Statement of

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on

Social Impact Bonds

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John K. Roman is a Senior Fellow at the Urban Institute. He is indebted to Kelly Walsh, Sam Bieler, Sam Taxy, Akiva Lieberman and Nancy La Vigne for past and current work with him on social innovations, including social impact bonds. All opinions expressed herein are solely the author's and should not be attributed to any of these individuals or any organizations with which Roman is associated.

Mr. Chairman and members of the Committee:

Thank you for the opportunity to testify before you on HB 951 and to discuss the potential for social impact bonds to benefit the citizens of Maryland. Although there is some disagreement over how to finance the social welfare infrastructure in Maryland, there is almost no disagreement that there are significant gaps with costly consequences for the citizens and the state. While the social impact bond concept is new and relatively untested, it has great potential to improve service capacity across a broad range of programming that will continue to benefit Marylanders long after the original social impact bonds are completed.

On any given night, a cop on patrol in any Maryland community is going to encounter someone in crisis and provide ad hoc counseling. That person may be in crisis because of an alcohol or drug problem, or a mental health issue, or he or she may simply be despondent over their station in life. The causes of their crises are highly variable, but aside from diagnosable disorders, a criminal record, illiteracy, and homelessness are common themes.

The cop is delivering ad hoc counseling in many cases because the social welfare infrastructure in Maryland, as it is elsewhere, simply cannot handle the needs of the citizenry. The social safety net's deficiencies stem from the tension between providing as many services as Maryland can and taxing at a rate that stifles growth.

Social impact bonds can ease that tension. These bonds infuse private capital into under-resourced sectors to create a social service infrastructure that reduces the harms experienced by those in crisis while simultaneously reducing their burden on the state. The goal is not to replace the public sector; it is to build a better safety net that allows the cops to go back to doing what they do best: law enforcement.

The social impact bond concept is straightforward: inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors. Private investors put up capital to fund interventions that are too big or too risky for the public sector. Performance targets are established, and if the private sector delivers, investors are rewarded with profits. If the performance targets are not hit, the government does not have to pay for the services delivered.

Social impact bonds, or SIBs, are being tested in many places around the world today. In New York City, Goldman Sachs, in partnership with the Bloomberg Foundation, has invested $9.6 million in a program to help thousands of young men in the jail at Rikers Island learn skills that research says will keep many of them out of jail in the future. An independent, rigorous evaluation using a randomized controlled trial—the gold standard in social science—is being used to measure the program's success. If the rate at which these young men recidivate meets performance targets (which are 10 percent below typical recidivism rates), then Goldman Sachs will have its principal returned and receive up to $2.1 million in profit from New York City. If not, the government pays nothing but still benefits from having received those services.

This big idea was first tested in Peterborough Prison in the UK, where it began two years ago and is ongoing. The U.S. Department of Justice funded three SIB-related projects last fall, including the project that I lead at the Urban Institute to create a blueprint for social impact bonds in America. The U.S. Department of Labor is evaluating state and local proposals to implement social service programs funded by SIBs and has committed up to $20 million to these projects. New York and Massachusetts, among others, have issued SIB solicitations. Numerous investment banks, venture capital firms, and philanthropies have indicated a strong interest in participating in these projects.

The appeal of SIBs is that everybody could win. Philanthropically oriented investors get a chance to leverage their gifts with the potential to receive a profit, allowing them to reinvest those same dollars in another worthy cause. If investors do not earn a profit, they still accomplish their initial goal to make a socially beneficial investment. The government gets private-sector investment for a risky intervention that otherwise may not have been tried (to the detriment of society). If the services are effective and successful, the government gladly pays for them. If they're not, public dollars can be reallocated to something else or returned to taxpayers.

The gap between the social safety needs of Maryland's citizens and the available resources to serve them is enormous. Let's take one example: illiteracy. Illiteracy is associated with substantial reductions in healthy behaviors because of an inability to read, understand, and act on basic health care information. The costs are high: across the United States, low health literacy produces upwards of $100 billion annually in added health expenses, most of which is shouldered by the public sector. Maryland's share of that burden could approach $2 billion.

Other potential costs associated with illiteracy include weakened labor market outcomes, especially for women. Research shows literacy is the most important predictor of labor market outcomes. Institutionalization, single parenting, and unemployment are all related to illiteracy.

Most SIB advocates suggest that the best candidates for private funding are programs with large up-front costs, programs that serve large numbers of people, and programs with a strong evidence base.

Adult literacy programs meet all three criteria. The scale of the problem—11 percent of Marylanders are illiterate—the enormous size of the societal costs, and the demonstrated effectiveness all make literacy programs a prime candidate for SIB funding.

Maryland faces many daunting social welfare challenges. These problems have remained intractable because their scale is beyond the ability of government to address alone. Social impact bonds' integration of private capital into traditionally public-sector activities shows great promise.