
Dynamics of Contracting Out and Performance Management in Third-Party Public Services Provision

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Growing use of market mechanisms in public services provision

- Market mechanisms (vouchers, contracting out) advanced in New Public Management/reinventing government reforms to promote efficiency, flexibility, innovation and accommodation of diverse public preferences, values and needs
 - Rationale in classic market paradigm (also neoclassical public administration, management sciences, public choice theory, new institutional economics): foster competitive market for services (choice) to spur innovation and squeeze out inefficient or ineffective providers through accountability for performance
 - Shift away from direct, noncompetitive public provision (government as monopolistic provider)

Challenges in employing market mechanisms in public sector

- Success stories in competitive sourcing highlight cost savings (for simple services such as refuse collection, toll road management, communications, etc.)
- Accountability/management challenges more likely with:
 - Vague or contentious policy goals and directives
 - More complex and highly specialized service technologies
 - Difficulties in measuring and monitoring performance
 - Too few providers and/or too little information to inform choice and assure competitive market
 - Incomplete contracts: contracting parties unable to fully specify all relevant (unforeseen) contingencies
 - Limited government management capacity

Performance measurement key to effective use of market mechanisms

- Accountability through exercise of choice (vouchers) or by contract design (with providers) requires:
 - Clearly defined performance goals and performance measures (and weights) aligned with them
 - What is not measured or measured poorly will also influence responses
 - Performance standards that “level the playing field” and promote performance improvement
 - Incentives that balance risks of failure with rewards for improved performance
 - Dissemination and use of performance information for choice, contract renegotiations and program management/improvement

Lessons: Dynamics of performance measurement and incentives

- Alignment between performance goal and measured performance decreases after introduction
 - Incentive designers begin with imperfect understanding of relationship between measured performance and goals (i.e., technology of production)
 - Providers know how to control measured performance and exploit this advantage
 - Extent of gaming depends on initial distortion of performance measure, time for and rate of learning
- Performance measures should be tested, evaluated, modified and/or discarded as incentive responses become known

Other lessons for use of market mechanisms and performance measures

- Contract/voucher design should deter providers from focusing more effort in particular activities or with specific clients to influence measured performance (when little value is added)
 - Equity/effectiveness/efficiency tradeoffs
 - High-stakes in performance measurement systems exacerbate pressures and gaming responses
- Desirability of providing incentives for any one activity decreases with difficulty of measuring performance in other activities that make competing demands on resources
- Managers need to understand what motivates providers (intrinsic vs. extrinsic, public service ethic) and their means for influencing performance

Case examples of market mechanisms and performance management

- U.S. active labor market programs
 - Change from contracting regime to vouchers
 - Dynamics: modification of measures over time
- Contracting in public welfare programs with performance based on client labor market outcomes
 - Refining contract design, measures and incentives
- Vouchers in market for supplemental educational services
 - Accountability challenges with market mechanisms

From contracting to vouchers

- JTPA: local job training centers combined direct services provision w/contracts with nongovernmental providers
 - Performance goals transmitted from federal level to states; states established adjusted standards; training centers incorporated performance standards into performance-based contracts (strongly encouraged by federal govt.)
- Chicago area case study of performance-based contracting (755 contracts w/122 providers)
 - Job placement rate, wage at placement, types of training, number of training “slots” specified
 - Final 15% of contract payment contingent on performance
 - Case workers often identified jobs (corresponding to slots) and recruited the “right” trainee

Shift to vouchers under WIA

- Local job training center-training vendor contracting relationships ended
 - Training providers certified but no longer guaranteed a specific funding level to continue services
 - Voucher recipients take training dollars to vendor of choice
 - Partners in One-Stop Centers provide basic WIA services (assessment, counseling)
- Unanswered questions:
 - We know less training is taking place under WIA, but there has been little study of how the market for employment and training (e.g., training services made available) changed for clients

Performance measures in U.S. workforce development programs

- Examples of early performance measures
 - Employment rates at termination or follow up (13 weeks after termination from the program)
 - Average wage rates of employed trainees at termination or follow up
 - Cost per employment (at termination)
- Changes in performance measures
 - Six month follow up
 - Average earnings *change* in 6 months
 - Additional dimensions: credential rate and satisfaction
 - Cost measure “retired”

JTPA performance measures, 1987-1989

Employment Rate at Termination	Fraction of trainees employed at termination
Welfare Employment Rate at Termination	Fraction of trainees receiving welfare at date of application who were employed at termination
Average Wage at Termination	Average wage at termination for trainees who were employed at termination
Cost per Employment	Training center's year's expenditures on adults divided by the number of adults employed at termination
Employment Rate at Follow-up	Fraction of trainees who were employed at 13 weeks after termination
Welfare Employment Rate at Follow-up	Fraction of trainees receiving welfare at date of application who were employed at 13 weeks after termination
Average Weekly Earnings at Follow-up	Average weekly wage of trainees who were employed 13 weeks after termination
Average Weeks Worked by Follow-up	Average number of weeks worked by trainees in 13 weeks following termination
Youth Employment Rate at Termination	Fraction of youth trainees employed at termination
Youth Employability Enhancement Rate	Fraction of youth trainees who obtained employment competencies (see note 3 below)
Youth Positive Termination Rate	Fraction of youth trainees who were "positively terminated" (see note 3 below)
Youth Cost per Employment	Training center's year's expenditures on youths divided by the number of youths positively terminated

Current WIA performance measures

Adults	Dislocated workers
Entered employment rate	Entered employment rate
Employment retention rate at 6 months	Employment retention rate at 6 months
Average earnings change in 6 months	Earnings replacement rate in 6 months
Employment and credential rate	Employment and credential rate
Older youth (19-21)	Younger Youth
Entered employment rate	Retention rate
Employment retention rate at 6 months	Skill attainment rate
Average earnings change in 6 months	Diploma rate
Employment/ education/ training credential rate	
Customer satisfaction	
Participant and employer satisfaction (based on statewide survey questions)	

Contracting in public welfare programs: Wisconsin Works (W-2)

- Wisconsin Works (W-2) program: pioneer in public welfare reform (model widely considered for adoption, e.g., U.S. states, UK, Israel)
- Major changes in administrative structures for welfare services delivery
 - Private sector agencies compete with public agencies for contracts to manage local-level programs (now managing more than 80% of W-2 caseload)
 - Performance-based contracts include monetary incentives to motivate W-2 agencies
- Opportunity to learn from evolution of contracts across four separate contract periods

W-2 contract characteristics across successive contract periods

- **1st contract (1997-99):** focus on reducing welfare caseloads
 - Unspent budget funds kept as performance bonuses, process-oriented performance measures
- **2nd contract (2000-01):** emphasis on W-2 service quality
 - Performance standards expanded and profits/bonuses restricted
- **3rd contract (2002-2003):** further refined performance standards
 - Additional performance standards and introduction of weights
- **Fourth contract (2004-2005):** Renewed emphasis on cost reduction; performance bonuses discarded
- **Subsequent contract:** reorganized service provision
 - Contracting for services vs. management of entire program, extended contract periods

W-2 agency performance by standard (2000-2001 vs. 2002-2003 contracts)

Performance Standards & Target Levels		2000-2001		2002-2003	
		Number and % of Agencies Achieved			
Entered Employment	Base Performance Level (35%)	70	99%	64	94%
Job Retention: 30 days	Base Performance Level (75%)	71	100%	65	96%
Job Retention: 180 days	Base Performance Level (50%)	70	99%	64	94%
Full and Appropriate Engagement	Base Performance Level (80%)	68	96%	63	93%
Basic Education Activities	Base Performance Level (80%)	64	90%	60	88%
Educational Activities Attainment	Base Performance Level <i>(Optional in 2000-2001)</i>	3	4%	59	88%
Average Wage/ Earnings Gain	Base Performance Level <i>(Changed to optional 2002-2003)</i>	71	100%	28	42%
Regression-estimated Earnings Gain	Earnings gain and standard error followed by calculated % with any gain (using UI data)	<u>-118.52</u> (80.56)	37%	<u>-112.95</u> (133.40)	42%

Bottom line: measured performance may not reflect real gains when measure is required.

Vouchers in supplemental educational services (SES) provision

- No Child Left Behind Act signed into law “to close the achievement gap with accountability, flexibility, and choice”
- Mandated use of market mechanisms to offer children in low-income families and failing public schools opportunity to receive extra academic assistance
 - Districts allocate fixed dollar amount per child; parent or child chooses provider; providers invoice district
 - Districts directed to maximize SES provider choice, measure provider effectiveness and withdraw approval from providers that fail to increase student academic achievement for two years

Accountability challenges in SES

- Federal program designed largely by states and implemented with little oversight at local level primarily by third-party providers
 - School district administrative and financial accountability through provider agreements, invoices and contract payments
- Established market of after-school study and tutoring programs, but volatile supply
- Measuring value: beyond self-reported data and internal performance evaluations by large national providers, little reliable information on SES vendor effectiveness
- Accountability through exercise of choice by parents and students limited by asymmetric information and cost-reimbursement contract design

SES provider market shares in Milwaukee Public Schools (MPS)

- Expanding and contracting numbers of SES vendors
 - 2003-04: 40 vendors, 18 w/ market share
 - 2004-05: 55 vendors, 28 w/market share; influx of faith-based providers
 - 2005-06: 35 vendors, 26 w/market share
 - 2006-07: 32 vendors, 30 w/market share
- Vendors—large or small, local or national—w/smallest or no market share most likely to exit
- Top five providers consistently had approx. 70% of total market share over study period (four of five top providers the same)

SES enrollments in MPS

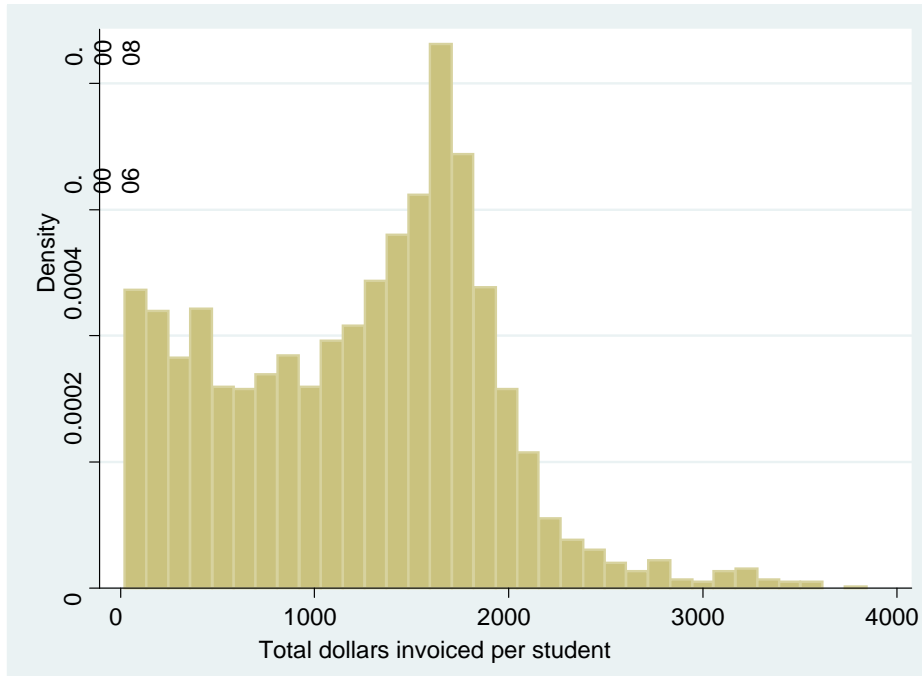
Academic Year	Eligible (Middle and High School)	Number Registered (% of eligible)	Number Attended (% of registered)
2003-2004	6508	3707 (57%)	3333 (90%)
2004-2005	9433	3826 (41%)	2610 (68%)
2005-2006	7351	3996 (54%)	2543 (64%)
2006-2007	8119	3897 (48%)	1315 (34%)

Sharpening tools for managing performance and accountability

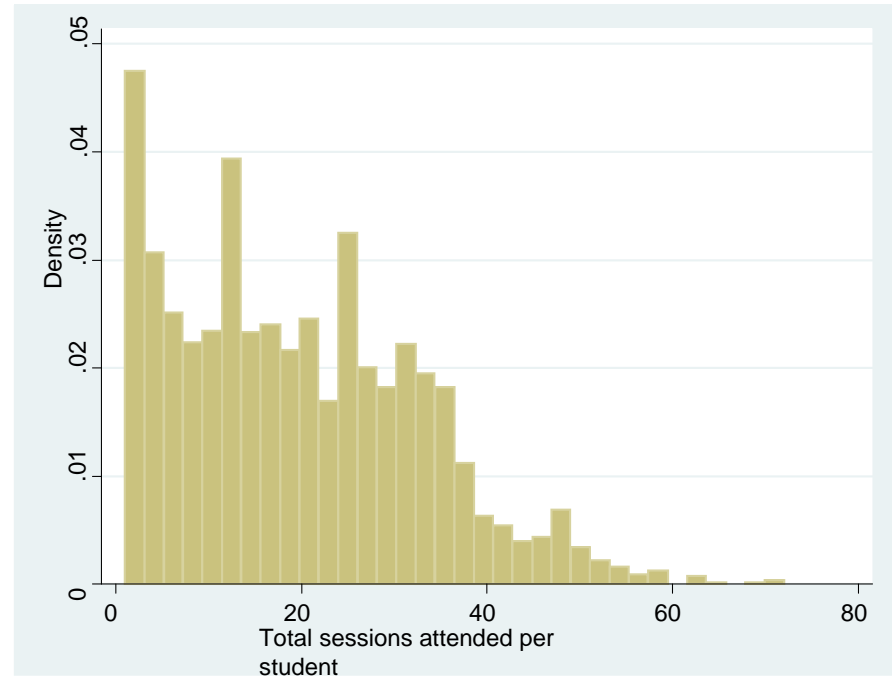
- Puzzling lack of relationship between SES hours attended by students and provider invoice totals and hours attended and provider performance
 - Total invoiced by providers a simple linear function of total number of sessions attended—two distributions should be very similar in shape
- MPS took steps to improve compliance with basic contract requirements and address financial performance concerns
 - New procedures instituted over time for verifying student hours attended (e.g., spot checking of SES sessions, cross-checking student signatures on SES attendance forms, and withholding approval of payments for services until all paperwork submitted)

Relationship of SES invoice totals to total SES sessions attended (per student), 2004-05

Distribution of SES invoice totals

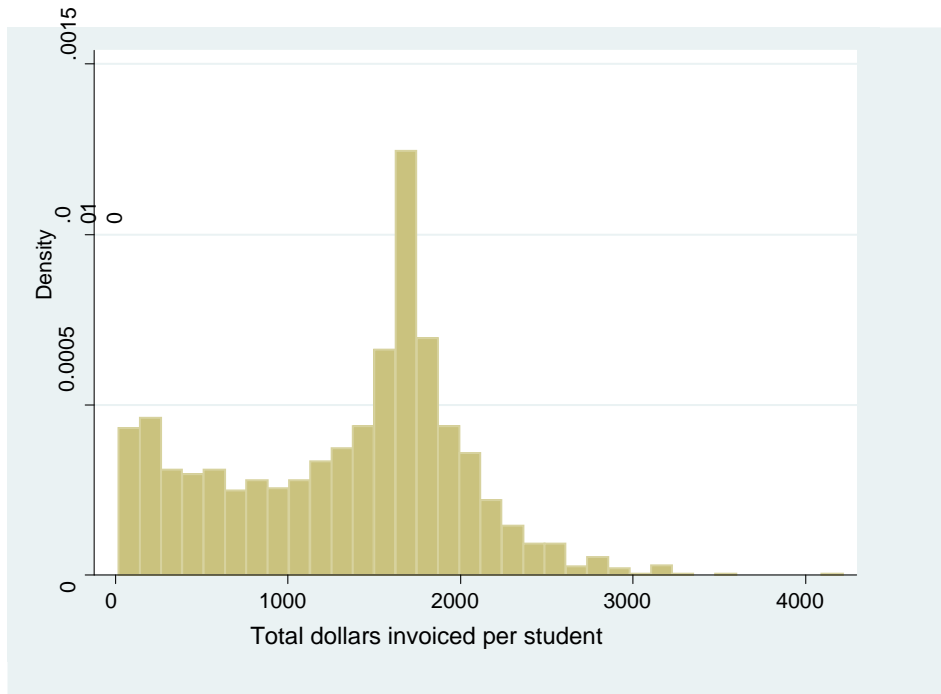


Distribution of total SES sessions attended

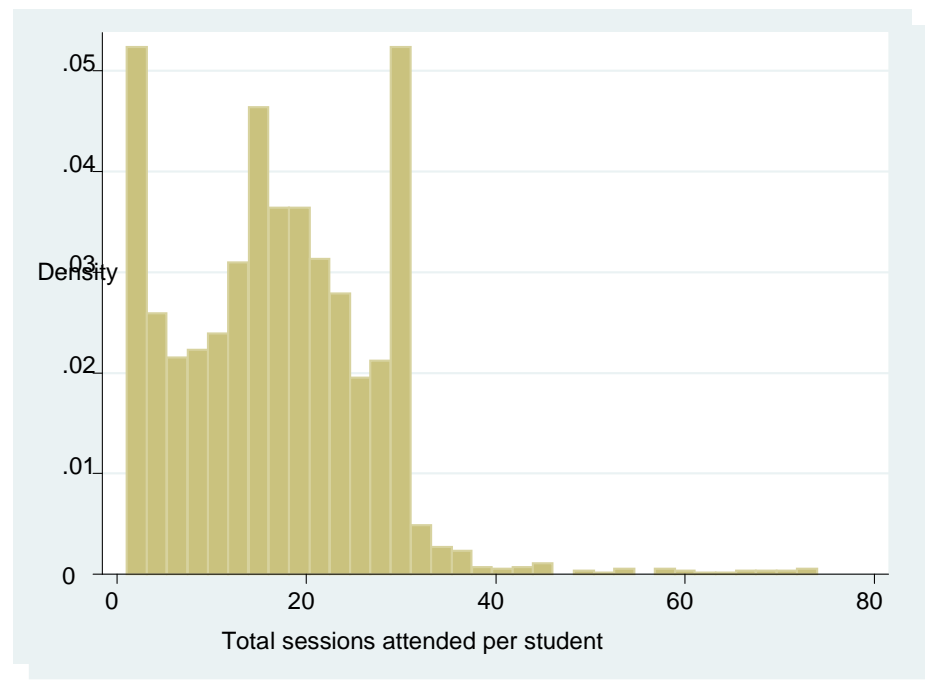


Relationship of SES invoice totals to total SES sessions attended (per student), 2005-06

Distribution of SES invoice totals

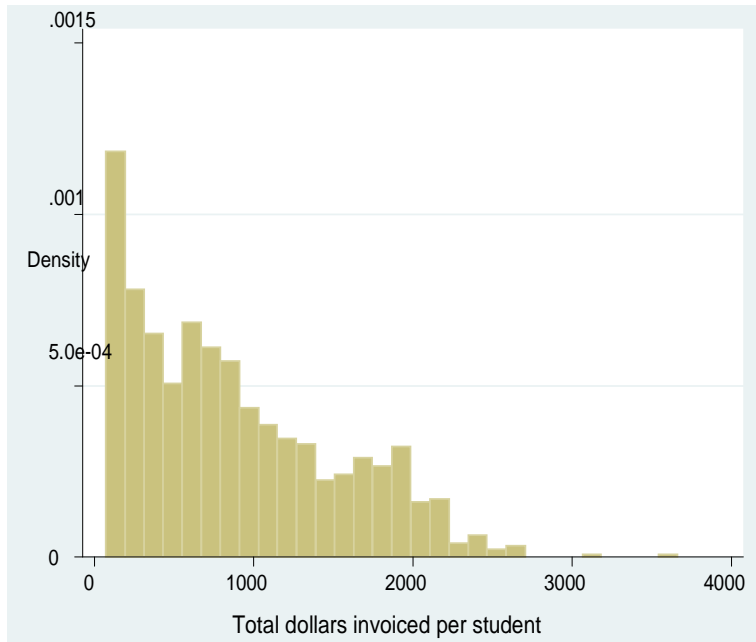


Distribution of total SES sessions attended

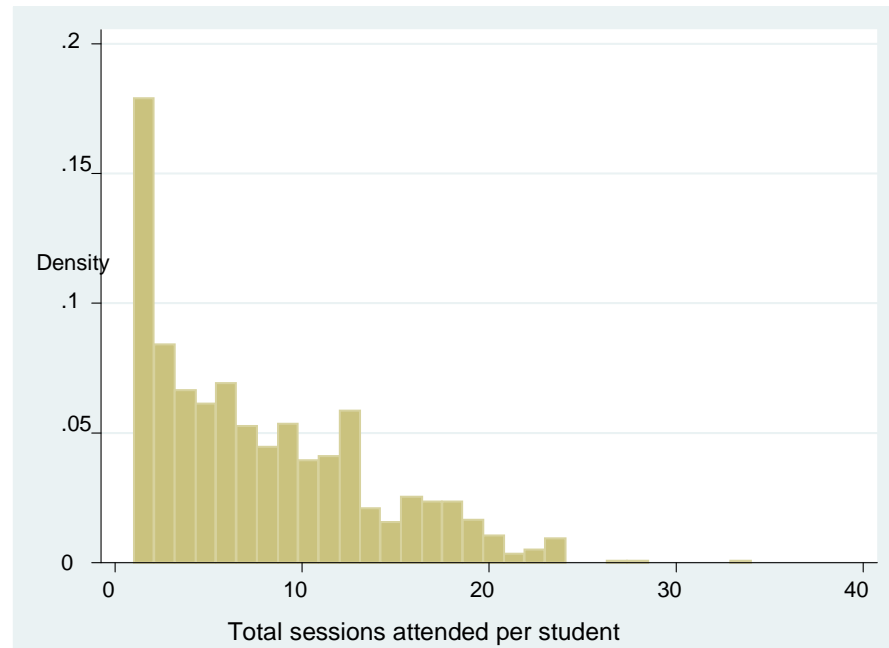


Relationship of SES invoice totals to total SES sessions attended (per student), 2006-07

Distribution of SES invoice totals



Distribution of total SES sessions attended



Summary of major lessons

- Difficulties in accurately measuring provider performance (value-added) pervasive, even where measures are (arguably) clear-cut and widely accepted
 - Lack of explicit measures of service quality and resources for accurately and timely measuring outcomes
 - By default, efficiency dominates as primary criterion for judging functioning of third-party provider arrangements
- Accountability efforts cannot be left to market choice
 - Performance measurement challenges contribute to limited information for consumers and lack of “discipline” in markets
 - Performance-based contract design an important tool for “managing for results”
 - Dynamics of performance management are complex and involve learning over time