

Payment by Results: A theoretical and atheoretical analysis

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Abstract

The growing use of Payment by Results (PbR) raises significant questions about the direction of public administration reforms. Much of the existing literature on PbR focuses on either: (a) criticising such commissioning arrangements as examples of marketisation or (b) examining the use of such instruments in specific sectors or specific arrangements. To date, there is little detailed examination of the theoretical underpinnings of PbR. In this paper, we consider why and how such innovations in financing and commissioning arrangements as Payment by Results have developed, and how they might be theorised. We suggest three potential drivers of these developments; these drivers are not mutually exclusive. First, such innovations can be seen as the logical next step in the New Public Management (NPM). Secondly, they can be viewed as an attempt by policy makers to deal with complexity in the social world. Finally, they can be explained as a means by which policy makers seek to facilitate and develop new and existing philanthropic activity and social enterprise. We explore, explain and evaluate these explanations, which we do not see as being mutually exclusive. We consider the policy objectives ascribed to PbR and whether and how these fit within the three broad theoretical explanations. In conclusion, we discuss the implications of outcomes-based commissioning theory on wider discussions about the use of PbR.

Introduction

There is increasing academic and policy interest in outcome-based Payment by Results (PbR) as a model for commissioning public services. Outcome-based PbR associates payment made to a service provider with the outcomes achieved (Cabinet Office 2011). By making some or all of payment for public services contingent on delivering agreed outcomes, it is argued that PbR reduces 'micro-management' on the part of the commissioner, encourages innovation and reduces government risk by transferring it to third party contractors.

To date there is a limited literature in this area (Albertson et al., 2018). Where articles have been published, they are often critical in nature with little connection between theoretical and empirical research. Overall, there are a small number of peer-reviewed empirical articles in the field. The empirical evidence that *does* exist tends to be found in grey literature; it is often evaluations commissioned by government and relates to a specific PbR-funded programme or intervention. These evaluations often fail to distinguish between Payment by Result as a policy instrument and the

Payment by Results: A theoretical and atheoretical analysis

programme or intervention that is being funded by PbR (O’Leary and Fox, 2017). Further, there is little detailed examination of the theoretical underpinnings of outcome-based commissioning (Albertson et al., 2018). In this paper, we hope to contribute to the developing understanding of Payment by Results by suggesting that there are three potential theoretical drivers of outcome-based commissioning. First, such innovations can be seen as part of a programme of public sector reform collectively known as New Public Management (Hood, 1991). Secondly, we argue that PbR can be seen as resulting from attempts by policy makers to deal with complexity in the social world. Finally, policy makers might seek to facilitate and develop new and existing philanthropic activity, social innovation and social enterprise through the use of PbR. In exploring these three theoretical explanations of the development of PbR, we draw on a number of criticisms of these types of arrangements, and recognise that the three explanations are not mutually exclusive or alternative theories.

This paper is structured as follows. First, we define Payment by Results, outlining the difference between case/activity based PbR and outcome-based PbR. We also differentiate PbR from other forms of outcome-based commissioning, particularly Social Impact Bonds (SIBs). We then provide a brief overview of the development and use of PbR in the UK. Secondly, we develop three broad theoretical explanations for the development of PbR identified by Albertson et al. (2018) in their book, *Payment by results and social impact bonds: Outcome-based payment systems in the UK and US*. We broaden their understanding of PbR as being consistent with New Public Management reforms to include a discussion of PbR as an example of neoliberal governance. We also examine Albertson et al.’s (2018) claim that PbR as a means by which policy makers deal with increasing complexity, linking this to arguments around risk aversion and risk transfer. We also explore the idea that PbR is a means by which policy makers seek to encourage innovation and social enterprise. In this we might compare Payment by Results in the UK to Pay for Success, PfS in the USA. Although these are often assumed to be similar paradigms, the motivation for the latter often comes from private philanthropists proposing innovation which might be picked up by government agencies. In this sense, PfS is rather more oriented towards increasing government, rather than private sector, provision (Albertson et al., 2018).

In the discussion section, we assess each of these three broad explanations. We reject neoliberalism as a coherent and developed theoretical explanation of the increased use of PbR. Rather, we particularly focus on risk aversion in response to increasing complexity, and the objective of encouraging innovation and social enterprise. These would seem quite contrary explanations of why PbR is increasingly use as a policy instrument, as innovation and enterprise might be seen to increase, and not decrease, levels of risk. However, we argue that these are complementary explanations of the growing use of PbR. We conclude by suggesting that further work is needed to link empirical and theoretical work on Payment by Results and other forms of outcome-based commissioning.

Payment by Results: A theoretical and atheoretical analysis

Defining Payment by Results

Payment by Results is a broad term, and is applied to a variety of policy instruments used by government (Battye, 2015). PbR is a form of outcome-based commissioning, where outcome-based commissioning is itself a general term used for using outcomes as a means of assessing performance (Lowe, 2013). The common theme underlying outcome-based commissioning is that payment is contingent on the delivery of specified goals or targets. This contrasts with more traditional forms of UK public sector funding, where payment is often made 'up front' and accounts for previous service use, demand, and/or staffing levels. In terms of PbR, a third party is contracted on the basis that payment for services will be made when agreed outcomes are achieved. The third party might be a private sector organisation, charity, or public sector provider organisation.

There is a degree of variety in PbR arrangements. One key level of variation in Payment by Results schemes is that between case-based or activity based approaches (largely found in the funding of healthcare) (Tan et al., 2015) and outcome-based approaches. In the United Kingdom, activity-based Payment by Results was introduced by the early 2000s as part of reforms to hospital based healthcare, and was part of the then government's attempts to introduce greater marketization in healthcare services (Appleby, 2012). It reimburses providers on the basis of 'Health Resource Groups'; either condition-related, or related to categories of procedures, interventions, or treatments (Lee et al., 2010). Similar reforms have been implemented in a number of different countries; the first in US healthcare, and subsequently in more than half of all Organisation for Economic Cooperation and Development (OECD) countries (Appleby et al., 2012). Case or activity-based Payment by Results has been the subject of much research, a number of evaluations, and published systematic reviews, often seeking to establish and quantify the impact of Payment by Results (Wright et al., 2014). There are also a number of studies that examine the accuracy of clinical coding and the effect this has on levels of payments made under PbR schemes.

The second variant of Payment by Results, and the version that is the subject of this paper, relate to outcome-based approaches. Such schemes involve payments made for achieving of outcomes which are typically some measurable, improvement in the condition, behaviour, or satisfaction of service users or programme participants (Finn, 2010), or of programmes, projects and public sector organisations. Often these outcomes will be monetised – that is, there will be the potential of assessing cost savings or benefits which result from this improvement. There are significant variations in the level at which payments are set, whether the PbR payment element is the whole or part of the overall payment, and the level at which results are measured (Battye, 2015).

Outcome-based Payment by Results are not the only form of outcome-based commissioning; Social Impact Bonds (SIBs) can also be understood as a class of Payment by Results (PbR) and both analysed as the logical conclusion of outcome-based performance management (OBPM) (Lowe and Wilson 2015), as they are intended to ensure that financial rewards directly flow from the achievement of specified outcomes. The difference between PbR and SIBs lies both in the source of financing (government in relation to PbR; social or private finance in relation to SIBs) but also in the

Payment by Results: A theoretical and atheoretical analysis

involvement of investors in the process of establishing outcomes to be delivered, and process of measuring these outcomes.

The developing use of PbR in the UK

Outcome-based PbR is increasingly used across a range of UK public services, including active labour market programmes, children's centres, housing related support services, probation services, social work, and family intervention programmes. In a recent review of the empirical evidence around PbR, Fox and O'Leary (2017) find at least thirty-five PbR programmes have been established in the UK since 2010. As this number only covers PbR programmes that have been formally evaluated, it is likely the total number of PbR programmes is considerably higher. Fox and O'Leary (2017) limit their review to programmes commenced since 2010 because outcome-based PbR is often associated with the public sector reform agenda of the Conservative-Liberal Democrat Coalition Government of 2010 to 2015. In its *Open Public Services White Paper* (Cabinet Office 2011), the Coalition government stated that PbR was an essential part of its public sector reform programme and would increase the accountability of public service providers.

Both Coalition parties shared an enthusiasm for a 'mixed economy' of public service provision with a bigger role of the voluntary and private sectors, and for developing new and innovative ways of commissioning public services. The Coalition Agreement (HM Government 2010) contained several references to outcome-based commissioning in different areas of government, and also emphasized the new government's desire to re-think size and role of the public sector and a belief in extending individual and community involvement in tackling social problems.

However, UK Governments were using Payment by Results before the Coalition Government came to power in 2010. The Labour government of 1997 to 2010, for example, used PbR to fund active labour market interventions under the New Deal programmes in the early 2000s (Battye, 2015), and the Social Work Practices pilots in the late 2000s (Stanley et al., 2013). Indeed, Mitch (2010) suggests that Payment by Results is not a recent phenomenon; in some areas, such as education, dates back to policy experiments in Victorian England.

The theoretical antecedents of Payment by Results

Much of the limited theoretical literature around Payment by Results focuses on the role that incentives play in these types of outcome-based commissioning arrangements. A core assumption underpinning outcome-based commissioning approaches is that incentives matter; in particular, that financial incentives will change the behaviour of commissioners and providers. This conjecture is not generally disputed, however, the incentive structure has been heavily criticised in the academic literature around Payment by Results, with concerns raised in two specific areas: First, PbR draws on extrinsic, financial incentives to change the behaviour of commissioners and providers. It is assumed those working in the public sector are more motivated by the intrinsic rewards of making a contribution

Payment by Results: A theoretical and atheoretical analysis

to society or doing good for others, and less by extrinsic rewards such as pay. However, there is a concern the use of extrinsic incentives “run the risk of subverting the intrinsic motivation” of public sector employees (Rothstein, 2008). Secondly, it is argued that the use of outcomes-based commissioning increases the possibility of ‘gaming’ the system (Lowe and Wilson 2015). The concern is that the cheapest means of achieving a statistical result will be adopted, even where this undermines the value of the programme. A persistent critique of PbR schemes is that they act as perverse incentives that increase the risk of ‘gaming’ behaviours. These include ‘creaming’ or ‘cherry-picking’; where providers privilege easy cases, thereby maximising providers returns (Battye and Sunderland 2011, Carter and Whitworth 2015). Here, there is a significant gap between the theoretical and empirical literature; empirical research finds evidence of such gaming behaviour (O’Leary, 2017).

Theoretical discussions about incentives focus very much on *how* PbR is intended to work, not on *why* PbR has developed as a mechanism for commissioning public services. Here, we hope to contribute to the developing understanding of Payment by Results by suggesting that there are three potential theoretical drivers of outcome-based commissioning. First, such innovations can be seen as consistent with a programme of reforms collectively known as New Public Management (Hood, 1991). Secondly, they can be viewed as an attempt by policy makers to deal with complexity in the social world. Finally, they can be explained as a means by which policy makers seek to facilitate and develop new and existing philanthropic activity, social innovation and social enterprise.

PbR and New Public Management

In the past three or four decades there have been a series of public sector reform programmes aimed at modernising and improving public service delivery. Christopher Hood, in a seminal paper in 1991, collectively termed these reforms as ‘New Public Management’ (NPM) (Hood 1991). NPM has been the subject of much academic debate and conceptual development, and some recent discussion around whether it is still a useful term. But what underlies the concept of New Public Management is what Ferlie et al. (1996) refer to as the three Ms, namely: markets; managers; and measurement. Patrick Dunleavy, writing with colleagues in 2006, provides an alternative summary of NPM, identifying a different three ‘chief integrating themes’. These are: first, disaggregation, that is splitting up large public bureaucracies to create a number of smaller, less hierarchical organisations; secondly, competition, particularly splitting public services between provision and purchasing/commissioning functions; and, thirdly, incentivisation, with a greater emphasis on specific performance-based payment¹.

It is clear that PbR involves a mix of each of these themes. While the association of PbR with NPM is often focused on the role of incentives and performance management (Lowe and Wilson 2015), it is

¹ To these we might add a fourth theme (which Dunleavy et al., have associated with post-NPM reforms); the increasing use of digital and information technology.

Payment by Results: A theoretical and atheoretical analysis

also the case that PbR is related to wider themes within the NPM concept. The use of PbR is often associated with increased provider diversification and commissioning through externally contested markets. In associating PbR with the New Public Management reforms, there is invariably a connection made between PbR and neoliberalism (de Vries, 2010; Roberts, 2014). (Though such PbR has been directly associated with neoliberalism, over and above any link with New Public Management (McGimpsey, 2017; Kemshall, 2002).) Of course, neoliberalism is a word that is often used but rarely defined. When it *is* defined, concepts of neoliberalism are much contested. David Harvey argues it is “a theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade” (Harvey, 2005), a definition that is so broad as to encompass many, unrelated developments over the past five hundred years or so. However, to Harvey, marketisation in general is very much at the core of *modern* neoliberal thought as he goes on “if markets do not exist (in areas such as land, water, education, health care, social security, or environmental pollution) then they must be created, by government action if necessary. But beyond these tasks the state should not venture.” (*ibid.*)

When it was first introduced in 1938, the term ‘neoliberalism’ was taken to mean that the state ought to regulate markets, not that it ought to create and rely on them (Hartwich, 2009). The meaning of the term has now evolved to the extent that, today, neoliberalism is a much contested term (Hesmondhaugh et al., 2015; Venugopal, 2015) and, in addition to being imprecise, is overused (Watkins, 2010). It is a term most widely used in a pejorative sense – people seldom use it to describe their own outlook (Boas and Gans-Morse, 2009). (The Adam Smith Institute is a notable exception, yet they distinguish neoliberalism from the promotion of free-markets.)

It follows that we cannot explain marketisation by the assumption that there is a coherent, well defined and well thought out ideology which promotes this approach to public service delivery. The appeal – or assignment of blame – to modern neoliberal thought (if there is such a thing) appears rather to be an *ex post* attempt to associate and describe a series of reforms and developments which themselves arise through the interaction of political and financial incentives and risks. It is to the task of outlining these we turn in the following.

PbR and complexity

New Public Management might be considered a meso-level theoretical explanation (Albertson et al., 2018), in that it describes how but not why policy makers may seek to innovate. Meso-level theories such as New Public Management and meta-level theories – such as appeals to supposed neoliberalism – provide instrumentalist-based explanations of the development of PbR. These explanations assume that policy makers and others have deliberately and strategically intended to introduce forms of outcome based commissioning in accordance with an *a-priori* ideological stance. But there are alternative explanations, which do not assume a degree of coordination or collective instrumentality by policy makers; explanations we suggest that have greater explanatory power than

Payment by Results: A theoretical and atheoretical analysis

either NPM or ideology. We argue the development of PbR is best seen, not through historical institutionalism – as the latest, path dependent part of a wider set of institutional reforms – but rather as a piecemeal and largely unplanned development, adopted and amended by policy makers in some areas of social policy. This explanation argues that PbR is rather the response to political incentives carried out in the context of societal complexity.

According to David Dequech, ‘complexity is a complex term’ (2001) which, to be fair, does not take us far. Indeed, J. Barkley Rosser, in papers in 1999 and with Marina Rosser in 2005, identifies many different definitions, meanings and forms of complexity and a number of theories that seek to describe and explain complexity. Complexity of human choice in a dynamic world, and the complexity of the human social world is a theme that has been addressed by a number of important writers, including Hayek and Mises (Boettke and Coyne, 2005). But the development of complexity theory, and particularly an understanding of how the complexity of the social world shapes and is shaped by human decision making, owes much to Herbert Simon (Rosser and Rosser, 2005).

Complexity arises because the social world consists of a large number of parts that interact on many different levels (Simon, 1996). It arises because of the spontaneous order of the human social world; that individually purposeful action does not result in some fixed equilibrium system but rather is shaped by the unintended consequences arising when individually purposeful actions are aggregated. This complexity is reflected in: demographic changes; post-industrialisation; changes in the labour market; increased globalization; climatic vulnerability; changing expectations of taxpayers and service users; increasing demand; increasingly complex demand; and changes in information technology. Albertson et al. (2018) argue that growing complexity alongside increasing demands are likely further to reduce the risk appetite of policy makers, incentivizing them to seek commissioning arrangements that transfer political and financial risk to third parties. Therefore, policy makers may respond to complexity through decentralisation, transferring political and/or financial risk, increasing the number of providers engaged in delivering programmes, and focusing payment arrangements on the delivery of results. Outcome-based commissioning arrangements thus aim to transfer risk, in whole or in part, away from government (Battye 2015) in general. As PbR payments are only made when contractual outcomes are achieved, it is assumed that risk of service failure is transferred from government to providers.

A key further policy objective of outcome-based commissioning in the UK is to encourage new entrants to the market. Rather than government providing directly public services, delivery is spread across a number of non-government providers, thus diffusing risk and hence lowering systemic risk. Risk is also reduced through a process of ‘depoliticising’ (Burnham 2001) service delivery. It can be argued PbR may depoliticise certain public services by taking them out of the realm of political influence and decision-making. Thus, decisions about how services are delivered become technocratic rather than political (Flinders and Wood 2014). As such, PbR can be seen as part of a wider depoliticizing agenda that includes Foundation Trusts in health, School Academies in education and Probation Trusts in criminal justice (Diamond 2013). The motivating school of thought here is that markets might well be more stable than political ideologies and motivations.

Payment by Results: A theoretical and atheoretical analysis

PbR and social innovation

The final theoretical motivator of outcomes-based commissioning identified by Albertson et al. (2018) is that of social innovation and social enterprise. While Albertson et al. discuss this in relation to Social Impact Bonds, it is clear that the desire of government to encourage (or to be seen to encourage) social innovation underpins the development and use of PbR commissioning arrangements (Webster, 2016). PbR was intended to generate innovation both by influencing both commissioners' and providers' behaviour. For commissioners, PbR aims to change their focus: towards outcomes achieved by providers and away from specifying service delivery models and monitoring inputs and outputs, so that "the choice of method to achieve those objectives is transferred from the commissioner the provider" (Frontier Economics, 2014). For providers, the flexibility and choice of how and what interventions were delivered to meet the desired outcomes, coupled with financial incentives for meeting those outcomes, was intended to generate creativity and innovation in service delivery approaches.

But PbR as a tool for innovation goes further than incentivising behaviour changes by providers and commissioners. It is also the case the PbR has a market-making function; it is intended to increase innovation through competition between, and diversification of, public service providers. Further, there is some evidence that PbR is used policy makers as a means of financing new and different policy interventions and programmes. O'Leary (2017) in a review of the use of PbR in social care in the UK, suggests that many of the PbR programmes cover a number of new and different forms of social care, or ways of organising and delivering social care. In these instances, outcome-based PbR is part of a wider dialogue of innovation or change. This suggests that there is a nested relationship between PbR and innovation. Innovation is incentivised (at least in theory): at the policy/programme level; in terms of the provider market; in relation to the commissioning of services; and in how individual services are delivered on the ground.

Discussion

The three theoretical explanations for the development of PbR as a policy instrument discussed here were originally identified by Albertson, Fox, O'Leary and Painter in their book *Payment by results and social impact bonds: Outcome-based payment systems in the UK and US* (Albertson et al., 2018). These authors state that the three explanations are not alternative or mutually exclusive, and do not evaluate the three theoretical antecedents. In this paper, we have taken and further developed the three theoretical underpinnings suggested by Albertson et al., and in this section, want to assess each.

Seeing PbR as the latest public sector reform covered by New Public Management invariably links PbR to arguments relating to neoliberalism. However, appeals to neoliberalism from such poorly conceptualised, ubiquitous critiques, we do not find them particularly useful. A number of inherently

Payment by Results: A theoretical and atheoretical analysis

different and quite contradictory objectives, policy positions and programmes are held to be neoliberal, perhaps reflecting the underlying assumption that neoliberalism is the latest phase of capitalism, which itself is asserted to be inherently conflictual and full of contradictions.

Rather, we argue that there is merit in seeing the developing use of PbR as driven by policy makers desire to reduce risk and also encourage innovation. It is clear that much policy language around PbR and other forms of outcome-based commissioning is framed in terms of risk transfer, though little empirical work has so far tested the extent to which such transfers are achieved through the use of PbR.

The increasing use of PbR is also driven by a desire to innovate. Innovation here is a nested concept. It includes: (1) innovation by policy makers in terms of designing new programmes or interventions; (2) innovation in terms of increased diversification of numbers and types of service providers, generating both competition and collaboration; (3) innovation by commissioners in the form and nature of their contractual arrangements; and (4) innovation by service providers in the ways in which they design and delivery public services, and engage with service users and the wider public.

There is, thus, a contradiction inherent in the use of PbR both to reduce government risks and encourage innovation. The “result” for which payment is made is seldom “innovation”. Yet, for the service provider, innovation is a risky business; the potential of failure is an inherent part. As operationalised through PbR, subcontracting moves government from command and control, hierarchical arrangements to structures which seem to involve greater autonomy and choice by commissioners and service providers. But PbR is often used in ‘wicked problem’ social policy areas (O’Leary 2017); entrenched, complex, multifaceted social problems typified by degrees of equifinality and multifinality², that have largely been impervious to previous government policies or programmes. Existing programmes or interventions are already seen as failures. Promoting innovation in such areas through the use of outcome-based payment schemes is relatively low cost and low risk for policy makers, but it might not be low risk for service providers. If the service provider innovates and the new intervention fails, under PbR arrangements the government does not pay as risk has been transferred. Yet, if the innovation succeeds, policy makers may claim the credit for motivating the new interventions, programmes or ways of doing things. For policy makers, this would seem to be a win-win position.

Conclusion

In seeking to solve long-standing social problems, and deal with the arising problems of the 21st century, policy makers are motivated either to innovate or promote innovation. Such innovation might be informed by an ideological stance, where politicians promote interventions in line with their world-view. However, there are political risks involved in too close an identification with a particular policy.

² That is, one cause leading to many different outcomes; multiple causes leading to one outcome.

Payment by Results: A theoretical and atheoretical analysis

These political risks stem from taking responsibility for alleviating social problems in an increasingly complex globalised national economy.

Alternatively, social innovation might be informed by the conditions and incentives with which different actors in the policy debate face. Such actors will comprise, not only politicians, but also those who plan, deliver and require social interventions.

We have argued that the development of outcomes based commissioning, and payments by results in particular, does not arise from a coherent socio-political paradigm – though of course, it is possible that such a motivation might be ascribed *ex post*. Rather, policy makers innovate at a meso-level, attempting to respond rationally to the incentives they face. We have discussed and analysed the political incentive structure in the UK and shown how, in response to their responsibility to the electorate, policy makers may seek both to ensure the achievement of quantifiable policy results, that is, results which will justify their choice of action taken, and minimise their exposure to risk.

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Payment by Results: A theoretical and atheoretical analysis

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Payment by Results: A theoretical and atheoretical analysis

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