



Paying for Success

How to make contracting out work
in employment services



Edited by Peter Lilley MP
and Oliver Marc Hartwich

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Executive Summary

In December 2006 the Department for Work and Pensions commissioned David Freud to investigate welfare reform. The Freud Report, which was published in March 2007, had one core recommendation: to use the private and voluntary sectors in the provision of employment services. But while Freud briefly mentioned experiences made abroad, there was no detailed analysis of the reforms in other countries. Among UK policy makers, knowledge of international experience is patchy.

This gap spurred Policy Exchange to commission research about five countries that have reformed the way in which they provide employment services to jobseekers: Australia, the United States (Wisconsin), Germany, Denmark and the Netherlands. These countries are most frequently mentioned in welfare reform debates. Their experiences are assessed with regard to the lessons they hold for the UK by former Secretary of State for Social Security, Peter Lilley MP.

Welfare systems are notoriously complex. Understanding them requires considerable knowledge of the political systems, culture and labour markets in which they operate. Policy Exchange thus commissioned local experts who had in-depth knowledge of their (welfare) states. Their task was twofold: on the one hand they were asked to judge the effects of contracting out employment services on employment and, consequently, welfare spending. On the other hand, they were tasked with identifying any difficulties that had been experienced in the process.

The overall results are encouraging. The essays in this compilation show how use of the private and voluntary sectors has brought improvements in the employment services sector. While it is sometimes hard to isolate the effects of reforms in this area

from the more general changes to the welfare system, it is clear that contracting out employment services can improve the jobseekers' chances to find work quickly.

However, potential difficulties arise from the design of the contracting out regimes. Some of the authors have reported cases of 'creaming' and 'parking', where service providers concentrated on jobseekers that were the easiest to deal with or delayed and sometimes even ignored the most challenging cases. In Australia, success fees were sometimes fraudulently paid to employers taking on jobseekers for a limited period.

Altogether, *Paying for Success* provides insights into the design, implementation and pitfalls of contracting out regimes in employment services. While welfare reform experiences are hardly ever directly transferable from one country to another because of national peculiarities, the reforms documented in this collection of essays will be valuable to UK policy makers.

There appears to be growing cross-party recognition that welfare reform along the lines suggested in the *Freud Report* is the way forward, and indeed *Paying for Success* confirms its benefits. But in doing so, mistakes made abroad should and can be avoided.

Key lessons:

Peter Lilley: Paying for success

- The welfare reforms documented in this volume show the potential of contracting out employment services. In Wisconsin welfare rolls fell by 80% over three years. If similar changes in the UK achieved only a quarter of this change, the annual budget for Incapacity Benefit claimants would be cut by £1 billion, and funding for lone parents with children over seven by around £300 million.

- If the UK matched the 50% drop in job placement costs achieved in Australia, the cost of operating the welfare system would be cut by £250 million.
- In mainland Europe, too, welfare reforms have had positive effects. Germany's unemployment count fell by 1 million in the two years after it started to reform its welfare state. Both Denmark and the Netherlands have been more successful in getting lone parents and the disabled back to work than other EU countries.

The main lessons that should be learnt from the international employment services reforms are as follows:

- Markets for welfare-to-work schemes evolve rapidly, so policy makers must be prepared to change regulations, particularly incentives, when they do.
- Each country has unique circumstances, and must pay attention to them when designing its own system.
- Deadweight losses are significant in systems that pay by results. 'Creaming', where companies concentrate on the people who are easiest to get back to work, and 'parking', where private providers ignore the hardest to get into employment, can be significant problems. The state may therefore have to identify the hardest to place individuals if private contractors do not have a positive incentive to do so. However, for all parties it is hard to identify such people.
- Negotiating contracts that give private providers appropriate incentives is difficult. To get the right outcomes, the state needs to be shrewd and may need to bring in negotiating skills from outside when it draws up such agreements.
- Choice is important, but experience in some countries suggests that benefit recipients do not pick and choose between welfare to work providers as much as scheme designers would like.
- Rating systems can reinforce payment by results to ensure desired outcomes.
- The conditions and sanctions faced by benefit recipients are central to their participation in back-to-work schemes.

Australia: The experience of contracting out employment services in Australia

(Peter Saunders)

- Contracting out cut the cost of getting claimants back in to work significantly. The Australian Productivity Commission found that in the first four years after the changes, the cost of the country's labour market programmes fell from AUD 3.7bn to AUD 1.3bn.
- The pursuit of cost savings has damaged the service quality received by the most needy welfare recipients.
- The 'choice' aspect of the market-based system has had little impact. Claimants have not acted like customers in a real market.
- The contracting out model worked well when its goal (getting claimants back into work) was simple. But when its aims became less clear (i.e. once it was given more social targets), it became less effective.

The United States (Wisconsin):

The Experience of Privatization of Welfare Services in Wisconsin (Jason Turner)

- The state saved around 15% of its welfare budget during the first contract period after the start of the reforms.
- Claimants showed themselves to be far more resilient to changes in their benefits and demands for them to work than previously thought.
- Flexibility among system designers and managers was important when they had to steer the system past unexpected problems.
- Big changes in what the state politicians were saying about welfare reform significantly affected the behaviour of the private contractors.

- The vitality of private providers, plus the incentives they faced, was vital to the success of the scheme.

Germany: The Labour Market Reform in Germany and its Impact on Employment Services (Hilmar Schneider)

- The reforms of employment services were part of a bigger welfare reform package that made significant contributions to the falls in unemployment after their introduction between 2003 and 2005.
- Because claimants have not had strong incentives to demand high quality services from providers, the system has not worked as well as it could have done.
- The lack of a price mechanism that could reveal the costs of working in certain areas has made placing the hardest to reach claimants unprofitable.
- The introduction of private providers has induced a significant amount of deadweight loss.

Denmark: The creation and regulation of markets in employment services – Danish experiences (Thomas Bredgaard)

- The introduction of the contracting out approach gave policy makers an opportunity to shift welfare policy towards a ‘work first’ approach.
- The Danish reforms moved through

two phases: the regime was created first, but it was tweaked when contractors were asked to ‘make a difference’ rather than just relieve the state of its administrative burdens.

- The creation of the market exposed politicians to the problems of dealing with behaviour that was profit-seeking but not supportive of the needs of many claimants. They thus had to deal with a situation that was working well, but not as efficient and simple as they had expected. Ultimately, the designers of the changes were made aware of the need to strike a balance between the possibilities of a market system and the social objectives of welfare policies.

The Netherlands: It’s the client stupid! An active role for the client in Dutch employment services (Els Sol)

- The emphasis on short-term job outcomes meant there were no incentives for providers to help the most disadvantaged.
- Outcomes were improved once Individual Reintegration Agreements were introduced in 2004 and the system was thus moved away from a ‘one size fits all’ structure.
- Comparing the quality of providers has been difficult, but the introduction of a ratings system will help.

1

Paying for success - the international experience of contracting out

By Peter Lilley MP

Payment by results is not a difficult concept to grasp. Nor is it novel.

Reward success and people will be more likely to deliver success. Invite organisations to compete to deliver the success which brings that reward and success is even more likely. But it has taken a long time even to consider applying these simple concepts to the public services.

There are few areas where success is more valuable than in helping people off welfare and into work; it is in the interest, above all, of the workless person; it is in the interest of their families and communities; it is in the interest of taxpayers through reducing the welfare burden; and it is in the interest of the economy through increasing the workforce.

The only people at present who do not stand to benefit directly from success in enabling people to move from welfare to work are those whose job it is to help them do that.

Maybe that is one reason the UK has been less successful at boosting employment than might be expected after a long period of steady growth with a deregulated labour market.

Even among men of prime working age¹ – 25 to 49 – more than one in nine is not in gainful employment after 15 years of steady growth. Their employment level has stagnated between 88 and 89% throughout

this decade and is still below the recent peak employment rate of 90.3% reached in 1990. Even that is far short of the employment rates of prime working age men in the 1950s and 60s which were over 96%, albeit not on an entirely comparable basis. Among older workers and lone parents the proportion currently not in work is far higher even than one in nine. And the proportion of young people not in work or education has actually risen since 1997.

The New Deal has not achieved the success that its supporters expected and even its critics hoped for. So it is not surprising that attention is returning to the idea of harnessing reward and competition to make our efforts to get people back into work more effective.

The last Conservative government announced plans to pilot a scheme called Britain Works loosely modelled on America Works which features in the studies below. It sought to harness the profit motive to the task of getting the long term unemployed into work on the basis of payment by results. As Secretary of State for Social Security I was disappointed that we had not started to do this earlier. The division of responsibilities between the Department of Social Security (DSS) and the Department of Employment (DEmp) was a major factor slowing things down.

1 For comparisons over time it is best to look at the employment rate of males of prime working age since the proportion of women who wish to work has changed over time for cultural reasons as has the proportion of young people staying in education and of old people approaching retirement age who choose early retirement.

Anyone with experience of Whitehall will know that it was easier to get the USA and USSR to cooperate at the height of the cold war than to get two Whitehall departments to work together.

Whether by accident or design, the Labour government removed that obstacle by merging the DSS and DEmp into the Department for Work and Pensions (DWP) in 2001. Had the plans to bring in private initiative and payment by results not been sidelined before then, that merger would have speeded up their implementation. It will make it easier to implement them now that they are being revived².

In the meantime other countries have taken up the idea of contracting out employment services to the private and voluntary sectors and of paying them by results for helping people get off benefit and into work. If we are to make up for our lost decade we need to learn from experience built up abroad.

That is why Policy Exchange commissioned five studies carried out by experts in each of the main countries which have been experimenting on these lines.

These studies reveal that the potential of this approach is, indeed, considerable. Wisconsin saw welfare rolls fall by 80% over three years. If the UK were a quarter as successful over the long run we could hope to see savings in the annual budget for Incapacity Benefit of over £1 billion and of the order of £300 million on lone parents with children over seven.

Australia reportedly reduced the cost of job placement by half. If DWP's placement costs are proportionate to those in Australia and savings were a quarter of those in Australia the British taxpayer could save around £1/4 billion annually on operating costs alone.

Above all the process of contracting out focuses attention on the central objective of helping people back into work. In Germany, before this was done, only 10%

of the Federal Labour Agency's 90,000 employees were involved in job placement.

It is hard to quantify the impact of contracting out in most of the countries studied since it formed one part of more comprehensive reforms which often came in over several stages. Nonetheless, it is significant that, for example, in the two years following the contracting out of some placement, Germany has seen unemployment fall by 1 million - the largest and most rapid decline in its history. And both Denmark and the Netherlands, who make extensive use of the voluntary and private sectors, have been more successful than other EU countries in increasing employment among previously excluded groups like the disabled and lone parents.

We have made considerable progress in the UK in tackling unemployment, i.e. in reducing the number of people on Job Seekers' Allowance. There is more to be done particularly for the long term unemployed, the repeat claimants and the growing number of NEETS (youngsters not in employment, education or training).

However, the largest category of people who are excluded from employment is those on Incapacity Benefit. This is an international phenomenon. It reflects two factors. First, changes in the labour market in developed countries have reduced the number of jobs available to the least skilled requiring purely physical effort or repetitive actions. They have been replaced by jobs mostly in the service sector which may not require formal skills but involve a degree of mental or personal involvement and adaptability. The second factor is that people displaced from the old physical and repetitive jobs have discovered how to access incapacity and similar benefits which are usually higher than unemployment benefits and do not require them actively to seek work. Once on those benefits they tend to lose motivation and employability so that they become permanently detached from the labour market.

² Although, when Chancellor, Gordon Brown was hostile to the idea for contracting out put forward in the Freud report, he has recently given them his backing.

In the UK access to the old Invalidity Benefit simply required a note from the claimant's own doctor which was usually forthcoming. So the number on it trebled over 15 years. After I replaced this with Incapacity Benefit (IB), which required an objective medical test, the number of claimants fell slightly, but then stabilised at the still appallingly high level of 2.6million.

Welfare reform is not a static process. I always envisaged further reforms and will wholeheartedly support measures by this government or the next to actively help people move from IB into work. Clearly some people with particularly severe disabilities will be unable to do so. However, the majority probably could do some form of work and would benefit from it. The more successful we are at helping them into work the more generous we will be able to be towards those who are genuinely too handicapped to do so.

The problem is that most people on IB face a chicken and egg situation. Out of work they lose motivation, their health deteriorates, and they become less attractive to employers. If they could get into work it would restore their motivation, often be good for their health, and enable them to acquire on the job skills. Even unskilled jobs require some knowledge and familiarity with the task - most of which can only be acquired on the job. Although most IB claimants could do valuable work, far fewer have the ability to identify what they can do beyond their previous occupation, fewer still have the ability to market themselves. And even if they could, a potential employer may require compensation for the period during which a new recruit is learning on the job.

So if we are to make serious progress in helping people off IB they will need support from an organisation which is motivated – to boost their confidence; to identify their aptitudes; to 'market' them to potential employers; and, if need be, subsidise them for a period. We take it for

granted in most other spheres that those involved in marketing and sales themselves require incentivising with rewards for success. It is high time we introduced that into the business of helping to sell the substantial but currently unrealised abilities of those on Incapacity Benefit.

Key lessons

The five studies commissioned by Policy Exchange reveal that, although the concepts of payment by results and contracting out are simple, their application is complex and fraught with difficulties. Every country that has adopted this approach has largely had to learn from trial and error how to implement it effectively. Hence the value of these studies. We can at least learn from their experience, emulate their successes and avoid some of their mistakes.

An adaptable system is essential

- Markets for welfare to work schemes evolve rapidly, so policy makers must be prepared to change regulations, particularly incentives, when it does.
- Each country has unique circumstances, and must pay attention to them when designing its own system.

However much we benefit from foreign experience and however well planned the system may be at the start, it will still need further adaptation in the light of experience. That has been true of every other country. One reason is that the market evolves as new suppliers gain expertise or prove inadequate and fall by the wayside. In Wisconsin the system was so successful that it had to be scaled down to deal with a far smaller case-load. In Germany ill-judged contract terms bankrupted the major provider of placement services.

Most countries found that incentives needed to be modified to avoid inducing perverse responses or because they were exploited in unintended ways. And systems

need to adapt to each country's unique circumstances – its labour law, economic structure, employment culture etc. So it is important that the initial system is not too rigid, top down, over specified or inflexible to be adapted in the light of experience.

Getting the incentives right

- Deadweight losses are significant in systems that pay by results.
- 'Creaming', where companies concentrate on the people who are easiest to get back to work, and 'parking', where private providers ignore the hardest to get into employment, can be significant problems.

The experience of all five countries suggests that one of the most difficult problems is designing the right structure of incentives for the providers. The most intractable issue inherent in any system of payment by results is how to minimise 'deadweight losses', discourage 'creaming' and prevent 'parking'. A 'deadweight loss' is payment for helping people to get jobs who would have got them by their own efforts. 'Creaming' is where suppliers select (if they have any say in who they take on), or focus their efforts on, those clients who are easiest to get into work – many of whom would have obtained a job with little or no help. This is particularly likely if providers are paid the same amount for everyone they help into work rather than being paid more for the harder to place or for increasing the proportion of their case load who find work above a base level. 'Parking' is ignoring, or devoting least attention to, the hardest to place clients who actually need the most intensive support. 'Parking' is likely to be a particular problem if the remuneration system provides additional resources or rewards for helping the hard to place only after they have been unemployed beyond a threshold period.

There is no simple solution to these problems in practice.

But in theory they can be minimised by designing incentives to align providers' interests with those of the taxpayer - which largely coincide with those of the jobless. The taxpayers' interest is to maximise savings on benefits (by helping people get work and stay in work) net of the cost of providing such help.

Bizarre as it may seem, not even the DWP's interests have been aligned with those of the taxpayer. The Department has not been allowed to use any of the savings in the benefit bill that it makes from welfare-to-work programmes to fund those programmes. The Conservative Green Paper on Welfare Reform promised to remedy this problem. This seems to have prompted the Chancellor to announce in his 2008 Budget statement that he will do likewise in future years.

Ideally, providers' interests would be aligned with those of the taxpayer if, in respect of each cohort of benefit claimants for which they were given responsibility, the providers were rewarded for reducing the benefits this cohort claimed in each future year by being paid a share of those benefit savings. The providers would use their share of benefit savings to meet the costs they incur in getting and keeping people off benefits – any surplus representing their profit for doing so effectively. One way to establish a fair and competitive level for the share of benefit savings needing to accrue to the provider would be to invite them to bid in terms of the amount they would require to undertake the task.

To assess how much the cost of benefits had been reduced by the provider's efforts would require a reliable forecast of what the benefits incurred by that cohort would have been in each future year without the provision of a welfare-to-work programme. Such forecasts can be made. Experience shows what proportion of a given cohort typically leave benefits each year and how many subsequently return and for how long.

For example, for a given cohort of new Incapacity Benefit claimants about 25% leave within three months; by six months some 42% have left; by nine months 52% have left and by the end of the first year it is about 58%. The pace then slows and by the end of the second year the original number of claimants has fallen by some 67%. So a provider would only be remunerated in any period to the extent he had reduced the welfare rolls below the projected base level for that period. This would eliminate the 'deadweight loss' problem.

Logically, the provider should be responsible *indefinitely* for each cohort of individual claimants assigned to him. He would then have an incentive to identify potential long term claimants and help them into work early, even if that requires disproportionate resources, since he will then be remunerated in respect of every future year they are not claiming benefit. Thus there would be no incentive for 'parking' the hard to place. On the contrary, providers would have an incentive to identify those who, without help, would probably spend the longest time on benefit and focus his efforts on them because if he can reduce the number of long term claimants he will be rewarded annually. Moreover, the provider would only be remunerated in respect of additional claimants helped into work for as long as they remain in work. The provider would not have any incentive to focus on the easy to place unless he could accelerate their return to work relative to what they would have achieved without extra help. And he would only do so as long as the cost did not exceed his promised share of benefit savings. So there would be no incentive for 'creaming'.

I emphasise that this is the theoretically optimal system of remunerating providers. It has not been adopted in full in any of the countries studied. Wisconsin Works has come nearest to it, with remuneration for welfare-to-work providers based on

savings relative to welfare spending plus administration costs in the pre-contract period.

One reason this model is likely to remain a purely theoretical ideal is that it implies indefinite responsibility for each cohort of claimants allocated to a provider. That would require indefinitely long contracts for a given cohort – which is unlikely to be acceptable and would limit competition and contestability. It would also require the ability to forecast with confidence the base level of benefit the long stayers would be receiving were it not for the extra welfare-to-work services provided under the contract. That information exists nationally on the basis of past experience but may not be available for local markets and specialist subgroups of claimants who may be assigned to individual contractors. The longer the contract period the more it is likely to be affected by changes in the economic environment which can neither be predicted by the Department nor influenced by the provider. Also, once contracting out becomes the norm there will no longer be any information about what would have happened in the contemporary economic climate in the absence of welfare to work programmes. So that too would make the theoretical model unacceptable in practice.

“ The aim must be not just to get people into work but to help them stay in work and preferably in rewarding jobs ”

Nonetheless, the model provides a useful theoretical template against which actual and proposed contract terms can be evaluated. Interestingly, David Freud suggested a three year contract period in respect of each cohort of claimants. This is considerably longer than applied elsewhere and apparently twice as long as the Treasury is prepared to consider. It would, however,

give scope – subject to getting other contract features right - greatly to reduce the incentive to ‘cream’ and ‘park’ benefit claimants. In addition, the problem of ‘deadweight losses’ would be reduced by only allocating to a provider a cohort of claimants who had already been on benefit for, say, six or twelve months.

One reason the Treasury is reportedly reluctant to envisage three year contracts is that they tacitly assume that providers will not be paid until the end of the contract period and will therefore demand substantially higher rewards. In fact, payment related to the saving in benefits relative to that expected in each period for each cohort could result in payment to providers as and when savings in benefits actually accrue to the Treasury.

One point this ideal template highlights is that remunerating providers simply on the basis of the absolute number of claimants helped into work in each period can lead to distortions. It gives no incentive to help them remain in work. Indeed, Germany found that making the first payment to the provider immediately after one of their clients was placed in a job led to fraud as well as ‘deadweight loss’. Still less does it give providers any incentive even to identify claimants who are likely to be hardest to place – let alone to devote proportionately more effort to prevent them becoming long term unemployed and eventually unemployable.

Identifying hard to place claimants early

- The state may have to identify the hardest to place individuals if private contractors do not have a positive incentive to do so. However, for all parties it is hard to identify such people.

If the provider of welfare-to-work services does not have an incentive to identify those likely to be hardest to place, the DWP or its prime contractor will have to undertake this. It will need to establish a

triage system to categorise claimants from the beginning by the degree of help they are likely to need and assign rewards and resources for helping them into work correspondingly.

Unfortunately, it is not easy to identify those likely to be hard to place. Attempts to find criteria which correlate with the effort needed to help any individual into work have not been very successful. Even a past benefit record is only a partial guide – partly because a majority of all claimants of JSA, for example, have been previous recipients. The fact that any individual is particularly difficult to place often only becomes clear with the passage of time after the basic interventions have failed. Yet we know that the longer people spend out of work the harder it becomes for them to get a job. So the earlier the intervention, the better.

Developing a triage system with criteria which accurately identify hard to place individuals early on should be a high priority. The methods used in Australia to classify claimants and in the Netherlands to relate support packages to individuals may be valuable in developing such a system.

Some categories of jobless people are self evidently more likely to be hard to integrate into employment than others – particularly drug and alcohol abusers, ex-prisoners, those with serious mental problems or learning difficulties. They will also probably need specialist help and may well need to be assigned to specialist organisations, appropriately remunerated for the more intensive effort needed to help them into work. It may well be that other categories are also identifiable and could usefully be assigned to a specialist provider – those unable to read or write or lacking numeracy, for example.

Acquiring skills in negotiating contracts

- Negotiating contracts that give private providers appropriate incentives can be

difficult. To get the right outcomes, the state needs to be shrewd and may need to bring in negotiating skills from outside when it draws up such agreements.

A key feature of the contracting out of welfare to work – as Denmark established as early as 1992 – is that it requires a split between purchaser and provider. The purchaser/provider split has been found to be beneficial in other areas of public services. It focuses attention on defining the objective of the service. And it prevents decisions being dominated by the vested interests of the provider.

However, it raises a central issue which every country has faced in trying to contract out their welfare-to-work system based on payment by results: how to negotiate contracts which provide appropriate incentives with the right choice of organisations to take on the task of helping people get into work.

As the UK goes down this route we will need to be clear about our objectives. The aim must be not just to get people into work but to help them stay in work and preferably in rewarding jobs. Remuneration should reflect and incentivise that. At the same time the contract must encourage suppliers to focus on helping the hardest to place back into work while avoiding paying for those who would have got jobs anyway. Ideally contracts should allow suppliers time to build up expertise (particularly at the start of the process) in the art of helping people into work. Yet it is also desirable that suppliers face challenges from new entrants and from other suppliers who prove more successful. The ultimate aim is to ensure the services provided are best suited to the needs of those who are being helped into work – which may differ between different categories like the long-term unemployed, older workers, those with different incapacities – as well as between individuals. That may

require specialist organisations contracted to focus on specific groups. Voluntary and other organisations with such skills may exist in some locations but need to be built up from scratch in others. In theory, at least, claimants are the ‘clients’ and should be able to choose between providers thereby exercising consumer pressure on them.

Devising and negotiating contracts which appropriately incentivise a suitable array of suppliers through remuneration terms, duration, degree of monopoly, geographical extent and scope of specialisation is a highly complex task. It requires skills that government Departments rarely possess and will need either to master or delegate to others – most likely through a appointing a prime contractor. It will be necessary to harness a large number of providers working in collaboration. But as the Wisconsin study suggests it is important that there is a lead contractor who can decide who does what. Relying on a partnership of equals can result in paralysis.

Giving claimants a choice of provider, though desirable, may not be worth pursuing

- Choice is important, but experience in some countries suggests that benefit recipients do not pick and choose between welfare to work providers as much as scheme designers would like.

The idea of allowing claimants to choose between alternative providers is attractive in theory. It should put pressure on providers to offer jobless people the services they want in ways they find most accessible. And it should make it more likely that jobless people are matched to providers offering the approaches best suited to their needs. But Australian experience suggests that these theoretical attractions do not emerge in practice. Most claimants failed to choose and had to be assigned to a provider. The Danes and

Germans also found that in practice few claimants exercised choice. The Australian authorities attribute this to the fact that benefit claimants are often people who are least used to exercising choice. It may also be that choice is most effective where people have to repeat the decision process – as when we buy necessities. But choice is least effective where, as in this case, the user is making a one off choice between providers with no previous experience of any of them to draw upon.

So it would probably be unwise to rely too heavily on claimant choice to force providers to compete to offer ever improving services to jobless people. If choice can only be provided by artificially creating alternative suppliers, who may be suboptimal in size, it is probably not worth the candle.

On the other hand the Dutch experience of providing each claimant with a personally tailored and transferable work plan may well be worthwhile studying.

Successful outcomes, rather than a prescribing process, should drive up quality

- Rating systems can reinforce payment by results to ensure desired outcomes.

The Australians, finding claimant choice to be ineffectual, have developed a star rating system to drive up quality. This may have a degree of merit. But the overriding incentive to succeed should be provided by the system of payment by results.

Conditionality is key to success

- The conditions and sanctions faced by benefit recipients are central to their participation in back-to-work schemes.

The success of contracting out and payment by results ultimately rests on making benefits conditional on engagement with work. The conditions and sanctions regimes are crucial – though the subject of future Policy Exchange study rather than these papers. The rigour with which conditions and sanctions are enforced will markedly affect providers' success in getting people back to work. If those powers were given to the provider there could be a severe temptation to exercise them too vigorously. So it is important that enforcement powers are exercised by a separate body – in the UK the DWP itself.

Conclusion

There can be little doubt in the light of foreign experience that it is right to seek to harness the profit motive to help people from welfare to work. But it will meet with resistance from those with vested interests in the status quo. That includes not only the public sector unions but some of the welfare lobbies who are more interested in seeking compensation for their client group than helping people leave it.

So implementing a successful programme of contracting out will require both courage and skill. But the intellectual tide worldwide is moving in this direction. The practical evidence suggests it can hardly fail to be an improvement on the status quo. And, above all, the needs of several million of our most disadvantaged fellow citizens demand that we harness the powers of competition and incentive to give them the opportunities from which they have been excluded.

2

The experience of contracting out employment services in Australia

by Peter Saunders

Introduction:

Welfare reform in Australia

Over the last twenty years, the Australian welfare system has been radically reshaped. The reforms started under the Hawke and Keating Labor governments, and gathered pace with the election of John Howard's Liberal/National Coalition government in 1996. With the return of a Labor government in November 2007, further reform is likely, although the direction that this will take is not yet clear.

The reforms of the last two decades have affected both the payment of benefits, where claimants have increasingly been required to undertake some prescribed activity in return for income support, and the organisation of employment services for jobless people, where government has come to rely on private and community sector organisations to deliver key functions.

The changes to the benefits system are not dramatic when compared with, say, the US experience, but they are significant. Activity requirements were initially applied to young, unemployed claimants, but they have gradually been extended both to older unemployed people and to sole parents with children of school age. There have also been changes to the definition of 'incapacity' in an attempt to limit the growth of Disability Support Pension

numbers. Nevertheless, most working-age Australians drawing income support are still not expected to perform any activity in return for their benefit, and total spending on income support has continued to rise. About one in seven working-age Australians is wholly or mainly dependent on welfare, even though the economy has been booming and jobs appear plentiful.¹

The privatisation of employment services was a more dramatic change, for when the old Commonwealth Employment Service (CES) was shut down and replaced by a new purchaser-provider model in 1998, Australia went down a path that no other country had explored. This system has now been in operation for almost ten years and has attracted growing attention around the world.

The origins of contracting out

The welfare reform process started in 1988 when a voluntary training, job placement and child care service (JET) was introduced for single parents seeking to return to the labour market. At the same time, a new unemployment benefit, called Newstart Allowance, was introduced and the long-term unemployed were for the first time required to participate in 'Intensive Assistance' in return for their payment.²

1 Saunders P, "What are Low Ability Workers to do When Unskilled Jobs Disappear?" *Issue Analysis (Centre for Independent Studies)*, no 91, December 2007

2 Intensive Assistance offered personalised support to help claimants get back into work. Following assessment of skills and job capability, it aimed to improve employability through tailored education and training.

These innovations were followed in 1994 by the *Working Nation* program, the core of which was a 'Job Compact' which guaranteed claimants who had been out of work for 18 months or more a job placement for 6 to 12 months, backed up by training as appropriate. To deliver this, the government enlisted the help of a variety of non-government agencies. The CES remained responsible for finding unemployed people jobs (the 'job matching' function), but management of labour market programs was shared between the CES agency, 'Employment Assistance Australia', and a variety of specialist voluntary and commercial agencies judged to have expertise in handling people with special difficulties. Contracts were awarded by fixed-price tender, and by 1996-97, 20% of cases had been contracted to private firms and 25% were being handled by community sector agencies, with the remaining 55% still managed by CES or other public sector agencies such as further education colleges.³

The new Liberal/National Coalition government that came to power in 1996 scrapped Labor's *Working Nation* program on the grounds that it was expensive and largely ineffective in getting people permanent jobs. In its place, it introduced a policy of 'mutual obligation' which required that young unemployed people should undertake a recognised activity in return for their payments. Over time, this mutual obligation policy has been extended. Although nearly two million people (almost one-fifth of the working age population) are still drawing welfare benefits of one kind or another, and the welfare dependency rate among working-age adults is as high as it has ever been.

What was not scrapped, however, was Labor's policy of contracting out employment services. Indeed, within a year of coming to office, the new government shut down the Commonwealth Employment Service altogether and replaced it with a completely new system based on the purchaser-provider model.

The new employment services system: Centrelink and the Job Network

From 1946 to 1998, the federal government's employment service, the CES, was responsible for assessment of job seekers, employment assistance, management of labour market programs, and monitoring compliance with activity requirements.⁴ But in the 1996-97 Budget, the government announced that CES was to be closed and replaced by a single statutory authority, called Centrelink, working with several hundred non-governmental employment agencies, organized as a 'Job Network' (JN).

Centrelink was conceived as the 'gateway' for unemployed people seeking labour market assistance. Operating under a Business Partnership Agreement with the Department of Employment and Workplace Relations (DEWR), its role included:

- determining eligibility of job seekers for Job Network services;
- providing information to job seekers about Job Network services;
- registering job seekers;
- assessing the job seeker's relative labour market disadvantage;
- referring job seekers to Job Network providers; and
- administering job seeker participation and compliance requirements.⁵

Under this system, Centrelink is the first point of entry for anyone seeking unemployment assistance. At its 321 Customer Service Centres, job seekers are assessed, registered and then referred on to a JN service provider. The original idea was that, once assessed, clients would choose their own JN provider, but most do not in fact do this and are instead allocated through an automated referral system.⁶

All other employment services were contracted out to JN agencies. These represented a mixture of for-profit and not-for-profit (charitable, religious and community) service providers, many of which

3 Eardley T, "Outsourcing Employment Services: What have we learned from the Job Network?" Paper to Centre for Applied Economic Research conference on the Economic and Social Impacts of Outsourcing, University of New South Wales, pp 6, 4-5 December 2003

4 Wong P, "Reward for effort: Meeting the participation challenge", *Australian Labor Party Discussion Paper*, November 2006

5 Australian National Audit Office, "DEWR's Oversight of Job Network Services to Job Seekers", *Audit Report*, no 51, 2005

6 Productivity Commission, "Independent Review of the Job Network", report no 21, June 2002

already had some experience of running labour market programs under previous *Working Nation* contracts.⁷

The employment assistance agency formerly run by CES (Employment Assistance Australia) was turned into a commercial company in which government owned 100% of the shares, and it joined the Job Network under its new name of Employment National. At the first round of tenders (Employment Service Contract 1, or ESC1), Employment National won a 37% market share, making it the biggest single JN service provider, but its share declined sharply to just 8% in ESC2, and in 2003, at the end of the ESC2 contract period, the company was wound up when the federal government failed to find a buyer.⁸

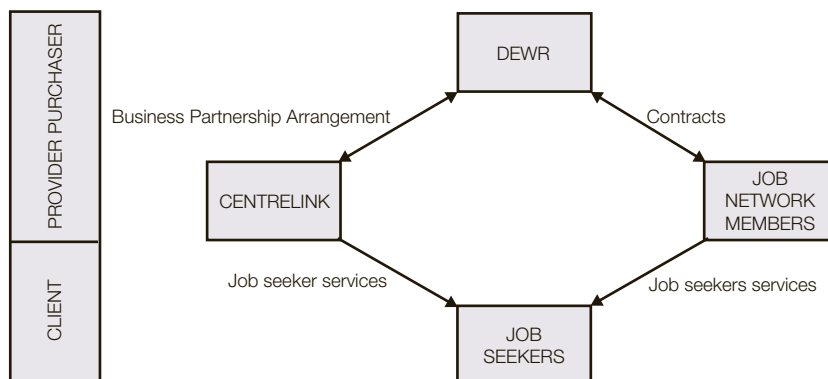
JN service providers are answerable to DEWR, although their customers are referred to them by Centrelink (see Figure 1). They were given responsibility for three core functions which had previously been the responsibility of the CES: Job Matching (i.e. finding vacancies for unemployed people to fill), Job Search Training (a total of 15 days training in writing application letters, compiling CVs, and interview techniques), and Intensive Assistance, which is aimed at those who

have been out of work for an extended period or are deemed to be at risk of long-term unemployment. JN providers also manage some minor programs, like the New Enterprise Incentive Scheme (to help job seekers set up businesses) and Harvest labour services (organising vacancies for seasonal farm work), and they are required to monitor job seeker compliance with activity requirements and to inform Centrelink of any breaches.

JN members enjoy flexibility in the services they provide and how they do it. Some specialize (e.g. by providing services for those with disabilities or for Indigenous job seekers), although unemployed people with special needs, such as those with mental health or substance abuse problems, are referred to the Personal Support Program which operates outside the Job Network. The relationship between DEWR (the purchaser), job seekers (the clients) and Centrelink combined with the JN agencies (the providers) is set out in Figure 1.

From the outset, the idea was that JN members should compete for referrals and be paid by results ('outcomes'). Fees-for-service were paid by DEWR when a job seeker was taken on by a JN provider, and outcome payments were added when

Figure 1: The new purchaser-provider model for delivery of employment services⁹



7 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, pp 6, 2003

8 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, 2003

9 Australian National Audit Office, "DEWR's Oversight of Job Network Services to Job Seekers", *Audit Report*, no 51, 2005

clients were successfully placed in a job (a lower outcome fee is payable if they complete an education or training course). This structure of fees and outcome payments has been revised over time as DEWR's policy priorities have shifted between rewarding rapid placements of job-ready clients and encouraging long-lasting placements of disadvantaged job seekers. But the key measure of success has always been placement of unemployed people in work (a so-called 'Work First' strategy).¹⁰ The more successful a JN provider is in getting unemployed people back into work, the more DEWR pays them, and the more likely they are to have their contracts renewed at the next round of bidding.

“ It was hoped that an incentivised system would result in more unemployed people getting jobs more quickly ”

quality and those that met the required standard were then ranked by price. Agencies submitting tenders could decide which of the three core service functions they wished to provide (it was not a requirement that all agencies offer Intensive Assistance as well as Job Matching and Job Search Training), and some bidders offered specialized services aimed at certain kinds of clients. Contracts were awarded to the agencies promising to deliver the required services at the lowest price.

Contracts were awarded to 223 successful bidders (a slight drop compared with the 243 agencies involved in contracting Intensive Assistance services under *Working Nation*).¹² Half of these were private (for-profit) contractors, 44% were community sector organizations, and the remaining 6% were government agencies (including Employment National, which ended up with a 37% market share). 79% of successful bidders at ESC1 had previously held government contracts for managing and administering labour market programs under the old *Working Nation* model.¹³

Following an early DEWR evaluation of how the JN was operating, a second round of contract tenders (ESC2) took place in mid-1999 when all first-round contracts expired. The Department was concerned that some service providers were neglecting the most difficult of their three core functions – Intensive Assistance to prepare the most disadvantaged job seekers to return to employment – and were instead making easy money finding rapid placements for job seekers who would probably have found jobs anyway if left to themselves. To counter this, ESC2 contracts required providers to agree an individual 'Preparing for Work' plan for anyone who had been unemployed for 13 weeks. This would identify any barriers to employment and put in place a strategy for overcoming them. Some observers thought this sig-

The aim of the reform was simple. It was hoped that an incentivised system would result in more unemployed people getting jobs more quickly, and in cost savings (efficiency gains) accruing to the government. As the relevant Minister, David Kemp, explained at the launch of the JN in 1998: 'An overhaul of employment services was needed because the old system under the CES didn't get enough people into jobs. It tended to 'manage' unemployed people rather than place them in jobs. Job Network focuses on results. Job Network members will be paid when they place a job seeker in a job for a sustained period of time.'¹¹

Job Network contracts

The first round of competitive tendering for JN contracts took place in mid-1997. Over 1,000 organisations submitted a total of 5,300 tenders for \$1.7 billion worth of contracts. DEWR vetted all tenders on

10 Strictly speaking it is not a 'Work First' strategy, for clients are registered for unemployment allowances by Centrelink and are then referred to a JN provider to find them work. This contrasts with the US 'Work First' approach where the emphasis is on finding clients a job before they register for benefits (see Mead L, *Government Matters*, Princeton University Press, 2004). Nevertheless, compared with the previous system, the new arrangements undoubtedly emphasise job placement as the primary outcome.

11 'New job network to replace the CES', media release, 26 February 1998.

12 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, table 1 pp 8, 2003

13 Productivity Commission, "Independent Review of the Job Network", report no 21, June 2002

nalled a move back towards an emphasis on training and labour market subsidies which had been scrapped when *Working Nation* was abolished.¹⁴

At ESC2, the original 29 Job Network regions were reduced to 19 in an attempt to make contracts more financially viable.¹⁵ These regions were then divided into a total of 137 Employment Service Areas (ESAs) so bidders could target their services at particular populations (e.g. Indigenous people in remote areas). ESAs covered between 100 and 18,000 job seekers, but most catered for between 4,000 and 6,000. DEWR wanted to recruit two or three competing providers in each ESA, but in some remote areas, no bids were received, and agency arrangements had to be negotiated outside the JN bidding process.

In the end, 168 bidders (including the government-owned Employment National) were given contracts worth \$3 billion at ESC2.¹⁶ The decline in the number of JN providers as compared with ESC1 was mainly due to the withdrawal of agencies offering only Job Matching and Job Search Training, for 80% of JN expenditure went on Intensive Assistance, and without this money, most providers found participation in the Job Network was not financially worthwhile (by the time of ESC3, held in 2003, every JN provider was required to offer Intensive Assistance).¹⁷ But although the number of different providers fell, the number of sites at which they operated rose to 2,010 (a 54% increase over ESC1). The Job Network was therefore expanding at the same time as it was concentrating.

Incumbency proved a strong advantage when it came to getting a contract at this second round of bidding, for 87% of ESC1 contractors succeeded at ESC2. The market share achieved by not-for-profit community groups increased from 30% to 45%, and for-profit companies increased their share from 33% to 47%.

These gains were made at the expense of Employment National whose share fell from 37% to 8%.

Incumbency proved even more important at the third round of contracts (ESC3) in 2003, for sixty per cent of business was now reserved for existing high performers. These were identified by 'star ratings' based on DEWR's estimation of the value added by each JN member over the previous two years. To measure 'value added', DEWR applied a complex formula that took account of the characteristics of clientele and of the local labour market as well as raw job outcomes data. Star ratings had been designed to help job seekers select the best provider, but as we saw earlier, few of them make an active choice. But the ratings system also fulfils a second key function by allowing DEWR to assess the quality of different JN providers when their contracts come up for review. With the abandonment of price competition from 2003 onwards (see below), these quality ratings have become vital in securing future contracts.

At ESC3, the 86 best performing JN members were 'invited to treat', and 74 of them took up the offer. Only 40% of business was put out to open tender, and in the event, most of this was mopped up by existing JN members. Only seven new providers joined the Job Network in 2003, and they won just 1.5% of the market (four existing providers who had not been invited to treat also won contracts in the open competition).

In all, 2,100 bids were received in 2003, an average of 15 in each ESA, and 109 organisations eventually won contracts.¹⁸ As in the previous contract rounds, therefore, the number of agencies shrank, and so this time did the number of JN offices (down to 986 sites, with 110 offering specialist services such as those for Indigenous job seekers). This reduction in the number of JN outlets was, however, balanced by the licensing of 266

14 Eardley T, "Outsourcing Employment Services: What have we learned from the Job Network?" Paper to Centre for Applied Economic Research conference on the Economic and Social Impacts of Outsourcing, University of New South Wales, pp 6, 4-5 December 2003

15 The larger number of labour market regions and providers in ESC1 was intended to promote competition, but was reduced to improve the economic viability of providers (Productivity Commission, "Independent Review of the Job Network", report no 21, pp 4.8-4.9, June 2002).

16 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, 2003

17 Productivity Commission, "Independent Review of the Job Network", report no 21, June 2002

18 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, 2003

organisations offering only *Job Matching* services (see below for details). These new licensed agencies share information on vacancies and job seekers with the 109 full JN members, so the total capacity of the job matching system was expanded substantially. According to a National Audit Office report in 2005, 250 localities now have an employment office where there was not one previous to 1998.¹⁹

ESC3 continued the trend towards market concentration. Existing providers consolidated their position and got bigger while outsiders found it increasingly difficult to break in. After 2003, the top five JN providers had 39% of market share, and the top ten had 55%. The average market share for those outside the top ten was 0.5%.²⁰ The two largest JN members were both community organizations: the Salvation Army (with a 15% market share) and Mission Australia (8%).²¹ Not-for-profit providers between them accounted for 54% of Job Network members (with a 50% market share), while commercial providers made up 43% (with a 47% market share). Following the closure of Employment National, the public sector shrank to just 3% (with 3% market share).

A fourth round of contract tendering was scheduled for 2006, but it never took place. When ESC3 expired in 2006, all existing contracts were extended for three more years, except where performance (measured by star ratings) was deemed unsatisfactory.

This trimmed the number of JN members from 109 to 103. Rolling local area tenders have now been introduced so poor performers can be replaced throughout the extended contract period at six monthly reviews. It is unclear whether these arrangements will now become permanent, or if another round of open tendering will take place in 2009 when the current extension period ends.²²

Learning by experience

By the time the third round (ESC3) of contracts took place in 2003, substantial changes had been introduced into the organization and management of the Job Network. These followed the publication in 2002 of an independent review by the Productivity Commission (PC), a statutory authority charged with analyzing and evaluating the delivery of government services.

The PC review found that the 'new framework has many advantages and should be retained.'²³ It thought the purchaser-provider model made the objectives of employment services providers clearer (by setting out contractual requirements in tender documents), and that incentives for achieving these objectives had been strengthened. There had also been cost efficiency gains. The new system was cheaper than earlier programs (like *Working Nation*), and it gets more favourable feedback from job seekers (e.g. a 1999 survey recorded a 'strongly positive view overall by job seekers about the JN').²⁴ Employer satisfaction too was running quite high (on balance, employers preferred the new system to the old CES),²⁵ although only 20% of employers in 1999 had actually used the Job Network to recruit labour. The PC also forecast that outcomes would improve over time as poor performers lost their contracts. It quoted evidence that the best JN performers were achieving outcome rates 12 percentage points higher than the average. The star ratings system meant they would increase their market share over time, thereby driving up the average level of performance of the network as a whole.

Not everything was positive, however. There was still a problem of 'perverse incentives' with hard cases being 'parked' on benefits while agencies focused their efforts on easier-to-place clients in order to maximize outcome payments. There were also substantial 'deadweight costs' since

19 Australian National Audit Office, "DEWR's Oversight of Job Network Services to Job Seekers", *Audit Report*, no 51, 2005

20 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, 2003

21 Department of Employment and Workplace Relations, *Job Network Employment Services Contract 2003-2006*, March 2003

22 Full details of 2006-09 Job Network contracts can be found at: <http://www.workplace.gov.au/workplace/Publications/Purchasing/PreviousTenders/Employmentandrelatedservicesguidelinesandagreements2006-2009.htm>

23 Productivity Commission, "Independent Review of the Job Network", report no 21, pp xxii, June 2002

24 Productivity Commission, "Independent Review of the Job Network", report no 21, table 6.1, June 2002

25 Productivity Commission, "Independent Review of the Job Network", report no 21, pp 6.23-6.25, June 2002

many of the successful ‘outcomes’ achieved by JN members would, in the view of the PC, have occurred even without the intervention of JN providers.

Nor was the PC impressed by the JN’s record in getting unemployed people back into work through Intensive Assistance programs. The report accepted that active labour market programs around the world generally achieve little success, and that *Working Nation* had achieved little in this regard either. Nevertheless, it concluded that Australia’s new employment services system was not having the impact that had been hoped: ‘Job Network programs have so far probably only had modest effects on job seekers’ chances of gaining employment.’²⁶ It also took issue with DEWR’s claim in its own second stage evaluation of the JN that Intensive Assistance programs were achieving a 10% net impact on unemployment of participants. According to the Productivity Commission, this estimate was ‘significantly overstated’.²⁷

In the light of these problems, several key changes were implemented in the organization of the Job Network in time for the third contract round (ESC3).

First, price competition was abandoned as DEWR returned to the fixed price tenders which had operated under *Working Nation*. This change implicitly recognized that some providers had been winning contracts with low tenders, but had then been maximizing their outcome payments by focusing their efforts on job-ready customers (who actually needed little assistance) while neglecting the harder cases. In 2003, the Department specified in detail the services it wanted to buy, and it fixed the price for each service, choosing among tenders according to its judgement of the quality of the service each agency could provide. This, of course, favoured existing providers who had already established reputations and enjoyed strong star ratings. Indeed, we have seen that the best performers were issued with invitations to

treat and did not even have to subject themselves to the competitive tender process.²⁸

“ JN providers are now paid a fee when they accept someone onto Intensive Assistance... If the client is subsequently placed in a job for at least 13 weeks, they get an ‘interim primary outcome’ payment ”

Secondly, fees-for-service and outcome payments were re-weighted to offer higher returns for sustained outcomes achieved by long-term unemployed job seekers. Commencement fees (paid when job seekers were referred to a JN member) were scrapped. Instead, JN providers are now paid a fee when they accept someone onto Intensive (and Customised) Assistance. If the client is subsequently placed in a job for at least 13 weeks, they get an ‘interim primary outcome’ payment (a ‘full primary outcome’ payment is made after 26 weeks, and smaller ‘secondary outcome’ payments are made when they place clients in education courses or in part-time jobs where they still draw some welfare benefits).

In ESC2, only 15% of commencements resulted in a job lasting 13 weeks, and another 8% resulted in an ‘interim secondary outcome.’ Most (about 70%) of the income of JN members therefore came from non-outcome-based commencement fees.²⁹ Since 2003, however, this balance between fees and outcome payments has shifted, and the rewards for work with long-term unemployed clients have been boosted.³⁰ Under ESC3, someone unemployed for 3 years who gets a job lasting 26 weeks would earn his or her JN provider a \$6,600 outcome payment, which compares with an average of \$4,500 earned over the previous 3 years in fee for service and other (Job Seeker Account) payments.³¹ As a result of this restructuring of fees and payments, the balance of income between

26 Productivity Commission, “Independent Review of the Job Network”, report no 21, pp xxxviii, June 2002

27 Productivity Commission, “Independent Review of the Job Network”, report no 21, pp 5.20, June 2002

28 Star ratings are issued every 6 months (at each ‘contract milestone’) on a rolling 2 year basis. 70% of providers score 3 stars or better (5% get 5 stars, 4% get 1 star, indicating ‘room for improvement’ (Department of Employment and Workplace Relations, *Job Network Star Ratings*, Australian Government July 2007). Stars are awarded based on job placement and outcome data. Where there are significant divergences in stars awarded to different providers within a single Employment Services Area, business is redirected from weak to stronger performers.

29 Productivity Commission, “Independent Review of the Job Network”, report no 21, pp xxxiv, June 2002

30 In 2007, initial job placements attracted a fee of \$165 - \$385 (depending on duration of previous unemployment). Intensive Assistance recipients placed in jobs lasting 13 weeks pay \$550 - \$4,400, and in jobs lasting 26 weeks (a ‘final outcome’) they attract an additional fee of \$825 - \$2,200 (again depending on their prior length of unemployment). Where IA people are placed in jobs which reduce but don’t terminate their welfare benefits, fee paid = \$550 - \$1,100. See Department of Employment and Workplace Relations, *Job Network Star Ratings*, Australian Government, pp 5, July 2007.

31 Senate Community Affairs Committee, *A Hand Up, Not a Hand Out*, Commonwealth of Australia, pp 67, 2004

fees and outcome payments seems to have shifted (one of the leading non-profit providers, CentaCare, operated by Catholic Social Services, reports, for example, that 47% of its revenue in 2006 came from placements and outcomes).³² Fees paid in respect of ‘Customised Assistance’ (offered when claimants have been unemployed for 12 months) were also increased (in 2003-04, 48% of all service fees were paid in respect of customized assistance).³³

“ If they are still jobless after six months, FJNE job seekers under the age 50 are required to participate in a six-month *Work for the Dole* project ”

32 Excluding payments for Job Seeker Accounts – see Murray P, “A Job Network for Job Seekers”, *Catholic Social Services Discussion Paper*, pp 25, November 2006

33 DEWR estimates that service fees of \$250 million were paid in 2003-04 for provision of Intensive Assistance (customized assistance), and that this represented 48 per cent of total service fees, quarterly payments and one-off payments (excluding outcome payments) to JN members in that financial year. Outcome payments for intensive support job seekers commencing and remaining in employment or education for periods of at least 13 or 26 weeks duration totaled a further \$171 million (Australian National Audit Office, “DEWR’s Oversight of Job Network Services to Job Seekers”, *Audit Report*, no 51, pp 127, 2005)

34 Australian National Audit Office, “DEWR’s Oversight of Job Network Services to Job Seekers”, *Audit Report*, no 51, pp 54, 2005

35 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, 2003; Wong P, “Reward for effort: Meeting the participation challenge”, Australian Labor Party Discussion Paper, November 2006

principles and processes in a manner that is sensitive to the job seeker's culture, circumstances and background.³⁴ For example, the third Employment Services Contract stipulated that Job Network members should contact and meet face-to-face with each job seeker once every fortnight during their first period of *Customised Assistance*. This meant a total of twelve service contacts were required in the course of a six-month period of Customised Assistance. Breach of this contractual requirement could result in a provider losing star ratings, and therefore being disadvantaged at any later period of contract renewal. However, stipulations like this can only set a quality baseline (there is no incentive to exceed the minimum quality standards), and they depend on a high level of surveillance to see if they are being followed.

A fifth change saw the introduction of licensing for job matching agencies wishing to link to the Job Network. ESC3 contracts for the first time required all JN members to offer Customised Assistance. The exclusion of agencies offering only job matching functions was compensated by these new licensing agreements under which *Job Placement Only* organisations were given access to the government’s new JobSearch database listing around 90,000 vacancies, and were paid a fee of up to \$550 if they succeeded in placing a job seeker in work. In return, these organisations were required to list all their non-executive vacancies on the database, for other providers to share. At the inception of this scheme in 2003, 375 licenses were awarded (including 109 to JN members).³⁵

The Active Participation Model

All these changes in 2003 were important, but the most significant of all was the adoption of an integrated ‘Active Participation Model’ for managing job seekers. This was key to the new rule that

A third change made in 2003 was the introduction of Job Seeker Accounts. These consist of money set aside by DEWR to cover expenditure incurred by JN providers on behalf of their clients in helping them get work. These accounts are intended to cover things like purchase of work clothing or equipment, payment of travel costs, course fees or payment of subsidies to employers (which again looks very much like a return to the days of *Working Nation*). This initiative was designed to encourage JN members to put extra effort into finding work for their toughest cases, but we shall see later that it has generated new problems, with JN members complaining about the detailed level of scrutiny their claims receive from DEWR, and some suggesting that their rivals are ‘buying jobs’ by blowing large sums on short-term employer subsidies.

Fourthly, to meet continuing concerns about poor service quality, ESC3 introduced an Employment Services Code of Practice and built a Job Network Service Guarantee into the Employment Services Contract: ‘The Code and Service Guarantee require that JNMs deliver a guaranteed set of services in accordance with specified

job seekers must remain with the same JN member throughout any single unemployment episode. This not only made it easier to monitor their progress over time, but it also meant a single plan for case management could be devised which all JN members would have to follow. In principle, this meant it should no longer be possible to ‘cream off’ the easy cases while ‘parking’ the difficult ones.³⁶ It also meant *JobSearch* and *Intensive Assistance* could run together in a continuum of increasing intensity as time passes. This new ‘service delivery continuum’ is outlined in Figure 2.

There are two main classes of job seekers who can access JN services:³⁷ the ‘Fully Job Network Eligible’ (FJNE), who are registered as looking for work and who are receiving income support (all job seekers aged 15 to 20 and not in full-time education or training are also included in this category)³⁸; and ‘Job Search Support Only’ (JSSO) job seekers, who are looking for work but are not FJNE (this second category might include, for example, single parents with pre-school age children or Disability Support Pensioners who are seeking employment even though they are not required to work).³⁹ Individuals in both categories are eligible to receive

JobSearch Support services, which means they get access to the Australian JobSearch national vacancy database, where their CV or ‘vocational profile’ is automatically matched with available vacancies on a daily basis. But only FJNE job seekers qualify for the additional services offered in the *Active Participation Model*.

If an FJNE job seeker remains unemployed after three months, they move into Intensive Support.

This begins with a period of Job Search Training that includes help with writing job applications, interview skills, and confidence building. Job search support continues during this period, so clients continue to search actively for employment.

If they are still jobless after six months, FJNE job seekers under the age 50 are required to participate in a six-month *Work for the Dole* project (or other Mutual Obligation activity). Participation (which normally takes up two days per week) is a condition of continuing to receive income support payments.

If they are still unemployed after 12 months, job seekers move into Intensive Support customised assistance (ISca). ISca is a six-month period when job seekers receive substantial, intensive and person-

36 The CEO of Job Futures noted at a recent conference that keeping job seekers with the same provider throughout means providers have to pay more attention to difficult cases rather than just parking them. Under ESC3 ‘providers who do not successfully achieve this goal not only find it difficult to remain financially viable but also find it increasingly difficult to keep their service provision contract with DEWTR’ (Dudley S, *Not Just Any Job*, Paper to Australian Social Policy Conference, University of New South Wales, pp 3, July 2005).

37 Australian National Audit Office, ‘DEWR’s Oversight of Job Network Services to Job Seekers’, *Audit Report*, no 51, 2005

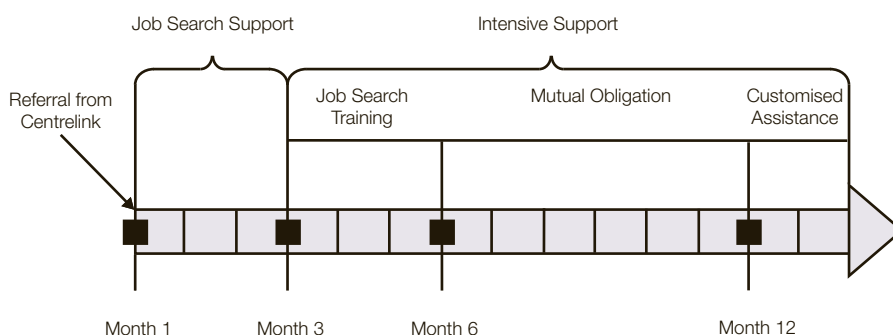
38 FJNE Job seekers do not receive income support until they have attended their first meeting with their Job Network provider.

39 Since 2005, all DSP and PP claimants have been allowed to volunteer for JN services and register directly with a JN provider if they want to.

40 Australian National Audit Office, ‘DEWR’s Oversight of Job Network Services to Job Seekers’, *Audit Report*, no 51, 2005

Figure 2: Stages in the Active Participation Model⁴⁰

Service delivery continuum



Source: ANO

Note: Job seekers who are the most disadvantaged in the labour market receive immediate access to ISca

alised assistance. It is tailored to individual needs and includes training, work experience in a subsidized placement, or referral to a language or literacy and numeracy training program. At this stage, JN providers may also draw on the Jobseekers Account for funds to support these various activities.

Job seekers who are identified by Centrelink as most disadvantaged skip the first 12 months of this continuum and move straight into ISca.

In the year ending June 2005, 144,300 job seekers participated in JobSearch Training, 298,900 had Customised Assistance, and 148,000 did a Mutual Obligation activity, of whom 81,900 did a Work for the Dole placement.⁴¹

More employment outcomes at less cost?

Not even the critics of the JN reform deny that it has succeeded in one of its key objectives - to reduce costs. DEWR's 2001 Net Impact Study claimed that the JN Intensive Assistance program had achieved better net job outcomes (i.e. after factoring out cases where people would have achieved employment even without assistance) compared with *Working Nation*, but this claim was later challenged by the Productivity Commission, among others. What was not challenged, however, was the claim that the system was delivering outcomes more cheaply than the *Working Nation* program that preceded it.

According to DEWR, each person placed in a job was costing between \$5,000 and \$6,000, compared with \$10,000 to \$16,000 under the previous arrangements.⁴² Each net employment outcome from Intensive Assistance programs was on average costing \$22,000 using the JN, compared with \$35,100 under the old system.⁴³ The methodology used to calculate net outcomes may have been suspect, but given that the same

methodology was applied to both the 'before' and 'after' data, the cost savings were clearly real.

In its 2002 report, the Productivity Commission noted that the aggregate cost of labour market programs fell by half in the first four years of the Job Network (from \$3.7bn to \$1.3bn), and that this saving was achieved with no apparent change to unemployment levels.⁴⁴ Similarly, Tony Eardley of the Social Policy Research Centre accepts that, 'The Network does seem to have made efficiency gains compared to earlier employment services in terms of public expenditure,' although he immediately adds that the changes have led to 'only modest improvements, if at all, in macro employment outcomes.'⁴⁵

DEWR continues to insist that the JN is not only cheaper than its predecessor - it is also delivering better employment outcomes. For its 2005 Net Impact Study, DEWR used a new methodology for estimating net job impacts based on a complex logistic regression modelling procedure which it claimed was the one approved by both the Productivity Commission and OECD. This factored out compliance effects (where jobseekers leave the welfare system as soon as they are required to begin some prescribed activity)⁴⁶ as well as dead-weight losses (people who would have found work anyway) and substitution effects (people who find a job but push someone else into unemployment as a result). And the results were impressive.

DEWR found that three months after completing the relevant program, 55% of those in JobSearch Training were in employment, as were 46% of those who did Customised Assistance and 32% of those who did Work for the Dole.⁴⁷ Net outcomes were calculated by comparing these actual outcomes with those predicted for people not having done these programs.⁴⁸ DEWR reported a positive 11% net impact on employment outcomes for those doing Job Search Training, a 10% net

41 Department of Employment and Workplace Relations, Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation - A Net Impact Study, Department of Employment and Workplace Relations, report 1/2006, April 2006

42 Department of Employment and Workplace Relations, Job Network Evaluation Stage 3: Effectiveness Report, Department of Employment and Workplace Relations, Report 1/2002, pp 4, 2002

43 Australian National Audit Office, "DEWR's Oversight of Job Network Services to Job Seekers", Audit Report , no 51, 2005

44 Productivity Commission, "Independent Review of the Job Network", report no 21, pp 5.24, June 2002

45 Eardley T, "Outsourcing Employment Services: What have we learned from the Job Network?" Paper to Centre for Applied Economic Research conference on the Economic and Social Impacts of Outsourcing, University of New South Wales, pp 10-11, 4-5 December 2003,

46 Eardley T, "Outsourcing Employment Services: What have we learned from the Job Network?" Paper to Centre for Applied Economic Research conference on the Economic and Social Impacts of Outsourcing, University of New South Wales, pp 9, 4-5 December 2003. Suggests the biggest portion of net impact was compliance effect.

47 Department of Employment and Workplace Relations, Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation - A Net Impact Study, Department of Employment and Workplace Relations, report 1/2006, pp 7 table 1, April 2006

48 Department of Employment and Workplace Relations, Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation - A Net Impact Study, Department of Employment and Workplace Relations, report 1/2006, pp 8 table 2, April 2006

impact for those undergoing Customised Assistance, and a 9% net impact for those undergoing a Mutual Obligation activity (7% in the case of Work for the Dole). Customised Assistance participants were also more likely than a comparable control group to have left income support, and to have done so more quickly.

Applying its new methodology retrospectively to its own, earlier, JN net impact studies, DEWR found that Intensive/Customised Assistance had achieved a net impact of just 0.6% in 2001, rising to 6.2% in 2002 and to 10.1% in 2005. It claimed this dramatic improvement could be explained by the adoption of the Active Participation Model, including the new fee structures and the Job Seeker Account.

The Department also compared these outcomes with those achieved by roughly comparable interventions overseas. It found, for example, that the 10 percentage point net impact of Customised Assistance compared very favourably with the 5 percentage point net impact achieved for similar long term unemployed clients in the UK who went through the New Deal.⁴⁹ It concluded: ‘These impacts are...equal to or better than those of high performing programs internationally.’⁵⁰

Looking at the raw figures, in 2006-07 the Job Network placed 186,400 long-term unemployed job seekers in jobs lasting at least 13 weeks (all these were either disadvantaged job seekers or people unemployed for more than 3 months). Another 6,600 on Intensive Support got education outcomes. The 2006-07 placements figure is a new record compared to 2000, when only 47,200 long-term/disadvantaged job seekers were placed in jobs.⁵¹

Problems and criticisms

Notwithstanding these impressive results on cost efficiency and (it seems) on net job impacts, the contracted-out employment services system continues to attract criti-

cism, and there clearly are a number of unresolved problems which will need to be addressed in the future.

Consumer choice

The original intention that Job Seekers should choose their service provider never really worked – most simply get allocated a JN provider by Centrelink after their needs have been assessed. Part of the reason for this may be inadequate information – the National Audit Office found that Centrelink offices were failing to give job seekers enough information about different JN members to allow them to make an informed choice.⁵² But it also undoubtedly reflects the characteristics of the clients themselves. DEWR’s core client group – ‘disadvantaged job seekers’ – are not people who are used to making active choices and decisions in their lives, and it always was a faint hope that they would put time and effort into selecting a JN provider, rather than simply leaving it up to Centrelink to give them one.

Not only do they fail to choose their own provider, but since the introduction of the Active Participation Model, job seekers are not allowed to switch between providers, except under very limited circumstances, so dissatisfied consumers can no longer ‘vote with their feet.’ All of this undermines one of the core advantages of a market model, which is that producers have to compete to attract consumers. In reality, even though unemployed clients are still called ‘customers,’ the real customer for JN members is and always was DEWR.

The absence of real consumer sovereignty in this quasi-market means there has been a recurring problem of rewarding or penalising the quality of the service being provided to job seekers by different JN members. When consumers do not choose between providers, other, generally inferior, ways have to be found to judge the quality of service they are being given.

49 Department of Employment and Workplace Relations, *Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation – A Net Impact Study*, Department of Employment and Workplace Relations, report 1/2006, pp 9, April 2006

50 Department of Employment and Workplace Relations, *Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation – A Net Impact Study*, Department of Employment and Workplace Relations, report 1/2006, pp 4, April 2006

51 ‘Job network continues to break records’ Media Release, Minister for Workforce Participation, 27 July 2007; Karvelas P, ‘Agencies put More Jobless into Work’, *The Australian*, 16 January 2006.

52 The audit assessed the quality of the information provided to job seekers by Centrelink at four centres, to see whether it was good enough for job seekers to make an informed choice of JN member. It found: ‘The provision of information and information products at information seminars and in information display areas was variable, often poor, and did not meet minimum requirements specified in the Business Partnership Arrangement. Many information seminars were not conducted prior to the job seeker making a choice of their JNM, and some job seekers did not attend a seminar at all’ (Australian National Audit Office, ‘DEWR’s Oversight of Job Network Services to Job Seekers’, *Audit Report*, no 51, 2005).

Sometimes this has been done by surveys (DEWR maintains that job seeker satisfaction levels are high, although this has been disputed by critics); the number of complaints can also be measured, although there are doubts about how effective the complaints procedures are in allowing clients to express dissatisfaction.⁵³ Codes of practice establish minimum standards, but their effectiveness depends on how well they are policed, and they fail to distinguish varying quality standards above the minimum level.

Increasing complexity and administrative costs

Given that the immediate consumers of the service do not discriminate between different providers, DEWR has to take on this role itself. This has created a recurring tension between the desire to give JN providers autonomy to run their own businesses and to innovate in response to varying local circumstances, and the need to monitor them from the centre to ensure they are fulfilling their contractual obligations and that public money is not being wasted.

The CEO of one provider says there was very little prescription from the centre in the first 3 or 4 years of the Job Network, but that criticisms from the Productivity Commission and elsewhere led to more DEWR control, so that today there is, 'a high degree of prescription of process combined with an awful lot of detailed administration'.⁵⁴ This is borne out by Catholic Social Services, which runs JN member Centacare. It complains of micro-management from DEWR, citing cases where tiny claims for reimbursement from the Job Seekers Account have been subject to intense scrutiny. According to Catholic Social Services, the old 'bureaucratic mindset' of the CES has re-emerged in recent years.⁵⁵

Part of the administration burden carried by JN members has been the cost and time involved in preparing tenders,⁵⁶ but

this issue has to some extent been addressed by scrapping the 2006 contract round and renewing all existing contracts. Nevertheless, a recent Labor Party review of the Job Network claims feedback from JN members is still raising concerns about the time and money spent on administration, and it also draws attention to the cost of DEWR's own administration (\$411.5m spent on administering labour market programs in 2006 – 18% of its total budget for these programs).⁵⁷ Similarly, Catholic Social Services points to the apparent inefficiency in having 1,200 DEWR staff in Canberra overseeing local management in just 1,100 offices.⁵⁸

Attenuation of competition

We have seen that by ESC3, it had become very difficult for new entrants to win JN contracts, for 60% of business was reserved for existing providers and most of the remaining 40% ended up with them too. The advantages of incumbency were reinforced by the decision in 2003 to merge Intensive Assistance, job search training and job matching in the new Active Participation Model, for this knocked out providers who could not offer IA services (although the new licensing system did bring in new suppliers of job matching services). The result was a dwindling in the eligible pool of service providers and a concentration of business in a smaller number of JN members. This can clearly be seen by comparing the number of bids received at ESC1 (5,300) with the number received at ESC3 (2,100).

Coupled with the increasing direction from the centre and the closing down of effective competition in the tendering process, this concentration of JN membership suggests that ten years after the old CES model was scrapped, the new system has begun to look increasingly like the old one. As Tony Eardley suggests: 'The JN has swung back to being highly regulated and government-controlled and only open to

53 The 2002 PC review recorded a 'strongly positive view overall by job seekers about the JN' (Productivity Commission, "Independent Review of the Job Network", report no 21, pp 6.6 table 6.1, June 2002), and found complaints running at less than 0.1% (pp 6.15). However, the National Audit Office report found job seeker awareness of the Code, Service Guarantee and associated complaints mechanisms remains 'very low,' and thought that this might prevent them from complaining about poor service (Australian National Audit Office, "DEWR's Oversight of Job Network Services to Job Seekers", *Audit Report*, no 51, pp 66, 2005).

54 David Thompson, CEO of Jobs Australia, interviewed on Counterpoint (ABC Radio National) Transcript: "Job Network Burn Out?", 31 July 2006.

55 Murray P, "A Job Network for Job Seekers", *Catholic Social Services Discussion Paper*, pp 20, November 2006

56 Productivity Commission, "Independent Review of the Job Network", report no 21, pp xxxi-ii, June 2002

57 Wong P, "Reward for effort: Meeting the participation challenge", *Australian Labor Party Discussion Paper*, pp 88, November 2006

58 Murray P, "A Job Network for Job Seekers", *Catholic Social Services Discussion Paper*, pp 20, November 2006

new entrants to a limited degree. It now makes even less sense than before to think of it as a genuine ‘contestable market.’⁵⁹

Quantity, not quality

Part of the problem that DEWR has encountered in monitoring and regulating the performance of JN members is that objectives such as speed, sustainability and equity of service cannot easily be measured. The result is that easily-measured outcomes (the quantity of successful job placements) are rewarded, while other objectives which DEWR says it wants to encourage (particularly those to do with service quality) are not.

In a recent, well-publicised and scathing report, Catholic Social Services claimed that although service quality is emphasized in JN contracts, it cannot be measured and is therefore not enforced. It claims that: ‘Ultimately the only real reward is for quantity of outcomes – Government expectations with respect to outcome quality and service quality are platitudes... providers who pursue [quality objectives] receive the same unit outcome fees and star ratings as those who give little attention to them... Job seekers are frequently met by a one size fits all service from providers focusing on quick fix and process oriented solutions (such as outcome buying) which often result in a mismatch between a job seeker and a job.’⁶⁰

This complaint that quality considerations are being neglected received support from the 2005 National Audit Office report which found that levels of contact between JN providers and job seekers rarely met contractual specifications. Job seekers receiving Customised Assistance are meant to meet with their service provider once a fortnight, but the Audit revealed an average of only 6.7 appointments per job seeker over a 22 week period, when eleven appointments were scheduled. The report concluded: ‘The nature and level of problems identified raises concerns about whether assistance is actually intensive and personalised’.⁶¹

The Audit report went on to note that, while the introduction of the Code of Practice and Service Guarantee was a positive step, these documents contain service commitments that are ‘largely subjective.’⁶² DEWR’s ‘Quality Key Performance Indicator,’ introduced at ESC3, is based on the Department’s satisfaction that services have been delivered in compliance with the Code and the Service Guarantee, but according to the National Audit Office, this assessment has to be based on ‘subjective judgements by DEWR contract managers, because most of the service commitments in the Code and Service Guarantee are not clear, measurable statements of service requirements.’

“Catholic Social Services claimed that although service quality is emphasized in JN contracts, it cannot be measured and is therefore not enforced”

A related problem is that DEWR’s Quality Indicator takes the form of a simple pass/fail hurdle. The default is that all JN providers pass unless a clear reason has been identified for applying a fail. The National Audit Office found that this pass/fail system did not allow DEWR to assess changes in performance over time, nor to compare variations among those who pass: ‘DEWR’s ability to gain assurance that job seekers receive high quality services from JNMs is limited by the lack of objective and measurable performance indicators relating to DEWR’s specified service standards.’⁶³

Perverse incentives and unethical practices

From the outset, DEWR has struggled to get the incentives right. The 2002 Productivity Commission report found problems of ‘creaming’ and ‘parking’, and although the Active Participation Model attempted to resolve both of these problems, these criticisms continue to surface.

59 Eardley T, “Outsourcing Employment Services: What have we learned from the Job Network?”, Paper to Centre for Applied Economic Research conference on the Economic and Social Impacts of Outsourcing, University of New South Wales, pp 2, 4-5 December 2003

60 Murray P, “A Job Network for Job Seekers”, *Catholic Social Services Discussion Paper*, pp 54, November 2006

61 Australian National Audit Office, “DEWR’s Oversight of Job Network Services to Job Seekers”, *Audit Report*, no 51, pp 131, 2005

62 Australian National Audit Office, “DEWR’s Oversight of Job Network Services to Job Seekers”, *Audit Report*, no 51, pp 55, 2005

63 Australian National Audit Office, “DEWR’s Oversight of Job Network Services to Job Seekers”, *Audit Report*, no 51, 2005

It is regularly claimed by critics that some JN members are short-circuiting the system to maximize their payments, and that more scrupulous providers are being disadvantaged and are having to cut the quality of their service just to stay in business. These concerns were forcibly expressed in 2006 by the Social Affairs correspondent of the *Sydney Morning Herald* who claimed: ‘The experiment has gone wildly wrong... rorts, unethical practices, waste of taxpayers’ money and short-changing of the unemployed are endemic... Competition is the wrong model if it rewards the cynical and punishes the ethical.’⁶⁴

A report issued by Catholic Social Services detailed some of the powerful perverse incentives that still remain in the system of payments. For example, if a JN member fails to place a job seeker in work in the first three months, it pays to minimize further assistance until twelve months have elapsed so as to qualify for the higher outcome payments attaching to placement of long-term unemployed clients.⁶⁵ Similarly, it pays to place a client in a short-term position, knowing they will soon return to unemployment, rather than putting in extra effort to find a more sustainable placement.

This report also identified a variety of practices which are arguably fraudulent as well as unethical. It claimed, for example, that the drive to maximize outcome payments was resulting in manipulation of recorded outcomes (a claim that was also made back in 2002 by the Productivity Commission). It suggested that some providers get an extra payment by starting clients on a low level job and then having them upgraded. Some JN members pay employers when placements do not turn up for work so as to maintain the continuous record of employment that is needed to prove a successful outcome. And some are said to engage in ‘outcome buying,’ using money from the Job Seekers Account

to subsidise employers so they will create short-term jobs that would otherwise not exist and that will collapse once the subsidy is withdrawn (\$102m was spent in 2005-6 on subsidizing 40,000 placements).⁶⁶

It is impossible to tell how widespread these practices are, and other JN agencies have rejected these claims. The main industry body (National Employment Services Association) maintains that DEWR scrutiny is very tight and there is ‘no evidence of people working to perverse incentives.’ Similarly, the CEO of one of the for-profit JN members says the participation requirements of the Active Participation Model mean it is now ‘impossible’ to delay placing people.⁶⁷ But malpractice does still occur, and it does not only involve the for-profit agencies.⁶⁸ In 2006, even the Salvation Army was ordered to repay \$9m after a DEWR investigation found they had wrongly classified some of their clients as needing Customised Assistance.

Undermining the autonomy and ethos of the community sector

Some of Australia’s biggest religious charities have become heavily reliant on government financing as a result of their participation in the Job Network. Public funds make up half the turnover of the non-profit JN providers, while commercial recruitment firms rely on government for only 3% of their profits.⁶⁹ The Salvation Army, Centacare (run by the Catholic Church), Mission Australia and Wesley Uniting Employment together now rely on JN contracts for one-third of all their income. As the *Australian Financial Review* noted, JN contracting ‘has been a key to the transformation of the charitable sector into big business enterprises under the Howard government.’

This high level of financial dependency has undoubtedly compromised the integrity of the community sector, and this is nowhere more apparent than in the repeat-

64 Horin A, “Jobless Just Pawns in a Nasty Numbers Game”, *Sydney Morning Herald*, 16 November 2007 (‘rort’ is Australian slang for fraudulent practice). This article was prompted by the Catholic Social Services report which claimed: ‘Some providers are sacrificing service quality for outcome volume just to survive’, Murray P, “A Job Network for Job Seekers”, *Catholic Social Services Discussion Paper*, November 2006

65 Murray P, “A Job Network for Job Seekers”, *Catholic Social Services Discussion Paper*, pp 36 and 38, November 2006

66 Murray P, “A Job Network for Job Seekers”, *Catholic Social Services Discussion Paper*, pp 31, November 2006

67 Morris S, “Job Network Agencies Split on System Abuse”, *Australian Financial Review*, 24 November 2006

68 Maiden S, “Millions Owed on Jobless”, *The Australian*, 13 February 2006. As we saw earlier, disadvantaged job seekers are referred immediately to customized assistance under the Active Participation Model. In 2005, responsibility for classifying job seekers passed from Centrelink to JN members themselves, and this led to a spike in special payments, triggering the investigation.

69 Bruttel O, *Managing Competition in a Public Service Market: The Job Network in an International Perspective*, Centre for Labour Market Research Discussion paper, no 3, pp 6, 2003

ed strains between the government and the not-for-profit JN members over so-called 'breaching penalties'.⁷⁰

If a jobseeker breaks the terms of his or her Preparing for Work Agreement, their Job Network provider is required to submit a 'participation report' to Centrelink which may then impose a financial 'breaching penalty' on the individual concerned.⁷¹ Breaches can result in a reduction of welfare payments, and repeated breaches can lead to full suspension of payments for up to eight weeks, or until the job seeker complies. In the early years of the Job Network, many thousands of people were sanctioned,⁷² but following inquiries by the Ombudsman and the Productivity Commission, procedures were changed and the numbers have fallen.⁷³ Nevertheless, the most recent figures (for the period from October to December 2006) still show nearly 4,000 people were suspended for eight weeks for breaching the conditions of their income support payment for the third time.⁷⁴

Welfare organisations campaigned against the breaching penalties system almost from the outset, and in 2002 they even set up their own 'independent inquiry' into breaches and penalties.⁷⁵ It concluded that the breaching system had operated in an 'arbitrary, unfair or excessively harsh' manner; that 'breaches are imposed too frequently'; and that penalties are 'often too severe' and cause 'unjustifiable hardship'.⁷⁶ It recommended that Activity Agreements should be watered down, that Centrelink should consider waiving penalties altogether if they are likely to cause hardship, and that no penalty should involve withholding more than 25 percent of benefits or should run for more than 8 weeks in total.

Although the federal government agreed in 2003 to reduce the penalty for a first breach, and set up a taskforce to ensure that Centrelink enforces the rules 'fairly,' the welfare groups have persisted with their demand that no penalty should last more

than eight weeks or exceed a 25% reduction in payments.⁷⁷ If this were ever implemented, it would bury the principle of mutual obligation, for claimants who did not wish to meet the requirements imposed on them could simply settle for a three-quarters payment, knowing that nothing more could be done to force them to comply.

The truth is that many welfare bodies have never felt comfortable managing the punitive aspects of their JN role. These are organisations whose traditional rationale has been helping people in need, and they have continually resisted punishment of non-compliance. The result is that they weaken the compliance regime at the same time as they compromise their own principles. The 2002 Productivity Commission report found that non-profit service providers under-report breaches by 12 per cent. This reflects their willingness to indulge transgressors, rather than any overzealousness on the part of other JN members.⁷⁸ As one sympathiser put it, "They often push their contractual obligations to the legal limits in order to avoid reporting a client to Centrelink for breaching."⁷⁹

In 2006, these tensions came to a head when the government extended mutual obligation requirements to single parents whose children had reached school age. The welfare groups fiercely opposed this change,⁸⁰ and some (like the St Vincent de Paul Society) refused to have anything to do with it. Yet despite their opposition, eighty organisations agreed to participate in a new 'financial case management scheme' designed to monitor families where breaching penalties had been imposed and to dispense special payments where there was evidence of hardship affecting children. Within a year, however, twelve welfare organizations had pulled out of the scheme, led by Catholic Social Services, arguing that the policy of breaching single parents was immoral and that they wanted nothing more to do with it.⁸¹

70 Tingle L, "Charity Faces Not-so-Tender Test", *Australian Financial Review*, 24 September 2002. See also Ramia G and Carney T, "New Public Management, the Job Network and Non-Profit Strategy", *Australian Journal of Labour Economics*, 6:2, 2003

71 There are two ways in which claimants may find themselves in breach of the conditions governing their payment: administrative non-compliance (e.g. failing to attend at the office of Centrelink or a Job Network service provider when required to do so, or failing to provide information when requested to do so); and activity test breaches (e.g. a failure to undertake an activity, such as training or job search, laid down in an Activity Agreement, or obstructiveness in the process of finding a job). Administrative breaches are seen as less serious than Activity Test breaches, and they attract lesser penalties. I have discussed breaching in more detail in Saunders P, *Australia's Welfare Habit and How to Kick it*, CIS/Duffy & Snellgrove, 2004.

72 Even though the total number of unemployed claimants was falling between 1997 and 2001, the total number of breaches rose by 220 per cent. Most of these were first offences but over 30,000 people were breached for the third time in two years in 2001-02 and were therefore cut off from payments altogether for eight weeks. See Saunders P, *Australia's Welfare Habit and How to Kick it*, CIS/Duffy & Snellgrove, 2004.

73 The 2002 investigation of Centrelink and the Job Network by the Commonwealth Ombudsman identified 'some deficiencies in Centrelink procedures and practice' which resulted in mistakes being made – McLeod RN, *Social Security Breach Penalties – Issues of Administration*, Canberra, pp ii, 2002

74 Peatling S, "Little Centrelink Cheer for the Poorest of the Poor", *Sydney Morning Herald*, 18 December 2007.

75 Pearce D, Disney J, and Ridout H, *Making it Work*, Report of the Independent Review of Breaches and Penalties in the Social Security System, 2002. The inquiry was sponsored by The National Welfare Rights Network, ACOSS, the Brotherhood of St Laurence, Jobs Australia, Job Futures, Mission Australia, the Salvation Army, the Smith Family and the CPSU.

76 Pearce D, Disney J, and Ridout H, *Making it Work*, Report of the Independent Review of Breaches and Penalties in the Social Security System, paragraphs 18-21, 2002

77 Senate Community Affairs Committee, *A Hand Up, Not a Hand Out*, Commonwealth of Australia, recommendation 14, 2004

78 The Productivity Commission found (Productivity Commission, "Independent Review of the Job Network", report no 21, pp 6-18, June 2002) that for-profit JN providers had higher breaching rates (12 percentage points higher) than not-for-profits. This is because they are more loath to report clients (6.20)

79 Kinnear P, "Putting Obligation in its Place", *Impact*, pp 9, February 2002. Kinnear is a former branch manager in the Australian public service and Research Fellow at the left-wing Australia Institute.

80 The Salvation Army complained that 'vulnerable groups within the community will almost certainly be adversely affected by this policy' (*The Australian*, "Salvos pull out of welfare to work", *The Australian*, 31 October 2006.

81 *The Australian*, "Twelve groups pull out of welfare to work", *The Australian*, 16 February 2007.

82 Murray P, "A Job Network for Job Seekers", *Catholic Social Services Discussion Paper*, pp 15, November 2006

83 Davidson P, *Strengths and Weaknesses in Australian Welfare to Work Policy*, Paper to Australian Social Policy conference, University of New South Wales, July 2007. These cannot, presumably, be serious mental health problems, otherwise these claimants would all be on DSP.

84 ABC Radio National Transcript, *Job Network Burn Out?*, 31 July 2006.

85 Brotherhood of St Laurence, "Brotherhood Welcomes Labor Call to Overhaul Job Network", *Brotherhood of St Laurence Media Release*, 25 October 2006. See also Nicholson T, "Social Inclusion the Path to Prosperity", *The Australian*, 23 November 2007.

86 Dudley S, *Not Just Any Job*, Paper to Australian Social Policy Conference, University of New South Wales, pp 5, July 2005

87 Dudley S, *Not Just Any Job*, Paper to Australian Social Policy Conference, University of New South Wales, pp 5, July 2005

Clearly, the welfare organisations feel increasingly compromised by the long-term relationship they have established with the government. They have become dependent on the government's money, but they do not want to dance to its tune.

Management of the hardest cases

The Job Network was set up when unemployment in Australia was running at over 8 per cent. It has virtually halved since then. This means there are fewer cases for JN members to manage, and that most people looking for a job can find one without much assistance. The cases that remain on JN members' books tend to be a lot more difficult and labour-intensive. This has caused problems for all JN members (reduced unemployment has forced some agencies to lay off staff), and it has prompted suggestions that the JN framework may be ill-suited to delivering the sorts of services and outcomes that are now required.

Caseloads have certainly got tougher. Catholic Social Services reports that the proportion of its clients with less than a Year Ten education has increased since ESC3 from 19% to 25%.⁸² The President of ACOSS (the peak welfare body) reports that 64% of those on the Newstart unemployment payment for more than two years have a Year Ten education or less. So too do 62% of those with disabilities and 72% of single parents claiming Parenting Payment. Nor is lack of education the only problem, for 45% of sole parents on Parenting Payment, 30% of Disability Support Pension claimants and 35% of long term Newstart Allowance recipients have mental health conditions.⁸³ These are the people JN providers are increasingly trying to help. As the CEO of Jobs Australia suggests: 'A significant number of the people left in the queue have very complex needs, typically mental health issues, housing issues, family relationship issues, all sorts of things that may make it difficult for them to comply.'⁸⁴

Some JN members now openly doubt

whether the JN system in general, or the Active Participation Model in particular, is appropriate for managing cases like these. The Brotherhood of St Laurence, for example, criticizes the emphasis on 'rapid movement into any job without ongoing support for career advancement or skill development,' and it claims the system is not well suited to handling people who are not job ready. It is a system geared to fast throughput of job-ready unemployed people, but these aren't the clients any more.⁸⁵

Sheriden Dudley (CEO of Job Futures, a combined community groups JN member) echoes these sentiments. He says the continuum model that underlies Active Participation is premised on the assumption that people can follow a pathway into work, but some cannot: 'We know that many job seekers are not able to follow this linear pattern and that the reality for many people is they move in and out of the system. This is particularly true for those with a mental illness... One of the many challenges facing JN is how do we support people through periods when they simply can't work, when employment outcomes seem at times to be the sole driver of the system.'⁸⁶ He goes on to argue for a system of rewards that acknowledges non-economic outcomes – 'many of those who have been referred to these programs in the past require a great deal of support in dealing with personal issues before they are ready to join an employment program.'⁸⁷ Under present arrangements, for example, a JN provider can put a huge amount of effort and resources into someone, but if they then drop out of work before 13 weeks have elapsed, their JN provider receives no payment.

The National Employment Services Association (NESA) is another voice arguing that the 'work first' ethos now needs changing. It says there should be more emphasis on 'proper' skills training rather than on rapid placement, and that this could make a positive contribution to

meeting growing skills shortages in the economy.⁸⁸ Whether people with mental health and other problems, who have failed to complete a Year 10 education, are actually capable of being trained to fill skilled vacancies is, however, an issue that these commentators rarely address.⁸⁹

Before it lost office, the Howard government made clear it was aware of some of these problems and that it intended to address them by further reforming the JN system at the 2009 contract round.⁹⁰ The new Rudd government has also swiftly signalled its intention to change fee structures in order to reward those dealing with the hardest cases, probably by strengthening interim payments.⁹¹ Whether this will be enough to answer the concerns of the JN providers is, however, doubtful, for there appears to be a fundamental problem in measuring non-specific outcomes like getting someone off drugs or building their self-confidence to a point where they can face going to a job interview. After ten years of wriggling within the JN system, the not-for-profits seem now to be suggesting that the whole system needs fundamentally rethinking, and at the time of writing, the new Rudd government has announced a review which will look into these concerns prior to the scheduled 2009 contract round.

Conclusions

Nearly ten years after employment services were contracted out to a new Job Network, there have clearly been significant economies and cost savings for the Australian taxpayer. There is also some evidence that placement of unemployed people into jobs has improved as compared with the outcomes achieved before 1998, and that the purchaser-provider model is now generating positive net impacts for most categories of job seekers that are as good as any in the OECD.

Yet having recognized this, there have been recurring concerns that savings have

been achieved at the expense of the quality of service offered to the most disadvantaged job seekers. To some extent, these claims reflect the anti-market and anti-competitive prejudices of many of the journalists, academics and not-for-profit JN providers who comment on these matters, for they instinctively prefer a cooperative, public sector model to a competitive private sector one. However, there is also some real substance to these claims, for some JN service providers have cut corners, and some (including religiously-based not-for-profit contractors) have been guilty of unethical or fraudulent practices.

An incentivised system like the Job Network will always run the risk that service producers will sacrifice quality and look for the easiest returns. In some cases, unethical and fraudulent practices are motivated by greed (a desire to maximize outcome payments); in others they may have been motivated by shrinking margins and the intensified struggle to keep their heads above water as a result of a declining client base and the increasing difficulty of placing the marginal clients who remain on their books. But whatever the immediate reasons, the root of the problem is structural, for this is a 'market' where consumers enjoy little or no sovereignty.

Job Network members cater to people who are not paying for what they receive and who have limited power to switch between providers if they are unhappy with what they are getting. The Australian experience suggests this is probably unavoidable, for much of the client base lacks the experience, capacity or desire to act as rational and discriminating consumers. This failure of the 'customer choice' ideal has inevitably led to a tightening of Departmental control, monitoring and regulation of JN providers as the only effective way of ensuring service quality. This has in turn resulted in increased administrative costs, both for DEWR and for JN members. It has also subverted one

88 National Employment Services Association, *Workforce of the Future*, NESA (South Melbourne), pp 4, 2007.

89 Saunders P, "What are low Ability Workers to do When Unskilled Jobs Disappear?", *Issue Analysis (The Centre for Independent Studies)*, no 91, 6 December 2007

90 Karvalas P, "Job Seekers to Face Radical Shakeup", *The Australian*, 21 July 2007

91 Karvalas P, "ALP Eyes New Job Network system", *The Australian*, 18 December 2007. See also Thomas M, "A Review of Developments in the Job Network", *Parliamentary Library Research Paper*, no 15, 24 December 2007

of the original aims of the reform, which was to give service providers the flexibility to innovate and to free them from the stranglehold of the central bureaucracy. As things have turned out, increasing central control has curtailed flexibility and has to some extent reproduced the old top-down system of bureaucratic management.

“ Rather than concentrating on getting these people into jobs, the not-for-profits want to be paid for helping them overcome their ‘barriers to work’ and for getting them fully ‘job-ready’ ”

Increasing central control has also exacerbated the tensions between the Department (the final and arguably ‘real’ customer for their services) and the not-for-profit service providers. This tension has been present right from the start, as is apparent from the long-running war of attrition over breaching penalties. As the mutual obligation policy has been extended to increasing numbers of welfare claimants (and to new categories of claimants, such as single parents), so these strains have become worse, culminating in a number of providers renegeing on their agreements to participate in the new ‘financial case management scheme’ for single parents.

Many of the not-for-profit JN members are lukewarm (at best) about mutual obligation and they dislike the ‘Work First’ principle around which the JN system has been constructed. They feel their mission has increasingly put them at odds with what their government masters are telling them to do. By 2006/07, some of them were openly campaigning to get the whole system scrapped, or at least radically overhauled. This tension at the heart of the Job Network has arguably been bad for the not-for-profit sector (whose autonomy and defining purpose have been compromised), and bad for the government and

the Department (which has struggled to have its policies implemented in the way that it intended).

The basic problem, therefore, is that this is not a ‘market’ in any recognizable sense of the word. Unemployed clients are called ‘customers,’ but most of them do not even choose their service provider, let alone pay them.⁹² As for the supply side, the JN providers are paid by results, but they can hardly be said to be competing for business any more, given that 97% of business allocated at the 2003 contract round went to existing JN members, and the 2006 round was scrapped as existing contracts were rolled over for another three years. Provided they meet minimum quality standards and maintain an adequate level of job placement outputs, JN members are now in little danger of being usurped by new competitors.

The real danger to their business is not competition from other suppliers, but government financial stringency.

The not-for-profits, in particular, have been active in campaigning for a change to the funding formula, arguing that the existing system of fees and outcome payments is unfair and outdated now that most of their cases consist of ‘disadvantaged’ clients. They want ‘Work First’ scrapped and more generous (and less conditional) payments introduced so that they can work long-term with disadvantaged clients in highly intensive, one-to-one, supportive relationships. Rather than concentrating on getting these people into jobs, the not-for-profits want to be paid for helping them overcome their ‘barriers to work’ and for getting them fully ‘job-ready.’

The push is therefore on to transform an employment services system with an economic rationale into a social services system with a social work rationale, and with a change of government in Canberra, it is clear that the Job Network model has reached a critical fork in the road.

As for whether a country like the UK would be well advised to follow in Australia’s footsteps, the lesson seems to be

92 They might become genuine customers if they relied on personal Unemployment Insurance or ‘Temporary Earnings Replacement Accounts’ rather than government welfare benefits – see Feldstein M and Altman D, *Unemployment Insurance Savings Accounts*, National Bureau of Economic Research, December 1998; Brunner L and Colarelli S, “Individual Unemployment Accounts”, *The Independent Review*, no 8, pp 569–585, 2004; Saunders P, “A Welfare State for Those Who Want One, Opt Outs for Those Who Don’t”, *Issue Analysis (Centre for Independent Studies)*, no 79, January 2007

that the purchaser-provider model works well if the desired outcomes are kept simple. If the clear aim is to get welfare claimants into work, then a system like the Job Network (coupled with appropriate reforms to the conditions attaching to receipt of welfare payments, and a tough sanctions regime for when these conditions are breached) can perform a lot better than a public sector bureaucracy. But if other objectives get tacked onto this, or the aim gets watered down or subverted (e.g. by moving away from a Work First policy), then the purchaser-provider model is likely to become less effective and manageable. The more difficult it is to measure outcomes, the less attractive a Job Network model is likely to be.

It is a case of horses for courses. A quasi-market in employment services will deliver lower costs and somewhat better job outcomes (although no labour market program, public or private, will generate strong net outcomes). But the Job Network is not a system designed or suited to delivering social work support to people with mental health problems, those who never finished school, drug and alcohol abusers, or those who have never become habituated to the routines of working. It is for the government to decide how it wants to manage these 'hard cases,' and if it wants to adopt a 'therapeutic' or 'treatment' approach, a profit-driven, contracting-out model is probably not the best option for managing it.

Australia

- GDP, 2007: \$890 billion⁹³.
- Population, 2005/6: 20.6 million⁹⁴.
- Number of people in the labour force, 2005/6: 10.6 million⁹⁵.
- Average weekly wage among adults in full-time work: \$967.9⁹⁶.
- Total spending on welfare, 2005/6: \$42 billion⁹⁷.
- Total spending on unemployment benefit, 2005/6: \$4.4 billion⁹⁸.
- Rate of per week unemployment benefit, 2005/6: \$182.50⁹⁹.
- Number of people unemployed, 2005/6: 514,000¹⁰⁰.
- Number of unemployed people in 2005/6 out of work for one year or more: 264,000¹⁰¹.
- Number of days formerly unemployed people must be in work for their assistance to be considered successful: 91 until an interim period, 182 until final assessment¹⁰².
- Total spending on incapacity benefit, 2005/6: \$7.3 billion¹⁰³.
- Rate of per week incapacity benefit, 2005/6: \$222.20¹⁰⁴.
- Number of people on incapacity benefit, 2005/6: 712,000¹⁰⁵.
- Total spending on lone parent benefit, 2005/6: \$4.3 billion¹⁰⁶.
- Rate of per week lone parent benefit, 2005/6: \$220.20¹⁰⁷.
- Number of people on lone parent benefit, 2005/6: 433,000¹⁰⁸.
- Average cost of successful placement in the private or voluntary sectors, 2005/6: \$19,750¹⁰⁹.
- Average per-placement saving from use of the private and voluntary sectors, 2005/6: \$11,639¹¹⁰.

93 An estimated figure; Central Intelligence Agency (2008) *The 2008 World Factbook* (USA: Central Intelligence Agency).

94 Australian Bureau of Statistics (latest relevant year) *Labour Force Survey* (Australia: Australian Bureau of Statistics).

95 Australian Bureau of Statistics (latest relevant year) *Labour Force Survey* (Australia: Australian Bureau of Statistics). Plus author's calculations.

96 Australian Bureau of Statistics (latest relevant year) *Year Book Australia* (Australia: Australian Bureau of Statistics).

97 *Ibid.*

98 *Ibid.*

99 *Ibid.*

100 Australian Bureau of Statistics (latest relevant year) *Labour Force Survey* (Australia: Australian Bureau of Statistics). Plus author's calculations.

101 *Ibid.*

102 *Ibid.*

103 Australian Bureau of Statistics (latest relevant year) *Year Book Australia* (Australia: Australian Bureau of Statistics).

104 *Ibid.*

105 Australian Bureau of Statistics (latest relevant year) *Labour Force Survey* (Australia: Australian Bureau of Statistics). Plus author's calculations.

106 Australian Bureau of Statistics (latest relevant year) *Year Book Australia* (Australia: Australian Bureau of Statistics).

107 *Ibid.*

108 Australian Bureau of Statistics (latest relevant year) *Labour Force Survey* (Australia: Australian Bureau of Statistics). Plus author's calculations.

109 Figure refers to Intensive Assistance off-benefit outcomes compared to *Working Nation* programs (1995-96) at constant 2000 prices. Author's calculation.

110 *Ibid.*

3

The experience of privatization of welfare services in Wisconsin

by Jason Turner

“The welfare system as an institution is abhorred by society because it separates the receipt of income from the need to work. But why do we think of work as so necessary to legitimize income? In its unique capacity to enable individuals to have the opportunity to serve others by producing valuable goods and services, work fulfills a basic human need. Work connects individuals to larger society – and in order for welfare’s destructive influence to finally end, work and income must be permanently rejoined.”

These words, written in 1995, laid out a fundamental premise of what was to become *Wisconsin Works*, a welfare reform notable not only for its departure from the existing welfare system of income support, but also in that it was devised from scratch without reference to any existing law. I was part of the changes, so give some insider’s insights during the following account of the changes.

In 1994 and 1995, the years when *Wisconsin Works* was being developed, the concerns of academics and policy makers about the rise of welfare dependency and its intractability were paramount. Since the onset of President Lyndon Johnson’s Great Society welfare dependency had

grown and grown, sometimes pausing, never permanently retreating.

Various reform efforts had been tried. These included experiments with versions of a negative income tax; required registration for job search; additional funds for education and training – all of which had failed to stem the rising tide of dependency. The challenge to the designers of *Wisconsin Works* was to devise a plan so powerful in its effects that it would be capable of stopping and reversing this trend.

Wisconsin and the national income support system

Government income support programs in America can be grouped into three categories – unemployment insurance, disability insurance and welfare.

- Unemployment insurance provides temporary income for individuals whose positions have been eliminated. Those fired or let go for good cause are not eligible. The amount of the benefit is set by the state up to a maximum and is based on the claimant’s work history and prior contributions to the fund through his employer. The maximum duration of benefits is typically six months.

- Disability insurance provides federally issued payments to individuals whose incapacity has been determined by the state to make the claimant incapable of providing for himself through earnings (parents may also claim disability payments on behalf of their children). The amount of these payments is not high, but is more than obtainable through welfare.
- *Welfare* is the term Americans use for the general income support program for low income families (named *Aid to Families with Dependent Children (AFDC)* until 1996, thereafter *Temporary Assistance to Needy Families*). Eligibility is limited to families in which parents are living with their dependent children. Unlike parts of Europe, a young man or woman out of school with no dependents and no work history cannot walk into an office and ask for income support (although job centers offer low-cost or no-cost job training and education, plus help finding work)¹. As a practical matter, the overwhelming proportion of welfare recipients are lone mothers with one or two children, sometimes more. Monthly cash benefits usually range between \$400 and \$600 per month, with food stamps bringing the total up to \$650 to \$800 per month.

Wisconsin's Governor Thompson was elected in 1986 on a platform of reforming welfare, and won an unexpected victory. Over the subsequent five years from 1987 through 1993 Thompson proposed changes to the welfare system almost once a year. These changes came in the form of experiments, called "waivers" of federal program rules. These programme change requests to the federal government would mostly be seen as modest by today's standards, but they all struck a similar and consistent theme, namely that welfare recipients should work and accept personal responsibility.

The state legislature, controlled by the opposition Democrat party, grew increasingly frustrated by the support for reform that the Governor had created through his series of proposals. Finally, the legislators struck back by passing a law which would completely abolish the existing *AFDC* programme. The law provided that in its place, the Governor must propose a work-based alternative. Would the law calling for abolition of the entire cash safety net for the poor be vetoed by the Governor? If so, reasoned some of the legislators, the opposition could take away his claim as the agent of reform, and they would be free to make proposals of their own.

Instead, Governor Thompson accepted the opportunity to design a work-based program from the ground up, unconstrained by existing law. He then set about his task in earnest, assembling a group of his staff to develop a proposal.

The philosophical underpinnings of the Wisconsin approach to welfare reform

The 1995 proposal resulting from the Governor's planning group was unprecedented in two ways. First, it was a complete change from the existing approach rather than an attempt to work around the edges of existing law. As a result, the program was generated from a set of consistent philosophical principles which were mutually reinforcing. Some of these principles and their rationales are summarized below.

1. For those who can work, only work should pay.

There are both economic and practical reasons for tying income to work. First, experience shows that entitlements to income without work have unwanted effects on dependency. In addition, it is essential that parents understand they will always be responsible for supporting themselves and their families through work:

¹ A handful of states provide for "general assistance", usually very low benefits available to singles, often concentrated among those with mental health or substance abuse problems.

this influences behavior and motivation in ongoing constructive ways. Finally, experience shows that individuals without extensive work history are usually in a stronger employment position after one or two years of actual work (at any wage) than after a comparable period of work preparation through education and training.

2. Begin with the assumption that everyone is capable of some kind of work.

The best way to help an individual out of work get back into the labor force is to provide an actual work opportunity which matches their capabilities. This is contrary to many government subsidized “helping” programs which seek to identify barriers and limitations to work, and in so doing categorize and place individuals out of the reach of the workplace where they might very well have succeeded if given the opportunity. Only by testing the suitability of work through actual attempts to work can any true limitations which prevent full participation in the labor force be identified and resolved.

3. Strengthening the ability of parents to provide for their children is a better approach than having the government intervene directly on their behalf.

In well-meaning attempts to look after the interests of children, government has, over time, participated in many of the roles that were previously the exclusive responsibility of parents.

There are many calls for government to take on still further responsibility for assuring the well-being of children. However, government cannot raise children, only parents can. Government can do the most by helping to put parents in a position to meet their responsibilities, not by taking away these responsibilities for itself.

4. Measure the fairness of the new system by comparison with working families

It is sometimes argued that a work-based welfare system will be unfair unless it can

be shown that those formerly dependent on various benefit programs will continue to receive a comparable package while working. Others argue that it is unrealistic to expect work for wages unless such wages will guarantee a high enough standard of living to make work seem worthwhile.

But self-sufficiency through work should be seen as an end in itself, quite apart from the package of benefits gained or lost as a result. More important is the relationship that those who are receiving welfare benefits have with comparable individuals who are working to support themselves and have not asked for assistance.

5. Look to non-government organizations to deliver the program.

It is axiomatic that government programs, authorized by legislation, must be overseen by government as an agent of the public interest. However, for too long government has been the assumed operator of the programs it devises. A more effective model is almost always for the government to set the ground rules and then let non-government entities actually operate programs under public oversight.

The Wisconsin-Works program (or W2) Under W2 there is no entitlement to cash assistance based on income alone. When an individual without work applies for help at a W2 agency, their access to cash benefits is dependent upon their actions to help themselves become economically self-sufficient through private employment. All individuals participating in the program “earn” their income (cash assistance) through participation, measured by the hour, in one of four tiers of employment in private or public settings. These four are from highest to lowest, which make up an employment “ladder”.

The Four Tiers of the Ladder:

1. *Unsubsidized Employment*

Individuals entering W2 should always be guided to the best available immediate job opportunity in the private sector. The agency is geared and focused on matching every participant's capabilities with the best work option available when they arrive, rather than diverting them to extended education and training.

Unsubsidized employment pays the market wage (currently about \$7.00 - \$8.00 per hour) along with the earned income tax credit (EITC) which contributes up to \$4000 per year depending upon family size and income.

2 *Subsidized Employment (Trial Jobs)*

Where an individual could succeed in private employment but lacks work experience or, in some instances, skills, the W2 agency can provide wage subsidies to private employers for a temporary period in order to offset some of the additional costs of integrating a new employee into the worksite. In practice, Trial Jobs are rarely used because employers say that the economics favour hiring even unskilled workers directly without the modest Trial Job wage subsidy, and they prefer to stay away from the administrative tasks of collecting the subsidy.

3. *Community Service Jobs (CSJs)*

If an individual tries and cannot find private employment, the next option is to work in exchange for benefits, in either a government or non-profit organization which serves the public. Examples include simple office work or outdoor maintenance for government. These jobs are intended to be 30 hours per week, to be useful even with minimal training or background, and to offer the opportunity for individuals without a work background to learn-by-doing, i.e. to get them experience in supervised work and task orientation in

an employment setting. An additional ten hours can be used for education and training, plus job search.

In order to replicate the circumstances of the workplace, the W2 cash benefit of \$673 per month is reduced (by a factor equal to \$5.85, the minimum wage) for each hour of scheduled work missed. CSJs are intended to be temporary. Each assignment is generally not to exceed six or nine months. The by-product of labour in such a setting is intended to contribute to the community and fulfill the essential civic role of work – giving to others in exchange for wages.

“ In practice, Trial Jobs are rarely used because employers say that the economics favour hiring even unskilled workers directly without the modest Trial Job wage subsidy ”

4. *Transitional Jobs*

For those unable to perform independent, self-sustaining work even in a CSJ because of limitations such as mild disability or substance abuse, Transitional Jobs are available for participation in work or vocational training and other activity such as treatment, consistent with an individual's capabilities. The grant amount is \$628 (less than that of a CSJ) for up to 28 hours of eligible activity, and up to twelve hours of additional education and training.

Summary of Incentives for Participants to go to Work

In order to receive cash assistance, an individual enrolled in W2 faces approximately the same number of hours dedicated to a community service job or a transitional job, as they would in full-time private employment. Leisure without obligations is no longer an option.

At each step up the work ladder, from Transitional to unsubsidized employment,

the net after-tax income (which includes the earned income tax credit for those in private employment) increases. Therefore, participants have every reason to accept the highest employment option they qualify for, starting with unsubsidized employment if available, or if not to move up the ladder when the option presents itself.

Supportive services such as subsidized child care or free medical care are no longer reserved for those enrolled in the welfare system, but rather to anyone on the income scale. Therefore, there is no longer an advantage to enrolling in welfare to just to receive these extra benefits.

The Operational Considerations Driving Program Design and the Privatization of Served

When implementing the work-based system, the W2 designers were faced with a dilemma. The organizational requirements of W2 are higher than that of running an income maintenance agency where the primary task is determining eligibility based on income (along with making referrals to separate job training or employment agencies).

Previously, welfare operations were divided into two parts: the eligibility determination process on the one hand, and all other services such as job placement, training and subsidized child care on the other. County government always provided eligibility determinations directly, and would perform the other services either directly or through contracts to private service providers.

The county-run welfare system could function satisfactorily where its central task was performing routine eligibility determinations. However, for more ambitious tasks the government has well-known limitations:

- It lacks accountability due to the diffusion of responsibility;
- Its performance compromised by decisions subject in part to political considerations;
- It loses mission focus as energy is sunk into attempting to coordinate the multiple organizational units operating a given program (e.g. the state policy making function, the county administrative function, and the non-profit service delivery function);
- It has an inability to shed non-functioning operational units.

In particular, Milwaukee, Wisconsin's largest county (population one million), showed resistance to mission change or operational improvement. Like many large cities, Milwaukee's welfare agency had weak management and a labor force rarely challenged to perform. In the period leading up to W2, the state had attempted to get the welfare agency to properly refer welfare recipients to private agencies for work or training; and when not participating in such training, to reduce cash benefits until recipients complied. The county agency exhibited limited bureaucratic capacity to carry out such multi-step processes. Furthermore there was not much interest among top management in the objective itself.²

In any event the requirements for W2 went beyond the task of eligibility determination and referral for employment. An agency would have to act in such a way as to limit its own size and influence in the lives of participants and instead to empower them to achieve economic self-sufficiency. Through contract incentives, its designers believed they could achieve this.

The two parts eligibility and job placement, were merged into one so that there would be a single organization wholly accountable for results. This organization, Wisconsin Works, owns the Job Center, provides eligibility determinations for cash

² The situation among counties outside of Milwaukee was much better, with most county agencies embracing the mission of economic self-sufficiency for its welfare population. But some objected to the state's preferred "work-first" approach to achieving this objective rather than the traditional education and training model. The designer's explanations and exhortations favoring the work-first approach and explaining its rationale, including the research evidence of its efficacy, were most influential when falling on willing county ears. However, even there the state had made progress in this regard by the introduction of "Work-First" pilots. These pilots, in which applicants for assistance looked for work even while their application was pending, proved successful in achieving early employment outcomes. Even better, the success of "work-first" was touted by the pilot counties themselves, leaving them to sell the idea rather than the suspect state.

benefits and gives work support, such as subsidized child care or “job access loans” (cash to help with enabling employment, e.g. for repair of an auto so the participant can drive to work). Most importantly, the role of the *W2* agency is to help applicants find the best available job opportunity at the time of application, and provide such a job itself as a last resort.

Helping individuals with marginal work histories required closer connections among case-workers, employers and participants. *W2* case workers were paid higher salaries and carried far lower caseloads than traditional caseworkers (about 75 instead of around 300). They could be recruited from among the best of the existing case workers, but also from the outside. Personality characteristics were judged to be more important than longevity or a specialized education.

Finally, *W2* agencies were designed to experience the maximum latitude to find their own solutions to achieving the desired outcomes; namely, employment and caseload reduction. In this regard state policy makers had struggled with some of the counties (not others) over the years before the implementation of *Wisconsin Works*.

Competition for vendor selection

In order to maximize the likelihood of *Wisconsin Works* succeeding, its designers envisioned a competition for program operators, open to any and all organizations, county government included. As potential *W2* agencies, three of the four types of potential *W2* operators had different strengths:

- County government, particularly in smaller or rural counties, was in certain places the only organization with the infrastructure ready to go. Looking forward, in many instances counties had dedicated staff and supportive elected officials.

- Non-profit organizations were sometimes well established and were already providing the kinds of services required under *Wisconsin Works* – particularly those that were likely to be expanded, such as community service jobs, which rehabilitation agencies such as Goodwill already provided on a relatively large scale.
- For-profit businesses were already providing employment and training services and could be expected to offer dynamic energy and be more capable of assuming risk. However, in the period leading up to *W2*, for-profit organizations were only a modest factor in the overall inventory of operating providers so this sector would need to be developed.
- Quasi-government providers, in particular the “private industry councils” with governing boards appointed by the counties along with volunteers from the local business community were the least appealing as agents of change. They were usually highly politicized organizations that made grants to employment and training vendors, and were hobbled by internal conflicts on their boards and in no position to lead a dynamic in-house operating agency. Consistent with our open competition, they were not excluded from the RFP process.

In an attempt to cajole the incumbent service providers into a force for change, their freedom of action was maximized to provide the clearest possible incentives for success.

In the past, multiple organizations combined into consortia diffused responsibility, and required consensus to act. Poor performing partners could not be expelled because they were part of the management team. Further, states would ask for a multiplicity of happy results – but the achievement of one would often

compromise the fulfillment of another.³ Under *W2* the state's objectives were clear – to maximize family economic self-sufficiency through employment and to reduce the corresponding cash assistance caseload. Partnerships were permitted, but only ones with prime- and sub-relationships so that leadership roles would remain clear.

Another consideration was size. A phenomenon was noted: the smaller the county agency, the higher the employment rate.⁴ Of course, the welfare population in small counties is generally easier to serve, and the culture of self-reliance higher. But there were other differences too, having to do with span of control. In a big city welfare department a recipient might not see the same caseworker twice, something which leads to anonymity. Follow-through is less likely to occur face-to-face and more likely through a computer tracking program. Responsible recipients looking to connect with the department for help often will not get through to caseworkers by telephone, with voicemails piling up. Managers and supervisors manage by numbers, paper files and adherence to regulations, not through the exertion of personal leadership.

For this reason Milwaukee was divided into six regions of about 6,000 welfare cases each, so that the state would contract with multiple vendors. Each region was drawn so that it would have, to the biggest degree possible, recipients of similar general characteristics. In addition to the expectation that smaller vendors would perform better, the scheme's designers hoped that multiple vendors in Milwaukee would reduce the state's risk, and that low performing vendors could be replaced with less disruption. Finally, they also hoped that smaller vendors becoming identified with their surrounding neighborhoods. Prospective vendor agencies were permitted to bid on more than one, and in the event one of the

applicant vendors (Goodwill) was awarded two regions, each with its own agency office.

Contract Incentives

Rather than replacing the old *AFDC* program with another one operated on the basis of the same regulatory “command and control” mechanism, the programme designers were looking to create powerful contract incentives which would be in alignment with the incentives that the participants themselves would experience.

In the period prior to *W2* there was an experiment with a simple form of performance incentives for job placement and training agencies which had functioned better than expected.⁵ The vendors earned part of their allocations based on their job placement success and they went earnestly to work, increasing placements by 29% the first year. But what was equally remarkable at the time was the degree to which vendors had been misallocating effort and resources prior to the introduction of this outcome-based payment system. One vendor director said “I had thought we were supposed to be getting recipients general equivalency degrees” (remedial education degrees). He said this despite the fact that the state had been exhorting the vendors to change their emphasis to employment for some time. It thus seemed that words were deficient and that the right tools had finally been adopted.

The initial contracts from September 1997 through December 1999 were structured so that reductions in the caseload resulting from movement off *W2* cash assistance into employment would reduce costs which would then be shared with vendors as follows:

- The initial contract amount was set by county region by calculating the current total welfare expenditures in the most recent period (including cash

³ For example, many states would ask their welfare training vendors to simultaneously increase exits due to employment and to maximize average wages at exit. These are both worthy objectives, but maximizing participant employment exits, including those with limited work experience, will depress average wages at exit (although not necessarily in the long run, as those in the labor market increase their wages over time). In this example it would be better for the state to give one assignment to welfare-to-work vendors (to get as many as possible into the labor market) and a second assignment to education and training vendors (to improve wages through skills upgrades among both the working and non-working population). The success measurements for each will differ, as will the corresponding strategies.

⁴ For example, for every 100 welfare cases in Milwaukee, there were 15 entered employments over a year, while the median mid-sized county obtained 26 and small counties 33.

⁵ In Milwaukee, the six job placement and training vendors were grouped into two teams, A and B. Each team had a lead vendor, and the proportion of referrals from the state to the respective teams was exactly proportionate to their respective total budgets for services. Since vendors from Team A had two-thirds of the total job placement and training budget from the state, they were referred to all individuals with social security numbers whose last three digits were between 001 and 666, with the balance to Team B. This system of referrals was easy for desk clerks to learn, and at the end of the competitive period the state could easily determine employment outcomes by using the social security numbers to match against quarterly wage payments already present in the state data file.

benefits, employment services and administration), and reducing this amount by twenty percent. This total amount could be allocated by the agency according to its needs, after cash benefits were first paid to eligible participants.

- Agencies generating caseload reductions which generated savings beyond the total budgeted amount for the period could keep the first seven percent of the savings in the form of unrestricted income (or profit). Thereafter additional savings would be divided three ways:
 1. Forty-five percent would revert to the state in the form of budget savings
 2. Forty-five percent could be allocated by the W2 agency to their local community for expenditures in general support of low income families, with approval of these expenditures by the state;
 3. Ten percent of additional savings would revert to the W2 agency in the form of unrestricted income (or profit).
- Agencies whose expenditures during the contract period exceeded the total allocation from the state would be obligated to provide the difference.

The Contracting Process

When the initial *Wisconsin Works* plan was made public in April 1995, it met with great interest. However, early discussion revolved around the provision which would open *Wisconsin Works* contract opportunities to any potential service provider – county, non-profit or for-profit. Since all state legislators have constituents employed in county welfare departments, almost all legislators heard from county employees concerned about the future of their jobs. From the perspective of the state welfare department, many or most of

Wisconsin's 72 county governments, especially in rural areas, were likely to do a good job administering W2, and the scheme's designers did not want to jeopardize the overall future of the plan due to objections over which were unlikely to prevail.

“ A phenomenon was noted: the smaller the county agency, the higher the employment rate ”

Looking to make the best of the situation, the designers created a right of first refusal for county governments which wished to operate W2 and met certain performance objectives in the twelve months prior to contract selection. The performance objectives selected were directly related to ones which would make the W2 agencies successful in helping their participants gain employment once the program went live in September 1997.⁶ The response upon the publication of these measurement elements by county management and employees was electric. County elected officials and managers began in earnest to work on achieving the right of first refusal, setting up their measurement systems and organizing their agencies along the lines required. At the end of the measurement period all but about half a dozen counties had succeeded in meeting the requirements, with the most notable and expected exception of Milwaukee (where county elected officials had in any event by then decided not to compete for W2, reasoning that the fiscal risks outweighed the rewards).⁷

The state next contacted prospective vendors located outside Wisconsin in order to have a robust and competitive bidding market, especially within Milwaukee. At that time several big for-profit corporations specializing in information technology were actively considering entering the

⁶ These performance objectives included:

- Reducing the welfare caseload by ten to twenty-five percent depending on prior results;
- Placing greater numbers of recipients into unsubsidized employment of at least 20 hours per week, increasing over three measurement periods;
- Placing those not working in private employment into the equivalent of community service or other jobs, increasing over three measurement periods;
- Reducing expenditures for cash assistance;
- Credit given to counties which had cooperated with the state and performed well in the past.

⁷ The right of first selection process showed that in certain circumstances government entities are motivated by financial incentive structures as well as private vendors are, and that the resulting improvements in operations, if any, should not be automatically assumed to derive exclusively from privatization.

welfare-to-work marketplace. They reasoned that their profitable IT businesses, already serving state human service agencies throughout the country, would be natural partners in gaining entry wherever they received contracts as welfare-to-work vendors. Companies considering such line extensions of their business at that time included Electronic Data Systems (EDS); Lockheed Martin IMS; Affiliated Computer Services (ACS); Deloitte & Touche; and IBM. However, although some of these companies already had welfare-to-work contracts elsewhere, for various reasons none of these giants elected to bid on *Wisconsin Works* in Milwaukee or in the state (EDS partnered with Goodwill, an eventual Milwaukee vendor, but provided only IT services).

It is possible that they were unnerved by the unusual state contract, in which vendors would be liable for making up shortfalls over the state budgeted amount (including shortfalls in cash assistance amounts) in the event they were not successful (smaller vendors, especially non-profits agreeing to sign the state contract, perhaps reasoned that were they poised to go under, the state would have to bail them out or take over the program, which in fact was true although it never happened).

One large for-profit that did submit a bid for several regions in Milwaukee was Maximus, a corporation which had pioneered the human service operations business in Los Angeles in the 1980s. Some smaller for-profits also submitted bids in Milwaukee and elsewhere in the state. After the RFP process contracts were awarded in Milwaukee to the following:

- Employment Solutions, a for-profit subsidiary of Goodwill Industries, a major provider of welfare-to-work services in Milwaukee and a long-time vocational rehabilitation agency with national presence. This agency was awarded two Milwaukee regions.

- Opportunities Industrial Corporation (OIC), an African-American community vendor which had provided welfare-to-work services in Milwaukee and was part of a national organization.
- United Migrant Opportunities Society (UMOS), a Hispanic community vendor which had provided welfare-to-work services in Milwaukee.
- YW-Works, a for-profit subsidiary of the Milwaukee YWCA and two other organizations which had provided services in Milwaukee.
- Maximus, a for-profit corporation without previous contracts in Wisconsin.

Eight counties other than Milwaukee were served by five private agencies in the initial implementation contracts.

The program results from the implementation of *Wisconsin Works* As September 1997 W2 start date was awaited, the programme's designers believed there would never be a more propitious set of circumstances boding for the experiment's success:

The plan was about to open its doors "on the street" almost exactly as planned, with virtually no significant design compromises along the way; the state economy was strong and general unemployment was going down; certain elements of the program had already been put in place in advance of implementation and the caseload was already moving in the right direction; the Right of First Refusal had organized the counties which would run the program around the program design; the Wisconsin public was well informed by the Governor and the media about the plan

and was with it all the way; its natural opponents among foundation-funded advocacy organizations and academics at the

University of Wisconsin were temporarily subdued (even if not supportive they acknowledged the plan's comprehensiveness and internal consistency); welfare recipients themselves had been exposed to and absorbed several years of media and public discussion about the importance of work; soon work in some fashion was to be the only option for receiving cash assistance; and for county and vendor operators alike the stakes were exceedingly high on both the upside and the downside.

Events had created a "perfect storm".

The results were more powerful than anyone, including its most optimistic planners, had anticipated. Immediately after *Wisconsin Works* opened, the welfare case-load began to collapse. In the year prior to W2, Wisconsin had about 55,000 welfare cases statewide – this dropped to 11,000 cases in the first thirty-six months of the program (thereafter rising slowly and then falling back to 11,000 in 2005)⁸

At the end of the second year the state looked back at all of the *Wisconsin Works* cases which had been enrolled in the program at some point and were now closed (32,000 cases or 81% of all who had enrolled). Of these, fully 76% had closed for earnings and income (9% had chosen not to roll over into the new W2 program from the old one, 8% had enrolled but then closed for failing to comply with W2 program requirements such as attending work assignments, 4% no longer met basic eligibility requirements and 2% closed for other reasons). Among those working, about half were earning between \$12,000 and \$18,000 per year (before additional refundable tax credits), about a third were earning less and about a fifth were earning more⁹ (the 1998 poverty threshold was \$13,001 for a family of three).

As would be expected with large numbers entering the labor force, poverty dropped substantially in both Milwaukee and the rest of the state.

The child poverty rate (a more sensitive measure than adult poverty) peaked at 34% in Milwaukee in 1993, declining in the period before W2 implementation, and then, in the first single year afterward, dropped a full six percentage points to 20%. Thereafter it rose slowly along with the weakening of the national economy around 2002; by 2006 after the beginning of the recovery it had given back about half of the drop from the top (the state and national trends were much gentler, but also followed a similar curve).¹⁰

The Critics of Wisconsin Works

Wisconsin Works is about ten years old, and has almost certainly been the most studied and analyzed program of welfare reform in the U.S. (in just the first three years the Urban Institute counted 53 studies completed or underway).¹¹ There are numerous critics of W2 and its work-first approach.¹² Criticisms fall into two categories: shortcomings in program implementation, particularly in Milwaukee, and the continuation of poverty as a social problem. Issues related to the first of these criticisms will be discussed at greater length below.

Wisconsin's most vocal critics at first warned of serious consequences which could be anticipated from large numbers who would be unable to cope with the work requirements of W2, and so would drop-out or never apply. Many would end up homeless, resorting to crime or, worse, the neglect or maltreatment of their children. None of these alarming predictions have come to pass. Instead, the rate of homelessness has remained flat¹³, crime is down 12% in the state since program introduction¹⁴, and incidents of child abuse and neglect have fallen in Wisconsin as they have nationally.¹⁵

Of course, poverty has not been stricken from the face of the Wisconsin prairie. Even if every individual who enrolled in W2 had found full-time work right away

8 Wisconsin Department of Workforce Development figures. Note that 9000 welfare cases without an adult (child-only) are excluded from both figures.

9 Wisconsin Department of Workforce Development, *Case Closure Study*, Wisconsin Department of Workforce Development, 2000

10 U.S. Census Bureau, see <http://www.census.gov/>

11 Urban Institute, *Overview of Research Related to Wisconsin Works*, Urban Institute, March 2000.

12 As an example see University of Chicago Chapin Hall Center for Children, *Issue Brief #107*, May 2006.

13 Reliable statistics are difficult to obtain; anecdotal reports from author's interviews with the director of Hope House, Milwaukee's largest shelter, indicates that the total number of overnight stays has remained relatively constant since *Wisconsin Works* was introduced; fewer individuals are entering the shelter but this is offset by an increase in average length of stay. Also see Milwaukee Continuum of Care Steering Committee, *Homelessness in Milwaukee*, July 2007 for a point in time survey.

14 Wisconsin Office of Justice Assistance, *Crime and Arrests in Wisconsin 2006*, Wisconsin Office of Justice Assistance, pp 105, 2006

15 See Urban Institute, *Welfare Reform's Effect on Child Welfare Caseloads*, Urban Institute, February 2001; University of Chicago, Chapin hall center for Children, *Issue Brief #107*, table 5, May 2006.

16 University of Wisconsin, Institute for Research on Poverty, *Child Support Demonstration Evaluation, Phase I Final Report*, pp 2, 2001

17 State of Wisconsin, Legislative Audit Bureau, *Evaluation of the Wisconsin Works Program*, table 27, April 2005

18 Another criticism is that Wisconsin's work-first, or labor attachment model, would benefit from the addition of more hours of education and training, or even that education and training should substitute for community service work hours (note that non-work activities including training have been increasing as the program matures, but is intended to be an adjunct not a substitute for work). However, education and training as an intervention for the welfare population has been exhaustively studied over thirty years, including using extensive random assignment experiments, and has consistently been demonstrated to have barely detectable, or no detectable impact on wages or employment (one experiment in Portland Oregon with mixed work and training emphasis showed some impacts).

19 This categorization is based on the judgment of the author of this paper, taking into consideration general performance over the entire contract periods, reputations within Milwaukee and the state, and the author's own knowledge. The three high performers have been Goodwill (Employment Solutions), YWorks (YWCA lead agency); and Maximus. The average performer has been United Migrant Opportunity Society (UMOS) and the poor performer was Opportunities Industrialization Corporation (OIC) which is now out of business. The high performer which got off to a bad start and recovered is Maximus. The organization hired a poor director who was fired after a scandal, after which operations improved markedly. As of the date of this paper, the state has added new vendors and organized the contracts differently, which is not taken into consideration here.

20 The descriptions which follow are based on interviews in January and February 2008 with Milwaukee agency directors and managers who were present at that time, and the author's own recollections.

and kept their jobs forever, many of those starting in entry level jobs would go through a period of income below poverty on the presumed way to wage increases over time. Yet wage growth has been stronger than academics predicted. An early study from the University of Wisconsin reported:

In part because of the substantial caseload reductions that preceded the implementation of W2, many of the first participants in W2 had low levels of education, substantial family responsibilities, and a history of reliance on welfare. Notwithstanding these barriers, we find higher levels of employment than have been found in other states, and substantial growth in employment and earnings over the short period considered. Average family income... increased, rising from about \$12,000 in 1998 to nearly \$15,000 in 1999, and the poverty rate [among participants] fell from 77 percent to 67 percent¹⁶.

Looking over a longer period, for those who left W2 at the end of 1999 and had full or part time employment in each of the following four years, average annual income increased by 22%. Of this group 37% had exceeded poverty based on income alone, while 57% were above poverty after tax credits.^{17 18}

Privatization After Implementation
While traditionally about half of Wisconsin's welfare population lived outside of Milwaukee, after the sharp caseload reductions more than four fifths of the remaining small number of cases reside in the county, which is fully privatized, so that will be the focus of this section. However, it should be noted that in the balance of the state, the numbers of counties which have elected to privatize has steadily increased, from eight in the first contract, to 21 in 2005. Of the privatized

counties, one is a medium sized city, three are suburban Milwaukee, and the other 17 are rural.

Within the rural areas of Wisconsin, the growth in the privatization of W2 makes sense in part because there are so few remaining cases, and some counties no longer think of welfare as one of their main lines of business (superseded by foster care and adoption, medical assistance, distribution of food stamps, subsidized child care etc.). In the early years of *Wisconsin Works*, in which funds were plentiful because of caseload reductions, many counties merged their related programs into "one-stop" job centers with modern offices and equipment.

Among the five contract vendors the state selected for Milwaukee, one might consider three of these high-performing (one of these got off to a bad start and recovered), one average, and one poor (the last is no longer in business).¹⁹ The transition between the old program and the onset of *Wisconsin Works* under the new privatized agencies, from those who experienced it, can best be described as an intensive, compressed and creative fervor.²⁰

The new private agencies were not only operating under a completely new set of contract provisions, but also under a new mindset. Competition for good operations' directors was pronounced and in addition agencies responded by looking for line staff outside the traditional social work background. Some agencies advertised in sales and marketing magazines and sites because they were looking for employees comfortable interacting with businesses in a more professional environment and willing to accept contingent compensation based on performance.

In one high-performing agency the ratio of new hires to transitioned staff was high - about three to one. In others agencies it was lower. Of the older staff who had worked in county government, some transferred to other county human service jobs,

some retired voluntarily, and some were hired by the new agencies as at-will employees. With competition for good staff, salaries increased. Former workers earned a salary of around \$28,000 per year (1997 dollars) with sizeable benefit packages; new workers in one agency earned \$35,000 to \$38,000 with annual bonus opportunities of three to five thousand dollars, albeit with lower benefits. All agencies had their employees sign non-compete contracts, as they were concerned that the expense of training on this new program would be lost to competitors (in the event, no enforcement of these contracts ever occurred).

In addition to hiring from the outside, agencies also directed their relationships to employers. All agencies paid special attention to assuring their job developers had solid connections with employers and access to jobs. One agency created a new title called “business service representative” which did no casework but whose job it was to take orders from employers and act as their representative within the agency in order to find the best employee fit. Business service reps would interact with caseworkers, each with their own bonus structure and incentives for job placement, but with differing internal customers.

As pressure mounted prior to the start date of W2, managers and new staff worked late and the state helped by keeping its caseload computer system open nights and weekends. Each case transitioned on the computer from welfare to W2 would take two hours; there were thousands of them to be changed. One agency set up a separate room with 20 computers and a knowledgeable programmer to allow case workers to have quiet time for the transition. All this was occurring as new offices were being built and fitted-out (one agency built a new professional office from the ground up in the heart of a district which had once seen race riots).

Finding good middle managers is always key in government and human service organizations (and experience shows almost always more difficult than finding good agency directors or good line staff), and this task was made more difficult because new middle management hires were not familiar with the technical aspects of the job, nor the welfare rules, which had to be understood in order to explain to staff how to operate in the new environment. The absence of quality middle managers has been a major shortcoming of agencies which performed below expectations.²¹

In addition to their internal pressures, agencies had to go outside and to the public to assure that existing welfare recipients came into the offices and changed their enrollment. All agencies made special efforts, using door hangers, going to churches, being interviewed on television, and in some cases doing home visits if individuals did not respond to multiple letters. In the end, about 30% of the former welfare recipients declined to enroll in the new program (some were already working off the books, others might not be eligible, still others did not want to participate under the new work requirements).

Work sites had to be prepared, and some agencies showed creativity here too. One purchased a plastics fabrication plant in order to provide easy work which would be fiscally self-sustaining, another used its own packaging, used clothing store, and commercial laundry service, still others used the county's existing program with many outdoor assignments such as keeping parks maintained.²²

Competition among vendors during this period was constructive. Each had its own geographic region, so in a sense they were not competing for “customers”. Every agency had its own performance goals and financial targets, but at the same time they did not want to be perceived as lagging. Once a month the five agency executive directors would meet, to hammer out common concerns (and, to a degree, to act as a counterweight to the powerful state agency).

²¹ Good middle management is more important in government and quasi-government than in the private sector. There are more rules which must be observed, more direct supervision needed below because compensation is not directly tied to achievement, and more complex processes occur between top management directives and line staff implementation.

²² However, the existing community service job inventory in Milwaukee operated by the county, which had been set up to accommodate single men and women under the recently terminated “general assistance” program, was insufficiently utilized by W2 agencies.

Inter-agency work groups were formed around subject areas such as transitioning cases from one program to the other.

The Successive Contracts

During the first contract period the savings far exceeded the most optimistic expectations of the program's designers. In Milwaukee, \$319 million had been allocated for all expenditures including cash benefits. Of this amount 84% was spent, leaving \$26 million for agency profits, \$13 million for reinvestment in the community and \$13 million to the state in the form of savings, just as provided for in the contract.

Certain critics of W2 have said that the first round of contracts did not contain performance criteria, but its designers certainly did not view it this way, nor did the vendors. These Milwaukee vendors were taking substantial risks in a completely unknown environment. Their performance would be measured by their employment success leading to caseload reductions, while leaving them with the operating room to get there in the best and most innovative way.

Critics also claimed that agencies could simply reduce costs by denying service to applicants, or arbitrarily categorizing them as job-ready, thereby excluding access to community service jobs.

This objection too, was unfounded. Agencies created procedures to move applicants through their system, and while individual cases might not be processed properly, no agency would risk denying service with the stakes so high (in addition, the state could penalize an agency \$5000 for each instance of denied service, although it never found it necessary to invoke such a penalty).

Nevertheless there were significant problems with vendor implementation. Two of the high-performing agencies billed hundreds of thousands of dollars improperly to the W2 program as they chased new business outside the state and billed W2 for employee work there.²³ Both these

agencies reimbursed these disallowed costs and made additional payments in compensation. However, one of these two agencies declined to bid on a third contract period as a result. Its loss was to be a great detriment to operations in Milwaukee.^{24 25}

In the face of bad publicity over the misallocation of funds, the state agency overreacted. In the third contract period the state added a surfeit of performance goals. It sharply reduced operating funding levels to below what was necessary, and permitted any performance bonuses to be earned only as a reimbursement for funds the agency had already expended, putting these agencies in a very serious financial risk were they to fail to meet the standards after the fact. In short, the state had shifted to the agencies almost all risks but without any opportunity for rewards.

In addition to pressing its vendors beyond what was necessary for good management, the state made a second mistake. After the exit of the high-performing agency which had misallocated funds, there remained two of six regions without an operator. The state had failed to cultivate other potential replacement vendors from outside Milwaukee and so doubled the contracts of two of the existing Milwaukee vendors, which was acceptable as far as this went. But in the subsequent fourth contract period the state gave three of the six regions to the lowest performing vendor, reshuffling the deck once again and in a way which proved most unfortunate. The winning vendor's executive director and others with whom he had ties were indicted for kickbacks in 2004 and sent to prison.²⁶ The agency folded soon after.

The Milwaukee operations are recovering from these setbacks. In the most recent contract period the state has at last brought in fresh vendors from outside the county, increased the contract responsibility of incumbent strong vendors, and management has significantly improved. In an indication that the state intends to devote more of its attention to *Wisconsin Works*, it

23 The agencies were Maximus, a for-profit vendor, and Employment Solutions, a for-profit subsidiary of Goodwill Industries of Southeastern Wisconsin.

24 The agency was Employment Solutions, which had contracts in two regions and performing exceptionally well.

25 It should be noted that improper expenditures are not the exclusive province of the private sector. The state routinely audits county government expenditures and finds improper expenditures requiring reimbursement (for example a state audit of the Milwaukee County Hospital discovered such a high level of improper expenditures that the county resorted to selling the hospital, i.e. privatizing it). However, unlike government misallocations, private sector transgressions are considered more serious violations of the public trust by all concerned, and probably should be.

26 The agency was Opportunities Industrialization Corporation of Greater Milwaukee, now defunct.

has dedicated a new agency to the function. The *W2* caseload is stable and low, and participant exit for employment continues at a high rate (though understandably slower than in the first early period after implementation).

Lessons from the Wisconsin Works Privatization and Contract Management Experience

Looking back from the vantage point of ten years, one sees that *Wisconsin Works* unleashed a wave of change on a scale unanticipated and unprecedented. Dependency was reduced far more than expected to the point that it is now considered only a secondary public policy issue. Former welfare recipients proved far more resilient than believed, took available jobs in large numbers, increased their wages over time and reduced the corresponding poverty rate. The state saved enormous sums as benefit payments to the formerly dependent were replaced by wages. The state legislature has re-allocated these funds in a variety of activities including programs for youth, literacy, nutrition, and domestic violence prevention.²⁷

While the newly available funds were a welcome indication of program success it created a challenging political dynamic, with critics denouncing the profits earned by the private agencies. The state should have been better prepared to forthrightly make its case that program savings were only available because families were newly self-sufficient, and that a portion of the savings were being plowed back into the community through the reinvestment provisions or through state reallocations.

The first lesson here is that program changes on the scale of *W2*, combined with privatization and new vendor contract incentives, will require swift iterative actions on the part of each actor, state and vendor community, in order to maintain an equilibrium and manage through the learning process.

In addition, it is evident that the administration which took over after the election of 2002 (Governor Jim Doyle, Democrat) lost focus on the program. In a familiar turn of events in every democracy, newly elected officials must stake out their mark distinct from their predecessor's, and Wisconsin Works was indelibly linked to Governor Thompson, the previous post-holder.

The new administration brought its own philosophy to governing, but in a way that was inconsistent and reactive. In 2003 the state declared that the program should be participant-friendly and explicitly offer a greater array of services. It instructed the vendors to assure that all barriers to participation in the program be identified and resolved before reductions in benefits due to non-participation were taken, partly in response to program critics (due to the new rule's ambiguity, vendors sometimes allowed inactive participants to receive cash benefits). Then, not long thereafter the state reacted to a resulting increase in the *W2* caseloads by again emphasizing early employment and work, leading to confusion on the part of agencies and vendors.²⁸

The second lesson, then, is that the governing agency must maintain an interest in the state of the vendor marketplace and in the incentive signals it is sending. Vendors do not operate on autopilot, and will feel comfortable taking risks where they feel their footing is secure. Frequent significant changes in stated program objectives reduce performance; smaller changes at first are more readily absorbed.

The state initially selected good vendors in Milwaukee (along with at least one poor-performing one) but it did not tend to the creation of a vibrant marketplace for the growth of competitive services there. People often take for granted that there will always be competitors and options in the private sector marketplace for goods and services. However the competitive marketplace environment for human service deliv-

27 Department of Workforce Development, *Letter from Secretary to State Auditor*, Department of Workforce Development, March 31 2001.

28 State of Wisconsin, Legislative Audit Bureau, *Evaluation of the Wisconsin Works Program*, pp 98, April 2005

29 The Netherlands has done this, creating a new vendor community for job placement of several hundred.

30 As an example of process measures that the initial contract did not measure but should have, is the weekly average number of work hours assigned. Lack of attention to this measure is in part responsible for its decline from 26.5 average weekly work hours in 1998 to 17.7 in 2004. See State of Wisconsin, Legislative Audit Bureau, *Evaluation of the Wisconsin Works Program*, table 37, April 2005

31 Performance standards and measurements included required caseload ratios, caseworker training requirements, customer satisfaction, new required basic skills training for participants, wage increase measurements, job retention, full or part-time employment measures, among others.

32 For instance, agencies allocated funds among program components differently, had variations in sanction rates, job placement and retention rates, performed differing participant assessments, used job access loans at different rates

33 An estimated figure; Central Intelligence Agency (2008) *The 2008 World Factbook* (USA: Central Intelligence Agency).

34 DeNavas-Walt, C.; Proctor, B.D.; and Smith, J. (2007) *Income, Poverty, and Health Insurance Coverage in the United States: 2006* (United States: US Census Bureau).

35 United States Department of Labor, News: *The Employment Situation: December 2006* (http://www.bls.gov/news.release/archives/empsit_01052007.pdf).

36 DeNavas-Walt, C.; Proctor, B.D.; and Smith, J. (2007) *Income, Poverty, and Health Insurance Coverage in the United States: 2006* (United States: US Census Bureau).

37 Social Security Administration (2002) *Social Security Bulletin, Statistical Supplement 2002* (United States: Social Security Administration).

38 *Ibid*

39 US Department of Labor (2006) *Evaluating State Unemployment Insurance (UI) Tax Systems Using the Significant Tax Measures Report* (United States: US Department of Labor).

40 United States Department of Labor, News: *The Employment Situation: December 2006* (http://www.bls.gov/news.release/archives/empsit_01052007.pdf).

41 *Ibid*.

42 Social Security Administration (2002) *Social Security Bulletin, Statistical Supplement 2002* (United States: Social Security Administration).

43 Author's calculations from Social Security Administration data (<http://www.ssa.gov/OACT/ProgData/icp.html>).

44 Social Security Administration (<http://www.ssa.gov/OACT/ProgData/icp.html>).

45 US Department of Health and Human Services, TANF Financial Data: http://www.acf.hhs.gov/programs/ofs/data/2006/tableF_2006.html.

46 US Department of Health and Human Services (2006) *Temporary Assistance for Needy Families Program (TANF): Seventh Annual Report to Congress* (United States: US Department of Health and Human Services).

47 US Department of Health and Human Services (http://www.acf.hhs.gov/programs/ofa/caseload/2006/2006_1parent_tanssp.html).

ery remains insufficiently developed. The third lesson then, is that the state itself must actively create and nurture a competitive marketplace environment. It should recruit potential vendors from outside its borders even when no bids are active, it should conduct annual meetings with prospective vendors to discuss the program state of affairs, and it should consider setting aside a certain portion of each contract for new entrants into the marketplace.²⁹

What about the nature of contract performance criteria themselves? The initial contract incentives in which agencies shared in reduced expenditures was powerful and outcome-based but did not give sufficient information about ongoing program activity levels such that thorough reports could be made to the public and policy makers.³⁰ On the other hand, in the third contract period the state created so many measurement standards that taken together they did not drive agency performance toward an understandable or sufficiently narrow mission objective.³¹ The fourth lesson, then, is that the state should determine its most impor-

tant policy objectives, organize its performance payments for these using outcome based measures (but a limited number of process measures too), and refrain from trying to achieve all conceivable desirable objectives through one contract.

The fifth and final lesson from the Wisconsin experience is that the energy and creativity generated by private vendors in conjunction with powerful contract incentives were together essential to achieving the program success. During the most intensive and creative period of the *Wisconsin Works* transition, the new Milwaukee vendors, the other county agencies and the state worked cooperatively at a breakneck pace to get ready. Each organization knew its responsibility and mission objectives. Once operations began, each Milwaukee agency approached its objectives by operating their programs in different ways with differing emphases.³² And when all is said and done, including all the programs avoidable and unavoidable mis-steps, the lives of Wisconsin's poor have been permanently improved.

United States

- GDP , 2007: \$13.8 trillion³³.
- Population, 2005/6: 296.4 million³⁴.
- Number of people in the labour force, 2005/6: 152.7 million³⁵.
- Average weekly wage among adults in full-time work, 2005/6: \$735³⁶.
- Total spending on welfare , 2005/6: \$2.6 trillion³⁷.
- Total spending on unemployment benefit, 2005/6: \$46.1 billion³⁸.
- Rate of per week unemployment benefit, 2005/6: \$275³⁹.
- Number of people unemployed, 2005/6: 6.8 million⁴⁰.
- Number of unemployed people in 2005/6 out of work for one year or more: 1.3 million⁴¹
- Number of days formerly unemployed people must be in work for their assistance to be considered successful: varies by state.
- Total spending on incapacity benefit, 2005/6: \$52.9 billion⁴².
- Rate of per week incapacity benefit, 2005/6: £237.21⁴³.
- Number of people on incapacity benefit, 2005/6: 812,000⁴⁴.
- Total spending on lone parent benefit, 2005/6: \$11.3 billion⁴⁵
- Rate of per week lone parent benefit, 2005/6: \$82⁴⁶.
- Number of people on lone parent benefit, 2005/6: 1 million⁴⁷.

4

The labour market reform in Germany and its impact on employment services

by Hilmar Schneider

Introduction

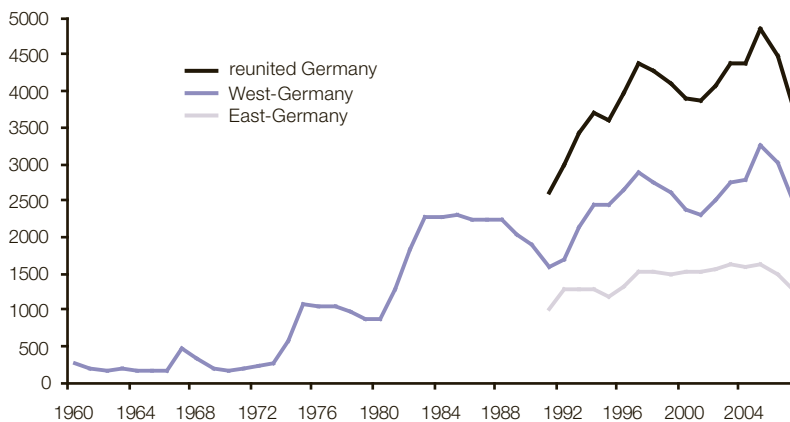
The German Labour Market Reform moved through several steps between 2003 and 2005. It accompanied many changes in all areas of active and passive labour market policy. One of the major ideas of the so-called Hartz-commission, which was commissioned by the German government in 2002 to develop reform proposals, was to reduce unemployment by cutting the amount of time people spent out of work. It proposed placement procedures and measures to impair the receipt of unemployment compensation.

Since many changes took place at the same time, it is difficult to disentangle the

contribution of each of them. However, experts agree that the reforms, as a whole, significantly contributed to the sharp decrease in unemployment since 2005, although this still has to be proved in terms of econometric evidence. The number of people out of work dropped by one million between 2005 and 2007, the biggest fall in Germany's post-war history (see Figure 1).

The German system of unemployment benefits and welfare Before 2004 there were three benefit levels: unemployment support (Arbeitslosengeld),

Figure 1: Registered unemployment in Germany (thousands)



Source: Federal Labour Agency

unemployment aid (Arbeitslosenhilfe), and welfare (Sozialhilfe). Since 2005, unemployment aid has been abolished. Welfare is now called Arbeitslosengeld II.

Workers (but not the self-employed or so-called 'minijobbers') are required to contribute to public unemployment insurance. The Federal Labour Agency (FLA) administers the scheme. They are entitled to receive support when out of work. The maximum duration of unemployment support is one year, depending on the number of months employed in the preceding time period.

For the elderly, the maximum duration of unemployment support is gradually extended. Until January 2006, it lasted for up to 32 months for job-seekers above the age of 57. But this was frequently used as an early retirement device. Since February 2006, the maximum benefit period has been 18 months. From 2008 on it will again be 24 months.

The level of unemployment support is not means tested and is only related to previously earned income. For job-seekers living without dependent children, it amounts to 60% of previous remuneration. For job-seekers living with dependent children, it is 67%.

Up to 2004, job-seekers coming to the end of their unemployment support automatically qualified for unemployment aid. Although means tested, the latter was not subject to a time limit. Its maximum level was also attached to previously earned net income.

For job-seekers living without dependent children, unemployment aid amounted to 50% of previously earned income. For job-seekers living with dependents, it came to 57% of previous earnings. Unemployment aid was paid by the FLA, but funded by federal taxes.

Job-seekers without other sources of income are eligible for welfare. It is currently fixed at 347 euros per month nationwide (plus coverage of housing

costs, which may vary regionally), for a single person. On average, this means around 650 euros per month for a single person and around 1,800 euros per month for a four-person household.

Income from employment is largely deducted from welfare claims, something which causes a classic welfare trap for low-skilled workers by generating an implicit minimum wage. For a single worker it is around 10 euros per hour.

In all, Germany is currently spending about 1.6% of its GDP on unemployment support and welfare. This figure doesn't include spending on active labour market policies, which account for another 0.7% of GDP.

Job-seekers subject to unemployment support have to notify their local office of the FLA. The same was true for job-seekers eligible for unemployment aid.

The municipalities are responsible for welfare claims. Up to 2004, they had, in principle, to cover welfare costs on their own. In cases of financial weakness, however, they were supported by their federal states.

Since 2005 joint offices of the FLA and local municipalities have been established (Arbeitsgemeinschaften) – a change that was meant to eradicate antagonism between local welfare authorities and the FLA (which had led to useless cost-shifting). Previously, municipalities gained by sending their clients to public employment programs for one year rather than investing in placement or training. In doing so, the workers gained sufficient eligibility for unemployment support during that year, and the municipalities moved them off their books for a while.

The change was heavily opposed by the municipalities from the very beginning. They were upset because the government eliminated the former cost-shifting opportunity at the same time. Moreover, the municipalities feared losing even more autonomy by being forced into a joint operation with the FLA.

The resistance of the municipalities led to a compromise during the legislative process: 69 of them were exempted from establishing a joint office. However, the performance of both organizations was to be evaluated before a final decision had to be made (experimental clause, § 6c SGB II).

Meanwhile, the constitutional court decided that joint operations of federal institutions and municipalities was not in accordance with Federal Law so the change has to be abolished by 2010. The government now has to decide whether responsibility for welfare is to be completely given to the Federal State or the municipalities. The most likely outcome is a form of responsibility similar to the one used before 2005.

The Reform of Placement Activities

The reform itself was triggered by the so-called placement affair. In early 2002, it became evident that the number of placements claimed by the Federal Labour Agency (FLA) was remarkably biased upwards, because it used to accredit a large part of successful individual job search to itself. Up until then, the FLA had a de facto monopoly on placement activities.

It turned out that only about 10% of the more than 90,000 employees of the FLA were actually engaged in placement activities, although placement was widely viewed as one of its major tasks. Not surprisingly, the process operated by the FLA became the subject of harsh criticism. As a consequence, privatization and re-organization of the schemes run by the FLA emerged as a suitable solution.

Mainly in 2003, but also in 2002, several new placement instruments were introduced:

- In March 2002 the FLA started issuing placement vouchers (§ 421g SGB III). Each one entitles its owner to use a private placement agency after three months of unemployment (six weeks since 2005). If the agency successfully places a client, it receives an incentive payment from the FLA.
- The first payment is made at the beginning of employment, the remaining part only after six months of continuous employment. There are no market entry barriers to service providers.
- Originally, the value of the voucher was determined by the duration of unemployment. The first tranche could be encashed on the very first day of employment. This, however, induced fraud and deadweight loss. Thus, since 2005, the first tranche is paid out only after six weeks. The total value of the voucher has also been fixed at 2000 euros. Abuse fell substantially after the change.
- As an alternative to placement vouchers, the FLA, since 2002, has been allowed to contract-in third parties to carry out placement activities. After six months of unemployment, job-seekers may also now claim the use of these private agencies (§ 37 SGB III).
- Contrary to placement vouchers, the FLA has discretion over performance-related bonus payments. Since 2003, private agencies have also been eligible for compensation if they are engaged in the placement of specific target groups like the elderly, youth, and long-term unemployed (§ 421i SGB III).
- In 2003, Public Temporary Work Agencies (PSAs) were introduced. They were meant to operate as the flagships of the reform (§ 37 c SGB III). Each of the 180 regional districts of the FLA had to establish at least one.
- The general idea was to make systematic use of the commonly observed attachment effect of temporary work. Since roughly one third of employees working on behalf of a temporary work agency are thought of as likely to be permanently hired by the lessee sooner

or later, it appeared to suggest the use of temporary work as a placement tool (with a special focus on hard-to-place unemployed). Therefore, PSAs were subsidized for hiring the hard-to-place unemployed and could also claim a bonus payment for each individually successfully placed at a lessee. The government intended to place 500,000 people via the change.

The main problem with outsourcing placement services arises from an unusual trilateral contract relationship between service provider, client, and paying authority (see Figure 2). A job-seeker makes use of a service, but does not have to pay for it. The service provider has to claim for bonus payments at the FLA, but the FLA can only indirectly judge whether this claim is justified. Because of a lack of cost control, such a constellation is vulnerable to serious inefficiencies.

According to contract management theory, the main problem is one of differences between principals and agents.¹ The former is a representative of the public interest who wants to maximize public utility. The latter are public authorities like the FLA, external service providers and job-seekers.

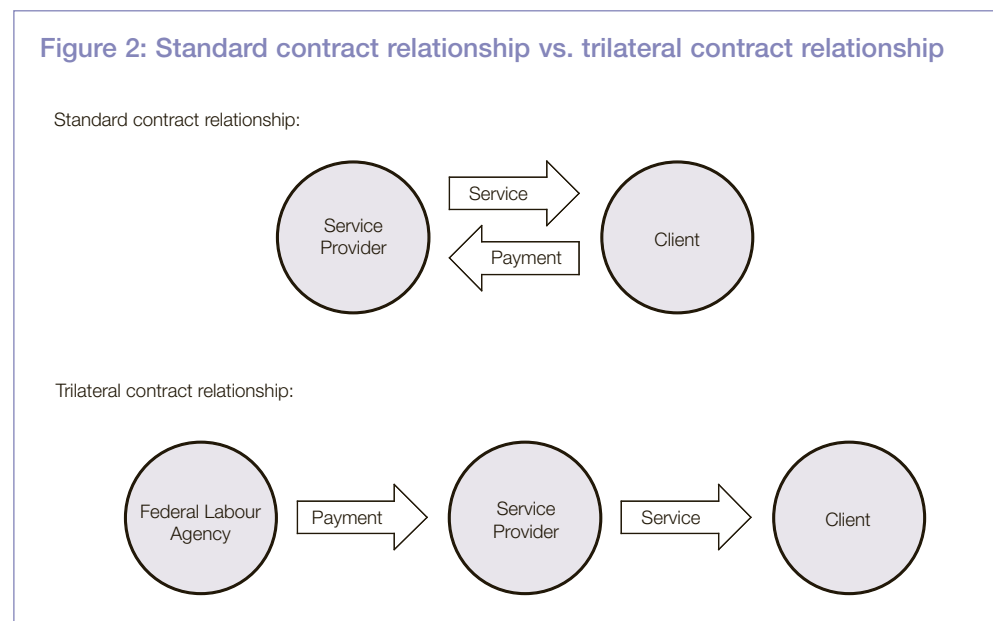
Within this setting, the FLA and service providers have to cope with their specific principal agent problem. Even if the head of each institution behaves in accordance with public interest, this may not necessarily be true of his employees. Each individual follows his or her own interest, which may mean he or she doesn't follow the aims of the institution.

Economically, this could be overcome via an internalization of economic risk, e.g. by cost-sharing between job-seekers and the FLA. This would stimulate job seekers to insist on service quality directly from the service provider and thus ensure that it behaves as the FLA wants.

However, this was not implemented. Instead, FLA monitoring relies on information reported by service providers. Verification by the FLA is indirectly based on its records of the former job seeker and his or her time at a new employer.

Evaluation results

The reform act as a whole was accompanied by a Parliamentary resolution saying that each instrument had to be evaluated within the shortest possible time period (BT-Drs. 15/98). Based on this statement,



¹ See Le Grand J, *Motivation, Agency, and Public Policy: Of Knights and Knaves, Pawns and Queens*, Oxford University Press, 2003

a large scale research project was commissioned by the Federal Ministry of Labour and Economics, involving about 80 researchers from various German research institutes and universities. The final reports were due in June 2006.

External placement services were evaluated within module 1a “Reform of Placement Processes”, carried out by a research consortium under the leadership of the Social Science Research Center Berlin (WZB).² Using a quasi-experimental approach that compared ex-post recipients of a placement voucher or participants in external placement activities to non-recipients or non-participants, they mainly focused on individual effects. For each recipient a similar non-recipient was identified. Analogously, matched pairs were formed for participants and non-participants in external placement activities.

Another module was devoted to macro effects.³ The idea was to control for substitution. It could be that certain instruments have a positive impact on the individual level, but only at the expense of reducing the employment prospects of non-participants. In such a case, the overall effect on employment could end up in a zero-sum game.

Unfortunately, however, the necessary aggregate data for placement vouchers and external placement activities are not available. It was therefore impossible to produce macro level results for the instruments under investigation.

Independently of the research project commanded by the German government, a specific project on placement vouchers and external placement activities was carried out by the Centre for European Economic Research (ZEW) on behalf of the FLA.⁴ The focus of this study was micro-oriented and based on a matched-pair approach as well.

Conditional independence is a central assumption of the matched-pairs method. This means that the treatment effect is

always the same, given a set of characteristics of a certain individual. As a consequence, the treatment effect can be identified statistically by taking a sufficient number of pairs of individuals, where each pair is identical in terms of observable characteristics, except for the treatment.

However, participants and non-participants may not differ systematically with regard to unobserved characteristics that affect the outcome. If this condition is violated, the pairs differ in more than only the treatment so it is not possible to ascribe differences in the outcome to the treatment alone.

Unfortunately, the validity of the condition of irrelevant unobservables can neither be tested nor proven. People could differ, for example, with regard to their general activity level, which is difficult to observe when based on usual characteristics like sex, age, education, profession, and the like.

But if people who claim for a placement voucher are more active in general than non-claimants and if this activity level makes it more likely that claimants find a job, a comparison of claimants and non-claimants in terms of job finding rates is biased by such unobserved a priori differences. It is therefore essential to make the best possible use of available observables.

The two studies at hand were carried out thoroughly enough in that respect. However, the WZB study reports a remarkable incidence of deadweight loss under placement vouchers, which means that in a considerable number of cases, placements were declared, ex-post, as induced by a service agency, even though the match came about independently. Statistically, this is equivalent to a violation of the conditional independence assumption. Consequently, the results reported later on should be taken with caution.

The recent quantitative importance of the three placement instruments under consideration can be found in Figure 3. Vouchers are playing a minor role. On

2 Wissenschaftszentrum Berlin für Sozialforschung, Institut für Angewandte Sozialforschung, *Evaluation der Maßnahmen zur Umsetzung der Vorschläge der Hartz-Kommission - Modul 1a: Neuausrichtung der Vermittlungsprozesse*, Bericht 2006 für das Bundesministerium für Arbeit und Soziales, 2007

3 Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Institut für Sozialforschung und Gesellschaftspolitik, *Evaluation der Maßnahmen zur Umsetzung der Vorschläge der Hartz-Kommission - Modul 1f - Verbesserung der Beschäftigungspolitischen Rahmenbedingungen und Makrowirkungen der Aktiven Arbeitsmarktpolitik*, Bericht 2006 für das Bundesministerium für Arbeit und Soziales, 2007

4 The results are published in Pfeiffer F, Winterhager H, “Vermittlungsgutscheine und Beauftragungen Dritter im Vergleich”, *Zeitschrift für Arbeitsmarkt-Forschung*, 39 (3 and 4), pp 425-445, 2006 and Pfeiffer F, Winterhager H. *Selektivität und direkte Wirkungen von Vermittlungsgutscheinen: Empirische Befunde aus der Einführungsphase*, *Perspektiven der Wirtschaftspolitik*, 7 (3), 399-419, 2006

average, 5,500 people per month were placed via vouchers in 2006, with a slight increase in 2007. The number given refers to the number of payments for the first tranche of the voucher. Official numbers for the second tranche after six months are currently not available.

Compared to the initialization period of placement vouchers, the recent figures show a sharp decline. In total, the FLA issued 1.4 million placement vouchers in its initial version until December 2004. 8% of them were encashed by the end of 2005. The following decline was a reaction to increasing evidence of the already mentioned abuse of placement vouchers.

The average stock of people subject to placement by third parties culminated in late 2005, and was followed by a rapid decline afterwards. Out of an average stock of about 100,000 people in 2006, they were able to place about 46,000 clients.

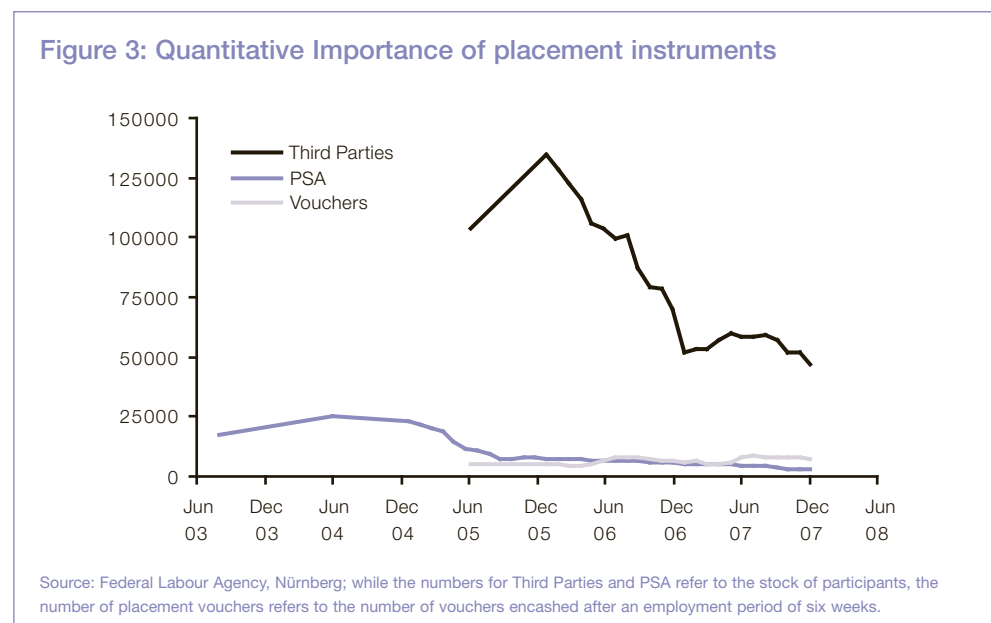
The average stock of job-seekers employed at a PSA amounted to less than 4,000 in 2007. There were 12,600 in 2005, and 6,000 in 2006. Here again, the tendency is still downwards. In 2006, PSAs were able to place 12,000 clients. However, they are clearly well short of the ambitious target of 500,000 set by the government.

The overall number of placements encountered by the Federal Labour Agency in 2006 sums to 915,000 (compared to 7.4 million outflows per year, 3 million of them into employment). According to the figures given above, the number of placements by private or voluntary services amounted to 124,000 in 2006. It is thus fair to say that placements outside public employment services accounted for 13.6% of the total figure in 2006.

Placement Vouchers

Among the new placement instruments, the voucher is the only one that freely allows a job seeker to choose a service provider. In principle, this should induce competition among service providers and therefore allow for efficiency gains. As mentioned above, however, the divide between service recipient and payment responsibility may offset or even outweigh potential efficiency gains.

Both available studies report a positive impact from placement vouchers. The WZB study, however, restricts this result to the second generation vouchers, while the ZEW study explicitly refers to the introductory period.



According to the WZB report, the employment rate of placement voucher recipients was 7.7 percentage points higher than that of non-recipients. But the authors point out that matches induced by a voucher are less sustainable than other matches in terms of average employment duration.

This seems to be especially true for males in east Germany. The regional effect is so strong that it dominates the overall average, although the sustainability of matches in west Germany does not differ much between recipients and non-recipients of vouchers. The authors take this as an indication for a considerable amount of deadweight loss – especially in east Germany.

The market for private placement isn't transparent. There is no official institution rating or evaluating private and voluntary employment services. Responsibility for ratings is more or less at the discretion of local authorities. However, they have little information on external placement agencies – something which would allow them to conduct performance monitoring.

This is different from the market for training providers. Since 2005, each training provider has had to be approved by a certifying authority according to a number of quality criteria. The only device of quality assurance in the private placement sector that exists is a code of conduct, which has been passed by the association of private placement agencies.

However, this code is not very binding, so in the absence of sanctions area-wide quality assurance still needs to be solved. Only plain straightforward placement voucher fraud may lead to market exclusion by commercial inspectorates and possible legal action.

Due to the absence of transparent monitoring, low-skilled workers are particularly likely to be disadvantaged, not only because they have more difficulties in finding a suited private placement agency, but

also because they are not very profitable for private placement agencies. The potential for quality improvement by competition is widely corrupted by lack of market transparency.

“ The employment rate of placement voucher recipients was 7.7 percentage points higher than that of non-recipients ”

Placement by Third Parties

Placement by third parties comes in several components: profiling, activation, job acquisition, and case management. This section, however, concentrates on the holistic approach to placement by third parties. This is the rule underlying § 37 SGB III since 2006, but has been in practice since 2003.

Judging by official announcements, placement introductions by third parties were not meant as a competitive measure, but as support for public placement activities instead. This points to a delicate issue. Since third parties have to be commanded by the FLA, it is unlikely that the FLA will make active use of an instrument that has the potential to shed bad light on its own performance.

If the FLA commanded third parties, it would probably try to shift hard-to-place clients. Service providers cannot reject certain clients that are assigned for a placement program by the FLA.

Commanding third parties became accomplished via a centralized and nationwide tendering procedure launched by the FLA. Especially in the beginning, the advertised lots were relatively large and covered more than one, local FLA district. Sub-lots were then assigned to local labour agencies, who could assign clients of their choice to the program. Large-scale tendering was explicitly intended to destroy local networks.

According to a 2003 report by the German Federal Court of Auditors, corruption in local districts of the FLA was a major source of exaggerated prices for placement services. Because of large-scale tenders, the resulting offers were indeed dominated by supra-regional service providers.

In the aftermath, prices deteriorated despite the fact that in 47 of 104 tenders in 2004/2005 only one or no offer was made. However, from the second half of 2005 onwards, lots became smaller again after heavy complaints by local labour agencies that organizational disorder was caused by new and unknown service providers.

The culmination of the upheaval was marked in 2005, when the strongest competitor, holding a market share of 26%, went bankrupt. Since then, the tendering process has remained centralized, but now refers to certain local districts of the FLA.

“ While established local service providers became threatened by bankruptcy, expanding inter-regional providers had to recruit inexperienced and low-paid employees ”

Interestingly, competition has not made much progress since then. In 2006, the FLA received only a single offer in two thirds of its auctions.

The low profitability of the tenders is a major reason. Especially for contracts based on performance related bonus payments, the risk is taken by the service providers.

In 2006, roughly two thirds of all contracts were based on performance-related bonus payments. For the rest, contractors could claim an additional general expense claim of 75 euros per client. In cases of a purely bonus-based contract, the proportion of successful placements must be unrealistically high in order to make the

operation beneficial for a private service provider. Not surprisingly, this increases the incentive to concentrate on “good” risks in order to maximize revenue.

Evidence for subsequent creaming effects is clearly supported in both evaluation studies. The development was accompanied by a deterioration in wages and a rise of precarious employment at private service providers. This has to be taken into consideration when interpreting the poor evaluation results for external placements.

While established local service providers became threatened by bankruptcy, expanding inter-regional providers had to recruit inexperienced and low-paid employees. The overall service quality declined.

Programs now typically run for six or twelve months. The typical lot size lies between 50 and 150 participants. Competition between local service providers is more or less non-existent. This makes it difficult to compare the performance of different service providers, because each comparison encounters the peculiarities of different local labour markets. Consequently, the incentive for service providers to increase their effort lags markedly behind a situation where several providers can be directly compared when competing within the same local area.

The impact analysis carried out by the WZB does not support the expectation that private placement is more efficient than public placement. It clearly shows that external placement has no measurable impact on placement speed compared to direct placement by the FLA. On average, it usually takes about 4 months for participants as well as non-participants to re-enter employment.

However, in terms of sustainability, placement performance by third parties is even worse than that of the FLA. While the average placement duration of job-seekers placed by third parties is 12 months, comparable job-seekers directed by the FLA stay in their jobs, on average, for 16 months. Third parties perform par-

ticularly poorly when dealing with the elderly or in regions with high unemployment. Only males in East Germany are benefitting from external placement. However, the reason for this is unclear.

According to the WZB study, the average costs for placement by third parties amounted to 600 euros in 2004 and 725 euros in 2005. Unfortunately, no reference is available for non-participants. The WZB study incorrectly assumes zero placement costs for non-participants, which is only valid if non-participants received no alternative treatment at all. Since this is not the case, it is not possible to assess the cost-saving potential of external placement.

Placement by Personal Service Agencies

PSAs are publicly subsidized temporary work agencies. Job-seekers assigned to a PSA get a regular work contract there. A PSA may also train its clients in order to improve their employability.

Contrary to a commercial temporary work agency, however, the PSA has to employ its workers throughout the contract period of normally 12 months, no matter whether they can be lent out or not. Depending on the employability of a job-seeker, this introduces a risk for PSAs.

The PSA business model is based on a mixture of bonus payments for successful permanent placement and case-related lump-sum payments to cover wages and training by the FLA. The establishment of a PSA is subject to a tendering process. The level of bonus payments and case-related lump-sum payments has to be offered by bidders.

The hiring rate of PSAs is a field of obvious conflict. It turned out that PSAs, on average, hired less workers than agreed upon in the contract with the FLA. Because they want to reduce their risks, they are reluctant to hire too many workers.

Critics argue that PSAs are more or less a subsidy for commercial temporary work agencies and that the instrument generates

nothing but deadweight loss. This was especially true during the introductory phase of PSAs, when lump-sum compensations were relatively high on average.

However, the argument even holds after prices have deteriorated. On average, lump-sum compensation is now 500 euros per case per month. Given the economic risk of not being able to lend out workers, there is not much left for additional activities like active placement or training.

At first glance, it now pays for the FLA to send job-seekers to a PSA – the lump-sum compensation is less than the average cost of unemployment benefit. However, one has to take into account that average duration of unemployment is higher for employees of a PSA than for other unemployed people.

Compared to the high expectations of PSAs at their introduction, they have been a complete failure. According to the evaluation results from the observation period 2003-2004, the situation is dominated by a strong locking-in effect.

Being employed at a PSA seems to lower job-search activities. Compared to a control group, the employment probability of workers in a PSA six months after leaving the PSA is, on average, 6.4% lower than that of the control group at the same point in time. On average, members of the control group entered into employment one month earlier than their counterparts at a PSA.

By the end of 2005, the government abandoned the clause that each local district of the FLA had to run at least one PSA. This should be viewed as the virtual end of the instrument. Its quantitative importance is now close to zero.

Conclusion – Efficiency Gains by contracting out placement services?

By and large, the German experience with contracting-out of placement services is not encouraging. However, it isn't evidence against the usefulness of competition and

privatization in general. The introduction of private placement services is related to existing public institutions that are not really interested in competition.

Since the FLA can selectively assign job seekers to different agencies, the poor performance of private service providers may have been actively brought about by the FLA in order to maintain its power. In any case, the existing studies show a latent danger of deadweight loss when introducing external service providers. This is especially true for placement vouchers and PSAs.

To some extent, the failure of private placement services is because of an unsolved principal-agent problem. Service clients do not have strong incentives to insist on service quality from providers. Even if they did, they could hardly sanction poor quality. As an option for overcoming the lack of immediate quality control, models of cost-sharing between clients and the FLA should be considered.

Besides this, it seems that competition didn't improve quality enough. This is especially true for placement by third parties. To a large extent, this may be due to a monopsonistic market structure where the FLA is the major service demander.

There is no market driven price increasing mechanism in case of bad quality or no supply at all. Competitors try to enter the market via price dumping. Consequently, the profitability of private placement for hard to place clientele seems to be unattractive.

The German experience thus suggests that price flexibility among service demanders is important. Competition should be organized by the best output at a given price level. The winner could be rewarded with an extra lot at the same price level. Continuous tournaments among a number of competitors at various price levels would allow for an optimization of costs and benefits at mid-price levels.

5 An estimated figure; Central Intelligence Agency (2008) *The 2008 World Factbook* (USA: Central Intelligence Agency).

6 Destatis.

7 Of population aged between 15 and 65 years. Source: IWH.

8 Gross wage figures in West Germany used. Includes part time jobs and 'minijobs'. Source: Deutsche Rentenversicherung Bund: Rentenversicherung in Zahlen 2007.

9 Bundesministerium für Arbeit und Soziales, Sozialbudget 2006.

10 General rule for Arbeitslosengeld used: 60%/67% of previously earned net income. Source: Bundesagentur für Arbeit.

11 Count of people registered as unemployed at the Federal Labor Agency (who could be employed for up to 15 hours per week. Figure does not include individuals in active labour market programs, early retirement schemes and suchlike (exclusions which amount to roughly 25% of the registered unemployed). Source: Federal Labor Agency.

12 Please note, these figures are systematically underreported due to artificial interruptions of unemployment duration caused by sickness and suchlike (standardized OECD figures report an increase from 48 to 57% between 2002 and 2006). Source: Bundesagentur für Arbeit.

13 Deutsche Rentenversicherung Bund: Rentenversicherung in Zeitreihen, p. 199.

14 Includes partial payments. Source: Deutsche Rentenversicherung Bund: Rentenversicherung in Zeitreihen, p. 134.

Germany

- GDP in 2007: \$3.25 trillion⁵.
- Population, 2005/6: 82.3 million⁶.
- Number of people in the labour force, 2005/6: 54.8 million⁷
- Average weekly wage among adults in full-time work, 2005/6: \$827.33⁸
- Total spending on welfare, 2005/6: \$1 trillion⁹ (30.2% of GDP).
- Rate of per week unemployment benefit, 2007: \$260.91.¹⁰
- Number of people unemployed, 2005/6: 4.5 million (11% of population)¹¹.
- Number of unemployed people in 2005/6 out of work for one year or more: 1.9 million¹²
- Number of days formerly unemployed people must be in work for their assistance to be considered successful: 180.
- Total spending on incapacity benefit, 2005/6: \$20.7 billion¹³
- Rate of per week incapacity benefit, 2005/6: \$237.63¹⁴.

5

The creation and regulation of markets in employment services - Danish experiences

by Thomas Bredgaard

Introduction

When trying to contract-out Public *Employment Services (PES)*, decision-makers are confronted with two intricate challenges: first, to create a market structure that resembles a “real market” and then, second, to establish regulatory mechanisms for monitoring and controlling market behaviour.

Both of these tasks are fraught with important questions: can cost-efficient markets supply high-quality services? How can free-market competition be combined with public regulation? Can public regulation to reduce transaction costs and opportunistic behaviour go together with ambitions to reduce public bureaucracy? How can private service providers that are motivated by economic incentives be encouraged to cater for the long-term unemployed with severe barriers to labour market entry? How can a competitive market structure be combined with partnerships, policy learning and mutual trust between providers and purchasers? Contracting-out is not a panacea; there are several answers to these problems. The Danish experience in creating and regulating a market for employment services is reviewed in this essay.

Since 2003 Danish *PES* have been partially contracted out to various “other actors” (private service providers, educational institutions, trade unions, unem-

ployment insurance funds etc). The two phases of the implementation of the tendering model, the initial creation of a market structure parallel to the *PES*, and the subsequent regulation of the market through a new structure of local jobcentres in each municipality are reviewed here.

It’s clear from the review that the contracting-out of *PES* is not responsible for Denmark’s current low unemployment rates, but rather, are a result of the historic economic boom experienced over the past few years. Furthermore, the problems in creating and regulating markets for former *PES* have not been resolved in Denmark, although important lessons can be learned by reviewing its experiences.

Historical and institutional background

In order to know where we are and where we are going, we need to know where we have come from. In international comparisons, Danish labour market regulation is quite unique. Even if the welfare state follows the Scandinavian traditions of universal services and benefit provision and the public sector is large in international comparison, the labour market has traditionally been characterised by limited state intervention.

The Danish model is “liberal” in the sense that the state does not, in principle, inter-

vene in the voluntary collective bargaining of labour market organisations (trade unions and employers associations) and job protection for ordinary employees is weak.¹

This has created a special relationship between a flexible labour market with high job-to-job mobility and a relatively generous social security system – often labelled Danish “flexicurity”.

In the last couple of decades active labour market and educational policies for the unemployed have grown in importance as the third corner in a “golden triangle”.² In it, active labour market policies have two functions: to motivate the unemployed to take and seek vacant jobs (a deterrence effect), and to help the unemployed that are not capable of finding a job on their own (a qualification effect).

Denmark’s history of limited state intervention in its labour market shaped its system of job placements as well as its labour market policy. Until the late 1960s the “private” unemployment insurance funds (closely affiliated to the trade unions) mediated and allocated vacant job positions to their unemployed members as well as administering unemployment insurance. In 1969 a unified Public Employment Service (*PES*) was created, among other things, to take over responsibility for job placements for the insured unemployed. However, the unemployment insurance funds remained somewhat active in allocating vacant jobs to their members through ‘parallel-broking’.

The municipalities have become more active in unemployment policy since the late 1970s. Being responsible for benefit administration and service provision for recipients of social assistance (unemployed persons without insurance entitlements), they created make-work programs, education and training, especially for young people. They were also allowed, from 1991, to allocate jobs on the ordinary labour market to their target groups.

After strong criticism of the *PES* inabil-

ity to service the ordinary labour market, the conservative-led coalition government decided in 1990 to ‘liberalise’ and modernise the *PES*. The liberalisation was meant to create a market for job placements through temp work agencies, unemployment insurance funds and trade unions. However, the market never materialised in full because of an “unlevel playing field” where the services of the *PES* remained free of charge. The *PES* subsequently maintained its position as the largest job provider for unemployed people.³

In 1994, a major labour market reform attempted to strengthen the position of the *PES*. Some of the main changes included a shift towards earlier and more individualised interventions in the unemployment spells and the introduction of new activation instruments (individual action plans, upgrading education and training, job rotation and leave schemes). The new activation policy was traded-off with a shorter unemployment benefit period (currently 4 years) and a stronger criteria for labour market availability and sanctions.

The implementation of the new active labour market policy was given to tripartite regional labour market councils in which representatives of the labour market organisations played a dominant role in policy-making. The new approach did not, however, halt the criticism of the *PES* for being inefficient, unresponsive and expensive.⁴

In 2002, a fundamentally new approach to *PES* reform was taken. The steering and organisation of labour market policy was changed substantially with the contracting-out of the *PES*, which was one of the main elements in the labour market reform ‘More people into employment’ (*Flere i Arbejde*).

Rhetorically, the introduction of a “quasi-market model” was never framed as privatisation, contracting out or liberalisation of the *PES*, but merely as a wish to include “other actors” in service delivery.

1 Jørgensen H, *Consensus, Cooperation and Conflict: The Policy-Making Process in Denmark*, Edward Elgar, 2002

2 Madsen PK, “Denmark: Flexibility, Security and Labour Market Success”, *Employment and Training Papers (International Labour Organisation)*, no 53, 1999; Bredgaard TF and Larsen F, “Quasi-Markets in Employment Policy in Australia, the Netherlands and Denmark”, *CARMA Research Paper*, no 6, 2007

3 Csonka A, *Fri Formidling: Om Liberalisering af Arbejdsformidlingen*, Socialforskningsinstituttet, 1992

4 Bredgaard T and Larsen F, *Udlisteringen af Beskøftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006; Bredgaard T, Larsen F and Møller LR, “Contracting out the Public Employment Service in Denmark: A Quasi-market Analysis”, in Bredgaard T and Larsen F, *Employment Policy from Different Angles*, DJØF Publishing Copenhagen, 2005

This helped to secure broad political support – even from the trade unions, who came to consider themselves as service providers in this new market.

The use of different types of service providers was, however, not new in itself: public authorities had previously contracted educational institutions and unemployment insurance funds in the implementation of labour market policies, especially in the delivery of education and training.

But the split between purchasers and providers through binding and formal contracts and tendering rounds was new. A fresh “institutional logic” was introduced.⁵

The planning and delivery of employment services was delegated to independent service providers.⁶ All former restrictions on the duration, scope, target groups, average prices and types of activities were abandoned. Service providers winning contracts with the *PES* were allowed “freedom of methods” in selecting the most suitable path to reintegration of the unemployed, as long as they complied with the contract and the broad frames of the law on active labour market policy.

The arguments for introducing tendering models in employment services vary according to the country of implementation. Nevertheless, there are several common themes.⁷ The dominant ones are as follows:

- *Improved efficiency*: open competition between independent service providers improves the efficiency of services (understood as quicker and higher employment effects). This creates more “value for money” (less public spending).
- *Improved quality*: service providers that target specific groups contribute to more innovative methods and tailored individual solutions, thus improving the quality of services. Freedom for the unemployed to choose a provider is also expected to improve the quality of services.

- *De-bureaucratisation*: open tendering models are smoother, more flexible and responsive to changes in the business cycle and the needs of target groups. They thus create a less bureaucratic employment service – one where individuals are not clients but consumers and costumers.

Before evaluating the Danish attempts at achieving these objectives, one should keep in mind that one is evaluating a “quasi-market” and not a conventional commodity one.⁸

“ Providers must be motivated by economic incentives, and purchasers by the welfare of citizens ”

Market implies that state provision is replaced with independent and competitive market providers. *Quasi* suggests that these markets differ from conventional ones in at least three ways: one, not all providers aim at maximising profits or are necessarily privately owned; two, demand in the market is often public and not private and, three, the choice of provider is often delegated to a third party (the purchaser). The preconditions for well-functioning quasi-markets in welfare policy are thus different from those of conventional markets. Le Grand and Bartlett use four evaluation criteria: efficiency, responsiveness, choice and equity.⁹

To achieve these criteria four preconditions must be fulfilled: one, a competitive market structure must be established (with many service providers as well as purchasers, easy entry and exit, and free pricing); two, accurate information on costs and quality must be available, together with low transaction costs to avoid moral hazard and adverse selection; three, providers must be motivated by economic incentives, and purchasers by the welfare of citizens; four, the creaming and parking of clients (inequality) must be avoided.

5 See Struyven L, “The New Institutional Logic of Public Employment Services”, in Bredgaard T and Larsen F (eds), *Employment Policy from Different Angles*, DJØF Publishing Copenhagen, 2005

6 Bredgaard T, Larsen F and Møller LR, “Contracting out the Public Employment Service in Denmark: A Quasi-market Analysis”, in Bredgaard T and Larsen F, *Employment Policy from Different Angles*, DJØF Publishing Copenhagen, 2005; Bredgaard T and Larsen F, *Udlitteringen af Beskoftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006

7 See Bredgaard TF and Larsen F, “Quasi-Markets in Employment Policy in Australia, the Netherlands and Denmark”, *CARMA Research Paper*, no 6, 2007; Bredgaard T and Larsen F, *Udlitteringen af Beskoftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006; Bredgaard T and Larsen F, *Employment Policy from Different Angles*, DJØF Publishing Copenhagen

8 See Le Grand J and Bartlett W, *Quasi-Markets and Social Policy*, Macmillan, 1993

9 Le Grand J and Bartlett W, *Quasi-Markets and Social Policy*, Macmillan, 1993

The creation of the Danish “quasi-market”

When the Danish “quasi-market” had been in operation for nearly two years, the Minister of Employment proudly announced:

*“I can’t think of any precedent in Danish politics when such a huge market has been created from scratch in such a short time. A market that, on top of everything, is already operating on a par with the PES [...] Other actors are here to stay”.*¹⁰

The Minister voiced one of the main parameters of success: the increase in the number of unemployed people referred to external service providers. Ironically, however, the size of the market has shrunk ever since the claim. As seen in the figure below, the number of insured unemployed referred to “other actors” peaked in early 2005 with about 40 %. It currently stands at around 10 %¹¹; so what happened?

From its inception in 2003, the government set the first minimum target: that at least 15% of insured jobseekers should be referred to “other actors”. In addition, local authorities were asked to set minimum targets. The Minister of Employment could

issue, but not dictate, guidelines for these targets, The tradition of municipal self-governance constrained him.

Traditionally, local authorities have only sporadically used open competitive tendering., They tended to only use external providers on an ad-hoc basis. In any case, the PES quasi-market was kick-started and grew constantly until its peak in 2005.

A few contracts have been phased out since then, while the Minister of Employment issued an action plan (see below), which put a temporary halt to the conclusion of new contracts.¹² However, new contracts were signed and gradually took effect in 2007. The market is thus expected to recover in the coming years. The new local jobcentres (an amalgamation of the PES and municipalities, cf. below) are also beginning to sign contracts with external providers, particularly for uninsured persons with severe barriers to labour market entry.

These changes suggest that the “quasi-market” for employment services is dynamic and volatile. Between the first and second tendering rounds the composition of providers has shifted: private providers are winning market share at the expense of educational institutions and, to

10 Newsletter from the Danish Ministry of Employment, no. 11, November 2004

11 In absolute number, around 22.000 unemployed individuals are currently referred to “other actors” during the year (app. 14.000 full-time equivalents).

12 Due to the national action plan (see below) unemployed individuals are transferred to external providers at a later point in time in their unemployment spell (typically after 6 months), and they remain with a provider for typically one year. Compared to before, this leads to a reduction of the volume of persons referred to external providers. On the other hand, the intensity of activities has increased since providers have to provide longer-term and consecutive activities.

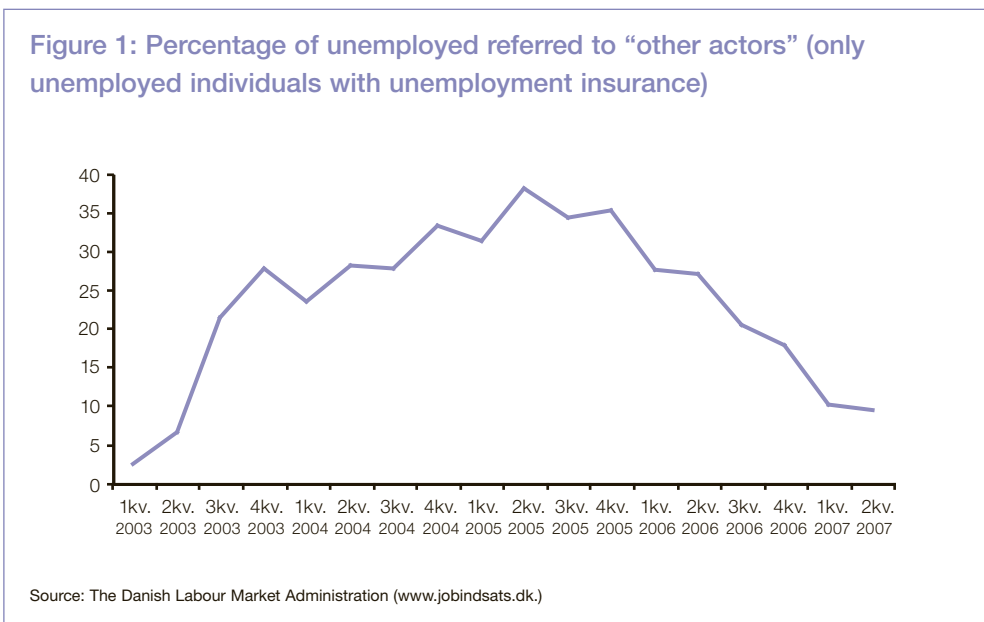


Table 1: Number of “framework contracts” and market shares in Denmark¹³

	No. of framework contracts 2003	Share in percentage 2003	No. of framework contracts 2005	Share in percentage 2005	No. of framework contracts 2007	Share in percentage, 2007
Private providers	94	51%	222	62%	83	79%
Educational institutions	38	20%	59	16%	5	5%
Trade unions and unemployment insurance funds	25	13%	44	12%	3	3%
Consortia	19	10%	16	4%	13	12%
Other	10	5%	19	5%	1	1%
Total	186	99%	360	99%	105	100%

Source: The Danish Labour Market Administration.

a lesser extent, trade unions and unemployment insurance funds. Even as the market size shrunk considerably from 2005, the same tendency applies; private providers are currently out competing the other types of providers (see table below).

Efficiency, responsiveness, choice and equity are also central in the creation of a well-functioning “quasi-market”.¹⁴ Experiences (not only in Denmark) show that there are substantial transaction costs in establishing a quasi-market for employment services. Some will be transitional, but others, related to contract renewal, monitoring, supervision, benchmarking, and controlling market behaviour, are recurrent. There is one main problem: transaction costs tend to increase as the market becomes more competitive and transparent.

While it is feasible to reduce transaction costs by entering into more stable provider and partnership relations (see the *Australian Job Network*), this implies moving further away from the original intentions behind the competitive tendering model.¹⁵ In the first phase of contracting out (2003-2005) the transaction costs in Denmark turned out to be substantial – for some surprisingly so. The providers found that preparing and presenting ten-

der bids required a disproportionate amount of resources. The administrative tasks, such as working out payment and documentation of jobseekers’ employment situation, also turned out to be quite demanding,¹⁶ not least because Denmark operated a regional tendering model with different tendering criteria in each region.

Regional purchasers found it difficult to precisely describe the services required, and the call for tenders was therefore rather vague at times – and very heterogeneous across regions. This led to diverging interpretations of the services to be delivered, which again created extra work when attempts were made to settle differences over expectations.¹⁷

There is another dilemma in the competitive tendering model: transaction costs increase as jobseekers are given more *freedom of choice*. “Quasi-markets” often depart from conventional commodity markets where the “consumer is the king” because choice is determined by public, not private, demand and, therefore, delegated to a third-party (the purchaser).

A 2004 survey in Denmark found that 67% of jobseekers did not feel they had had the opportunity to choose between providers.¹⁸ They are often automatically allocated to a provider by the *PES* system,

13 “Framework contracts” are pre-qualification contracts signed with external providers. In order to operate on the market, a service provider also needs to conclude a subsequent specific contract with purchasers. So “framework contracts” does not guarantee that any unemployed persons are referred to the provider.

14 See Le Grand J and Bartlett W, *Quasi-Markets and Social Policy*, Macmillan, 1993

15 Considine M, *Enterprising States: The Public Management of Welfare-to-Work*, Cambridge University Press, 2001; Sol E and Westerveld M, *Contractualism in Employment Services: A New form of Welfare State Governance*, Kluwer Law International, 2005

16 Rambøll, *Erfaringsopsamling Vedrørende Inddragelsen af Andre Aktører I Beskøftigelsesindsatsen*, Rambøll Management, 2004

17 Rambøll, *Erfaringsopsamling Vedrørende Inddragelsen af Andre Aktører I Beskøftigelsesindsatsen*, Rambøll Management, 2004

18 Rambøll, *Erfaringsopsamling Vedrørende Inddragelsen af Andre Aktører I Beskøftigelsesindsatsen*, Rambøll Management, 2004

but rejection is possible if other “equally effective” providers are available (which is often not the case).

As explained above, the Danish quasi-market model was introduced parallel to a still-functioning *PES* system, which, in principle, should make it possible to compare the *outcomes and effects* of the two systems. In practice, this is far from easy, as the first simple effect measurements have proved.¹⁹

“ It has been far more difficult than anticipated to meet the conditions for establishing a well-functioning quasi-market for employment services ”

It has been far more difficult than anticipated to meet the conditions for establishing a well-functioning quasi-market for employment services. Admittedly, a market has been established with a relatively high number of service providers (at least until 2005) and purchasers, but the market is really more an expansion of what was already in existence than the establishment of a new quasi-market.²⁰

It's impossible to evaluate the efficiency of this market at present, either in terms of cost-effectiveness or employment effects. There have been high levels of information asymmetry and transaction costs. As a result, both transparency and freedom of choice have been reduced. Consequently, the authorities have introduced regulation to make both the quasi-market work better and to eliminate some of the unacceptable outcomes of the tendering model.

Regulation of the Danish “quasi-market”

Although the Danish “quasi-market” had only been going for about 18 months, in spring 2005 the Minister of Employment issued a plan to rectify some of its worst

aspects. It was the first example in Denmark of an attempt to re-regulate the market.

Its main objective was to use external providers as part of a competence strategy rather than a resource one.²¹ Instead of relieving the *PES* of standardised and administrative duties (like the “contact periods, see below), specialised external providers would be contracted for clearly defined target groups, where providers could “make a difference”.

The action plan was also an attempt to create a more centralised and standardised market for employment services in light of the decentralisation of labour market policy to local jobcentres in each municipality (see below). The most important changes of the action plan were as follows:

- External providers only to be used where there is a clear employment rationale and for clearly defined target groups where they can *make a difference*. The initial basic contact (after 3 months) with jobseekers no longer to be contracted out to external providers.
- The use of external providers must be as smooth and un-bureaucratic as possible. Complicated (regional) payment models and contracts replaced by one *simplified and centralised payment model* and standard contracts.
- Financial incentives should be used to get jobseekers as quickly as possible into employment rather than using activation or educational activities (*work first*). Performance payment must amount to 75% (the remaining 25 % is paid as an intake fee). A successful outcome is measured as being in ordinary employment, education or adult apprenticeships for at least 13 weeks within the last 26 weeks (transfer into private job training is rewarded with half the bonus). Pay can be adjusted to give a higher bonus for more challenging target groups such as long-term unemployed or immigrants. External providers are to take over *full financial responsibility* for all activities

19 National Labour Market Administration, *Effekt af Indsatsen hos Andre Aktører: Foreløbig Opgørelse [New Frames for the Involvement of 'Other Actors']*, Arbejdsmarkedsstyrelsen, 2005

20 Rambøll, *Erfaringsopsamling Vedrørende Inddragelsen af Andre Aktører I Beskøftigelsesindsatsen*, Rambøll Management, 2004

21 Ministry of Employment, *Handlingsplan for Brug af Andre Aktører*, Arbejdsmarkedsstyrelsen, 2004; National Labour Market Administration, *Effekt af Indsatsen hos Andre Aktører: Foreløbig Opgørelse*, Arbejdsmarkedsstyrelsen, 2005

during the contract period, and are obliged to ensure that jobseekers participate in activation activities for at least 40% of the time.

- To support the tendering model, a national IT system was designed. There was to be more focus on *measurable outcomes* and *benchmarking* of productivity. Comparable measurements of provider outcomes were to be established and published on the internet (at the time of writing, this module is still not operational).
- The *supervision and control* of service providers to be strengthened by central administration as well as local jobcentres (random samples, unannounced visits, monitoring of contract compliance, outputs and outcomes).

As indicated above, until 2005 external providers were mainly used to “relieve” the PES of administrative tasks; that is, as extra hands to help out with the contact periods.

The “contact periods” were invented in 2003 as a guarantee that the PES would contact jobseekers at least every 3 months, and as an availability check on the individual unemployed. Previously, the PES had not been in contact with each unemployed person on such a regular basis, and the new contact periods, therefore, drained the resources of a PES-system that was already squeezed financially.

Contracting-out this service to external providers thus provided financial and administrative relief for the PES, and soon became the dominant instrument for outsourcing to the market. By implication, the focus was largely on minimising costs and not maximising effects.²²

With this approach, external service providers quickly developed into a flexible but extended arm of the PES, which did not promote specialisation, innovation and individualisation as intended. As the national action plan takes effect, this might change as external providers can no longer

be used to handle purely administrative tasks (such as contact periods).

However, at the same time, the financial risks of specialisation, innovation and individualisation are transferred from the public authorities to the providers. The payment model is tuned towards higher outcome bonuses, and providers have to finance all jobseekers’ activities themselves (instead of referring them to activities paid for by the authorities).

One important advantage in the first Danish tendering round was that instead of relying on standardised national measurements and evaluations (since they were not available at that time), practically all purchasers used regular, informal meetings and dialogue with providers for mutual exchange of experiences and alignment of interests. It could be argued that the need for coordination and monitoring was partly solved by means of a culture of cooperation and dialogue.

Whether it will be possible to preserve this culture in the wake of the action plan is, however, an open question. On the one hand, the involvement of external providers has been shifted away from administrative tasks to delivery of services where specialised providers can make a difference; on the other hand, it has introduced a much more outcome-focused payment model, something which may threaten the mutual trust needed for partnership and cooperation.

In general, a competitive tendering model easily leads to conflicts of interest between principal (authorities) and agents (providers). As the principal wants to keep agents at arm’s length, expectations and outcome demands are communicated to the providers through tendering rounds and contracts. In principle, this secures transparency in the market and a level playing field for providers.

But, on the other hand, most providers call for dialogue and cooperation. As they see it, discussion allows for corrections, improvements and harmonisation of inter-

22 Rambøll, Erfaringsopsamling Vedrørende Inddragelsen af Andre Aktører I Beskøftigelsesindsatsen, Rambøll Management, 2004

ests, which may secure a more targeted and successful delivery of services. However, in the view of the authorities such cooperation might bias the process and favour some providers over others, and therefore not secure a level playing field.²³

The new, centralised tendering regime and payment model may also have major implications for equal access to services and the fair treatment of jobseekers. So far *creaming and parking* has not been explicitly on the agenda in Denmark. This could be because such opportunistic behaviour does not occur; that information asymmetry means the authorities do not know what is happening on the ground; or that *creaming and parking* is taboo. Based on our data from interviews, we have found indications that all three explanations have some validity.²⁴

It is also evident that the open prioritisation of target groups, something which is clear from a comparison with Australian and Dutch experiences, does not happen to the

same extent in Denmark.²⁵ However, there is a risk that *creaming and parking* will become more widespread with the new central payment model of 25% commencement fee and 75% performance-related pay and the transfer of economic risks upon providers.

In general, quasi-markets have difficulties in catering for the needs of the jobseekers least ready for ordinary employment if outcomes are measured shortly after intervention (e.g. 6 months later). There are also problems when instruments are focused on short-term interventions (i.e. jobseekers are “turned in the door” which is the informal expression of the Danish *PES*) and if economic risks are shouldered by the providers (i.e. providers motivated by economic incentives will be reluctant to invest in jobseeker where the return on investments is uncertain).²⁶

The box below summarises the main characteristics of the Danish “quasi-market” model in employment services, as it has developed since its inception in 2003.

23 Bredgaard T and Larsen F, “Implementing Public Employment Policy: What Happens When Non-Public Agencies Take Over?”, *International Journal of Sociology and Social Policy*, vol 27, no 7/8, pp 287-300, 2007; Bredgaard TF and Larsen F, “Quasi-Markets in Employment Policy in Australia, the Netherlands and Denmark”, *CARMA Research Paper*, no 6, 2007

24 Bredgaard T and Larsen F, *Udliteringen af Beskøftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006

25 Bredgaard T and Larsen F, *Udliteringen af Beskøftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006; Bredgaard T and Larsen F, “Implementing Public Employment Policy: What Happens When Non-Public Agencies Take Over?”, *International Journal of Sociology and Social Policy*, vol 27, no 7/8, pp 287-300, 2007; Bredgaard TF and Larsen F, “Quasi-Markets in Employment Policy in Australia, the Netherlands and Denmark”, *CARMA Research Paper*, no 6, 2007

26 Bredgaard T and Larsen F, *Udliteringen af Beskøftigelsespolitikken: Australian, Holland og Danmark*, DJØF-forlaget, 2006; Bredgaard T and Larsen F, “Implementing Public Employment Policy: What Happens When Non-Public Agencies Take Over?”, *International Journal of Sociology and Social Policy*, vol 27, no 7/8, pp 287-300, 2007; Bredgaard TF and Larsen F, “Quasi-Markets in Employment Policy in Australia, the Netherlands and Denmark”, *CARMA Research Paper*, no 6, 2007

Table 2: Summary characteristics of the Danish “quasi-market” for employment services

Service delivery systems	Local jobcentres (one in each municipality) and external service providers
Purchasers	National labour market administration, employment regions (4), local jobcentre (91)
Levels of tendering	National (service tenders), regional (state framework contracts), local (one or more jobcentres)
Service providers	Private consultancy firms, recruitment firms, temp agencies, educational institutions, unemployment insurance funds, trade unions
Types of contracts	Framework contracts (pre-qualification) and binding contracts (2+2 years)
Payment model	One national payment model <ul style="list-style-type: none"> ● 75 % outcome payment (13 weeks uninterrupted ordinary employment with in last 26 weeks, transitions to ordinary education or adult apprenticeships. Half bonus if transition into private job training) ● 25 % intake payment ● Providers have to finance all activities from their own budgets ● Price bids are given as average price for specified target groups for 52 weeks
Selection criteria	<ul style="list-style-type: none"> ● Price (40-50 %) ● Other criteria (50-60%)

The construction of new local jobcentres in each municipality has also been an important part of the 2005 plan. Until 2007, Denmark had a two-tiered employment system: the *PES* had responsibility for services and benefits (together with the unemployment insurance funds) for people with unemployment insurance, while the municipalities remained responsible for people on various types of social security (social assistance, disability benefits, vocational rehabilitation etc.).

However, when a liberal-conservative government came into office in 2001, the liberal Minister of Employment soon declared that the government was aiming for a more unified governance system (a 'one-stringed' system). It looked to municipalise the system by shifting the responsibility for, and target groups of, the *PES* to new municipal jobcentres.²⁷

It met fierce opposition, however, from its political opponents, and the labour market organisations (trade unions and employers association) that preferred the state *PES* system in which they traditionally had major influence over labour market policy formulation, steering and implementation. The reform came to a standstill.

However, a window of opportunity opened in 2004 when the government moulded the 275 municipalities into 98 larger ones and transferred competencies away from the regional level. This gave impetus to governance reform in employment policy. After another round of heated political bargaining, the government found a narrow majority with the nationalist party (Dansk Folkeparti), and moved forward to implement a new local jobcentre structure from 2007.

The new structure is not a full municipalisation as the government intended, but a rather incoherent organisational compromise. Each municipality now has a local jobcentre which is charged with (re)integration of the labour market.

Benefit administration and sanctions remain with either the unemployment insurance funds (insured unemployed) or the municipal administration (uninsured unemployed).

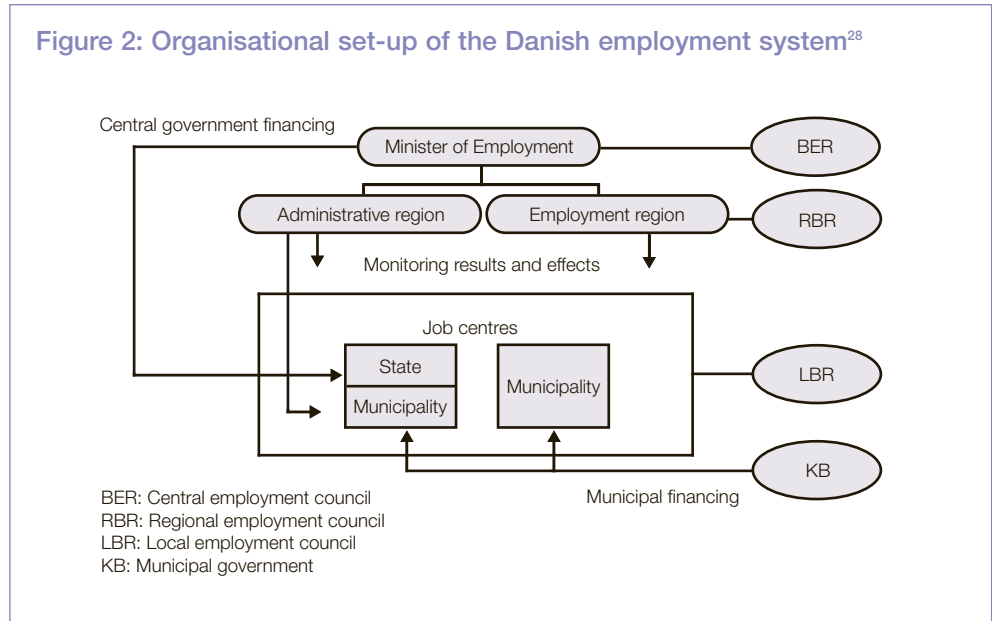
“ After another round of heated political bargaining, the government found a narrow majority with the nationalist party, and moved forward to implement a new local jobcentre structure from 2007 ”

There are two different types of jobcentres. In the majority of municipalities (77) the *PES* and the municipal social and employment departments are working side-by-side in the same building. The *PES* is, however, still responsible for services and benefits for insured unemployed, and the municipalities for uninsured unemployed – which also means that there are two different executives: one from the *PES* and one from the municipality (quite similar to the German *Arbeitsgemeinschaften*, ARGE). The remaining 14 jobcentres are run exclusively by local authorities on a trial-basis (evaluation will take place in 2010), which means that municipalities have also assumed responsibility for administering unemployment insurance benefits (cf. figure below).

There are different ways of tendering in each level of this new governance system. The Minister of Employment can issue national tenders for specific groups which are administered by a new contracting unit in the national labour market administration.

In September 2006 just such a tender was announced for two target groups: one, unemployed individuals with vocational education (e.g. bricklayers and hairdressers) or with a short to medium-term academic education (e.g. dental technicians, teachers, nurses) and, two, unemployed individuals aged 55+ (including

27 In a longer-term perspective, the implicit objective was also to create a unified benefit system, i.e. to amalgamate unemployment insurance benefits and social assistance (and thereby also remove benefit administration from the unemployment insurance funds).



former executives). The national labour market authorities contract providers, but the local jobcentres are free to decide whether they want to make use of them (they sign a specific contract with each provider when they do).

In between the national and regional level, tenders are made for unemployed academics. The tenders are national, but administered by the regional employment authorities. The local jobcentres are obliged to refer any unemployed academic in the municipality to the providers that have been certified to deliver these regional services.

At the regional level, each authority can decide to make its own tender for target groups that are not covered by the aforementioned tenders. If they do so, the local jobcentres are obliged to use them.

Even if the homogeneity of the target groups described above can be debated, there is, nonetheless, a clear division of labour between the national and regional authorities on the one side and the local jobcentres on the other. The former assume responsibility and contract out services for unemployed target groups with vocational and higher education (the easiest target groups), while the latter

target groups with little or no education and training (the most difficult target groups).

The local jobcentres can – alone or together with other jobcentres – make their own calls for tender for their target groups. So even if the volume of the market has declined in recent years, it is clear that there are a number of different opportunities for contracting out in the new governance system, which is still in its infancy.

In relation to the use of external providers in the local jobcentres, it is important to recall that the Minister of Employment can only dictate quantitative minimum targets for the state *PES* system for insured unemployed. The municipalities are free to decide whether to contract-out services to external service providers.

Once the minister has set the targets for private provider involvement, it is, even in the public system, to a very large extent the public parts of the local jobcentres who, in cooperation with regional and local tripartite employment councils, manage the tendering process. Thus, there are currently two parallel systems for provision: the local jobcentres and private providers.

²⁸ The national, regional and local employment councils (BER, RBR and LBR) exist to give advice to the respective political and administrative authorities, and assist in monitoring the results and effects of the local jobcentres. The councils are tripartite bodies composed of administrative/political representatives, representatives of the municipalities, and representatives of the labour market organisations (the latter have a majority of representatives in all three councils).

Conclusion and policy challenges

The Danish “quasi-market” for employment services has been in operation for nearly five years, and has gone through two distinctive phases of implementation. Firstly, it was created between 2003 and 2005 – or, to be precise - an already existing market for reintegration of insured unemployed was substantially extended. In the second phase of implementation after 2005, the market shrunk substantially as a consequence of the introduction of a new contract regime.

In the new contract regime specialist providers are asked to “make a difference” for target groups rather than relieve the PES of administrative duties. The delivery of services is now taking place through a new structure of local jobcentres in each municipality.

Judging by the Danish experience, it is difficult to create and regulate a market in employment services that lives-up to political expectations and the preconditions for a well-functioning market. The anticipated efficiency gains and cost-savings, which are spurring the introduction of quasi-markets, are still largely unknown and undocumented. Even if the Danish labour market is currently outperforming the majority of European countries on a range of labour market indicators (cf. appendix below), it is unwarranted to claim that the contracting-out of the *PES* accounts for the relative success.

Instead, the quasi-market model creates a new type of employment policy, as well as new conditions for steering and regulating the labour market. Clouded in the “technical” language of improved efficiency and effectiveness, such changes are often neglected and depoliticised. Setting aside ideological motivations for choosing to contract out employment services, the Danish experience gives at least three reasons for decision-makers to introduce the quasi-market model.

One, the open tendering model is well suited to support a politically intended shift in the substance of employment policy. Internationally, there is a trend towards a stronger work-first approach. This implies a shift away from both a traditional passive social security (where lack of demand is seen as the main cause of unemployment) and a human capital approach (where lack of competencies and qualifications is seen as the main cause of unemployment).

The work first approach interprets unemployment as a result of inadequate (individual) economic incentives and motivation. Finding a job as quickly as possible, where any job is seen as a “good job”, is the objective.

Implementing such a policy shift has, especially in Denmark, turned out to be difficult within existing public implementation structures. Policy intentions are distorted and skewed during the implementation process, especially by relatively autonomous local municipalities and case workers.²⁹ The quasi-market model offers a depoliticized and efficient structure for implementation of a work-first rather than human capital approach.

Two, the unemployed are being prioritized. Tailoring initiatives and cost-efficiency is a positive formulation of this approach, but in reality it is a way to avoid spending disproportionate resources on unemployed people with few chances of ever finding a job, or the deadweight costs of putting resources into unemployed people capable of finding a job on their own. Private providers seem much more susceptible towards such creaming and parking than traditional public employment advisors.³⁰ From a public policy perspective the result is, however, increasing inequality in service delivery, and inequality before the law.

Finally, contracting out provides political decision-makers with better instruments to control the expenditures of

²⁹ Larsen F, Abildgaard N, Bredgaard T and Dalsgaard L, *Kommunal Aktivisering: Mellem Disciplinering og Integration*, Aalborg Universitetsforlag, 2001; Bredgaard T, Dalsgaard I and Larsen F, “An Alternative Approach for Studying Public Policy: The Case for Municipal Implementation of Active Labour Market Policy in Denmark”, *University of Aalborg, Department of Economics, Politics and Administration, Working Paper*, no 4, 2003; Considine M, *Enterprising States: The Public Management of Welfare-to-Work*, Cambridge University Press, 2001

³⁰ Also see Considine M, *Enterprising States: The Public Management of Welfare-to-Work*, Cambridge University Press, 2001

employment policy. Admittedly, it might be more expensive to enter into contracts with non-public agents in the short-run, but it does give more flexibility (through, for example, changing the amount of services bought from providers according to fluctuations in unemployment rates). The problems of organisational restructuring are transferred from the public to the private sector. When unemployment figures are low it is probably much easier to fire a private provider than a public servant.

“ It might be more expensive to enter into contracts with non-public agents in the short-run, but it does give more flexibility ”

Political decision-makers may have a variety of reasons for contracting-out public employment policy. One thing should, however, be an obvious conclusion from this analysis: choosing a quasi-market model involves much more than a discus-

sion about “technicalities” in relation to how employment policy is implemented in the most effective and cheapest way. A quasi-market model (and its design) does have an important impact on the substance of employment policy and the possibilities of governing the labour market.

Public decision-makers need to strike a balance between the dynamism of the market and the need to fulfil political and social objectives. On the one hand, authorities try to let the market work on its own premises as a means of improving efficiency, quality of services and innovation. On the other hand, interventions may be required to remedy the unintended outcomes of market behaviour; e.g., to reduce creaming and parking, transaction costs and underinvestment in education. Doing so, however, erodes the original market principles of competition, choice and autonomy. Striking the balance between the logic of the market and social goals is therefore inherently difficult – and basically not a technical or administrative issue – but a genuine political dilemma.

31 An estimated figure; Central Intelligence Agency (2008) *The 2008 World Factbook* (USA: Central Intelligence Agency).

32 OECD (2007) *Employment Outlook* (Paris: OECD).

33 Danish Ministry of Employment.

34 Statistics Denmark.

35 Danish Ministry of Employment.

36 Statistics Denmark.

37 Danish Ministry of Employment.

Denmark

GDP, 2007: \$310 billion³¹.

Population, 2007: 5.4 million³².

Rate of per week unemployment benefit, 2005/6: \$500.35³³.

Number of people unemployed, 2005/6: 114,000³⁴ (3.9% of population).

Number of days formerly unemployed people must be in work for their assistance to be considered successful: 13 weeks in a given 26-week period.

Rate of per week incapacity benefit, 2005/6: \$526.39³⁵.

Number of people on incapacity benefit, 2005/6: 258,000³⁶.

Rate of per week lone parent benefit, 2005/6: \$435.45³⁷.

6

It's the client, stupid! An active role for the client in Dutch employment services

by Els Sol

Historical background:
marketization as part of a major
welfare reform

The Dutch began to reform their activation policies relatively early. They started to do so after seeing ever larger amounts of their population taking disability benefit despite many of them being fit enough to work. This phenomenon came to be known as the 'Dutch disease'.¹

The large number of disabled pensioners was a legacy of past policies. Previous governments had encouraged employers to shift mature-age workers with moderate disabilities from their payrolls on to the public disability pension system, which was integrated with workers' compensation.

Claimants received only limited help from the government in their search for employment. Job search requirements were relatively lax. Welfare recipients were seen as objects of policy rather than subjects who could actively contribute to increasing opportunities. The *Public Employment Service (PES)* delivered the government's active labour market policies that were meant to lessen the problem. But it had a lousy image, small market reach, and, ultimately, little effect.

The increase in demand for, and costs of, social security was initially met with

retrenchment of the system. Expenditure was stabilised as a result, but there were no reductions in long-term unemployment. Further steps were taken once the government realised that its generosity could not be sustained unless the level of joblessness fell.

A new 'activating regime' (*activerend stelsel*), inspired by a government think-tank, was subsequently introduced. The status quo was represented as a security net in which clients had become trapped. In the new system the same net would act as a trampoline in which people on benefits would be bounced back into the labour market.²

Unemployment and disability were no longer seen as the consequences of social and economic problems, but as the results of a social security system that could be used by individuals (employers, employees and benefit recipients) for their own benefit. Labour participation was to become the prime goal of social economic policy. The idea that full societal participation could be achieved outside the sphere of paid labour (through voluntary work, for example) was rejected.

The activation and re-integration of claimants into the labour market (ideas inspired by the policy debates in the United States and United Kingdom) came

1 Visser J and Hemerijck A, *A Dutch Miracle: Job Growth, Welfare Reform and Corporatism in the Netherlands*, Amsterdam University Press, 1997

2 WRR, *Een Werkend Perspectief [A working Perspective]*, WRR, 1990

to dominate Dutch policy thinking. Under several left-right ‘purple’ cabinets³ ‘Work above Income’ became equivalent to the UK’s ‘Work First’ slogan. Employment was seen as the most important part in the attempts to solve several social and economic problems.

In 2007 the current Christian-Social Democratic cabinet acknowledged that for some, regular paid employment is a step too far and extended the targets to include social activation, but the ‘Work above Income’ system still has its two original, and most important, components. The first one is a - relative to Anglo-Saxon countries - still generous social security system that encourages work and includes sanctions; an active labour market policy is the second.

The latter rests on four elements: one, a general labour market policy; two, a ‘reintegration’ scheme which offers back-to-work services to the unemployed and those most likely to lose their jobs; three, temporary labour market policies for specific groups (women and the old); and, four, sheltered employment for those whose productivity level is too low to (re-)enter normal employment.

Since 2002 employment services have been delivered by companies and not-for-

profit providers in a quasi-competitive system called the ‘re-integration market’. As a part of the broader welfare reform package a new governance system was set up to replace the five separate benefit agencies and the obsolete *Public Employment Service*. A negative evaluation of the *Public Employment Service* in 1995⁴ gave the government the chance to create what was to become a hybrid of public one-stop-shops and a private employment services market.

In 2000 a government think-tank called ‘The Future of Labour Market Policy’ concluded that different labour market conditions called for deeper adoption of re-integration policies.⁵ Its report, ‘Aan de slag’ (Getting it done), recommended that the focus of reintegration policy be shifted from benefit dependence to help for movements from state support to the labour market. The report proposed the budgeting of welfare schemes; the use of placement results to steer benefit administrations; more flexibility in welfare-to-work and reintegration budgets; and the creation of a proper quasi-market for employment services. Private providers were seen as more effective, more client-oriented, and cheaper.

Table 1 Chronological overview of the main reforms in governance 2001-2006

	Law	Main features
2001	<i>Structuur Uitvoering Werk en Inkomen</i> (Structure Implementation Work and Income)(SUWI)	<ul style="list-style-type: none"> Foundation of one unemployment benefit Agency (UWV) Foundation of one-stop shops (CWI) Abolition of the <i>PES</i> Obligation to tender all employment services Introduction of a market with for profit providers
2003	<i>Wet werk en bijstand</i> (Work and Welfare Act)	<ul style="list-style-type: none"> Decentralisation of welfare towards municipalities on a budget based system
2006	<i>Wet werk en arbeid naar arbeidsvermogen</i> (Act on work and income according to labour capacity for disabled)	<ul style="list-style-type: none"> Obligation of employers to offer employment services to the disabled

3 Under Wim Kok between 1994 and 1998, and 1998 to 2002.

4 De Koning J et al, *Arbeidvoorziening in Perspectief*[The *PES* in perspective], The Hague, 2005

5 Parliament/TK, “Aan de Slag,” Parliament/TK, no 1 (27914), 2000-2001

The report and its recommendations became the basis for the privatisation, agentification and decentralisation that were central to the institutional reforms that took place between 2000 and 2006 (see table 1 for details).

In line with the proposals, a new *Structure for Work and Income (SUWI)* was introduced in 2002. It replaced national employment assistance programs – including public sector jobs for jobless people and vocational training programmes – with a contestable market for employment assistance. Employment services for the most disadvantaged job-seekers were decentralised and contracted out to private and community organisations.

Characteristics of the Dutch model
Each of the main characteristics of the Dutch model of marketization are listed below:

- *The Department of Social Affairs*

This government department is responsible for the general management of the programme but has delegated its role of gateway for the intake and referral of all social security benefit claimants to the local Centres for Work and Income (CWI), which are public entities. It has also given away its role as principal for the fully privatised system of employment service delivery for the long-term unemployed to the National Benefit Agency for the (short-term) Unemployed and Disabled (UWV), and to all 450 municipalities for the people on social assistance.

Both the UWV and municipalities have been obliged to contract out. This rule has been enforced in order to create a proper market and to restrain municipalities from delivering their welfare-to-work services in

house or through local public or non-profit satellites (many of which have performed badly).⁶ But as a result of political pressure by the municipalities in 2006, this obligation lapsed for municipalities. In cases where municipalities do contract out they have to conduct tenders according to European norms (as does the UWV).

“ Private providers were seen as more effective, more client-oriented, and cheaper ”

Parliament wanted public tasks (intake, eligibility and sanctioning) to remain in public hands. In this model, private companies replace what the public sector previously offered the hardest to help claimants. The public Centres for Work and Income get the more standardised tasks of dealing with the mainstream benefit claimants.⁷

The Department of Social Affairs ultimately funds nearly all benefit and employment assistance schemes, but does not specify the form or content of contracts. The UWV and municipalities decide which employment services are to be offered to clients.

- *Centres for Work and Income*

During the first six months of unemployment, claimants who are close to meeting the needs of available jobs are given help by the Centre for Work and Income (CWI). If recipients are still out of work after six months they are transferred to the UWV or municipality. People with significant difficulties in getting employment are immediately referred to the municipalities or the UWV and thereby to companies and not for profit providers. CWIs use an

6 MvT, Parliament/ TK 28870, no 3

7 For the disabled who are still under employment contracts with their employers, a *private* market for employment services was created in 2006. The employer takes on the role as principal and buys employment services for his personnel from private (for profit) providers. A major incentive for employers to buy employment/outplacement services is the legal obligation to continue payments to a disabled employee under an employment contract for two years. This is a third market segment for the providers in the Dutch reintegration market, next to the municipal and UWV segment. Other than principals in the two first segments, employers do not use open tenders for employment services. As this new market segment in the reintegration market completely differs from the welfare-to-work market model in the UK where only transitions from benefit to work and are incorporated, and transitions from work to work are not, this article focuses on the other segments only.

‘Opportunity Meter’ to profile the people they work with. After being transferred to either the national UWV or a local municipality, claimants are offered intensive support, which is delivered by private providers in a quasi-market and is funded by the UWV employment services budget or the municipalities depending on the type of benefit.

- **Municipalities**
The Dutch municipalities are a separate public administration layer with their own social assistance budget, political responsibility and control. Since 2004 they have had complete policy freedom, so in each area can develop their own reintegration policies in return for big financial incentives. The Minister of Social Affairs is only responsible for the system of social assistance, which means he takes care of the judicial framework, the distributive budget code and monitor system.
- **The UWV**
The relationships faced by the benefit agency are different. The Department of Social Affairs determines the instruments and the UWV implements them. Since the Structure for Work and Income Act (2001), the UWV has been steered and monitored on the basis of performance indicators which are related to the flow of claimants from unemployment or disability benefit to the labour market. There are no financial incentives.
- **Private for and not-for-profit providers**
Dutch recipients of income support – except parents with young children and people with severe disabilities – are obliged to engage with the labour market. Individuals must maintain some sort of work in order to remain eligible for continued receipt of the benefit. Private employment providers thus have all recipients of income support as

their clientele, i.e. those people in the social security systems for the unemployed, disabled and those on welfare.

- **Client councils**
Jobseekers are represented by local and national client councils, which together form the National Client Council (LCR). The LCR is a statutory body whose main function is to represent the views of clients to the Minister as part of the RWI consultative mechanism. The LCR has had success in advocating individual client accounts for employment assistance (IROs, see below) and a network of independent advisors to help clients to locate and negotiate with reintegration providers.

- **Board for Work and Income and Inspectorate for Work and Income**
Two organisations oversee the quasi-market: the Board for Work and Income (RWI) and the Inspectorate for Work and Income (IWI).

The tripartite advisory Board for Work and Income (RWI) is responsible for the quality and transparency of the private market for employment services and for labour market and reintegration policies in general. A system of self-regulation (based on the subsidiarity principle⁸) is meant to induce transparency.

The Inspectorate for Work and Income (IWI) is the second monitoring organisation. It tracks the legitimacy and efficiency of the provisions by the UWV and the legitimacy of the implementation of the WWB by the municipalities. Both organisations report to the Minister of Social Affairs

The Department of Social Affairs established the main rules for evaluation of process effectiveness of the market in a report entitled ‘Towards a functioning reintegration market’ (*Naar een werkende reintegratiemarkt*).⁹ They are:

8 Teulings CN, Bovenberg A and van Dalen HP, *De Calculus van het Publiek Belang*, Ministerie van Economische Zaken, 2003

9 Ministry of SZW, *Naar een werkende reintegratiemarkt*, Ministry of SZW, 2002, http://docs.minszw.nl/pdf/35/2002/35_2002_3_3085.pdf

- Entrance and competition: no specific entrance criteria, a 'sufficient' level of competition, and a level playing field for FP and NFP providers.
- Transparency.
- Public and open tender procedures.
- Payment by performance.
- High quality of service delivery.
- Access to services for all clients.
- Freedom of choice for all clients.

The creation of a quasi-market and contracting out of employment services by benefit agencies are seen by the Dutch government as vital to the results-orientated system it wants to see. Both changes force principals to set concrete targets and formulate success criteria for providers.

Because it brings policy and practice together, the role of principal makes municipalities and the unemployment benefit organisation more aware of what welfare-to-work schemes require. Competition between providers should uncover any new intervention techniques developed by providers. Furthermore, the existence of multiple principals – there are more than 450 municipalities – means there will be a laboratory for any changes.

A Market for employment services in practice

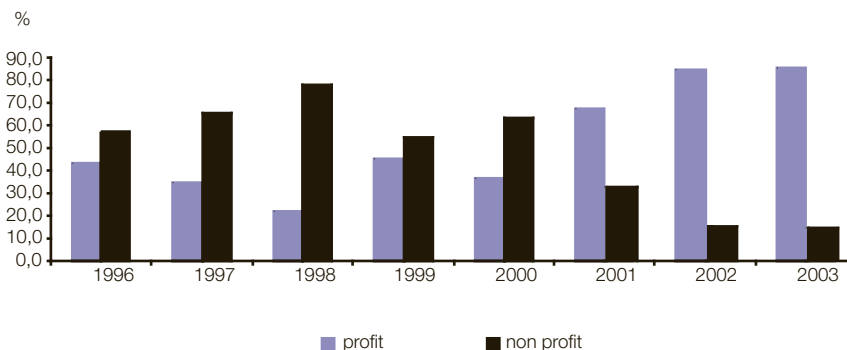
The Dutch market for employment services developed quickly. It used the experiences of already existing companies like temp work agencies, vocational training institutes and other specialized, mainly non-profit, organisations, and new commercial entrants. In the Netherlands the reintegration market quickly developed into a for-profit market.

Currently, not-for-profit providers are a small proportion of the UWV market. They serve no more than 4 percent of it and tend to be specialised companies working with disabled people.¹⁰ However, exact figures for the whole market are not available. Historically, the Dutch have not had as great a role for the non-profit sector in this domain as the Anglo-Saxon countries have, due to better provision from the government itself.

For an illustration of the effect of the introduction of the marketization for non-profit companies in the city of Amsterdam, see table 2 below.

Not much is known about the results of the non-profit providers, who are mainly active in the municipal market. There is no

Table 2 Expenditure of reintegration budget in percentage of non -profit and for profit reintegration companies, Amsterdam, 1996-2003



Source: Sol E and Hoogtanders Y, "The Road to Privatisation: The Amsterdam Case", in Sol E, and Westerveld M (eds), *Contractualism in Employment Services*, Kluwer Law International, 2005

10 Koning P, "Maatschappelijk Verantwoord Reintegreren", *Economisch Statistische Berichten*, no 4525 (92), pp 791-794, 2007

monitoring of them on a national scale. It is often argued that not-for-profit providers may behave differently during market failures as they attract more intrinsically motivated employees who provide better services (and are often driven by equity concerns).¹¹ If they receive donated labour, they might produce at lower costs, provide higher quality or focus on market segments that are less profitable.

“ UWV contracts are awarded to providers on the basis of five criteria: experience, price, placement percentage, methods used and drop-out rates ”

A Dutch empirical study¹² found companies to be more active in selecting clients relative to other providers. They put more effort into encouraging potential clients to start a programme (which gets them extra payments). However, they do not place more people in work than not-for-profit providers. Other research into employment-based early intervention strategies for social assistance claimants found better placement rates for profit-motivated providers than for municipal workplace companies.¹³

On a yearly basis the national public budget for reintegration amounts to two billion euros. It has been estimated that private providers account for around one third of public resources.¹⁴ Boaborea, their industry body, claims that only 17 percent of the budget is actually spent on their services, the rest being taken by the public administration (CWI, UWV, municipalities). The total number of employment services delivered annually in the period 2002-2006 was 150,000, of which 19% of the services went to the disabled, 21% to the unemployed and 60% to social assistance claimants.

Research over the period shows that the chances of a claimant getting intensive help is dependent on age (the young have

a better chance) and duration of the benefit claim (the longer duration, the better (cumulative) probability). Men on social assistance have a 28% chance and women a 22% chance after one year, while unemployment benefit claimants face odds of 33% and 32% respectively.

Procurement and tender design

There are a number of different models. At one extreme is a model of one prime contractor with a large contract for all benefit claimants and for a long period of time, at the other end is a system of multiple contractors for small groups and small, short-term contracts. The Dutch chose the latter path in 2002 in order to address the risk of creaming and to give specialised (small) providers a level playing field. Providers were offered contracts to assist small ‘batches’ or ‘parcels’ of claimants with similar characteristics, specifying the form of help that should be given. The social benefit administration UWV contracted out by way of procurement of various cohort types on a national scale.

In 2002 the agency contracted out as many as 53 cohort types and 474 individual cohorts. Over the years the benefit agency has decreased the number to just three groups (the disabled, young disabled and unemployed) and 20 types of individual cohort.

Short contract durations (of one year) left major risks with providers and led to a high turnover of personnel among the providers. The substantial tender costs for providers were also a major difficulty.

The cost and time involved in preparing tenders meant a heavy administrative burden, which initially built a high threshold for small, specialized providers, who lost territory. The introduction in 2004 of a kind of voucher by the benefit agency UWV, called the *Individual Reintegration Agreement* (see below), eliminated this entrance barrier for small providers, who (re-)entered the market in large numbers. However, the municipal

11 Le Grand J, *Motivation, Agency and Public Policy: Of Knights and Knaves, Pawns and Queens*, Oxford University Press, 2003

12 Koning P, “Maatschappelijk Verantwoord Reintegreren”, *Economisch Statistische Berichten*, no 4525 (92), pp 791-794, 2007

13 Sol E, Castonguay J, van Lindert H and van Amstel Y, *Work First Werk: Op Weg naar Evidence Based Work First*, Divosa, 2007

14 Kok L, Hollanders D and Hop J, *Kosten en Baten van Reintegratie*, SEO, 2006

market is still difficult for the small providers because of the red tape endured in tender procedures, the demands they face, the short timescales of the contracts, the payment structure (no cure, less pay), and the lack of guaranteed clientele.¹⁵

Between 2002 and 2008 the UWV organised seven tender rounds. Despite the great number of principals involved, in practice the majority of the market is in the hands of the benefit agency and four big cities (Amsterdam, Rotterdam, Den Haag, Utrecht). It is, therefore, a buyers' market.

UWV contracts are awarded to providers on the basis of five criteria: experience, price, placement percentage, methods used and drop-out rates. Initially, placement percentages were weighted highly. Depending on the target groups there are different weights for criteria. As the tenders up until now have been primarily based on price competition, it has been difficult for providers to stand out on quality.¹⁶ This led the UWV and municipalities to choose the lowest bidder for employment services, at the cost of service quality and the development of specialisms.

Although the type of services was prescribed, in terms of content they were left at the discretion of the provider. When, in 2003, the 'no cure, no pay' and 'no cure, less pay' models of payment were introduced - in order to give further incentives to providers - price competition threatened to lead to a race to the bottom. The services to be delivered during the bidding were of less importance. A cry for help from the former chair of Boaborea persuaded the UWV not lower prices any further.

Contract design

The first contracts ran for one year, but since 2004 the UWV and most municipalities have used longer contracts as a means to achieving more commitment and lower transaction costs. Lately, there has been a trend towards using framework contracts and longer contracts (of up to two years).

They get rolled over if case managers (municipalities) and reintegration coaches (the UWV) are content with the service delivery and output. These public servants directly influence the number of clients providers actually get, thus giving them a bigger say in the market than before.

The fee structure is geared to achieving outcomes. Retention in unsubsidised employment for at least six months is the key payable outcome for providers. In practice the duration can be shorter. The UWV uses the operational definition that a client has to have worked for two months and has an employment contract of at least four months. So a client still counts if after two months he drops out.

Providers are either paid on a 'no cure, no pay' basis - for the relatively easy to help - or a 'no cure, less pay' basis for the difficult ones. Typically, the reward per client consists of a fixed payment when the action plan is approved (20% maximum), a fixed payment six months later (40-50%) and bonus payments in cases of job placement for at least two and six months (40-50%). In practice some providers park the hardest to help and cash the payment of the service inputs. There is only a fixed payment for the easy to place.

Much attention has been focused on how to create a well functioning reintegration market (particularly around the design of transparent tender procedures with low thresholds in order to contract providers with the best price/product combination). As a result the focus of providers was on the bidding not on results, and on the means - packages of services, called 'trajectories' - and too little on the goal (outflow to work). A trajectory consists of some or one of the elements of diagnosis, guidance/ soft skills, vocational training and placement.

Reintegration contracts generally did not offer providers sufficient funds to invest in the relatively costly forms of employment assistance such as training. As a result, the nature of reintegration services shifted from

¹⁵ Mallee L and Mevissen J, "Re-Integratie in Nederland: Een Private Markt voor het Publieke Domein", *Tijdschrift voor Arbeidsvraagstukken*, no 2, pp 106-119, 2007

¹⁶ Vinke, *Evaluatie Aanbestedingscontracten*, TNO, 2003

help for overcoming barriers to work towards assistance in the search for work. This is still a problem and probably more so now because the clients that remain are, because of the economy's ability to create jobs for so many people, the least skilled and thus most difficult to help. One of the criteria for a well functioning reintegration market is the openness of service delivery to all (see above). The financial incentives of the Act on Work and Income has incentivised municipalities to seek quick wins in outflow, helping first and foremost the easy to help. The UWV, however, is more open to all clients, thanks to the IRO (see below).

In all, since 2002 the UWV and the municipalities have gained experience in tendering, thus overcoming their teething troubles. Nowadays there is no excessive monitoring to ensure that providers are fulfilling their contractual obligations. Discontent with the lack of quality of service made the UWV start yearly auditing of providers.

The lack of transparency in the Dutch model is a major problem. To create a threshold in the market and for providers to be able to distinguish themselves from other competitors, Boaborea developed a quality assurance system for the sector. There is currently a national *quality mark* for all providers (a 'keurmerk'¹⁷) dealt with by a Foundation called Blik op Werk. Blik op Werk also developed a provider monitor with placement figures, satisfaction scores and other information for future customers and clients (the 'reintegratiemonitor').¹⁸ In 2006, the UWV developed a benchmark for itself that allowed it to assess providers with the best price-quality combination.

IRO: The client as customer

A major criticism of the contracts under the tender system was the 'one size fits all' service and the lack of innovation and differentiation promised by the model's designers. By making customers out of the immediate consumers of the service the

government has countered part of the problem. The result has been more satisfied customers, more successful job placements, a proliferation of providers and an overhaul of the tender system.

In 2004, the government introduced Individual Reintegration Agreements (IROs) between individual clients, the UWV and reintegration providers, following complaints by client organisations and Members of Parliament. The introduction was strongly supported by the National Client's Council as a means to engaging clients in welfare-to-work activities and giving them greater control over the process. In the beginning the ministry was far from convinced that a personal budget for the client was necessary to provide them with freedom of choice, but pressure from parliament was intense, so it agreed.

The core elements of the IRO arrangement for the client are the choice of provider and the opportunity to compose an activity plan. Both factors come close to making the client the principal, and thus to establishing a real market instead of a quasi one.

The UWV buys the IRO in the name of the client and in line with his or her wishes. In only 2 percent of cases are IROs turned down. Every client that is diagnosed for intensive help can use the IRO, irrespective of whether or not a client needs guidance in it.

Compared to the tender process, the IRO procedure offers more freedom of choice to the client, the provider more possibilities to deliver a 'made to measure' service, and the reintegration coach/case manager more room to manoeuvre. For the differences between IROs and tendering see table 2.

Between 2004 and March 2007, 66,455 IROs started. 62 percent have been for people on unemployment benefit and 38 percent for the disabled. IROs became popular overnight. This spectacular growth has now stabilised to 60 percent of all people on 'trajectories' by the end of 2006.

17 www.blikopwerk.nl

18 www.blikopwerk.nl

The price of an IRO service package (trajectory) is a factor 1.1 times more expensive for the disabled and 1.3 times for the unemployed. The placement percentages related to regular (tendered) IROs are 1.3 to 1.6 times higher for the disabled and a factor of 1.1 to 1.3 times for unemployment benefit claimants. IROs can be negotiated to a maximum price of EUR 5,000 each, but must be approved by the funding body, the UWV. The municipal market is reluctant to introduce similar budgets.

The introduction of IROs has led to a dramatic expansion of the number of small providers in the market. Upon the introduction of IROs in 2004, the UWV had 60 contractors. It now has 2,100. For optimal use of the IRO, clients need more information on providers than is currently available. The quality mark sets a threshold in the market, but there are still too many providers to choose from.

The IRO has become such a huge success that it currently endangers the whole tendering system as the UWV is no longer able to refer the contractual amount of clients to providers and is unable to audit such a large amount of providers.

The new purchasing system

From 1 April 2008 the UWV (and thereby the Department of Social Affairs) introduced a completely new way of purchasing re-integration products and IROs.¹⁹ A so-called 'purchase framework' now determines how the agency will purchase products. Tenders for whole target groups will be a thing of the past. From now on the benefit agency will purchase for individual clients.

There will no longer be price competition as the benefit agency will determine product prices. Competition is based on the quality of services of the provider. Providers are selected on the basis of minimal requirements (e.g. client satisfaction results, placement percentages). A provider has to meet these requirements in order to be on the potential providers list. The better results

the more chance providers have of being able to continue to deliver services.

A reintegration coach – an employee of the UWV – and the client determine together what is needed for the client to return to the labour market. If this is done, the client chooses the company that will deliver the services. In effect reintegration coaches are playing a larger role in the guidance of the clients, at the expense of the providers. Only in the case of the IRO will the provider be responsible for such guidance.

The new rules are inspired by the Australian Star rating system, i.e. competition over quality is to replace competition over price. Providers that do not deliver the required standards will not be awarded any further contracts. The payment-by-placement results system applies to IROs.

Evaluation

Table 2 Characteristics of UWV clientele, results and costs by IRO and by tender (2004-2007)

		IRO	Tender
Number		66,455	131,323
<i>Client characteristics</i>			
Status	Disabled	38 %	47%
	Unemployed	62 %	53%
Age	Disabled	38,8%	39,1
	Unemployed	44,3%	42,9
Education	low skilled		
	Disabled	28%	
Price	Unemployed	19%	
	pro 'trajectory' in €	4,500	3,850
	Disabled in €	4,730	4,320
Placement ²⁰	Unemployed in €	4,431	3,430
	Disabled	40%	29%
Total Cost per placement	Unemployed	47%	35%
	Disabled in €	7,025	9,980
		Unemployed in €	6,870 6,540

Source: APE, *Vierde Voortgangsrapportage IRO*, APE, 2007

19 <http://www.uwv.nl/zakelijk/re-integratiediensten/inkoopkaderreintegratiediensten/index.aspx>

20 In percentages of total entrance per cohort for 2004.

The Act on Work and Assistance (2004), together with the strong financial incentives for municipalities and clients, has proven to be a major success – figures for social assistance are currently as low as in the seventies.²¹ However, with the limited data available it is difficult to assess the contribution of the new reintegration market to the effectiveness of the transition from welfare to work. A recent evaluation by the Department, called ‘Beleidsdoorlichting Reintegratie’, concluded that there is a ‘small positive effect’ on the probability of making such a transition but that it does not, over the short-term, pay back in terms of benefit savings (see also effectiveness below).²²

A major weakness of the model is the emphasis on short-term job outcomes and a lack of resources and incentives to invest in the most disadvantaged. A major strength of the system is the relatively strong emphasis on positive engagement with clients in the form of the introduction of IROs and the role of the Client Councils. The quality mark also helps to make the reintegration market more transparent.

The flexibility and scope for experimentation at the local level are further strengths of the decentralised model. There is scope within the policy and service delivery framework for municipalities to switch to more investment and more intensive help for the many disadvantaged jobseekers attuned to local labour market needs. On the other hand the model suffers from a lack of professionalism among its municipal principals, from missing national standards regarding the quality of service provision, and from learning from practice. The lack of accurate national data on program effectiveness is also a problem.

There has been little empirical research in to the net effectiveness of the privatised reintegration service in the Netherlands.²³ The few studies that have looked into this

area have concluded that the impact of welfare-to-work services is present but has been limited, and that employment services do shorten periods of unemployment.

However this type of research cannot provide an answer regarding the relative effectiveness of private service delivery over public service delivery. Neither does it give much information on how to achieve a better price/result combination. Some reports conclude that (meagre) placement results are related to (low) prices and point the finger at the importance of a well qualified public principal for better results.²⁴

Conclusions

The Netherlands has chosen a different model than the one proposed for Britain by David Freud. The Dutch system has big and small principals, including clients (IROs); a large amount of providers (some big and many small, but mainly for-profit in the unemployed and disabled sector); a mixture of for-profit and not-for-profit providers in the hard-to-help segment; national and local tenders (only using work budgets, no benefit ones); short-term contracts (one to two years); sustainable placement (six months); the use of quality marks for providers; partnership as the basis of cooperation between private providers and public organisations (chain management); and a weak culture of monitoring and evaluation.

The Freud approach has as its main elements one national principal (the DWP); tenders with a small amount of big providers; the use of work and benefit budgets combined (‘DEL’ and ‘AMI’); a benchmark to focus competition on results (i.e. a star rating system); five year contracts; and obligations to guide clients for three years.

Goal displacement is a danger in the UK model. In markets where there is only one buyer, providers tend to focus on the principal and his output indicators. This is a

21 Bosselaar H, Bannink D, van Deursen D, and Trommel W, *Werkt de WWB? Resultaten van Nieuwe Verhoudingen Tussen Rijk en Gemeenten*, Begroting SZW, 2007

22 http://docs.minszw.nl/pdf/35/2008/35_2008_3_11424.pdf

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risk in a market where the relationship between output indicators and net effectiveness is necessarily indirect. Star ratings do not offer a sufficient solution for this problem as experiences in the Australian market show.²⁵

In the Dutch model, the introduction of the individual contract IRO and multiple buyers/principals are safeguards against this drawback. IROs focus on the client as the real customer and on matching through direct quality control by the client. This incentivises providers to deliver custom made services.

The large amount of providers in the Dutch market increases the risk of lack of transparency in the market. A quality mark for providers and a national provider's guide must safeguard against this danger. Providers must use the quality mark to dis-

tinguish themselves from competitors.

The weak spots in the Dutch model are the short time horizon of the contracts which endanger the quality of services offered in the market, the noncommittal attitude in professional guidance by the Department of Social Affairs and – despite the large amount of study reports – the lack of solid evaluation studies.

Obviously there are differences between more and less marketized systems for the delivery of public employment services. Shortcomings, however, are not univocal to one or the other model of marketization. At this time no conclusive evidence from research is available. The choice for a largely for profit market delivery system or a hybrid remains first and foremost a political assessment.

The Netherlands

- GDP, 2007: \$2.7 trillion²⁶.
- Population, 2005/6: 16.3 million²⁷.
- Number of people in the labour force, 2005/6: 7.4 million²⁸.
- Average weekly wage among adults in full-time work, 2005/6: \$841.3²⁹
- Total spending on welfare, 2005/6: \$143.3 billion³⁰.
- Total spending on unemployment benefit, 2005/6: \$6.8 billion³¹.
- Rate of per week unemployment benefit, 2005/6: \$1, 359 (maximum)³².
- Number of people unemployed, 2005/6: 483,000³³.
- Number of unemployed people in 2005/6 out of work for one year or more: 200,000³⁴.
- Number of days formerly unemployed people must be in work for their assistance to be considered successful: 6 months³⁵.
- Total spending on incapacity benefit, 2005/6: \$16.3 billion³⁶.
- Rate of per week incapacity benefit, 2005/6: \$1, 359 (maximum)³⁷.
- Number of people on incapacity benefit, 2005/6: 958, 340³⁸.
- Total spending on lone parent benefit, 2005/6: \$6.6 billion³⁹.
- Rate of per week lone parent benefit, 2005/6: \$338.6⁴⁰.
- Number of people on lone parent benefit, 2005/6: 365,000⁴¹.

25 Thomas M. "A Review of Developments in the Job Network", *Parliament of Australia Research Paper*, no 15, 2007-2008

26 An estimated figure; Central Intelligence Agency (2008) *The 2008 World Factbook* (USA: Central Intelligence Agency).

27 Centraal Planbureau (<http://www.cpb.nl/nl/prognoses/nlinfo.html>); Centraal Bureau voor de Statistiek (<http://statline.cbs.nl/StatWeb/start.asp?p=Search/Search>).

28 Centraal Planbureau (<http://www.cpb.nl/nl/prognoses/nlinfo.html>); Centraal Bureau voor de Statistiek (<http://statline.cbs.nl/StatWeb/start.asp?LA=nl&DM=SLNL&lp=Search%2FSearch>).

29 Centraal Planbureau (<http://www.cpb.nl/nl/prognoses/nlinfo.html>).

30 Centraal Bureau voor de Statistiek (<http://www.cbs.nl/NR/rdonlyres/FFD33AE0-4F01-45FA-B3D1-90FD1EFFCA5D/0/2007k4p104p30art.pdf>).

31 *Ibid*

32 Ministerie van Sociale Zaken en Werkgelegenheid (http://home.szw.nl/index.cfm?menu_item_id=13730&hoofdmenu_item_id=13825&rubriek_item=391905&rubriek_id=391817&set_id=134&doctype_id=6&link_id=132310&doc_id_sub=18588#link9737800).

33 Centraal Planbureau (<http://www.cpb.nl/nl/prognoses/nlinfo.html>); Centraal Bureau voor de Statistiek (<http://statline.cbs.nl/StatWeb/start.asp?LA=nl&DM=SLNL&lp=Search%2FSearch>).

34 Centraal Bureau voor de Statistiek (<http://www.cbs.nl/nl-NL/menu/themas/arbeid-sociale-zekerheid/publicaties/artikelen/archief/2006/2006-2055-wm.htm>); <http://statline.cbs.nl/StatWeb/start.asp?LA=nl&DM=SLNL&lp=Search%2FSearch>.

35 UWV (<http://www.uwv.nl/>).

36 Centraal Bureau voor de Statistiek (<http://www.cbs.nl/NR/rdonlyres/FFD33AE0-4F01-45FA-B3D1-90FD1EFFCA5D/0/2007k4p104p30art.pdf>).

37 Ministerie van Sociale Zaken en Werkgelegenheid (http://home.szw.nl/index.cfm?menu_item_id=13730&hoofdmenu_item_id=13825&rubriek_item=391905&rubriek_id=391817&set_id=134&doctype_id=6&link_id=132310&doc_id_sub=18588#link9737800).

38 Centraal Bureau voor de Statistiek (<http://statline.cbs.nl/StatWeb/table.asp?LYR=G2:0,G1:0,G3:0&LA=nl&DM=SLNL&PA=37638aom&D1=0,48,96,111&D2=a&D3=a&D4=0&D5=a,I0-83&HDR=T&STB=G4>).

39 Centraal Bureau voor de Statistiek (<http://www.cbs.nl/NR/rdonlyres/FFD33AE0-4F01-45FA-B3D1-90FD1EFFCA5D/0/2007k4p104p30art.pdf>); <http://statline.cbs.nl/StatWeb/start.asp?LA=nl&DM=SLNL&p=Search%2FSearch>).

40 Ministerie van Sociale Zaken en Werkgelegenheid (http://home.szw.nl/index.cfm?menu_item_id=13730&hoofdmenu_item_id=13825&rubriek_item=391905&rubriek_id=391817&set_id=134&doctype_id=6&link_id=132310&doc_id_sub=18588#link97371500).

41 Centraal Planbureau (<http://www.cpb.nl/nl/pub/cepmev/cep/2005/pdf/h5.pdf>).

Appendix

Table I Type of public private partnerships created under the Dutch model

	Public market	Public market	Private market
Type of clients	Unemployed and disabled with rights, without employment contract	Social Assistance claimants	Sick and disabled employees, with employment contract
Intake and referral of clients	Centre for Work and Income	Centre for Work and Income	Companies specialised in working conditions
Income maintenance	Employee Insurance Agency (UWV), Contribution based	Municipalities Means tested	Firms Contribution-based Contribution based
Direct job placement	CWI	CWI	Reintegration companies
Case Management/ Provision Employment Services	Re-integration companies	Re-integration companies	Re-integration companies and in-house
Sanctions	Employee Insurance Agency (UWV)	Municipalities	Firms
Tendering	Employee Insurance Agency (UWV)	Municipalities (not obligatory)	Firms (not obligatory)
Voucher	UWV Individual Reintegration Agreement (IRO)	Municipalities Personal Reintegration Budget (PRB)	

At a time of growing cross-party support for contracting out employment services, knowledge of international experiences with such reforms is still patchy among UK policy makers.

Policy Exchange commissioned research about five countries that have reformed the way in which they provide employment services to jobseekers: Australia, the United States (Wisconsin), Germany, Denmark and the Netherlands. Their experiences are assessed with regard to the lessons they hold for the UK by former Secretary of State for Social Security, Peter Lilley MP.

The overall results are encouraging. The essays in this compilation show how use of the private and voluntary sectors has brought improvements in the employment services sector. However, potential difficulties arise from the design of the contracting out regimes.

Altogether, *Paying for Success* provides insights into the design, implementation and pitfalls of contracting out regimes in employment services. While welfare reform experiences are hardly ever directly transferable from one country to another because of national peculiarities, the reforms documented in this collection of essays will be valuable to UK policy makers.



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