

IMPACT BONDS IN THE LATIN-AMERICAN CONTEXT: POLICY TRANSFER ANALYSIS FOR MEXICO, CHILE AND COLOMBIA

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ABSTRACT

Impact bonds are a recent mechanism to address social issues by involving the private sector, government, and nongovernmental organizations. Among the first candidate countries in Latin-America to implement such mechanisms are Mexico, Chile and Colombia. However, notwithstanding the several proposals and projects designed in these countries to alleviate internal social problems, no impact bonds have been implemented yet. This research attempts to identify the unique constraints within each country that hinders the implementation of impact bonds through the policy transfer approach. The findings show that the constraints are related to the politicization by interest groups in some areas (Mexico), the political cycles (Colombia), and the level of centralization (Chile).

Key words: *Development Impact Bonds, Pay for Success Contracts, Public Policy, Policy Transfer, Social Impact Bonds.*

INTRODUCTION

The pursuit of profits and solving social problems usually are considered as two opposing and irreconcilable objectives. While mainstream investors assume that it is the responsibility of governments and charities to tend to social issues, traditional philanthropic and civil society organizations reject the idea that for-profit businesses have the right to support organizations in promoting equality, justice, and defending social causes. In essence, it is assumed that creating economic value is best left to private companies and that improving social welfare best left to governments and nonprofit organizations (Bugg-Levine & Emerson, 2011). However, impact investments are proving that these two objectives - making profits and addressing social issues - can be achieved simultaneously, and that they are capable of creating a new investment market that improves social and environmental conditions.

Impact bonds are a kind of impact investment that are becoming a popular mechanism to tackle social issues and provide financial returns to investors. Impact bonds aim to address social issues using an innovative and preventative approach that brings together the private sector, nongovernmental organizations, and the government or a donor agency. These mechanisms are divided into Social Impact Bonds (SIBs) and Development Impact Bonds (DIBs).

The UK initiated the first SIB in 2010, and since then, more than 40 projects, primarily in developed countries, were established. In developing countries, DIBs provide an alternative for addressing social needs because DIBs do not require governments to pay for the proposed social outcome, therefore they avoid budgetary pressures from the government. India developed the first DIB in 2015 for improving school enrollment of girls. In Latin America and the Caribbean, the Inter-American Development Bank (IADB) started promoting SIBs with resources for technical assistance and feasibility studies through the Multilateral Investment Fund (MIF) to adopt this model. Mexico, Chile and Colombia are the first candidate countries in the region to

implement such mechanisms. However, despite several proposals and projects designed for these countries, neither the SIBs nor the DIBs have been applied.

The primary interest of this research is to assess and identify the potential constraints that hinder the implementation in these countries through the policy transfer framework developed by Benson (2009). In this context, we evaluate the possible limitations of the transfer process on the demand side, the programmatic characteristics of the impact bonds, the application constraints, and the contextual factors in the selected countries, in order to understand why no impact bonds have been implemented and what major obstacles exist for this mechanism in the region. In addition, the first SIB in the UK and the first DIB in India are used as benchmarks to analyze their transferability.

The organization of this research is as follows: The first section explains the concept of impact bonds. The second section provides the methodological framework to identify the potential constraints for the transfer of impact bonds in the selected countries. The third section interprets and analyzes the relevant findings to answer the research questions. Finally, the fourth section presents the possibilities and restrictions for each case individually.

1. UNDERSTANDING IMPACT BONDS

1.1 Social Impact Bonds

Social Impact Bonds (SIB) have a basic design that can be modified depending on the needs of the social issue and the contract agreements. SIBs includes five main stakeholders: investor(s), an intermediary, a service provider, an independent evaluator, and the outcome payer plus the target population (see Figure 1).

The process starts with the private investors, who provide the funding to a service provider with the necessary expertise to deliver a service that helps the target population. If the evaluator validates that the pre-agreed outcomes were fulfilled, the outcomes payer, repays the investors. In most cases, the intermediary is in charge of bringing together the different actors, discussing the details of the transaction and raising capital for the project (Goodall, 2014; Instiglio & Thomson Reuters Foundation, 2014; Liebman & Sellman, 2013).

In order to manage the resources and the contracts with the different stakeholders, a legal entity called a Special Purpose Vehicle (SPV), or Special Purpose Entity (SPE), can be created and included as part of the framework (Gustafsson-Wright et al., 2015; Mulgan et al., 2011). Although the SPV does not deliver any services, it acts as the lead organization, and carries out such tasks as receiving the capital from the private funders, ensuring the delivery of the intervention, passing the funding to the service provider, managing the contracts with the agencies and monitoring their performance, and receiving the outcome payments and transferring them to the investors. This entity is controlled either by the intermediary or the investors. After the investors are repaid, the remainders of the outcome payments are kept by the owner of the SPV.

Depending on the stakeholders, the context and the agreements for the intervention, the impact bond framework can vary. The contract relation with the outcome funder falls into one of the three types described by Goodall (2014) and Gustafsson-Wright et al. (2015): The first is the *managed impact bond structure*, in which the outcome payer makes a contract with the intermediary or a SPV controlled by the intermediary. The intermediary plays a leading role through the transaction process and is in charge of managing the performance of the service delivery. In the *intermediated structure*, the outcomes payer makes a contract with the investors or a SPV controlled mainly by investors. In this case, the intermediary is still responsible for most of the transaction and is contracted by the investors or SVP to supervise the performance of the service delivery. The last contract relation is the *direct structure*, in which the outcomes payer contracts directly with the service provider, while the outcomes payer has the leading role and manages the performance of the intervention.

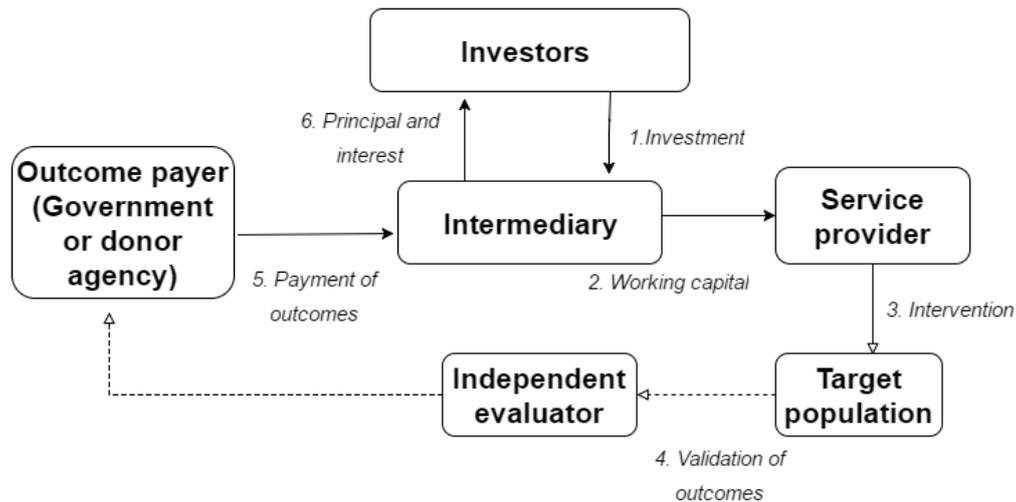


Figure 1. Basic social impact bond model (Authors).

1.2 Development Impact Bonds

The Development Impact Bond (DIB) scheme is based on the same principles as the SIB. The main difference is in the roles the outcomes payer and government have in the structure. DIBs are designed to be implemented in lower and middle-income countries¹ in which a foundation, a donor agency, or an international organization (with the support of the host country), pays the investors fully or partially once the outcomes have been achieved and verified. According to the Center for Global Development & Social Finance, two basic models can be used for the DIBs: a direct contract between outcomes funders and service providers, or contracts via a new corporate entity or development impact partnership (2013).

In the first DIB model, there is a direct contract between outcomes funders and the lead service provider in which they detail the payment conditions in the case that the service provider achieves the agreed social outcomes (similar to Figure 1). Depending on the specific circumstances in the target country, a memorandum of understanding between the government and the service provider can be made to define the government's goals, and the way in which the service provider will help to meet them. Like the SIB model, the repayment to the investors depends on the level of success.

In the second DIB model, the contracts are held by a New Corporate Entity (NCE), called a Development Impact Partnership (DIP), which holds the investors funds and the contracts with the different parties: the outcomes funders, service providers, developing country government, investors and the intermediary. It is also responsible for the design and implementation of the strategy to deliver the outcomes. The outcomes funders and the NCE have to agree on the outcomes contract and establish the conditions of the payments to the NCE if the outcomes are achieved (see Figure 2). The donor agencies and partner governments can be involved as co-commissioners of outcomes. The investors and the NCE make an investment agreement regarding the amount of capital needed, the timeline, and terms of repayment. The investors' funds are transferred to the DIP which uses them to finance the service providers' delivery costs upfront. As in the first model, the government and the DIP can make a memorandum of understanding to define the government's goals and how the DIP can help to achieve them. The measurements and the validation of the outcomes are agreed upon by the outcomes funders and an independent organization that will audit the results reported from the intervention, known as a verification agent.

¹ The middle-income countries are classified in lower-middle-income economies with a per capita income from \$1,026 to \$4,035 USD, and upper-middle-income economies with a per capita income from \$4,036 to \$12,475 USD (UNIDO, 2014; World Bank, 2016a).

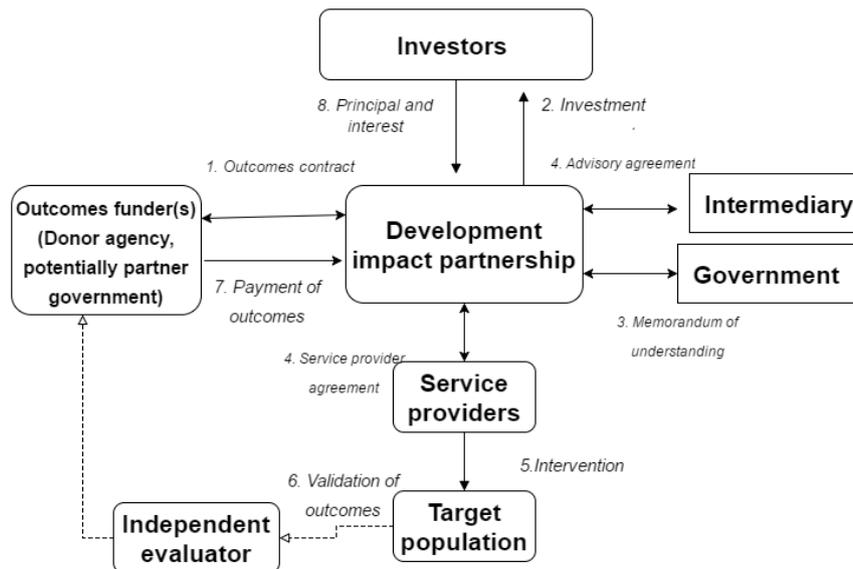


Figure 2 DIB: Contract via New Corporate Entity / Development Impact Partnership
(Authors, based on Center for Global Development & Social Finance, 2013)

2. THE POLICY TRANSFER FRAMEWORK

When a policy or a program seems promising, governments try to adopt it to achieve similar outcomes to those in the original model, which is precisely what happened with SIBs. In political science and public policy analysis, this process of adopting policies and programs from other public bodies is called “policy transfer”. It is understood as “the process by which knowledge about policies, administrative arrangements, institutions and ideas in one political setting (past or present) is used in the development of policies, administrative arrangements, institutions and ideas in another political setting” (Dolowitz & Marsh, 2000, p. 6).

The policy transfer process has four components distributed between the demand and the supply side. On the demand side, the policy demand represents the need for a policy or program for a specific issue. It can be satisfied by the policy-makers if they search for policies implemented in other places facing similar issues, and bring them to their country or jurisdiction. On the supply side, once a policy has been found to address the issue in question, understanding the conditions and characteristics in the exporter jurisdiction (where the policy or program was designed), is necessary to fulfill the supply. It is also required to have sufficient understanding of the importer jurisdiction in regards to the institutional, political, legal, social and economic context to assess whether it is feasible to transfer the policy, and if the necessary requirements to apply it, are present (Benson, 2009; Page, 2000; Rose, 1993, 2005).

Usually, it is assumed that the transfer process will lead to a successful policy implementation, (based on the success of the exporter country), it is not always the case (Dolowitz & Marsh, 2000; Rose, 1993). Possible constraints that can hinder the implementation are the complexity and uniqueness of the policy or programs (Rose, 1993), institutional and structural impediments, insufficient economic and political resources to implement the transferred policies (Dolowitz & Marsh, 2000), cognitive constraints in the pre-decision phase, environmental obstacles in the implementation, and the domestic public opinion (Evans, 2009). Constraints can be classified into four types: the demand side, the programmatic characteristics of the policy being transferred, contextual factors, and application constraints (Benson, 2009; Benson & Jordan, 2011). Based on the constraints and their classification, Benson proposes an analytical framework to examine the transferability of programs between contexts (2009). To identify and assess whether the policy transfer process had any constraints or not, he associated a series of questions to the factors that could interfere with the adoption of a policy (See Table 1). If there are many, difficult constraints (high constraints), the chances of success for the

policy transfer will diminish and a form of synthesis, emulation or influence of the original policy is more advisable to address the issue in question. If there are few, soft constraints (low constraints), then the transfer is more likely to be successful and a copy or adaptation form of the original policy can be implemented.

This theoretical framework will be used to assess whether the Social Impact Bonds (SIBs) and the Development Impact Bonds (DIBs) can be applied or not in the selected countries. This framework will help us understand why the impact bonds have not been implemented in this region, and it will also help identifying current and potential constraints in the adopting countries.

The benchmarks for the research are the SIBs in Peterborough, UK and the DIB in Rajasthan, India. The first one was chosen because it was the first project of this type to be implemented and because it was used as a reference to develop further SIBs within the UK and other countries. There is sufficient available information regarding the design, the role of the stakeholders and evidence of the outcomes from the intervention of the cohorts that were evaluated. In the case of the DIB, it was chosen because it is also the first project of this type to take place. Although the information available is not as abundant as in the case of the SIB in Peterborough, the analysis of its design and implementation process are relevant and useful to understand how developing countries can use the DIB model and the necessary conditions for adoption.

Mexico, Chile and Colombia were chosen as the adopting countries for this research. They were selected because the Multilateral Investment Fund (MIF) and the innovation lab for the Inter-American Development Bank group have considered them among the early candidates for the implementation of an SIB in Latin America, and because they already have SIBs projects in an advanced design stage (Levey, 2014). Since 2014, the MIF has been allocating resources to encourage the use of social impact bonds in the region. They focus on developing the right conditions for growing the market, identifying social needs and interventions, assessing the legal framework, and providing training and advisory support to the interested stakeholders in the model (Multilateral Investment Fund, 2014). In Mexico, the state of Jalisco analyzed the design of an intervention to move single mothers permanently out of poverty, while Instiglio conducted a feasibility study to reduce recidivism in Chile, and another to reduce school dropouts and teenage pregnancy in Colombia (Bloomgarden & Levey, 2015). Therefore, it is relevant to assess the potential constraints in the transfer process of these countries and whether there are conditions that allow them to adopt the impact bonds model.

To assess the demand factor, the income inequality shown in the Gini coefficient by the Organization for Economic Cooperation and Development (2014), the human development index (HDI) by the United Nations Development Program (2015) and the World Development Indicators (WDI) database by the World Bank (2016b), will be used. The WDI will be used to analyze specific issues as youth unemployment, primary and secondary school attendance, and the prevalence of diabetes. These social issues were chosen because they represent current conditions and basic needs that are not being met, and because there are potential impact bond projects that can address them.

The programmatic constraints will be assessed by analyzing the structure of the SIB and the DIB models themselves. For the contextual constraints, the following issues will be assessed: the existence or absence of legal frameworks in Mexico, Chile and Colombia that can enable the adoption of impact bonds; factors such as rule of law, control of corruption, political stability, and government effectiveness for the period 2009 – 2014 from the Worldwide Governance Indicators (WGI) created by the World Bank (2015); the political context and politicization of private interventions in social areas in Mexico, Chile and Colombia; the status of public resources in social policies, the number of potential service providers, and potential investments. For the application constraints, the extent at which the selected countries have to change their current structures to adopt the impact bonds models will also be analyzed.

Table 1 Factors constraining transferability (Authors, based on Benson, 2009)

Factors constraining transferability	Key questions
<i>Demand side constraints</i>	
Policy demand	Is there a demand for the policy or program?
	Is there potential resistance to transfer?
<i>Programmatic constraints</i>	
Programmatic uniqueness	How unique is the program?
Programmatic complexity	How complex is the program?
<i>Contextual constraints</i>	
Path dependency	Are past policies restrictive or enabling?
Existing structures	Are existing structures restrictive or enabling?
Political context	Is politicization apparent?
Resources	Does the receiving context possess adequate resources for transfer?
<i>Application constraints</i>	
Institutional substitutability	Would new institutional structures be needed?
Scales of change	Is the anticipated scale of change large or small?
Programmatic modification	Are programmatic adjustments needed?

The methodological limitations for this research are related to the availability of comparable information among the exporting and adopting countries. For the first stage, there is much less information available with regard to the evaluation of the cohorts and outcomes for the DIB in India compared to the SIB in Peterborough.

3. ASSESSING IMPACT BONDS THROUGH THE POLICY TRANSFER APPROACH

3.1 Demand side constraints

The demand represents the social needs in a country, and if there are no social issues to be addressed by the impact bonds, it is not feasible to adopt them. The interest and willingness of the policy-makers to satisfy the demand for a policy is crucial to the implementation.

Is there a demand for the program? Yes. There is a demand for programs and policies that cover social needs in the three Latin-American countries. There is a large income inequality within their population. The Gini coefficient for Mexico is 0.47 and 0.50 for Chile, both have the highest income inequality measured by the OECD. The OECD average Gini coefficient is 0.31, while for the UK it is 0.34. In the case of Colombia, although it does not belong to the OECD, the last data available for its Gini coefficient is 0.53, which shows an even higher income inequality compared to Mexico and Chile (World Bank, 2016).

Comparing the conditions of youth unemployment, primary and secondary school attendance, and diabetes among the same countries, it is observed that the three Latin American countries have mixed conditions, in some cases they have similar conditions to the UK, but in others they are closer to the Indian context. The UK presents the second highest unemployment rate from the five countries, the mean rate from the period 2010 to 2014 was 7.5%, while the youth unemployment was on average 19.6%. India had on average 3.5% of unemployment and 10.4% youth unemployment for the same period. In Mexico, the average unemployment rate was 5% and the youth unemployment rate 9.6%. In Chile, the unemployment rate was 6.8% and the youth unemployment 16.9%. In Colombia, the average unemployment rate for that period was 10.6% and the youth unemployment rate 20.7%. There is a demand for action on this topic in the five countries, the demand will be classified as medium-high for Colombia, the UK and Chile, while Mexico has a medium demand and India a medium-low demand.

In the education sector, the UK has the lowest rate of children not enrolled in primary school age. From the period 2010 to 2013, it was less than 1% on average, with a rate of unenrolled adolescents below 2%. Mexico has on average 3.2% of the children unenrolled in primary school, but a rate of 12.6% of adolescents out of school. In India, the rate of children unenrolled

in primary school is 5.1%, but 23.2% of adolescents out of school. While Chile has the greatest percentage of unenrolled children in primary school at 6.1%, but the lowest rate of adolescents out of secondary school, 1.7%. For Colombia, the percentage of children out of primary school is 3.1% and has 0.9% of adolescents out of school, however the last available information in the database is from 2009. Except for the UK, there seems to be a demand in other countries. This is especially the case Chile and India regarding the primary school attendance, followed by Mexico and Colombia. While with regards to secondary school attendance India and Mexico have the higher demand.

In Mexico, 15.8% of the population has diabetes² prevalence, followed by Chile and Colombia, both with 10% for the year 2015. India has 9.3% of its population with diabetes, while the United Kingdom has the lowest prevalence of this disease, only 4.7%. The demand for a policy to treat and prevent this disease is present in these developing countries.

Is there potential resistance to transfer the program? No. There does not seem to be any resistance from the policy-makers neither in Mexico, Chile nor Colombia. The three countries have shown their interest in the use of SIBs, either by attending the meetings organized by the Multilateral Investment Fund (MIF) aiming to spread the use of these mechanisms since 2014 or by starting the design of a SIB as such. Mexico, Chile and Colombia have been considered as part of the main candidates to focus the resources and make agreements for the implementation (Levey, 2014).

3.2 Programmatic Constrains

When a policy or a program presents a high degree of complexity, it is less likely to be transferred successfully to another country. In the case of the impact bonds, its complexity does not show in the concept, but rather in the details of the interventions themselves, which vary from one context to another.

How unique is the program? SIBs and the DIBs do not have elements of “uniqueness” in the sense that Rose describes. Their implementation is not restricted to a specific place and target population that only exists in a determined space and time (1993, 2005). SIBs have already been transferred and applied to various scenarios, in spite of the different contexts and the social issues in the adopting countries. The SIB structure can be transferred if the countries have similar stakeholders and the same degree of involvement. There needs to be a social issue or a vulnerable population that can be helped with a preventative and innovative approach. In addition, there must also be investors who are interested in financing the model, service providers that have the expertise, and a government that has the commitment and resources to pay for the outcomes.

When the budgetary capacity does not allow a government to be the outcomes payer, as in the SIB model, but there are socially motivated investors, service providers and a population with deep social needs, then the DIBs are a suitable option. Such features are commonly found in the low and middle-income countries (Center for Global Development & Social Finance, 2013). The element of uniqueness is not present in the impact bonds model; they are flexible and adjustable as long as the stakeholders and the legal and institutional frameworks within a country or jurisdiction enable its use.

How complex is the program? The degree of programmatic complexity, according to Rose, can be assessed based of the following features: multiple goals, a vague empirical focus, multiple causes for a desired outcome, unfamiliarity with the original design and unpredictability of the outcomes (1993, 2005). If these features are present, then the program has a high degree of complexity that makes it difficult to be transferred.

The understanding of the SIB model will depend on the information and knowledge that the adopting country has. In the case of Mexico, Chile and Colombia, the model is not unknown anymore because all of them have been involved in the meetings organized by the MIF in order

² This data includes diabetes type I and II (see: World Bank, 2016b)

to acquire the necessary knowledge and information regarding the SIBs model. Until February 2015, these countries have taken part in the communications strategy and SIB events organized by the MIF (Multilateral Investment Fund, 2015). The interventions have already proven their effectiveness to achieve expected outcomes, so unpredictable outcomes should be limited.

With respect to the DIBs model, the complexity of the model is similar to the SIBs, their differences are in the structure and the role of the outcomes payer. Like in the SIBs, the unpredictability factor is reduced due to the proven interventions by the social provider. In regard to the familiarity with the model, this model is not being explicitly disseminated in any of the selected countries.

3.3 Contextual constraints

A policy or a program might be unsuccessful if the context of the adopting countries restricts its functionality. Factors, such as a path dependency, the existing structure, the political context, and the availability of resources, can turn into obstacles if they do not match the conditions of the exporter country, or if they create new obstacles for the adoption of the new program. Mexico, Chile and Colombia show promising contexts for the adoption of impact bonds, and especially SIBs, but the constraints are to be related to the existing structure, the political cycle and the politicization context.

Path dependency: Are past policies restrictive or enabling the transfer process? Neither Mexico, Chile nor Colombia have a specific law that provides direct references to the impact bonds. However, these countries have laws on Public-Private Partnerships (PPPs) that can be used for the contracts and agreements between the government and the intermediary or service providers in an SIB (Honjiyo, 2015).

A review of the legal frameworks in developing countries made by Instiglio and Thomson Reuters Foundation shows that there is legal leverage in Mexico for all the stakeholders to develop and perform their functions as part of the SIB model (2014). The review of the Chilean legal structure shows that the political and administrative authorities have a relatively low autonomy to contract with third parties (Ibid). Due to its centralized governmental structure, any negotiation has to be made by the central government, i.e. executive power, so local governments act primarily as agents, and are not allowed to make their own policy decisions in comparison to the decentralized states (Gatica, 2015; Von Baer & Torralbo, 2012). In Colombia, although the SIBs are not specified in its legal framework, the current legislation allows contracts and agreements between the private and public sector, which can be used for the implementation of these impact bonds (Instiglio & Thomson Reuters Foundation, 2014).

Existing structures: Are existing structures restrictive or enabling? The performance of the institutions and the existing structures can hinder the transfer process of the impact bonds in the selected countries. This is assessed with the data from the Worldwide Governance Indicators (WGI): four factors were chosen to compare the performance of the existing structures in the selected countries with the benchmarks for the SIB and the DIB. These factors are the rule of law, control of corruption, political stability and absence of violence, and government effectiveness for the period 2009 - 2014. The data represent the percentile rank that indicates the country's rank among all countries covered by the WGI project, in which a percentile value of 0 corresponds to lowest rank, and 100 to the highest rank, i.e. the greater the percentile rank, the better its performance.

The rule of law factor shows to what extent the agents have confidence in society and to what degree they abide by its rules, including the quality of contract enforcement, property rights, police, courts and the likelihood of crime. Mexico has a low performance, its average percentile ranked was 35.34, being the lowest rate if compared to the levels in the selected countries. Colombia has the second worst performance among these countries with a 43.47 average percentile rank, below India. Chile shows a high performance, its average percentile rank was 87.90, performing better than the rest, but under the 93.52 rank from the UK.

The control of corruption factor shows the perceptions of the people regarding the use of public power for private gain on both a small and large scale, and the degree to which the state is influenced by elites and private interests. In Mexico, the percentile rank was 40.59, which is slightly better than the one from India, 36.40, but still a very low performance compared to the 92.20 percentile from the UK. Colombia has an average percentile rank of 44.50 and performs better than Mexico, but it is still low compared to Chile and the UK. Chile has a high performance percentile rank of 90.37, which much similar to the conditions from the UK.

The political stability and absence of violence and terrorism factor measures the perceptions of how likely it is to have political instability events and/or politically motivated violence, as well as terrorist actions. Mexico shows a low performance with an average percentile ranking of 22.95, but performs better than India with a percentile rank of 12.12. Colombia has the lowest percentile rank of this period with 9.19, which is even lower than in India. While Chile has a medium performance ranking, it has an average percentile of 63.42, performing even better than the UK with a percentile ranking of 58.20.

The government effectiveness factor indicates the perceptions of the quality of public services, the civil service and its independence from political pressures, policy formulation, and implementation, as well as the credibility of the government's commitment to such policies. Colombia has an average percentile rank of 53.54, higher than the Indian percentile of 51.22, but far too low compared to the UK percentile. Mexico's average percentile was 61.75, which can be considered as a medium performance. In the case of Chile, its percentile rank is 85.74, a medium-high performance below the UK average percentile of 91.39.

The existing structures in Mexico and Colombia can restrict the transfer process, while in Chile they are more likely to enable it, due to their higher performance.

Political context: Is there obvious politicization? In this regard, the political issues and the perception of the population in the adopting country can hinder the transfer of the impact bonds. According to Marta Garcia, a director at Social Finance and leader of impact bonds projects in Latin America, the private interventions in the public sector can be politicized by interest groups, the political cycle or internal conflicts (personal communication, June 9, 2016). A SIB in the public healthcare system in Mexico did not take place because of the opposition of the National Union of Social Security Workers (SNTSS). In Chile and Colombia, SIBs were delayed due to political elections.

There has not been any attempt to use a DIB in Mexico, Colombia or Chile yet, but it can be assumed that there are fewer constraints in the political context for this model than in the SIB, since the government has a much smaller role in the scheme. In Mexico, the DIB does not seem to have obstacles unless there is some political interest group taking part in the provision on a social service. In Chile and Colombia, the political issues come from the government, rather than the private sector or the civil society organizations, a similar assumption can be made.

Resources: Does the receiving context possess adequate resources for the transfer process? The resources that the public sector and the investors can allocate will depend on the SIB agreements and budgetary capacity. For the DIB, the resources will also depend on the investors and the outcomes payer. In both cases, the number of potential service providers is a relevant factor to ease the transfer of the projects.

The use of public resources shows the capacity and interest of governments to improve the living conditions of its population. The average public expenditure on education in Mexico is 5.1%, in Chile is 4.3% and in Colombia is 4.6% of its GDP, which are not far from 5.6% in the UK and 3.5% in India, the two reference points of the research. In regard to healthcare, from the total government expenditure Mexico allocates 11.4% and Chile 14.6%, which is less than the 16.2% allocated by the UK, while Colombia allocates 18.2% in this sector, exceeding the UK expenditure and the 4.5% allocated by India.

With respect to the investments needed to fund impact bonds, the attraction of impact and commercial investors plays a crucial role. In Latin America, impact investments are gaining

traction and are an option for these projects. According to the Annual Impact Investor Survey, the region is one of the leading areas in terms of capital allocated, and investors have expressed strong interest to increase the amount invested in 2016 (GIIN, 2016). In addition, the region has 11% of the global impact investing assets under management, approximately US\$6.6 billion (Ibid).

Mexico, Chile and Colombia have a well-developed environment in regards to third sector organizations. According to the International Center for Not-for-Profit Law, the not-for-profit sector in Mexico is composed of 19,777 active civil associations and 3,135 private assistance institutions (2016). Chile had approximately 31,399 nonprofit organizations classified as NGOs, according to the National Register of Legal Entities (Ministerio Secretaría General de la Presidencia, 2013; Soto Coronado, 2013). According to the *Confederación Colombiana de ONGs*, in Colombia there are 71,789 nonprofit organizations in the country (2016). In these Latin-American countries, such organizations can be involved as service providers in the impact bonds scheme in different areas.

3.4 Application constraints

Finally, the constraints in the application of the impact bonds could also hinder the success of the implementation. Nevertheless, for Mexico, Chile and Colombia, the scale of change, the substitutability of institutions, and the programmatic changes do not seem to be obstacles for the adoption of the impact bonds.

Institutional substitutability: Would new institutional structures be needed? For the SIBs, it would not be necessary to create new institutional structures that substitute the functions of the institutions used in a SIB, like in the UK. There is a current legal framework that can be used to implement the SIBs in Mexico that would be considered within the PPP scheme. Nevertheless, PPPs and SIBs are not the same, therefore a legal specification of this model would be more appropriate, since a modification in the regulations of the PPPs will directly affect this model. Similarly, in Chile, the framework for the PPS³ can be used for the adoption of the SIB model, but a legal specification or even a specific law for the model would avoid future conflicts in its implementation. Colombia has the appropriate legal framework to introduce the SIBs, either as part of a direct assignation or a public tender process, while the constitution and two specific laws⁴ on public-private agreements and contracts can be used to introduce such mechanisms. For the DIBs, besides the memorandum of understanding, there is no necessity to create any new institutional structure, since the agreement is between private entities in which the government does not take a leading role in the structure.

Scales of change: Is the anticipated scale of change large or small? The changes that can be expected with the adoption of a SIB are related to the governmental authorities and their awareness and knowledge about the possibilities and functioning of the model. The MIF, together with Social Finance, are working on the capacity building of intermediaries and governments in order to provide information and training to make them aware of the benefits of this model and the different sectors in which they can be used. For the DIB, change at such scale is not anticipated, at least for the governments. Their main task is the memorandum of understanding with service providers and the evaluator (Marta Garcia, personal communication, June 6, 2016). In any case, the implementation of impact bonds can have an effect in the design of governmental programs policies, as the authorities may focus more on the outcomes and building alliances and cooperative agreements with the nonprofit and private sectors.

Programmatic modification: Are programmatic adjustments needed? The specific interventions as such cannot be copied, they have to be adapted and changed according to the

³ Public Procurement System of Chile (PPS), Sistema de Compras Públicas in Spanish

⁴ See: Instiglio & Thomson Reuters Foundation (2014). Law 1150. Law 1508 on Public-Private Partnerships or Article 355 of the Colombian Constitution.

conditions and the circumstances where they are implemented. An unaltered education DIB, like the one in India, will not have the same effect and outcomes in Mexico, Chile or Colombia, where the school dropout causes and conditions are different. However, the structure of the impact bonds is meant to be used without altering it, as long as there are stakeholders involved and interested in the models and conditions that enable the adoption of the framework. Hybrids or a mixture between the SIBs and the DIBs are also possible.

4. POSSIBILITIES AND RESTRICTIONS

As demonstrated in this research, impact bonds are capable of aligning financial rewards with social outcomes, and bringing together the expertise of the public, private and the third sector to work on the same goal, despite their different backgrounds and incentives. Among the benefits of impact bonds are the potential savings for the government, the stable access to resources for the third sector, and the financial and social motivation of the investors. Due to the preventative approach of SIB intervention models, the public sector can save resources because the program or policy will help mitigate the costs of ongoing social issues, thereby reducing public expenditure in the future to alleviate these problems. In the DIB model, although the government is not an outcome payer, it benefits from the improvement in the living conditions of its population. The third sector organizations obtain resources to perform their activities, and have the opportunity to reach their goal while they innovate social interventions. Lastly, the private sector obtains a rate of return and fulfills their desire to make a positive impact on the society.

In Latin America and the Caribbean, the Multilateral Investment Fund has promoted the use of SIBs, since it considers them more suitable for the region, meanwhile they have ignored the DIBs as an alternative or a possible hybrid, rather than a central project. In the cases of Mexico, Chile and Colombia, although their conditions do not present any restrictions for the DIBs and even though the government is not involved in the contract agreements, the implementation could be better, but there are no proposals or projects to apply this model in these countries yet. In general terms, the structure and features of the SIBs and the DIBs model can be used in Mexico, Chile or Colombia. The reasons and major obstacles for the impact bonds will be presented for each case individually.

Mexico: On the one hand, there are factors in Mexico that enable the transfer process of the impact bonds, especially the SIBs, but on the other hand, political factors can potentially restrict their adoption and successful implementation. As previously explained, the country has social needs that can be tackled through these mechanisms. The country has a high demand for policies and programs to support the population with diabetes, as well as a medium demand for actions addressing youth unemployment and school dropout from children and adolescents.

The factors enabling the transfer process of impact bonds in Mexico are: cooperation and interest from the government, adaptability of the models, legal structure, and the conditions and resources from the potential stakeholders. There is no apparent resistance to the use of SIBs from the side of the government and most likely this also applies for the DIBs, since the government would spend less resources and be less involved as in the SIB model. There are no programmatic constraints within the structures of the impact bonds, the SIBs have been adopted in countries other than the UK, and also the DIBs could be in countries with similar needs as India as long as the stakeholders are interested. The legal framework of the Mexican law on PPPs enables the adoption and implementation of SIBs, and although it does not specify them by law, the contracts can be concluded. For the DIBs, the structure used would be a contract between private entities, with the recognition of such contract by the state and the memorandum of understanding accordingly. For the impact bonds in general, Mexico has a well-developed environment of third sector organizations that can take part as service providers. Impact investments are growing in the region and in the country as a whole, and those resources can

be allocated to impact bonds projects to fund them. The government spends public resources in areas like education, healthcare and social policies.

The constraints for the transfer of impact bonds in Mexico are related to factors such as rule of law, control of corruption, political stability and absence of violence, in which it has a low performance. The low standard for the rule of law in Mexico implies that the conditions in the contract enforcement, property rights, courts and the police, can potentially hinder the performance and even the implementation of SIBs and DIBs. Furthermore, the recent violence in the country due to the war on drugs, can discourage the investors and service providers to work in some areas.

Besides the structural constraints, the politicization in Mexico in some areas plays a decisive role for the implementation of projects. Two of these areas are public healthcare and education, which both have the largest labor unions in Latin America, the SNTSS in the healthcare and social security sector, and two in the public education system, the National Educational Workers Union (SNTE) and the National Coordinator of Education Workers (CNTE).

The implications for impact bonds in politicized sectors are at a high risk of opposition from interest groups and the potential failure of implementation. In the event an impact bond is pursued and implemented in such sectors, the interest groups have to be informed about the process of the intervention and its goals in order to avoid any misunderstandings. However, impact bonds are not conceived as a substitute or replacement for the public services provision, but as a complementary preventative approach to the governmental functions. In the state of Chiapas, the performance-based contract designed by Instiglio to increase high school enrollment does not have any opposition because it does not compete with the teachers or the institutions. Also, the SIBs in the state of Jalisco have not faced any controversy because their goal is to lift single mothers out of poverty to complement a current governmental program in which they receive a direct transfer of resources.

Chile: The factors in the Chilean context enable the transfer of impact bonds in general, but the SIBs have been more heavily promoted and seem to be more suitable than the DIBs. This is due to the social needs of the country. Although Chile has the highest income inequality from the OECD countries, it has a HDI higher than all the Latin American countries, except for Argentina. Its demands and social conditions are more similar to those from developed countries than those from developing countries such as India. There is a medium-high demand for programs related to youth unemployment, children out of school, but a low demand for diabetes prevention actions and programs for adolescent out of school.

The factors that enable the transfer of impact bonds in Chile are the current legal structures, the legal frameworks and the apparent lack of political instability and application constraints. It has a high standard in regard to contract enforcements, property rights, and the public has a positive perception of the courts, police, and control of corruption and a low likelihood of crime. There is a perception of a medium-high quality with regard to the credibility of the government's commitment to its policies, the public and civil services, the policy formulation, and the existence of freedom of expression and association. Furthermore, the perception of political stability and the absence of violence is higher than in the UK. The SIBs can be adopted through the Public Procurement System of Chile (PPS), although the PPS has not specified the use of SIBs, it can be used to enforce the contract between the public and the private sector. In case DIB implementation is pursued, it would not require the PPS framework, but rather a private contract between the investors and the outcomes payer, together with the memorandum of understanding accordingly.

Chile has suitable conditions for the implementation of SIBs, it seems that the biggest constraint has been the lack of commitment from the government and its demanding centralization. Although the feasibility study for a recidivism project started in 2014, there is no binding commitment from the central government to be more involved yet and the contracts and negotiations have been delayed due to electoral processes in 2016 and 2017. The

implementation will likely not be until 2018. The local governments have no faculties to pursue these agreements, and only the central government, through the Ministry of Finance, is the appropriate entity to take part in a SIBs scheme, because it has a central role in the allocation of budgets and is responsible for the efficient execution of public resources (Gatica, 2015).

Colombia: The factors that enable the transfer of the impact bonds model in Colombia are the demand for programs and policies to solve social issues, the low resistance to these mechanisms and the legal framework that allows them to take place. There is a medium-high demand for actions to solve issues related to youth unemployment and a medium demand to reduce the number of children out of school. The country has a low-medium demand to attend the prevalence of diabetes. In regards to the prevalence of adolescents out of school, Colombia shows a low demand, since only 0.9% is in this situation. There is a low resistance to the introduction and proposal of SIBs, since the projects presented by Instiglio were considered by the national and the local government. The projects proposed are related to the improvement of children's education, unemployed youths, and youths in vulnerable situations, which is coherent to the demands shown in this research.

Although the country has a low-medium performance with regards to the rule of law and the control of corruption, it is better than the performance of Mexico and can enable the implementation of impact bonds. Also, the medium performance of the government's effectiveness is an enabling factor, since the investors can trust that the government will repay them if the pre-established outcomes are achieved.

The current legal framework allows the implementation of SIBs even though they are not specified in the legislation. The agreements and contracts between the public and private sector can take place as established by the PPPs regulation, the regulation on procurement with public resources and the direct contracting of nonprofit entities focused on activities of public interest and social development. However, similar to the cases of Mexico and Chile, the SIBs are strongly promoted in Colombia, and until now there are no proposals to introduce DIBs.

The restrictive factors identified in the case of Colombia are related to the political cycles that have delayed the implementation of the SIBs proposals and the potential instability as well as violence in the country. As in the case of Chile, the lack of commitment from the government has hindered the implementation and further conversations about SIBs projects. Projects to reduce teenage pregnancy and improve educational outcomes for adolescents in the region of Antioquia started in 2012, but have not yet been implemented. The project to improve the employability of vulnerable youths has not taken place either, although it has already proven its effectiveness through a pilot project that is expected to be scaled soon. Another potentially restrictive factor for Colombia is its low performance on political stability and absence of violence. Of the five countries analyzed, Colombia has the lowest rating, which could discourage investors and hinder the work of service providers, like in Mexico. However, the country has shown great advances in security measures since the 1980s and 1990s. Furthermore, the peace treaty with the paramilitary and guerillas, currently in the final stages, can reduce the restrictive character of this factor.

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