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Economic analysis of programs that could qualify for a human capital performance bond pilot

Executive summary

Introduction

Human capital performance bonds are predicated on the assumption that health, education, and social service programs produce social outcomes that have measurable economic value. A clear example is job training programs, which increase state income and sales tax revenues when they successfully achieve employment and wage gains for participants. Other types of programs may not increase tax revenues, but they might save money by reducing costly state spending, such as for repeat incarceration or chronic homelessness. This economic value is equivalent to cash and has the same financial value as cash flow in a business. Accordingly, just as businesses use projected cash flow to finance their current spending, state government could do the same to finance social programs based on their expected future payback.

Invest in Outcomes, led by founder Steve Rothschild, has proposed using state appropriation bonds in a pilot initiative to test this new model for funding programs by rewarding those that successfully meet set performance goals. For every million dollars in bond funding, programs in the pilot would have to generate cash flows of $140,000 per year for up to 10 years to cover the interest (4%), amortization (8%), and administrative costs (2%).

This executive summary is for a report prepared by Wilder Research that identifies the types of programs that are best suited for this performance-based funding pilot.

Wilder Research first examined the cash flows and projected savings for a set of workforce programs associated with the Greater Twin Cities United Way, which provided a data set that includes aggregated placement and 6-month retention rates, wage changes, and criminal background information for 22 metro-area programs. In the absence of data regarding the number and ages of dependents among workforce program participants, we computed cash flows for three types of job placements: 1) one adult, no dependents, 2) one parent with one child age 30 months, and 3) one parent with three children (ages 30 months, 4 years, and 6 years).

Then we reviewed and analyzed cost-benefit studies of other service and program areas that could demonstrate opportunities for big enough cost avoidance or income growth to produce sufficient cash flows.

The final section describes the key design features and data elements for evaluating the pay-for-performance pilot.

Subsequent reports will examine in detail 1) two other service and program areas that demonstrate initial opportunities for big enough cost avoidance or income growth to produce sufficient cash flows; 2) the rules, procedures, and safeguards of the pay-for performance process during the pilot; and 3) a detailed evaluation plan that pertains to each type of service or program in the pilot.

Summary of key findings

First-year and 10-year projected cash flows of workforce programs

Workforce programs produce cash flows through increased tax revenues due to increased wages of persons placed in jobs as well as due to possible decreases in public assistance payments. Using conservative assumptions that may not capture all the economic value produced for the state of

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Minnesota from a set of 22 metro-area workforce programs associated with the Greater Twin Cities United Way, we computed for the five highest performing workforce programs the number of additional placements in the first year required to cover the interest, amortization, and administrative costs on a $1 million bond and the number of additional placements required to cover the costs of the bond over 10 years.

To cover the first year costs of a $1 million bond would require an additional 29 placements, or about 6 percent more placements than the 463 placements these five programs had altogether in the past year. However, to cover the bond costs over 10 years would require 29 more placements for a total of 58 additional placements, or about 13 percent more placements altogether than in the past year for the five top performing programs.

Other potential service categories that are suitable for pay-for-performance funding

The other service and program areas that have demonstrated the potential to produce big enough cost avoidance or income growth to pay off the bonds and to benefit from performance-based funding and, thus, should be considered for the pilot appear to be:

- Addiction treatment services, for which the benefit-cost ratio reaches 12:1 when factoring in savings related to reduction in crime and health care use and increased tax revenues due to increased productivity of treated individuals.
- Adult day health programs that substitute for nursing home care for frail elderly, which have shown benefit-cost ratios of 5:1.
- Supportive housing, which have shown health care costs reduced nearly 50 percent and declines in incarceration costs of 76 percent.
- Employment for people with disabilities, with potential return of $3 for every $1 invested.

Conclusions

The job placement and retention performance of metro area workforce programs suggests that human capital performance (HUCAP) bonds are a feasible way to fund some workforce programs. The state should be able to pay off the bonds based on public assistance and tax benefits saved and increased tax revenues. The programs would have to gauge their placement and retention outcomes against the top performing programs and decide if they have the capacity and right mix of participants to increase their placements by, at most, about 13 percent.

Addiction treatment services and adult day health programs are the two most promising service areas to explore further at this time for the bond pilot. Wilder Research is currently conducting a comprehensive return on investment study of supportive housing in Minnesota. Invest in Outcomes should revisit supportive housing as a candidate for pay-for-performance funding when that study is completed at the end of 2011.

Finally, these initial conclusions do not mean that these are the only program areas in which the HUCAP bonds can work. There may be other areas where the potential is high but the economic studies and data are too limited at this time to qualify for the bond pilot.

Acknowledgments

This study was funded by the Bush Foundation and completed with the technical assistance, review, and advice from Brian Paulson, Greater Twin Cities United Way; Raymond Robertson, Macalester College; Art Rolnick, University of Minnesota; and Steve Rothschild, Invest in Outcomes.

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For more information

This summary presents highlights of the *Economic analysis of programs that could qualify for a human capital performance bond pilot,* prepared for Invest in Outcomes with funding from the Bush foundation. For more information about this report, contact Richard Chase at Wilder Research, 651-280-2706.

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MAY 2011