Child Welfare Privatization and Child Welfare:

Can the two be efficiently reconciled?

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A Lesson from History

Debates over the use of private contractors to deliver child welfare service trace back to the 19th century. In the decades following the Civil War, the prevailing model was for private agencies to receive public funds to detain children from poor, usually immigrant families residing in the ghettos of cities such as Boston or New York. Some children were put aboard "orphan trains," and permanently relocated with farm families in the expanding Midwest (Cook 1995). The arrangement was economically attractive for private agencies because there was a market for labor in rural regions and private firms received a fee for each indenture (Brace 1880: 225). These programs were framed as a moral mission to quickly assimilate the "dangerous classes" into American culture. Cities, too, may have perceived a benefit from reduced urban poverty. Low in priority was the interests of the children and their biological parents.

Why did a system dominated by private providers transform to a public service? To a great extent, pressure grew from changes within the field of social work. As poverty became a less acceptable rationale for breaking up families, coupled with an expanding awareness for the role in environmental factors as causes for social problems, services shifted from moral reform to basic psychological and social intervention (Jimenez 1990). Increasingly, protecting children had to be balanced with the objectives of rehabilitation and family reunification. This emergent objective clashed with the early 20th century practice of paying private agencies based on a payment-per-placement method, which directly rewards private agencies for keeping children in long-term care, separated from their biological families. Early reformists argued for the socialization of child welfare services precisely because the inherent incentives of this contract system led private

agencies to overextend out-of-home placements for children, leading to outcomes that were contrary to the best practices in the profession (Folks 1902).

Michigan was an early state to recognize the inconsistency between the private contract model and best practices in child welfare policy. Child cases were removed from private control, and placed under the authority of a three-member board appointed by the Governor (Folks 1902: 84). Other states were more gradual in minimizing their reliance on private contractors. By the 1930s, roughly three-quarters of child-caring institutions were still private. The economic depression, however, soon exposed the frailties of the privatized system. Demand for child protection services intensified at the same time private charities were burdened in their ability to raise funds. Private agencies clamored for additional money from local governments, and when that was not forthcoming, financial assistance arrived from the federal government in 1935 with the Social Security Act. Since then, as the U.S. expanded the financing of child welfare, there has been an incremental shift toward governmental control of these services.

It is important to appreciate from this brief historical account that private contracting for child protection is an old concept. As policy makers realized a century ago, it is difficult to harmonize the financial and operational goals of private providers with the aims of child welfare. The conundrum, in a nutshell, is that service through contract, regardless of design, imposes economic value on specific outcomes. And private contractors systematically respond to the incentives or risks in the contract: when the contract provides rewards for private firms to move children rapidly toward adoption, children are adopted (Blackstone et al. 2004; Unruh & Hodgkin 2004); when the payment arrangement penalizes private firms for cases where children remain in out-of-home care

for extended periods, children rapidly return to their biological parents or to adoption (Meezan & McBeath 2003); when private firms are paid a fixed rate for foster-care placements, regardless of duration, children remain in temporary care (Zullo 2002). Clearly, the contract terms shape the behavior of private providers.

The consistency of this finding implies that private contractors make decisions regarding children that are based on their agencies financial interests, rather than what is best for the child. There is no easy way to avoid this tension. Formulas can be put in place that creates incentives to reduce the length of temporary child placements, but this potentially increases the risk of premature family reunification. Contract terms that reward adoption must, directly or indirectly, reward the rapid termination of parental rights. Either arrangement can endanger children or interfere with family reunification. Hence the contradiction between private contracting and child welfare: the unidirectional value arising from contract relations is inherently at odds with the polyvalent and humanitarian nature of social work. Arguably, the best system is not one that attaches economic rewards to specific case outcomes, but rather, one that gives child protection workers the skills and resources to make judgments on the behalf of children and their families. Achieving such an "incentive neutral" environment is simply easier when the service is delivered publicly.

A Contemporary Lesson: Kansas

States that do privatize child welfare services quickly learn this lesson, and soften the incentives posed by the contract approach. The Kansas case is illustrative. In 1996, Kansas contracted for family preservation, foster care, and adoption services to a network of non-governmental providers. In the first four years, contractors were paid a fixed

amount per client (a “case rate”), an arrangement that places the contractor at risk for unit cost and service duration. Private providers grossly underestimated unit costs. In response the state intervened by absorbing private agency losses, which quadrupled state funds for adoptions, and necessitated similar large increases for family preservation and foster care (Unruh & Hodgkin 2004). In the 2000 contract, Kansas abandoned the case rate system with an arrangement that reimburses contractors based on the number of children in care (KAS 2003), eliminating the risk of caring for hard-to-place children. Kansas also relaxed performance standards. Initially, adoption providers were required to place 70 percent of children in permanent settings within 180 days; this was lowered to 55 percent in 2000 (Unruh & Hodgkin 2004). And, in 2005, foster care and adoption were combined in each service region to reduce monitoring and administrative costs, and to better serve children by ensuring continuous case management. Thus, by absorbing contractor risk and consolidating service functions, Kansas has greatly minimized the hard incentives of the contract relations, and engaged in a costly rediscovery of the merits of a centralized state-based approach.

The Cost of Privatizing Child Welfare Services

Economists use the phrase “moral hazard” for situations when the incentives for the contractor (agent) are at cross-purposes with the public (principal). Moral hazards exist for many types of publicly funded services, but they are especially strong for child welfare. Much of the reason is that the “clients” of child welfare services are from poor, often single-parent families. Children and the poor are members of our society that lack political power. As such, clients that feel they are abused by service providers have little voice and scarce options to remedy their grievances. To guard these vulnerable clients,

and prevent private contractors from responding to the contract incentives in ways that override the interests of children, state agencies that privatize must invest heavily in contractor monitoring. The cost of monitoring contractor activities is particularly high with managed-care arrangements which, through a combination of performance-based contracting, prospective payments, and capitation, are designed to force private agencies to reduce costs (GAO, 1997; Malm et al. 2001; Geen & Tumlin 1999). Concluding and summarizing the literature:

1. **There is no evidence that privatizing child welfare services reduces costs**. Child welfare privatization experiments, such as Kansas, Milwaukee, and Florida, have not only failed to reduce service cost, but have resulted in a cost escalation that is faster than rising caseload levels. See the case-level analysis by Freundlich & Gerstenzang (2003) and Zullo (1998).

2. **Privatizing requires additional state resources to monitor and administer the contract.** Privatization will predictably expand administrative overhead costs by diverting time toward case reporting, oversight activities, and billing tasks (Ezell 2002; Grønbjerg 1997), and might require significant investments in information systems (Kahn & Kamerman 1999:61-8).

3. **Privatizing increases the level of bureaucratic management tasks.** To monitor contractor performance, the level of paperwork by the state and contractors will increase. As such, resources devoted to paperwork will be diverted from direct client care. In all likelihood the total number of supervisors to social work staff will increase because the state will have to establish a team of supervisors to "shadow" the work of the private contractors (Emspak et al 1996).

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