

Expanding Payment-by-Results



Strategic choices and recommendations

Max Chambers



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Executive Summary

The Ministry of Justice is currently consulting on plans for rolling-out a system of payment-by-results (PbR) for offender management services across England and Wales. The decision to expand payment-by-results, whereby providers are paid (or not) for reducing reoffending rates, is a big shift in criminal justice policy – brought about by Justice Secretary Chris Grayling’s decision to abandon his predecessor Ken Clarke’s pilot programme, which was testing PbR at a small scale. The impact of the Justice Secretary’s decision will be substantial, far-reaching and felt by the criminal justice system and those working in it for years to come.

This paper examines the background to the policy, sets out some clear choices facing policymakers as they develop the roll-out strategy, and makes a number of new recommendations about the best way to ensure its success.

The first part of the paper argues that the new set of ministers at the MoJ were correct to abandon the piloting approach that had been underpinning the payment-by-results strategy until just a few months ago.

Fundamentally, the principle of trialling payment-by-results mechanisms was a good idea – and was one that Policy Exchange recommended in a 2010 paper. Well-designed and strategically-conceived piloting, providing a strong evidence base for future policy, could have been very helpful. However, there was never a clear strategy for the pilot programme. In fact, there were so many planned pilots – each with such a myriad of different ways of doing payment-by-results – that officials now concede that it would have been almost impossible to identify anything new or useful by waiting for the results. In addition, the pilot programme was being funded through new investment rather than existing budgets – a model never suitable for national expansion.

Just as crucially, the majority of the projects would not have delivered any reoffending results until 2016/17 at the earliest, with full results not available until at least 2020. This presented a clear risk that the PbR agenda – a key reform with the potential to transform the criminal justice system – could drift, or even be abandoned altogether, as momentum and political support evaporated.

Despite the problems, the pilot phase should not be seen as a failure. Although it was proving difficult to get many of the planned pilots off the ground, the time taken to navigate PbR propositions in this new area has meant that a huge amount of learning has been captured by commissioners and providers, and there are now a very clear set of choices facing those designing the roll-out. These choices will materially affect the quality of the PbR programme: choosing wrongly now could produce a bad or ineffective scheme, or cause the procurement to fail and the policy to never get off the ground.

The report sets out some clear choices for PbR expansion in offender management in each of the following areas:

- How to fund it;
- Which offenders to include in it;
- How to structure it, including which organisations to include in the new system;
- How to pay under a PbR system (i.e. the commercial model);
- How to measure PbR outcomes properly;
- How to integrate PbR delivery within the criminal justice system and more widely; and
- How to procure and manage the roll-out.

It makes a number of strategic recommendations for the Ministry of Justice, including the following:

- **PbR expansion should predominantly be funded through existing budgets, rather than new investment.** The pilot programme was funded through ‘new money’, making it unviable as a roll-out model. Instead, existing budgets should be used, constituting the relevant parts of the probation and prison budgets. PbR should, in this context, be seen as a way of enhancing performance while managing shrinking budgets, rather than as a method of attracting new investment, creating new services, and trying to secure cashable savings.
- **New investment should be explored too, if this can be tied more tightly to savings.** If the Ministry of Justice can more directly demonstrate cashable savings from the scheme (by creating an outcome measure that properly takes account of system demand), it should prepare a business case for the Treasury for new investment in PbR expansion. The creation of a top-up investment pot would supplement existing budgets and provide new investment to deliver larger reoffending reductions.
- **The inevitable consequence of using existing budgets is the privatisation of parts of the probation service.** PbR demands that the risk of failure (e.g. financial risk) is transferred to the private sector because the public sector cannot be allowed to fail. If existing budgets are to be the main contributor to funding the scheme, this inevitably means that the control of the assets and the staff themselves must also transfer. Alternatives to outsourcing – such as joint ventures where risk is transferred to the private sector but fundamental control of services remains in the public sector, have been tried as part of the pilot phase, and were found to be unworkable.
- **Privatisation of elements of probation will release efficiencies to provide new services for short-sentenced prisoners.** The only core element of probation work that has ever been put out to competition, Community Payback in London, is now being provided at around 60% of the previous costs. This demonstrates the scale of savings in the £1 billion offender community services budget that are possible through private sector financial management and disciplines. It is through these savings that services to short-sentenced prisoners, who currently receive no community supervision, should be predominantly funded.

- **Support for short-sentenced offenders should not be mandatory or provided for in legislation.** On balance, we disagree with the consultation's assertion that new provision for short-sentenced offenders should be mandatory. Mandating support is unlikely to be the best way for providers to engage with this often chaotic and hard-to-reach client group. Compulsory support may also severely restrict providers' freedom to innovate and prioritise the allocation of resources across a cohort; the task of reducing reoffending would be skewed towards enforcement, rather than the rehabilitation of those who are ready to engage and be helped (the currently neglected side of the coin). Additionally, given that the only obvious tool for dealing with non-compliance would simply be a return to custody, mandating support may simply further damage the offenders' chances of success, and further drive up costs in the criminal justice system.
- **The provider must be given maximum control of the offender journey.** It is essential that providers, who are taking all the risk, be given control of the end-to-end offender management of offenders to enable them to reduce reoffending. Indeed, it is only investigation and advice to court (offence assessment and sentence recommendation) where there is a strong argument for the exclusion of front-line probation functions. These services could also represent some of the 'service fee' elements we recommend be introduced as part of the commercial model.
- **Commissioners should consider including back and middle office functions in probation privatisation.** With over one in four probation staff in a support function, and each of the 35 Trusts having their own bespoke functions, there is clear scope for directing savings here towards new provision for reducing reoffending. This could either be included in the PbR procurement, or completed as a separate exercise, depending on time constraints.
- **The Ministry of Justice must take strategic steps to build this market.** For PbR to work, the Ministry of Justice must play a market stewardship role – ensuring that a viable market can be built, with metrics that work for the taxpayer too. It is clear that the commercial models pursued as part of the pilots are wholly unsuitable for the proposals contained in the government's consultation.
- **Due to the new scale of contracts and the new dimension of probation outsourcing, the commercial propositions must be much lower-risk – and should eventually look far more like conventional outsourcing contracts.** It should by now be absolutely clear that the Ministry of Justice will not be able to ask providers to take 100% of the risk in these contracts. This model was not viable for providers, had already led to market failure in the pilot phase, and is not appropriate as PbR is scaled and financial risk levels are multiplied. The real debate is about what percentage of the overall contract should be put at risk, and then how that risk should be structured (bearing in mind the crucial issue of how to measure reoffending outcomes). Given the scale of the contracts, Policy Exchange believes that around 20% of the contract value should be put at risk, dependent on decisions about measurement. A new model, designed to stand up to the rigours of commercial investment decisions, should include:

- **A substantial service fee** – reflecting the fact that providers will be delivering the sentence of the court, not merely a service to reduce reoffending. As a starting point, we suggest that this be around 80% of the contract value.
- **Payments for success reflecting cost savings, not just statistical significance** – reflecting the fact that modest reductions in reoffending should produce marginal cost savings.
- **Additional bonus payments for substantial success** – tied to savings and funded through a top-up to the Rehabilitation and Resettlement Fund.
- **Risk ramping up over time** – as the provider and supply chain develops experience, overcomes initial implementation problems and reaches ‘steady state’. This is especially important because providers will be asked to make substantial efficiencies in probation in order to fund new services for short-sentenced prisoners. Reducing reoffending, at the same time as undertaking such a transformation of existing services, will be very challenging – and risk levels should reflect this.
- **The measure of reoffending must be changed to maximise impact on costs savings and crime, and to build sector support.** When the government is paying by results, the result really matters. As has been demonstrated by the Public Accounts Committee’s investigations into the Flexible New Deal and similar contracts, when people in the sector dispute the integrity or utility of a measure, or the social impact it purports to have made, it detracts from the way the policy is viewed and can discredit it in the eyes of the media and the public. So the binary measure of reoffending, measuring the proportion of offenders in a cohort who reoffend, must be abandoned. It commands almost no sector support (damaging the policy from the outset), and is not the best measure of reoffending in a PbR system for either reducing crime or reducing costs. Though there are a range of potential replacement options, we recommend a simple system of differential pricing (albeit retaining a binary measure) which will both cut crime and costs, and command sector support. It will also alleviate fears about ‘parking’ of hard cases and the ‘creaming’ of those who are easier to help.
- **An additional measure – representing system demand – should be introduced:** to make these reforms sustainable, the Ministry of Justice must examine measures of recidivism that are much more closely aligned to cost savings. If the Ministry of Justice wants to persuade the Treasury for new investment in this PbR programme, they should examine measures which directly incentivise reductions in demand (as in the recently commissioned Social Impact Bond in New York City’s Rikers Island prison). This would include reductions in re-incarceration of prisoners, and reductions in first-time entrants to custody at the front-end. In this way, they could achieve something similar to the ‘DEL:AME Switch’ achieved in the welfare-to-work market, where savings in the benefits bill are spent up-front on finding jobseekers work. In other words, a new measure would make the relationship between investment and savings more direct, transactional and precise.
- **Prisons in the public sector should be wrapped into PbR, including by setting an individual, establishment-level target for reducing reoffending.** There is a clear and substantial risk in these reforms that the public sector

prison service will become completely detached from the rest of the system, with little incentive to participate or cooperate. Policy Exchange believes a key goal for PbR should be to reform public sector working practices, culture and performance management. To drive cooperation and integration between public sector prison staff and private/voluntary sector PbR partners, prisons should be given a clear, individual target for reducing reoffending, appropriate to the circumstances of the prison. The lever of full prison competition should be retained for those prisons which do not cooperate with PbR providers. To cement this new incentive, we believe that Prison Governors should be paid by results, with bonus payments available to Governing Governors and other senior managers for success in reducing reoffending.

- **The voluntary sector should be encouraged to play their part.** The role of the voluntary sector as part of supply chains should be protected by the adoption of an accreditation process for a new standard for providers (such as the Merlin Standard in the welfare-to-work sector), which would protect small providers from unfair or exclusionary supply chain arrangements.
- **A learning culture should be fostered by the Ministry of Justice, and clarity provided about the evidence base for reducing reoffending.** As reoffending outcomes have never been delivered in this way or at this scale, delivery models (and contracts) should be deliberately flexible, recognising the fact that providers will likely need to make mid-course corrections and change their approaches regularly. Creating a learning culture is vitally important to the successful creation of this market. So a black box solution, where providers' delivery models are hidden from view or are otherwise opaque, would not be ideal. The optimum model for this market may be more of a 'perspex box', where best practice can be seen and spread to maximise learning, but providers' intellectual property, management information and data can be properly protected.

1

The Context

As part of the Coalition Agreement, the government committed to “introduce a ‘rehabilitation revolution’ that will pay independent providers to reduce reoffending, paid for by the savings this new approach will generate within the criminal justice system.”¹

The policy has its origins in the 2007 Conservative Party green paper on prison reform, *Prisons with a Purpose*.² It was adopted by the previous government through the establishment of a pilot in Peterborough by the Rt. Hon Jack Straw MP, just weeks before the 2010 General Election. Following the election, the Ministry of Justice’s 2010 departmental business plan contained a commitment to spread ‘the principles of payment-by-results’ across the criminal justice system by 2015.³

The approach of the previous Justice Secretary, Ken Clarke, had been to pilot PbR approaches in a number of areas up until the summer reshuffle in 2012.

However, his replacement, Chris Grayling, quickly decided to abandon this strategy – cancelling all pilots that had yet to begin, and instead looking to expand the use of PbR much more widely across England and Wales, without waiting for the results of the pilots.

The original strategy

The MoJ had been testing the use of payment-by-results through a series of pilots, as outlined in the green paper, *Breaking the Cycle*.⁴ Around twenty pilots had either begun or were in the process of being commissioned. These included:

- The Peterborough pilot (began in 2010)
- The HMP Doncaster pilot (began in 2010)
- Two planned probation pilots in Wales and the West Midlands (cancelled)
- Two planned prison pilots at HMP Leeds and HMP High Down (cancelled)
- Two pilots linked to the Department for Work and Pensions’ Work Programme in Wales and East Midlands (began in 2012)
- Two planned innovation pilots (cancelled)
- Five local authority justice reinvestment pilots in London and Manchester (began in 2011)
- Two youth justice reinvestment pathfinders (began in 2011)
- A number of drug recovery pilots led by the Department of Health (began in 2012)

These pilots were testing a number of different cohorts, operational arrangements, commercial models and outcome measurements. Key differences included:

1 The Coalition: Our programme for Government, Cabinet Office, May 2010 http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition_programme_for_government.pdf.

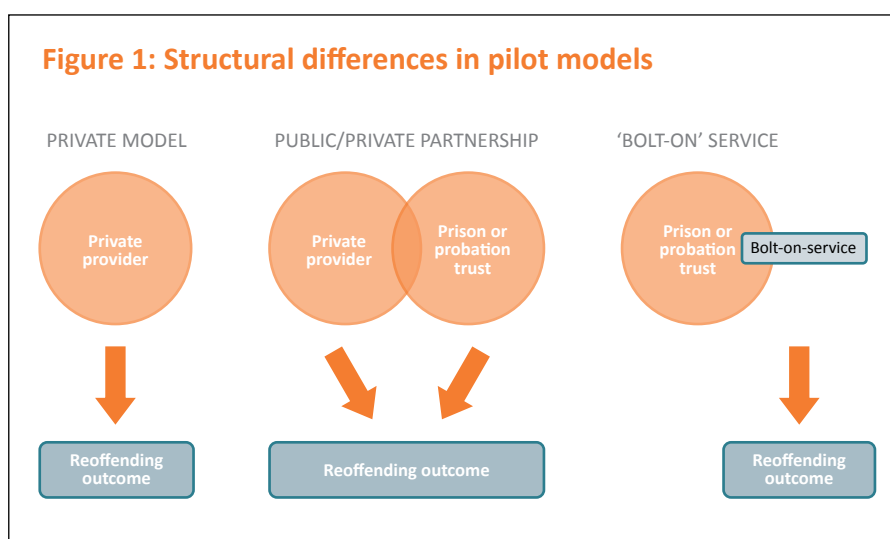
2 *Prisons with a Purpose: Our sentencing and rehabilitation revolution to break the cycle of crime*, Conservative Party green paper, March 2008.

3 Ministry of Justice Business Plan 2012–2015, Ministry of Justice <http://www.justice.gov.uk/downloads/publications/corporate-reports/MoJ/moj-2012-business-plan.pdf>.

4 *Breaking the Cycle: Effective Punishment, Rehabilitation and Sentencing of Offenders*, Ministry of Justice, December 2010 <http://www.justice.gov.uk/consultations/consultation-040311>.

Target group: different cohorts of offenders were to receive interventions in different pilots. Some projects focused only on those low and medium-risk offenders receiving community sentences; some included short-sentenced prisoners only (offenders sentenced to less than 12 months in custody); and other pilots included all inmates of a prison as eligible offenders.

Operational and commissioning model: some pilots were based on a pure outsourcing model (e.g. at private prison HMP Doncaster), where the whole offender journey was entirely managed by the private sector, with the provider paid according to outcomes; others were based on a public/private partnership (e.g. HMP Leeds), where new joint ventures would be set up and services jointly run, with risk transferred to the private sector; others were merely a bolt-on service (e.g. HMP Peterborough), where a narrow ‘reducing reoffending service’ would be added on to existing custodial delivery, with the provider of these specific services paid by results. In these models, different actors from the public, private and voluntary sector were variously responsible for delivering the outcome.



Commercial model: in part as a result of the different commissioning and operational models, the various pilots contained different commercial models. For example, the Doncaster model involved the provider (Serco) putting 10% of their annual contract price at risk in return for meeting a specified reoffending reduction outcome.

The public sector pilots sought to notionally transfer public sector staff into a new commercial vehicle, with the private sector guaranteeing some of these costs and receiving bonus payments for reducing reoffending.

Other pilots involve new delivery with no guaranteed income, with providers either being paid or not according to outcomes. Others included options for funds to be paid up front and then ‘clawed-back’ in the event of outcomes not being achieved, thereby providing working capital.

Outcome measurement: one pilot (HMP Peterborough) sought to measure reductions in the frequency of reoffending (how often re-offenders are reconvicted of new crimes), whereas the majority of other pilots involved paying

providers according to success in reducing the proportion of offenders who were reconvicted (the so-called ‘binary measure’).

Some pilots (e.g. the Work Programme pilots) compare one provider’s performance with a control group of offenders which receives no additional interventions, in the same area. Other pilots compare reductions to a cohort’s predicted rate, using matched offender characteristic profiles to ensure a fair comparison can be made; others sought to measure statistical significance based on an analysis of the fluctuations in reoffending rates over a historical period.

The sheer complexity of the possible operational, commercial and legal options inherent in any of these models meant that a period of experimentation was a good idea. However, a lack of clear strategy for experimentation and failures of implementation meant that the pilots began to become a barrier, rather than an enabler, of expansion.

Support for the pilots ebbs away

By mid-2011, pilots at Peterborough, HMP Doncaster and the justice reinvestment pilots in London and Manchester had begun, and the next wave of new pilots outlined in *Breaking the Cycle* were beginning to be commissioned. However, just a year later, the decision was made to expand PbR across England and Wales without pursuing the remaining pilots and without waiting for pilot results. There are a number of reasons why Policy Exchange believes that this was the right decision.

No clear strategy for the pilots

In principle, pilots could have provided valuable intelligence to inform a future roll-out, but a lack of strategic focus and certainty about a post-pilots plan caused support for the planned pilots to gradually ebb away. Useful intelligence gleaned as from the pilots could have included:

- which agencies in the criminal justice system were most responsive to PbR incentives (i.e. where in the system PbR should be rolled out);
- for which groups of offenders a PbR approach was most beneficial;
- at what price to set a future tariff for offenders to ensure MoJ achieves value for money;
- new evidence about the level and type of reoffending reductions which are achievable;
- evidence about gaming or other perverse behaviours driven by PbR;
- the impact on delivery models of different incentive mechanisms and different kinds of providers;
- evidence about market readiness and capacity;
- insight into procurement methodologies necessary to go to scale and the approach MoJ procurement would need to take;
- better understanding of how to specify PbR services; and
- the size and potential of the investment market;

However, the specific characteristics of the different projects were not tied to any of this, nor to any plan for roll-out of payment-by-results – just an ambiguous commitment to spread ‘the principles’ of PbR. This appeared to cause officials and politicians to be unclear about why different aspects were being tested, and to what end.

As a result of the lack of strategic focus, the pilots were all so disparately configured that it would have been extremely difficult, if not impossible, to evaluate and compare them usefully, or learn lessons for the future.

In addition, providers (who were being encouraged to bid for PbR projects) were given no certainty about the prospect of future roll-out; expanding ‘the principles’ of PbR could have meant anything from full roll-out of PbR models in the private and voluntary sectors (similar to the national Work Programme scheme) to a minimalist application of ‘best practice’ delivery models for reducing reoffending throughout the public sector. This lack of certainty about key strategic questions compounded the procurement problems that hampered the development of many pilots (see below).

“The fact that ‘new money’ was being used to fund the pilot programme, instead of utilising the existing budgets of prisons and probation, meant that the planned pilots were unlikely to represent viable roll-out models”

Pilots were being commissioned with ‘new money’, not existing budgets

The majority of the pilots were funded (or due to be funded) completely from a new pot of money earmarked specifically for the pilot programme, including additional funds over and above the budget of the prison or probation trust involved.

To take just one example, the pilot at HMP Leeds had a maximum value of around £1.25 million per year, or £6m over the four years of the pilot – all on top of the prison’s existing budget.⁵ Scaled up, this would mean that expanding a PbR model to all prisons in England and Wales would cost well over £150 million a year. Applying PbR to community provision would, in the same way, have loaded new costs into that system too.

The fact that ‘new money’ was being used to fund the pilot programme, instead of utilising the existing budgets of prisons and probation, meant that the planned pilots were unlikely to represent viable roll-out models. Additionally, this encouraged the perception that PbR was an ‘add-on’ – doing little to challenge ingrained public sector approaches or culture.

Timescales would have caused the PbR agenda to drift, or even be lost altogether

Most of the newly-commissioned pilots would not have produced results for the first year of delivery until well after the next general election. This is because, due to the way that reoffending is measured, there is a 34 month time lag from the beginning of delivery until the first results – comprising of:

- a 12 month period in which to build up a full cohort of offenders;
- a 12 month period in which those offenders might reoffend;
- a 6 month period in which an offender could be reconvicted of crimes committed in the previous year; and
- a 4 month period in which to verify conviction data on the Police National Computer.⁶

Add to this a 3 to 6 month implementation period before ‘go-live’ and a protracted procurement process, and many of the first year results may not have

⁵ Information obtained as part of discussions with commissioners and providers.

⁶ Information obtained as part of discussions with commissioners and providers.

been available until 2017 at the earliest, with the full evaluation of the four-year pilots unavailable until after 2020.

Given these timescales, there was a clear danger that the PbR agenda – a flagship policy and a vehicle with the potential to transform the criminal justice system – could drift aimlessly for many years, and most likely be lost altogether as momentum and political support evaporated.

Procurement challenges beset the pilot programme

Some of the models being pursued for the pilot programme were so complex, and so new to commissioners, that it was inevitably very difficult to get the procurement right. NOMS (and the providers) was being asked to do a very difficult job: not only was there no real roadmap for procuring these pilots, but there was also a series of difficult ‘red lines’ drawn by Ministers which meant that the process was always likely to be problematic.

For example, the HMP Leeds PbR pilot procurement ended in market failure, as all providers pulled out of the running having refused to sign up to the commercial model being pursued by NOMS, due to its level of financial risk and the low level of operational control available to providers. Other pilots such as the Wales and West Midlands community pilots, and the innovation pilots, were in development for around 12 months, with no end date for procurement, or start date for delivery, in sight.

To put the complexity and procurement challenge into context: while NOMS had struggled to procure eight relatively small pilots worth around £50 million⁷ over a twelve month period, eight prisons, with contracts valued at around £2 billion, were successfully put out to competition by NOMS in the same period.

Key procurement challenges included:

- **Complex propositions:** the design of the pilots underlined quite how detached the PbR policy had become from the original, relatively simple aims. For example, the HMP Leeds pilot involved establishing a joint venture between public and private sector, with a new company jointly running a particular wing within HMP Leeds and a through-the-gate service in West Yorkshire. This kind of model was always likely to cause a plethora of operational, commercial and legal challenges.
- **Unrealistic and inflexible commercial models:** Ministers insisted that providers would be paid no money at all if statistically significant reoffending reductions were not delivered. In practice, this meant a provider could be paid £1 million for achieving a 5% reduction in reoffending, but be paid nothing at all for a 4.9% reduction.

This kind of commercial model proved to be extremely unrealistic, especially when market confidence and knowledge was (and remains) inevitably low because reoffending outcomes on the scale demanded by MoJ have never been delivered before. The ‘cliff-edge’ created also takes no account of the fact that there will be similar cost savings for the MoJ above and below the statistically significant target (5% in this example). However, NOMS was seemingly unable to offer flexibility on key commercial and legal issues – apparently because of the overall constraints of the policy set by Ministers.

⁷ Information obtained as part of discussions with commissioners and providers.

Table 1: Example commercial model

Reoffending reduction	Payment	Provider profit/loss	Savings to MoJ
4.8%	£0	-£900,000	?
4.9%	£0	-£900,000	?
5.0%	£1,000,000	+£100,000	?
5.1%	£1,100,000	+£200,000	?

- **Market engagement and co-design:** NOMS has conceded as part of its most recent market engagement exercises that although there was a good degree of co-design and engagement with providers, it was perhaps insufficient in meeting the new challenges generated by the new models. The complexity generated, combined with the level of risk that providers were being asked to take, demands an approach to procurement which is genuinely two-way, with much more dialogue, cooperation and flexibility.

Despite the protracted nature of some of the procurement exercises, and the fact that key pilots were unable to begin, the time and effort spent in navigating these complex issues was undoubtedly not wasted and should not be viewed as a failure. There was an enormous amount of learning that has been captured by commissioners and providers, and some very clear conclusions reached about the future direction of the policy.

A new direction for payment-by-results

The appointment of a new Ministerial team at the Ministry of Justice has come at a crucial time. The fact that the pilots were proving hard to secure, coupled with a recognition that the policy of payment-by-results in criminal justice would likely have lost momentum and even disappeared completely, meant that it was sensible for the new team to reflect on the implementation of the policy so far, and to consider how its principles could be applied to maintain momentum and deliver the much-vaunted rehabilitation revolution.

If all of the pilots had been eventually secured and had begun delivery (albeit most likely through a revised commercial model), the major thing that policymakers would actually have been waiting for is the first set of reoffending results of the first year cohorts (in 2016/17 at the earliest).

However, the precise level of reoffending reductions achieved would not and should not materially affect, at a policy level, how payment-by-results is rolled-out nationally; the fact that one pilot might have achieved a better outcome than another in five years time is, in fact, largely irrelevant to strategic decisions about the structure of roll-out. The fundamental structural issues – such as which agencies to incentivise, how to set tariffs, determining the commercial and legal models – have all been tested to destruction as part of the procurement processes.

The Ministry of Justice now has a considerable amount of intelligence and experience, obtained through market engagement (and some early pilot delivery) about how to implement this policy – and a set of clear challenges, choices and risks to carefully navigate as it does so.

2

Choices

This section sets out some clear choices facing policymakers in the Ministry of Justice about how to expand payment-by-results. The main decisions relate to:

- How to fund PbR expansion
- Who to include in a PbR system
- How to pay under a PbR system (i.e. the commercial model)
- How to measure PbR outcomes (i.e. the measure of reoffending)
- How to integrate PbR delivery
- How to procure and manage the scheme

Fundamentally, many of the choices can only be determined with reference to the overarching purpose of the PbR policy. Is PbR intended to cut the number of crimes committed by offenders, or to cut the costs of those crimes incurred by the state? Is it a scheme for attracting additional investment into the criminal justice system to reduce demand (a so-called justice reinvestment approach), or simply a method for getting greater value out of existing, declining budgets? Or do policymakers see the real prize of PbR as being culture change – and the creation of an outcome-focused and more integrated criminal justice system?

In reality, the answer should be a combination of all these – but we believe policymakers must, in the aftermath of the pilot phase, go back to first principles and decide what weight to give to these often competing aims.

How to fund

How the Ministry of Justice chooses to fund PbR expansion will have significant consequences for the implementation of the policy, including the structure of the commissioning model, the shape of the commercial model and the detail of both the payments and the results.

New investment

Originally, it was intended that PbR be funded through the savings captured upstream as a result of the policy, as stated in the Coalition Agreement. This approach would mirror the way that the Work Programme is funded by the Department for Work and Pensions, using the principle of the ‘DEL:AME Switch’, whereby if a provider succeeds in getting someone a job, the net savings in the benefits bill is used to reward the success.

Implementing payment-by-results in this manner in the criminal justice system is more complicated because the savings are more opaque and less transactional in nature (see below). In order to replicate the DEL:AME Switch approach, policymakers (and the Treasury) would need to be confident that:

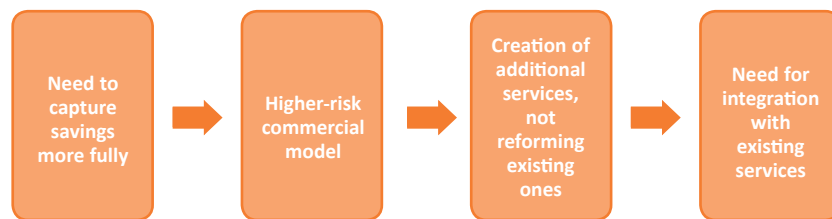
- **There was a direct link between the measurement and the associated avoided costs:** the system would have to be devised with cost-savings very clearly intended as a consequence of the result, e.g. savings in benefit bills.
- **Reductions in demand could be directly attributed to the providers' interventions:** this would ensure that the reductions would not have happened anyway, without the additional investment.
- **Savings were capable of being captured:** projected savings in the criminal justice context are notoriously 'lumpy' and non-linear, making them hard to capture properly. It is only at the point of closing down whole prisons and courts that significant savings can be released.
- **Savings were, indeed, captured:** some in the Ministry of Justice (and more widely) worry that even if reoffending was reduced to such an extent that a large amount of offenders avoided prison, the demand on the system might be replaced by other offenders, who are currently avoiding apprehension, prosecution or incarceration. Alternatively, so the argument goes, judges would simply fill the available places through tougher sentencing.

As currently constituted, we do not yet know if PbR will produce the kind of cashable, net savings required to fund the policy up-front. Indeed, while the ongoing pilots may eventually produce some evidence about savings, they will not do so in time for the national scheme.

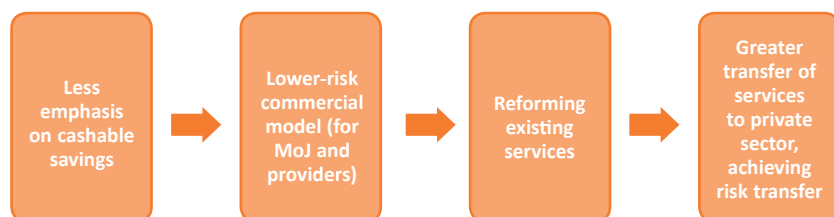
In any case, the majority of the pilots have not been set up with cash savings in mind. For example, the measurement of the pilots is invariably focused around either the frequency or proportion of reconvictions of a cohort of offenders. As described in more depth below, this is not the best method to use if a reduction in overall demand on the criminal justice system is the primary goal.

The scaling of PbR, and the expansion of a scheme across England and Wales, certainly offers a big opportunity to rethink the funding model; operating at scale, it is possible that large, cashable savings could be produced, with consequent reductions in the prison population, court and legal aid costs, and probation caseloads. An investment case along these lines would certainly warrant examination from the Treasury, but it must be preceded by a rethink from the Ministry of Justice about the measurement of results – and the inclusion of measures which focus on system demand and re-incarceration levels, not simply reconviction in court.

Naturally, using new money will also likely create the need for a higher-risk commercial model, itself more directly linked to cashable savings. Funding in this way is also likely to lead to the creation of new 'value-add' services, rather than encourage reform of existing prison, probation and other community services. The diagram below summarises the impact of utilising new money to fund PbR expansion.

Figure 2: The impact of investing new money to fund PbR expansion**Existing budgets**

Given the lack of certainty over cashable savings, there is a strong argument that PbR must be funded through existing budgets – at least initially. This would mean a stronger focus on better outcomes, even with declining budgets – desirable in any case, given the £4 billion annual expenditure on prisons and probation.

Figure 3: The impact of utilising existing budgets to fund PbR expansion

As this diagram demonstrates, funding PbR predominantly out of existing budgets will not only ensure that the policy can be rolled-out nationally without huge additional investment, it will also help to mitigate some of the commercial issues generated throughout the pilot procurement: if there is no new money at stake and the focus is on achieving better outcomes within existing (albeit, declining) envelopes, there is no longer any impetus or requirement for the aggressive, ‘cliff-edge’ commercial models which have been pursued so far.

Using existing budgets also has consequences for the public sector, which cannot easily be subject to payment-by-results principles. The vast majority of existing prison and probation delivery sits within the public sector, but payment-by-results demands that financial risk be transferred to the private sector. Squaring this circle – where delivery sits with the public sector, but financial consequences are borne by a private sector partner – was hugely challenging in the cases of HMP Leeds, Staffordshire and West Midlands Probation Trust, and Wales Probation.⁸ Asking providers to take significant financial risk, but not allowing them to manage the staff delivering the outcomes, is prohibitive to these sorts of investment decisions.

⁸ Private interview.

Commissioners and providers have been simply unable to achieve the necessary balance between the level of risk borne by the providers, and the commensurate level of operational control that would be required by the private sector. It may follow that if the Ministry of Justice decides to fund PbR out of existing budgets, greater privatisation of services is the natural consequence.

Who to target

The issue of which offenders to include for PbR services depends very much on what problem policymakers are trying to solve. At the moment, the plan outlined in the government's response to the Probation Review is to focus the policy on offenders sentenced to less than twelve months in prison and those on community sentences.

Short-sentenced offenders

There is a clear provision gap for this cohort, as the majority currently receive no probation support (unless they are aged between 18 and 21). There is also a clear *prima facie* rationale for their inclusion in PbR delivery, as the reoffending rates for this group are much higher than for other prisoners on community or longer prison sentences. This vicious cycle has created a so-called 'revolving door', with people regularly cycling in and out of prison, little time or opportunity for rehabilitation in custody, and offenders falling through the cracks of what support is available in the community, once released.

However, short-sentenced offenders may not constitute the optimal cohort for PbR from a cost savings perspective. Around 70,000 short-sentenced prisoners are released every year, but because of their short stay in custody, they make up only around 8,000 prison places at any one time.⁹ Reducing the reoffending rates of this cohort may not produce huge cashable savings (discussed further below) proportionate to the effort involved to turn around so many offenders' lives.

However, it should be noted that due to the high turnover of places, there are additional and disproportionate costs for processing these offenders on reception to, and discharge from, custody. Identifying savings in these areas is straightforward in principle, but it is much more difficult to concentrate any savings in order to make them cashable (i.e. a 5% reduction in short sentenced prisoners across the estate only gives the Ministry of Justice a cashable saving if you can concentrate the reduction in capacity in one or two places).

Of course, as short-sentenced prisoners currently receive no statutory supervision on release from prison, extending services to them will necessitate significant additional expenditure.

Mandatory support for short-sentenced offenders

There is another crucial question about whether support from the PbR provider for this cohort should be mandatory for the offender. On the one hand, mandatory support would give providers some levers for ensuring contact with offenders on release (if the compulsion could be coupled with useful penalties for non-compliance). It would, in other words, 'get people through the door'.

However, mandating support is unlikely to be the best way for providers to engage with this often chaotic and hard-to-reach client group. The evidence from similar schemes, such as in Peterborough, indicates that providers need to

⁹ Analysis using prison population data and average sentence lengths.

spend their time dealing with those who are ready to be engaged and willing to be helped.

Compulsory support may also severely restrict providers' freedom to innovate and prioritise where the allocation of resources across a cohort; the task of reducing reoffending would be skewed towards enforcement rather than rehabilitation (the currently neglected side of the coin).

Additionally, given that the obvious tool for dealing with non-compliance would simply be a return to custody, mandating support may simply further damage the offenders' chances of success, and further drive up costs in the criminal justice system.

A statutory requirement, as outlined in the consultation, would also severely complicate the implementation of the new contracts – making any phasing additionally complicated, given the need for a clear-cut change in sentencing. Providers would have to contend with people being released from prisons who were not compelled to be supervised by the PbR provider at the same time as offenders were released from the same prisons with mandatory supervision requirements.

Community-sentenced offenders

There is a strong argument for including these offenders in the scope of a national PbR scheme. Reoffending rates for those sentenced in the community have remained relatively static for the last decade and, although it is not always a linear process, it is with these offenders that a progression to a more expensive prison sentence might be avoided.

Proposals were put forward as part of the planned probation pilots in Wales and Staffordshire and West Midlands to exclude high-risk offenders from the scope of payment-by-results, and to continue to manage these offenders in conjunction with the police and other local agencies, in line with Multi-Agency Public Protection Arrangements (MAPPA) and Integrated Offender Management (IOM) procedures.

Policy Exchange believes there is a reasonable case for retaining a small number of high-risk offenders within these arrangements – but nothing like the 1/3 of offenders proposed by probation trusts as part of some of the pilots. The vast majority of offenders are suitable for PbR provision; in reality, it is only the very high risk (Tier 4) or MAPPA cases where retention may be arguable.

Clearly, risk is dynamic and can change over time, so the interface between the PbR provider and the probation trust needs to be excellently managed, with clear lines of communication and robust working practices. The Ministry of Justice also needs to ensure there are no perverse incentives on either side, particularly with those charged with assessing risk (i.e. the probation service).

Short-sentenced offenders and community-sentenced offenders

The reason the government appears to have decided to focus on these two groups for PbR delivery is that policymakers believe that the tools for reducing the reoffending rates of both these groups lie in the community setting. Short-sentenced offenders invariably re-offend because they cannot access key services on release from prison – and there is little time to address their offending behaviour in a short custodial stay.

It makes sense for the same provider and supply chain to be working to reduce the reoffending of both groups in the community simultaneously.

Longer-sentenced prisoners (12 months to 4 years)

At present, longer-sentenced prisoners appear to be excluded from the PbR roll-out. Clearly, for these offenders, who will be released on licence, what happens in the custodial setting is much more relevant to their reoffending rates, with much more time for rehabilitation to address addiction, attitude and employability issues.

Wrapping the prison system into PbR is more difficult than in the community setting and is complicated somewhat by the Ministry of Justice's recent announcement of an end to the competition of prison management, which would have been one way to facilitate PbR expansion.

However, Policy Exchange believes it would be a missed opportunity not to include longer-sentenced prisoners (with the exclusion of those more serious offenders serving over four years) in some way. The reoffending of this cohort is extremely costly: whilst the reoffending rates for prisoners fall as sentences get longer, when a long-sentenced prisoner reoffends, they will be more likely to receive a long prison sentence – either because they are involved in serious criminality, or because of their persistent offending. This means that this cohort's recidivism is a key driver of system demand.

Due to the transient nature of the prisoner journey, involving a multitude of transfers to different establishments often all over the country, it will not be appropriate for the PbR provider (see below) to deliver in-custody services to these offenders to any significant degree. However, it would make sense for the PbR provider to provide post-custodial supervision of these offenders. This would ensure that there are not two parallel, fragmented systems in the public and private sector providing post-custodial services.

The responsibility of the individual prisons is discussed further below, in the section on integration.

Which organisations to involve

The next choice is which agencies or organisations should be involved in PbR provision and how they should be included as part of the commissioning model. As outlined above, Policy Exchange believes there is a strong argument for involving all offenders in custody and community, except very high-risk cases. However, the way different organisations should be involved may differ.

Probation

The analysis above demonstrates that many of the tools necessary for reducing the reoffending of the target groups of offenders lie in the community. It also concludes that if PbR is to be funded wholly or mainly through existing budgets (rather than new provision being 'bolted-on' to existing services), the inevitable conclusion is that parts of probation delivery will need to be transferred to the private sector to secure the necessary risk transfer.

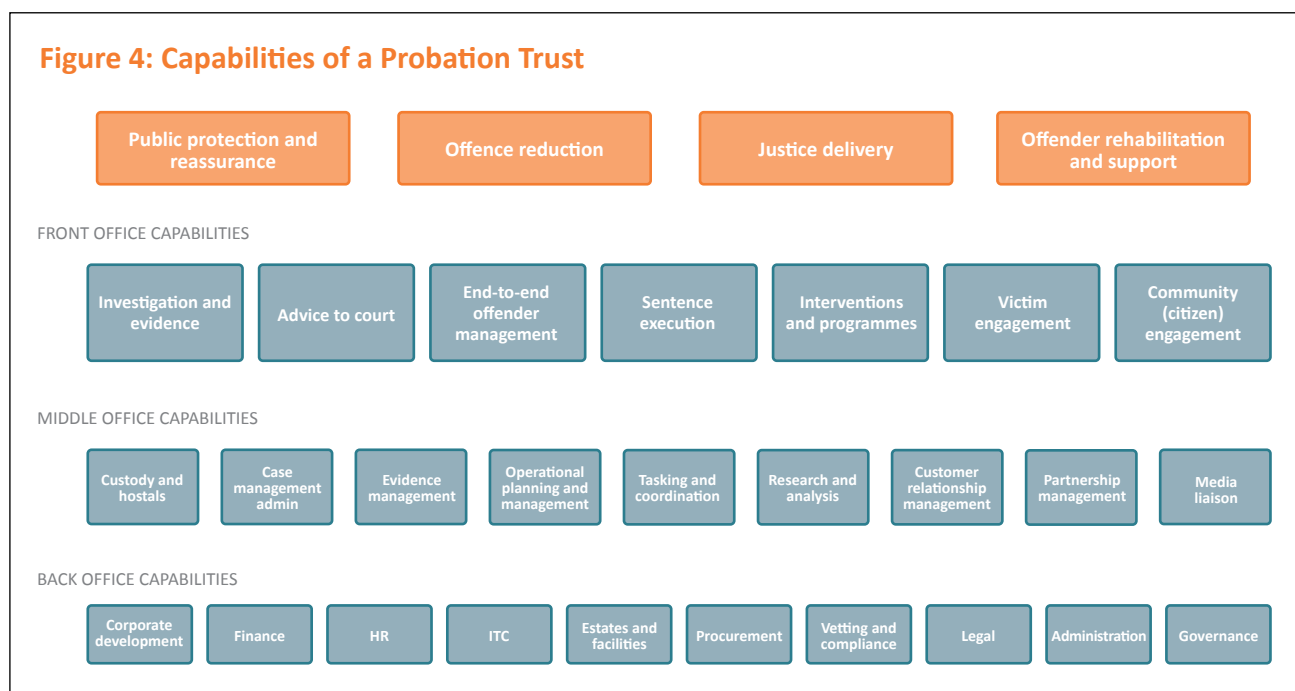
Introducing competition to elements of probation will also deliver substantial efficiencies by itself, which could be invested in new provision for the short-sentenced prisoner cohort. The only element of probation that has been competed is Community Payback delivery in London, in 2011. As part of this competition, the new private provider, Serco, will now deliver the service for around 60% of the costs incurred in the public sector.¹⁰ This demonstrates

¹⁰ Conversations with providers and commissioners.

the scale of funds that could be released from the £1 billion expenditure on offender services in the community.

There are many in the criminal justice system who would also argue that much greater competition in the probation system – one of the last public sector monopolies – is long overdue, and will help to change the culture, management and performance of an unreformed system that has never felt the pressure of contestability, with plans for greater use of the private and voluntary sectors (dating back to 2004 and even earlier) never materialising. However, the government should not underestimate the level of opposition that plans for greater competition will generate, as seen in other heavily-unionised sectors.

Figure 4: Capabilities of a Probation Trust



Determining which parts of probation to include in scope of the procurement for PbR will be important. As organisations bearing financial risk, it is essential that providers be given control of the end-to-end management of offenders to enable them to reduce reoffending. Providers must control the types and sequencing of interventions received by offenders and, as far as possible, should be responsible for case managing them and ‘owning’ the relationship. Indeed, it is only investigation and advice to court where there is a strong argument for exclusion.

While the public sector probation service should retain responsibility for the highest-risk individuals, many of the front-line roles of probation staff should transfer to the private sector, along with the infrastructure required to support them. This will ensure that costs are not duplicated, with two separate suites of support functions.

At present, no matter what the size of each trust, each supplies its own, stand alone, back and middle office functions. As a result, it is no surprise that more than one in four probation employees works in a support function. Based on the overall budget for probation, and the cost of individual trust infrastructure,

middle and back office functions represent costs of an estimated £160–200 million per annum.¹¹ Policy Exchange believes that significant resources could be freed up in these areas and re-invested in provision to reduce reoffending.

Back and middle office functions should be included as part of the PbR programme. If the PbR programme and outsourcing of other probation functions can be pursued as part of the procurement process, it would make sense for service providers to partner with business process outsourcing (BPO) providers to form consortia where appropriate alongside the inevitable reduction in the number of probation trusts.

Including these services and encouraging these partnerships will maximise the resources which can be directed towards achieving the outcomes, and will also ensure that services do not become fragmented – with providers not being overly-reliant on the remaining probation functions.

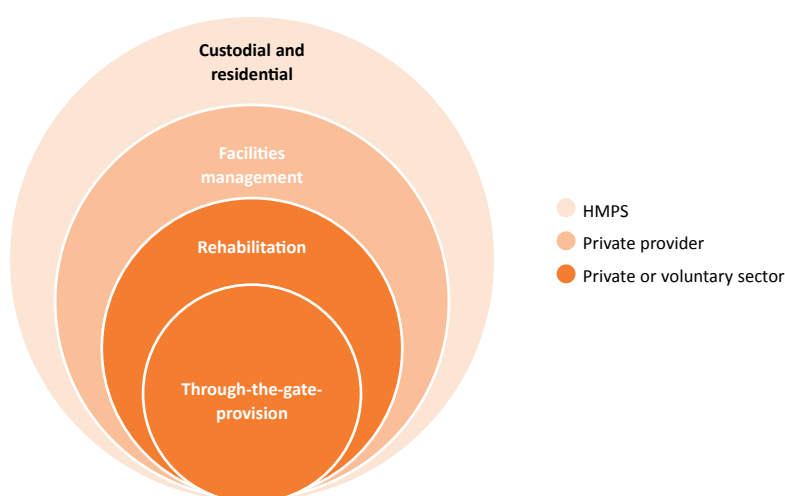
Prisons

Policy Exchange believes that reforming the prison system should be a key part of these reforms, and that the dependencies between on prisons for the PbR provider make this an absolute necessity.

The government has announced that in the future, the management of prisons will not be competed – a reversal of the rolling programme of prison competition outlined in the Ministry of Justice’s 2010 Competition Strategy.

The Ministry of Justice appears to have adopted the so-called French Model of prison management, whereby a range of providers would deliver different elements of custodial services.¹² Prison security and residential services would be provided by the public sector’s Her Majesty’s Prison Service (HMPS), with facilities management (maintenance, construction, catering etc) provided by the private sector. Resettlement and rehabilitation services would also be carved out and managed by the private and voluntary sector. It is as part of this partnership model that an opportunity for expanding payment-by-results into the prisons system presents itself.

Figure 5: French model of custodial delivery



¹¹ Private interview.

¹² <http://www.justice.gov.uk/news/press-releases/moj/next-steps-for-prison-competition>.

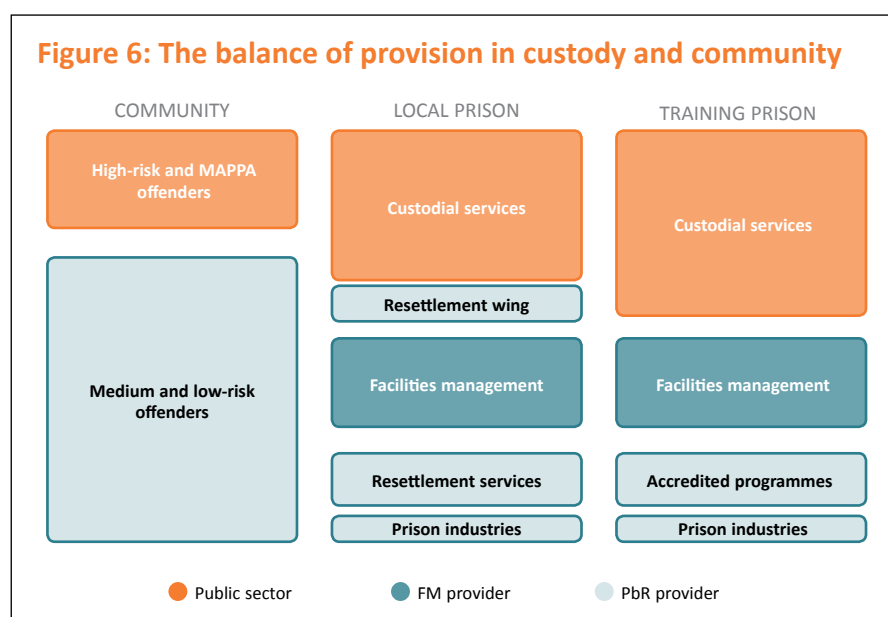
If indeed the Ministry of Justice does pursue the so-called French Model, the contracting out of the rehabilitation and resettlement (or so-called ‘through-the-gate’) provision within local prisons potentially represents a natural vehicle for payment-by-results. The budgets within local prisons currently earmarked for this activity could be combined with the community budgets discussed above to create a single rehabilitation fund. This would drive coherence and proper coordination of resettlement and community services, something which is currently sorely lacking in many establishments. This should include the Offender Learning and Skills Service (OLASS) budgets, which provide educational and vocational services in prisons. Putting the PbR provider in control of this suite of services will dramatically enhance their ability to impact on reoffending outcomes.

There are questions about whether charities and trusts, which provide some rehabilitation services at low or no-cost, would begin to withdraw in-prison services, or begin to charge for them, if this were to happen. Negotiations would be required at a local level to manage the transition and the main custodial budget would, nevertheless, provide reasonable funds (perhaps 3–5% of each prison’s budget) for PbR delivery.

The Ministry of Justice could decide to go further, especially in local prisons which will release the vast bulk of short-sentenced prisoners. PbR providers could even be given control of a bespoke Resettlement Wing, into which prisoners about to be released into their area would be funnelled, to ensure that they are sufficiently prepared for release and that engagement with mentors and case managers can have usefully started. This would build on the model put forward by HMP Leeds as part of the PbR pilots

In prisons where prisoners are serving longer sentences, the PbR provider could provide the Accredited Programmes (e.g. Sex Offender Treatment Programmes, Cognitive Behavioural Programmes, etc.) received by offenders, and could look to provide prison work – finding employers who would be willing to employ offenders on release from prison, as well as inside the establishment.

The split of services in the community and in the custodial environment would operate like this:

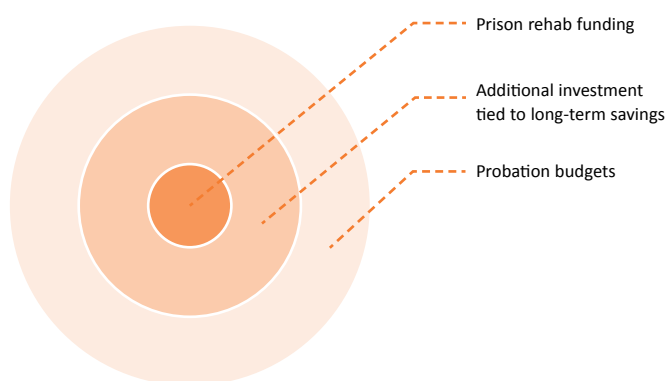


While using the custodial budgets of prisons to provide rehabilitation services in this way would bolster the size of the overall budget for PbR expansion, it would leave unanswered significant questions about how to integrate the incentives of the public sector – which manages the establishments and control access to prisoners, and the private sector – burdened with the task of improved outcomes, but without the requisite degree of operational control. Mitigating this issue is examined more closely in the section below on integration.

The introduction of payment-by-results also provides a unique opportunity to think creatively about prison population management. Each contract package area (CPA) could be allocated a specific number of prisons, including local prisons, training prisons and open prisons, serving local offenders on sentences of less than four years. The PbR provider would provide community sentences, limited in-custody services, and post-release support for all offenders, and be subject to an area-wide reducing reoffending target.

If resettlement and rehabilitation funds could be horizontally commissioned as part of the PbR expansion, the fund could be ‘topped-up’ further with additional investment from the Ministry of Justice, if a measure could be tied more directly to financial savings, or tied to a plan to disinvest in capital programmes such as prison building. The potential for such a measure is also discussed further below, in the section on measurement.

Figure 7: The possible make-up of a combined Rehabilitation and Resettlement Fund



How to pay

The procurement of PbR programmes is notoriously difficult and, given the political impetus behind these reforms and the desire to expand PbR quickly (with results before 2015), finding a balanced and appropriate commercial model will be absolutely crucial to getting the scheme up and running.

It is clear that, during the pilot phase, the Ministry of Justice had unrealistic expectations about the level of financial risk that the market could be asked to bear in PbR scenarios. Some of the prohibitive features of the previous commercial models are outlined below:

‘Cliff-edge’ payment mechanism

Providers were set a statistically significant reoffending target (e.g. a 5.0% reduction), based on an analysis of historical fluctuations in reoffending rates in the area, or at the establishment, for the cohort.

The provider would deliver services and meet the costs of delivering those services, but would only be paid if the target was met 34 months later when it was possible to measure success against the target. If the reoffending rate was only reduced by 4.9%, the provider would be paid nothing. This meant there was no guaranteed income for the provider, and everything is at risk. This not only meant there was a long gap between investment and return, but also created difficulties for providers because they would not have known whether their interventions were working until it was too late to affect the outcome.

Over a four year contract, this meant that just one single year where the target is missed will create a loss-making contract, with no prospect of ever breaking even.

As described earlier, this ‘cliff-edge’ payment structure was driven in large part by the fact that the pilots were being commissioned with ‘new money’, which necessitated that payments could not be made for so-called ‘failure’.

It may also have been driven by the fact that the Ministry of Justice was indeed able to secure one major pilot that was based on this kind of commercial model. The Peterborough Social Impact Bond pilot pays the investors in the project only if a minimum 7.5% reduction in the frequency of reoffending is achieved. As this was the first PbR pilot in this field, this may have indicated that such a model was reasonable and appropriate in the circumstances, and demonstrated the kind of risk profile suitable for the market conditions. However, a very similar, recently-commissioned project in New York underlines quite how wrong this assumption is.

In August, the City of New York, Bloomberg Philanthropies, Goldman Sachs and MDRC announced the commencement of the United States’ first Social Impact Bond (SIB). The project, aiming to reduce re-incarceration of young men held at Rikers Island prison, bears striking similarities to the Peterborough Social Impact Bond, but also contains key differences which perhaps illustrate why Peterborough should be disregarded as a commercial model prototype.

- In New York, Goldman Sachs is the investor, whereas in Peterborough funding was provided by grant-making trusts and foundations.
- A large part of Goldman Sachs’ investment (a \$9.6 million loan) is guaranteed by a (\$7.2 million) grant from the Bloomberg Fund, substantially reducing the lender’s risk.¹³
- It is also significant that if the project fails to reduce reincarceration by the statistically significant target, but still reduces reincarceration overall, the investors still receive a payment of \$4.8 million, or 50% of their original investment.¹⁴ This effectively acts as guaranteed income, and coupled with the Bloomberg Fund grant, substantially de-risks the proposition.
- Incredibly, the New York model will also pay Goldman Sachs for the entire four years’ delivery based solely on the first year’s outcomes – with the same outcome projected for the following three years.¹⁵ This not only substantially cuts down the time taken for repayment of the loan, but also provides the opportunity to disinvest and abandon the project if outcomes are not delivered in Year 1. Again, this dramatically reduces the investor’s financial exposure.¹⁶

¹³ Information provided by Goldman Sachs.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

The level of protection demanded by Goldman Sachs clearly reflects the high-risk nature of the delivery: projects such as this are very new, and outcomes on this kind of scale have never been delivered before.

The substantial protections secured in New York contrast starkly with the Peterborough model, where no guaranteed income protections are built in to the commercial model. One reason might be that, as charitable investors, there was less commercial impetus for receiving a return during the negotiations for Peterborough. This should be borne in mind by the Ministry of Justice, especially considering the fact that it is mainly private companies, not trusts or foundations, who will be providing investment to fund PbR delivery. In other words, propositions such as the one at Peterborough are unlikely to stand up to the rigours of commercial investment decisions.

It should be pointed out that there are other kinds of protections built into the Peterborough model by Social Finance (the intermediaries) and the Ministry of Justice to maximise the chances of the investors seeing a return, including the option to allow providers to receive reconciled payments at the end of the project if the average reduction meets the target, even if some in-year targets are missed.¹⁷ However, it is precisely these sorts of protections that the Ministry of Justice subsequently sought to disallow as part of the second wave of pilots.

Whatever the reason for the differences, it is clear that a model with a cliff-edge payment structure, no guaranteed income and no room for flexibility is likely to lead to market failure and long delays to the roll-out of this policy.

“It is clear that a model with a cliff-edge payment structure, no guaranteed income and no room for flexibility is likely to lead to market failure and long delays to the roll-out of this policy”

Liabilities without control of assets

The planned pilots involving the public sector (as the PbR roll-out also will) sought to achieve the transfer of financial risk without giving the private provider the requisite control of the staff or infrastructure. At HMP Leeds, the prison staff in the proposed model were not even intended to be seconded, let alone transferred, to the new commercial entity, yet the providers were asked to guarantee the costs of their salaries in the event of the reoffending reductions not being achieved. The issue of how to manage public sector staff in a situation where the totality of risk has been transferred was never reconciled in negotiation and led to market failure in this instance.

New commercial vehicles

The same pilots demanded that new companies be set up, with joint governance between NOMS and the private provider. These caused all sorts of complex legal negotiations during procurement about voting rights, assets and accounting, but also caused problems for providers in terms of making the case internally for investment in the projects. This is because the use of new commercial vehicles can cause difficulties in terms of additional set-up and running costs, the appointment of directors (and potential conflicts of interest) and tax efficiency.¹⁸ Above all, new vehicles added extra complexity to an already challenging commercial proposition.

¹⁷ Private interview.

¹⁸ Information obtained as part of discussions with commissioners and providers.

Targets without reference to cost savings

So far, the Ministry of Justice has set baselines by examining fluctuations in the historical reoffending rates of the cohort in question (e.g. the last eight years' worth of reoffending data at a particular prison, controlled for changes in offender characteristics), and setting a reoffending target which represents a statistically significant deviation from these fluctuations. However, this methodology a) presumes that there has been no change in the delivery of services within the prison/probation trust in the period, and b) takes no account of the fact that there will be cost savings for the Ministry of Justice even before the point of statistical significance.

This methodology also drives the cliff-edge commercial model, as any outcome which does not meet the statistical significance point is deemed to be 'failure'. While this kind of certainty about the attribution of the outcome to the intervention to the provider might be welcomed by the National Audit Office, it is not helpful when policymakers are trying to build a market for rehabilitative services.

Devising a new commercial model

An appropriate commercial model will provide a good balance between financial risk and potential reward. It should also protect the Ministry of Justice's position and reflect their overall exposure, relative to the status quo.

It should also take account of the new features of the commercial proposition. For example, probation outsourcing is now a critical component of the model, adding a new dimension to the previous commercial parameters.

The government is now planning to:

- a) outsource a large part of the probation service;
- b) use some of the substantial efficiencies generated to create new provision for short-sentenced prisoners; and
- c) to pay by results for improvements in reoffending for community-sentenced prisoners and all prisoners;
- d) do all of this at a much larger scale than in the pilots.

We believe that these new features will inevitably mean that the commercial model will be procured with arrangements far more akin to traditional outsourcing than the kind of model pursued in the pilot programme. Staff, assets, infrastructure and liabilities are being transferred to private providers (or social consortia and investors) and the government is now procuring and specifying services – carrying out the sentence of the court, managing risk, engaging with victims etc. On top of that, providers are charged with improving performance (reduced reoffending) and maintaining the level of protection given to the public through competent supervision of offenders and the management of risk.

Policymakers and politicians must therefore reset their expectations about what these contracts might look like in terms of financial risk – particularly in light of the likely scale of the contracts (16 contract package areas in England and Wales have been proposed).

For instance, a typical contract might be secured with a successful bid of £22 million per year. A maximum price might have been set by the Ministry of Justice at £25 million, which will have already applied an efficiency saving to the costs of delivering existing services (e.g. £30 million per year). So the provider already has

to deliver to more offenders (because of the inclusion of short-sentenced prisoners) and deliver services more efficiently.

In addition to the financial risk inherent in committing to savings on this scale, and the pension and redundancy liabilities which may need to be borne by the provider, the Ministry of Justice must then apply the principles of payment-by-results.

Given the new dimension of probation outsourcing, and the fact that high-risk models were unworkable in many of the pilots, it should by now be absolutely clear that the Ministry of Justice is not going to be able to ask providers to take 100% of the risk in these contracts. The new scale of the contracts just emphasises this further. To illustrate: if a provider took all the risk on a five year contract (for instance), worth £22 million a year, this would mean a total of £110 million would be put at risk, with no guaranteed income whatsoever. With the first outcome payment made 34 months following the start of the contract, the provider would have had to provide around £60 million in working capital before the prospect of any payment. Models like these were unworkable in pilots with a fraction of these amounts at risk. In other words, anything which looks like this will be completely unviable for the market.

The real debate is about what percentage of the overall contract should be put at risk, and then how that risk should be structured (bearing in mind the crucial issue of how to measure reoffending outcomes). Given the scale of the contracts, Policy Exchange believes that around 20% of the contract value should be put at risk, dependent on decisions about measurement (see below section). An even lower risk percentage may eventually be required (e.g. the 10% put at risk in the Doncaster pilot), given the Ministry of Justice's need to create and sustain a viable market.

In the light of these considerations, and the learning so far, Policy Exchange believes a new commercial model should contain some or all of the following elements:

- **A substantial service fee:** this would allow for guaranteed income for providers and would reflect the fact that the scheme is being funded primarily out of existing budgets. It would also reflect the fact that the PbR provider is indeed providing services, not least delivering the sentence of the court. The Ministry of Justice could ask providers to compete on the level of service fee as part of the procurement process. However, we believe that the service fee should represent at least 80% of the contract value. This properly reflects the fact that there will be no significant net efficiency savings from the outsourcing exercise; instead, providers will be making significant efficiency savings from current delivery to create the headroom for providing for short-sentenced prisoners.
- **Payments for success, regardless of statistical significance:** it is perverse and prohibitive to investment decisions that a 0.1% can make the difference between being paid or not. Regardless of whether this methodology is formally retained, a more subtle payment mechanism which allowed for cost recovery and/or 'stepped losses' for achieving reductions in reoffending should be introduced. This will be discussed further in the below section on measurement.
- **Bonus payments linked to cash savings:** for significant reductions above a certain level, substantial bonus payments should be available – more closely tied to Ministry of Justice savings and/or identified efficiency plans. This is explained further in the next section.

- **Ramping up risk over time:** the level of risk should be increased over the life of a contract, as the provider and supply chain develops experience, overcomes initial implementation problems and reaches ‘steady state’. This is especially important in a scenario like this where the government is asking providers to make efficiencies straight away – which will naturally require a huge amount of concentration of efforts and resources. Demanding reoffending targets and financial risk at the same time may detract from this primary aim. Ramping up risk over time would reflect the way the Work Programme was commissioned, with ‘attachment fees’ paid to providers when jobseekers join the programme eventually disappearing in the later years of the contract.
- **Flexibility:** above all, the commercial model should be flexible during the procurement process. While commissioners and providers should have a strong initial idea of the ideal commercial model, it should not be set in stone, potentially causing delays, retendering and market failure further down the track.

How to measure

When the government is paying by results, the result really matters. When people in the sector dispute the integrity or utility of a measure, it detracts from the way the policy is viewed and can discredit it in the eyes of the public, the media and key partners for delivery. Recent controversy sparked by the Public Accounts Committee over the Work Programme’s predecessor schemes demonstrates the problems that can occur when measures become discredited and highlights the need for policymakers to design PbR programmes that command broad support from the outset.

Ultimately, whether or not the introduction of payment-by-results in offender management is deemed to be a success will be determined in large part by the extent to which people believe that the policy has had a positive social impact and the absence of doubts about the validity of its aims. In other words, people have to agree on (or at least, not disagree with) the definition of success for the policy to be judged favourably.

The measurement of payment-by-results in offender management is already a vexed and contentious issue – and one that must be addressed by policymakers and politicians. Examining the purpose of the policy is instructive in deciding upon the right way to measure: Is the priority to cut the costs of reoffending (financial impact), or to cut the number of new crimes committed (social impact)? What kind of provider behaviour should the government incentivise and disincentivise through the measurement?

Reconviction as a measure of rehabilitation

The government measures reoffending levels at an individual level according to whether an individual has been reconvicted of a new criminal offence in the 12 months following a sentence. These individual outcomes are then loaded into an annual cohort.

It is widely assumed that this measure is a strong indicator of whether or not an offender has been ‘rehabilitated’. Clearly though, when the British Crime Survey reports around 9.5 million victims of crime a year, but only 1.4 million result in a conviction,¹⁹ the situation is not so straightforward.

19 Sentencing Statistics
2006–2010, Ministry of Justice.

In reality, reconviction rates are a social construct, and can be influenced by all sorts of other factors, such as changes in police practice (e.g. are more people being dealt with through out-of-court disposals which do not count as a conviction?) or police deployment (are the police able to apprehend criminals at the same rate as before?).

Reconviction rates are really a proxy measure which give a good indication of both severity (as more serious offences are more likely to be dealt with in court) and costs to the criminal justice system (as reconvictions and sentences drive up system demand and cost more than offences dealt with in other ways or not detected at all). However, although reconviction rates are undoubtedly a better measure of whether someone has been rehabilitated than other proxy measures such as whether offenders are in employment or off drugs, we should not pretend that the measure means anything more than whether someone has been reconvicted in court of a further offence.

The government has, up until now, favoured the use of the so-called 'binary measure', which measures the proportion of offenders in a cohort who are reconvicted of an offence committed in the twelve months following the end of a sentence. Many in the criminal justice sector prefer the frequency measure, used in the Peterborough pilot, which measures the volume of offences committed by a cohort of offenders in the same period. The arguments are summarised below.

Table 2: Binary v frequency

Measure	Binary	Frequency
Impact on costs	Greater impact	Lesser impact
Impact on crime	Lesser impact	Greater impact
Supported by evidence	Does not reflect non-linear desistance process	Reflects desistance process
Likely provider behaviour	Targeting of offenders with whom desistance is a possibility; withdrawing services from offenders who re-offend	Targeting of most prolific offenders to deliver large reductions
External factors	Minimal external factors	Heavily influenced by caution rate
Support from sector	Minimal support	Broad support

Binary v frequency

The binary rate is opposed by many practitioners in the sector, and while accepted by likely PbR providers as the most likely to be chosen by the government, is generally not thought by them to be the best, or the fairest, way of assessing impact and rewarding quality. Reducing the number of convictions of a prolific offender from 100 convictions a year to one would be, many argue, a tremendous success. Many also believe that the binary rate does not reflect the fact that desisting from crime is a process, which involves setbacks and relapses not

accounted for in a binary system. Significant too is the argument that a binary rate directly incentivises the ‘parking’ of the hard cases (e.g. the prolific offenders) and the ‘creaming’ or ‘cherry-picking’ of the easier cases, with whom desistance can be most readily achieved. It also means that when someone does re-offend, there is a direct incentive to withdraw services and stop working with them.

The last set of ministers in the Ministry of Justice contended that because offenders often get sentenced in court for multiple offences at the same time and serve concurrent sentences for those multiple offences, merely reducing the frequency of reoffending did not save much money because court and prison costs would not be impacted in a significant way. In other words, people would still be cycling through the system. Reducing the binary rate, on the other hand, will mean people do not go back into the criminal justice system at all, maximising cost savings. As a result, so the argument goes, cherry-picking to reduce the numbers coming back into the system is exactly what policymakers should be encouraging providers to do.

However, although the binary rate is likely to produce some additional cost savings, it is not, by any stretch, the best measurement for delivering cost savings as an outcome. If, as described above, there is an ambition to use the opportunity of a scaled, national PbR programme to realise large savings, the MoJ must devise a measure to better take account of demand. The only thing the binary rate illustrates is whether someone has been re-convicted; it does not tell you whether they have received a 20 year prison sentence, costing

taxpayers millions of pounds, or a £60 fine following a brief hearing in a magistrates’ court.

“Previous Policy Exchange work has highlighted the danger that the frequency rate of reconviction is heavily influenced by the rate at which the police use cautions, rather than prosecuting offenders in court”

Previous Policy Exchange work has also highlighted the danger that the frequency rate of reconviction (which excludes the use of cautions, even though this requires an admission of guilt) is heavily influenced by the rate at which the police use cautions, rather

than prosecuting offenders in court. There is a very strong link between changes in police practice (e.g. using more cautions) and changes in the frequency of reconvictions. If the Ministry of Justice were to use the frequency measure, it must control for local changes in police practice. Any statistical significant uplift (or reduction) in the proportion of offences dealt with via a caution would be accounted for in any apparent reduction (or increase) in the frequency of reoffending.

For all of the reasons outlined above, neither the binary rate nor the frequency measure is satisfactory, as currently constituted. Indeed, perhaps part of the problem so far has been that people have been looking at measurement in a rather binary way (if you’ll excuse the pun). In fact, rather than simply choosing between the two measures, there are very small but significant changes that could be made to them to mitigate many of the problems identified above.

Not every option below should be pursued, as this would add to the overall complexity, but one or a combination of some of them would all represent an improvement on the current preferred measure.

Differential pricing combined with the binary rate

Retaining the binary rate, but introducing a very simple method of differential pricing, would deal with many of the concerns around parking and cherry-picking. This would involve splitting the cohort into three groups based on their risk of reoffending:

- **Low:** those offenders who are unlikely to reoffend, all things being equal.
- **Medium:** the ‘swing voters’ in the middle who may, with the right interventions, desist completely from crime.
- **High:** those offenders who are not ready to engage with services and very unlikely to cease offending, regardless of interventions received.

The Ministry of Justice could pay providers different amounts for reductions in the binary rate of reoffending with each group, including higher amounts for those who are least likely to desist. This would incentivise providers to work with the hardest-to-help as well as the middle group where most impact can be achieved.

Determining who would fall into what group could be relatively straightforward. The Ministry of Justice believes that the single biggest determinant of the binary rate of reoffending of a cohort is the average score of the cohort on the Offender Group Reconviction Scale (OGRS3), which measures the likelihood of reoffending.

OGRS3 is based on static factors relating to an offender’s criminal career, such as their age, age of first conviction, number of previous convictions and current sentence. The OGRS formula produces a score out of 100 for an offender to give an indication of the likelihood of reoffending, and already categorises offenders into one of three groups – low (0–30), medium (30–60) and high risk (60–100). Replicating a system such as this, and setting a different outcome payment for success with each group, would help to build support for the binary measure – and ultimately, will deliver better outcomes because providers will take a more balanced approach to targeting.

An even more ambitious strategy (most likely for a future commissioning round, rather than the first) might be to pay a basic tariff, multiplied by the OGRS score of the offender, similar to the model in Lewisham’s financial incentive model pilot. For example, if the basic tariff was £30, providers would be paid £300 for an offender with a low OGRS score of 10 not reoffending, and £2700 for achieving the same outcome with an offender with an OGRS score of 90.

A blended outcome measure, combining the binary rate with a frequency measure

Another option would be to simply introduce a blended outcome measurement which took account of both binary and frequency rates. 30% (or similar) of payments could be based on frequency, with the remainder based on the binary rate (with differential pricing). This would remove any incentive to ‘park’ hard cases. A blended measure would, however, probably cost providers (and the Ministry of Justice) more money at a macro level, as resources would have to be allocated more evenly according to risk of reoffending and would therefore be more stretched across a bigger cohort.

Payments based on system demand measurements such as re-incarceration

We have shown above that the reconviction measure is really a proxy measure for reoffending and whether an offender has been ‘rehabilitated’. We have also argued that the binary measure is not the best way of assessing impact on demand. Given this, it would make sense for the Ministry of Justice to examine measures which are much more closely aligned to costs.

If the Ministry of Justice’s preferred measurement is one which generates the largest savings, or if it wants to persuade the Treasury for new investment in this PbR programme, they should examine measures which directly incentivise reductions in demand. This would include reductions in re-incarceration of prisoners and reductions in first-time entrants to custody.

For example, the SIB recently introduced in New York uses the measure of re-incarceration of prisoners released from Riker’s Island. It pays the service provider based on reductions in the number of projected bed days in custody, according to a baseline. This allows direct cost savings to be realised. The savings are non-linear – first, savings on heating and catering are made, and eventually much larger savings will be realised as units are closed and staff costs can be reduced.

Table 3: Payment structure for New York City SIB²⁰

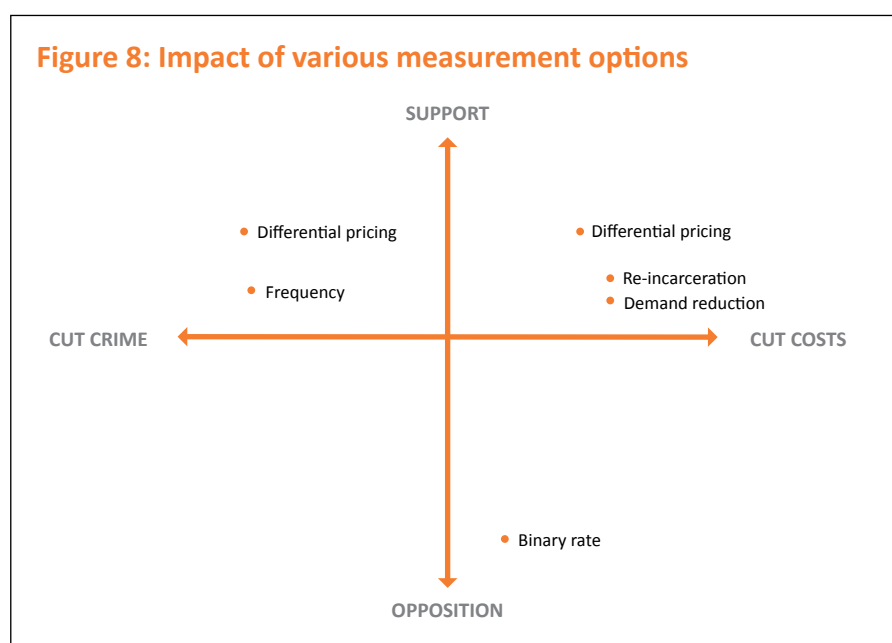
Reduction in re-incarceration rate	Projected long-term city net savings (\$)
>20.0%	\$20,500,000
>16.0%	\$11,700,000
>13.0%	\$7,200,000
>12.5%	\$6,400,000
>12.0%	\$5,600,000
>11.0%	\$1,700,000
>10.0%	\$1,000,000
>8.5%	\$1,000,000

The Ministry of Justice’s pilots in London and Manchester, where agencies are incentivised to reduce front-end demand on the criminal justice system, also provide an interesting template for the inclusion of measures such as this. If providers were also incentivised to reduce overall demand on the criminal justice system – and were given control of probation and other resources – it is likely that, in addition to providing community sentences and a through-the-gate service, providers would also invest in preventative services outside of the formal criminal justice system, to reduce front-end demand. Incorporating financially-focused measures too, such as re-incarceration percentages or overall levels of demand, would also drive the right kind of provider behaviour, and allow the Ministry of Justice to more readily make investment decisions (and business cases to HMT) about PbR in future rounds of commissioning.

²⁰ Information provided by Goldman Sachs.

The following diagram summarises the various measurement options, illustrating their relative positions in relation to the purpose of the policy and the likely support from the sector.

Policy Exchange believes that the binary rate, as currently constituted, is neither fish nor fowl: it is not closely linked enough to cashable savings, nor does it command significant support. A simple system of differential pricing appears to us to be a far superior option – dealing with concerns about cherry-picking and parking, commanding sector support, and both cutting costs (through a binary measurement) and crime because providers will target resources at the most prolific and hardest-to-help.



Setting a baseline and dealing with deadweight

The reason for setting a baseline is to work out, as far as possible, what would have happened to reoffending if the PbR mechanism had not been introduced. This allows the commissioner to eliminate, or at least minimise, deadweight. Theoretically this means the Ministry of Justice can ensure that payments to providers can be made only for reductions in reoffending that are directly attributable to the provider. In other words, if the Ministry of Justice is very confident that it knows exactly what this baseline performance is (in each year of the contract), and you only pay for performance which exceeds this, then there is no deadweight.

In the pilot phase, the Ministry of Justice took a seemingly logical approach to setting a baseline for measuring reoffending performance. The approach was to put in a gap between the baseline and the payout point to represent statistical significance. However, the existence and the precise nature of this gap (e.g. 5.3%) helped to exacerbate the cliff-edge nature of the commercial model and caused significant problems for providers.

Setting a baseline is even more difficult now. Not only are there significant system reforms (e.g. the privatisation of large parts of probation), there are also substantial cuts in spending and new services being introduced (e.g. for short-sentenced

prisoners). So there is a large amount of uncertainty about the baseline because all of these changes will have an impact on reoffending rates. It is also very difficult to estimate their precise impact. Theoretically, the MoJ could get rid of a lot of this uncertainty by using some sort of control group but this is tricky both operationally and politically.

Given these difficulties, we believe that the best solution is to consider deadweight in the context of the contract package as a whole. The fact that there will be a small amount of deadweight will be known to bidders who, if the competition is efficient, reflect that in their bids for the service fee elements. This will mean that any deadweight will be effectively clawed back through the procurement mechanism. This is the way deadweight was approached in the Work Programme procurement, and is what we mean in the earlier section by recommending that the Ministry of Justice 'introduce payments for success below the point of statistical significance. This will also reflect the cost savings produced by these reductions in reoffending.

How to integrate

There are a number of important questions relating to integration which the Ministry of Justice should consider as part of PbR expansion.

1. How to integrate PbR delivery with custodial delivery;
2. How to integrate PbR delivery with other existing PbR schemes; and
3. How to integrate with other public services.

1. Integration with prisons

One of the risks of expanding payment-by-results is that services may become fragmented, with crucial cogs in the criminal justice machine not linking well together, or indeed, working against each other. Aligning incentives and taking steps to address fragmentation will therefore play a crucial role in ensuring the success of the scheme.

Perhaps the key risk is that PbR principles are only applied to the community setting, rather than inside prisons too. A potential role for expanding PbR in the prisons system has been described above, utilising the French Model of prison management. The integration of prison and community budgets in the manner envisaged should go some way to achieving coherence in the offender journey and achieving a good balance in terms of what services are delivered in each setting.

However, there is a clear danger that, even if these budgets are transferred to the PbR provider, the remaining 'rump' of public sector prison delivery will be left to its own devices, with little or no incentive to facilitate or cooperate in the work of the PbR provider. This would be a major problem for two reasons:

a) It could cause serious logistical and delivery difficulties for the provider.

Prison management and custodial staff are in complete control of who accesses prisons, when prisoners are let out of their cells to receive services and what quality of data and information travels to providers as prisoners are released. A prison service that is not incentivised to cooperate or contribute to the delivery of the PbR provider has the potential to present a large obstacle to results being delivered.

b) It would fail to bring about culture change – a significant prize for PbR.

Policy Exchange believes a key goal for PbR should be to reform public sector working practices, culture and performance management. The culture of the prison needs to reflect a clear purpose – reducing reoffending in this case. If ‘core’ custodial management does not reflect this overall culture, good rehabilitative work is at risk of being undone by public sector custodial staff who do not understand or value (or have any ownership of) the activity or the desired outcomes.

There is also strong evidence that a ‘whole prison approach’ is key to reducing prisoners’ reoffending, with every interaction with prisoners, no matter how small, potentially crucial in bringing about behaviour change and, ultimately, desistance.

We have suggested above that prisoners serving less than four years should be included in the PbR model. So finding a way of wrapping the public sector prison service into the PbR model, in conjunction with a commercially-incentivised private/voluntary sector partner, would therefore be a significant achievement.

Prisons are, by their very nature, command-and-control environments. As a result, the system is very responsive to targets, which have been used as an instrument to drive a number of important outcomes. However, many of these relate to historic policy drivers, such as preventing escapes, or are exercises in box-ticking, such as the notoriously poor quality measure of whether an offender has accommodation on release.

Prisons have never been set targets, or indeed, been judged wholly or in part according to their reoffending rate. Though there have been vague, system-wide targets for reducing reoffending in the past, they have never been set at an individual level. In fact, the reoffending rates of individual prisons have only been published once, in 2010.²¹

If NOMS is able to set HMP Leeds a statistically significant target for reoffending as part of an aborted pilot, based on historic fluctuations, there is no reason why every prison could not be set such a target according to a similar baseline. This could form part of, and be linked to, a geographic, contract package area (CPA) target for reducing reoffending.

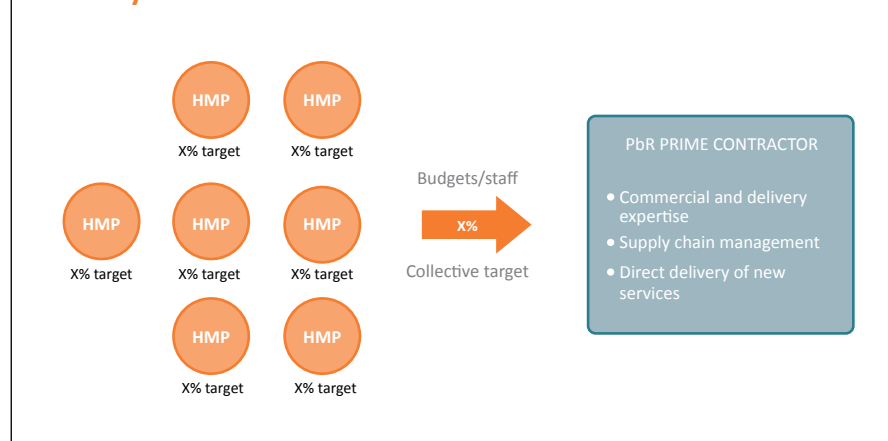
This would drive cooperation and integration, and bind the public and private sector efforts more closely together. It will not matter in policy terms if the individual targets are not absolutely met – and there will be complications due to the fact that many training prisons do not discharge many prisoners, transferring them instead. The point is that reoffending targets, linked to the overall performance management regime, will begin to drive the right kind of behaviour, and compel prison staff and management to think more, and to think more strategically, about their contribution to the offender journey outside the prison gates.

As part of the departmental statements on the recent prisons competition (PCP2), it is clear that the Prison Service has committed to making substantial efficiencies in return for not being subject to the threat of competition. Policy Exchange believes that the lever of competition of prison management should be retained to help ensure that these efficiencies are driven through, but also to help compel the kind of culture change that must be brought about in relation

²¹ Compendium of Reoffending Statistics and Analysis, Ministry of Justice, 2010 <http://www.justice.gov.uk/downloads/statistics/mojstats/compendium-of-reoffending-statistics-and-analysis.pdf>.

to reducing reoffending. Measures relating to cooperation with the PbR partner, and the reoffending rate itself, should be used as part of determining the overall performance rating of the prison. The worst-performing prisons might face the threat of market-testing, in line with the Ministry of Justice's strategy over the last decade.

Figure 9: Achieving integration between prisons and PbR delivery



In the medium term, Policy Exchange believes that a full system of *prison league tables* could be developed. This system would properly take account of historic performance and changes in the characteristics of offenders in the establishment. It would also reflect the length of time offenders had spent in that prison relative to other establishments and would group establishments together to ensure fair comparisons could be made (e.g. Category B Local prisons). Policy Exchange will develop this idea in further work later in 2013.

2. Integrating with other PbR programmes

The other major government PbR programme is the Work Programme, commissioned by the Department for Work and Pensions – though there are also others, including the DWP and local government programmes addressing problem families, which involve payment-by-results.

Given that some of the people receiving interventions as part of these schemes will likely be on a number of simultaneous schemes, it makes sense both from an economic and delivery perspective to consider how co-commissioning, or at least greater cooperation, could be achieved in the medium term.

There are two existing MoJ pilots which use the vehicle of the Work Programme (by way of a contract variation) to deliver a PbR scheme focused on reducing reoffending. This is clearly an option for PbR expansion, but would exclude those providers who do not deliver the Work Programme. Additionally, given the huge financial pressures facing Work Programme providers over the next 12–24 months, it is unwise to even consider a co-commissioning approach at this point.

It would, though, make sense to consider how best to integrate Work Programme delivery and PbR delivery, rather than procurement. For example, Work Programme providers responsible for delivering employability services

to prisoners on release (Payment Group 9 under the Work Programme) could sub-contract (or be compelled to sub-contract) their delivery to the PbR provider. Alternatively, the two providers could pool their resources to ensure a joined-up approach to addressing the needs and barriers of the offender/jobseeker. Similar consideration should be given to integration with other schemes.

To achieve this, the Ministry of Justice should give serious attention, as part of the procurement process, to providers' plans to integrate their services with existing schemes. In the long-term, future rounds of commissioning should examine the potential for the dual outcome – of reduced reoffending and sustained employment – to be delivered by the same provider, in the same area.

Integrating with other public services

Not only are there crucial dependencies for PbR on local services such as drug and alcohol teams, mental health specialists, GPs and housing providers, there will also be some successful, locally-owned strategies for reducing reoffending. It is important that this good work and goodwill is not lost in the proposed model. To help bring this about, services (and contractual arrangements) should be designed in consultation with local authorities and service providers. Emphasis should also be placed on the PbR providers' ability to integrate and work effectively in conjunction with these agencies. Contracts and tenders should also ensure that the providers are appropriately incentivised to work with these local groups.

Police and Crime Commissioners: One key relationship for the PbR providers will be the newly-elected Police and Crime Commissioners (PCCs) – many of whom have expressed an interest in reducing reoffending as a method for reducing crime.

As a proponent of the introduction of PCCs, and as a supporter of their widened remit for crime as well as policing, Policy Exchange strongly advocates a future, prominent role in PbR in offender management for PCCs. At the moment, it is too early for most (or any) PCCs to be substantially involved in the design or commissioning of the PbR roll-out. However, it will be important that the Ministry of Justice consults PCCs on key elements of the policy and includes them in important decisions and announcements about their areas. We welcome the attention given to this issue, and the efforts to provide a semblance of co-terminosity between PbR areas and PCC areas, in the consultation document.

How to procure

There are a number of choices for the Ministry of Justice about how to procure and manage the PbR roll-out to ensure its success. Many of these will be informed by strategic decisions about the kind of market the Ministry of Justice wants to build as this policy is taken forward.

Co-design/early engagement

The clear lesson from the pilot phase, reinforced during the Ministry of Justice's most recent market engagement exercise, is that co-design of PbR propositions will be crucial. There was a palpable gap between departmental expectations about how to structure PbR opportunities and the market's view about the viability of

these models. This gap must be closed further if workable PbR contracts are to be designed. Co-design sessions, regular market engagement workshops and efficient dialogue sessions would all make a positive impact.

As part of this, early engagement on the commercial model will be crucial. As mentioned above, the model should be flexible (and subject to competition in key areas), but a period of early engagement will help set market expectations and avoid problems further on in the process.

Contract size

The size of the contracts, coupled with the risk profile of the commercial model, will determine what kind of market is developed. The contracts need to be numerous enough for a competitive market to develop, whilst at a scale appropriate to attract new entrants from around the world. They also need to be local enough to encourage local ownership and cooperation, including by leaving the door open in future for integration with Work Programme providers and/or Police and Crime Commissioners. We welcome the emphasis placed on this in the consultation document.

Reflecting the Work Programme, it is likely that prime contractors should be encouraged to work with a series of sub-contracts to work on specialist aspects of offender need. They may be given full autonomy in a particular area to allow these supply chains (and networks with existing local authorities, etc.) to be built. Full transparency over performance will allow other providers in other areas to recognise and replicate best practice.

However, there is also the potential for probation staff to spin out and form mutuals, acting as sub-contractors to large primes. This is something we expect the private sector to work with Trusts on and facilitate in terms of capacity building and financing.

The role of the voluntary sector

The Ministry of Justice should ensure that the role of the voluntary sector as part of supply chains should be protected. The Merlin Standard, an initiative pioneered by the Department for Work and Pensions together with providers, protects supply chains from unfair or exclusionary supply chain arrangements, encourages the spreading of best practice and champions positive behaviours. A similar arrangement in the Justice sector would ensure that supply chains can be fairly constructed, and a market sustainably built.

The evidence base

The Ministry of Justice should be clear about how it will choose between providers advocating different approaches to reducing reoffending. There are inherent tensions between different academic theories about what works to reduce reoffending: for example, evidence that is part of the stable of the 'what works' literature (heavily favouring cognitive-behavioural therapy (CBT) approaches to reducing reoffending) differs greatly from evidence which stresses the importance of the process of desistance, valuing significant relationships and offender-designed interventions. There are also 'needs'-based theories, positing that addressing factors such as unemployment, addiction and mental health problems is the key to reducing reoffending.

The evidence base is broad and disparate, and many theories have been promoted by NOMS at various times. Clarity about the way commissioners view the evidence is important, as is making the evidence available in as useful a way as possible.

In determining a balanced commercial model, the Ministry of Justice should also bear in the mind that the vast majority of the academic literature on what works to reduce reoffending measures effectiveness according to the frequency of reoffending or in the United States, the frequency of re-arrest. Measuring according to a binary rate of reoffending is rarely done as part of randomised control trials or other studies, which means the evidence base for designing operational models and determining investment decisions based on this measure, is weak.

There is also a balance between providers constructing delivery models which are ‘evidence-based’ and models which seek to innovate, trialling ‘promising’ practices. This tension can again be seen in the differences between the New York SIB and the Peterborough model. In New York, a CBT programme, delivered in custody, is the provider’s solution to cutting reoffending. In Peterborough, the focus is on the transition to the community on release – using a mentoring service. However, this is technically only a ‘promising’ approach, according to the Ministry of Justice’s latest commissioning plan.

Commissioners, policymakers and providers often talk about a ‘black box’ approach to payment-by-results, meaning that so long as the provider delivers the outcome, they are free to try whatever solution (within reason) they see fit. We support this, and would suggest that politicians refrain from promoting or favouring one particular solution (e.g. mentoring) over another, where possible – especially as this reinforces the way in which NOMS currently operates. Moving to a more black box culture will represent a fundamental shift from the NOMS commissioning approach (which is very prescriptive and centrally-directed) and this transition needs to be supported at all levels.

It is also worth stressing that, because these outcomes have never been delivered in this way or at this scale, delivery models and contractual commitments should be deliberately flexible, recognising the fact that providers will likely need to make mid-course corrections and change their approaches regularly.

Creating a learning culture is vitally important to the successful creation of this market. So a completely black box solution, where providers’ delivery models are hidden from view or are otherwise opaque, would not be ideal. The optimum model for this market may be more of a ‘perspex box’, where best practice can be seen and spread to maximise learning, but providers’ intellectual property, management information and data can be properly protected.

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Recommendations

Many of the decisions taken on the issues identified above will impact on the criminal justice system for years to come. A key lesson from the pilot phase is that it is vitally important that these kinds of options are fully scrutinised at the outset; choosing wrongly now could produce a bad or ineffective scheme, or cause the procurement to fail and the policy to never get off the ground.

Some choices, such as how to construct the commercial model and how to properly measure PbR, are interdependent and will need to change in tandem with each other to ensure a balanced and appropriate model. However, Policy Exchange believes that the following steps would, as things stand, dramatically improve the chances of success of the PbR roll-out.

- **PbR expansion should predominantly be funded through existing budgets, rather than new investment.** The pilot programme was funded through ‘new money’, making it unviable as a roll-out model. Instead, existing budgets should be used, constituting the relevant parts of the probation and prison budgets. PbR should, in this context, be seen as a way of enhancing performance while managing shrinking budgets, rather than as a method of attracting new investment, creating new services, and trying to secure cashable savings.
- **New investment should be explored too, if this can be tied more tightly to savings.** If the Ministry of Justice can more directly demonstrate cashable savings from the scheme (by creating an outcome measure that properly takes account of system demand), it should prepare a business case for the Treasury for new investment in PbR expansion. The creation of a top-up investment pot would supplement existing budgets and provide new investment to deliver larger reoffending reductions.
- **The inevitable consequence of using existing budgets is the privatisation of parts of the probation service.** PbR demands that the risk of failure (e.g. financial risk) is transferred to the private sector because the public sector cannot be allowed to fail. If existing budgets are to be the main contributor to funding the scheme, this inevitably means that the control of the assets and the staff themselves must also transfer. Alternatives to outsourcing, such as joint ventures, where risk is transferred to the private sector but fundamental control of services remains in the public sector, have been tried as part of the pilot phase, and were found to be unworkable.

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- **Privatisation of elements of probation will release efficiencies to provide new services for short-sentenced prisoners.** The only core element of probation work that has ever been put out to competition, Community Payback in London, is now being provided at around 60% of the previous costs. This demonstrates the scale of savings in the £1 billion offender community services budget that are possible through private sector financial management and disciplines. It is through these savings that services to short-sentenced prisoners, who currently receive no community supervision, should be predominantly funded.
 - **Support for short-sentenced offenders should not be mandatory or provided for in legislation.** On balance, we disagree with the consultation's assertion that new provision for short-sentenced offenders should be mandatory. Mandating support is unlikely to be the best way for providers to engage with this often chaotic and hard-to-reach client group. Compulsory support may also severely restrict providers' freedom to innovate and prioritise the allocation of resources across a cohort; the task of reducing reoffending would be skewed towards enforcement, rather than the rehabilitation of those who are ready to engage and be helped (the currently neglected side of the coin). Additionally, given that the only obvious tool for dealing with non-compliance would simply be a return to custody, mandating support may simply further damage the offenders' chances of success, and further drive up costs in the criminal justice system.
 - **The provider must be given maximum control of the offender journey:** It is essential that providers, who are taking all the risk, be given control of the end-to-end offender management of offenders to enable them to reduce reoffending. Indeed, it is only investigation and advice to court (offence assessment and sentence recommendation) where there is a strong argument for the exclusion of front-line probation functions. These services could also represent some of the 'service fee' elements we recommend be introduced as part of the commercial model.

“Policy Exchange believes a key goal for PbR should be to reform public sector working practices, culture and performance management”
 - **Commissioners should consider including back and middle office functions in probation privatisation.** With over one in four probation staff in a support function, and each of the 35 Trusts having their own bespoke functions, there is clear scope for directing savings here towards new provision for reducing reoffending. This could either be included in the PbR procurement, or completed as a separate exercise, depending on time constraints.
 - **The Ministry of Justice must take strategic steps to build this market.** For PbR to work, the Ministry of Justice must play a market stewardship role – ensuring that a viable market can be built, with metrics that work for the taxpayer too. It is clear that the commercial models pursued as part of the
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pilots are wholly unsuitable for the proposals contained in the government's consultation.

- **Due to the new scale of contracts and the new dimension of probation outsourcing, the commercial propositions must be much lower-risk – and should eventually look far more like conventional outsourcing contracts.** It should by now be absolutely clear that the Ministry of Justice will not be able to ask providers to take 100% of the risk in these contracts. This model was not viable for providers, had already led to market failure in the pilot phase, and is not appropriate as PbR is scaled and financial risk levels are multiplied. The real debate is about what percentage of the overall contract should be put at risk, and then how that risk should be structured (bearing in mind the crucial issue of how to measure reoffending outcomes). Given the scale of the contracts, Policy Exchange believes that around 20% of the contract value should be put at risk, dependent on decisions about measurement. A new model, designed to stand up to the rigours of commercial investment decisions, should include:
 - **A substantial service fee** – reflecting the fact that providers will be delivering the sentence of the court, not merely a service to reduce reoffending. As a starting point, we suggest that this be around 80% of the contract value.
 - **Payments for success reflecting cost savings, not just statistical significance** – reflecting the fact that modest reductions in reoffending should produce marginal cost savings.
 - **Additional bonus payments for substantial success** – tied to savings and funded through a top-up to the Rehabilitation and Resettlement Fund.
 - **Risk ramping up over time** – as the provider and supply chain develops experience, overcomes initial implementation problems and reaches 'steady state'. This is especially important because providers will be asked to make substantial efficiencies in probation in order to fund new services for short-sentenced prisoners. Reducing reoffending, at the same time as undertaking such a transformation of existing services, will be very challenging – and risk levels should reflect this.
- **The measure of reoffending must be changed to maximise impact on costs savings and crime, and to build sector support.** When the government is paying by results, the result really matters. As has been demonstrated by the Public Accounts Committee's investigations into the Flexible New Deal and similar contracts, when people in the sector dispute the integrity or utility of a measure, or the social impact it purports to have made, it detracts from the way the policy is viewed and can discredit it in the eyes of the media and the public. So the binary measure of reoffending, measuring the proportion of offenders in a cohort who reoffend, must be abandoned. It commands almost no sector support (damaging the policy from the outset), and is not the best measure of reoffending in a PbR system for either reducing crime or reducing costs. Though there are a range of potential replacement options, we recommend a simple system of differential pricing (albeit retaining a binary measure) which will both cut crime and costs, and command sector support.

It will also alleviate fears about ‘parking’ of hard cases and the ‘creaming’ of those who are easier to help.

- **An additional measure – representing system demand – should be introduced:** to make these reforms sustainable, the Ministry of Justice must examine measures of recidivism that are much more closely aligned to cost savings. If the Ministry of Justice wants to persuade the Treasury for new investment in this PbR programme, they should examine measures which directly incentivise reductions in demand (as in the recently commissioned Social Impact Bond in New York City’s Rikers Island prison). This would include reductions in re-incarceration of prisoners, and reductions in first-time entrants to custody at the front-end. In this way, they could achieve something similar to the ‘DEL:AME Switch’ achieved in the welfare-to-work market, where savings in the benefits bill are spent up-front on finding jobseekers work. In other words, a new measure would make the relationship between investment and savings more direct, transactional and precise.
- **Prisons in the public sector should be wrapped into PbR, including by setting an individual, establishment-level target for reducing reoffending.** There is a clear and substantial risk in these reforms that the public sector prison service will become completely detached from the rest of the system, with little incentive to participate or cooperate. Policy Exchange believes a key goal for PbR should be to reform public sector working practices, culture and performance management. To drive cooperation and integration between public sector prison staff and private/voluntary sector PbR partners, prisons should be given a clear, individual target for reducing reoffending, appropriate to the circumstances of the prison. The lever of full prison competition should be retained for those prisons which do not cooperate with PbR providers. To cement this new incentive, we believe that Prison Governors should be paid by results, with bonus payments available to Governing Governors and other senior managers for success in reducing reoffending.
- **The voluntary sector should be encouraged to play their part.** The role of the voluntary sector as part of supply chains should be protected by the adoption of an accreditation process for a new standard for providers (such as the Merlin Standard in the welfare-to-work sector), which would protect small providers from unfair or exclusionary supply chain arrangements.
- **Operational, commercial and legal models should be co-designed with providers:** this will aid procurement, develop higher-quality propositions and help develop the market. Early engagement on the commercial model, in particular, will be beneficial given the timescales.
- **A learning culture should be fostered by the Ministry of Justice, and clarity provided about the evidence base for reducing reoffending.** As reoffending outcomes have never been delivered in this way or at this scale, delivery models (and contracts) should be deliberately flexible, recognising the fact that providers will likely need to make mid-course corrections and change

their approaches regularly. Creating a learning culture is vitally important to the successful creation of this market. So a black box solution, where providers' delivery models are hidden from view or are otherwise opaque, would not be ideal. The optimum model for this market may be more of a 'perspex box', where best practice can be seen and spread to maximise learning, but providers' intellectual property, management information and data can be properly protected.

The government's decision to expand payment-by-results, whereby providers are paid (or not) for reducing reoffending rates, is a big shift in criminal justice policy. This paper examines the background to it, sets out some clear choices facing policymakers as they develop the roll-out strategy, and makes a number of new recommendations about the best way to ensure its success.

The first part of the paper argues that the new set of ministers at the Ministry of Justice were correct to abandon the piloting approach that had been underpinning the payment-by-results strategy until the middle of 2012. The pilots were not being commissioned strategically, would have produced results only in 2017 and beyond, and were being procured with 'new money' – a model never suitable for national expansion. There were also significant implementation and procurement problems which caused delays to schemes getting off the ground.

However, there is now a huge amount of learning about the best way to implement payment-by-results and a very clear set of choices facing those designing the roll-out. The report sets out some clear choices for PbR expansion in offender management in each of the following areas:

- How to fund it
- Which offenders to include in it
- How to structure it, including which organisations to include in the new system
- How to pay under a PbR system
- How to measure PbR outcomes properly
- How to integrate PbR delivery within the criminal justice system and more widely
- How to procure and manage the roll-out

The report makes key recommendations on reforming both the payment (commercial model) and the result (reoffending measure) for the payment-by-results roll-out. These include changing the binary measure of reoffending, which commands little sector support and risks damaging the implementation of the policy from the outset. We also recommend that, in order to build a viable and sustainable market for offender management services, the commercial models pursued by the Ministry of Justice must be less aggressive and risky than in the pilot phase, in order to be attractive enough for prospective PbR providers.

We also recommend that the prisons system be wrapped into the PbR model to ensure incentives are aligned and implementation problems are minimized. We believe that setting local prisons an establishment-level reoffending reduction target will go some way to driving the kind of culture change and mindset shift that will be required for the public sector to cooperate as part of this new system, especially now that the lever of full prison competition has been removed.

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