

Contracting out employment services: lessons from Australia, Denmark, Germany and the Netherlands

Sharon Wright

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Executive summary

Introduction

- ◆ The UK government aims to eradicate child poverty and reduce public spending by increasing the employment rate to 80 per cent.
- ◆ Proposals to contract out employment services to private and voluntary-sector agencies are a key part of this ‘work-first’ strategy.
- ◆ Rising unemployment (showing weakening labour demand) and the credit crunch (which may well affect liquidity among private sector providers) which occurred after the model was designed justify a rethink.
- ◆ This report examines the international research evidence and finds remarkably little justification for the proposed changes to the delivery of employment services.

Why contract out employment services?

- ◆ Current UK government proposals to contract out employment services are intended to: eradicate child poverty; raise the employment rate to 80 per cent; achieve ‘better cost-effectiveness’; improve low skills; tackle multiple disadvantage; reach the hardest to help; benefit wellbeing; and promote innovation.
- ◆ The underlying assumption is that competitive market forces will ensure cost savings and higher quality services.
- ◆ These delivery changes will be implemented as part of a ‘work-first’ strategy, which can be effective for some jobseekers, but has limitations as it:
 - ◆ is not an effective strategy for eradicating poverty – particularly in countries like the UK, where benefit levels and minimum wages are inadequate;
 - ◆ assumes the labour market can absorb everyone who wants a job and is competitive and flexible;
 - ◆ will be undermined by adverse economic conditions;
 - ◆ assumes jobseekers are in a position to accept work;
 - ◆ may not be an effective way to assist people facing multiple disadvantages to paid employment;
 - ◆ relies on an abundance of real local job opportunities, without which benefit recipients may be required to seek work that does not exist or accept unsuitable or unsustainable jobs;

- ◆ can lead to a majority of jobseekers repeatedly moving between insecure poorly paid jobs and unemployment.
- ◆ The current UK employment rate of 74.7 per cent is already exceptionally high in historical and international comparisons.
- ◆ Whilst compelling people to look for and accept jobs, regardless of their quality, suitability or sustainability, can result in reducing the numbers of people claiming particular benefits in the short term, it is unlikely to result in long-term reductions in child poverty.

What does international evidence tell us about the effects of contracting out employment services?

- ◆ There is limited evidence to suggest that contracting out employment services creates efficiency gains or cost savings.
- ◆ Research evidence highlights substantial problems and significant implications associated with contracting out employment services to private and voluntary sector providers.
- ◆ In other countries, a market-driven approach to providing employment support has been found to be ineffective because it promotes the ‘creaming’ and ‘parking’ of jobseekers, particularly for those who have complex, multiple and long-term needs.
- ◆ ‘Work-first’ reward systems accentuate these problems.
- ◆ Effective support for the ‘hardest to help’ is expensive and complex. International research shows there is a lack of evidence that contracting out employment services to external agencies offers any better solution to this challenge.
- ◆ There is little evidence that the large-scale involvement of voluntary and private sector providers leads to innovation in service delivery.
- ◆ Instead, standardisation among different types of provider is commonplace in countries where employment services are contracted out to external agencies.
- ◆ A range of different provider organisations in a variety of countries consistently favour short-term ‘work-first’ strategies over the provision of more expensive (longer-term) education and training.
- ◆ This means it is unlikely that subcontracting employment services will be an effective strategy for raising skills.

Conclusions

- ◆ In the absence of clear evidence that contracting out employment services will deliver any of the intended benefits, careful consideration needs to be given to:
 - ◆ developing an appropriate longer-term strategy that is resistant to short-term economic changes and is capable of delivering the stated goals of: saving public money; eradicating child poverty; achieving an 80 per cent employment rate; raising skills; reducing the number of people claiming benefits; and assisting those facing multiple disadvantages;
 - ◆ the procedures and possible unwanted or perverse effects of outcome-based performance management;
 - ◆ alternative forms of performance measurement that recognise and reward:
 - ◇ 'distance travelled', since some jobseekers need in-depth support over a long period (perhaps several years) in order to move towards employment;
 - ◇ new ways of improving skills and training, since these will not automatically improve as a result of contracting out;
 - ◇ better support for people in vulnerable situations to prevent the loss of paid work;
 - ◇ better support for employers to promote the employment, retention and advancement chances of disadvantaged people;
 - ◆ benchmarking for quality;
 - ◆ the conflicts between market forces and instrumental efforts using compliance and control;
 - ◆ the necessary scope and cost of regulation;
 - ◆ the length of contracts, with longer contracts offering greater stability and better opportunities for longer-term strategies for assisting people facing multiple disadvantages.

Since the late 1990s, the UK government has taken several steps to reduce the numbers of people claiming social security benefits by encouraging, supporting or compelling people to find paid work. The current government is relying on this ‘work-first’ strategy, based on an aspiration of increasing the employment level to 80 per cent, as its main approach to eradicating child poverty. Recent proposals argue that savings can be made by contracting out employment services, currently provided mainly by Jobcentre Plus, to private and voluntary sector organisations.¹

An important part of the justification for these reforms is the experience of other countries. This report reviews the research evidence in order to draw lessons from the experiences of other countries that have taken similar steps to subcontract employment services to external organisations.

Over the last decade, several countries have changed the way they provide employment advice and job-matching services to benefit recipients. The UK is one of a few countries to have experimented with using non-government organisations to help people into work.² Only two countries – Australia and the Netherlands – have chosen to replace their public employment service with a system of competitive tendering.³ This is believed by some policy makers and analysts to offer greater efficiency and to promote higher quality services. This report seeks to establish what evidence there is to support the anticipated benefits of reforming employment services in this way.⁴

Why contract out employment services?

In December 2006, the Government commissioned investment banker David Freud to review its welfare-to-work programme and make recommendations to increase the employment rate (despite this already being exceptionally high by historical and international standards⁵) and reduce both labour market inactivity and in-work poverty.⁶ One of Freud's major proposals was to reduce the role of Jobcentre Plus and instead sub-contract employment services to private companies and voluntary sector organisations. Freud's ideas have been endorsed in the 2008 Green Paper, *No-one Written Off: reforming welfare to reward responsibility*.⁷ These proposals were controversial and highly significant since they potentially hold far-reaching consequences for UK citizens, the voluntary and private sectors and Jobcentre Plus. The reasons given for reforming the delivery of employment services in the UK are given below in Box 2.1.

Box 2.1:

The stated motivations for contracting out UK employment services

The recommendations of the Freud Report are presented as justifiable on the following grounds.

- ◆ To attain 'better cost-effectiveness'.
- ◆ To achieve the Government's aspiration of an 80 per cent employment rate.
- ◆ To help deliver reductions in child poverty.
- ◆ To improve 'poor performance on low skills'.
- ◆ To tackle multiple disadvantage and 'benefit dependency'.
- ◆ To reach the 'hardest to help'.
- ◆ An imperative to act because evidence has shown that work is generally good for health and wellbeing.
- ◆ To assist the most disadvantaged people find work through intensive and individualised support.
- ◆ To promote innovation by using private sector providers with a different skill set.

Like other countries⁸ that have taken similar steps (primarily Australia, the Netherlands and to a lesser extent Denmark and Germany), the key justifications are to increase efficiency and stimulate higher quality services.

Box 2.2:

Common expected benefits of contracting out employment services⁹

- ◆ Better efficiency:
 - ◆ simpler processes;
 - ◆ less bureaucracy;
 - ◆ reduced costs.
- ◆ Higher quality services:
 - ◆ more effective;
 - ◆ more flexible and responsive;
 - ◆ more innovative;
 - ◆ more personalised.

Policy makers in several countries share the expectation that market principles will intensify competition between different providers (see Box 2.2).¹⁰ It is anticipated that outcome-based targets will create incentives for providers to offer effective services.¹¹ An increased number of diverse providers will have flexibility to develop services and this is believed to promote innovation that will lead to more flexible, responsive and personalised services.¹²

Many of these potential advantages of contracting out employment services coincide with the perceived benefits of local co-operation between agencies (which is promoted actively by the European Union through the European Employment Strategy). The idea is that agencies operating in localities will have detailed knowledge and expertise of the labour market conditions, of particular user groups (for example, ill or disabled people, lone parents or minority ethnic groups) and connections with employers. Co-operation between local agencies is believed to offer the following benefits:

- ◆ 'local flexibility and responsiveness;
- ◆ sharing knowledge, expertise and resources;
- ◆ improving efficiency;
- ◆ developing joined-up services;
- ◆ capacity building;
- ◆ gaining legitimisation and 'buy-in'.¹³

Objective expectations?

The stated advantages of contracting out employment services are presented by governments in an objective scientific light, without balancing them with detailed analysis of the potential disadvantages or risks. However, the terms of the proposals are heavily influenced by the underlying assumption that market competition is the best way to ensure that services operate successfully and, in particular, that independent agencies operate more efficiently and effectively than public bureaucracies.¹⁴

It is important to recognise that this assumption is shaped by ideological values and political persuasion, rather than being founded on a sound evidence base. In addition to this, hidden motivations may exist for pursuing a contracting-out strategy. For example, in the Netherlands, one country-specific political reason for decentralising employment services could have been to reduce the influence of labour-market organisations.¹⁵ In more general terms, the development of contracting out employment services can be seen as a deliberate strategy to reinforce a ‘work-first’ approach to dealing with unemployment and inactivity.¹⁶

Connections between ‘work-first’ policies and contracting out services

Countries that have taken steps to develop the use of market forces in delivering employment services are often also those that have come to prioritise ‘work-first’ forms of welfare reform – albeit from different starting points. The ‘work-first’ approach was pioneered by countries like the United States and Australia, where the value of social security benefits tends to be low and the pressure on unemployed or inactive people to find work is high.¹⁷ It is important to understand that the combination of ‘work-first’ policies with heavy reliance on non-government agencies, particularly private companies, in providing employment services represents very significant changes to citizens’ rights and responsibilities.¹⁸

These UK ‘work-first’ policies are described as creating an ‘active’ benefit system to replace previous arrangements, which are described as ‘passive’. There are three problems with this way of understanding policy developments. Firstly, the ‘active’/‘passive’ labels are based on misunderstandings and misrepresentations of labour market situations and eligibility requirements for claiming benefits in the past.¹⁹ Secondly, the false dichotomy of ‘active’/‘passive’ benefit systems misrepresents the role of social security – benefit systems that protect people against poverty are not passive, but rather empowering and allow for better conditions for job seeking. Thirdly, the UK ‘work-first’ approach is only one form of ‘active labour market policy’ – many other types exist in other countries (almost all other European Union countries offer benefits that are better at alleviating poverty than those in the UK²⁰), with

variation in the type and extent of enabling support and punitive sanctions available to people looking for work.²¹

Whilst ‘work-first’ approaches can be effective for some jobseekers, there are several substantial problems with this as a strategy for providing social security for all unemployed and inactive groups in every part of a country.²² Firstly, ‘work-first’ policies assume that the labour market is competitive and flexible, and that it will be able to absorb everyone who wants a job.²³ In order for ‘work-first’ approaches to be successful, economic conditions need to be healthy enough to support a buoyant labour market and those looking for work need to be in a position to be able to accept work.²⁴ It is much more difficult for ‘work-first’ policies to be effective in adverse economic conditions²⁵ or if the people looking for work face substantial or multiple disadvantages.²⁶ There are also differences between regions. In the UK, for instance, the success of the New Deal programmes varies according to the employment opportunities in certain geographical areas.²⁷ Without real local job opportunities, benefit recipients may be required to seek work that does not exist, or to accept unsuitable or unsustainable jobs. This leads to what analysts have described as ‘churning’ or a ‘carousel effect’,²⁸ where people move back and forth between relatively short periods of low-quality employment and unemployment. In fact, research from Germany and the Netherlands shows that this approach can ‘result in a majority of recipients repeating previous experiences of below-poverty, temporary employment without career mobility’.²⁹

In the UK, concerns about keeping jobs are especially important because 70 per cent of jobseeker’s allowance claims are repeat claims³⁰ and one in ten lone parents leave work in any one year, which is more than double the rate of job exits for non-lone parents.³¹ These frequent movements in and out of work are costly, and improving job retention could be more effective in raising the employment level than changing delivery arrangements for employment services. In fact:

If the rate of job exits among lone parents was reduced to the level of non-lone parents, the 70 per cent employment target could be met without any increase in the number of lone parents entering work.³²

These concerns have led to calls for the UK government to develop a ‘work-first plus’³³ approach that invests in ‘human capital development’,³⁴ particularly to ensure that people who get jobs stay in work and see an improvement over time in their pay and conditions. This would involve developing better opportunities both before and after benefit recipients gain employment. There needs to be a recognition that some people who are out of work but want to work face multiple disadvantages and require in-depth and long-term support to cope with their complex life situations and to move towards the labour market, perhaps over several years. Employment services providers could usefully intervene to assist people in the journey towards work. For the most disadvantaged jobseekers, rewarding providers for progression towards job-readiness (rather than only using incentives for job placements) could play a very important role in a more sustainable long-term approach to enabling people to gain and keep paid jobs.

Opportunities need to be developed for support services that enable training, education, skills, health and personal development both *before* and *after* people move into work.³⁵ The argument is that genuine employability cannot be achieved simply through compulsory activities to seek work. There must also be:

A strengthening of holistic ‘coping and enabling’ services, and a commitment to credible, high-quality training that can deliver sustainable transitions to work and career progression.³⁶

‘Work-first’ as an anti-poverty measure?

One of the stated aims of contracting out UK employment services is to contribute to reducing child poverty. However, the conditions under which providers will attempt to place unemployed people, lone parents and ill and disabled people into work have already been set. The Government’s choice of welfare-to-work strategy, along with the prevailing labour market conditions, limits the extent to which compelling or encouraging benefit recipients to find work can be successful in reducing child poverty.

The current UK employment rate is exceptionally high in historical and international comparison. The employment rate has remained above 70 per cent during the period of welfare-to-work reforms (1997-2008), with the rate of 74.9 per cent in March 2008 being the highest level since comparable records began in 1971.³⁷ The UK has one of the highest employment rates in Europe (one of only five countries of the EU27 to maintain a rate of above 70 per cent) and the Organisation for Economic Co-operation and Development.³⁸ Similarly, healthy economic conditions have allowed for a decade of low unemployment (though this now looks as if it may be going into reverse). This means that, if simply having a high employment rate was in itself an effective route to tackling child poverty, the UK would already have achieved low child poverty – which it has not. The relationship between high employment, low unemployment and low child poverty is therefore much more complicated than the Freud Report and welfare reform Green Paper seem to assume.³⁹

Since 1999, ‘welfare to work’ has been used as the main strategy to achieve the Government’s objective of eradicating child poverty by 2020. At first, this approach did meet with some success, reducing the rates of child poverty rapidly to a level lower than at any time in the preceding 15 years.⁴⁰ However, by 2007 there were major concerns that this ‘work-first’ strategy was ‘wholly inadequate’⁴¹ to accomplish the goal, and international league tables have continued to put the spotlight on the UK’s very high levels of child poverty.⁴² In fact, despite the Government’s conviction that ‘work is the best route out of poverty’,⁴³ half of all children experiencing poverty live with a working parent⁴⁴ and, in about one in three cases, getting a job does not result in escaping from poverty.⁴⁵ Analysts and campaigners argue that if child poverty is to be eradicated, solutions beyond encouraging and requiring benefit recipients to get jobs will have to be invested in.⁴⁶

Crucially, while compelling people to look for and accept jobs regardless of their quality, suitability or sustainability can result in reducing the numbers of people claiming particular benefits in the short term,⁴⁷ it is unlikely to result in long-term reductions in child poverty. In order for insecure paid employment to reduce child poverty, it would have to be accompanied by protective measures such as: high universal child benefits that do not fluctuate when parents move in and out of work; along with above-poverty minimum wages; and/or additional tax allowances or in-work tax credits that allow working parents to afford necessities; and above-poverty benefit rates for times when a deregulated labour market does not offer parents secure employment.

Economic growth from 1997 to 2008 supported the UK government's welfare-to-work strategy through strong labour demand. At the time of writing, the UK economy is on the brink of recession, with a falling employment rate (down from 74.9 per cent to 74.7 per cent over the quarter to September 2008), rising unemployment (up by 81,000 people – 5.5 per cent – over the quarter to August 2008), a claimant count of 904,900, (a rise of 32,500 people in a single month) and falling job vacancies (613,200 vacancies, down 56,900 over the quarter).⁴⁸ The expanding labour market which supported recent employment policy has now stalled and so cannot be expected to deliver the demand on which welfare-to-work policies rely.

Recommendations from the Freud Report and the Government's welfare reform proposals are built on the assumption that market forces will deliver greater efficiency than the public sector, drawing lessons from examples of contracted-out employment services in other countries. The next chapter assesses research evidence to determine how valid these claims are.

What does international evidence tell us about the effects of contracting out employment services?

This section presents the results of a review of international research evidence on contracting out employment services in order to assess the extent to which the expected advantages (outlined in the previous section) have been realised. The experience of other countries provides valuable insights into the potential impact that contracting out employment advice and job-matching services might have in the UK.

The first observation is that, despite very different welfare traditions, there are key similarities between countries in the way that market forces have been introduced to reform employment services. One strong common feature is that providers are managed via outcome-based incentives. Another is that, although flexibility is offered for agencies to decide exactly how to deliver employment services, there tends to be a strong split between the roles of benefit administration (especially in making initial claims and referrals), which usually continues to be the reserve of government agencies, and the role of employment services (including job matching, advice and referral for further training), which is the new domain of private and voluntary sector providers.⁴⁹ These changes have also been implemented alongside a tightening of conditions for claiming social security benefits.

The second general point is that the heavy use of market forces in the field of employment services has been found to create 'several problems'.⁵⁰

The following sections consider the international evidence in relation to the following key questions.

- ◆ Does contracting out employment services increase efficiency?
- ◆ Does contracting out employment services create higher quality services?

Does contracting out employment services increase efficiency?

The development of quasi-markets is based on an assumption that increased competition will result in increased efficiency and higher quality. However, there is a trade-off between equality and efficiency.⁵¹ The current UK proposals appear to be driven strongly by the motivation to reduce public spending and this intention has also been of primary importance in driving reforms in Australia, the Netherlands and Denmark, particularly in relation to the engagement of private companies.⁵² The

use of market forces is also expected to reduce bureaucracy and simplify processes. These points are considered below.

Cost cutting

Recent research comparing the contracting out of employment services in Australia, the Netherlands and Denmark concluded that the anticipated 'efficiency gains and cost savings' were 'still largely unknown and undocumented'.⁵³

In Australia, the initial establishment of the Job Network is officially reported to have reduced public spending on labour market programmes by half.⁵⁴ The cost per placement reduced dramatically. This reduction in costs has been shown to be entirely due to increased efficiency, rather than increased effectiveness, since the new arrangements failed to achieve greater impacts.⁵⁵ This increased efficiency is inevitable given that contracting out has also gone hand-in-hand with a more 'work-first' approach. The prioritisation of cheaper, shorter interventions has led to a decrease in the cost per client. However, the longer-term barriers faced by many clients have not been addressed.

There is no evidence that the marketised system in the Netherlands is any more efficient than the arrangements it replaced and overall public spending on 'reintegration' has increased.⁵⁶ The average cost of placements has also increased.

Transaction costs

Introducing a contracting model is only likely to be successful if the gains in efficiency are worth more than the increased transaction costs.⁵⁷ These include writing tenders, negotiating and securing contracts, and monitoring the quality of the services provided, including their outcomes.⁵⁸ However, research findings from Australia, the Netherlands and Denmark show that 'transaction costs are an inescapable bi-product of contracting out'.⁵⁹ In both Australia and the Netherlands (the only countries to have entirely marketised their employment services), there were high transaction costs for purchasers and providers.⁶⁰ This presents a major challenge to the process of tendering because minimum transaction costs are a requirement of a functioning quasi-market.⁶¹

Although transaction costs may be expected to decline over time as the quasi-market becomes more established, the German experience of contracting out has resulted in high transaction costs even in the second and third rounds of tendering.⁶²

The process of tendering is very cost heavy in Australia and the Netherlands, which reflects an essential flaw in the tendering model – subcontracting is presented as a way for governments to save money and achieve higher quality services, but the tendering process itself creates massive bureaucratic efforts and incurs high transaction costs.⁶³ Cost savings can only be achieved if the involvement of external agencies (private and voluntary organisations) outweighs the transaction costs resulting from the tendering process.⁶⁴

Transaction costs and length of contracts

Transaction costs are likely to be lower if contracts are awarded for longer time periods. Longer contracts may also be of benefit in facilitating longer-term strategies for jobseekers (perhaps including education and training rather than immediate job entry). This could benefit jobseekers who face multiple disadvantages. However, the disadvantage of longer contracts is that it makes it difficult for the market to be accessible to new providers and ‘the Dutch case proves above all that seeking a balance between effectiveness and efficiency is far from easy’.⁶⁵

Box 3.1:

Pricing of services

When employment services are contracted out, decisions have to be made about what price to charge for services and this is a key concern when providers are awarded contracts.

Price is the most significant incentive for cost-effective [provider] behaviour, but **the price of job brokerage and reintegration services is not clearly definable**. After all, it is impossible to predict, for every individual person, how long it will take and which services will be used in order for him or her to find work, in spite of all the tools and data technology. A private provider will take this risk into account in the price calculation, while the government will attempt to minimise creaming off.⁶⁶

Free pricing (rather than fixed prices being set in advance by governments) is a necessary condition for the operation of pure market forces. However, free pricing has to be mediated by governments to ensure that good quality services are possible and so that providers are not driven out of the market. This means having enough providers who are active in the market, as well as enough purchasers. In Australia (as proposed in the UK), the market has a strong central hierarchy, controlled by the state. This means there is only one commissioning body to select service providers. The Netherlands, by contrast, has several purchasers because of the decentralised nature of the institutions. This means that it is possible for employment services in the Netherlands to operate according to market mechanisms. On the other hand, in Australia, the government continues to inhibit the operation of market values with a high level of control and regulation. In Australia, minimum prices and fixed prices are used, while in the Netherlands there is free competition according to price. One advantage of fixed pricing is that it can prevent a downward price spiral, which, if left unchecked, is likely to reduce possibilities for innovation and specialist services, particularly in-depth or long-term interventions designed to move the most disadvantaged jobseekers towards the labour market (as opposed to the quick fix of placing job-ready people into work).

Ongoing costs

It may be tempting to view the creation of a new market structure as a one-off cost, but international evidence demonstrates the importance of considering the ongoing efforts (and costs) of maintaining and regulating this type of market.⁶⁷ The Australian experience shows that transaction costs may be reduced by establishing more stable contractual relationships with providers. Cross-national comparison indicates that where 'transaction costs seem to be higher, the freer and more transparent the market and conditions for competition are'.⁶⁸ However, intervening to limit competitive tendering challenges the original reasoning for introducing quasi-markets.⁶⁹ In addition to this, in Australia the cost of public regulation is particularly high.⁷⁰ Australia, the Netherlands and Denmark have all seen an increase in public regulation over time.⁷¹

Investment of funds from external providers

In the UK proposals, part of the rationale for involving external agencies in the provision of employment services is that public money will be saved because costs will be absorbed by providers in private industry and the voluntary sector. However, evidence from the Netherlands shows that provider organisations were unpleasantly surprised by the resources required to tender for employment service contracts⁷² and this investment is wasted when bids are unsuccessful. In the Netherlands, bureaucratic complexity and the time and money spent on administration were considerably higher than expected.⁷³

Direct delivery of services by non-governmental agencies relies on the goodwill of potential providers and it is difficult to imagine a situation in which either private companies or voluntary organisations will have the spare resources to prioritise lengthy administrative tendering activities without compromising or subverting other parts of their organisational goals. Private providers operating in the labour market arena are faced with business risks over which they have no control – that is, if the labour market changes they may have fewer clients and/or more disadvantaged clients. If the labour market contracts, as it is doing in late 2008, they may find it more difficult to place people. These inherent labour market risks are likely to be 'costed' into any offer to deliver services from the private sector.⁷⁴ Private companies will have to be reassured that their endeavours have a good chance of being profitable.

The Freud model implied up-front borrowing from banks to finance the roll out of services, which would then be paid for by the state in outcome payments over time:

The prime contractor route will enable ... the possibility of leveraging very substantial funding from the private sector. It would also open up financial resources from the banking community to allow the extremely large investments implied here.⁷⁵

The credit crunch and consequent crisis in liquidity makes a financing model dependent on the banks look outdated and undeliverable.

However, there is a concern that the transference of costs to the voluntary sector may be unethical and could have a major impact on the ability of the sector to fulfil obligations to vulnerable citizens (especially if the rules and rewards of the game change part way through), particularly in relation to advocacy and its independent stance from which to analyse and critique government policy developments. The growth of government contracting risks undermining the unique strengths of the voluntary sector – its anonymity and ability to think independently, precisely the advantage that government seeks to harness.

Bureaucracy

In fact, rather than moving away from bureaucracy, there is evidence that market-based employment services generate substantial new forms of bureaucracy – ie, instead of de-bureaucratisation, widespread ‘re-bureaucratisation’.⁷⁶ This is the opposite of the intended effect.⁷⁷ The expansion of new types of bureaucracy is largely due to the need for regulation. Governments must establish new systems for the monitoring, evaluation and regulation of new markets. This is very evident in Australia, but less marked in the Netherlands. Rather than simplifying processes, the creation of fragmented services without clear lines of accountability may be experienced by jobseekers as involving more complex, rather than simpler processes.

Does contracting out employment services create higher quality services?

One of the key justifications for contracting out employment services is that it will lead to higher quality services. The findings from international research outlined in this section allow reflection on the likelihood that this might happen in the UK. Several difficulties are identified, centring around the core tension between establishing the conditions for a well-functioning market and promoting high quality services that benefit even the most disadvantaged jobseekers. A secondary tension is that ensuring high quality services requires the establishment of minimum standards and investment in regulation, which can conflict with the other primary goal of saving money.⁷⁸ The experiences of other countries show that these tensions are very real and not easily resolved. The following sections explore the potential for contracted-out employment services to create higher quality services, which are more effective, flexible, responsive, innovative and personalised.

Effectiveness

A key justification for contracting out employment services in the UK, as in certain other countries, is that it will increase efficiency. When a quasi-market is introduced, a contractual relationship is established between the commissioning body and the service provider, emphasising

performance measurement and targets for results.⁷⁹ However, in Denmark there have been major problems with the ineffective outcome reward systems that prioritise ‘work-first’ gains. In an expanding labour market, targets were easily met and exceeded by private providers, meaning that activation budgets were spent, having been emptied to ‘reward’ providers. This demonstrates the risks of making mistakes in the design of contracts, which can have a profound negative impact on services for jobseekers.⁸⁰

Box 3.2:

Measuring success and rewarding providers

The success of employment service providers is commonly measured using outcome-based indicators. These performance incentives influence the way in which providers design services because they reward only very specific outcomes. The choice of how to measure success and the related issue of how to reward providers is therefore central to the way in which the ‘quasi-market’ will operate. It is essential that policy makers give careful consideration to the likely consequences and potential perverse effects of their methods of measuring and rewarding success. Here, there are important lessons from international experience.

There is a need for measurement and reward systems that acknowledge clients’ starting points, reward distance travelled and reward sustainability. These are not the types of systems currently being proposed in the UK, which look set to make the mistake of rewarding quick wins (ie, short-term job placements), with the disadvantage of offering little for the ‘hardest to help’ and the unwanted side effect of encouraging ‘creaming’ and ‘parking’.

Flexibility

Contracted-out services are often intended to provide more flexible, tailor-made, responsive services, which some policy makers and commentators see as preferable to traditional centralised bureaucratic ways of delivering employment services. However, there is evidence that the process of tendering can promote standardisation, particularly in the early stages of assessing user’s needs.⁸¹ Standardisation is difficult to avoid in competitive employment service markets. In order to achieve competitive advantage, providers will inevitably seek opportunities for rationalisation and economies of scale, by developing ‘off-the-peg’ content rather than tailored responses.⁸²

One specific issue is that the initial categorisation of jobseekers’ needs tends to be organised around a judgement of how close they are to the labour market (ie, how easy they will be to place into employment). This process is necessary in systems where contractors are financially rewarded according to how they assist those at different stages; it is designed to encourage private and voluntary providers to assist groups who are ‘hard to help’ as well as those closer to the labour market.

There is a strong motivation for processes for categorising jobseekers to be transparent and objective in marketised systems, to ensure that payments for successful outcomes are fair in order to prevent exploitation or competitive advantage. However, ensuring objectivity and transparency creates a preference for assessing jobseekers' needs (which can be complex, multi-faceted and potentially not always well understood by the user themselves) using standardised bureaucratic tools – for example, fixed questionnaires (in the Netherlands) or automated web-based questionnaires (in Australia). The style of such questionnaires can miss crucial information and limit scope for understanding barriers to employment. It can reinforce the idea of treating jobseekers according to broad categories, rather than as individuals, thus limiting scope for flexibility and responsiveness.

Process and outcomes

Evidence about the effectiveness of quasi-markets in employment services has been limited (particularly in the case of the Netherlands where only limited information is available), difficult to interpret (because of external effects⁸³) and disappointing (especially in the Australian case⁸⁴).

How effectiveness is measured is of critical importance. The use of market forces increases the likelihood that effectiveness will be measured according to outcomes, rather than by considering inputs or processes. There are big questions about the capacity for outcome-based performance measures to combat cherry-picking/creaming and parking.⁸⁵ Providers in contracted-out employment services can be evaluated in two different ways: according to market criteria or according to results criteria.⁸⁶ Providers in the marketised parts of the German system are motivated by financial incentives.⁸⁷ However, this rewards concentrating assistance on those who are already closest to the labour market.

It has been long established that the act of matching jobseekers to job vacancies involves processes of sifting, screening and selection, ultimately to the employer's (rather than the jobseeker's) requirements and preferences.⁸⁸ The inherent tension in job matching (regardless of which type of organisation does it) is that advisers have to mediate between the potentially conflicting needs and interests of employers and jobseekers (see Box 3.3).

Box 3.3:

The in-built tension of job matching

The practice of matching jobseekers to job vacancies involves fundamental tensions.

The problem was that if a matching service is provided on employers' terms then the best qualified, most skilled users with the longest and most recent experience should be referred to employers, therefore disadvantaging those users who most need assistance from the service that is meant to be specifically designed to help them. On the other hand, if a job-matching service places users who are least desirable to employers, the risk is that employers will go elsewhere to fill their vacancies.⁸⁹

Thus, regardless of whether they are public, private or voluntary agencies, advisers are expected to operate in the interests of jobseekers but cannot risk acting against the interests of employers. This presents a policy-making dilemma.

There is evidence from several countries that employers discriminate against women and non-white people, and studies from the UK and the Netherlands highlight employer discrimination against disabled people.⁹⁰ The labour market is competitive (ie, employers want to employ the best people), meaning that those who cannot compete on an equal footing are disadvantaged. Jobseekers who have severe, multiple or unpredictable barriers to getting and keeping a job cannot control the conditions of the labour market. Employers will continue to exercise preferences regardless of how much responsibility individuals accept for looking for work and regardless of the efforts of providers. This means that labour market inequalities cannot be addressed by contracting out employment services. Persistent labour market inequalities require supply-side employer interventions as well.

Whilst reliance on civil servants to deliver employment services certainly does not prevent this from happening, it is important to know whether or not the introduction of market forces increases the likelihood of selective or discriminatory practices in job placement. In Australia and the Netherlands, there is evidence that providers extensively 'cream' off those jobseekers who are easiest to help and most likely to have positive results (for example, the most highly skilled/qualified and job-ready) to prioritise their labour market placement over assisting other 'harder-to-help' jobseekers.⁹¹ This is a major consideration both for social justice concerns of equality and for market competition because the avoidance of creaming is essential to the effective operation of quasi-markets.⁹² Furthermore, the favouring of some jobseekers over others may simply result in labour market substitution effects (ie, when one group of disadvantaged jobseekers gains work, another group of disadvantaged jobseekers finds it even harder to get a job) rather than any substantial increase in the overall employment rate (which in the UK

is a stated policy aim). As illustrated above, the overall employment rate could be raised by a more preventative policy approach that enables people to keep their existing jobs, rather than focussing mainly on pressurising people who have already lost jobs to find new ones.⁹³

There is a balance to be met between preventing undesirable outcomes (for example, creaming,⁹⁴ parking and substitution) without over-regulation which is costly and has potential negative effects on market mechanisms.

Evidence of creaming has also been found in the parts of the German employment services that have been opened up to market forces, *despite the fact that the referral process was specifically designed to avoid creaming*. The easiest to place jobseekers were still more likely to be placed into work because ‘employment offices were subject to extreme pressure to produce favourable results’ and because providers could not be sanctioned for this strategy.⁹⁵

In addition to this, agencies in both Australia and the Netherlands have been found to engage in widespread ‘parking’ of clients – that is, withholding resources from jobseekers who have low chances of gaining employment.⁹⁶ In Australia, jobseekers are selected for support according to risk and there is evidence that four out of five users are ‘parked’.⁹⁷ The Australian government now acknowledges that the star rating incentive structure (whereby the government rates providers, with between one and five stars, on their job placement and short-term, 13 or 26 weeks, retention performance) has the effect of encouraging providers to concentrate their efforts on activities that are most likely to result in financial rewards, rather than ensuring their action is in the jobseeker’s best interest.⁹⁸ These practices are related to the incentive management systems (including performance-related pay), which transfer financial risks directly to providers.⁹⁹ This can lead to increased intervention from the state to regulate against creaming and parking.¹⁰⁰ Similarly, in private employment services in Germany ‘many jobseekers are parked’.¹⁰¹

There was some early evidence from Australia that the placement chances of unemployed people were significantly improved by the introduction of the Job Network.¹⁰² However, the Australian government has since acknowledged that this initial report was based on a flawed methodology and has recognised that the biggest impacts are created by the ‘compliance effect’¹⁰³ – ie, the welfare-to-work system required people to look for work, so they did. It is very difficult, therefore, to identify any clear effectiveness gain as a result of the introduction of contracting out because the market mechanism cannot be analysed in isolation from the concurrent policy developments that increased compulsion for jobseekers.¹⁰⁴

In terms of outcomes, 60 per cent of Australian jobseekers who found work held a temporary contract.¹⁰⁵ Those who were still employed after 12 months of leaving Intensive Assistance (57 per cent) and Job Search Training (63 per cent) had about a 50:50 chance of staying with the same employer.¹⁰⁶ This indicates a high level of labour market insecurity. In addition to this, half of the Intensive Assistance participants had been through the programme before. There is ‘a considerable carousel effect’.¹⁰⁷

The effectiveness of quasi-markets in employment services is influenced by tensions in the aims of the exercise since stimulating competition may not always be compatible with the attainment of policy goals.¹⁰⁸ Indeed, this raises a crucial tension between the goal of efficiency and the goal of equality¹⁰⁹ – which in the UK is a stated goal of the welfare reform Green Paper.¹¹⁰ The introduction of market forces and the potential perverse effects of performance incentives have been found to increase complexity and heighten the risks for all parties involved.¹¹¹

Innovation

The creation of more innovative services is one of the strongest impartial arguments for developing the contracting out of employment services. However, international research shows inherent difficulties relating to the application of market forces in employment services, which actually inhibit innovation. In Australia and the Netherlands, ‘in spite of the freedom to choose their own methods, providers hardly ever come up with innovative solutions’.¹¹² This is one of the most disappointing findings of the international experience of contracting out employment services. However, it is perhaps to be expected, since providers are primarily concerned with their organisational survival, which impedes risk-taking in service design. The performance management of services, focussed on outcome-based payments as it is in both of these countries, as well as strong regulation (particularly in Australia) serve to further impede innovation because penalties and rewards for providers prioritise quick fixes.¹¹³ The whole system of competitive tendering relies on minimising costs, rather than maximising effects.¹¹⁴

A broad range of providers in countries with quite different welfare traditions converge in their preferred methods: to motivate and encourage people to look for work and to prepare them with job-readiness training activities.¹¹⁵ This indicates that providers have a clear preference for orientating services towards ‘work-first’ priorities. More expensive, longer-term forms of intervention, like formal education and training (which might raise education and skill levels, but have less certain or immediate employment outcomes) only seem to be used to a very limited extent by subcontracted providers.¹¹⁶ It is difficult to discern the extent to which this is a result of the tendering model rather than a political change towards ‘work-first’ priorities.¹¹⁷ What can be observed, however, are the effects of the widespread use of outcome-based performance management procedures. This approach, based on financial incentives, assumes that policy goals are adequately translated into valid and reliable performance indicators¹¹⁸ and takes much less account of inputs and processes.¹¹⁹

Potential routes for innovation – for example, the involvement of recruitment agencies in the new employment services market, have not been realised in Australia, the Netherlands or Denmark.¹²⁰ Generally, employers have had little involvement in welfare-to-work initiatives, meaning that the pressure placed on individuals to seek work is not matched by the creation of new or adapted employment opportunities. This separation of employers from welfare-to-work developments

therefore risks compounding existing labour market inequalities and skills mismatches, which may ultimately undermine the effectiveness of the policy in achieving its stated aims.

One very real risk is that the UK reforms may repeat these mistakes by rewarding quick fixes that favour the most job-ready jobseekers and the most instrumental of providers.¹²¹ There is evidence of successful innovation from the UK pilots of Working Neighbourhoods and Pathways to Work. There is a concern that more effective, intensive or long-term approaches to enabling people to find and retain sustainable work may be ruled out by rigid centralised contracts.¹²²

In the UK, the Netherlands and Denmark:

There remain questions about the capacity of contractualism to deliver the innovation and responsiveness sought from multi-agency approaches – the unequal power between purchaser and provider limits the potential for sharing ideas; the short-term nature of some contracts (as in the Netherlands) can undermine attempts to build consistent, long-term interventions; the rigidity of certain forms of contracting (as in the UK) can actively discourage partnership-working; and the process of marketisation itself can prevent specialisation, as providers seek efficiencies in the battle for limited funding.¹²³

There are concerns that the UK ‘work-first’ approach already pays insufficient attention to the long-term interventions (such as education or training) that could best help disadvantaged people.

Compulsory work-focused activity must be balanced by both a strengthening of holistic ‘coping and enabling’ services, and a commitment to credible, high-quality training that can deliver sustainable transitions to work and career progression.¹²⁴

In fact, in the case of employment zones (EZs), the UK government explicitly stated that: ‘EZ is a ‘work-first’ programme and there will be no financial reward for training or other ‘developmental’ outcomes’.¹²⁵ In an official evaluation of the employment zones, it was noted that:

All-in-all, there were probably few opportunities for those in work to progress towards better jobs within the organisations where they obtained their first jobs... Equally significant in this respect is the evidence that when people lost their job, they tended to revert to being unemployed, rather than having accumulated additional ‘employability’ which enabled them to make a more rapid return to work the next time the need arose.¹²⁶

Market domination

Policy makers who promote the use of market forces to organise employment services seem to believe that the involvement of a range of different providers will promote innovation. However, international evidence shows that a small number of large contractors benefit disproportionately from tendering mechanisms, unless governments make explicit arrangements to ensure that new and small organisations can enter the market, as has been done in the Netherlands.¹²⁷ In

Australia and the Netherlands, the introduction of contracting out led to an initial significant increase in the number of providers.¹²⁸ In Australia, where the market is furthest developed, each tendering stage has seen decreasing numbers of providers appointed to deliver services.¹²⁹ Similar trends have also been observed in the Netherlands and Denmark.¹³⁰ This means it is conceivable that over time the unstable market in employment services may be dominated by a relatively small number of organisations. The Dutch experience is interesting in this regard because the market came to be dominated by a relatively small number of providers.¹³¹ However, the recent introduction of individual jobseeker budgets caused a sudden rapid increase in the number of providers.¹³²

There is evidence of large multinational providers being successful in gaining government contracts in several different countries. This is a situation that should be monitored closely. This tendency towards decreasing numbers of providers (and hence domination by large, possibly multinational, providers) means that market forces are not operating properly. It is certainly possible that large multinational private providers will profit disproportionately from new contracting arrangements in the UK. This could have two foreseeable unintended effects that could be detrimental to jobseekers and the UK economy. Firstly, job placement practices may be standardised at a global level – ie, the opposite of harnessing local knowledge to develop innovative methods. Secondly, taxpayers' money may be diverted from supporting vulnerable UK citizens (who use their benefit income to support local economies) to wealthy overseas shareholders. Since the benefit savings of getting people into work will be reinvested in providers, this could mean a cash flow out of the UK to overseas investors, creating a reverse Robin Hood effect. This effect might not matter if there was good evidence that a different delivery system would produce much better results, but, as this review suggests, there is little evidence that it will.

Lack of choice

Market principles assume consumer choice (ie, service providers compete to attract the consumer and the most successful enterprise will be the one that offers the best service). However, when employment services are contracted out, the purchaser is not the end user, but either the government or a special purchasing organisation. A major challenge to the market mechanism is the fact that service users do not choose the service, rather they are subjects of mandatory (even punitive) systems that condition the responses of benefit recipients by applying incentives and sanctions.¹³³ Even in Australia, where jobseekers can, in principle, opt for different providers, they are automatically assigned to providers in most cases and real choice is only possible in 20-30 per cent of cases. For those who can choose, the overriding factor is proximity of location.¹³⁴ There also appear to be doubts that benefit recipients would have access to sufficient information to allow them to make rational choices, even if a variety of services existed within a proximity to which they could realistically travel.

The combination of tendering (with its ‘work-first’ outcome-based incentives for providers) with welfare-to-work policies (that encourage or force people into the labour market) seems to create a situation that undermines important aspects of market competition.¹³⁵ The principles of control and incentive, in both the tendering process and welfare-to-work policies, heavily promote compliance (by providers and jobseekers), punish non-compliance and thus inhibit choice. The potential effects of this should not be underestimated. Ultimately, denying service users and providers real choice may prevent the development of market competition, which could potentially otherwise lead to innovation and high quality services. In particular:

The decentralised tendering procedure has the advantage of taking into account the local labour market situation and the needs of the jobseekers. However, the unemployed cannot choose between different providers and therefore cannot influence the price and quality of the service.¹³⁶

Quality

It may be that the increased focus on propelling people into work is relatively incompatible with protecting the most vulnerable citizens.¹³⁷ In the Netherlands, there have been criticisms that services have been inadequate for jobseekers who are further from the labour market – for example, those with multiple or complex needs or those who have not worked for a long time.¹³⁸ This is thought to be related to the system of tendering because it can be difficult, or sometimes impossible, to overcome the very real barriers that people face to entering or retaining employment. Attempting to assist the ‘hardest to help’ has been found to be expensive, time-consuming and complicated. This prohibits action from the point of view of subcontracted providers because it would require them to take risks which they may view as unprofitable and requires investment that is unlikely to be cost-effective. In Australia, the Netherlands and Denmark, quasi-markets have been found to have difficulty in meeting the needs of the most disadvantaged jobseekers.¹³⁹

A related issue is that employment agencies do not necessarily have the scope to address several of the fundamental issues that face some people who are not in employment (for example, chronic, acute or intermittent health difficulties; housing problems or homelessness; benefit entitlement; substantial caring responsibilities; childcare needs; addictions; protection from violence; transport difficulties). Neither can independent employment agencies exert substantial influence over the structure or operation of local labour markets, meaning that jobseekers must be adapted to fit the labour market, rather than labour markets adapting to the needs of jobseekers (in terms of, for instance, the type of work available, working hours, conditions and pay, and the needs and preferences of employers).

Market forces and distrust

There is evidence to suggest that the introduction of market relations in employment services breeds distrust between public agencies and private or voluntary subcontractors because the interests of the different agencies are brought into direct competition.¹⁴⁰

The public authorities, according to the providers, distrust providers whom they suspect, by definition, of thinking of profit maximisation only (and short-changing the authorities); and the providers feel that they are being increasingly hemmed in by regulation of every minute detail, under constant surveillance and robbed of the autonomy to organise delivery of services.¹⁴¹

This may be related to certain types of market design and regulation, but represents a risk to governments, like the UK, who are considering developing such markets, since the development of subcontracting may result in the loss of existing good working relationships (based on trust and effective communication) with the voluntary and private sectors. It could be surmised that good trust and communication between sectors is essential for the development of effective and high quality services for users – it would seem that market forces risk losing this possibility.

Contracting out may limit co-operation (particularly if institutions and policy structures are rigid) and when the subcontracting of specialist provision (for example, on behalf of the most disadvantaged jobseekers) is undermined by high transaction costs and greater emphasis on cutting costs than promoting high quality.¹⁴² Co-operation between different types of agencies at a local level has many potential benefits, which are implicit in the justifications given by governments for creating quasi-markets (see Section Two). However, evidence from the Netherlands and Denmark shows that partnership-working can be undermined by power differentials and damaged by the development of competitive forces.¹⁴³ Weakening the role of centralised public employment services in the Netherlands and Denmark also raises concerns about the ability of local partnerships to provide ‘a consistent level of basic services’.¹⁴⁴ A particular concern is that expertise of dealing with a range of jobseekers, including those who are most disadvantaged, can be lost when existing public employment services are dismantled.¹⁴⁵

The motivation of the purchasing agency (in the UK, the Department for Work and Pensions) and the service provider is an important aspect of the operation of contracted-out employment services.

The purchasing agency must respond to the wants and needs of the unemployed and increase the choices open for their clients. The service providers should pursue economic objectives.¹⁴⁶

Similarly, in order for market forces to operate, information must be available to both the purchaser (the Department for Work and Pensions) and those tendering for contracts. However, market principles inhibit the free sharing of information because of the need for competitive advantages. In the case of matching jobseekers to vacancies, this may have perverse effects (as indeed has been shown to have been the case in public employment services where competition exists between

different offices¹⁴⁷). An important concern is that each provider will keep separate private lists of job vacancies with local employers, for which they submit 'their' jobseekers. This could mean that each jobseeker will only have limited access to the entire pool of vacancies in the local area. The provider that jobseekers are assigned to or 'choose' is likely to have a strong impact on the vacancies for which they will be encouraged to apply. The goal of getting people into work may then be adapted to getting certain jobseekers into particular vacancies. Limiting jobseekers' access to information about vacancies would seem to be a perverse method for assisting them into employment.

Customer satisfaction

Although objective measures of efficiency and effectiveness show little clear benefit of contracting out employment services, there is some evidence that unemployed people are relatively satisfied with services provided by non-government agencies.¹⁴⁸ It seems that private providers in particular may have access to resources that allow the creation of a comfortable environment for jobseekers. Along with this, private companies seem to use methods of dealing with jobseekers that make people feel respected and confident that the provider is making serious efforts to assist in finding a suitable job.¹⁴⁹ It is not clear to what extent these factors are based on real differences in the abilities of non-government agencies to enable people to find work. Customer satisfaction may reflect the separation of the roles of benefit policing from job matching (which are often dealt with simultaneously by public providers such as Jobcentre Plus) and an unwillingness of providers to initiate sanctions. It has been said of the Australian providers that they can bark but not bite.

The UK government currently aims to eradicate child poverty by 2020 and increase the employment level to 80 per cent. This ‘work-first’ approach intends to combine inadequate benefit levels with high levels of control over the behaviour of benefit recipients and service providers. These steps are presented as being justified, at least in part, because of the experience of other countries.

This report has provided a detailed examination of research evidence on the experience of other countries. Remarkably little evidence has been found to justify proposals to contract out UK employment services to private and voluntary sector agencies.

The use of quasi-markets in employment services is not necessarily worse than delivery by the public sector. However, there are few clear-cut indications that it is better,¹⁵⁰ particularly because analysing the success of market mechanisms cannot be studied in isolation from the effects of other substantial policy changes, particularly the increases in compulsion for benefit recipients to find work, which were implemented at the same time. It is very difficult to assess whether or not quasi-markets in employment services offer higher quality services or better value for money because of a lack of ‘valid and systematic knowledge on the outcomes and effects the system is able to deliver’.¹⁵¹ Similarly, caution needs to be exercised when identifying the causes of increases in employment rates or decreases in the numbers claiming benefits because these are sensitive to wider economic trends and local labour market conditions.

It is also difficult to assess objectively the extent to which the difficulties associated with contracting out employment services are particular to their specific country context (particularly since labour markets are changing). This is an important consideration because it determines the possibilities for problems to be rectified by modifying the design of the tendering model. The international literature reflects ongoing debate about this issue and several prominent experts view the tendering process as being inherently fraught with dilemmas that are difficult to resolve.¹⁵² Although many individual private and voluntary sector agencies undoubtedly provide a good service to jobseekers, the creation of a market in this field is problematic, particularly where provider behaviour is strongly controlled by economic incentives. An effective system of job matching needs to involve open dialogue between different interest groups (free from the distrust and secrecy created by the desire for competitive market advantage), including employers, specialist providers, government and independent organisations that advocate on behalf of disadvantaged groups.

In the absence of clear evidence on the benefits of contracting out employment services, careful consideration needs to be given to:

- ◆ the procedures and possible unwanted or perverse effects of performance management;

- ◆ benchmarking for quality;
- ◆ the conflicts between market forces and instrumental efforts using compliance and control;
- ◆ the necessary scope and cost of regulation.

Recommendations

The UK government should rethink its strategy for providing employment services in light of the doubts presented by international evidence – ie:

- ◆ the ineffectiveness of ‘work-first’ strategies in adverse economic conditions;
- ◆ the lack of evidence that cost savings will be made;
- ◆ the lack of evidence that skills levels will be raised;
- ◆ evidence that contracting out creates problems and has significant impacts on existing public providers, and new voluntary sector and private providers;
- ◆ evidence that the most disadvantaged jobseekers are likely to benefit least;
- ◆ evidence that innovation is not likely to be promoted;
- ◆ evidence that ‘work-first’ policies that rely on the use of short-term, output-based incentives shape the behaviour of providers to prioritise ‘quick fixes’.

There is currently an opportunity for government to invest in sustainable long-term approaches which may be more effective (particularly for jobseekers facing multiple disadvantages). This could result in better retention in jobs that are suitable and sustainable.

If UK employment services are to be contracted out on a large-scale:

- ◆ a longer-term approach (which is resistant to short-term economic changes) needs to be adopted to achieve the stated goals of: saving public money; reducing child poverty; achieving an 80 per cent employment rate; raising skills; reducing the number of people claiming benefits; and assisting those with multiple disadvantages;
- ◆ benefit rates for adults need to be raised to levels that prevent poverty and provide people with sufficient income to keep them close to the labour market;
- ◆ greater stability may be likely if contracts are long term rather than short term (although this may lead to market domination by a small number of large providers);
- ◆ higher quality is more likely to be achieved if the criteria for tendering is based on quality rather than price. Fixed pricing that is carefully designed and adequate to allow more in-depth and longer-term

strategies for the ‘hardest to help’ may offer better conditions for innovation than free pricing;

- ◆ incentive targets for providers should not be based only on the ‘output’ of people gaining employment;
- ◆ incentives should be very carefully constructed in order to recognise that:
 - ◆ some disadvantaged people are not immediately ready to be placed into employment and their return to work may need to be supported over a long period of several years. So, ‘distance travelled’¹⁵³ should be rewarded instead of final job outcomes;
 - ◆ new ways need to be found for improving skills and training – this will not happen automatically by contracting out employment services;
 - ◆ better support needs to be provided for people in vulnerable situations before losing employment and after entering employment, in order for them to retain work;
 - ◆ the large-scale contracting-out of employment services is not the only delivery model available. The successful partnership arrangements for the delivery of Pathways to Work provide an alternative model for best practice;
 - ◆ better support needs to be provided for employers (and if necessary, incentives and controls) in order to ensure that employers retain vulnerable workers and that people progress above entry level into better pay and conditions in the long term;
- ◆ opportunities for dialogue and partnership-working should be built into the system.

Table 4.1:

Stated aims of introducing quasi-markets to employment services with findings from international research

Stated aim	Findings from international research	Evidence to endorse policy proposal?
Reduce child poverty	There is no evidence that contracting out employment services reduces child poverty. Similarly, simply having a high national employment rate does not eradicate child poverty. The UK already has an exceptionally high employment rate and an exceptionally high child poverty rate. Research shows that whilst welfare-to-work strategies can reduce the number of people claiming particular social security benefits, they will not necessarily result in reductions in poverty.	No
Better cost-effectiveness	There is little evidence that the development of quasi-markets will result in savings in public spending, especially because transaction costs are high.	No
Increased employment rate (to 80 per cent)	There is no research that proves a link between the type of organisation providing employment services and the overall employment rate of the country. Without large-scale contracting out of employment services, the UK already has one of the highest employment rates of the EU27 and OECD. It is unknown whether or not an employment rate of 80 per cent is a realistic aspiration.	No
Improve low skills	Different types of provider organisations in a variety of countries favour short-term 'work-first' strategies over the development of more expensive longer-term training or education solutions. There is little evidence to suggest that quasi-markets in employment services will improve low skills.	No
Tackle multiple disadvantage	Widespread creaming and extensive parking, combined with preferences for short-term job placement rather than long-term training (promoted by 'work first' output-based incentives for providers) mean that market forces do not serve people with multiple disadvantages well.	No
Tackle 'benefit dependency'	This is a politically-driven phrase, which is often used to imply that claimants should be 'pushed' off benefits. An alternative, more constructive focus is to support people by providing adequate incomes for those in and out of work, in order to prevent and alleviate poverty. Adequate benefit rates, combined with effective services, would offer better opportunities to enable people to seek and retain paid employment. There is no evidence to suggest that only changing the type of provider will reduce the numbers of people claiming benefit. Reducing the numbers of people claiming particular social security benefits has been done in several countries by tightening eligibility conditions and increasing requirements for people to look for and accept paid employment. In international comparison, the UK's actively seeking work conditions for unemployed people are already relatively strict and workers are offered relatively little protection to stay in the type of work they previously held.	No
Ensure health and wellbeing through work	No evidence was found to suggest contracting out employment services will ensure better health or wellbeing. The beneficial effects of paid employment 'depend on the nature and quality of work' and the 'social context...particularly social gradients in health and regional deprivation'. ¹⁵⁴	No
Provide intensive and individualised support	International evidence suggests that contracting out leads to standardisation as providers seek competitive advantage through economies of scale. The situation in the Netherlands should be monitored closely in this regard.	No
Promote innovation	Cross-national research shows that market forces create conditions that promote compliance and inhibit risk-taking. This means that output-based incentives are very unlikely to promote innovation.	No

Models of contracting out

Both Australia and the Netherlands represent examples of public employment services that have been contracted out on a large scale. On the other hand, Denmark and Germany provide examples of how market forces may be used to supplement existing, and continuing, public provision.

Case study one: Australia – the pioneer of fully quasi-market reform in employment services

In 1998, Australia pioneered the radical marketisation of public employment services¹⁵⁵ and took these reforms further than any other country, with the role of public institutions being reduced to a residual minimum. The Job Network (a network of approximately 200 private and not-for-profit organisations) was created to replace the existing public services for job matching, job search training and intensive assistance. The former Commonwealth Employment Service was replaced by Centrelink, an autonomous government agency, which provides a one-stop shop for social security claims and referrals to the Job Network. The Department for Education, Employment and Workplace Relations issues calls for tender and is the only purchaser of services. Privatised organisations that were formerly part of the public employment service have not been able to compete in the market.¹⁵⁶

Outcome-based performance payments were introduced as incentives, with higher payments for the 'hardest-to-help' groups and fixed payments for specific target groups.

Case study two: the Netherlands – full marketisation

In 2001, the public employment service in the Netherlands was decentralised and subcontracted to non-government organisations.¹⁵⁷ At national level, this meant open tendering for services for those eligible for social insurance benefits, unemployed and disabled people, who became the responsibility of the new benefits agency (UWV, Employees' Insurance Administration). At municipal level the administration of claims for social assistance remains a public responsibility. Also at municipal level, reintegration services were privatised (to an autonomous public company, Kliq, which became a private company in 2002 and subsequently went bankrupt despite a rescue package from the European Community in 2003). The Netherlands also has a 'one-stop shop' for registration and placement offered by the Centres for Work and Income, which took over some of the tasks of the previous job centres.¹⁵⁸ Privatised organisations that were formerly part of the public employment service have not been able to compete in the market.¹⁵⁹

Outcome-based payments are made to providers for those closest to the labour market (payment made only when work is secured) and payments based on period out of work and outcome for those further from the labour market.

Case study three: Denmark – partial marketisation

Quasi-markets were partially introduced to employment services in Denmark in 2003 alongside the public employment service, which continues to operate at central and municipal levels.¹⁶⁰ This partial marketisation is viewed as supplementary to public provision and is still in the early stages of development. Denmark has seen first the rapid expansion and then the contraction of contracted-out provision due to chaotic provider-reward systems. The messy introduction of contracting out had a material impact on the quality of services available to clients.

Case study four: Germany

The German government has been experimenting with contracting out employment services since 2003.¹⁶¹ These steps have not been as far developed as those in the UK and are still far behind the marketised systems in Denmark, the Netherlands and Australia. The German system has followed the Dutch experience by concentrating on incentives rather than monitoring.

Appendix Two

Understanding quasi-markets

Quasi-markets are different from 'real' markets in several important respects.¹⁶² The key difference is that customers do not directly buy services themselves. Rather, the government sets the conditions for a tendering process, within which organisations (sometimes including public sector agencies) compete to win contracts. It is a separate purchaser (perhaps the government itself) that buys the service on behalf of the end users (in employment services, this means on behalf of people claiming benefits or looking for work). This means that customers do not directly pay for services. Instead, there is a split between the purchaser (for UK employment services this will be the Department for Work and Pensions) and the provider (the organisation that wins the contract). Service providers in quasi-markets also differ from conventional markets because they are not necessarily private companies and they do not necessarily aim to maximise profits.

Several fundamental critiques have been made of the use of quasi-markets, principally, that competitive behaviour only emerges from the operation of genuinely open markets and so cannot be applied effectively in environments where choice is not possible. A particular concern is that quasi-market arrangements are dominated by the state and tend to have a single (or very limited number) of purchasers. The stimulation of competitive market behaviour can be strictly limited in situations where services are monopolised by a small number of providers. For quasi-markets to operate effectively, the following conditions are necessary:

- ◆ a competitive market structure (price, accessible and wide field);
- ◆ availability of all relevant information;
- ◆ minimum transaction costs;
- ◆ correct (financial) incentives;
- ◆ avoidance of creaming.¹⁶³

In addition to this, we need to assess the extent to which market competition can help to meet policy objectives in terms of:

- ◆ efficiency;
- ◆ freedom of choice;
- ◆ responsiveness;
- ◆ quality;
- ◆ equity.¹⁶⁴

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