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Goldman to Invest in City Jail Program, Profiting if Recidivism Falls Sharply

By DAVID W. CHEN

New York City, embracing an experimental mechanism for financing social services that has excited and worried government reformers around the world, will allow Goldman Sachs to invest nearly $10 million in a jail program, with the pledge that the financial services giant would profit if the program succeeded in significantly reducing recidivism rates.

The city will be the first in the United States to test "social impact bonds," also called pay-for-success bonds, which are an effort to find new ways to finance initiatives that might save governments money over the long term.

First used in Britain and now being explored in Australia, the bonds are rapidly capturing the imagination of some public officials in the United States: on Wednesday, Massachusetts announced that it was completing negotiations with two nonprofit groups to finance juvenile justice and homelessness programs, with the promise of repayment only if the programs work.

The federal government, Connecticut, New York State and Cuyahoga County, Ohio, among others, are at various stages of considering using the bonds to harness new funds for human-services programs.

In New York City, Mayor Michael R. Bloomberg plans to announce on Thursday that Goldman Sachs will provide a $9.6 million loan to pay for a new four-year program intended to reduce the rate at which adolescent men incarcerated at Rikers Island reoffend after their release.

The money is not a huge amount for Goldman, which last month reported over $900 million in second-quarter profit, and the investment promises a public-relations benefit for the Wall Street bank. For the city, the money allows the Bloomberg administration to demonstrate, and test, several of its priorities: enlisting private sector help in financing public needs, and tying program money to rigorous outcome evaluations.

The Goldman money will be used to pay MDRC, a social services provider, to design and oversee the program. If the program reduces recidivism by 10 percent, Goldman would be repaid the full $9.6 million; if recidivism drops more, Goldman could make as much as $2.1 million in profit; if recidivism does not drop by at least 10 percent, Goldman would lose as much as $2.4 million.

“This promising financing model has potential to transform the way governments around the country fund social programs, and as first in the nation to launch it, we are anxious to see how this bold road map for innovation works,” Mr. Bloomberg said in a statement.

“Social impact bonds have potential upside for investors,” he added, “but citizens and taxpayers stand to be the biggest beneficiaries.”

In a twist that differentiates New York’s plan from other governments’ experiments with social impact bonds, Mr. Bloomberg’s personal foundation, Bloomberg Philanthropies, will provide a $7.2 million loan guarantee to MDRC.

If the jail program does not succeed, MDRC can use the Bloomberg money to repay Goldman a portion of its loan; if the program does succeed, Goldman will be paid by the city’s Department of Correction, and MDRC may use the Bloomberg money for other social impact bonds, said James Anderson, director of the foundation’s government innovation program.

Jeffrey B. Liebman, a professor of public policy at Harvard University who has written about social impact bonds, said the New York contract would be widely scrutinized.

“This will get attention as perhaps the most interesting government contract written anywhere in the world this year,” Dr. Liebman said. “People will study the contract terms, and the New York City deal will become a model for other jurisdictions.”

But social impact bonds have also worried some people in the nonprofit and philanthropy field, who say monetary incentives could distort the programs or their evaluations.

“I’m not saying that the market is evil,” said Mark Rosenman, a professor emeritus at Union Institute and University in Cincinnati, “but I am saying when we get into a situation where we are encouraging investment in order to generate private profit as a substitute for government responsibility, we’re making a big mistake.”

Goldman approached the city after hearing that New York officials and MDRC were interested in social impact bonds. In an interview, Alicia Glen, the head of Goldman Sachs’s Urban Investment

Group, said the company was confident that the program would work.

“This is a new approach — no city has ever done something exactly like this before — and we were able to get comfortable with the risks, which other financial institutions may not have been,” Ms. Glen said. “But we are confident that the city will identify enough savings that we’ll get a reasonable return on the investment.”

The Goldman money will finance a program called Adolescent Behavioral Learning Experience, or ABLE, as a part of the Bloomberg administration’s year-old Young Men’s Initiative, which seeks to improve prospects for black and Latino adolescents. 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.

Currently, nearly 50 percent of young men released from Rikers reoffend within a year.

City officials said they hoped the concept of social impact bonds could also be used to finance programs on homelessness, foster care, special education or health care. By using the mechanism to pay for prevention programs that are often too expensive for government to afford, the officials say they believe that they could save taxpayers money over the long term.

“Government is paying for outcomes that the government wants to achieve,” Deputy Mayor Linda I. Gibbs, the program’s chief architect, said. “This is designed to provide a template for other initiatives so we can do more.”

New York’s program is modeled, in part, after one in Peterborough, a London suburb, that began in September 2010 and is still years from being fully evaluated.

In Massachusetts, Jay Gonzalez, the secretary of administration and finance, is a proponent of social impact bonds. “We’ve got to change from the idea of, ‘We just pay for stuff and hopefully get the results,’ ” Mr. Gonzalez said in an interview. “The beauty of this is if they perform to get the results, then we pay. If they don’t, we don’t pay.”

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