Pay-for-Success (PFS) projects, commonly known as “social impact bonds” (SIBs), have received significant attention in the U.S. and around the globe as a way to attract more funding to solve societal problems. A PFS project is a contract between investors, governments, and service providers in which investors commit to financing a government program with the hope of receiving investment returns based on the achievement of societal outcomes such as reduced rates of recidivism or improved health outcomes. Under the most common PFS model, a government contracts with a private sector provider and commits to repaying an investor (or investors) according to specific outcome targets monitored by an independent evaluator.

By giving private investors the opportunity to profit from high-performing government programs, PFS monetizes the social value of policy initiatives, generating positive returns for investors as well as positive societal outcomes.

The U.K. was the first country to implement a PFS project in 2009, a partnership that funded probationary services for ex-prisoners at Her Majesty’s Prison in Peterborough. In this example, reduced recidivism was forecasted to reduce government expenditures on the prison system and trigger outcome payments based on those savings. The U.K. still has more active PFS projects than any other nation, but the U.S. has also seen substantial interest from investors, service providers and local, state and federal policymakers. The first PFS project in the U.S. was piloted at Rikers Island prison in New York City with a model similar to that of the Peterborough project in the U.K. Since that project, local, state and federal policymakers have advanced other projects across the U.S. that use PFS structures to fund affordable housing, childcare, environmental infrastructure, and other services with the goal of improving lives while saving money for government offices and agencies.

If implemented at scale throughout the U.S., PFS could generate significant cost savings and increase the efficacy of government programs by providing previously unavailable funding for successful programs. Like the U.K., the U.S. is a relatively auspicious environment for PFS projects because it encourages more robust partnerships between private and public sector entities than do many developing countries and some developed European economies. Nonetheless, the sector is still nascent in the U.S. and the future of PFS remains uncertain. Drawing on examples from across the country, this article identifies a set of lessons learned from the early years of PFS and argues that political leadership from local policymakers will play a critical role in determining the future of PFS in the U.S.
Lessons from the Field

In the relatively small number of PFS projects that have been implemented around the world, several trends have emerged. The barriers to designing and implementing a successful PFS project can vary significantly depending on the social, economic, and political contexts of the project, but researchers, policymakers, and practitioners have identified a number of common lessons through their experience with PFS:

**PFS can catalyze innovation in service delivery, but government entities and nonprofits are sometimes reluctant to adapt to new ways of doing business.**

- Implementing effective PFS projects often requires nonprofits and government agencies to adopt a quantitative, evidence-based approach to their programs. PFS offers both sectors long-term opportunities for growth, but adopting new strategies is not always easy – especially in cases where service providers are attempting to solve complex, multifaceted societal challenges and may be hesitant to fully embrace a heightened focus on quantifiable outcomes. Some of the benefits of supportive housing or workforce development programs in urban areas, for example, may not be easily monetized (public safety, improved foot traffic in certain areas, etc.) but have clear benefits for society. In cases like these, projects that align closely with a mayor, county executive, or governor’s policy priorities are most likely to have the necessary political will and financial support behind them.[4]

**Identifying the right outcomes to measure can make the difference between a good headline and substantive impact.**

- The question of what outcomes to measure is key to all PFS projects. The moral and analytical debates underlying these decisions demonstrate the unique challenges of public-private partnerships. Societal challenges like homelessness, domestic violence, and recidivism present unique measurement challenges. Take the examples of the Rikers Island or Peterborough projects, which supported behavioral therapy and probationary services at prisons in an effort to reduce prisoner recidivism. These projects raised questions about how long ex-prisoners would have to stay out of jail in order for the project to be deemed a success, and whether the program should take into account additional indicators such as employment or mental health outcomes. Measuring too many indicators may hinder projects’ ability to succeed by creating standards that are unrealistically high, but PFS projects with too few indicators will result in limited impact. This balance is ultimately a critical determinant of PFS projects, and each party to a PFS transaction should determine their “must-have”
Mitigating financial risk with philanthropic capital can be a decisive step in attracting for-profit investors.

- A number of PFS projects in the U.S. and internationally have been funded by a combination of philanthropic capital and for-profit investment.\[5\] Because PFS investments offer returns that are comparable to or lower than many traditional investments, they are often viewed as an unnecessary risk by financial institutions and other for-profit entities. These firms, however, can reap reputational benefits by increasing their association with socially responsible investing through PFS—and donors and philanthropic institutions can provide additional incentives through loan guarantees, mezzanine debt, and lower-return investments. Philanthropic capital has been essential to nearly every PFS project in the U.S., and will likely continue to play an important role until PFS projects have been able to demonstrate consistent financial returns.

Spending on PFS projects within one government department or agency might improve another department’s bottom line, creating a “wrong pocket problem” that limits agencies’ incentive to participate.

- When a PFS project achieves its stated outcomes, the government agency that dedicates resources for the project—whether staff time or financial support—often does not reap the financial savings that are generated by the project.\[6\] In the case of Denver’s recent PFS project to fund supportive housing, for example, the Colorado State Division of Housing and the Denver Housing Authority provided funding via project-based vouchers, but the outcome metric measured was a reduction in the amount of time that individuals in the supportive housing program spent in jail, which most directly affects the budget of the Colorado Department of Corrections. This is an example of the “wrong pocket problem,” and elected officials in Denver demonstrated how this problem can be resolved. The project, which required the participation of the Colorado Governor’s Office, the City of Denver, the Denver Crime Prevention and Control Commission, the Colorado Division of Housing, the Colorado Housing Finance Authority, and the Denver Housing Authority,\[7\] was only able to move forward with the political support of both the Mayor of Denver and the Governor of Colorado.\[8\] Although the “wrong pocket problem” is a real issue in many cases, this project demonstrates the opportunity to address the problem and invest in evidence-based solutions through continued political leadership.
Governments face difficulties attracting the diverse expertise needed for a PFS project, creating a realistic contract without a standardized model, and funding the necessary administrative costs because of budgetary constraints.

- Like any new or experimental model, PFS requires certain policymakers to dedicate scarce staff time and resources toward design and implementation. Local governments might also not have the technical expertise to design and implement PFS projects, and would otherwise have to hire firms to do so. Philanthropists and nonprofit institutions such as universities and think-tanks have played a crucial role in minimizing the costs associated with PFS. As demonstrated by the supportive housing PFS project in Denver, the role of nonprofit institutions such as the Harvard Kennedy School’s Government Performance Lab, the Urban Institute, and the Nonprofit Finance Fund is significant in catalyzing and coordinating PFS initiatives at this early stage in the sector’s growth.

PFS projects are broadly attractive for investors, nonprofit service providers, academics, and policymakers, but they can be controversial for some politicians and opponents of privatization.

- Proponents of PFS have encountered dissent from progressive politicians and others who are concerned that PFS projects would serve as a precursor for additional privatization of government services. In Rhode Island, for example, the largest state employees union opposed legislation to create a $25 million PFS project because union leaders saw the project as “a back-door way to privatize the delivery of social services programs.”[9] Because each PFS project is reliant on political support in order to move forward, such arguments could pose serious long-term challenges to the project pipeline and must be addressed by proponents of PFS.[10]

PFS contracts can be effective both for piloting new solutions to intractable problems and for expanding proven programs.

- It is not yet clear whether PFS will become more widely used for pilot programs or for expanding the use of initiatives that have already been proven effective. In New York City, for example, the Rikers Island project supported an Adolescent Behavioral Learning Experience (ABLE) program, an experimental therapy meant to reduce recidivism – and this tactic of using PFS for pilot programs has been more common thus far.[11] PFS does not only have to be used for pilot programs, however. PFS projects like the recent “Environmental Impact Bond” in Washington, D.C. that provided funding for “green infrastructure” (which is already widely used by cities
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around the world), have demonstrated the potential to expand existing investments in evidence-based initiatives and programs.[12]

**PFS projects cannot move forward without the support of elected officials.**

- In order to move a project from design to implementation, the project must have support from either the legislative or executive branch of government. Legislators can incentivize and support PFS projects through enabling legislation, while the executive branch can provide leadership by allocating funding for PFS projects during the budget process.[13] Examples like Rhode Island, where PFS legislation ultimately stalled in the state senate because of significant pushback from interests concerned about widespread privatization of social services, demonstrate that political dynamics must be taken into account when planning PFS projects.[14]

**The Importance of Local Leadership**

In recent years, Congress has introduced and debated several legislative initiatives to support PFS but has been unable to pass any legislation that specifically allocates funding for PFS projects. President Obama was publically supportive of a $300 million initiative to fund PFS projects during the final years of his presidency, but no legislation addressing these projects or supporting PFS in any specific way advanced through both the Senate and House of Representatives.[15]

Nevertheless, some federal officials have taken action despite the political gridlock. In 2009, President Obama signed the Edward M. Kennedy Serve America Act authorizing the Social Innovation Fund (SIF) as a program of the Corporation for National and Public Service.[16] Although this legislation did not specifically allocate funding for PFS, agency leaders at the SIF subsequently committed more than $50 million to help organizations, local governments, and universities develop strategies and technical capacity to implement PFS projects across the country.[17]

Despite a lack of legislative progress on PFS at the federal level, however, state and local policymakers have continued to study, design and implement PFS projects irrespective of federal action. Dozens of projects across the U.S. are now at various stages of development, and local policymakers are using the projects to tout their own reputations for innovative, solutions-oriented government policy at the local, county and state levels.[18] In order to maximize the benefits of these projects and ensure that they are designed and implemented
effectively, policymakers should learn from the experiences of others to identify what works, what doesn’t, and the roles of each stakeholder group in the process.

If the U.S. is to take advantage of the tremendous potential of PFS projects, policymakers must base their future efforts on a set of best practices gleaned from previous projects. Irrespective of federal action, elected officials and agency leaders can seize the opportunity to work at the local level to advance PFS projects that improve lives and help governments work more efficiently. PFS projects can be used in numerous areas of government policy to expand funding for proven programs or to pilot new initiatives, and the lessons outlined above can provide a useful guide for policymakers in either case.

References


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