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'Pay for Success': a Better Way to Deliver Social Services?

The idea of shifting the risk of failed initiatives from taxpayers to investors is catching on.

Nobody likes to pay taxes, but I suspect that most people would find it a little easier to take if they knew their tax dollars were funding the achievement of concrete public goals. That's the idea behind "pay-for-success" programs that have been launched during the last year in Illinois, Massachusetts and New York state and are being developed or considered in several others.

Under these programs, government sets out a set of specific goals in areas such as mental illness, homelessness or preventive health care. Private investors and philanthropic organizations then finance the work of nonprofits to deliver cost-effective, evidence-based social services on behalf of the state. The investors receive "success payments" only if the desired results are achieved.

Last December, New York became the first state to launch a pay-for-success program. There the goal was to reduce recidivism among 2,000 recently released prison inmates. Bank of America and Merrill Lynch raised the bulk of the investment capital for the $13.5 million initiative. For them to get a return on their investment, the program must either reduce recidivism by at least 8 percent or increase the rate of employment for released prisoners by at least 5 percent compared to historic averages. If the investors achieve their performance goals, reduced prison and public-assistance costs will save New York taxpayers $7.8 million.

Illinois is using pay for success to improve placement outcomes and reduce re-arrests for young people involved in the child-welfare and juvenile-justice systems. Massachusetts is employing the model to improve employment outcomes and post-secondary degree attainment among participants in adult basic education. The Obama administration has also gotten into the act, funding a model project in Ohio and committing $500 million to fund other state and local pay-for-success programs.

California is the latest state seeking to launch a pay-for-success program. A bill that has passed the state Senate and is awaiting action in the Assembly would create a pilot program beginning next year under which the director of the state's Office of Planning and Research would identify and submit potential "social impact partnerships' to the legislature for its consideration each year between 2015 and 2020, when the pilot would sunset. Seed money would come from a Social Innovation Financing Trust Fund. As in other states, investors would be paid only if the desired goals are achieved.

In a government culture that too often focuses on inputs, such as how much money is spent on a program rather than on the outcomes it produces, going through the goal-setting exercise alone makes the pay-for-success approach worthwhile.

To achieve the concept's full potential, the public sector will need to carefully monitor outcomes and become adept at writing contracts that hold investors' feet to the fire. But if governments succeed and shift the risk of failed initiatives from taxpayers to private investors, it won't take long for pay-for-success programs to become very popular.

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