

SHAPING THE SUCCESS OF SOCIAL IMPACT BONDS IN THE UNITED STATES: LESSONS LEARNED FROM THE PRIVATIZATION OF U.S. PRISONS

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ABSTRACT

American government officials are starting to experiment with a novel government-funding and privatization structure known as a social impact bond (“SIB”). An SIB is a contract between a government agency and a private entity in which the government agrees to pay the private entity an agreed-upon sum only if it can meet certain goals or outcomes. Currently, SIBs exist both globally and domestically, and are targeted to solve perpetual social ills such as the high homelessness and recidivism rates plaguing certain communities.

By analogizing the problems facing private prisons to the potential problems facing the use of SIBs, this Note details the privatization challenges that government officials will likely face as they implement SIBs. Most importantly, this Note is the first to propose how government officials implementing SIBs can overcome the traditional obstacles facing privatization schemes—both through the structure of SIBs and through additional contractual solutions. Finally, the Note concludes with a discussion about how elements of SIBs can be incorporated to improve existing privatization models such as private prisons, and how SIBs alter the existing debate about privatization in this country.

INTRODUCTION

Consider this scenario: a local government faces high incarceration rates with astronomical prison costs in the midst of

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shrinking budgets. It knows that to lower these costs, it must lower recidivism rates. It knows also that multiple think tanks have concluded that prisoner-rehabilitation programs lower recidivism rates, thus potentially saving the government millions of dollars. Logic would suggest that the government invest now in these programs to yield greater cost savings and lower future crime rates. Yet it struggles to fund the program's up-front costs in the face of constricting budgets and opposition to funding additional services for a historically unpopular population. At the same time, a wealthy corporation is searching for new investments in an increasingly tight economy. It is also looking to raise its social consciousness and charitable profile while still adhering to its first priority of accruing profit for its investors. Although the challenges facing the local government and the private corporation seem worlds apart, their varied interests can intersect and form an innovative private-public partnership that has the potential to deliver to both the public and private actors the outcomes they desire. This partnership and the agreement that follows is a new concept known as a social impact bond.

A social impact bond (SIB) is a novel government-funding structure that focuses on funding outcomes rather than on funding inputs into government programs.¹ An SIB is an agreement “between one or more government agencies and an external organization where the government specifies an outcome (or outcomes) and promises to pay the external organization a pre-agreed sum (or sums) if it is able to accomplish the outcome(s).”² For example, if a local government wants to reduce its homelessness rate by x percent, it offers a private investor y dollars if the investor can achieve that level of reduction—but only if the investor achieves that goal. In this sense, the term *bond*

1. See Benjamin R. Cox, *Financing Homelessness Prevention Programs with Social Impact Bonds*, 31 REV. BANKING & FIN. L. 959, 964 (2012) (“Social impact bonds are sometimes called ‘pay for success’ (‘PFS’) bonds because they only pay upon realization of a contingency—successful completion of the social intervention program.”). When the government funds inputs, it funds labor, start-up costs, and equipment. In contrast, when the government funds outcomes, it funds the realized goals or benefits that result from the program. For example, in the context of a prisoner-rehabilitation SIB, inputs include hiring staff and buying educational materials. The outcome would be the reduced reconviction rate of the group of prisoners enrolled in the rehabilitation program.

2. JITINDER KOHLI, DOUGLAS J. BESHAROV & KRISTINA COSTA, CTR. FOR AM. PROGRESS, SOCIAL IMPACT BONDS 101: DEFINING AN INNOVATIVE NEW FINANCING TOOL FOR SOCIAL PROGRAMS 2 (2012), available at <http://www.americanprogress.org/wp-content/uploads/issues/2012/03/pdf/sib101.pdf>.

is misleading because SIBs differ substantially from bonds.³ Bonds generally offer a fixed rate of return.⁴ In contrast, although bondholders assume risks of nonpayment, SIBs are likely riskier investments because the external organization receives a return only if certain outcomes are met.⁵ Thus, unlike the majority of government contracts in which the government pays up front for the services of a private organization, SIBs fundamentally change the structure of government contracts, refocusing them on outcome-driven goals.⁶

SIBs can fund social programs such as those aimed at reducing the recidivism rate among released prisoners, reducing homelessness, and increasing access to early childhood education.⁷ Usually, SIBs involve several actors, including government agencies, private institutions, and nonprofit and philanthropic organizations.⁸ This nexus allows each actor to execute the role for which it is best suited and transfer the roles in which it traditionally underperforms to the actor that is better suited to implement them.⁹

The use of SIBs globally has led U.S. lawmakers and business leaders to begin to initiate pilot SIB programs in the United States.¹⁰

3. MCKINSEY & CO., FROM POTENTIAL TO ACTION: BRINGING SOCIAL IMPACT BONDS TO THE U.S. 12–13 (2012), available at http://mckinseyonsociety.com/downloads/reports/Social-Innovation/McKinsey_Social_Impact_Bonds_Report.pdf.

4. See *Bond*, DICTIONARY OF FIN. & BANKING (Jonathan Law & John Smullen eds., rev. ed. 2012), <http://www.oxfordreference.com/view/10.1093/acref/9780199229741.001.0001/acref-9780199229741-e-385?rskey=q1cBaC&result=523&q=>. But note that the “fixed” rate can also be based upon a formula, in which the nominal return can change over time. See *id.*

5. JITINDER KOHLI, DOUGLAS J. BESHAROV & KRISTINA COSTA, CTR. FOR AM. PROGRESS, FACT SHEET: SOCIAL IMPACT BONDS 1 (2012), available at http://www.americanprogress.org/wp-content/uploads/issues/2012/04/pdf/sib_fact_sheet.pdf.

6. See *id.* (“Normally, government agencies fund tightly proscribed activities. In a Social Impact Bond, however, a government agency defines an outcome. The agency contracts with an external organization that promises to achieve that outcome and only pays the organization if it is successful.” (emphasis omitted)).

7. *Id.* at 2; Jon Michaels, *Privatization’s Progeny*, 101 GEO. L.J. 1023, 1052 (2013).

8. See Drew Von Glahn & Caroline Whistler, *Pay for Success Programs: An Introduction*, POL’Y & PRAC., June 2011, at 19, 19.

9. See MCKINSEY & CO., *supra* note 3, at 17 (“SIBs are generating interest for several reasons. One reason is that public-private partnerships and other multistakeholder arrangements have been shown to be effective ways to address complex, dynamic problems that exceed the capacity of a single sector or actor. SIBs, if executed well, can spur cross-sector collaboration and cooperation.”).

10. See NONPROFIT FINANCE FUND & THE WHITE HOUSE, PAY FOR SUCCESS: INVESTING IN WHAT WORKS 1 (2012), available at http://payforsuccess.org/sites/default/files/pay_for_success_report_2012.pdf (describing the progress of the British and Australian governments in implementing SIBs and explaining the increased interest in SIBs among U.S.

In implementing SIBs, U.S. government officials and business leaders must be cognizant of the challenges that accompany private involvement in traditional government functions. The increasing interest in SIBs also intersects with the prevailing trend toward privatizing traditional government functions such as incarceration.¹¹ Thus, SIBs implicate a larger policy debate about the propriety of such privatization. This Note does not aim to come to a conclusion about the desirability of privatization, but rather it argues that SIBs can overcome the challenges that plague other forms of privatization.

Government actors considering contracting with private investors in an SIB must be alert to these challenges and must implement solutions to mitigate the negative effects that these challenges have on SIBs. But with sparse scholarship on this novel funding structure, government actors have little predictability as to the problems they will face and the potential solutions to these problems. This Note contributes to the limited existing scholarship on SIBs by analogizing the problems facing private prisons to the potential problems facing the use of SIBs, thus providing government actors a roadmap of the challenges they will likely face in implementing SIBs. This Note also suggests specific proposals to overcome these challenges. Because both the privatization of prisons and SIBs inject private parties into traditional government spheres,¹² the two contexts share several important similarities. As a result, private prisons can serve as a useful analog in identifying the potential pitfalls facing the use of SIBs. Additionally, this Note will contribute to the scholarship by making the reverse application as

local and state governments as well as President Obama's \$100 million request for SIBs in his 2012 budget).

11. Cf. Carolyn Hoecker Luedtke, *Innovation or Illegitimacy: Remedial Receivership in Tinsley v. Kemp Public Housing Litigation*, 65 MO. L. REV. 655, 695 & n.231 (2000) ("While the 74,000 privately held prisoners are a small proportion of the 1.8 million prisoners in the United States, it is a trend which introduces many of the accountability problems seen in the receivership context."); Dru Stevenson, *Privatization of State Administrative Services*, 68 LA. L. REV. 1285, 1285 (2008) ("Privatization is an increasingly prevalent feature of state administrative law. It affects and overlaps all the traditional areas of academic discussion regarding state administrative law, including preemption, separation of powers, due process, and sovereign immunity. A cursory survey of recent litigation shows courts grappling with privatized state prisons, healthcare facilities, welfare programs, motor vehicle departments, workers' compensation programs, and schools." (footnotes omitted)).

12. See Sharon Dolovich, *State Punishment and Private Prisons*, 55 DUKE L.J. 437, 455-58 (2005) (explaining that the private sector assumed responsibility for running penal facilities which the state had previously run, due to high incarceration rates).

well—that SIBs offer solutions to improve the existing problems facing private prisons and other traditional forms of privatization.

This Note has five parts. Part I will explain the structure, operation, and emergence of SIBs. Part II will identify the similarities between private prisons and SIBs and explain why the problems plaguing private prisons are a good indicator of the potential problems of SIBs. Part III will describe the three primary problems facing private prisons. Part IV will analyze how these problems will likely arise in the context of SIBs and how the structure of SIBs can mitigate these problems. It will also propose additional contractual solutions to mitigate privatization’s negative effects. Finally, Part V will discuss how elements of SIBs can be incorporated to improve private-prison operation and how SIBs fit within the larger policy debate about privatization.

I. THE BASICS OF SIBS

A. *The Structure of SIBs*

SIBs may be structured in different ways, but all of them share similar features. First, SIBs require government agencies to define a desired outcome.¹³ Second, SIBs must have an external organization to execute the program that delivers the outcome, often known as a service provider.¹⁴ Third, SIBs need a population that benefits from the services.¹⁵ Additionally, though not necessary, most SIBs involve investors who provide seed capital to fund the external organization’s activities and intermediaries who manage the SIB project overall.¹⁶ SIBs can also include “evaluation advisers (to help monitor and refine the program), and independent assessors (to determine if SIB targets are met).”¹⁷ In most SIB structures, an intermediary plays the largest role: it contracts with the government, “raising capital from investors,” choosing the external organization or service provider, and working with independent assessors to assure that the project’s goals are being met.¹⁸ Nevertheless, SIBs may take on other forms;

13. KOHLI ET AL., *supra* note 5, at 2.

14. *Id.*

15. *Id.*

16. MCKINSEY & CO., *supra* note 3, at 7. *But see* KOHLI ET AL., *supra* note 5 (containing no discussion of investors or seed capital).

17. MCKINSEY & CO., *supra* note 3, at 7.

18. *Id.* at 15.

their flexible structure makes SIBs potentially useful in a variety of situations.¹⁹

B. *Benefits and Challenges of SIBs*

There are several benefits to SIBs that make the funding structure advantageous over traditional forms of government funding. First and foremost, SIBs tie profit to socially valuable results. By avoiding the need to finance projects with taxpayer money, SIBs transfer risk from the government to either the investors who provide initial capital for the project or the external organization.²⁰ The government compensates the investors or external organization only if the target outcomes are met.²¹ Unlike traditional privatization in which the government pays the up-front costs even if the initiative ultimately fails,²² SIBs insulate the government from such risk by shifting it to private entities.²³ This “bang for the buck” structure thus mitigates wasteful public spending while also incentivizing organizations to target programs that achieve results.²⁴

19. See Kristina Costa & Jitinder Kohli, *Social Impact Bonds: New York City and Massachusetts To Launch the First Social Impact Bond Programs in the United States*, CTR. FOR AM. PROGRESS (Nov. 5, 2012), <http://www.americanprogress.org/issues/economy/news/2012/11/05/43834/new-york-city-and-massachusetts-to-launch-the-first-social-impact-bond-programs-in-the-united-states> (“So long as these principles are retained, the structure of the deal and the players at the table can potentially take many different forms. Social impact bonds have great potential in a range of preventive social programs . . .”).

20. See SOC. FIN., A NEW TOOL FOR SCALING IMPACT: HOW SOCIAL IMPACT BONDS CAN MOBILIZE PRIVATE CAPITAL TO ADVANCE SOCIAL GOOD 4–5 (2012), available at http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFIN_AL_0.pdf (“If improved outcomes are not achieved, the government is not required to repay the investors, thereby transferring the risk of funding prevention services to the private sector and ensuring accountability for taxpayer money.”).

21. MCKINSEY & CO., *supra* note 3, at 7; SOC. FIN., *supra* note 20, at 4–5; see also Michaels, *supra* note 7, at 30 (“But, if the program does not meet the benchmarks, the bond organization recoups either none of its expenditures or only a fraction of what it initially invested. This means that the government doesn’t subsidize the private provider’s lack of success, and that the onus is on the bond organization to police the provider’s progress.”).

22. See SOC. FIN., *supra* note 20, at 13 (“Most governments pay for social services with insufficient consideration to how effective the programs actually are in achieving better outcomes for the target population.”).

23. See MCKINSEY & CO., *supra* note 3, at 7 (“[An] SIB is a multistakeholder partnership in which philanthropic funders and impact investors—not governments—take on the financial risk of expanding preventive programs that help poor and vulnerable people.”).

24. See *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, KNOWLEDGE@WHARTON (Sept. 12, 2012), <http://knowledge.wharton.upenn.edu/article.cfm?articleid=3078> (“SIBs not only provide new sources of up-front capital for programs, but they are a way for the government to ensure it is getting real bang for its buck. . . . This prompts

Second, SIBs provide seed capital to programs that lack funding because of limited government revenue due to the 2008 recession.²⁵ For many state and local governments, budgets remain tight.²⁶ With limited budgets, revenues will likely go toward the most entrenched social programs as opposed to innovative projects that have never been implemented.²⁷ Governments are also less likely to use their limited budgets to fund projects that serve historically unpopular groups such as the homeless²⁸ and the prison population.²⁹ To fix these funding deficiencies, SIBs usher in private capital to wholly replace or supplement public revenue to fund social programs.³⁰

Third, SIBs fund promising alternative programs and initiatives.³¹ Philanthropic organizations, think tanks, and other nonprofit organizations face a dilemma in the sense that they expend considerable resources on research regarding alternative programs and innovative solutions, but then lack the resources to execute those

a reevaluation of government outlays away from programs that don't work and toward programs that do.” (quoting George Overholser, CEO, Third Sector Capital Partners)).

25. *See id.* (“While state tax collections are recovering from the hit of the recent recession, total state tax revenues adjusted for inflation for the first quarter of 2012 are still down 1.6% compared to the same quarter in 2008, according to the Nelson A. Rockefeller Institute of Government.”).

26. *See id.* (“And as of the first quarter of 2012, local tax revenue had actually fallen in real terms, by 1.8% over the previous 12 months.”).

27. *Cf.* Stephen F. Befort, *The Constitutional Dimension of Unilateral Change in Public-Sector Collective Bargaining*, 27 A.B.A. J. LAB. & EMP. L. 165, 165 (2012) (noting that as a result of the economic downturn and the decreased tax revenues it caused, discretionary expenses have been cut). Indeed, in some states, even the most important public services such as public education and low-income access to healthcare have experienced significant revenue decreases as a result of the recession. *See* Nicholas Johnson, Phil Oliff, & Erica Williams, *An Update on State Budget Cuts*, CTR. ON BUDGET AND POLICY PRIORITIES (Feb. 9, 2011), <http://www.cbpp.org/files/3-13-08sfp.pdf>. Thus, the allocation of state resources to innovative, untested social programs is even more unlikely in these states.

28. *See* Taylor Pospichel, Note, *Are California's Homeless Children Being Left Behind?: Analyzing the Implementation of McKinney-Vento Education Rights in California*, 10 HASTINGS RACE & POVERTY L.J. 121, 131 (2013) (“The State’s limited budgetary resources have caused many cutbacks in funding for homeless service providers, therefore there is little relief for families experiencing or at risk of homelessness.”).

29. *See* Erwin Chemerinsky, *The Essential But Inherently Limited Role of the Courts in Prison Reform*, 13 BERKELEY J. CRIM. L. 307, 310 (2008) (“[T]here is a lack of political will to provide for adequate funding for prisons. There is no constituency with any political clout to pressure for sufficient funding for prison facilities or prison services. Politically powerless, prisoners certainly are a ‘discrete and insular minority.’”).

30. *See Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (explaining that SIBs raise capital from “outside investors” for new social programs).

31. MCKINSEY & CO., *supra* note 3, at 7–8.

programs.³² The government usually will not fund these programs because of the inherent risk involved in an unknown program. SIBs usher in the private sector, which, unlike the government, thrives on these types of high risk, high reward investments.³³ Because investors can provide seed capital and are in a better position to bear the risk of such investments, SIBs can cultivate innovative social programs that the government would not normally fund.³⁴

Finally, SIBs enable collaboration among different actors in the public and private realm as opposed to the traditional structure in which the government divides “money and information into different ‘silos,’ preventing programs and agencies from working together effectively.”³⁵ In this aspect, SIBs are unique because they allow each actor to execute the portion of the project in which it excels.³⁶ For example, the government and its elected officials are best suited to establish the desired outcomes. Because government officials are elected, their popular election and accountability to the public gives them the legitimacy to establish what an SIB’s goals should be.³⁷ The private sector is best positioned to provide capital to fund the initial activities or inputs.³⁸ The service provider, which is usually a nonprofit, has the expertise in the particular area of concern and is

32. *See id.* at 8 (“To date, some nonprofit service providers have faced a frustrating situation: they’ve taken the time to collect data and discover what works for vulnerable people, only to find that there is no way to get these alternative programs to scale.”).

33. Investors thrive on and assume risk in investments because they are better able “to cope with risk by hedging or diversification” as compared to the government. PHILIP GRAY & TIMOTHY IRWIN, *WORLD BANK GRP., EXCHANGE RATE RISK: ALLOCATING EXCHANGE RATE RISK IN PRIVATE INFRASTRUCTURE PROJECTS 3* (2003), available at <http://rru.worldbank.org/documents/publicpolicyjournal/266gray-121203.pdf>.

34. *See Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (“This market, Hsieh says, could provide critical funding to ‘scale up programs that might not have been scaled before.’ In addition, he notes, ‘maybe the government will be more likely to look for new approaches because the financial risk is being borne, in part, by the markets.’” (quoting Nien-he Hsieh, Associate Professor, Harvard Business School)).

35. KOHLI ET AL., *supra* note 2, at 3.

36. *See* SOC. FIN., *supra* note 20, at 12 fig.1 (explaining the role of the investors, intermediary organizations, service providers (nonprofits), and the government).

37. *Cf.* James Gardner, *Consent, Legitimacy, and Elections: Implementing Popular Sovereignty Under the Lockean Constitution*, 52 U. PITT. L. REV. 189, 200–13 (1990) (arguing that governmental legitimacy comes from “popular sovereignty and the consent of the governed”).

38. SOC. FIN., *supra* note 20, at 12 fig.1 (explaining that private investors’ roles in SIBs are to “make long-term investment[s]” in the project). An example of this is when investors pay service providers, such as prison-rehabilitation specialists, to implement SIBs. *See supra* note 20. In the context of prison rehabilitation, the input is the labor of service providers in executing the program. For greater explanation on the definition of inputs, see *supra* note 1.

best positioned to actually execute the program.³⁹ Thus, because each actor is best suited to carry out its own targets, the program is more effective.

An interrelated benefit, and one not yet contemplated by the literature, is that SIBs reflect a structure that acknowledges that the largest social ills of our day cannot be confronted by the government, the private sector, or philanthropic organizations acting alone. Rather, in an SIB, these actors work in concert to address large-scale social issues. This multifaceted approach to problem solving is a major advantage compared to other government-financing models.

Though SIBs have a plethora of potential benefits, there are several barriers to their emergence in the United States. First, there is limited data on their success in practice.⁴⁰ In theory, SIBs have a variety of advantages over traditional government-funding models, but because they are still in their infancy, there is limited data to support such a contention.⁴¹ Second, SIBs require that potential investors be willing to assume the risk of a particular project or operation.⁴² The potential pecuniary gains of success must be large enough to induce a private investor to assume the risk of failure.⁴³ Therefore, SIBs cannot feasibly fund all projects, but only those that sufficiently incentivize the private sector to invest. Third, SIBs are likely not the appropriate mechanism for funding projects that take longer than a couple of years to evaluate, thus limiting the range of their applicability.⁴⁴ Finally, because SIBs increase the number of

39. SOC. FIN., *supra* note 20, at 12 fig.1 (“By providing effective prevention programs, the nonprofits improve social outcomes and reduce demand for more expensive safety-net services.”).

40. MCKINSEY & CO., *supra* note 3, at 11.

41. *See id.* (“Because SIBs are so new—the UK pilot is currently the world’s one and only SIB—much of what’s been written about them has been based on theory rather than data.”).

42. *See* JEFFREY B. LIEBMAN, CTR. FOR AM. PROGRESS, SOCIAL IMPACT BONDS: A PROMISING NEW FINANCING MODEL TO ACCELERATE SOCIAL INNOVATION AND IMPROVE GOVERNMENT PERFORMANCE 3 (2011), available at http://www.americanprogress.org/wp-content/uploads/issues/2011/02/pdf/social_impact_bonds.pdf (arguing that private investors assume most of the risk in SIBs and thus “the interventions must have sufficiently high net benefits” for the investor to be willing to invest).

43. *See id.* (“The most significant obstacle to making social impact bonds work is identifying interventions with sufficiently high net benefits to allow investors to earn their required rates of return.”).

44. *See Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (“In this embryonic stage, you are best off focusing on programs where you can assess results in the short term,” Weigelt suggests. ‘If you need to wait 10 years to see if the goal was hit, that is not a good project for a SIB.’” (quoting Keith Weigelt, Professor, Wharton School of the University of Pennsylvania)). As SIBs are in their infancy, techniques may evolve to enable

actors who have a stake in the project, SIBs require strong communication among the actors.⁴⁵ Most likely, the investors will have to hire an intermediary organization to oversee the project as a whole.⁴⁶ The increased up-front costs associated with this model may make investors hesitant to invest.⁴⁷ Despite these disadvantages, the many benefits of SIBs have resulted in considerable interest among private investors.⁴⁸

C. *The Use of SIBs Globally*

The United Kingdom pioneered the use of SIBs in September 2010.⁴⁹ To fund the SIB, a nongovernmental organization (NGO) known as Social Finance UK raised £5 million in seed capital from investors.⁵⁰ Known as the Peterborough Prison Project (the Peterborough SIB), this ongoing SIB aims to rehabilitate short-term prisoners over several years.⁵¹ The recidivism rate of these prisoners will be compared with the recidivism rate of prisoners who are not enrolled in the rehabilitation program.⁵² If the recidivism rate among prisoners enrolled in the program drops by 10 percent relative to the

their use in longer-term projects. At their current stage of development, SIBs are likely limited to shorter-term projects.

45. See EMMA DISLEY, JENNIFER RUBIN, EMILY SCRAGGS, NINA BURROWES & DEIRDRE CULLEY, RAND EUR., LESSONS LEARNED FROM THE PLANNING AND EARLY IMPLEMENTATION OF THE SOCIAL IMPACT BOND AT HMP PETERBOROUGH 49 (2011), available at <http://www.justice.gov.uk/downloads/publications/research-and-analysis/moj-research/social-impact-bond-hmp-peterborough.pdf> (noting that one of the challenges in the implementation of the Peterborough SIB is the “need for coordination”).

46. See SOC. FIN., *supra* note 20, at 12 (“Launching a Social Impact Bond requires a significant effort up front to identify and vet potential programs and then negotiate a contract in which the government agrees to repay investors if the selected nonprofit service providers achieve specified social outcomes. A dedicated SIB intermediary can play a valuable role in these initial stages.”).

47. See *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (“Compounding that challenge is the fact that SIBs do come with additional costs. Those costs include advisors who help governments structure a SIB along with independent evaluators who will assess whether the program hit the agreed-upon targets.”).

48. See *id.* (“According to a survey focused on high net worth individuals released in May 2010 by San Francisco-based Hope Consulting, about 50% of those surveyed were interested in impact investing, pointing to a potential market of \$120 billion.” (citing HOPE CONSULTING, MONEY FOR GOOD: IMPACT INVESTING OVERVIEW 7 (2010), available at <http://www.hopeconsulting.us/wordpress/wp-content/uploads/2013/04/MFG1-Impact-Investing-Overview.pdf>)).

49. MCKINSEY & CO., *supra* note 3, at 19.

50. *Id.*

51. DISLEY ET AL., *supra* note 45, at 3.

52. *Id.*

control group of prisoners, the government will pay investors a return of 7.5 percent.⁵³ If the rate drops more, the government will pay a higher return of up to 13 percent.⁵⁴ As with most SIBs, if the outcomes are not met, investors will receive no return and will lose their entire investment.⁵⁵ Because the project has a six-year term, it is not yet known how successful these bonds will be in lowering recidivism rates.⁵⁶ Nevertheless, the agreement has been successfully executed and the program is underway.⁵⁷

D. *The Emergence of SIBs in the United States*

The concept of SIBs is gaining popularity among governments and the private sector in the United States.⁵⁸ Most notably, New York City Mayor Michael Bloomberg announced the first SIB in the nation at the local level in 2012.⁵⁹ Its goal is to reduce the recidivism rate among young men who are released from Rikers Island Prison (Rikers).⁶⁰ The SIB involves several actors. Goldman Sachs represents the private investor and is providing the up-front costs (via a \$9.6 million loan) to MDRC, the nonprofit organization that oversees the service providers that carry out the intervention.⁶¹ Bloomberg

53. *See id.* at 40 (“Social Finance indicated that if reconviction events are reduced by 10% across all cohorts, investors are expecting an annual internal rate of return of around 7.5% . . .”).

54. *Id.*

55. *See id.* (noting that investors will receive an “outcome payment” only if reconviction events are reduced by a certain percentage).

56. *See id.* at i (“However, given the early stage of development of the Peterborough SIB, we are unable to draw conclusions about or comment on outcomes.”).

57. *See id.* (explaining that the report’s goal is to show the development of the contract and the “early lessons” to be learned from the “implementation” of the program).

58. *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24.

59. MICHAEL R. BLOOMBERG, CITY OF NEW YORK, BRINGING SOCIAL IMPACT BONDS TO NEW YORK CITY 2 (2012), available at http://www.nyc.gov/html/om/pdf/2012/sib_media_presentation_080212.pdf.

60. *Id.* at 5.

61. *Id.* at 6. The service provider for the Rikers Island SIB is the Osborne Association, whose staff members are charged with implementing a program known as Adolescent Behavioral Learning Experience (ABLE). It plans to work with more than 10,000 Rikers Island prisoners during the time period of the SIB. According to the Osborne Association’s website, the prisoners

will participate in an evidence-based cognitive behavioral intervention, skill-building recreational activities, and reentry planning. . . . The primary component of the ABLE program is an evidence-based cognitive behavioral therapy (CBT) intervention. CBT is provided as a supplement to the regular academic program offered by the Department of Education (DOE) to adolescents in jail. The daily class schedule for each youth includes one period of CBT, which is facilitated by ABLE staff. The youth also have opportunities to participate in enhanced recreational and

Philanthropies has also agreed to provide a \$7.2 million loan to MDRC to guarantee part of the investment.⁶² Additionally, the Vera Institute of Justice is an independent assessor that will “determine[] whether the project achieves the targeted reductions in reincarceration.”⁶³ If recidivism rates fall within four years, then the city’s Department of Correction will pay MDRC, which then will pay back Goldman Sachs for its initial investment.⁶⁴ If the program does not meet its goals, the Department of Correction pays nothing.⁶⁵

For Goldman Sachs to break even on its original investment, the recidivism rate must be reduced by 10 percent,⁶⁶ which represents roughly \$1 million in long-term net savings for the city.⁶⁷ If recidivism drops by 20 percent or more, Goldman Sachs can profit up to \$2.1 million⁶⁸ and the city can save a staggering \$20.5 million in long-term net savings.⁶⁹ Although the results of the program will not be available until 2017,⁷⁰ if successful, the structure of this SIB will likely serve as a model for other local, state, and even federal SIBs in the future, as it is the first SIB established in the United States.

extra-curricula[r] activities aimed at skill-building for successful re-entry, including leadership, job readiness, team building, positive socialization, and behavioral and emotional management. Many young people will also receive reentry planning and follow-up services.

About the Adolescent Behavioral Learning Experience (ABLE), THE OSBORNE ASS’N, available at <http://www.osborneny.org/programs.cfm?programID=43> (last visited Aug. 4, 2013).

62. BLOOMBERG, *supra* note 59, at 6.

63. *Id.* at 4.

64. *Id.*

65. *Id.* at 6.

66. David W. Chen, *Goldman to Invest in City Jail Program, Profiting if Recidivism Falls Sharply*, N.Y. TIMES, Aug. 2, 2012, at A14.

67. BLOOMBERG, *supra* note 59, at 7. Goldman Sachs’s potential \$2.1 million profit comes from the approximately \$11.7 million that the government will pay MDRC if it achieves a reduction of 20 percent or more. *Id.* If it achieves such a reduction, the city pays MDRC \$11.7 million and MDRC turns around and repays Goldman Sachs this sum of money. See John Olsen & Andrea Phillips, Goldman Sachs, *Rikers Island: The First Social Impact Bond in the United States*, CMTY. DEV. INV. REV. 2013, at 97, 99, available at <http://www.frbsf.org/community-development/files/review-volume-9-issue-1.pdf>. Subtracting Goldman Sachs’s original investment of \$9.6 million, it stands to yield a \$2.1 million profit. Regardless of the program’s success, MDRC must repay Goldman Sachs for its loan, which it is able to do either through success payments received from the City or through the Bloomberg Philanthropies loan of \$7.2 million given to guarantee Goldman Sachs’s investment. *Id.* Thus, at worst, Goldman Sachs stands to lose \$2.4 million.

68. Chen, *supra* note 66.

69. BLOOMBERG, *supra* note 59, at 7.

70. Caroline Preston, *Getting Back More than a Warm Feeling*, N.Y. TIMES, Nov. 9, 2012, at F1.

Even in their infancy, SIBs are gaining traction among U.S. political actors. Although the novelty of SIBs poses the risk of uncertainty to both government officials and private investors, there is support for their use in preventive programs in which governments have failed to invest. If the theoretical advantages of SIBs come to fruition, SIBs could signal a new wave of social-impact investing. Before the successes of SIBs can be evaluated, however, they must first be implemented. In establishing these agreements, government officials will face obstacles in their efforts to ensure that SIBs do not fall prey to the traditional pitfalls of the privatization of government services.

II. PRIVATE PRISONS AS AN ANALOG TO SIBS

An examination of the problems of private prisons can help pinpoint potential challenges facing the use of SIBs in the criminal-justice system. With limited research on SIBs, lawmakers interested in establishing SIBs have minimal insight as to their potential problems. This means that choosing to enter into an SIB agreement with private investors becomes even more of a gamble in the midst of tightening budgets and economic uncertainty.⁷¹ In this light, the privatization of prisons can serve as an analog to examine the potential successes and pitfalls of SIBs. Because of the similarities between the privatization of prisons and the use of SIBs in the criminal-justice system, the problems plaguing private prisons are a good indicator of the potential problems of SIBs.

Because both the privatization of prisons and the use of SIBs involve the outsourcing of public services for profit, there are several integral similarities between the two contexts that make private prisons an apt analog to the use of SIBs in the prison system. First, the same impetus that resulted in the creation of private prisons is driving the use of SIBs in the criminal-justice system. Second, the primary motivation in both contexts is profit. Third, both the privatization of prisons and the use of SIBs inject the private sphere into traditional government functions. And, fourth, private prisons and prisoner-rehabilitation SIBs result in the private sector's involvement with a historically unpopular group with few advocates. These similarities allow private prisons to serve as an accurate

71. See *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (explaining that state and local governments' budgets have decreased significantly since 2008).

indicator of the problems that will likely face SIBs as governments implement them in the future.

First, the driving force behind the emergence of SIBs is the same as the impetus for the creation of private prisons. The movement to privatize prisons was fueled by the striking increase in incarceration during the 1980s.⁷² As one scholar explains, “by the mid-1980s, many states were facing serious budgetary problems traceable to the increased cost of running their prison systems, and these problems have only grown in intensity as incarceration rates have continued their upward climb.”⁷³ The increased rate of incarceration combined with the financial pressures to house a rapidly growing number of inmates resulted in a push to build and operate prisons more economically.⁷⁴ Similarly, the use of SIBs in the criminal-justice system, particularly in the context of rehabilitating prisoners, has emerged as a solution to rising overall incarceration and reincarceration rates.⁷⁵ Because incarceration is so costly⁷⁶ and because repeat incarceration is prevalent,⁷⁷ lowering recidivism rates is a key strategy to reduce costs.⁷⁸ But rehabilitation programs are also costly, and governments often do not have enough money in their budgets to execute such rehabilitation programs.⁷⁹ Considering the

72. Dolovich, *supra* note 12, at 455.

73. *Id.* at 456.

74. *Id.* at 455–58.

75. See *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (noting that SIBs are well-suited to fund rehabilitation and preventative programs for the nearly “50,000 incarcerated youth who are non-violent offenders and 1.6 million incarcerated adults with mental disorders or substance abuse problems” who can benefit from these services).

76. Jeffrey Brand-Ballard, *Moral Emotions and Culpability for Resultant Harm*, 42 RUTGERS L.J. 315, 333 (2011). See generally JOHN SCHMITT, KRIS WARNER, AND SARIKA GUPTA, CTR. FOR ECONOMIC AND POLICY RESEARCH, THE HIGH BUDGETARY COST OF INCARCERATION at 10 (2010), available at <http://www.cepr.net/documents/publications/incarceration-2010-06.pdf> (detailing the high cost of incarceration in America and its causes).

77. See Brian C. Kalt, *The Exclusion of Felons from Jury Service*, 53 AM. U. L. REV. 65, 132 (2003) (“Given that most felons will leave prison some day, and that recidivism is high, rehabilitation can be viewed as a means of crime control, not just as a reward to a malefactor.”); Daniel S. Nagin, Francis T. Cullen & Cheryl Lero Jonson, *Imprisonment and Reoffending*, 38 CRIME & JUST. 115, 120 (2009) (“[R]eoffending among prison inmates is high, with rates of official recidivism often reaching 60 percent within 3 years.” (citation omitted) (citing Patrick A. Langan & David J. Levin, *Recidivism of Prisoners Released in 1994*, 15 FED. SENT’G REP. 58 (2002))).

78. See BLOOMBERG, *supra* note 59, at 7 (providing a table that shows that reducing reincarceration can save New York City millions upon millions of dollars in the long term).

79. See *Social Impact Bonds: Can a Market Prescription Cure Social Ills?*, *supra* note 24 (noting that the “source[s] of funding for many social programs” are being cut).

unpopularity of prisoners among the public,⁸⁰ local governments may find it difficult to earmark funds for rehabilitation programs even if their end goal benefits society as a whole. Therefore, like private prisons, SIBs emerge as a solution to the budgetary problems facing local governments recovering from both the recession and the inability to earmark funds for rehabilitation programs when the state does have enough funds.⁸¹

Second, SIBs and private prisons have the same primary goal of financial gain. For both private-prison operators and private investors in the SIB arrangement, financial gain is the primary, if not ultimate goal for the private-sector actor.⁸² Although the state pays at different points in the timeline of the program or service to be administered for private prisons and SIBs,⁸³ the state remains “the ultimate paymaster” and the ultimate source of profit for both private-prison operators and SIB private investors.⁸⁴

A third similarity between private prisons and SIBs is the injection of the private sphere into traditional government functions. Fundamentally, because both private prisons and SIBs are forms of privatization, they center on the “contracting out of government services to the private sector” for profit.⁸⁵ Thus, concerns about inappropriate policymaking, compromising quality to cut costs,

80. David M. Adlerstein, Note, *In Need of Correction: The “Iron Triangle” of the Prison Litigation Reform Act*, 101 COLUM. L. REV. 1681, 1693 (2001).

81. See Dolovich, *supra* note 12, at 455–56 (explaining that private-prison contractors re-emerged as a response to rising incarceration rates and funding obstacles).

82. See *id.* at 460–61 (stating that private-prison operators’ primary concern for profit has led to “disturbing results” for prisoners); see also Max Rivlin-Nadler, *Goldman Sachs Looks To Turn a Profit on a Program To Fight Recidivism*, THE NATION (Aug. 20, 2012), <http://www.thenation.com/article/169472/goldman-sachs-looks-turn-profit-program-fight-recidivism> (describing that when public services are outsourced privately for profit, the public purposes of the service are secondary to the motive for profit).

83. See KRISTINA COSTA, SONAL SHAH, SAM UNGAR & SOC. IMPACT BONDS WORKING GRP., CTR. FOR AM. PROGRESS, FREQUENTLY ASKED QUESTIONS: SOCIAL IMPACT BONDS 1 (2012), available at http://www.americanprogress.org/wp-content/uploads/2012/12/FAQ_SocialImpactBonds-1.pdf (“In a social impact bond agreement, the government pays for realized outcomes at the conclusion of a contract, rather than paying upfront for programs or activities that may or may not have their anticipated effects.”).

84. See Dolovich, *supra* note 12, at 458 (“[T]he state remains the ultimate paymaster and the opportunity for private profit is found only in the ability of the contractor to deliver the agreed services at a cost below the negotiated sum.” (quoting RICHARD W. HARDING, PRIVATE PRISONS AND PUBLIC ACCOUNTABILITY 2 (1997))).

85. See Jon D. Michaels, *Privatization’s Pretensions*, 77 U. CHI. L. REV. 717, 717 (2010).

accountability, and oversight will likely arise.⁸⁶ Outsourcing public services to private entities for private profit profoundly affects the distribution of power among the state, the public, and the private sector.⁸⁷ Therefore, it is privatization's ultimate profit motive combined with its tendency to alter the relationship among private and public actors that make the problems that affect private prisons a strong predictor of the obstacles that SIBs will face.

Finally, the last integral similarity is the private sector's involvement in providing services to a historically unpopular group. With respect to both private prisons and those SIBs aimed at reducing recidivism rates among prisoners, the private sector is interacting with a target population that is historically unpopular⁸⁸ and has few legal safeguards once convicted of a crime and incarcerated.⁸⁹ Thus, privatization attempts raise questions about the government's monitoring of the operation of prisons and rehabilitative programs. Therefore, without watchdog groups or advocates for incarcerated felons, the private sector may abuse the power it has over the target population.

Although SIBs and private prisons face many of the same obstacles, SIBs are uniquely positioned to overcome the challenges confronting private prisons, as this Note will explain in Part IV. Because of the limited research on the use of SIBs, lessons learned from the privatization of prisons are central to the development and implementation of successful SIBs.

86. *See id.* at 718–19 (noting that privatization's critics point to accountability concerns such as the evasion of oversight and that privatization can result in the private sector's ability to alter policies that they are supposed to "neutrally" execute).

87. *Cf.* DISLEY ET AL., *supra* note 45, at iii ("In other payment-by-results arrangements, government has tended to maintain some control over the selection of providers. In the Peterborough SIB the government leaves that selection to an intermediary (such as Social Finance in the Peterborough SIB) and has no direct relationship with the service provider.").

88. David Cole, *Jurisdiction and Liberty: Habeas Corpus and Due Process as Limits on Congress's Control of Federal Jurisdiction*, 86 GEO. L.J. 2481, 2482 (1998).

89. *See* Kamal Ghali, *No Slavery Except as a Punishment for Crime: The Punishment Clause and Sexual Slavery*, 55 UCLA L. REV. 607, 620 (2008) ("Many state prosecutors are unwilling to prosecute prisoners for political reasons and tend to ignore most prison abuses.").

III. THE THREE PRIMARY PROBLEMS PLAGUING PRIVATE PRISONS

A considerable number of competing scholars have debated the propriety of private prisons.⁹⁰ The scholarship focuses on three primary problems. First, the act of privatization allows private prisons to exert a greater influence on public policy than is desirable, which leads to issues of accountability. Second, because private institutions have a profit motive, some private prisons compromise the quality of a prison to lower costs and thus increase profits. And third, the privatization of prisons has resulted in government relinquishment of monitoring and oversight roles that ensure the safety and efficacy of prisons.

These three problems have serious implications. Although they do not mean that all private prisons are worse than public prisons, they shed doubt on the contention that privatization is an automatic solution to poorly run government services. For private prisons to be a viable solution to the incarceration problem in the United States, these problems must be addressed.

A. *Privatization Allows Private-Sector Policymaking which Leads to Issues of Accountability*

One of the primary concerns about the privatization of prisons is that the private actor will set policy even though the private actor is only supposed to execute the policy set by a legislature or a government agency.⁹¹ In this context, the argument against private prisons is that they allow the private-prison operator to exert too much influence over prescribed legislative ends, leading to issues of accountability.⁹² In theory, privatization should operate as follows: the government “sets programmatic goals and requirements” while it hires a private actor to actually implement the program.⁹³ Theoretically, the private actor is to have no influence or involvement

90. See Dolovich, *supra* note 12, at 440 (noting that the “emergence of privately run, for-profit prisons, or ‘private prisons,’ sparked a heated debate” (quoting HARDING, *supra* note 84, at 2)).

91. See Michaels, *supra* note 85, at 719 (“They use government contracting in a way that substantively alters (or temporally ossifies) the very policies they are supposed to be neutrally administering.”).

92. See *supra* notes 85–87 and accompanying text.

93. Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1395 (2003).

in setting policy.⁹⁴ Rather, the private actor's job is to implement what the government has agreed is the appropriate policy.

In practice, however, private actors have much more responsibility and decisionmaking power than the government originally intended them to have.⁹⁵ This is because "the power to implement and apply rules is inseparable from the power to set policy."⁹⁶ For example, private-prison employees interact with prisoners on a daily basis and review their daily behavior.⁹⁷ Thus, it is these employees' standards or at the very least their interpretation of standards that form the basis of acceptable prisoner conduct.⁹⁸ This type of informal private-sector policymaking is exacerbated by the "necessarily incomplete" contracts between the government and private-prison operators that allow private operators "wide latitude in running the prison."⁹⁹

There are several areas in which private-prison operators and their interest groups have affected policy, but the most important area is sentencing. Private-prison operators have exerted considerable influence over sentencing in states without fixed sentencing guidelines.¹⁰⁰ In these states, the amount of time a prisoner serves is determined by the prisoner's actions and behavior as decided by prison officials during the prisoner's incarceration.¹⁰¹ Thus, private-prison employees have considerable discretion in deciding what behavior violates the rules and what behavior will result in the issuance of disciplinary tickets.¹⁰² During a disciplinary hearing, prison officials decide whether the behavior is severe enough to revoke

94. See Michaels, *supra* note 85, at 719 (stating that private actors are "supposed to be neutrally administering" policies).

95. See Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 551 n.15 (2000) ("Contracting out service provision segues in many cases from implementation of government policy into policy making itself.").

96. Metzger, *supra* note 93, at 1395.

97. Dolovich, *supra* note 12, at 518.

98. See *id.* ("[T]hose prison officials with direct day-to-day contact with inmates are in a position of considerable power over the length of the sentence individual inmates will ultimately serve.").

99. See *Developments in the Law—The Law of Prisons*, 115 HARV. L. REV. 1838, 1877 (2002) ("Contracts are necessarily incomplete: because the government and the private provider can only describe a general service and cannot specify beforehand in full detail exactly how the contractor should provide that service, the contractor has wide latitude in running the prison.").

100. Dolovich, *supra* note 12, at 518–23.

101. *Id.* at 518.

102. *Id.* at 518–19.

good-time credits and, thus, extend the incarceration period.¹⁰³ The determination of what behavior is punishable and what behavior can lead to a revocation of good-time credits constitutes a public-policy decision that should be decided by a legislature or a government agency.¹⁰⁴ Nevertheless, because a private prison's operation is so inextricably intertwined with its ability to discipline and to exert power over prisoners, private-prison employees effectively set policy in this area.¹⁰⁵

The danger of the private sector's involvement in such policymaking is that its policies will usually be designed to maximize the private operator's profit.¹⁰⁶ Because "profitability depends on maintaining a high occupancy rate, [private-prison operators] could encourage their employees in subtle and not-so-subtle ways to make judgments regarding individual inmates' behavior so as to prolong the amount of prison time that inmates serve."¹⁰⁷ The impact of "a single parole denial or revocation of good-time credit" is substantial, as it can be worth ten-thousand to twenty-thousand dollars or more per year for the private operator.¹⁰⁸ Thus, private prisons have a weighty interest in ensuring high incarceration rates, and their policies will likely reflect such an economic interest.

The private sector's considerable influence over policy related to private prisons leads to issues of accountability.¹⁰⁹ Whom does the public citizenry hold accountable for undesirable policies related to sentencing guidelines when private-prison actors are "further removed" than a public agency "from direct accountability to the

103. *Id.* at 519. Good-time credits, also known as good-conduct time, is credit given for a prisoner's good behavior during incarceration. The credits go toward a reduction in a prisoner's sentence, and are thus effectively a determination of the amount of time a prisoner serves.

104. See Richard A. Bierschbach & Stephanos Bibas, *Notice-and-Comment Sentencing*, 97 MINN. L. REV. 1, 2 (2012) ("In theory, criminal sentencing is a matter of justice, a question of public policy. Legislators, sentencing commissions, police, prosecutors, and judges are supposed to weigh an array of public values. In a democracy, voters naturally expect public servants to serve the public's shared sense of justice.").

105. See *supra* note 98.

106. See Dolovich, *supra* note 12, at 520 ("When the facility is run by a private, for-profit corporation, the worry is that the process will be skewed even more strongly against the inmate. The guard writing up the infraction, and in many cases the hearing officer as well, will be employed by a corporation with a direct financial stake—indeed, a paramount interest—in maintaining a high occupancy rate.").

107. *Id.* at 518.

108. *Id.* at 522.

109. See *supra* notes 86, 91–99 and accompanying text.

electorate”?¹¹⁰ Whom do prisoners hold accountable if they believe that the policies related to discipline, disciplinary hearings, revocation of good-time credits, and parole hearings are fundamentally unfair? These accountability concerns are aggravated by the very nature of incarceration itself.¹¹¹ The inability of the public and the prisoners to hold operators accountable for the most crucial aspects of criminal-justice policy such as sentencing constitutes a serious pitfall of private prisons.

B. Concerns about the Quality of Private Prisons as Compared to Public Prisons

The second major problem with private prisons is that, because private institutions have a more acute financial interest in their operation than the public sector, some private prisons compromise the overall quality of a prison to lower costs and thus increase profit.¹¹² It should be noted that there is considerable scholarly debate as to whether private prisons actually lower the quality of their prisons to save money or whether their spending cuts eliminate wasteful spending in prisons without lowering the quality of the prison overall.¹¹³ Nonetheless, the scholarship highlights a real danger that private-prison operators will diminish the quality of the prisons to save funds and make extra profit.

There are two primary types of spending cuts in private prisons. First, private-prison operators can cut the amount spent per inmate for basic prisoner needs.¹¹⁴ The operator reduces or eliminates nonessential services such as libraries, recreational activities, and

110. See Freeman, *supra* note 95, at 632 (explaining that unlike government agencies, private actors have an additional step of removal from “direct accountability to the electorate”).

111. See *id.* (“Running a prison involves something more than enforcement: It confers on private actors a powerful combination of policy making, implementation, and enforcement authority in a setting rife with the potential for abuse.”).

112. See Lucas Anderson, Note, *Kicking the National Habit: The Legal and Policy Arguments for Abolishing Private Prison Contracts*, 39 PUB. CONT. L.J. 113, 125 (2009) (“To increase profit margins, many private prison companies implement cost-cutting measures that detract from essential inmate services. These service impairments frequently lead to foreseeable yet tragic situations.”); see also Dolovich, *supra* note 12, at 473–80 (explaining the negative effects of private prisons on “conditions of confinement”).

113. In some studies, private prisons perform comparably to public prisons. For example, one commentary points to several safeguards such as contract rescission, competition and the threat of replacement, and civil suits as checks on private-prison operators that prevent them from lowering the quality of prisons. *Developments in the Law—The Law of Prisons*, *supra* note 99, at 1878–85.

114. Dolovich, *supra* note 12, at 474.

prisoner-rehabilitation programs.¹¹⁵ Second, private-prison operators can cut both the amount of labor and the amount spent on labor in private prisons.¹¹⁶ This includes hiring underqualified guards, minimizing the number of staff in a prison, and reducing staff training.¹¹⁷ Although these cuts reduce the cost of incarceration per prisoner, they also raise serious concerns regarding the quality of private prisons.¹¹⁸

In several studies, private prisons have not fared well when compared with their public counterparts.¹¹⁹ Private prisons, relative to public prisons, tend to face two major problems as a result of cost-cutting measures. For one, private prisons experience an elevated incidence of violence.¹²⁰ Because private prisons staff fewer, less effectively trained prison guards than public prisons, more violent incidents occur among prisoners in private prisons than among their public counterparts.¹²¹ A second problem is that private prisons tend to have an increased rate of recidivism among their inmates because private prisons have “almost no contractual incentive to provide rehabilitation opportunities or educational or vocational training that might benefit inmates after release”¹²² Thus, cost-saving measures

115. *See id.* (“First, contractors will be tempted to reduce the amount spent on meeting inmates’ needs. In a prison, every aspect of inmates’ lives is dictated by the institution: when, what, and how much they eat; whether they get leisure time, adequate medical care, protection from harm, or access to rehabilitative or educational programming; the content and design of their beds and their cells; and when they shower and for how long. . . . In a private prison, each of these aspects of inmates’ lives offers the potential for increasing profit margins.”).

116. *Id.* at 475–76.

117. *See id.*

118. *See id.* at 476 (noting that these cuts “increase the threat to inmates of physical assault”).

119. *See* Michael Brickner & Shakyra Diaz, *Prisons for Profit: Incarceration for Sale*, HUM. RTS., Summer 2011, at 13, 15 (noting that private prisons may perform worse in the areas of “protection for the public, rehabilitation for the offender, and punishment for the criminal”); Dolovich, *supra* note 12, at 502–05 (explaining that private prisons tend to have more violent incidents than public prisons); Brad W. Lundahl, Chelsea Kunz, Cyndi Brownell, Norma Harris & Russ Van Vleet, *Prison Privatization: A Meta-analysis of Cost and Quality of Confinement Indicators*, 19 RES. ON SOC. WORK PRAC. 383, 384 (2009) (“Neither cost savings nor improvements in quality of confinement are guaranteed through privatization. . . . An empirical argument against privatization may be made based on the finding that publicly managed prisons tend to provide better skills training programs and seemed to generate fewer complaints or grievances.”).

120. *See* Dolovich, *supra* note 12, at 473 (“[P]rivate prisons are likely to be more violent . . . than state-run prisons.”).

121. *Id.* at 502–05.

122. *See* Patrick Bayer & David E. Pozen, *The Effectiveness of Juvenile Correctional Facilities: Public Versus Private Management*, 48 J.L. & ECON. 549, 554 (2005); *see also*

have resulted in quality diminishment in the important areas of safety and rehabilitation.

C. *Government Relinquishment of Its Monitoring and Oversight Roles*

The third and final major problem plaguing private prisons is that they have resulted in government relinquishment of monitoring and oversight roles that are designed to ensure the safety and efficacy of prisons.¹²³ Effectively overseeing private prisons consumes substantial resources—“only a constant and omniscient governmental presence within the prison walls could ensure that a demanding contract’s performance standards are met” because private-prison operators have an incentive “to conceal information” and records.¹²⁴ Because government monitoring is costly,¹²⁵ sufficient and effective governmental monitoring would essentially swallow the savings that a private prison accrues.¹²⁶

Not only does the government have little incentive to conduct more than minimal monitoring of private prisons, but it is also difficult for external groups, such as watchdog organizations, to monitor the prisons.¹²⁷ Although NGO and civilian oversight have

Anderson, *supra* note 112, at 130 (“The findings of the Bayer and Pozen study demonstrate how private prison companies encourage recidivism by actively neglecting or discouraging rehabilitative programs.”); Brickner & Diaz, *supra* note 119, at 15 (2011) (“States such as New Mexico, Alaska, Hawaii, and Vermont, which have some of the highest percentages of privatized prison beds, also have some of the highest three-year recidivism rates.”).

123. See James Theodore Gentry, Note, *The Panopticon Revisited: The Problem of Monitoring Private Prisons*, 96 YALE L.J. 353, 358–60 (1986) (discussing several factors that “suggest . . . that the state as monitor will be less reliable than the state as administrator”).

124. Anderson, *supra* note 112, at 133.

125. Nicole B. Cásarez, *Furthering the Accountability Principle in Privatized Federal Corrections: The Need for Access to Private Prison Records*, 28 U. MICH. J.L. REFORM 249, 294 (1995).

126. See Anderson, *supra* note 112, at 133 (“The degree of governmental oversight that would be necessary to ensure that private prison companies actually adhere to demanding and particularized contract or accreditation requirements would be so great as to increase costs to the point where neither the Government nor the contractor would agree to such terms.”); see also Cásarez, *supra* note 125, at 294 (“An agency therefore has little incentive to convert cost savings into monitoring expenses.”).

127. See Warren L. Ratliff, *The Due Process Failure of America’s Prison Privatization Statutes*, 21 SETON HALL LEGIS. J. 371, 407 n.183 (1997) (“Without access to information on privatization contracts, inmates would not be able to learn the full range of their rights . . . nor would inmates, their lawyers, watchdog groups, or the media be able to ascertain whether private prisons had adequate contractual safeguards in place.”).

been considered effective in aspects of the criminal justice system,¹²⁸ structural barriers to revealing private-prison records and information make such external oversight unlikely to be as effective in the private-prison context.¹²⁹ Because private-prison records are unlikely to be covered by the Freedom of Information Act,¹³⁰ it is almost impossible for watchdog organizations to gather objective information regarding the quality, safety, and efficiency of private prisons.¹³¹ This is a serious concern considering that the very nature of prisons lends itself to abuse and violence.¹³² Thus, because of the government's relinquishment of oversight and external groups' inability to monitor private prisons, many of these abuses persist, creating a more violent and degenerate prison atmosphere.

In conclusion, problems relating to inappropriate policymaking over sentencing, lowering quality to save costs, and inadequate monitoring plague private prisons. Even if private prisons save money by cutting costs, the cost of violent and overcrowded prisons is too high to justify their existence in their current state. Lawmakers considering SIBs should pay careful attention to these privatization problems and consider how they may affect the success of SIBs.

IV. THE PROBLEMS AS APPLIED TO SIBS AND POTENTIAL SOLUTIONS

This Part will analyze how the problems described above may affect the use of SIBs in programs such as lowering recidivism rates among prisoners. The potential for these problems to affect the success of SIBs should not be viewed as an argument against their use or against privatization more generally. Rather, it should be viewed as an instructive lesson for local, state, and federal government officials contemplating the use of SIBs. Government officials can maximize

128. See Michael B. Mushlin & Michele Deitch, *Opening Up a Closed World: What Constitutes Effective Prison Oversight?*, 30 PACE L. REV. 1383, 1397–98 (2010) (“Probably the best-known examples of oversight of the criminal justice system in the United States arise in the context of civilian oversight of law enforcement, rather than in the prison context.”).

129. See Cásarez, *supra* note 125, at 291 (stating that “prison records created and maintained by private prison management firms are unlikely to be considered agency records and therefore will not be subject to the” Freedom of Information Act).

130. Freedom of Information Act, 5 U.S.C. § 552 (2012); see Cásarez, *supra* note 125, at 291.

131. See Cásarez, *supra* note 125, at 259 (“Only prisoners are in a position to judge the quality and sufficiency of the services provided, and prisoners are neither the most visible nor the most articulate group in society.”).

132. See *supra* notes 120–21 and accompanying text.

the success of SIBs by preempting or mitigating these problems. For each problem, this Part will discuss how the structure of SIBs inherently mitigates the problem and what additional mechanisms can be instituted to prevent or further address the problem. Finally, this Part will propose several integral model provisions to be included in an SIB agreement, similar to the Model Contract and Model Statute that have been proposed for private prisons.¹³³ These provisions aim to rectify the privatization problems associated with private prisons.

A. Privatization Facilitates Private Sector Policymaking Leading to Issues of Accountability

One of the problems of private prisons is that they allow private actors to exert a considerable degree of influence over policy decisions that should be made by the government, resulting in issues of accountability. This problem manifests itself in SIBs when the private sector cherry-picks the issues or target populations in which to invest.¹³⁴ For example, private investors may consistently want to fund programs that target only female prisoners while eschewing projects that target male populations.¹³⁵ The private sector's willingness to invest only in certain social programs or in certain populations could lead to the government expending more money on that target population than originally intended. In this sense, the private sector is asserting a greater influence over what society thinks are important investments and thus, can directly affect or change public policy.

The structure of SIBs mitigates this problem because private investors will only target and invest in projects for which they know the government will pay them a return if they meet certain agreed-upon outcomes and goals.¹³⁶ If no money is allocated to a particular SIB in the first place, the private investor will almost certainly decide not to pursue that project. Additionally, the theoretical success of

133. For a discussion of the Model Contract and Model Statute, both proposed in an article by Professor Ira P. Robbins, *The Legal Dimensions of Private Incarceration*, 38 AM. U. L. REV. 531 (1989), see *infra* Part IV.D.

134. See DISLEY ET AL., *supra* note 45, at iv (“A risk in [payment-by-results] models is that providers focus on members of the target group who are the easiest to help.”).

135. Cf. Candace Kruttschnitt & Rosemary Gartner, *Women's Imprisonment*, 30 CRIME & JUST. 1, 44 (2003) (“Recidivism data uniformly indicate that women are less likely to reoffend than men.”).

136. See generally MCKINSEY & CO., *supra* note 3, at 14–15 (describing the structure of SIBs and the interaction among the different SIB actors).

SIBs has raised interest among a substantial group of investors.¹³⁷ The more successful these projects are, the more interest that these projects will likely generate among private corporations and investors. Corporations and investors are generally interested in a variety of social projects, so the more interest there is among SIBs, the less likely it is that any one investor or corporation can influence the government to earmark money for a particular project while failing to focus on other social ills. This variety of interest is apparent as governments and investors have adopted even unpopular SIB projects such as rehabilitating prisoners.¹³⁸

Apart from the structural components of SIBs, lawmakers can rely on additional mechanisms to mitigate problems of inappropriate policymaking. One way to mitigate the concern that private-sector interest in a particular program will result in the government earmarking funds specifically for that project and taking away funds from projects that are socially desirable is to set up appropriations for SIBs in the budget.¹³⁹ For example, legislators may earmark a certain amount for prison-rehabilitation programs, early childhood education programs, or reducing homelessness. This solution relates to the structure of SIBs because private investors will only be interested in investing in projects for which they know the government will compensate them if they meet the agreed-upon outcomes.

Although there is a potent threat that the private sector may improperly influence legislative ends via SIBs, there are several steps that government actors can take to prevent such improper influence. In addition to the structural-mitigation aspects of SIBs, government actors can further mitigate these concerns by earmarking funds for desired legislative projects in advance of accepting SIB proposals from private investors. It is important to note that even with the implementation of this solution and the structural mitigation of SIBs, the private sector will likely still influence legislative ends to some

137. There is substantial interest among the wealthy in social-impact investing. *See supra* note 48.

138. *See supra* notes 29, 80, and 88 and accompanying text.

139. Massachusetts has established a “Social Innovation Financing Trust” (the Trust) to be funded “through annual appropriations,” but the funds themselves are not further earmarked for specific projects agreed upon by the legislature. *See Costa & Kohli, supra* note 19. The commonwealth solicited proposals for only two types of SIBs: homelessness and juvenile justice. *Id.* Although the commonwealth’s solicitation of proposals for these pinpointed goals mitigates the risk that private investors can improperly influence legislative ends, specifically earmarking appropriations in the Trust is a stronger and more permanent solution to mitigating such improper influence.

degree due to the nature of an SIB as an agreement between multiple actors.¹⁴⁰

B. Concerns about the Quality of SIBs

A second concern with private prisons is that the profit motive will lead the operator to sacrifice quality for cost savings. In the context of SIBs, the private investor may choose a less-qualified service provider or may reduce the number of staff to administer the rehabilitation program to prisoners. However, the structural model of the SIB can address this problem quite significantly. Unlike the prison context in which the overall quality of the prison may suffer but prison operators will still be paid a set rate for every prisoner,¹⁴¹ in an SIB, the government only pays investors if the required outcome is achieved.¹⁴² Because SIBs embed economic incentives for improved quality into the agreement, the motive for profit is inextricably linked to the desired socially valuable result.¹⁴³

The private sector will likely not compromise quality because if it does, the very outcome that it relies upon for profit will not be achieved.¹⁴⁴ For example, a program with fewer, less-qualified staff members will be less likely to actually succeed in rehabilitating prisoners. Consequently, any money the private investors put forth will likely be a waste unless that investment can achieve the agreed-upon outcome.¹⁴⁵ Rather, the economic incentives of the SIB result in significant private investment into the quality of SIB programs to achieve the outcome and make profit. Therefore, by tying profit to high-quality outcomes, SIBs structurally mitigate the risk—so commonly associated with privatization—that private actors will compromise quality for cost savings.

140. Cf. DISLEY ET AL., *supra* note 45, at 38 (explaining under the conclusions and potential lessons for future SIBs that the outcome measure had “the confidence of all stakeholders,” which would include the private investor).

141. See *supra* notes 106–09 and accompanying text.

142. See SOC. FIN., *supra* note 20, at 4–5.

143. See *supra* notes 20–24 and accompanying text.

144. See LIEBMAN, *supra* note 42, at 2 (“The private investors also perform an important form of quality control. That’s because service providers must convince the private investors that their program model and management team are likely to achieve the performance targets.”).

145. See *id.* (“[I]f performance targets are missed, [investors] will lose the money they invested.”).

Another way in which SIBs structurally mitigate the problems facing privatization is that the service providers themselves can perform a quality-monitoring role. In fact, service providers have much more expertise in the program to be administered and more experience with the target population than do private investors or the government.¹⁴⁶ Because the service provider will most likely be a nonprofit or an NGO dedicated to achieving the particular goal (for example, lowering recidivism rates or reducing homelessness),¹⁴⁷ the service provider will likely voice its concerns to the other SIB actors if there are quality-control issues, understaffing, abuses, or other problems.¹⁴⁸

Overall, the economic incentives underlying an SIB mitigate the concern that the private sector will compromise the quality of an SIB for cost savings. In addition to these structural-mitigation mechanisms, quality-control issues could also be decided before the contract is signed between the parties to the SIB.¹⁴⁹ Overall, the use of SIBs has tremendous potential to diminish the quality issues that face private prisons.

C. *Government Relinquishment of its Monitoring and Oversight Roles*

The third and final problem with private prisons is that a shift of power from the government to the private sector may result in the government's abandonment of its monitoring role. In the context of SIBs, the concern is that the government will relinquish its

146. Cf. SOC. FIN., *supra* note 20, at 28 (giving a hypothetical in which a nonprofit organization has focused heavily on a particular topic such as homelessness and has developed programs to address that particular topic in-depth).

147. Cf. *id.* at 17 (identifying “nonprofits with programs that have been shown to be effective” as “ideal candidates for SIB funding”).

148. Nonetheless, one can argue that a service provider hoping to retain employment as a service provider still has an incentive to underreport problems. Although that is a possibility, compared to private-prison operators or other for-profit providers, nonprofit service providers have a greater incentive to act as a watchdog. See Louise G. Trubek, *Old Wine in New Bottles: Public Interest Lawyering in an Era of Privatization*, 28 FORDHAM URB. L.J. 1739, 1744–47 (2001) (“Nonprofit agencies serve as ideal candidates for providing services in a privatized system because they tend to be more participatory in their internal structures and delivery mechanisms than their for-profit counterparts. . . . Moreover, as nonprofits become more embedded in the social service delivery network, they are more likely to speak out when the needs of the community are not being met. Because they are in the best position to know what these needs are, nonprofits have a certain built-in credibility that other actors typically lack.”).

149. The ways in which the contract itself can mitigate concerns related to the quality of SIBs are discussed in Part IV.D.

monitoring role of the rehabilitative program because of the cost associated with such monitoring.¹⁵⁰ Again, SIBs have structural controls that mitigate this problem quite significantly. Although SIBs, like private prisons, could transfer power from the government to private parties, SIBs distribute that power among more parties, including the intermediary organization, private investors, independent assessors, and the service provider.¹⁵¹ Therefore, unlike in the private-prison context, in which power shifts almost exclusively to the private-prison operator,¹⁵² in the context of SIBs, power shifts to multiple actors.¹⁵³ Because power is distributed among more actors, there are more groups of people who have access to and can monitor the program.

Furthermore, unlike in the private-prison context, the private company investing in an SIB is not operating or administering the services to the prisoners. Rather, the service organization, usually a nonprofit organization whose goal is to serve the target population, administers the program.¹⁵⁴ Because these organizations usually involve staff who are dedicated to rehabilitating prisoners and who have expertise in working with prisoners, there is less concern that the service organization would exert power over prisoners in an improper manner in the way private-prison employees can.¹⁵⁵ In this sense, concerns about abuse are generally mitigated by the very nature of prisoner-rehabilitation SIBs, which are designed to afford learning opportunities and counseling for prisoners.¹⁵⁶

The final and perhaps most robust structural solution to address problems related to ineffective monitoring is the economic incentives that an SIB creates. The government pays only if the targeted outcomes are met, so the private actor has an incentive to monitor the

150. *Cf. supra* notes 85–87 and accompanying text.

151. *See* MCKINSEY & CO., *supra* note 3, at 14–15 (describing the structure of SIBs and the interaction among the different SIB actors); Michaels, *supra* note 7, at 30 (discussing the relationships involved in an SIB).

152. *See* Anderson, *supra* note 112, at 122–24 (describing the discretionary powers delegated to private-prison administrators).

153. MCKINSEY & CO., *supra* note 3, at 14–15.

154. *Id.*

155. *See supra* Part III.C.

156. *See* Chen, *supra* note 66 (“The jail program, which will offer counseling and education for an estimated 3,400 incarcerated adolescent men each year, will be run by two nonprofit organizations, Osborne Association and Friends of Island Academy, and overseen by MDRC.”).

program to identify and to eliminate any abuses.¹⁵⁷ Because monitoring is designed to eliminate abuses against the population to be served (in this case, the prisoners to be rehabilitated) and because such abuses would presumably lower the chances of meeting the targeted goals of lowering recidivism rates,¹⁵⁸ the SIB incentivizes the private actor to assume the cost of monitoring to detect and to stop such abuses. Therefore, as compared to the current structure of private prisons, SIBs lessen the need for government oversight of the services they provide, resulting in even greater cost savings to the government while still ensuring baseline monitoring of the program.

Lawmakers could entertain several additional solutions to mitigate the problem of ineffective monitoring. SIBs should still require some independent governmental oversight. Unlike private prisons, in which government monitoring and oversight expenditures would swallow up any of the savings produced by privatization,¹⁵⁹ the same is not true of SIBs. Because the government has no up-front costs and does not have to provide up-front funding for the inputs of the program (such as paying the service provider),¹⁶⁰ it might still make financial sense to monitor and oversee the program. Because there are so many other actors who can monitor the safety and efficacy of the program, the costs associated with oversight can be lowered substantially.

For example, one cost-effective monitoring solution is to incorporate a board or a task group similar to the New York City Board of Correction, a well-known, independent-oversight organization.¹⁶¹ Members of this task group could be political appointments made by the mayor or other local authority.¹⁶² Like the

157. See LIEBMAN, *supra* note 42, at 2 (“The investors and bond-issuing organization also have strong incentives to rigorously monitor and improve program performance; if performance targets are missed, they will lose the money they invested.”).

158. Alexander Volokh, *Prison Vouchers*, 160 U. PA. L. REV. 779, 785 (2012) (“Brutal conditions, as well as excessive use of high-security segregation, make prisoners less useful members of society and more likely to reoffend.” (footnotes omitted)).

159. See Anderson, *supra* note 112, at 130–32 (explaining that studies have failed to find that private prisons offer substantial savings, in part due to the costs of compliance monitoring and enforcement).

160. See Cox, *supra* note 1, at 968 (describing the funding structure of SIBs in which the government does not pay for initial inputs, but rather pays only upon the achievement of agreed-upon targeted outcomes).

161. See Mushlin & Deitch, *supra* note 128, at 1401 (“One of the best-known examples of governmental oversight is the New York City Board of Correction, which oversees and regulates the city’s jail system.”).

162. *Id.*

New York City Board of Correction, the members should not be compensated¹⁶³ so that the costs would remain low. In this sense, though it is a government entity and represents the government, “there is an element of citizen involvement incorporated into this model.”¹⁶⁴ To be most effective, the task group should have the authority to monitor the program firsthand, obtain reviews from staffers, and generally ensure that the program does not abuse the power that its operators have over the prisoners.

In conclusion, the structure of SIBs, coupled with additional solutions, has the potential to reduce or even eliminate the problems associated with private prisons. Undoubtedly, the most important structural element of SIBs is the payment model that rewards the private actor only if the program achieves the desired outcomes. This payment scheme creates economic incentives to ensure high-quality programs and effective internal monitoring of potential problems, thus curbing many of the issues that burden private prisons. Though the incentives associated with SIBs abate these burdens, there are additional solutions, described above, that governments can implement to mitigate accountability, quality, and monitoring issues. These additional solutions should be incorporated into the SIB agreement.

D. Important Provisions in SIB Agreements: The Legal Aspects of SIBs

The cornerstone of an SIB is the agreement between the government and the various SIB actors.¹⁶⁵ From a legal perspective, the contract should include provisions that rectify the nondelegation and due process issues plaguing private prisons. Many of these issues raise questions about whether incarceration is a core government function that cannot be delegated,¹⁶⁶ and whether private firms’ discretionary authority over inmates’ liberties violates due process.¹⁶⁷ Responding to the emergence of private prisons, the research

163. *Id.*

164. *Id.* at 1402.

165. *See generally* DISLEY ET AL., *supra* note 45, at 17 fig.1 (illustrating the complex contractual agreements necessary to execute the Peterborough SIB).

166. *See* Robbins, *supra* note 133, at 574–75 (1989) (discussing the means by which private prisons can avoid constitutionally impermissible behavior).

167. *See* Ratliff, *supra* note 127, at 403–09 (contending that prisons have too much power and that prison contracts are unconstitutional not because of the nondelegation doctrine but rather on due process grounds).

regarding the negative effects of private prisons, and the lack of scholarship on the legal aspects of private prisons, Professor Ira Robbins published an article on the legal aspects of incarceration.¹⁶⁸ The article proposes a Model Contract and Model Statute for jurisdictions to emulate if they decide to privatize their prisons.¹⁶⁹

The Model Contract and Model Statute aim to resolve many of the problems described above by creating a more complete contract that “preserv[es] accountability in the private-incarceration process.”¹⁷⁰ For example, to mitigate issues related to inappropriate policy delegation, the Model Contract and Model Statute provide that “the contractor has no authority to influence the length of stay for any inmate.”¹⁷¹ Additionally, in terms of quality issues, the relevant terms set forth that “the contract must offer substantial cost savings and at least the same quality of services as would result from government provision.”¹⁷² With respect to monitoring issues, the terms state that “a permanent on-site monitor is required to enforce standards”¹⁷³ and that “the contractor must meet the operating standards of quality specified by the American Correctional Association.”¹⁷⁴

Because the contract requires a performance bond to be posted and fines to be imposed if standards are violated,¹⁷⁵ it incentivizes private-prison operators to consciously mitigate the problems typically associated with the privatization of prisons.¹⁷⁶ Furthermore, because the Model Contract and Model Statute envision that the contracting government agency as well as third-party beneficiaries such as inmates and the public may sue for breach of contract,¹⁷⁷ the

168. Robbins, *supra* note 133.

169. For a summary of the Model Contract, see *id.* at 738–57. For the Model Statute, see *id.* at 789–94. The purpose of the article was not to espouse a view as to the desirability of private prisons relative to public prisons, but rather to stress that “if privatization is undertaken,” local governments “*must ensure accountability* — to the public, to the government, to the inmates, and to the contractor’s own promises.” *Id.* at 543 (first emphasis added).

170. *Id.* at 612.

171. See Kenneth L. Avio, *On Private Prisons: An Economic Analysis of the Model Contract and Model Statute for Private Incarceration*, 17 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 265, 276–77 (1991) (summarizing the core aspects of the Model Contract and Model Statute).

172. *Id.*

173. *Id.* at 277.

174. *Id.* at 276.

175. Robbins, *supra* note 133, at 647.

176. Avio, *supra* note 171, at 284 (explaining that a performance bond is one of several “incentive mechanisms” to fix quality issues).

177. Robbins, *supra* note 133, at 616, 783.

threat of legal liability also ensures that private-prison operators adhere strictly to the guidelines and the requirements memorialized in the contract.

Although Professor Robbins's Model Contract and Model Statute would seem to mitigate many of the problems associated with private incarceration, the provisions have not been widely adopted.¹⁷⁸ Furthermore, other approaches, such as imposing due process restrictions on the prison operators in the contract, have also been ignored.¹⁷⁹ Rather, contracts between the contracting agency and the prison contractor remain alarmingly "lax" in many cases.¹⁸⁰ Most private-prison contracts are incomplete¹⁸¹ and provide considerable autonomy for private-prison employees behind closed prison doors.¹⁸² Perhaps the reluctance to adopt the Model Contract and Model Statute comes from the unwillingness of private-prison firms to be subject to third-party liability. Or, perhaps the provisions of the contract are too costly for the private firm to execute at a profit. Regardless of the reason, contracts between government agencies and private-prison firms remain incomplete, allowing an inappropriate amount of policymaking authority to be delegated to the private prison without accountability for their outcomes such as safety and rehabilitation rates.

Although governments have not adopted the Model Contract and Model Statute for private prisons,¹⁸³ professional organizations should attempt to create a similar model contract or model provisions

178. See Ratliff, *supra* note 127, at 419 ("In sum, the vast majority of the nation's prison privatization statutes do not sufficiently insulate inmates' liberties from contractors' financial biases.").

179. See *id.* at 423–24 ("[T]o satisfy due process, the state and federal governments cannot entrust their rulemaking and adjudicative powers to financially-interested parties. . . . Whether or not prison privatization is living up to its policy promises, this Article has shown that the vast majority of today's private prison statutes are unconstitutional.").

180. See *id.* at 407 ("Much like the federal government, twelve states have also taken a strikingly lax approach to prison privatization. At the extreme, nine of these states have not made even token attempts to limit the breadth of contractors' powers over inmates' liberties.").

181. See *Developments in the Law—The Law of Prisons*, *supra* note 99, at 1877 ("Contracts are necessarily incomplete: because the government and the private provider can only describe a general service and cannot specify beforehand in full detail exactly how the contractor should provide that service, the contractor has wide latitude in running the prison.").

182. See *id.* ("[T]he contractor has wide latitude in running the prison."); Ratliff, *supra* note 127, at 403 ("First, I highlight the complete failure of the federal government and twelve of the privatizing states to place any meaningful due process restrictions on contractors' authority.").

183. See *supra* note 178 and accompanying text.

for SIBs and governments to adopt.¹⁸⁴ Like the Model Contract and Model Statute for private prisons, an SIB agreement should incorporate accountability and government oversight measures.¹⁸⁵ Unlike the Model Contract and Model Statute, in which the primary focus is on accountability through numerous specific contractual provisions that expose the private-prison operator to contractual liability,¹⁸⁶ the focus outlined here is on accountability via target outcomes that create economic incentives to perform well. The emphasis on targeted outcomes is preferable because ensuring accountability via specific contractual provisions on every imaginable quality control or monitoring issue is unrealistic. In this context, several key provisions are suggested below.

1. *Compensation Must Be Tied to Targeted Outcomes and Socially Valuable Results.* SIBs are a more optimal form of privatization because they link profit to the private actor's ability to achieve targeted outcomes and socially valuable results. Because profit is preconditioned on achieving the agreed-upon outcomes, the private actor must invest in high-quality programs to achieve such results.¹⁸⁷ Thus, one of the ways that the contracting government agency can ensure high-quality services is to implement robust compensation measures. As an example, for the Peterborough SIB, government officials determined the value of rehabilitation (the targeted outcome) by using a "value for each reduced reconviction event" and "the number of reduced reconviction events."¹⁸⁸ Because the value for each reduced reconviction event will likely be the product of negotiation between the government and the intermediary or management organization,¹⁸⁹ this is one way in which the government can ensure that the private sector does not improperly

184. See DISLEY ET AL., *supra* note 45, at 54 ("[S]ome interviewees reported an appetite for, and interest in, developing some standard contract terms and definitions for SIBs, which could make drafting and signing up to future SIB contracts an easier process.").

185. See *supra* notes 170–74 and accompanying text.

186. See Robbins, *supra* note 133, at 616 ("The contractor's failure to meet its contractual obligations could make it liable to the contracting agency for breach of contract and, under the language of the Model Contract, to the public and inmates as third-party beneficiaries.").

187. See LIEBMAN, *supra* note 42, at 2 (describing the link between the private investor engaging in quality control and choosing the service provider who is "likely to achieve" the agreed-upon outcomes).

188. DISLEY ET AL., *supra* note 45, at 40.

189. See *id.* (noting that the "value for each reduced reconviction event" was "negotiated and agreed between Social Finance and the Ministry of Justice").

influence policymaking by setting its own optimal target for lowering recidivism rates.

Yet, it is important to note that this goal is a product of negotiation, and, thus, SIB actors will be able to influence the targeted outcomes based upon the amount of risk they think they can bear. Nonetheless, because the desired outcome will save a government more money than what it will expend if the outcome is met, a government pays only for socially valuable results.¹⁹⁰ And because a private actor will want to maximize its chances of meeting the targeted outcomes, SIBs incentivize a private actor to invest in high-quality programs and to identify and curb any abuses against the target population.¹⁹¹ Therefore, provisions tying profit to *results* as opposed to *inputs* are the most integral component of the agreement, and SIB actors must identify precisely the targeted outputs to be achieved by the program, operation, or services.

Hence, it cannot be underscored enough how the SIB model improves upon traditional forms of privatization such as private prisons in which the private contractor receives up-front government payment to fund inputs. The pressure to meet the outcomes to make a profit shifts much of the burden to ensure the success of the program to the private actors involved in the SIB.¹⁹²

The remaining proposals below suggest how the government can mitigate the quality-concern issues and monitoring issues associated with private prisons by requiring certain provisions in the SIB contract. Unlike in the private-prison context, in which the operator would likely not follow the provisions without being required to do so, in the SIB context, the private actor will likely adopt these provisions even without contractual pressure to ensure that the program is successful. For example, to achieve a reduction in recidivism rates among high-risk repeat offenders, an organization has to invest in a highly qualified service provider whose employees meet certain minimal qualifications and training requirements,¹⁹³ even

190. See BLOOMBERG, *supra* note 59, at 7 (showing that if there is a reduction in reincarceration rates of 16 percent or more, the city's projected long-term net savings are greater than the city's payment to the intermediary organization).

191. See LIEBMAN, *supra* note 42, at 2 (explaining that "private investors also perform an important form of quality control" because they must pick high-quality service providers who can achieve the outcomes and that they are incentivized to monitor the program).

192. See MCKINSEY & CO., *supra* note 3, at 7 (explaining that it is "philanthropic funders and impact investors" who assume the "financial risk of expanding" socially valuable programs).

193. See *supra* Part IV.B.

if the SIB agreement does not specify what qualifications or what level of training is required. The same reasoning applies when considering the program's minimal staff-ratio and monitoring requirements. Nonetheless, provisions in the agreement add an extra layer of security by ensuring the private actor's adherence to the provisions. But agreements are often incomplete. When the agreement is silent on an important quality-control issue, the economic incentives that SIBs create are powerful because they increase the chances that the private actor will err on the side of higher quality to maximize profit even without specific contractual provisions requiring it to do so.

2. *Establishing Employee Qualifications and the Service Provider.*

An additional way to ensure high-quality rehabilitative services is for the government to set minimal qualifications for employees who are providing the rehabilitative services. Like the Model Contract and Model Statute provisions regarding employee training, there should be an established minimal level of training required of all employees who engage in rehabilitative services.¹⁹⁴ In the context of an SIB to lower recidivism rates, this could include a minimal level of work experience or required training programs provided by the service provider.¹⁹⁵ As with private prisons, “[t]raining is one area in which prospective contractors may attempt to reduce costs in order to ensure that they make a profit.”¹⁹⁶ The structure of SIBs mitigates this issue because investors will only profit if the services are successful, and thus, they will want highly trained staff. Nonetheless, such qualifications should be agreed upon in the contract to further ensure such high-quality staff and to prevent cost-cutting measures in employee training throughout the course of the program.

3. *Monitoring Provisions.* One of the key provisions to ensure governmental accountability is to provide for government monitoring and oversight in the contract. The SIB contract should include a

194. See Robbins, *supra* note 133, at 687 (“It is imperative that all of the private contractor’s employees receive adequate training in order to ensure the safety and security of the inmates, the staff, and the surrounding community.”).

195. See *id.* (“The Model Contract requires that all prison and jail employees receive new-employee orientation training prior to their initial assignment with the contractor. It also provides for regular training and continuing-education programs that are appropriate for the various types of employment.”).

196. *Id.* at 781.

provision that the monitor will be an employee of the contracting government agency and will have unimpeded access to the rehabilitative-services site.¹⁹⁷ Furthermore, the contract should provide that the monitor will have complete access to records and other documentation related to the administration of the rehabilitation services.¹⁹⁸

In sum, these provisions have the potential to solve many of the issues affecting private prisons. Unlike with private prisons, these model provisions might have a considerable impact on the emergence of SIBs because there are not many SIB agreements already in existence.¹⁹⁹ Because contracts can mitigate many of the negative aspects of private prisons, governments should be advised of the critical role contractual terms play in developing effective SIBs. Though the contract can include specific provisions regarding quality-control issues and government oversight of the services to be administered, the primary focus should be to establish well-defined and measurable outcomes. It is these targeted outcomes and the incentives they create that result in high-quality programs, sufficient internal monitoring, and general accountability of the private sector in SIBs.

V. LESSONS LEARNED FROM SIBS AND THE POLICY IMPLICATIONS OF SIBS

The potential problems facing SIBs and the proposed potential solutions are informed by and build upon private-prison research. An unexplored aspect of SIBs is how their elements can remedy existing problematic privatization schemes such as private prisons. Up to this point, this Note has focused on the problems facing private prisons,²⁰⁰ how they will affect SIBs,²⁰¹ and how SIBs can overcome such problems both structurally and through modifications in the SIB agreement.²⁰² Even though private-prison research demonstrates ways

197. *See id.* at 752 (“The contract monitor [and his or her staff] shall be provided an office in the facility and shall have access at all times, with or without notice, to inmates and staff, [and] to all areas of the facility” (first alteration in original)).

198. *See id.* (“The contract monitor . . . shall have access at all times . . . to all books, records (including financial records), and reports kept by the contractor concerning the renovation, repair, construction, maintenance, and operation of the facility.”).

199. *See supra* notes 40–41 and accompanying text.

200. *See supra* Part III.

201. *See supra* Part IV.

202. *See supra* Part IV.

to maximize the success of SIBs, the reverse point can be made as well. That is, SIBs themselves offer instructive lessons that can help remedy problems embedded in existing privatization models. Additionally, if SIBs are to be used more widely or if their elements are to be incorporated into existing privatization schemes, governments must understand how SIBs fit within and alter the current debate over the privatization of public services for profit.

A. SIBs Offer Lessons to Make Private Prisons More Safe, Just, and Effective

The economic-incentive structure of SIBs provides an instructive lesson in how to improve the overall quality, justness, and effectiveness of private prisons. An overarching theme of this Note is that when economic incentives are embedded contractually such that private profit is tied to outcomes, it increases the chances of attaining socially valuable results and minimizes the risk that the quality of a program might be compromised in the name of efficiency. The current payment structure for private prisons, however, creates a completely different and perverse incentive.²⁰³ Because private prisons are funded on a per-prisoner basis, they incentivize private-prison operators to refrain from funding rehabilitation programs so as to generate a steady stream of prisoners to maximize profit.²⁰⁴ This incentive is so contrary to the public interest and safety that the payment structure of private prisons should be changed to reflect the payment structure of SIBs to ensure more safe, just, and effective private prisons.

Private-prison contracts must create “more efficient incentives.”²⁰⁵ One solution is to model the payment like an SIB in

203. See Peter J. Duitsman, Comment, *The Private Prison Experiment: A Private Sector Solution to Prison Overcrowding*, 76 N.C. L. REV. 2209, 2262 (1998) (“[M]any opponents of private prisons are concerned that the profit motive and the per diem payment plan provided in many contracts create an incentive for private prisons to desire recidivism.”).

204. Cf. Daniel L. Low, *Nonprofit Private Prisons: The Next Generation of Prison Management*, 29 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 1, 7 (2003) (“For-profit organizations have a fiduciary duty to shareholders to maximize profits, so they cannot spend money on improving prison conditions or improving rehabilitation programs unless it will increase their profits.”).

205. See *id.* at 46 (“Some of these problems could be rectified if contracts with private prisons created more efficient incentives. . . . Such an incentive system would internalize the externalities of investments in programs and the social costs of recidivism, improve long-term efficiency, and encourage private prisons to improve rehabilitation programs and prison conditions.”); see also Duitsman, *supra* note 203, at 2262 (“[C]ommentators have proposed that

which the payment depends entirely upon achieving the targeted outcomes. In the prison context, the targeted outcomes could be the rate of violence as compared to counterpart prisons or the rate of recidivism of prisoners released from the private prison as compared to counterpart prisons. Thus far, there have not been strong calls for a contractual provision that makes payment entirely contingent upon achieving such results. Rather, critics of the current private-prison system have called for a nonprofit private system with the same per diem payment model as private prisons or have argued that the government can offer “a bonus for recidivism performance in addition to the per diem payment.”²⁰⁶ Even critics of private prisons have adhered to the per diem payment plan because many private-prison firms do not have enough capital to run large-scale prisons without the government’s up-front financing.²⁰⁷

Payment schemes can be reformed such that the government pays the private-prison operator an up-front per diem rate that allows the operator to break even and that allows the government to precondition any profit upon a particular violent-incident rate or recidivism rate. This scheme would still persuade private-prison operators to enter into prison-operating contracts because of the potential for profit. At the same time, it would also incentivize them to sustain prisons with sufficient numbers of highly trained guards to lower violent incidents and to invest in rehabilitation programs that lower recidivism rates. Because the potential for profit is located in lowering rates of violence and recidivism, this model removes the perverse incentive to have as many prisoners incarcerated as possible.

Furthermore, this payment scheme would mitigate each of the three problems plaguing private prisons. Because payment would no longer be on a per-prisoner basis, it would remove the incentive to

contracts may actually be used to require reduced rates of recidivism. Using contract-based fines to penalize private prison operators for violations of recidivism-reduction requirements, inmate safety, health care quality, or other standards, agreements between private contractors and the government can invoke the profit motive to encourage compliance with the state’s defined goals of incarceration.” (footnote omitted)). Both of these sources explain an interest among actors to embed contractual economic incentives, but nothing as strong or as potent as those incentives structurally embedded in an SIB, in which payment depends completely on the achievement of agreed-upon outcomes.

206. Low, *supra* note 204, at 46.

207. *See id.* at 7 (“Government contracts provide the almost exclusive source of revenue for private prisons . . .”).

adversely affect and prolong a prisoner's sentence.²⁰⁸ Additionally, because profit depends upon lowering violence and recidivism rates, prison operators would be incentivized to invest in a greater number of well-trained prison guards and rehabilitation programs, thus mitigating the quality issues associated with private prisons.²⁰⁹ And finally, preconditioned payments would incentivize private firms to self-monitor abuses in their prisons because the more frequently abuses are committed against prisoners, the lower the chances that the private-prison operators can meet the outcomes required to make a profit.²¹⁰ Therefore, aspects of the SIB economic-incentive model can be incorporated into private-prison contracts to ensure socially valuable results such as an increase in the quality and safety of prisons as well as a decrease in recidivism among those housed in private prisons.

B. SIBs in the Context of the Larger Privatization Debate and Counterarguments

The economic incentives underlying SIBs constitute a critical advantage over traditional privatization models. Although this Note advocates that elements of SIBs can remedy the privatization ills of private prisons, SIBs raise a unique set of concerns related to the larger privatization debate. As officials adopt SIBs or some of their elements to improve private prisons, they must be cognizant of the ways in which SIBs contribute to the existing privatization debate and the counterarguments against their implementation.

SIBs simultaneously form a part of the existing privatization debate while altering it as well. Thus far the policy colloquy surrounding privatization has focused on whether the private or public sector can carry out services more efficiently.²¹¹ This comparative debate pits public against private and usually concludes

208. See Duitsman, *supra* note 203, at 2263 (surmising that a per diem payment scheme may influence private-prison operators facing financial pressure to “disallow ‘good time’” but that contracting can mitigate these concerns).

209. See *id.* at 2261–62 (describing how performance-based measures and the profit motive in a private-prison contract can incentivize private-prison firms to invest in rehabilitative programs for prisoners).

210. See *supra* note 158 and accompanying text.

211. Dolovich, *supra* note 12, at 441 (“[D]ebate on this issue has focused on the relative efficiency of private prisons as compared to their publicly run counterparts and has assumed that, if private contractors can run the prisons for less money than the state without a drop in quality, then states should be willing to privatize.”).

that one is the victor.²¹² SIBs, however, are fundamentally transforming this one-dimensional normative debate into one that examines a shared partnership between the government and the private sector.²¹³ SIBs necessitate shared decisionmaking authority that culminates in a partnership between the government and the private sector.²¹⁴ SIBs cannot be easily characterized as a situation in which the government abdicates its role and the private sector assumes that role purely to profit. Rather, SIBs acknowledge that to address the many serious issues facing this country, there is a role for both the public and private sectors to execute.²¹⁵

In this light, SIBs bring together the government, private investors, NGOs, and nonprofits to assume the role for which each is best suited to maximize efficiency and quality. Though the government transfers a considerable amount of power to other players, it by no means abdicates its role, but rather leads when it comes to setting targeted outcomes that fuel economic incentives.²¹⁶ This dispersion of power is a key aspect of SIBs, and the normative debate should focus on the challenges surrounding the distribution of power and the ability of multiple players to work together to accomplish shared goals.²¹⁷

Opponents of SIBs may raise the increased costs of negotiation among multiple actors as a counterargument against their implementation. In response, it should be noted that the increased

212. *See id.* (“The private prisons issue has thus widely been viewed as a choice—even a competition—between alternative organizational forms.”).

213. *See* SOC. FIN., *supra* note 20, at 22 (“SIBs signify a new paradigm of public-private partnerships in the wake of the financial crisis, one that privatizes the risks and shares the gains.”).

214. *See id.* at 16 (“Although complex, the SIB partnership establishes a system of checks and balances that prevents any single party’s self-interest from undermining the pursuit of shared objectives.”).

215. *See* Katie Gilbert, *The Latest in Socially Conscious Investing: Human Capital Performance Bonds*, INSTITUTIONAL INVESTOR (Jan. 10, 2012), http://payforsuccess.org/sites/default/files/institutional_investor_the_latest_in_socially_conscious_investing_human_capital_performance_bonds.pdf (“Whether or not pay-for-success is the model that sticks, the White House’s Marta Urquilla says that going forward, the public sector will be increasingly interested in opportunities to partner with private capital to address social issues that have grown too large for the government to handle alone.”).

216. *See* Costa & Kohli, *supra* note 19 (“Massachusetts, and any future government entity entering into a social impact bond agreement, will need to ensure that outcomes are specific, measurable, and stringent enough that they cannot be accomplished merely by chance.”).

217. *See generally* DISLEY ET AL., *supra* note 45 (presenting interviews and recommendations in an evaluation that concern the actors’ abilities to work together in contracting, implementing, and executing the SIB).

up-front costs of SIBs have not deterred Goldman Sachs from funding an SIB. Nonetheless, at this point in time, too few SIBs exist to empirically compare the costs and benefits of SIBs to the costs and benefits of traditional privatization programs. Although such an analysis will likely be useful, especially in ascertaining the deterrent effect that any such costs may have on the implementation of SIBs, such empirical questions are beyond the scope of this Note and are an area for further scholarship comparing the desirability of SIBs to traditional forms of privatization.

A second potential aspect of the SIB debate focuses not on the distinction between the private and public sector, but rather on the meta-theoretical aspects of this nontraditional form of governance. SIBs are unique because in one sense, they facilitate executive aggrandizement and in another sense, they necessitate shared decisionmaking as described above.²¹⁸ The executive-aggrandizing aspect of SIBs, as compared to other traditional forms of privatization, is a potential counterargument against their implementation. SIBs facilitate executive aggrandizement because they allow the executive greater power via government contracts to accomplish “distinct public policy goals that — but for the pretext of technocratic outsourcing — would be impossible or much more difficult to attain in the ordinary course of nonprivatized public administration.”²¹⁹ For example, to establish the Rikers prisoner-rehabilitation SIB, there was no bill introduced in the legislature, no legislative debate, and no legislative approval for the use of this SIB.²²⁰ Rather, it was Mayor Bloomberg’s office that coordinated with Goldman Sachs (the private investor) and MDRC (the intermediary) to negotiate an agreement largely “behind closed doors.”²²¹ Because the crux of an SIB is the agreement itself, it usually takes a small group of government officials (usually the executive’s staff members) to negotiate the contract on behalf of the government.²²² Though legislatures may play a role in allocating funds for SIBs generally,²²³ it

218. See *supra* notes 214–17 and accompanying text.

219. See Michaels, *supra* note 85, at 719 (arguing that privatization results in “workarounds” that increase the executive’s power).

220. See Costa & Kohli, *supra* note 19 (detailing the emergence of the SIB at Rikers).

221. *Id.*

222. See Costa & Kohli, *supra* note 19 (explaining that it was Mayor Bloomberg’s administration in New York City and Governor Patrick’s administration in Massachusetts that took the lead in establishing the SIBs).

223. See *supra* note 139 and accompanying text.

is the executive branch that will likely decide which SIBs are worth investing in and how to structure the agreement.²²⁴ Executive aggrandizement is not necessarily a negative aspect of SIBs, however, especially when the very structure of SIBs requires a few key stakeholders to negotiate the agreement on behalf of the government.²²⁵ Nonetheless, executive aggrandizement is a unique aspect of SIBs that merits attention as SIBs emerge as a prominent solution to complex policy problems.

In sum, just as the lessons learned from the pitfalls of private prisons offer instructive insight into creating successful SIBs, the economic-incentive structure of SIBs also suggests solutions to the problems plaguing private prisons. The interest in incorporating elements of SIBs into private-prison agreements and adopting them wholly means that government officials will have to be alert to new issues surrounding this form of privatization.

CONCLUSION

Although SIBs are still in their infancy, there is considerable interest in their use among local, state, and federal government officials. Yet with no tangible data on the success of SIBs, government officials and private investors seeking to collaborate in an SIB have limited information as to the challenges they will face. Though there is no substitute for concrete results, this Note strives to give potential SIB actors greater predictability regarding the challenges they will face by using the privatization of prisons as an analog to the use of SIBs. This analysis creates a dual paradigm in which the problems facing private prisons offer instructive lessons to maximize the success of SIBs, and conversely, the economic-incentive structure of SIBs offers ways to improve private prisons.

Beyond offering lessons to improve private prisons, SIBs can influence the privatization debate more generally. SIBs alter existing privatization models by tying private profit to socially valuable results. In this light, the structure of SIBs creates economic incentives that can mitigate the accountability, quality, and monitoring problems associated with privatization. Additionally, unlike other forms of privatization, SIBs differ considerably because they require a shared

224. See *supra* note 222 and accompanying text.

225. See DISLEY ET AL., *supra* note 45, at 54 (describing the complexity of SIB contracts). Because SIB contracts are complex and involve experience with “private finance initiative contracts,” *see id.*, the pool of people negotiating these contracts will be small.

partnership between private and public actors. This characteristic changes the very landscape of the privatization debate by shifting the debate from which actor can better deliver a given service to how each actor can work together to collectively deliver the service.

Governments should be cautiously optimistic about this innovative new financing scheme. Although real results are needed before hailing SIBs as a revolutionary funding model, their theoretical ability to mitigate many privatization ills is promising. Therefore, with appropriate contractual planning and coordination among private and public actors, SIBs have the potential to remedy a variety of pressing social ills such as by lowering recidivism rates, improving access to early childhood education, and lowering homelessness rates. Though these programs do not have the political salability to yield up-front public funding, SIBs offer new hope for sustained investment in these important social programs.