Work 2.0

Policy Exchange

Helping the hardest to help: targeted assistance, incentives and the Work Programme

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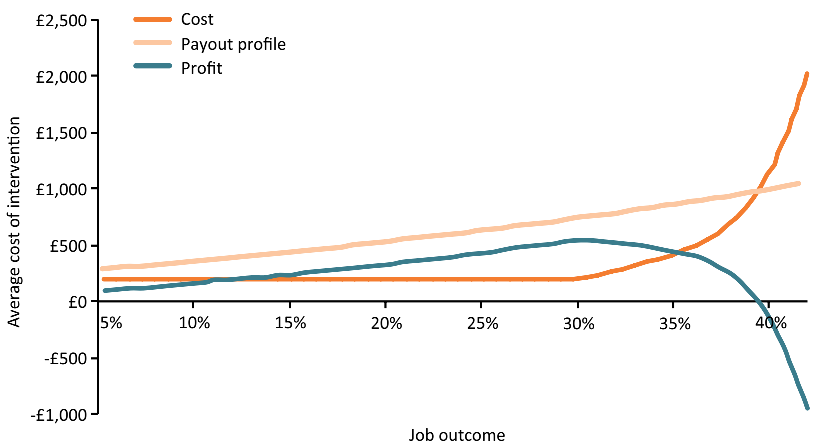
Executive Summary

The Coalition Government's welfare-to-work policy for the long-term unemployed is based around an ambitious new approach, the Work Programme. Replacing thirteen existing back-to-work schemes, this all-encompassing, national scheme is led by private and third sector providers and represents a very significant element in the Government's labour market and economic strategy.

For the long-term unemployed, getting the next iteration right, 'Work Programme 2.0', is very important. However, there is a significant risk this will not happen. In particular, by incentivising providers to treat people according to the type of primary benefit they receive rather than their particular needs, there is a serious danger of inefficiency: both by overpaying for employment support for claimants who do not need it and underfunding necessary support to get the hardest-to-help claimants back into work.

Figure ES1: How rational 'parking' takes place



This lack of properly aligning financial incentives with a claimant's distance from the labour market is associated with perhaps the most frequently cited problem with the Work Programme – 'creaming and parking'. 'Creaming', (also sometimes called 'active targeting') involves providers targeting help at those individuals closest to the labour market because they are the most (or the only ones) that are profitable. 'Parking' refers to the lack of sufficient resources and support for those claimants unlikely to generate any revenue for the provider because they are unlikely to enter sustainable employment. This report outlines why parking represents the biggest obstacle to the success of Work Programme 2.0. This arises not only because it involves a failure to fulfil the purpose of the programme – to return the hardest to help claimants to sustainable work – but also because little effort is made before claimants are placed on the programme to identify those this is most likely to happen to.

Unfortunately, there is significant evidence that 'parking' has happened in the Work Programme. This stems, among other things, from: employment support based on length of claim and benefit rather than need, financial incentives which do not align risk and reward, lack of flexibility in the contracts to adjust for the needs of particular local labour markets or changes in the wider economy. Finally, there remain significant issues around the viability of specialist interventions provided by subcontractors who have struggled to make the niche services needed for the hardest-to-help financially viable due to limits on assurance of future work, lack of upfront payments and other factors.

"The dramatic increase in the number of long-term unemployed since the financial crisis and the long-term 'scarring' effect this will have on this section of the labour market make the need for future reform very pressing"

Whether providers choose to ignore the contract structure or not, the fact remains that the financial structure directly incentivises against providing appropriate provision to each claimant according to distance from the labour market – overpaying for some, underpaying for others. It should be stressed that this is not to suggest that providers deliberately 'park' claimants whose provision is not properly paid for.

Some providers try to reduce parking by placing greater emphasis on harder to help claimants in their internal performance targets. For example, this can mean that success with harder to help claimants adds more 'points' to an advisers' performance evaluation, or having advisers specialise in harder-to-help claimants with lower performance targets. Crucially, however, this process is largely related to benefit type (and thus payment). Even if providers have linked this weighting to distance from the labour market rather than payment group, it cannot be denied this is potentially directly contrary to their financial interest and does not provide a sustainable model for Work Programme 2.0.

Why it matters

The Work Programme constitutes the government's main delivery mechanism for assisting the hardest-to-help long-term unemployed get back to work. Its future success or failure will have an enormous impact on whether the hardest-to-help claimants enter sustained employment. The dramatic increase in the number of long-term unemployed since the financial crisis and the long-term 'scarring' effect this will have on this section of the labour market make the need for future reform very pressing. The effect on the public finances, in terms of ongoing benefit expenditure as well as additional public services, is also very significant – not least since the hardest-to-help claimants are also likely to be the most costly on an ongoing basis in the absence of appropriate support.

Getting Work Programme 2.0 right for Universal Credit

It is evident that Universal Credit implementation is a long-term reform that will not have reached full roll-out by the time the new Work Programme is designed. The danger is therefore that Work Programme 2.0 is not designed with alignment in an eventual Universal Credit centred unemployment benefit system in mind, leading to contradictory or non-compatible objectives until a possible 'Work Programme 3.0' – perhaps beyond 2020 – is conceived. This would mean sacrificing the potentially transformative nature of Universal Credit, losing the 'moment of change' to integrate support with the opportunities presented by, and intentions of, the new welfare system. In particular, it is important that we do not lose the opportunity to use the more sophisticated real time data available with Universal Credit to improved provision for the long-term unemployed.

A failure of the system to anticipate these changes would mean putting off any significant reforms to the current welfare-to-work system. This would be to miss an important opportunity. In particular, to:

- Encourage the development of a 'mini-jobs' market below sixteen hours at the equivalent of national minimum wage;
- Incentivise skills development and progression of workers in wages and hours further up the income scale;
- Build a more tailored and personalised system of employment support.

Merely 'tweaking' the existing contracting structure for another round of contracting would fail to exploit the potential of the government's welfare reforms and ensure their effectiveness reaches the most vulnerable groups. Such changes are needed today, not in a decade's time.

This report also notes that the reforms have to be realistic. Any reforms have to be designed in 2014/15 and plan for the intermediate years between now and full Universal Credit roll-out and it will not be possible to design the system in a 'big bang' reform solely focused on the theoretical end goals of the government's welfare reforms without accounting for the intervening steps. This report therefore suggests a two-phase approach for Work Programme 2.0:

- A short-term contract model for the programme during Universal Credit roll-out, partially aligned with its objectives, and;
- A long-term contract to kick in once Universal Credit has been fully implemented, fully aligned with its objectives.

A short-term change does not necessarily require a revolutionary 'break' with the structure and business models designed for Work Programme 1. Such an alignment might simply be to redesign the segmentation system, allowing the differential pricing to reflect claimant's degree of barriers to work, without changing payment mechanisms, projected claimant flow or Contract Package Areas at all. Even this simple change would be a significant step towards the ultimate objectives of the welfare system.

In summary: Work Programme 2.0 must reflect the intentions and objectives of Universal Credit that will be rolled out during the programme.

Proposals

As Policy Exchange has previously argued, the welfare system remains one predicated on assessing and supporting claimants according to the primary benefit they are claiming and the length they have been claiming. For Work

Programme 2.0, it will be necessary to begin to reform this model of funding. The Australian model of employment support follows a 'variable payment structure.' Simply, this means that payment follows the jobseeker according to an assessment of their need. This is dependent on the classification level given by the Job Seeker Classification Instrument, a computer-based segmentation tool for determining a claimant's particular needs and characteristics and a Jobs Capacity Assessment to assess barriers to work.

Proposal 1: *Develop a new model of employment support contracts based around the claimants' distance from the labour market rather than primary benefit type and length of claim. This should be based on the Job Seeker Classification Instrument developed in Australia, to be administered by Jobcentre Plus.*

Why better segmentation is needed for Work Programme 2.0

As identified in our previous report, *Personalised Welfare*,[1] significant risk persists from the practice of 'one size fits all' methods of classifying the needs of claimants. The existing framework is largely based on categorising and treating claimants according to their age, the type of benefit they receive and how long they have been receiving it rather than the barriers to work they face. For example, this means giving a much higher reward for a highly motivated claimant who has left Incapacity Benefit than someone with learning difficulties and drug and mental health problems who happens to be on Jobseekers Allowance, even if they have a very long history of worklessness. Where early intervention regardless of benefit type is available, it is not always appropriate. Ex-offenders, for instance, may have grown out of their past and not have any particular barrier to employment. Early access to more extensive support based on broad characteristics may be unnecessary or misplaced.

A better diagnostic tool able to identify specific barriers to work will allow support to be better targeted. This technique has been used with success in Australia and in limited pilot trials in the UK. It embraces a whole host of information not taken into account by Jobcentre Plus or the existing Work Programme. For instance, it can include things like family circumstances, language skills, ethnicity, living arrangements, country of origin, transport, workplace support needs, geographic location (especially remoteness from centres of employment), recent work experience, homelessness, criminal record and qualifications.

To develop this new approach, it will be necessary to build capacity in the welfare-to-work industry and this will take time: advisers will need to be trained to deal with their new responsibilities; private and third sector providers will need time to build capacity and supply chains to deal with increased demand; and, most importantly, significant research and testing will need to be undertaken to create an effective segmentation process.

Proposal 2: *Any new segmentation mechanism should be based on the existing claimant group flows – using existing projections as to the proportion of claimants referred to each group, the same payments, but with determination of each claimant's categorisation performed through the segmentation tool rather than primary benefit type. This will be a transitional arrangement before full implementation of Universal Credit.*

1 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

This would help to eliminate deadweight and properly target incentives. This would be an interim approach before Universal Credit is rolled out and would allow the development of an effective segmentation process over time.

The Work Programme also has little means to adjust for changing economic conditions and local labour markets factors. Specifically, the limited regional contract price differentiation (through bid discounts in Job Outcome payments) does not address the more fundamental issue of geographical dispersion within the contracting areas rather than between them. This means that parking behaviour is likely to occur at the sub-contract area level because of the heterogeneity of local labour markets.

Proposal 3: *Explore allowing variations in pricing by inter-regional geography to reflect the cost of capitalisation, level of risk and local labour market conditions within each contract package area. More radical alternative arrangements, such as commissioning the Programme on Local Enterprise Partnership (LEPs) boundaries, which would also help address coordination with ESIF and skills programmes, should also be explored.*

For the first time, Universal Credit will create incentives for employment for below 16 hours a week. It therefore makes sense to structure Work Programme contracts in a different way (rather than the effective 16 hours threshold). A further iteration could incorporate incentivising progression of claimants beyond this point.

Proposal 4: *Explore options for incorporating incentives for progressing claimants beyond existing Universal Credit thresholds for conditionality. This could include payment for assumed benefits saved and additional tax receipts accrued over the contract period.*

It is likely that the existing system undermines the value or potential that part-time or 'mini-jobs' could play in reintroducing hard-to-help claimants to the labour market. Such claimants may need to transition from 'mini-jobs' before progressing on to greater hours.[2] Tailoring the level of earnings targeted for each claimant, as well as the progression in earnings should form a key feature of the segmentation system.

Proposal 5: *Exploring alternatives to the '16 hours rule' at national minimum wage for job outcomes, with a view to focusing incentives on additional monies earned to be phased in during the roll-out of Universal Credit. This would follow Jobcentre Plus' experience with PAYE data and the provider payment IT system. This should incentivise providers to place some claimants in lower earning or 'mini-jobs' where this is a more appropriate goal, as well as incentivising them to increase their earnings according to their circumstances established in the segmentation tool.*

A significant barrier to procuring the best service for the long-term unemployed is a failure to reflect the record of effectiveness of providers in consideration of awards for new contracts. Historically, EU procurement rules have been perceived to prevent the UK government as purchaser of services to take into account past performance in awarding contracts, as a means of preventing barriers to entry in the market and preventing anti-competitive or protectionist award practices.[3]

2 Or the equivalent of 16 hours at National Minimum Wage.

3 Or the equivalent of 16 hours at National Minimum Wage.

However, the new EU Procurement Directive that came into force in 2014 may allow bids to be excluded because of poor performance based on objectively 'proportionate' criteria.[4,5] In other words, it should allow past performance to be taken into greater consideration during Work Programme 2.0. The most straightforward way to implement this and sharpen incentives is to follow the Australian model. A 'star rating system' has been instrumental in driving up standards and achieving value for money.

Proposal 6: *Explore the means to create a system of star ratings in future contracting, including publication of each provider's rating on a quarterly basis. This should use regression methodology to adjust for the characteristics of claimant groups and labour market conditions between contract areas, using the flexibilities available in the new EU Procurement Directive. Incentives should be based on relative performance between providers rather than estimates of non-intervention.*

Claimants with significant barriers to paid full-time employment are often excellent candidates for self-employment. Yet the existing scheme to allow unemployed people to do this – the New Enterprise Allowance Scheme, is not available to claimants on the Work Programme.[6]

Proposal 7: *Extending the availability of the New Enterprise Allowance Scheme to all claimants who are identified as likely to benefit from it as identified by the segmentation tool, including those already on the Work Programme. In the long-term, this support should be available from day one and throughout a claim.*

The effect of Universal Credit on customer groups and, potentially, Job Outcome definitions, could not have been anticipated in prior business models and may significantly affect the ability of Work Programme contractors to deliver services to hard-to-help groups in Work Programme 2.0.

Proposal 8: *Maintaining the flexibility of the Department of Work and Pensions to change the terms of contract for Work Programme 2.0 to account for the needs of Universal Credit.*

The Work Programme is also a particularly long contract – up to nine years before all sustainment-in-work payments might theoretically be paid. This creates surety for contractors and lowers transaction costs, but at the expense of preventing flexibility within DWP when awarding new contracts. The introduction of Universal Credit and the need to align Work Programme 2.0 with it makes this flexibility still more necessary.

Proposal 9: *Future contracting should be more iterative, perhaps on a three-year model as in Australia.*

A significant issue has also emerged with the treatment of sub-contractors in the Work Programme. Several took on contracts that were not financially viable, had few referrals and several went out of business. There is a significant risk that specialist skills and necessary interventions may be lost as experienced staff and firms with extensive institutional knowledge leave the industry or go bust. It is important to ensure this improves in Work Programme 2.0.

4 'Commission Staff Working Paper Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council', 5.3.2. Impacts of STR.LEGI.FACILIT option, p. 60, http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/SEC2011_1585_en.pdf

5 http://www.anthonycollins.com/briefings/uk-response-commission%E2%80%99s-proposed-new-eu-procurement-directive

6 http://www.ytko.com/news/new-enterprise-allowance-not-for-work-programme-participants

Proposal 10: *Create an Independent Regulator, responsible for overseeing the prime/sub-contractor relationship, as well as reviewing appropriate fees and contract conditions.*[7] *This remit could include price revisions, market share shift according to performance and adjustment of prices. This would supercede the existing Mediation Service and some market management roles of DWP.*

The mismatch between expected and actual client flow has also seriously disrupted the financial planning of many organisations. It would be prudent to enact some safeguards to give subcontractors greater certainty in the future for specialist services.

Proposal 11: *In future bids, a new code of conduct should replace the Merlin standard to promote certainty and viable operating models for small subcontractors, including a 'single bid' system. This will prevent subcontractors having to make costly duplicate bids to prime providers in each contract area. Fulfillment of these undertakings should be enforced by the Independent Regulator.*

In the event of provider failure, the Department anticipates that another prime contractor can take over with a quick 'mini-competition' to determine which one it will be. However, how this could be achieved is not well defined. It would therefore be prudent to lay contingency plans in advance.

Proposal 12: *There should be an assessment of which alternative methods might be used to mitigate moral hazard, such as a special administration regime or 'living wills' to ensure the continuation of services and set out clear transition mechanisms for market share shift should one or more providers fail.*

Some have also criticised the contract award process as being too focused on price rather than the quality of the service offer.[8]

Proposal 13: *Explore ways to award contracts more on quality rather than price, following a reassessment of the pricing structure on a regional macroeconomic level. This could include complete phasing out of bidding discounts and specification of financial incentives purely through the segmentation tool.*

The existing contracts also give providers very little opportunity to distinguish on the basis of regional or cyclical conditions. In the bidding process, some companies may have preferred some regions over others due to regional labour market conditions.[9] Providers could end up being rewarded or penalised for macroeconomic conditions largely beyond their control, as particular labour markets improve or worsen.

Proposal 14: *In* Work Programme 2.0, *payment levels should be subject to automatic adjustment determined by leading (rather than lagging) macroeconomic indicators on a regional, or sub-regional basis. Which indicators might be used should be subject to consultation or piloting before full roll-out.*

One element of the Work Programme system that is unusual is the lack of up-front fees available for the hardest-to-help groups and a relative lack of such contracts for subcontractors. There have also been issues around DWP requests for additional information in addition to that stipulated within the contracts.

7 http://www.merlinstandard.co.uk/mediation.php

8 http://www.guardian.co.uk/society/2012/feb/07/work-programme-cheap-contracts-awarded

9 For example, we note that one unsuccessful Prime bidder – PwC – exclusively bid in London and the South-East.

Proposal 15: *For the hardest to help groups, an estimate of cost of compliance with DWP's administrative and compliance costs should be paid as an upfront attachment fee for claimants furthest from the labour market.*

The 'black box', alongside onerous confidentiality requirements, make it difficult to disseminate information on best practice between firms. The high degree of secrecy mandated ranges from a blanket ban on data sharing to even preventing contractors making press releases without DWP authorisation.[10] The sharing of comparable performance data, information and technical advice across the industry could be significantly improved.

Proposal 16: *Developing an independent panel on best practice in Work Programme 2.0, building on the work of the best practice group. This should develop a similar structure to the Knowledge Transfer Network to share innovation and facilitate dissemination of best practice within the welfare-to-work Industry.*

Ensuring levels of employment support are transparent is a key means of minimising the risk of parking, but this has to be achieved without demanding overly prescriptive standards and data measurement that might stifle innovation. It is important to ensure that Work Programme 2.0 gets this balance right.

Proposal 17: *Providers should be permitted to publish any non-personal performance data they wish subject to quality thresholds defined by the Independent Regulator. There should be no further demands to publish or provide additional data to DWP over existing requirements.*

The Work Programme is match funded between the UK and the European Structural and Investment Fund (ESIF) in England. Since these funds are supposed to add to existing programmes rather than override or replace them, in practice, this means that ESIF programmes can be ad hoc and uncoordinated.

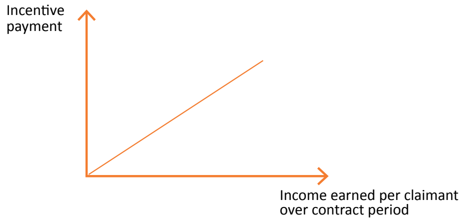
Proposal 18: *Conducting a Review on improving the use of ESIF funding with a view to more effective integration into Work Programme 2.0. A similar process should be undertaken for the ERDF and other Structural Funds to eliminate duplication as far as possible.*

10 http://www.thirdsector.co.uk/go/news/article/1110933/work-programme-contract-bans-charities-attracting-adverse-publicity/

Proposed Work Programme 2.0 incentives under Universal Credit

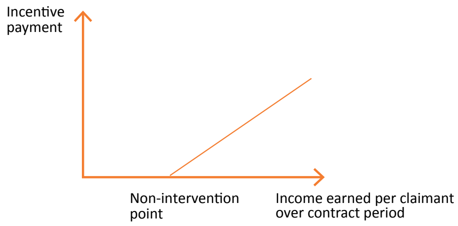
In the long-term following full Universal Credit roll out, this report proposes that all existing payments (outcome and sustainment) should be replaced with *one incentive payment based on a claimant's total earnings over the life of the contract.* Specifically, *an incentive payment calculated from a percentage of the claimant's total earnings over the period of the contract* would be the most appropriate means of differential pricing. The level of provider earnings should be usually be capped at the point the claimant's earnings cause them to exit Universal Credit claimant commitment conditionality (i.e. once the claimant is no longer required to look for employment).[11]

Variant 1: Simplified model – incentive payment based on claimants' total earnings



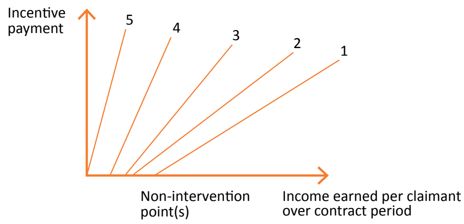
To limit or prevent 'deadweight' costs (i.e. earnings that would have happened anyway, regardless of the providers' services), a non-intervention point should be calculated, below which providers receive no incentive payment for any of their claimants' income. These thresholds could be set low (perhaps below deadweight) to replace attachment fee/service charge element of the contract.

Variant 2: Simplified model with non-intervention point



Additionally, each client group identified in the segmentation process should have a differentiated non-intervention point (i.e. those groups furthest away from the labour market will have a lower non-intervention point). Harder to help claimant groups should also have a greater percentage of total claimant earnings as the incentive payment. In summary: providers should receive a greater share of total earnings where the claimant is further away from the labour market.

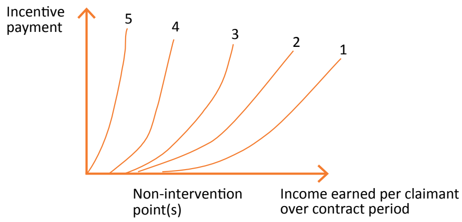
Variant 3: Differentiated payment profiles for different claimant groups (where '1' is the claimant group closest to the labour market and '5' is furthest away)



11 The cap could be raised for certain groups to achieve other social objectives, however.

A further development as the segmentation process develops should indicate where greater incentives are needed to 'push' providers to increase earnings beyond a certain point (i.e. the marginal costs would always exceed the marginal returns up to a certain desired level of claimant earnings). This will allow us to identify where the percentage of earnings incentive needs be greater. It is likely that the percentage will need to be increased more sharply for claimant groups further away from the labour market.

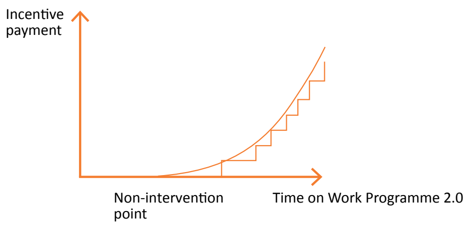
Variant 4: Differentiated payment profiles for different claimant groups with increased incentives further up the earnings scale (where '1' is the claimant group closest to the labour market and '5' is furthest away)



One problem with this model is that may allow 'parking' of claimants within payment groups (i.e. the payment profiles within each group remain the same, while the variation in distance from the labour market may remain significant). A balance has to be struck between too much complexity on the one hand, and too much simplification leading to undesirable incentives (such as parking) on the other.

However, a possible way to mitigate this might be to make use of another proxy: the length of time the claimant has been in the programme. An effective way to achieve this in the long term would be to *incorporate a variant of the target accelerator model within each claimant grou*p. This provides escalating payments for claimants according to the order in which each claimant in a particular cohort enters work.

Variant 5: Individual claimants' accelerator model multiplier according to time on Work Programme 2.0



Not all of these reforms should be implemented if this capacity is not effectively developed. Nevertheless, we believe that even a simple system of incentives based on earnings would have several advantages over the present system:

- It eliminates the existing pass/fail 'cliff edges' for incentives. For example, the incentive to 'park' a claimant who is not already in sustainable employment six months from the end of the contract because they are not likely to reach this point before the end of the contract (or remain in employment without interruption for six months to trigger payment after the contract period ends). Providers are rewarded however small the improvement in level of earnings.

- It creates clear incentives for progressing claimants already in work throughout the contract.
- Incentivises providers to look for 'mini-jobs' following the logic of Universal Credit and aligning providers' incentives with claimants' conditionality.
- Payments can be ongoing through the real-time information (RTI) systems being developed between HMRC and DWP to monitor claimants' employment income and thus Universal Credit payments. Work Programme provider payments could happen automatically alongside Universal Credit calculations. This would radically reduce or eliminate the need for providers to evidence claims and reduce administrative problems created by year to date (YTD) calculations and opportunities for fraud and error.
- It would reduce complexity in the incentive process and the block payments at different stages of the contract (i.e. the existing job outcome and sustainment targets), potentially improving the viability of employment support business models.
- The principle behind it is clear, the incentives are simple to understand and can be adjusted over time to minimise parking, ensure marginal returns exceed marginal costs for different client groups and to make improvements as experience of the model develops.

1
Outline

It is evident that Universal Credit implementation is a long-term reform that will not have reached full roll-out by the time the new Work Programme is designed. The danger is, therefore, that Work Programme 2.0 is not designed with alignment in an eventual Universal Credit centred unemployment benefit system in mind, leading to contradictory or non-compatible objectives until a possible 'Work Programme 3.0' – perhaps beyond 2020 – is conceived. This would mean sacrificing the potentially transformative nature of Universal Credit losing the 'moment of change' to integrate support with the opportunities presented by, and intentions of, the new welfare system. A failure of the system to anticipate these changes would mean putting off any significant reforms to the current employment support mechanism for the long-term unemployed. This would be to miss a significant opportunity. In particular, to:

- Encourage the development of a 'mini-jobs' market below 16 hours at the equivalent of national minimum wage;
- Incentivise skills development and progression of workers in wages and hours further up the income scale;
- Build a more tailored and personalised system of employment support.

It is important not to lose the 'moment of opportunity' presented by this new phase of the Work Programme. Merely 'tweaking' the existing contracting structure for another round of contracting would fail to exploit the potential of the government's welfare reforms and ensure their effectiveness reaches the most vulnerable groups. Such changes are needed today, not in a decade's time. This report is aimed at helping to achieve that outcome.

It is also important to note that the reforms have to be realistic. Any reforms have to be designed in 2014/15 and plan for the intermediate years between now and full Universal Credit roll-out and it will not be possible to design the system in a 'big bang' reform solely focused on the theoretical end goals of the government's welfare reforms without accounting for the intervening steps. This report therefore suggest a two-phase approach for Work Programme 2.0:

- A short-term contract model for the programme during Universal Credit roll-out, partially aligned with its objectives, and;
- A long-term contract to kick in once Universal Credit has been fully implemented, fully aligned with its objectives.

A short-term change does not necessarily require a revolutionary 'break' with the structure and business models designed for Work Programme 1. *In extremis*, such an alignment might simply be to redesign the segmentation system, allowing the differential pricing to reflect claimant's degree of barriers to work, without changing payment mechanisms, projected claimant flow or Contract Package Areas at all. Even this simple change would be a significant step towards the ultimate objectives of the welfare system.

What is the Work Programme?

The Coalition Government's welfare-to-work policy for the long-term unemployed is based around an ambitious new approach, the Work Programme. Started in June 2011 as part of the 'Get Britain Working' welfare reforms and replacing thirteen existing back-to-work schemes, this all-encompassing, national scheme is led by private and third sector providers and represents a very significant element in the Government's labour market and economic strategy. It is projected to deal with 3.3 million claimants in total by 2015/16[12] for which the providers will have responsibility for up to two years at a cost of £3–5 billion over a total of seven years up to 2018, with the aim of filling some 300–400,000 vacancies on a sustained basis. Though outcome-based funding has been used in the UK since the late 1980s (through the then Training and Enterprise Councils, for example[13]), the Freud Report in 2007 and Commissioning Strategy in 2008 in particular, have led to an increasing emphasis on payment by performance in a new 'welfare market'. This approach is now being applied across the public services:

> *'Payment by results should be implemented across the public sector without exception – where it exists already, it should be made more forceful and sophisticated, where it does not exist, it should be introduced with very limited transitional periods.'*[14]

> *'We will create a new presumption… that public services should be open to a range of providers competing to offer a better service.'*[15]

Welfare-to-work schemes involving payment-by-results have evolved significantly over the past decade, starting with Labour's 'Welfare to Work' Budget in July 1997: in particular, Employment Zones in 2000, Pathways to Work in 2003 and Flexible New Deal in 2009. This policy direction has culminated in the Work Programme's aim of an entirely outcomes-based, payment-by-results model of outsourcing, involving 18 prime contractors and around 800 supply chain partners and 500 voluntary groups.

The idea of payment by results is that it will allow providers to innovate, boosting quality and value without risking taxpayer money. Since Government will only pay if they succeed this provides an effective way to unlock future benefit savings. Claimants are referred at a certain point in their claim largely depending on the primary benefit they receive. Providers are then able to mandate a wide range of activities in addition to conditions imposed by Jobcentre Plus largely independent of government control, enabling them to innovative more effectively. The transfer of risk to the private sector aligns taxpayer interests with private interests and has been the subject of extensive academic research.[16]

12 Work Programme cumulative attachments, DWP Tabulation Tool.

13 Dan Finn, 'The 'Welfare Market' and the Flexible New Deal: lessons from other Countries', p. 3. http://eprints.libr.port.ac.uk/archive/00000099/01/1_DF_LEPU_Article_31_10_08.pdf

14 Downey A, Kirby P, Sherlock N, 'Payment for Success – How to shift power from Whitehall to public service customers', KMPG 2010, http://www.kpmg.co.uk/pubs/204000%20Payment%20For%20Success%20Access.pdf

15 David Cameron 'How we will release the grip of state control', Telegraph, 20th February 2012, http://www.telegraph.co.uk/comment/8337239/How-we-will-release-the-grip-of-state-control.html

16 For example, see Steve Aos, Washington State Institute, Jackie Mould, Be Birmingham and Michael Little of the Darlington Social Research Unit.

Several other countries (Denmark, Germany, Canada and Israel, for example) have successfully developed similar schemes.[17]

The ultimate aim of rewarding providers solely on the basis of sustainable work (rather than the legacy purely 'work first' approach of rewarding the placing of claimants in any job regardless of how long it lasts) has substantial implications for the future of employment services as well as the future of this form of public sector outsourcing generally. Unlike previous volumes-based supply contracts, the idea is that providers will be able to develop sophisticated diagnostics to identify barriers: such as self-esteem, experience, training, alcohol or drugs problems. These barriers should then be addressed with appropriate, tailored interventions paid for by the provider: training, therapy, CV building, mock interviews and confidence workshops, along with things like transport, childcare and caring costs, for example.[18] For more serious or difficult to address barriers that prime providers are unable to fulfil, specialist subcontractors are contracted to provide more niche interventions. This is a sophisticated and well-thought out system and a significant improvement over historic employment support programmes. Unlike the preceding scheme Flexible New Deal, there is a significantly differential payment system, provider intervention is over a two year period rather than one, sustainable job outcomes are measured over two years rather than 26 weeks, while referrals will take place at the same time (twelve months) or earlier. These are all welcome reforms.

However, several problems remain. The recovery of the UK economy, while now underway in earnest, has taken considerably longer than that anticipated when tenders were submitted in 2010/11. This, alongside the ambitious nature of the targets set and tightly drawn financial rewards, has created significant difficulties and a non-trivial risk of failure of key objectives for the programme in its future form. For 'Work Programme 2.0', the next iteration of the programme, this includes: significant threats to the sector's future financial viability, a systemic failure to meet DWP's minimum performance levels[19] and, more importantly, to provide an adequately targeted, timely and cost effective means of assistance to the long-term unemployed. These risks are particularly high for those jobseekers who are the 'hardest to help', or furthest from the labour market.

For the long-term unemployed, getting the payment-by-results mechanism used in Work Programme 2.0 presents the most significant challenges. If it is goes wrong, it can mean 'parking' the hardest-to-help through lack of identification and targeting of assistance. Unfortunately, there is significant evidence this has happened. This stems *inter alia* from employment support based on length of claim and benefit rather than need, financial incentives which do not align risk and reward, lack of differentiation according to local labour markets and failure to adjust for changes in the wider economy. Finally, there remain significant issues around the viability of specialist interventions provided by subcontractors who have struggled to make the niche services needed for the hardest-to-help financially viable due to limits on assurance of future work, lack of upfront payments and other factors.

As identified in our previous report *Personalised Welfare*,[20] significant risk persists from the practice of 'one size fits all' methods of classifying the needs of claimants. The existing framework is largely based on categorising and treating claimants according to their age, the type of benefit they receive and how long they have been receiving it rather than the barriers to work that they face. This means, for example,

17 Wright S, 'Contracting out employment services: lessons from Australia, Denmark, Germany and the Netherlands', Child Poverty Action Group, 2008.

18 'The Work Programme Invitation to Tender: Specification and Supporting Information', DWP 2010, p. 57. http://www.dwp.gov.uk/docs/work-prog-itt.pdf.

19 'The Work Programme Invitation to Tender: Specification and Supporting Information', DWP 2010, http://www.dwp.gov.uk/docs/work-prog-itt.pdf.

20 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

giving a much higher reward for a highly motivated claimant who has left Incapacity Benefit than someone with learning difficulties, drug and mental health problems who happens to be on Jobseekers Allowance, even if they have a very long history of worklessness. Where early intervention regardless of benefit type is available, it is not always appropriate. Ex-offenders, for example, may have grown out of their criminality and not have any particular barrier to employment. Early access to more extensive support based on broad characteristics may be unnecessary or misplaced. For example, DWP research into a more personalised approach found some counterintuitive predictors of long-term unemployment, such as having access to public transport to travel to work, or having English as a first language.[21]

> "The next steps in welfare reform must involve creating a more targeted and personalised form of employment assistance based on need and that this will help play a major role in reducing welfare dependency in the UK"

These practices entail 'deadweight' costs through the state providing unnecessary or unsuitable interventions, as well as increasing the length of time claimants spend on benefits by delaying appropriate support. This threatens the implicit social contract between claimants and the state: that it is the claimant's responsibility to do all that is reasonably possible to gain employed, but in return, it is the state's responsibility to provide a reasonable level of assistance for them to attain that goal. It is fair to ask claimants to do more for their benefits, but this has to be balanced by appropriate assistance to fulfil these conditions.

In a remarkably robust labour market that has nevertheless often been difficult for the long-term unemployed, the next steps in welfare reform must involve creating a more targeted and personalised form of employment assistance based on need and that this will help play a major role in reducing welfare dependency in the UK. We have suggested a series of new segmentation tools aimed at identifying a claimant's distance from the labour market as the principle means of doing this. Personalisation of support simply cannot be realised through a programme which segments people according to age, length of claim and benefit type. An entirely fresh approach is therefore needed.

It is important to note that the limitations of the existing system became particularly evident when two related changes to the contract structure were made:

- From April 2013, a higher level of Job Outcome Payment discount began, payable when a claimant has been in a job for a continuous or cumulative period of up to six months and agreed by each provider during the contract tendering process, amounting to around 6% of contract value.[22]
- From April 2014, the Attachment Fee (a flat payment for providers when a claimant is referred and successfully 'attaches' to the Work Programme) was completely phased out, meaning providers no longer received any 'upfront' funding.[23]

Both these factors have increased the financial pressures on the Work Programme: a significant 'moment of truth' as to the future viability of the Work Programme in its present form. Should one or more providers fail in the future due to major mispricing (perhaps particularly those whose business models

21 Matty S, 'Predicting likelihood of long-term unemployment: the development of a UK jobseekers' classification instrument', Department for Work and Pensions Working paper No 116, p. 16, http://research.dwp.gov.uk/asd/asd5/WP116.pdf

22 The Work Programme Invitation to Tender: Specification and Supporting Information', DWP 2010, http://www.dwp.gov.uk/docs/work-prog-itt.pdf.

23 The Attachment Fee is differentiated according to client group and was 100% of the contracted price in 2011/12, 75% in 2012/13, 50% in 2013/14 and 0% for 2014/15 onwards.

rely disproportionately on successfully sustaining employment for harder-to-help groups), it will be necessary to further develop the government's plan for transitional special resolution regimes to ensure that appropriate services continue in the event of firm-wide or systemic failure.

It is not simply that these difficulties could enter the picture at the level of one particular underperforming provider or another. Significant doubts have arisen as to the ability of the Work Programme structure to meet its objectives. While the situation has improved significantly since the first sustained job outcomes in November 2012[24] were released, this nevertheless has major implications as to the future of the programme. Most importantly, it may imperil appropriate support to some of the most vulnerable in society. Something must be done for those the system is failing. This report attempts to provide some of these solutions. Specifically, we will examine:

- Whether and how existing Work Programme provision for the long-term unemployed should be renegotiated or supplemented to target support more effectively at the hardest-to-help;
- What the new Work Programme contracts should look like once the existing contracts expire;
- What the effect of different payment structures are.

This report begins by outlining the characteristics of the claimants concerned and the performance of the Programme in assisting them thus far.

Client profiles

First, it is worth noting that the vast majority of unemployed people will have no contact at all with the Work Programme. Even when the labour market was weak, 87% of Jobseekers Allowance claimants did not reach the threshold for Work Programme referral, interacting solely with Jobcentre Plus.[25,26] Those who are eventually referred have essentially been 'parked' with Jobcentre Plus for up to a year (or potentially longer if they have 'cycled' through stages of unemployment several times without having reached the threshold of intervention, such as being on Jobseekers Allowance (JSA) for 22 of the last 24 months, for example). During this time, they will have had very limited access to employment support such as the Flexible Support Fund. This 'waiting period' will likely result in barriers to work becoming more substantial, falling morale and other problems developing – a deadweight labour 'scarring' cost we explored in a previous report.[27] They are then split into broadly nine different 'Claimant groups', with varying points of referral and payment levels differentiated between them (see Table 1).

This is, in effect, an evolution from the Flexible New Deal scheme where, instead of a 'flat fee' largely unreflective of how disadvantaged a claimant is, there is significant differential pricing in an attempt to concentrate the greatest resources at the hardest-to-help. In this sense, this segmentation process is a welcome reform. However, as many have observed,[28] the difficulty with this approach is that it does not adequately incentivise provider performance for those furthest from the labour market. The original Conservative Party proposals for this new programme on which the existing scheme is based were, in fact, ambitious in this direction. They stipulated that fees would be differentiated:

24 Work Programme official statistics, DWP Tabulation Tool.

25 Off flow rate, Jan-March 2011.

26 We note that this does not necessarily provide a fair representation of the long-term unemployed, with around 71% of those leaving JSA for employment still in sustained work 7 or 8 months later. Oakley M, Welfare Reform 2.0, Policy Exchange 2012, http://www.policyexchange.org.uk/images/publications/welfare%20reform%202%20point%200.pdf

27 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

28 For example, see http://www.lvsc.org.uk/media/51974/dwp%20reponse%20to%20lespn%20letter%20re%20wp%20monitoring%207%20jul%202011.pdf

Table 1: Claimant groups

Claimant group	Description	Referral period (mandatory unless specified otherwise)
1	JSA customers aged 18 to 24.	From nine months.
2	JSA customers aged 25 and over.	From twelve months.
3	JSA customers given early access to the Work Programme (including 18 year old NEET participants, Repeaters, JSA Ex-IB participants).	From three months (voluntary or mandatory).
4	JSA customers who have recently moved from IB following a work capability assessment.	From three months.
5	Voluntary ESA customers including contribution based, work related activity and support group.	At any time (voluntary).
6	New work capable income-based ESA customers/ expected to be capable of work within a given period of prognosis in Work Related Activity and Support Group.	From date of reassessment/ when expected to be ready for work within three, six, twelve months or more (dependent on WCA outcome).
7	Income-related ESA customers who have recently moved from IB following a work capability assessment placed in Work Related Activity and Support Group.	At any time claimants are expected to be fit for work within three, six, or twelve months (dependent on WCA outcome).
8	Voluntary IB and Income Support (IS) customers.	At any time (voluntary).
9	Prison leavers who claim JSA (since April 2012).	Anytime from first day a claim is made within three months of release date.

Source: DWP, *Information note on statistics for Work Programme* http://statistics.dwp.gov.uk/asd/asd1/work_programme/work_prog_note.pdf, *Work Programme Provider Guidance, Chapter 2 – Work Programme Claimant Groups*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/306484/wp-pg-chapter-2.pdf

> *'Depending on a range of factors such as how long an individual has been out of the labour market, their health, and their skills. Factors like these have often been found to be reliable indicators of the relative difficulty and cost of restoring an individual into the world of work. As the system develops, differential pricing is likely to become increasingly sophisticated.'*[29]

Perhaps due to time constraints and limitations on available data and existing IT systems, this ambition was largely unfulfilled in drawing up the Work Programme. Nevertheless, it does hold out the prospect of a more nuanced system in the future. Several providers have long privately acknowledged the need for a more differentiated structure, and this has now become the public position of the industry, advocating an 'accurate jobseeker needs assessment' and 'employment streams' according to need.[30] For now, however, the premise of the system is that the type of primary benefit received and how long the claimant has received it is a reasonable proxy for their barriers to work and the financing necessary to achieve a return to sustainable work.

However, this approach can only be a very inadequate mechanism of targeting assistance at the needs of the most vulnerable. Those with mental health issues, physical or learning disabilities for example, could potentially appear in any of the categories above with the level of help they receive not necessarily reflecting their needs (for example, as outlined earlier, work capable ESA claimants might

29 'Get Britain Working', Conservative Party, 2009.

30 For example, see 'Evolution not revolution: Recommendations for the future provision of employment support for the long term unemployed', ERSA 2013.

receive more help due to higher funding, but have fewer barriers to work than some JSA claimants, for example).

One possible defence of this system is that there is a category for JSA early referrals (Claimant group 3). This provides a means to 'capture' claimants for whom the other claimant group categories are not appropriate. It could be argued this demonstrates a commitment to targeted early intervention where appropriate already present in the current system. However, we believe the opposite is true. Claimant group 3 has a huge range of types of client with entirely disparate needs. Listing those in this group (and the payment structure), reveals just how opaque and inefficient this process is. It includes those who are:

- ex-offenders;
- have physical or learning disabilities;
- have mild to moderate mental health issues;
- are care-leavers;
- are carers or ex-carers;
- are homeless;
- are former Armed Forces personnel;
- have substance dependency problems.

The failure to differentiate in terms of support for this very diverse group reveals the urgent need for reform. From available categorisation, it is not even clear which of these groups require more help. Generic performance data will not reveal real outcomes for each of these groups, their individual needs, performance relative to the initial cause of the referral, nor stimulate innovation and adoption of best practice across the providers for their specific needs.

This means that the focus of Work Programme 2.0 will have to change substantially. It is clear that the structure of existing performance statistics, based on Contract Package Area (CPA) and claimant group will not be satisfactory to stimulate innovation nor identifying areas which need improvement the most.

Provider segmentation

Despite these problems and the misalignment of financial incentives with need, it remains the case that most providers attempt to operate a diagnostic assessment independent of the client groups outlined above. They generally divide claimants into tiered bands of provision (sometimes known as a 'traffic light' system):

- 'Green' – work-ready/close to the labour market, able to return to work with minimal support (usually solely by the provider);
- 'Amber' – some distance from the labour market, requiring some advanced interventions to address complex needs (often including procuring non-Work Programme provision such as the Skills Funding Agency or NHS);
- 'Red' – multiple barriers to work requiring protracted support (often including from subcontracted specialists) and specialised intervention by other agencies.

This might suggest that the existing structure works: that claimants are treated according to need rather than benefit type. The engagement streams outlined above, while crude, are a significant improvement on simply treating all claimants in the same way simply because they happen to be claiming the same type of primary benefit.

However, there are several problems with this proposition. First – whether providers choose to ignore the contract structure or not, the fact remains that the financial structure directly incentivises against providing appropriate provision to each claimant according to distance from the labour market – overpaying for some, underpaying for others. It should be stressed that this is not to suggest that providers deliberately 'park' claimants whose provision is not properly paid for (although some will privately admit this), or that there is a 'secret' corporate policy communicated to staff to ensure that this happens. Most providers publically and explicitly reject 'parking' as a matter of policy and there is no reason to dispute this assertion. As one evaluation put it:

> *'It is unclear how far [parking] is driven less by some explicit strategy and more by a 'needs must' response to the unexpectedly high number of referrals received by many providers in the more job-ready categories.'*[31]

Instead, parking is a phenomenon that emerges in a number of implicit ways. It often happens at the grass-roots level through personal advisers who can generally override the diagnostic tool. It is not difficult to see how this works in practice. A busy personal adviser – with perhaps a hundred clients or more – is set a performance target. Usually, this is a mix of job outcomes and sustainability. The target is often challenging and is buttressed by being ranked against other advisers (often explicitly and publicly on a 'ranking' chart displayed in the office). The adviser has wide discretion over what interventions they give a client over and above minimum service levels. Of course, the incentive here is to ensure the target is met – which in practice means giving most help to those clients most likely to help them meet targets. Necessarily, this means focusing on the easiest to help claimants and assisting them more intensively than those with more severe difficulties in returning to employment in order to meet the target. Across the organisation as a whole, this rational response to incentives by individual personal advisers creates widespread 'parking' without any explicit policy or mandate to do so.

Some providers mitigate this by placing different weightings in the rankings to harder to help clients – the harder to help, the more 'points' that client brings to the adviser's performance, or by having advisers specialise in harder-to-help claimants with lower performance targets. Crucially, however, this process is largely related to benefit type (and thus payment). Even if providers have linked this weighting to distance from the labour market rather than payment group, it cannot be denied this is potentially directly contrary to their financial interest and does not provide a sustainable financial model for Work Programme 2.0.

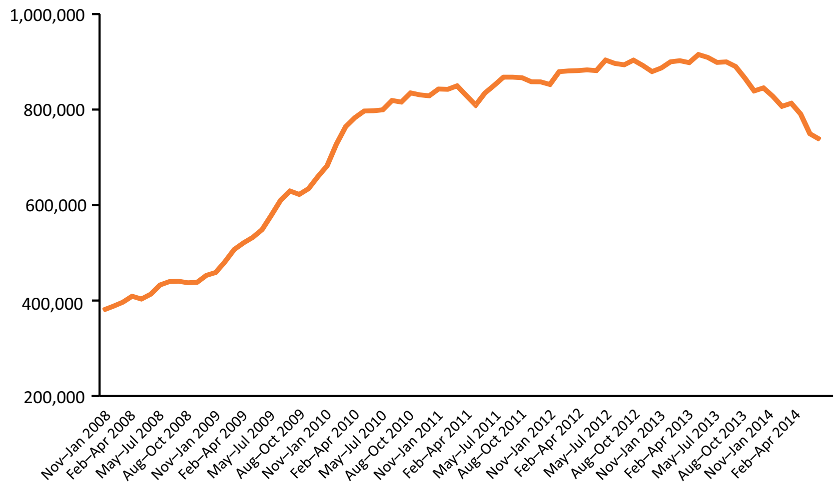
Why it matters

The viability of a small number of government contracts and the firms delivering them might not sound important – or at the very least as if it constitutes a small, obscure element of government policy. Yet, as we have argued, this is far from the case. The Work Programme constitutes the government's main delivery mechanism for assisting the hardest-to-help long-term unemployed back to

31 Newton B et al, 'Work Programme evaluation: Findings from the first phase of qualitative research on programme delivery', DWP Research Report No. 821, p. 124.

work. Its future success or failure will have an enormous impact on whether the hardest-to-help claimants enter sustained employment. The dramatic increase in the number of long-term unemployed in the aftermath of the financial crisis further highlights the importance of this programme. The long-term 'scarring' effect this will have on the labour market even as the economy recovers make the need for future reform very pressing.

Figure 1: Unemployment over 12 months



Source: Labour Force Survey. Seasonally adjusted, all aged 16 and over.

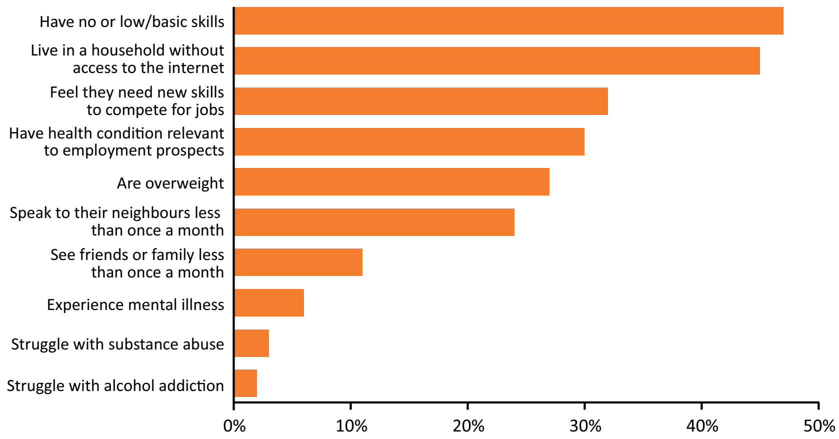
From 2008 to 2012, the number of people unemployed for more than a year increased by over 520,000, or 137%. During this period, further issues were posed by the ongoing reassessment of people claiming Incapacity Benefit, people who may have spent years if not decades out of the labour market being introduced to mainstream employment support for the first time. Though the labour market has improved significantly since this period, finding these claimants work even in an improving labour market will be a formidable challenge.

It is also worth considering what characteristics claimants on the Work Programme have more generally. While there is some data on the barriers to employment that the unemployed have (for example, they are twice as likely to suffer from a long-term illness as the general population)[32] precise diagnostics across the Work Programme are not available. Given they are generally more long-term unemployed, these barriers are likely to be significantly worse than the unemployed population in general. Figure 2 shows one provider's analysis of its claimants.

Almost half of claimants cite low or basic qualifications and 30% cite a health issue relevant to their employment prospects. This highlights just how difficult the challenges posed in assisting the Work Programme clients back to work are. While providers are being paid to tackle these issues, the fact that 35% of claimants have been unemployed for three years or more clearly demonstrates that previous programmes, as well as the provision from JCP, has not proven effective for these claimants. Ensuring the Work Programme improves on previous results is vital to ensure these claimants receive adequate provision in the future. Unfortunately, results continue to show significant difficulties.

32 General Lifestyle Survey, Office for National Statistics 2011.

Figure 2: Work Programme claimant profiles



Source: A4e. Customer surveys: Management Information; A4e Big Conversation Winter 2010, Summer 2011, Winter 2011.

The performance of the Work Programme

Over the course of the Work Programme, there have been significant disputes over its ability to get claimants back to work over the long term. Initially, DWP performance targets were being almost systemically missed. However, while the results have improved significantly since, with providers generally meeting or exceeding Minimum Performance Levels for JSA groups (but not, it should be stressed, ESA groups),[33] this record has led many commentators to assess them as being unrealistic. This has led to some significant disagreements.

Most notably, in 2012, a National Audit Office report (NAO), based on statistical precedents in Flexible New Deal, estimated job outcomes significantly below that of the Department for Work and Pensions (DWP).[34] In contrast to DWP estimates of a 40% rate of job entry for the Flexible New Deal claimant group (i.e. excluding the new, potentially harder-to-help claimant groups now on the Work Programme), the NAO estimated that only 26% would achieve this status.[35] This was based on FND performance data with attempts to adjust for new features; an approach some have criticised as inadequate.[36] Unusually, DWP disputed the NAO's figures (who formally registered a disagreement) based on HMRC-tracked performance outcomes that they claim to be in line with their expectations.

In an entirely new contractual model, such disputes are perhaps inevitable. By definition, the 'Invest to Save' model requires a 'counterfactual' from which welfare savings can be measured. This was always likely to be inaccurate in a new market with little experience of such calculations. These 'non-intervention' estimates by DWP were deliberately set to be stretching and do not reflect the significantly slower economic recovery than projected when the contracts were tendered.

Though set high and from a limited evidence base, minimum intervention level targets as to job outcomes were generally seen below the Department's estimate of non-intervention across the industry. The evidence shows that failure for many of the hardest to help claimants is a real danger. This is a problem on two counts. First, that it may undermine the financial viability of an unreformed Work Programme 2.0, forcing providers either to scale back provision to minimum

33 See 'The Work Programme', National Audit Office 2014, http://www.nao.org.uk/wp-content/uploads/2014/07/The-work-programme.pdf

34 'Department of Work and Pensions: The introduction of the Work Programme', National Audit Office 2012.

35 'Introduction of the Work Programme', National Audit Office 2012.

36 http://www.cesi.org.uk/blog/2012/jan/nao-predicts-rocky-times-work-programme

levels or leave the industry entirely. Second and more importantly, failure to enable the long-term unemployed to enter work on this scale will continue to be a problem: for the claimants concerned, the taxpayer and the economy.

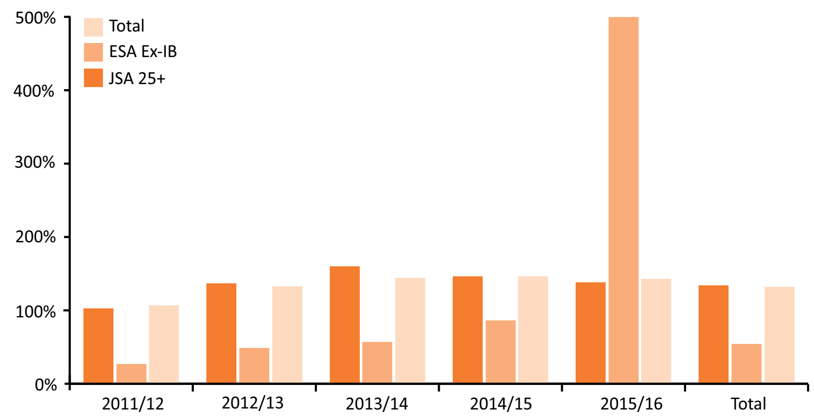
The minimal room for slippage from the DWP's expectation of performance make it clear that the risk of future failure is very real indeed. For example, a Social Market Foundation report estimated that a decline in performance from the 40% forecast to the non-intervention estimate of 30% would change a potential provider profit margin of 5% to a theoretical loss of 30–40% (even excluding any discount providers have applied to their Job Outcome Payments as identified earlier).[37] A lower estimate of performance or higher base provider costs could push this potential loss even higher. Some have suggested that providers responded to this situation by cutting costs, perhaps by as much as a third.[38] One report summarised feelings in the industry as:

> *'Overall confidence that the Work Programme will succeed… is very low, and very few groups are confident that that the differential payments on offer for different kinds of customers are adequate to ensure the Work Programme helps harder to reach groups.'*[39]

There can be little doubt the above view became widespread amongst key stakeholders in the Work Programme. A survey of ACEVO members showed only 9% thought differentiated payments were reaching the hardest to help.[40]

There is also the issue of referrals, which DWP have significantly revised following revisions to OBR forecasts. In the early stages, this may have helped to ease financial conditions in the short term through an increase in upfront attachment fees. However, flows were very different from those initially anticipated, with referrals for JSA groups up substantially, former IB claimants far lower initially and 'backloaded' due to delays in assessment procedures, and with less consistency over the contract period. Revisions were very large, both downward and upward. For four claimant groups in particular years, flows were revised down to less than half that originally forecast, in three others, it more than doubled.

Figure 3: Work Programme referrals as a percentage of original estimates*



* 2013/4 onwards projected.

37 'Department of Work and Pensions: The introduction of the Work Programme', National Audit Office 2012, p. 28.

38 Mulheirn I, 'Over-optimism and the Work Programme', Guardian 25th January 2012, http://www.guardian.co.uk/local-government-network/2012/jan/25/over-optimism-work-programme-worried

39 http://www.lvsc.org.uk/media/57778/fair%20chance%20to%20work%20-%20vcs%20experiences%20of%20work%20programme%20in%20london%20-%20lvsc%20oct%202011.pdf

40 http://www.acevo.org.uk/document.doc?id=1730

Table 2: Work Programme referrals estimates as % of original estimates

Range	Claimant group description, year (fiscal)
0–50%	JSA Ex-IB 2011, ESA Volunteer 2011, ESA Ex-IB 2011–2
50–100%	ESA Volunteer 2012–5, ESA Ex-IB 2013–4
100–150%	JSA 18–24 2011, 2015, JSA 25+ 2011–2, 2014–5, JSA Early Access 2013–5, JSA Ex-IB 2012–3, ESA Flow 2011
150–200%	JSA 18–24 2012–3, JSA 25+ 2013, JSA Early Access 2012, JSA Ex-IB 2014, ESA Flow 2012–5
200%+	JSA Early Access 2011, JSA Ex-IB 2014, ESA Ex-IB 2015

Source: DWP.

Developing a successful welfare-to-work programme for the long-term unemployed under conditions of such uncertainty has clearly been challenging.

How it is working in practice

Research for this report involved visiting several employment support organisations, including Prime Work Programme providers, Jobcentre Plus, charities and subcontractors. We found several types of innovative activity associated with the Work Programme, including general employment support, relaxation, foundation, motivational strategies, exercise, sleep and routine exercises. However, staff often struggled to deal with hard-to-help clients, often in 15 minute interview slots, who have complex needs. We also found a wide variety of organisational links: some Work Programme providers had strong links with charities or other agencies, others had links which were weak and informal.

"Personal advisers generally believe that sustaining someone in a job is most vital in the first few weeks and this is particularly critical in a labour market often weak for the long-term unemployed"

Personal advisers generally believe that sustaining someone in a job is most vital in the first few weeks and this is particularly critical in a labour market often weak for the long-term unemployed. Frequently, such employment is entry-level, temporary, seasonal, or zero-hour contracts, which many claimants are reluctant to try. Under the pre-Universal Credit system, being 'signed off' after working 16 hours a week, claimants are effectively 'punished' for trying to enter the labour market. This includes not just Jobseekers Allowance but also passported benefits such as loss of free school meals and healthy start vouchers. Even with a rapid reclaim system, this can often mean a wait of weeks before benefits are restored.

Clearly, addressing these difficulties is a key objective of Universal Credit in the sense that the transition between working and non-work should be smoother. But the implications of this change have yet to sink in. Advisers said that their clients are not even aware of it, indeed, some noted that even Working Tax Credit was not something properly communicated to clients by Jobcentre Plus. Advisers frequently complained of Jobcentre Plus staff not being able to handle complex questions, with little direct communication between individual staff. In some regions, the introduction of the Work Programme was coupled with a reduction in co-location of Provider and Jobcentre Plus offices, with JCP advisers nervous of giving too much attention to one provider.

Firms adapted to the Work Programme with performance management techniques such as targets and ranking of staff contribution. Quantitative targets (such as 13 or 26 weeks in sustainable employment) are quite normal, with individual performance targets monitored through monthly (or twice monthly) reviews, with other metrics including confirmed and outstanding jobs placements. As previous noted, while advisers are sometimes credited for overcoming additional constraints and operate a diagnostic tool regardless of claimant group, in many cases these targets are based on client group, mirroring the contract system.

Advisers often emphasised that a personalised approach is generally the most effective means of meeting these targets but that it has been difficult to achieve. For example, high numbers of claimants started the programme having been transitioned after long periods in legacy welfare-to-work schemes, while others were kept with Jobcentre Plus for longer and held off from joining these programmes. In addition, unexpected flows which we identified earlier interfere with a personalised process, meaning advisers sometimes have at times had as many as three or four times the number of claimants they had under legacy New Deal and FND schemes, often averaging 125–175 clients.

This chapter has outlined the main elements of the Work Programme, as well as some of the issues surrounding its provision of effective supportive to the long-term unemployed. We will now consider what specific problems exist in the Work Programme system and why they have arisen.

2
What are the Problems?

Payment by results: a panacea?

> *'Any move to payment by results creates new challenges for commissioners in setting and monitoring appropriate outcomes. These need to be set to align incentives correctly between the provider and the public interest; they need to be complex enough to prevent gaming but not so complex as to undermine the flexibility of providers… Furthermore, to ensure accountability for those – often vulnerable – users of payment by results public services, performance needs to be monitored closely, so that no-one gets stuck over the long term receiving services from a failing provider, while commissioners wash their hands of the problem, unperturbed because they do not have to pay.'*
>
> HM Government, *Open Public Services White Paper*, 2011, p. 34

Chapter 1 argued that the most significant issue in ensuring appropriate assistance is given to the long-term unemployed is ensuring that the contracts to provide this support are correctly constructed and that incentives are properly aligned with the outcomes targeted. A failure to do this means that claimants furthest from the labour market will not receive the support they require, as well as failing to fulfil the government's side of the bargain in ensuring that, while claimants have a responsibility to do all they reasonably can to find work, adequate employment support is provided to ensure this can happen.

However, while payment by results are an effective way to ensure taxpayers only pay for effective interventions and spurring innovation through private sector providers, it is less clear that this approach is a 'panacea' in government procurement. Rather, it is important to consider whether it is one instrument in the commissioning 'toolkit' of procurement, useful for specific tasks rather than all tasks. The risk that Government becomes a 'one club golfer', applying purely quantifiable PbR metrics to all types of contract. The problem with this is that other, more suitable types of contract could be neglected even where they are appropriate.

To assess whether the Work Programme's contracts are properly constructed, it is right to review how the procurement process works. This is explored below.

Procurement practices

The process of awarding Work Programme contracts came in two stages:

- Accreditation to the Employment Related Support Services Framework (UERSS framework), to select the firms allowed to bid based on their ability to deliver employment services;
- A competition for each contract package area (based on region).

The first stage, in effect, allowed the Department to consider the bidders' experience, but not necessarily in employment services. In effect, this means assessing firms solely on their ability to deliver large contracts, rather than their specific expertise in employment services. This is done on the basis that any such evaluation could prejudice the ability of new firms to enter the market. The second stage did not even have this small qualifying criteria: every bid had to be considered solely on the award criteria: specifically ruling out a judgment based on a firms' experience or their past performance.

The problem with this system is that it specifically bars the assessment of a bid on the simple criteria of whether the firm had proved itself able to successfully deliver such programmes in the past.[41] In effect, the Department for Work and Pensions has had to accept the 'prettiest', paper-based bids of firms, discounting practical experience. Many of the criticisms of the Work Programme by the Public Accounts Committee revolved around the fact that Primes which were perceived to be failing had been awarded contracts despite also failing in the past,[42] such as under the legacy Pathways to Work scheme for incapacity benefit claimants,[43] or ESIF funded programmes. Consistent failure to meet outcome targets for legacy schemes were not considered. Conversely, similar problems emerged under the similar system of Job Services Australia, where many providers protested that they had lost contracts despite excellent ratings under the proceeding Job Network system. A Senate committee report noted:

> *'The committee majority was concerned to hear from witnesses about an over-reliance on written submissions and the evidence of inadequate validation of claims made in the tender documents. It notes with sympathy suggestions that the process needs to include direct contact with short-listed tenderers, which may include an interview process.'*[44]

This is a perennial problem in UK public sector procurement. Historically, EU procurement rules have been perceived to prevent the UK government as purchaser of services to take into account past performance in awarding contracts, as a means of preventing barriers to entry in the market and preventing anti-competitive or protectionist award practices.[45] Ironically, an arguably far greater barrier to market entry are the 'route to market' costs associated with procurement framework accreditation, effectively shutting out firms without the expertise in the procedure process necessary to put together such 'paper based' bids and the considerable financial resources both to be eligible and to invest in gaining access to these frameworks without any guarantee of success. This essentially limits small businesses to being subcontractors as they are usually incapable of complying with the framework. The cost of adapting these frameworks for the purposes of new contracts (or 'pipecleaning') is very expensive both for the Department and suppliers, with the cost of gaining accreditation for a framework often as expensive as making a full bid. In the final analysis, the cost of such 'square one' contracting for every government procurement is inevitably passed down to the taxpayer through higher bids.

A rigid interpretation of the Treaty of Rome and enforcement of equal treatment and non-discrimination, has led to accusations of 'gold plating' EU Directives not intended to be applied so strictly. There is no EU Directive that specifically bars past performance being reflected in contract awards, for example. An excessive

41 http://www.ncvo-vol.org.uk/sites/default/files/cabinet_office_procurement_issues.pdf

42 For example, see http://www.guardian.co.uk/politics/2012/feb/09/a4e-welfare-to-work-contract

43 http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/404/404.pdf

44 'DEEWR tender process to award employment services contracts', Education, Employment and Workplace Relations References Committee, 2009, p. 16.

45 Specifically, EU directives implemented by the Public Contracts Regulations 2006 and Utilities Contracts Regulations 2006.

fear of legal challenge on this basis is a well-documented problem throughout the UK public sector.[46] However, the new EU Procurement Directive that came into force in 2014 may allow bids to be excluded because of poor performance based on objectively 'proportionate' criteria.[47, 48] In other words, it should allow past performance to be taken into greater consideration during Work Programme 2.0.

This would be a clearly desirable outcome. However, this is not to argue that past performance should be the only criteria or can be easily judged. A selection process that privileged incumbency for its own sake would risk becoming a closed market, potentially driving up costs and stifling innovation and as we have seen, existing procurement criteria significantly raise barriers to entry already.

Performance under the Work Programme's legacy schemes such as Pathways or Flexible New Deal were under very different contracting and regulatory arrangements that make it difficult to make a 'like for like' comparison. In particular, those programmes did not afford providers the same freedom to innovate as exists under the Work Programme. It could be argued that it would be unfair to judge companies' potential performance on Work Programme 2.0 based on poor delivery performance in delivering previous programmes which were drawn up very differently. In addition, historic differences (such as the state of the labour market) mean objective measurement can be unreliable, even with due diligence.

Nevertheless, the existing system – failure to reflect past performance except through the opaque criteria of experience delivering large contracts – prevents the use of one of the most basic criteria on which to base a procurement decision. When a businessman considers which supplier to buy a service from, or a customer decides what brand of good to buy, one of the first things they will consider is whether they have bought that good or service before. This happens without any consideration of whether the process is 'fair' or not. Certainly, prior experience of a good or service will 'prejudice' the outcome, but this may be positive or negative. Sometimes they may choose to stick with the 'devil they know' rather than take a risk on a new supplier. On other occasions, they may wish to 'take a chance' on a competing offer because they were dissatisfied with their past choice. All this takes place without excluding or including a particular firm. While government processes must be fair and transparent and meet a higher threshold of accountability than a firm or individual, by pretending the central criteria of past performance in the purchasing process does not exist, UK procurement seriously undermines its capacity to negotiate the best deal possible. This has seriously implications both for the value for money for the UK taxpayer, as well as the performance of the Work Programme in assisting the hardest to help unemployed.

The failure to reflect past performance also prevents the use of key features of successful performance management – the 'vitality curve' system associated with former CEO of GE Jack Welsh for example[49] – as well as employment services contracts in other countries. The Jobs Services Australia model uses 'past performance in the delivery of employment assistance or similar services to Job Seekers and employers', composing some 40% of the selection criteria for non-specialist 'Stream' services.[50] Crucially, however, this does not prevent free entry into the market. It is not necessary for bidding firms to be an incumbent, merely that they provide evidence of past performance in relation to:

46 http://www.cnplus.co.uk/news/scrap-procurement-gold-plating-say-architects/8630825.article

47 'Commission Staff Working Paper Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council', 5.3.2. Impacts of STR.LEGI.FACILIT option, p. 60, http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/SEC2011_1585_en.pdf

48 http://www.anthonycollins.com/briefings/uk-response-commission%E2%80%99s-proposed-new-eu-procurement-directive

49 See http://www.scribd.com/doc/72238204/Jack-Welch-Vitality-Curve

50 http://www.deewr.gov.au/EmploymentEmploymentServicesProcurement/Documents/Attachment5_ BIDDINGFOR BUSINESSANDTENDER EVALUATION.pdf, p. 106.

- previous clients who have attained and sustained employment;
- employers to which you have matched Job Seekers, and;
- training providers with which you have worked.'[51]

In other words: past performance could be established by a number of services, not simply the one for which the bid was submitted. A further feature of the Australian system that helped to boost performance (and which could not be considered by existing UK procurement practices) was the development of a star ratings system. Originally introduced in 1999 to allow claimants to choose between provider alternatives, it was based on a statistical regression model controlling for non-performance factors such as the labour market and the profile of particular claimant groups.[52] The system was developed from assessment of two Key Performance Indicators:

- Time taken for each claimant to gain an employment outcome relative to other providers;
- Effectiveness in achieving other outcomes compared to other providers.

These indicators were measured for each stream with greater weight given to the harder-to-help streams 3 and 4. Long-term outcomes were given greater weight for the hardest-to-help stream 4 claimants, while indicators for those claimants closest to the labour market in stream 1 gave greater weight to the time taken to job placement. After initially giving a set distribution of ratings for each, the system switched to rating providers relative to their distance from the average. The practical effect of the rating system was to boost performance and innovation in 'setting a comparative order of merit among Job Network providers, reflecting its assessment of their performance… as an incentive to improve provider performance through competitive pressure.'[53] This process also spurred competition between different centres to achieve the best performance. It has proven successful and played a significant role in recontracting decisions:

> *'The Department estimated that within two years of introducing reliable star ratings 13-week job outcomes increased from 15 per cent to 35 per cent. Providers had easy access to data enabling them to compare local performance and the Department would relocate local market share at six-monthly performance reviews when star ratings were published. In 2003, 60 per cent of contracts were simply 'rolled over' for successful three-star performers and, in 2006, only some ten per cent of low performing contracts were put out to competitive tender.'*[54]

This experience has clear lessons for the UK. By allowing firms greater certainty that their performance will be taken into account, incumbents are able to invest for the long-term, and incrementally improve their performance over time (through experience and familiarity with a particular local labour market, for example), leading to a better outcome. It also demonstrates that consideration of past performance need not be a non-rigorous, qualitative process: providing a fair basis for objective comparison.

As noted previously, a significant difference between the Work Programme and its legacy schemes is the claimant groups it is assisting, which are likely to be significantly more difficult to help. We explore this issue below.

51 http://www.deewr.gov.au/Employment/Employment ServicesProcurement/Documents/Attachment5_BIDDINGFORBUSINESSAND TENDEREVALUATION.pdf, p. 107.

52 Mansour J, Johnson R, 'Buying Quality Performance', WorkDirections 2006, p. 21, http://buyingqp.files.wordpress.com/2012/03/buying-quality-performance-_july-2006_.pdf, Lam M, 'Performance measures for welfare-to-work programmes: The relevance of Australian star ratings to the UK', Work Directions 2007.

53 'DEWR's oversight of Job Network services to job seekers', Australian National Audit Office, 2005, p. 13, http://www.anao.gov.au/~/media/Uploads/Documents/2004%2005_audit_report_51.pdf

54 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 9.

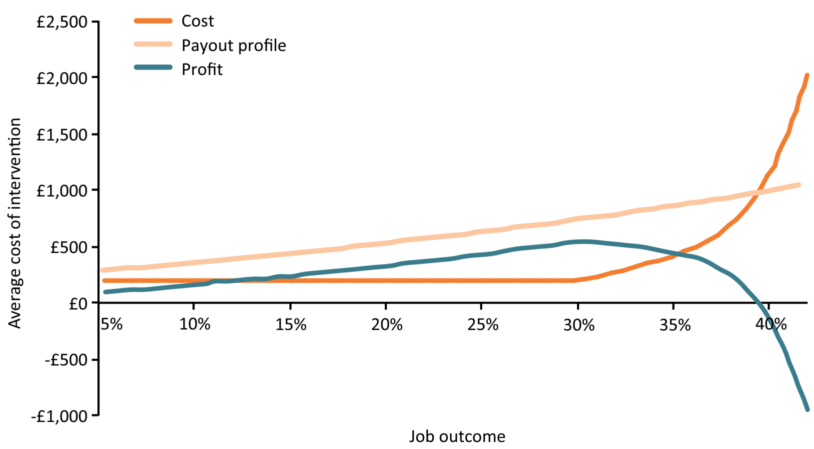
Former incapacity benefit claimants: the big new claimant group

The treatment and conditionality for former Incapacity Benefit claimants is now significantly different. It brought together claimants who may have significantly greater barriers to work than the Work Programme's legacy schemes, with other jobseekers for the first time. Providers had little experience dealing with this group unlike other types of claimant which they served under Flexible New Deal and in particular, their volume. These claimants may have been disconnected from the labour market for years, if not decades. Since they historically have had no conditionality attached to them, the Department for Work and Pensions had little or no information or contact. Former Incapacity Benefits claimants are also very different, from those temporarily ill to others who have never worked, meaning widely differing support requirements.

While some are keen to work,[55] others have launched numerous appeals which has limited flow and caused knock-on supply chain problems in subcontractors as we identified earlier. With around 40% of assessments being overturned on appeal, it also seems there may be significant problems with the assessment process. At the same time, Remploy and other assisted employment schemes have been scaled back and replaced with alternative provision such as Access to Work.[56] Providers report they have found some ex-IB customers work easily (particularly if they have previous strong work histories), others have identified the problem of ex-IB claimants who 'dropped out' of the reassessment process and reappearing as ordinary JSA jobseekers and not having funding attached to them necessary to address their needs. The failure of the incentive system to take account of the diverse needs of this group highlights the wider challenge faced by Work Programme 2.0. By incentivising providers to treat people according to their need rather than the type of primary benefit they receive, there is a serious danger of inefficiency: both by overpaying for employment support for claimants who do not really need it, and underfunding necessary support to get the hardest-to-help claimants back into work.

'Creaming and parking'

Figure 4: How rational 'parking' takes place



55 A 2005 Disability Rights Commission report found 1.1 million claimants would like to work.

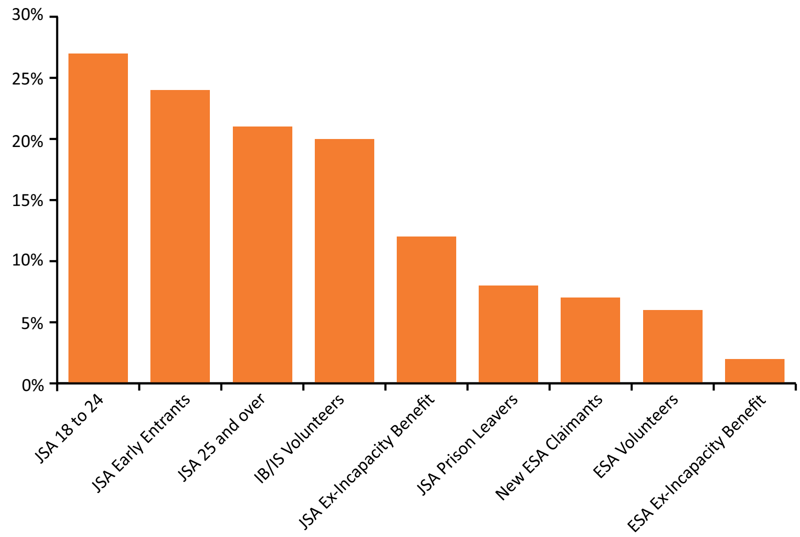
56 http://www.dwp.gov.uk/supplying-dwp/what-we-buy/access-to-work/

This lack of properly aligning financial incentives with a claimant's distance from the labour market is associated with perhaps the most frequently cited problem with the Work Programme – 'creaming and parking'. 'Creaming', (also sometimes called 'active targeting' or 'cherry picking') involves providers targeting help on those closest to the labour market because they are the most (or the only ones) that are profitable. 'Parking' refers to the lack of sufficient resources and support for those claimants unlikely to generate any revenue for the provider because they are unlikely to enter sustainable employment. We believe that parking represents the greater problem – not only because it involves a basic failure to fulfil the purpose of the programme – to return the hardest to help claimants to sustainable work – but also because little or no effort is made before claimants are placed on the programme to identify those this is most likely to happen to. As the Department for Work and Pensions acknowledged in discussions of the preceding Flexible New Deal programme:

> *'Parking represents a greater risk than creaming… because providers cannot influence who joins… providers do not have the freedom to take on only the job seekers most likely to find employment.'*[57]

While it is still too early to draw a final conclusion, the existing data strongly supports the view that parking is widespread:

Figure 5: Cumulative job outcomes as a percentage of attachments, March 2014



Source: Department for Work and Pensions.
N.B. JSA Prison Leavers began referral to the Work Programme in March 2012.

While these figures are to some degree misleading (claimants on the Programme may have gained employed but not yet 'triggered' a Job Outcome Payment, and the results should be judged by cohort over the full Programme rather than an interim 'snapshot') they show a clearly divergent picture in terms of outcomes for different types of claimant. Around 21% of Jobseekers Allowance

57 DWP, *Flexible New Deal: evidence paper*, December 2007

claimants over 25 have found employment and worked continuously for six months (i.e. to trigger a Job Outcome), but this falls to just 2% for Employment and Support Allowance claimants who had previously claimed Incapacity Benefit. Many of these were in effect 'parked' with Jobcentre Plus during the set-up stage of the Work Programme. As the Public Accounts Select Committee has found:

> *'There is some emerging evidence that those who are hardest to help are being parked with minimum support, and therefore little prospect of moving into work.'*[58]

With even the most optimistic estimates of any claimant groups return to sustained employment not exceeding 50%, it was clear from the start that not all claimants entering the Work Programme would be assisted into sustainable employment. As outlined above, it could be argued that parking is an entirely rational response to the incentives provided in the contract system. Why should providers spread resources thinly across their whole client group (above minimum service standards) when they are not expected to get at least half of claimants into work under even the most optimistic estimates? Necessarily, this is a system which is very likely to result in the hardest-to-help claimants being inadequately resourced to return to employment. Since providers are able to define few minimum performance standards (the logical conclusion of the 'black box' agenda), the most costly-to-help claimants may either make little or no progress because they lack help, or, should they gain employment, represent a 'bonus' to the provider which they made no effort to earn. As we have noted, the Work Programme attempts to compensate for this by having differing payment structures for different categories of claimants, but these are very widely drawn and focused on benefit types rather than needs, leading to inefficiency and deadweight. This is a serious concern in itself. But we must also confront an even more troubling issue: the Work Programme in its current form may not be able to help the most vulnerable claimants.

Parking the hardest to help

> *'With the best efforts the industry can possibly put into place we're not going to get all of those [Work Programme clients] into work.'* [59]
>
> Chris Grayling MP, former Minister for Employment, 19th October 2011

> *'Money available for the most vulnerable is insufficient – and is compounded by deadweight.'*

> *'It's not about supporting 100 customers. It's about getting 50 of them into a job. The other 50 are collateral damage. At the end of the day, they don't care about that other 50. It's an outcome contract, not a service contract.'*[60]
>
> Work Programme provider executive

As previously outlined, the potential problem of the existing payment-by-results model is that it creates 'creaming', with providers targeting help on those closest to the labour market because they are the most (or the only ones) that are profitable. Those that are unlikely to generate any revenue for the provider because

58 http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/936/936.pdf, p. 5.

59 http://www.policyreview.tv/video/616/4327

60 http://www.guardian.co.uk/society/2012/feb/28/why-work-programme-bad-business?newsfeed=true

they are unlikely to gain employment are 'parked' without access to sufficient resources. This 'parking' is a rational response to the incentives provided in the contract system – when there is not sufficient money available to invest in the hardest-to-help.

As we identified in our previous report *Personalised Welfare*,[61] the degree of barriers to work can be entirely unrelated to the primary benefit type claimed. For example, a highly-motivated, skilled former incapacity benefit claimant may have few or no barriers to employment, whereas a JSA claimant who is unmotivated and has drug or mental health problems will have many. A payment system based on benefit type directly incentivises parking and is very unresponsive to widely varying or changing circumstances. For example, one oddity of the system is that claimants remain in the same customer group even if they change their benefit type during the programme. In summary: a pricing structure based on benefit type is not well adjusted to attach additional rewards for delivering outcomes for clients furthest from the labour market.

"A pricing structure based on benefit type is not well adjusted to attach additional rewards for delivering outcomes for clients furthest from the labour market"

How to support those who do not return to work

Given that many – and likely a majority – of claimants will not gain sustainment employment during the Work Programme, the issue arises of what will happen after the programme ends – having occurred for the first cohort in June 2013. It is notable that previous employment support programmes, such as New Deal, were vulnerable to 'cyclers' who were referred back to Jobcentre Plus, then back onto the programme after the statutory 12 months – figures show this occurred to 264,000 claimants three times and 18,500 five times or more – remarkably, the then government's justification was that each cycle 'moves participants closer to the labour market.'[62]

Addressing this means tackling a serious issue: how to help claimants who do not enter sustainable employment during the Work Programme in an effective way. Though penalties exist for providers who perform below a benchmark of non-intervention (though we note that these are only assessed by DWP for payment groups 1, 2 and 6 rather than across the board; a policy which seems to run contrary to the agenda of personalisation[63]), no such penalty exists for claimants who return to Jobcentre Plus at the end of the Work Programme. With success rates targeted no higher than 50% for any claimant group (as we have outlined, targets that are significantly higher than legacy programmes, even with easier to help claimant groups and that have been repeatedly called into question[64]), what happens to this large group of claimants, perhaps many of them former Incapacity Benefit recipients, will be crucial.

A 'Work for Your Benefit' model was mooted for those claimants who did not enter sustained employment after Flexible New Deal, but never proceeded beyond a pilot scheme.[65] More recently, the government has begun a series of programmes called 'Help to Work' targeted at the long-term unemployed who may have lost the habits of a working routine, including daily attendance at the job centre, a Community Work Placement of up to six months or 'intensive

61 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

62 http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm080425/text/80425w0016.htm

63 'The Work Programme Invitation to Tender: Specification and Supporting Information', DWP 2010, http://www.dwp.gov.uk/docs/work-prog-itt.pdf, p. 13.

64 'Department of Work and Pensions: The introduction of the Work Programme', National Audit Office 2012.

65 http://www.dwp.gov.uk/docs/2010-work-for-your-benefit.pdf

Jobcentre support.'[66] These claimants will have gone through the allotted periods with Jobcentre Plus and the Work Programme. This programme builds on pilots focused on claimants who have cycled through legacy New Deal schemes: a six-month 'Community Action Programme' (CAP), rolled out for the first post-Work Programme cohort from April 2013. This was a workfare based scheme to be conducted alongside a separate group of claimants undergoing more intensive Jobcentre Plus Adviser based support, called 'On-going Case Management' (OCM).[67] The former is similar to the work experience placements found in Australia, through the 'Green Corps' and mandatory Work for the Dole provision for the long-term unemployed. The preliminary results were promising – only 74% of OCM recipients were in receipt of benefits 41 weeks after random assignment compared to 76% of CAP recipients and 81% of the control group (who only received normal Jobcentre Plus assistance and conditionality).[68] There were also positive impacts on softer outcomes such as motivation, confidence and jobseeking behaviour. Within the OCM 'participants who reported having received tailored support were more likely to have a positive job outcome.'[69] The study concluded that:

> *'On the basis of these findings, this report recommends that very long-term claimants are assessed in terms of their support needs and that claimants with the most severe and persistent barriers are provided with tailored and intensive support from Jobcentre Plus advisers, and if deemed appropriate, an element of protracted work experience that is relevant to their skills and career interests.'*[70]

As we outlined in our report, *Welfare Reform 2.0*,[71] it is premature to roll out this programme before its effects have been fully evaluated and tested. As a DWP report highlights, '…there are few systematic evaluations that isolate the impact of workfare from other elements of welfare-to-work programmes.'[72] An impact assessment of the workfare sanction programme, Mandatory Work Activity, found that the scheme was ineffective at increasing employment in the long-term.[73]

While it is questionable to extend the conclusions of this finding to all workfare schemes (limited by things like the inability to disseminate the consequences of non-compliance over time and its effect on deterrence, and the ability to escape the sanction by signing off and back on to benefits) we believe it is important that rigorous, randomised control pilots are used to develop this new policy. In particular, our previous reports have outlined pilots to extend the nature and scope of employment support provided by the private and third sectors; and pilots of new conditionality tools.

Further randomised control trials of workfare: randomly assigning post-Work Programme claimants to either workfare or the standard system of support and assessing the long-term impacts on benefit receipt and employment would allow evaluators to properly assess the deterrent effect of the scheme. The results of this should be used to inform the wider application of workfare. Our report *Something for Nothing* also outlined a strategy for a fuller evaluation of workfare schemes.[74] We believe workfare-style arrangements should be piloted through suitable control areas to measure policy impacts, especially for those claimants with attitudinal problems, for whom non-financial sanctions are more appropriate which do not place families into poverty.[75]

66 https://www.gov.uk/government/news/help-to-work-nationwide-drive-to-help-the-long-term-unemployed-into-work

67 http://www.dwp.gov.uk/docs/wp-cap-1.pdf

68 'Support for the very long term unemployed trailblazer', DWP ad hoc analysis, December 2012, p. 12, http://statistics.dwp.gov.uk/asd/asd1/adhoc_analysis/2012/20121203_svltu_ad_hoc_stats_publish.pdf

69 Rahim N et al, 'Evaluation of Support for the Very Long-Term Unemployed Trailblazer', Department for Work and Pensions Research Report 824, 2012, http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep824.pdf

70 Rahim N et al, 'Evaluation of Support for the Very Long-Term Unemployed Trailblazer', Department for Work and Pensions Research Report 824, 2012, p. 9, http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep824.pdf

71 http://www.policyexchange.org.uk/publications/category/item/welfare-reform-20-long-term-solutions-not-short-term-savings

72 Crisp, R., & Fletcher, DR., (2008). A comparative review of workfare programmes in the United States, Canada and Australia. DWP Research Report No. 533. London http://research.dwp.gov.uk/asd/asd5/rports2007-2008/rrep533.pdf

73 http://statistics.dwp.gov.uk/asd/asd1/adhoc_analysis/2012/early_impacts_mwa.pdf

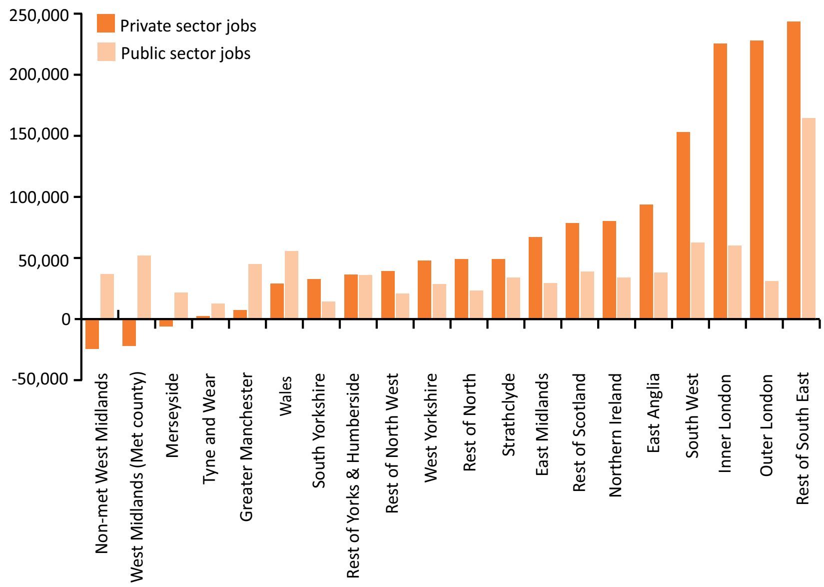
74 http://www.policyexchange.org.uk/images/publications/something%20for%20nothing%20-%20sep%2011.pdf

75 See Miscampbell G, 'Smarter Sanctions: sorting out the system', Policy Exchange 2014, http://www.policyexchange.org.uk/publications/category/item/smarter-sanctions-sorting-out-the-system

Regional and cyclical problems

Aside from the acute barriers to work for certain claimants which may not be addressed by the Work Programme, a related issue has received comparatively little attention: that it may be significantly more difficult to get some claimants back to work due to conditions in the local economy and labour market. This renders the viability of the Work Programme dependent on macroeconomic forces beyond the control of its contractors. Aside from significantly lower economic growth for the UK as a whole since Work Programme contracts were tendered until recently, economic performance in particular regions has been and will continue to be very different.

Figure 6: Net change in number of jobs by region, 1997–2010



Source: Labour Force Survey.

Looking at net job gains and losses of jobs from 1997 to 2010, even at a regional level, it is clear just how varied the UK's labour market performance can be. Certain regions were largely excluded from the net job gains of the last economic cycle and were largely dependent on public sector job creation (or indeed entirely in the West Midlands)– not a source of new employment which is likely to be significant given restraints on public spending applying up to at least 2017/18. Those areas of the country which suffered most during the recession are often also those most vulnerable due to future reductions in public sector employment[76] and lack of private sector job growth. Looking ahead, the outlook for regional unemployment shows continuing divergence between the South and the rest of the country.[77]

To some degree, the likely impact this would have on the resources needed by Work Programme providers to get claimants back to work – in other words, that it would be more expensive in regions with slack labour markets, and cheaper in regions with more buoyant ones – was recognised in the contracts' construction. Providers were able to differentiate their pricing by offering a discount on their Job Outcome

76 'Cities Outlook 2012', Centre for Cities, http://www.centreforcities.org/assets/files/2012/Cities_Outlook_2012.pdf

77 London, City & Regional Prospects, CEBR 2012, http://www.cebr.com/wp-content/uploads/London-City-Regional-Prospects-Press-Release-May-2012-Regional-Economies.pdf

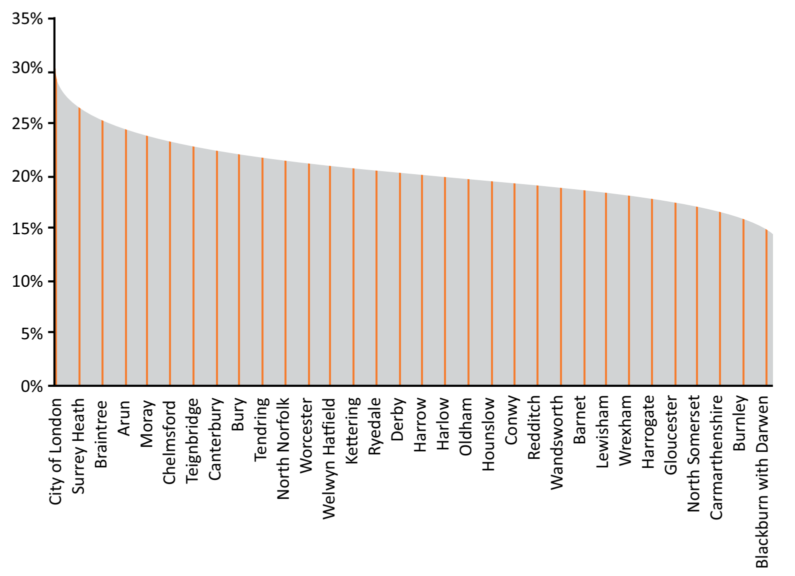
payments (awarded after a given period of when a claimant first enters work). This could be used to differentiate between the strengths of regional labour markets. This is because providers have no control over the strength or weakness of the local labour market and it would be counterproductive to reward or penalise them on this basis.

However, there are several reasons to believe that this distinction is inadequate. First, these payments only represent a small proportion of the total (mostly made up of sustainment payments). Their share was further reduced from April 2013 with a second discount, leaving still less room to differentiate as 'the amount of the attachment fee and the sustainment payment was fixed.'[78] This leaves providers with very little opportunity to distinguish on the basis of regional conditions which vary widely or changing labour market conditions. In the bidding process, some companies may have preferred some regions over others due to regional labour market conditions. For example, one prospective Prime bidder planned to bid exclusively in London and the South-East, but ultimately pulled out because it did not believe the market was viable, and also withdrew as a subcontractor.[79] Other companies expressed similar concerns.[80] One potential prime provider stated:

> *'When we came to evaluate it, we looked at the financial risk against potential rewards … The return for the risk for us wasn't there, because the programme was an untested financial model.'*[81]

The problem with such a system is plain to see. Providers could end up being rewarded or penalised for macroeconomic conditions largely beyond their control, as particular labour markets improve or worsen. This also makes it difficult to compare performance standards as no 'level playing field' exists. Indications from Job Outcome statistics for the Work Programme suggest very significant differences in performance in different regions:

Figure 7: Job outcomes as a percentage of attachments by Local Authority, March 2014



There are nearly 400 data points included in this chart. Given the size constraints of the chart area, only some Local Authorities are labelled. This was done at random, but based on where the LA was positioned in the distribution. Full results are available at bit.ly/pxjoboutcomes.

Source: Department for Work and Pensions.

78 Chris Grayling, Evidence to the Work and Pensions Select Committee, 19th March 2012, HC 1903-i, http://www.publications.parliament.uk/pa/cm201213/cmselect/cmworpen/1903/120319.htm

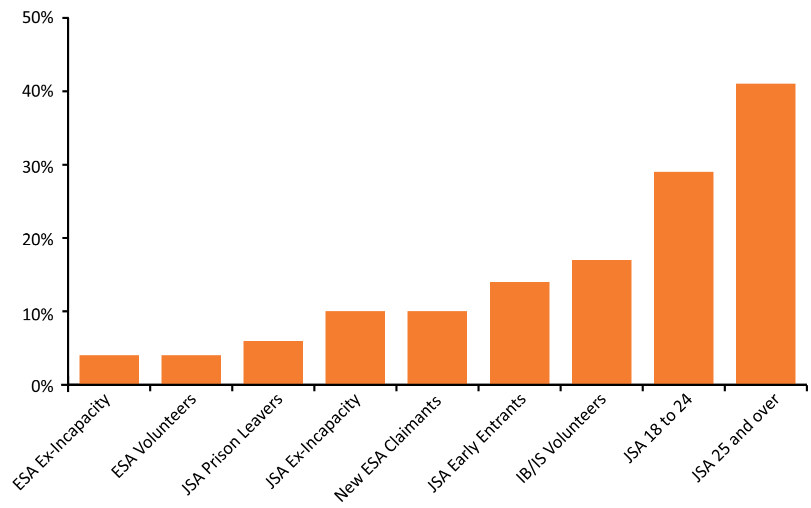
79 http://www.telegraph.co.uk/finance/jobs/8560038/PricewaterhouseCoopers-opts-out-of-Governments-welfare-to-work-programme.html

80 Another major outsourcing company, Capita, did not bid because it did not believe the contracts were viable. Others have stated that they were aware the business model was not viable but thought the contracts would be adjusted at a later date.

81 Lane P, Foster R et al., 'Work Programme Evaluation: Procurement, supply chains and implementation of the commissioning model', DWP Research Report No 832, p. 19, http://www.cesi.org.uk/sites/default/files/publications/WPevaluation_implementation.pdf

Job Outcomes achieved in the City of London and Horsham were 30%. But in Dundee City and Inverclyde they were under 14%: less than half the proportion. To some degree, this may be reflected in differences in the claimant cohorts' composition or differences in the Job Outcomes discount agreed to by providers. Nevertheless, it seems plain that differences in the strength of local labour markets is having a significant effect. A similar picture emerges when we consider variation in regional outcomes by benefit group:

Figure 8: Lowest job outcomes by Local Authority as percentage of highest by claimant group, March 2014



Source: Department for Work and Pensions. Local authorities where no data given excluded.
N.B. Prison Leavers began referral to the Work Programme in March 2012.

For every group, Job Outcomes in the lowest Job Outcome local authority are less than half that in the highest. Only for JSA claimants over 25 does the proportion exceed 30%. For ESA former incapacity benefit claimants, Job Outcomes are only 0.8% in South East Wales, but 4.8% in the North of Scotland: a six-fold difference. There is therefore little evidence to suggest that existing arrangements adequately reflect differences in labour market performance.

As Richard Johnson, a former Managing Director at Serco's Welfare to Work has commented, it will be necessary to:

> *'Carefully monitor and benchmark performance… through national comparisons, including identifying roughly comparable labour markets from within different regions… it is almost certain that the funding levels will have to be reset periodically, facilitated by open book accounting.'*[82]

However, despite extensive evaluation by DWP, no changes to the pricing mechanism have been made since the Work Programme was designed in 2010. This is not to suggest that an 'ideal' system could or should be able to 'iron out' differences between regions entirely. Nevertheless, these figures do underline a fundamental reality: it may be easy to get a particular profile of customer a job during a booming economy in a prosperous area, but very difficult to get a

82 **Richard Johnson, Managing Director, Serco Welfare to Work, 'Structuring the Work Programme to change society'.** http://indusdelta.co.uk/debate/structuring_work_programme_to_change_society_sercos_richard_johnson_debates_and_deliberates/4

worker with the same characteristics a job in a deprived area in a weak labour market. However, under the existing structure, the incentives for a provider remain unchanged. This is in contrast to the situation under Flexible New Deal, where DWP increased the service fee element from 20% to 40% due to worsening economic conditions in 2009.[83] This raises concerns that several areas (or even entire regions) will be left without adequate provision – because the pricing structure will not make it profitable for providers to give adequate support in that region. In simple terms, this has led some to suggest:

'In hard economic times, and particularly in unemployment hot spots, we need to pay more.'[84]

Perhaps as importantly, significant 'parking' problems are likely to occur within the (very large) regional contract areas, as certain parts become very profitable, others completely unviable and providers adapt their operating models across their offices to maximise profits. We also note that the failure to reflect this in the current contract structure does not reflect international best practice. For example, in Australia, the Employment Pathway Fund (a flexible pool of funds to reduce claimants' barriers to work), a 1.7 multiplier to the claimant group and service fees applies to remote areas.[85]

A simple improvement based on more flexible regional differentiation alone would not be without difficulties, however. Regions are an inadequate proxy for complex commuting and work patterns. Any economic metric or weight could suffer from a lack of accurate real-time data. Conversely, an overly complex pricing structure might undermine the ability of providers to make meaningful bids and exacerbate unpredictability – arguably an issue with the Australian model, where 144 outcome fee types for wide-ranging outcomes necessitate time consuming administration and evidencing.[86] We will explore this issue below.

The problem with complexity

Trying to compensate for all factors beyond a provider's control which might influence employment outcomes is likely to lead to over complexity and false economies. For example, smaller contract areas which attempted to differentiate according to job density (i.e. the number of jobs in an area) would have significant definitional issues. People do not necessarily work in the areas they live; improved infrastructure has resulted in increased labour mobility, making a discrete 'local labour market' difficult to define. An area which has very few jobs might have no unemployment problem if its inhabitants all commute to where they are; conversely, an area with many job vacancies might still have severe unemployment problem if these are mismatched with available local skills. Though Travel to Work Area analysis provides a partial solution, there is no easy solution. Excessive differentiation according to geography might also undermine the basic premise of the Work Programme – for regions to attract economic investment by creating a skilled, work ready population. The belief is that investment will flow to depressed areas as the private sector seeks out the labour supply.

Adapting the payment structure to be flexible and dynamic according to local economic conditions might make it difficult for providers to submit meaningful offers because of the unpredictability of prices changing according to labour supply and demand, adding to an already significant risk of mispricing due to

83 House of Commons Work and Pensions Committee, 'DWP's Commissioning Strategy and the Flexible New Deal', Second Report of Session 2008–09, Volume I, Report, together with formal minutes, to be printed 25 February 2009, p. 11.

84 Richard Johnson, Guardian 21st February 2012, http://www.guardian.co.uk/commentisfree/2012/feb/21/work-programme-help-jobless-not-contractors?newsfeed=true

85 http://www.deewr.gov.au/Employment/EmploymentServicesProcurement/esc2009_12/Documents/ESRFT.pdf

86 http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep752.pdf, p. 23.

lack of information and precedent for such a programme(setting the incentive structure for former Incapacity Benefits within the Work Programme has been likened to providers trying to 'pin the tail on the donkey', for example). In addition, the time lag between available data and that between changing conditions of employment or unemployment data could mean that providers are paid a rate which is no longer relevant by the time it is calculated. Attempting to retrospectively correct this on the basis of more up-to-date information might exacerbate the unpredictability for providers, making it impossible for them to make meaningful bids.

Size of contractors

The Work Programme has contracted with a small number of large providers on the 'Freud' model': 40 Work Programme contracts are split across 18 package areas, with two or three providers across each region. The contract terms set out that market share will be shifted to better performing providers with subcontractors providing specialised services below them. The idea is to reduce transaction costs through the significant organisational and financial strengths to the process which large contractors may provide and may not be available to the public sector.

This has the effect of limiting risk to the government by reducing the risk of provider failure: these large firms must be well capitalised to bid for the programme and so are less likely to go bust. In addition, as we have seen, smaller firms may have capacity issue problem (starting with bid submissions) or difficulties constructing a viable supply chain. Nevertheless, the size necessary to become a primary contractor makes the barrier to market entry high, limiting competition, reinforced by the large package area and regional duopolies (or triopolies) created by the contracts award process. It is worth noting that only one company – G4S – was new to the employment services market – all other successful bidders had previously been contracted on New Deal or Flexible New Deal provision. With the exception of the Careers Development Group, charities whose bids were unsuccessful: the Wise Group lost £20 million of its £33 million annual turnover as a result, for example.[87]

Under similar programmes, most countries have witnessed a 'shake out' of smaller providers as the market developed; either through withdrawal or not winning contract renewals.[88] Getting the balance right – leveraging the advantages of involving larger firms (at low risk) and involving smaller firms, to encourage innovation and make use of specialist skills, is difficult and has been a significant issue in successive employment support contracts.

Subcontractor difficulties

> *'DWP is operating a monopsonistic market. As a result of the terms, my organisation, like many others trying to deliver this contract, is going to go bust… We may have spent six months of providing fortnightly advice sessions and weekly interventions (training, workshops, activities, projects etc) and met all the client's expenses for attending, but we will not be paid for any of this. Payment will only be forthcoming after six months of "sustainable employment"… No one has had any experience of such draconian payment terms.'*[89]

87 http://www.ft.com/cms/s/0/f47b7960-c43c-11e0-ad9a-00144feabdc0.html#axzz2Hy1UDpGf

88 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP 2010.

89 Subcontractor, the Guardian, 13th January 2012, http://www.guardian.co.uk/society/2012/jan/13/work-programme-contract-providers

As outlined above, one of the purposes of the Prime/sub-contractor model is that it would allow large prime providers with significant balance sheets to take more financial risk and 'cushion' the impact of the payment-by-results DEL/AME switch model. This model means that government payments are only made *after* the service has been delivered and shown to work to reduce government spending – in this case, welfare bills.[90] 'You can fund current expenditure, in terms of investing in upfront employment services, and pay for them from the future benefit savings that come out of that.'[91] Since smaller, often charitable specialist organisations are often thinly capitalised, their direct use of this model is considered unsuitable because they are unable to take the financial risk of waiting for payment on the basis of the success of a service already provided. Subcontractor contracts are designed to avoid this problem, as well as provide a conduit to refer clients to their appropriate specialist services.

However, significant evidence has emerged that this is not happening. Some sub-contractors report that the pricing structure has largely been passed onto them in the case of long-term interventions, with some allegations that the most difficult to help claimants have simply been 'parked' with them,[92] with prime contractors using the process to transfer risk down the supply chain.[93] Others have complained of prime contractors 'freezing' them out of the Work Programme altogether to reduce costs.[94] For example, an early National Housing Federation Survey found that, out of 120 housing associations sampled, only nine had contracts and only five of these had had referrals.[95]

Unlike those with 'end-to-end' contracts, those with 'call' contracts, i.e. those without contractual guarantees of referrals and/or who are providing specialist interventions, have often received very few, or in some cases, no referrals.[96] A survey by NCVO found that 35% of contractors surveyed had received no referrals; with a further 15% receiving between just one and ten.[97] The similar reforms in Australia led to several smaller non-profit organisations criticising the programme as undermining their viability and service provision.[98] One community and voluntary sector (VCS) manager described it as:

> *'local VCS organisations will find themselves… awaiting work as sub-contractors – sat waiting like an agency worker awaiting a call to do a shift and hoping you earn enough to survive until the next job… Is this really what we want for the future of the sector?'*[99]

There are other practices – giving subcontractors cash upfront for referrals but then 'clawing it back' in the event the required outcomes are not achieved, for example – which may make it easier for some subcontractors to make the Work Programme viable. However, whichever of these applies, it is clear that for many subcontractors, the 'softening' of the payments profile intended has in some measure been absent, with contracts largely replicating the results-based terms provided to the prime providers (often at a discount). Several organisations report going out of business, losing intellectual property to prime providers, or being forced to lay off staff with key skills. Several specialist staff and organisations have already left the industry. The long-term damage through loss of non-subcontractor expertise through skills, goodwill and institutional knowledge, could be substantial. This underlines the importance of developing arrangements before the current round of contracts expires, as

90 Freud D, 'Reducing dependency, increasing opportunity: options for the future of welfare to work : An independent report to the Department for Work and Pensions', 2007, http://www.dwp.gov.uk/docs/welfarereview.pdf, 'No one written off: reforming welfare to reward responsibility' DWP Public consultation 2008, http://www.dwp.gov.uk/docs/noonewrittenoff-complete.pdf

91 House of Commons Work and Pensions Committee, 'DWP's Commissioning Strategy and the Flexible New Deal', Second Report of Session 2008–09, Volume I, Report, 25 February 2009, paragraph 18.

92 http://www.tsrc.ac.uk/LinkClick.aspx?fileticket=oJrkSIkyQyg=

93 Pushed to the edge', Locality, 2011, p. 2.

94 Pushed to the edge', Locality, 2011, pp. 1–2.

95 http://www.housing.org.uk/idoc.ashx?docid=0833c8d0-0ee7-4073-8130-3363fc1a7fd1&version=-1

96 http://www.civilsociety.co.uk/finance/news/content/11326/employment_minister_not_keen_to_address_payment_concerns_on_work_programme

97 http://www.ncvo-vol.org.uk/sites/default/files/sig_survey_june_2012_report_17.9.12.pdf

98 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 4.

99 Caulfield R, 'Is the VCS the agency worker of the future?', Third Sector, http://frontline.thirdsector.co.uk/2011/07/28/is-the-vcs-the-bank-worker-of-the-future/

well as ensuring that the most vulnerable claimants get early access to the most appropriate help.

It has often been commented that the Merlin Standard – a code of conduct for how prime providers should deal with subcontractors,[100] minimum performance standards and DWP Code of Conduct have had little impact on these issues, despite widespread complaints from sub-contractors.[101] The requirements mostly focus around the providers' behaviour being 'fair and reasonable' but there is little clarity about how this should be applied in practice. Most primes in reality have few minimum performance standards, varying from interviews at fixed periods across all jobseekers to vague mission statements. This is in contrast to similar schemes in Denmark or Australia for example, where a single standard is set by the department and has significant impact on many aspects of each contractor's provision.[102] Some have argued that the very nature of a hard outcomes based system militates against the continuation of niche providers:

> *'The way funding is currently geared, I think the programme will actually start to strip out specialist interventions, will start to focus on those people that are closest to the labour market, and the needs of people who are the hardest to help will be excluded.'*[103]

While the role of the third sector is strongly emphasised in DWP's Commissioning Strategy, it has been said that this commitment has not gone far enough. The reality of becoming 'bid candy' (i.e. entered into a prime provider's bid to improve its attractiveness by window-dressing it with some charitable sector involvement, but without guarantee or real prospect of significant work going to them) has been a serious issue for many sub-contractors – affecting capital availability and business viability. Some charities have not been contacted since they were put in the bids, or have not been given alternative work where their existing contracts were with incumbent providers who did not win the contract in their area, and where the successful prime contractor had already made arrangements with other subcontractors. Others have been unable to renegotiate poorly worded contracts, or having allegedly high management charges levied by primes as a 'route to market', which the Merlin Standard's arbitration board (designed to promote good practice in the treatment of subcontractors) cannot prevent. For those subcontractors who had contracted with unsuccessful prime provider bidders, recontracting with other providers has proven a difficult process – particular if the latter already have a saturated market for the provision of particular services.

The prime/subcontractor issue in government procurement

As has been seen, the development of convoluted and expensive procurement frameworks create additional barriers to entry which few charities or small businesses can afford. Of 40 Prime contractors of the Work Programme, only one (Shaw Trust) is held by a charity;[104] and some 88% of the value of the contracts went to profit-making companies.[105] Organisations needed a turnover of £20 million a year to be considered for the Work Programme and to have substantial additional business: significantly higher than for previous schemes.

100 'The Merlin Standard is standard of behaviour to which prime providers are expected to adhere in their relationship with their subcontractors. It is designed to encourage excellence in supply chain management by prime providers, to ensure fair treatment of sub-contractors and development of healthy high performing supply chains'. http://www.dwp.gov.uk/supplying-dwp/what-we-buy/welfare-to-work-services/merlin-standard/

101 For example, see Cook S, 'Editorial: Merlin Standard must be enforced in the Work Programme', Third Sector, http://www.thirdsector.co.uk/news/1105092/Editorial-Merlin-Standard-enforced-Work-Programme

102 Finn D, 'Job Services Austrailia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 22.

103 Richard Johnson, House of Commons Work and Pensions Committee, 'DWP's Commissioning Strategy and the Flexible New Deal', Second Report of Session 2008–09, Volume I, Report, together with formal minutes, to be printed 25 February 2009, Q113.

104 The Rehab Group, also a charity, is involved in a partnership delivering a Work Programme contract.

105 http://www.publications.parliament.uk/pa/cm201012/cmselect/cmworpen/718/71802.htm

> *'Under FND1 providers were required to fund up to £4m of working capital during the first contract year (based on contracts ranging from £20–60m pa). Under the Work Programme, typical contracts may require more significant working capital to be available, and for a longer period before break-even is achieved…. Given what is likely to be a more challenging reward model weighted far more heavily to the delivery of successful job outcomes, we have determined that the value of business awarded to a single organisation should not normally exceed 50 per cent of its existing annual turnover. This means that we would not expect to place organisations on the Framework whose current turnover is less than £20 million per annum.'*[106]

This has had the effect of excluding voluntary and community sector (VCS) provision from the prime contractor level, despite extensive institutional experience of delivering such schemes at the prime contractor level.[107] In a sense, this may be sensible: government has to protect taxpayer money by ensuring its prime contractors are organisationally and financially robust enough to deliver the services they are contracted to. Some markets have economies of scale which tend to reward the bigger players (by having several offices across a region, for example). There may even be a natural oligopoly in some markets. This was the experience of Australia during the formation of Job Services Australia, which, as has been noted, experienced a 'shake out' of smaller providers through withdrawal or failure to win new contracts. The transaction costs of direct government procurement with smaller players can be prohibitive as procurement managers need significant resources to deal with so many different contracts or companies, potentially outweighing the efficiency gains the process enables. Onerous costs associated with multiple departmental objectives such as diversity and risk assessment, drive up costs to the point smaller or less well experienced firms are not able to risk the upfront costs of market entry, potentially resulting in market distortion.

Nevertheless, there is a priority in the Work Programme and other areas of government procurement to engage significantly with small companies without excessive transaction costs where it is appropriate, while continuing to exploit the advantages of larger, prime contractors. A procurement framework which allowed direct engagement of small companies with government without significant tendering costs for either party would have considerable applicability not just in welfare but across government. Unfortunately, no such model has yet been developed in the UK.

One possible solution provided by Australia is the Job Futures and Jobs Australia model. These networks of small providers pooled their resources and expertise in order to bid for and deliver primary contracts.[108] This model enabled smaller organisations to directly deliver contracts by bidding as a single entity and then subcontracting operations to its member organisations. Further development of payment-by-results markets in the UK may encourage smaller organisations to pursue a similar direction.

106 http://www.dwp.gov.uk/docs/erss_qa.pdf

107 'Pushed to the edge', Locality, 2011, p. 1.

108 For a history of Job Futures, see https://www.jobfutures.com.au/images/stories/JFFiles/JobFutures_ASharedVision_1997-2007.pdf

3

Proposals to reform the Work Programme

Differences with Flexible New Deal: evolution not revolution

In legal terms, the Work Programme was a clean break from its predecessor: complete termination of contracts, a new retendering process and different providers in new areas. But in some fundamental respects, Flexible New Deal (FND) was simply a slightly less sophisticated predecessor to the Work Programme. Unlike its predecessor New Deal, where fees were largely based on referrals with little relationship to quality of service or impact, FND had more direct rewards for job outcomes and sustainment.

> *'Flexible New Deal [had several similarities to the Work Programme] including: large contracts with prime contractors; individualised support delivered through local subcontractors; and largely results-based payments to providers. The Committee concluded that the design of the first phase of Flexible New Deal would not prevent creaming and parking and recommended that DWP introduce differential payments to financially incentivise providers to work with all types of customer, including the hardest to place in jobs.'*[109]

The FND payment model was originally split between a service fee (20%), Short Job Outcome fee (50%) and Sustained Outcome fee (the remaining 30%). Notably, once the recession began, it was felt necessary to revise these totally to (40%, 30% and 30% respectively) due to the difficulties apparent in the labour market in 2009 (with a view to restoring the original proportions two years' subsequently). In contrast, the Work Programme's financial incentives are significantly lower and were not adjusted for significantly lower growth projections than those when the programme was conceived. This raises important questions about contract variation due to macroeconomic changes and the viability of the Work Programme generally we explored earlier. The payment structure differed in three major respects from the Work Programme:

- The service fee (rather than Attachment Fee) was an ongoing monthly payment rather than a flat fee;
- The fees were flat and not differentiated by client group, strongly incentivising parking.[110]
- Each region had a fixed contract value, ironically meaning that firms with more ambitious outcomes targets received lower payments per outcome.

109 House of Commons Work and Pensions Committee, 'DWP's Commissioning Strategy and the Flexible New Deal', Second Report of Session 2008–09, Volume I, Report, 25 February 2009, http://www.publications.parliament.uk/pa/cm201012/cmselect/cmworpen/718/71805.htm

110 http://statistics.dwp.gov.uk/asd/asd1/adhoc_analysis/2012/fnd_costs_1201.pdf

This system was a significant change from legacy schemes. FND brought about a much greater focus on outcomes rather than processes, differentiated by types of claimant (however inadequately) and freed front-line operations to find innovative solutions. In this context, it makes sense to think of the Work Programme as a natural progression from FND rather than a revolutionary step. As such it should be seen as a further step towards a more effective system rather than a final destination.

Aside from FND, another key precedent for the reform of the Work Programme is the creation of Job Services Australia. The experience of its development, problems and progress are key to our understanding of how the Work Programme might be reformed or improved in the future. We explore the main features of the Australian model below.

The Australian model: Job Services Australia

Following the election of the Liberal (centre-right) Party in 1996 under John Howard, Australia fundamentally restructured the nature of its employment services operations. All conventional government-run employment provision was contracted on competitive tender to commercial, charitable and government organisations, collectively known as Job Network (later to be renamed Job Services Australia in 2009) and a new organisation for the administration of claims and profiling claimants to determine who required the greatest support was created, called Centrelink. Claimants were then assisted through the incentives provided by outcomes according to need (for example, specialist support for those with disabilities).

During the first contracting round from 1998 to 2000, this involved low provision for those expected to be unemployed for just three or six months (basic job searching skills and training), contracted on a bid price. More 'Intensive Assistance' was targeted at the long-term unemployed on the basis of a combination of service fees, job placement fees and sustainment at 13 and 26 weeks from the point of referral, varied by the degree of service provided, on a fixed price, with bids assessed on the basis of service quality.[111] The second round of contracts (2000 to 2003) moved all forms of provision to a bid-based system, based on quality and price with a minimum floor, with the latter seeming to dominate the contract award process. This included more extensive government monitoring of service levels, size of caseloads and intensity of assistance.[112] This form of provision was of limited success, however. Only 15% of claimants gained jobs resulting in a payment for a sustainable job outcome at 13 weeks, with 70% of providers' income derived from claimants' enrolment on the programme.[113]

The third round of contracts (in two rounds from 2003 to 2009), dropped price competition entirely, focusing provision around specific services and restricted 'Job Seeker Account' funds which could be used across a provider's caseload to reduce a claimant's barriers to work.[114] These funds were often used for provision of work clothes or travel expenses and even wage subsidies or bonuses to employers – normally geared to payment trigger points in the contract.[115]

From 2009, this system was reformed into four 'streams' of provision, with Stream 1 being the most job ready and receiving the least financial incentives,

111 http://jobaccess.gov.au/Jobseekers/Help_available/Free_expert_help_with_employment/Job_Services_Australia/Pages/home.aspx

112 'Independent Review of Job Network.', Productivity Commission, 2002, p. 415, http://www.pc.gov.au/projects/inquiry/job-network

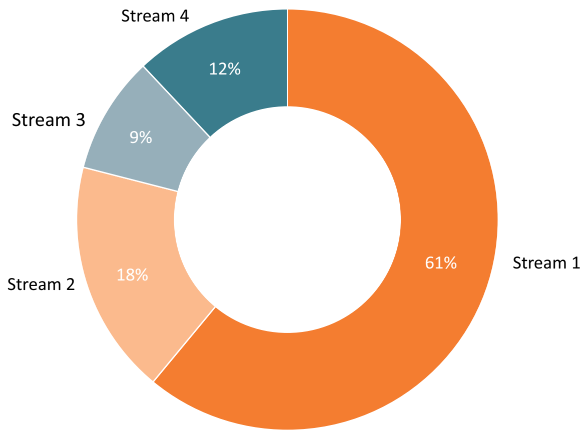
113 'Independent Review of Job Network.', Productivity Commission, 2002, p. xxxiv, http://www.pc.gov.au/projects/inquiry/job-network

114 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 8.

115 'Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation – A Net Impact Study', Department of Employment and Workplace Relations, 2006.

and Stream 4 being furthest from work and receiving the most. Stream 1 provision is primarily administrative support for 'work ready' claimants: help with CVs, access and assistance to job search, identifying work experience and training opportunities, regular meetings with an employment adviser and regular assessment to ensure this minimal level of support is all that is required.[116] This determination is made through a Jobseeker Classification Instrument for which Centrelink regularly exceeds a 95% accuracy target[117] by weighting the probability of long-term unemployment for as age, health, previous employment, social standing and other characteristics. Some have criticised this approach as too expensive and costly because the majority of claimants do not require intensive support. However, it should be noted that the majority of claimants will never be given more than this minimal provision:

Figure 9: Entry of claimants to Job Services Australia



Source: 'Review of the Job Seeker Classification Instrument', Australian Government Department of Education, Employment and Workplace Relations.

Where a claimant is identified as having many barriers to work through the profiling tool Job Seeker Classification Instrument (JSCI), an Employment Services Assessment (for jobseekers) or Job Capacity Assessment (for those claiming Disability Support Pension) is triggered, meaning referral either to Stream 4 or, if the claimant is incapable of work, to separate Disability Employment Services provision.[118] Once the stream is finished, generally after 12 months, claimants are usually moved to a form of work experience or training for a minimum of 15 hours a week for six months (during which time providers receive a reduced level of service fees), or, less often, a higher stream of provision. The payment system is now composed of the Job Seeker Account, outcome payments for sustained work at 13 and 26 weeks, service fees and job placement fees.[119] These are dependent on the claimant's reduction in benefit claim, which 'stream' they were part of and whether their placement in work was brokered or assisted.

The overall customer journey can be summerised as follows:

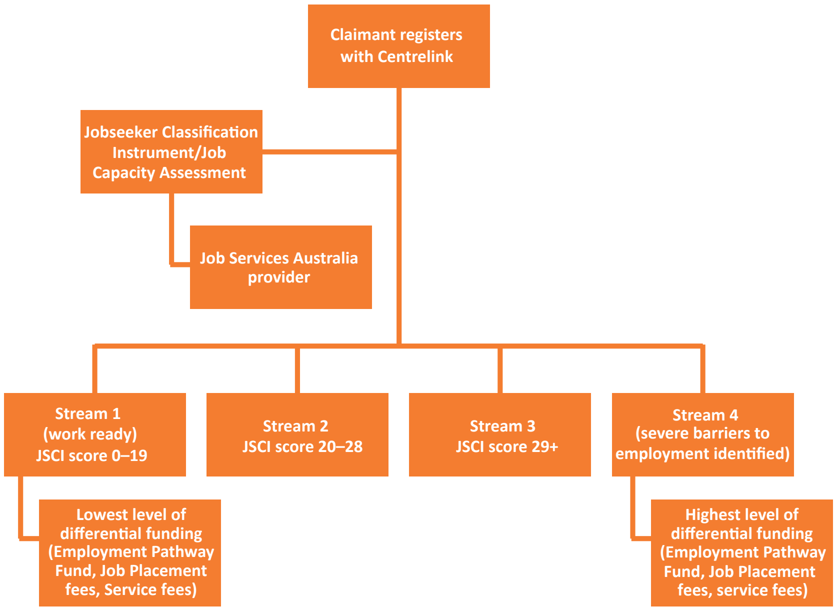
116 See http://www.deewr.gov.au/Employment/JSA/EmploymentServices/Pages/streamServices.aspx

117 http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep752.pdf, p. 25.

118 http://www.deewr.gov.au/Employment/JSCI/Pages/JSCI.aspx

119 'Administration of Job Network Service Fees', Australian National Audit Office, Canberra, 2008, http://anao.gov.au/~/media/Uploads/Documents/2007%2008_audit_report_38.pdf

Figure 10: Centrelink customer journey



Each claimant has an individually developed 'map', an Employment Pathway Plan, back towards employment, setting out their responsibilities as well as employment assistance which would be provided. This assistance is financed through an Employment Pathway Fund, a flexible fund to allow the purchase of appropriate services (differentiated by Stream: ranging from just A$11 for Stream 1 to A$1650 for Stream 4 in 2011).[120] Outcomes are paid for placing claimants in training such as apprenticeships which result in employment relevant to the skilled gained. The main advantage of this system is that it delivered better services for less public spending. As Professor Dan Finn put it:

> *'The Australian approach created a viable network comprised of for-profit and non-profit providers whose performance improved over time, with evidence suggesting that the JN delivered more outcomes for half the cost of the previous system. In this process, providers used the flexibility they were given to develop new service delivery models that, at their best, allowed case managers to tailor services to different participants, provide continuity of support, test methods for motivating job seekers, and provider various post placement services.'*[121]

Report from the Australian Government consistently showed that the system was both cheaper and better performing than the preceding, state provision.[122] Sustainable employment outcomes at three months increased from around 30% in 2004 to more than 45% in 2009.[123] The total impact on the long-term unemployed increased from just 0.6% in 2001 to 10.1% in 2005.[124] Evaluations of the service found an improvement in short-term job prospects of between 5 and 10%.[125]

The model has not been developed without difficulties, however. 'Creaming' the easier to help claimants and 'parking' the hardest has proved a perennial problem which needed to be addressed through adjustments in the incentive system, with providers often targeting the easiest claimants only for guaranteed profits. Provision of more expensive services remained limited, with several

120 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 31.

121 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 1.

122 Thomas, M., 'A review of developments in the Job Network', Research Paper No. 15, 2007.

123 Davidson, P., 'Did work first work? The effect of employment programs in reducing long term unemployment in Australia (1990–2008)', Australian Bulletin of Labour, Vol. 37 No. 1, 2010.

124 'Customised Assistance, Job Search Training, Work for the Dole and Mutual Obligation – A Net Impact Study', Department of Employment and Workplace Relations, 2006.

125 Finn, D (2008) *Lessons from contracting out welfare to work programmes in Australia and the Netherlands*, Joseph Rowntree Foundation, 2008, p. 26.

specialist organisations becoming sidelined or leaving the industry entirely.[126] Initial experience showed that providers did little with a claimant after only two months, when most successful job placements occurred.[127] In more recent years, the system has been criticised for abandoning the 'black box' and becoming increasingly prescriptive in specifying service requirements and interventions, increasing costs with compliance costs alone consuming 15% of the industry's budget and up to half the available service hours[128] through increased time spent on administration, data input and consequent reductions in innovation, with increasing ringfencing of resources for specified provision.[129] Caseloads are frequently well over 100 per adviser and up to 200 at peak times[130] and there have been complaints the system has become rigid and impersonal.[131]

As previously seen, these are the very same issues that have arisen during the Work Programme. Learning from this experience will be key to addressing these issues in any short or long-term reforms. Similar lessons should also be learned from a similar system instituted in the Netherlands, which attempted to base its contracting on claimants' distance from the labour market.

The Netherlands

Similar to the JSCI, in 1999 the Netherlands introduced a 'Kansmeter' (or 'chance meter') designed to determine a claimant's distance from the labour market based on a standardised scored evaluation interview with an adviser at their Centre for Work and Income (the equivalent of Jobcentre Plus in the UK), grading claimants from phase 1 (job ready) to phase 4 (hardest to help). However, this caused several problems, with poor classifications of streams and, in particular, unnecessary referral to phase 4, with 18% of claimants finding work without agency assistance.[132] This system was abandoned in 2007 and replaced by a two-step classification process: 'A' claimants who were ready for work and 'B' who required additional support, with reassessment every three months.

As is clear from this example, developing an effective classification tool has several potential pitfalls if it is done incorrectly. As identified in our previous report,[133] it will take time to build the capacity to segment claimants accurately, with both practice and new technology refining the system over time. The experience of the JSCI in Australia and the Kansmeter in the Netherlands present many opportunities to learn from previous experience in conducting an effective piloting of such techniques in the UK.

Elimination of deadweight

A significant barrier to the success of the Work Programme is that is does not properly identify those claimants who are most likely to benefit from being fast-tracked to appropriate support from day 1 of a claim; in effect, leaving them 'parked' in Jobcentre Plus for up to 12 months with its associated 'scarring' from dislocation from the labour market and deadweight costs of spending a longer period of time on benefits. The advantages of more effective support can be easily demonstrated: if even just 5% of the total claimant base can strongly be demonstrated to be likely to be on benefits after 1 year, providing them with day 1 support would provide earlier support for around a fifth of the total jobseekers who are likely to reach 12 months.[134]

126 Considine, M, Lewis, J and O'Sullivan S, 'Activating States: transforming the delivery of 'welfare to work' services in Australia, the UK and the Netherlands', 2008, http://www.ssps.unimelb.edu.au/data/assets/pdf_file/0006/159036/report_industry_partners_australia.pdf

127 'Job Network Evaluation, Stage One: implementation and market development', Department of Employment, Workplace Relations and Small Business, 2000, http://www.deewr.gov.au/Employment/ResearchStatistics/ProgEval/Documents/JNEStage1.pdf

128 'Response to the Review of Employment Services', National Employment Services Association, 2008.

129 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 7.

130 'The Future of Employment Services in Australia', Australian Government Discussion Paper, p. 30.

131 Fowkes, L, 'Rethinking Australia's Employment Services', Whitlam Institute 2011, http://www.whitlam.org/__data/assets/pdf_file/0004/181183/Rethinking_Australias_Employment_Services.pdf

132 Finn, D, 'The British 'welfare market' Lessons from contracting out welfare to work programmes in Australia and the Netherlands', Joseph Rowntree Foundation 2008.

133 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

134 19.6% of Jobseekers Allowance have been claiming for more than 12 months (May 2014, nomisweb).

However, opposition to these ideas principally rely on the idea of deadweight: that we do not understand adequately the drivers of unemployment and we would be paying for inefficient interventions because of this inability.

The first point to note is that the existing system pays for a great deal of deadweight already. Specifically:

- 'Parking' people on the Claimant Commitment who will not find work before the Work Programme begins;
- Paying for unnecessary interventions through broad and generic categorisation of existing customer groups (both services directly provided by Jobcentre Plus and within the Work Programme where providers are paid too much for clients closer to the labour market than their primary benefit type suggests);
- The cost of paying for 'cyclers' who leave benefits but then return to them without reaching the threshold for intervention (either at Jobcentre Plus or within the Work Programme);
- Replication of provision where Work Programme services are uncoordinated with efforts made by other government agencies (local authorities, housing associations, etc.)

There are thus significant savings to be had: both benefit savings of getting long-term claimants support and therefore back into the labour market faster, and reducing payments for unnecessary interventions through the broad and generic categorisation of the existing customer groups within Jobcentre Plus. It is far from the case that previous segmentation experiments have proven inadequate to improve this process, with the Australian JSCI instrument regularly exceeding 95 % accuracy.

Preliminary work in the UK has also been promising. A report by the Department for Work and Pensions used a logistic regression model based on statistically significant predictors – using administrative, attribute and attitudinal data – to determine the probability that a claimant would reach the 12 month point of a claim. This was achieved through telephone surveys based on the Australian Jobseeker Classification Instrument model (albeit through a research company after, rather than at the point of claim). It revealed that 59% of the variation in data could be explained by the model.[135] Those with the top 10 per cent of JSCI scores were correctly predicted to reach long-term unemployment 31% of the time. The report notes that:

> *'This approach to claimant segmentation could assist the more efficient targeting of support to those with the greatest need, with those included in the high risk category receiving appropriate and possibly early intervention.'*[136]

As the report notes, however, this creates a tradeoff between deadweight through wrongly targeting additional support on claimants who would not have reached long-term unemployment (of twelve months or over) and reaching the maximum number of claimants likely to be long-term unemployed. This is starkly illustrated by its ranking of 'operational effectiveness':

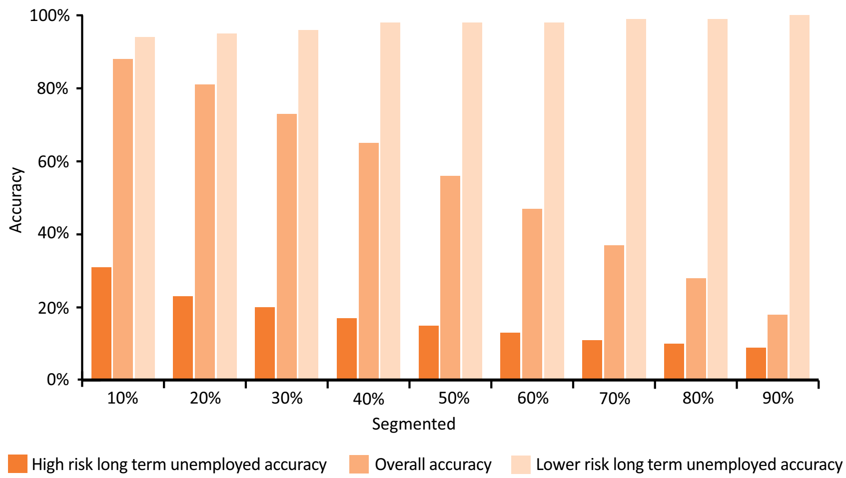
135 Matty S, 'Predicting likelihood of long-term unemployment: the development of a UK jobseekers' classification instrument', Department for Work and Pensions Working paper No 116, http://research.dwp.gov.uk/asd/asd5/WP116.pdf

136 Matty S, 'Predicting likelihood of long-term unemployment: the development of a UK jobseekers' classification instrument', Department for Work and Pensions Working paper No 116, p. 3, http://research.dwp.gov.uk/asd/asd5/WP116.pdf

Table 3: Ranking of JSCI operational effectiveness

	Targeting top 30% of JSCI score	Targeting top 8% of JSCI score
Proportion of all long-term unemployed captured by segmentation	70%	32%
Proportion of all non long-term unemployed receiving 'unnecessary' support	26%	6%
Proportion of targeted group reaching long-term unemployment	30%	68%
Proportion of targeted group not reaching long-term unemployment	70%	32%

Figure 11: Model accuracy at different cut off points



Source: Matty S, 'Predicting likelihood of long-term unemployment: the development of a UK jobseekers' classification instrument', Department for Work and Pensions Working paper No 116, p. 21, http://research.dwp.gov.uk/asd/asd5/WP116.

In other words, targeting fully the top 30% of JSCI scorers 'captures' some 70% of long-term unemployment – a significant result – but only at the 'deadweight' cost of unintentionally targeting 26% of all non long-term unemployed claimants who do not require this support. This means that some 70% of the targeted group did not reach long-term unemployment and so may not have required any support which would have been provided. Alternatively, narrowing the focus to just the top 8% of JSCI scores narrows the success rate – capturing only 32% of the long-term unemployed – but with the benefit of reducing the proportion of those receiving unnecessary support to just 6% of their total – or only 32% of the targeted group.

There is a clear trade-off evident in these findings. 'As we expand the cut off point for high risk… we slightly increase the accuracy in the lower risk group… but this is outweighed by a larger decease in accuracy in the high risk group… As we strive to increase the total number of high risk individuals captured by the model we sacrifice some accuracy when predicting them.'[137] Given the current level of sophistication of the segmentation tool and the tight conditions

137 Matty S, 'Predicting likelihood of long-term unemployment: the development of a UK jobseekers' classification instrument', Department for Work and Pensions Working paper No 116, p. 21, http://research.dwp.gov.uk/asd/asd5/WP116.pdf

of the public finances, it would obviously be undesirable to commit to costly interventions for the long-term unemployed when we are aware seven-tenths of claimants selected for such interventions were not going to be long-term unemployed in any case. On the other hand – a much narrower focus – meaning only just less than a third of those selected would be incorrectly in receipt of such treatment – would be done with the knowledge that these interventions would correctly target only around a third of those who would be long-term unemployed – leaving two-thirds without adequate assistance. This has led to the conclusion in the past that:

> *'Statistical modelling of the risk of long-term unemployment… have generally concluded it was not possible to accurately predict which clients were at risk.'*[138]

It is therefore clear that enacting a transition towards this new system will not be easy. Learning from the Australian model, it would be advisable for the transition to take place in stages – beginning with only those rated the most highly likely to remain long-term unemployed to keep deadweight to a minimum and hold down costs. This is preferable to a 'big bang' approach which would necessarily mean significant deadweight and allow problems and inaccuracies in the segmentation process to be worked out. We propose that this transitional referral flow is incrementally increased as the efficacy of the segmentation tool is improved. Once the payment system transitions to an entirely outcomes based model, this process should be able to accelerate with lower risk of failure.

Particularly given the huge rise in case complexity since the advent of Flexible New Deal, this model will take time to bed in. There are many aspects of this new system which are largely absent in UK employment services provision. Specifically:

- A graduated pricing structure for providers based on distance from the labour market;
- More iterative contracts (normally three years rather than five to seven, with up to nine years of payments);
- Contract award based on performance, with guarantees for the best performers and automatic exit from the market for the worst;
- Experience of private providers being involved from day one of a claim (albeit usually with minimal or no intervention).

We will now explore how some of these features should be included in Work Programme 2.0.

Creating variable payment structures

As has been seen, lack of sufficient information to judge claimants' distance from the labour market and the cost of providing appropriate interventions remains a difficulty in creating an effective mechanism for future welfare-to-work contracting. However, as we identified in *Personalised Welfare*,[139] there are several silos of information that government could tap into which would help breach this gap. Specifically:

138 Hasluck, C, 'Targeting Services in the Individual Customer Strategy: the Role of Profiling. A Review of Research Evidence', DWP Research Report 192, 2004, p. Ii, http://research.dwp.gov.uk/asd/asd5/working_age/wa2004/192rep.pdf

139 olmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

- Data gathered from other Departments;
- Data available from Information Services companies;
- Data from within Jobcentre Plus and;
- Data from claimants through the use of new diagnostic tools.

The government is likely to hold a great deal of information on a claimant which might be put to more effective use. Contact with doctors, the police, HMRC, local authorities and other public services are all likely to have left a data trail which will tell us a great deal about the claimant and his or her needs (all benefits claimed in their lifetime, for example). At the same time, private information services companies have developed sophisticated techniques to understand their clients: from what goods and services they are likely to buy to credit scores determining whether a customer is likely to pay back a loan: diagnostics which can be used to identify characteristics at a much more micro level than the broad categorisations used in the Work Programme. Crucially, these credit risk tools also model the likelihood of long-term unemployment. However, as we have seen, none of this data – from other departments or private companies – is used in DWP's current segmentation process or shared with providers to facilitate the targeting of appropriate interventions.

This form of differential payment was acknowledged in DWP's Commissioning Strategy, which set out an ambition to trial:

> *'More sophisticated, differentiated models that recognise those customers who can be helped more quickly to find their route to a sustained job and those who will need determined action to tackle their particular barriers'.*[140]

The Department has made some limited progress in this direction – notably its work age customer base project which attempted to create a detailed profile of all working age benefit customers. The review concluded that:

> *'This analysis proves that it is possible to successfully create distinct and meaningful segments of DWP customers from DWP administrative data and which are not solely based on primary benefit type. The resulting segmentation is an important asset as DWP develops and implements plans for the Work Programme and Universal Credit. In addition, the experience gained and lessons learnt will be invaluable for future segmentation development within DWP.'*[141]

However, the degree to which this approach has been applied is limited. Aside from some discretionary Early Access by Jobcentre Plus, such as for 'Repeaters' who have received Jobseekers Allowance for 22 out of the last 24 months, 18 year olds who have been 'NEET' for six months, ex-carers or the homeless for example,[142] the system remains one predicated on assessing and supporting claimants according to the primary benefit they are claiming and the length they have been claiming.

To take the DWP's Commissioning Strategy to its next stage, it will be necessary to break this model of funding. The Australian and Netherlands model of employment support follows a 'variable payment structure.' Simply, this means that payment follows the jobseeker according to an assessment of their need. This is dependent on the classification level given by the Job Seeker Classification

140 DWP Commissioning Strategy 2008, p. 22, http://www.dwp.gov.uk/docs/cs-rep-08.pdf

141 Department for Work and Pensions, http://www.dwp.gov.uk/docs/cpa-analysiscustomer-base.pdf

142 http://www.dwp.gov.uk/docs/wp-pg-chapter-2.pdf

Instrument, a computer-based segmentation tool for determining a claimant's particular needs and characteristics and a Jobs Capacity Assessment to assess barriers to work. Our previous report *Personalised Welfare*,[143] proposed that this would be administered by a new Jobcentre Plus service, CommunityLink, at the start of a claim, and updated using additional data collected during the claim – whether from adviser assessment, change of circumstances or the availability of new information materially affecting the claim. This allows day 1 support to be provided based on payment differentiated by the degree of support necessary to return the claimant to work, following the consistent track record of such a system in Australia and other countries.[144]

Proposal 1: *Develop a new model of employment support contracts based around the claimants' distance from the labour market rather than primary benefit type and length of claim. This should be based on the Job Seeker Classification Instrument developed in Australia, to be administered by Jobcentre Plus.*

Building capacity

To develop this new approach, it will be necessary to build capacity in the welfare-to-work industry and this will take time: advisers will need to be trained to deal with their new responsibilities; private and third sector providers will need time to build capacity and supply chains to deal with increased demand; and, most importantly, significant research and testing will need to be undertaken to create an effective segmentation process. The Australian experience saw the former service, Commonwealth Employment Service (renamed Employment National) undertake a significant share of the contracts until capacity could be built before the service was wound up in 2003.

Proposal 2: *Any new segmentation mechanism should be based on the existing claimant group flows – using existing projections as to the proportion of claimants referred to each group, the same payments, but with determination of each claimants' categorisation performed through the segmentation tool rather than primary benefit type. This will be a transitional arrangement before full implementation of Universal Credit.*

This would help to eliminate deadweight and properly target incentives. This would be an interim approach before Universal Credit is rolled out and would allow the development of an effective segmentation process over time.

How to reflect regional and cyclical differences

Chapter 2 explored the limited way in which the Work Programme reflects differences in the economic climate and local labour markets, and its relatively inflexible way of adjusting to change or diversity in these factors. Specifically, the limited regional contract price differentiation (through bid discounts in Job Outcome payments) does not address the more fundamental issue of geographical dispersion within the contracting areas rather than between them. This means that parking behaviour is likely to occur at the sub-contract area level because of the heterogeneity of local labour markets. This means the hardest to help claimants are likely to be parked in locales within a Contract Package Area where the labour market is weakest.

143 Holmes E, Oakley M (ed.), 'Personalised Welfare', Policy Exchange 2011, http://www.policyexchange.org.uk/publications/publication.cgi?id=252

144 Bimrose J et al., 'Skills Diagnostics and Screening Tools: a Literature Review', DWP Research Report 469, p. 6, http://research.dwp.gov.uk/asd/asd5/rports2007-2008/rrep459.pdf

One way to mitigate this problem at the regional level would be to extend the discount principle to the sustainment payments. This would allow variations by geography to reflect the cost of providing employment services differentiated by area: accounting for things like the cost of capitalisation, level of risk and local labour market conditions within each Contract Package Area. However, overall regional differentiation may be minimal given the size of the bidding areas, with areas within them greatly differing in terms of job potential. This reinforces the need to develop a fully workable segmentation process that identifies barriers to work and the cost of addressing them at the claimant level – including geographical access to employment opportunities. A more radical alternative approach might be to commission Work Programme 2.0 on the basis of Local Enterprise Partnerships (LEPs). Since these are smaller and afford the opportunity to coordinate in alignment with local authority boundaries and European Structural and Investment Fund (ESIF) programmes, the risk that particular regions will not receive sufficient services could be reduced.

Proposal 3: *Explore allowing variations in pricing by inter-regional geography to reflect the cost of capitalisation, level of risk and local labour market conditions within each contract package area. We should also explore more radical alternative arrangements such as commissioning the Programme on Local Enterprise Partnership (LEPs) boundaries, which would also help address coordination with ESIF and skills programmes.*

Rewarding higher paid work

Another issue is that providers are only rewarded for getting people into sustainable work, but not for getting people into better paid jobs – or for how they progress. If this could be changed it would save the government money in less transparent ways and boost tax revenue. But the evidence suggests that low-paid work is also less likely to be sustainable (though whether this is because of the job itself or the characteristics of those employed in it is more disputable).[145]

Connected to this issue is the role of in-work conditionality under Universal Credit, the government's project to incorporate most tax credits and means-tested benefits into one system. For the first time, conditions of actively seeking work will be given to those claiming Universal Credit. Though there is little detail of exact policy for applying conditionality to those needing to increase hours or pay included in the draft regulations for Universal Credit[146] at the time of writing these conditions are being applied to those who are earning below that of a 35 hour week at National Minimum wage (i.e. £212.80), with the potential to reduce the threshold due to circumstances such as care responsibilities.[147] The regulations also state that 'at the launch of Universal Credit… it is not intended that those with earnings above a lower cut off limit will be subject to an intensive conditionality regime.'[148] This means that conditionality for those in work but earning relatively little and relying extensively on state support will only face conditionality up to the existing cut-off of 16 hours work. In short, despite better returns to work and more support from the government, extra conditionality will not be targeted at those in low-hours jobs. Our report *Slow Progress* advocated ways to incorporate more effective in-work conditionality to those claimants below this threshold and that a public consultation should be launched seeking views on how progression incentives should be included

145 For example, see Cappellari L, Stephen P, Jenkins S, 'Transitions between unemployment and low pay', in Polachek S, Tatsiramos K (eds.) Work, Earnings and Other Aspects of the Employment Relation (Research in Labor Economics, Volume 28), 2008, pp.57–79.

146 http://www.dwp.gov.uk/docs/uc-draft-regs-2012.pdf

147 http://www.cesi.org.uk/keypolicy/universal-credit

148 http://www.dwp.gov.uk/docs/uc-draft-regs-2012-memorandum.pdf, p.47.

in the next round of Work Programme contracts in order to give government time to build up a workable and commercially viable model before contracting begins.[149]

Our analysis suggested that around 1.3 million people will be subject to some form of in-work requirements and support – an older report by the Resolution Foundation estimated around 1.2 million.[150] Given the number of people in part-time work who want a full-time job who are seeking one is around 30%[151] and the lack of an active conditions regime for this group in the past, this poses major challenges. It will mean ensuring that conditionality is tailored appropriately to claimants – that it is neither too onerous on some nor too lax on others – and that employment support provided is commensurate to that conditionality and the income level being targeted. How to progress those claimants taking smaller 'mini-jobs' below these thresholds through higher wages, longer hours or alternative employment is thus a key underdeveloped area in the integration of Universal Credit and the Work Programme.

"The existing system does not incentivise providers to place claimants in jobs below the requisite level of earnings to be off benefits, nor to progress them to become higher earners"

Creating new incentive structures to financially reward prime contractors for progressing claimants from these smaller jobs to ones with greater earnings will be complex. In particular, it will be important to ensure that gaming does not take place (for example, placing a claimant in a job with a lower salary, then claiming a reward for progressing them to a position with a higher salary). Rewards for getting claimants into smaller jobs which they would have got anyway, or may have got higher paying ones under the right circumstances, are clearly undesirable.

It is perhaps little understood that there is no 'hours' requirement in the existing Work Programme contracts as such. The requirement of a job outcome are that a Work Programme customer is off benefit for 3 or 6 months (dependent on claimant group and with rules about permissible breaks). Before Universal Credit, this generally meant a claimant working more than 16 hours (thus becoming ineligible for Jobseekers Allowance) or exceeding a particular level of earnings dependent on circumstances.[152] The existing system thus does not incentivise providers to place claimants in jobs below the requisite level of earnings to be off benefits, nor to progress them to become higher earners.

This will be appropriate for the majority of claimants for whom the sole goal of being off benefits and into full-time work is appropriate without any intermediate steps. However, for some claimants (those transitioning out of the Work Related Activity Group, preparing to re-enter the labour market after a prolonged absence, or others with work limiting health problems, for example), it may be better for them to start at a lower level of hours and earnings before progressing to higher earnings. To achieve this, it makes sense for the Work Programme to have appropriate incentives to achieve this end. If this does not happen (i.e. providers are paid neither for mini-jobs outcomes nor sustainment), it is possible that claimants who are suitable for mini-jobs but not as yet permanent roles, may be 'parked' without access to appropriate support because providers are not incentivised to assist them through the intermediate steps.

149 Garaud P, Oakley M 'Slow Progress', Policy Exchange 2013.

150 http://www.resolutionfoundation.org/media/media/downloads/Conditions_Uncertain.pdf

151 http://www.policyexchange.org.uk/images/publications/welfare%20reform%202%20point%200.pdf

152 Written evidence, Permanent Secretary, Department of Work and Pensions to the Public Accounts Select Committee, http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1814/1814we04.htm

This, it could be argued, is already happening and runs contrary to the logic of Universal Credit in encouraging some claimants to take 'mini-jobs' which will always be financially worthwhile.

One way to avoid this would be to adopt the 'pathway outcomes' model available through Job Services Australia. This is a payment which recognises 'a participant's progress towards achievement of sustainable employment or education, such as substantial part-time work relative to their assessed work capacity.'[153] This is intended to reward achievements in progressing claimants, including reductions in income support entitlement. However, one of the objectives of the Work Programme was to move away from rewarding providers for 'soft' outcomes that do not necessarily lead to employment. To achieve this while also following the logic of Universal Credit, a key objective of Work Programme 2.0 should be that the incentive structure is based on the earnings of the claimant. While the 'DEL/AME' has been appropriate in the past (which notionally targeted benefits saved), under Universal Credit this would have the perverse effect of concentrating incentives on claimants in ways unrelated to distance from the labour market (whether the claimant lived in a high-cost area and was thus costly significantly more through Housing Benefit, for example). It is also important that the conditionality regime applied to claimants and the targets set for provided are properly aligned. In our report *Slow Progress*, we advocated that:

> *'When Work Programme contracts are re-tendered, payments should be based on the total earnings a claimant earns over the contract period. For instance, providers might receive a fixed proportion of a claimant's total earnings, which reflects the benefit savings which they are delivering. This proportion could vary by contract group such that providers receive higher rewards for those least likely to find and progress in sustainable employment… If contracts with providers did allow variation before re-tendering, we believe that this approach should be piloted as soon as possible in order for it to inform the next round of contracts.'*[154]

Basing the incentive structure on a claimants' total earnings gained over the contract period is an appropriate measure, both to incentivise the provision of mini-jobs, progression in earnings and to match claimants' conditionality with incentives for providers under Universal Credit. This could be accompanied by a 'cap' on payouts to limit government liabilities. Our previous report advocated that providers should be given access to the monthly earnings of claimants placed with them to ensure interventions are targeted with the most sophisticated data available. The availability of real-time information on earnings under Universal Credit that would underpin the incentive system could thus also be useful to personalise the employment system.

The use of total earnings as the primary basis of the Work Programme payment model has a number of advantages. It incorporates both the incentivisation of prime contractors to target assistance at smaller earnings jobs and an increase in reward should providers be able to progress a claimants earnings. The target for earnings and benefit reduction need to be personalised through the segmentation system. The defining question must be: 'given the characteristics of this individual, what reasonable point in the labour market should the Work Programme be aiming to get them within the period of the contract, at what point, and given what set of financial rewards to achieve this outcome?'

153 http://www.deewr.gov.au/Employment/EmploymentServicesProcurement/DES2010_2012/Documents/DESQA.pdf

154 Garaud P, Oakley M 'Slow Progress', Policy Exchange 2013.

This follows the logic of the muted threshold of 35 hours earnings at National Minimum Wage. A further iteration could incorporate incentivising progression of claimants beyond this point.

Proposal 4: *Explore options for incorporating incentives for progressing claimants beyond existing Universal Credit thresholds for conditionality. This could include payment for assumed benefits saved and additional tax receipts accrued over the contract period.*

Some may see it as contradictory that Universal Credit will create incentives for employment for below 16 hours a week, but to retain a job outcome measure based on 16 hours within the Work Programme contracts. A job outcome payment based on additional monies earned, benchmarked at 16 hours at national minimum wage, rather than a flat fee might be more effective in tying the Work Programme to the purpose and intent of Universal Credit. However, it is important to be careful to ensure a monies-earned based system does not create administrative difficulties over and above those already present in the existing system. It will be necessary to ensure automated IT checks through PAYE and HMRC verification are in place to ensure this works efficiently without creating unnecessary burdens, both for the Department for Work and Pensions and Work Programme providers. This should be possible once the IT systems being developed for Universal Credit are fully operational.

In the final analysis, it is likely that the existing system undermines the value or potential that part-time or 'mini-jobs' could play in reintroducing hard-to-help claimants to the labour market. Single parents, the long-term unemployed, or those with health conditions (ex-Incapacity Benefit claimants for example) may not be able to take on any more hours initially, in turn disincentivising providers to work with these groups or setting unrealistic expectations about full-time employment in the short-term. Such clients may need to transition from 'mini-jobs' before progressing onto greater hours.[155] Tailoring the level of earnings targeted for each claimant, as well as the progression in earnings should form a key feature of the segmentation system.

Proposal 5: *Exploring alternatives to the '16 hours rule' at national minimum wage for job outcomes, with a view to focusing incentives on additional monies earned to be phased in during the roll-out of Universal Credit. This would follow Jobcentre Plus' experience with PAYE data and the provider payment IT system. This should incentivise providers to place some claimants in lower earning or 'mini-jobs' where this is a more appropriate goal, as well as incentivising them to increase their earnings according to their circumstances established in the segmentation tool.*

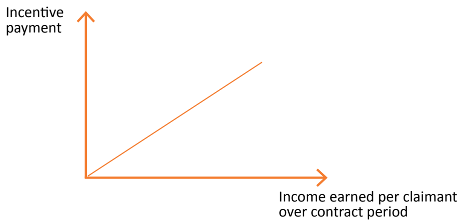
155 Or the equivalent of 16 hours at National Minimum Wage.

Our proposal: How the payment structure would look under Work Programme 2.0

All existing payments should be replaced (outcome and sustainment) with *one incentive payment based on claimants' total earnings over the life of the contract*.

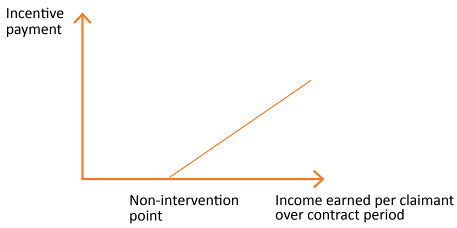
There are several ways this earnings-based measure could be implemented. Specifically, *an incentive payment calculated from a percentage of the claimants' total earnings over the period of the contract* would be the most appropriate means of differential pricing. The level of provider earnings should be usually be capped at the point the claimants' earnings cause them to exit Universal Credit claimant commitment conditionality (i.e. once the claimant is no longer required to look for employment).[156]

Variant 1: Simplified model – incentive payment based on claimants' total earnings



To limit or prevent 'deadweight' costs (i.e. earnings that would have happened anyway, regardless of the providers' services), a non-intervention point should be calculated, below which providers receive no incentive payment for any of their claimants' income. These thresholds could be set low (perhaps below deadweight) to replace attachment fee/service charge element of the contract.

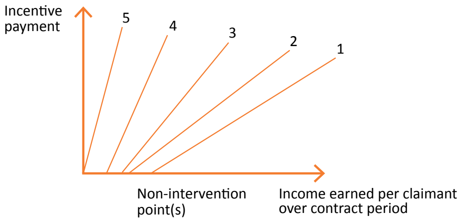
Variant 2: Simplified model with non-intervention point



Additionally, each client group identified in the segmentation process should have a differentiated non-intervention point (i.e. those groups furthest away from the labour market will have a lower non-intervention point). To prevent harder to help claimants being parked because the estimate of non-intervention has been calculated too low (arguably a feature of the present system where job outcomes are, in effect, unpaid for until a claimant has been in continuous work for six months), this should also incorporate a 'low-ball' further discounts below Departmental estimates for the hardest to help groups to ensure incentives are sharp enough for providers not to park them at the outset. Harder to help claimant groups should also have a greater percentage of total claimant earnings as the incentive payment. In summary: providers should receive a greater share of total earnings where the claimant is further away from the labour market.

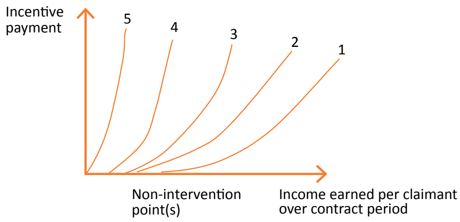
156 The cap could be raised for certain groups to achieve other social objectives, however.

Variant 3: Differentiated payment profiles for different claimant groups (where '1' is the claimant group closest to the labour market and '5' is furthest away)



A further development as the segmentation process develops should indicate where greater incentives are needed to 'push' providers to increase earnings beyond a certain point (i.e. the marginal costs would always exceed the marginal returns up to a certain desired level of claimant earnings). This will allow us to identify where the percentage of earnings incentive needs be greater. It is likely that the percentage will need to be increased more sharply for claimant groups further away from the labour market.

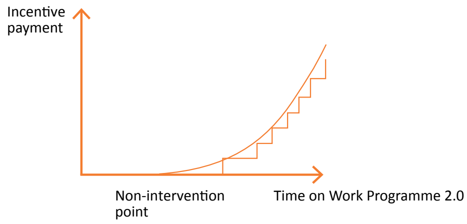
Variant 4: Differentiated payment profiles for different claimant groups with increased incentives further up the earnings scale (where '1' is the claimant group closest to the labour market and '5' is furthest away)



One problem with this model is that may allow 'parking' of claimants within payment groups (i.e. the payment profiles within each group remain the same, while the variation in distance from the labour market may remain significant). Though a significant improvement on the existing system, this is inevitable in any system which allocates claimants to client groups. This is necessary because it would be too complex, bureaucratic and become unviable for providers to construct viable business models if, say, each claimant were given an individual payment profile, nor does DWP possess the necessary data to construct such a profile at the present time. Limitations both of knowledge and experience mean so complex a system is likely to fail. Instead, a balance has to be struck between too much complexity on the one hand, and too much simplification leading to undesirable incentives (such as parking) on the other. Recognising this requires grouping claimants in the segmentation process. While such grouping using a segmentation process based on distance from the labour market rather than benefit type will be a considerable improvement, it cannot ever be perfect.

However, a possible way to mitigate the parking problem within claimant groups might be to make use of another proxy: the length of time the claimant has been in the programme. An effective way to achieve this in the long term would be to *incorporate a variant of the target accelerator model within each claimant group*. This provides escalating payments for claimants according to the order in which each claimant in a particular cohort enters work.

Variant 5: Individual claimants' accelerator model multiplier according to time on Work Programme 2.0



Some of these iterations may prove too complex or stretching for existing data. Effective modelling may prove impossible given the capacities and market development conditions which will exist during the new round of Work Programme contracting. As a result, this report does not suggest that all of these reforms should be implemented if this capacity is not effectively developed. Nevertheless, even a simple system of incentives based on earnings would have several advantages over the present system:

- Prevent the pass/fail 'cliff edges' for incentives, e.g. the incentive to 'park' a claimant who is not already in sustainable employment six months from the end of the contract because they are not likely to reach this point before the end of the contract (or remain in employment without interruption for six months to trigger payment after the contract period ends). Providers are rewarded however small the improvement in level of earnings.
- Creates clear incentives for progressing claimants already in work throughout the contract.
- Incentivises providers to look for 'mini-jobs' following the logic of Universal Credit and aligning providers' incentives with claimants' conditionality.
- Payments can be ongoing through the real-time information (RTI) systems being developed between HMRC and DWP to monitor claimants' employment income and thus Universal Credit payments. Work Programme provider payments could happen automatically alongside Universal Credit calculations. This would radically reduce or eliminate the need for providers to evidence claims and reduce administrative problems created by year to date (YTD) calculations and opportunities for fraud and error.
- It would reduce complexity in the incentive process and the block payments at different stages of the contract (i.e. the existing job outcome and sustainment targets), potentially improving the viability of employment support business models.
- The principle behind it is clear, the incentives are simple to understand and can be adjusted over time to minimise parking, ensure marginal returns exceed marginal costs for different client groups and to make improvements as experience of the model develops.

Example

The claimant undergoes the segmentation process and is placed in claimant group 2. In total, they earn £15,000 over the two years of the contract (against a £22,000 theoretical maximum they could earn without exiting claimant commitment conditionality).

Variant 1: providers are paid a flat 5% of total earnings over the contract period. The provider earns £750.
(£15,000 @ 5% = £750)

Variant 2: providers are paid 8% of total earnings above £5,000. The provider earns £800.
(£5,000 @ 0%, £10,000 @ 8% = £800)

Variant 3: providers are paid a greater percentage according to claimant group. This claimant is in group 2 which has a 9% of total earnings payment rate above a £3,000 threshold. The provider earns £1,080.
(£3,000 @ 0%, £12,000 @ 9% = £1,080)

Variant 4: providers in group 2 have escalating payments according to level of earnings. For payment group 2, there is a £3,000 threshold, 5% payment up to £5,000, 10% payment up to £10,000 and a 15% payment from £10,000 to £22,000. The provider earns £1,350.

(£3,000 @ 0%, £2,000 @ 5%, £5,000 @ 10%, £5,000 @ 15% = £1,350).

Variant 5: the payments remain as above, but the percentages are further varied according to how long the claimant has been on the programme. This claimant progressed significantly during the programme so her earnings are 'backloaded' towards its end. This results in the payments being multiplied in total by 1.15, so in total the provider earns £1,552.
(As above x time multiplier 1.15 = £1,552).

Components of Work Programme 2.0 price mechanism

In examining the old system and our proposed reforms, the price mechanism can be summerised as:

Work Programme '1.0'

Regional labour market variant (until 2014)

Primary benefit claimed

Length of primary benefit claim (current)

Limited other metrics (prison leaver, Early Access)

Work Programme '2.0'

- Regional labour market variation
- Intra-regional labour market variation
- In work progression
- Stage of the economic cycle
- Exogenous barriers to work (e.g. outdated skills/industry)
- Endogenous barriers to work (e.g. family background, attitudes to work, etc.)
- Any other barriers to employment (attitudinal etc.)

How to account for past performance

As outlined in Chapter 1, a significant barrier to effectively procuring the best service for the long-term unemployed is a failure to reflect the record of effectiveness of providers in consideration of awards for new contracts. The most straightforward way to implement this and sharpen incentives is to follow the Australian model: to provide surety to the better performers that their contracts will be renewed, while those that fail are 'kicked out' of the next contract round of competitions – that is, they are unable to bid. As we have seen, this was evaluated through a star rating system. From more than 1,000 organisations submitting bids in 1997, just 99 core providers were delivering services by 2009;[157] a similar situation is expected to occur in the Work Programme as contracts consolidate around the most effective group of 'super-providers' able to accumulate the most effective expertise and economies of scale.

This star rating system has been instrumental in driving up standards and achieving value for money in the Australian market and it is to be hoped that similar effects could be achieved in the UK.

Proposal 6: *Explore the means to create a system of star ratings in future contracting, including publication of each providers' rating on a quarterly basis. This should use regression methodology to adjust for the characteristics of claimant groups and labour market conditions between contract areas, using the flexibilities available in the new EU Procurement Directive. Incentives should be based on relative performance between providers rather than estimates of non-intervention.*

Greater emphasis should be placed on non 'paper-based' evaluation – potentially through an interview process for short-listed candidates. Following the Australian

157 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 10.

model, providers performing above a set high standard of performance could have an assumption of automatic renewal, with those below a minimum standard removed from the retendering process.

This may involve revising statutory interpretations of EU procurement rules, as well as lobbying by the UK government on interpretation of the new EU Procurement Directive. This may not be as difficult as it seems, however: the original Flexible New Deal contracts of five years allowed them to be extended for a further two, for example.[158] By ensuring that the best performers are given certainty that their contracts will be renewed and the worst performers will not be rehired, this should have the effect of sharply increasing incentives to perform. It also follows the logic that any businessman would in the private sector: if an existing supplier is doing a good job, it is very likely to business would make the decision to rehire them; conversely, if the supplier has done very poorly, it is very unlikely the business would consider hiring them again, no matter how good their new bid. We believe the same logic must be applied in the public sector.

Incapacity Benefit claimants and self-employment

As previously outlined, the flow of former Incapacity Benefit claimants into the Work Programme system has been impeded by a lengthy appeals process often stretching over months, with many making a new sickness benefit claim. This threatens the financial viability of the Programme and its specialist subcontractors in particular. One way to address these issues would be to adopt the best practice of other countries. Claimants with significant barriers to paid full-time employment are often excellent candidates for self-employment. Yet the existing scheme to allow unemployed people to do this – the New Enterprise Allowance Scheme, is relatively meagre: providing only three months' Jobseekers Allowance, followed by half for three months and loans of up to £1,000.[159] While. from October 2012, this has been accessible from day one of a claim (as opposed to the preceding six months), more problematically, claimants on the Work Programme are not eligible for the scheme.[160] In contrast, the Australian New Enterprise Incentive Scheme is available to clients throughout their period with Job Services Australia, providing an allowance for up to 52 weeks, rental assistance for 26 weeks and significant mentoring during the first year of operation.[161] To foster experimentation in types of provision for the hardest to help, the Australian system also provides an 'Innovation Fund' to help these claimants find and sustain employment.[162]

Proposal 7: *Extending the availability of the New Enterprise Allowance Scheme to all claimants who are identified as likely to benefit from it as identified by the segmentation tool, including those already on the Work Programme. In the long-term this support should be available from day one and throughout a claim.*

Changes in contracts

> *'The Prime Contractor shall comply with any proposed variation to the Contract.'*[163]
>
> Work Programme contract summary, clause 6.3.10

The seven year contracts stipulate wide flexibility for DWP to make amendments to the Work Programme before they are retendered[164] due to 'funding changes,

158 House of Commons Work and Pensions Committee, 'DWP's Commissioning Strategy and the Flexible New Deal', Second Report of Session 2008–09, Volume I, Report, together with formal minutes, to be printed 25 February 2009

159 http://www.dwp.gov.uk/adviser/updates/new-enterprise-allowance/

160 http://www.ytko.com/news/new-enterprise-allowance-not-for-work-programme-participants

161 http://www.deewr.gov.au/employment/jsa/employmentservices/pages/neis.aspx

162 http://www.deewr.gov.au/Employment/JSA/Pages/innovationfund.aspx

163 http://www.dwp.gov.uk/docs/work-prog-contract-summary.pdf

164 http://www.dwp.gov.uk/docs/work-prog-draft-terms.pdf

unexpected performance trends, or changes in policy' due to changes in anticipated volumes or economic change and alterations resulting in policy changes. The Department can use its Change Control Process, with negotiations conducted by its Provision Management Division's Specialist Commercial Team.[165] It reserves 'the right to review contracts for changes in economic conditions', stop referrals for some customers, begin referrals for others, change the point of entry, flex eligibility criteria and change 'the scope and nature of the customer groups'.[166]

Initiatives through payment-by-results systems have been introduced to reduce the number of workless households through the Troubled Families programme, day one referrals for ex-offenders by JCP advisers (previously three months) from April 2012, mandatory community work for those who do not find sustainable work coming out of the Work Programme, the wage subsidy scheme for younger workers through the Youth Contract, changes to conditionality and sanction regimes, and the introduction of Universal Credit, focused principally on increase financial incentives for 'mini-jobs' of less than 16 hours. All these changes will significantly affect the functioning of Work Programme 2.0.

In particular, the effect of Universal Credit on customer groups and, potentially, Job Outcome definitions, could not have been anticipated in prior business models and may significantly affect the ability of Work Programme contractors to deliver services to hard-to-help groups in Work Programme 2.0.

Proposal 8: *Maintaining the flexibility of the Department of Work and Pensions to change the terms of contract for Work Programme 2.0 to account for the needs of Universal Credit.*

The length of the Work Programme contract

The Work Programme is also a particularly long contract – up to nine years before all sustainment-in-work payments might theoretically be paid. This creates surety for contractors and lowers transaction costs, but at the expense of preventing flexibility within DWP when awarding new contracts and has involved specifying long-range numbers for pricing job sustainability from a relatively shallow base of experience. Given the proposal above, providers should have greater certainty that their performance and long-term investments will be recognised in a more effective way than in the past. This will create the opportunity to allow more regular adjustments in the parameters of the Work Programme to account for changes in conditions (for example, arising from a misalignment of incentives due to economic or labour market changes), as well as avoiding some of the negative effects of a 'big bang' procurement cycle across the board on existing relationships, networks and staff. While the concept of a purely PbR-based model of employment services is bedding inton the UK and the uncertainly in practical application of these contracts in what is still a relatively new market, a more iterative procurement process would make sense, at least in the medium term, to allow for frequent adaption as more is learnt about the most effective criteria. Designing a system which simultaneously: minimises 'parking' of the hardest to help claimants, maximises sustainable employment outcomes, drives up performance through competition and prevents gaming is difficult and may require several refinements. As identified above, a contracting process that involves greater adjustment for cyclical economic changes, as well as greater difficulties in getting claimants

165 http://www.publications.parliament.uk/pa/cm201012/cmselect/cmworpen/1438/143804.htm

166 http://www.dwp.gov.uk/docs/work-prog-draft-terms.pdf, p. 48.

back into work in specific regions, (or, more importantly, sub-regions within a particular contract area) is necessary to ensure the Work Programme is effective. But getting this right will be complex and take time to get right.

Proposal 9: *Future contracting should be more iterative, perhaps on a three-year model as in Australia.*

Ensuring the viability of sub-contractors

As outlined in Chapter 2, a significant issue has emerged with the treatment of sub-contractors in the Work Programme. Several have taken on contracts which are not financially viable, have had few referrals and are going out of business. There is a significant risk that specialist skills and necessary interventions may be lost as experienced staff and firms with extensive institutional knowledge leave the industry or go bust (the liquidation of People Service in July 2011, for example).[167] It is important to ensure this improves in Work Programme 2.0.

Proposal 10: *Create an Independent Regulator, responsible for overseeing the prime/sub-contractor relationship, as well as reviewing appropriate fees and contract conditions.*[168] *This remit could include price revisions, market share shift according to performance and adjustment of prices. This would supersede the existing Mediation Service and some market management roles of DWP.*

The mismatch between expected and actual client flow (often associated with delays in referrals of reassessed Incapacity Benefits claimants due to a prolonged appeal process) has seriously disrupted the financial planning of many organisations. Some of this may simply be 'teething troubles' following the formation of a new system over a very short time-scale.[169] This is less of a problem where providers deliver a significant proportion of their services directly. Nevertheless, for others it would be prudent to enact some safeguards to give subcontractors greater certainty in the future for specialist services.

Proposal 11: *In future bids, a new code of conduct should replace the Merlin standard to promote certainty and viable operating models for small subcontractors, including a 'single bid' system. This will prevent subcontractors having to make costly duplicate bids to prime providers in each contract area. Fulfillment of these undertakings should be enforced by the Independent Regulator.*

Accelerator model

Another frequently mentioned framework for reforming the Work Programme is the Accelerator model. This alternative incentive structure was first proposed by WorkDirections in 2006[170] and is regularly supported by the Social Market Foundation. It proposes increasing or graduating payments levels according to the total number of people providers put into work. This is based on the assumption that jobseekers who get back into work quickest would require the least help, whereas those taking longer to place would be more difficult. The idea is based on the theory that it is possible to set payments so that the marginal payment of assisting the next client always exceeding the marginal cost (that is, providers will always have a sufficient incentive to help the next claimant). This would allow providers to be paid more for groups which are the hardest to help, either through a 'flat' fee during the term of a cohort's contract, followed by top-up

167 http://www.rescare.com/newsroom/2011/announcement-concerning-sale-of-peopleserve-limited.php

168 http://www.merlinstandard.co.uk/mediation.php

169 In total, the entire process from contracting through to programme start was less than a year – from the formal advertisement for expressions of interest for the framework competition in the Official Journal of the European in late June 2010 through to going 'live' in April 2011.

170 Mansour J, Johnson R, 'Buying Quality Performance', WorkDirections 2006, http://buyingqp.files.wordpress.com/2012/03/buying-quality-performance-_july-2006_.pdf

payments according to overall performance at the end, or an assumed 'trajectory' of job placements for a particular cohort, with a provider paid if they achieve above the assumed level, or have payments removed if they do not.[171] The idea is that this would avoid the problem of 'creaming' and 'parking' by ensuring there is always sufficient reason to provide an sufficient level of service for each claimant. However, while this is a step up from basing provision on benefit claimed, there are several problems with this:

- There may be considerable deadweight for certain groups who are mispriced as harder to help than they actually are (clusters of relatively job-ready claimants who may be relatively easy to place in sustainable employment, for example);
- Distance from the labour market and the time taken to return to work may not always be correlated (low-levels of intervention that require a long time to work for example);
- The business model challenges posed by further uncertainty as to the level of potential payment for each client (i.e. not guaranteed by payment group);
- It may not be possible to construct a payment model where marginal payments are always ahead of marginal costs (there may be a 'wall' or 'cliff edge' of claimants beyond which providers cannot – or dare not – provide sufficient support, creating parking);
- The lack of a direct connection between the incentive system and getting claimants off benefits or into higher earning jobs.

While pilots of the Accelerator model were muted for 2011, none took place.[172] Notably, these pilots, to be called Personalised Employment Programmes, were designed to tackle all barriers to employment regardless of primary benefit type being claimed and create a 'single, integrated, flexible employment programme'.[173] While potentially a more effective mechanism than an incentive structure based on primary benefit type, in the final analysis we believe this model poses too many potential risks for an employment services industry already under significant pressure. The complexity and unfamiliarity of the system would engender a prolonged learning process for Work Programme providers who may find it difficult to develop a successful business model in the medium term. This is in contrast to the segmentation model we have outlined which would give a clear level of financial incentive for each claimant, based on their distance from the labour market rather than the order in which they return to work.

Nevertheless, to ensure that the most effective model for future employment support is developed, we believe it would be useful to commission pilots for both these schemes as well as expanding the use of randomised control trials and rigorous evaluation in policymaking.

Reviving pilots

The previous Labour government ran a number of pilots in the welfare space alongside a series of national programmes: at least 15 of the former and 22 of the latter. All of these have been wound up or superseded by the Work Programme. These types of pilots should be reintroduced. Creating new data for proper

171 Ian Mulheirn, Evidence to the Work and Pensions Select Committee, October 2008, Q58, http://www.publications.parliament.uk/pa/cm200809/cmselect/cmworpen/59/8102204.htm

172 'DWP's Commissioning Strategy and the Flexible New Deal', House of Commons Work and Pensions Committee, Second Report of Session 2008–09, Volume I, Recommendation 21, http://www.publications.parliament.uk/pa/cm200809/cmselect/cmworpen/59/5912.htm

173 http://www.dwp.gov.uk/docs/pep-event-presentation-dec-2009.pdf

analysis of deadweight and building procurement models which de-risk provider performance for the public purse must be a key objective for future welfare reform (and indeed for outsourcing more generally as new, innovative models of partnership and engagement are developed). County-level experimentation was very useful in developing the efficacy of the Wisconsin reforms in the United States during the early 1990s, for example. It is important that such proper, randomised control pilots are used to develop policy and that they are disseminated properly. Proper evaluation of the pilots and phased implementation is vital to ensure that sufficient data and institutional knowledge is built up before the next iteration of the Work Programme. In particular, our previous reports have outlined pilots to extend the nature and scope of employment support provided by the private and third sectors; and pilots of new conditionality and workfare tools. This may also involve opening up pilots to public and private sector competition.

Alternative models for future randomised control trials

In addition to the Australian and Accelerator model outlined earlier, it would be useful to experiment with alternative incentive and payment structures for future Work Programme provision. Specifically:

Upfront fees/'fee for failure'

In Chapter 1, three of the key problems outlined with the Work Programme were: the pressures on financial models imposed by a retrospective payment-by-results model which phased out upfront payments, the lack of incentive for providers not to 'park' hardest-to-help claimants and return them without employment at the end of the Work Programme, and the difficult issue of how to assist those claimants who are unable to obtain sustainable employment. One way of addressing these issues would be to retain upfront fees (as per the Attachment Fee), but combine these with a 'fee for failure'.

> "A 'fee for failure' combined with greater up-front funding would significantly sharpen incentives, may be a useful way to allow market entry for less well capitalised companies and would form a useful element of future pilots"

This would involve recreating the upfront attachment fee (which would ease cash flow and perhaps lower barriers to entry for less-well capitalised market entrants) but charge providers a 'fee for failure' if claimants fail to enter sustainable employment by the end of the Work Programme. To some degree, there is such a fine already in the form of the 'deadweight' cost providers pay by returning a customer to Jobcentre Plus because any investment they have made in moving that person into work will be lost (assuming, of course, that the customer has not been 'parked' – though even there costs exists in terms of minimum service). Any 'fining' system is likely to be ineffective if the level of fine is less than the resources needed to avoid it, or it encourages providers to move a claimant into any job at the two year mark to avoid the fine. Nevertheless, a 'fee for failure' combined with greater up-front funding would significantly sharpen incentives, may be a useful way to allow market entry for less well capitalised companies and would form a useful element of future pilots.

Employment Zones 2.0

An interesting model might involve exploring a new form of Employment Zones. These alternative delivery models were introduced on a trial basis in 2000 to replace all employment support provision in 15 high unemployment areas, partly based on a recognition that existing New Deal provision was too centralised and inflexible. It involved 'black box' non-prescription of service processes and a limited form of payment-by-results. Providers were paid an upfront fee followed by the equivalent of 21 weeks' worth of unemployment benefit which providers were then responsible for passing onto claimants, replacing the functions of Jobcentre Plus in these areas. The rest of the contract was based on getting and sustaining claimants in employment for at least 13 weeks. This led to several innovations, including the development of specialist roles and alternative centre locations. Subsequent evaluation showed a 32% greater job outcomes compared to non-pilot long-term unemployed[174] and an 8% overall improvement in 13 week job outcomes over comparable Jobcentre Plus areas[175] and almost doubling sustainable job outcomes for the long-term unemployed.[176] This success was largely put down to increased flexibility for advisers in tailoring provision and focusing on sustained employment outcomes, including discretionary funding of claimants for everything from interview clothes to bespoke training.[177] Further trials of the Employment Zones model through 'Building on the New Deal' pilots were scrapped in June 2006.[178]

In some senses, this provision is similar to the Work Programme: flexibility over types of intervention, the use of private providers and an emphasis on sustainable employment. However, several distinctions remain: contracts were competed for on the basis of quality rather than price, the type of provision was transparent once it had been tendered, Jobcentre Plus was not involved even in conditionality and minimum quality standards were specified centrally rather than provider defined. A more radical form of Employment Zone provision might be piloted for the hardest-to-help groups. For example, a calculation could be made for harder-to-help groups their expected duration in unemployment and their corresponding DEL/AME funding. This money could then be given to providers upfront, hence becoming less risky for them (perhaps minus an efficiency discount) along with a duty of care for 24 months, under which they are responsible for the customers' interventions, benefits and costs (if any) to Jobcentre Plus. Providers would get to keep all the money that is not spent (perhaps with a profit share or cap mechanism). This programme would require accessing the AME funding upfront rather than through the benefits that have been accrued (the original DEL/AME switch concept).

Behavioural economics trials

More innovative approaches might based on developing research in behavioural economics. For example, a trial based around loss aversion might involve allowing anyone who has claimed benefits for over five years (or significantly cycling in and out of work over that period) to keep 80–90% of their benefits for their first year in work (then to be tapered down over the next two years to align with other claimants with the same circumstances on Universal Credit). This would be expensive (though one might argue that the benefits would have to be paid anyway after such a long spell of unemployment, so deadweight costs are

174 Hasluck C et al, 'The Wider Labour Market Impact of Employment Zones', DWP, Report 175, 2003.

175 Hales J, et al, 'Evaluation of Employment Zones: Report on a Cohort Survey of Long-Term Unemployed People in the Zones and a Matched Set of Comparison Areas', National Centre for Social Research, 2003.

176 http://www.variant.randomstate.org/18texts/18workinglinks.html

177 http://www.jobcentreplus.gov.uk/JCP/Customers/Programmesandservices/Employment_Zones/

178 'Full Employment and World Class Skills: Responding to thechallenge', Work and Pensions Select Committee, October 2007, p. 7.

minimal), but the claimant would be more skilled and loss adverse to leaving work having entered it once benefits began being withdrawn, and less likely to leave.

Claimant control trials

One little-discussed characteristic of the Work Programme is that it is non-discretionary. Claimants have no choice over which provider they are referred to, nor to the sub-contractors they may be sent to subsequently. Some organisations have questioned this, notably the National Council for Voluntary Organisations.[179]

What to do if a provider fails – or there is system-wide failure?

> *'Organisations that promised a discount will not be paid enough a head to cover the upfront costs of running the programme. Their only hope is that the government will be forced to find ways to pay them extra in years three, four and five on the basis that the programme is too important to fail.*[180]

There are serious issues around the financial viability of various contractors involved in the Work Programme. While the business models and financial assumptions of providers are varied and it would be unsatisfactory to generalise, there are a number of common themes. Some have signed contracts with large discounts in outcome payments which began in April 2013. Some have struggled with cash flow and breaching financial covenants. Some are relying on a 'rapid turnover' model, assuming their main profit-making will occur with the JSA 25+ group; others believe the large payments available for former IB claimants transferred to JSA is the more profitable group. All found the targets of the Work Programme stretching, and there may be a widespread inability to make a profitable return. This poses serious risks, both to the viability of the employment support industry itself and, perhaps more importantly, the availability of tailored, personalised support for the most vulnerable, long-term unemployed.

However, as with the previous New Deal and Flexible New Deal programmes, the Work Programme carries the risk of moral hazard. If providers are unable (say, due to insolvency or other financial imperatives) or unwilling to help large numbers of claimants (due to incentives to 'park' for example), it is likely that the government would either have to provide this assistance directly, or, more likely, renegotiate the provider's contractors to ensure commercial viability.[181] If a provider fails, in the short term it may be possible to redistribute to the remaining providers in the relevant package areas, as mooted. However, intervention is still likely to happen if market failure occurs due to inaccurate cost assessment or providers consistently fail to meet fund-dependent targets. As referenced earlier in this report, both are quite possible. It is feasible that several providers will encounter financial difficulties by 2017 and some may drop out of bidding for Work Programme 2.0 at all. This is largely the story of the government's 'Pathways to Work' programme, in which DWP were forced to pay contract service fees early due to risks to the supply chain caused by supplier underperformance and cash flow difficulties.[182] A similar story of providers withdrawing or going bankrupt through unprofitable contracts also characterised the Flexible New Deal, (with deteriorating labour market conditions leading to higher service fees) and the Training and Enterprise Councils.

179 http://www.civilsociety.co.uk/finance/news/content/11326/employment_minister_not_keen_to_address_payment_concerns_on_work_programme

180 'Coalition work scheme raises doubts', Financial Times, August 24th 2011, http://www.ft.com/cms/s/0/c7d966e2-ce5a-11e0-99ec-00144feabdc0.html#axzz2Hy1UDpGf

181 The Youth Contract, announced in response to high levels of youth unemployment, is perhaps a good example of this type of supplementary intervention. See http://dwp.gov.uk/docs/youth-contract-details.pdf

182 'Support to Incapacity Benefits claimants through Pathways to Work', National Audit Office, p. 9. http://www.nao.org.uk/publications/1011/pathways_to_work.aspx

In the event of provider failure, the Department anticipates that another Prime can take over with a quick 'mini-competition' to determine which one it will be in the manner of the existing 5% market share shift according to performance[183] (though the method for this, along with termination clauses are not well defined). However, it would be much more difficult for government to impose losses on providers than is generally thought. Simply transferring claimants within a package area to another provider would result in inadequate assistance – the other provider simply could not raise capacity quickly enough to deal with perhaps twice their original number of claimants overnight. In practice, government would either end up providing inadequate support through Jobcentre Plus, dramatically increasing volumes for advisers in the non-failing client or bailing out the failed provider: and in the worst case scenario, a combination of all three. It would thus be prudent to lay contingency plans in advance.

Proposal 12: *We should examine what alternative methods might be used to mitigate moral hazard, such as a special administration regime or 'living wills' to ensure the continuation of services, and set out clear transition mechanisms for market share shift should one or more providers fail.*

Reassessing the Youth Contract

As with Flexible New Deal and the Future Jobs Fund, the Work Programme also had an effective wage subsidy scheme: the Youth Contract. Policy Exchange's previous report *Too Much to Lose*, set out proposals to modify the Youth Contract,[184] a wage incentive scheme for 16 to 24 year olds for jobs lasting a minimum of 26 weeks for more than 16 hours per week. It gave employers a £2,250 rebate of the first six months of a job start for 18 to 24 year olds but is not linked to acquiring new skills or progression but was ended for new claims in August 2014.

Work Programme providers are supposed to help identify where such an incentive would be appropriate, along with appropriate job opportunities. This report recommended that the Youth Contract was widened to any age group having difficulties entering the labour market through the segmentation process we have identified – by metrics such as troubled family history, total lack of work experience, low household income and so on. Youths not from these backgrounds are likely to find jobs independently and any wage subsidy simply constitute deadweight.

While it was, in some senses, 'built around' the black box procurement (and was theoretically an advantage within the programme for providers trying to place younger claimants – though there were issues around discrimination laws and providers having no way of selecting which claimants were able to use the scheme), this approach runs contrary to our focus on personalisation and segmentation. From the outset, it gave claimants an advantage in the labour market based on age rather than underlying barriers or characteristics. It effectively privileged a particular group at the expense of the rest. It necessarily and explicitly paid for more deadweight by subsidising jobs which young claimants may have been able to fill anyway. As identified in *Too Much to Lose*, it is not apparent that there is a particular problem at the younger end of the labour market which is not evident elsewhere. This may have been reflected in the scheme's much lower than expected take-up.[185]

While the development of an intermediate labour market is likely to have some impact, we do not believe it provides a long-term solution to assisting the

183 See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/245155/mss-table-2012-13-perf-year.pdf

184 http://www.policyexchange.org.uk/publications/category/item/too-much-to-lose-understanding-and-supporting-britain-s-older-workers

185 http://www.ft.com/cms/s/0/97e40d92-1340-11e4-925a-00144feabdc0.html#axzz3Ady3kpsH

long-term unemployed back to work (a 'cliff edge' may develop where many former claimants become unemployed as subsidies end, for example, as it has for previous schemes). Work Programme providers also have this option but clearly do not believe it is in their interest to do so given the financial arrangements available. Instead, we need to consider alternative remedies for more sustainable employment. These are explored below.

Building a significant new system of employment support for the hardest to help in the short-term

There are significant difficulties applying the payment-by-results model to the hardest to help. In the short-term, before a completely new contracting system based around segmentation in the long term can be built, as we have outlined, innovative alternatives such as an Employment Zone-style model might be experimented with on a pilot basis.

The goal would be to extend the logic of segmentation outlined above into 'day 1' unemployed support, scoping out how this would look and examining how the transition could be managed. The key to this is the identification of barriers (fitting into the government's data sharing and service co-ordination agenda) and ensuring that the financial incentives for tackling these is timely and appropriate. Without significant adjustment, there is scope for significant social problems in terms of: inadequate arrangements for the hardest-to-help (in particular, in the former Incapacity Benefit group), alongside 'privatising the profits, nationalising the risks' in terms of a renegotiations in the event of systemic failure. It is not fair to increase the 'stick' of conditionality and sanctions without providing appropriate support to help the most vulnerable fulfill their commitments.

As previously outlined, the government has already somewhat abandoned the payment-by-result approach through the (now ended) Youth Contract. It therefore has implicitly accepted that an absolute payment-by-results structure is insufficient to fulfil all employment support needs in the labour market. Maximising the efficiency of this market necessitates a reassessment of the relative merits of structures, contracts, incentives and pricing which have been built into the Work Programme and, in particular given the difficult economic climate, how these structures affect provision for the most vulnerable claimants. In particular, some have criticised the contract award process as being too focused on price rather than the quality of the service offer.[186]

Proposal 13: *Explore ways to award contracts more on quality rather than price, following a reassessment of the pricing structure on a regional macroeconomic level. This could include complete phasing out of bidding discounts and specification of financial incentives purely through the segmentation tool.*

Regional variation

> *'Confidence levels that the Work Programme will deliver for harder to help groups (or indeed that it will meet its targets at all) are very low…There is no provision in the pricing and design of the Work Programme to allow for the additional barriers to work and costs to delivering services that exist in London as opposed to other areas of the UK.'*[187]
>
> 'Fair Chance to Work: initial voluntary and community sector experiences of the Work Programme in London', LVSC, October 2011

186 http://www.guardian.co.uk/society/2012/feb/07/work-programme-cheap-contracts-awarded

187 http://www.lvsc.org.uk/media/57778/fair%20chance%20to%20work%20-%20vcs%20experiences%20of%20work%20programme%20in%20london%20-%20lvsc%20oct%202011.pdf

Chapter 1 showed that prime providers were able to differentiate their pricing by offering a discount on their job outcome payments (awarded when a claimant first enters work). This could be used to differentiate between the strengths of regional labour markets, over which the providers have no control. But these payments only represent a small proportion of the total (mostly made up of sustainment payments), and they were phased out, leaving a predominantly national pay structure. These give providers very little opportunity to distinguish on the basis of regional or cyclical conditions. In the bidding process, some companies may have preferred some regions over others due to regional labour market conditions.[188] Providers could end up being rewarded or penalised for macroeconomic conditions largely beyond their control, as particular labour markets improve or worsen. For example, Research from the Centre for Economic and Social Inclusion has already found that London has seen lower outcomes due to a large pool of high-barrier clients, higher business costs, and a highly competitive labour market for unskilled and semi-skilled work.[189]

It may be extremely easy to get a particular profile of customer a job during a booming economy in a prosperous area, but very difficult to get the same worker profile a job in a deprived area during a recession. However, under the existing structure, the revenue for a provider would remain unchanged. The fear is that several areas (or even entire regions) will be left without adequate provision – because the pricing structure will not make it profitable for providers to give adequate support in that region. Significant 'parking' problems might also occur *within* the contract areas, as certain parts become very profitable, others completely unviable and providers adapt their operating models across a particular region to maximise profits. The relative characteristics of an area: offending rates, effective social networks, levels of public health, skills training, number of care leavers and so on, vary considerably and are likely to have very significant effects on the employability of claimants within a relatively small geographical area. This 'parking by place'[190] could happen, for example, because the labour market is particularly weak in some parts of a Contract Package Area, or in remote areas where transport costs reduce or eliminate the potential profit of successfully placing a claimant in work.

Regional contract price differentiation does not address the more fundamental issue of geographical dispersion within the contracting areas rather than between them. This means that parking behaviour is likely to occur at the sub-contract area level because of the heterogeneity of local labour markets. This could lead to the 'parking' of entire communities where unemployment is widespread.

Extending the discount principle to the sustainment payments might mitigate this. This would allow variations by geography to reflect the cost of capitalisation, level of risk and local labour market conditions within each contract package area. However, this would only address the issue of regional differentiation which may be minimal given the size of the bidding areas – areas within them may greatly differing in terms of job potential. This reinforces the need to develop a fully workable segmentation process that identifies barriers to work and the cost of addressing them at the individual level – including geographical access to employment opportunities.

Since the financial crisis, the labour market has evolved in very heterogeneous ways. Trends continue to indicate a spatially very uneven pattern of employment in the UK, while demographics, skill levels, industries growth and decline, supply

188 For example, we note that one unsuccessful Prime bidder – PwC – exclusively bid in London and the South-East.

189 http://www.cesi.org.uk/Resources/CESI/Documents/Work_Programme_report.pdf

190 http://buyingqp.com/2012/03/11/parking-by-place/

and demand all fluctuate over time. For example, 321,400 private sector jobs were created in Greater London between 1998 and 2008 compared to just a tenth of that number for the rest of the UK.[191] Issues like transport, contracts and seasonality can be very disparate between areas.

Proposal 14: *In Work Programme 2.0, payment levels should be subject to automatic adjustment determined by leading (rather than lagging) macroeconomic indicators on a regional, or sub-regional basis. Which indicators might be used should be consulted on and piloted before full roll-out.*

Best practice and the black box

> *[I will] 'champion industrial espionage, because what the Work Programme is all about is chasing best practice… we will see a real drive to innovate.'*[192]
>
> Chris Grayling MP, former Minister for Employment, 19th October 2011.

The concept of the 'black box' is that providers will continually improve the design, sequencing and effectiveness of their interventions through a complete freedom to innovate – entirely outside any rubric of Departmental requirements for particular types of provision. There is some evidence that this has happened within providers – the best performers seem to combine intensive activity, combined with innovation and new ideas to address barriers and build close relationships with the business community. However, this information is anecdotal and there is no rigorous analysis of best practice across the industry. The grey area between disseminating best practice across an industry while protecting commercially sensitive information and intellectual property is a perennial problem in government outsourcing. To some degree, this is a natural province of trade associations (in this case, the Employment Related Services Association) and the consequence of the competition for new contracts and performance through the payment-by-result model. Companies also have to protect their intellectual property rights, a less onerous task given the 'black box' structure. However, some providers have complained of additional DWP requests for information in addition to that stipulated in their contracts, adding to their compliance costs.

One element of the Work Programme system that is unusual is the lack of up-front fees available for the hardest-to-help groups and a relative lack of such contracts for subcontractors.

Proposal 15: *For the hardest to help groups, an estimate of cost of compliance with DWP's administrative and compliance costs should be paid as an upfront attachment fee for claimants furthest from the labour market.*

This incentivises the Department not to increase administrative burdens over the span of a contract (as this would also increase their costs). Another issue is that the 'black box', alongside onerous confidentiality requirements, make it difficult to disseminate information on best practice between firms (there are also issues around clarity of communication in driving claimant behaviour). The very high degree of secrecy mandated ranges from a blanket ban on data sharing to even preventing contractors making press releases without DWP authorisation.[193] Particularly where performance data is guarded so secretively through contractual

191 Webber C, Swinney P, 'Private sector cities: A new geography of opportunity', Centre for Cities 2010.

192 http://www.policyreview.tv/video/616/4327

193 http://www.thirdsector.co.uk/go/news/article/1110933/work-programme-contract-bans-charities-attracting-adverse-publicity/

obligations, and the restrictions on data sharing have been so tightly drawn by DWP, it would seem prudent to develop a more sophisticated policy on a government level than simply 'championing' ad hoc (and in some senses illegal) industrial espionage. For example, a commitment to regular common surveys, ongoing evaluation by DWP of emerging best practices and 'open book' accounting might help to disseminate best practice in the industry and ensure any future pricing structure is based on accurate, comparable data. Policy Exchange has previously recommended a 'perspex box' for offender management services, where best practice is transparent and shared widely, while intellectual property, data and management information remains with the respective providers.[194]

Professor Dan Finn has stated:

> *'DWP may wish to also consider an approach that quickly identifies findings that could help develop market knowledge in its earliest stages and, through dissemination, facilitate more speedy market development than might otherwise occur. The spread of best practices may be accelerated further if DWP and other interested organisations develop opportunities for brokering information exchange and technical advice.'*[195]

The sharing of comparable performance data, information and technical advice across the industry (for example, on the optimum caseload of a particular profile of claimant per adviser, or the results of diverse techniques of engagement with claimants placed in work to aid sustainment) could be significantly improved without imperilling a particular firms' intellectual property or being overly prescriptive.

Proposal 16: *Developing an independent panel on best practice in Work Programme 2.0, building on the work of the best practice group. This should develop a similar structure to the Knowledge Transfer Network to share innovation and facilitate dissemination of best practice within the welfare-to-work Industry.*

Allowing flexibility and respecting providers' intellectual property on the one hand, and making use of transparent standards to reduce parking (and hence pressure to increase specifications) on the other, is a difficult balance to strike. The Work Programme attempts to minimise prescriptive rules, tracking and publishing Key Performance Indicators alongside job entry rates. Ensuring levels of employment support are transparent is a key means of minimising the risk of parking, but this has to be done without demanding overly prescriptive standards and data measurement which might stifle innovation. It is important to ensure that Work Programme 2.0 gets this balance right.

Proposal 17: *Providers should be permitted to publish any non-personal performance data they wish subject to quality thresholds defined by the Independent Regulator. There should be no further demands to publish or provide additional data to DWP over existing requirements.*

European Structural and Investment Fund

The Work Programme is match funded between the UK and the European Structural and Investment Fund in England (ESIF). The ESIF's objective is to extend employment opportunities and improving workforce skills as part of the 'Europe 2020' strategy, totalling in £2.5 billion in EU funds and the same in UK matching funding, including Skills Support for the Unemployed and Skills Support for

194 Chambers M, 'Expanding Payment-by-Results', Policy Exchange 2013, http://www.policyexchange.org.uk/images/publications/expanding%20payment%20by%20results.pdf

195 Finn D, 'Job Services Australia: design and implementation lessons for the British context', DWP Research Report No 752, 2011, p. 4.

Redundancy.[196] Since these funds are supposed to add to existing programmes rather than override or replace them, a prerequisite of the funding is demonstrating added value – particularly difficult within the 'black box' competitive structure. This involves onerous compliance criteria for prime contractors.[197]

For example, the Troubled Families Programme is designed to help the 120,000 most troubled families in England by 2015 who, at a minimum, receive at least one working age benefit and there is a sustained pattern of worklessness. The purpose of the programme has considerable overlap with the Work Programme, with up to 30% of contract values being paid according to job outcomes. However, due to the necessity of being 'additional' to existing provision, any family with a member already on the Work Programme is automatically ineligible for Troubled Families.[198] It also means duplication and waste is inevitable (overlapping with the more short-term European Globalisation Adjustment Fund, and European Regional Development Fund, for example). Much of the financing goes through the Skills Funding Agency (SFA), which is largely uncoordinated with the Work Programme. Coordination largely takes place through referrals by providers, who 'where they identify an outstanding skills barrier to work, to refer clients to the flexible skills training on offer locally.'[199] In practice, this means that SFA funded training is largely ad hoc and unrelated to labour market demand.

Some local authorities have developed their own innovative and coordinated approaches, especially in combination as city-region combined authorities (the Manchester Partnership's Troubled Families programme, for example).[200]

However, all too often, public authorities have felt obliged to spend their budgets simply in order to gain the match funding, even if this diverts resources from their core functions (the previous Local Neighbour Fund for example). Duplication frequently occurs in local authorities, who often have poor communications with providers and provide independent employment services. Skills-based learning and training by local authorities is often soft and little co-ordinated with providers (taking place outside the Employment Related Support Services framework), with available funding concentrated on elective qualifications rather than skills or routes in employment. This prevents DWP from identifying duplication, churn and cross government spending, as well as identifying very significant areas of deadweight. ESIF also continues to rely on input measures rather than performance.[201] Since many Jobcentre Plus advisers and clients are unaware of the fund, its use is often poor or badly timed.

It is not our purpose here to review the ESIF as a whole or the potential for reform of EU structural funds generally.[202] Nevertheless, it makes little sense for these parallel programmes to continue and not follow the logic of the government's policies in regard to winding up similar domestic programme into the larger framework of the Work Programme. Bringing together family policy, intermediate labour market policy, sustainment, progression, skills and training support into an integrated, tailored package would surely be a more efficient approach. A House of Lords report identified several areas of flexibility in the use of this funding which remain untapped.[203]

Proposal 18: *Conducting a Review on improving the use of ESIF funding with a view to more effective integration into Work Programme 2.0. A similar process should be undertaken for the ERDF and other Structural Funds to eliminate duplication as far as possible.*

196 http://skillsfundingagency.bis.gov.uk/providers/programmes/esf/

197 http://www.dwp.gov.uk/docs/work-prog-draft-terms.pdf, p. 51.

198 The family may continue to receive ESIF provision should an individual become eligibility for a Work Programme referral during the programme, however. http://www.dwp.gov.uk/esf/resources/co-financing-organisations/dwp.shtml

199 Skills for Sustainable Growth, Strategy document, pp. 33–34, http://www.bis.gov.uk/assets/biscore/further-education-skills/docs/s/10-1274-skills-for-sustainable-growth-strategy.pdf

200 See: http://www.manchester.gov.uk/manchesterpartnership/info/5/public_service_reform/40/troubled_families

201 'Evaluation of the Added Value and Costs of the European Structural Funds in the UK': Report DTI and Office of the Deputy Prime Minister. 2003, http://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/files/file12203.pdf

202 A good introduction to the issue is 'Off Target: The case for bringing regional policy back home, Open Europe 2012, http://www.openeurope.org.uk/Content/Documents/PDFs/2012EUstructuralfunds.pdf

203 House of Lords European Union Committee, 9th Report of Session 2009–10, 'Making it work: the European Social Fund', 2010, http://www.publications.parliament.uk/pa/ld200910/ldselect/ldeucom/92/92i.pdf

The Coalition Government's welfare-to-work policy for the long-term unemployed is based around an ambitious new approach, the Work Programme. It represents a very significant element in the Government's labour market and economic strategy.

For the long-term unemployed, getting the next iteration right, "Work Programme 2.0", is very important. However, there is a significant risk this will not happen. In particular, by incentivising providers to treat people according to the type of primary benefit they receive rather than their particular needs, there is a serious danger of inefficiency: both by overpaying for employment support for claimants who do not need it and underfunding necessary support to get the hardest-to-help claimants back into work.

This report contains 18 proposals on how to improve the Work Programme, including how to better segment jobseekers by their particular barriers to work, how to align Work Programme 2.0 with the roll-out of Universal Credit, and how to better recognise local labour market conditions.

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