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policy solutions that work for low-income people

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PFS Incentive Fund RFI

Response to Request for Information: Strategies to Accelerate the Testing and Adoption of Pay for Success (PFS) Financing Models

To whom it may concern:

The Center for Law and Social Policy (CLASP) is submitting these comments in response to the request for information on strategies to accelerate the testing and adoption of Pay for Success (PFS) financing models. CLASP develops and advocates for federal, state and local policies to strengthen families and create pathways to education and work, with a focus on low-income populations. Our comments below draw on an ongoing CLASP review of current experience with Pay for Success contracts as well as relevant portions of the vast literature regarding performance contracting, performance management, and strategies to link public policy and implementation with research evidence. We are delighted to share key themes now and will be publishing the paper in the coming months. If we can provide any additional information based on this work, please let us know.

We applaud the Administration's interest in improving outcomes in a range of areas where governments provide services. We are intrigued by the possibility of using PFS contracts as a means of expanding services, leveraging private investment and improving the evidence base for what works. However, we wish to emphasize that PFS approaches are not a goal in and of themselves; they are only worthwhile to the extent that they contribute to the goal of expanding high quality prevention-oriented services. As discussed below, we do not believe that they are appropriate for all types of government services. In particular, at this stage of development they should not be used to supplant existing core services.

Some of the supporters of pay for success contracts sometimes use rhetoric that emphasizes the differences between PFS and traditional government contracts, and implies that most existing services are ineffective because of the lack of rigorous evaluations. In fact, of course, there is a long history of performance-based contracting in many government services, as well as other strategies for using both rigorous research and ongoing administrative data on outcomes to guide policy and program choice as well as implementation. Therefore, such rhetoric is inaccurate and has the potential to undercut public support for government programs. We urge the Administration to avoid such rhetoric.

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Our responses address several of the key questions included in the Request for Information. In particular, we address questions 1, 2, 3, 4, and 7.

1. Instead of focusing on particular programs, the budget language proposing the Fund is broad in scope. What agencies and/or program areas are best suited for the Fund and why? What level of evidence exists in these areas about interventions that work? What is the threshold of evidence that a program should have in order to merit consideration for a PFS approach? What other factors should be considered in setting resource priorities for the Fund?

A wide range of areas have been suggested as possibilities for PFS contracts. We suggest the following criteria for assessing whether a PFS model offers promise

- **Preventive Intervention that Can Be Taken to Scale**. At the heart of a PFS contract is a preventive intervention (or set of interventions) that can improved outcome, but where there is a need to go to scale, In addition to a model that has been shown effective, there must be an identifiable pool of individuals who could benefit and service providers who are able to expand or replicate the intervention. We believe that it is appropriate to experiment with both PFS projects that support specific interventions, as is the case for the U.S. projects to date, and ones that provide flexible individualized packages of services for a given population, as in the Social Impact Bond in Peterborough prison in the U.K.

- **Evidence Base for Intervention** We do not believe that the intervention must have been previously tested through a rigorous controlled evaluation; in fact, because the government entity only pays for outcomes, PFS contracts can be a way for governments to reduce their risk in supporting innovation. However, there must be a sufficient evidence base in support of the intervention to make the investors who supporting the project believe the project will succeed. In practice, these investors will be the de facto arbiters of what evidence is convincing. Note that in the Peterborough prison example, the investors relied on their confidence in the agencies that are providing ex-offenders with services, rather than on evidence supporting a specific intervention.

- **Shared Understanding of Success**. While implicit in the very term "pay for success," it is important to highlight the importance of agreement on the desired outcomes, and the ability to measure these outcomes in ways that reflect the value added by services. When services have multiple goals, performance payments that are based on only a subset of these goals have a real risk of distorting service delivery or having perverse incentives. For example, child welfare services must balance the need to protect children from dangerous environments against the reality that removing children from their parents itself inflicts trauma; a pay for success contract that used an overly simple measure of success could encourage providers to tilt excessively in one direction or the other. In addition, it is crucial to ensure that the pay for success format does not distort the population served, for example by allowing providers to achieve targets by limiting services to those who are less vulnerable. (This has been an ongoing issue in many approaches to performance-based contracting, for example in child welfare services, employment programs, and health programs.) Finally, there must be agreement about whether the government agency is truly indifferent to the means by which the service provider will achieve the desired outcomes, or if there is only flexibility within a specified menu of options.

- **Expansion of Services**: We believe that PFS contracts should be limited to expansions of services to individuals who are not already being served, rather than replacing existing services. This is important because service provider may reach a point where it is clear that they will not meet the designated milestones needed to receive performance payments. At that point, a profit-motivated provider will rationally pull out and stop providing services. This is only acceptable if the program is serving people who would not otherwise have received services.

2. The budget proposal encourages maximizing the leverage of Federal funds by engaging intermediaries, including state, local and tribal governments. What other kinds of groups should be considered as intermediaries? Are there other organizational constructs that should be considered? The ability to demonstrate whether a PFS intervention produces the desired results is the backbone of the model. How can the Federal government encourage the adoption of low-cost yet rigorous outcome measures? What are some of the barriers to using administrative data in a PFS scenario, and how might they be addressed?

CLASP does not have opinions regarding the entities that should serve as intermediaries under these contracts. Under this question, we address two issues: the use of administrative data, and the tension between measuring outcomes and impacts.

<u>Use of administrative data</u>

Outcome measurement is much cheaper and thus more feasible at scale when it is based on existing data (e.g. unemployment insurance earnings records, health care system use, correctional systems outcomes), rather than requiring new data to be collected. Use of administrative data also produces higher responses rates than surveys, and is not subject to distortions from self-reporting. There is enormous potential for "big data" to make ongoing performance measurement cheaper and faster. But with very few exceptions, this potential has not yet been realized. There are often legal or technical barriers to using existing data for this purpose, particularly when measures require linking disparate data sets, such as linking educational program data to employment outcomes. In many cases, the data needed for performance measures may belong to other agencies or other levels of government than the one developing the project. It is important to bring such agencies into the conversation as early as possible, to understand their concerns and priorities, and to recognize that they may need to be compensated for their costs.

The Federal government can promote the use of administrative data for outcome measurement by sharing guidance regarding data use and confidentiality requirements, as well as by convening interested parties. This is an issue with much broader implications than PFS contracts, and the discussions should not be limited to entities that are pursuing such a financing mechanism.

Outcomes versus impacts

The RFI does not directly address the question of whether PFS contracts should pay based on participant outcomes (or improvements in outcomes) or if they should only pay for *impacts*, or the effects of the program on participant outcomes, compared to what would have happened in the absence of the services. Outcomes are far easier to measure, particularly for large scale interventions, and they may be self-evidently extremely important – for example, if all children in a low-income community are proficient at reading by third grade or no teens begin smoking. They also are typically well-suited to assessing large, system-wide change, and they offer organizations using them the opportunity for continuous improvement – that is, the ability to see whether intended changes are occurring and to fine-tune the intervention if not.

However, because programs are only one factor in determining outcomes, there is not necessarily a correlation between the programs with the best outcomes and the programs with the largest impacts, if programs are in different economic contexts or serve different populations. In particular, there is an extensive literature that shows that programs serving highly disadvantaged populations often achieve lower levels of outcomes than ones that serve more advantaged population, even when they have greater impacts

The "gold standard" for measuring program impacts is the use of a random assignment methodology, with a control group that does not receive the program services. (Control group members are typically provided with the existing baseline services and/or are allowed to access services generally available in the community.) While the clarity that such a research design provides is desirable, such experiments are often costly, can be challenging to implement, and are better suited to small scale programs than to large scale interventions that are designed to change broad systems. They are not well-suited to the early stages of an intervention, when adaptation to the needs of the population and the context may be desirable. They also may pose ethical considerations for providers who must turn away vulnerable individuals in need of services.

Given these challenges, the few social impact bond projects that are currently under way all use comparison groups, but not full random assignment. In these programs, outcomes are compared to similar individuals at different locations, or in a prior time period. When such comparison groups are used to measure impacts, it is important to think closely about external factors that might affect the groups disparately, such as a regional recession that might affect employment rates, or a change in the criminal penalties for drug use that would reduce re-incarceration rates.

It is also critical to ensure that intermediaries or service providers cannot achieve their outcomes targets by "creaming," or designing programs in such a way as to exclude the most disadvantaged populations. Any PFS contract that makes payments based on outcomes rather than impacts should also include measures of access and participation. In addition, it may be appropriate to provide tiered levels of outcome payments, where providers can earn additional amounts for succeeding with more disadvantaged individuals, who may be more costly to serve effectively.

3. Outcome payments and financing support (e.g., credit enhancement, loans or advances) are two forms of assistance meant to complement one another in stimulating PFS approaches. What criteria should be used to decide how to split the Fund between these two forms of assistance? Should a certain proportion of the fund go toward outcome payments versus financing support, such as 50/50, 30/70, etc.?

As noted above, Pay for Success approaches should be evaluated based on whether they contribute to the goal of expanding high quality prevention-oriented services. Moreover, by definition, a program that pays a return to investors will be more expensive than the exact same program that is paid for with direct government funding. Even if the government needs to borrow to pay for the up-front costs, governments can generally borrow at much lower interest rates than would be required by a PFS investor. In addition, PFS models incur additional costs, such as the fees charged by evaluators and intermediaries.

Therefore, the goal of these efforts should not be to "stimulate Pay for Success" approaches, but rather to determine whether these approaches are effective in expanding quality services at a competitive price. If Pay for Success contracts cannot attract private investment without additional government intervention or support beyond the outcome payments, this is an important lesson to learn. Financing support should only be provided when it is needed to test a specific PFS variation, such as testing whether nonprofit service providers can successfully compete and perform under contracts where payments are 100 percent outcome based.

4. Is there an optimal structure for both the timing and tiering of outcome payments? For example, should the projects allow for some degree of "progress payments" based upon achievement of early outcomes? Should the projects allow for "bonus payments" for extraordinary performance? What are the trade-offs of adapting different structures to different projects versus supporting a standardized approach?

We strongly believe that the PFS field is not yet at a stage where a standardized approach is justified. Only a few PFS projects are in the field, and none have yet reached the point at which outcome payments are made. There is simply no basis on which to decide what would be the right structure to use in a standardized approach. One of the areas in which this effort could make a significant contribution is in understanding the tradeoffs and implications of different structures for the timing and tiering of outcome payments.

That said, we believe that for many of the areas in which preventive investments could save governments and society as a whole money, these savings will not be fully realized for many years. For example, a program that supports disadvantaged high school students in their studies and encourages them to go to college will not have significant returns until its participants have completed college and entered the workforce. In fact, in the short run, participants may have less labor force participation and pay less in taxes than their peers who do not participate. Early childhood interventions such as home visiting programs and high quality preschool have even longer payoff periods, as their full benefits are not realized until the children grow up to be adults.

It is unrealistic to expect profit-minded investors to wait this long to receive payments. Therefore, for PFS contracts to make sense as a way to support such investments, it must be possible to identify interim outcomes that are strongly associated with the desired long term outcomes. In some cases, these may result in shorter term savings (e.g. South Carolina has suggested that home visiting programs will save Medicaid costs, and Utah's SIB is based on the expectation that preschool will reduce at-risk children's use of special education services when they enter public schools.) However, at this stage, it is worth experimenting with projects that make payments based on interim outcomes that do not result in immediate savings but that are expected to generate long-term savings. One beneficial outcome of these investments could be improving the evidence base on the relationship between interim measures of progress and longer-term outcome measures.

7. What process would be most helpful to states, local governments and tribes to apply for either outcome payments or financing supports? What do states and localities need in order to be ready to participate in a competitive process and resulting projects?

PFS contracts require a whole ecosystem of organizational capacity, including government contracting offices, intermediaries, evaluators, and investors. Just participating in the competitive process can consume a significant amount of public resources. In some cases, such as coming to a shared understanding of the desired outcomes of an intervention, these up-front investments of time will add public value even if an applicant is not chosen for funding. In other cases, such as negotiations with potential investors, these may not have spillover benefits. As much as possible, the competition should be designed so as not to require applicants to engage in these limited additional value activities before they have been selected. For example, the federal government could identify a pool of investors, intermediaries, and evaluators who would be willing to work with whomever is selected for funding, rather than requiring each applicant to identify their own partners. The federal government could also conduct training for procurement staff among the selected entities, rather than expecting applicants to have existing expertise among their employees.

Thank you for your consideration.

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