



# Solving the Wrong Pockets Problem

## How Pay for Success Promotes Investment in Evidence-Based Best Practices

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Pay for success, or PFS, is intended as a transformative solution for a long-intractable barrier to effective governance: the wrong pockets problem, which posits that societal needs and governmental realities often act at cross-purposes.

The wrong pockets problem describes a situation where the entity that bears the cost of implementing a practice—including an evidence-based best practice—does not receive a commensurate benefit. Because the costs outweigh the benefits for that implementing governmental actor, projects in the public interest do not receive sufficient resources. Thus, project investment is suboptimal, and overall social welfare is—in equilibrium—suboptimal. Sustained inefficiency is the norm.

This wrong pockets problem particularly affects prevention programs, whether they are behavior-modification programs, public health programs, structural prevention programs, or broad policy changes. By no means unique to US governance, the wrong pockets problem has spurred the development of PFS projects around the world.

Despite a growing body of empirical evidence rigorously demonstrating the effectiveness of many programs across numerous social services, advances in the implementation of evidence-based practices has been slow. The gap between the potential scale that effective programs could reach and what governments actually fund grows larger each year.

PFS is an innovative financing mechanism designed to directly address this problem. Through public-private partnerships, governments, private or philanthropic funders, social service providers, evaluators, and intermediaries infuse evidence-based programs with capital, investing in demonstrated ideas that have traditionally had access to too few resources. PFS enables proven evidence-based programs to be scaled, promising programs to grow their evidence base, and potential programs to be evaluated.

PFS provides a logical framework that can help remove barriers to better governance. Here we describe several wrong pockets problems and advance PFS theories of change that may address those issues.

## What Is the Wrong Pockets Problem?

A central challenge to governments seeking to implement evidence-based prevention policies, programs, and practices is that the government body charged with implementing or expanding evidence-based practices pays the up-front costs of the initial investment but likely doesn't receive compensating benefits in the near term, or possibly ever. There are three primary reasons this occurs, including because the benefits occur in the future, because the benefits are real but small and occurring per capita, and because returns are hard to measure. As a result, evidence-based programs often are underfunded or remain on the shelf.

**Benefits occur in the future.** Current research suggests that prevention and remediation programs with the most positive, stable results require large up-front investments for outcomes that occur well into the future. These are generally public health programs aimed at groups who already use extensive governmental and other resources and can be forecast to consume more future resources than the general public. They include

- home visitation focused on child and maternal health and welfare;
- family-based therapy for high-risk adolescents in lieu of secure placements;
- foster care and adoption programs with supports for hard-to-place populations; and
- integrated programs with supports for homeless people with multiple problems, such as substance abuse, mental illness, low education attainment, limited past employment, and justice system involvement.

**Real but relatively small benefits occur per capita.** For these programs, large-scale programs are required to achieve benefits sufficient to warrant the substantial initial investment. Mainly primary prevention programs, they include

- public education for children enrolled in prekindergarten programs; and
- programs addressing major public health issues such as asthma, diabetes, and obesity.

**Returns are hard to measure.** For these programs, there is no easy way to quantify the benefits of the investment. They include

- prisoner reentry programs, where benefits tend to accrue outside governmental budgets, particularly programs that reduce victimization costs rather than corrections costs;
- child welfare programs, where benefits tend to be better life course outcomes that accrue over many years, and where benefits tend to accrue to citizens rather than governments; and
- aging-in-place programs for the frail elderly, where the benefits tend to be quality-of-life improvements rather than budgetary savings.

All these programs have a strong evidence base that includes several rigorous, objective, and transparent evaluations demonstrating a causal link between the policy or program's theory of change and better outcomes for participants. But, because of the wrong pockets problem, the governmental body that would pay for a new or expanded program will ultimately not experience the benefit and thus chooses (logically) to underinvest, to the detriment of society.

Conceptually, six main types of program underfunding can be attributed to the wrong pockets problem:<sup>1</sup>

1. **Intraagency:** one or more divisions within a single agency (such as police, probation, courts, corrections, and parole within the criminal justice system) pay for a program, but another division within that same agency receives some of (or all) the benefits.
2. **Interagency:** one agency (such as the criminal justice system) pays the cost of a program, but another agency (such as the public health system) receives some of (or all) the benefits.
3. **Time:** one executive and/or legislative administration pays the costs of a program, but a future administration receives some of (or all) the benefits.
4. **Regional governance:** one place (such as a city government) pays the costs of a program, but a different place (such as a bordering county) receives some of (or all) the benefits.
5. **Intergovernment:** one level of government (such as a municipal government) pays the costs of a program, but another level of government with jurisdiction in the same geography (county, state, or federal) receives some of (or all) the benefits;
6. **Noncashable savings:** citizens benefit from the program, but this savings is not reflected in any budget; thus, while society benefits, governments cannot capture that benefit.

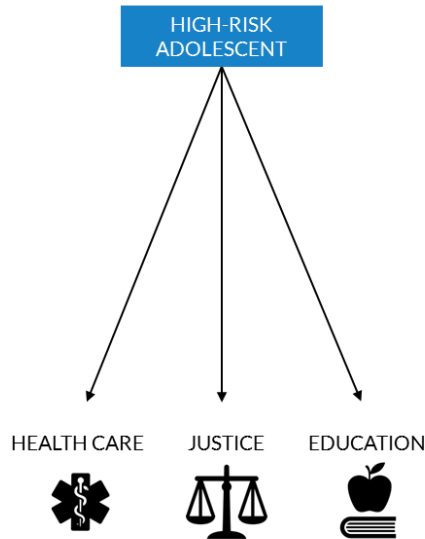
PFS illuminates potential solutions to each of these variations on the wrong pockets problem. Today, governments inherently bear all the risk of programming, and barriers maintain the status quo. Risk pooling efforts, which allow different agencies or governments to pool the risks from funding new or scaled-up programs, still require up-front government investments and do not, by and large, encourage shifts in government thinking about service delivery and performance management. PFS allows governments to shift risk to private and philanthropic funders, thus encouraging governments to invest where the cost-benefit ratio is otherwise suboptimal.

In helping to resolve some barriers to the wrong pockets problem, PFS programs have the potential to yield significant and widely spread benefits, both cashable and noncashable (figure 1).

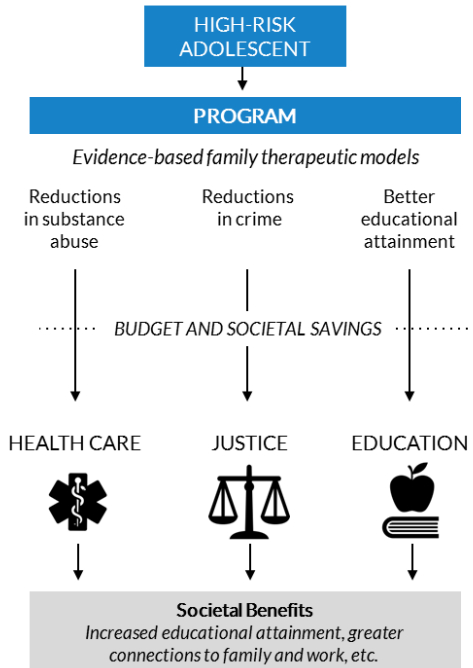
FIGURE 1

### Pay for Success Programs Can Yield Multiple Benefits

Because a vulnerable individual can touch multiple systems...



one program can lead to savings across multiple systems.



## Role of the Government

The key actor in solving the wrong pockets problem is the government. Each version of the wrong pockets problem described here is essentially related to the structure of government financing. Traditionally, costs and benefits within government are “stovepiped,” so one entity pays costs and another receives benefits.

### Within a Single Agency

The classic wrong pockets problem of drug courts in box 1 illustrates this stovepiping: within a single agency (public safety), some entities pay the costs (courts) and others reap the benefits (including police, probation, corrections, and parole). In such a case, the entities bearing the costs have little incentive to invest in programs that yield benefits elsewhere.

A standard approach to solving the drug courts wrong pockets problem is for those within public safety to agree to share saved resources. In theory, probation, corrections, and the police could all reimburse the courts for their investment. In practice, there is no mechanism to facilitate this transaction, and there are substantial bureaucratic obstacles to its implementation.

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## BOX 1

### Drug Courts: The Classic Wrong Pockets Problem

Drug courts are a specialized court docket, where defendants in the criminal justice system are granted a deferred prosecution if the court believes an underlying substance disorder caused their criminal behavior. A successful drug court participant (a drug court “client”) receives more than a year of community-based court-monitored treatment rather than jail; if the client completed the program, the initial charges are dismissed.

Drug courts are effective and return benefits that are greater than the cost of operation; as a result, they have been adopted by almost all mid- and large-sized criminal court systems (Rossman and Zweig 2012). The consensus of over 100 studies is that drug courts reduce new criminal offending by 10 to 15 percent over usual criminal case processing, which tends to include incarceration and community supervision (Marlowe 2010).

Much of the benefit of drug courts, however, accrues to criminal justice system agencies other than the court system. When new offending is reduced, the police, probation, corrections, and parole—and the public health system—all benefit. While the courts do experience some direct benefit, that benefit is smaller than the cost burdens associated with administering drug courts. Drug courts, overall, present a substantial additional burden to a court system; thus, the incentives of the court system are to minimize that burden and limit drug courts.

Yet, for society, and the other actors in the criminal justice system, drug courts are very advantageous. If a drug court client is successfully treated, the police will spend less time investigating reoffenses, prosecutors and public defenders will spend less time arguing their cases, and pretrial services will have fewer clients to manage, as will corrections and parole. Society as a whole will also benefit because fewer people will be victimized.

But the decision of whether to fund drug courts lies solely with the court system, where all the incentives are aligned against drug courts. As a result, drug courts serve only a small percentage of all substance-involved offenders, somewhere between 1 percent (Sevigny, Pollack, and Reuter 2013) and 3 percent (Bhati, Roman, and Chalfin 2008). Thus, while drug courts reduce future criminal behavior, reduce costs to public agencies including law enforcement and corrections, improve tax revenues, and generally improve the lives of drug court clients, less than 50,000 of the 1.5 million drug-involved Americans prosecuted each year are diverted from business-as-usual criminal justice system processing into drug courts (Bhati, Roman, and Chalfin 2008).

Drug courts are the classic example of a proven program that has not been scaled because of the wrong pockets problem. Drug courts exhibit each of the problems described earlier: benefits are distant, up-front costs are high, and, because the effects are real but relatively small, many people have to be treated to achieve worthwhile cost savings. Thus, drug courts are difficult to fund at scale.

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## The PFS Solution

In a PFS project, the court system would be encouraged to invest in drug courts. The court would not be obligated to pay for the development of community-based infrastructure designed to deliver the required treatment. Thus, the court would be more likely to sentence drug-involved offenders to the setting where they can receive optimal treatment: community-based services.

If the drug court uses external service providers, the court would also not be obligated to pay for those services until they were demonstrated effective. That repayment would reflect the reduced burden on the court, as the demand for court services by drug court clients declines.

It is also possible to conceive of a scenario where some of the repayment is drawn from law enforcement, probation, and corrections to reflect the benefits those systems receive from a successful drug court. Because the transaction is structured in advance and not implemented in real time, it is theoretically straightforward for different agencies to commit to a repayment of programs from which they will benefit. In other words, PFS provides the breathing room for the implementing department to move ahead with the program and for the benefiting agencies to commit to a future payment, both of which are contingent on the attainment of beneficial outcomes.

## Across Multiple Units of Government

A larger wrong pockets problem is that within geographies—whether cities or counties or states—often a few individuals, families, blocks, or communities consume disproportionate resources. These consumers are likely to cross agency silos and demand services from a host of governmental actors. Agencies engaged with those populations are constrained in their ability to communicate, for both good reasons (protection of confidentiality) and bad (incompatible data systems). Thus, coordinated care is extremely limited, and those with multiple problems requiring complementary solutions from multiple agencies do not receive them.

Consider these two examples:<sup>2</sup>

- A middle-aged man returns from a two-year prison term to be supervised in his community. While released, he is under state supervision (parole) as he completes his requirements. Perhaps he has a history of homelessness, mental illness, a substance abuse disorder, and/or a chronic medical condition. He is likely to have a limited education and a spotty employment history. He may have child support payments that are in arrears, and he may have restitution responsibilities for the crime he committed. He is also likely to have no voting rights, so he has no say in the society he is reentering and is therefore a key member of no one's constituency.
- A 15-year-old lives in a broken home that is investigated by the child welfare system. He is behind in school, connected to the special education system, and perhaps has been referred to a school other than his neighborhood public school. He has committed offenses and has been adjudicated delinquent by the juvenile justice system and is effectively in their custody while

being treated in the community. He may move frequently between the houses of friends and relatives and may have no fixed address. He has siblings and relatives in a similar situation.

In both situations, this vulnerable individual will require services from multiple agencies with jurisdiction in different departments and with different budgets guiding their practices. Here, the problem is magnified: multiple bureaucracies who rarely coordinate care or share data must do so.

## The PFS Solution

The case for PFS in these cross-department wrong pocket problems is clear: some central authority must be established. Agencies that are unable to raise needed capital independently to solve a problem can in effect pool their risk through a PFS project. A single payor, through a financial intermediary, could raise the capital to fund a holistic program. But in order to coordinate care and data, one entity must take ownership for the outcomes of the individual, family, community, or place.

The limits that current procurement rules place on the ability of departments within a state agency to transfer funding based on evidence-based outcomes are magnified when cross-agency transfers are considered. While various mechanisms have been proposed to pool risk and capital within (and across) agencies,<sup>3</sup> PFS appears to be the most promising for constructing deals around prevention and other public interest investments. Rather than coordinating data and implementation practices on an ongoing basis, PFS allows multiple departments to cede authority to an intermediary charged with coordination. The multiple departments involved in the project need only commit to sharing costs if the project produces previously agreed-upon outcomes.

## Future Benefits of Prevention

One central problem with implementing prevention programs, with or without PFS, is that the benefits occur well into the future but the costs are immediate. The evaluation literature identifies many prevention programs that are either proven or promising but remain underinvested. Because the benefits of such programs occur beyond the current administration's purview, there is little incentive to invest in them.

Most PFS-funded programs would fall within a public health definition of a prevention program. A public health model helps articulate the different prevention programs that tend to benefit future, rather than current, administrations. Public health practitioners think of three levels of such programs: primary (targeting individuals and places with no known issues), secondary (targeting individuals and places with risk factors), and tertiary (remediating prevention for individuals or places with known problems).<sup>4</sup>

Paradoxically, the benefits of program occur in reverse temporal order: tertiary prevention has the most immediate benefits, secondary prevention yields benefits that accrue further in the future, and primary prevention has the most distal benefits. Thus, most current "prevention" spending is really tertiary prevention responses—efforts to stop a known problem from getting worse.

Primary and secondary prevention programs target individuals, families, communities, and geographies with observable risks. Meta-analytic research from the Washington State Institute of Public Policy,<sup>5</sup> the federal government’s What Works initiatives, and other sources tend to find that programs in this category have the largest benefit-to-cost ratios. Tertiary prevention tends to be focused on reducing mortality, lowering the risks of future morbidity, and reducing short-term antisocial behavior.

Unfortunately, the benefits of such programs are counterfactual—that is, savings occur either because future spending is prevented or because expenditures are going to prevent negative outcomes—rather than a reaction to clearly negative situations. A child with siblings in foster care, or involved with the justice system, or failing to advance by standard guidelines can be aided by a range of evidence-based practices. However, the benefits (mainly reduced expected public expenditures) are most likely to occur after the administration that funds the investment has concluded. Thus, there are obvious disincentives to those investments, and the choice to invest in programs with smaller total benefits but more immediate outcomes is more intuitive, but myopic.

## The PFS Solution

PFS makes longer-term prevention investments more attractive by committing future governments to pay for evidence-based best practices transacted by the current government. While more conventional contracting could achieve the same objectives, the simple fact is that governments rarely make these investments. PFS is a forcing mechanism that accelerates scaling of evidence-based programs by acknowledging that current activities are suboptimal.

One common issue among providers and funders is a concern that future governments will renege on the commitments of past administrations. The current approach is to construct projects that consider all future contingencies as a way of incentivizing contracts. Another approach is to use the full faith and credit of a government to ensure compliance with a transaction.<sup>6</sup> A third approach is to use market forces to guarantee compliance: governments that default in these projects are unlikely to be appealing partners in future PFS projects, whereas their peers who follow through on PFS contracts are likely to see their transaction costs for future PFS deals decline.

## Regional Governance

It is a virtual truism in regional planning and political science that jurisdictional boundaries structurally impede evidence-based investments. On one hand, it is difficult for governments to collaborate given incompatible procurement systems and financing mechanisms. On the other hand, the policies and practices of one jurisdiction affect the outcomes experienced by neighboring geographies. Thus regional governance challenges present perhaps the largest obstacle to evidence-based governance in a specific area.



Consider changes in the housing infrastructure of Washington, DC, that followed implementation of the HOPE VI initiative in the late 1990s.

The goal of HOPE VI was to tear down dense high-rise public housing projects that were bereft of opportunity and had become magnets for victimization. Many residents of these projects and neighborhoods moved to neighboring areas. While research about the post-move outcomes of those who were displaced is mixed, neighboring geographies, such as Prince George's County in Maryland, were clearly affected by Washington, DC's policy change (Cahill, Lowry, and Downey 2011; Voith and Zielenbach 2010). Since Washington, DC, and Maryland have separate governments, the consequences of the HOPE VI efforts were in effect imposed on Maryland.

PFS offers new opportunities for cities, counties, or localities to collaborate on reforms that generate change across geographical areas. But, it is important to note that these regional disincentives are a wrong pockets problem.

## The PFS Solution

Although a PFS approach to regional issues has yet to be pursued, theoretically this solution would solve a key problem. As a thought experiment, consider the problem of homelessness in a dense metropolitan area. If one municipality in the region implements an evidence-based program to reduce homelessness, two effects are likely:

- that municipality is likely to see demand for its services increase, and
- neighboring geographies are likely to see a reduction in their costs.

Thus, the incentives for the proactive municipal government to implement an effective service are minimized. PFS allows geographies to pool risks, invest in geographically disparate evidence-based programs, and improve outcomes across multiple places.

## Nonfederal Spending of Federal Investments

A critical issue in governmental reform could be labeled the "federalist" wrong pockets problem. Here, the problem is that the federal government provides pass-through funding to prevention programs across multiple substantive areas (public health, education, justice, etc.). However, if a local geography (which could be municipal, county, or state) saves the federal government money by shifting resources from a well-intentioned but non-evidence-based program to a proven best practice, today the savings accrue exclusively to the federal government. Thus, there are no incentives for a local government to shift to more proven practices.

One clear example is the use of Medicaid dollars. Some Medicaid dollars support investments in evidenced-based prevention, including ones focused on behavioral changes that, for example, reduce the incidence and prevalence of diabetes, asthma, and obesity. If states provide half the funding and the federal government provides the other half, states have incentives to maximize the cost-effectiveness

of the state dollars but not the federal ones. If, on the other hand, states had an incentive to maximize the effectiveness of the total investment, including the federal portion, funding of more evidence-based programs would be incentivized. A similar problem exists in the relationship between states and local governments, where structured payments to local governments are also shared, and the incentives from sharing benefits of more proven practices are not optimized.

## The PFS Solution

PFS potentially solves this problem by forcing debate on two levels:

- At the federal level, PFS could motivate legislative and regulatory changes that enable savings from PFS-funded evidence-based programs to be shared between the larger funder and the administering government. The classic example of this shift would be authorizing the federal government to share PFS-funded efficiencies with states and localities, particularly in Medicaid service provision. PFS is a potential forcing mechanism to facilitate these changes.
- At the federal, state, and local level, procurement processes may conflict with each other. At the federal level, PFS could incentivize the federal government to address procurement issues that currently create disincentives to reforms that drive more efficient state and local provision of federal pass-through dollars. At the state and local level, PFS may incentivize governments to work unconventionally, principally around the process by which collaborative ventures such as PFS are solicited.

## PFS That Benefits Citizens Rather Than Government

From a governmental perspective, tangible benefits of new investments in evidence-based programs fall into two categories: cost savings or future revenue increases. Some of those benefits may be cashable, in that a budget line item may reflect the savings or increases. Or they may be noncashable benefits, where the cost savings and revenue generation benefit government but are too diffuse within the budget to directly observe. But what do we do when benefits accrue to the public and do not appear within government budgets?

Consider a program designed to reduce recidivism among high-rate offenders. If the program is successful, criminal victimization will be reduced. Would-be victims will experience fewer injuries and deaths, smaller productivity losses, and less trauma, among other benefits. These benefits to society do not appear in any budget, yet they are successful government achievements and should be encouraged.

Most current PFS projects focus on projects predicated on future revenue increases that are mainly cashable, meaning the flow of revenue into a budget is directly observable (such as an increase in tax revenue or a decrease in the use of services). However, this approach should be reviewed because it does not address three other social benefits:

- programs with multiple benefits across multiple systems where the theoretic link from the program to better outcomes (such as a program that leads to a reduction in new offending and more employment) is obscured because the casual mechanisms are complex;
- programs that benefit society in ways that simply are not observable within a budget: programs that create greater income equality, improve perceptions of justice, or are more culturally competent, all of which are in the public interest; or
- programs with benefits that accrue directly to the public, without any mediation by governmental actors: reduced violent crime is the most obvious example, but programs that increase quality of life, or health, or educational attainment also create societal benefits that do not appear in governmental budgets.

Neither the goal of increasing revenues as a result of PFS-funded projects that are cashable nor reducing negative impacts to citizens that are not cashable is intrinsically superior. Both are difficult for governments to observe and claim credit for. Thus, a major challenge for government will be to motivate important transactions that fund prevention activities indirectly. An advantage for PFS-funded projects is that these questions become less pivotal than they would be in traditional budgeting—as long as funders are willing to support these activities, and governments are willing to commit to paying for predetermined outcomes.

## The PFS Solution

PFS projects, as currently understood, are a concept and not a noun. That is, as long as a funder is identified, a service provider is contracted to implement an evidence-based program with fidelity, and a government agrees to pay for improved outcomes, a PFS project can be constructed. Thus, PFS creates the opportunity for government to invest in programs with noncashable benefits in a way that is not achievable through traditional annual budgeting. If all parties agree that the benefits of the program are worth investing in, and worth recompense, then the PFS transaction can fund investments in services that yield a mix of cashable and noncashable benefits.

In the future, some threshold will likely be established around the proportion of cashable to noncashable benefits that are acceptable to all parties in these transactions. However, further exploration is warranted in the current developmental phase of PFS, and transactions with high noncashable-to-cashable ratios should be explored.

## Conclusion

The wrong pockets problem is a challenge to the implementation of evidence-based best practice in the United States and around the world.<sup>7</sup> The central impediment to remediation of wrong pockets has been a focus on why evidence-based programs have been underfunded, rather than on the structural constraints that have led to the problem.

Each actor in a PFS project faces significant barriers to entry. Service providers must demonstrate empirically that their programs can reasonably be expected to achieve outcomes. Funders must accept that below-market rates of return are a possibility and that variation in social service provision is inherently more uncertain than other types of investments. Evaluators must acknowledge that social science research is difficult in practice. All these obstacles are relatively easy to overcome.

But most important, governments must acknowledge the wrong pockets problem around the implementation of evidence-based best practice, particularly around effective prevention programs. And, governments must acknowledge that this problem has not been solved with business-as-usual governance.

The formulation of a PFS project surfaces these impediments and lays bare the solutions to those problems. Whether or not a PFS project is completed, that process of identifying structural barriers to funding effective practices will help to reform systems, and push them to change funding mechanisms and focus on governments buying outcomes rather than outputs.

## Notes

1. In each of these instances, society experiences what economists refer to as a public goods problem. The public goods problem is sometimes described through the tragedy of the commons metaphor, which refers to a communitarian town with a grassy public square where farmers are allowed to graze their stock, free of charge. Since no one who benefits from the square is required to pay for its upkeep, eventually the actual payers of the maintenance of the space (the tax-paying citizens) will (reasonably) refuse payment for upkeep, and all will lose benefits.
2. The gender-specific language in this passage is intentional; most of the target populations for these types of programs are male.
3. For example, some places have proposed and implemented intergovernmental risk pools and equalization pools, primarily to meet health insurance challenges.
4. Public health defines prevention more broadly than it is understood colloquially. It encompasses three levels of prevention:  
  
Primary prevention. These programs target individuals and places with no known issues. This would include teaching children and adolescents currently at an appropriate weight healthy eating habits to avoid future obesity or heart disease, or children with no prior justice system contact about prosocial behaviors.  
  
Secondary prevention. Most currently funded prevention activities occur in this space and are usually diagnosed with a risk and/or needs assessment. Here, individuals with a risk factor—an adolescent with a sibling in custody, a young adult with a parent or sibling whose behavior or habits contributed to their death, a place near a geography that is failing—are targeted for a program.  
  
Tertiary prevention. More commonly known as remediation, tertiary prevention is work with individuals or places that have a known problem. This could include blighted communities in need of transformation or revitalization, offenders in need of rehabilitation, or individuals in need of behavioral supports for health problems ranging from diabetes to substance abuse.
5. The Washington State Institute for Public Policy regularly updates its cost-benefit database of preventive public policies: [http://www.wsipp.wa.gov/BenefitCost/WsippBenefitCost\\_AllPrograms](http://www.wsipp.wa.gov/BenefitCost/WsippBenefitCost_AllPrograms).
6. For example, the Government of Massachusetts has backed PFS contracts with the full faith and credit of the Commonwealth: <http://www.goldmansachs.com/our-thinking/trends-in-our-business/massachusetts-social-impact-bond/MA-juvenile-justice-pay-for-success-initiative.pdf>.

7. Evidence-based best practices means preventive programs that are proven (have significant evidence base) and have strong potential to yield greater benefits than costs. A number of sources can support policymakers' efforts to find evidence-based policies. For example, the Coalition for Evidence-Based Policy has launched the Top Tier Evidence initiative to serve as a "validated resource to distinguish research-proven social programs" (<http://toptierevidence.org/>).

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