

# Social Impact Bonds: Korean Perspectives

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# Social issue: Economic polarization

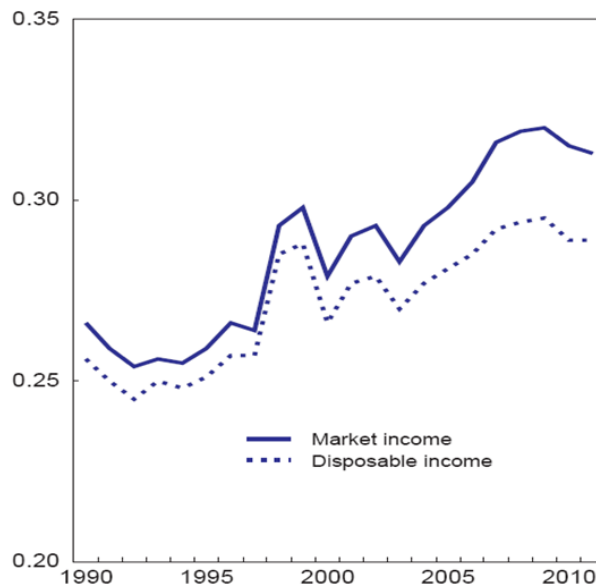
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Background

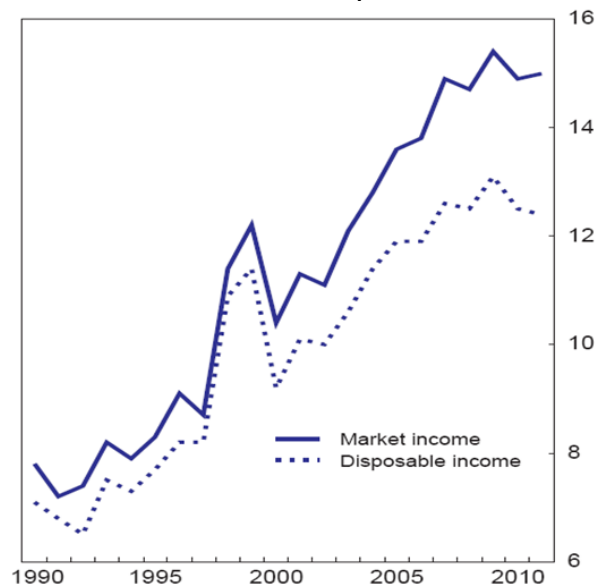
- ❖ Economic polarization is a major social issue in Korea.
  - South Korea's income inequality index and relative poverty rate are getting worse.

Inequality has been increasing in Korea<sup>1</sup>

A. Gini Coefficient<sup>2</sup>



B. Relative Poverty Rate<sup>3</sup>



1. For urban households with at least two persons.

2. The Gini coefficient can range from 0 (perfect equality) to 1 (perfect inequality).

3. Relative poverty is defined as the share of the population that lives on less than half of the median income.

Source: OECD Economic Surveys KOREA (2012)

# Social issue: Economic polarization II

1

Background

- ❖ Many Koreans believe that economic polarization prevents them from climbing the social ladder.

## Recent surveys show that:

- 98.1% of respondents predicted that upward class mobility is harder to achieve.
- 36% of the above-mentioned pessimistic respondents cited deepening economic polarization as the reason for class immobility.

Source: Hyundai Research Institute (2012)

- 60% of Korean political experts responded that the expansion of social welfare and solutions to polarization will be the biggest issues in the coming 2012 presidential election in Korea.

Source: Hankook Ilbo (2012. 06)

# Limitations of public social welfare |

1

Background

- ❖ Public social welfare is important but not enough to solve the polarization problem.

- To solve the polarization problem, many politicians advocate the expansion of public social welfare.

However,

- “Given the impact of ageing, Korea should be cautious in expanding social welfare programmes.” (OECD)
- There is a heated controversy over the expansion of social welfare without tax hikes.

# Limitations of public social welfare II

1

Background

## ❖ Problems with public social welfare services

1

Limitation of budgets for social welfare.

2

Addressing the symptoms, rather than the causes, of social problems.

3

Inefficient development and operation of social service programs.

4

Poor measurement of public service performance, and as a result, no accountability.

# What is the SIB?

2

SIBs

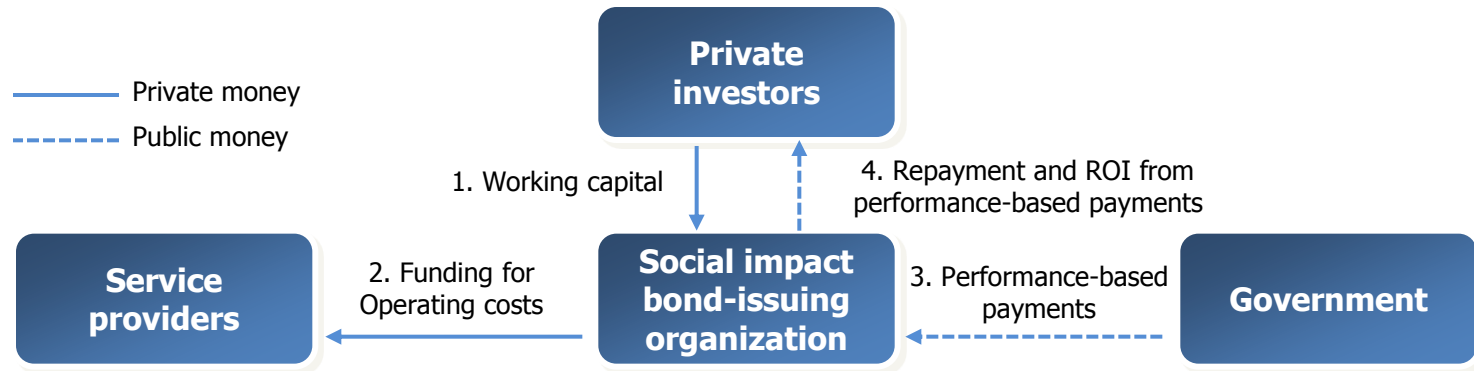
- ❖ The social impact bond (SIB) is a contract where investors are paid based on improved social outcomes which related social services create.
  - In the contract, the government pays for social outcomes that result in budget savings.
  - The SIB is neither debt nor equity. It is a hybrid instrument that has complex characteristics - an upper limit of returns on investment like bonds and performance-based returns like equity (bond-like returns and equity-like risks).
  - Under the Financial Investment Services and Capital Markets Act (FSCMA), SIBs can be viewed as derivatives-combined securities.

# Investment structure of the SIB

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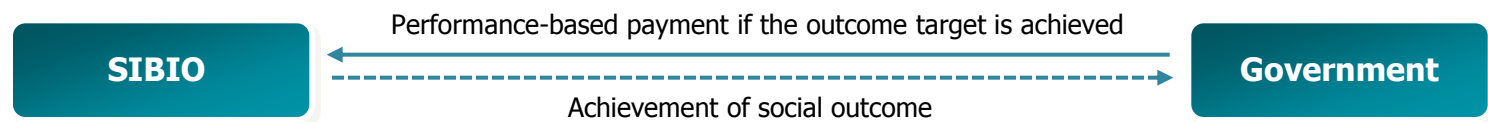
SIBs

## The Four Key Players in the SIB Model



Source: Jeffrey B. Liebman, Social Impact Bonds (2011)

- The contractual relationships of the SIB consist of the following: Government-SIBIO, SIBIO-Investors, SIBIO-Service Providers, Government-Independent Assessor, etc.
- The main contract of the SIB structure is between the government and the SIBIO (Social Impact Bond –Issuing Organization).

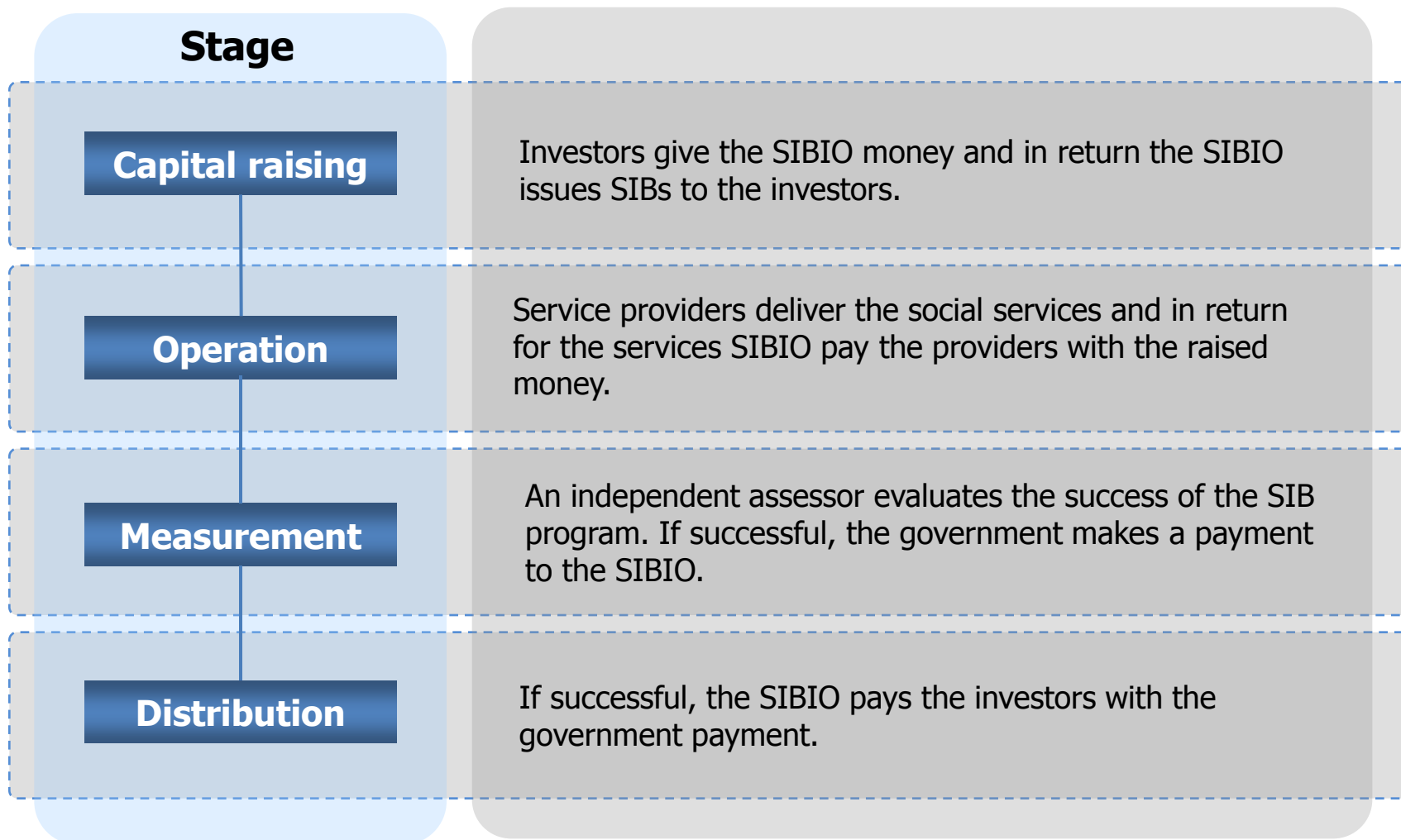




# Process of the SIB scheme

2

SIBs



## Early intervention

- ❖ SIBs finance early intervention programs.
  - The costs for early intervention services are less than the costs for future crisis intervention services.
  - SIB programs address causes of social problems, not symptoms.

## Private-public partnership

- ❖ SIBs are private-public partnerships.
  - The public sector can close the funding gap by using private capital for social services.
  - Private and professional service providers create more efficiency.

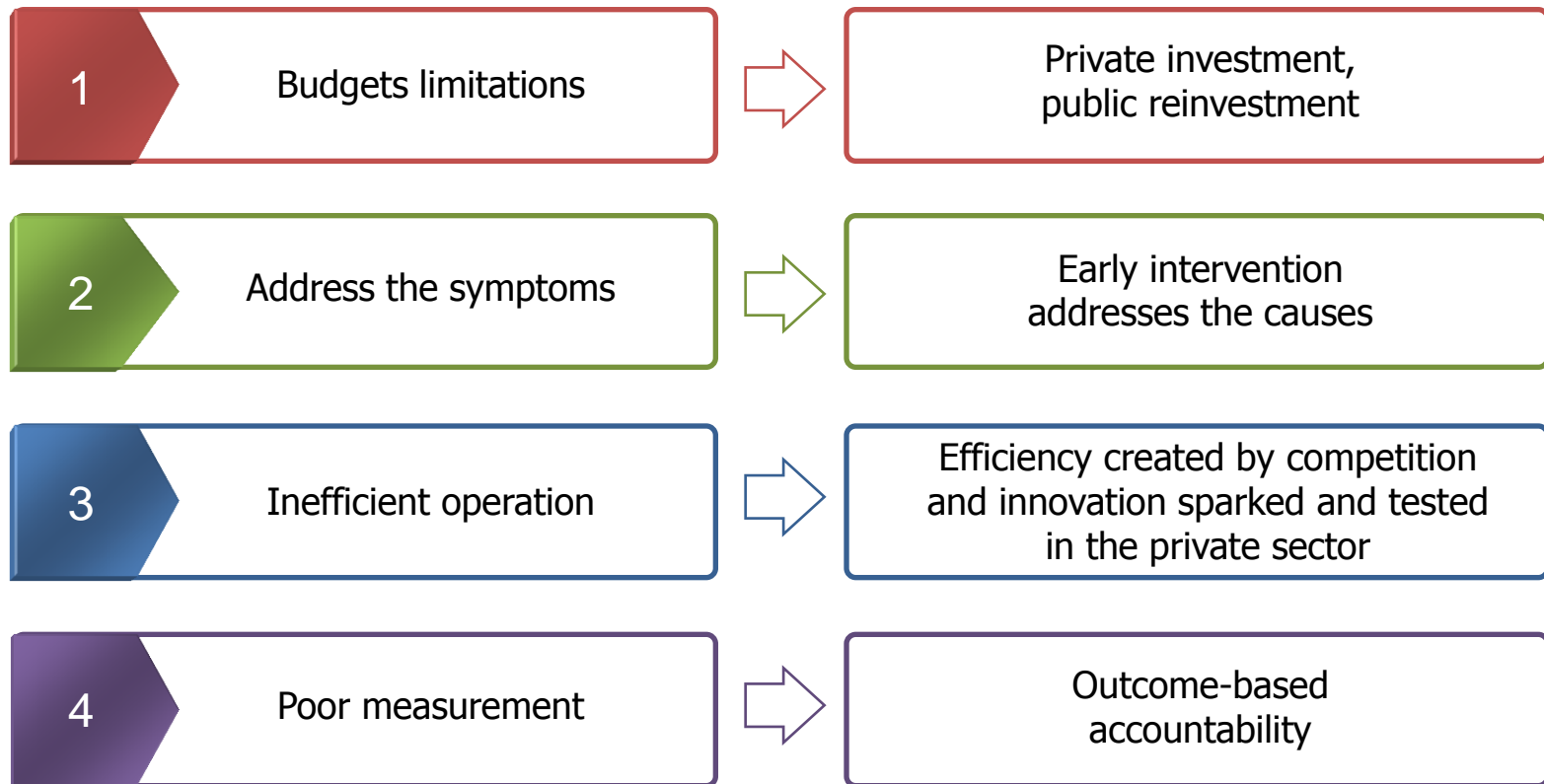
## Outcome-based contract

- ❖ SIB contracts are outcome-based.
  - Outcome-based measures prevent irresponsible social services and enhance accountability in social services.
  - In an outcome-based system, only efficient and competitive service providers survive.
  - Taxpayers pay only when the social program is successful and results in public cost savings.

# SIBs address the shortcomings of the public sector

2

SIBs



# Why should taxpayers pay to SIB investors?

- ❖ To justify the government payment to the SIB investors, the SIB program should create budget savings and the government payment should be out of the savings.
- ❖ The budget savings can be made as an SIB program creates
  - early intervention that saves the budget for future crisis intervention and
  - cost-effectiveness that saves the budget compared with a public-sector program.

# Benefits and challenges of SIBs

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SIBs

## Benefits

vs.

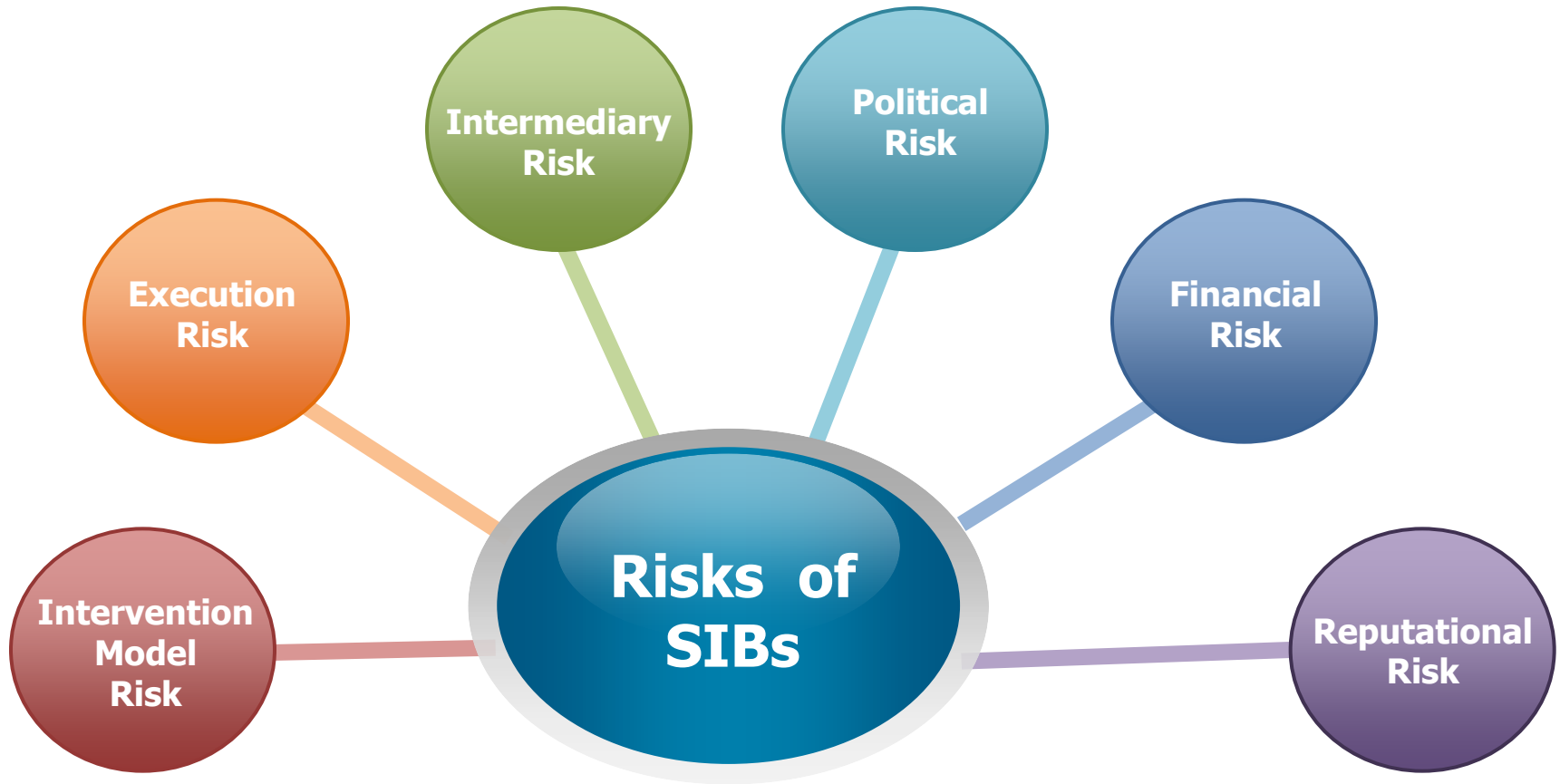
## Challenges

- Improved performance and lower costs
- Accelerating adoption of new solutions
- More rapid learning about what works

- The interventions must have sufficiently high net benefits
- The interventions must have measurable outcomes
- The treatment population must be well-defined up front
- Impact assessments must be credible
- Unsuccessful performance must not result in excessive harm

Source: Liebman, Social Impact Bonds (2011)

# Risks associated with SIBs



Source: Social Finance, A New Tool for Scaling Impact (2012)

# Essential requirements for a successful SIB model

3

Applicability

❖ The following conditions are required for an SIB model to be feasible and efficient:

- high public costs caused by a social problem
- expected cost savings by early intervention to address the causes of the social problem
- measurable outcomes
- cost-effectiveness created by the private sector
- net social benefits greater than the costs

✓ “Net Social Benefit= Direct Effects + Net Effect of Externalities”

(Langford, Social Impact Bonds in Canada, 2011)





## ❖ Potential areas of application

### ➤ Social needs and social costs

- ✓ High social needs for a social safety net and high social costs caused by social polarization

### ➤ Education, job-training, healthcare, childcare, elderly care, and homeless

### ➤ e.g., English education program for low-income students

- ✓ Social costs – additional government spending on special education for local students (e.g., English village), income polarization, low birth rate, and social class tension
- ✓ Challenges – measuring the outcomes (comparison data), defining the target group, designing the SIB's intervention program

## ❖ Potential players in Korea

### ➤ Government

- ✓ Central government and/or local government, and lottery fund

### ➤ Intermediary (SIBIO)

- ✓ Social finance-type that specialize in management, finance, and related social issues

### ➤ Investors

- ✓ Foundations, conglomerates, and financial companies (e.g., financial literacy education services)

- Principal guarantee is an issue - no principal guarantee like Peterborough SIB, partial principal guarantee like Goldman Sachs SIB

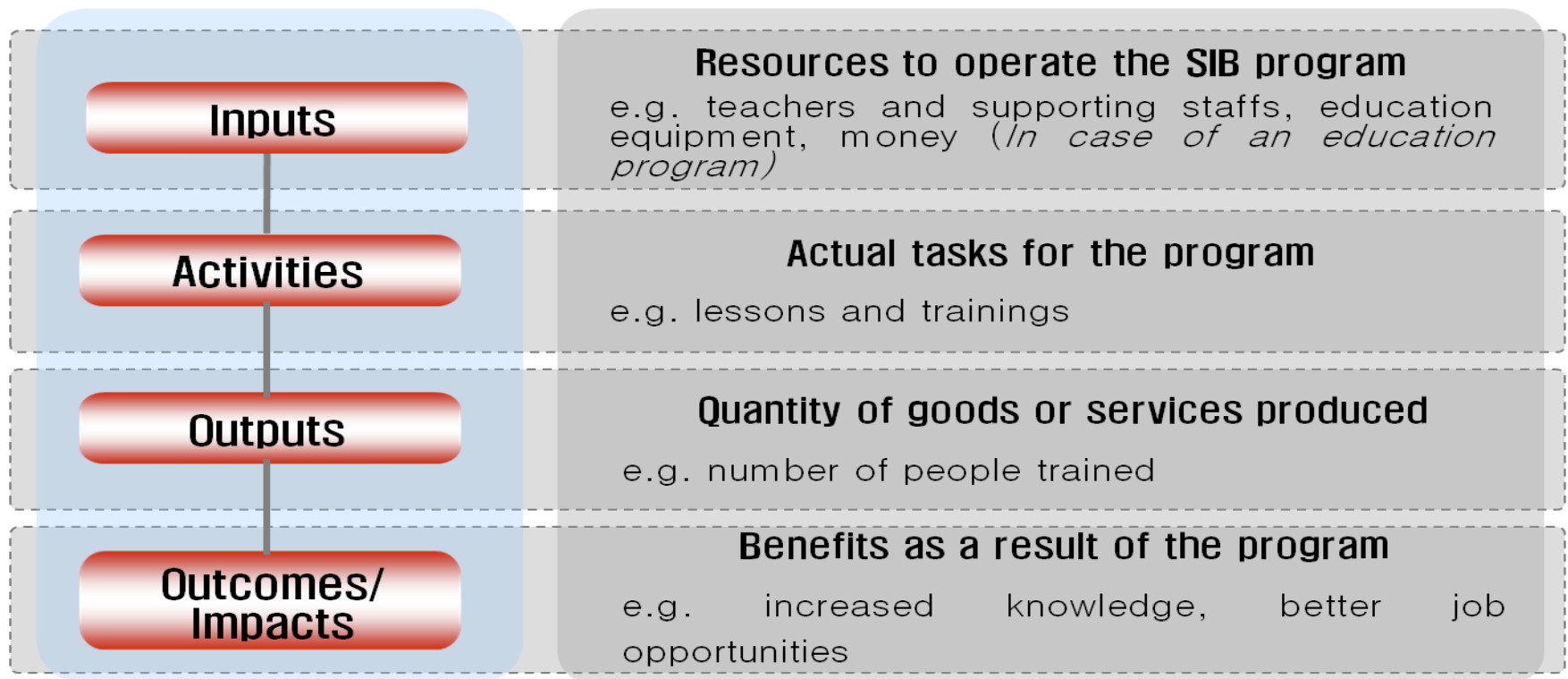
### ➤ Service providers – social enterprises that have a track record in related areas

### ➤ Independent assessor

# Success of an SIB program: Not just outputs but outcomes

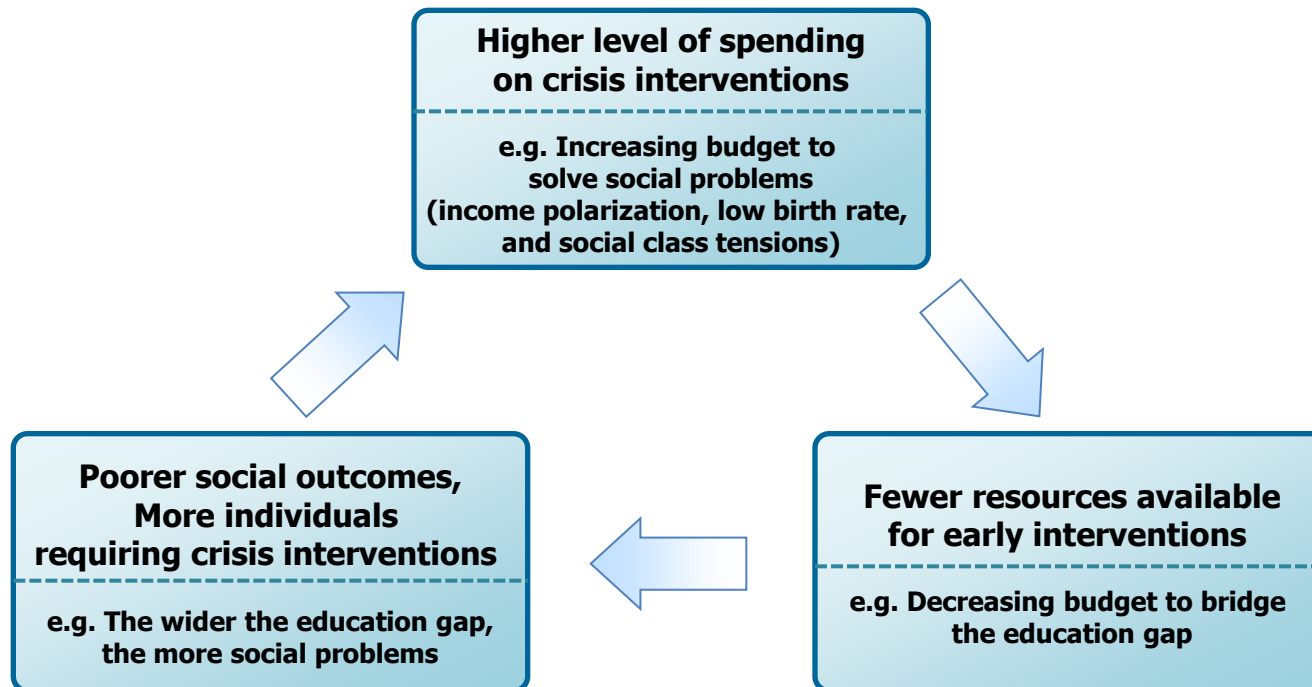
- ❖ The success of an SIB program depends not on the outputs but on the outcome.

Logic Model of an SIB Program



# Vicious cycle caused by failure of early intervention

- ❖ Vicious cycle caused by failure of early intervention to close the English education gap in Korea.



Source: Social Finance, Towards a New Social Economy (2010)

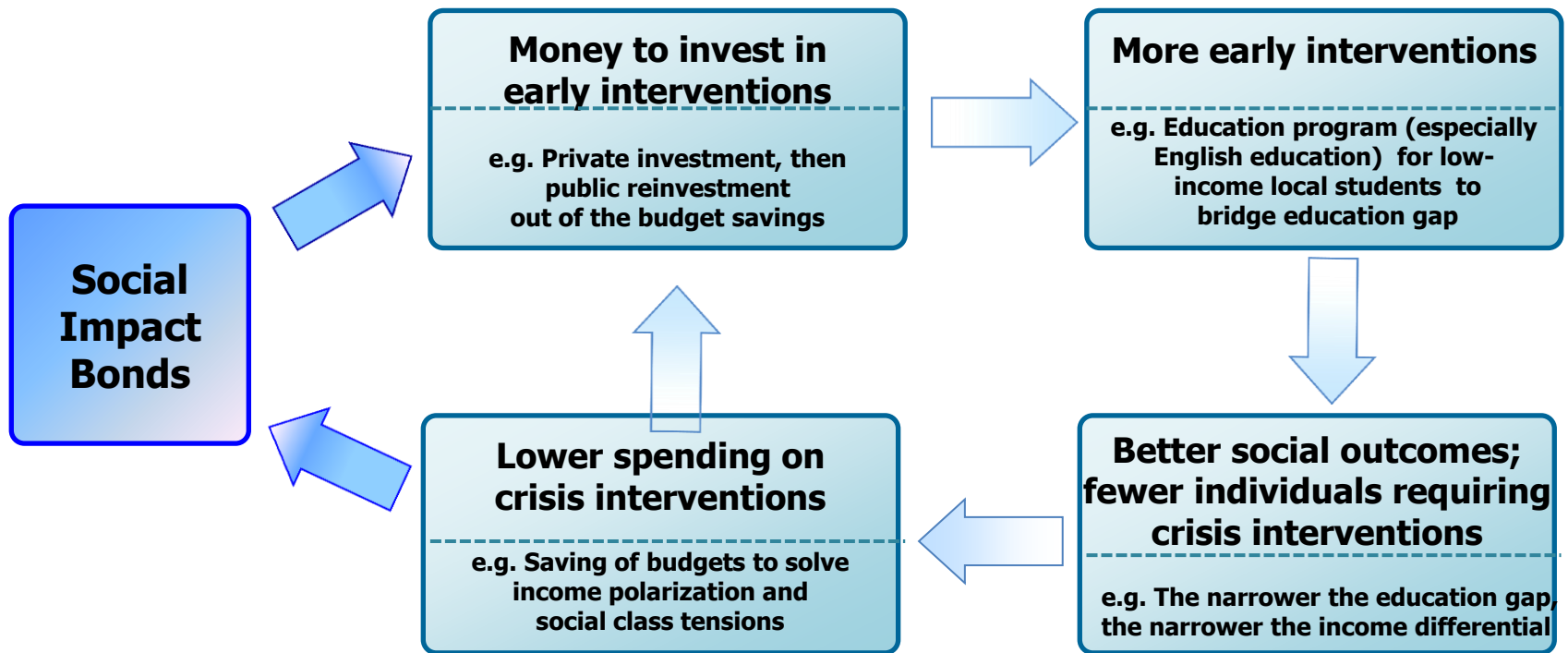
\* Examples are added to the original source.

# Virtuous cycle catalyzed by SIBs

3

Applicability

- ❖ Virtuous cycle catalyzed by an SIB program to close the education gap in Korea.



Source: Social Finance, Towards a New Social Economy (2010)

\* Examples are added to the original source.

Thank you

