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.

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[18] See chapter 3, 'Objectives and indicators'.