

Contracting out welfare to work in the USA: delivery lessons

By Dan Finn

In 1996 the Personal Responsibility and Work Opportunities Act devolved significant new powers to individual states for implementing 'Temporary Assistance for Needy Families' (TANF). States could contract out all services, including eligibility for TANF financial assistance, and give contracts to faith-based organisations on a new basis (known as 'charitable choice').

This report contains findings from a review of literature on the contracting out of these welfare to work services, with a particular focus on the experience of Wisconsin and New York City.

Main findings

There has been no comprehensive evaluation of the impacts of contracting out welfare to work in the USA but the following findings emerged from survey and case study evidence published by various policy institutes and academics and from the reports of various audit, oversight and regulatory authorities:

- In 2001 nearly all states contracted out some TANF services with a market value of \$1.5 billion, accounting for 13 per cent of federal TANF expenditure. Some 88 per cent of the total funds contracted by state governments – and 73 per cent of the state-level contracts – were with non-profits; the rest with for-profit providers. In eight states half of the contracted funds were with for-profits. The value of the TANF market has since fallen, reflecting declining caseloads. One study found that between 2001 and 2004, the average dollar value of TANF contracts fell by 27 per cent and the average number of state contracts from 121 to 59. There had, however, been an increase in the proportion of contracts held by faith-based organisations.
- A significant minority of states, such as Wisconsin, contracted out case management and eligibility determination to the private sector but most states retained public control of TANF eligibility, reorganising their welfare offices to provide work-focused eligibility and case management services, but contracted with the private sector for other employment-related services.
- There were three types of TANF contracts – 'pure pay-for performance', 'cost-reimbursement' and 'fixed price'. In practice many welfare agencies used 'hybrid contracts' that sought to balance performance incentives, provider viability and the delivery of particular services. Studies reported that staff at contracting agencies found designing contracts and managing performance 'challenging'. The implementation process has been dynamic and welfare agencies have had to frequently revise the terms of their contracts as problems have arisen and conditions have altered. The role of auditors has been particularly important in identifying poor contract design and oversight.
- There is variation in the size of contracts. Many welfare agencies issued a significant number of smaller contracts that allowed them to acquire specialist providers, reduced reliance on large contractors, and enhanced future competition by keeping entry costs low. This also reduced the risks from poor performance as a weak provider could more easily be replaced. Other welfare agencies, however, used a 'prime contractor' model. This allowed them to work with fewer, well-capitalised contractors. Larger contracts limited administrative and monitoring costs, allowed contractors to reap economies of

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scale and gave them scope to coordinate services. These contracts attracted for-profits organisations which targeted markets with large caseloads.

- There has been much debate about the role of national for-profit providers and controversy about their operation in particular states, especially in the first phase of contracting out. Concerns also have been expressed about the impact that welfare to work contracts have had on the composition and service delivery of the non-profit sector.
- Most studies report that welfare agencies attach importance to the experience and opinions of clients. Contracts normally require providers to agree individual service plans and meet minimum service standards. To gain more insight into the experience of service users many welfare agencies supplement their limited on-site monitoring of client experience with customer satisfaction surveys. Some carry out surveys with individuals who declined services or were sanctioned.

The evidence review did not consider the merits of the general arguments concerning the privatisation of welfare to work services. The concern was with the policy and delivery issues emerging from the US welfare market and the implications of these findings for the design, regulation and local delivery of the emerging British welfare market:

- 1 Contractors and their frontline staff inevitably gain an advantage when implementing new contracts as they develop greater operational knowledge of how to achieve specified outcomes. The development of a performance payment system will involve an evolutionary process of trial and error and is likely to require an extended period of monitoring, evaluation and modification. It is important also that in addition to agreeing the delivery of specified outcomes, contractors agree some general values that will help steer the behaviour of the contractor as they make use of the flexibilities they enjoy.

- 2 There is continuing tension between regulation, transparency and flexibility. As the Wisconsin experience illustrates, poor contract design and oversight can result in unintended outcomes. Subsequent redesign has now given Wisconsin increased control over the performance, governance and service delivery of contractors but this has reduced their freedom to innovate. The role of independent oversight is important as those with responsibility for policy and implementation have a clear interest in the 'success' of contracting out.
- 3 The US evidence illustrates the importance of contracting agencies independently monitoring client experience and ensuring that robust systems are in place to respond to complaints of unfair treatment and poor service delivery. In many contracted-out federal programmes agencies must conduct customer satisfaction surveys and the results, as in Wisconsin, may be used as a benchmark performance indicator. These instruments are important both because they provide important information on service delivery and because they can militate against 'creaming' where job-focused performance benchmarks might encourage contractors to deliver most to those clients easier to place.
- 4 There will need to be a significant investment in information systems and in contract negotiation and revision. This should include the continuing development of skilled contract managers. Contracts need to ensure that staff involved in service delivery have appropriate training and development opportunities so that they can discharge their responsibilities properly.
- 5 The virtues of competition are difficult to sustain if there is competition only for contracts. Once a delivery market is established incumbent providers enjoy acquired advantages. Contracting agencies face a difficult trade-off between the potential improvements that might be gained from a new contractor and the transaction costs and service delivery disruption that will

arise when holding an open competition. The efficiencies of contracting should also be sought by creating effective competition between providers within markets. There is, however, scant evidence in the literature on how such competition is driven in the US welfare market, albeit New York City uses the data from its contractor information system to drive the performance of its prime contractors. There was also little evidence on empowering clients to exercise choice between different welfare providers.

- 6 The use of prime contractors reduces administrative costs and generates economies of scale but, as the New York case study illustrates, this may be at the price of a loss of insight into service delivery, the experience of clients and of relationships between the prime and its subcontractors. The viability and performance of subcontractors is important both for immediate service delivery and as a future source of competition for the prime contract.
- 7 There are risks attached to the significant involvement of for-profit organisations. They are likely to follow profit maximisation strategies shaped by contract incentives and this may not necessarily deliver what is best for clients, especially for those with greater barriers. Moreover, if the entry of for-profits into local delivery systems displaces existing private and public infrastructure, future capacity may be at risk when market conditions change and larger for-profits remove their capital to seek greater profits elsewhere.
- 8 Developing and managing contracts for welfare to work and eligibility services is a complex and demanding task for administrators and managers. There is a sharp and continuous 'learning curve' and it takes time to learn how to steer the market to minimise perverse incentives and to capture the efficiencies and innovation that independent contractors can offer. As one US analyst concluded, *'successful contracting requires government to be smart buyers and good contract managers'*.

The full report of these research findings is published for the Department for Work and Pensions by Corporate Document Services (ISBN 978 1 84712 288 9. Research Report 466. October 2007). It is available from Paul Noakes at the address below.

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