,⁶ and the coalition government has committed to introducing a 'rehabilitation revolution' and fostering a system with greater involvement of the private and voluntary sectors in rehabilitating offenders. Endorsing SIBs, such a system would pay independent

2. <http://www.justice.gov.uk/consultations/docs/breaking-the-cycle.pdf>

3. Ministry of Justice, Spending Review Press Notice 2010, available http://www.hm-treasury.gov.uk/spend_sr2010_press.htm

4. Audit Commission (2007) *Seeing the Light: innovation in public services*, London, Audit Commission.

5. Lord Carter, *Securing the Future: Proposals for the efficient and sustainable use of custody in England and Wales*, 2007.

6. <http://www.guardian.co.uk/society/2010/jun/30/kenneth-clarke-prison-sentencing-reform>

providers to reduce re-offending from the new savings that the approach would generate within the CJS.⁷

However, Social Impact Bonds are not applicable in every area where there is pressing social need. We have identified the following 7 essential criteria for a SIB:

1. The intervention is preventative
2. The area is one of high social need
3. There is evidence of efficacy
4. The impact is measurable
5. The approach aligns incentives
6. Savings generated are greater than costs
7. The government prefers a SIB in that particular setting

The first criterion states that an intervention funded by a SIB must view prevention as key as well as seeking to prevent re-offending by those leaving prison. Funding for preventative programmes is often lacking — helping former offenders is not necessarily emotionally appealing and the public hold the belief that prison is there to punish. Public spending, particularly in the current climate is likely to go to other priority areas.

Secondly, the intervention must be applied in an area of high social need. The prison population stands at 85,276⁸ and is set to increase to up to 95,000 by 2015.⁹ Those in prison have compounded social needs and many have experience a lifetime of social exclusion.¹⁰ Prison is expensive, and despite its aims of rehabilitation and deterrence, two thirds of ex-prisoners reoffend within 2 years of release, and often become trapped in a cycle of offending.

There is no easy solution to prevent reoffending, yet literature highlighting effective interventions has become increasingly developed over the past 30 years. A recent study collating a number of rehabilitative reviews shows strong results across many interventions, stating *'The volume of research and the consistency of the findings of the systematic reviews make this [the efficacy of rehabilitation] a sufficiently sound general conclusion, bordering on 'beyond a reasonable doubt' to provide a basis for correctional practice and policy'*.¹¹ Similarly, a meta-analysis conducted by Illescas et al¹² considered over 2,000 individual studies taken from America and

Europe on the effects of rehabilitation on re-offending. Overall, the average reduction on offending was 20 per cent, with no study showing an effect less than 10 per cent.

The benefits of programmes for ex-offenders can also be found in the UK. For example the St Giles Through the Gates programme offers former offenders who have served a sentence of at least one year a support service addressing the 7 pathways to reducing re-offending. They are met at the prison gates and given housing, benefit, education, employment and training support and can be referred to specialist services. Independent analysis has demonstrated that those who have been through the programme have a re-offending rate 40 per cent lower than the national average — only 15 per cent re-offend after 12 months of release.¹³

For a SIB to work, it must be possible to measure the impact of the intervention. Data on reoffending and sentencing outcomes are held by the Police National Computer. As most reoffending occurs in the first two years after release, and is typically measured at one and two years, there is sufficient and reliable data to highlight whether the intervention has met its aims.

SIBs should also act to align the incentives of the contracted parties. Although the financial burden of prison, courts and probation fall to the Ministry of Justice via NOMS, the charitable sector is equipped to provide support services to reduce re-offending at a relatively low cost, but does not always reap the benefits of doing so. A SIB would realign these incentives encouraging greater preventive action, as not only would the funder receive their original investment on successful completion of the work, they would also get a return on their investment. Central Government would save money from reduced offending, and charitable sectors investments would be repaid.

Importantly, the savings generated for the government stakeholder must be greater than the cost of the intervention. A 2002 estimate put it at some £11bn a year, however, using a SIB to fund an intervention package can generate substantial savings, greater than the cost of

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7. http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

8. Prison Population and Accommodation Briefing, Ministry of Justice — 15th October 2010.

9. Prison Population Projections, 2009-2015 England and Wales, Ministry of Justice Statistical Bulletin, available <http://www.justice.gov.uk/stats-prison-population-projections-2009-2015.pdf>

10. Social Exclusion Unit (2002), Reducing re-offending by ex-prisoners, London: Social Exclusion Unit.

11. Lipsey and Cullen (2007), The effectiveness of correctional rehabilitation: a review of systematic reviews, Annual Review of Law and Social Science, Volume 3.

12. Illescas, S., Sanchez Meca, J., & Genoves, V. (2001). Treatment of offenders and recidivism: Assessment of the effectiveness of programmes applied in Europe. *Psychology in Spain*, 5 (1), 47-62.

13. St Giles Through the Gates, an analysis of economic impact, December 2009, Pro Bono Economics & Frontier Economics.

commissioning. The Young Foundation has estimated is that for a cost of £1,500 per person a range of interventions could be applied to effect a 10 per cent improvement in re-offending performance on sentencing rates. This could generate real and cashable savings of the order of £2,300 per person to the Ministry of Justice, more than sufficient to pay back the original investment plus interest.¹⁴

Lastly, there must be government preference for a SIB. The Coalition Government is committed to a 'Rehabilitation Revolution' that would fund up-front preventative activities designed to reduce later offending rates. They are committed to payment by results, and it is hoped that within a range of those mechanisms SIBs can have a central place.¹⁵

Kenneth Clarke commented,

*This Government has a historic opportunity to initiate a more constructive approach to rehabilitation. This means making prisons places of punishment, but also of education, hard work and change. As part of our radical approach to rehabilitation we are considering a range of payment by results schemes like the Social Impact Bond. The voluntary and private sectors will be crucial to our success and we want to make far better use of their enthusiasm and expertise to get offenders away from the revolving door of crime and prison.*¹⁶

The first SIB has been piloted in a private prison in Peterborough. The pilot will last 6 years, and aims to prepare 3,000 short term prisoners (who do not receive statutory probation support) for their lives post imprisonment. Support for former offenders is provided by St Giles, Ormiston Trust and others, and if re-offending is reduced by an agreed amount, the MOJ will repay the original investment plus an additional return, based on the savings created — generated from a reduction in prison places, courts costs and associated police and probation costs.

Modelling SIBs for Criminal Justice: from theory to cashable savings

Below is a worked example of how an intervention costing £1,500 per person resulting in a reduction of re-

offending of some 10 per cent could release cashable savings, from a reduction in custodial and non custodial sentences, for the Ministry of Justice.

The basic cost model assumes that court and legal costs per case average is around £2,900; the annual cost of incarceration is £39,000; and the cost of a non-custodial sentence is around £4,300. The expected length of time served in custody (where applicable) is calculated from the average sentence served by an offender, and the expected length of future custody spells.

The next step is to estimate the effect of a 10 per cent improvement in reoffending performance on sentencing rates. We estimate a baseline two year reoffending rate in the target group of some 61 per cent, with an associated 41 per cent reincarceration rate. A 10 per cent improvement in performance sees the reoffending rate drop to 56 per cent, and reincarceration rates drop to 37 per cent.

A further factor is the extent to which offending severity may reduce as a result of the intervention. We have modelled an impact equal to half the reduction in sentencing rates for custodial sentences.

A final issue is the extent to which potential savings can actually be achieved — there are many fixed costs associated with prisons. A conservative estimate is to assume that only 60 per cent is cashable.

Our calculations suggest that the average saving per person through reduced numbers of custody days and court appearances is of the order of £2,300. This sum is more than enough to pay back the original investment of £1,500, plus annual rate of return of 7.5 per cent, plus a margin for the Ministry of Justice.¹⁷

Advantages of SIBs

The case for SIBs in the field of criminal justice is strong — they offer much potential for increasing the magnitude and quality of investment available to reduce re-offending. Crucially, SIBs are able to save money even at a time of intense pressure on public resources. Further to the outlined case for SIBs in criminal justice, there are other advantages of SIBs.

14. For a detailed analysis of savings to the MOJ see Chapter 4 — Modelling SIBs for Criminal Justice.

15. http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

16. MOJ News Release, 'Minister launches social impact bond pilot'.

17. For a full cost modelling of SIBs and criminal justice, see Mulgan et al, 'Social impact investment, the opportunity and challenge of Social Impact Bonds' (2010).

SIBs act to correct poor incentives. In many fields of public policy, incentives are poorly aligned, with those who have the ability to improve social outcomes lacking the structural incentives to act. For example, Local Authorities responsible for providing services to young people that divert them away from crime do not share the savings from reduced prison numbers. Similarly, charities that have the potential to implement programmes which aim to reduce re-offending do not reap the benefits of reduced costs for the Ministry of Justice. SIBs can function to align activities in a systematic way.

SIBs also offer the potential to unlock new funding. Maintaining funding in the realm of criminal justice is often difficult, and where funding is available it may be diverted towards more emotionally appealing areas, such as homelessness. Equally, political considerations make it difficult for Government to spend money in certain areas. Prisoners, young offenders, and drug users are disadvantaged in this way and these very categories impose the greatest costs on society. Against the current backdrop of public sector cuts, crime prevention activities are likely to be even more difficult to fund. The SIB framework offers a potential way of funding these activities — those with the knowledge and confidence in criminal justice rehabilitation are able to seek investment, with investors able to seek repayment of up-front capital with an additional return.

SIBs put evidence at the heart of the process, strengthening the evidence base for ‘what works’ — and what does not work. Studies mentioned above highlight that preventative and rehabilitative programmes can and do reduce re-offending. SIBs allow programmes which work well to be scaled up, in turn generating future savings for the Ministry of Justice and society.

Importantly, SIBs offer genuine risk transfer — risk is transferred from the Government to the investor. If a scheme fails to demonstrate the agreed results the government is not compelled to pay out. Conversely, governmentally funded preventative work carries a risk as if it fails the government effectively pays twice — for the failed preventative work and prison costs. This genuine risk transfer has both financial and political advantages for the government.

SIBs are also advantageous for charitable foundations who are likely to be attracted to investments that go beyond traditional grant making by providing a return. The funds invested by the charitable investor can be reused on projects year after year, rather than being a

one-off spend. This enables investors to support more projects and for a longer time period. Many foundations do give funding for preventative programmes without the possibility of repayment, but SIBs offer the opportunity for repayment to be issued, with an additional return on investment. This creates the ability to leverage existing charitable giving, where promising ideas had previously been held back by a lack of finance.

For the commercial investor, SIBs are a new opportunity to seek returns. They allow private funders to access new sources of investment return that have not previously been available, while supporting work that improves social well being.

For the delivery agent, SIBs also provide a level of certainty that their activities will be funded over a long period of time providing continuity to staff and clients. SIBs are a systematic structure whereby delivery organisations can achieve consistent goals and predictable funding. SIBs also encourage greater investment in evaluation of impact — an issue that delivery agencies (especially in the voluntary sector) often find difficult to resource sufficiently.

Prisoners, young offenders, and drug users are disadvantaged in this way and these very categories impose the greatest costs on society.

Overcoming the Challenges of SIBs

Despite the significant potential benefits of SIBs, there are also significant challenges. SIBs are largely an untested concept, however, most challenges can be managed and avoided if properly considered when the SIB is being developed and the programmes designed. The challenges centre around the risks of SIBs.

Primarily, SIBs bring with them an execution risk — if the intervention does not reach its desired effects then the funder will not get their original investment back. The risks to funders in terms of not achieving results must be manageable, providing confidence that the interventions are likely to achieve the desired results. No matter how promising an idea seems, or how good the pilot data, the history of social interventions shows that medium scale implementation is a significant risk, and there is rarely a strong evidence base providing cast-iron confidence that a particular set of interventions will work in a particular place and context. This is particularly true in the case of criminal justice — no two offenders’ needs are the same, and what works in one prison may not work in another.

To manage this risk, SIB partners should ensure a strong business case supports the proposed SIB. The terms of the contract between funders and those delivering and paying out on the SIB should be

transparent, potentially including loopholes to incorporate continuous learning and programme development into delivery.

Secondly, there are challenges surrounding how to measure an intervention's impact fairly. Funders and Government must be confident that the metric used in a SIB has no systematic bias and that the impact is statistically significant (the intervention must have been applied to a suitably large cohort and the effects are not down to chance). Robust measurement requires that there is a clear link to the desired outcome, shared assumptions on costs, conservative and defensible forecasts and an allowance for second order effects (which occur when the intervention has effects on the wider system with implications for cost savings and social outcomes).

Where the SIB's intervention is the primary intervention working with particular groups (for example those who have served short term sentences and do not receive statutory support upon release) the link to improved outcomes is clear. Where the SIB intervention affects people who already participating in a range of interventions (for example those who have served a sentence of over one year and will receive probationary post release support) the link is more problematic to calculate.

To manage this risk, SIB partners should ensure the business case identifies the range of interventions currently being undertaken within SIB target groups; consider including existing services as part of the SIB in a consortia approach; and use a control group with similarly high levels of existing interventions to compare with the group involved in the SIB, thus comparing the impact the SIB has in addition to existing interventions.

Lastly there are challenges in relation to the basis risk of SIBs. Achieving 'real' savings for government stakeholders can be difficult as existing structures may not allow savings to be counted as genuine savings or the specific government stakeholder may not benefit from the saving (e.g. if the saving is returned to general government revenue).

In particular, the minimum change required for a genuine saving is difficult to pin point. For example, when one individual no longer claims welfare benefits the government makes a saving, but to save on prison costs a whole wing/prison may have to close before government achieves cashable savings. To manage this risk, SIB partners can ensure the process of making savings is clearly agreed at the beginning of the SIB; and/or reconsider the scale of the SIB is the impact will be insufficient to achieve actual savings for government.

Diffuse benefits can also be an issue. Although the vast majority of savings will accrue to the Ministry of Justice, reducing re-offending will generate savings in other areas. It may prove challenging to collaborate across local and central Government to address the question of where the multiple benefits fall. For example, less reoffending has large direct savings for the Ministry of Justice, while other departments may make quantifiable but small benefits across health, education and housing that are difficult to quantify and pool together. To manage this risk, SIB partners can attempt to create more place integrated programs in local areas; and/or tailor the SIB interventions to achieve sufficiently high savings for one particular government stakeholder to pay out on the SIB.

A final challenge for SIBs will be ensuring that SIBs don't displace existing spending and interventions. This is particularly challenging where there are overlaps with existing public provision where funders could simply cut their current spending by an amount proportionate to new money raised via a SIB. To manage this risk, partners can include existing providers in the SIB rather than bypass them, and/or reach agreement with existing providers to maintain current level of spending or programme delivery.

Conclusion

SIBs are an innovative financial tool which can be adopted to revolutionise the way preventative programmes are funded, allowing the government to achieve 'more for less' from public services. The government already views SIBs as one of the many tools for investing in and achieving social outcomes, particularly in the field of criminal justice.

SIBs present the opportunity to invest widely in preventative projects to reduce re-offending, in turn saving central government money and improving the life and prospects of offenders and ultimately public safety. If implemented properly, they could halt the trend of hyperincarceration, reduce the prison population and stem the cycle of re-offending.

They are being actively considered or developed over many social policy areas, and tested in many parts of the world, including the USA, Australia and across Europe. Their advantages are clear and appealing, however, at this stage taking into account their lack of application, it is hoped that SIBs will under-promise and over-deliver. Their implementation and execution is likely to be complex, but these barriers which can be overcome with piloting and experimentation.