Ronnie Horesh

Market Solutions for Social and Environmental Problems

Social Policy Bonds

SocialGoals.com

rh@SocialGoals.com

Contents

Introduction

There's no shortage of cash for projects that, in civilisational terms, are trivial: $680 million to develop a five-blade razor from a three-blade razor[1] for instance; and there's no lack of human ingenuity when one company alone manufactures and markets 61 brands of dogfood.[2] It often seems as though there are more resources of all kinds lavished on the launch of new laundry products or sorting out the tax affairs of wealthy binational couples than there is spent on avoiding war or eradicating global poverty. Could this have something to do with the much bigger financial incentives on offer to the people who market soap powder or perform shifty-but-legal accountancy manoeuvres? This book will try to show that the answer is 'yes'; and that it's in our long-term interest to redirect some scarce resources into achieving social and environmental goals.

It will describe a new financial instrument, Social Policy Bonds, whose purposes are to make the achievement of social and environmental goals more efficient, to make the goals themselves more stable over time, and to make them more transparent and so bring in greater public participation and buy-in. The bonds would do this by injecting the market's incentives and information-generating power into all processes necessary to achieve our goals. They could be issued and backed by anyone: supranational bodies such as the United Nations or the World Bank, national or local governments, non-governmental organizations, wealthy philanthropists, or groups of concerned individuals. These bodies could issue Social Policy Bonds in pursuit of a similarly wide range of goals: anything from global peace, or the prevention of catastrophe of any sort, to reduced national crime rates or cleaner, tidier cities.

How much scope is there, really, for improved efficiency and effectiveness in the solution of our social and environmental problems? Our problems are clear: some of the most obvious include violent political conflict between and within states; fears of nuclear conflagration; poverty amidst plenty in the rich countries; chronic morbidity and malnutrition in much of the third world; the effects of natural disasters; and the risks of environmental catastrophes such as those arising from climate change. But the existence of these problems is not in itself proof that we are solving them inefficiently. Are we perhaps just lacking the required resources? So the first chapter attempts to show that the agents with whom, in the industrialised world, we entrust the biggest share of our problem-solving resources are inefficient and create problems for their own citizens, for other countries, and for the global commons: these are the national governments of the rich countries. The second chapter looks at some of the causes and consequences of government inefficiency. In the third chapter, I introduce Social Policy Bonds: a new financial instrument designed to channel the market's efficiencies and incentives into the achievement of social and environmental goals. The fourth, fifth and sixth chapters look at some of the practical aspects of the bonds and compare them with current policies, including those that have some market component. The seventh chapter shows how concerned groups or philanthropists could issue their own Social Policy Bonds, with the aim of raising female literacy in a developing country. The eighth chapter discusses how the bonds would work politically, and the final chapter looks in more detail at which goals should be targeted under a Social Policy Bond regime.

---

[1] *Gillette's Five-Blade Wonder*, William C. Symonds, 'Business Week', 15 September 2005.

[2] *Pet food and pseudo-variety*, Steve Hannaford, http://www.oligopolywatch.com/2007/03/ 19.html, 19 March 2008, sighted 6 April 2008. The company is Menu Foods.

Chapter 1

Government spending on social and environmental goals is inefficient

This chapter looks at the policies of the rich world's national governments. It will first look at some of humanity's problems, then argue that:

- Governments could be doing better
- Government policymaking is a crucial determinant of well-being
- Government policymaking is driven by things that have little to do with well-being

We could be doing better: the news is decidedly mixed

Humanity's problems are well known. After 43 years and $568 billion (in 2003 dollars) in foreign aid to Africa, large numbers of children on that continent are still dying through want of cheap medicines and bed nets that could prevent half of all malaria deaths.[3]

Neither has violent political conflict gone away: In the 1990s 3.6 million people, most of them civilians, were killed in conflict.[4] New kinds of war are being fought that are less disciplined and more spontaneous than the old. In these 'low-intensity' wars, occurring in recent times in Ivory Coast, Somalia, Sudan, Liberia, East Timor and the former Yugoslavia, the civilian proportion of the dead reaches 90 percent.[5]

Meanwhile the *potential* for catastrophe represented by the proliferation of weapons of mass destruction, especially nuclear, is increasing. The total world nuclear stockpile now consists of over 36 800 warheads. (In addition to deployed nuclear warheads, thousands more are held in reserve and are not counted in official declarations.[6]) Countries as poor as North Korea now have the capacity to threaten neighbouring countries with nuclear weapons. One expert estimates that, barring radical new anti-proliferation steps, the odds of a terrorist nuclear attack occurring in the ten years from 2004 are about even.[7]

Everywhere, the commons – publicly owned resources, the things that cannot be reduced to private property: the air, the water, the wandering animals, the public land, the wildlife, the fisheries – are being degraded, or disappearing altogether. A 2003/04 report on the state of the commons[8] summarises the bad news:

- Our shared life support systems — the atmosphere and our fresh water supply in particular — are deteriorating.

- Our cultural and scientific commons are being privatized.
- Noise of all sorts is destroying the commons of quiet.

Further suggestive evidence comes from the United Nation Environment Programme, which says that major threats to the planet such as climate change, the rate of extinction of species, and the challenge of feeding a growing population are among the many that remain unresolved, and all of them put humanity at risk. It identified in its 2007 report, no major environmental issues for which the foreseeable trends are favourable.[9] It reported:

- loss of fertile land through degradation,
- unsustainable pressure on resources,
- dwindling amount of fresh water available for humans and other creatures to share, and
- risk that environmental damage could pass unknown points of no return.

The world climate appears to be changing, perhaps too rapidly for many ecosystems to adapt. The consequences for much of the human population could be disastrous.

What is the commons?

Commons is the generic term. It embraces all the creations of nature and society that we inherit jointly and freely, and hold in trust for future generations.

Common assets are those parts of the commons that have a value in the market. Radio airwaves are a common asset, as are timber and minerals on public lands. So, increasingly, are air and water.

Common property refers to a class of human-made rights that lies somewhere between private property and state property. Examples include conservation easements held by land trusts, Alaskans' right to dividends from the Alaska Permanent Fund, and everyone's right to waterfront access.

Common wealth refers to the monetary and non-monetary value of the commons in supporting life and well-being. Like stockholders' equity in a corporation, it may increase or decrease from year to year depending on how well the commons is managed.[10]

Mainstream economists keep track of private income or wealth but seldom acknowledge the existence of the commons, nor do they often measure its degradation. [11] It's either assumed to be trivial, or it's ignored just because it's difficult to define, let alone value. Economists don't necessarily assume the negative impacts on the commons from economic development are zero, but they appear to assume implicitly that they are less than or equal to the positive impacts. The negative impacts of economic growth include the degradation of the commons, and there is also a respectable case for arguing that the rich countries have exported some such impacts to the rest of the world. In the words of Professor Richard Norgaard: 'At least to some extent, the rich nations have developed at the expense of the poor and, in effect, there is a debt to the poor. That, perhaps, is one reason that they are poor.'[12] It's worth acknowledging here that there are positive externalities of wealth generation beyond those that appear in company accounts and monetary measures of economic activity. These include the important benefits to society arising from employment: such as reduced poverty and crime - which themselves have important positive spin-offs for the commons. Just as almost all the negative externalities of economic development are ignored, so too are those positives that bypass the measured monetary flows.

But even within the rich countries there are serious social problems and pockets of poverty. Our populations suffer from crime and the fear of crime. Health services appear always to be in crisis and schools fail to educate many of our children to be functionally literate.[13] With a massive public sector, and after decades of ever-increasing taxation, the British Government today is still targeting the birth weight of babies in the country's most disadvantaged areas.[14] And for all that we live in the most prosperous societies ever, continuing economic growth doesn't seem to have made us much happier.[15]

Government policy is crucial

In the industrial countries, government spending is both high and rising. So much so that, for example, one in three households across Britain is now dependent on the state for at least half its income. More than seven million households are getting most of their income from government handouts.[16]

For the countries in the rich world total government expenditure as a proportion of Gross Domestic Product ranges from about 35 percent in the US and Australia, through 45 percent in the UK and Germany, to more than 50 percent in Italy, Denmark, France and Sweden.[17] The role of government in some regions of the rich world exceeds that of Communist China or the former Soviet Union. In Wales, for example, the public sector accounts for 66 percent of the economy.[18]

Note that these are proportions of a GDP that has been rising. And it's worth pointing out that increases in government expenditure have occurred despite the rhetoric about 'rolling back the frontiers of state'. Political conservatives in the United States used to define themselves largely by their belief in less government. 'Many still view themselves that way, but the self-conception no longer has anything to do with reality. ...[F]or the 101 biggest programs that the Contract With America Republicans proposed to eliminate as unnecessary in 1995, spending has now risen 27 percent under a continuously Republican Congress.[19]' While there may have been dips in government spending as a proportion of national income in some countries in recent years, in almost all of the rich countries it continues to grow in absolute terms.

Of course, government isn't the only body trying to achieve social and environmental goals. There are numerous private bodies: charities and non-governmental organizations, working to alleviate poverty and other depredations. But at least in terms of expenditure, they are dwarfed by government spending, which is only the most quantifiable measure of its influence: government intervenes in other ways that affect citizens' standard of living. Most obviously government creates laws and regulations including those affecting trade, sets monetary and fiscal policy, and favours or penalises certain institutions and activities. However, from the volume of its spending alone we can see that government's interventions are sufficiently important to merit scrutiny and that if government were significantly inefficient that would hurt its citizens' well-being.

Anecdotal evidence is not enough

Government spending is high so its efficiency has a bearing on whether it is worthwhile looking at alternatives, and in which direction we should look. We take 'efficiency' here to be the efficiency of conversion of all the world's resources into net improvements in social and environmental outcomes.

Immediately we run into measurement difficulties. We know that national governments in the rich countries are big. We also see that there are large unsolved social and environmental problems at all levels – global, national and local – and that some of them appear to be worsening. We suspect government to be ineffective and inefficient and can certainly cite anecdotal evidence to that effect. And this is not just the feeling of economists, academics or journalists. I don't think many ordinary people would reply 'yes' to the question once posed by John Fund: 'Ask yourself: If you had a financial windfall and decided to tithe a portion of it in a way that would best help the less fortunate, would you even think about giving a check or donating time to the government?'[20]

All these facts and aspersions *suggest* inefficiency but are not in themselves sufficient evidence of a systemic problem that requires a radically new approach. Why not?

First, because resources are always limited so individual government agencies can always declare that they simply have insufficient funding to deal effectively with their responsibilities.

Second, because however efficient and well-resourced is any particular large government programme, there will always be a few individuals who fall through the cracks. This is a feature of human nature in all but the most regimented societies. Unless there are very many such outliers, we cannot definitively ascribe their condition to the inefficiency of government programmes designed to help them.

Third, because many of the functions for which we rely on government cannot be easily automated. As such they have escaped the dramatic gains in productivity per person that have characterised agriculture and manufacturing. Services that remain largely a responsibility of government, such as teaching, policing, health care, and provision of welfare are not especially technology-intensive, and have benefited far less from the productivity gains that we have seen in manufacturing and other, less human-intensive, services.[21]

A fourth reason to be cautious in condemning government is one of definition and measurement. Our discussion is about the efficiency of government overall. What constitutes the overall health or success of a society is difficult both to define and to quantify as, very often, is the government's contribution to it. The choice and range of indicators of societal well-being will always have an element of subjectivity about them, and it is unlikely that even the best possible and most efficient government programmes would see all such indicators moving in the right direction all the time.

To see this let us consider indicators that are unequivocally worse for sustained periods than they were at times of equal or lower government expenditure broadly directed at improving them. We could take, for instance, the rise, over decades, in the number of drug crimes, the atmospheric concentration of halocarbons, the loss of species biodiversity, or the incidence in developing countries of malaria, which appears to be rising.[22]

In all cases, we should be seeing worsening indicators, while government expenditure on law and order, the environment and health over the same time has been climbing; in some cases very steeply. Could we conclude from these examples that government is inefficient?

Actually no. Take the example of malaria in a developing country. If the rate were found to have climbed, that would not itself be sufficient evidence that the government's health spending in that period were inefficient, even if that spending had risen markedly. Many variables other than inefficiency could explain a rising trend: there might have been a surge in the malaria parasite's resistance to insecticide, a rise in the population's predisposition to the disease, a reduction in non-governmental organizations' anti-malaria efforts, or changes in weather patterns that favoured the malarial mosquito. Some cities in Asia are so polluted that malarial mosquitoes cannot survive there. Cleaning up those cities might lead to increases in the malarial rate but still represent a net improvement in public health.

Perhaps we should be on firmer ground if we considered broader indicators. Take crime in Britain, where statistics are more readily available. In England and Wales the number of indictable offences per thousand population in 1900 was 2.4 and in 1997 the figure was 89.1.[23] These are offences that are reported to the police and recorded by them. Over the same period the population has increased by 63 percent – far less than the increase in number of crimes. Taking homicides alone (which in England and Wales include murder, manslaughter, and infanticide) the number per million population *more than doubled* from the early 1960s to 1997.[24]

Let us assume that the statistics are reliable and that crime has risen sharply in the past few decades. Poor government performance may have had little to do with this. Indeed, government may have performed superbly, given the many diverse factors that contribute to lawlessness. The worsening crime rate is not in itself sufficient to indict government – but even if it were, there is the question of how much weight we should attach to crime, compared to other areas in which similarly broad indicators show unequivocal improvements. For example: from 1901 to 1999 the life expectancy of new born children rose from 45 years for boys and 49 years for girls, to 75 years and 80 years respectively. Similar improvements can be seen for most of the measurable indicators of housing and education. In these areas, as in crime, government has undoubtedly played a large role.

The point is that a worsening of even quite broad indicators, even when government is spending increasing sums aimed at improving them, does not in itself *prove* poor government performance. There are simply too many other variables involved. Keep this in mind during the following discussion, which will cast aspersions on government and its policymaking machinery and rationale.

Indicators absent, vague or meaningless

Unfortunately, solid evidence about government performance even in a single policy area is hard to come by. The UK's National Health Service, which employs about 1.3 million,[25] is one of the western world's largest organizations.

> The results reported by the Office of National Statistics on measuring productivity in the National Health Service do indeed demonstrate that a wide variety of estimates are possible depending on the inputs and outputs used and the assumptions made about them. The reality is that, at present, there is no accepted measure of the value of total NHS output and comprehensive data to calculate one does not exist. From a letter to the Editor, *Economist*, 23 March 2006[26]

This comment, written by a Director of the UK's Office for National Statistics, tells us that the NHS budget, now about £90 billion a year,[27] is spent without a clue as to how much of it is being wasted.

GDP, the de facto target, is inadequate or misleading

> The more than minimal fraud is in measuring social progress all but exclusively by the volume of producer-influenced production, the increase in GDP.[28]

How has it come to be that efficiency of government expenditure is unknown and given so little priority that it's unknowable? The answer could be that when government first became interested in improving social welfare, economic growth itself was a fairly reliable target. As gross domestic product expanded, so did the well-being of much of the population and so too did government revenues and transfers that could – and did – supply public goods and relieve poverty. Efficiency is much more problematic to measure than production of manufactured goods and it was such production that dominated GDP during the years that the government's role in improving social well-being expanded in the industrial countries. In short, GDP was measured accurately by production, and social welfare tended to rise in line with GDP.

Both those relationships have gone awry. Services, much more difficult to measure, now generate most of the GDP of the rich countries. And while, at low levels of income and wealth the correlation between such easily measured variables and well-being is quite high, at higher levels that relationship breaks down.[29] Amongst other failings, GDP does not take into account changes in the quality of the environment or the distribution of income; it ignores human capital (the education and skills that are embodied in the work force) and leisure time, and it ignores such social problems as crime and homelessness.

Unfortunately, old habits persist and in the absence or non-use of reliable indicators of efficiency and well-being, economic growth tends to be used not only as an indicator but also as a target, sometimes implicitly and occasionally explicitly, by national governments. The idea that 'growth no longer makes us happier', given our current dogma, is 'as bizarre an idea as proposing that gravity pushes apples skyward'.[30]

There's nothing original about pointing out that GDP is not a perfect measure of human well-being, and perhaps few in government would *admit* to caring about GDP for its own sake. But politicians do use economic growth as an explicit justification for their policies, with GDP per capita, or rate of growth of GDP functioning as *de facto* targets for governments that have no large objective beyond staying in power. This doesn't stop politicians setting an array of micro-targets so narrow and meaningless that they have nothing to do with overall well-being and can anyway be easily manipulated.

There are attempts to design better alternatives: better in the sense that they do correlate with social and environmental well-being[31] but with a couple of exceptions[32] they are not yet explicit policy targets.

In summary, economic growth or GDP per capita as de facto indicators of social welfare, or as implicit or explicit targets, would be flawed even if they could be measured accurately. They don't correlate well any longer with wealthy societies' social and environmental well-being, and their failings as targets become more harmful as society grows bigger and non-monetary impacts become more significant.

Though many government projects and policies are routinely justified with either explicit forecasts or vague promises that they will lead to economic growth, there are other policy areas that have little directly to do with economic growth and in which decisions are taken on other grounds. What drives these policies?

What really drives policy

Primitive thought

What is particularly striking is how, at the highest level of national government, big decisions appear to be made on the basis of reactive, primal emotion. Rationality and the long-term interests of the people politicians are supposed to represent hardly figure at all.

> …policies are often adopted on the basis of less careful analysis than their importance warrants, leaving wide room for mistakes and misperceptions. Forces of knowledge destruction are often stronger than those favoring knowledge creation. Hence states have an inherent tendency toward primitive thought, and the conduct of public affairs is often polluted by myth, misinformation, and flimsy analysis.[33]

In a small way, this author has experience of such pettiness in the New Zealand bureaucracy, where a decision to split one government department into two, with all the attendant human and financial costs, was made on no basis other than a personality clash between a minister and a director-general. Rather more significant are the dangers of this type of thinking when military conflict looms large. An article about Henry Kissinger's role in US foreign policy quotes him saying to US President George W Bush's speechwriter, about radical Islamic opponents: 'We need to humiliate them'. Comments like this abound in high politics. George W Bush himself cried 'bring 'em on' at an early point in the invasion of Iraq. These are not examples of high-level thinking.

In more normal times, cold calculations of costs and benefits do make an appearance. But not always in the interests of ordinary people.

The interests of the rich

Policy is only one claim on people's time. For most people, most of the time, it's not a particularly compelling one. Naturally then, those with the most to gain, and the most free time or the most ability to buy other people's time, are in the best position to influence it. Before influence, though, comes access, and access to top politicians is a scarce resource that commands a price. In Australia this price has been reached by auction:

> Before the October election... a 45-minute walk with Attorney-General Philip Ruddock and "a quicker-paced jog" with Health Minister Tony Abbott each fetched bids of thousands of dollars.[34]

In this case the sums raised by this practice didn't end up in the politicians' bank accounts. Rather they fill up the election war chests of the major political parties. This practice is neither illegal nor must it necessarily lead to biased or flawed policymaking. Nor need it necessarily exclude the views of those without such direct access. But it is suggestive, and only a particularly bald example of what must occur in most systems of government.

Also working in favour of the wealthy are the complexity of policy and the policymaking process, and the time and patience necessary to engage with it. *Death by a thousand cuts*[35] tells the story of the successful campaign to repeal inheritance (estate) tax in the US. It is a fascinating story, attempting to solve the mystery of how the 'repeal of a tax that applies only to the richest 2 percent of American families [became] a cause so popular and so powerful that it steamrollered all the opposition placed in its way?'[36] Part of the answer was the rechristening of the tax as the 'death tax', which implies that the tax was on the hard-working deceased, rather than those wanting to inherit wealth. The tax was also depicted as a form of discrimination. There were opponents of the repeal, who argued that the estate tax was a crucial part of the American conception of giving everyone a fair chance in life, but it was already too late. The authors draw a blunt lesson from this, 'In politics, when you're explaining, you're losing.'

In the resources they can devote to influencing policy, corporations are at least as influential as wealthy individuals. Even in the relatively clean democracy of Germany, 'top companies admitted that they have been topping up the salaries of hundreds of local and national politicians.'[37] Again, there's nothing illegal about this practice, but it is suggestive.

The returns from outright lobbying can be very worthwhile. According to a former US Republican Party activist the US timber industry:

> spent $8 million in campaign contributions to preserve a logging road subsidy worth $458 million—the return on their investment was 5,725 percent. Glaxo Wellcome invested $1.2 million in campaign contributions to get a 19-month patent extension on Zantac worth $1 billion—their net return: 83,333 percent. The tobacco industry spent $30 million for a tax break worth $50 billion—the return on their investment: 167,000 percent. For a paltry $5 million in campaign contributions, the broadcasting industry was able to secure free digital TV licenses, a giveaway of public property worth $70 billion—that's an incredible 1,400,000 percent return on their investment.[38]

The degree to which the interests of the wealthy are built into the current system can be disheartening. Even the best-intentioned political movers and shakers have to make compromises. An article published two years before the US Presidential Election of 2008 revealed that the Democratic Party contender, Senator Barack Obama had helped to veto an amendment that would have killed vast loan guarantees for power-plant operators to develop new energy projects. Taxpayers for Common Sense, and Citizens Against Government Waste had called these guarantees 'one of the worst provisions' in the massive 2005 Energy Bill. The article reveals that Illinois-based Exelon Corporation, the nation's leading nuclear power-plant operator, is Obama's fourth largest patron, having donated a total of $74 350 to his campaigns.[39]

Ideology

J Krishnamurti, an Indian philosopher, put it this way:

> We are not concerned with feeding, clothing, and sheltering man but engrossed in a particular system which will guarantee food, clothing and shelter for all. The extreme left or the right are wrangling over a formula that will assure man security; so they are not concerned with man's happiness, but with which formula will guarantee him happiness.[40]

There's something seductive and persuasive about ideology. The sheer volume of documented history and personal recollection, in all their richness and complexity, combined with the application of selective memory means that most of us can plausibly attribute all the bad things that happen to the beliefs, politicians, countries or cultures that we don't like, and all the good things to the successes of the ideology that we favour.

Sometimes we aren't even aware that we are acting ideologically. One person's cultural given is another person's imposed ideology. Swimming in the sea of our own assumptions, it's not always easy to identify them. But apply them to other cultures, and the effects can be tragic. Greater western-style sexual equality for women has combined in Africa with the social acceptability of simultaneous long-term sexual relationships for both male and female partners, and much of the AIDS tragedy in that continent is the unhappy outcome.[41] But a happy exception has been Uganda, where infection rates fell, largely because of an advertising campaign urging the population to 'Be Faithful'. Tragically, this message has not been applied to other countries: it has been ignored by ideologues of both the left, who favoured condom use, and the right, who favoured abstinence. A huge share of the current western effort is now devoted to supplying antiretrovirals (ARVs) to those in Africa with full-blown AIDS. Unfortunately this laudable effort diverts resources from more cost-effective ways of dealing with the epidemic. 'ARVs are now reaching only a tiny minority of those in need and it will never be feasible to treat everyone. .... The "Be Faithful" message was neglected because it was not of interest to the bureaucracy concerned with AIDS.'[42]

This appears to be a particularly distressing case of well-meaning, hard-working people being hampered by their own ideology in their genuine efforts to alleviate a human disaster. Ideology remains an important, and inadequate, way of approaching the entire development cause. Western-style development is seen as offering a 'comprehensive final answer to all of society's problems, from poverty and illiteracy to violence and despotic rulers. It shares the common ideological characteristic of suggesting there is only one correct answer, and it tolerates little dissent. It deduces this unique answer for everyone from a general theory that purports to apply to everyone, everywhere.'[43]

This ideological impulse can be unstated, but no less devastating. The consequences are almost equally tragic when the curse of ideology is applied to the rich countries – which, despite much of the learned rhetoric, it still is. Writing about the Inuit in Canada, Jay Griffiths says:

> School is not a synonym for education. You might, if you're lucky, get a bit of an education at school, but for Inuit children, the land was their education. White lawmakers forced Inuit children to go to school, insisting that their parents settle in communities.... One result is that people are dependent on store-bought food, and if they have no cash they go hungry. ... a stark physical example of the effects of not knowing the land. But the psychological effects are everywhere. Without knowledge, you cannot be out on the land. Without survival skills, you can barely set foot beyond the perimeter of the community. Young people are effectively imprisoned by this ignorance into the

small and claustrophobic communities where they go stir-crazy.[44]

Schoolchildren in England have also suffered at the hands of the ideologues controlling the English educational system. There, politicians 'have been so intent either to defend or to oppose selection by academic ability that they have failed to set up a system of rigorous and useful qualifications for those whose interests are not academic. Standards have suffered in the name of inclusion, and vocational training has been chaotic. Meanwhile the great divide between public and private education has remained as important as ever.'[45]

Even if the policymakers are well intentioned, smart and hard working, they often lose sight of their original goal. They assume that they know best how to achieve their desired outcome. Eliminating selection was the supposed means by which one set of political ideologues would reach their goal of equal opportunity for all in the context of the English educational system. One outcome has been that grammar schools became fee-paying, and divisions widened. The ideologues didn't achieve their stated goal, but that was probably supplanted in their minds by the outcomes they did achieve: they strengthened their identity, reinforced their ideology, and bonded more closely with people who felt the same way. The losers of course have been the pupils suffering from their muddle-headed theory.

Government isn't content merely to raise and allocate funds for the (laudable) goal of educating children. It has a single, often astonishingly limited, vision as to what the form and substance of that education shall take. Naturally it's biased in favour of its own educational experience: steeped in the verbal, urban values, of the sort that can lead to careers in administration, lawmaking and politics. Before too long, government educational institutions are created and indeed, in the early days they are both necessary and successful. But soon they become big enough to be able to resist change. They develop their own caste of experts and ideologues. They refuse to take seriously people from outside their profession, and are strikingly resistant to challenge from the outside world.

It's the same in other fields: government views crime as something to be tackled by the police and justice system. Health is something for a Ministry of Health to deal with. Mental health is about psychiatrists, counselling and drugs. The policies are all neat and compartmentalized, just like the bureaucracies and the state of mind that generates them. The real world, though, is too messy for that. Effective policies in all areas need to adapt to our rapidly expanding knowledge and rapidly changing circumstances. They should accept diverse approaches and allow successful approaches to continue and unsuccessful ones to be terminated. Genuine, well-meaning government employees would not be ideologically driven. They would acknowledge that while broad goals in education, crime, welfare or whatever are stable over time, *the most effective ways of achieving them are not.*

For all these reasons it is odd that commentators castigate politicians for not having a coherent ideology or not being true to their party's principles. Ideological rigidity is a curse. It does nothing to achieve outcomes that are of interest to ordinary people, as distinct from ideologues and party hacks. Ideology cannot cope with changing circumstances, nor with the multiplicity of variables, mostly non-quantifiable, that actually determine outcomes. If social well-being, rather than ideological consistency is the real goal, we need adaptive, diverse strategies, not top-down, one-size-fits-all belief systems; they've been tried and they have failed; they failed not because 'they were never fully adopted' but because ideology implies a static monoculture. Society is not like that.

People outside government recognise this:

> The important thing in moral life is to do what is right, not to expound the principle which makes it so; and so often the principle eludes us, even when the rightness of the act is clear.[46]

Or, to be blunt, as a memorable line from the movie *Southern Comfort* put it: 'Comes a time when you have to abandon principles and do what's right.'[47]

Feeling, emotion and gesture

The rampant conflicts of the twentieth century have made people wary of ideology; at least of the self-aware, explicit, overtly destructive kind. But for those seeking some guiding principles for making policy there are few to be found in our complex societies, in which outcomes can be difficult to trace accurately to the people and events that generated them. Our extreme specialisation increases the distance between producers and consumers and the time lags between cause and effect. It widens the gap between policymakers and the citizens they represent. Big institutions, whether public or private sector, dominate, and it's difficult for ordinary people to identify with them. One result is that appearances, personalities, and emotional appeal assume a great importance in politics. Frank Furedi calls it 'therapeutic politics' which instead of being guided by principle, eschews substance on matters of policy, and 'attempts to establish a point of contact in the domain of the emotion with an otherwise estranged electorate.' Instead of standing up for what we believe to be the right thing to do, we uphold what we feel good about. This 'signifies the incorporation of emotionalism into the heart of political decision-making.'[48]

Feeling good is less about achieving or aiming for policies of substance and more about appearance. 'Gesture politics' has taken on a bigger role. 'The essence of leadership' writes Christopher Caldwell, in *The Triumph of Gesture Politics* 'has changed into something that is less and less about significant undertakings and more and more about dramatic stunts.'[49] It's easy to make promises and launch inquiries; much more costly to do anything about underlying problems. So we read reports like this:

The [British] Government has been forced to admit that three years after promising to rebuild 3,500 secondary schools not a single project has been completed.[50]

When Gordon Brown was Chancellor of Exchequer (Minister of Finance) he launched no fewer than 21 papers on skills, eight transport reports and six consultations on planning since 1997.[51] He launched transport reviews at the rate of nearly one a year between and 2006. In 2000 Brown proposed scrapping older lorries with a £100 million investment fund. 'Asked about this recently, ministers said they did not fund any such schemes.' In 2003, Mr Brown claimed that everyone on Jobseekers' Allowance would be assessed with a mandatory skills test. But 'Ministers recently told the House: "There are no mandatory skills courses linked to Jobseeker's Allowance".'[52]

This sort of thing is typical. Between policymaking and policy delivery there are manifold labyrinthine paths, obscured by the fog of committees, agencies, and the glossy outpourings of Public Relations professionals. The goal is not to deliver outcomes, but to remain in power, and for that, in what seems to be an era of mass, sub-clinical Attention Deficit Disorder, grandiose but vapid promises suffice. The gesture of unveiling new well-intentioned initiatives on the television news will do. Outcomes are a distant second to appearances.

It's a dangerous tactic. The Kyoto approach to climate change, for instance, is similar: high-sounding principles, top-level agreements, elegant trading mechanisms…and the likely outcome? A possible slight reduction in anthropogenic greenhouse gas emissions. The triumph of presentation over substance. It owes more to the need to be seen to be doing something, however devoid of value that something is. Government responses to random bombings, hijackings and other threats to our personal security are similarly - and predictably – expensive, incapable of adaptation, and ineffectual.[53]

Often the agenda is set by the concerns of the media, and these too often represent the needs of media companies, rather than those of an informed, rational, public. Commenting on the sheer volume of television that we watch (25 or 30 hours per week) and the difficulty we have in hearing subtle but critical messages against it, Bill McKibben says:

> If God decided to deliver the Ten Commandments on the *Today* show, it's true he'd have an enormous audience. But the minute he was finished, or maybe after he'd gotten through six or seven, it would be time for a commercial and then a discussion with a pet psychiatrist about how to introduce your dog to your new baby.[54]

Our politicians pander to this. Slow-moving stories without televisual appeal are ignored; campaigns that sound far-reaching and momentous are announced in response to headline news. They're usually ineffectual or destined to be forgotten as media attention moves onto something else.

'We mostly judge risks by their salience', writes John Kay. Salient risks are those that dominate the media and that everyone is talking about or that we have recently encountered. 'The risk of terrorist attack was not salient enough before September 11 2001 and too salient after. But, as you stand in line at airport security, observe that you are more likely to be killed by an object from space than in an aircraft crash.' If we were informed and rational, we'd look at the probability of an event happening, its consequences, and the costs of counteracting it rather than its visual and emotional impact. Mr Kay contrasts the political response to terrorism with that to malaria, which rarely makes the headlines but kills a million children every year. 'Malaria, eliminated from Europe and North America in the last century, has never been salient. But it is largely preventable - sleeping nets treated with insecticide alone dramatically reduce its incidence, and the discovery of an effective vaccine is a wholly realistic prospect. World leaders emphasise issues that are salient to them and to their voters.' This contrasts with, for instance, the Copenhagen Consensus[55] and rich individuals Bill Gates and Warren Buffett who have instead 'asked the questions - how likely? how costly? how amenable to action? - and put disease control at the head of their list of global issues. That judgment demonstrates the power of philanthropy over politics, of individual over collective action, of decision over discussion.'[56]

It's natural, though still irrational, that in our own lives we respond to events that are 'salient', even if they are unlikely to occur or recur. We are fallible human beings, and it's our nature to respond emotionally to salient events. But policymakers should do better. They fail us when they react irrationally, with taxpayer funds, to events that have assume a media profile out of all proportion to their real impact. As Patrick Buchanan wrote, 'In the five years since 11 September 2001, 85,000 people have been murdered in the USA, but not one in a terror attack.' But you'd never know that from the actions of our politicians.[57] The conflict between Israel and the Arab countries similarly accounts for a disproportionate share of media attention and hence the world's scarce peace-making resources. That conflict has led to the deaths of fewer than 100 000 since 1921: a grievous total, to be sure, but about half of four years' killings in only the Darfur region of Sudan.[58] If we were indifferent between war-induced deaths in either region, we'd focus a larger share of our scarce peace-making resources on Darfur and the rest of Sudan. Even if policymakers were genuinely so indifferent, the clamour arising from unequal media coverage means their resolve to do – or appear to do – the rational thing would quickly crumble.

If anything the irrationality and emotionalism in national and regional politics are set to increase. Research shows that much of today's 'in your face' televised political debate leads audiences to react more emotionally and to accord opposing views less legitimacy.[59]

Television is vastly influential in politics. TV corporations have their own imperatives, and these have everything to do with audience figures (and subscription and advertising revenue) and very little to do with fostering the mutual respect of opposing sides in political debates. Arguments are polarized, attitudes become extreme on all sides. Again, the complexity of today's policymaking world is a factor: the difficulty of attributing effect to cause in social and environmental policy means that emotion is far easier to communicate and exploit than a rational examination of the facts.

A variant of gesture politics is celebrity politics. Some things are best done by government. Indeed there are some concerns that under our current political configuration, only government can address. Many of these are quite mundane: eradicating poverty, supplying public services like law and order, defence, clean water and sewerage. As such, they don't do much to enhance one's image in the intensely image-conscious media. So many national governments like to associate themselves glamour, even those that are 'left wing' and supposedly helping the small guys. One example: film director Peter Jackson's blockbuster King Kong consumed at least $25 million of New Zealand taxpayers' money from a government scheme to encourage big-budget movies.[60] Note that in this instance big is beautiful: the New Zealand Government's offered a rebate of 12.5 percent of costs incurred in New Zealand. But that was *available only to movies with a budget of more than $50 million*, or to movies that cost between $15 million and $50 million if 70 percent of their budget is spent in New Zealand.[61] If the ruling New Zealand Labour Party had stood on a manifesto of subsidising the rich it would be less objectionable. But you will not find this principle anywhere stated on its website.[62] Bill Clinton's campaign advisor once said 'politics is show business for ugly people.' Ingratiating themselves with beautiful people is perhaps one solution to politicians' self-esteem problem. It may not be deception, but it does seem like distraction.

There is certainly a reluctance to present us with clear choices in politics. Choices create winners and losers, and the debased language of politics finds it difficult to admit that policies will make some people worse off. The notion of trade-offs – which is really what policymaking is all about - is almost absent from political debate. Instead we get vapid, vacuous platitudes that widen the distance between politicians and the people they are supposed to represent. Before the 2005 UK General Election you could hear the UK's ruling Labour party's election campaign coordinator declare that 'the priority must be to fashion an active citizenship'. Or one of its ministers attempting to kick start its election campaign by promising a new era of 'individual empowerment' in New Labour's third term.[63] Every policy statement is scripted, having first been tested on a focus group and fine-tuned by the public relations industry. Politics becomes a battle between Public Relations professionals. What purchase can ordinary people have on such nebulousness?

Meaningless numerical targets

Outgrowths of gesture politics are the meaningless numerical targets that sound worthy, but turn out to have little to do with improving societal well-being. One of the current UK Government's policy objectives, for example, is putting 50 percent of Britain's under-30s into higher education. Like many such targets it sounds worthwhile at first. One might pause for thought though, and ask why 50 percent? Wouldn't 66 percent be better? Or 75 percent? Even the 50 percent target means, in effect, helping non-academic types go on university courses to which they are unsuited and which do very little for their career chances. Neither has past expansion of tertiary education done a great deal to benefit the disadvantaged. It makes employers unnecessarily demanding of job applicants. 'In every developed country, expanding higher education has done less for equal opportunity than one might expect — whilst steering large subsidies towards the middle classes.'[64] Worst of all, perhaps, more funding for higher education means less for literacy and numeracy programmes. There is, of course, nothing wrong with people doing whatever courses they want. But it is highly questionable whether people should be subsidised to do so from a finite educational budget when, for example, 'Some 7 million adults in England - one in five adults - if given the alphabetical index to the Yellow Pages, cannot locate the page reference for plumbers', and 'one in three adults in [England] cannot calculate the area of a room that is 21 by 14 feet, even with the aid of a calculator'.[65]

Often a government's targets show a bias toward more government intervention, when a sector is almost crying out for less of it. So the British farming minister announced in July 2002, an 'action plan', including subsidies, to boost the role of organic farming, and the incoming German Agriculture Minister announced in her maiden speech plans to increase the share of organic farming in German agriculture from 2.5 to 20 percent over ten years.[66] As with much of the rest of agricultural policy in the rich countries these intentions will almost certainly take the form of significant transfers of resources from the poor who spend more of their income on food, to rich farmers and middle-class consumers. Why not reduce the billions of dollars that subsidise overproduction and intensify the pressure on the environment and on food safety? Again, there is nothing actually wrong with organic agriculture, though many of the claims made on its behalf do seem to be overstated.[67] But there is surely something unworthy of a government that seeks to impose arbitrary numerical targets for unstated or nebulous reasons that have nothing to do with improvements in social welfare.

The Accident and Emergency (A&E) departments in English hospitals have to ensure that 98 percent of patients transferred or discharged within four hours. If they fail, they are subject to financial penalties. One result is that, since these targets were imposed, more patients are transferred to hospital wards 'just in case'. This is costly in resource terms, but it benefits hospitals who receive as much as £1000 per admission, compared with about £100 for a patient treated in A&E. Admitting more patients is greatly in the financial interests of hospitals: it's called 'gaming the system'.[68]

Other examples are the recycling targets, adopted with enthusiasm, at least at first, by many countries and local authorities. In many cases recycling is helpful to the environment; but there are instances when it probably is not. One life cycle analysis estimated that the manufacture of paper cups consumed 36 times as much electricity and more than 500 times as much wastewater as the manufacture of much-derided polystyrene foam cups.[69] Another life cycle assessment analysis, commissioned by the British government, showed that disposable nappies have no greater impact on the environment than cloth nappies.[70] Perhaps that's why recycling in many areas has become a sort of pageant, so that concerned households assiduously sort their rubbish into colour-coded bin bags only to find out later that all the bags are thrown onto the same landfill once they are safely out of view.[71]

Control: an end in itself?

As ordinary people, we may find the motivations of the decision-makers obscure. Why, for example, did the European Union decide to double the amount of taxpayers' money it will give in aid to poor countries by 2015, when it could have done so much more by dismantling its import barriers?[72] According to Oxfam, import tariffs alone cost developing countries around $43 billion a year. These tariffs are actually the least significant weapon in the protectionist arsenals of rich countries. The total costs of all forms of trade barriers – including tariffs, non-tariff barriers, antidumping measures, and product standards – are more than double this amount, rising to over $100bn.[73] It does appear that the EU mandarins are more comfortable giving other people's money as charity than allowing poor countries to prosper through trade. Perhaps the real motivation is not to help people in the poor countries, but a wish to retain and, if possible, expand bureaucratic control over the lives of EU and non-EU citizens alike? We shall look more at the rich countries' agricultural support mechanisms below, but note that, as Oxfam says, the actual costs of the trade barriers to agriculture, textiles and clothing understate the real impact on the poor. 'They do not capture the costs of protectionism in terms of reduced opportunities for employment, reduced income for essential goods such as food and health care, or the long-term economic losses associated with restricted opportunities for investment. Nor do they capture the disproportionate impact on very poor households. Because Northern governments impose the most punitive import restrictions on goods produced by the poor, they systematically diminish the potential for trade to act as a catalyst for poverty reduction.'[74]

So could control be one of government's unstated objectives – one that it is unaware of itself? That would be consistent with some of its responses to terrorist threats. The Harvard School of Public Health looked at studies of the new procedures being implemented in the US.[75] It couldn't find any that showed whether the laborious, time-consuming and intrusive of X-raying carry-on luggage prevents hijackings or attacks. Neither was there any evidence that making passengers take off their shoes and confiscating small items prevented any incidents. The US Transportation Security Administration defended its measures by reporting that more than 13 million prohibited items were intercepted in one year. Most of these illegal items were cigarette-lighters. But the stated goal of these procedures is not to hit targets for the number of items confiscated. It's to reduce the terrorism threat to airline passengers. There's no evidence that, despite the expense and inconvenience of all these procedures, they are of any value at all. Evidence is similarly lacking that the Bush administration's 'aggressive interrogation techniques' and other suspensions of civil liberties have thwarted a single terrorist attack.[76]

The unimportance of outcomes

Emotion, reaction, ideology, feelings, media appeal, and control: it looks as though, in the absence of anything more coherent this array of motley motivations largely determines the spending of the largest and wealthiest organizations in human history: the national governments of the world's richest countries. What is particularly striking is how little socially beneficial outcomes themselves drive policy. A theme of this book will be the need to target such outcomes explicitly and transparently.

Yet might not all this be unrealistic? It's a trivial task to point out that the rich countries could be better run. In any human society it's always going to be possible to point to problems and inefficiencies. Some of these are quite serious, but to suggest, as I have done, that the reasons for these problems have to do with superficially unsatisfactory policy drivers is not evidence in itself of systemic failure at the national level of government. Anecdotal evidence is not enough and the above, while suggestive, is not conclusive.

The smoking gun: perverse subsidies

So what might constitute conclusive evidence that governments are inefficient? To this author, the answer is clear: perverse subsidies and their persistence over many years. First: what is a subsidy? For our purposes it can be defined as any measure that keeps consumer prices below market level or producer prices above market level, or that reduces costs for consumers and producers through direct or indirect support. A subsidy need not be a straight budgetary handout. It could take the form of a zero or low tax rate, or the provision of goods, services or finance below cost. Subsidies can also be given via barriers to imports of competing goods or services, which keep producer prices high.[77]

What then is a perverse subsidy? I will use the term to describe subsidies that economically inefficient *and* environmentally destructive.[78] In most cases they are also socially inequitable. They include policies that subsidise environmentally-intensive sectors or sub-sectors such energy, mining, fishing, forestry, transport, construction and intensive farming and agribusiness. They are not trivial: they amount to hundreds of billions of dollars a year.

Agricultural subsidies

Most agricultural subsidies are perverse. Support to producers in the developed countries as measured by the Organisation for Economic Cooperation and Development (OECD) totalled $268 billion in the year 2006.[79] Most assistance continues to be given in the form of market price support and output payments. These forms of support insulate farmers from world markets and impose a burden on domestic consumers. And the higher food prices that result from these policies bear most heavily on low-income consumers, for whom food constitutes a larger share of total household expenditure.

Farmers as a whole receive few of the benefits from government support to agriculture. OECD research shows that more than half of sums paid out to 'agriculture' end up as extra expenditure on farm inputs, such as fertilisers, pesticides, animal feedstuffs, machinery and farm buildings.[80] Farmers, because they are subsidised, buy more of these inputs, and the suppliers, knowing that farmers can afford to pay more, charge higher prices for them. Soil tests and veterinary fees, for example, typically cost about half the price in unsubsidised New Zealand as they do in Europe. So too do identically packed agricultural chemicals.[81] There are also very high administrative costs, as farmers have to comply with a whole host of stipulations to qualify for their assistance, and the masses of forms they fill in have to be duly scrutinised, filed, archived or otherwise disposed of.

Nevertheless, about 20-25 percent of taxpayer and consumer support to 'agriculture' in the OECD countries does end up going to farmers. But because much assistance to the sector takes the form of subsidised prices for their production, most of it goes to the farmers who produce most, and who you might think need support least. In the US, for instance, about 88 percent of support was found to go to the largest (in terms of gross sales) 25 percent of the farmers.[82] So the proportion of the billions of dollars for OECD agriculture that does end up with the smallest farmers is tiny: around three or five percent. And many of these farmers are part-timers, who do not depend solely on agriculture for their income - in the US and Japan farming accounts for around one-sixth of the average farm's household income.[83]

Surprisingly, many of the farmers who were supposed to benefit, have also suffered from high support levels. Because most support is based on output, which increases with the area of a farm, the additional income due to the support is largely capitalised into the least elastically supplied farming input, which is farmland. So those who were lucky enough to own land when these policies were first implemented, decades ago, benefited from a one-time windfall gain. But those who were unfortunate enough to miss out, and especially those who have to borrow to fund their farming ambitions, have suffered. Quantitative research on this effect is scanty, but one estimate is that a one percent increase in support prices in the UK leads to a 10 percent increase in the land price. For Canada, it was estimated that the abolition of direct government transfer payments would reduce total farm cash receipts by 13 percent and lead to a land price fall 18.5 percent in the long run.[84] High land values have meant that entry to the farming profession has been restricted to the wealthy, corporations or to the sons and daughters of farmers.

There is a danger here of thinking that people in OECD countries have been the only victims of agricultural support policies. Perhaps these polices are really intended to help people in other countries? No, they're not: they work by keeping out cheaper food from farmers in the food-rich developing countries who suffer by being excluded from the world's biggest food consuming markets. They also suffer because the rich countries' subsidised overproduction has reduced the value of their output on world markets and their import barriers have increased the volatility of world prices. Many would-be exporting countries in the developing world are desperately poor. The rich countries' agricultural support policies hit them where it hurts - it makes development from their agricultural base that much more difficult. Oxfam estimated in 2001 that the industrialised countries' agricultural policies (including tariffs and subsidies), cause annual welfare losses of $20bn for developing countries, or 40 percent of the value of aid flows.[85] Agriculture, along with textiles and clothing, has been the traditional route for development of almost all the world economies, and it is precisely imports of these products that the rich countries do most to restrict.

But consumers and taxpayers aren't the only victims. Farm subsidies have encouraged the extermination of wildlife throughout the developed countries. Market price support is still the main means by which these countries support their farmers and it does so in ways that encourage increased production per unit area. This encourages specialisation of production which imposes a bigger environmental burden on the land. It means the expansion of production onto marginal ands and environmentally valuable areas such as woodlands, ponds and hedgerows. It also puts pressure on animal welfare and food safety. Both have deteriorated, as market price support encourages ever larger units, and ever more intensive production systems.

That's not all. Michael Pollan explains the disastrous effects that farm subsidies in the US are having on that country's health. How is it, he asks, that 'today the people with the least amount of money to spend on food are the ones most likely to be overweight?'[86] The answer lies in the cost of various foods. '[T]he rules of the food game in America are organized in such a way that if you are eating on a budget, the most rational economic strategy is to eat badly — and get fat.' This is not the result of the free market. 'Compared with a bunch of carrots, a package of Twinkies, to take one iconic processed foodlike substance as an example, is a highly complicated, high-tech piece of manufacture, involving no fewer than 39 ingredients, many themselves elaborately manufactured, as well as the packaging and a hefty marketing budget. So how can the supermarket possibly sell a pair of these synthetic cream-filled pseudocakes for less than a bunch of roots?' It's US agriculture support policies that set the rules not only in the US, but to a considerable extent, for the entire world's food trading system. They determine:

> ...which crops will be subsidized and which will not, and in the case of the carrot and the Twinkie, the farm bill as currently written offers a lot more support to the cake than to the root. The result? A food system awash in added sugars (derived from corn) and added fats (derived mainly from soy), as well as dirt-cheap meat and milk (derived from both). By comparison, the farm bill does almost nothing to support farmers growing fresh produce. A result of these policy choices is on stark display in your supermarket, where the real price of fruits and vegetables between 1985 and 2000 increased by nearly 40 percent while the real price of soft drinks (aka liquid corn) declined by 23 percent. The reason the least healthful calories in the supermarket are the cheapest is that those are the ones the farm bill encourages farmers to grow.'

But surely, a devil's advocate might say, agricultural policies subsidise production and so make food cheaper than it would otherwise be? Not so: imports are deliberately restricted to help keep producer prices high. They also raise food prices for consumers: research commissioned by Open Europe estimates that ditching the Common Agricultural Policy (and other EU import barriers) would be worth £1500 a year to the typical UK household of four.[87]

So who are the big winners, then, from the complex array of agricultural support policies in the developed countries? Well, Prince Albert II of Monaco (whose fortune is estimated at 2 billion euros (£1.4 billion), receives €390 000 a year in subsidies from the CAP, as do the 29 more of France's biggest farmers. That is 217 times the average received by the 180 000 or so smallest farms, which make up 40 percent of the country's total. Over a quarter of payments to French farmers go to just 5 percent of farmers.[88] High food prices, as Oxfam found, mean that wealthy landowners like the Dukes of Westminster, Marlborough and Bedford, Lords Illife and de Ramsey and the Earl of Leicester can *each* receive subsidies from the public of up to £370 000 a year for growing their cereal crops.[89]

So the real beneficiaries are a fairly limited circle: large farmers, many of whom were already very wealthy by any standards, agricultural chemical manufacturers and processor, bureaucrats and, to an unknown degree, fraudsters. It's unlikely that rational consumers and taxpayers, if they were given the chance to vote on whether they wanted to support these people, would do so with much enthusiasm.

Thankfully, after years of pressure on budgets, and partly because of rising commodity prices, the trends are mostly downwards. Total support to agriculture in the OECD is now about 1.1 percent of GDP; a big fall from the 1986-88 average of 2.5 percent. Note though that, as a proportion of agricultural output, subsidies paid to European Union agriculture have hardly changed over fifteen years to 2005. The subsidy has fluctuated between 30-40 percent of total output depending on world prices. And even after the 2003 reform of the EU's Common Agricultural Policy, market price support (one of the most distortionary elements of the CAP) will remain the dominant form of CAP spending, decreasing only slightly from 58 percent to 53 percent of the total CAP spend. So the overall reduction in distortion will be slight. In Japan and the Republic of Korea government is reducing the role it plays in setting agricultural product prices. But what about the US? Harper's Magazine in late 2006 reported that the minimum amount of US Department of Agriculture farm subsidies since 2000 paid out to people *who do not farm* amounted to $1.3 billion.[90] And the terms of the 2007 Farm Bill, which over five years will disburse $307 billion, ensure that most of this largesse will go to commercial farm households, whose average income is $230 000.[91]

The case against the rich world's agricultural policies is damning and overwhelming, but they *have been around for several decades*. There has been some recent tinkering with them but essentially they are unchanged. Our politicians cannot summon the will to challenge the entrenched interests they represent. Nor is the estimated $268 billion they are currently costing a trivial sum. It's worth digressing for a moment to compare this total that the rich world gives to its own farmers with the financial assistance it gives to agriculture in developing countries, which amounts to around $10 billion per year.[92] In fact total aid, following a cut in their official aid budget, given by the wealthy countries that are members of the OECD's Development Assistance Committee amounted to just $104 billion in 2006.[93]

And yet, it continues. Look at the biofuel (energy sources made from plant material) industry which, 'has long been dominated not by market forces but by politics and the interests of a few large companies',[94] in large part Archer Daniels Midland, the major ethanol producer. Ethanol production in the US if feasible only because of large government subsidies and punitive tariffs that exclude the much cheaper and more efficient sugar-based ethanol from Brazil. In March 2007, during President Bush's trip to Latin America:

> [T]he one heralded achievement was a deal with Brazil on joint production of ethanol. But Bush, while spouting free-trade rhetoric for others in the conventional manner, emphasized forcefully that the high tariff to protect US producers would remain, of course along with the many forms of government subsidy for the industry.[95]

And what about the environmental effects of pushing biofuels? In March 2007 EU leaders agreed as a climate change mitigation measure to set a binding target that will make biofuel - - account for 10 percent of all the EU's transport fuels by 2020. But the European Commission has admitted that this objective may have the unintended consequence of speeding up the destruction of tropical rainforests and peatlands in South-East Asia – which would actually accelerate climate change.[96]

It's the self-entrenching and self-reinforcing nature of such distortions that is most problematic. The insight that won the Nobel Prize for Ronald Coase says that who actually owns property rights doesn't really matter, from the efficiency point of view. This may well be true in the long run, but the wrong choices can determine political and social development for a very long time.[97] Subsidies for agriculture, in all their guises, have gone on for several decades already. They are probably seen by their beneficiaries as a property right. They not only impede any movement toward a rational farm policy; they also empower those opposed to any meaningful reform.

It is the persistence of farm policy, despite the weight of the accumulated evidence that they are without a single positive feature, that makes it seem unlikely that our political system can ever convincingly meet the challenges we face at national and global levels that demand coherent, urgent and radical action.

Perverse subsidies to other sectors

Agriculture is perhaps the most documented example of a sector beholden to perverse subsidies. But there are others.

Fisheries

In November 2006 the United Nations General Assembly discussed banning high-seas bottom trawling, which scrapes the sea-floor bare, devastating deep-sea corals and sponge beds that have taken centuries or millennia to grow. The villains in this particular policy area include Japan, Russia, South Korea, and Spain. This disastrous strip mining of the high seas for fish is not only continuing: it is being subsidised. The Fisheries Economics Research Unit[98] at the University of British Columbia's Fisheries Centre estimates that bottom trawl fleets operating in the high seas receive an average of $152 million per year, which constitutes around 15 percent of the total landed value of the fleet.[99] These catches are unregulated and 'utterly unsustainable. With globalised markets, the economic drivers of over-fishing are physically removed and so fishermen have no stake in the natural systems they affect. While it may be a good short-term business practice to fish out stocks and move on, we now see global declines of targeted species.' [100]

This practice, environmentally disastrous as it is, is profitable only because of subsidies; half of which are fuel subsidies.

Fossil fuels

For every $1 going into solar power or wind power, there are $15 of government subsidy going into fossil fuels, which is crazy. Norman Myers[101]

In the mid 1990s it was estimated that subsidies for energy in OECD countries were running at between $70 billion and $80 billion; their main purpose being to support energy production. Coal is most heavily subsidised, followed by nuclear energy and oil.[102] In the same period, in 20 of the largest developing countries, the World Bank estimated in 1997 that annual fossil-fuel subsidies amounted to $48 billion.[103] More recently the Global Subsidies Initiative reported on subsidies to coal mining in the European Union, where aid helps producers cover operating losses. Germany, Spain, Bulgaria, and Romania all give assistance to their coal mining industries.[104] Smaller in scale, but not insignificant are the loopholes in the US, expanded by the Bush administration, which allow the value of gas collected from public lands and coastal areas to be undervalued. The shortfall is estimated at a minimum of $700 million. [105] Between 2000 and 2007, the UK government gave coal firms £220 million to help them open new mines or to keep existing mines working.[106] The UK government's current policy is to 'maximise economic recovery … from remaining coal reserves.'[107]

Add in taxpayer-financed road construction and the non-pricing of the negative environmental impacts of fossil fuel consumption, and it's clear that fossil fuel use is heavily subsidised. Echoing Norman Myers' words, Anatole Kaletsky writes:

> Global subsidies for energy research are now running at a pitiful $10 billion annually, compared with the $250 billion spent on subsidising the extraction of fossil fuels (mainly on the most polluting of all energy sources, coal).[108]

It's easy to see a chaotic level of policy incoherence here: on the one hand governments throughout Europe are saying we must reduce the demand for fossil fuels if climate change is to be averted. They encourage us to change our lightbulbs, insulate our lofts, and turn off our television sets at the wall. But they make no effort to reduce the supply of fossil fuels. On the contrary: they are subsidising its extraction and use.[109]

Road transport

Also benefiting from lavish perverse subsidies in the rich countries is road transport. Subsidies to private road transport include the hidden costs of providing road users with roads, space and complementary traffic services such as highway patrols, traffic management, and paramedics.

A report released in 2007 by the European Environmental Agency estimates that road transport in the EU-15 countries receives an estimated €110 billion in annual subsidies for infrastructure alone. (With another €7 billion in 'other budgetary transfers, a further €9 billion in tax exemptions and rebates). These are the *known* subsidies; their effect is to reduce the costs of road transport to users.[110]

For the years 1991 and 1989, two different studies estimated the net subsidies to road transport in the US at $55 billion and $174 billion, respectively, or 1 and 3 percent respectively of that country's GDP.[111] The wide range reflects the different estimates for parking subsidies and for providing complementary traffic services. The gap is large, but the main point is that 'American motorists either pay a fifth of the actual costs of their travel or they pay half. Or somewhere in between. Whatever the precise figure, the public subsidy is still huge.'[112] A more recent study of the hidden costs of parking in the US estimates the value of the off-street parking mandated by US city governments at between $127 billion and $374 billion a year.[113]

> 'the extent of free parking is so enormous and so normal that people just think it nature's endowment, like air. Everyone feels entitled to free air and free parking....If we also count the subsidy for free and underpriced curb parking, the total subsidy for parking would be far higher. . . Do we really want to spend as much to subsidize parking as we spend for Medicare or national defense?'[114]

Another study puts US government subsidies for highways and parking alone at between 6 and 10 percent of gross national product. Accounting for other costs, such as pollution cleanup and emergency medical treatment would imply a subsidy of about $5000 per car per year.[115]

Apart from helping destroy the environment, such subsidies also represent a transfer from taxpayers to wealthier citizens, who use the transport infrastructure disproportionately more than the poor, as they have better access to transport and more time in which to use it. [116] Meanwhile:

> There is little prospect of slowing the growth in China's oil consumption, because *the government* is committed to a car-led policy of development. The World Bank's Mr Dollar has recently described this as "a very questionable development choice"—though it had earlier been conceived with the World Bank's backing.[117]

I added the emphasis, because I think it's important to note that these choices are often not made by ordinary people, but by politicians and corporations – especially those in the construction industry.

Armaments

Thanks to Chalmers Johnson we know quite a lot about the costs of the US expansion into space weaponry in the form of the National Missile Defense (NMD) programme. [118] Johnson explains why such a system cannot, and can never, work. In practice it's impossible to identify with the certainty required whether a missile launch is hostile or not, and then tell the difference between an incoming warhead and a decoy. Yet the NMD programme has already swallowed up $130 billion of public funds, a figure that was planned to reach $1.2 trillion by 2015.

Jonathan Freedland takes up the story: ‘But the NMD pork-in-space project is far from exceptional. Seeking fat contracts, the big defense companies give donations to those politicians who will pay them back by commissioning expensive defense projects; the contractors then reward the politicians by locating their firms in their districts; finally the voters, glad of the jobs, reward the politicians by reelecting them.’ Johnson offers dozens of examples, including Florida's Democratic senator Bill Nelson, a member of the Armed Services Committee, who in the 2006 federal budget ‘obtained $916 million for defense projects, about two-thirds of which went to the Florida-based plants of Boeing, Honeywell, General Dynamics, Armor Holdings, and other munitions makers.’ Since 2003, Nelson has received $108 750 in campaign contributions from thirteen companies for which he arranged contracts.

As well as the massive waste involved, it’s the self-perpetuating nature of this game that is of interest: there is no incentive for those involved – the chosen districts’ voters, corporate contractors or politicians – to do anything to stop it. As Freedland puts it ‘Everyone benefits from this untamed form of military Keynesianism—except the next generations of Americans who can be expected to drown in a debt that now measures $9 trillion and grows daily.’[119]

Subsidies given to arms companies in other countries may be less spectacular but they are not insignificant. A well-researched British study estimates that the subsidies provided to UK companies involved in defence exports are worth at least £453 million annually, and possibly up to £936 million.[120]

Implications of perverse subsidies

Ultimately, it is only a matter of opinion that these subsidies are perverse. It cannot be proven, when it comes to agricultural policy for instance, that the benefits to the tiny coterie of wealthy individuals and agri-business corporations are heavily outweighed by the financial and environmental costs to all other human beings (and many other species). Similarly with the fisheries subsidies and the wilder, fantastic high-tech armaments programmes like the US Nuclear Missile Defense Program. Perhaps I am also on dangerous ground with my disdain for subsidies to fossil fuels, where the short-term apparent beneficiaries are a bit more numerous; and even more so in my disdain for road transport subsidies. I think though, that if we consider the combination of two aspects, my thoughts will become clearer. The first is the lost opportunity that these programmes represent; that is, the diversion of significant resources into wasteful and environmentally destructive programmes that make many of us dependent on their continuation. The second is the processes by which these policies were set up. It was never intentionally decided that very large sums of money, for instance, would be paid annually to the richest English aristocrats, or large construction companies, or even to the actually quite small proportion of the population that has access to cars.

And the resource costs are significant. By the calculations of the Earth Council, subsidies to just three the sectors of agriculture, energy and agriculture cost the world's governments at least $665 billion, and maybe as much as $840 billion, a year.[121] This amounted to somewhere between three and four percent of Gross World Product. This was very roughly about 7 or 8 percent of world governments' total spending. These are cautious estimates applying to three sectors, and they ignore subsidies given to specific corporations.[122]

Environmentally harmful subsidies

A workshop given by the OECD in 2002 attempted to quantify a slightly broader category of subsidy: environmentally harmful subsidies. Its estimates are similar – and similarly staggering. It looked at environmentally harmful subsidies in OECD countries, which mainly go to agriculture, mining, road transport and manufacturing, and in non-OECD countries where the main beneficiaries are the energy, water and fisheries sectors. The workshop found that, relative to GDP, subsidies are twice as large in non-OECD countries, and that as a proportion of world GDP, global environmentally harmful subsidies account for a staggering 4 percent. Perhaps most notable of all, agricultural subsidies in OECD countries account for over 30 percent of all subsidies.[123]

Persistence of perverse subsidies

All this tells us that very large absolute resources, representing significant proportions of government spending and national incomes are not only wasted, but contributing to and accelerating the destruction of our physical environment. They are only the most obvious wastages, where quantitative work has been calculated or estimated, collated and made public. They are also the programmes that are almost totally without redeeming features. As such it is particularly reprehensible *that there are no systematic mechanisms for halting these failed policies*.

Perverse subsidies are nothing new, and neither is knowledge about their perversity. The abuse of resources that constitute the rich world's agricultural policies, for instance, has been known about, and quantified, for decades. Their environmental depredations and the burdens they impose on consumers, taxpayer and developing countries have been estimated and documented for almost as long. *Yet these policies persist*.

It is not their size alone but the persistence of perverse subsidies in the face of all the damning evidence that casts doubt on other less obviously deranged government interventions, which might perform better, or which might just generate perversity that is on a smaller scale – or better concealed. They and their persistence may go some way in explaining the co-existence of very high levels of government spending with serious social and environmental problems. After all, governments that cannot dismantle perverse subsidies, given their cost and the long history of their well-documented failings, can hardly plead lack of resources. When the national governments of the richest countries that have ever existed squander so much, it is very difficult to argue that these societies' poverty amidst plenty, their environmental depredations and other failings arise solely from insufficient tax takings. Since policies as unambiguously dysfunctional as perverse subsidies persist, it's clear that governments do not have effective systems in place to terminate their failed programmes.

We can speculate as to why this is so. Anecdotal evidence suggests that people working in any large organization tend to believe that they should carry out only those activities that can plausibly be justified on the basis of a past record. These activities need not be very efficient, or even partly efficient. As far as government bodies are concerned they need only to have been tried in the past and not to have been publicly identified as disastrous. This is not a strategy designed to optimise performance; nor is it even designed to minimise failure. Rather it is designed to minimise the *public exposure* of failure. There is an almost total absence of a self-evaluative culture. Most organizations are poor self-evaluators. Myths, false propaganda, and anachronistic beliefs persist in the absence of strong evaluative institutions to test ideas against logic and evidence. Organizations turn against their own evaluative units as they threaten jobs and the status of incumbents. And organizations can attack their own thinking apparatus if that apparatus does its job![124]

Poor policies can also be self-reinforcing. Take agriculture: the main beneficiaries of the complex array of agricultural support policies in the developed countries – large landowners, many of whom were already very wealthy by any standards; agricultural input suppliers; food processors; programme administrators – form a formidable coalition against change. Their power to resist reform oppose reform is of course largely a result of the agricultural subsidies in the first place. Donations to political parties come more from the rich than the poor and the parties align themselves with the sources of their funding. That's one reason why agricultural subsidies are difficult to remove.

Another is lock in. In agriculture most of the subsidies inflate the price of farmland. A cut in those subsidies that are paid according to production levels (still the majority) would lead to a drastic fall in land values, causing genuine problems for those who borrowed money to buy land at its subsidy-inflated price. Lock in applies to other perverse subsidies. Road transport and fossil fuel subsidies have led to urban sprawl, or to be more accurate, they have led to more urban sprawl than an undistorted market would have preferred. They have also made motorised mobility more necessary than it would otherwise have been.

Perverse subsidies were originally well-intentioned; they stand exposed now as worse-than-useless, but inertia and vested interests block the reforms that are clearly necessary. Their persistence shows that:

- there is nothing intrinsic in the way government works that means it can terminate even its own failed policies,

- that even a well-meaning, democratic government's priorities can be subordinated to those of vested interests, including those of its own agencies, and

- that government interventions are not necessarily driven by society's goals and, indeed, can conflict with them.

Government is now so big that these flaws matter a lot.

---

[1] *Gillette's Five-Blade Wonder*, William C. Symonds, 'Business Week', 15 September 2005.

[2] *Pet food and pseudo-variety*, Steve Hannaford, http://www.oligopolywatch.com/2007/03/ 19.html, 19 March 2008, sighted 6 April 2008. The company is Menu Foods.

[3] *The utopian nightmare*, William Easterly, 'Foreign Policy', September/October 2005.

[4] Saferworld, UK http://saferworld.org.uk.

[5] *The horror of land mines,* Gino Strada, 'Scientific American', May 1996 (pages 40-45).

[6] *SIPRI Yearbook 2002*, Stockholm International Peace Research Institute, June 2002.

[7] See *An American Hiroshima,* by Nicholas D Kristof, 'New York Times', 11 August 2004. Mr Kristof is reporting the views of Professor Graham Allison, of Harvard University, author of *Nuclear Terrorism,* Times Books, August 2004, ISBN 9780805078527.

[8] *The State of the Commons, 2003/04,* Friends of the Commons, www.friendsofthecommons.org. Http://onthecommons.org/files/publications/stateofthecommons.pdf.

[9] *Planet's Tougher Problems Persist*, *UN Report Warns*, UN Environment Programme, Press Release, 25 October 2007. http://tinyurl.com/3yf4u6, sighted 21 February 2008.

[10] *The State of the Commons, 2003/04,* Friends of the Commons, www.friendsofthecommons.org. Available at http://onthecommons.org/files/publications/stateofthecommons.pdf.

[11] Peter Barnes, comment at http://onthecommons.org/node/694, sighted 19 February 2008.

[12] Richard B. Norgaard, ecological economist and UC Berkeley professor of energy and resources and co-author of *Rich nations' environmental footprints tread heavily on poor countries.* Comment appeared on http://www.physorg.com/news120157142.html, sighted 6 April 2008.

[13] Nearly four out of 10 adults in some parts of England cannot read or write properly or do simple sums. Source: *Basic Skills Agency* report, May 2000.

[14] Department of Social Security, Poverty and Social Exclusion Team, *Opportunity for All - Tackling Poverty*

and Social Exclusion, 1-11 John Adam Street, London WC2N 6HT, September 1999.

[15] See, for instance, *Happiness: lessons from a new science*, by Richard Layard, Penguin Press, 2005.

[16] *One third of homes dependent on benefits,* Brendan Carlin, 'Daily Telegraph', 13 February 2007 (http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/02/12/nwelfare12.xml, sighted 7 April 2007.)

[17] *National Accounts of OECD*: http://dx.doi.org/10.1787/OIF2007en26

[18] *Wales beats China to public cash,* David Williamson, 'Western Mail', 29 May 2006; http://tinyurl.com/2384xa, sighted 16 February 2008.

[19] *Interest-Group Conservatism: George Bush's Philosophy of Government,* by Jacob Weisberg, 'Slate', posted 4 May 2005. http://www.slate.com/id/2118053/, sighted 7 April 2008.

[20] *Compassion, not compulsion,* John Fund, 'Wall Street Journal', 18 April 2005.

[21] 'Besides the energy-producing industries, those that yield the most value added per labour unit are those considered more technology and/or knowledge intensive….' *Compendium of Productivity Indicators*, OECD, 2005 (page 32).

[22] *How not to control malaria,* 'New York Times', 16 October 2005.

[23] *A century of change: trends in UK statistics since 1900*, House of Commons Research Library, Research Paper 99/111, December 1999.

[24] '…some research recently suggested that it would be five times higher than it is if techniques of emergency surgery were the same as in 1960, since when the rate has in fact more than doubled, meaning that there are ten times as many murderous assaults now as in 1960.' *Murder Mystery,* Theodore Dalrymple, 'The Spectator', 6 January 2006.

[25] *NHS Careers: Careers in Management, Management – an Introduction:* http://www.nhscareers.nhs.uk/details/Default.aspx?Id=796, sighted 8 April 2008.

[26] From a letter to the Editor, 'The Economist', by Karen Dunnell, National Statistician, Office of National Statistics, London, published in 'The Economist' 23, March 2006.

[27] *NHS Careers: Careers in Management, Management – an Introduction:* http://www.nhscareers.nhs.uk/details/Default.aspx?Id=796, sighted 8 April 2008.

[28] J K Galbraith, *The Economics of Innocent Fraud*, Penguin Books, 2004.

[29] *Happiness: lessons from a new science*, Richard Layard, Penguin Press, 2005.

[30] *Reversal of Fortune,* Bill McKibben, 'Mother Jones', March/April, 2007.

[31] For work on alternatives see, for instance, the work done by the US think tank 'Redefining Progress': http://www.rprogress.org/index.html. See also the 'Human Development Index', mentioned in chapter 9,

below. More subjective, but also of interest, is Bhutan's concept of Gross National Happiness.

[32] See the entry in the online Wikipedia under Gross National Happiness: http://en.wikipedia.org/wiki/Gross_national_happiness.

[33] *Why states believe foolish ideas: non-self-evaluation by states and societies*, Stephen Van Evera, MIT Political Science Department and Securities Studies Program, 10 January 2002, version 3.5.

[34] Call for ban on 'auctions' of ministers' time, Michelle Grattan, 'The Age', Melbourne, 7 February 2005. http://tinyurl.com/6fxeuh.

[35] *Death by a thousand cuts: the fight over taxing inherited wealth,* Michael Graetz and Ian Shapiro, Princeton University Press, February 2005.

[36] *Tax Breaks for Rich Murderers*, David Runciman, reviewing *Death by a Thousand Cuts: The Fight over Taxing Inherited Wealth* by Michael Graetz and Ian Shapiro, in 'London Review of Books', 2 June 2005, http://www.lrb.co.uk/v27/n11/runc01_.html, sighted 21 February 2008.

[37] *German companies admit they are topping up politicians' pay,* 'The Times', 8 January 2005, http://www.timesonline.co.uk/tol/news/world/article409604.ece, sighted 22 Feb 2008.

[38] From *Capitalism 3.0: a guide to reclaiming the commons*, by Peter Barnes, Berrett-Koehler Publishers Inc, September 2006, quoting Kevin Phillips, a former (US) Republican party strategist.

[39] *Barack Obama Inc,* Ken Silverstein, 'Harpers Magazine', November 2006.

[40] J Krishnamurti

[41] *How, and How Not, to Stop AIDS in Africa,* William Easterly, 'New York Review of Books', 16 August 2007; http://www.nybooks.com/articles/20492, sighted 23 February 2008.

[42] Ibid.

[43] *The Ideology of Development,* William Easterly, 'Foreign Policy', July/August 2007.

[44] *Wild: An Elemental Journey,* Jay Griffiths, Tarcher, December 2006 (page 140).

[45] *Clever Stuff,* 'The Economist', 1 February 2007.

[46] *England: an elegy,* Roger Scruton, Continuum International Publishing Group, May 2006 (page 114).

[47] *Southern Comfort*, directed by Walter Hill, released 1982.

[48] *Therapy culture*, Frank Furedi, Routledge, 2004 (chapter 3, pp 60-61).

[49] *The Triumph of Gesture Politics,* Christopher Caldwell, 'New York Times', 23 January 2005.

[50] *Pupils kept in crumbling classrooms by red tape,* 'The Times', 15 January 2007.

[51] Figures and quotes in this paragraph all from: *Brown's nine years have been littered with empty promises, say the Tories,* Melissa Kite, 'Sunday Telegraph', 2 December 2006. ,

[52] Ibid.

[53] *Focus on terrorists, not tactics: it's easy to defend against what they planned last time, but it's shortsighted,* Bruce Schneier, ‘Minneapolis Star Tribune’, 13 August 2006. http://www.schneier.com/essay-121.html, sighted 23 February 2008.

[54] *The Age of Missing Information,* Bill McKibben, Plume, 1993 (page 216), ISBN-13: 9780812976076.

[55] www.copenhagenconsensus.com

[56] *Consider the salient truth about international concerns*, John Kay, ‘Financial Times’, 26 September 2006, http://www.johnkay.com/print/462.html, sighted 23 February 2008.

[57] *Losing the will to fight*, Patrick Buchanan, ‘The American Conservative’, 9 October 2006, http://tinyurl.com/ynptur, sighted 23 February 2008.

[58] From ‘more than 200,000 people have been killed and at least 2m others driven from their homes in Darfur since 2003.’ ‘The Economist’, 27 February 2007. See also *The middle of nowhere* by Edward Luttwak, ‘Prospect’, May 2007.

[59] *The Effect of 'In-Your-Face' Political Television on Democracy,* ‘Science Daily’, 13 December 2007; http://www.sciencedaily.com/releases/2007/12/071212201354.htm

[60] Reported in the ‘Dominion Post’, Wellington, New Zealand, January 2006.

[61] Ibid.

[62] New Zealand Labour: http://www.labour.org.nz/index.html.

[63] These two examples from Mick Hume, *From immigration to Iraq, they are a political class apart*,

'Spiked', 11 February, 2005; http://www.spiked-online.com/Articles/0000000CA8D1.htm, sighted 23 February 2008.

64 *Too many students,* Alison Wolf, 'Prospect', July 2002.

65 Statistics taken from *Improving literacy and numeracy: a fresh start.* A report of the Working Group chaired by Sir Claus Moser, (chapter 1), appointed in June 1998.

66 Bettina Wassener, *Green minister pushes for farming reform: One in five farms will be organic in 10 years' time if the government's policy goes according to plan,* 'Financial Times', 12 June 2001.

67 See, for instance, *Urban myths of organic farming*, Anthony Trewavas, 'Nature' 410, 22 March 2001.

68 *Patients admitted to hospital simply to hit targets,* 'The Times', 24 December 2007; http://www.timesonline.co.uk/tol/life_and_style/health/article3090643.ece

69 *Paper versus polystyrene: a complex choice,* Martin B Hocking, Science 251, pp 504-5, 1 February 1991.

70 *Life Cycle Assessment of Disposable and Reusable Nappies in the UK,* [UK] Environment Agency, May 2005; http://tinyurl.com/34vns3.

71 For example, in Chester: see [UK] 'Chester Standard', June 2002, and *Waste of time,* 'The Economist', 6 July 2002 (page 48), about recycling in New York.

72 President Barroso's statement at the G8 outreach session with leaders from Africa,
European Commission, 9 July, 2008; http://www.egovmonitor.com/node/19866.

[73] *Rigged Rules and Double Standards*, Kevin Watkins and Penny Fowler, Oxfam Campaign Reports, November 2002. ISBN 0855985259. Can be read online at http://publications.oxfam.org.uk/oxfam/display.asp?isbn=0855985259.

[74] Ibid.

[75] Airport security procedures: discussion of Harvard research taken from *Where should airport security begin?* by Bruce Schneier: http://www.schneier.com/crypto-gram-0801.html#3.

[76] *Forever Guantanamo,* Raymond Bonner, 'New York Review of Books,' Volume 55, Number 6, 17 April 2008.

[77] See summary page at http://www.ecouncil.ac.cr/.

[78] My usage is the same as Norman Myers: see *Perverse subsidies,* Norman Myers (Lead Author); Nancy E. Golubiewski and Cutler J. Cleveland (Topic Editors), 2007, in *Encyclopedia of Earth*. Eds. Cutler J. Cleveland (Washington, D.C.: Environmental Information Coalition, National Council for Science and the Environment). Published in the *Encyclopedia of Earth* 9 August 2007; http://www.eoearth.org/article/Perverse_subsidies, sighted 14 April 2008.

[79] *Agricultural policies in OECD countries: monitoring and evaluation 2007*, OECD, Paris, 2007. Highlights available through link at http://tinyurl.com/2q4sbw.

[80] OECD (1995) Transfer efficiency of agricultural price support, OECD, Paris, 1995.

[81] *How the CAP increases input costs for dairy farmers*, Linda Meijer, Ministry of Agriculture and Forestry, Wellington, New Zealand, 1996.

[82] *Distributional effects of agricultural support in selected OECD countries*, OECD, Paris, 1999.

[83] *A review of farm household incomes in OECD countries,* OECD document AGR/CA(94)27, OECD, Paris, 1994.

[84] *Measuring the capititalization of income transfer programs into agricultural asset values*, Turvey CG et al, 1995. http://www.agr.gc.ca/pol/pub/captransval/pdf/capitalization_e.pdf, sighted 15 April 2008.

[85] *Market Access And Agricultural Trade: The Double Standards Of Rich Countries,* chapter 4 of *Rigged Rules and Double Standards*, Kevin Watkins and Penny Fowler, Oxfam Campaign Reports, November 2002. ISBN 0855985259. Downloadable from: http://www.oxfam.org.uk/ sources/papers/tradereport.html.

[86] *You are what you* grow, Michael Pollan, 'New York Times Magazine', 22 April 2007; http://tinyurl.com/2qgbky.

[87] Open Europe Newsletter, 11 November 2005; http://www.satsig.net/open-europe.htm, sighted 17 April 2007.

[88] Europe's farm follies, 'The Economist' 8 December 2005, reporting on work done by Groupe d'Economie Mondiale (GEM) at Paris's Institut d'Etudes Politiques.

[89] *Survey sparks farmer subsidy row*, Nic Rigby, BBC Online, 24 January 2004; http://news.bbc.co.uk/1/hi/england/3423171.stm, sighted 16 July 2008.

[90] *Harpers Index,* 'Harpers Magazine', October 2006. Source given as 'Washington Post'.

[91] *Harvest of disgrace,* 'The Economist', 24 May 2008.

[92] Total commitments to agriculture, which in this definition includes forestry, fisheries, water and the environment made by bilateral and multilateral donors in 2002 (at 2000 prices). Source: *The state of food and agriculture, 2005*, FAO, 2005 (table 42).

[93] *Aid,* 'The Economist', 21 Feb 2008; http://tinyurl.com/5hu36l, sighted 16 July 2007.

[94] *How Biofuels Could Starve the Poor,* C Ford Runge and Benjamin Senauer, 'Foreign Affairs', May/June 2007; http://preview.tinyurl.com/3c6dlt, sighted 16 July 2007.

[95] *Starving the poor,* Noam Chomsky, 'Khaleej Times', 15 May 2007; http://tinyurl.com/5fdf9p, sighted 16 July 2007.

[96] *EU Green Targets Will Damage Rainforests,* 'Daily Telegraph', London, 28 April 2007; http://tinyurl.com/6r98ez, sighted 16 July 2007.

[97] *Property rights and the wrong path to democracy*, John Kay, 'Financial Times', 1 May 2007.

[98] Fisheries Economics Research Unit, University of British Columbia. Website: http://www.fisheries.ubc.ca/ru/feru/.

[99] *The last wild hunt -- Deep-sea fisheries scrape bottom of the sea*, Jessica Brown, Seaweb, 17 February 2007; http://tinyurl.com/5p24om, sighted 16 July 2007, reporting on work by Rashid Sumaila and Daniel Pauly of the University of British Columbia Fisheries Centre.

[100] *Scientists call for fuel subsidies ban to protect fish*, Nic Fleming, 'Daily Telegraph', London, 20 February 2007; http://tinyurl.com/6o94at, sighted 17 July 2008.

[101] *Norman Myers Interview: Conversations with History; Institute of International Studies*, UC Berkeley, 11 November 1998; http://tinyurl.com/6cnwnz, sighted 17 July 2008.

[102]These figures come from *Perverse Incentives: Subsidies and Sustainable Development*, A P G de Moor, Institute for Research on Public Expenditure, The Netherlands, 1996.

[103] *Global Subsidies Initiative, Sector Briefings: Energy,* http://www.globalsubsidies.org/en/resources/energy; sighted 17 July 2008.

[104] *European Commission report recommends no changes to coal subsidies*, Global Subsidies Initiative, archive; http://tinyurl.com/6pzwzf, sighted 17 July 2008.

[105] T*he Looting of Our Common Wealth: An Ongoing Saga – Another chapter in the looting of our common wealth: the Bush Administration helps natural gas firms to defraud the public*, David Bollier, onthecommons.org, 23 January 2006; http://www.commonsdev.us/content.php?id=748, sighted 17 July 2008.

[106] Under two schemes: Coal Investment Aid and the UK Coal Operating Aid Scheme. See *Coal Industry in the UK,* Department for Business Enterprise and Regulatory Reform, 2008; http://tinyurl.com/64wewq, sighted 17 July 2008.

[107] *Meeting the Energy Challenge: a White Paper on Energy,* Department of Trade and Industry, May 2007 (Para 4.07, page 107).

[108] *A new slogan for the environmental pressure groups: Some Gain, No Pain,* Anatole Kaletsky, 'The Times', 2 November 2006.

[109] As stated in *Rigged* by George Monbiot. Published in *the Guardian*, 11 December 2007. Available on www.monbiot.com.

[110] *Size, structure and distribution of transport subsidies in Europe*, European Environment Agency Technical Report, No 3/2007, ISSN 1725–2237 (table 2 page 15), 2007.

[111] These figures are from *Subsidising Unsustainable Development: Undermining the Earth with public funds,* by André de Moor and Peter Calamai, 1997 (chapter 5). Downloadable at www.envict.org.au/file/Subsidizing Development.pdf.

[112] *Subsidising Unsustainable Development: Undermining the Earth with public funds,* by André de Moor and Peter Calamai, 1997 (page 42). Downloadable at www.envict.org.au/file/Subsidizing Development.pdf.

[113] *The High Cost of Free Parking,* Donald C Shoup, American Planning Association, Planners Press, ISBN 978-1-884829-98-7, 2005.

[114] Ibid.

[115] *The elephant in the bedroom: automobile dependence and denial*, Stanley Hart and Alvin Spivak, 1993, quoted in *Suburban Nation*, page 94n.

[116] *The strategy of equality: redistribution and the social services*, Julian Le Grand, George Allen and Unwin, London, 1982. The author points out that a major declared objective of government spending on social services has always been redistribution of wealth to the poor. But, after examining the impact of public expenditure on health, education, housing and transport

in the UK, he concluded that in almost all the forms he scrutinised, it was distributed in favour of the higher social groups. Although the details of his results are obviously not up-to-date, the general features are still relevant.

[117] *Grim Tales*, 'The Economist', 29 March 2007; http://tinyurl.com/59fu5z, sighted 17 July 2008.

[118] *Nemesis* by Chalmers Johnson, Metropolitan Books; February 2007, ISBN 0805079114.

[119] From *Bush's Amazing Achievement*, Jonathan Freedland, 'New York Review of Books', 14 June 2007 (reviewing 'Nemesis' by Chalmers Johnson, see preceding note).

[120] *Escaping the subsidy trap*, Saferworld, Oxford, UK, ISBN: 1-904833-05-5

22 September 2004.

[121] *Earth Council Chairman's Report to the United Nations,* Maurice F. Strong, Chairman of the Earth Council and Rio+5 Forum at the Ministerial Session of the Meeting of the United Nations Commission on Sustainable Development 8 April 1997. http://www.ecouncil.ac.cr/-about/speech/strong/uncsd.htm. Subsidies to water in non-OECD countries accounted for perhaps another $45 billion.

[122] *Shopping for subsidies: how Wal-Mart uses taxpayer money to finance its never-ending growth*, Philip Mattera and Anna Purinton, Good Jobs First, May 2004. This study shows that the US retailer Wal-Mart received more than $1 billion in economic development subsidies from state and local governments across the US. Taxpayers have

helped finance not only Wal-Mart stores, but also the company's huge network of distribution centres, more than 90 percent of which were subsidised.

[123] *Environmentally Harmful Subsidies: Barriers To Sustainable Development*, Keynote address by David Pearce, OECD Workshop On Environmentally Harmful Subsidies: Paris, 7-8 November 2002; http://www.oecd.org/dataoecd/56/59/35198645.pdf.

[124] *Why states believe foolish ideas: non-self-evaluation by states and societies*, Stephen Van Evera, Massachusetts Institute of Technology, Political Science, Department and Security Studies Program, 10 January, 2002.

Chapter 2

Causes and consequences of failure

Discussing the Mao-induced famine that killed 10 million to 60 million Chinese, Tim Harford writes:

> In the 'world of truth' [ie markets] ... such disasters cannot happen. Mistakes, certainly, will be made - perhaps more frequently than under central planning. But the mistakes stay small; in market economies we call them 'experiments'.[1]

And in markets – in real, undistorted markets – failed experiments are terminated. This chapter looks at some of the consequences and causes of government failure. Often they accompany and reinforce each other.

Concentration and monoculture

Government has a long history of intervention in agriculture in the industrial countries. We have seen that perverse subsidies to agriculture in the rich countries have contributed to the devastation of the physical environment, diverted wealth from the poor to the rich and accelerated the massive overcapitalization of farms and rural depopulation. But does the agriculture sector have anything more to teach us about the effects of government intervention?

In much of the countryside in the west, the visual testament to a long history of government involvement is square kilometre after monotonous square kilometre of land devoid of trees, hedges and human beings, devoted to intensive production of crops or pasture. Subsidies have exaggerated this specialisation, partly because guaranteed prices have reduced the risks of on-farm specialisation and partly because capital assets receive favourable tax treatment. So one result of the combination of subsidies and centralised price-fixing and subsidies has been a greater degree of monoculture in agriculture than would otherwise prevail. And, because they are set by central government, subsidies and other interventions have led to a greater degree of monoculture than otherwise. As well, without the high levels of subsidy it's unlikely that farms would be as land-intensive as they are today. Net production would be lower, but so too would use of fossil fuels and prices to consumers. International comparative advantage would operate, so that the west would have imported more from the food-rich developing countries.

Another effect of government support has been the trend towards bigness. We saw in chapter 1 how big landowners and agribusiness corporates capture most of the benefits of support to the agriculture sector. One result has been the high degree of industry concentration in the sector (see box). This is accentuated by a regulatory environment that favours bigness. Regulations, often imposed because of problems caused only by large-scale operators, typically bear more heavily on smaller enterprises, which face higher proportionate compliance costs. The European Union, for example, insists that abattoirs be tiled: bureaucratic logic therefore dictated that a snail farmer was told to tile his packing room, which was classed as an abattoir, up to the ceiling to catch the blood.[2] The sum of these regulations has led to the closure of large numbers of local slaughterhouses, which makes things worse for the animals travelling to slaughter and can accelerate the spread of disease:[3] a single lot of hamburger meat at one US processing plant was once found to contain parts from 443 different cows.[4]

Economics, animal welfare and aesthetics considerations aside, though, are there any further concerns about a highly specialised, centralised monoculture in agriculture?

First, monocultures are inherently vulnerable to external shocks, whether caused by diseases, or climate, or interruptions to the supply of inputs. On this last point, it's worth bearing in mind that agriculture in the west now depends absolutely on low-cost oil and gas: as raw materials and energy in the manufacture of fertilisers and pesticides, as energy for planting, irrigation, feeding, fertilising, harvesting, processing, distribution and packaging. (Industrial production of fixed nitrogen for fertilizer now matches the natural rate of nitrogen fixation on the planet.[5]) In addition, fossil fuels are essential in the construction and repair of the agriculture sector's equipment and infrastructure, including farm machinery, processing facilities, storage, ships, trucks and roads.

Industrialised agriculture is one of the world's biggest consumers of fossil fuels.[6]

Industry concentration in agriculture

- The world's top 10 seed companies account for one-half of the global seed trade;
- The top 10 biotech enterprises account for nearly three-quarters of world biotech sales;
- The market share of the top 10 pesticide manufacturers is now 84 percent, while industry analysts predict that only three companies will survive the next decade.[7]

Second, is that the sector as a whole has grown dependent on government support and large corporations, not just for its income level and asset values, but for its sense of direction. When things go wrong in an industry characterised by a monoculture and dominated by a few big players, they go wrong in a big way and in ways to which ordinary people cannot respond, whether as producers or consumers. Government intervention has heightened the potential for disaster but, more drastically, it has *undermined the agriculture sector's capacity to respond and adapt to* *changing circumstances or scientific knowledge.* An industry that looks to government for price signals has no real need to anticipate or respond to the market. So, thanks largely to along history of government intervention, agriculture in the rich countries is *locked in* to a way of production that is land-intensive, highly specialised, critically dependent on fossil fuels, more vulnerable to shocks, and beholden to the business decisions that very large corporations take in the interests of their shareholders.

Without perverse subsidies or such a high degree of government involvement there might well have been trends towards more specialisation on the farm and a more concentrated agri-business sector. These features are not totally negative, and should not be denigrated in themselves. But without government intervention they would not have gone so far, and they would have been more reversible, so the sector as a whole would be more resilient to shocks, and more adaptable.

Urban monoculture

> Not TV or illegal drugs, but the automobile has been the chief destroyer of American communities ... One can drive today for miles through American suburbs and never glimpse a human being on foot in a public space, a human being outside a car or a truck ... While people possess a community, they usually understand that they can't afford to lose it; but after it is lost, gradually even the memory of what was

> lost is lost. In miniature, this is the malady of Dark Ages.[8]

It is no surprise to find that in other sectors with which government has been heavily involved for sustained periods, the effect is much as in agriculture: monoculture, an exaggerated dependence on big corporations, and reduced adaptability to changing circumstances. Centralised government thinking with its single-use zoning laws, subsidies to road transport, fossil fuels and construction have meant that the bleak, featureless landscape in our countryside has its counterpart in our sprawling suburbs and ever more similar city centres. (In Britain, for instance, the proliferation of chain stores has seen politicians warning that 'small and independent shops may vanish from the UK's High Streets by as soon as 2015'.[9]) The motor lobby is quick to say that cars and highways represent market forces and freedom of choice. They don't. 'The atomization of our society into suburban clusters was the result of specific government and industry policies rather than of some popular mandate', say the authors of *Suburban Nation,*[10] and they are right. The subsidies and access to government that the road sector receives have nothing to do with market forces. Some argue that the funds extracted from road users exceed the costs of building and maintaining highways. Even if this were true, it ignores the very high social and environmental costs of motoring.

But it doesn't really matter: the bigger point is that it was government, influenced by powerful corporate interests, that chose and subsidised road-based development. And, as in agriculture, our transport systems depend absolutely on fossil fuels: our dependence on oil has been locked in by decisions made decades ago. Any shortage of oil, however short-lived, will see prices leap and intimations of social breakdown. One estimate is that it would take a doubling of petrol prices to reduce US consumption of petrol by 5 percent.[11] And if we now find it impossible to live without cars and low-cost fuel and too expensive or dangerous to travel in any other way, that is a result of government's favouring one particular form of development.

There are other impacts arising from our dependence on oil and cars that are difficult to square with choices that individuals would make in a genuinely free market. Housing unaffordability is one. In 1970, about 50 percent of all families in the US could afford a median-priced home; by 1990 this number had dropped below 25 percent.[12] One reason is the way that planners and developers design our cities. In most residential developments it's now almost impossible for any adult to function without a car. The cheapest cars (in the US) cost around $6000 a year to run, which at typical mortgage rates equates to $60 000 in home-purchasing power.[13] For two adults, the impact on housing affordability is obvious.

It is not just a matter of direct subsidies. Take a look at how city governments in the US invoke eminent domain, which gives the state the power to appropriate private property for its own use. This use is supposed to be in the larger public interest. And in the nineteenth century and much of the twentieth, the individual states did invoke eminent domain primarily for public uses, seizing smallholder land to build roads, parks, railroads, hospitals, and military bases. But since then the public good has been redefined, so that it now interpreted as including economic growth that generates increased tax revenue for a local authority. Joshua Kurlantzick describes how city governments in the US combine with large real estate developers and 'big-box' retailers to exploit eminent domain for their own purposes.[14] The losers are homeowners and small businesses.

Sad though the spectacle of involuntary suburbanisation and urban monoculture in the west might be, the effects of government and the construction industry have been yet more lamentable in Japan. Alex Kerr contrasts the genuine love for nature of Japanese men and women with the destruction being wrought by government and corporations:

> It is impossible to get through a single day in Japan without seeing some reference - in paper, plastic, chrome, celluloid, or neon - to autumn foliage, spring blossoms, flowing rivers, and seaside pines. Yet it is very possible to go for months or even years without seeing the real thing in its unspoiled form. Camouflaged by propaganda and symbols, supported by a complacent public, and directed by a bureaucracy on autopilot, the line of tanks moves on: laying concrete over rivers and seashores, reforesting the hills [with a cedar monoculture], and dumping industrial waste.[15]

Government is always more comfortable dealing with big business. It identifies big business with economic success and most of its subsidies and corporate welfare programmes go to the largest companies.[16] Big business has the resources with which to lobby government, distort markets and manipulate the regulatory environment. There are other advantages too in being big: the tax systems in most countries favour those who can readily convert income into capital gains and so pay lower taxes than most small business proprietors. And the complexity of tax and regulatory systems, apart from their bias, also favours those with the resources to understand and best take advantage of them. Small businesses and ordinary people suffer and so too does our physical environment. We end up with bigger, more dominant corporations than we would wish for, and we are locked in to ways of doing things to a degree that we would not, as individuals in a free market, choose ourselves.

Government and big business: favouring the large and global

> *Minimum value of "small business" contracts given out by the US last year that went to Fortune 500 firms: $1.2 billion*.[17]

The rural and urban monoculture, sprawl, suburbanisation: all would have probably gone ahead anyway, without government intervention. The problem is not the monoculture; it's that we have more, possibly a lot more, of it than we really want, and that are locked in to it. Government is so big that when it intervenes it determines the physical and social environment in which we live.

In recent decades some national governments, it is true, have privatised state industries, relinquishing direct control over telecoms, railways and other sectors. But they have taken on a greater role in looking after the interests and needs of big business, [18] partly because of the size and power of the corporate sector, partly because as a big organization itself government understands big companies and partly because when corporate profits rise so do government taxation revenues.

Corporations and governments support each other in creating ideal conditions for corporate growth and for maintaining government's pivotal role. The large scale of social organization, and the very high degree of specialisation and complexity of our economies, while helpful to corporations, do not therefore arise from undistorted market forces, and do not therefore originate in decisions made by natural persons — though they are certainly maintained by our patronage as viable alternatives become ever more scarce. Corporations have drifted apart from natural persons, and the major influence on our society has changed from natural persons to corporate actors.[19]

The two parties might have nominally equal rights, but they have vastly different resources, which in any actual transaction can be decisive. This is a matter of concern, because the goals of the parties can conflict, and the victims tend to be natural persons and the commons.[20]

Another way of killing small business

Sometimes government and big business appear to be running a cartel with a single aim: to eradicate small businesses. But the initiative doesn't always come from the vested interests.

The UK's *Daily Telegraph* reported this story:

> The misery women go through all over the world queuing for public lavatories would be eased under new principles proposed by the World Toilet Organisation. Guidelines issued at the weekend by the National Environment Agency in Singapore, where the WTO is based, would mean women have at least equal facilities to men.[21]

The code requires medium-sized restaurants, bars and nightclubs to have as many female cubicles as they have male cubicles and urinals. Larger venues, and those such as theatres and cinemas where usage is confined to peak periods, would have to favour women's facilities by a ratio of 14:10. "It's very important where there are a lot of people," said Elisabeth Maria-Huba, a German social scientist. "Women need longer. And in a lot of cases women have to arrange themselves to go out again."

Political monoculture

> The gradual corruption of enterprises by bureaucracy appears to be inevitable. Once any enterprise becomes successful, it is doomed to be taken over by those for whom power and prestige are the central aspects of their lives. The forms are preserved, but the content is lost. Rituals replicate endlessly. This would seem to be a constant of human nature; the trick is to recognize when it has happened and not be fooled by the rhetoric. And if can happen to Christianity it can happen to anything. Including science. [22]

It's certainly happened to universities and research. Lamenting the failure of theoretical physicists to come up with radical innovations or dramatic shifts in our thinking, Mike Alder continues:

> Financial managers need to defend expenditures on the basis of maximising their expected return.... That inevitably means that the currently favoured paradigm gets almost all the money. ... So everyone goes for the best bet, and if it happens to be wrong, we all go bust.[23]

An academic monoculture to mirror our rural and urban monocultures? Mr Alder continues:

> Philosophers who are good are beyond price, but the mediocre are useless. Scientists tend to be

> technicians more than philosophers, but the system of rewards doled out by the bureaucrats in charge of the universities these days favours the technicians. It is so much easier to measure their output.[24]

It appears that the same is happening in the world of policymaking. In a bureaucratic setting there are few penalties if you advocate a tried and tested policy – even if it's a proven failure. It's usually better to play safe and do the conventional thing. Bureaucracy stifles creativity and sensitivity to human needs in policymaking just as surely as it does in religion and theoretical physics.

But what about large private sector corporations? Are they any more responsive to the needs of ordinary people? The evidence appears to be that, like governments, they are too big and cumbersome:

> Randy Hayes ... once told me of a talk he had with the uber-CEO of the Mitsubishi Company. Hayes said he was able to convince this CEO that Mitsubishi's program of global devastation for short-term profit was not in the long-term interest of either the planet or the company. Hayes achieved this moment of clarity only to have it followed by a far larger and more monstrous clarity for both himself and the Mitsubishi Head: Mr Mitsubishi had no idea how to change the practices of the company, *because the logic that drove the company was both systemic and autonomous*.[25] (Emphasis added.)

Even the short-term interests of parts of a single corporation, then, can be in conflict with the long-term survival of the corporation itself, let alone wider society. Perhaps big corporations, like governments, feel they are too big to fail. Or perhaps they are just so big that most employees have little direct, daily, interactive contact with natural persons in a real market. Most likely of all, those in their higher echelons believe that they can influence the government to disburse legislation or subsidies in its favour. There's plenty of supporting evidence for such a belief: recent (2007-08) turmoil in the financial world has shown that some finance institutions were right in believing that their irresponsible lending practices would be rewarded by a government bailout.[26]

When corporations - and governments - are small in relation to the damage they can cause, then perhaps there's no urgent problem. But when, as now, corporations and governments are huge, their dysfunctionality is a major loss, and possibly a threat to us all. We need more adaptive, diverse ways of achieving our social and economic goals. That is, after all, what governments are supposed to be doing. Government is sometimes so big it loses sight of this, and has an alarming tendency to focus on means, rather than ends.

Ends and means

> 'Hazard Analysis Critical Control Point' (HACCP) ... focuses on identifying the 'critical points' in a process where food safety problems - hazards -

> could arise... What HACCP boils down to is a system of checklists, form filling and record keeping. ... This system creates a paper trail so that in the event of a problem, the companies or producers implicated can demonstrate that they did their bit and walk away blameless, plausibly denying responsibility. ... A supermarket that poisoned customers by selling contaminated chicken... could use HACCP to show that its suppliers followed correct procedures so it was not at fault.[27]

This represents the triumph of process, and a confusion between means and ends. In this instance the system's overriding objective - the one that permeates the entire system - has little to do with food safety and everything to do with protecting oneself from disciplinary proceedings or lawsuits. Rational policy is subordinated to procedure.

> Yesterday I was told by my doctor that she cannot, at present, refer patients suffering from varicose veins for hospital treatment. Today I read your report that hospital waiting lists have come down. Is this coincidence? Are patients with complaints which, while not life-threatening are extremely irritating and debilitating, being denied treatment so that the Government can maintain that it has fulfilled an election pledge?[28]

What happens when process or meaningless numerical targets (see chapter 1) take over? They influence behaviour for the worse. Unless numerical targets are very carefully defined they can be manipulated to generate results quite different from those we actually want to achieve. In the UK secondary schools that encourage their pupils to sit 'softer' subjects such as leisure studies and performing arts can elevate their position in educational league tables at the expense of leading schools that focus on traditional subjects. One school ranked 478th by the British Department for Education and Science plummets more than a thousand places to 1623 when the softer subjects and vocational qualifications are excluded.[29]

The root of the problem here is essentially this: policymakers probably, and government officials and others charged with achieving targets certainly, see shorter hospital waiting lists, a higher place in the educational league table, or (see chapter 1) more organic farming or more recycling as *ends in themselves* rather than means to ends, and the results have been unfortunate, to put it mildly

Policymaking today is inescapably centralised, and important decisions are made that affect larger numbers of people. Given this reality, we have to accept that policy will often be determined by, if not formulated in terms of, quantifiable goals and numerical indicators, at all levels above the very local. Not all these targets are made clear to the public, and policymakers themselves may not set them explicitly. Indeed, governments have a fairly short history of expressing their objectives in terms of meaningful, objectively verifiable outcomes and, to be frank, they are not very good at it, as the examples above and in chapter 1 demonstrate.

Which numbers then should well-meaning policymakers whose remit covers any but the smallest community target?

A starting point, I believe, is that for indicators and targets to be useful they should be inextricably correlated with well-being – and it is the well-being of natural persons that we should be targeting, not that of corporations or institutions, which have entirely different goals.

With national governments being the size they are, and with global schemes bound to assume greater importance, poorly thought out global policies could be disastrous for all of us. Writing about the rush to subsidise biofuel production, George Monbiot says:

> It used to be a matter of good intentions gone awry. Now it is plain fraud. ... The reason governments are so enthusiastic about biofuels is that they don't upset drivers. They appear to reduce the amount of carbon from our cars, without requiring new taxes. It's an illusion sustained by the fact that only the emissions produced at home count towards our national total. The forest clearance in Malaysia doesn't increase our official impact by a gram.[30]

I was inclined to think insanity rather than dishonesty but Mr Monbiot may well be right. The implications for the planet are the same either way. Unfortunately, big government is far more concerned with adhering to its own agenda than it is about actually achieving worthwhile outcomes. And what is this agenda? What lies beneath all this confused policymaking, the targeting of means rather than ends, the persistent, destructive subsidies to vested interests; what is the ultimate goal of government, or indeed that of any big organization?

Self-perpetuation: the unacknowledged goal

According to Tim Coates the expenses of UK public libraries are so high in that the average book loan costs nearly £4.00.[31] Of course, libraries do many other things: they answer enquiries from the public, archive local history collections and, increasingly, lend DVDs, CDs and computer games. But still, £4 per book does seem excessive. Mr Coates hints at the likely explanation:

> In one London borough with nine libraries, there are nine tiers of "managers" between the counter staff and the local councillor who is responsible for libraries. The Library Manager, who handles admin; the Librarian, who chooses the books; the Area Manager; a Library Management Team; a Senior Management Team; the Chief Librarian; the Head of Cultural Services; the Education Director and, finally, the Council Librarian. Recently I talked to a chief librarian who said that when she started in Glasgow 30 years ago, the library service had a City Librarian and he was the only person not based in a library.[32]

The default setting for any agency in a position of power seems to be to expand or at the very least, to maintain its status. Sooner or later, the founding objectives of the agency cease to be its animating force, and the guiding principle becomes self-perpetuation. Most organizations' growth is circumscribed at some point by opposing power groups, and it is the collision of these groups that gives us our current political and social system. Big problems arise, though, where the groups have interests in common that are in conflict with those of ordinary people.

Most organizations have procedures for winding themselves up, but few willingly implement them. After foundation, they skip the existential question of whether their organization still meets a need that arises from outside itself. And few organizations consider whether their resources would be better deployed elsewhere. The smaller private sector bodies are kept on their toes by the discipline of opportunity cost: the better use of resources elsewhere, which motivates their controllers to seek higher returns, or be taken over, or go out of business. Public sector bodies, those charged with directly achieving our social and environmental goals, do not face the same disciplines. Nor do very large corporations; those that are big enough either on their own or with government help to distort or subvert the market.

Without such discipline, their purpose wavers. It is the same the world over: from schools to universities, from churches to trade union movements, from political parties to governments. Slowly, imperceptibly (at least to their employees) the organizations' actual objectives change. The nominal, constitutional goals remain in place but, as the world changes, self-perpetuation becomes by default the real purpose of these organizations. And the way to self-perpetuation is often served by methods that have little to do with an organization's stated purpose, or with the interests of society.

Take trade unions. Their aim is to serve the interests of their members. But not on the interests of their members as real people, *but as workers in a particular industry or for a particular company*. Historically, when workers were more specialised and less mobile, trade unions' objectives were congruent with those of their members. Thanks largely to the actions of trade unions in the past, times have changed, and their members' standard of living has risen. But not all unions have adapted. Some have acted against the longer-term, broader interests of their own members by making it impossible for companies or industries to stay viable unless they relocate overseas, or go out of business altogether. Notably immune from such pressure to adapt are the public-sector unions in the rich countries – mirroring the status of their employers as government agencies, exempt from market disciplines.

Perhaps there is little that trade unions organized according to crafts or companies that are obsolescent can do without a radical redefinition of their purpose. Interestingly, there is a precedent for such radical reshaping. With the decline of cathedral building in Europe after the Middle Ages, some guilds of operative (working) stonemasons began to accept honorary members to bolster their declining membership. From a few of these lodges evolved the modern symbolic or speculative Freemasonry, which particularly in the 17th and 18th centuries, adopted the rites and trappings of ancient religious orders and chivalric brotherhoods. These lodges were entirely voluntary. They could not coerce people, whether masons or not, into paying to support them. The old stonemason guilds, without knowing where their adaptive strategy would lead, metamorphosed into something profoundly different.

It's unlikely that today's big government bureaucracies will take that path. Because of their size and dominance, whether at local, national or supranational level, they can insulate themselves from disciplines that would keep their objectives consistent with those of the people they are charged with helping. Their starting point is their existence as organizations, and this severely constrains their capacity to contemplate policies that threaten their role. So, for example, the swollen agricultural bureaucracies of Europe and the US will – reluctantly - consider some re-orientation of farm subsidies, but not their abolition. All organizations of any size will resist changes that jeopardise their existence, even those that might be in the long-term interests of the people they are supposed to represent. But those that are not subject to external discipline will be more successful at doing so. Sometimes the interests of a government agency can not only diverge, but actually conflict with, those of some of the people that depend on them. So a bureaucracy can, for example, entrench people who depend on welfare bureaucracy in their roles as supplicants, because that is what ensures the continued survival of the bureaucrat.

There need not be anything inevitable or even deliberate about this: it is an observation rather than a law, but it does tend to apply especially to organizations other than those that depend on a free market. This includes private sector monopolies, as well as government and non-profit organizations, trade unions, churches, or state-subsidised schools, or health, housing, religious and social organizations.

It is especially unfortunate that organizational self-perpetuation seems to take precedence even when there is sense of crisis accompanied by a widespread realization that things cannot go on as before, and that outcomes – results – are what really matter. Just such a crisis occurred in New Zealand in the mid-1980s.

Essential terms

Inputs Expenditure, or those factors of production, such as staff, accommodation, other supplies, or other resources, that are used to produce goods and services. Amongst the inputs devoted to lowering crime, for example, would be: police numbers, numbers of patrol cars, and expenditure on policing.

Outputs Products that are directly attributable to the performance of an agency, such as number of reports produced and distributed or number of buildings constructed. Outputs of a crime-fighting agency could be:

numbers of police on the beat or on patrol at a time, number of police stations open 24 hours a day, number of toll-free phone lines, and the proportion of police emergency phone calls answered within 15 seconds.

Outcomes, objectives, goals Circumstances that are desirable *from the point of view of natural persons*. They are likely to be influenced by an agent's outputs *and* by factors outside agents' control. An outcome that might be targeted by crime-fighting agencies is a crime rate 10 percent lower than in the previous year (as measured by number of reported crimes, or responses to victim surveys). The terms 'objectives' and 'goals' are used synonymously in this text to mean desired outcomes.

Example A: New Zealand state sector reform

New Zealand was hit hard by the oil price shocks of the 1970s, and by the accession of the UK to the European Union and its protectionist agricultural policy. New Zealand's secure, high-priced market disappeared. In an effort to insulate consumers and producers from these events the New Zealand Government raised barriers to the country's imports of manufactured goods and intensified its intervention in the economy. Initially there was little opposition to this increased government intervention. But it led to inefficiencies that continued to multiply and deepen. Inflation was under symptomatic control - but only through the expedient of a wage and price freeze imposed in June 1982. By mid-1984 a number of acute problems had to be addressed. They included: a fiscal deficit which had reached nine percent of GDP; a growing *public debt* problem, whose servicing costs accounted for 15 percent of public expenditure; a persistent *current external deficit*; and an *overvalued exchange rate,* in support of the low-inflation objective. Unemployment was growing and the economy was stagnating. There was heavy selling of the New Zealand dollar, which threatened to exhaust the country's foreign exchange reserves. In short, most policy instruments were subordinated to the wage and price freeze and it became inevitable that this would have to be removed and that there would then be a resulting resurgence of inflation. By 1984 there was a sense of crisis.

People knew that radical changes in policy were needed. And when they came the changes *were* radical. All sectors of the economy were affected. One of the first acts of the new Labour Government was to announce a 20 percent devaluation of the New Zealand dollar, together with removal of controls on all lending and deposit rates. Exchange controls were removed in December 1984 and the New Zealand dollar has floated since March 1985. Key sectors of the economy - including finance, communications and transport - were deregulated. Export assistance was removed. Tariffs were lowered and the extensive import licensing system was dismantled. Government also began to disengage from commercial enterprises. Many of these were privatised or corporatised (that is, made independent of direct government management, and made accountable on a profit and loss basis). The tax system was overhauled, the central bank given increased autonomy in the pursuit of a single goal: to achieve and maintain price stability.

Over several years beginning in 1988, New Zealand's public sector was thoroughly and innovatively reformed. Tightly held central control gave way to autonomous departments, headed by chief executives with the authority to take decisions relating to the whole of their organizations. Chief executives are now expected to hire and fire staff, negotiate pay, manage their finances and capital assets, negotiate purchase agreements and be held to account for outputs. In the New Zealand public sector:

- accountability for resources and results is maintained through contestable, contract-like arrangements within government,

- performance agreements between government ministers and chief executives lay down standards and expectations for department heads, and

- purchase agreements between ministers and departments specify the outputs to be produced during the year.

The arrangements between ministers and departments specify *ex ante* the outputs they are required to deliver, but leave chief executives free to select the mix of inputs to be used in producing these outputs. This system has been extended to encompass the specification of, and accountability for, longer-term objectives. Since 1994 the New Zealand Government has defined the medium-term outcomes it is trying to achieve in nine ‘strategic result areas’ (SRAs) and linked the outputs delivered by each department to these SRAs through ‘key result areas’, which form the basis of their performance agreements.

The results have been mixed. According to a report commissioned by the New Zealand Government, there have been efficiency gains. However, the transactions costs incurred in negotiating agreements, monitoring compliance and preparing reports have been high, and in many cases have 'soaked up a substantial part of the efficiency gains' made from restructuring.[33]

In the context of bureaucratic change the New Zealand reforms were radical. But the reforms were constrained by the then existing institutional structures. At the outset of the reform programme, government departments had been envisaged as achieving specific *outcomes*. But that vision did not carry through.

Instead, outputs became the measure by which departments' performance is judged. One reason is said to be the self-interest of ministers and public servants, who are unwilling to be scrutinised.[34] Another is that while the supply of outputs can be directly attributed to departments' performance, outcomes can be influenced by factors beyond their control. As one commentator put it: 'outcomes are externalities in two-party relationships; therefore it is exceedingly difficult to assign responsibility for them.'[35]

So what happened? It looks very much as though the perceived need to assign responsibility in effect hijacked more thoroughgoing reform. The perception of such a need arises because the players – those whose responsibility is to be assigned – are known in advance and are assumed constant. And who are these players? Why, they are the existing government departments, of course. In effect the New Zealand reforms have *subordinated results to an assumed need to assign responsibility*, which in turn seems to be driven by existing institutional structures and their wish to perpetuate their own existence and degree of control.

Example B: The United States 'Results Act'

Concerned that the US federal government was more focused on programme activities and processes than outcomes, the US Congress passed the Government Performance and Results Act ('Results Act') of 1993. The Act 'seeks to improve the management of federal programs by shifting the focus of decision-making from staffing and activity levels to the results of federal programs.'[36] It requires federal agencies to submit to Congress strategic plans that outline their missions and goals.

What has been the result? In March 2004, the United States General Accounting Office (GAO) published its assessment.[37] There have been cultural changes within government agencies. Federal managers are now informed by significantly more outcome-oriented performance measures. Goals are both more quantifiable and results-oriented. There is a greater focus on performance measurement, orientation toward outcomes rather than inputs and outputs, and an increased focus on programme evaluation.[38]

All this is very good news. But the GAO report points to certain implementation problems. Importantly, there is no real co-ordination of an agency's annual performance goals with broader strategic goals.39 And:

> …in certain areas, federal managers continue to have difficulty setting outcome-oriented goals, collecting useful data on results, and linking institutional, program, unit, and individual performance measurement and reward systems. Finally, there is an inadequate focus on addressing issues that cut across federal agencies.[40]

The fault, it seems to this author, lies with the way in which strategic goals are chosen. Goals are still formulated *as if the existing agency structure were a given*. Setting outcome-orientated goals should not be the concern of 'federal managers'. It should be a part of the political process: the current agency, with a vested interest in its existence, structure and modus operandi, should not decide what outcomes to target.

> Mission fragmentation and overlap contribute to difficulties in addressing crosscutting issues, particularly when those issues require a national focus, such as homeland security, drug control, and the environment. GPRA requires a governmentwide performance plan, where these issues could be addressed in a centralized fashion, but OMB has not issued a distinct plan since 1999.[41]

Another crucial flaw is the small role given to efficiency in achieving targeted outcomes. While US agencies have begun to establish a link between results and resources,[42]

> [u]nfortunately, most existing federal performance appraisal systems are not designed to support a meaningful performance-based pay system in that they fail to link institutional, program, unit, and individual performance measurement and reward systems.[43]

The GAO found that only one of the six agencies that it looked in more detail clearly linked its costs of the achievement of outcomes.[44]

One difficulty, the GAO reports, is that it is difficult to establish outcome-based performance measures when the programme, or 'line of effort', is not easily quantifiable. 'In some agencies, particularly those that have a research and development component, managers reported difficulties in establishing meaningful outcome measures.'[45]

A second difficulty identified by the GAO is that the federal budget is allocated on an agency-by-agency basis, so it does not provide 'the integrated perspective of government performance envisioned by GPRA'.[46] It would be better if the budget were allocated according to crosscutting theme. As the GAO put it

> The development of a set of key national indicators could be used as a basis to inform the development of governmentwide strategic and annual performance plans.[47]

Indeed, the GAO goes on to recommend that there should be a government-wide performance plan.[48]

What we see in the US is that, as in New Zealand, existing institutional structures constrain a truly outcome-based policy. As far as citizens are concerned, efficiency should not be measured as effort per dollar spent, but as improvement-in-outcome per dollar spent. Outcome measures for bodies engaged in long-term activities, for example, research and development, should be subsumed into broader strategic goals. It should not be up to the government or a government agency to monitor how efficient agencies are in achieving sub-objectives. The risk and consequences of underachievement should be borne by the institutions themselves, not by ordinary members of the public. More crucially, the resource allocation should not be on an agency basis. Resources, ideally, would shift in and out of different activities depending on how efficient each activity is in contributing to the achievement of the strategic goals. But if that cannot be done because of the structures of our institutions or the way they work then it is time to subordinate our concept of an institution to the outcomes themselves.

The Government Performance and Results Act does represent a step forward for outcome-orientated government. But existing government agencies have too much say in both the choice of long-term goals to be targeted and in how resources aimed at achieving these outcomes are to be allocated. As in the case of New Zealand, efforts to move towards a system that targets social outcomes efficiently are drastically constrained by the acceptance of the existing institutional structure as a given.

Incentives and pluralism: the best features of the private sector

The aspersions cast on government need to be balanced by praise for what, at least in the west, we take for granted: the maintenance of law and order, defence against invasion, freedom of expression, and a generally rising standard of living and of health. We suspect that our national governments could do these jobs more efficiently but we ought to recognise that they do on the whole succeed in supplying these vital public goods and services. Similarly, they do a reasonably good job at raising revenue through their tax policies.

But there does appear to be a contrast between government's performance and that of the private sector. Deregulation of western economies and lower barriers to trade over the past three decades or so have vastly increased the range and quality of affordable goods and services. The freer operation of self-interest in the private sector has made many individuals very wealthy indeed. But the less well off and unwaged have gained little, at least in relative terms, and people from all backgrounds suffer from what they perceive to be a deteriorating social and physical environment. Many social and environmental objectives remain as remote as ever, despite large — and, in many cases, increasing — sums of taxpayers' money spent on trying to achieve them. And, as we saw in the case of perverse subsidies, appalling policies can persist indefinitely. Rather than ensuring their swift termination, our political system tends to give their beneficiaries the resources to lobby in favour of keeping them going. These policies, and especially their persistence over decades during which their deficiencies have been widely documented, fuel a suspicion that government could do a lot better. They underpin the contention that governments in the rich world have succeeded in part by transferring some serious social and environmental problems to the developing countries, to the commons, and to future generations.

It is likely that one reason for the failings in government's performance is that there are not sufficiently large numbers of influential people whose prosperity depends on its success. In the private sector, the success of an enterprise is identically equal to the success of its owners. But the motivation is very different for those agencies, whether they be public sector or non-governmental organizations, who take on the task of solving our social and environmental problems. *The vast majority of spending on social and environmental programmes is carried out by bodies whose success is barely linked to the welfare of those who are their intended beneficiaries*.

Unfortunately governments rarely set explicit targets in the form of outcomes that are meaningful to ordinary people. Their policies are driven by a whole host of factors – anything except outcomes in fact. Very often we hear politicians trying to defuse criticism of public sector schools, or hospitals, or whatever, by pointing to an increase in the budget for these organizations, as if increased spending will automatically lead to improved outcomes. Beholden to existing institutional structures or variants thereof, they cannot imagine that favourable outcomes can be achieved other than by continuing to do existing activities more intensively, whether by increasing funding for existing organizations or by creating new organizations in the same image. In effect, our policymakers sacrifice many worthwhile policy goals to the priorities of institutions.

There are pointers as to what are existing organizations' true priorities. We need only listen to the spirited, and often ingenious, defence of perverse subsidies presented with straight faces by the organizations that stand to lose most if they are withdrawn. Or discover that about half of the funds allocated to humanitarian relief and development aid organizations stays with these bodies.[49]

Such a mismatch between incentives and social goals becomes even more damaging when it perpetuates its own dysfunctionality. It then becomes a self-reinforcing process, which means that the already significant differences between actual policy outcomes and the desired outcomes of natural persons will widen over time. They will continue to widen until we radically re-orientate the way in which we formulate social and environmental policy.

In my view, such a re-orientation in the first instance means targeting and rewarding meaningful outcomes, rather than activities or institutions. That would be a necessary first step, but it is not sufficient. The other necessary step is to ensure that resources are allocated in ways that can most cost-effectively achieve societal outcomes. This is where markets enter into the picture.

Diverse, adaptive solutions

Targeting outcomes; yes. Providing incentives to achieve these outcomes; yes also. But even that combination would not suffice to ensure effectiveness and efficiency. When the distance between government and people is large, as it is in our highly specialised economies, national or global policy decisions about resource allocation are essentially central planning. Central planners think they know best how to solve economic, social and environmental problems, and their policies embody this assumption. Central planning is ponderous, uniform and slow to adapt, while the sort of complex issues – climate change, violent political conflict, crime and poverty – that we are discussing need exactly the opposite approach. Identifying these problems, articulating them and funding their solution does need centralised global or national bodies, but actually solving them requires diverse adaptive approaches, not central planning.

Markets are diverse and adaptive. Markets encourage people and firms to try different approaches, and also to assess the results of these approaches. Markets also hold people accountable for the results and ensure that ineffective or counterproductive approaches are terminated once they are seen to have failed. They both generate and make good use of a phenomenal information-processing power that central planning simply cannot emulate.

Unfortunately, many believe that market forces must inevitably conflict with social goals. This is partly because a large part of what passes for the 'market' in current parlance is anything but: it's more like large corporations and governments distorting the market to their mutual advantage. But it's also because the negative impacts of production unleashed by market forces are growing more numerous and more significant.

So it is important to remind ourselves that market forces and self-interest can serve public, as well as private, goals. Often, these private goals coincide with social goals, so that, for instance, the market routinely performs vital tasks such as food distribution and the provision of such indispensables as home medicines, baby needs, furniture and other consumer goods. These are exceedingly complex tasks, which would be impossible for central planners to co-ordinate. But they are undertaken continuously and reliably by a multiplicity of agents operating in reasonably competitive markets. They are accomplished in ways that fulfil not only the private goals of the firms and consumers involved but also society's goal of efficient supply of goods and services. This feat results from the combination of the self-interest of large numbers of market players, and their ability to react appropriately to ever-changing circumstances.

Governments tend to be centralist in their instincts. In practice, this has meant that market forces are rarely allowed to play a significant role in organizing the production and distribution of those goods and services that governments supply. Government agencies also operate in a non-competitive environment, which discourages self-evaluation.[50] Since the governments of the developed countries now spend a third or more of their economies' national income, these are significant deficiencies.

The manifold complexity and large scale of such global challenges as violent political conflict or climate change, the proliferation of intricate, obscure relationships between cause and effect: all point to the need for a pluralist solution. No single approach, no planning by a single body, however large, is going to work. We need to find a way of ensuring:

- that the pluralism evoked by market forces allocates the resources we devote to accomplishing our social and environmental goals,

- that any organizations that might arise are entirely subordinated to the achievement of these goals, and

- that rewards given to those who achieve these outcomes are linked to their success in doing so.

The next chapter, and the rest of this book, describe one such way.

---

[1] *The Undercover Economist*, Tim Harford, Oxford University Press, November 2005, ISBN 0195189779 (page 237).

[2] *Country File,* BBC1 television, UK, 8 February 1998.

[3] There were 1980 slaughterhouses in England, Wales and Scotland in 1971-72. In 1995-96 there were only 488. Source: *The BSE Enquiry: the Report*. Crown Copyright 2000; http://www.bseinquiry.gov.uk/report/volume13/chaptea2.htm#244748, sighted 17 July 2007.

[4] *Cheap chow*, 'The Economist', 8 March 2003, pages 77-8.

[5] *James Lovelock's Gloomy Vision*, Real Climate: Climate Science from Climate Scientists, http://tinyurl.com/6kfwva, sighted 17 July 2008.

[6] *Why Our Food Is So Dependent On Oil,* By Norman Church, 7 April, 2005, http://www.countercurrents.org/po-church0700405.htm, sighted 17 July 2008.

[7] *Oligopoly, Inc. 2005,* ETC Group, www.etcgroup.org, (Canada), http://tinyurl.com/6rrwuo, sighted 17 July 2008.

[8] *Dark Age Ahead*, Jane Jacobs, Random House, 2004, ISBN 978-1-4000-6232-4.

[9] *UK Corner Shops 'Risk Dying Out'*, BBC News Channel, 15 February 2006,

http://news.bbc.co.uk/1/hi/business/4714572.stm, sighted 17 July 2008.

[10]*Suburban Nation: the rise of Sprawl and the Fall of the American Dream*, Andres Duany, Elizabeth Plater-Zyberk, and Jeff Speck, North Point Press, April 2001, ISBN 0865476063.

[11] *No safety net,* 'The Economist', 10 September 2005.

[12] *The Next American Metropolis,* Peter Calthorpe, Princeton Architectural Pres, 1993, ISBN 1-878271-68-7.

[13] Ibid.

[14] *Condemnation Nation; retail chains and big business of eminent domain,* Joshua Kurlantzick, ReclaimDemocracy.org (first published by 'Harpers Magazine', October 2005); http://tinyurl.com/5qhdd8, sighted 17 July 2008.

[15] *Dogs and Demons: Tales from the Dark Side of Japan,* Alex Kerr, Hill and Wang, February 2002, ISBN 0809039435.

[16] *Shopping for subsidies: how Wal-Mart uses taxpayer money to finance its never-ending growth*, Philip Mattera and Anna Purinton, Good Jobs First, May 2004. This study shows that the US retailer Wal-Mart received more than $1 billion in economic development subsidies from state and local governments across the US. Taxpayers have helped finance not only Wal-Mart stores, but also the company's huge network free of distribution centres, more than 90 percent of which were subsidised.

[17] *Harper's Index,* 'Harper's Magazine', October 2006. Source given as Eagle Eye Publishers, Inc.

[18] *The corporation; the pathological pursuit of profit and power,* Joel Bakan, Free Press, 2003, ISBN 0743247442 (pages 154-156).

[19] *The Asymmetric Society,* James S Coleman, Syracuse University Press, May 1982, ISBN 0815601743.

[20] For more on this bias towards the big and global, see *Small is Beautiful, Big is Subsidized,* by Steven Gorelick, Dartington, UK: International Society for Ecology and Culture 1998.

[21] *Women stand to gain from proposed toilet code*, Sebastien Berger, 'Daily Telegraph', London, 21 November 2005 (online at http://tinyurl.com/643f7f, sighted 17 July 2007).

[22] Mike Alder, reviewing *The Trouble with Physics: The Rise of String Theory, The Fall of a Science, and What Comes Next*, by Lee Smolin (Mariner Books, September 2007, ISBN 061891868X), in a review entitled *Bureaucrats versus science*, 'Quadrant', December 2007.

[23] Ibid.

[24] Ibid.

[25] *The middle mind: why Americans don't think for themselves*, Curtis White, HarperOne 2003, ISBN 0060524367.

[26] For instance, the Bank of England's Special Liquidity Scheme amounts, in the view of the BBC's Business Editor Robert Peston to 'a banking-market bail out of an ambition we haven't seen in this country since the early 1970's and possibly longer than that.' Http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/04/

banks_big_bailout.html, sighted 13 August 2008.

[27] *Bad Food Britain: How a Nation Ruined its Appetite*, Joanna Blythman, Fourth Estate, 2006, ISBN 0007219946.

[28] From a letters to the editor of 'The Times', London, published on14 August 1999.

[29] *'Soft' subjects boost schools' ratings*, Jon Boone and Simon Briscoe, 'Financial Times', 9 March 2007; http://tinyurl.com/5b5npd, sighted 17 July 2008.

[30] *If we want to save the planet, we need a five-year freeze on biofuels,* George Monbiot, 'The Guardian', 27 March 2007.

[31] *Our libraries: where has all the cash gone?* Tim Coates, 'Reader's Digest', June 2007 (available as a pdf file: http://www.goodlibraryguide.com/pdf/TO_libraries.pdf).

[32] Ibid.

[33] *The spirit of reform: managing the New Zealand state sector in a time of change*, Allen Schick, State Services Commission, Wellington, 1996.

[34] *Looping the Loop: Evaluating Outcomes and Other Risky Feats* and *Essential Ingredients: Improving the Quality of Policy Advice*, [New Zealand] State Services Commission, 1999 (www.ssc.govt.nz).

[35] *The spirit of reform: managing the New Zealand state sector in a time of change*, Allen Schick, State Services Commission, Wellington, 1996.

[36] *Guide to Assessing Agency Annual Performance Plans*, General Accounting Office of the USA (1997), (www.gao.gov/special.pubs).

[37] *Results Oriented Government: GPRA has established a solid foundation for achieving greater results*, GAO-04-38, US General Accounting Office, March 2004.

[38] Ibid, page 12.

[39] Ibid, page 7.

[40] Ibid, highlights page.

[41] Ibid, page 9.

[42] Ibid, page 13.

[43] Ibid, page 16.

[44] Ibid, page 14.

[45] Ibid, page 17.

[46] Ibid, page 17.

[47] Ibid, page 18.

[48] Ibid, page 19.

[49] *Lords of Poverty: The Power, Prestige, and Corruption of the International Aid Business*, Graham Hancock, Atlantic Monthly Press, 1994, ISBN 0871134691.

[50] *Why states believe foolish ideas: non-self-evaluation by states and societies*, Stephen Van Evera, MIT Political Science Department and Securities Studies Program, 10 January 2002, version 3.5.

Chapter 3

Social Policy Bonds

Social Policy Bonds are a new financial instrument designed to inject the market's incentives and efficiencies into the achievement of social and environmental goals. The bonds could be issued and backed by a wide range of bodies, including local or national governments, non-governmental organizations, global bodies such as the United Nations, philanthropists, or ordinary individuals. If issued by government, the bonds' ultimate backers would, of course, be taxpayers. A fixed number of Social Policy Bonds ('bonds') would be issued. They would initially be auctioned to the highest bidders. The bonds' backers would undertake to redeem these bonds for a fixed sum *only when a specified social objective has been achieved*. It is this promise, and the market's view of how easily the objective can be achieved, that would underpin the bonds' market value. The bonds would not bear interest. They would be freely tradeable after issue, and their market value would rise and fall. Social Policy Bonds would 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: holders would raise their bonds' yield by achieving the targeted objective quickly. Once the targeted outcome had been achieved, whoever backed the bonds would redeem them. The rest of this chapter outlines the essential elements of a bond regime. Subsequent chapters look in more detail at their operational aspects.

Social Policy Bonds work by creating an interest group — bondholders — who have a strong interest in achieving the targeted social objective efficiently and quickly, or in paying others to do so. Assume, for example, that an urban authority is prepared to spend a maximum of say $10 million to reduce the crime rate within its borders by 50 percent. It issues one million bonds that become worth $10 when the crime rate falls below 50 percent of current levels for a sustained period — say one year. Because the market would see this objective as unlikely to be achieved in the near future, it would put a low value on the bonds when they are floated. Assume successful bidders pay as little as $1 for the bonds. (This sum would be held by the issuing authority partially to offset the cost of future redemption of the bonds.) Now, they hold an asset that could appreciate in value by 900 percent if a sustained halving of the crime rate were achieved. This provides the motivation for bondholders to do what they can to reduce the crime rate. Because the bonds are tradable at any time, the identity of bondholders in pursuit of the objective could be constantly changing. This group, essentially a coalition of interests in favour of achieving the targeted outcome, will at any time be made up of those who believe they can achieve the outcome most cost-effectively.

Social Policy Bonds could in principle, be used to solve any social or environmental problem that can be reliably defined and quantified. Key criteria for policy areas within which Social Policy Bonds would show the most marked improvement over current programmes are:

1. Existing policies have objectives that are unstated, obscure, uncosted or conflicting;

2. Problems are large-scale and have multiple causes, many of which cannot be readily identified;

3. Current approaches are either ineffectual or inefficient; and

4. Financial rewards to those involved in achieving objectives are currently uncorrelated to their effectiveness or efficiency in doing so.

Sadly, there are many such policy areas at all levels. At the regional and national levels they include crime, employment, health, education, and air pollution. At the global level they include the possibility of catastrophic climate change and nuclear conflict.

Markets minimise costs

Issuers of Social Policy Bonds would need to give some thought to how much achieving their objective is worth. They could estimate the maximum value of the targeted outcome. One consideration would be the financial impact of solving a social problem. Achieving certain social goals would actually bring about financial savings. A national government, for instance, could make a net financial gain by bringing down the number of unemployed claimants: the state saves unemployment benefit and gains an increase in income tax for each person who leaves the unemployment register and goes into gainful employment. Achieving this particular social goal could therefore generate a net fiscal benefit, even in the short term. For other targeted objectives, such as a lower crime rate, there could also be positive, but less easily quantifiable, net financial benefits, and these may take longer to arise. Other social goals, such as reduced rates of homelessness, or increases in literacy, might increase monetary returns to the government in the long term, but would generate very little net revenue in the short run. And there would be many social or environmental goals whose achievement would impose net financial costs on society in the foreseeable future.

But people and their governments want things other than for financial reasons. A society in which everybody can read, in which people feel safer from crime and breathe cleaner air is surely desirable in its own right. Bond issuers, whether government or private sector, have to decide on how far they will pursue these objectives, and how valuable they are. They would have to take into account the financial and nonfinancial benefits in deciding on the maximum value of each social goal, in advance of issuing the bonds. A bond regime would make this a simpler and more transparent task than the current array of social policies, because people would be asked to value outcomes, rather than activities intended to achieve these outcomes. If government were to use Social Policy Bonds in conjunction with other policy instruments to achieve the same goal, government would also have to decide on the proportion of total expenditure that would be spent on the bond component.

All these factors would determine how many bonds would be issued. The maximum cost to backers of a bond issue would (ignoring administration costs) equal: the total number of bonds issued multiplied by their redemption value, minus any revenues gained on floating the bonds.

Though they would have to decide on the *maximum* amount they want to spend on achieving their objective, those who issue Social Policy Bonds would not have to work out how much the *actual* cost would be with any accuracy. That would be done by bidders for the bonds in the open market. Assume again that bonds were to be used exclusively in pursuit of a 50 percent reduction in the crime rate, and that the urban authority issues one million bonds, of redemption value $10.00. If the market valued these bonds on flotation at $1.00 each, the net cost to the issuers of achieving the targeted objective (ignoring administration costs) would be $9 million. In other words, the market at the time of issue believes that the cost of achieving the objective, including its profit margin and after taking into account risk, would be $9 million.

Now suppose the bond issuers are completely in the dark about how much it will cost to achieve the targeted objective and instead of issuing one million bonds they issue ten million with the same redemption value, $10.00. They would then be liable for a maximum cost of $100 million. However, the market would still reckon that it could achieve the objective for around $9 million. So instead of valuing the bonds at $1.00 competition between potential investors would bid up the issue price of the bonds to around $9.10. (Social Policy Bonds would be an unusual financial instrument, in that the more that were issued, the higher would be their value!) *The issuers therefore would not have to estimate with any accuracy how much a targeted objective might cost to achieve, and they would put a cap on their total liability by limiting the number of bonds issued.*

So the Social Policy Bond mechanism ensures that the market, which means people *other than the bond issuers*, would decide roughly how much it costs to reach a specified social outcome. They would do this when they bid for the bonds at issue *and at all times afterwards*. This fact, and the would-be bondholders' incentive to minimise their costs, contrast with the current system in which the costs of achieving particular outcomes, if they are calculated at all, are not widely known nor subject to competitive bidding. Under the current system, in fact, many of the people charged with achieving social goals (or, more likely, with supplying certain inputs) have every incentive to inflate the projected cost of their doing so. Under a bond regime, however, the formidable information-processing power of the market would be channelled into minimising the costs of achieving these goals.

Note that the issuing body *could* add to the number of bonds in circulation after floating at any time, if it wanted to boost the efforts going into achieving a particular social goal, but this could encourage people to buy the bonds, and do nothing to achieve the targeted goal so that, when more bonds were issued, the value of their holding would rise. A better approach might be to declare the initial bond issue invalid, which would act as a spur to encourage would-be passive investors to become active, or to sell to active investors. If the issuers wanted, for whatever reason, to *reduce* such efforts, the situation would be a little more complicated. It could buy bonds back from holders, but doing so would reduce the total funds to be spent on achieving the targeted objective, and so would lower the value of all bonds in circulation. People might therefore be unwilling to buy bonds in the first place if they thought there were a high probability of the issuing body's buying some of them back in this way. They would demand some sort of premium for taking that risk. Alternatively, the issuing body could undertake either that it would never buy Social Policy Bonds back or that, if it did, it would pay the market price ruling before it announced its purchase intentions.

What would bondholders do?

Social Policy Bonds targeting the crime rate would rely on the people or institutions that hold bonds initiating or facilitating crime-reduction programmes. Bondholders could invest their own capital, or borrow on the strength of the redemption value of their bonds. They would have an incentive to cooperate with each other to help reduce crime, and to do so as cost-effectively as possible. These people's motivation would come from the expected capital gain they would enjoy as the bond price rises in line with the enhanced probability that the objective will be achieved early.

Consider some of the measures that active investors in bonds targeting the crime rate could put into operation:

- encouraging neighbourhood watch schemes;
- encouraging parents to monitor their children's activities more closely;
- subsidising recruitment of unemployed workers; or
- complementing police patrols with private security patrols.

In many countries, some arms of government already undertake one or more of these activities. And some longer-term projects, like research into the causes of crime, are done by private bodies or universities, independently of government or with only a small contribution from government funds. The crucial difference a Social Policy Bond regime would make is that people would have incentives to seek out and develop those ways of reducing crime that are most cost-effective. A police force, a bureaucracy, or an environmental health department, however well-intentioned, is not currently rewarded in ways that correlate with its success in achieving society's objectives — even if these are explicitly targeted. But under a Social Policy Bond regime the self-interest of bondholders would act so as to encourage those ways of reducing crime that would give whoever funds the bond issue the best return for their outlay. These ways may have been tried before, or tried in different cities, or *they may be new and untried*.

Bondholders would be motivated to seek out, invent and use the most efficient methods for the city or country whose crime rate is targeted.

Bondholders need not participate directly in any crime reduction projects. Their role could be one of financing such projects, on the strength of the increase in of their bonds, whether they plan to sell them quickly, or to hold on to them until redemption. They would be motivated by the anticipated supernormal profit arising from early redemption of the bonds.

One activity that bondholders might indulge in is lobbying government. So, in the crime example, they might press for longer prison sentences, thinking that these would deter potential criminals or keep convicted criminals out of circulation. Such lobbying, of course, already goes on because government is always making decisions that create winners and losers. Under a Social Policy Bond regime the source of this sort of pressure, and the motivation for it, would be more transparent than under the current system and it need not pose any different problems. (The next chapter looks at the subject of lobbying in more detail.)

Trading the bonds

Social Policy Bonds, once issued and sold, must be readily tradeable at any time until redemption. The operation of such a 'secondary market' would be critical to the way Social Policy Bonds work. Many bond purchasers would want or need to sell their bonds before redemption —

which might be a long time in the future. With a secondary market, these holders would be able to realise any capital appreciation experienced by their holdings of Social Policy Bonds whenever they chose to do so. This would make the bonds a more attractive investment in the first place.

Such capital appreciation would arise from upward movements in the market price of the bonds. Of course, these prices could move in either direction. Major determinants of the bond price would be:

- how remote the market believes the targeted objective is from being achieved;
- market perceptions of risk and uncertainty; and
- the relative attractiveness of other investments.

These and other determinants would vary with time. Note that the market's valuation of the bonds would be influenced not only by efforts that bondholders make toward achieving the targeted goal, but by external factors. Some of these could be apparent at the time of issue: for instance, one of the determinants of crime is demography. Specifically, the greater the number of young male adults, the larger the number of crimes tends to be, all other factors being equal. Demographic variables like this, and others that can be anticipated, would help determine the market price of the bonds at the time of issue. But other influences cannot be anticipated. So, for example, the market price of bonds targeting property crime could fall if, say, there were a string of power failures that led to looting. Or it could rise on the capture of a ringleader of a particularly successful gang of burglars or car thieves. The price of bonds targeting air pollution could rise or fall with climatic conditions, volcanic eruptions, or the price of oil or coal. The value of bonds targeting unemployment could rise or fall with financial data, such as the exchange rate (making the country a more or less attractive venue for overseas investment), or interest rates (making firms more or less likely to lay off employees).

As with other investments, risk and uncertainty would be important determinants of the bonds' market price. Bonds targeting more remote objectives (cutting crime by 80 percent say) would be riskier than those whose outcomes were closer to current levels (cutting crime by 20 percent). And there would also be uncertainty attached to the Social Policy Bond mechanism itself, especially in the early years of a bond regime, as it would be untried and unproven.

As with shares and other tradable financial instruments, the prices of Social Policy Bonds would be in constant flux. New information affecting the prices would become available day by day. As well as external influences on the bond prices, people would carry out research aimed at determining the value of the bonds as an investment. All this information would generate extremely useful insights into the relationships between circumstances, events, social problems and desired outcomes.

Giving investors in the bonds the chance to benefit from price movements is essential. Apart from making the bonds more attractive at issue, a healthy secondary market would be important for another crucial reason: some 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 had made their contribution and seen the capital value of their bonds increase in line with the increased probability of the bonds' early redemption, they might have no wish to speculate on the speed at which the remaining processes would be carried out. Other groups of active investors, who could have greater expertise in performing these later processes, must be given an incentive to use their expertise to accelerate attainment of the targeted objective. The possible capital appreciation of bonds bought from previous owners and sold at a still higher price (or redeemed) would provide this incentive. The new owners would, if they were successful in these later stages, realise this capital appreciation.

Cascading incentives

As the bonds are traded, they will tend to flow towards those who are most able to help solve the targeted social problem. In fact, though, trading of bonds would not always have to occur. Large bondholders might simply decide to subcontract out the required work to many different agents, while they themselves could hold the bonds from issue to redemption. The key point is that the bond mechanism would ensure that the people who allocate the finance have an incentive to do so efficiently and to reward successful outcomes, rather than merely to pay people for undertaking activities. At the limit, just one single investor could buy all the bonds. If this buyer were determined to hold on to the bonds until redemption, then the bonds would function as a sort of performance-related contract, with the issuers paying only when the objective had been achieved. The buyer could contract out most, or all, of the work required to achieve the objective, with the incentives generated by the bonds for speedy accomplishment cascading down from the bondholder to those subcontracted to do the work. If this bondholder, for whatever reason, were to become inefficient in pursuit of that objective, or were simply to lose interest in it, then he or she could simply sell the bonds to more efficient and more highly motivated investors.

Too large a number of small bondholders would probably do little to help solve targeted social problems by themselves. If there were many small holders, it is likely that the value of their bonds would fall until there were aggregation of holdings by people or institutions large enough to initiate effective problem-solving projects. In much the same way as share privatisation issues the world over have turned out, the bonds might end up mainly in the hands of large holders, be they individuals or institutions. Between them, these large holders could account for the majority of bond holding. Even these bodies might not be big enough, on their own, to achieve much without the cooperation of other bondholders. They might also resist initiating projects until they could be sure that other holders would not be 'free riders' (see 'The Free Rider Question' in the next chapter). So there would be a powerful incentive for all bondholders, tacitly or overtly, to *cooperate with each other* to help solve the targeted problem. They would share the same interest in seeing targeted objectives achieved quickly. So they could share information, trade bonds with each other or collaborate on objective-achieving projects. They could also set up payment systems to ensure that people, bondholders or not, were mobilised to help achieve targeted objectives. This might mean that bondholders pay people not according to how much they actually help contribute to an outcome – which can be difficult to determine – but according to how much bondholders *estimate* they are contributing to the outcome, or to more measurable variables as spending or outputs. But while there might on those occasions be no direct link between payment and efficiency in achieving the overall outcome, bondholders would have strong incentives to strengthen that linkage where it is worthwhile to do so. If they failed to do that they would not maximise their own rewards from holding Social Policy Bonds.

To summarise then: bondholders would either trade bonds, or make incentive payments to ensure that any proceeds from higher bond prices, or from redemption, would be channelled in ways most likely to stimulate speedy achievement of the targeted objective. Large bondholders, in cooperation with each other, would be able to set up such systems cost-effectively. Regardless of who actually owns the bonds, aggregation of holdings and the cooperation of large bondholders would ensure that people who help achieve social goals are rewarded in ways that maximise their efficiency.

Objectives and indicators

For a Social Policy Bond regime to be effective, clarity and transparency of objectives are essential. The targeted objective must be *carefully defined* so that targeted changes either actually are, or are strongly and inextricably correlated with, what society wants to achieve. For instance, numbers of reported crimes could be targeted if the objective were to achieve a safer urban environment. But this indicator may be unsatisfactory if, for instance, the crime rate became so high that people did not bother to report minor assaults or burglaries to the police. A more appropriate indicator might be derived from responses to victim surveys. Because the bonds target outcomes they demand clear thinking and transparency as to exactly what it is that society is aiming to achieve. Is reduced crime itself the real objective? Or reduced fear of crime? Or some combination of the two? Or, looking at employment: is lower unemployment our real objective? Or lower expenditure on unemployment benefit? Or higher employment? Is it worthwhile aiming to reduce, in particular, unemployment amongst 16–24 year old males? Or ethnic minorities? Or the unemployment rate in particular regions? Note that it would clearly be unsatisfactory to redeem the bonds the moment a targeted fall in unemployment has been achieved. The objective should be a *sustained* lower level of unemployment, and that is how it would have to be defined when the bonds are issued. Social Policy Bonds would give such clarity a higher priority than it enjoys under the current policymaking regime.

Targeted objectives should also be capable of being *targeted by quantifiable indicators*, whose progress accurately corresponds with progress toward the desired social outcome. As well, objectives should, in general, be as *broad* as possible, so that one particular objective cannot be achieved at the expense of other societal goals.

The last point needs elaboration. Consider the application of a bond regime to environmental problems. Assume the concentration of atmospheric lead were to be targeted by a bond issue. It might be that targeting lead in this way would cause people to increase their use of other polluting substitutes — and these could be at least as dangerous as the original levels of lead. One way of dealing with this problem could be to aim initially at an unambitious reduction in the lead level. Depending on the effects of such a reduction on the use of offending substitutes, other bonds could then be issued, either targeting the level of lead, or targeting the level of offending substitutes. But a better approach would 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 (see box, *What to target?*).

What to target?

Breadth of objective Social Policy Bonds lend themselves to targeting combinations of objectives. It would probably be unsatisfactory to target, say, atmospheric lead as the sole target of a bond issue targeting air pollution if it were likely that polluters would respond increasing emissions of other toxic chemicals. Instead, all atmospheric pollutants could be made the target of a single bond issue: the bonds could target an index encompassing all pollutants, weighted according to their lethality. Targeted objectives should, in principle, be as large-scale and broad as possible

Ends or means? In principle ends, rather than means to ends, would make better targets for Social Policy Bonds. Thus, it would be preferable for bond issuers to target, for example, homelessness, rather than housing starts, and leave it for bondholders to decide on how best to achieve that targeted goal. Similarly, it might be preferable to target not air pollution, but such indicators of environmental status as human, animal and plant health, perhaps in conjunction with more subjective indicators like the views people have about the quality of their environment, as measured by questionnaire responses. Bonds could be issued whose redemption value is on a sliding scale, reflecting the perceived adverse environmental impacts of the targeted range of pollutants.

Spatial distribution Bonds aimed at improving national averages of such indicators as pollution would be adequate sole policy instruments only if society were unconcerned about the distribution of pollutants. Otherwise bonds targeting pollution could be made redeemable only on the condition that pollutant thresholds shall not be breached in any part of the country concerned.

Redemption structure: time Bond issues could provide bonus payments for achievement of the targeted goal by a specified date. Or issuers could stipulate that bonds would not be redeemed unless the targeted objective were achieved by a certain date, or that they would be redeemed for a sum that would diminish over the time it took for the objective to be achieved. The market would factor all such potential penalties or bonuses into the bond price.

Redemption structure: partial fulfilment Rather than simply pay a lump sum upon achievement of a fixed goal, bonds could be issued that pay rewards for partial achievement of a long-term goal.

Similar concerns, perhaps less clear-cut, could arise when targeting regional problems. If bonds were issued targeting the number of unemployed people of working age in northeast England, say, then bondholders might attempt to solve the problem by paying the unemployed of that region to move somewhere else. This might, of course, be seen as a social benefit. But if not, provisos could written into the bond issue, such that they would not be redeemed if the population in the north-east fell below a certain level, or if the unemployed population in other regions rose above a certain level. In general, objectives that are complementary and that, if not pursued jointly, could conflict, should be targeted by a single bond issue.

Successful targeting: how not to do it

Even under the current system, policymaking by national and supranational governments is inevitably, though often only implicitly, aimed at improving some highly aggregated targets and indicators. Policymakers can identify problems in a society of more than a few thousand mainly by quantifying them: they have to use numbers to monitor progress toward solving these problems. There are perils in doing so, not all of them obvious. You would think, for instance, that reduced infant mortality correlates strongly with an improvement of society's well-being. But the bald figures may not be all they seem:

> In a tragic sort of way, inferior prenatal care could actually boost average life expectancy while lowering health care costs. Adequate prenatal care may reduce the incidence of miscarriage, especially in the second half of pregnancy. Had my wife's perinatologist not detected her dilating cervix in the 22nd week of pregnancy, we would probably have lost our daughter. And she would have been a miscarriage statistic, not an infant mortality statistic.[1]

Or, to take another example, it was found that British five-year cancer survival rates are lower than in other countries. Can one conclude that the UK's National Health Service is performing poorly and that physical well-being would be improved if only survival rates could be improved (as one journal did[2])? Not necessarily: as one commenter pointed out, an alternative explanation is that Britain does not waste money on extensive testing procedures for diseases it cannot cure.[3] For such diseases, and many cancers are among them, earlier diagnosis merely serves to raise the number of years between the identification of the disease and death—it does not affect expected mortality.

The inadequacies of such narrow targets bring to mind Goodhart's law, named after a former chief economist of the Bank of England, which says that whatever is adopted as a target ceases to be a relevant target once it has been adopted. It is essential to target indicators that are broad enough to be inextricably linked to well-being. In the current, institution-led target-picking environment, it is too easy to be misled by figures taken out of context. The examples given above, and targets such as A&E throughput rates (see chapter 1: 'Gesture politics') are irrelevant to the health of the population. Of course, defining broader health indicators and measuring them is more difficult than measuring the length of stays in A&E departments, but with sufficient ingenuity - of the sort that is currently applied to gaming the system - it can be done. To put it bluntly: if a government is concerned about the health of the population, then it should target the health of the population.

What we could do

Perhaps more compelling as targets than indicators averaged over a large population are indicators of more basic levels of social welfare. It does seem to be mainly at lower standards of living that the correlation between a quantifiable indicator and social welfare is strong and therefore valid as a guide to policymakers. Indeed it is perhaps government's historical successes at the basic level that have led it to apply the same policy approaches into the middle and upper range of well-being, where they will not be so effective. At higher levels of income, wealth or standard of living, it does appear that the correlation between well-being and objective criteria breaks down, or at least that extra resources generate diminishing returns. [4] [5] But it is not just from the point of view of efficiency (improvement in well-being per dollar) that the case for government intervention to help the poor should be made. The stronger case is that it is the poor or otherwise disadvantaged who are most in need of government intervention. It would be difficult to argue against the targeting of, say, improved basic levels of education and health in the industrialised countries, or broad indicators of poverty in the developing countries.

The Social Policy Bond concept could also be applied to the supply of public goods and services, such as reduced crime rates and a cleaner environment. Moreover, the bonds are versatile in that they can reward the absence, within a specified time period, of negative outcomes such as nuclear conflict, other manmade disasters, natural catastrophes or the damage they cause. For instance, a global body under the auspices of the United Nations could issue Social Policy Bonds ('Nuclear Peace Bonds') that would be redeemed only if there were fewer than 1000 deaths resulting from explosions of nuclear devices before 2050.

To simplify discussion this book looks at Social Policy Bonds with a straightforward payment structure; specifically an all-or-nothing objective, upon achievement of which a fixed sum is paid. But in practice, bonds could be issued that rewarded partial achievement of a long-term goal, or gave extra rewards for early achievement of goal. A perfectly competitive market would factor the risk-adjusted possibility of such payments into the flotation price making them conceptually equivalent to the all-or-nothing bonds discussed here, but there may be practical advantages in issuing these or other variants of the basic Social Policy Bond concept.

---

[1] *Prenatal and Neonatal Care,* Andrew Marx, 'Sensible Knave', an online blog, 2 October 2005; http://sensibleknave.blogspot.com/2005/10/prenatal-and-neonatal-care.html, sighted 17 July 2008.

[2] *The NHS's Cancer Failure, 'Prospect'*, February 2006; http://www.prospect-magazine.co.uk/article_details.php?id=7307, sighted 17 July 2008.

[3] *NHS Survival Rates,* Peter Sugarman (written 14 February 2006), letter published in 'Prospect' April 2006; http://www.prospect-magazine.co.uk/article_details.php?id=7381, sighted 17 July 2008.

[4] See *Happiness is a warm vote,* 'The Economist', 17 April 1999.

[5] "The point where more wealth ceases to imply more happiness is around $10,000 per capita annually", says Robert Wright, summarising work in this area in *Will globalization make you happy?,* 'Foreign Policy', September/October 2000. Available online at http://www.foreignpolicy.com/story/cms.php?story_id=1704.

Chapter 4

Practicalities and potential problems

Social Policy Bonds, if widely issued by government bodies, would represent a radical change in the way in which our society does things. At first sight, a government-backed bond regime may seem outlandish: it would appear to mean government giving up its responsibility for achieving important social goals to the private sector. It would also allow private companies to profit from the public purse. But it is important to realise that a government that it issued Social Policy Bonds would merely be contracting out the *achievement* of social objectives. The government would still set these goals and, by undertaking to redeem the bonds, would still be the ultimate source of finance for the projects that achieve them. Certainly some wealthy corporations or individuals would become even wealthier under a bond regime, but competitive bidding for bonds would bid away excessive profits. People would need to be reminded of these facts when asked to contemplate a bond regime. Also note that the bonds would simplify the targeting of societal objectives – like the avoidance of large-scale catastrophes - that currently receive scant attention. Nevertheless, the concept does raise some important questions. One concerns free-riders: could they undermine the operation of a bond regime? Another is whether a bond regime might generate perverse financial incentives. This chapter begins by responding to these questions, then goes on to consider other practical aspects of a Social Policy Bond regime.

The free rider question

Many people might purchase Social Policy Bonds with the idea of doing nothing but holding them until they could sell them at a profit. Such passive bondholders would have no intention of doing anything to help achieve the social goal targeted by their bonds. Some of them could be casual purchasers who would buy the bonds with the same intent as they would a lottery ticket. They would hope to hold bonds until their redemption or until their market value had risen sufficiently high for them to enjoy a worthwhile capital gain. Other passive investors might be speculators who thought that the likelihood of the targeted objective being achieved quickly were greater than the rest of the market believed it to be — in other words, that the bonds were underpriced. More cynical purchasers might buy the bonds cheaply in an attempt to block would-be investors from owning them until these investors were prepared to buy them at a higher price before they begin to achieve the targeted goal.

Another category of passive investor might be the hedger. These are people who, in the absence of the bond issue, would stand to lose if the particular targeted objective were achieved. Hedgers might buy the bonds as a form of insurance against that possibility. If crime were targeted, for example, hedgers might be those who breed guard dogs, or glaziers who operate where street crime is prevalent. (Actually, though, the losers from particular Social Policy Bond issues might not be clearly identifiable in advance, because the bonds would not stipulate *how* a goal is to be achieved. So, bondholders might decide that one of the most effective ways of reducing crime would be to subsidise the cost of guard dogs to home owners, which would *increase* demand for the animals.)

Casual purchasers and speculators would want to become ‘free riders’, hoping to benefit from any increase in the bond price without actually participating in any objective-achieving projects. Hedgers wouldn’t particularly want the value of their bonds to rise, but their bondholding would similarly reduce the supply of bonds available to active investors. None of these passive purchasers of Social Policy Bonds would do much to help achieve targeted goals. However, markets for the bonds would work to limit the benefits from passive investing. To see this, assume that most of a particular issue of bonds were held by would-be free riders. Then very little, if anything, would be done to help achieve the targeted objective. As the objective became more remote, the value of all the bonds would fall. And as the bonds lost value, they would make a more attractive purchase for people who *were* prepared actively to help achieve the targeted objective. So free riders would be tempted to sell, even at a loss, rather than see the value of their bonds continue to fall. Some history of falling bond prices would tend to make free riding on Social Policy Bonds less appealing with future issues. Free riding then would become a self-cancelling activity. There are other reasons why bondholding would be unattractive to potential free riders:

- Individual free riders would have no incentive to collude with other free riders, because the more they did so, the more remote the targeted objective would become, and the further would the value of their bonds fall. This would act so as to limit any free riding activity to small players.

- As with other financial instruments, small players would have to pay higher transaction costs than the bigger institutions — the ones that would be most likely to initiate objective-achieving projects.

- Small players also would not have access to the research that would enable big players to value the bonds accurately. Therefore they would be at a disadvantage in the market.

- No bondholder, whether an active or passive investor, would want to sell less than their complete holding to people it identified as free riders; otherwise their remaining holding would lose value. Free riders might therefore find it difficult to purchase small parcels of bonds. They would therefore prefer to take a position on the derivatives market; their doing so would therefore not affect the underlying value of the bonds.

Note also that even if free riders were to gain from holding Social Policy Bonds, they would be doing so only because their bonds had risen in value as a result of a targeted objective becoming closer to being achievement. As well, attempted free riding would have positive effects: it would add liquidity to the bond market.

Attempted free-riding could be further mitigated by stipulating time limits in the redemption terms of the bonds. Social Policy Bonds could be issued that target, say, achievement of a 99 percent literacy rate for children aged 11. But if the issuers anticipated too much free-riding, they could stipulate that they would redeem the bonds only if the target rate were achieved within, say, five years. Free-riders would then be holding a wasting asset, whose value as the target becomes more remote would decline even faster than if there were no specified time limitation.

These measures would also deter those who would buy the bonds, then do nothing to achieve the targeted goal in the expectation that the issuers are so keen to see the goal achieved that they then will issue more bonds and so boost the value of all the issued bonds, including their passive holding.

In short, there are grounds to believe that free riding need not seriously undermine the operation of a Social Policy Bond regime, mainly because it is unlikely much successful free riding would occur, and partly because even if it did, it could not do so to such an extent that it would impede the operation of the bond mechanism.

Collusion

It's likely that many bond issues will rely for their success on aggregation of holdings and tacit or overt collusion between the major bondholders, who will co-ordinate their target-achieving activities. But if they collude after the bonds have been floated, why then would they not collude in the market *before* the bonds are floated, agreeing together to refrain from entering the market until the bond issue price falls? They would then pay less for the bonds than they would in a competitive market. This sort of collusion is certainly a problem under the current system where contracts to supply goods or services are put out to tender. But existing corporations are structured entirely around the sale of goods or the provision of services – not the achievement of outcomes. Social Policy Bonds are best applied to broad policy areas where the question of how best to achieve a specific social goal cannot be easily answered at the time the bonds are issued. For example, take a broad objective like reducing air pollution in a region. There will be a wide range of ways in which the bonds can increase in value. These can involve: lobbying for higher tax on petrol, subsidising the sales of catalytic converters to cars-owners, subsidising bus fares or bikes, pedestrianising streets and a wide range of other possibilities. Most probably, the optimal approach will be a combination of many diverse activities, and this combination itself will be changing over time, in response to new events and expanding knowledge. There will be a kaleidoscopic continuum of optimal approaches, which will vary markedly according to the market value of the bonds. So, for example a bond that can be redeemed for $100 may be floated. The optimal combination of possible bond-price raising measures when the bonds are priced at $50 will be quite different from when the bonds are priced at $48, and *so will the range of corporations interested in buying the bonds*. Remember too, that bondholders can profit without holding the bonds till redemption. There will be a range of potential purchasers all with different time periods in mind. Some will have little interest in holding the bonds for a long time, adding to the competitiveness of the bond market.

Once bought, the work to achieve the targeted goal could done by a protean organization whose precise composition cannot and need not be known in advance (see below, 'A new type of organization') Certainly investors are likely to collude *after they purchase the bonds*, but their decisions as to whether to set up an objective-achieving organization, the structure and composition of any such organization, and the activities it pursues, will be entirely subordinated to their wish to see the bonds rise in value. There is a parallel here with the purchasers of shares of companies being floated: they have little in common before they actually own the shares and so no means by which they can collude to reduce the price of the shares they buy. Indeed, they are often competing with each other for the right to buy shares. But after purchase their interests coincide, and they can collectively influence the issuers' activities.

Perverse incentives

Assume that a government or private consortium issues Social Policy Bonds targeting air pollution. Bondholders might then try to persuade or bribe polluting firms to reduce their emissions. But what if polluters spurned bondholders' blandishments and continued to pollute at the same level? The market value of the air pollution bonds would fall, and polluters could collude to buy them at a lower price. They would then profit by reducing pollution and redeeming their bonds. Or they needn't buy bonds themselves; they could just wait for bondholders to offer them payments to reduce pollution. If a pattern of such behaviour were established, would there not then be perverse incentives, which would reward firms for stepping up their pollution (or anti-social or other anti-environmental behaviour) in advance of a bond issue, so that they can buy up bonds, reduce their pollution and reap a large profit?

Assuming pollution to be a by-product of production, then the output of these polluters would be at an above-optimal quantity, so their attempt to cash in on cynically raising their pollution would not be costless. Further, even if they behave in such a way, the targeted objective would still have been achieved for a sum equal to, or less than, the maximum cost for which the issuers have allowed. But it is a fact that the cost to bondholders would be lower if there were no such cynical behaviour. So a better answer to the question is that bonds are only one tool in a government's policy toolbox. National and local governments already have powers to regulate pollution; their ability to impose and strengthen their regulations at any time would make such cynical behaviour risky. In any case, this type of behaviour would probably be a threat only when there were a few big polluters who could collude. In such circumstances a bond regime might anyway not be the best pollution control mechanism, because their informational advantages over tradable permits for example might not be so significant (see chapter 6). The bonds work best for larger-scale problems with a multitude of causes, where there is less opportunity for a few miscreants to undermine their efficiency by performing illegal or anti-social acts.

Cynical polluters might also be restrained by the likelihood that bondholders could react not by paying them to reduce pollution but by looking for more cost-effective reductions elsewhere – including lobbying for stronger regulations or more robust enforcement of existing legislation.

But the possibility does remain that cynical businesses could benefit from their perverse behaviour. Or even that firms that previously generated no pollution whatsoever might begin to pollute so that they could benefit either from bondholders' paying them to pollute less, or from buying pollution reduction bonds cheaply, and then reducing their pollution and selling their bonds at a higher price. In all these cases there need be no collusion amongst bondholders. For 'market fundamentalists' contemplating using Social Policy Bonds as the sole means of achieving social and environmental goals, this might constitute a fatal flaw. But, again, the bonds would almost certainly complement a government's regulatory powers — including its powers to make new regulations and charge companies on the basis of how much pollution they emit. In such instances there would probably be enough existing or potential legal (and moral) sanction against cynical polluters to ensure that it need not happen. Governments would certainly retain its powers to tax or regulate in ways that would make perverse increases in pollution more risky, or criminal. And it bears repeating that, in a bond regime, bondholders would have powerful incentives to see that any existing rules against pollution were enforced, or that new and effective regulations on polluters would be imposed.

Nevertheless, and more generally, Social Policy Bonds would work by generating financial incentives for people to achieve particular goals, and this might encourage people to break the law to do so. Examples of acts that would be illegal, but that certain bond issues might encourage, are:

- emitting pollutants that, while unspecified in bonds targeting pollution, were still controlled or banned,

- forcibly preventing people from registering as unemployed, if bonds targeting unemployment were issued, or

- falsifying data used to compile measures of longevity or infant mortality that were elements of a targeted health objective.

Acts such as these are already illegal and will continue to be so, but people should be aware that any Social Policy Bonds they issue could generate greater inducements to commit them.

The bonds might also induce people to modify behaviour in ways that, while not illegal, undermine that which their issuers are trying to achieve. So, for example, if bonds targeting the number of reported property crimes were issued, bondholders might lobby insurance companies not to insist on police reports before paying out. Or they might persuade, or pay, insurance companies to raise their excess levels. Either activity would discourage people from reporting minor thefts. Neither would do anything to reduce property crime, but they would each make the targeted objective, lower numbers of *reported* property crimes, more achievable, and so lead to a rise in the bonds' market value. Insurance companies themselves could own the bonds, and so it would be in their own interest to deter people from reporting property crimes. In this particular case, the objective could be more carefully specified so as to target not 'reported crimes' but, for instance, the number of people who, in surveys of the public, say that they have experienced property crimes.

If higher levels of literacy were targeted, bondholders may be tempted to lobby in favour of easier reading tests. Again, judicious specification of the targeted objective should prevent this: the bonds could stipulate the exact reading test to be used, or that the test would have to be certified as appropriate by a specified panel of impartial literacy experts.

The need to specify targeted goals carefully is not, of course, limited to a Social Policy Bond regime. Government objectives laid down for schools in the UK, for instance, have led to increased enrolments in 'easy' subjects (media studies, for instance) rather than those (such as German or Spanish) that are graded more harshly.[1] Under the current regime policymakers and officials can escape or deflect censure because the adverse results of their policies are difficult to relate to their cause. If Social Policy Bonds were to lead to negative effects, the relationship between these effects and their cause would be easier to identify, and deterring such effects would be simpler than doing so under the current activity- or institutional- based funding arrangements.

In fact, these negative-but-legal activities could be lessened by a careful and cautious introduction of the Social Policy Bond mechanism.

Introduction of a Social Policy Bond regime

Social Policy Bonds would need to be introduced cautiously. Most likely they would be first tried out by philanthropic groups, non-governmental organizations or private individuals. Initial goals could be relatively small scale, contained and uncontroversial. Prediction markets, see box, might offer a way forward for trials of the bond concept.

Using prediction markets for smaller objectives

Prediction markets are ‘speculative markets created for the purpose of making predictions. Assets are created whose final cash value is tied to a particular event (e.g., will the next US president be a Republican) or parameter (e.g., total sales next quarter). The current market prices can then be interpreted as predictions of the probability of the event or the expected value of the parameter. Prediction markets are thus structured as betting exchanges, without any risk for the bookmaker.’[2]

There appears to be some evidence that they are better than pundits at forecasting election results or share prices. Their focus is on speculation or (possibly) hedging against possible events, rather than generating incentives to modify behaviour and bring about positive changes. But they are, in principle, not very different from Social Policy Bonds. An organization could enter a prediction market and place a bet *against*, say, literacy in Pakistan rising to 99 percent. If the bet were big enough, that would create an incentive for people not only to take the bet and wait passively for literacy to rise, but actively to help the process along, perhaps by initiating new projects or financing existing literacy-raising schemes on the expectation of winning their bet.

Existing prediction market platforms could be of great value in refining the Social Policy Bond concept: they could be used by private issuers of the bonds to test and observe their application to small-scale, self-contained social or environmental problems.

Public sector-backed Social Policy Bonds could complement, rather than replace, existing government or local authority programmes. Amongst the first targeted objectives could be petty crime in particular cities, the amount of litter deposited on city streets, or illiteracy rates of schoolchildren or adults. Local authorities or environmental groups could also issue bonds that target the water quality in rivers, for instance; indicators of success could be the number and variety of fish present. Unemployment in particular cities or regions could also be early targets of a government-backed Social Policy Bond regime. Another target could be basic literacy levels, perhaps in a developing country. Such contained, easily identifiable goals would help the bonds gain acceptability amongst the public, and encourage policymakers to discuss and refine the concept. With goals like these, watching out for negative behaviour of, or on behalf of, holders of such locally issued bonds would be a fairly simple matter. And if these bonds were issued in tranches, targeting incremental improvements in indicators, it would be even easier to observe and remedy any negative-but-legal behaviours. Later tranches of bonds could incorporate provisos stipulating that they would be redeemed only if any unwanted, and previously unspecified, results did not exceed a minimal level.

Bond-issuing bodies would apply lessons learned from such trials to subsequent bond issues, while central government or private issuers could collate and apply these lessons before issuing bonds with wider application. When bonds target new objectives for the first time they might be more likely to encourage unanticipated negative behaviour by bondholders. Lessons learned from such initial issues could be applied to later issues targeting the same objective. These lessons would extend beyond how to deal with bondholders' behaviour. They might, for instance, give some direction as to the circumstances under which bonds could best be used as complements to existing policies, and when they could safely replace them.

A cautious, gradual, introduction of Social Policy Bonds would be one means of minimising potential problems of a bond regime. If, despite such an approach, some bondholders behaved illegally, the bond issuers – whether government or private sector – could bring about legal proceedings against them. If bondholders behaved in negative, but legal ways, the bond issuers would have other options. In ascending order of severity, they could:

- persuade or cajole bondholders into toeing the line. They could do this publicly or privately — initially, at least, bondholdings could be registered in the same way as shares;

- buy back bonds, which would have the effect of lowering the market price of bonds remaining on the market (by reducing the total redemption funds; see chapter 5); or

- press for legislation against the negative activity.

In extreme circumstances government could declare any bonds it issues null and void. It could offer compensation related to the bonds' issue price or latest market price.

Effects on government's behaviour

> The desire to overcome politics is based on the assumption that, if not subject to structures imposed from on high, free human action - whether in international affairs or domestic politics - is unstable and dangerous. People who think in this way cannot conceive of there being an order which they have not consciously designed: they cannot imagine that people and states themselves might be able to develop rules, perhaps unspoken ones, to foster peaceful free commerce.[3] John Laughland

One of the likely impediments to a government-backed Social Policy Bond regime is the reluctance that policymakers would probably feel to relinquish some of their power. If it issued the bonds, government would lose most of its control over how society's social and environmental objectives are to be met. For this reason it's likely that the private sector may be the first issuers of the bonds. However, a government, or a body financed by a number of national governments, might decide that, facing a huge problem to which it sees no convincing solution, it could issue Social Policy Bonds. Problems such as nuclear conflict leap to mind. Unfortunately (to this author's mind) these governments believe, or say they believe, they have a solution to climate change in restricting greenhouse gas emissions. More likely is that government will first venture into Social Policy Bonds after the private sector, in one or two policy areas and even then only as a small proportion of its spending and as a supplement to a range of more conventional policy instruments.

Another possible problem arising from the integration of Social Policy Bonds into the current policy-making system arises from government's role as creator of statutes. This was mentioned fleetingly in chapter 3 in connection with holders of bonds targeting crime, who might think it worthwhile to lobby government for longer prison sentences. Government has the power to pass laws that would affect bond prices, or its actions could influence bond prices in other ways. For instance: government could come under great pressure not to increase unemployment benefits from holders of bonds targeting the number of registered unemployed. Note, though, that the source of the pressure, and the motivation for it, would be easy to identify. And lobbying is a legitimate activity. There is no reason why bondholders, in common with other pressure groups, should not lobby politicians. They would be doing so mainly out of financial self-interest of course. But existing pressure groups are also self-interested, and in the case of bondholders their self-interest would be more likely to coincide with society's interests if targeted objectives were correctly specified. Bondholders would lobby for legislative change, and they would benefit in obvious, pecuniary ways if they were successful, but so too would society in general.

As in the current policymaking environment, under a bond regime it would be up to politicians to weigh the evidence for and against any course of action promoted by lobbyists, with due regard to the lobbyists' motivation.

And it would be up to potential investors in Social Policy Bonds to take into account likely or possible changes in the legislative environment when bidding for the bonds.

The threat of bondholders lobbying governments for legislative changes could have a positive aspect. If governments intend to issue Social Policy Bonds, they could maximise their chances of the bonds' success by giving assurances as to their future behaviour. These could mean making relatively simple decisions early on. Governments could, for instance, decide now on the type of reading test to be used to measure how closely a national literacy target has been reached in a decade's time. But they could also choose to be more definite about their long-term spending plans. Would-be holders of bonds targeting literacy would be very interested to know as much as possible about government's projected expenditures on education in general, and literacy in particular. Similarly, prospective purchasers of bonds targeting atmospheric pollution would want to have some idea of, to mention just a few items: the government's petrol taxation, electricity generation or road building plans. Government would maximise interest in the bonds by being as open about its legislative and spending intentions as soon as possible. All such assurances would doubtless be subject to the usual scepticism attending pronouncements of this type.

Government would want the Social Policy Bonds it issues to be successful. Its assurances about its legislative and spending plans will never be absolute, but by giving what assurances it could a government would enhance the market for the bonds, and be able to achieve more social goals with the same budget. One way that a government issuing Social Policy Bonds could do this would be for it to specify that, as far as possible, its behaviour would be determined by objective criteria. So government might declare to potential investors in bonds targeting unemployment, for example, that changes in unemployment benefit payments would be strictly correlated with movements in a specified retail price index.

Of course, if the bonds were to target only small changes in unemployment, or crime rates, or air pollution, or whatever, the government's long-range plans would not be so significant to prospective bondholders. Targeting incremental improvements in social indicators, it might emerge after trials of the bond concept, could be the best way of dealing with the uncertainties of future government behaviour. Alternatively there may be many social goals for which it turns out that government's behaviour is a relatively insignificant component of the uncertainty that attaches to investment in any financial instrument: markets routinely deal with uncertainty by attaching lower values to riskier instruments.

While government's assurances about its future behaviour would exercise investors' minds, they would also be important to people who are consumers of government services. There would be important implications for bonds that target welfare expenditure. Take for example Social Policy Bonds that, aiming to tackle unemployment, would be redeemed only when spending on unemployment benefit fell by a certain level. Bondholders would then have an incentive to discourage people from applying for, or continuing to receive, unemployment benefit. They might lobby government not to increase the unemployment benefit paid to each person on the unemployment register, or even to reduce it. While it is difficult to imagine bondholders' doing so, and thereby incurring the wrath of much of the rest of society, there are no compelling reasons for making such lobbying illegal. But where government *should* draw the line, firmly, is on the question of who decides whether or not a person qualifies for state benefits. Decisions as to eligibility for state benefits must remain with the state. This is mainly for ethical reasons: these benefits are set, ultimately, by the political process, and are anyway little more than a safety net for most recipients. Bondholders should have the right to provide alternatives to these benefits; perhaps even the right to pay people not to claim them. But they should not have the right to decide who should qualify for them.

Assessment of indicators and insider trading

A bond regime would rely on authoritative, accurate and timely monitoring of the targeted social or environmental problem so that progress towards its solution could be impartially assessed. For large-scale bond issues there would probably be private sector information gathering, but the definitive, official, figures would have to be seen to be independent of bondholders, who could benefit unfairly from dubious data collection. Naturally the information as to how close the objective were to being achieved would have value. It would not be difficult, for instance, to imagine the latest official unemployment figures being sought in advance of official publication and used for 'insider trading' of bonds targeting unemployment If too much insider trading went on, it would increase the riskiness of the bonds to those without access to this information and tarnish their value as an investment. So how could it be minimised?

- Those involved in gathering, collating and processing relevant data could be bound by terms deterring or forbidding them from abusing privileged information.

- If large sums of money were at stake, there would be a great deal of private information gathering: investors, bondholders, and financial commentators would take their own soundings throughout the lifetime of each bond issue. There would be more interest in more frequently updated information, so that progress toward achieving objectives could be more readily charted. All this would serve to remove some of the allure from privileged figures that had yet to be publicised.

- Indicators for targeted objectives could be chosen with a view to minimising the possibility of insider trading being an important factor. Some imprecision about how objectives would be measured would help: a government could stipulate that bonds targeting such objectives as urban atmospheric pollution or crime rates in cities would be redeemed on the basis of data from a random sample of cities, rather than from all cities or a predetermined set of cities.

- The objectives themselves could be chosen to minimise the possibility of insider trading. Bonds targeting long-range objectives, such as cutting crime rates or unemployment by 50 percent rather than 10 percent, would probably be less sensitive to insider trading. With long-range objectives, each datum illegally withheld from the bond market would probably represent a smaller proportion of the total relevant information available to the bond market, and so have a lesser effect on the bond's market value.

None of these ways of mitigating insider trading will always be fully effective. That said, there are already sensitive indicators, such as unemployment or retail sales figures, that are capable of moving markets, and so there are already in place mechanisms to keep such information secret until it is time for publication. There are also sanctions against those who obtain, and act on, such information illegally. These mechanisms and sanctions might need to be strengthened under a bond regime, but it remains to be seen how important abuse of insider information would be. While insider trading does mean that unscrupulous people benefit at the expense of the public, it does not generally impede the operation of markets. Markets continue to function and the possibility that a low level of insider trading goes on is generally discounted by the broader market.

Futures and options markets

Another possible source of perverse incentives could arise from the development of futures and options markets in Social Policy Bonds. These would enable people to benefit from a falling bond price, so giving them an incentive to delay achievement of the targeted goal.

It is quite likely that there would be futures and options markets for large bond issues, and it is almost certain that the price of any particular Social Policy Bond would not always be rising monotonically from its float price to its redemption value. It would be justifiable, as well as efficient, if bondholders could hedge against consequent falls in the value of their assets. People who do not hold bonds might want to participate in markets for derivatives of bonds, some of which would rise in value as the targeted goal became more remote. This in turn means that speculators and short sellers could certainly profit from *short-term* bond price falls, and the question is whether these people would then take steps to impede progress towards any targeted goal.

There are two main reasons why they would probably not. The first is that, in the long term, the weight of money would be against them. Provided sufficient funds were allocated to achieving the targeted objective, there would be a net positive sum of money payable if the targeted objective were to be achieved, and a net zero sum paid as long as the goal were not achieved. All the long-term incentive would be to achieve the targeted objective. Those who, for whatever reason, would suffer from achievement of the objective could be compensated by bondholders, or bribed to change their ideas. Note also that for every buyer of a 'put' option there would be a seller, and that for every futures contract *bought* on the expectation that the bond price would fall, there would be an equivalent futures contract *sold* on that basis, so that the net incentive generated by derivatives would be in line with the incentive created by the underlying financial instrument, the Social Policy Bond: in the long run, this would favour achievement of the targeted objective.

The other reason that short sellers, or holders of 'put' options, in Social Policy Bonds might not take actions aimed at interfering with achievement of the goal is that such actions might well already be illegal or, again given the incentives that the bonds would generate, be made illegal – or have their provenance more enthusiastically investigated – once the bonds had been issued. Some miscreants might be tempted to sell bonds targeting water pollution short (or buy 'put' options) then dump a million tons of manure into Chesapeake Bay. But they would know that such an act is illegal – and that there will be people at the other end of their transactions who will be highly motivated to see the law enforced to its fullest extent.

Government as purchaser of bonds

Government agencies could, as competitive suppliers of objective-achieving services, participate as active investors in Social Policy Bonds under certain conditions, whether these were issued by another government agency, or by the private sector. Bondholders in the private sector would be unlikely to cry ‘unfair competition’, even if the operations of these agencies were heavily subsidised, because their own bonds would appreciate as a result of the government, or government-inspired, activity.

If government agencies were to participate in the market for Social Policy Bonds issued by central government or another government body, they should not have privileged access to information, which would deter others from buying the bonds. Also, it is important that any profits they receive, or losses that they incur as a result should accrue to that agency. The people who work for these agencies must have the same incentives as private sector bodies to perform efficiently. This would obviously change the character of those agencies, and would probably lead to their ultimate divorce from the public sector.

A new type of organization

Bondholders would form a coalition whose sole common interest is to enhance the likelihood of early achievement of the targeted social or environmental goal. They need not formalise this coalition. Indeed, its composition would be likely to vary over the time as the Social Policy Bonds could constantly be changing hands. This would not impede finding solutions to short-term, small-scale social or environmental problems, where progress toward solution can be readily monitored. But how could such a protean organization of bondholders work to solve problems that necessarily require a long time to achieve?

Consider the actions that people buying Social Policy Bonds targeting a long-term objective such as climate stability might take. They would want to see some appreciation of the value of their bonds even if they have no intention of holding on to them until the remote target of climate stability has been achieved. They might well realise, quite early on, that their bonds will lose value *unless they set up some sort of body with a longer-term commitment*. One possibility is that larger bondholders would collude to set up an investment company for the lifetime of the bonds. This company would have an appropriate, most probably stable, composition and structure and its job would be to vet potential climate-stabilising projects and help finance the efficient ones. The bondholders, once they had set up this company up could of course always sell their bonds on the open market: the setting up of the investment company could be one of the first projects they undertake in order to maximise the appreciation of their bonds. In principle, it's no different from any other objective-achieving project. Social Policy Bonds sold after the formation of this company would perform in the market like shares in the investment company. In keeping with the Social Policy Bond ethos, of course, all the company's activities would be tightly focused on the achievement of, in this case, climate stability. This avoids the almost inevitable bureaucratisation of large organizations and the supplanting of their founding ideals by their goal of self-perpetuation.

In general, to maximise the value of their bonds, those who buy Social Policy Bonds at flotation will have incentives to set up the most efficient objective-achieving institutional structure they can, whatever form that takes.

Existing institutions and the transition to a Social Policy Bond regime

Few of the bodies currently charged with achieving social goals are paid in ways that encourage better performance. Nevertheless these bodies are perhaps the largest repository of expertise for solving social problems and some of them are bound to be efficient, or to be capable of becoming efficient. It would be unwise as well as unfair and unnecessary for a government moving towards a Social Policy Bond regime to cut their funding too severely. The answer, at least for goals in policy areas for which there are already significant institutions, would be a gradual transition.

Take health, for example. In the UK, central government provides funding for regional health authorities (for spending on doctors, hospitals and prescriptions) according mainly to population level, age and need. Government also supplies funds directly to medical research organizations and academic institutions. A transition to a Social Policy Bond-based, rather than institution- or activity- based, funding programme would see the *direct* funding government gradually decline, while expenditure allocated by bondholders to the outcomes that all these institutions are collectively trying to achieve — longer life spans and a better quality of life, say — would gradually rise.

On introducing such a bond regime a government could decide to reduce its funding of health authorities and research institutes by 1 percent a year, in real terms. (The government could allocate the saved funding to the future redemption of the health bonds it has issued.) So after five years, each health authority would be receiving directly from central government only 95 percent of the funding that it formerly received. But bondholders could choose to supplement the income of some of these health bodies. They may judge a particular group of health authorities to be especially effective at converting the funds they receive into measurable health benefits, as defined by their bonds' redemption terms. Particularly effective health authorities might be working in deprived areas, where small outlays typically bring about larger improvements in health. Or bondholders might judge a particular research body to be worthy of additional funding, because it was conducting excellent research into a condition that would be likely to respond especially effectively, in terms of health outcomes, to additional expenditure. In such cases, bondholders would supplement their selected health authorities' or research institutes' funding. It may well be that these favoured bodies end up receiving a large boost in income throughout the lifetime of a bond regime.

It could also happen that investors in bonds targeting health look at completely new ways of achieving health objectives; ways that currently receive no, or very little, funding. To give a plausible example, they may be convinced that one of the best ways of achieving society's longevity objectives is to deter teenage drinkers from driving. Following this logic, they may find that one of the most efficient ways of doing so would be to lay on subsidised taxis for teenagers attending parties on Friday and Saturday nights – but only in certain parts of the country. It is difficult to imagine how our current centralised government fund allocation mechanisms could go about implementing such a programme. A Social Policy Bond regime would quickly eliminate some of the less rational distortions in other health care matters, amongst them the British National Health Service's terminal-care budget, 95 percent of which was allocated to the 25 percent of the UK's population who die from cancer, and just 5 percent to the 75 percent who die from all other causes.[4]

It is also likely that holders of bonds targeting health outcomes would greatly expand funding in areas such as health education or preventive medicine that rely on expertise outside those bodies traditionally devoted to health care.

Could bonds targeting remote objectives, such as a large rise in longevity, or a halving of the crime rate, be compatible with a gradual transition of the type described above, where funding to existing health institutions reduces by 1 percent annually? At first sight there would seem to be an apparent mismatch between such incremental reductions in government spending and the time scale needed to reach long-range objectives. The critical point here is that bondholders would be investing not on the basis of the annual reductions in government expenditure on existing health institutions, but on the basis of the redemption value of all the bonds issued. To be more precise, it would be this total redemption value, minus the bonds' existing market value, that would inform bondholders' investment decisions. This sum could be many times each year's incremental reduction in government's institution-based spending. One of the virtues of a Social Policy Bond regime is that bondholders could expect capital gains in the short run from investments that will begin to impact on the targeted goal only in the long run. By doing the initial groundwork efficiently and speedily – not usually a very lucrative proposition in the current regime – they could see short term rises in the bond price and early capital appreciation.

The accumulated reductions in spending to existing institutions would be one, but not the only, factor influencing how much government decides to spend on achieving a specified social goal. Also important would be the financial savings (if any) that achieving the objective would bring about, and the value society would place on any nonfinancial benefits.

Similarly gradual transitions would be warranted in other areas, such as education and crime, where schools and police forces, some of which are bound to be much more effective than others, are well entrenched. These institutions would receive slowly diminishing absolute levels of funding directly from government, while bondholders would again focus their spending on especially rewarding, in terms of specified education and crime outcomes, projects and institutions. As with health, it is likely that those areas that are initially most disadvantaged would again provide bondholders with the greatest return per unit outlay.

In newer policy areas, particularly the environment, it may be possible to expand spending allocated via the bonds at a faster rate: expertise in the environment is still relatively mobile, and it would be easier to quickly establish new outcome-based institutions or to reorientate existing ones.

In the shorter run, the Social Policy Bond concept will need to be tried, discussed and refined before it can be implemented for long-term social and environmental goals over a wide area. Most likely the first trials will come from the private sector – see chapter 7.

Interaction with existing programmes and projects

Note that, while changes in the source of funds would be gradual, those involved in existing institutions may well react by quickly reviewing how *all* their existing programmes and projects operate. If bondholders saw existing programmes as being particularly effective in achieving targeted outcomes, then they would be inclined to invest in them. On the one hand, the switch in funding would warn existing institutions that they could expect to see their relatively ineffective operations receive diminishing funds in the future. On the other hand, their effective operations could look forward to higher — possibly much higher — funding. Even a gradual transition involving 1 percent annual cuts in funds allocated to existing institutions that was balanced by a bond issue could bring about a rapid change in the way existing bodies conducted all their programmes. They may have to devote some of their resources into persuading bondholders of the cost-effectiveness of their activities; but this would not represent a radical difference from the way these bodies lobby for government funding nowadays. Under a bond regime they would have to do their lobbying on a more transparent, outcome-oriented, basis.

Would governments play fair?

Might issuing governments themselves try to avoid redeeming Social Policy Bonds, either by reneging on their commitments to do so, or by doing what they could to stop targeted goals from being achieved? The answer is: probably not. If governments were to issue Social Policy Bonds, they would be doing so as representatives of their citizens. They would therefore be under strong moral pressure to comply with their commitment to supply funds for bond redemption, and not to take actions impeding progress toward the targeted goal. But it would also be in governments' own interest to fulfil their obligations. If they did not, they would be discrediting the entire bond principle, which they might well want to deploy again, either domestically or as participants in efforts to solve global social or environmental problems.

Private sector issuers are more likely to default. The market would take this into account when valuing their bonds. Bonds backed by bodies who deposited their redemption funds into an escrow account overseen by a reputable institution would be seen as being virtually immune from the possibility of default, and so valued more highly.

What happens once an objective has been achieved?

Once an objective is close to achievement, the issuing body can float a new set of Social Policy Bonds aimed at maintaining the achieved outcome or at further improvements. Sustaining the outcome beyond the period specified in the original bond issue would probably be cheaper in terms of benefit per unit outlay than achieving it, while it is likely that further improvements targeted by a second bond issue would cost less than those achieved by the first. There are three main reasons for this, the first two of which are linked:

1. Assume that a bond issue aimed at reducing the level of some indicator from *x* led to its reaching a level of *y*. Most probably it would take more than a withdrawal of this funding for the indicator to revert back to *x*. Why? If the indicator represents the rate, in percent, of unemployment in one area, for example, many of the newly employed would stay in work, even if the absence of further expenditure on a bond issue meant that their salary would revert to the level that had previously failed to attract them into work. This would be partly because they were now more aware of the existence of low-paid work, partly because of the costs and disruption of reverting to an unemployed lifestyle and partly because they would now find the prospect of being unemployed less attractive than previously. If the indicator represented air pollution, to take another example, maintaining lower levels of pollution could be cheaper than achieving it because people

would have invested in machinery or other systems that cost less, per unit benefit, to keep running than they did to set up.

2. In a similar fashion, investors in Social Policy Bonds would learn from their experience of achieving the objective targeted by the first bond issue. They would have looked for, and experimented with, different methods of solving the targeted social problem, and would be able to choose the most efficient solutions for subsequent bond issues. If maintaining the cleanliness of a river, for instance, were targeted, then it is likely that any know-how about monitoring systems or equipment installation would be more cheaply available once an initial targeted lower level had already been achieved.

3. Less specifically, it is likely that general improvements in productivity, mainly arising from technology (including information technology), will continue to occur in our economies, and that bondholders would make use of them.

Of course, new issues of Social Policy Bonds will not always be the most cost-effective way of maintaining the achieved outcome. There might well be circumstances in which alternative actions, such as legislation or institutional monitoring, are preferable.

Social Policy Bonds and developing countries

The public sectors of most developing countries are smaller than in the rich countries, nor is their performance so well documented. This makes discussion of policymaking in these countries more difficult. Even so, that should not inhibit their consideration of Social Policy Bonds:

- Public sectors are growing even faster in developing countries than in the developed world from, of course, a smaller base. There is the opportunity therefore to avoid the policy mistakes that developed countries made.

- While public sectors in the developing countries are growing rapidly, they are still not big or efficient enough to cope with their very severe social problems and the enormous social changes that are occurring. Developing countries are urbanising rapidly, with all the social dislocation this entails. Crime rates are high, and there is a great deal of urban poverty and under-employment. Many children are outside the educational system altogether and standards in state systems, while variable, are generally very low. Environmental problems are especially severe in developing countries. Solutions to all these problems are unlikely to arise quickly from existing or evolving public sector bodies.

- Public sector employees in developing countries are generally not well paid, and are more susceptible to corruption than in most developed countries. This lowers their motivation to act in the public interest. So, even more than in developed countries, there is often little relationship between government spending and desirable outcomes. One pointer: an International Monetary Fund (IMF) survey of 50 developing countries concluded that 'there is little empirical evidence to support the claim that public spending improves education and health indicators'.[5]

Despite their smaller administrations, there is no reason why governments in developing countries could not issue Social Policy Bonds and redeem them. They could target broad health, educational and environmental objectives, where improvements could come quite rapidly, and whose achievement could bring large net financial benefits to the government. It is likely that efforts at data collection in most countries would probably have to be strengthened, but that might be easier and more fruitful than enlarging what, in many cases, is a corrupt and incompetent public sector and trusting in that to achieve social objectives.

Unfortunately, even more than in the rich countries, the stated objectives of politicians and governments differ from their real intentions. In many developing countries powerful politicians use their own hidden networks of placemen in key positions in important ministries to frustrate whatever projects or policies they find inconvenient. Outsiders, including especially overseas aid donors, find little correlation between what the governments in these countries say they want and what they do. World Bank and IMF personnel officially judge countries on their stated policies and plans, but in many countries these bear little relationship to the way the country is actually run.[6]

It may be that, in time, aid to these countries could take the form of Social Policy Bonds, rather than being given on a government-to-government basis. This could enable the bypassing of corrupt politicians, officials, and the institutions they control. Funds aimed at solving global environmental problems, such as climate change, could similarly reward those who undertook worthwhile projects, rather than corrupt governments. Or corrupt governments could choose to buy globally backed bonds. Their financial self-interest would encourage them to modify their behaviour to help achieve targeted global goals.

Summary

The introduction of a government-backed Social Policy Bond regime would be accompanied by operational challenges and problems, not all of which can be anticipated. But these potential problems should not be overstated. First, most probably there would be valuable lessons learned from the private sector's experience in issuing small-scale Social Policy Bonds. Second, existing laws, careful choice and specification of targeted objectives, more transparency in government as to what it wants to achieve and how it will behave would probably circumvent or remedy most of the potential difficulties. And some of the problems that a bond regime would entail are the inevitable result of policies that have as their measure of achievement quantifiable indicators. In an increasingly complex and interlinked world, the trend toward using these indicators for policymaking purposes is going to continue, regardless of whether Social Policy Bonds are issued or not. The key point is that the likely performance of a bond regime needs to be compared not with some imaginary, impractical utopia, but with likely alternative policy-making methods.

Before the next chapter, which looks at the advantages of a Social Policy Bond regime, we provide answers to some frequently asked questions.

Questions and answers

Shouldn't the Social Policy Bond idea be tested before it's applied to critical issues?

Ideally, the concept should be tried on small self-contained problems, where the causes of the problem could be many and not very obvious. Example targets could be a region's crime or literacy rate. One difficulty is that Social Policy Bonds probably work best for broad objectives over large geographical areas, where there are many possible causes of each social or environmental problem, making current policy tools, such as regulation or taxes difficult to implement. But certainly, the Social Policy Bond idea needs experimental application then refinement before it can be deployed to solve critical national or global problems.

Who would issue Social Policy Bonds?

Local and national governments could issue Social Policy Bonds, as could international bodies such as the United Nations and World Bank. But, importantly, non-governmental organizations, private individuals or philanthropic bodies who feel strongly about a particular social or environmental concern could also issue Social Policy Bonds. They could call on members of the public to add to funds available for bond redemption. Purchasers of these bonds could initiate projects that complement activities currently undertaken by governments, or they could aim for objectives that receive no government attention at all.

Who would buy the bonds?

The most important buyers of large bond issues would probably be institutions, who would buy many of the bonds, and use the profits they anticipate from early redemption, or bond price rises, as collateral to finance projects that would help achieve the targeted social objective. For smaller bond issues ordinary members of the public might hold the majority of the bonds.

Wouldn't people just buy Social Policy Bonds, then do nothing?

If too many people failed to take any outcome-achieving activities the value of their bonds would fall, as the targeted objective became ever more remote. At some point, the market price of the bonds would fall to such a low point, that it would pay somebody to buy the bonds, then do something to help achieve the targeted objective.

What happens if Social Policy Bonds are held by many different holders? That would mean that bondholders might be tempted to do nothing, or that they would not be rewarded in proportion to their efforts.

If too many Social Policy Bonds were held by would-be free riders who had no intention of doing anything to help achieve the targeted social objective, then the value of all the bonds would fall. This would lead to aggregation of bond holdings, so that most bonds would be held by relatively large owners. They would then have incentives to cooperate with each other. This would mean, amongst other things, that they would all benefit by agreeing on how the specified social problem could best be targeted. One element of the optimal strategy will be to decide who will be responsible for what activities, and how they shall be paid. Major bondholders will certainly have incentives to share information with each other, and perhaps to trade bonds with each other

But what about those with smaller holdings?

Some might think that holders of bonds representing, say, less than 2 percent of all the bonds issued wouldn't bother to help achieve the targeted objective because they will not be the sole beneficiaries of appreciation in the value of the bonds. There might not be many bonds in the hands of such small holders (see previous question), but if there were, what might happen? Depending on the objective, people may make more of an effort to achieve it, even if they hold only a small number of bonds. Some goals require only small efforts from large numbers of people and if a goal is widely supported and especially if it's applicable to an identifiable community, people might help achieve it regardless of their bondholding. In such cases, the bonds would serve mainly to stimulate a bit more interest or motivate large bondholders to channel the diffuse, but valuable, support for the goal.

Note also that people often *do* take actions that will enrich others as well as themselves. Minority shareholders and company managers, for instance, frequently initiate actions that will see major shareholders benefit far more than themselves. The important criterion for bondholders would be whether their participation objective-achieving activities will generate a sufficient return – financial and psychological – to themselves. They will not be deterred if their activities also benefit others. Of course, if their activities are successful in achieving a specified objective, then other bondholders may replicate them, so raising the price of the bonds significantly.

There is also the possibility that small bondholders (or people who hold no bonds at all) could invest futures or options markets for the bonds to leverage any bond price appreciation resulting from their activities.

What happens when a targeted objective has actually

been achieved? Wouldn't more bonds have to be issued to maintain the status quo?

For the bonds to be redeemed, the achievement would have to be *sustained* for a specified period. After that period, it is likely that the most successful and efficient systems developed to solve the social problem the first time will allow the bond to allocate less funding for maintaining or improving the new status quo.

Could the bonds really solve such global problems as climate change and violent political conflict?

Once the bonds have been successfully used at the local and national levels, there would be every reason to apply the principle to global problems. The thrust of the concept is to give people incentives to solve targeted problems. Too many global resources are wasted by inefficient, corrupt or malicious governments who have no wish or incentive to help solve global problems. Social Policy Bonds could bypass, co-opt, undermine or depose regimes that oppose social or environmental goals.

The introduction of a Social Policy Bond regime would be accompanied by operational challenges and problems, not all of which can be anticipated. But these potential problems should not be overstated. Existing laws, careful choice and specification of targeted objectives, more transparency in government as to what it wants to achieve and how it will behave would probably circumvent or solve most of them. And some of the problems that a bond regime would entail are the inevitable result of policies that have as their measure of achievement quantifiable indicators. In an increasingly complex and interlinked world, the trend toward using these indicators for policymaking purposes is likely to continue, regardless of whether Social Policy Bonds are issued or not. The likely performance of a bond regime needs to be compared with current policy-making methods.

---

[1] *Languages 'at point of no return',* BBC News Channel, 24 August 2006, http://news.bbc.co.uk/1/hi/education/5281126.stm, sighted 17 July 2008.

[2] Source: Wikipedia (http://en.wikipedia.org/wiki/Prediction_market), which has links to other sites of interest in this fast-moving field.

[3] *The Tainted Source: The Undemocratic Origins of the European Idea,* John Laughland, Time Warner paperbacks, 1998, ISBN 0751523240 (page 162).

[4] See *Alternative endings,* 'Radio Times' (UK), 13 July 2002. This was the subject of a British Channel 4 television documentary *Death: you're better off with cancer* broadcast on 16 July 2002.

[5] *Does higher government spending buy better results in education and health care?*, Anjeev Gupta, Marijn Verhoeven and Erwin Tiongson, IMF Working Paper WP/99/21, February 1999.

[6] *Africa: the heart of the matter,* 'The Economist', 13 May 2000.

Chapter 5

Advantages of a Social Policy Bond regime

> [W]e tend to believe that there is some natural state of justice to which political life would revert if only the conflicts between interest groups could be resolved. But whatever justice we enjoy arose from the conflicts between interest groups, and no such natural state of justice has ever existed. The only natural state is unjust.... Clive James [1]

Indeed, the things we do in our own interest can have far-reaching benefits for everyone. Adam Smith's invisible hand has generated enormous material wealth, which, sometimes with help from government, has lifted billions out of poverty. But there remain chronic social and environmental problems, some of which are self-entrenching and many of which cannot be solved within the existing policymaking framework. The world is too small and interlinked now for the solution of social and environmental problems to be left to chance. We can and should do better than wait for natural justice to arise from collisions between interest groups. Government can intervene effectively where it is well meaning and solutions are easy to identify, but it is not omniscient and is easily defeated by complexity. It cannot effectively achieve many of our most urgent social and environmental goals. Social Policy Bonds represent a middle way between the happenstance of a free market approach to solving our problems, and the top-down, coercive and (often) ham-fistedly inefficient way of central planning. There is no question that government at all levels is absolutely necessary to articulate society's goals and raise the funds necessary to achieve them. Those are the things it does best – and only government can do them effectively. But government does a poor job in actually achieving our social goals. Under a Social Policy Bond regime government would continue to prescribe targeted outcomes and raise revenue. But it would be the market's job to allocate that revenue to the most efficient achievers of these goals: that is what the market does best.

This chapter looks at some of the likely advantages of Social Policy Bonds over current policies. It concludes with a look at how a bond regime with the objective of climate stability could improve on the Kyoto Protocol.

Efficiency

The main likely advantage of Social Policy Bonds is that, because they would inject self-interest into all stages necessary for solving social problems, they would be *more cost-effective* than current, activity-based programmes. For the same expenditure, therefore, more could be achieved.

Efficiency gains arise from many sources.

Pluralism

> In an uncertain, changing world, most decisions are wrong, and success comes not from the inspired visions of exceptional leaders, or prescience achieved through sophisticated analysis, but through small-scale experimentation that rapidly imitates success and acknowledges failure. This disciplined pluralism is the true genius of the market economy. John Kay [2]

What accounts for the triumph of the western market economies over the state-controlled, centrally-planned economies of the Soviet Union and its satellites? Some would say it represents the victory of materialist motivations over political ideals. But, as Mr Kay points out, it is more likely that the efficiencies and incentives of pluralism had won out over central direction; in short, that decentralisation and diversity had triumphed over dirigisme and central planning.

Almost by definition, governments are centralist in their instincts. They also operate in a non-competitive environment – and one that discourages self-evaluation.[3] But such centralisation is necessary to articulate society's wishes. It's also a good way of raising revenue from countless individuals who cannot themselves do much to bring about social and environmental goals. Where centralisation fails, as the Soviet Union found, is when it comes actually to achieving those goals.

Its centralist instincts mean that government has real difficulties in investigating new approaches in its social and environmental programmes. Government, like any large organizations, is inherently conservative and generally more interested in maintaining the status quo; which largely means preventing, or obscuring the source of, failure rather than rewarding success. In many areas of social and environmental policy it believes it should carry out only those activities that it can plausibly justify on the basis of a past record. These need not be very efficient, or even partly efficient. As far as many government bodies are concerned they need only to have been tried in the past and not to have been publicly identified as disastrous. This is not a strategy designed to optimise performance; rather it is a strategy that minimises the risk of perceived failure. It does nothing to discourage the continuing of inefficient, unimaginative activities, whose main recommendation is that they have been done before. As the persistence of social problems attests, these activities are not always very successful.

Neither can government readily try a wide range of diverse approaches in different regions, mainly because it would find doing so administratively irksome, and partly because it would have to risk criticism from people who had experienced the less successful ideas. So government generally adopts a uniform approach. It has goals that apply over its whole remit – which is all to the good – but then it applies its policies in a similarly uniform manner – which can often be counterproductive.

Take crime, for example. In one area crime might be a very obvious and direct result of unemployment. A factory closure might be expected to lead to a soaring crime rate in this particular locality where, perhaps, young males would be put out of work. But under most countries' crime-reduction regimes there is very little incentive for anyone – public or private sector – to explore this link and see whether diverting funds from, say, the police to employment creation on a small scale, would be a better way of fighting crime. Most governments would find it politically difficult to subsidise the continued operation of one particular factory when similar factories would receive less favourable treatment only because their employees were deemed to be less likely to commit crimes if their factories closed. Another example: screening for certain forms of cancer might be found to be of particular benefit only to women in poorer households. Yet the government would find it politically very difficult to deny such screening to *all* women. In a Social Policy Bond regime that targeted national health, bondholders would put maximisation of their return per unit outlay, which in this case would be maximisation of the health returns from cancer screening to the taxpayers' dollar, above such considerations. Such a regime would still be backed by government, but with the actual allocation of health resources being done by bondholders in pursuit of cost-effectiveness, the government would escape accusations of favouritism or discrimination.

Uniform approaches often go hand-in-hand with government's tendency to enlarge its own role. Government often applies its regulations regardless of whether or not they are appropriate in particular circumstances. Take the costs of complying with burdensome regulations for small businesses. The UK's Care Standards Act of 2000, is just one of many instances. It obliges every care home to have at least 14.1 square metres of private and public space for each elderly resident and at least eight single rooms for every double room. This sort of legislation has meant that over the past five years, at a time when the number of dependent elderly people in the UK has been rising, 50 000 care-home beds have been lost — about ten percent of the total — and as a result 5000 much-needed hospital beds are occupied by elderly people who do not have acute medical needs.[4] Another example: potential employers can be deterred from starting a business because a government body insists that would-be employees are at risk from, for example, an absence of fire escapes. Government denies people the choice of whether to accept a slightly higher risk of a fatal accident at work, in return for a job. While it is all very well to protect workers in this way, when people cannot find work locally they have to travel. In doing so they may well face a risk of dying in a car accident far higher than that of being trapped in a building with no fire escapes. No government programme has systemic ways of varying its procedures to account for such nuances.

Social Policy Bonds would encourage investigation of local circumstances, on the basis that doing so could lead to more efficient ways of achieving targeted outcomes than a uniform approach. The most efficient solutions for many social and environmental problems are *not* always known in advance, and the optimal choice is seldom a one-size fits all, top-down, government-dictated policy. More often, it is a matter for investigation and experimentation, and a wide variety of approaches is essential. Bondholders might find, after a bit of experimenting with different approaches, that certain activities work better than others under certain conditions. They would take the best of these approaches, and apply them where their return would be greatest, and they would recognise that for most broad objectives a mosaic of diverse activities will be most efficient.

A Social Policy Bond regime would combine the best features of centralised decision-making with the pluralism of markets. Under a bond regime, diverse, adaptive approaches would be encouraged - a contrast to the stultifying and failing centralised ways in which we are currently trying to solve global problems. The 'true genius' of the market, which currently is mainly channelled into improving the sales and profits of private corporations, would be channelled directly into the public good.

All this is not to say that corporations are efficient themselves:

> That there is waste in government is obvious; but the question is compared to what? We individuals are wasteful too. Corporations are paragons of waste, as a glance at executive compensation packages would suggest.[5]

Of course corporations also fail and investors in Social Policy Bonds will be no different. But, as Milton Friedman put it: corporations learn, governments don't. Government inefficiency in achieving social goals imposes costs on society. If bondholders initiate projects that fail, either they will terminate them themselves, or they will be the losers, not taxpayers.

Targeting outcomes

Targeting desired outcomes themselves, rather than the ways in which a government body currently thinks they might be best achieved, also generates efficiency gains.

Deals with uncertainties

All is not as it seems with systems as complex as the environment. It would seem obvious that encouraging people to walk rather than drive would reduce fossil fuel use or greenhouse gas emissions. But:

> The grinding, milling, wetting, drying, and baking of a breakfast cereal requires about four calories of energy for every calorie of food energy it produces. A two-pound bag of breakfast cereal burns the energy of a half-gallon of gasoline in its making. All together the food-processing industry in the United States uses about ten calories of fossil-fuel energy for every calorie of food energy it produces. That number does not include the fuel used in transporting the food from the factory to a store near you, or the fuel used by millions of people driving to thousands of super discount stores on the edge of town....[6]

However, other estimates differ markedly. Research done in 1994 indicates that for US agriculture as a whole, it has been estimated that for every calorie of food produced ‘only’ 0.7 calories of fossil energy was consumed.[7]

In a similar vein we might assume that travelling by train is kinder to the environment than flying or going by car. But analysis shows that high-speed rail can consume more fuel per passenger than cars or even short-haul aircraft. This happens when electricity for the rail network is generated by oil- and coal- fired power stations, which convert fossil fuel into oil-equivalent at only 40 percent efficiency. As well, for supposed health and safety reasons in the UK, rail passengers cannot travel in the front third of the two vehicles that drive the fastest trains, and there have to be 'seat-free crumple zones' as well as toilets for the disabled (each occupying the space of eight seats). The result is trains of 186 seats that weigh 227 tonnes, or a massive 1220kg per seat.[8]

All this is to say only that it's not always obvious how to proceed when confronting environmental problems, and that our first instincts might be wrong. Unfortunately, such are the disconnects in our complex societies that our first instincts are likely to be expressed as government reaction which, because of government’s size and power, can entrench or aggravate problems rather than solve them. Under the current system government bodies are set up, or regulations enacted, on the basis of what appears to be the biggest cause of a targeted problem. But the reality is that there are few strong, persistent incentives for government actually to get it right.

That is why, with complex systems, an outcomes-based approach, such as Social Policy Bonds, might be best: rather than try to think of the best way of solving a problem, a better approach would be to define the desired outcome and reward people for achieving it, however they do so. If our goal is to reduce greenhouse gas emissions, target those emissions (though it might be even better to target climatic variables instead – see Example 1, below). If our goal is to reduce traffic congestion then target that. And if it's some combination of the two: target some index of that combination. The market is better placed than any central authority to work out whether doing achieving these targets means putting people into cars or trains, or encouraging people to eat locally grown vegetables instead of highly processed cereals.

Sometimes the uncertainties arise not only from complexity, or lack of definitive research, but from our limited experience.

> Because of the slow maturation of human beings, we have not had sufficient time...to understand the multi-generational health consequences of exposure [to organochlorines] .... However, we do know that these compounds play havoc with human physiology, with effects that include cancer, infertility, immune suppression, birth defects and stillbirths.[9]

It seems that there are three ways of responding to such imponderables. We can adopt a strong version of the precautionary principle, which says that if there is a strong suspicion that a certain activity may have environmentally harmful consequences, it is better to control that activity now rather than to wait for incontrovertible scientific evidence. There's much to be said for this when looking at new processes, but applying it to current technology would probably mean a drastic reduction in the quality and quantity of human life that we could support. Another response is the one that has been prevalent until now: essentially to ignore the problems created by technology until they become obvious emergencies when, especially if the species they affect are photogenic or the people they affect are ones with whom we identify, government takes some coercive action.

But Social Policy Bonds might offer a third way that acknowledges that we cannot know in advance the likely results of new scientific or industrial processes, but doesn't halt technological advance. The bonds could specify targeted goals for human, plant and animal health; probably in the form of indices, but with minima for each identified species or environmental indicator. The profit motive would both enlarge and motivate the pool of people interested in exploring the likely effects of new technology on the environment and in working towards reducing their impact. A handful of politicians or government-appointed experts cannot anticipate every such impact in advance of the application of new technology. But participants in a market for Social Policy Bonds targeting environmental health would have *continuous* incentives to look for and deal with planetary depredations before they become intractable.

Lack of conclusive evidence has certainly delayed the implementation of measures to combat climate change for example. Our current system implicitly requires proof beyond reasonable doubt before it will take steps. Policymakers have no effective way, in short, of dealing with matters, on which they are not expert, on which the experts cannot agree, and on which the evidence on both sides seems equally compelling. One of the virtues of the Social Policy Bond approach is that it can be deployed as insurance against potential disasters about which we know very little (see chapter 9 'Insurance against catastrophe').

Deals with change

We perhaps should not have unrealistic expectations of our politicians. According to Nassim Taleb there are fields in which experts are useful – judging livestock, pilot-testing new aircraft, brain surgery, accountancy – and those where, as Taleb puts it 'experts tend not to be expert' – investing in shares, selecting personnel selectors, or interpreting intelligence about foreign countries. He argues that 'things that move', requiring anticipation and prediction, do not usually have experts, while 'things that don't move' seem to have some experts.[10] Policymaking is very definitely in the former category. It's a little unfair to expect our politicians and officials to find solutions to social and environmental problems in a fast-changing, diverse society. And not only our professional policymakers: *any* panel of experts is going to disappoint.

Social Policy Bonds, as we saw above (chapter 4: 'A new type of organization') would subordinate the membership of the problem-solving body to the problem itself. The need to generate solutions would dictate the composition of the groups engaged in solving it. When 'things that move' are creating problems, they demand adaptive, diverse responses, rather than top-down, one-size-fits-all government-mandated efforts. Importantly, though our larger social and environmental *goals* don't change very frequently. They are 'things that don't move', and politicians or any group of concerned people can represent us quite well in articulating these goals and helping make us aware of necessary trade-offs. Whoever issues Social Policy Bonds would specify their goal and contract out its achievement to the private sector, a field in which 'things move'– and in which their expertise would count for little against the pluralist adaptability of highly-motivated investors in the bonds.

Freedom to experiment

Another source of efficiency when compared with government-run social and environmental programmes is that Social Policy Bonds allow greater latitude to experiment. In Thailand there is a long-running, gruesome insurgency by Islamist insurgents in the deep south of the country. As one response, the Thai Government put up television screens in coffee shops and bars in an effort to distract potential militants. Though this author believes that the potential for television, movies (including pornography) to distract men away from militarism has been unfulfilled, unfortunately, simply the fact that this initiative has been undertaken by the Government could be its downfall. This is partly because any initiative the Thai Government takes is going to be widely mistrusted, or can be misinterpreted to the impressionable, just because it is a Government initiative; and partly because in putting up public television screens the Government has exposed itself to ridicule if the insurgency continues.

Similarly provocative, if undertaken by government would be subsidising intermarriage between two warring ethnic or religious groups, whether in southern Thailand or areas of conflict like the Middle East.* Again, if such measures were implement by government, they would be regarded as intolerable by one or other faction – or both – and probably aggravate the conflict. But the private sector is much freer to experiment with initiatives of this sort. Their failure would not run the same risk of deepening a conflict, and private sector operators could go further. In the Thailand example, investors in Social Policy Bonds targeting the insurgency could, for instance, organize the screening of explicit, raunchy DVDs to men in the southern provinces. They would not be deterred by embarrassment or fear of ridicule and, if the screenings failed to dampen the conflict, they would have incentives to try something else or sell their bonds to investors with different ideas.

---

* See digression, 'Doing what governments cannot do', chapter 9.

Markets reduce adjustment costs, innovation

That markets minimise costs of doing things was outlined in chapter 3. But when the stakes are high enough, markets can lead to the exploration of completely different ways of doing things. When forecasting the costs of new environmental regulations, economists routinely ignore an elementary economic lesson: markets cut costs through innovation. And innovation can be promoted through regulation.[11] Indeed, it seems that industry groups routinely overstate the costs of complying with regulations, believing they will be much larger than they turn out to be.[12] Specifying an environmental outcome, then, as regulations do, and punishing those who fail to achieve it can, in a market economy, focus our ingenuity on achieving that outcome, and doing so at least cost. Markets can stimulate unanticipated, creative solutions when there are incentives to do so. Of course, the desired outcome need not be as mundane as compliance with a new regulation: it could be achieving a targeted goal through the issuing of Social Policy Bonds. Encouraging innovation that cuts costs is an instance where government's size and centralised decision-making power are not just an advantage but are indispensable for the setting and financial backing of larger goals.

Efficient costing of objectives

How are we to weight different environmental impacts? Consider solar panels: silicon fabrication factories are energy and water intensive and the manufacture of silicon wafers uses energy; most often generated using fossil fuels, with all their attendant pollution. Then there are the potential problems of disposal at the end of a panel's life. The panels are frequently doped with toxic materials like arsenic.[13] Or take a current controversy: biofuels. Land devoted to their production can withdraw land not only from agriculture, raising food prices, but also from land that could otherwise support orang-utans.[14] Similarly, catalytic converters in car exhausts may reduce most air pollution, but at the cost of fuel efficiency.[15] In both these instances our climate change goal conflicts with our other environmental goals.

How should we go about sorting our environmental priorities? The problem is one of weighting entirely different environmental impacts. We'd all like to see climate change reduced *and* pollution fall *and* more orang-utans, and, for that matter, better healthcare along with lower crime rates and all the rest. In the real world, though, we have to choose between different goals. There are genuine difficulties with weighting such diverse, competing demands for society's scarce resources, but a large part of the problem is that we have little idea of the monetary cost of the solutions to our diverse problems.

Social Policy Bonds could help. As we saw in chapter 3 ('Markets minimise costs') they have an advantage over other policy instruments in that the cost of achieving a targeted outcome is minimised and capped. The market prices of the bonds provide best estimates of this cost continuously and transparently, and it is the competitive market that decides on how much the solution to a targeted problem will cost. Let us look at the benefits of this information in more detail.

Say, for example, a government decides to pursue the objective of lowering some index of the crime rate from 50 to 40 units. Assume that the government issued one million bonds targeting the crime rate, each redeemable for $10 once the lower level of crime has been attained. The *maximum* cost to the government of achieving this objective would then be $10 million. But if the bonds, when issued, fetched $5 each, then the market would be saying that it thought it could achieve this objective for just $5 million. It wouldn't say *when* it thought it could achieve that objective, but that could be inferred from market behaviour and the market value of the bonds compared with other financial indicators. But what if the bonds sold for virtually nothing and the market value of the bonds failed to move from that floor? That would mean that the government had miscalculated: in the market's view there would be no realistic chance of the objective being achieved for an outlay of $10 million in the foreseeable future. The government could respond in different ways:

- It could wait for new technology to arrive, or for circumstances to change in other ways, such that the market would see the objective as becoming more easily achievable, and the value of the bonds would consequently rise. Or

- It could issue more bonds, with the same specification, also redeemable for $10. It might do this in stages, gauging the market reaction to each new tranche of bonds, which would tell government the maximum cost of achieving the objective.

Either way, the government could be reasonably sure that it would be getting the best possible deal expressed as 'reduction in the crime rate per unit outlay'. This important benefit was mentioned in chapter 3, but is worth spelling out in more detail. We saw how a government, say, issuing Social Policy Bonds could determine the maximum cost of achieving its objective by limiting the total number of bonds issued and their redemption value. We saw too, that under a Social Policy Bond regime, it would be the collective wisdom of those in the market for bonds that would determine how much the government (that is, taxpayers) would actually pay to achieve the targeted outcome: and they would have every incentive to minimise that cost.

But the bond mechanism would not merely minimise the *total* cost of achieving a specified objective. It would also indicate the *marginal* cost of achieving further improvements. Say the one million crime reduction bonds were to sell for $5 each. This would tell the government that the present value of the expected maximum cost, including bondholders' profits, of reducing the crime level from 50 to 40 units would be $5 million. The government might then suppose that it could afford to be more ambitious, and aim for a further fall to 30 units. It could issue a million additional bonds redeemable when this new lower rate were reached. These would (probably) have an initial market value of less than $5, reflecting the (probably) diminishing returns involved in preventing crime. The point is that, by letting the market do the pricing of the bonds, the government would be getting an informed view of the *marginal* cost of its objectives. So if the bonds targeting the new level of 30 units were to sell for $4 each, then the maximum cost of achieving that objective would be $11 million, being equal to: $5 million (paid out when the level fell from 50 to 40 units) plus $6 million (paid out when the level fell from 40 to 30 units). The marginal cost of a 10-unit drop in crime would thus have been revealed to have risen from $5 million to $6 million. Should the government aim for a further fall to 20 units? Following such crime rate-targeting bond issues *it would have robust information about the cost of doing so.*

This is, of course, a simplified example and in fact the bond market would continuously update its pricing information. Say that new research, of the sort that might be stimulated by an initial bond issue targeting crime, suggested new ways of reforming or deterring criminals. Bondholders may, for example, have financed successful research into more effective reform programmes, or set up more appealing alternative lifestyles for especially hardened criminals. How would the market react to such developments? Once their effectiveness had been revealed, the value of all the bonds would rise. Instead of being priced at $5 and $4, the two crime reduction issues of the example might sell for $8 and $7. The total cost to the government of redeeming these bonds would not change: it would remain at $11 million (though redemption would most probably occur earlier). But the market would be generating new information as to the likely cost of future reductions in the crime rate. The market would now be expecting reductions of 10 units of crime to cost $2 million (from 50 to 40 units), and $3 million (from 40 to 30 units). The new research would have reduced the costs from $5 million and $6 million (respectively). So the cost of any further crime reductions would also fall, and by following market price movements policymakers could gauge approximately by how much.

These figures are hypothetical, but they do indicate the role that markets for Social Policy Bonds could play in helping the government, and taxpayers, decide on their spending priorities. The market for the bonds is elegantly efficient in conveying information about the cost of achieving objectives and, crucially for policymakers, how this cost varies with time and circumstances. It doesn't tell us which particular trade-offs to make: that can only be decided by the political process, but it does give us best estimates of the cost of, say, protecting orang-utans as against that of increasing climate stability by a certain amount. To be more explicit: under a bond regime targeting both climate stability and an index of species diversity we could say that reducing raising climate instability by, say, 10 percent will cost $x, while maintaining the current level of biodiversity will cost $y. Or we could say that raising literacy rates by x percent will cost the same as reducing the number subsidised university places by y percent. This information would be immediate, upfront, and available to all. It would be determined not by a handful of so-called experts, but by competitive bidders who have incentives to get it right – and it is not available under the current policymaking system.

The importance of this sort of information, generated by a competitive market with many players, can hardly be exaggerated. It was largely the absence of market-generated information that contributed to the failure in history of central planning.[16] Market prices reflect all of the information used by all who transact, or choose not to transact, in the market. Central planning fails in comparison with a market economy because it encounters the limits of human beings' calculating capacity: no individual or group of individual planners knows or feasibly can know all the dispersed information that is embodied in prices. Even with a sound incentive system in place — and the former Centrally Planned Economies had some fearsome systems — without the information that only markets can generate the computational task of organizing an efficient allocation of resources is too great. Prices incorporate and simplify all of the dispersed information implicit in getting a product or service to the marketplace. Markets for Social Policy Bonds would continually generate and reveal this information to policymakers and all those involved in achieving social and environmental outcomes — probably for the first time on a systematic basis. *A Social Policy Bond regime would combine market information with incentives to use it efficiently: the synergies arising could be of enormous benefit to society as a whole.*

Allocating resources between competing projects can, and perhaps should, be quite a sophisticated exercise. New techniques, such as treating investments like share options, can be more useful than the fairly crude cost-benefit analysis often used by government bodies. One feature of the share option approach is that it can deal more readily with changing circumstances: for example, it keeps open the possibility of making large investments if a project shows early promise. The market for Social

Policy Bonds would allow potential bondholders to deploy such investment criteria more readily than government bodies, which are constrained by existing institutional structures.

More than 100 people were killed violently yesterday in the US. More than 100 people are being killed today, and more than 100 will be killed tomorrow. There will be no blaring headlines, no anguished hand-wringing, no serious debate about the costs and benefits of controlling the causes of these deaths by violence. That's for one simple reason: these violent deaths are not caused by a gun-toting college student, nor by terrorists; they are the result of road accidents. On average 119 people die every day on American roads.[17] Worldwide, road deaths are estimated to be 1.17 million per annum, with over 10 million crippled or injured.[18]

I have linked impartiality to transparency because while it is quite legitimate to be more concerned by, say, 100 violent deaths caused by a terrorist and 100 violent deaths caused by road accidents, the policy implications of our bias are rarely made explicit. Research indicates that our attitudes to risk have little to do with rationality, and a lot more to do with our emotions.[19] So we might choose to drive rather than fly, raising our chance of death or injury, because we have an irrational fear of flying. For informed individuals this is their choice and they ought to be free to make it.

But we should probably prefer that our policymakers be more rational. In the cold light of day, for instance, we might feel just as strongly that our scarce conflict-reduction or foreign aid resources be devoted to where they can do most good rather than to areas where chance has made emotionally stirring media footage available.

Unfortunately, it does seem that we biased against solving problems that move too slowly for television or take place beyond camera range; and unfortunately too, many social and environmental problems: the extinction of species, nuclear weapons proliferation, climate change, fall into this category. Again, even here there is nothing necessarily wrong with our current priorities: the problem is that they have been made implicitly; with our eyes closed to their costs and the available alternatives.

Social Policy Bonds would change that. Their targeting of outcomes means that we would find it easier to be rational in our policy choices. If Social Policy Bonds target a broad health indicator – such as life expectancy adjusted for quality of life[20] – then investors in the bonds would channel their life-enhancing resources into those areas that would maximise the increase in life expectancy per dollar spent. It would be in their interests not to be swayed by the priorities of the media or our irrationality. Of course, when defining the measure of health that we want the bonds to target we might still choose, for instance, to weight deaths caused by air accidents more heavily than those caused by road accidents. But we would be doing so with our eyes open, aware that by doing so, we would not be maximising efficiency in terms of life expectancy gained per dollar spent.

Transparency in goal-setting would go a long way toward demolishing two further obstacles on the way to efficient achievement of social goals:

- ‘Capture’ by bureaucrats: transparency of policy goals would make government unlikely to name itself the beneficiary of its own policies.

- Taxpayers’ funding of corporate and middle-class welfare: Social Policy Bonds, by making explicit targeted outcomes could put an end to projects that in effect tax the poor for the benefit of the middle class or the rich.

That these are significant obstacles can be seen from the perverse subsidies of chapter 1, or the distribution of US housing subsidies, of which three times as much goes to the richest fifth of the population as to the poorest 20 percent.[21] This may be a result of deliberate manipulation by vested interests, or could arise from the way in which policy is made and expressed, with political debate, when it is not swayed by emotion, centring on arcane discussion about legal niceties and institutional funding and structures. Social Policy Bonds would focus on identifiable outcomes; they demand transparent, explicit, coherent objectives.

Consider the European Union’s Common Agricultural Policy. Its supposed objectives, as laid down in 1957 in the Treaty of Rome (1957), are:

1. to increase agricultural productivity,
2. to ensure a fair standard of living for [farmers], and

3. to assure the availability of [food] supplies,

4. ...at reasonable prices.[22]

These vague, mutually conflicting and open-ended objectives would not have been acceptable to people formulating desired outcomes for targeting by Social Policy Bonds. A bond regime would force a rethink on this and other policy issues. Drugs policy, for instance. Under a bond regime it would be difficult to avoid asking hard questions. Is a reduction in drug taking an end in itself, or a means to an end? If the latter, then what are these ends, and would it not be more efficient and transparent to target them directly? Unemployment may also have to be seen in a new light. Again, is lower unemployment an end in itself? Or a means to an end? Some studies have indeed suggested that the strongest influence on happiness is employment: people with jobs are very much happier than the unemployed.[23] But if lower unemployment were seen mainly as a way of ensuring that fewer people fall below a certain income level; or if it were seen as a means of lowering the crime rate, or improving mental health, then some combination of these objectives should be the targets for government policy. Answers to questions such as these would be unavoidable *at the outset* of a Social Policy Bond issue, but they are rarely posed, and still more rarely answered, under the existing policymaking regime.

Even where there is increased pressure for accountability under the existing regime, policies such at the Common Agricultural Policy have a momentum of their own. It is never made transparent, of course, but for those who administer these policies and their other beneficiaries, any visionary goals were largely forgotten along time ago, to be replaced by the goal of perpetuating the policies themselves and the institutions that administer them.

Transparent social goals would require a transparent process for formulating them. And a clear expression of desired social outcomes and their relative priorities would mean that progress toward them could be accurately monitored.

More attractive money flows

Further advantages of Social Policy Bonds over current policymaking systems arise because in most cases they have more politically appealing money flows.

Consider a government's environmental policy. Most current methods of pollution control inflict, right from the beginning of their implementation, identifiable losses on people and corporations in pursuit of objectives whose benefits will be realised only in the long run. Social Policy Bonds, however, would reward people for achieving successful outcomes. There would be opportunities for investors to profit from their bondholdings as soon as the bonds are issued – they could realise a capital gain any time they sell their bonds. The bonds would of course ultimately be redeemed by funds from the issuing government's general revenue, and taxes would still have to be levied to provide this but there is, nevertheless, a presentational advantage.

The other, more significant, money flow advantage of Social Policy Bonds is that the bonds' backers incur significant expenditure only when targeted outcomes have actually been achieved and the bonds redeemed. For this reason, government-backed bonds may attract greater political support for certain policies than agency- or activity- based programmes. And for the same reason they may encourage people or groups in the private sector to pursue their own social and environmental objectives by issuing their own Social Policy Bonds.

Buy-in

> A whopping 90% of Americans surveyed by a new Harris Interactive poll believe big business has too much power and influence in Washington D.C.[24]

Not 'business', note, but 'big business': indeed 92 percent of respondents thought small businesses had too little power. There are other signs of ordinary people's alienation from politics and policymaking, including low electoral turnouts, falling membership of political parties, increasing disenchantment and apathy towards politics. The distance between government and the people is a concern, especially as it seems to be widening in most democracies.

The gap would narrow if more people participated in policymaking. One reason it's difficult to stimulate interest is that policy is formulated in terms that are difficult to relate to outcomes with which the public can identify. Policymakers appear to concern themselves with decisions about funding for different government agencies, or with dispensing patronage to big business and other lobbies, or presenting themselves in the best light or… almost anything, in fact, except outcomes that are meaningful to real people.

A government that issued Social Policy Bonds would, from the outset, have to concern itself with social and environmental outcomes. Its main roles would be to articulate society's wishes regarding these outcomes and to raise the revenue that would fund these outcomes. Unlike most of the current determinants of policy, the language of outcomes and the necessary trade-offs between them is comprehensible and so accessible to people other than politicians, bureaucrats, lawyers and public relations experts. If people understand what a policy is all about, they can participate more in its development, refinement and implementation. They will better understand the limitations and trade-offs that are intrinsic to public policymaking.

Take environmental goals: we could reframe our policies in terms of explicit, agreed, meaningful, environmental goals rather than, as at present, rights, processes, activities or the funding or structures of institutions. Rather than target, for instance, greenhouse gas emissions we could, under a bond regime, target our real goal: a reduction in the instability of the climate. Instead of trying to monitor and pin down polluters of air and water, we could agree on and target the quality of air and water. There is likely to be more consensus over such goals than there is about how to reach them. Even if people disagreed with these goals, they would have been involved in their formulation and know that their opinions were considered rather than ignored.

This means quite a few things, but perhaps the most important is citizen buy-in, which means the support, approval or at least the acknowledgment that due consultation has occurred. This in turns means the reconnection of citizens with the people who make policy on our behalf; the sharing of responsibility and concern for policy initiatives. For that reason, more people would be drawn into policymaking - an end in itself as well as a means toward getting greater public buy-in to the resulting policies.*

Correlation with public benefit

A less obvious benefit of a Social Policy Bond regime is that they would be a means whereby private gain would be strongly, visibly and inextricably correlated with public benefit. Some bondholders, whether institutions or individuals, would start out rich and, if their bonds rose in value, would become richer. But working successfully to achieve desired social goals would most probably be seen as a laudable way of acquiring wealth. There are intangible benefits from having people or institutions grow rich in this way. There are many disaffected people

---

* See also chapter 8, 'The need for an engaged public'.

who, in some cases no doubt justifiably, view with suspicion or alarm the very high incomes or profits of corporations engaged in activities of little obvious net social or environmental benefit. They are also unconvinced that 'trickle-down' occurs to any meaningful degree. Wealth, in these people's eyes, must inevitably result from exploitation, either of other people or the commons. Social Policy Bonds would shift this worldview and, by helping people take a more positive view of the act of earning an income and accumulating wealth, could make for a more cohesive society. A socially acceptable way of becoming wealthy would also make it more politically feasible to tax less socially desirable ways more heavily – not an end in itself, but a means of raising more tax revenue for redistribution or increasing the number and quality of public goods and services.

Stability

The irrelevance of root causes

A Social Policy Bond regime would help guarantee stability of policy objectives. This is particularly important when looking at bonds backed by a national government or global body. Such bonds could target goals with a necessarily long lead time and investors would not be deterred from taking measures to achieve them by fears of a reversal of government policy — or, indeed, a change of government. Only the ends of policies, not the means, would be laid down by government. Obviously the objectives would have to be carefully defined, but there is a wide consensus over what constitutes most social goals. A government would be unlikely to repudiate such universally desired *objectives*, even if a ruling party with a different political outlook had issued the associated Social Policy Bonds. The risk that it might (and so become the first government *openly* to support higher unemployment, lower standards of health care, etc) would be not much greater than that of a government refusing to redeem fixed interest stock issued by any of its predecessors. This risk, always present, is factored into the prices of conventional government-issued bonds, and in no way impedes the operation of bond markets.

Importantly, governments would have to give assurances as to their future behaviour if the bonds were to be as successful as possible. For maximum success, they would also have to choose their objectives in consultation with opposition political parties as well as the electorate.

Because Social Policy Bonds could target broad objectives, which are more likely to be stable over time, they would probably have informational advantages over more narrowly specified policies. As an example, let us take the myriad ways in which a government's health care funding can be allocated. The government has to make its resource allocation decisions on the basis of data that are necessarily incomplete. How can it know in detail the effect that spending on, say, cancer diagnostic machinery will have on the overall health of the nation, as compared with subsidising the cost of nicotine chewing gum? So, by default, health expenditure is influenced by groups of medical specialists with little incentive or capacity to see improvements in the *general* health of the nation as an objective. As a result, funding of these specialities depends to a great and varying extent, on the strength of their lobby groups or on their public profile, rather than on what would best meet the needs of society. We mentioned above (chapter 4 'Existing institutions and the transition to a Social Policy Bond regime') the British national health care system's terminal-care budget: 95 percent of this is allocated to the 25 percent of the UK's population who die from cancer, and just 5 percent to the 75 percent who die from all other causes.[25]

Stable objectives would also mean that rational allocation of resources would not be undermined by high-profile events. For instance, in the aftermath of a tragic rail disaster in London that resulted in the deaths of 40 people the UK Government came under considerable pressure to order the installation of an automatic braking system for trains that go through red signals. Cold calculations showed that this would cost around $21 million for each life that the system could be expected to save. This is around five times the figure that the UK Treasury used as its benchmark valuation of a human life, which means that if the government had succumbed to pressure to install the automatic braking system it would have diverted funds from more cost-effective life-saving projects, and so caused the loss of more lives than it would have saved. A Social Policy Bond regime that had as its objective the maximising of the number of lives saved per government dollar would not waver in the face of spectacular one-off events.

Poverty in the developing world

In the developing world the stakes are higher. Decisions are being made about pathways to development that might – or might not – be condemning millions to perpetual poverty. There are respectable arguments on both sides.

> Everyone agrees that Africans are desperately poor and typically endure governments that are, to varying degrees, corrupt and capricious. The dispute is about causes and consequences. One group--call it the poverty-first camp--believes African governments are so lousy precisely because their countries are so poor. The other group--the governance-first camp--holds that Africans are impoverished because their rulers keep them that way. The argument may seem pedantic, but there are billions of dollars at stake, and millions of lives. The fundamental question is whether those who are well-off can salve a continent's suffering, or if, for all our good intentions, Africans are really on their own.[26]

Poverty in Africa seems to cry out for the outcomes-based approach that I advocate. Thousands of learned books and papers discuss the reasons for poverty in the poor countries. One decade it’s institutions or governance that is seen as the problem; the next it’s colonial history, or evolutionary psychology.[27] The assumption seems to be that once we locate the cause of poverty, we can set about tackling it. Unfortunately many of the people trying to identify that cause belong to one professional priesthood or another: government employees, academics and ideologically committed think-tankers, many of whom, while no doubt well intentioned, are much better at finding theories that validate their prejudices than actually eradicating poverty.

Social Policy Bonds, provided they were backed with sufficient funds, need not decide on any of these big issues. They would subordinate all approaches not to the whims and caprices of development theory, but to the stable desired outcome: the eradication of poverty. By contracting out the solution to the market they would motivate people to reduce poverty without prejudice as to what causes it. They *might* spend time trying to find the causes but under a Social Policy Bond regime they would do so only if that were to maximise the reduction in poverty per dollar. Otherwise they will leave the identification of causes to the theoreticians and ideologues - where it belongs, along with their endless, futile, debates.

Violent political conflict

Similarly with violent political conflict: war, or civil war. Once it's happening, it's not difficult to reel off plausible reasons for its occurrence, or even its inevitability. Indeed, war appears to many of us, as it did to the ancient Greeks, to be part of the natural order of things. Poverty, ignorance, despair, and differences of wealth, ethnicity, religion, class, culture or ideology: all these are thought to be some of the 'root causes' of war and violence. So are inequalities in access to resources, scarcity and economic decline, insecurity, the violation of human rights, exclusion or persecution of sectoral groups, and state failures including declining institutional and political legitimacy and capacity. Or, the list goes on: historical legacies, regional threats, the availability of weapons, economic shocks, and the extension or withdrawal of external support. Demography is also important: large numbers of unemployed males can catalyse conflict. Sometimes inward factors are pertinent, such as individual pathologies; perhaps a history of being abused that predisposes someone to seek power and use it violently in later life. The media too may have to share some of the blame, especially when they present violence as an acceptable and effective way of solving problems.

No doubt all these factors can and do play a part in fomenting and fanning the flames of conflict. But even aside from the impossibility of eliminating every potential cause of conflict, there is no inevitability that these causes will lead to war. Selective memory has strengthened these linkages in the collective mind, but for each of these 'root causes' there are examples that disprove any simple cause-and-effect relationship. There are, for example, dozens of countries in which people of different ethnicity and religion live happily side-by-side. There are also thousands of decent, peaceable and fulfilled adults who as children were horribly abused. One researcher into child abuse concluded that it does increase the risk of later criminality - but not always. The 'intergenerational transmission of violence is not inevitable,' she wrote.[28] There are many instances of land disputes that have ended. Take, for example, the border between Scotland and England, once the setting of a 300-year old series of bloody conflicts, now as peaceful as any border in the world. The Swiss have a high rate of gun ownership and an enviable absence of internal political conflict, as well as a low rate of gun crime. Japan is still a relatively peaceful society, but one in which lurid depictions of violence are avidly produced, promulgated and consumed, and have been for many years. An analysis of the world's civil wars since 1960 concluded that although tribalism is often a factor it is rarely the main one. It also found that societies composed of several different ethnic and religious groups were actually *less* likely to experience civil war than homogeneous societies.[29]

Perhaps Tolstoy summed it up best:

> The deeper we delve in search of these causes the more of them we discover, and each single cause or series of causes appears to us equally valid in itself, and equally false by its insignificance compared to the magnitude of the event.[30]

Rather than try to look for and deal with the supposed root causes of violence, then, we could issue Social Policy Bonds targeting conflict reduction. These could be backed by governments, institutions or anyone else with a genuine interest in peace. Not peace at any price, of course: the targeted goal should include broad quality of life indicators as well as some of the inevitable consequences of conflict. If world peace were being targeted, most national governments would, ideally, contribute to the redemption funds, perhaps in proportion to their Gross Domestic Product. If reductions in a regional conflict were targeted, governments in that region would probably be the largest backers. These bonds would become redeemable *only when the targeted components of violent political conflict reached a very low* *level.* Importantly, the bonds would make no assumptions as to *how* to minimise conflict—that would be left to bondholders. The best ways of ending the scourge of war in a diverse, ever-changing world of conflict, would no doubt vary dramatically: but the goal itself – peace – would be stable.

One of the biggest advantages of specifying policy in terms of outcomes, as would the issuers of Social Policy Bonds, is that it becomes conceivable to target a much wider range of very broad objectives than is possible under the current, command and control policy system. Goals such as the eradication of poverty or war suddenly become feasible policy objectives. So too does the avoidance of climate change.

Example 1: Climate Stability Bonds

In their long essay titled *Death of Environmentalism* the authors describe how the environmental movement in the US has lost ground over the past 30 years. Discussing climate change, the authors say that '[t]he problem is that once you identify something as the root cause, you have little reason to look for even deeper causes or connections with other root causes.'[31]

Quite so. The evidence that the global climate is changing rapidly now seems almost undeniable.[32] That said, scientists are divided as to (a) how fast climate is changing, (b) the effects of climate change, and (c) how much people can do about it. Economists and policymakers are questioning how much people should do about it. And there are still a few who argue that the climate is not changing at all in any meaningful way. Despite these uncertainties, climate change has the potential to inflict serious harm on human, animal and plant life, so there is a strong argument for doing what is necessary to prevent it, slow it down, or minimise its adverse effects.

The December 1997 Kyoto Protocol ('Kyoto') saw 159 nations reach the world's first legally binding commitments to reduce the global output of carbon dioxide and five other gases thought to contribute to the 'greenhouse' effect. Thirty-eight industrialised countries agreed to reduce emissions by 2012 to an average of 5.2 percent below their 1990 levels and, in July 2001, 180 countries reached a broad political agreement on the operational rules that will govern the Protocol, which came into effect in February 2005. In Cancún, Mexico, at the end of the year 2010, various pledges were annexed to the UN process. It is universally recognized that these are nowhere near strong enough to limit climate change to an increase of two degrees, which is what the Cancún texts require.

The agreed emission reduction targets are far lower than those that some environmentalists had hoped for, and that some countries, most notably the European Union, had been advocating. Even if they are reached, they will only slow, not stop, the build-up of carbon dioxide and other greenhouse gases in the atmosphere. (Carbon dioxide, which is given off by fossil fuel combustion, is thought to be by far the most important of the man-made greenhouse gases that form an insulating blanket around Earth.) Kyoto and Cancún are only supposed to be first steps, of course, and it's acknowledged even by its proponents, that its effect will on the climate will be so small as to be almost unnoticeable.

Kyoto embodies the assumption that controlling the targeted greenhouse gases is the best way of achieving climate stability. But with climate change, the biological and physical relationships involved are many and complex. Even specialists disagree about the degree to which the multitude of biological and physical variables influences climate change. Indeed, the veteran environmental maverick James Lovelock warned that a rapid cutback in greenhouse gas emissions could speed up global warming.[33]

Apart from the daunting uncertainties about the role of greenhouse gases in climate change, there is even less understanding of the role that agriculture and forestry can play as sinks for these gases. At least one climate model suggests that chopping down the Earth's trees would help fight global warming. This can happen because trees affect the world's temperature by means other than the carbon they sequester. For instance forests will generally reflect less radiation back from the Earth than snow: even after a blizzard they can be darker than a snowy landscape.[34] The implications are that, with our very limited knowledge of the causes of climate change, we ought to target not the ways in which we currently think we can stabilize the climate, but the goal of climate stability itself. We simply don't know enough about the mechanisms underlying climate change to make policy today on *how* to stabilize the climate.

The scientific complexities of climate change are analogous to those of a social system, and our policymaking cannot cope with great complexity other than by trial and error. It cannot reliably identify the cause and effect in complex systems, and it certainly cannot cope with rapidly expanding knowledge, nor with the diversity inherent in large geographical areas. When it reacts, it's often too quick to identify a causal relationship, and then base policy on it. The Kyoto agreement is one such response to climate change. It implicitly assumes it knows whether James Lovelock is right or wrong, or whether tree cover does or does not accelerate climate change, or the answers to hundreds of other uncertain scientific relationships.

A bond regime targeting climate stability would bypass these, and other, uncertainties, and encourage research into clarifying the relevant scientific relationships. *Climate Stability Bonds* would be issued on the open market and would become redeemable for a fixed sum only when the climate had reached an agreed and sustained level of stability.[35] In this way there would be no need for the targeting mechanism to make assumptions as to *how* to stabilise the world climate: that would be left to bondholders.

Ideally Climate Stability Bonds would be backed by the all national governments, under the supervision of a world body, possibly one supervised by the United Nations or World Bank. This body would undertake to redeem the bonds using funds that could perhaps be obtained from all countries, in proportion to their Gross Domestic Product. It would be up to individual countries to decide how to raise funds — presumably they would do so from taxation revenue. Importantly though, no bonds would be redeemed until the objective of a more stable climate has been achieved and sustained. Climate Stability Bonds would be issued by open tender, as at an auction; those who bid the highest price for the limited number of bonds would be successful in buying them. A fixed number of bonds would be issued redeemable for, say, $1 million each, only when climate stability, as certified by objective measurements made by independent scientific bodies, had been achieved and sustained. As with other Social Policy Bonds, once issued, Climate Stability Bonds would be freely tradable on the open market.

People would differ in their valuation of the bonds, and their views would change as events occurred that made achievement of a stable climate a more or less remote prospect. They would also change when new information about climate, and about the causes of climate change, was discovered.

There are obvious difficulties involved in defining what a stable climate actually is, *but the same difficulties apply when attempting to monitor the success or otherwise of Kyoto*. Presumably scientists will monitor such objectively verifiable indicators as temperature, change in temperature, rate of change of temperature, precipitation, and many others, at a wide range of locations. Climate Stability Bonds could also target the *effects* of a rapidly changing climate on human, animal or plant life: a bond regime would be sufficiently flexible to target, in one bond issue or several, a combination of a wide range of indicators and goals, whether scientific or social, such as the frequency and severity of adverse climatic events, the numbers of people killed or made homeless by such events, or the insurance payouts to which they give rise.

Climate Stability Bonds would be redeemed only when climate stability, as defined by such a set of indicators, had been achieved and sustained.

What might bondholders do?

A Climate Stability Bond regime would not dictate how to achieve a stable climate. Bondholders could undertake a wide range of projects including:

- helping countries or companies to set up and run greenhouse gas emission control programmes;
- helping countries or companies to set up carbon sequestration plantations;
- investigating innovative ways of removing greenhouse gases from the atmosphere; or
- carrying out, or supporting, research into increasing the albedo of the Earth or its atmosphere.

Bondholders could also be expected to finance other research and initiatives, all aimed at stabilising climate as cost-effectively as possible.

Some governments, research institutes and others are already carrying out these or similar activities. But, under a Climate Stability Bond regime, bondholders would have an incentive to seek out those ways of achieving a stable climate that will give them the best return on what is, in effect, the taxpayers' outlay. Only when the targeted degree of climate stability were achieved would governments have to pay for it by redeeming the bonds. Until then, bondholders would have to finance the initiatives that they think would achieve climate stability. The body that issues the bonds would, in effect, be contracting out the achievement of climate stability to the private sector — having defined the nature and degree of the stability that it wanted, and undertaken to pay bondholders once it had been achieved.

Advantages of Climate Stability Bonds

Climate Stability Bonds would encourage people to do whatever is necessary to achieve climate stability. The bonds would not rely on the robustness of our existing scientific knowledge even as to whether the climate is changing in the way that many scientists believe it is, let alone as to how best to stabilise it. Kyoto aims to reduce emissions of a small range of gases. But there may be other causes of climate change that are far more important, of which we are currently unaware. And these need not be man-made: natural variability of climate has had severe impacts on human life in the past[36] and could still be playing a role. Kyoto, responding to effects whose causes are uncertain, embodies a limited number of fixed ideas about the nature of the relationships involved. A bond regime targeting climate change directly might well lead to cuts in greenhouse gas emissions, *but it would not assume that doing so is the best solution*. Climate Stability Bonds would improve on Kyoto because they would encourage behaviour leading to the desired outcome, rather than seek to control activities whose effects on climate stability are not fully known. Take, for example, the potential solution offered by Freeman Dyson that falls outside the purview of Kyoto: growing the biomass in the soil by 'a hundredth of an inch a year'. [37] It might be that new farming practices, such as no-till farming and avoiding the use of the plough can cause biomass in the soil to grow sufficiently fast to stop the carbon in the atmosphere from increasing. This may or not be accurate or feasible, but the point is that we need to supply incentives to people who prevent climate change *without prejudging how they do so.*

Bondholders would also be motivated to be *efficient* in achieving climate stability. They would initiate whichever climate-stabilising projects they thought would give them the best return for their outlay. The more efficient bondholders were in achieving climate stability the more they would gain from appreciation of the value of their bonds. Their efficiency would maximise the degree of climate stability that *society as a whole* would achieve per dollar outlay. Because of the colossal sums involved, the benefits that Climate Stability Bonds could offer in comparison with activity-based regimes, such as Kyoto, could be huge.

Further advantages of a bond regime are:

- Funds for climate stability would not need to be used for scientifically approved projects. They could, for instance, be used to bribe corrupt or malicious governments to modify their behaviour in favour of achieving climate stability.

- The issuing government bodies would pay up only when a stable climate had been achieved: any risk of failure or of undershooting the climate stability target would be borne by bondholders, rather than taxpayers.

- The market for Climate Stability Bonds would continuously generate and display prices that would be of immense value in maximising the efficiency of allocation of investors' resources (see chapter 5 'Efficient costing of objectives').

- That formulating the redemption terms for Climate Stability Bonds would entail clarifying of what is actually wanted. 'Climate stability' as targeted by Climate Stability Bonds could be defined such that bondholders would tackle only the negative effects of climate change.

Following up this last point, there might be large immediate benefits for humanity if one component of the goal targeted by Climate Stability Bonds were 'the numbers killed or made homeless by adverse climatic conditions'. A bond regime would allow that sort of flexibility; Kyoto does not.

Trying to stabilise the world's climate is going to require a huge range of different projects. Reducing greenhouse gas emissions or sequestering carbon might be helpful, but they are not necessarily going to be cost-effective. Other ways yet to be discovered could be far cheaper. Kyoto is deficient in that it offers no incentives to find out how to achieve a stable climate most cost-effectively. Climate Stability Bonds would encourage the most efficient solutions given the knowledge available at any time, and they would stimulate research into finding ever more cost-effective solutions. This would occur because of the nature of the bond mechanism, and would require no presupposition as to the optimal set of solutions. The bond issuers would dictate only the objective — climate stability — not the ways of achieving it. Crucially too, this objective could be so defined as to attract more political and public support than Kyoto's cuts in greenhouse gas emissions. Without such support no policy addressing climate change is likely to be coherent, let alone successful.

Kyoto may not go far enough

The debate about climate change is so politicised that criticism of the Kyoto Protocol is often taken to be synonymous with denial that climate change is happening. In fact, it's quite possible that Kyoto would be far too little far too late, even if it were fully implemented. Then Climate Stability Bonds would be channelling more resources into mitigating or preventing climate change than will Kyoto and its successors. When the bonds are first issued, potential investors would decide how much they are worth. If they believe that governments aren't putting enough resources into redeeming the bonds, they will ignore the bond issue or buy the bonds for virtually nothing and just sit on them. At that point, the issuing governments would have to put in more resources and issue more bonds. The value of all Climate Stability Bonds would then rise as would-be bondholders see that they can make worthwhile gains by doing something to stabilise the climate.

Carbon trading – a distraction

The flaws of carbon trading regimes:

- They are driven by government regulation, and as in any such activity, there is a high chance that politicians will change the rules of the game, at times of their choosing, with unpredictable consequences. Thus Latvia was at one point suing the European Commission for an increase in its allocation of allowances. There have been another several other such cases.[38]

- They are too limited. Expensive bureaucracies are being set up whose whole focus is less on climate change than on meeting Kyoto compliance conditions. The trading mechanism is elegant but not linked in any reliable way with climate change targets. New Zealand's greenhouse gas emissions trading system isn't even coupled with an overall emissions target. Carbon trading *will not bring about climate stability, because it is not designed to do so.*[39]

- Only big firms can afford to hire carbon accountants, liaise with officials and pay the costs of registering projects with the United Nations. Yet these are often the companies that local people battle hardest against in defence of their livelihoods and health.

Carbon trading seems likely to be a corporatist non-solution to the climate change problem. It is unlikely to discourage the industries most addicted to coal, oil and gas from carrying on exactly as before.

So under a bond regime, and unlike Kyoto, a firm commitment to stabilise the climate would not be the result of bargaining and deals struck between the various members of the relevant bodies. Rather, the resources devoted to mitigating or preventing climate change would be decided by would-be investors in Climate Stability

Bonds: these people have powerful incentives to devote whatever resources are necessary to achieve climate stability – but no more.

What if Kyoto is on the right track, in the sense that emissions of greenhouse gases are actually the main cause of climate change? There are several reasons why Climate Stability Bonds could still perform better than Kyoto:

1. Reducing anthropogenic greenhouse gases might not be the best way of reducing the concentration of greenhouse gases in the atmosphere;

2. Reducing the concentration of greenhouse gases in the atmosphere might not be the best way of preventing or mitigating climate change;

3. Preventing climate change might not be the best way of preventing the worst effects of climate-induced catastrophe.

A Climate Stability Bond regime would also be more adaptive than Kyoto. Even if capping greenhouse gas emissions is currently the best way of preventing climate change it might not always remain so. Climate Stability Bonds could adapt to our expanding knowledge: Kyoto cannot.

But even if we assume that capping anthropogenic greenhouse gas emissions is consistently found to be the best way of averting climate change and its worst effects; *even then*, this author believes that Kyoto is deeply flawed. How would a Climate Stability Bond be better in those circumstances? Holders of Climate Reduction Bonds would still target anthropogenic greenhouse gases in a similar fashion to Kyoto, but they would have *strong incentives to do so more efficiently*. They would want and would have wider scope for action. For example, they wouldn't be bound by political correctness or realpolitik of the sort that exempts some countries that emit huge quantities of greenhouse gases from any disciplines at all. They would have the flexibility to buy these regimes off or otherwise undermine any weakening of the disciplines. Kyoto is so politicised and its money flows so unpalatable that it is seen as an imposition: in the rich countries it's seen as an imposition by environmentalists on everybody else. In the poor countries it's seen as an imposition by the rich countries on them. Kyoto means huge upfront costs for a very small payoff well into the future. Being a political construct it is so compromised that even its most ardent advocates think it ineffectual in its own right. They see it as first step; but it is one that might well not be taken – as distinct from being endlessly discussed, debated and written into law.

A bond regime, however, would target an outcome that ordinary people can understand, empathise with, and support; and that would entail taxpayer spending only when it had been achieved. Such buy-in is essential for tackling climate change: an urgent challenge that will concern the entire planet for decades to come.

Climate Stability Bonds: questions and answers

To make climate stability bonds a viable solution, wouldn’t there have to be a lot of them; enough to make them preferable to business as usual?

Certainly, or to be a bit more accurate, the total redemption value of the bonds would have to be significant. Note though (1) that the bonds could complement existing efforts to combat climate change and (2) that the redemption funds could be supplemented by contributions from government or anybody else throughout their lifetime. The market prices of the bonds, and there changes, would help the bonds' backers decide whether to issue more bonds after the initial float.

A Climate Stability Bond regime could mean offering industry a part of the payoff in order to keep them from polluting: is that not like bribery? Shouldn't such antisocial behaviour be regulated by laws, and rewarded?

Factories that emit pollutants are not necessarily engaging in antisocial behaviour. They might be generating many more positive than negative externalities. If their pollution is illegal then the emitters should be tackled by the law. But what about behaviour that is not illegal, and that is partly antisocial and partly pro-social, like a typical factory in a western country? Bondholders would have powerful financial incentives to seek out those factories that pollute most and (1) see whether they are in fact complying with the law and, if they are not, report them to the authorities, and (2) if they are operating legally, offer a subsidy (bribe) to install cleaning equipment, or to reduce its output, or close down completely.

Bondholders will also have incentives to lobby for more stringent laws, and to persist in monitoring all polluters for their compliance with the laws. Note that this sort of bribery already goes on: owners of dirty cars are often rewarded for trading up. Smokers in Dundee, UK, are being offered rewards for quitting.[40] North Korea is offered aid in exchange for suppressing its nuclear programme. The alternatives are so dreadful that notions of fairness or justice are less relevant than securing the desired outcome at almost any cost.

---

[1] *The Meaning of Recognition: New Essays 2001-2005,* Clive James, Picador, 2006 (page 4); available online at http://www.clivejames.com/lectures/recognition (sighted 18 July 2008).

[2] *The Centralised Road to Mediocrity*, John Kay, 'Financial Times', 28 February 2006, available online at http://www.johnkay.com/political/431, sighted 18 July 2008.

[3] *Why states believe foolish ideas: non-self-evaluation by states and societies*, Stephen Van Evera, MIT Political Science Department and Securities Studies Program, 10 January 2002, version 3.5.

[4] *The great granny grab*, Ross Clark, 'The Spectator', London, 17 August 2002.

[5] *The irrationality of 'economics'* Jonathan Rowe, onthecommons.org, 29 May 2007; http://onthecommons.org/content.php?id=1092, sighted 18 July 2008.

[6] *The oil we eat: following the food chain back to Iraq*, Richard Manning, 'Harper's Magazine', February 2004. Available at http://www.harpers.org/archive/2004/02/0079915, sighted 18 July 2008.

[7] *Food, land, population and the US economy,* David Pimentel and Mario Giampietro, November 1994; http://www.dieoff.com/page55.htm, sighted 18 July 2008.

[8] *Rail loses the environmental advantage,* 'Modern Railways', June 2004.

[9] *The Ecology of Commerce*, Paul Hawken, HarperCollins, 1994, ISBN 0887307043.

[10] *Black swans: the impact of the highly improbable*, Nassim Nicholas Taleb, Random House, April 2007, ISBN 978-1400063512. (The summary of this point is based on a review of the book, titled *Advice from a chimp 1) no experts, 2) more mess*, by Daniel Finkelstein, writing in 'The Times', 27 June 2007.

[11] *Polluted Data,* Eban Goodstein, 'The American Prospect', 30 November 2002. Available online at http://www.prospect.org/cs/articles?article=polluted_data (sighted 18 July 2008).

[12] Ibid.

[13] Letter to the editor of 'The Economist', by Peijing The, 'The Economist', 7 December 2006; http://www.economist.com/opinion/displaystory.cfm?story_id=8380052, sighted 18 July 2008.

[14] *Brit's eye view: are we too obsessed with climate change?* Peter Madden, online discussion at 'Grist';

http://gristmill.grist.org/story/2007/8/20/11026/6273, sighted 18 July 2008.

[15] Ibid.

[16] See Hayek, F A, *The Pretence of Knowledge,* in his *New Studies in Philosophy, Politics, Economics and the History of Ideas*, Routledge and Kegan Paul, 1982, ISBN 0710087421.

[17] *Roadway Deaths Rise to Highest Level in 15 Years,* Sholnn Freeman, 'Washington Post', 23 August 2006; available online at http://tinyurl.com/qwl6u, sighted 18 July 2008.

[18] *Road Safety Overseas*, US Department of State. Webpage: http://travel.state.gov/travel/tips/safety/safety_1179.html, sighted 18 July 2008.

[19] See *Fooled by Randomness*, by Nassim Nicholas Taleb, Random House, 2001, ISBN 0-8129-7521-9 (page 38).|

[20] For a description of Quality Adjusted Life Years see *So what is a QALY?*, Bandolier, at http://www.medicine.ox.ac.uk/bandolier/band24/b24-7.html, sighted 18 July 2008.

[21] *The Ecology of Commerce*, Paul Hawken, HarperCollins, 1994, ISBN 0887307043.

[22] Excerpts are from Article 39 of the Treaty of Rome, available online at http://www.hri.org/docs/Rome57/Rome57.txt, sighted 18 July 2008.

[23] See, for example, *Happiness is a warm vote,* 'The Economist', 17 April 1999.

[24] *Poll Says 90% of Americans Believe Big Business Has Too Much Power. Will Change Follow?,* ReclaimDemocracy.org staff, 1 December 2005; http://tinyurl.com/6adq8j, sighted 18 July 2008.

[25] See *Alternative endings,* 'Radio Times' (UK), 13 July 2002. This was the subject of a British Channel 4 television documentary *Death: you're better off with cancer,* broadcast on 16 July 2002.

[26] *Why is Africa still poor?,* Andrew Rice, 'The Nation', 24 Oct 2005. Available online at http://www.thenation.com/doc/20051024/rice, sighted 18 July 2008.

[27] *The Moral Animal: Why We Are, the Way We Are: The New Science of Evolutionary Psychology,* Robert Wright, Vintage, August 1995, ISBN 0679763996.

[28] *The cycle of violence,* Cathy Widom, 'Science', vol 244, pages 160-66, 1989.

[29] Paul Collier and the World Bank, cited in *The global menace of local strife,* 'The Economist', 24 May 2003 (page 26).

[30] *War and Peace,* Leo Tolstoy, Signet Classics, 1968, ISBN 0451523266 (page 730).

[31] *The Death of Environmentalism: Global warming politics in a post-environmental world,* Michael Shellenberger and Ted Nordhaus, available online at http://grist.org/news/maindish/2005/01/13/doe-reprint/, sighted 18 July 2008.

[32] See *The Scientific Consensus on Climate Change*, by Naomi Oreskes, 'Science', vol 306, 2004.

[33] *James Lovelock: Reducing emissions could speed global warming,* Charles Clover, 'Daily Telegraph' (London) 29 October 2007. Available online at http://tinyurl.com/5gld7k, sighted 18 July 2008.

[34] *Trees may warm the Earth,* 'The Economist', 12 April 2007. The article is reporting on a study led by Govindasamy Bala, of the Lawrence Livermore National Laboratory, in California.

[35] See bibliography for details of this author's book on Climate Stability Bonds.

[36] See, for example, the references cited by J T Overpeck, in *Climate Change: The Hole Record,* Nature 403, 714-715, 17 February 2000.

[37] *Heretical Thoughts About Science and Society*, Freeman Dyson, 'Edge: The Third Culture', 8 August 2007, available online at http://tinyurl.com/yozuja (sighted 19 July 2008). Excerpted from *Many Colored Glass: Reflections on the Place of Life in the Universe* (Page Barbour Lectures) by Freeman Dyson, University of Virginia Press, 2007, ISBN 0813926636.

[38] *Lightly carbonated,* 'The Economist', 2 August 2007.

[39] See *Government's energy vision bold but no silver bullet*, Press Release from Greenpeace New Zealand, 11 October 2007; available online at http://tinyurl.com/6haahm, sighted 19 July 2008.

[40] *Smokers offered money to give up*, BBC News Channel; http://tinyurl.com/59g2mm, sighted 19 July 2008.

Chapter 6

Comparison with other 'more-market' approaches

Many countries' governments have recognised the inadequacies of the conventional approach to solving social problems. Recognising that the market is better at allocating scarce resources than government, they have made various efforts to give the market more influence over these decisions. But what exactly are markets? Some people are put off by the term. They associate markets with big business and its largely successful efforts to manipulate the social and political agenda in its own interests. And it's true that market forces are often invoked to justify anti-social behaviour:

> Only economists talk about markets. Business can't tolerate markets. They don't want markets in which informed consumers make rational choices. What they want is deluded consumers who will make irrational choices. That's what hundreds of billions of dollars in advertising are spent on. You don't get any information about the product.[1]

When it comes to markets, there is a huge difference between big business and government on the one hand, and small businesses and natural persons (as distinct from corporate bodies) on the other. Big business and government are suspicious of markets, which depend for their vitality on numerous decisions made by people and firms acting diversely and responsively within ethical and legislative bounds. They don't fully trust markets because they cannot fully control them. They much prefer the rhetoric of markets to the reality: 'Large companies are less and less about making something for a specific market and increasingly about manipulating the arrangements behind such makings.'[2]

But markets, when they are not corrupted or distorted, are the best way of allocating our scarce resources: all the evidence of history as well as economic theory supports this. So how successful have governments been in channelling market forces into social goals?

Privatisation

Privatisation is the selling of assets owned by government suppliers of services and the transfer of control to shareholders. It has been widespread. In many countries utilities, such as railways, electricity companies and telecoms have been fully privatised. In the UK most of the local authorities' housing stock has been sold to ex-tenants.

How successful has privatisation been? In those countries with rule of law and secure property rights it has had some success, at least when compared to the performance of nationalised industries. There have been some improvements in efficiency, and because of the taxes they pay on their profits, privatised companies now make positive contributions to government funds — a dramatic change from when they were publicly owned and were mostly a drain on public funds. But some of the labour the industries shed on privatisation has not found alternative employment, and it appears that it was government's disengagement from day-to-day operating decisions, rather than the transfer of ownership, that secured privatisation's efficiency gains.[3] Customers have on balance gained from privatisation, but not hugely. There have been significant improvements in service to customers where businesses have faced competition, as in telecoms and airlines. Fears that privatisation would lead to a loss of universal service or to higher charges for the poor have proved unfounded,[4] but again, regulatory policy has probably been an important factor. In many cases privatisation has merely brought about a change from government monopoly to private monopoly. As far as customers are concerned that means little change: the ability and freedom of customers to switch suppliers of goods or services determines how competitive a market is and how well market forces function. So privatisation has created a need for very detailed public regulation of certain industries, and this has been quite at odds with what was expected by the government and its advisors. What we have now 'is not a clear case of the state withdrawing as an economic agent but rather changing its role as such.'[5] This might be one reason why, despite widespread privatisation, the volume of government spending has hardly fallen in the industrialised countries.

Privatisation of services like basic education, health care, and social insurance would probably not be politically acceptable in many countries; at least, not without further extensive regulation. The problem is that private businesses have private goals, and while these may coincide with social goals some or even most of the time, there will always be some people who either through their own, or their parents', misfortune, indolence or apathy, will not be well-served by private institutions pursuing purely private goals. This, of course, is true of the current system, but the current system can claim that because it is not private it has the public interest at heart. (It may be failing to look after the public interest, and it may be very expensive and inefficient, but it can make that claim.) A fully privatised school system, for instance, would have no market incentive to raise the educational standards of the less bright children of poor parents.

In short, privatisation can be helpful as one way of giving more meaningful incentives for people to run services currently run by government agents. But private companies are not generally rewarded for achieving desirable social outcomes. Privatisation is merely a transfer of assets, or a disengagement of government from the running of certain activities. By itself, it cannot supplant the government's role as a safety net for the neediest members of society or as a provider of public goods.

Voucher schemes

Education voucher schemes have been used by several states in the northeastern US, and in the UK. Parents are given vouchers that they can use to purchase schooling for their children from whichever schools they wish, whether they be government or private.

Vouchers assign greater importance to the demands that consumers actually make of an education system, rather than to the services that government employees or others think they should want. Most parents agree on the importance of basic academic subjects. They expect that, at a minimum, their children will have mastered reading, writing, and elementary maths by the time they are out primary school. Parents are also concerned about career preparation. But beyond these basics, priorities differ widely. Vouchers allow parents to make their own decisions, and encourage schools to compete to supply what parents want.

Voucher schemes have some of the advantages of Social Policy Bonds: through markets parents are motivated to seek the best education available at the price, and schools are motivated to supply it. Under a voucher scheme government continues to pay for education. But vouchers do have some disadvantages. Some of these stem from the fact that the vouchers do not specify outcomes. They specify only that they must be used to pay for children's going to school. This works well for those children whose parents are capable of making informed choices and willing to do so. It does not work so well for the children of less informed or less motivated parents, and these are precisely those who most need help. So under a voucher system, it would still be possible for desired social outcomes, such as universal literacy, say, not to be achieved. Another concern is that vouchers could encourage the negative aspects of competitive behaviour. Under a Social Policy Bond regime rewards from self-interest would be inextricably tied to outcomes. In voucher schemes, on the other hand, self-interest could take the form of suppliers competing against each other in ways that undermine their ability to achieve targeted outcomes efficiently. This would be especially likely when consumers lack information, as is likely to be the case in, say, provision of health services.

As well, voucher systems could not readily be applied to goals that have a strong public good element such as better law and order, improved health care, and better environmental protection. These limitations make it difficult to apply voucher schemes widely.

Contracting out of existing services and the UK's Private Finance Initiative

The UK Government's Private Finance Initiative (PFI) aims to encourage the private sector to invest in major public infrastructure projects, such as hospitals, schools, and roads. The PFI was introduced by a Conservative Government 1992, and has attracted interest from other countries. In a PFI deal, a private firm contracts with the government to build something (a school, say, or a road) and frequently to maintain it for decades. Nearly 800 deals have been signed since 1992, with a combined value of more than £55 billion.[6] The government specifies the outputs it requires, in terms of the nature and level of service required, and invites the private sector to bid for the contract to supply these outputs. Taking hospitals, for example, the private sector partner is usually responsible for:

- designing the facilities according to National Health Service (NHS) specifications;

- building the facilities to time and at a fixed cost;

- financing the capital cost: the private sector partner recovers this cost by renting the facilities to the NHS, generally for periods of more than 25 years; and

- operating the facilities: most of the staff, including cleaners, catering, porters, security and maintenance staff, are employed by the private contractor. Receptionists, secretaries and lab technicians may also be employed by the private sector (but doctors and nurses are employed by the NHS).

When using the PFI the UK Government is, in effect, contracting out the building of the hospital and non-health staffing to the private sector. It is the private sector PFI partner that assumes the risks in each of these areas; this reduces the overall risks to the public sector associated with procuring new assets. Moreover, because the PFI partner's capital is at risk, it will have a strong incentive to continue to perform efficiently throughout the life of the contract.

The Private Finance Initiative, as with contracting out of services generally, is reasonably efficient at supplying carefully specified outputs. Specification of these outputs can be a costly exercise (though costs will fall as different public sector bodies share their output-specification experiences), as is the monitoring of compliance, but allowing the private sector to bid to supply outputs is generally more efficient than paying directly from public funds. A report commissioned by the UK Treasury puts the average estimated saving for a sample of projects as 17 percent.[7] A noteworthy aspect of the PFI has been the private sector's willingness to bear the risks of overruns on such items as construction cost. Indeed, this transfer of risk to the private sector is estimated to account for 60 percent of the forecast savings that result from the PFI.[8]

The UK's National Audit Office investigated the PFI and its report, based on three years' data, was published in March 2007. As the *Economist* says, it makes worrying reading:

> The average tendering period for a PFI is 34 months, no faster than when the [Pubic Accounts Committee] produced its report in 2003. Contracts are often altered after the final bidder has been chosen, so the discipline of competition is removed. Departments regularly underestimate the cost of professional advice, typically by around 75%. Besides heaping up the costs to taxpayers, such difficulties may be turning companies off the idea of bidding for work. Before 2003 85% of PFI projects attracted three or more bidders. By 2006 that was down to 67%.[9]

Nevertheless, because it is only outputs that are specified under the PFI and because of the degree to which they must be specified to ensure efficiency, the PFI, as with contracting out of services tends:

- to depend on the viability of the company awarded the contract,
- to be limited to particular stages of an outcome-delivering enterprise, and
- to reinforce established ways of doing things.

There are significant legal and administrative problems too in negotiating complicated, one-off contracts that can last for decades with private companies. Overall, the PFI has been unimpressive and many still see it as 'simply an accounting trick'; a way of keeping government spending off its balance sheet.

Outputs, however efficiently supplied, do not necessarily lead to more favourable, or more efficiently supplied, outcomes. So under the PFI a new hospital may be a little more likely to be built on time, to exact specification, and cost-effectively. But Social Policy Bonds targeting general health indicators would not assume that a new hospital were the best way of achieving society's health goals in the first place. It is anyway likely to be administratively simpler, as well as more congruent with society's real goals, to measure broad outcomes than the outputs of individual companies.

Tradeable contracts to supply an outcome

What if public sector contracts were made tradeable, so that the winner of a competitively tendered contract could sell the right to supply a specified service? Payment would be on delivery of the service. Say, the contract is to build a hospital. Perhaps the successful bidding company (company 'A') would be part way through the construction, then decide it had done what it could, and try to sell the contract for delivery of the hospital on the open market. The value of the contract would depend mainly on how far the construction were away from completion. The net increase in value to A would also depend on how cost-effective A had been. The more cost-effective, the greater its profit on selling the contract. The new contractor, B, would still have an incentive to complete the construction efficiently. A contract's tradability would help avoid the problem of possible collusion (tacit or not) between bidders for contracts; under the current system, inflated bids can succeed if the bidders agree (explicitly or not) to inflate their bids.

So tradability of contracts in this way would encourage suppliers of services to continue to minimise costs and maintain efficiency *after* they have started helping deliver the specified service. Under the current system there may be a tendency for contractors, or their employees, having won a contract, not to maximise the speed and efficiency with which they go about solving the targeted problem or, more likely, supplying the agreed output. While contractors can sometimes benefit from being efficient, they cannot always enjoy this benefit in terms of immediate cash capital gains. There is scope for incentive payments, or penalty clauses, but these are crude, ad hoc arrangements that are costly to set up, administer and enforce. In our example, though, A does benefit, provided it is efficient and the contract is readily tradeable.

Tradability would also transfer the risk of breach of contract from the tax- or rate- payer to bondholders. If, under a contract system, the successful bidders fail to do what they were legally obliged to do, then it is up to the aggrieved party — the central or local government agency — to take proceedings against them. Even if such actions are successful, they can be protracted and costly, and there is always the risk that the company will go out of business, again, leaving the taxpayer liable for any consequent losses. However, making a contract tradeable means that underperforming investors could simply sell the contract to another company that believes it will be more efficient.

This concept approaches that of Social Policy Bonds. In principle the issuing body could specify not the delivery of a service or output (construction of a hospital), but the achievement of an outcome (increased quality-adjusted life expectancy in a certain region), and the contract could be bought by a consortium of companies, rather than a single company, and be tradeable at any time thereafter.

The main difference between such a tradeable contract and a Social Policy Bond issue is that the bonds could be bought and held by anybody; individuals as well as companies. When floated, the bonds would be bought by the highest bidders, whoever they might be. The composition of the outcome-achieving organization would thus be unknown in advance, as would its structure. Both its composition and its structure would change, as the bonds changed hands, which they could do at any time after flotation. Compared with tradeable contracts, this would make ownership of Social Policy Bonds more fluid, which would mean more market liquidity and more transparency.

If the Social Policy Bond concept were to generate more market activity, it would make more practical the targeting of remote objectives; ones that may take years or decades to achieve. Many businesses would be reluctant to take on these goals without the possibility that they could benefit in the shorter run. Social Policy Bonds would allow them to do what they could to achieve the target, then benefit from selling their bonds at a higher price, letting the new bondholders continue the advance toward the goal. Similarly, a liquid market for the bonds would make it more quickly apparent that those charged with achieving a social goal had underestimated their costs or overestimated their efficiency. Under a regime of tradable contracts for which there were no liquid market, such deficiencies might take a fatally long time to become obvious. But under a Social Policy Bond regime the market prices of the relevant bonds would fall, making it clear to everyone that the current contractors were inefficient, and making it easier for other investors to take over the reins and pursue the targeted objective. And, as we saw in chapter 5, there are other advantages arising from the information that the bonds' market prices would generate. To recap: markets in the bonds would continuously reveal information that would tell the issuers and anyone who might want to supply objective-achieving services: (1) how close a targeted objective were to being achieved; (2) the potential rewards from buying the bonds and participating in objective-achieving projects; and (3) the likely costs of marginal improvements beyond those already targeted. This would be of immense value to policymakers.

New Public Management

New Public Management is a loose, broad, term used to describe the wave of public sector reforms throughout the world since the 1980s. The idea underpinning NPM is that more market orientation in the public sector will lead to greater cost-efficiency for governments, without having adverse side effects.

> [A]s successful as several NPM-inspired reforms of the public sector might have been and still may be, what one notices first when looking at the public and private spheres is the difference, not the similarity. The state is denoted primarily by its monopoly of power, force, and coercion on one side

> and its orientation towards the public good, the commonweal or the *ben commune*, on the other; the business world legitimately focuses on profit maximization. NPM however, as it has been said, "harvests" the public; it sees no difference between public and private interest. The use of business techniques within the public sphere thus confuses the most basic requirements of any state, particularly of a Democracy, with a liability: regularity, transparency, and due process are simply much more important than low costs and speed.[10]

At first sight, Social Policy Bonds would appear to suffer from the problems Drechsler correctly identifies as afflicting conventional attempts to replicate in the public sector the profit maximisation imperative of the business world: a narrow definition of efficiency isolated from context; and, on all the evidence, failure to deliver on its promises. Contracting out, as he says, 'has proven to be excessively expensive and often infringing on core competences of the state as well as on the most basic standards of equity.' [11]

As Social Policy Bonds embody the contracting out principle, how do they square up against Drechsler's legitimate strictures against New Public Management?

The most important consideration is that a bond regime would be entirely subordinated to 'transparency and due process'. Indeed, the agreement on explicit, transparent, outcomes would be the starting point of a Social Policy Bond issue. Formulating policy in terms of outcomes rather than, as at present, inputs, outputs, activities and institutions would draw more people into the policymaking process. To attract consensus and support, these outcomes would have to be meaningful to real people, rather than merely to government agencies or corporate bodies. A government-backed Social Policy Bond regime would aim to achieve broad social and environmental goals. Profit maximisation fails when, as in NPM, it tackles narrow objectives, when non-quantifiable social and environmental externalities are offloaded onto wider society and the commons.

A Social Policy Bond regime could explicitly tackle some of the social and environmental problems created by profit-maximising private entities. Instead of targeting the ever-proliferating array of micro-objectives that characterise NPM, it would target important societal goals, like better basic health and literacy outcomes, reduced crime, and a cleaner environment. Social Policy Bonds, moreover, would be compatible with a large state, a small state or anything in between. Government would relinquish its monopoly on how to achieve social goals or supply public services, but would still be the ultimate source of funding for their achievement and, most important of all, it would still define and set them.

NPM fails because of the narrowness of its vision; probably a result of its ideological origins. It also has formidable needs for greater inspection and supervision. As well, the definition of efficiency touted by NPM, with its focus on narrow goals is not necessarily the same as that which would be most useful to society as a whole, which demands a broader, longer-term vision and, especially, consensus and buy-in.

Tradeable permits to pollute

A tradeable permit regime determines the maximum amount of pollutant that can be discharged. People then trade permits to emit amounts of pollutant making up this total. Markets decide the price and allocation of the permits. Tradable permits are most relevant to unpriced resources, such as the assimilative capacity of the environment. They are most widely used in pollution control and are best applied to limit emissions of pollutants that have marked thresholds. In the US, markets for permits to emit sulphur dioxide have been in operation for several years. Tradeable permits can work well with intrinsically large-scale processes, or for controlling emissions that have no polluting substitutes. Such processes and substances can be monitored and controlled quite easily, because doing so is unlikely to lead to offsetting increases in pollution via the setting up of difficult-to-monitor small-scale processes, or the emission of polluting substitutes that are not being monitored. But technological and ecological complexities mean that these processes and substances are a minority. Air pollution in aggregate, for example, results from many sources and many different processes. Immense quantities of information would be needed to establish, monitor and enforce a comprehensive system of pollution control using tradeable permits to pollute. A bond regime, however, could be more flexible. It could target an index of 'air pollution', embodying a combination of targets for levels of pollutants and their effects on human, plant and animal life. In general, it is air (or water) pollution as a whole, or the adverse effects of such pollution, that need control, not the concentrations of single pollutants.

A Social Policy Bond regime could have informational advantages when targeting broad objectives. These advantages could be significant when there are large numbers of polluters, or where scientific relationships are uncertain. It seems likely that tradeable permits to pollute will continue to play only a small role in environmental protection.

Polluter Pays Principle, pollution taxes

The Polluter Pays Principle (PPP) says simply that those who pollute the environment must pay for the damage they have caused. The idea originated in the 1970s when members of OECD countries sought a means by which pollution control costs would be financed by the polluters rather than the public in general. Take, for example, a lake that is polluted by run-off from of farms nearby. The farmers are "externalising" the costs of their activities. The cost of waste disposal in the form of pollution is borne by the people living and working near the lake. Similarly, car drivers externalise the costs of air pollution and most of the other social and environmental costs of car driving. The PPP intends to compel such polluters to bear the real costs of their pollution. Such 'internalising' of these costs would discourage the polluting activity or encourage polluters to use cleaner technologies. The PPP underpins the idea of holding certain businesses responsible for the costs of recycling or disposing of their products' packaging, or US laws requiring the cleanup of, for instance, accidental spillages of oil. The assumption is that once these costs are internalised, the optimal amount of pollution will be the result.

In the case of an oil spill, the cost of a cleanup is relatively easy to identify, and there is little subjectivity involved, but if we take car driving as an example, assignment of the real costs of all the different environmental and social impacts is all but impossible.

Given the formidable problems of assigning these costs in larger-scale, complicated, circumstances, application of pollution taxes is more feasible. The intent is to reduce pollution by raising the cost of polluting activities. But:

> We assume that if we raise pollution prices, pollution will come down. But not even the smartest economist can know how quickly it will come down, or by show much. We can only proceed by trial and error. Much of the tax-setters' time will be spent debating how much of a price hike will produce how much of a reduction in pollution, when in fact what we should be debating is how quickly we want pollution to drop. Once that debate is settled, we should be able to set a value at the agreed-upon level. We can't do that with pollution taxes. Pollution taxes, in short, though better than nothing, are far from an ideal way to protect nature. [12]

The aim should not be to devise an elegant tax mechanism; one that is theoretically optimal, but impossible to apply in practice. Rather, the goal is to reduce environmental pollution to a certain level in the most cost-effective manner. Where objective criteria apply, and the polluters are easy to identify, the PPP may work best. In other cases it may be more politically (as against economically) efficient for beneficiaries to pay for clean-up costs. Pollution taxes have a role to play too. The point is that these are tools to be deployed in service of a pollution-reduction objective, not ends in themselves. A Social Policy Bond regime would be quite compatible with all these, and other, tools. Bondholders, given an environmental goal to reach, could deploy or advocate the use of any combination of these tools.

Take the example of a polluted lake; one that is grossly polluted by wealthy farmers. Then the political process would probably demand that the farmers pay to clean it up or have their polluting activities legally restrained or taxed. But where the lake is already healthy, though not quite healthy enough to attract fee-paying fishers, then the beneficiaries of a clean-up - would-be tourist operators around the lake, perhaps - could reasonably be asked to pay for it to be cleaned up, or to compensate farmers for reducing their polluting activities. Note that in this instance, which is in microcosm the situation as it is currently, the debate about who pays generally precedes the cleanup.

Now simply assume that the lake is polluted and either a local authority of a group of nearby residents on their own initiative, decide to issue their own Lake Health Bonds. These would be redeemable for a fixed sum only when the lake's water quality had reached a target level for a sustained period. The local authority or the residents could contribute to the redemption funds used to redeem the bonds. Bondholders could then begin the cleanup operation immediately. Part of the cleanup could entail lobbying one or other tier of government to impose taxes on either the polluters or the beneficiaries – *whichever will be more cost-effective*. In other words, the issue of who pays would be secondary to that of the cleanup. Social Policy Bonds are therefore quite compatible with the use of the PPP, or indeed pollution taxes or the principle that beneficiaries pay. Such instruments, and others such as straight regulation, should be seen merely as tools to reach society's environmental goals. The bonds give people incentives to choose the optimal combination of these tools for each specified goal.

Catastrophe bonds

Catastrophe bonds are typically issued by insurers or other bodies that stand to lose if a defined catastrophe occurs. Investors buy the bonds for a principal, and then typically receive a high rate of interest. They will also see their principal returned, provided a defined catastrophe (a hurricane, for example, or a pandemic) does not occur. In such a case, the investors will make a healthy return on their bond purchase. But if the catastrophe does occur then the investors do not receive the principal, which is retained by the insurance company and used instead to fund the claims by insurance policies. Catastrophe bonds transfer some of the risk of unusual and devastating events from insurers (and reinsurers) to capital markets. Since catastrophe bonds were first issued in 1997, after Hurricane Andrew in Florida and a huge earthquake in San Francisco caused reinsurance premiums to rocket, their use has risen spectacularly. After a slow start it was estimated that the market for natural-catastrophe bonds had jumped from about $700m in 1997 to $5.3 billion in 2005.[13] They have advantages for investors in that they offer high yields and their risks are uncorrelated with other market risks. So far there have been few payouts and the bonds have proved quite profitable for investors.[14]

Catastrophe Bonds differ from the 'more-market' approaches discussed above, and from Social Policy Bonds, in that they were not designed to modify behaviour. They are used primarily as a form of insurance for bodies, including especially insurers and government agencies, which would stand to lose in the event of a catastrophe. Investors in the bonds assume some of the risk of the catastrophe occurring, in return for higher than normal yields, but they cannot and are not expected to do anything to reduce the chance of the catastrophe occurring.

In principle though, with just a little tweaking, catastrophe bonds could be made into Social Policy Bonds. For instance, a government could issue Social Policy Bonds that would reward people if, say, a disastrous hurricane did not occur. Holders of the bonds would then be in a similar position to holders of catastrophe bonds: they win if there is no catastrophe. However, the redemption terms of the Social Policy Bonds could be defined a little differently. Rather than make the occurrence of a natural disaster such as a hurricane or earthquake the catastrophe that triggers a lower payout to bondholders, the trigger could be the numbers of people killed or made homeless by such an event. This would give holders of the catastrophe bonds incentives to reduce those numbers.

Insurance companies could issue bonds against even more specific ‘catastrophes’, with triggers such as the number, or value, of insurance claims or payouts during a certain period, or following a natural a disaster, whether specified or unspecified. These would, in effect, be privately-issued Social Policy Bonds.

Cash incentives to engage

According to Jim Giles, New York this year became the first city in a rich country to try to alleviate poverty by offering cash incentives to improve people's engagement in areas such as education, health and employment. Mexico was the pioneer. Top-down projects, such as subsidies for staple foods and healthcare were mostly unsuccessful. So the government gave cash payments to low-income families to be spent however they wanted, provided they behaved in approved ways. For example, a family could earn about $20 a month by enrolling their child in primary school and ensuring that s/he attended regularly. Similar payments were made if children had regular health check-ups. In the rich countries it is mainly the US that uses such incentives, and there only in a few isolated drug-treatment programmes. Whether they succeed in stopping drug abuse in the long term is uncertain.[15]

It's a controversial approach, but one that can work well, especially at low levels of income or engagement, where, say attendance at primary school is inevitably going to confer a benefit on the child and its family. In other circumstances, and for larger populations, it might be preferable for governments (or private sector groups) not to make such payments directly but rather to set broad health, education and employment targets and let the private sector work on achieving them, using these cash incentives or not, as they see fit. The reasons for this are that private bodies will be more concerned than government that their cash payments generate positive changes in behaviour, and they will be less afraid of withdrawing them from people they deem to be poor risks. Private bodies would have stronger incentives to identify and refuse to make payments to people who will behave negatively only in order to qualify for payments made to stop, and they would be less squeamish about discriminating against them. As well, government monitoring of compliance could arouse fears of excessive surveillance whereas people would be more prepared to accept payments from private bodies, which would probably be less able to abuse their privacy. Cash incentives like this might be seen as unfair subsidies to the undeserving or the dissolute, but so long as they are ethical and legal it would be unwise to rule them out.

They do though need careful oversight, and this becomes clear when numerical targets can be inconsistent with society's real goals. For example, a similar approach is being used in hospitals in the US, and more recently, in the UK, where 'hospitals are to be given cash bonuses - for keeping people alive. Regional health bosses are planning to try out a US system of rewarding trusts [that] have low death rates, levels of infection and readmissions.'[16] This sort of incentive scheme can quite easily be abused; in this instance by hospitals refusing to accept morbid patients. Depending on how the targets are defined, hospitals might benefit by simply refusing to take in as patients those deemed most likely to succumb. This can happen under current target-driven regimes, when hospitals are penalised for failing to meet badly-chosen targets.[17]

Cash incentives to individuals are best seen as a tool, which can be used by government or private bodies, including holders of Social Policy Bonds, where behavioural changes or numerical targets are strongly linked to societal goals. Cash payments to institutions should be subject to the same provisos that apply to Social Policy Bonds generally, especially the need to specify broad, meaningful goals.[18]

Summary: Social Policy Bonds compared with other 'more market' approaches

In comparison to a Social Policy Bonds backed by government, the contracting out of existing services suffers because of the need for government to specify in detail what is required. Similarly, the information demands of tradable pollution permits mean that they can be used only for inherently large-scale processes that can be monitored quite easily. The Private Finance Initiative suffers from the same flaw, which limits its application and adds to its implementation costs.

Because of the limitations inherent in the contracting out of services, it would seem that *privatisation* and *vouchers* are the most widely applicable of the 'more market' alternatives to government. A combination of privatised schools, for example, and vouchers, could do much to raise standards in education with unchanged, or even reduced, public expenditure. But note the problem of children whose parents have no wish or ability to make an informed decision as to their schooling. For education, this could turn out to be a minor problem, as sufficient numbers of well-informed parents would probably ensure that the standards of all schools would probably rise in a privatised system. But lack of information would be more critical in health care, where most consumers have little information about the treatment they need and standards are far more difficult to judge. They rely on the medical profession to tell them.

In general, when a system allows private interests to flourish, there will be some people who suffer either because they are poor, or because they are uninformed. Giving the poor purchasing power would help them, but only insofar as they can make an informed decision and are willing to do so. When the service is one like education, most people would probably fall into that category. But when the service is one like health care, where most consumers are in the dark, the number of uninformed or misinformed people would be very large.

Social Policy Bonds would solve this information problem in ways that privatisation or voucher schemes, or combinations of the two, cannot. They would give a voice to society's concerns, expressed in terms of explicit desired *outcomes*. Compared to privatisation or voucher schemes, they would have advantages in education where some people's children may fall through the cracks, and they would have more significant advantages in health care, where most people are uninformed. There are, after all, important public good aspects in having an educated and healthy population. And government-backed Social Policy Bonds could score even more heavily over other more-market mechanisms in the delivery of those objectives that have an even purer public character, such as reduced crime rates or a cleaner environment.

For the same reasons, Social Policy Bonds might also have political advantages. Most of the arguments in favour of continued government intervention in areas like health, education, and welfare crystallise around what would happen to the poor or unfortunate if government were to withdraw. Social Policy Bonds may be superior to other 'more market' approaches, in that government would not relinquish its role in bringing about better outcomes for the poorest members of society. It would simply withdraw from *achieving* these goals, but continue to set these goals, and to be the ultimate source of finance for their achievement. Society's goals are not the same as an aggregation of all its members' individual goals weighted by purchasing power. As a society, there are outcomes like safer neighbourhoods, lower infant mortality, or 100 percent literacy, which people collectively might want to achieve, and know they can achieve, but which a fully privatised system would not guarantee. Social Policy Bonds, because of their focus on outcomes, would allow full discussion and consultation as to what society's goals are, and how much society values their achievement. They would then reward people for achieving them at least cost to society.

Whoever holds Social Policy Bonds, especially if the bonds target a long-term goal, could well decide to benefit from the experience of some of the 'more-market' approaches discussed above. They could, for instance, pay cash incentives to young children to attend school or reading classes in pursuit of educational or literacy goals; they could lobby in favour of wider application of the Polluter Pays Principle, or taxes on pollution. For broad, long-term goals, Social Policy Bonds might function more as a meta-system: one that encourages the use of a range of other mechanisms, including more-market approaches, but also, when they will be more cost-effective, non-market approaches such as regulation. For many long-term problems, no single measure, market or non-market, will be enough. The Social Policy Bond concept is versatile: it will reward the most efficient mix of policy measures, without prejudice as to their political or ideological backing.

---

[1] *Master Mind*¸ Noam Chomsky, in an interview by Shira Hadad, 15 November 2005, Noam Chomsky's ZSpace Page; http://www.zmag.org/znet/viewArticle/5018, sighted 19 July 2008.

[2] *Where stuff comes from,* Harvey Molotch, Routledge, 2003, ISBN 978-0-415-95042-8 (page 204).

[3] *The Balance Sheet*, John Kay*, Prospect,* July 2002.

[4] Ibid.

[5] *Privatisation has increased state regulation,* Dr Jonathan Michie, Lecturer at the Judge Institute of Management Studies, and a Fellow of Robinson College, Cambridge, UK, speaking at a seminar on *The Elusive Concept of Sovereignty*, held at the Finnish Institute in April 1996. Available online at http://www.lausti.com/articles/es_1/michie.htm, sighted 19 July 2008.

[6] *Bad, and not improving,* 'The Economist', 8 March 2007.

[7] *Value for money drivers in the Private Finance Initiative,* Arthur Andersen and Enterprise LSE, commissioned by (UK) Treasury Taskforce, 17 January 2000.

[8] Arthur Andersen and Enterprise LSE, op cit, note 7.

[9] *Bad, and not improving,* 'The Economist', 8 March 2007.

[10] *The Rise and Demise of the New Public Management*, Wolfgang Drechsler, 'post-autistic economics review', issue no. 33, 14 September 2005. Available online at http://www.paecon.net/PAEReview/issue33/Drechsler33.htm, sighted 19 July 2008.

[11] Ibid.

[12] From *Capitalism 3.0: a guide to reclaiming the commons,* by Peter Barnes, Berrett-Koehler Publishers Inc, September 2006, quoting Kevin Phillips, a former (US) Republican party strategist.

[13] *Natural Hedge,* 'The Economist', 29 September 2005.

[14] *Death Bonds Drub Corporate Debt as Insurers Get Subprime Lift,* Oliver Suess, Bloomberg.com; http://tinyurl.com/67zpj7, sighted 19 July 2008.

[15] *Cash incentives: Worth every penny,* Jim Giles, 'New Scientist' number 2631, 22 November 2007.

[16] *Cash for keeping patients alive,* 'Manchester Evening News', 9 February 2007; http://tinyurl.com/2tu2pg, sighted 19 July 2008.

[17] See chapter 2, 'Ends and means'

[18] See chapter 3, 'Objectives and indicators'.

Chapter 7

How to issue your own Social Policy Bonds

It may well be the private sector that first issues Social Policy Bonds. This chapter looks at how this might be done.

Example 2: Female Literacy Bonds

> Officially, 53% of Pakistanis are literate. Others say the figure is nearer 30%. Literacy, often defined as no more than the ability to write one's name, is as low as 3% among women in some rural areas.[1]

While Pakistan's religious schools are widely seen as fomenting terrorism, hatred of the west, and ignorance, its mainstream schools are also, to say the least, underachieving. With its population of 160 million, Pakistan's failing educational system is a major concern and one that doesn't seem amenable to the current policy mix. So let us assume that a group of enlightened philanthropists decides that an urgent priority is to increase the literacy rate of girls and young women in Pakistan form its current level of 30 percent (or 28 percent[2]) to 95 percent.

The philanthropists need not know anything about the Urdu language. They would though be convinced that raising the female literacy rate in Pakistan would be a good thing in itself, and perhaps make the world a safer place for themselves and their descendants. They need have no particular expertise, either about how to achieve their goal or about which charities or government bodies are best placed to help achieve it. But, in accordance with the Social Policy Bond principle, those who wish to see an objective achieved do not need such expertise. Instead the philanthropists could proceed by depositing some of their funds into an escrow account at a trustworthy financial institution. These would be their contribution to the cause of female literacy in Pakistan. They could then call on members of the public to swell this account by making their own contributions. This contents of the account will be used to redeem 'Female Literacy Bonds', which the philanthropists would issue and promise to redeem for $10 each once a specified female literacy rate for females in Pakistan has risen to 95 percent. They would probably add certain provisos into the redemption terms. For instance, they would probably not wish to see a rise in female literacy at the expense of male literacy, of basic health programmes. So they could stipulate that the bonds shall not be redeemed if the male literacy rate falls, or if health indicators for the Pakistani population show a decline.

The literacy goal would need to be monitored by some reputable and trusted body. It might be that there is already such a body, impartially and reliably measuring the literacy of Pakistani girls and women. If not, the philanthropists will have to organize their own. This body could perform standardised tests of representative but random samples involving hundreds of Pakistani girls and women. Only when the female literacy rate as measured by this body does reach 95 percent would the philanthropists instruct the escrow account managers to redeem the bonds.

Once issued, the Female Literacy bonds would then be sold on the open market for whatever price they will fetch. (Any proceeds could be used to cover administrative costs, or returned to the philanthropists, or used to enable the issuers to add to the number of bonds issued for this, or other, social goals.) Who would buy the bonds? The Pakistani Government, currently the largest current supplier of literacy-increasing services, might decide to buy some or all of them. It would then be in a position to reap financial rewards by doing what it could to increase the literacy of Pakistani schoolchildren. It could do this by channelling resources into expanded or improved literacy classes. It might, for example, change the school curriculum to give literacy in colloquial Urdu a higher priority, or it could decide to strengthen and enforce laws against truancy. It could broadcast literacy programmes on television and conduct research into the most efficient ways of increasing literacy in its society.

If at any time others thought they could do a better job than the Pakistani Government, they would be in a position to bid more for the bonds than their current market value, and buy them from the Government. Similarly if the Government did not want to be actively involved: people and institutions, based in Pakistan *or anywhere else*, could buy the bonds instead and work to modify or supplement the Pakistani school system's literacy teaching. While the targeted literacy goal would be more readily achieved by the support and participation of the Pakistani Government, *it would not rely on such support*.

Given the gap between the current female literacy level and the target, the bonds might at first sell for a fraction of $10. Some people might buy the bonds at these very low prices and just wait for their price to rise, much as they would buy a lottery ticket, wishing to become free-riders (see chapter 4). But what would happen then? The value of the bonds would fall still further. The lower the value of the Female Literacy Bonds falls, the more profit people can make if they buy the bonds and then do something to raise the literacy rate of girls in Pakistan. The bonds would be tradable so people can sell them whenever they want. If somebody thought they could do something to raise the female literacy level, then they would buy bonds and make a profit on the increase in value as it became more likely that the target will be achieved quickly. They wouldn't have to wait till the objective had been achieved: the market would value their bonds more highly, even before redemption. The bonds would most probably end up in the hands of a few large holders, who would have incentives to co-operate with each other, and to finance those projects that they believed would be most effective in raising the level of female literacy.

Advantages

The advantages as well as the mechanics of Female Literacy Bonds would be the same as for any other Social Policy Bond issue. There are many funding programmes that distribute cash to favoured activities, organizations or individuals, but Female Literacy Bonds would *inextricably* link payments to the targeted *outcome*: a female literacy rate of 95 percent in Pakistan. Unlike programmes currently run by governments or non-governmental organizations the bonds would encourage diverse, responsive and cost-effective projects. The prospect of financial reward would motivate and enlarge the pool of people with an interest in raising female literacy in Pakistan. Bondholders would gain most by ensuring that the goal is reached quickly. The philanthropists who issue the bonds could try to accelerate progress toward their goal (and mitigate attempted free-riding) by stipulating a time limit for its achievement, beyond which they will not redeem the bonds. They would make no assumptions as to *how* to raise female literacy — that would be left to whoever buys the bonds, who have every incentive to maximise the increase in female literacy in Pakistan for each dollar they spend.

Any doubts about how effective groups of motivated individuals can be when government efforts appear to have achieved little should be dispelled by the research done by James Tooley, who looked at private schools for the very poor in developing countries.[3] Typically these are small, shabby operations, sometimes occupying a single classroom, staffed in some cases by just the teacher-proprietor and an assistant. Fees can be less than ten US cents per day. Despite the fears of some aid organizations, these schools '...everywhere were outperforming the government schools in the key curriculum subjects – even after controlling for background variables.' Even when the per pupil teacher cost was calculated 'private schools came out less expensive: In the government schools in Lagos State, for instance, per pupil teacher costs were nearly two and a half times higher in government than in private schools.'

Holders of Female Literacy Bonds can do things that other organizations cannot. While charities, for instance, do marvellous work with limited resources they cannot routinely use their funds to bribe officials either to do their job properly or to look the other way. Nor can they deliberately undermine those in power who can obstruct their work. They cannot, in short, play hardball even when doing so would greatly benefit thousands of ordinary people. But it is not solely a matter of standing up to the obstructive politicians, the corrupt bureaucrats, the well-meaning idealists, the ill-meaning ideologues, the generals, or the men of religion who in many countries wish to keep their people ignorant and poor. It is also a matter of bringing financial self-interest to bear.

Holders of Female Literacy Bonds would have incentives to carry out a wider range of literacy-raising initiatives than either governments or non-governmental organizations, and to do so more cost-effectively. As well as bypassing – or buying off – the people in authority who may be blocking progress toward higher literacy rates, bondholders could lobby the Pakistani Government to give a higher priority to literacy in schools, or they could develop literacy-teaching projects of their own. They might finance production and broadcasting of literacy programmes for television, or set up village schools, or give prizes to the most literate families in villages. It would be up to bondholders to decide on those programmes that will give them the highest increase in female literacy per unit outlay. As we saw in chapter 5, the market prices of the bonds and the changes in these prices over time would supply helpful information as to how fast the objective were being achieved, and as to whether more funds would be required for this long-term project. The market prices of the bonds would be publicly quoted, just like those of ordinary bonds or shares.

Some in the Pakistani Government, religious institutions, or militant organizations might resent the targeting of such objectives by external agencies in this way. But the bonds would present a way of increasing literacy that can modify or circumvent these people's uncooperative or obstructive behaviour; a way that can co-opt or subsidise those who want to help, and at the same time bypass, distract, or otherwise undermine, those who oppose the literacy goal. As well, while under the current system people can oppose literacy teaching in ways that attract support, under a Female Literacy Bond regime, they would have openly to declare their opposition to female literacy itself. There might be some who would do this, but it's likely that most of those who are currently obstructing female literacy would be reluctant to do so. It is precisely this focus on the *outcome*—rather than activities or institutions—that would help strengthen the coalition working to achieve it.

In summary, the advantages of a Female Literacy Bond regime over conventional methods of raising literacy would be similar to those arising from other Social Policy

Bonds: they include enhanced cost-effectiveness, stability of policy goals for what would most probably be a long-term objective, transparency, and more attractive money flows.

Private sector Social Policy Bonds for all

Who might be interested in privately issued Social Policy Bonds, and why?

- Philanthropists and others who are cash-rich but time-poor and have high ideals that can be expressed as quantifiable social and environmental objectives. They could collaborate and issue their own Social Policy Bonds, setting up an escrow account for funds to redeem them. Less wealthy people – ordinary members of the public – could be asked to swell this account by depositing their contributions into it.

- Organizations in the public or private sector already involved in trying to achieve the targeted objective. They could seek funding from holders of the relevant Social Policy Bonds, who, if they believe these organizations' activities are efficient will find it worthwhile to help finance their existing projects.

- People could set up new organizations specifically to buy the bonds, work towards the targeted objective, and sell their bonds once they have risen in value.

---

[1] *Teacher, don't leave them kids alone,* 'The Economist', 4 April 2007.

[2] *Inside the madrasas,* William Dalrymple, 'New York Review of Books', 1 December 2005.

[3] *Educating Amaretch: private schools for the poor and the new frontier for investors,* James Tooley, 'Financial Times', 17 September 2006. Available online at: http://tinyurl.com/6regwj, sighted 19 July 2008.

Chapter 8

Social Policy Bonds, policy and politics

This chapter tries to show that the flaws in current policymaking are systemic, that they have led to serious disenchantment with politics and that Social Policy Bonds may attract wider public participation and more public buy-in to policymaking.

How is policy currently made: incremental adaptation

> [N]atural selection proceeds via a narrow point-to-point pathway, not a wide all-encompassing one. In solving any given problem it can make use of only what happens to be available at that particular time. Black leaves might be superior to green, but no new structure will appear... unless it is immediately adaptive.... Thus green leaves dominate because they happen to have come along before black ones, and also because chance uncovered no route from green to black that was adaptive at every new step.[1]

This process is analogous to that by which policy is currently made. Incremental adaptation and historical accident have left us with the decision-making bodies of today. These include not only government and its myriad agencies, but private sector corporations, religious bodies, interest groups, non-governmental organizations and individuals. There's no inherent reason why these bodies will somehow generate solutions to such new and global problems as climate change, or nuclear war. They have, as we saw in chapter 1, proved incapable of putting a swift end to the perverse subsidies. They have not halted such threats as nuclear proliferation. They have favoured, and in many places, imposed, an infrastructure that locks us into a development process heavily biased in favour of large corporations and against our physical and social environment.

In both evolution and society, what's missing is a long-term strategy. Take one, global, example: there is no question that the employees of the United Nations do genuinely want to see an end to (say) climate change but as an institution its focus is on the immediate: it looks at *what it thinks* is the next step forward, *taking where it is now as a given*. And why not? Evolution has not only proceeded in that direction; we, as individual products of such a process, embody the assumption that incremental adaptation is the best way of proceeding. For the most part, it is: where there is mutation and consequent diversity and sufficient time for evolution to winnow out the unfit, the fittest do survive. But the current policymaking world has little scope for the competition that sees an end to unfortunate mutations. Government and big business are dominant. They don't necessarily terminate failed policies. The vested interests are so deeply entrenched, the global challenges so urgent, the level of aggregation at which problems need to be solved is so high, and the world is so much smaller, that the Darwinian method of allowing optimal solutions to emerge from what is not that wide a range of possibilities will probably not work. There is too little time to wait for incremental adaptation to address, say, climate change or nuclear proliferation. And we have only one planet; the result of a successful policy mutation may not only be too late, but can be swamped too readily by the wrong choices. From the viewpoint of social Darwinism, we have something close to a policy monoculture. Evolution of policymaking systems has too little time to play a major role.

This contrasts with the role that evolution can play within the Social Policy Bond paradigm: when bonds are issued, people have incentives to explore, refine and try out new ways of doing things, and to exploit only the most successful approaches. There will be a hugely more abundant diversity of, for example, different – and varying – potential solutions to climate change than there is of different political systems. The combination of diversity and adaptability can succeed within an outcome-focused paradigm like a bond regime. But there isn't enough scope for it to select the paradigm itself against the entrenched existing policymaking systems.

There is also the question of what we mean by 'fittest'. In biological evolution, the fitness that Darwinism favours is reproductive fitness. Someone who leads a miserable, diseased life, has plenty of children, and dies at age 20 is more fit, in this sense, than a healthy, happy but childless person who lives to be 100. Fitness in the policymaking world may have a similarly narrow meaning: a system that is fit in evolutionary terms need not be the one that maximises the well-being of its people, especially in a world where any group of moderately well-off misanthropes can increasingly access technology that can threaten anybody else. (Present-day North Korea for instance.) It so happens that in recent decades, by and large the societies (or coalitions of societies) that were militarily most successful were also the ones that delivered the largest economic surpluses to their population, and that such surpluses were correlated with well-being as well as military success. But there is no inevitability about such correlations. The relationship between economic and destructive power breaks down if you have a regime as nasty as, say, North Korea. And the link between economic wealth and the power to threaten also breaks down, if you have regimes sufficiently misanthropic, deranged or suicidal.

This is the end point of the political monoculture (see chapter 2). It's not necessarily the domination by government and the big corporations that constitute the problem. It's the fact that together they form, in effect, one policymaking body, with little scope for creative diversity along Darwinian lines. We still have the possibility of adapting, but more and more it is brought into the service of government and big business, and the objectives of those organizations are, at best, different from those of ordinary persons and, at worst, in conflict with them.

The logic of incremental adaptation

Incremental adaptation tends to focus on narrow, quantifiable goals. One public sector manifestation has been the proliferation of micro-targets that, with the limited vision of a government agency, seem perfectly reasonable, but from the point of view of society are meaningless at best (see chapter 1 'Meaningless numerical targets'). In parallel, the private sector had developed 'enterprise systems', or ES, which 'bring together computer hardware and software to standardize and then monitor the entire range of tasks being done by a company's workforce.'[2] In other words, they reduce complex human activities to a series of processes that can be mapped out and programmed by a computer It is ES that the Wal-Mart corporation has applied to the retain economy, to the great benefit of its shareholders and customers. 'It relies on electronic tags, sensors, and "smart" chips to identify goods and components at different stages of the production and distribution chain, a practice that has brought enormous gains in productivity. Such innovations allow managers to find out immediately not only that production and distribution are falling behind schedule, but also why.'[3] The benefits, in the form of enhanced labour productivity, are obvious.

The health care industry in the US has seen widespread application of ES. Managed care organizations (MCOs) apply ES with the aim of standardizing and speeding up medical care, 'so that insurance companies can benefit from the efficiencies of mass production: faster treatment of patients at reduced cost, with increased profits earned on increased market share. This seems to work only from the very narrow perspective of the MCOs' accounts.' It is the narrowness of that perspective that is the relevant issue here. The patients aren't happy: they 'experience similar frustrations (and worse) to those that all of us feel when ringing a call-centre - where ES is also widely used.' Nor are the workers:

> [T]he widespread use of enterprise systems has given top managers much greater latitude to direct and control corporate workforces, while at the same time making the jobs of everyday workers and professionals more rigid and bleak. The call centers of the "customer service" industry, where up to six million Americans work, provide an egregious example of how these workplace rigidities can make life miserable for employees. At call center companies … agents must follow a script displayed on their computer screens, spelling out the exact conversation, word for word, they must follow in their dealings with customers. Monitoring devices track every facet of their work: minutes spent per call, minutes spent between calls, minutes spent going to the bathroom.[4]

There's nothing intrinsically wrong with all this. In a diverse, adaptive corporate environment, the disadvantages of ES would in the long run penalise the companies that apply them. Frustrated customers would shun them, and employees, 'dissatisfied with the destruction of a sense of community in the workplace'[5] and with few career prospects, would look for work elsewhere. ES after all, are a tool, and if the companies that use them don't prosper, they will learn to deploy others.

But what about when there is no real competition? Increasingly ES is being applied to bureaucracies, white-collar business, and universities. And if government and the bigger corporations apply ES, or more broadly, any dysfunctional, incremental approach to achieving their limited objectives, then the result would be an entrenchment of an organizational monoculture, where there is no genuine market either for customers or employees. What works very well as an enterprise-level tool in a competitive environment, can fail spectacularly when markets are distorted and government and big business together are so dominant that they leave no room for a longer-term approach, geared toward solving broad social and environmental problems. Our policy monoculture more and more resembles that of a large corporation running Enterprise Systems, in which short-run, narrowly-focused goals predominate.

> Look at [the US intervention in] Iraq. If the US said they were going to leave on a certain date, then for every week without any killings, the date would move forward, and for every week with a killing, the later and later the date would be delayed. This way those who killed would not be seen as heroes but those keeping the Americans in the country.[6]
> Edward de Bono

We cannot know whether this would work, but Mr de Bono is surely correct when he says that we 'have to be open to possibilities and willing to explore'. That there is little chance of his idea being seriously considered by the decision makers is the key point. There is an urgent need now for a policymaking system that allows the possibility of development other than along lines laid down a long time ago, and in a manner other than subordinate to short-term, narrowly-based organizational goals. What would be a sure sign that we don't have such a system; that policymaking has developed such that its goals are quite different from those of the people it is supposed to serve?

The widening gap between policymakers and people

Writing about the United States Government's perceived need to 'reframe pretexts not only for [military] intervention but also for militarized state capitalism at home', Noam Chomsky says:

> It is sometimes argued that concealing the development of high tech industry under the cover of "defense" has been a valuable contribution to society. Those who do not share that contempt for democracy might ask what decisions the population would have made if they had been informed of the real options and allowed to choose among them. Perhaps they might have preferred more social spending for health, education, decent housing, a sustainable environment for future generations...as polls regularly show.[7]

They might – or they might not. But it would be better if they had the option. So even in the democratic United

States people feel they have little to contribute to decision-making and their feelings are accurate. Graphic novelist Marjane Satrapi says:

> If I have one message to give to the…American people, it's that the world is not divided into countries. … You are American, I am Iranian. We don't know each other, but we talk together and we understand each other perfectly. The difference between you and your government is much bigger than the difference between you and me. And the difference between me and my government is much bigger than the difference between me and you. And our governments are very much the same.[8]

It's especially poignant ('We, the people....') that Ms Satrapi can accurately point to the gap between the American government and American citizens. Big government is not necessarily a problem in itself, but it tends to come with remote government – which probably is. We saw, when discussing perverse subsidies in chapter 1, examples of how sizable transfers from (big) government can entrench the influence of large corporations, in ways that at the very least, are not positively approved of by most ordinary people, and at times conflict with, for example, smaller businesses and the environment. Big government is self-entrenching in that way. It is comfortable dealing with (and accepting campaign funding from) big corporations, who enjoy explicit subsidies, as well as a favourable regulatory environment, and the implicit subsidies of a government-funded infrastructure and (often) economic protection.

Governments confuse the fortunes of big business with those of the wider economy, and those of the wider economy with those of society. One result is that the individual citizen in most democratic western countries probably *does* feel as remote from decision making as does the average Iranian citizen. We have a policy monoculture not only within countries, but at least in terms of responsiveness to individuals' needs, between countries.

Buy-in an end in itself

One indication of the gap between policymakers and the people they are supposed to represent could be the contrast between objective measures of citizens' well-being and how people actually feel. Musing upon Britons' unhappiness with their current condition, as shown in opinion polls, books with titles like *Time to Emigrate?*, and emigration figures themselves, is *the Economist*:

> Though the British have always been hypochondriacs, earlier bouts of intense self-deprecation—after the war, when bread was rationed and the empire fell apart, or the discontented late 1970s—have coincided with real hardship. By any sane measure, the current grouching doesn't. ... Even the maligned public services have improved.... Most, for example, report that their own encounters with the National Health Service have been good. ...But these inklings [of British good fortune] tend to be submerged in the mud of disgruntlement: the same public is

> convinced that, in general, the NHS is a wreck. What explains this disconnect?[9]

The Economist attributes the grouching and disgruntlement to hypochondria, but it is likely that the lack of buy-in to policy is responsible. Government in Britain is extremely centralised.[10] It seems likely that Britons would be less miserable about their condition – even if their health service, cultural makeup, educational achievement, and the rest were exactly the same, objectively – if they had been allowed more participation in the political processes that had brought it about.

There is solid research to back up that suggestion. Switzerland has a federal structure whose 26 cantons have use assorted instruments of 'direct democracy', notably 'initiatives' to change the canton's constitution, and referendums to stop new laws, change existing ones, or prevent new public spending. Cantons vary in the ease with which these instruments can be used. University of Zurich researchers showed that, after allowing for other variables, the more democratic the canton, the more people living there reported being happy:

> Messrs Frey and Stutzer [found] that a one-point increase in this democracy index, after stripping out the effects of the other variables, increases the share of people who say they are very happy by 2.7 percentage points. What this means is that the marginal effect of direct democracy on happiness is

> nearly half as big as the effect of moving from the lowest monthly income band to the highest.[11]

Is that a result of the outcomes of the process making people feel better, or is it the process itself? Participation in initiatives and referendums is restricted to Swiss nationals. Foreigners living in Switzerland aren't allowed to vote in the Swiss initiatives and referenda, so they will experience the outcomes of more consultative government but not the benefit of taking part in the process. In fact, Frey and Stutzer's data show that 'that direct democracy improves the happiness of foreigners and Swiss nationals alike—but the increase for foreigners is smaller, only about one-third of the increase for nationals.' In other words, it wasn't just the effect of the decisions made by direct democracy that led to greater well-being. The *participation in the process itself* accounted for most of the increased happiness.

Immigration to the west is one subject on which buy-in is especially important. Consultation on such a sensitive subject could make a lot of difference, not necessarily to the immigration statistics, but to the far less quantifiable but at least as crucial matters of attitudes and trust. Lack of consultation, has not helped:

> A bleak picture of the corrosive effects of ethnic diversity has been revealed in research by Harvard University's Robert Putnam, one of the world's most influential political scientists. His research shows that the more diverse a community is, the less likely its inhabitants are to trust anyone – from their next-door neighbour to the mayor.[12]

It may be that people would willingly have traded some loss of a sense of community in return for the possible economic gains resulting from large-scale immigration into the rich countries, but it is worthwhile asking where the initiative for such immigration, and why it has been allowed to occur with so little public participation. It might be that with full consultation the same number of migrants (or even more) would have been permitted entry. When it comes to hosting migrants from many different cultures and backgrounds, public participation and the buy-in it generates are essential. It's not the result of the process that is necessarily important, it's the process itself. It seems certain that immigrants would both be more welcome and feel more welcome, if their entry had been decided by the public, rather than, as appears to be the case, the short-term financial needs of big corporations.

The problem is that, with exceptions like the Swiss cantons, we don't have the machinery for such consultation, even where, as in immigration, the implications of a policy can be readily understood by everyone. Of course, in many cases policy is expressed in less accessible terms: institutional structures, spending allocations, micro-targets, or legislative or regulatory measures.

Outcome-based policy can reconnect

Social Policy Bonds, because they express policy goals in terms of outcomes that are meaningful to ordinary people, could help reconnect government with the public. If people understand what a policy is all about they can participate more in its development, refinement and implementation. Outcomes are more comprehensible to more people than the unconsidered, unstated, vague, or platitudinous goals that characterise current policymaking. If people have the chance of participating or at least understanding discussion about policy, they will also understand the limitations and trade-offs that are intrinsic to public policymaking. They are likely then to buy in to policies; to reconnect with policymakers by the sharing the responsibility for policy initiatives.

This matters hugely when government has to rein in activities to which we have become accustomed, in the face of new threats. Climate change is a prime example: a problem that demands a coherent response to an unforeseen but urgent challenge. Of course buy-in would be desirable in other areas too. The current system, because of the widening gap between policymakers and citizens, discourages buy-in. Expressing policy in terms of identifiable outcomes would help close that gap, but it is only a necessary, not sufficient, condition for engaging a wider public: our experience of immigration policy tells us that even when the meaning of a policy is comprehensible the public is rarely consulted. But this could be largely a question of habit – something that a Social Policy Bond regime would quickly break.

If the public did play a more active role in policymaking would it add anything of value apart from the substantial benefits arising from that involvement in the process?

It was in 1979 that the US Public Health Service (PHS) first set national health goals.[13] Goals to be achieved by 1990 included a 35 percent reduction in infant mortality, a 20 percent reduction in childhood deaths, a 20 percent death rate reduction for adolescents and young adults, and 25 percent death rate reduction for adults aged 25 to 64 years. For persons over the age of 65, the aim was to reduce the number of disability days, with the goal of improving the quality of life for older adults.

These are all meaningful, clear goals, and it actually gets better. For the next stage, the PHS developed papers on 15 disease prevention and priority health promotion areas. After consultation with 167 experts, draft objectives were circulated to more than 2000 organizations and individuals for review and comment. The result of this collaboration was *Promoting Health/Preventing Disease: Objectives for the Nation*, published in 1980.[14] This set 226 objectives with targets for achievement by 1990, and laid the foundation for a similar exercise ten years later. A draft of objectives to be achieved by the year 2000 was released in September 1989. Public comment was invited and used to create a consensus document, *Healthy People 2000,*[15] which launched a 10-year national initiative to improve the health of all Americans. The result?

> A comparison of the 1989 draft of the objectives with the final 1990 publication does show that substantial revisions were made based on public comment.[16]

This exercise shows that *it is quite realistic to expect valuable contributions from the public when policy is expressed in terms of broad, targeted outcomes*. Expertise will be needed to help develop and refine numerical targets but the public's contribution is extremely valuable. It overcomes the danger that targets chosen by public agencies will be influenced by the objectives of these bodies, principally self-perpetuation, which are not always in line with those of citizens. And it generates invaluable buy-in: public understanding of and support for a policy it helped to create.

More generally, getting the public to participate in setting goals for Social Policy Bonds would require more than just the government's willingness to relinquish some control. Presentation of policy options in the form of targeted outcomes will help, but there will still be a need for a better-educated public. Basic economic principles should be more widely taught, for instance. There is a strong case too for more widespread statistical knowledge, and especially for more accessible presentation of statistical facts. It is not only the public that is woefully under-educated in this respect: the usual expression of probabilities as percentages rather than natural frequencies makes them far more difficult to understand, even for the experts, in fields as critical as health care and law courts.[17]

Social Policy Bonds would combine efficiency in achieving social goals with transparency about exactly what these goals would be and how much they would cost to achieve. This combination of efficiency and transparency could generate its own dynamic and transform policymaking. It would take away much of government's discretion as to which bodies, corporations or interest groups receive public funding. The thrust of political debate would shift away from discussion about policy instruments and declarations of increased agency-based spending; as though these were sufficient measure of a government's contribution to achieving social goals. Instead the entire political process could shift towards:

- more consultation with citizens as to what society's social and environmental goals should be,

- exploring and articulating information about the trade-offs that are involved in achieving specified goals,

- defining society's goals in terms that people can understand and that are measurable; these goals would be explicit and would appear on election manifestos: their relative priority would be a matter for open political debate, and

- organizing appropriate issues of Social Policy Bonds, and redeeming them once targeted social and environmental outcomes had been achieved.

Initially at least there would be some public services, such as defence, whose outcomes are difficult to define and quantify. And government would still have some discretionary powers to allocate finance to meet unexpected events, such as civil defence emergencies. But outcome-based policy, which would be the defining characteristic of a Social Policy Bond regime, would remove some of government's discretionary power over how it spends its revenues. Naturally then, there would be some opposition to a government-backed bond regime.

Opposition and support

There would most probably be resistance from people already in the public sector: those who currently face very limited competition in supplying services that would be made contestable under a Social Policy Bond regime, and civil servants who administer transfer and subsidy programmes. Public sector trade unions could be expected to resist Social Policy Bonds, in the same way as they have opposed privatisation, the UK's Private Finance Initiative and education voucher schemes in the US and UK.

Many of these people's jobs would probably gradually disappear during the transition to a Social Policy Bond regime, but of course there would be more, and more fulfilling jobs, created in a Social Policy Bond environment.

Politicians might also oppose Social Policy Bonds, despite the likelihood that the bonds would achieve their stated objectives more readily. This opposition would come from a natural desire to hold on to power – in this instance the powers to dictate *how* social and environmental goals shall be achieved – that a Social Policy Bond regime would, within limits, transfer to the private sector. Other opponents could be those who believe they benefit from the current array of transfers and subsidies, including those in industry and agriculture who benefit from perverse subsidies and import barriers, as we saw in chapter 1, and who would suffer from the removal of their special privileges, at least in the short term. Many of these privileges are granted only because the identity of their beneficiaries and their true costs to everyone else are not widely known, as they would be under a bond regime. Opposition to a bond regime could also come from some better-off consumers of subsidised goods or services, who might be surprised to learn exactly how much their activities benefit from lavish taxpayer subsidies. But much of this opposition would be eased by a gradual transition to a bond regime, and an appreciation of its long-term benefits.

Support for a bond regime is likely to be more muted because the benefits would probably be more diffuse. Some in government would be keen on the bonds, because they would enjoy playing to their strengths: identifying, articulating and anticipating society's goals, and raising the revenue necessary for their achievement. Government would not suffer from today's disdain and cynicism, as it would not automatically be blamed for goals that were not achieved.

In the long run, after Social Policy Bonds have been tried and refined, support for government-backed bonds should come from those who are sincere in their wish to see improvements in the position of the poorest members of society and in the provision of public goods — and many politicians do fall into this category. These people would concentrate their energies on promoting the use of Social Policy Bonds that target the well-being of their constituents. In general, the poor, and those who claim to represent them would support the bonds — if they were open-minded, and after experimental trials of the bonds had been shown to work. But most importantly of all would be the support from taxpayers once it became clear that targeted outcomes could be achieved at less cost to themselves and that they would not have to assume the risk of failed programmes.

Size of government

What would Social Policy Bond-issuing government look like? Much of the debate about government spending in the developed countries centres on its size rather than its efficiency. The two are linked, at least rhetorically. It is hard to voice the case for reducing the size of government when many so many social and environmental problems persist. Yet it is arguable that they persist because the government programmes that are supposed to solve them are inefficient. If problem-solving became more efficient under a bond regime, what would that mean for the size of government?

A government issuing Social Policy Bonds could most likely achieve its existing goals more cost-effectively, and so might lower the taxes it imposes on its citizens. A reduced tax burden would generate benefits in a number of ways:

1. Lower taxes reduce the burden to the economy by more than the taxes themselves. This is only partly because of savings in the administration costs that taxes impose. More important are the so-called deadweight costs of taxes. These arise because of the way taxes distort production and consumption behaviour. They mean that even if all tax revenue were handed straight back to producers and consumers, the economy as a whole would be worse off than if there were no taxes. Deadweight losses would be much reduced in a lower-tax environment.

2. Tax cuts have acquired something of a bad name in recent years, as their major beneficiaries tend to be wealthy, well-advised individuals and corporations. But under a bond regime the poor would benefit not only from more efficient provision of services currently supplied by government, but also from future tax cuts. In many countries low-income earners face proportionately high marginal tax rates paying, as they do, both income taxes and social security taxes. Their employers may also be paying a payroll tax. While a general cut in taxes would benefit the already wealthy, the poor would also gain significantly.

3. Facing lower tax bills, people might feel more willing and sufficiently wealthy to get together to solve social problems that are addressed badly or not at all by the current system. They might even issue their own Social Policy Bonds, perhaps to address local concerns or urgent problems in poorer countries.

4. Many people object to big government not only on the grounds that it is inefficient, incompetent or worse, but also on the grounds that it infringes the liberty of its citizens, by virtue of size alone. For these people, smaller government would be an end in itself.

But there might well be a countervailing influence in the other direction. Because government would be more efficient and its goals more transparent and subject to consensus, people might well be willing to allow it a *larger* role. New environmental concerns are bound to present themselves, and the outcome-orientation of Social Policy Bonds could make government less wary about stipulating goals too in other areas, such as crime, where there is consensus over what results are required, but little agreement on how to achieve them.

In short, Social Policy Bonds would be compatible with smaller or larger government. Either way, though, because of their focus on identifiable and meaningful outcomes, the bonds would reduce the distance between government and citizens.

[1] *Our biotech future*, letter by Raymond Firestone to the editors of the 'New York Review of Books': 11 October 2007; available online at http://www.nybooks.com/articles/20680.

[2] *They're micromanaging your every move*, Simon Head, in a review of The Social Life of Information by John Seely Brown and Paul Duguid, Harvard Business School Press, January 2000, ISBN 9780875847627. Available online at: http://tinyurl.com/6foqud.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] *Edward de Bono: 'Iraq? They just need to think it through'*, Angela Balakrishnan, 'The Guardian', 24 April 2007. Available online at http://tinyurl.com/5su5xe, sighted 19 July 2008.

[7] *Failed States: The Abuse of Power and the Assault on Democracy*, Noam Chomsky, Metropolitan Books, April 2006, ISBN 0-8050-7912-2 (page 127).

[8] *Sexual Revolutionaries*, Michelle Goldberg (interviewing Marjane Satrapi), Salon.com, April 2005. Available online at http://tinyurl.com/5p3z3s, sighted 19 July 2008.

[9] *On hypochondria,* 'The Economist', 7 June 2007.

[10] See, for instance, *Our regional viceroys must be answerable to voters*, Philip Davis, 'The Guardian', 29 March 2006. Available online at http://tinyurl.com/6zlqjo, sighted 19 July 2008.

[11] *Happiness is a warm vote,* 'The Economist', 17 April 1999.

[12] *Study paints bleak picture of ethnic diversity,* John Lloyd, 'Financial Times', 8 October 2006. Available online at http://tinyurl.com/68wm3b, sighted 19 July 2008.

[13] *Healthy people: the Surgeon General's Report on Health Promotion and Disease Prevention*, Public Health Service, US Department of Health, Education and Welfare, 1979. Publication No PHS 79-55071.

[14] *Promoting Health/Preventing Disease: Objectives for the Natio*n. Washington, D.C., U.S. Dept. of Health and Human Services, 1980.

[15] *Healthy People 2000: National Health Promotion and Disease Prevention Objectives*, US Department of Health and Human Services, Publication No PHS 91-50212, 1990.

[16] *Objectives-Setting for Improved Health: The Public Health Service Healthy People Program*, 1990, page 4. Html version available online at http://tinyurl.com/56qfge, sighted 19 July 2008.

[17] *Calculated Risks: How to Know When Numbers Deceive You,* Gerd Gigerenzer, Simon and Schuster, 2003, ISBN 0743254236 (pp41-3).

Chapter 9

Objectives for a Social Policy Bond regime

Social Policy Bonds may have advantages when targeting of large, complex problems. We look briefly at such examples in the first part of the chapter: including poverty Africa, nuclear proliferation, war and environmental catastrophe, and other public goods and services. But the bonds are not the best way of solving all society's problems. The current system - largely one of top-down implementation of specific projects – can work well for problems whose the causes are easy to identify, for which the solutions easy to deduce, and that will respond predictably to regulation or legislation. The second part of this chapter looks at the limitations of a bond regime.

Poverty in Africa

When a government or global body nowadays targets a policy goal as broad as 'poverty in Africa', we are probably right to see it hopelessly idealistic. That's partly because we know from experience that under the current system such good intentions, even if backed up by millions of dollars, rarely translate into meaningful improvements in well-being. So, after 43 years and $568 billion (in 2003 dollars) in foreign aid to the continent, Africa seems doomed to economic and political stagnation. There are still many deaths from malaria, including those of children, that could be prevented for tiny sums of money. Medicine that would prevent half of all malaria deaths, for example, costs just 12 cents a dose. A bed net that would protect a child from getting malaria costs $4.[1] William Easterly asks 'why then do comprehensive packages almost always fail to accomplish much good...?' It seems that biggest problem is 'that the rich people paying the bills do not share the same goals as the poor people they are trying to help. The wealthy have weak incentives to get the right amount of the right thing to those who need it; the poor are in no position to complain if they don't.[2] The problem is compounded by poor governance: essentially greedy and corrupt politicians and officials. To their credit, givers of aid to Africa have recognised this:

> The latest aid-givers' consensus is to identify "good" countries, still quite a small bunch, and let them spend the cash as they see fit. Yet time and again, good guys—most recently, Ethiopia's Meles Zenawi and Uganda's Yoweri Museveni—slip back into old despotic ways, putting aid-givers into a quandary.[3]

The top-down approach to aid continues to be, with some exceptions, a disaster. It's uncoordinated and unaccountable and channels billions to corrupt leaders who steal or squander the money. If it does try to measure its success it does so by monitoring adherence to questionable ideological criteria (see chapter 1 'Ideology') or the volume of aid dollars pledged or spent. Not, in short, by meaningful results. From the pragmatic point of view, it doesn't matter whether this human tragedy is a result of tribalism, colonial history, genes, kleptocratic or psychopathic leaders, or whatever. It is most practical to see it, as does Easterly, as a problem of perverse incentives. And the fact is that there are few incentives for those with the cash and capability to spend money where it will yield the largest improvement in welfare per dollar, and there are big financial rewards to those who would deny the poor the small sums that could dramatically improve their welfare.

Some African governments are quite cynical: they are quite happy to bargain away their citizens' lives and well-being for a few more years in power. A Social Policy Bond regime targeting poverty in Africa could change all that. It could mobilize people to eliminate government corruption, or to bypass or undermine recalcitrant governments, in order to achieve basic human needs for their people. The bonds, whether backed by concerned governments outside Africa, or by wealthy individuals or non-governmental organizations anywhere, could generate incentives for such a mobilization. They would rejig the incentives in accordance with the wishes of those who put up the funds to redeem the bonds.

And Africa's problems are so desperate that the continent's well-being can be accurately targeted by quantifiable indicators, such as morbidity, literacy, infant mortality, longevity and caloric intake – which is not always true in the rich world. Work on applying the bond principle to the poorest countries in the developing world is made easier by such pre-existing metrics as Human Development Index, which is a broadly-based measure of development as measured by literacy, school enrolment, life expectancy and income.[4] As well, the World Bank[5] and United Nations[6] publish tables of social indicators of development. These metrics could be readily adapted for targeting by Social Policy Bonds. In chapter 3, we looked at the criteria that those social problems favouring the bonds over conventional solutions. They are, in brief: that the problems are complex, with few obvious causes; that existing policies are vague and ineffectual; and that rewards to problem-solvers are not currently linked to their efficiency. Poverty in Africa fits all these criteria, and with the ready availability of indicators of human well-being would seem to be suited to a Social Policy Bond approach.

Environmental disaster and war

There are potential problems even more compelling than poverty. Two important ones are identified by Noam Chomsky.

> The selection of issues that should rank high on the agenda of concern for human welfare and rights is, naturally, a subjective matter. But there are a few choices that seem unavoidable, because they bear so directly on the prospects for decent survival. Among them are at least these three: nuclear war, environmental disaster and the fact that the government of the world's leading power is acting in ways that increase the likelihood of these catastrophes. It is important to stress the "government," because the population, not surprisingly, does not agree. That brings up a fourth issue that should deeply concern Americans, and the world: the sharp divide between public opinion and public policy....[7]

This sums up humanity's predicament accurately, though this author would not ascribe particular blame to the US Government but rather to political systems everywhere, which vary a lot, but are probably most concerned with perpetuating themselves. In an increasingly complex world it's too easy to escape or deflect censure for corrupt or incompetent policies: relationships between cause and effect are too obscure; blame can always be shifted. Political debate mirrors the system's obsession with irrelevance. But clear away the fog of strident commentary and party politics and you will find a high degree of consensus over what people actually want. Chomsky's probably right: most of us would see nuclear war and environmental disaster as humanity's most serious challenges. But our political systems don't allow us to express our concern directly. At best we can choose people who say - amongst many other things - they care about these issues but who, when in power, cannot or will not focus on them. It's not necessarily the politician's fault: they are part of a system whose main motivating principle is basically to keep things going as they are. Hence the chasm between public opinion and public policy.

Chomsky blames the US Government, but we believe that blaming this or that faction is to get dragged into the very system whose failure he so well describes. As with poverty in Africa, pragmatism dictates that we move on from blame and ideology and instead investigate ordinary people's actual priorities. Under a Social Policy Bond regime, these priorities would take the form of outcomes to be targeted. We believe, with Chomsky, that we should then have a clear instructions to deal with the possibility of nuclear war and other major threats to human life, including global environmental challenges, or war in general. Would that be too idealistic?

> If an apparently convincing general solution to the problem of war were achievable, it is probable that someone would have discovered it by now. The fact that none such has yet been promoted suggests that the scholarly campaign against war may have been thoroughly misconceived. ... [War] is simply too rich a subject to be captured, let alone prospectively controlled, by the conclusions of general theory.[8]

In this, writes Professor Gray, war is similar to disease: individual maladies can be treated and even cured but 'disease per se does not lend itself to direct scientific assault'.

To a point, perhaps. In the early days, dramatic victories against disease in general were won by the provision of basic sanitation and clean water, and the direct assault continues with basic health education, food safety legislation and many other activities. True, drug companies benefit by developing new therapies for specific diseases, but there are many basic health precautions that, in effect, do prevent or mitigate all disease. All this is only to say that a combination of specific and general measures have worked dramatically to reduce the incidence of disease in the west. And if with disease, why not with war?

A Social Policy Bond regime would target *all* violent political conflict, including wars within and between states. It would not directly generate solutions to the problem of war, but it would give incentives to those who are currently engaged in conflict reduction and conflict resolution. It would also enlarge the numbers of people willing and able to work toward those ends, whether they aim to defuse specific conflicts or participate in a more general war-reducing effort. We don't need to know in advance which combination of concepts or methods will yield the best result. What we do need are adaptive, diverse solutions to the problems of potential or actual armed conflict in all its myriad manifestations.

Insurance against catastrophe

Cataclysmic war or environmental catastrophe are only a subset of a range of actual and potential problems bedevilling humankind. Others (see chapter 3) are the risks arising from new biological advances or scientific experiments that concentrate energy, or natural disasters such as asteroid impacts or volcanic supereruptions.[9]

Unfortunately the number and likely impact of potential catastrophes is rising. Technology is changing rapidly, and as the world becomes more densely populated and interlinked more and more processes or events that could be conveniently ignored in the past or handled informally now pose a risk to millions of human beings. But it is near-impossible for anyone, including conventional policymakers to identify the most likely future catastrophes and their causes. One lesson from our climate change experience (apart from how little we are doing even now to avoid it) is that we seem to be close to a catastrophe that few could have anticipated when fossil fuels first started to be burned. But climate change actually has had a long lead time and there were people, decades ago, who suspected it might happen.[10] There are now so many potential catastrophes without even those portents that the organizations we hope will help us anticipate and avoid them - government agencies, mainly – cannot realistically be expected to do so.

Government policymaking can succeed when it's well meaning, has sufficient resources and the problems it has to solve are easily identified and do not conflict too much with powerful interests. Unfortunately, many of the new problems arising from denser, more linked, populations and higher technology are difficult even for a well-resourced government, or indeed any single big organization, to anticipate, let alone do much to forestall. These newer threats are in addition to the 'known unknowns' of climate change and other possible environmental disasters. How should we deal with such threats?

One way forward might be to issue Social Policy Bonds as insurance against large-scale disasters. A national government could issue Social Policy Bonds that would reward investors if an *unspecified* event killing more than, say 10 000 of its citizens in any one 48-hour period, does not occur before a specified date, several years hence. The bonds would encourage investors to investigate all sources of potential disaster, *impartially*; that is, without favouring those that have a high media profile, for example, or those that are the remit of existing public or private sector bodies.

Globally, the concept could be scaled up: a collection of governments under the auspices of the United Nations or non-governmental organizations could issue similar bonds, aimed at preventing even larger-scale disasters. Again, the nature or cause of the disaster need not be specified: the bonds would function in a similar way to catastrophe bonds (see chapter 6), except that they would have the explicit purpose of making it worthwhile for investors to prevent disasters happening or mitigate their effects – and sufficient backing to motivate such investors. At both the national and global level, the particular merit of the Social Policy Bond approach is that there is no need for a handful of experts to try to anticipate the causes of future disasters and to allocate funds according to their views with only today's knowledge at their disposal. Investors in Social Policy Bonds would do this work themselves, without bias, and would be motivated to *adapt to new information continuously, during the entire lifetime of their bonds*.

Digression: doing what governments cannot do

Gone are the days when a government could, for instance, recognise that Ms A receiving unemployment benefit (say) does in fact benefit from such a payment, while Mr B's long-term interests would be best served by putting some pressure on him to find a job. Perhaps big, government is necessarily out-of-touch despite its expanding role in our lives. It certainly finds it difficult to adapt and diversify its approach. Under a Social Policy Bond regime, however, it could supply the incentives for investors to adopt the sort of finely-tuned initiatives that it cannot itself practise.

Government finds it difficult to intervene in other areas where its behaviour will be construed as favouritism. Take ethnic or religious conflict, which is often deemed intractable. Existing efforts at inter-communal peace often empower the very people whose authority depends on maintaining and widening the divisions between the communities; which can be a disastrously self-reinforcing process. One way forward might be to encourage intermarriage between the antagonistic communities. For most governments, advocating or even discussing such an idea would be political suicide. But for holders of Social Policy Bonds targeting conflict, it would merely be another tool that can choose to use or not, depending on their view of how effective it will be. If intermarriage is likely to work, it should be tried; and if it does work, it should be rewarded. Under a bond regime targeting the end of violence between communities in conflict, no official programme of sponsored intermarriage need be contemplated. Bondholders, though, could do, or cause to be done, things that governments cannot do. There would be no sinister motives underlying their actions; their motive, clear and comprehensible to all, would be explicitly mercenary with no sinister overtones: to raise the value of their bond holdings.

As human beings, most of us agree that anything that resolves conflict peacefully and at a bearable cost should be encouraged. Apart from fanatics, even the devout on both sides of most conflicts, away from public fora and in their cooler moments, would put human survival above ethnic purity or identity politics. Even a little intermarriage between two warring factions could go a long way. Most likely, under an enlightened Social Policy

Bond regime, rather than being directly encouraged, intermarriage would be the happy outcome of a range of projects aimed at increasing informal contacts between the two sides, including such trust-building measures as lower barriers to trade, school exchange visits, or mixed sports teams. One of the benefits of a Social Policy Bond regime is that it can stimulate actions like these including, if necessary, the direct sponsoring of intermarriage, or the birth of mixed-ethnicity children which, if governments were to undertake them directly, would be met by near-universal disdain and opposition.

Eradicating poverty in the rich countries

Richard Layard finds that there appears to be no link between the generosity of a welfare state and the level of well-being within it.[11] It does appear that beyond certain levels of income and wealth, more money does not make us much happier.[12] But the literature is not conclusive and some studies show a correlation between wealth and happiness *within* nations.[13]

If we accept these findings there would seem to be a clear policy implication, which is that government intervention should focus on the eradication of poverty. This is partly because the implicit dogma that faster economic growth as (badly) measured by GDP per capita means more well-being seems to be mistaken, and partly because is the poor who are most need government intervention and who would most benefit from it by any objective criteria. It is at lower levels of income, nutrition, wealth, or environmental status, where well-chosen numerical variables correlate most strongly with what most of us would consider improvements. We have seen that too much government spending is channelled into the provision of subsidies and infrastructure to corporations, the wealthy and the middle class. Eradication of poverty should be a priority of the governments of the rich countries, whether or not they introduce Social Policy Bonds.

Provision of public goods

National governments should, of course arrange the provision of the public goods such as defence, and law and order. There is no particular reason why a Social Policy Bond regime cannot be deployed to supply these goods and services, though it's more likely that the bonds will have proved themselves in other areas before they can replace current policies. Other services with a strong public service element, such as health, education and housing, especially at the more basic levels, would make good candidates for targeting by a bond regime.

Social Policy Bonds could moreover play an important role where public goods are now only implicitly targeted. Here, explicit targeting would serve to channel resources into maintaining valuable goals that are currently present only by default. These include the avoidance of catastrophic social and environmental collapse (see 'Insurance against catastrophe', above).

Mental health

A Social Policy Bond regime should probably target mental health explicitly, but so too should our current political system. According to the UK's Mental Health Policy Group 'one in six of all people [in the UK] suffer from depression or chronic anxiety, which affects one in three of all families'.[14] Mental health is of course difficult to quantify - to put it mildly. We can readily measure and increase *spending* on treatments like psychological therapy, as the Group advocates. But how are we to know whether such spending is cost-effective, or even effective? One approach could be to take small randomised samples of a population, and measure their behaviour and responses to specific questions or psychological tests. This is similar to the approach taken by crime surveys, which are thought to be more reliable indicators of the level of criminal activity than numbers of crimes reported to the police. These surveys simply poll a sample of people and ask whether and how they have been affected by crime.

In any case, there is no case for ignoring mental health just because, with our current tools, it is difficult to measure. That is more of an argument for developing better metrics. The alternative looks far worse: as with the physical and social environment, with both of which it's inextricably bound up, mental health is in danger of being allowed to deteriorate by default, because nobody got round to quantifying it until the effects of its degradation were too catastrophic to ignore.

In this context, work by Richard Louv is important. Referring to the communities in which 75 million Americans live, he says:

> Try to put up a basketball hoop in some of these communities, let alone build a tree house. The message to kids and parents is very clear: nature's in the past. It doesn't count anymore. The future's in electronics. The bogeyman lives in the woods. Playing outdoors is illicit and maybe even illegal.[15]

As the introduction to Louv's interview says, 'after tens of thousands of years of children playing and working primarily outdoors, the last few generations have seen such interaction with nature vanish almost entirely.' Louv argues that this has incalculable implications for children's physical and mental health, and for the future of environmentalism. At last research linking nature to healthy child development is starting to be investigated, and studies already show that 'prisoners in prisons, people in the infirmary - those who have a view of a natural landscape heal faster.'[16]

What does this have to do with Social Policy Bonds? Conventional ways of trying to solve health problems such as Attention Deficit Disorder or vaguer feelings of anxiety and depression involve specific, targeted, treatments, which can be biochemical, psychological or psychiatric. There's very little interest in trying to *prevent* such problems because there are no institutions that can benefit from doing so. The massed ranks of drug company employees, psychologists and psychiatrists, while they individually may suspect that 'nature therapy' can invigorate communities, do not belong to organizations that can act on that suspicion. There are plenty of incentives in place to sacrifice nature on the altar of economic growth. Against that imperative, the well-being that comes from preserving nature counts for very little. Government-run health services are largely influenced by narrowly-based interest groups. Something as diffuse, unprofitable and poorly researched as nature therapy stands little chance of influencing the direction society takes under the current array of policy drivers.

A Social Policy Bond regime targeting long-term mental health would be different. Bondholders would have powerful incentives to seek out whichever ways of raising mental health are most cost-efficient. There would be no prejudices in favour of existing ways of doing things or existing institutions and lobby groups. They would stimulate, consider and, quite possibly act on research like Louv's, rather than be sidetracked into safeguarding vested interests.

A single quality of life target?

Why not then target a single 'quality of life' indicator for the whole of society, taking into account all quantifiable social and environmental objectives: quality of life, physical and mental health, education level, environmental pollution, crime, homelessness unemployment, leisure time and any others? Surely targeting one single aggregated 'social welfare' indicator would be the optimal approach?

The more obvious objection to doing this is the daunting practical problem of defining a meaningful and measurable indicator of social welfare. The second is even more fundamental. Aiming for an increase in a single social welfare indicator carries with it an assumption that society's needs can be traded off against each other. But for many of the needs for which government usually assumes responsibility such trade-offs cannot be made. For the neediest beneficiaries of government's welfare programmes, a massive increase in priority for, say, health care would be unlikely to compensate for a total withdrawal of government funds from, say, basic education. 'Safety net' programmes in particular are scarcely amenable to trade-offs. In the same way a lowering of the crime rate, say, however welcome it might be, could hardly compensate for the total collapse of a country's physical environment.

Limitations

The discussion above points to the two main limitations of Social Policy Bonds. They don't tell us which targets to choose, and they rely on quantitative indicators, which have their limitations.

How to choose targets

Social Policy Bonds may well minimise the cost of achieving specified social and environmental goals but they don't tell us *which* goals to target. Not directly. Currently the prioritising of social and environmental goals seems to be driven by concerns other than maximising returns on spending. Policies have their proponents and interest groups, and their relative bargaining power often dictates society's policy direction. One organization that does, though, look at 'political triage' is the Copenhagen Consensus. It questions existing political priorities, on the basis that though we should like to solve all the world's problems, resources are limited and we have to prioritise. For instance, it estimates the existing cost of the Kyoto Protocol $180 billion a year and says it will make a minuscule difference to the world's climate, 'delaying temperature rises by just seven days [sic] by 2100'. But it calculates that:

> A tenth of the annual cost of the Kyoto Protocol – or a tenth of the US budget this year for the wars in Iraq and Afghanistan – would prevent nearly 30 million new infections of HIV/AIDS. The same sum could similarly be used to help the four million people who will die from malnutrition this year, the 2.5 million killed by indoor and outdoor air pollution, the two million who will die because they lack micronutrients (iron, zinc, and vitamin A), or the two million whose deaths will be caused by a lack of clean drinking water.[17]

Assuming the figures are correct, it would seem clear that we ought to divert funds away from Kyoto towards AIDS and malnutrition prevention but that is to some extent a subjective view, because we are comparing the seven days delay with human lives saved. Taking the same figures, though, assume that the decision lies between saving the lives of the four million who would otherwise die of malnutrition this year or the 2.5 million killed by air pollution. Then, we are comparing like with like, and the choice should be to save the four million. We can, and should, question the assumptions underlying these figures, but the exercise indicates how, in principle, we can come up with an impartial prioritizing of scarce global resources.

The problem is that, even with all the caveats, such easily compared, objective criteria are rarely to hand. How much, for instance, is biodiversity worth? How is the avoidance of lost biodiversity to be weighed against people's wish for cheaper fuel?

Social Policy Bonds cannot answer these questions, but they can help in two ways. We saw in chapter 5 ('Efficient costing of objectives') how the market prices of the bonds at flotation and thereafter generate estimates of the total and marginal costs of achieving targeted goals. The total cost estimates would be continuously refined and updated by a large pool of motivated observers. They would probably be better estimates than those calculated from the sort of estimates made nowadays: typically one-off calculations performed by a relatively small number of academics or government employees. The marginal costs derived from bond prices would also represent a big improvement over the information currently available to decision-makers, once they have decided which projects to support. Ultimately, these decisions will have to be made on a political basis. But here again, a Social Policy Bond regime could help: a bond regime, because of its transparent targeting of meaningful outcomes would make it easier for more people to participate in policymaking generating, as we have discussed (chapter 5) more buy-in than current politics affords.

Numbers have limitations

Anything that exists, exists in some quantity, and can therefore be measured. Lord Kelvin

Specifying targets for a Social Policy Bond regime won't always be easy. Take something that seems readily quantifiable, such as climate change. Critical questions immediately arise: do we want to mitigate or prevent climate change? Climate change is likely to increase flooding, drought, storms and (in some countries) food shortages - would we be better off targeting these detrimental human outcomes, rather than climatic variables? But what about the entire global ecology - is it to be valued solely in terms of the services it provides to humans? Important and difficult questions to be sure, but *exactly the same questions arise however we attempt to address climate change*. At the high level of aggregation at which governments operate, policymaking relies heavily on quantifiable indicators.

In households or families where people live closer one another, people probably know a lot more about each other's general state of happiness. They know when the people that matter most to them are happy, and they have a fairly good idea of the events and circumstances that will make them happy. They probably could not quantify or even articulate these matters, but neither do they have to. This probably holds too for extended families and close communities. And for most of us, happiness cannot be readily expressed as a list of numerical indicators. We should probably all feel temporarily happier with *incremental* increases in bank balances, salaries, or years of healthy life but, for most of us most of the time, our overall level of happiness or well-being is more a state of mind than the result of a set of numerically defined circumstances.

Decision-making become more complicated for larger societies. Even so, when benign national governments first began intervening to solve social and environmental problems, the problems themselves were more obvious, the causes of problems could be more readily identified, and so could the solutions. Governments were largely successful in their policy interventions on behalf of the disadvantaged: they instituted basic health and education for their own populations. They provided other public goods, such as law and order, and sanitation. And they did so with great success. Even so, support was not unanimous. Thus, *The Times*, editorialising against measures to provide basic sanitation in London:

> [W]e prefer to take our chance of cholera and the rest than be bullied into health[18]

In our industrial societies, with their large, complex economies, government bodies and non-governmental organizations have far more complicated tasks. They have enlarged their role and largely supplanted families, extended families, and communities in supplying a range of welfare services to a large proportion of their populations. Increasingly, and of necessity, government relies numerical indicators to manage its resource allocation.

But this use of indicators is relatively recent, unsystematic and unsophisticated. Few indicators are targeted explicitly for a sustained period: the targeted range of inflation is a rare exception, as is the coherent range of indicators presented in the UK Government's attempt to tackle poverty. [19] Other indicators, such as the size of hospital waiting lists, don't measure what matters to people or are prone to manipulation. Even when numerical goals are clear and meaningful they are rarely costed, they are almost always too narrow, and they are largely chosen to mesh in with the goals and capabilities of existing institutional structures. Those broad targets that are targeted with some degree of consistency tend to be economic aggregates, such as the inflation rate, or the rate of growth of Gross Domestic Product — which appears to be *de facto* indicator par excellence of rich and poor countries alike. But GDP's shortcomings as a single indicator of the health of an economy are well known (see chapter 1). Under a Social Policy Bond regime it is unlikely that statistics like GDP would assume the authority they appear to have nowadays.[20] Government would instead target ends rather than means: social and environmental outcomes that are meaningful to natural persons, as against government agencies and corporate bodies, rather than growth rates or other abstract economic indicators.

Accepting that goals for society will continue to apply on a large scale, they will increasingly have to be represented by numerical indicators. It would appear that the choice will increasingly be between (a) the current de facto targeting of per capita GDP along with an almost random array of narrow, easily manipulated indicators that have no necessary relationship to societal goals, and (b) the targeting of consistent, transparent, mutually supportive indicators that represent meaningful social outcomes.

Obviously this author would prefer the latter, but it should be recognised that even when following that approach policymakers will need to be guided by the limitations inherent in quantifiable indicators. The policy implication would be that *government could usefully concentrate on those policy areas where numbers are helpful*. It is generally at low levels of health, educational level, housing, income, caloric intake etc, that increases are strongly correlated with an individual's welfare. Beyond basic levels, individuals' ultimate objectives are for the most part inescapably subjective. They cannot be measured, nor can the societal counterpart of social welfare, and government should recognise this limitation. It can never know as much about people's well-being as other people: Lord Kelvin's remark is, of course, nonsense. A better guiding principle is that attributed to Albert Einstein: 'Not everything that counts can be counted, and not everything that counts can be counted.'

Financial incentives may be counterproductive

If numerical indicators are limited, so too is self-interest as a motivating force. People perform valuable social or environmental services not only for monetary gain, but also because they enjoy doing them for their own sake, because they believe them to be the morally right things to do, or because they believe that their actions will advance some cause to which they are committed. These 'intrinsic' motives are qualitatively different from external, monetary incentives, and offering monetary rewards might 'crowd out' or undermine these less mercenary and more civic-minded motivations. Bruno

Frey, a Swiss economist, has researched and written about this effect.[21] Crowding out internal motivation can occur, he writes, because, monetary incentives can undermine people's feelings of self-determination and self-esteem. Also, when external incentives are supplied, the 'person acting on the basis of his or her intrinsic motivation is deprived of the chance to exhibit this intrinsic motivation to other persons.' Not mentioned by Frey, but also plausible is that financial incentives can undermine the cognitive outlook that sees socially and environmentally beneficial services as worthwhile in their own right, rather than as a cost for which compensation and payments must be paid by taxpayers.[22]

While these considerations would have implications for a bond regime, they apply to some degree to existing policy methods. But as Frey says, crowding-out effects are not always significant. In markets, based on relations amongst essentially self-interested strangers, financial incentives as exhibited through the price effect do work as classical economics predicts. That is, they work to increase supply. And when (as they would be under a bond regime) external rewards are seen as recognition of the importance of, say, civic duty rather than an attempt to 'buy' one's civic performance, they may well support, rather than undermine, moral and other intrinsic motivations.[23] A bond regime could give bondholders incentives to further Frey's research, exploring the relationships between financial incentives and civic performance. They could use this knowledge to minimise the costs of achieving targeted objectives by, for example, finding out when monetary incentives are least likely to supplant the intrinsic motivations of people who help achieve objectives, and concentrating their use in those circumstances.

Money as a reward could be less efficient than respect

In general, large financial compensation packages have been a feature of the private sector, and we have been unhappy about paying people large sums of money directly to achieve social and environmental goals. This author shares that feeling to a degree. But people do respond positively to financial incentives, and it's not always a question of appealing to people's greed. People crave respect and nowadays, and however we might feel about it, that respect nowadays comes largely through being wealthy. But not invariably. Consider Japan:

> The Japanese have understood that what people are largely pursuing in the workplace is not so much money as the respect of the people around them, and therefore maintain a sophisticated - indeed, bizarrely over-elaborate to the Western eye - economy of respect in addition to the economy of money. They have understood that a large part of what money-seeking individuals really want is just to spend that money on purchasing social respect, through status display or whatever, so it is far more efficient to allocate respect directly.[24]

Rather than offer financial incentives could we perhaps reward people who help achieve societal goals with higher social status? An honours system could go some way toward rewarding people who forgo financial fortune for the good of society. Indeed, many countries have honours systems that are - or were - intended to do this. People also gain status merely by being admitted to exclusive societies, by working for reputable organizations; or they are pleased simply to be recognised in their role by cognoscenti. And many social reformers are quite happy to toil away without needing their efforts validated by any external body. They might be happier for knowing that they are helping to improve the society in which they live but, for a very large number, their reward lies simply in knowing that they are making a contribution.

Sadly though, the role that respect detached from financial wealth plays in Japanese society is exceptional in today’s world, and we cannot rely on it or the altruism of social reformers everywhere to meet the serious social and environmental challenges we face. Whether for good or ill, the context within which social status functions independently of financial status is rapidly disappearing from many developed countries: and an individual’s social status is becoming more and more synonymous with his or her level of wealth and income. Re-instatement of a popular culture that confers high status on those who achieve social and environmental goals would be a difficult task in our highly mobile world. It would have to be an evolutionary process. It could conceivably happen under a Social Policy Bond regime where, if rewarding people with wealth became too inefficient, bondholders could devise ways of rewarding people with respect instead.

The current, government-backed trend though, is in the opposite direction. The British government's honours system is an example. It used to honour dedicated people for the financial sacrifices they made for the public good, but more and more it now pays homage to entertainers and sportspeople who, whatever their other troubles, are not financially impoverished.

So in the meantime, facing severe and urgent social and environmental challenges, what are we to do?

> The world is being destroyed - no doubt about it - by the greed of the rich and powerful. It is also being destroyed by popular demand. There are not enough rich and powerful people to consume the whole world; for that, the rich and powerful need the help of countless ordinary people.[25]

We ordinary people are reacting perfectly rationally to the incentives on offer. A Social Policy Bond regime could radically reorientate the incentives so that we should be rewarded less for destroying the world and more for helping save it.

The future

With their limitations described above, Social Policy Bonds are hardly perfect. They don't tell us which objectives to choose, they rely on aggregated numerical targets, and they can crowd out, or function less efficiently than, people's more altruistic motivations. But the true comparison, it bears repeating, should not be with some utopian regime under which people always do the right thing, but with the current regime, within which potentially catastrophic social and environmental problems loom large and, when failed policies are backed by government or other vested interests, there are few systemic ways of stopping them.

Social Policy Bonds would change that. If governments issued them, their focus on outcomes would blur the distinction between the public and policymakers. People would take more of an interest in politics encouraged by the centrality of explicit, meaningful outcomes in a bond regime. There would be less ambiguity, and less ideology. No longer would politicians be able to claim that simply by increasing expenditure or restructuring government departments they were addressing society's health care concerns.

People would have higher expectations of what their taxes can achieve and the necessary trade-offs. They would be more aware that extra expenditure on, for example, keeping street crime down, might mean a worsening of local air quality. Single-issue campaigners might find themselves engaging more realistically with political realities.

Intra-country comparisons, already compiled in many countries, would take on new significance. People in one city or region seeing, for example, that the level of basic educational achievement of their children was lower than in other cities, might vote for more of their local taxes to reduce that disparity. They would not be discouraged by their not being educational experts; nor would they look to central government or educational professionals for the answer. Their focus would be on the priority they give to the educational goal as against other social goals.

At the national level, the most obscene wastes of taxpayers' money would disappear. Transfers and subsidies would be channelled to those who evidently need it. People would be given income support because they satisfied some objective criteria saying they were poor; not because they had deceived the public or played on its emotions. Industrialists and farmers who benefit from the wide array of disguised and perverse subsidies, transfers, and import barriers, would lose out, at least in the short term. Instead funds would be devoted to redeeming Social Policy Bonds that generate meaningful social goals at least cost.

Eventually a wide range of social and environmental priorities would be achieved through Social Policy Bonds though some would probably continue to be supplied by government employees for many decades.

A coherent, explicit range of meaningful social and environmental goals is but one of the two essential elements underpinning the Social Policy Bond concept. The other is market forces. The combination of two elements should generate better social outcomes more cost-effectively. Governments or people would have more money to spend or more leisure time, or both, which could benefit society in many ways.

Resources are always going to be limited and Social Policy Bonds would not change that. Priorities and choices will always have to be made. Private issuers of Social Policy Bonds would have their own priorities, for which they would contribute their own funds. Governments though would, as they do now, have to decide on which problems to solve, and on the sums allocated to their solution. But democratic governments are good at representing and articulating their people's wishes and raising revenue for satisfying them. Where they are not so successful is in working out the most efficient ways of achieving these goals. This achievement is really a matter of allocating scarce resources. In economic theory, and on all the evidence, markets are the best way of allocating scarce resources to achieve prescribed ends. Social Policy Bonds would allow both government and the market to do what each is best at: respectively: prescribing ends, and allocating resources to meet these ends.

In the long run the widespread acceptance that self-interest can be channelled into solving social problems could have more far-reaching implications. International transfers of taxpayer funds appear to be at least as prone to misallocation as their domestic equivalents. International or global social or environmental problems such as malnutrition or climate change could be made the targets of future Social Policy Bonds, whether issued by governments, international bodies, non-governmental organizations or private sector philanthropists. Corrupt governments could be major purchasers of such bonds. Or they could be induced by major bondholders to alter their destructive policies. Either way, they would have incentives to modify their behaviour to help achieve targeted goals, whether these include ensuring that food supplies reach their own starving citizens, or doing what they can to achieve trans-boundary objectives such as global environmental goals. Social Policy Bonds would be more likely to be effective than current aid programmes, because bondholders would benefit only by actually solving targeted social and environmental problems – as distinct from running agencies only peripherally engaged in achieving their stated purpose.

Internationally backed Social Policy Bonds targeting poverty, malnutrition or deadly conflicts are most probably a long way into the future. Before then, Social Policy Bonds will probably have to be issued on a smaller scale, and the concept will have to be gradually refined and deployed more widely and successfully at the local, regional and national levels.

For government to relinquish most of its discretion as to how to achieve social and environmental goals would require some courage as well as humility. Yet in doing so, it could bear in mind that it would not be renouncing its existing sanctions against illegal acts. It would still be defining society's goals, and it would still be the ultimate source of finance for achieving them. In fact, the current system, when viewed impartially, would appear to be far more irrational. Under it, large proportions of national income are spent in pursuit of nebulous goals, few of which are costed, many of which conflict with each other, and many of which primarily benefit the better off —

some of them already very wealthy indeed. Administering this expenditure is a burgeoning bureaucracy, which, on the rare occasions its performance is even measured, is almost invariably shown to be woefully inefficient.

The acceptance of a Social Policy Bond regime, even with the aim of achieving national goals as uncontroversial as lower crime rates, or better health and education outcomes, may be politically difficult, and must be a gradual process. But the potential benefits should not be ignored. By injecting market forces into the achievement of social and environmental goals, Social Policy Bonds could achieve these goals more transparently, cost-effectively and with much more buy-in from people of every background.

---

[1] *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good,* William Easterly. Penguin Press HC, 2006; ISBN 1594200378.

[2] *The Utopian Nightmare,* William Easterly, Foreign Policy, Sept/Oct 2005.

[3] *Will Africa ever get it right?,* 'The Economist', 26 April 2007.

[4] See Wikipedia for an introduction to the Human Development Index: http://en.wikipedia.org/wiki/Human_Development_Index.

[5] *Social Indicators of Development*, World Bank; http://www.ciesin.org/IC/wbank/sid-home.html, sighted 19 July 2008.

[6] Ibid.

[7] *Failed States: The Abuse of Power and the Assault on Democracy*, Noam Chomsky, Metropolitan Books, April 2006, ISBN 0-8050-7912-2.

[8] From chapter 1 of *Another Blood Century: Future Warfare*, Colin Gray, Orion Books, October 2006, ISBN 0304367346.

9 Our Final Century?: Will the Human Race Survive the Twenty-first Century? Sir Martin Rees, William Heinemann, 2004, ISBN 0-434-00809-5.

[10] Swedish chemist Svante Arrhenius 'recognized that industrialization and climate change were intimately related and that the consumption of fossil fuels must, over time, lead to global warming.' He spoke about it to the Swedish Academy in 1895. From *Field notes from a Catastrophe: Man, Nature, and Climate Change*, Bloomsbury, 2006, ISBN 978-1596911253.

[11] *Happiness: lessons from a new science*, Richard Layard, Penguin Press, 2005.

[12] This is known as the Easterlin Paradox. See http://en.wikipedia.org/wiki/Easterlin_paradox.

[13] See for instance, *Happiness Is Increasing in Many Countries - But Why?*, Bruce Stokes, Pew Global Attitudes Project, 24 July 2007. Available online at http://tinyurl.com/5jte6y, sighted 20 July 2008.

[14] *Therapy could 'cut benefits bill'*, BBC News Channel, 19 June 2006; available online at http://news.bbc.co.uk/1/hi/5093694.stm?ls. Original research available from the UK's, LSE, Centre for

Economic Performance, Mental Health Group: http://cep.lse.ac.uk/research/ mentalhealth/default.asp.

[15] *Louv Story, An interview with Richard Louv about the need to get kids out into nature,* by David Roberts, 'Grist', 30 Mar 2006; http://www.grist.org/news/maindish/ 2006/03/30/louv/index.html, sighted 20 July 2008.

[16] Ibid.

[17] *A time for clarity,* Bjørn Lomborg, Project syndicate 2008. Available online at http://www.project-syndicate.org/commentary/lomborg25/English, sighted 20 July 2008.

[18] Leading article from 'The Times', 1 August 1854.

[19] *Opportunity for All - Tackling Poverty and Social Exclusion,* Department of Social Security, Poverty and Social Exclusion Team, 1-11 John Adam Street, London WC2N 6HT, September 1999.

[20] See *The costs of economic growth*, E J Mishan, Staples Press, 1967, ISBN 0140210903 for a discussion of 'index economics'.

[21] *Not just for the money: an economic theory of personal motivation*, Bruno S Frey, Edward Elgar, 1998, ISBN 9781858988450.

[22] *Crowding out virtue,* Gerald F Gaus, 'Agenda', 5 (4), Australian National University, 1998. This is a short review of Bruno Frey's book, cited above (note 21).

[23] Ibid.

[24] *Japan, a refutation of neo-liberalism*, Robert Locke, 'post-autistic economics review', 21 March 2005. Available online at

http://www.paecon.net/PAEReview/issue23/Locke23.htm, sighted 20 July 2008.

[25] *Conservation is good work,* Wendell Berry, 'The Amicus Journal', Winter 1992.

Epilogue: beyond ideology

If Social Policy Bonds are so marvellous.....why doesn't anyone issue them? The Social Policy Bond idea has been in the public domain for about 20 years, and it has not been so far been adopted anywhere, to my knowledge. But neither has it been dismissed outright. It tends to provoke initial enthusiasm amongst economists and decision makers, but then to be forgotten as other more pressing issues arise. Robert Shiller, Professor of Economics at Yale University, wrote to me at the end of 1996, praising the Social Policy Bond idea, saying that it creates "a large interest group for the solution of important problems. The political and other effects of creating such an interest group could be incalculable." The draft of an earlier book on the bonds elicited extreme comments at both ends of the range from the two referees: one dismissed the text as an irrelevance. The other called the idea "original and ingenious" and "a substantial contribution to debate about public policy".

Initially I thought governments would be most interested in the bonds. They spend vast sums of money - around 40 percent of national incomes - on social and environmental activities, so you might imagine, as I did, that they would be keen to try out any idea that could make their spending more cost-effective. I was probably naive. Governments, I now believe, are quite happy to pursue failed policies as long as these policies have been done before. Supporting a failed but conventional policy is less risky to the aspiring politician or bureaucrat than supporting a new policy, even one that is far more likely to succeed. This is what happens when the people in government, invariably (in my experience) well-meaning and hard-working, are rewarded for carrying out activities rather than for achieving outcomes. Provided their programmes have been tried before, their careers are unlikely to suffer.

What about the private sector? I have tried to interest various philanthropic organizations, but not a single one has had the courtesy even to respond to my initial approach. Think-tanks and non-governmental organizations have been more forthcoming, and I have spoken to some of them and they have published my work. None, though, has taken the idea further. I suspect this is because Social Policy Bonds are a 'right wing' (market) way of achieving 'left wing' (social) goals. The right wing doesn't like any sort of intervention, while left wingers see the word 'markets' and run a mile. That is pure speculation on my part.

In April 2002, I presented a paper on the bond concept to joint meeting of the Agriculture and Environment Committees at the Organisation for Economic Cooperation and Development (OECD) in Paris. At the meeting, delegations from most of the OECD's member countries made comments on the paper. These were mostly along the lines of "this is very interesting — but unworkable in practice." But one of the delegates perhaps articulated the deeper feelings of those present, who were overwhelmingly government employees: "if this gets adopted we'll all be out of jobs!"

Over the years, certain private individuals have engaged with the idea and considered issuing their own Social Policy Bonds for projects as diverse as boosting voter registration, raising literacy in developing countries and developing open-source software. Though none of their projects has yet reached fruition, I am heartened and encouraged by such efforts.

Bibliography

Investing for the future, Ronnie Horesh, 'UK CEED Bulletin No 35', Centre for Economic and Environmental Development, Cambridge, UK, September-October 1991. (Presented as Room Document 3 to the December 1994 meeting of the OECD Joint Working Party of the Committee for Agriculture and the Environment Policy Committee.)

Social Policy Bonds: Injecting market incentives into the solution of social problems, Ronnie Horesh, AEU Occasional Papers, University of Cambridge, Cambridge, UK, August 1992.

Injecting incentives into the solution of social problems: Social Policy Bonds, Ronnie Horesh, 'Economic Affairs', 20 (3), Institute of Economic Affairs, London, September 2000.

Better than Kyoto: Climate Stability Bonds, Ronnie Horesh, 'Economic Affairs', 22 (3), Institute of Economic Affairs, London, September 2002.

Websites

The main Social Policy Bonds website:
http://SocialGoals.com

The Social Policy Bonds blog site:
http://socialgoals.com/blog/blog.html

The Wall Street Performer Protocol: Using Software Completion Bonds to fund open source software development, by Chris Rasch,
http://www.firstmonday.dk/issues/issue6_6/rasch/index.html

Index