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# **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

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- 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

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- 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

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- 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

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- 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

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- 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

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- 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

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- 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

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- 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

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- 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

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

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# Current WIA performance measures

<b>Adults</b>	<b>Dislocated workers</b>
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
<b>Older youth (19-21)</b>	<b>Younger Youth</b>
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	
<b>Customer satisfaction</b>	
Participant and employer satisfaction (based on statewide survey questions)	

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

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- 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

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- **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			
<b>Entered Employment</b>	Base Performance Level (35%)	70	99%	64	94%
<b>Job Retention: 30 days</b>	Base Performance Level (75%)	71	100%	65	96%
<b>Job Retention: 180 days</b>	Base Performance Level (50%)	70	99%	64	94%
<b>Full and Appropriate Engagement</b>	Base Performance Level (80%)	68	96%	63	93%
<b>Basic Education Activities</b>	Base Performance Level (80%)	64	90%	60	88%
<b>Educational Activities Attainment</b>	Base Performance Level <i>(Optional in 2000-2001)</i>	3	4%	59	88%
<b>Average Wage/ Earnings Gain</b>	Base Performance Level <i>(Changed to optional 2002-2003)</i>	71	100%	28	42%
<b>Regression-estimated Earnings Gain</b>	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

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- 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

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- 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)

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- 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

<b>Academic Year</b>	<b>Eligible (Middle and High School)</b>	<b>Number Registered (% of eligible)</b>	<b>Number Attended (% of registered)</b>
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%)

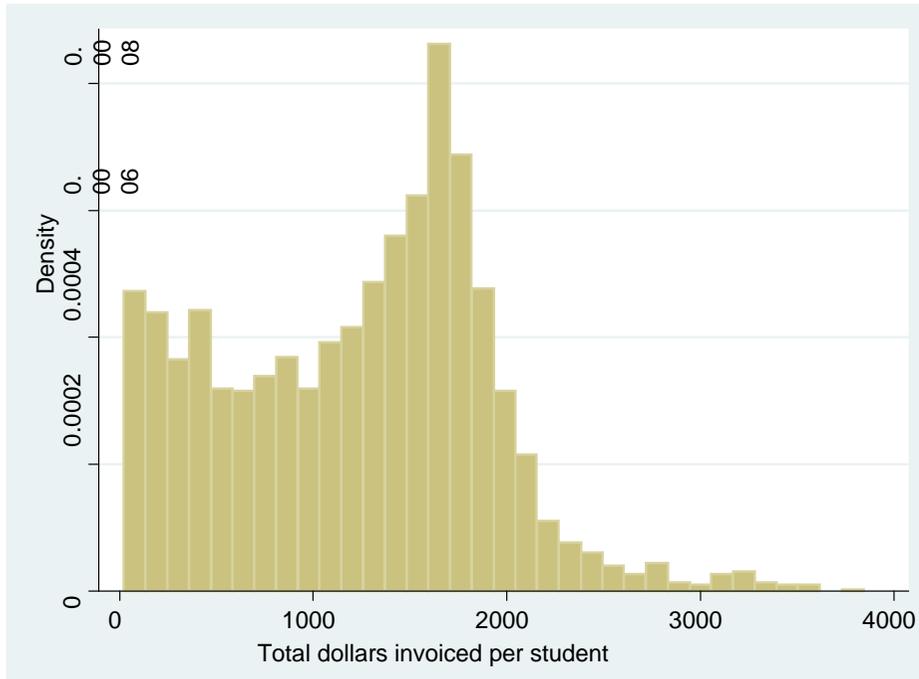
# Sharpening tools for managing performance and accountability

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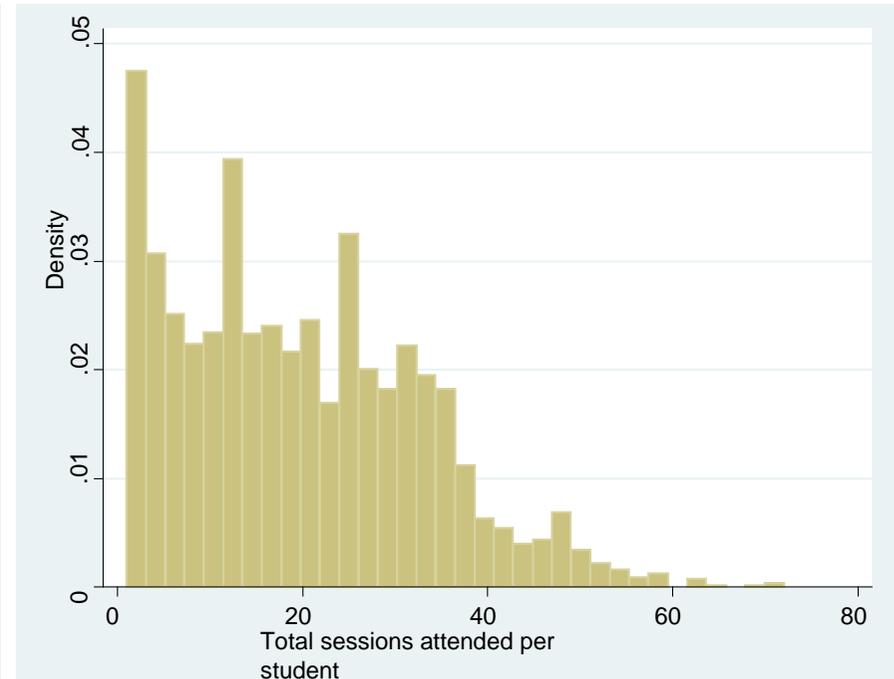
- Puzzling lack of relationship between SES hours attended by students and provider invoice totals and hours attended and provider performance
  - Total invoiced by providers a simple linear function of total number of sessions attended—two distributions should be very similar in shape
- MPS took steps 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

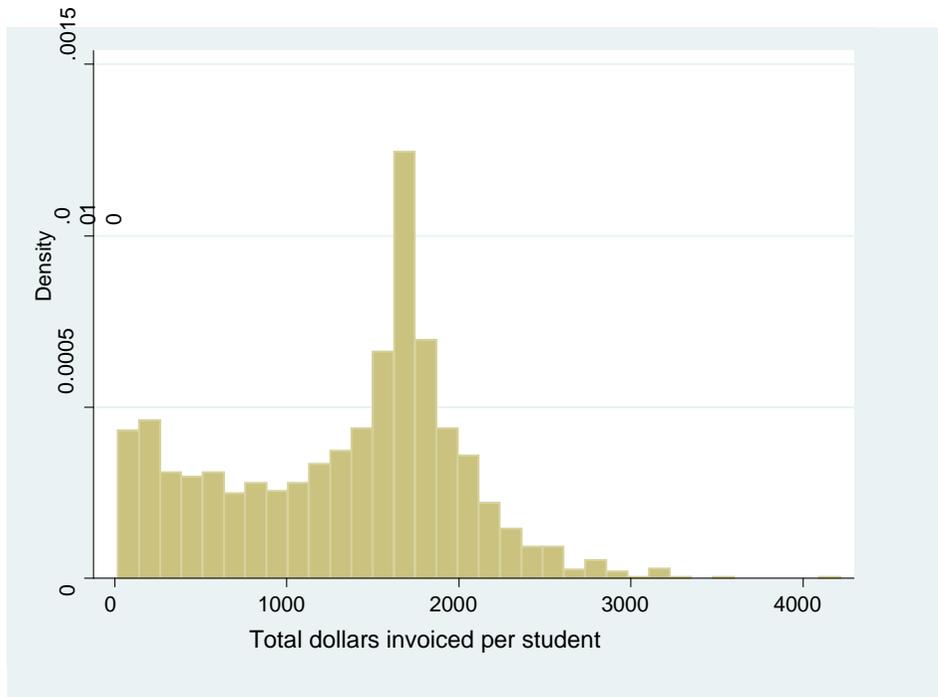


Distribution of total SES sessions attended

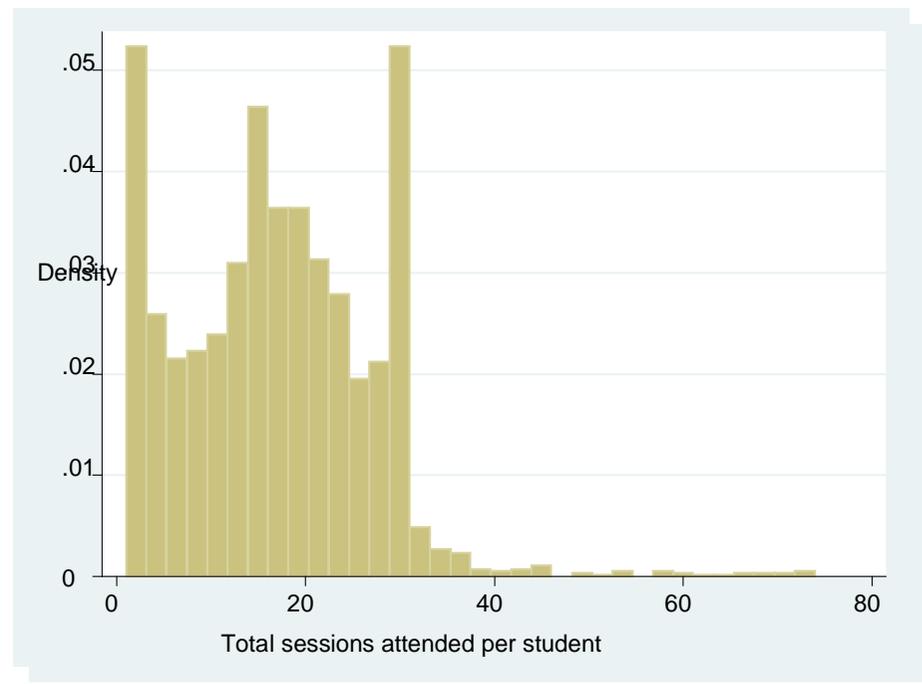


# Relationship of SES invoice totals to total SES sessions attended (per student), 2005-06

Distribution of SES invoice totals

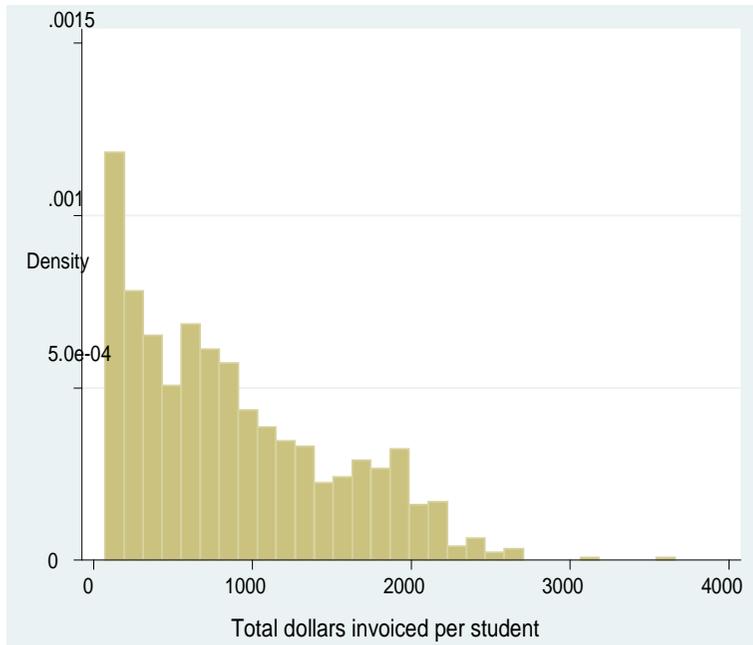


Distribution of total SES sessions attended

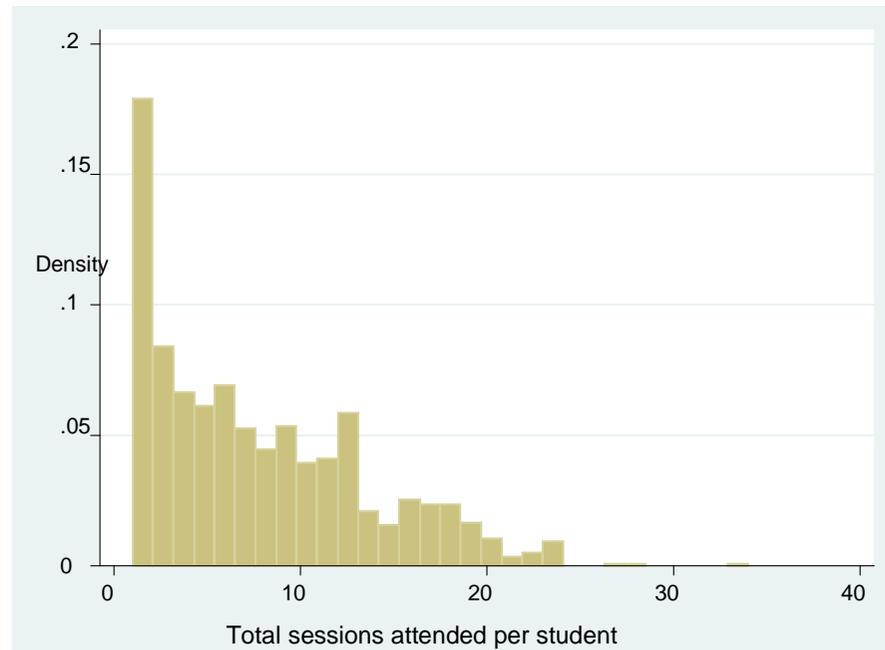


# Relationship of SES invoice totals to total SES sessions attended (per student), 2006-07

Distribution of SES invoice totals



Distribution of total SES sessions attended



# Summary of major lessons

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- 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