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Contracting out welfare to work in the USA: delivery lessons

Dan Finn

A report of research carried out by the Centre for Economic and Social Inclusion, University of Portsmouth on behalf of the Department for Work and Pensions

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Summary

In 1996 the Personal Responsibility and Work Opportunities Act devolved significant new powers to individual states for implementing 'Temporary Assistance for Needy Families' (TANF). States could contract out all services, including eligibility for TANF financial assistance, and give contracts to faith-based organisations on a new basis (known as 'charitable choice').

This report contains findings from a review of literature on the contracting out of these welfare to work services, with a particular focus on the experience of Wisconsin and New York City.

Main findings

There has been no comprehensive evaluation of the impacts of contracting out welfare to work in the USA but the following findings emerged from survey and case study evidence published by various policy institutes and academics and from the reports of various audit, oversight and regulatory authorities:

- In 2001 nearly all states contracted out some TANF services with a market value of \$1.5 billion, accounting for 13 per cent of federal TANF expenditure. Some 88 per cent of the total funds contracted by state governments – and 73 per cent of the state-level contracts – were with non-profits; the rest with for-profit providers. In eight states half of the contracted funds were with for-profits. The value of the TANF market has since fallen, reflecting declining caseloads. One study found that between 2001 and 2004, the average dollar value of TANF contracts fell by 27 per cent and the average number of state contracts from 121 to 59. There had, however, been an increase in the proportion of contracts held by faith-based organisations.

- A significant minority of states, such as Wisconsin, contracted out case management and eligibility determination to the private sector but most states retained public control of TANF eligibility, reorganising their welfare offices to provide work-focused eligibility and case management services, but contracted with the private sector for other employment-related services.
- There were three types of TANF contracts – ‘pure pay-for performance’, ‘cost-reimbursement’ and ‘fixed price’. In practice many welfare agencies used ‘hybrid contracts’ that sought to balance performance incentives, provider viability and the delivery of particular services. Studies reported that staff at contracting agencies found designing contracts and managing performance ‘challenging’. The implementation process has been dynamic and welfare agencies have had to frequently revise the terms of their contracts as problems have arisen and conditions have altered. The role of auditors has been particularly important in identifying poor contract design and oversight.
- There is variation in the size of contracts. Many welfare agencies issued a significant number of smaller contracts that allowed them to acquire specialist providers, reduced reliance on large contractors, and enhanced future competition by keeping entry costs low. This also reduced the risks from poor performance as a weak provider could more easily be replaced. Other welfare agencies, however, used a ‘prime contractor’ model. This allowed them to work with fewer, well-capitalised contractors. Larger contracts limited administrative and monitoring costs, allowed contractors to reap economies of scale and gave them scope to coordinate services. These contracts attracted for-profits organisations which targeted markets with large caseloads.
- There has been much debate about the role of national for-profit providers and controversy about their operation in particular states, especially in the first phase of contracting out. Concerns have also been expressed about the impact that welfare to work contracts have had on the composition and service delivery of the non-profit sector.
- Most studies report that welfare agencies attach importance to the experience and opinions of clients. Contracts normally require providers to agree individual service plans and meet minimum service standards. To gain more insight into the experience of service users many welfare agencies supplement their limited on-site monitoring of client experience with customer satisfaction surveys. Some carry out surveys with individuals who declined services or were sanctioned.

The evidence review did not consider the merits of the general arguments concerning the privatisation of welfare to work services. The concern was with the policy and delivery issues emerging from the US welfare market and the implications of these findings for the design, regulation and local delivery of the emerging British welfare market:

- 1** Contractors and their frontline staff inevitably gain an advantage when implementing new contracts as they develop greater operational knowledge of how to achieve specified outcomes. The development of a performance payment system will involve an evolutionary process of trial and error and is likely to require an extended period of monitoring, evaluation and modification. It is important also that in addition to agreeing the delivery of specified outcomes, contractors agree some general values that will help steer the behaviour of the contractor as they make use of the flexibilities they enjoy.
- 2** There is continuing tension between regulation, transparency and flexibility. As the Wisconsin experience illustrates, poor contract design and oversight can result in unintended outcomes. Subsequent redesign has now given Wisconsin increased control over the performance, governance and service delivery of contractors but this has reduced their freedom to innovate. The role of independent oversight is important as those with responsibility for policy and implementation have a clear interest in the 'success' of contracting out.
- 3** The US evidence illustrates the importance of contracting agencies independently monitoring client experience and ensuring that robust systems are in place to respond to complaints of unfair treatment and poor service delivery. In many contracted-out federal programmes agencies must conduct customer satisfaction surveys and the results, as in Wisconsin, may be used as a benchmark performance indicator. These instruments are important both because they provide important information on service delivery and because they can militate against 'creaming' where job-focused performance benchmarks might encourage contractors to deliver most to those clients easier to place.
- 4** There will need to be a significant investment in information systems and in contract negotiation and revision. This should include the continuing development of skilled contract managers. Contracts need to ensure that staff involved in service delivery have appropriate training and development opportunities so that they can discharge their responsibilities properly.
- 5** The virtues of competition are difficult to sustain if there is competition only for contracts. Once a delivery market is established incumbent providers enjoy acquired advantages. Contracting agencies face a difficult trade-off between the potential improvements that might be gained from a new contractor and the transaction costs and service delivery disruption that will arise when holding an open competition. The efficiencies of contracting should also be sought by creating effective competition between providers within markets. There is, however, scant evidence in the literature on how such competition is driven in the US welfare market, albeit New York City uses the data from its contractor information system to drive the performance of its prime contractors. There was also little evidence on empowering clients to exercise choice between different welfare providers.

- 6 The use of prime contractors reduces administrative costs and generates economies of scale but, as the New York case study illustrates, this may be at the price of a loss of insight into service delivery, the experience of clients and of relationships between the prime and its subcontractors. The viability and performance of subcontractors is important both for immediate service delivery and as a future source of competition for the prime contract.
- 7 There are risks attached to the significant involvement of for-profit organisations. They are likely to follow profit maximisation strategies shaped by contract incentives and this may not necessarily deliver what is best for clients, especially for those with greater barriers. Moreover, if the entry of for-profits into local delivery systems displaces existing private and public infrastructure, future capacity may be at risk when market conditions change and larger for-profits remove their capital to seek greater profits elsewhere.
- 8 Developing and managing contracts for welfare to work and eligibility services is a complex and demanding task for administrators and managers. There is a sharp and continuous 'learning curve' and it takes time to learn how to steer the market to minimise perverse incentives and to capture the efficiencies and innovation that independent contractors can offer. As one US analyst concluded, *'successful contracting requires government to be smart buyers and good contract managers'*.

1 Introduction

The Government has announced a 'major transformation' in the delivery of welfare to work programmes in which it will '*learn from international experience*' to best '*harness the strengths*' of public, private and third sector provision (DWP, 2007).

This paper contains findings from a systematic review of literature on the contracting out of welfare to work services in the USA. It reflects, in particular, on the experience of Wisconsin and New York City since 1996. Wisconsin led the way in US welfare reform, was the first to extensively contract out its delivery system, and the 'Wisconsin model' has been the source of much policy emulation in both the USA and in Europe. Outside Milwaukee, the state has used contracts also to deliver welfare to work services to a dispersed and relatively small population. New York City, by contrast, has the highest welfare population in the USA. Its welfare to work delivery system was initially based on the Wisconsin model but has undergone significant reform and most services are now contracted out to a small network of prime contractors who are paid by results.

This evidence review does not consider the merits of the general arguments concerning the privatisation of welfare to work services.¹ Its concern is with the policy and delivery issues that emerged from the design of contracts, payment for performance, the use of prime contractors, and the impact on services, especially for those 'hardest to place'. It considers organisational and resource challenges that government agencies have encountered in managing contracted-out services and the implications of these findings for the design, regulation and local delivery of the emerging British welfare market.

2 The literature

There has been no comprehensive evaluation of the impacts of contracting out welfare to work services in the USA. There is, however, survey and case study evidence from various policy institutes and academics and findings from audit, oversight and regulatory authorities. Interest groups have also published extensively on the privatisation of welfare services. Proponents argue that private contractors bring innovation and new capacity to service delivery and that competition and payment for performance generates efficiencies and cost savings. Officials involved in welfare to work services delivery stress that contracting out enabled them to speedily and flexibly expand capacity and restructure delivery systems (including, where required, the ability to renegotiate contracts). Critics dispute the idea that the conditions for effective competition exist in the delivery of welfare programmes and deem efficiencies and savings claimed as illusory. They contend that transaction and contract management costs have increased after contracts were awarded and that welfare agencies have had to remedy unforeseen deficiencies in the services delivered by providers.

¹ For general reviews of US evidence and literature on privatisation of welfare and social services see Nightingale and Pindus, 1997, and Winston *et al.*, 2002.

3 The contemporary US welfare market

The Personal Responsibility and Work Opportunities Act (1996) and its TANF programme enabled US states to lead in the design and delivery of welfare to work programmes. TANF eligibility was limited to five years, with states required to engage an increasing proportion of adult recipients, mostly lone parents, in work or work-related activities as a condition for cash assistance. States could contract out all services, including eligibility for TANF financial assistance, and give contracts to faith-based organisations on a new basis (known as 'charitable choice'). In 1997 Congress also created the \$3 billion Welfare-to-Work grant programme, providing additional resources for employment and job retention services for hard-to-employ welfare recipients.

Most states retained public control of TANF eligibility, reorganising their welfare offices to provide work-focused eligibility and case management services but contracted with the private sector for other services. A significant minority of states, such as Wisconsin, also contracted out case management and eligibility determination to the private sector. Eligibility determination for other federal income support programmes for poor people, such as Food Stamps and Medicaid, must, however, be delivered by public sector agencies.²

Prior to the legislation most contracted service providers were non-profits who had previously delivered a variety of services including job preparation and job placement services funded by the federal Department of Labor. In 2001/02 the federal General Accounting Office (GAO) (now Accountability) undertook a comprehensive review of contracting out in TANF. It reported that in 2001 nearly all states contracted out some TANF services with a market value of \$1.5 billion, accounting for 13 per cent of federal TANF expenditure. Some 88 per cent of the total funds contracted by state governments – and 73 per cent of the state-level contracts – were with non-profits; the rest with for-profit providers (GAO, 2002, p.3). In eight states half of the contracted funds were with for-profits.

In the three years following the GAO study the value of the TANF market fell, reflecting declining caseloads. One study found that between 2001 and 2004 the average dollar value of TANF contracts fell by 27 per cent and the average number of state contracts from 121 to 59. There had, however, been an increase in the proportion of contracts held by 'faith-based organisations' although this was concentrated in a relatively small number of states (Jacobsen al, 2005, p.43; p.46).

² Federal rules require state employees to decide eligibility but some time limited waivers have been granted and elements of the application and delivery process may be contracted out. Food Stamp operations, for example, are privatised to varying degrees in 21 states. In the most extensive, and controversial, privatisation in Texas, eligibility for Food Stamps, Medicaid and other benefits is delivered through private sector call centres with phone and online applications.

Other legislative changes impacted on the welfare market. The Workforce Investment Act (WIA) (1998) did not relate directly to TANF-funded services but created opportunities for collaboration between welfare agencies and workforce development services. WIA mandated that access to 18 federal employment and training programmes be coordinated through one-stop career centres. In some states both TANF and WIA employment and retention services have been coordinated and in some cases co-located. Non-profit organisations and private companies directly manage some of these career centres (as in Florida) and in most states hybrids of public and private consortia deliver traditional public employment services (Bersharov and Germainis, 2004).

On the ground welfare to work services are now contracted out by a range of agencies and it is usual to find workforce development agencies contracting out services under different federal programmes for similar target groups but with different eligibility requirements and funding rules (see the appendix for more on 'service integration').

4 Procurement and contracts

The procurement of TANF contracts typically involved several phases. After development of a state strategy a contracting agency would be charged with producing a work plan that outlined the objectives to be met by a contractor and how they would meet them. After consultation, sometimes with potential contractors, the state or local agency issued a public Request for Proposals (RFP). In a detailed study of six states that contracted out case management, Mathematica researchers found considerable variation in the degree of flexibility and prescription in RFPs. The aim was often to give contractors the flexibility to innovate but this was balanced by requirements that would ensure particular services were delivered and standards met. Purchasers also wanted contractors to demonstrate that they had undertaken the advance planning required (McConnell *et al.*, 2003, p.3). Some contracting agencies made efforts to assist smaller providers to compete for contracts by giving detailed information on programme requirements and providing tailored feedback on bids.

The GAO (2002) reported that after the receipt of proposals contracting agencies evaluated the bids using at least the following criteria: price/cost, staffing, experience and technical and/or other resources. Mathematica found that to increase fairness, selection committees were composed of public agency staff often with independent citizens and/or consultants. In making decisions the '*greatest number of points generally went to programme design, organisational capacity, or past performance*', albeit contractors were subject to pressures to keep costs down (McConnell *et al.*, 2003, p.xix).

The Mathematica study reported that contracts in their six study sites were for one or two years but typically included options for renewal. Contractual performance standards involved both outcome and process measures. Outcome measures included employment, job retention, earnings and participation in work activities. Process measures included enrolments, completion of assessments, accuracy of

referrals and, sometimes, staff training. The number of performance measures in contracts varied between five and 23.

There was variation too in the size of contracts. Many welfare agencies issued a significant number of smaller contracts that allowed them to acquire specialist providers, reduced reliance on large contractors and enhanced future competition by keeping entry costs low. This reduced also the risks from poor performance as a weak provider could more easily be replaced.

Other welfare agencies, however, used a 'prime contractor' model. This allowed them to work with fewer, well-capitalised contractors. Larger contracts limited administrative and monitoring costs, allowed contractors to reap economies of scale and gave them scope to coordinate services. These contracts attracted for-profits organisations which targeted markets with large caseloads (Bryna Sanger, 2003). The larger for-profits enjoyed comparative advantage as they could draw on existing technology and management systems and deploy specialist staff with experience of designing project budgets and preparing effective proposals.

Mathematica assessed the relative merits of the three contract types used by welfare agencies (McConnell *et al.*, 2003, p.xx):

- 1 Pure pay-for-performance contracts.** Providers were compensated only when they achieved specific performance goals, relating to the number of clients who achieved certain outcomes, the percentage of clients who met performance goals, or both. Pure pay-for-performance contracts were the least risky for public agencies and the most risky for service providers, especially where contractors were reliant on referrals from welfare offices over which they had little control.
- 2 Cost-reimbursement contracts.** Providers received payments for the expenses they incurred. Generally, costs were restricted to those approved in a budget agreed in the procurement process. Under cost-reimbursement, most of the risk was borne by the public agency. Payments had to be made to the contractor regardless of the quality and effectiveness of the services, albeit they might depend on uncertain fluctuations in referral flows.
- 3 Fixed-price contracts.** Providers were paid an agreed fee regardless of performance or the actual cost of providing services. Under fixed-price, the public agency and contractor shared the risk. The agency had to make payments irrespective of the quality and effectiveness of services but the contractor bore the risk that costs could be higher than anticipated.

In practice many welfare agencies used '*hybrid contracts*' that sought to balance performance incentives, provider viability, and the delivery of particular services. An example illustrates how a welfare agency sought to combine training that might last between three to 12 months, with performance payments for job placement and retention. The contractor was paid an enrolment fee but had to incur a considerable portion of initial programme costs before receiving performance payments (\$1,000 on job placement; \$400 if the client had health benefits within

six months; and \$1,600 if the client was continuously employed for a year). To offset the risk incurred in relying on referrals from welfare offices, the contractor was guaranteed enrolment payments for at least 75 per cent of the proposed entrants (Yates, 1998, p.6). The Mathematica study reported that even in the locality with the highest proportion of pay-for-performance, contractor viability was underpinned by a fixed monthly payment of 15 per cent to 25 per cent of their budgets, irrespective of their performance (McConnell *et al.*, 2003, p.xxii).

There has been much 'learning by doing' in the development of the US welfare market. One study reported that in the early phases of contract implementation many issues emerged from misunderstandings about expectations, such as, *'the number and nature of clients to be served; what 'counts' as a job placement, a no-show client, a client contact; access to facilities, data or other agency property; payment methodologies and schedules; and reporting requirements'*. Poor contract design meant the agency might *'spend the following year dealing with contract disputes'*. Such disputes were more easily resolved where the agency adopted a 'partnership' approach with contractors where compliance monitoring was supplemented by dialogue and a joint commitment to ensure *'contract (and client) success'* (Yates, 1998, p.2; p.4). In some cases this could involve redesign of the contract itself.

5 Contract management, audit and oversight

Whilst service delivery may be contracted-out-welfare agencies and administrators remain publicly accountable for service quality and effectiveness, policy compliance and the proper use of public funds. To perform this function they must gather performance information and monitor service delivery but the benefits from such scrutiny must be balanced against the costs they and contractors incur. Both the GAO (2002) and Mathematica's studies reported that staff at contracting agencies found designing contracts and managing procurement and performance 'challenging' and remained on a steep learning curve.

These studies, and others, found that monitoring typically included site visits, case file reviews, interviews with clients, performance data analysis and, where deficiencies were found, developing and implementing improvement plans. A significant task, and investment, across states has been to devise and implement information systems that enable agencies to track clients, monitor provider performance and verify service delivery and outcomes, especially to secure accurate and timely job placement, retention and wage data.

The role of auditors has been particularly important in a context where administrators were 'learning' and local politicians and contractors had invested political and financial capital in the success of their local systems. The GAO study (2002) reported that state auditors had identified problems with how some welfare agencies procured contracts and how they monitored contractors and subcontractors. Audits undertaken in 2000 reported deficiencies in poor monitoring in 15 states and in poor oversight or poor procurement in four. The responsible

Federal agency (Health and Human Services) responded to such audit reports only on an ad hoc basis and had not analysed national trends or developments in contracting out. HHS rejected the GAO recommendation that it undertake such reviews systematically on grounds of cost and its perception of the devolution inscribed in the legislation (GAO, 2002, p.5).³

6 Providers in the welfare market

A number of studies have investigated the type of contractors that deliver US welfare to work services. There are three distinct categories (GAO, 2002; McConnell *et al.*, 2003; Bryna Sanger, 2003):

- 1 National for-profits:** Those identified include Curtis & Associates, Inc.; Maximus; America Works; and Affiliated Computer Services, Inc (previously Lockheed Martin IMS). They typically hold contracts in multiple states and have considerable resources to secure contracts. Two are large corporations that provide technology and systems management services for different levels of government and deliver other contracted-out social services, such as child support collection and enforcement.
- 2 Local branches of national non-profits:** These include faith-based and secular organisations, such as, the Salvation Army, YWCA, Catholic Charities and Goodwill Industries. The local branches involved in TANF are experienced service providers with distinct social purposes and a history of contracting with government to deliver a wide range of services.
- 3 Local and regional non-profits:** These can be faith-based or secular. They are typically smaller concerns with more limited access to resources and administrative capacity. Some focus their activities on a particular neighbourhood, ethnic or client group.

There has been much debate about the role of the national for-profits and controversy about their operation in particular states, especially in the first phases of contracting out. Critics cite examples of corporate malpractice, including inadequate and poor provision of services, misappropriation of funds and other financial irregularities (Berkowitz, 2001; Freedman *et al.*, 2002; Bryna Sanger, 2003; DeParle, 2004). In some areas the organisations have lost contracts; in others they have taken remedial action and continue to deliver services. The corporations

³ Annual state TANF plans provide detailed information on programme activities, financial data and performance against legislative objectives. HHS assesses and compiles this state data in an annual report to Congress. The US Office of Management and Budget is now independently assessing the performance of each federal programme using a 'Programme Assessment and Rating Tool'. Broad results for TANF performance can be found at <http://www.whitehouse.gov/omb/expectmore/detail/10003502.2005.html>.

themselves point to their successful delivery of contracts in many other areas and continue to stress the organisational and management capacities they bring to the market.

One consequence of these early controversies, however, is that local political opposition and legal challenges now undermine both the speed and effectiveness sought when using for-profit companies and such companies are now deterred from entering particular markets (Bryna Sanger, 2003, p.47).

On a more general level the 'welfare' corporations have emerged as a powerful interest group, locally and nationally, lobbying, for example, for further privatisation of welfare services, such as Food Stamp and Medicaid eligibility. There are criticisms also of conflicts of interest and the 'revolving door' whereby politicians and administrators associated with welfare privatisation have been recruited by these corporations (Freedman *et al.*, 2002).

Involvement in the welfare market has had a major impact on non-profit organisations. In the early phase of welfare reform, prior to 1996, there was significant growth in the '*non-profit human services sector*', especially in metropolitan areas (Twombly, 2001). The market continued to develop after TANF implementation but competition from private organisations and the emergence of prime contractors has had significant impacts. It has fuelled a more general concern about non-profit delivery in privatised social services and whether involvement in the welfare market would '*force them to reconfigure their operations and organisations in ways that could compromise their missions*' (Ryan, 1999, p. 134).

The evidence is mixed. A detailed study of larger non-profit organisations with major contracts found that some struggled with the challenge but others had improved their performance and '*developed services consistent with their social mission*' (Bryna Sanger, 2003). They had comparative disadvantages, such as their restricted capacity to raise capital on financial markets, but they could raise funds from individuals and foundations that enabled them to compete and enhance their service provision.

The experience of smaller non-profit organisations has been equally mixed. Many studies report how some have left, while others have equity and service quality issues due to the transition from grants to contract and performance incentives. Some, who provide specialised services, have been able to win contracts directly. In the states with prime contractors, smaller organisations frequently bid as partners or named subcontractors. The larger for-profit or non-profit organisations provide capital and management, financial and programme expertise, while the smaller community-based organisations offer specialised knowledge of particular client groups and credibility with hard-to-reach communities. One feature of non-profit delivery is that their involvement has not appeared to generate the levels of opposition experienced by the for-profits (Winston *et al.*, 2002; Bryna Sanger, 2003).

There has been debate about the 'shake out' amongst community-based and small non-profits that accompanied the transition to a performance-based welfare market in cities like New York. For some the process has removed providers who were less effective, thereby improving services for clients. Others fear that clients with special needs may be less well served and have expressed concern about the loss of '*assets that might not show up on a balance sheet*' but which contribute to the already limited social capital of poor communities (Fischer, 2001, p.1; Bryna Sanger, 2003).

Finally, there are few systematic studies of how non-profit or for-profit contractors deliver services. Case study and anecdotal evidence suggests they have different management styles and that staff employment conditions, incentives and training vary in important ways. McConnell *et al.*, for example, report that for-profits appeared to work closely to the conditions of the contract and were driven by performance outcomes. In contrast, non-profit agencies were more likely to meet the needs of their clients despite their contract obligations. Stakeholders also often perceive a difference in programme approach suggesting that case management provided by nonprofits is more holistic than that of for-profits. McConnell *et al.*, report, however, that they found '*no conclusive evidence*' that '*one type of contractor consistently provides better services than another*'. Contractor performance reflected local demographic and economic context as much as organisational type (2003, p.25-26).

7 Case studies: welfare to work contracts in Wisconsin and New York City

The following section offers more detailed consideration of the design of welfare to work contracts in Wisconsin and New York City and the providers that deliver them. Whilst these case studies are not representative they illustrate the challenges to 'making markets' in welfare to work delivery.

7.1 Wisconsin works – 'W-2'

Wisconsin led the way in US welfare reform and was amongst the first to contract out its delivery of case management and other services. The Wisconsin 'work first' and 'full engagement' workfare model has been the source of much policy emulation in both the USA and in Europe. TANF caseloads have declined rapidly and by June 2006 there were only 10,109 'cases' receiving assistance from Wisconsin Works, or W-2, which had replaced TANF cash benefits in 1996. Nearly 80 per cent of these cases were in Milwaukee.

The delivery of W-2 is contracted out to a mix of public and private agencies responsible for providing all services including cash payments to eligible participants. In 2005 the Wisconsin Department for Workforce Development (DWD) agreed contracts with 44 organisations to deliver services between 2006 and 2009. In Milwaukee, W-2 has been delivered by private non-profit and for-

profit contractors since 1997 but beyond the city W-2 continues primarily to be delivered by counties, either individually or in consortia. W-2 agencies make extensive use of subcontractors. DWD monitors the main contracts and its seven regional offices are responsible for monitoring subcontractors.

There have now been five 'RFPs'. The first four contracts were for two years' duration; the most recent is for four years⁴. Wisconsin has used what is called a 'Right of First Selection' (RFS) where contractors who meet specified performance standards face no competition when bidding for the next contract. RFS first enabled continuity for county agencies judged to be delivering TANF effectively but was subsequently extended to all qualifying contractors to reduce the disruption to services and transaction costs involved in competitive recontracting. There has since been some variation in the number of contractors awarded RFS status at each point of recontracting. Competition for those contracts not covered by RFS has largely been between existing providers, with little evidence of new entrants into the market. In Milwaukee the number of providers fell to three in 2005 after one major non-profit organisation had its contract withdrawn.

There has been no formal evaluation of the W-2 contracting process but state officials have described it as an 'iterative process' involving constant problem solving and policy changes (Bandoh, 2003). Much of this learning took place in the first two contracting periods when local officials and contractors were severely criticised by state auditors and advocates (Bryna Sanger, 2003; DeParle, 2004).

The first contract (1998-99) was '*an example of the potential for serious unintended incentives*' (McConnell *et al.*, 2003, p.48). The contracts were cost-reimbursement but included a bonus that depended on the difference between actual costs and a specified maximum. If costs exceeded the maximum, the difference was the responsibility of the provider. If the provider spent less than the cap, however, it received a portion of the savings. Critics of the contract argued that it gave contractors the incentive to ignore clients or serve them less well. The contract generated controversy when large caseload reductions in Wisconsin resulted in significant windfall profits for the providers – in one case, more than \$9 million. There was also lax control of the expenditure that did take place and of how contractors were operating (one was estimated to have spent \$1.1 million on a marketing campaign). Several private agencies were also found to have been engaged in financial mismanagement and irregularities (LAB, 2005; DeParle, 2004).

The criticisms of the contract led Wisconsin to completely overhaul its bonus provisions. From 2000 contract incentive payments have been limited to the

⁴ This comprises Family Assistance which provides cash payments to those who qualify under TANF rules and Safety Net Assistance which is available for eligible low income households and those who exhaust their TANF entitlement (cash payments are limited to two years).

achievement of specified performance measures rather than unspent funds. Under these cost-reimbursement contracts 80 per cent is paid during the programme with 20 per cent retained for performance bonuses paid at the end of the contract term. An agency is granted RFS if it meets minimum standards. It is paid restricted bonuses (which must be reinvested in purposes consistent with TANF) for reaching intermediate performance levels, and unrestricted bonuses for the highest performance levels.

The 2000/01 contract was shaped by a new programme emphasis on 'informed choice' (DWD, 2001). County employees were contracted with separately to provide initial assessments and information about services available before referral to a W-2 contractor. Staff at contracting agencies were required to attend DWD authorised training courses to ensure knowledge of programme objectives. Contractors were subject to increased 'management and financial accountability expectations', in areas of financial reporting, cost reimbursement controls and cost oversight.

In subsequent contracts W-2 funding levels have fallen faster than caseload reductions and contractors have frequently requested additional funding to pay for the more costly elements of service provision. Contract expenditure per participant declined from \$1,001 in 1997/99, to \$772 in 2004/05 (when cash payments to participants accounted for just under 40 per cent of expenditure). There is significant variation in the amount spent per participant by different contractors (LAB, 2005, p.17).

A 2005 audit found that in 2004 more than half of participants had not been screened to identify barriers, a fifth of participants were not assigned to work activities and there was little incentive to ensure that more harder to place workfare participants moved into regular employment. A survey of leavers found that only 20 per cent earned more than the poverty level in the year after they left, albeit this increased to just over 40 per cent when tax credits were included. Job retention was a problem and over 40 per cent of leavers were employed by 'temp' agencies (LAB, 2005).

The most recent W-2 contract introduced a new approach. The priority is now to '*effectively connect low income individuals to the workforce*' by ensuring that participants '*secure and retain jobs and advance in the workforce*' (DWD, 2005, p.1). In Milwaukee case management and 'job development' have been contracted separately to encourage specialisation and to reduce reliance on too few contractors. W-2 agencies are under new requirements to integrate services with other workforce development and community support programmes.

The contract introduced strict limits on what providers can spend on '*promotional events, telecommunication, executive compensation, legal services and retainers and rent*'. Contractors are subject to more detailed service delivery-related obligations with poor performers at risk of financial sanction and, ultimately, loss of contract. The contract contains a mix of process and outcome performance

standards. The former continue to focus on factors such as caseload size and customer satisfaction (average score of 6.5 on 10-point scale for 10 different items). The outcome standards include wage at placement (new); employment within 60 days of skills training (new); job placement rate and retention at 30, 60 and 180 days.

Whilst W-2 has evolved to provide more education, training and barrier reduction services, community organisations and advocates remain concerned that contract incentives leave those with the greatest barriers without the services they need (LAB, 2005; Gardiner *et al.*, 2007).

7.2 New York City – the role of prime contractors

New York City has the largest welfare population in the USA, in part because it has a more generous system of public assistance (PA).⁵ Radical welfare reform was implemented in 1996. The programme was partly modelled on the Wisconsin experience with a strong emphasis on 'diversion' and 'full engagement' in work activities. By March 2006 the caseload had fallen to just over 400,000, down from over 1.1 million in 1995.

The significant organisational changes were implemented by the city 'Human Resource Administration' (HRA), responsible for delivering most income support benefits and related programmes. In 1998 it began converting local welfare offices into 30 jobcentres, reclassifying public sector officials as 'Job Opportunity Specialists', with responsibility for eligibility, case management and sanctions. Food stamp and Medicaid eligibility are determined in other public offices and WIA-funded training services are now delivered through another network of Workforce Career Centres.

Job search, placement and work experience programmes are contracted out to private agencies. Until 1999 these services were delivered through multiple contracts with 'dozens' of local non-profit agencies. By early 2000 all these services were consolidated by HRA into 17 multi-million dollar 'prime contracts' awarded to 13 for-profit and non-profit organisations (Fischer, 2001).

The initial contracts totalled 'nearly half a billion dollars' over a three-year period (Youdelman and Getsus, 2005, p.17). Instead of using a conventional RFP, officials undertook a 'negotiated acquisition' that enabled them to identify bidders, invite them to bid and shape contracts around provider strengths. The process was controversial and mired in legal and legislative challenges (Bryna Sanger, 2003, p.35). Subsequently, HRA used the 'negotiated acquisition' process to develop programmes for 'special populations'. This involved 30 contracts, worth \$128 million, awarded exclusively to non-profits. The contracts provided 'significant

⁵ This comprises Family Assistance which provides cash payments to those who qualify under TANF rules and Safety Net Assistance which is available for eligible low income households and those who exhaust their TANF entitlement (cash payments are limited to two years).

cash advances, more adequate funding and regularised reimbursements' (Bryna Sanger, 2003, p.67). This was, in part, a response to criticisms of the lack of intensive services provided by the earlier prime contractors and the problems that nonprofit subcontractors were reporting.

The main prime contractors delivered either 'Skills Assessment and Job Placement' (SAP) or 'Employment Services and Placement' (ESP) services. SAP contractors were co-located in jobcentres and provided assistance during the first two weeks before an applicant received PA. SAP providers were paid standard fees for the initial assessment but mostly for job placements, 13 and 26 week retention, with more paid if the client earned enough wages to eliminate the need for public assistance (OC CNY, 2007). One study reported that SAPs were paid \$250 per person to diagnose potential work barriers, with between \$750 and \$1,750 per person for placement and retention (Fischer, 2001, p.8).

When an applicant was awarded PA they were reassigned randomly by jobcentre staff to one of 11 ESP contractors. ESP provision commenced with a 'rapid work attachment' phase in the first two weeks, after which the individual spent two days a week with the ESP provider and three days a week on a mandatory Work Experience Placement (WEP), usually with a city agency (most notably the City Parks Department). ESP provision could include short training courses or mandatory treatment programmes.

ESP providers were paid only for job entry and retention performance with similar milestones as those in SAPs (OC CNY, 2007). In the second contract period, for 2002/05, the incentives were rebalanced to pay a higher premium on retention (see Table 1). This was introduced because contractors had been too willing to earn fees by placing participants in short-term jobs. The basic ESP programme also evolved to allow more participants to access support services, including basic education and training.

Table 1 **ESP performance-based contract: sample milestone payment rate**

	1999/2001	2002/2005
Placement:	\$1964	\$1227
13th week:	\$1473	\$2209
or high wage	\$1964	\$2700
26th week:	\$ 491	\$ 491
or high wage and/case closed	\$1473	\$1473
Maximum total	\$5401	\$5400

Source: Youdelman and Getsus, 2005, Table 3.

The use of prime contractors required a significant change in contract management. HRA could reduce its administrative load, relying instead on a new performance management information system. 'Vendorstat' was introduced in 2000 allowing

for immediate recording of job placement and attainment of payment milestones. Monitoring was reduced to the verification of placements and retention by quarterly audits of a sample of prime contractor cases, with follow up work only where discrepancies occurred. In effect HRA allowed prime contractors to play *'the role of monitor'* in the system (Bryna Sanger, 2003, p.40). One paradox was that HRA administrative savings had to be offset by *'higher paid staff with database and computer skills'* (Ibid, p.41). The city auditor has continued to criticise HRA about a *'lack of consistent documentation on employment, work hours and wages'* (OC CNY, 2007, p.17).

In New York City the relationship between prime and subcontractors has been the subject of controversy, especially in the early period of transition when many providers found themselves relegated to subcontractor status (Biberman, 2001; Fischer, 2001). There were complaints about having to undertake new assessments, late payments and overly complex requirements that were *'as excessive and costly as when they reported directly to the city'* (Bryna Sanger, 2003, p.69). A more fundamental issue concerned the structure of programme provision. Subcontractors were largely reliant for referrals on the prime contractor, by which time more work ready clients would have been *'skimmed off'*. Subcontractors highlighted that prime contractors controlled their cash flow, generally *'top sliced'* an overhead charge, and had passed most risk to them (Youdelman and Getsos, 2005).

On the other side, other subcontractors stressed that they had been able to access large contracts they could not bid for and they enjoyed some of the economies of scale and additional supports that prime contractors could deploy. One noteworthy innovation was the network of community-based providers affiliated to *'N-PAC'* (Non-Profit Assistance Corporation) that won a prime contract. N-PAC does not deliver training or employment services but places all participants with its providers. It liaises with HRA, handles administrative and financial tasks, and provides information services and technical and programme assistance. The consortia was established by SEEDCO, a medium-sized intermediary, that pools public, private and philanthropic funding and reduces financial risks for N-PAC members by basing its own payments only partially on performance (Bryna Sanger, 2003, p.59). SEEDCO has introduced related programme innovations, such as *'EarnFair'*, a temporary employment agency that provides employment opportunities for up to two years to welfare recipients and others from job placement programmes (see www.earnfair.com).

In 2005, alongside a major review of New York's poverty reduction strategy, it was decided to restructure welfare to work provision and to combine SAP, ESP and WEP provision into a single *'Back to Work'* programme. Contracts were awarded to 22 prime contractors that commenced in August 2006. Each contractor is expected to provide customised and flexible employment and work experience services and work with a client *'from start to finish'* after handover in a jobcentre. The contractor must develop a *'Job Retention and Career Plan'* for each participant to document their efforts to *'advance'* the individual through skill development and financial planning.

Contractors receive only a nominal administrative payment for clients not placed in jobs and only partial payment for short-term job placements. The emphasis is on sustained jobs and career trajectories, with enhanced payments for the hardest to help and those who no longer need public assistance (Egglestone, 2006). The total annual funding for the HRA Works programme amounts to \$63 million and contracts reward the milestones outlined in Figure 1.

Figure 1 New York City HRA 'Back to Work' performance milestones

<p>Employment plans</p> <ul style="list-style-type: none"> • Completion of an employment plan (pre-employment). • Completion of an employment plan (post-employment). <p>Unsubsidised employment</p> <ul style="list-style-type: none"> • Placement into unsubsidised employment for 30 days (minimum 20 hours a week). • Retention in unsubsidised employment for 90 days after initial placement. • Retention in unsubsidised employment for 90 days with case closing. • Retention in unsubsidised employment for 180 days after initial placement • Retention in unsubsidised employment for 180 days with wage gain. <p>Incentive/disincentive payments</p> <ul style="list-style-type: none"> • Incentive payment for a decline in the number of participants who have failed to comply with work requirements and whose cases are sanctioned. • Incentive payment for an increase in the rate of sanction removal. • Disincentive for an increase in the public assistance recidivism rate. • Disincentive for a decline in administrative indicators (e.g. employment plan completion and timely attendance notification). <p>Source: Youdelman and Getsus, 2005, Appendix A.</p>

The new delivery model responds, in part, to criticisms that providers placed few participants in sustained employment and that contract incentives did not encourage them to invest in the hardest to place (Youdelman and Getsus, 2005, p.3). Contractors now are expected to invest more in skills development and develop more effective links with the workforce development system.

Critics emphasise, however, that the contracts do not reward placement in education and training or in intensive services (Sanghvi, 2006) and make no formal distinction between full- or part-time job placements (OC CNY, 2007). Others point to a continuing lack of coordination with workforce development agencies, even though both systems continue to *'prepare customers for many of the same jobs, in the same citywide labour market'* (Fischer, 2007).

8 Individual clients: customer satisfaction and complaints

Most studies report that welfare agencies attach importance to the experience and opinions of clients. Many supplement their limited on-site monitoring of client experience with customer satisfaction surveys. One study found considerable variation in how such surveys were implemented and interpreted. They often took the form of short questionnaires distributed at service delivery locations. Response rates varied and contractors were critical that results often highlighted complaints over which they had no control (McConnell et al, 2003, p.55). In Wisconsin, and other states, however, such surveys now are implemented more rigorously and considered an important contractual performance indicator. Several welfare agencies also use 'mystery shopper' programmes, undertaken by independent organisations, to gain more insight into the experience of service users. Some carry out surveys with individuals who declined services or were sanctioned. These instruments not only provide important information on service delivery but may help agencies ensure that 'creaming' of 'easier to serve' clients is not taking place (Yates, 1998).

Contracts often require providers to agree individual service plans and meet minimum service standards. Providers and welfare agencies themselves are generally required to have complaints procedures in place to respond if services are unfairly denied to clients or those received are of poor quality. As problems have emerged with service delivery, new client-focused requirements and procedures have been introduced. In Wisconsin, for example, clients should now be informed of the services available so that they are able to make an 'informed choice', and contractors can be fined \$5,000 per incident for failing to serve a recipient or applicant. The State Department has also recently created an independent Ombudsperson to more 'rapidly address' complaints from individuals who have problems in accessing W-2 services. In other states 'hotlines' have been introduced to more speedily respond to complaints and enquiries.

Many of these changes have been driven in response to the legal and political challenges that welfare agencies and contractors have faced. Advocacy groups have played an important role in ensuring accountability, upholding the legal entitlements of service users and monitoring the ways in which private providers might not be delivering appropriate services or benefits (Freedman *et al.*, 2002). Legal advocates used the courts to challenge the policies of welfare agencies, as in New York, on issues such as 'due process', the award of contracts, service eligibility, and access to education and training. These challenges, whilst often highly contentious, have contributed to the evolution and better governance of the welfare market.

Conclusion: policy implications

This review has synthesised much of the published evidence available on the US welfare to work market. The findings suggest that the implementation process has been dynamic and that welfare agencies have had to frequently revise the terms of their contracts as problems have arisen and conditions have altered. The original work first and full engagement models changed as many states developed new support services, supplemented workfare with waged transitional jobs, and placed greater emphasis on job retention, skill acquisition and career development. Contract design too evolved, as in Wisconsin and New York City, to reward providers for securing these outcomes. These arrangements will change further as states adjust to recent changes in federal TANF targets.⁶

There may be no rigorous impact evaluation studies but there is now a developed body of US experience and 'know how' about different contracting models, the use of prime contracts and the relationships between service delivery and performance incentives. Many of the reports reviewed in this study analysed the 'lessons learned' in the design and implementation of contracts and contain much detail that may be of practical assistance in the British context (see, for example, Yates, 1998; Winston *et al.*, 2002; McConnell *et al.*, 2003; Bandoh, 2003; Gardiner *et al.*, 2007).

Some of these 'lessons' and recent developments have relevance for developing the British welfare market:

- 1** Contractors and their frontline staff inevitably gain an advantage when implementing new contracts as they develop greater operational knowledge of how to achieve specified outcomes. The development of a performance payment system will involve an evolutionary process of trial and error and is likely to require an extended period of monitoring, evaluation and modification. It is also important that in addition to agreeing the delivery of specified outcomes contractors agree some general values that will help steer the behaviour of the contractor as they make use of the flexibilities they enjoy.
- 2** There is continuing tension between regulation, transparency and flexibility. As the Wisconsin experience illustrates, poor contract design and oversight can result in unintended outcomes. Subsequent redesign now has given Wisconsin increased control over the performance, governance and service delivery of contractors but this has reduced their freedom to innovate. The role of independent oversight is important as those with responsibility for policy and implementation have a clear interest in the 'success' of contracting out.

⁶ TANF reauthorisation in the Deficit Reduction Act (2006) increased the proportion of the caseload to be engaged in 'work' to 50% and reduced states' flexibility in using certain activities to satisfy the participation requirements. If states do not meet these requirements they will incur federal penalties.

- 3 The US evidence illustrates the importance of contracting agencies independently monitoring client experience and ensuring that robust systems are in place to respond to complaints of unfair treatment and poor service delivery. In many contracted-out federal programmes-agencies must conduct customer satisfaction surveys and the results, as in Wisconsin, may be used as a benchmark performance indicator. These instruments are important both because they provide important information on service delivery and because they can militate against 'creaming' where job focused performance benchmarks might encourage contractors to deliver most to those clients easier to place.
- 4 There will need to be a significant investment in information systems and in contract negotiation and revision. This should include the continuing development of skilled contract managers. Contracts need to ensure that staff involved in service delivery have appropriate training and development opportunities so that they can discharge their responsibilities properly.
- 5 The virtues of competition are difficult to sustain if there is competition only for contracts. Once a delivery market is established, incumbent providers enjoy acquired advantages. Contracting agencies face a difficult trade-off between the potential improvements that might be gained from a new contractor and the transaction costs and service delivery disruption that will arise when holding an open competition. The efficiencies of contracting should also be sought by creating effective competition between providers **within** markets. There is, however, scant evidence in the literature on how such competition is driven in the US welfare market, albeit New York City uses the data from its contractor information system to drive the performance of the prime contractors. There was little evidence also on empowering clients to exercise choice between different welfare providers.⁷
- 6 The use of prime contractors reduces administrative costs and generates economies of scale but, as the New York case study illustrates, this may be at the price of a loss of insight into service delivery, the experience of clients and of relationships between the prime contractor and its subcontractors. The viability and performance of subcontractors is important both for immediate service delivery and as a future source of competition for the prime contract.

⁷ There is a growing evidence base on the use of 'vouchers' in the workforce development system, especially the use of Individual Training Accounts (ITAs) and Personal Reemployment Accounts. ITAs are used by TANF clients and can assist them in acquiring skills as they enter and advance in the labour market. WIA evaluation studies were, however, beyond the scope of this review but may merit further investigation.

- 7 There are risks attached to the significant involvement of for-profit organisations. They are likely to follow profit maximisation strategies shaped by contract incentives and this may not necessarily deliver what is best for clients, especially for those with greater barriers. Moreover, if the entry of for-profits into local delivery systems displaces existing private and public infrastructure, then future capacity may be at risk when market conditions change and larger for-profits remove their capital to seek greater profits elsewhere.
- 8 Developing and managing welfare markets is a complex and demanding task for administrators and managers. There is a sharp and continuous 'learning curve' and it takes time to learn how to steer the market to minimise perverse incentives and to capture the efficiencies and innovation that independent contractors can offer. As one US analyst observes, '*successful contracting requires government to be smart buyers and good contract managers*' (Bryna Sanger, 2003, p. 27).

Appendix

Service integration

The case studies highlight that a significant challenge for policy makers, administrators and private contractors implementing programmes has been to coordinate separately funded TANF provision with workforce development and other support services, such as childcare, child support and child welfare. Wider studies report that, as in Great Britain, US categorical funding programmes and ‘service system silos’ result in programmes that become self-contained, with administratively required, but unnecessary, barriers that result in individuals and families experiencing fragmented services and assistance (Lepler *et al.*, 2006).

Under the flexibility provided by the 1996 TANF legislation, some states developed programmes to deliver coordinated services, including co-location of welfare and workforce development services in ‘one stops’ (as in much of Wisconsin); blending of separate funding streams; the development of common application processes; and the use of common performance measures (Ranghelli, *et al.*, 2003; Noyes and Corbett, 2005).⁸

⁸ The National Governors Association’s Center for Best Practices is developing an evidence base on ‘cross-systems innovation’ where states and local governments are attempting to further integrate TANF, workforce development and social service provision. See, for example, <http://www.nga.org/Files/pdf/0402CROSSYSYSCAPACITY.pdf>

Two developments which impinge directly on performance measurement and contract design may merit further investigation:

- 1 The impact of federal 'common performance measures' of employment and earnings outcomes, applied to WIA programmes and now being 'tracked' for TANF. By minimising different reporting and performance requirements the aim of the measures is to facilitate service integration, reduce barriers to cooperation and enhance assessment of the comparative effectiveness of different programmes⁹. As this 'whole-system' approach to performance measurement beds in there may be valuable lessons in how such measures influence contract design, reduce duplication and stimulate 'joined-up' service delivery.
- 2 The implementation of what are called 'master contracts'. These are an administrative mechanism which involves a comprehensive agreement between a funding agency with responsibility for several categorical programmes (e.g., county, state or federal government) and a service delivery provider to deliver a more comprehensive, responsive and coordinated set of services. The 'master contract' allows commissioner and provider to align their funding and service delivery goals by combining multiple, uncoordinated contracts into a single agreement (see, for example, Lepler *et al.*, 2006).

⁹ See http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=2195 and for TANF the section on Job Training Common Performance Measures at http://www.acf.dhhs.gov/programs/olab/budget/2006/cj2006/sec4_02_perf_anlys_2006cj.doc

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