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# Payment by performance

Payment mechanisms for policy outcomes - but they are hard to deliver

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## ‘If policy analysts carry bumper stickers, they should read: Payment on Performance.’

The great American political scientist, Aaron Wildavsky, wrote these words almost forty years ago, and yet politicians have only recently begun to give them serious attention.

For the most part, governments pay for process and promises. Despite ambitious statements about anticipated policy outcomes and annual budget papers, daily news papers remind us that what governments buy from their agencies, most of the time, are inputs – quotas of teachers, police officers and hospital beds.

And public servants are inclined to measure how well they have complied with the rules, since due process is safer and easier to deliver than due performance.

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The vast majority of public service contracts are little better – specifying inputs or at best low-level outputs, hemmed in by policy settings that make bold innovation difficult, if not unthinkable.

In recent years, this has begun to change, with the emergence of new contract models, where government pays when there is clear evidence that an outcome, or at least a high-level output directly linked to that outcome, has actually been delivered.

The attractiveness of such a model to Ministers and to Treasuries is not difficult to explain. Done well, it is not difficult to explain to the public at large. And yet the challenges are immense.

It is often difficult for public officials to state clearly in advance what the key outcomes of a particular programme are – to reduce the complexities and uncertainties of the future policy environment to a single set of performance conditions.

Administrative law, probity commissions and public accounts committees find it difficult to embrace the idea that public services should be judged first and foremost, by whether or not they deliver better outcomes.

And it is much easer to design highly prescriptive contracting models that deliver economy (and even equity and integrity), than write contracts with performance regimes that drive up quality.

And yet, politicians and public officials have been grappling with Wildavsky’s Proposition, with varying degrees of success, for some years now.

A decade ago, a number of American states contracted the management of foster care to third sector agencies, with payments based, in large part, on their success in finding safe, permanent homes for children. Independent studies have shown dramatic improvements in average length of stay and the rate of adoptions.

Around the same time, the Blair Government contracted the management a number of failing Local Education Authorities to private firms, with payment based, in part, on their success in improving student performance relative to the national average.

Most of these contracts have since expired (after early success), but two local authority areas – where the contracts are held by Serco Group plc – have enjoyed a remarkable turnaround, with improvements in student performance at twice the national rate over the past four years.

In an attempt to improve the liveability of local neighbourhoods, some British local authorities are contracting the maintenance of the 'streetscene' to private firms, assigning them overall responsibility for street cleaning, refuse collection, verge maintenance, graffiti removal and, in some cases roads and pavements. In Woking, the views of local residents, ascertained by independent surveys, impacts the profits of contracts.

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Some of the best examples of 'payment on performance' are to be found in job placement for the unemployed, where independent sector providers are paid, in part, based on their success in finding sustainable positions for job seekers.

Australia's 'Job Network' scheme was a pioneer in this field, and proof of our leadership can be found in the number of Australian firms that have won similar contracts in the UK and continental Europe.

The UK has learned from the Australian experience, and while it is difficult to compare the two models, in the latest round of welfare-to-work contracts, the UK has shifted a great deal more performance risk to the independent sector.

Under the UK's 'Flexible New Deal', providers receive only 40 percent of their costs by way of service fees, with the rest being paid on placement and when the job seeker has been in work for 13 and 26 weeks. Until the recession, the up-front payment was going to be 20 percent.

While mistakes have been made with early versions of the welfare-to-work contracts, there is a great deal of optimism in the current UK government about the application of 'payment by results' to manage other problematic public services.

In particular, there is interest (on both sides of the political fence) in the application of these lessons in offender management, with independent sector providers assuming some of the risk of bringing down reoffending rates.

Immediately prior to the recent UK election, the then Justice Secretary announced a pilot scheme for 'payment by results' in offender management that draws on funds from social investors.

There has also been considerable interest in the application of this model to the management of long-term health conditions such as diabetes, asthma and coronary disease.

In the US, where private health funds are able to capture the financial gains from preventive care, the science of chronic disease management is now well developed and public service managers in the UK and Australia have benefited from the innovations North American health care providers have introduced in self-management.

And yet huge uncertainties remain about how and where to implement outcome commissioning. Targets need to be stretching but realistic, challenging policymakers and providers to innovate with new service solutions that cut across traditional boundaries, without creating expectations that are unrealistic over the short- to medium-term.

*"Coming up with independently observable and objectively measurable outcomes can be problematic"*

Coming up with independently observable and objectively measurable outcomes can be problematic, especially where there is a long pause between the intervention and the result. Too short a time period will make it difficult for providers to secure a return on their investment; too long will increase inflexibility and introduce extraneous variables that are difficult to cost.

Commissioners must refrain from meddling in the detail of service provision, whilst ensuring that they are comfortable with the innovations being made, and learning the lessons to improve the system as a whole.

Of course, it will take time for private providers to learn how to manage such risks. Some companies will be over-optimistic and suffer financial and reputational loss in the process.

But as we have already seen in the markets for foster care, long-term condition management and welfare-to-work, other providers – public, private and not-for-profit – will learn how to manage these risks, and come up with innovative new solutions to some of the wicked problems of public service provision.

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