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SOCIAL POLICY BONDS

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SUMMARY

Almost everyone can benefit from the more efficient and equitable provision of services currently provided by the government. Social policy bonds are suggested as a way of achieving that goal. The bonds, issued for whatever price they will fetch on the open market, would be redeemable for a fixed sum, but only when the specified social objectives have been achieved.

Key words: social policy, efficiency, bonds

1 BACKGROUND

Despite ever-increasing material prosperity western societies are plagued by seemingly intractable social problems. There is near unanimity over what needs to be done: unemployment must be reduced; housing, education, health services must be improved. Yet there seems to be a broad consensus in current political thinking that efficiency and compassion are conflicting goals: that these problems can't be solved until national prosperity is raised and some of the benefits trickle down to the less well-off.

The myth that social problems are best solved by this roundabout and protracted process is one that needs exploding if New Zealand - or indeed the whole western world - is not to leave many of its citizens behind in the race for prosperity.

But a naive faith in trickle down is rife in policy making circles and has excused western government actions which have directly led to, for example, increases in unemployment and the cutting back of welfare expenditure. Such effects are undesirable - and should be unacceptable - in a society such as ours with highly developed technological and organisational skills. A hands-off approach by government is seen as an end in itself in many influential circles yet people are forgetting the supposed rationale for small government: that big government is inefficient and wasteful.

Social policy: current approach

Most people would agree on certain basic social objectives: full employment, for example or better health, education and housing. The way in which these objectives are currently targeted is, at best, indirect and haphazard: government encourages economic growth in the hope that the benefits will outweigh the costs and then tries, via the tax and welfare system, to effect some redistribution. So responsibility for solving social problems remains with, or is dispensed by, government bureaucracy - a byword for inefficiency.

Much of the debate about how to solve these problems has taken the form of a simplistic left-right shouting match with little intelligent content. On the left we have the tired cliches of those who think government money alone can solve problems, who inhibit free trade and economic efficiency for the short term benefit of powerful groups of workers to the detriment of less powerful workers, the unwaged and the third world. On the right we have the apotheosis of self-reliance as a virtue: the smugness of those who succeed under the present system with their (guilt-induced?) contempt for those who fail. The problems remain unsolved.

Self-interest

Wealth generation is a complex process but in the communist as well as capitalist world it's gradually being realised that the most effective catalyst for the generation of wealth is self-interest. While we may not like the implications of this, it's a fact and if we recognize it we can channel self-interest into solving social problems, not just individual ones. In many countries government-imposed constraints to self-interest have been slackened in recent years and wealth creation has become a more efficient process as a result.

But neither efficiency nor wealth creation has an ethical dimension. Self-interest, unmodified by a social conscience, has no social responsibility. It can generate more wealth but the distribution of that wealth to address social concerns remains problematic.

These concerns include such diverse expenditure items as social welfare, health services, education and other public goods such as highways, and the police force. Inefficiencies in their provision blight all the western world - as testified by those who slip through the social welfare net, the numbers of unemployed, those on hospital waiting lists or those illiterate after years of schooling. Poverty amidst plenty, obvious in the UK, the US and parts of Western Europe is in danger of becoming a feature of New Zealand life as well. The fact that these inadequate social services are paid for by many not so well-off citizens leads to a widespread cynicism (or resignation) about the possibilities of progress in a social democracy. The unsolved problems, combined with this jaundiced view of the virtues of consensus have already led to the ominous airing of extreme political attitudes.

Social problems should not have to rely on trickle down for their solution. They can and should be dealt with more directly and more efficiently. Apart from being a worthwhile end in itself their solution would bring more people into the productive sector and would allow the removal of many of the remaining constraints on free market forces. A more prosperous society, with fewer social problems, would result.

Why is society so inefficient in achieving its social objectives? The fact that their achievement is in the hands of government must be at least part of the answer. The system - though not the individuals working for the system - is inherently cynical: at the limit the solution of a social problem by a government institution can lead to the dissolution of that institution. More generally, at the day to day level, there is no relationship between the solution of problems and the rewards to those employed to solve them. So the pace at which the system moves is dictated by that of its least committed operatives. Without self-interest there will always be enough of these to inhibit attainment of society's objectives.

Very few government employees are given any tangible inducement to perform better. As a consequence it is only at the highest level of government that there is any correlation between efficiency and payoff. Even there the payoff, in the form of kudos to past or present governing parties is often misplaced, given the extreme complexity of today's economies, the time lags between a policy's implementation and its consequences, and the absence of convincing mechanisms to investigate government efficiency. It is still largely true that expenditure, unrelated to results, is seen as the measure of a government's commitment to achieving its social objectives. Attitudes are changing and it is now more widely recognised that throwing money at a problem does not inevitably lead to its solution, but attempts to save money often see the most cost-effective programmes cut back, while the most well-established, and often the most wasteful are allowed to continue. There is no mechanism to ensure that the most efficient programmes are encouraged, but there are usually sufficient entrenched interests to ensure that inefficient programmes remain.

The contracting out of social services to private bodies is often canvassed as a more efficient way of achieving society's objectives. At the local level contracting out of services previously supplied by government has led to increases in efficiency (for example in laundry services at UK hospitals). But opportunities for this sort of efficiency gain are limited to very specific services where performance is easily verified: generally single processes of a local, short term nature. Long term services, needing several processes, and being of a greater than local application cannot be contracted out in this way.

Neither is privatisation the answer: private agencies have private objectives and there is no intrinsic reason why these should coincide with social objectives. Privatisation, and the need to give shareholders a decent return on capital, all too often lead to the provision of services only to those most able to afford them.

So the contrast between the private and public sectors has sharpened in recent years. Deregulation and the freer operation of self-interest in parts of the private sector have made a lot of people very wealthy indeed. But the less well-off have gained little and market forces are often cited to justify measures that hurt the poor. It seems only fair that government should formulate social policy in such a way as to ensure that the less well-off also receive the eficiency benefits from a system where incentives play a more prominent role.

The question remains: how can self-interest be injected into social policy in a way which would benefit society as a whole? The next chapter describes a mechanism by which this might be achieved.

2 DESCRIPTION

How can self-interest be harnessed into making the achievement of social objectives more efficient?

In essence the achievement - but not the setting - of social objectives is contracted out to the private sector via a free market in a new sort of financial instrument: government-issued social policy bonds (SPBs). First a word about conventional bonds: these are issued by a government (or government agency, or private company) as a means of raising money. Normally bonds are redeemable for a fixed sum, at a fixed date and yield a fixed rate of interest. Often they are issued to raise money for a specific purpose; to fight a war, or to finance particular engineering projects. My proposal is to issue bonds which are *not* redeemable at a definite time in the future, nor do they bear interest. They are bonds which are redeemable *only when the government objective in question has been achieved.* Social policy bonds would be issued by government at whatever price they will fetch on the open market and thereafter could be bought and sold by any willing individual or institution at their free market price. Once the targeted objective had been achieved they would be redeemable, as are conventional bonds, for a fixed, predetermined sum. They therefore differ from conventional bonds in that they would have an uncertain redemption date, which, in combination with a fixed redemption value, implies an uncertain yield. Also, the initial sale and redemption of the bonds would involve a financial loss to the government. Importantly this loss on the bond issue would be offset by the financial and social benefits of objective achievement.

The operation of the scheme can best be explained by considering an example. Take the objective of the reduction of unemployment. Assume that a fixed number of bonds is issued, redeemable for $10 only when unemployment is down to, say, 20000. These bonds are floated, nationally and overseas, on open tender as at an auction: those who bid the highest price for the limited number of bonds available will be successful. Importantly all bonds would find a buyer: the price might be very low, but the bonds will all be sold. What factors will determine the price of these bonds? Most obviously the market's assessment of *how likely* and *when* the objective will be achieved. Interest rates on alternative investments will also be a factor. The bonds could go for as little as 1 cent if people thought there was virtually no chance of this particular government objective being achieved in their lifetime. People will of course differ in their assessment of the value of the bonds and their views will change with time as events make achievement of the targeted objective a more or less likely prospect. But the bonds once issued would be transferable at any time; market prices would be publicly quoted just like those of ordinary bonds, or shares.

Let's assume now that the bonds targeting unemployment have been issued and sold. The opening value of the bond might have been say $2.50. People, or institutions, now hold bonds which can quadruple in value once unemployment is down to 20000. The government has nothing more to do: the holders of the bonds now have a strong interest in seeing the value of their bonds increase as quickly as possible. (If other people's interest is stronger they will bid more for the bonds than the current holders think they're worth and will thus own them. So SPBs will generally be in the hands of those with the strongest interest in seeing the objective attained.)

Who would buy the bonds?

1 *Passive investors hoping to make a capital gain*. These would include:

a casual purchasers who might buy bonds in the same way as they would a Lotto ticket. They would hope to hold onto the bonds until redemption, or until the market price of their bonds had risen sufficiently high for them to enjoy a worthwhile capital gain.

b speculators who know, or think they know, that the likelihood of the objective being achieved is greater than the rest of the market thinks it is, and that the bonds are therefore underpriced. They would similarly hope to make a capital gain from holding the bonds.

c perhaps the most important category of passive investor is the hedger who, in the absence of the bond issue, would stand to lose if the particular social objective were achieved. Hedgers would buy the bonds as a form of insurance policy against this possibility. In the unemployment example passive investors in this category might include proprietors of video game parlours or the manufacturers of inferior goods (goods such as cheap foodstuffs for which demand declines as incomes increase).

Passive investors wouldn't do very much about achieving the objective. Their bonds, though, would encourage them to support, or to moderate their opposition to, objective-achieving initiatives. But the success of the bond issue would depend on

2 *Active investors* including:

a specialist brokers who would buy the bonds from the government or other holders, and who would then finance initiatives that would help achieve the objective. They could use their own capital, or borrow on the strength of the redemption value of their bonds, in order to support such projects. These purchasers' motivation will come from the expected capital gain they will enjoy as the bond price rises with the enhanced probability that the objective will be achieved early.

b organisations directly implementing the objectives whose bond-holding would directly enhance the profitability of any actions they take which would help in achieving the objective.

Active holders, in this example, could be expected to increase employment by using part of the present value of their expected above-normal yield from early redemption of the bonds to finance their own, or others', labour recruitment drives.

Examples of the initiatives which would be taken by active holders would be:

--defraying the cost of recruitment to existing or new enterprises
--supplementing the income of prospective employees
--matching vacancies with those currently unemployed
--defraying costs of training or transfer of new employees.

The bond issue can also be expected to lead to other unemployment reducing activities, whose precise nature may not be known in advance. (Much will depend on the definition of unemployment used: for instance the objective could be defined in such a way as to encourage job-sharing initiatives.)

Prospective holders of the bonds would have an incentive (and given free capital markets, the means) to buy them from current holders if they think they can do a better job of achieving the government objective. Thus the provision of the means by which the objective is attained is not in the hands of entrenched interests. Note that this also applies to passive bondholders of the (a) and (b) categories (passive holders who are not insuring against achievement of the targeted objective). If these investors have sufficiently large holdings of the bonds they will be highly motivated to become active rather than see their returns from bondholding suffer as the targeted objective becomes an ever more remote possibility. By becoming active themselves these bondholders will increase the likelihood of early redemption of the bonds.

Many of the initiatives which would be stimulated by the unemployment reducing bonds of the example are to some extent taken by governments nowadays, but the critical difference is that with the bond method the initiatives are stimulated by the self-interest of the bondholders and are not operated by a bureaucracy which, however well-intentioned, is not rewarded in ways which correlate to its success in objective-achievement. SPBs provide a strong motivation for bondholders to seek out those ways of reducing unemployment which will give them the best return for their outlay.

The bonds direct self-interest into those processes necessary for objective-achievement that will respond most readily. The government does not have to plan this: it is the self-interest of bondholders that ensures it. Current efforts by government generally focus on the most obvious symptom of a social problem - not on the problem as a whole. Thus an inefficient industry on the verge of bankruptcy might receive vast amounts of taxpayers' money at the expense of cheaper job creation initiatives. Social policy bonds improve on ad hoc arrangements of this kind which are not only inefficient but also expose decision-makers to bribery or corruption. Another significant advantage over conventional policy is that government pays only when the targeted objective has been achieved.

The next chapter considers some objectives that might be targeted by SPBs, and looks at some practical aspects of their application.

3 APPLICATION

Areas where social policy bonds would be expected to show the most marked improvement over existing government-influenced methods of objective achievement would be those where financial rewards to those currently involved in objective-achievement are not related to the degree of attainment of the objective. There are many areas like this, where government is the principal player. Some of these areas, and examples of how policies within them could be substituted by SPBs are:

--Crime prevention: Currently touted methods of combatting crime are longer sentences for convicted criminals and more money for the police force. SPBs would hone in directly on what society actually wants to achieve: they would target numbers of reported crimes.

--Employment: SPBs targeting unemployment could replace a wide range of measures including protectionist barriers to imports of labour intensive manufactures which are aimed at maintaining employment in certain industries. Here the efficiency gains from SPBs which target unemployment directly would be dramatic.

--Health: Priorities for health services are strongly influenced by groups of medical specialists with little incentive or capacity to see improvements in the *general* health of the nation as an objective. So funding of these specialities depends on the strength of their lobby groups. And what is arguably the most efficient way of spending the taxpayer's health dollar - preventive medicine - receives derisory funding because it has no powerful lobbyists.

Targeting general indicators of well-being - life expectancy, infant mortality, disability - would ensure that scarce resources are allocated in ways which would directly achieve *society's* health objectives. The bonds would divert, impartially, government funds into those areas of the health service (or they would encourage the exploration of new areas) that would most efficiently use them to achieve the targeted objectives.

--Housing: SPBs might target the numbers of homeless, or the number of new approved housing units completed, or occupancy rates of the existing housing stock.

--Education: SPBs could target results achieved in basic literacy and numeracy tests taken by schoolchildren.

--Pollution: SPBs could target nationally averaged levels of water or air pollution.

With all these examples there would be difficulties in the specification of the objective to be attained. 'Approved housing units' for instance, or 'reported crimes' could be subject to varying interpretation or to deliberate attempts to falsify the information required to monitor achievement of the objective in question. But these difficulties are not insuperable as long as the following three processes are soundly carried out:

1 quantification
The objective must be capable of being quantified or there must be a strongly correlated proxy for the objective whose targeting would inevitably result in the objective's being achieved.

2 definition
Careful thought will have to be given to the definition of the objective targeted by the bonds. Consider the unemployment example. It would be unsatisfactory to redeem the bonds when unemployment was down to a certain level for a short time only. The objective is a *sustained* level of low unemployment and this is how it would have to be defined when the bond is issued.

3 monitoring
All bond issues will require reliable and accurate monitoring of the targeted problem so that progress towards the attainment of the social objective can be reliably and unambiguously assessed. This surveillance must also be seen to be independent of government or interest groups, both of which could benefit unfairly from dubious data collection. The nature of the monitoring (whether it's carried out at local, regional or national level for example, or the level of aggregation at which independent organisations are involved) would depend on the objective being targeted, and to some extent, on the amount of government money at stake.

The market for social policy bonds

For the SPBs to work it is essential that active investors purchase the bonds and directly, or indirectly, help to solve social problems. But there is no need artificially to boost investor interest in the bonds: the anticipated supernormal profit arising from early redemption of the bonds generates the required self-interest and so supplies the motivation for achieving the government's social objective *provided* there is a buoyant market for the bonds.

SPBs, once issued and sold, must be readily tradable at any time until redemption. This is critical to the operation of the SPB mechanism. Many bond purchasers will want, or need, to sell their bonds before redemption - which may be a long time in the future. If there were no secondary market these holders would not be able to realise any capital appreciation experienced by the bonds. This would remove much of the incentive to purchase the SPBs when issued.

But there is another important reason for requiring a healthy secondary market in the bonds: active investors may be able to speed up only one, or a few, of the processes necessary for the targeted objective to be achieved. Once these investors have done their bit, and seen the capital value of their bonds increase in line with the resulting increased probability of the bonds' early redemption, they may have no wish to speculate on the speed at which the remaining processes will be carried out. Other groups of active investors, who will have greater expertise in performing these later processes, must be given an incentive to use their expertise to accelerate attainment of the objective. The possible capital appreciation of bonds bought from previous owners and sold at a still higher price (or redeemed) provides this incentive. The new owners will, if they are successful in these later stages, realise this capital appreciation.

The secondary market is also necessary from the government's point of view. Government could, as a competitive supplier of objective-achieving services, participate as an active investor in the SPBs. But it should also be able to participate as an passive investor.

Government, while it may profit from appreciation of the bonds it purchases, will also be interested in the cost of its social policies. The SPB principle is superior to existing budgetary mechanisms in that the cost of each scheme is not only inexorably linked to attainment of its objective, but its maximum cost can be decided in advance. The number of bonds is limited and the most the scheme could cost the government would be the cost of redeeming the bonds very soon after they are issued (this assumes a negligible issue price) plus all the administrative costs. Even then though, *the objective will have been achieved* before any cost is incurred.

The efficiency of SPBs could be tested by allocating the same sums of money as are currently allocated for a particular social objective to the redemption of SPBs which target the identical objective. The maximum cost to the government of the issue could then be set so as not to exceed the expenditure that would anyway have been incurred in pursuit of the same objective.

We should note that SPBs will allow for the complexity of social problems. No single approach will solve them so a wide variety of approaches to their solution is essential. SPBs will encourage and reward *the most efficient* of these approaches. This occurs because of the nature of the bond mechanism, and requires no selection or supervision by government (or government agency) of the most efficient policy. Only the objective, not the policy, is dictated by government. This feature tends to stabilise the political environment. Obviously the objectives will have to be carefully defined but there are extremely important objectives for which a wide - in practical effect, unanimous - consensus exists: lower unemployment; better health, education, housing, or reduced crime levels, for instance. A government is unlikely to repudiate such universally desired *objectives* even if the associated SPBs were issued by ruling parties with a different political outlook. The risk that it might (and so become the first government *openly* to support higher unemployment, worse standards of health care etc) would be not much greater than that of the government refusing to redeem fixed interest stock issued by any of its predecessors. This risk, always present, in no way impedes the operation of bond markets.

Lastly: the impact of SPBs on the money supply. In the short run each bond issue taken singly, and especially if the objective were not a distant prospect, could be deflationary: the money supply could be reduced considerably if a popular bond sold for a high price on flotation. However, in the long run, with careful choosing of targets and a constant counterpoint of bond flotation and redemption, the effects of SPBs on the money supply could chime in with any desired monetary strategy.

The next chapter looks in some detail at the efficiency and distributional aspects of SPBs.

4 EFFICIENCY AND DISTRIBUTION

Economists generally evaluate policies on the basis of two criteria: efficiency and distribution. (Distribution here means the distribution of income and wealth amongst the population.) Often society's efficiency and distributional objectives conflict. With social policy bonds conflicts of this sort can arise both with the choice of objective to be targeted (*ends*) and in the specification of that objective (*means*).

Ends

Imagine that national prosperity - or a proxy for it such as Gross National Product - could be adequately quantified and were targeted by a bond issue. Then bonds might be issued which would be redeemed only when the rate of growth of GNP had remained at 5% or greater, per annum, for 10 years. SPBs would, we can assume, be an efficient way of achieving this objective; but we should note how limited this objective is. It says nothing about the distributional effects of target hitting. A significantly higher GNP, while looking impressive in league tables, would hardly conform to society's preference if almost all the increased prosperity ended up in a few dozen pairs of hands. Society would willingly accept a lower growth rate if the extra GNP could be more equally distributed.

SPBs give no indication as to how policies are going to be achieved. Thus targeting a national economic objective (so as to raise GNP, for example, or to reduce inflation) may well lead to adverse distributional or other socially negative consequences. These negative effects could be targeted by other bonds or ad hoc legislation but it would be much better for each bond issue to ensure that distributional problems are not aggravated for two main reasons: 1 because the negative effects would be difficult to anticipate, and 2 because in the absence of a foolproof social safety net some, perhaps many, of those whom society considered already disadvantaged could be adversely affected and remain uncompensated for the further decline in their standard of living.

It is for this reason that I have called the bonds *social* policy bonds: initially at least the bond principle should be used to fulfil social policy objectives whose achievement would definitely not hurt the underprivileged. They should target explicitly objectives whose achievement would improve the distribution of income or wealth within society. There are always winners and losers when policies are implemented and in the end society's distributional criteria cannot be precisely, or unanimously defined. But it is important that the bond principle's efficiency improvements should not conflict with broadly accepted distributional objectives.

With more highly developed transfer and welfare systems, which could ensure that society's distributional objectives will be met under any circumstances, the bond principle could be applied beyond social policy objectives. Then cross-subsidisation of bond issues could occur...for instance: bond issues that raised manufacturing productivity, or export earnings, or national prosperity generally, could subsidise those that targeted purely humanitarian objectives such as reduced infant mortality, or better care for the elderly.

Means

From the *efficiency* point of view it appears that the more broad the specification of the objective the better. For instance: it would be more efficient to target the national total of unemployed than to aim to make the same cut in the total by targeting the regions separately. Targeting total unemployment in this way would imply that we are indifferent between, say the loss of 1000 jobs evenly distributed around the country and the closure of a large factory employing the same number of workers in a small provincial town.

In general to the extent that we are not concerned about who is unemployed, or which particular young children benefit from lower infant mortality, or who benefits from social policies specification of these targets in terms of national totals makes sense in that the bond target would correlate quite closely with society's aims. More specific distributional objectives - reducing unemployment amongst ethnic minorities for instance - could, of course, be targeted, though with some loss of efficiency compared to the targeting of a reduction in the total unemployed by the same amount.

It is worth emphasising here that any distributional criteria have to be explicitly specified as the bond's objectives. The SPB mechanism will not allow policies to be justified on the basis that a particularly deserving group *might* benefit if they are implemented. This is an improvement on current policy where gains to deserving groups are cited in favour of policies which benefit them only peripherally, if at all, and where most of the benefits often accrue to those whom - if society had been given the chance to identify them - would be considered much less deserving cases.

The question of the optimum breadth of specification of the targeted objective can be approached from another angle. Assume that we target the level of atmospheric lead in a bond issue. It might be that targeting lead in this way would cause people to increase their use of subtitutes - which could be more dangerous than the original levels of lead. One way of anticipating this problem would be to aim initially at unambitious reductions in the lead level. Depending on the effects of this reduction on the use of offending substitutes, other bonds could then be issued targeting the substitutes, or further targeting the level of lead.

But a better approach might be to target, more comprehensively, atmospheric pollution. This could be expressed, perhaps, as an index of atmospheric pollutants weighted according to their lethality and other factors.

We should note that the same problem occurs in conventional policy, where efforts to promote or cut back on particular activities can give rise to unforeseen and undesirable side effects. By choosing the optimum breadth of objective specification - in this example: by targeting atmospheric pollution as a whole - the bond principle can minimise this possibility.

Taken together the efficiency and distributional criteria provide a useful framework for looking at the advantages of social policy bonds over conventional government policy:

Advantages of social policy bonds

1 The main advantage of SPBs is that they make the achievement of social objectives more efficient by injecting self-interest into every stage of the process. Thus efficiency in the attainment of distributional aims is improved. For the same government expenditure, therefore, more could be achieved in the social policy area. Additional gains accrue for other reasons:

2 The bonds guarantee stability of policy objectives. Policy instability is an important reason why people do not undertake projects or activities that could benefit society. Objectives with a necessarily long lead time (for example: to reduce levels of water pollution to half current levels) could be targeted by SPBs and holders of the bonds would not be deterred from taking measures to achieve them by fears of a reversal of government policy - or indeed, a change of government. In the current policy making environment decisions about projects are plagued by policy uncertainty arising from government decisions which are subject to all the whims and inefficiencies of political expediency. Uncertainty also surrounds the behaviour of the aspiring political parties which differ not so much in their stated objectives but, more critically, in the ways they will strive to achieve them.

3 The bonds make policy objectives more transparent. Apologists for current policies often point to benefits which can result only haphazardly - if at all - from their implementation. SPBs would ensure that objectives are explicitly identified, and that indirect methods of achieving them would be encouraged only if they were efficient.

4 A less obvious distributional benefit would arise from the existence of a means of acquiring wealth where private gain is strongly correlated with public benefit. Many bondholders would be rich, and, if their bonds were redeemed early, they would become richer. But this socially acceptable way of acquiring wealth would allow other, less socially beneficial forms of wealth accumulation (inheritance, or activities of little social benefit), to be taxed more heavily.

Extension of the bond principle

The bond principle will have to be applied, developed and refined before it can supplant the role of government as we know it. But once solutions to society's distributional problems are found the bond principle can be used in other areas. Bonds could, for instance, be used to target quantifiable components of national prosperity.

In the *very* long run the widespead acceptance of the fact that self-interest is the most effective catalyst for change can have more far-reaching implications, transcending national boundaries. Supranational problems - war, famine and disease - might be made the targets of internationally backed bond issues. This, however, is a long way into the future. The next, and final, chapter, looks at some of the problems involved in fitting national social policy bonds into the current political environment.

5 INTEGRATION

Integrating social policy bonds into the current political system will need new approaches to budgetary planning and policy making.

Budgetary planning

SPBs, at first sight, would be difficult to incorporate into conventional budgetary planning. The time profiles of costs of, and benefits from, SPB issues differ markedly from those associated with current policies. At this stage not much needs to be said: SPBs could initially be used as supplements to, rather than substitutes for, existing policies. Experience gained in this transition stage could be used later, when the size of major bond issues demands that their effects on government income and expenditure be more accurately anticipated. But note that the possibility, at any time, of government purchase and sale of the bonds can be used to remove much of the budgetary planning uncertainty. Also note that explicit targeting of objectives is likely to lead to explicit calculation of the value of their achievement - a useful discipline, but one rarely followed by today's politicians.

Policy making

The most significant problem concerning the integration of social policy bonds into current policy making procedures is probably the incentive they will give for bondholders to achieve the specified objectives at the expense of other societal goals.

Illegal activities could be dealt with by existing laws, backed by a system of bondholder registration which would identify those with the largest incentive to commit them. Unfortunately there may be activities undertaken by bondholders in pursuit of a targeted objective which, while not illegal, conflict with society's other interests. Possible negative activities would differ according to the targeted objective. Obviously the drafting of the bonds would have to exclude these as far as is feasible but it is always possible that unforeseen negative - but legal - activities could be undertaken by bondholders to bring about early redemption. The discussion in the previous chapter considered as an example the possibility of substitution of untargeted pollutants for targeted ones. Objectives which are complementary and which, if not pursued jointly, could conflict, should therefore be targeted by a single bond issue.

A number of safeguards could also be used against *unforeseeable* negative, but legal, activities undertaken in pursuit of a targeted objective. These could include the following:

--- registration of bondholders with the aim, if necessary, of encouraging (or bribing) them to achieve targeted objectives only by socially acceptable means

--- provisos on the bonds specifying indicators of social welfare which, while not explicitly targeted by the bond issue, must be satisfied for the bonds to be redeemed. These provisos could be used to prevent the undertaking of activities with adverse effects to bring about attainment of the targeted objective. Thus SPBs targeting unemployment could embody provisos to the effect that the bonds would not be redeemed if the emigration rate, say, or the inflation rate, exceeded certain specified limits. Or:

--- multi-targeted bonds, with more than one objective could be issued.

In more extreme circumstances the government could, once the bonds had been issued:

--- introduce ad hoc measures to make the negative activities illegal or to mitigate their effects

--- declare a particular bond issue invalid and compensate the current bondholders according to a formula related to the price they paid for the bonds.

These dangers should not be overstated. It is likely that existing laws, combined with careful choice and specification of the bond objectives would make the use of these safeguards unnecessary. And the question of how well social policy bonds would achieve societal goals needs to be considered alongside current policy making methods. There have been many instances in conventional policy making where the actual results of a policy are not just unintended, but often run counter to the original intention. Thus, rent controls, intended to benefit tenants, have discouraged landlords from letting property. The result is that private rented accommodation is harder than ever to find, so that rents have increased. Again, policies intended to benefit manufacturing workers - such as import barriers for manufactured products - have hurt the very people they were intended to help.

If single policies are sometimes difficult to get right in today's policy making environment then combinations of policies frequently result in interactions which are unforeseen and unforeseeable. Policy makers in today's environment can escape or deflect censure because the adverse results of their policies are difficult to relate to their cause. Violence, drug-taking, and petty crime, for example, are all blamed on anything from television, to this government, the previous government, the wartime traumas of a previous generation...and so on. If SPBs were to lead to negative effects the relationship between these effects and their causes would be identifiable and the filtering out of negative effects would be a simple matter compared to the methods available to today's policy makers.

Another possible problem arising from the integration of SPBs into the current policy making system arises from government's role as creator of statutes. Laws affecting the bond price could be passed. For instance: government could come under great pressure not to increase unemployment benefits from holders of bonds targeting unemployment. Once again, however, the source of the pressure, and the motivation for it, would be easy to identify. In any case the threat of such pressure has a positive aspect: for bond issues to be as successful as possible governments would have to give assurances as to their future behaviour. This could be another means by which SPBs stabilise political objectives.

Conclusions

Resources are always limited and social policy bonds will not change this. Priorities and choices will always have to be made: under the bond principle the choice of problems for which bonds are issued and the funds allocated to their solution will remain in the hands of governments with all their imperfections.

Yet the advantages of the bonds over existing policy instruments are not insignificant. Social policy bonds will achieve society's distributional objectives more efficiently, and less randomly, than the current combination of ad hoc policies and trickle down. The bonds would also lead to more stable policy objectives and a more transparent policy making process. There would be other benefits too, arising from the existence of a means by which private gain is correlated to social benefit. And lastly: the bond principle allows any adverse effects of government policy to be much more reliably traced to their source than does a conventional policymaking regime.

Of course, the surrendering of policy instruments to the private sector - even with the aim of achieving social objectives - will be politically difficult, and must be a gradual process. But the potential benefits cannot be ignored. Social expenditure on education, health, pensions, unemployment benefit and other items has been growing very rapidly in the western world. In the OECD countries it now accounts for a quarter of gross national product - as against 14% in 1960. Even the relatively small gains in efficiency which would arise from cautious trials of the bond principle will prove extremely significant to those most in need.