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For Federal Programs, a Taste of Market Discipline

By [DAVID LEONHARDT](#)

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Wouldn't it be nice if taxpayers could somehow get a refund for government programs that didn't work? Instead, the opposite tends to happen. Programs that fail to make a difference — like many of those that train workers for new jobs — endure indefinitely. Often, policy makers don't even know which work and which don't, because rigorous evaluation is rare in government. And competition, which punishes laggards in the private sector, is typically absent in the public sector.

But there is some good news on this front. Lately, both American and British policy makers have been thinking about how to bring some of the competitive discipline of the market to government programs, and they have hit on an intriguing idea.

[David Cameron](#)'s Conservative government in Britain is already [testing it](#), at a prison 75 miles north of London. The [Bloomberg administration](#) in New York is also considering the idea, as is the State of Massachusetts. Perhaps most notably, [President Obama](#) next week will propose setting aside \$100 million for seven such pilot programs, according to an administration official.

The idea goes by one of two names: pay for success bonds or [social impact bonds](#). Either way, nonprofit groups like foundations pay the initial money for a new program and also oversee it, with government approval. The government will reimburse them several years later, possibly with a bonus — but only if agreed-upon benchmarks show that the program is working.

If it falls short, taxpayers owe nothing.

The [first British test](#) is happening at Her Majesty's Prison Peterborough, where 60 percent of the prisoners are convicted of another crime within one year of release. Depressingly enough, that recidivism rate is typical for a British prison.

To reduce the rate, a nonprofit group named [Social Finance](#) is playing a role akin to venture capitalist. It has raised about \$8 million from investors, including the Rockefeller Foundation. Social Finance also oversees three social service groups helping former prisoners find work, stay healthy and the like. If any of those groups starts to miss its performance goals, it can be replaced.

For the investors to get their money back starting in 2014 — with interest — the recidivism rate must fall at least 7.5 percent, relative to a control group. If the rate falls 10 percent, the investors will receive the sort of return that the stock market historically delivers. "It's been only a few months," says Tracy Palandjian, who recently opened a new Social Finance office in Boston, "but the numbers are coming in O.K."

[Antony Bugg-Levine](#) of the Rockefeller Foundation told me it had invested in the project for two main reasons. One, it expected to get its money back and then be able to reuse it. Two, if social impact bonds work, they have the potential to attract for-profit investors — and vastly expand the pool of capital that's available for social programs.

Clearly, social impact bonds have limitations. For starters, it's hard to see how private money could ever pay for multibillion-dollar programs like [Medicaid](#) or education.

Just as important, the execution of any bond program will be complicated. It will depend on coming up with the right performance measures, which is no small matter. Done wrong, the measures will end up rewarding programs lucky (or clever) enough to enroll participants who are more likely to succeed no matter what.

But whatever the caveats about the bonds, the potential for improving the government's performance is obviously huge. That's true in education, health care, criminal justice and many other areas.

A recent [review](#) found that 10 major social programs had been rigorously evaluated over the past two decades, using the scientific gold standard of random assignment. Only one of the 10 — Early Head Start, for infants, toddlers pregnant women — was a clear success. Yet all 10 still exist, and largely in their original form.

[Jon Baron](#), the president of the Coalition for Evidence-Based Policy in Washington, points out that the social problems addressed by antipoverty programs have not gotten much better in years. School test scores have barely changed. College graduation rates for low-income students have stagnated. The poverty rate is [as high](#) as it was in 1981. Median household income is lower than it was in 1998.

"If we just keep funding social programs the way we have been," Mr. Baron says, "there's not a lot of reason to think we'll have much success."

The Obama administration's seven pilot programs would create bonds for, among other areas, job training, education, juvenile justice and care of children's disabilities. Nonprofit groups like Social Finance could apply. So could for-profit companies, said the White House official, who asked not to be named because the president had not yet released next year's budget. The \$100 million for the bonds would come out of the budgets of other programs, to stay consistent with Mr. Obama's announced freeze on non-security spending.

Officials in Massachusetts and New York are looking at similar ideas but have not yet decided whether they will issue bonds.

Beyond the impact of any single program, the bonds have the potential to nudge all government agencies to pay more attention to results. Mr. Obama, after all, campaigned as a reformer who wanted to create a sleek, efficient "[iPod government](#)." He has had some success, like the expansion of a program — backed by years of [solid evidence](#) — in which nurses go to the homes of new at-risk parents to counsel them.

Over all, though, the administration has not done enough to improve government efficiency. Put it this way: If someone asked you how Mr. Obama had made government work better, would you have an answer?

Making government work better will be all the more important in the years ahead. The free market is not going to solve many of our biggest problems, be it stagnant pay or [spotty](#) medical care. And government — in Washington and locally — is going to be financially squeezed for a long time.

There never was a good excuse for wasting billions of taxpayer dollars on programs that didn't work. But now, especially, there's no excuse.