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Making the Public
Employment Service More
Effective through
the Introduction of Market
Signals

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**LABOUR MARKET AND SOCIAL POLICY -
OCCASIONAL PAPERS N°25**

**MAKING THE PUBLIC EMPLOYMENT SERVICE MORE EFFECTIVE
THROUGH THE INTRODUCTION OF MARKET SIGNALS**

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SUMMARY

Many OECD countries have taken steps to increase competition in areas that have been typically dominated by public monopolies in the past. The goal is to improve the production and delivery of public goods and services. Among these areas, governments have introduced market signals to make the public employment service (PES) contestable in some of its activities in order to improve its effectiveness. This has involved *i*) liberalisation of the rules and regulations governing private employment agencies; *ii*) the use of market-type mechanisms (MTMs) such as contracting-out; and *iii*) organisational reforms, for example separating purchasers and providers of services to jobseekers.

Separating purchasers and providers is an important requirement to make the delivery of public services contestable. For example, if the PES provides training and also purchases it on the open market, it may have the incentive to deal with only one segment of the market, making it difficult to compare its performance with that of other training providers and thus to say whether it is providing the most cost-effective service. Separating purchases and providers is also a pre-requisite for the introduction of market-type mechanisms such as contracting-out. Many OECD countries do contract out various active labour market programmes (ALMPs). But there are few robust studies indicating the extent of cost savings achieved through contracting-out and whether they persist over the longer-term. Studies of contracting-out in other areas of the public service reveal relatively substantial cost savings: more such studies are needed in the area of contracting out of services provided by the PES.

Liberalisation of rules and regulations pertaining to private employment agencies has occurred in many OECD countries. Nevertheless, several countries still continue to restrict their role on the grounds that the PES needs a monopoly position in order to provide all jobseekers with the same opportunities to find work. With an adequate regulatory structure, however, it seems possible that expanding the use of private providers will lead to efficiency gains in the job-placement market -- including for the long-term unemployed -- thereby meeting both efficiency and equity objectives. One simple way that governments can achieve such gains is by paying the private and community sectors to place the long-term unemployed in regular jobs.

Australia has gone the furthest among OECD countries in using the private sector not only in the delivery of job-placement services, but also of ALMPs more generally. Through the introduction of case management for the long-term unemployed, and those at-risk to it, the private and community sectors are allowed to play a substantial role in the placement of disadvantaged jobseekers. To some extent, jobseekers have a choice between case managers in the public and private sectors. Case managers outside the public sector are paid a fee that varies with the outcome they achieve for the jobseeker. Further changes to the system are planned by early 1998. These interesting innovations in the area of placement -- particularly for disadvantaged jobseekers -- will be of interest to other OECD countries as they attempt to make the provision of ALMPs more effective.

Introducing competition into services provided by the PES raises a number of practical issues which are not easy to resolve. For instance, it requires knowledge and skills that may not currently exist within the PES. In addition, it may require widespread changes in how the PES is set-up and the policy framework is structured, generating large transactions costs. Whatever the changes undertaken, it seems likely that the PES will maintain an important co-ordination role in the design and implementation of ALMPs. Member countries are just beginning to experiment on the approaches that can be taken; more experimentation is necessary, along with rigorous evaluation of the changes and their impacts.

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MAKING THE PUBLIC EMPLOYMENT SERVICE MORE EFFECTIVE THROUGH THE INTRODUCTION OF MARKET SIGNALS¹

INTRODUCTION

Recently, many OECD countries have taken steps to increase competition in areas that have been typically dominated by public monopolies. The goal is to improve the production and delivery of publicly provided goods and services. As part of this effort, many countries have begun to examine more closely how the Public Employment Service (PES) operates, and how the efficiency of the services it provides, notably to the unemployed could be improved. To make the PES more responsive to the needs of local labour markets, for example many countries have decentralised decision making and implemented internal performance measures for staff and local or regional offices that are closely monitored by a national or central office. Governments have also introduced market signals to make the PES contestable in some of its activities in order to improve its effectiveness. This has involved *i*) liberalisation of rules and regulations governing private employment agencies; *ii*) the use of market-type mechanisms (MTMs) such as contracting-out; and *iii*) organisational reforms, for example separating purchasers and providers of public services.

This paper focuses on the contestability issue. Unlike in other parts of the public sector, however, for example the health sector, comparatively little work has been done on documenting measures, and on their appropriate design to increase contestability of the PES. This paper therefore has two objectives: first, to describe various methods to increase contestability along with their possible strengths and weaknesses; and second, to give some country examples on recent initiatives. In particular, the paper examines methods to increase contestability in two specific areas: *i*) the PES placement function; and *ii*) the delivery of active labour market programmes, especially training.

The paper opens with a brief overview of the main objectives of the PES. It then turns to a discussion of contestability issues, opening with a discussion of purchaser/provider arrangements followed by an overview of market-type mechanisms, namely contracting-out, vouchers and user charges. Country initiatives in these areas are used to highlight how they might be implemented along with possible pitfalls. This is followed by a discussion of the role of private employment agencies in some OECD countries. Recent developments in Australia to make the placement market for the long-term unemployed more contestable through the use of competitive case management are then examined. The final section draws together some conclusions to guide policy making in this area.

A. OBJECTIVES OF THE PES

In order to put the contestability discussion into context, it is useful to review briefly the main functions of the PES:

- First, it attempts to achieve an efficient allocation of resources through its job brokerage role (i.e. operation of a labour exchange).² For example, less-skilled workers may not know where to search for work and firms in some sectors may have difficulty finding suitable staff. These informational imperfections can inhibit the timely matching of jobseekers to vacancies, resulting in less-than-optimal jobsearch. Better job matches lead to both private and social gains, the former through increased lifetime earnings, and the latter through reduced costs associated with unemployment. There is also a positive externality in that quicker and better job matches will ultimately lower inflationary pressures.³
- Second, it attempts to achieve an equitable distribution of the burden of unemployment. Certain groups are disadvantaged in the labour market and bear the brunt of unemployment. The PES attempts to achieve (vertical) equity by focusing relatively more effort on the most disadvantaged jobseekers. Furthermore, the use of active and passive labour market programmes can overcome liquidity constraints facing the unemployed who cannot afford to search for jobs or purchase (or borrow) to invest in activities such as training that may help their future job prospects.
- Third, it is a means of advancing the goals of government in the area of labour market policy (and more generally, economic policy). For example, given the market failure in the provision of private insurance for the unemployed, it is publicly provided. Although this therefore provides a social benefit, it also entails the adequate enforcement of the work-test to minimise government outlays which is sometimes seen as an important reason, in itself, to have a PES.⁴ Government objectives may also include training for displaced workers to help move them to new occupations, attempts to foster labour mobility etc.⁵

The multiple objectives of the PES have naturally led to tension over their relative importance. This has been amply illustrated in the continuing debate over whether the PES should implement the "work-test".⁶ Those against the PES having this role argue that placement work tends to be reduced in importance -- particularly in downturns -- when the PES administers the work test, and that it then becomes seen as an unemployment and not employment service, with the result that both jobseekers and employers become reluctant to use it. The other main conflict arises out of attempting to meet equity goals. Employers are usually reluctant to hire the more disadvantaged jobseekers. Indeed, a focus on them makes employers even more reluctant to turn to the PES for job applicants. But it is difficult to say whether dissatisfaction has also resulted from poor performance by the PES, which could be due to how it is set-up, run and regulated and which goal should take primary importance.⁷

Evaluation evidence on whether the PES achieves the various roles assigned to it is inconclusive (see Annex 1 for further details). On the one hand, recent studies on the effectiveness of the PES in Canada, the United Kingdom and the United States (Osberg, 1993; Gregg and Wadsworth, 1996; Thomas, 1997; and Jacobson, 1994) all indicate that it does lead to private payoffs, i.e. it helps integrate the unemployed back into work, particularly the long-term unemployed. Furthermore, it tends to be used more during cyclical downturns, and it is then that it is most effective. Moreover, various evaluations of programmes in which the PES is usually heavily involved, such as job-search assistance and re-employment bonus

programmes, found them in general to be effective in reducing search time among the unemployed (OECD, 1993a; Fay, 1996). But, on the other hand, although this implies an important role for the PES, it does not necessarily imply that the PES should be the main actor involved. Nor, for example, does it indicate that the PES is meeting its goals in the most efficient way.

B. CONTESTABILITY OF THE PUBLIC EMPLOYMENT SERVICE

What is meant by contestability?

Governments and their agencies tend to provide services under monopoly conditions, which may lead to their inefficient provision. Attempts to stimulate competition have come through outright privatisation of the provision of some services, "corporatisation" of government departments and to the introduction of "contestability" in the provision of other services. A recent Australian publication gives the following definition for contestability (Hepner, 1995):

"Prospect of competition in public sector activities to improve both programme efficiency and effectiveness."

Essentially, this implies that public sector activities can be challenged ("contested") by other providers who may be able to offer the same services at lower costs or better quality. This will only be possible, however, if there is a "level-playing field", i.e. a market where public and private providers operate under the same conditions. In order to put public and private providers on the same footing, governments have more closely examined the management structure under which services are provided. This falls under the domain of purchaser/provider arrangements. Once the government decides upon the appropriate management structure, it can then decide what -- if any -- market-type mechanisms (MTMs) are necessary to help stimulate competition. Each of these areas is taken up below.

An overview of purchaser/provider arrangements

Part of the re-examination of the services (or goods) that governments provide usually begins with an analysis of purchaser/provider arrangements, i.e. the management set-up to ensure that a service is provided in an efficient and effective manner.⁸ In broad terms, a purchaser is the agent who decides what will be produced, and the provider is the agent who delivers the agreed outputs or outcomes (Smith, 1995).

For many public services, the government is both a purchaser and provider, i.e. it decides how much of a service it wishes to purchase and then provides it too. For example, in the education sector, the government in most OECD countries is the predominant purchaser of education. It is also typically the predominant provider at most levels of education. But work done at the OECD suggests that the decision to provide a public good or service need not imply a decision to produce it, and decisions about who produces may be separated from decisions about "how much", "for whom" and "what" to produce (OECD, 1991).

A recent paper produced by the Australian Department of Finance discusses several possible purchaser/provider models (Smith, 1995). Among them are:

- Separating physically the roles of purchasers and providers so that there is a clear distinction between the services desired by the purchaser and how the services are provided. The purchaser decides what it would like provided, and lets providers compete with each other to supply the service. There can be a number of purchasers and providers and contracts are generally set up between them, usually legally based.
- Letting the public service act as a purchaser on behalf of the eventual consumers. Purchasers identify the needs of the population, plan, purchase and co-ordinate the mix of services from providers who have been identified to meet the needs in question. Case management in Australia, described below, falls under this arrangement.

Potential benefits and costs of clarifying purchaser/provider arrangements

There are many possible benefits and costs associated with any change in purchaser/provider arrangements, and these are outlined in Box 1. Probably the most important benefit is the possibility to facilitate competition. For example, moving beyond the government as the sole provider can introduce competition into the provision of a service as the private (and perhaps community) sectors become involved. But to avoid a loss in accountability, there must be some mechanism to ensure that service providers are responsive to the needs of the purchaser. This is typically done through contracting arrangements set up between the purchaser and provider. Therefore, changes in purchaser/provider arrangements may also stimulate -- or require -- the use of market-type mechanisms such as contracting out.

Splitting the purchaser and provider roles along different lines of responsibility is an important prerequisite to enhancing efficiency. But changes to these arrangements have to be viewed as a package. For example, as outlined below, changes in how training to the unemployed is provided may require substantial changes in policy "infrastructure" and the creation of new lines of accountability and policy feedback. Setting up new structures creates transactions costs that must be weighed against any benefits resulting from the changes.

A simple example may help clarify some of these issues. The PES may decide that some fraction of the unemployed would benefit from a training course. On behalf of the unemployed, it would therefore purchase labour market training (since the provision of training to the unemployed is usually free). But it could also decide to be the main provider of training, and in many countries, the PES does in fact offer training courses. The main problem with the purchaser and provider lying within the same authority, however, is that the service may not be provided efficiently. Indeed, as noted in OECD (1996a), as long as the PES can decide who is to be serviced by itself and who should be serviced by private providers, it avoids any direct comparisons with the efficiency of its own operations. Thus, the PES could alternatively decide how much training is necessary and let other institutions -- both public and private -- provide it through a contracting out process. If the PES does decide to provide training, however, it should not have the authority to allocate individuals among training providers since it would probably have an incentive to allocate the unemployed to training programmes that it provides itself.⁹

Box 1.
Costs and benefits from changing purchaser/provider arrangements

Benefits

These arrangements *can*:

- Improve working relationships and clarify responsibilities
- Minimise conflicts of interest
- Facilitate contestability and competition
- Enhance accountability
- Increase managerial autonomy
- Improve client responsiveness
- Reduce client "capture"
- Assist managers to prioritise activities

Concerns

These arrangements *can*:

- Reduce communication and co-ordination
- Heighten the focus on inputs rather than outputs
- Be based on inappropriate contracts (e.g., too general or, alternatively, too inflexible)
- Produce high transaction and compliance costs
- Result in a loss of in-house expertise
- Blur lines of accountability
- Disrupt staff

Source: Adapted from Smith (1995).

An overview of market-type mechanisms (MTMs)

The instruments generally referred to in the discussion of MTMs include: user charges, contracting out, vouchers, creation of property rights, internal pricing, inter-governmental contracts and intra-governmental and non-price competition (Lacasse, 1992). Since each MTM can take on a wide variety of forms, it is difficult to generalise about any "ideal" form and to how effective they might be. In addition, whether they are used, and how exactly they are used will vary country-to-country, reflecting different government structures, customs and priorities. Nevertheless, they are typically advocated on efficiency grounds. Implementing them, however, may require substantial organisational changes, and may make policy making more difficult or less coherent.

The MTMs most often discussed with respect to the PES are contracting out (of active labour market programmes), vouchers (for training), and user charges (for placement). These will be discussed in turn.

Contracting out: some general principles

Contracting out refers to the use of a competitive bidding process to help decide who should have the right to produce or deliver goods and services. Rimmer (1994) notes that this is an alternative to monopoly in-house provision, where a public sector agency is sheltered from competition from other public or private

sector organisations. It can therefore help to make sheltered markets contestable. Governments at all levels have been turning to contracting out the provision of goods and services, although usually more often at the local level (Lacasse, 1992).

Contracting out, on the surface, therefore seems an obvious way to improve the provision of a public service. There are, however, a number of critical determining factors. Indeed, with the use of contracting out increasing in virtually all Member countries, the OECD has developed "Best Practice Guidelines" that identify the key success factors for achieving the benefits of contracting out government services. Box 2 outlines these important factors.

Box 2.
Best-practice guidelines for contracting out -- summary

- Secure top management involvement to generate support and guidance for the initiative to succeed;
- Focus on staff issues: keep staff informed as well as relevant trade unions;
- Ensure valid comparisons between in-house and external bids; in particular, carry out a thorough costing of the activity to serve as a benchmark, including direct and indirect costs such as depreciation and cost of capital;
- Treat in-house bids the same in all respects as outside bids. If the public sector is allowed to bid for contracts, then careful consideration to "playing-field" conditions is important, e.g. whether the public sector by virtue of its size or influence has unfair advantages over the private sector;
- Foster competitive markets; contracting out practices can play a major role in the development of markets for the relevant services;
- Specify service requirements in terms of outcomes or outputs, not inputs;
- Monitor performance and foster co-operative relationships;
- Develop and maintain the necessary skills required for contract management.

Source: (OECD, 1997)

Although many of the points in Box 2 seem obvious, they raise a number of important implications. For example:¹⁰

- Staff resistance can make the process very costly. This has given rise in several countries to disputes over "outsourcing" between unions and firms.
- Competitive markets in the supply of the service are important. Where they do not exist, resource allocation is unlikely to be efficient and in fact may make provision worse if the purchaser becomes restricted to one external provider. But even where they do exist, there may be inadequate interest by outside suppliers. Outside interest will, among other factors, be a function of the detail required in the bid, the scope and duration of the contracts, and the complexity of the bidding process. Conversely, where no outside suppliers exist, this does not imply that there is no interest. It may take a change in various market elements to make provision worthwhile. And, possible competitors must also have both ease of entry to and exit from the market.
- Focusing on outcomes will allow the provider to decide how best to offer the service, but this entails adequate monitoring of the contract to ensure that the conditions attached to it are carried out.

- Length of the contract is important. A longer length may lend stability to the provider and help a potential market develop. But too long a contract length may lead to non-competitive practices by preventing new entrants from entering the market. Finding a balance over the length of the contract is important.¹¹

The PES provides services that differ from many of those that are usually contracted out by governments. In particular, they usually require large degrees of specific human capital. Borland (1994) discusses issues related to contracting out in this area:

- If the provision of the service involves a lot of specific human capital, the market may be small and a bidding process through competitive tendering and contracting out may not lead to prices being close to marginal cost;
- It is likely that issue of the quality of service will loom large in the debate. Since it may be difficult to spell out quality provisions in a contract, Borland (1994) argues that where quality is important for welfare purposes, public provision of the service is likely to be preferred.

The most obvious example in the area of contracting out where quality and specific human capital would be issues relates to the provision of labour market training. For example, the standards imposed to provide training, such as licensing requirements to carry out certain occupations such as teaching, may become *de facto* barriers to entry. These barriers, however, must be viewed in the context of providing "quality" services. Another relevant concern is economies of scale, for example it may be difficult for private training providers to compete against large public institutions in the education sector. Finally, when dealing with the unemployed, another factor becomes important: risk of enterprise failure. This would be detrimental to the jobseeker, particularly in local areas that do not have large numbers of private/community providers. This would imply that a public entity of some sort would be needed as a last resort option.

Contracting out training in OECD countries: some examples

This section draws on countries' experiences to provide concrete examples that illustrate the possibility to contract out various active labour market programmes and changes that occurred in purchaser/provider arrangements, along with relevant concerns. Indeed, in many countries, the PES has always had close contact with the private and community sectors and examples of contracting out are found in the area of training (to be enlarged with further country examples).

Example: Contracting out training in Sweden

In the 1960s and 1970s, a nation-wide network of labour market training centres was created (AMUs) under the joint administration of education and PES agencies. Until recently, most of the training providers were part of the civil service (OECD, 1996b). From 1993, the AMU became a publicly owned company financed by course fees in competition with other providers. The PES is under instruction to purchase courses so as to give equal treatment to all providers. Between 1989-90 and 1994-95, the market share of the AMU fell from 75 to 36 per cent, with private providers gaining a market share of 45 per cent over the same period. The average course cost per participant week in Sweden fell 20 per cent in real terms since 1989-90. Competition

between the AMU and private providers has undoubtedly been a major factor in this falling cost. Gradual improvement in procurement skills of PES staff (i.e. a learning curve exists) is another. Concerns have been raised, however, about the quality of training and further evaluation evidence on outcomes is needed to see if outcomes for the unemployed have increased as a result of competition.

Contracting out arrangements can take on more complex forms as shown by the case of Training and Enterprise Councils (TECS) in the United Kingdom.

Example: Contracting Out Training in the UK

In the United Kingdom, TECs have responsibility for labour market training and some employment programmes (Mosley and Degen, 1994). They are private enterprises under contract to the Department of Education and Employment. They comprise a Board of Directors which includes the chief executives of local enterprises, and staff which run the TECs. TECs are expected to fulfil all of their contractual obligations with the government by contracting out to service providers. For example, they first contract out to "Training Agents" whose job is to determine the training needs of the jobseekers who have been referred to them by the Employment Service. Training Agents in turn contract out to Training Managers who develop training programmes. Training Managers may in turn provide training themselves or contract it out. In some cases, TECs have contracted out to the local PES to be the Training Agents. Typically, Training Agents are not allowed to be Training Managers to avoid any conflict of interest. Contracts are awarded primarily on a competitive basis, but are usually with organisations that have a history of involvement in government programmes.

A recent review of the TECs highlights a number of important issues with respect to the system of contracting out (Mosley and Degen, 1994). First, the contractual arrangements that TECs engage in are complex. For example, contracts between the TECs and the government must meet a number of budgetary, accounting and performance-related criteria, in part because TECs receive public funds. These constrain TECs on their ability to tailor training to the needs of individuals. As part of the contract, TECs operate on annual budgets, although they have a three-year planning cycle. This creates problems for funding bodies with whom they sign contracts, for example training managers who may receive contract renewals only at the last moment. This may therefore affect the provision of training, which in some cases may need to last over a longer time period or span contract renewal periods between the TECs and the government. The system as a whole is also quite complicated, with TECs having complex contractual structures with many different external bodies. This entails significant transactions costs, and perhaps a loss of economies of scale in purchases. In addition, careful monitoring and evaluation to ensure that the training provided leads to positive outcomes is also critical to ensuring that quality did not decline. An additional problem with the contracting out arrangements relates to payments, which are primarily based on inputs (i.e. number of training weeks provided) and not outputs. Contracts do appear to have moved towards outcome-based measures, for example TECs may be paid on the basis of the recognised qualifications that they deliver to jobseekers. But the payment is still not directly related to whether training leads to a job. Although training managers are

eligible for a bonus if the trainee gets a job, this is not part of the main funding. On the one hand, this reduces problems of "creaming". On the other, training may not be relevant.

The linkages between the TECs, the Employment Service and the contractors are important to the success of the provision of training, but are difficult to evaluate. However, Mosley and Degen (1994) note that co-ordination between TECs and the ES following training completion appeared to be a problem. For example, training participants may still need help with job search, but the ES may focus on other groups. Moreover, the training market itself might not be responsive to client needs, forcing the TECs to offer training themselves, contrary to the goals of the system. Against this background, it is also not clear that Board members actually know more about local labour market training needs for the unemployed. Rather, staff made decisions about allocation of training funds based on their views of local labour market conditions. Mosley and Degen (1994) do note, however, that on the whole, there appear to have been cost savings, with many TECs running surpluses. But these savings may have resulted from poorer quality training. A recent evaluation of Employment Training, however, found that it did improve job-finding prospects, tending to suggest that quality did not suffer (Payne et al., 1996).

The Netherlands provides another example of contracting out of training. But there appears to have been a problem with the purchaser/provider split, i.e. the PES had the incentive to choose its own training for jobseekers over that which is offered in the private sector.

Example: Training in the Netherlands and public procurement

Dercksen and de Koning (1996) discuss the provision of training in the Netherlands and the importance of the PES in its provision. They note that about half of the funds spent by the PES go to training, with about 40 per cent going to its own training institutes (vocational training institutes), 35 per cent to subsidies for various training programmes and only about 25 per cent to private training institutes. The low share of the PES funds going to private trainers reflects a number of factors. First, since the PES is not separate from its own training institutes, it has the incentive to allocate funding to them and maintain its own market share. Second, public procurement among the regional offices was not widespread. Procedures had been set up to tender based on costs, quality and duration of courses. But 10 of the 25 regional offices had not yet implemented a public tender procedure and those that did spent only small parts of their budget on it. The authors argue that separating the institutes from the PES would help to expand the private market and rationalise courses on offer (i.e. avoid duplication). In fact, this process is now underway in the PES.

Summary of contracting out

Costs and benefits of contracting out

The various examples suggest the following possible benefits to contracting out:

- Lower costs in the provision of ALMPs such as training.
- Programmes better tailored to participants' needs through involvement of local actors who are more familiar with local labour market needs. This should lead to better outcomes.
- Better matching of the demand for services with the supply by adjusting the number of contracts in place.

But the examples cited above also indicate that contracting out can be complicated and that its effectiveness depends on a number of factors. For example, how purchaser/provider arrangements are set up is important. Experience in the Netherlands suggests that the PES may prefer to protect its market share rather than to contract out when it is also a provider of training to the unemployed. In addition, there is limited evaluation evidence on the costs and benefits of contracting out. For example,

- Although cost savings were realised through contracting out in Sweden, this may have been at the expense of quality. There is no evaluation evidence yet available on the overall impact of contracting out in areas such as labour market training. But a decline in the average quality of a programme is not always a reason for concern. This will depend on the savings that result from the decline and preferences for quality (King, 1994).
- Since most contracting out is done for relatively simple goods or services, studies in other areas may not be as relevant for the provision of services such as training, which require relatively high skill levels.
- Evidence from other areas provides ambiguous results. For example, a study on contracting out in the United States notes that there is considerable debate on the savings that have resulted (Sims Dudley, 1991). Under the Circular A-76 programme begun in 1955, which established national procedures for the award of commercial activities by the federal government, the government is supposed to rely on private sector goods and services that were available from commercial sources, i.e. it was not supposed to compete with the private sector. Despite this long history of contracting out, the gains (or losses) from it have yet to be clearly identified. On the other hand, a review of studies on contracting out of various government services in a variety of sectors suggests that savings can be relatively high (OECD, 1993b).
- Particular country institutions may hinder or promote contracting out. For example, where employment protection legislation is relatively strict, it may be difficult to contract out if it implies a loss of jobs in the purchaser organisation.¹²

Although there is some limited evidence that contracting out can lead to lower unit costs of some programmes such as training there is no evaluation evidence available on whether contracting out leads to better outcomes for the unemployed. But even where joblessness is not reduced, social savings may still result if externalities associated with prolonged joblessness are included, such as reductions in crime and health problems. But these latter effects are notoriously difficult to measure. It is also important to be clear about the savings that will result to society through contracting out. Contracting out may result in efficiency gains in the public sector as employees focus better on more clearly identified tasks, or private providers lead to more efficient provision of services. But when only transfers result, there are no net benefits to society. For example, if cost savings are a result of wages being lower in the private sector than in the public sector, a shift from public to private provision is only a transfer, not net social savings.¹³

To the extent that wage reductions are a result of the dissipation of monopoly rents, however, mitigates this concern and may imply social gains.

Other Market-Type Mechanisms

Vouchers

Vouchers have received a lot of publicity as a means of making suppliers provide services more relevant to the needs of the purchaser. For example, recipients of vouchers can "shop around" among suppliers thereby introducing a competitive element into areas where provision is only public. This is typically the argument put forward to support vouchers for education. Giving vouchers to students or their parents and allowing them to shop around may force public schools to become more responsive to community needs. But there is little conclusive evidence on the impact of vouchers, and several unanswered questions remain. For example, with respect to labour market programmes, important considerations include:

- Access to information on choices open to the voucher holder, and the degree to which such choices are feasible, e.g. transportation costs to various providers. In such a situation, vouchers may simply lead to a form of creaming, i.e. the least disadvantaged jobseekers may benefit the most.
- The use of vouchers assumes that jobseekers are motivated enough to use them. This may be a particular problem with the long-term unemployed. Considerable oversight would be necessary to make sure they are in fact used, although they may be offered simply as a work-test. The PES would therefore retain an important role in their delivery.
- Unless the voucher holder has a true choice among providers, vouchers will do little to stimulate competition. Indeed, where the PES controls access to training or provides its own, it may have little incentive to provide all relevant information to the voucher-holder. But where the PES does offer training or other programmes that are also offered in the private sector, the use of a voucher could force the PES to improve the quality of such programmes.

In the area of wage subsidies, there is only little evaluation evidence and what evidence exists tends to suggest that vouchers may be ineffective. In analysing the results of an experiment in the United States, which provided jobseekers with vouchers that enabled employers to benefit from a reduction in their wage bill if they took on voucher-holders, Burtless (1985) found that individuals who told employers about the voucher fared worse than those who did not. One explanation for this result is that knowledge about the vouchers stigmatised the jobseekers in the eyes of the employers, i.e. it conveyed a negative signal about the expected productivity and work motivation of the voucher-holder.

User Charges

User charges have been used in many public sector areas, for example in pollution control, water supply, roads and air transport, and to some extent, in the health area. They have also been used in the health field. But in terms of labour market programmes, they have not been widely used. This reflects a number of considerations, including Convention 96 of the ILO which prohibits the charging of the users of the PES with a view to making a profit. But it also reflects the obvious point that many unemployed people have limited resources with which to pay for placement or training programmes. And while loans may be

possible, banks may discriminate against them because they have no job and participating in a programme is not a guarantee of obtaining a job¹⁴.

Nevertheless, user charges do exist, mainly for the employed. In addition, user charges can also be levied on firms that use the PES, similar to the fees charged by private placement agencies. For example, in Belgium, the Flemish placement agency (VDAB) charges employers for certain activities such as more intensive screening of job applicants through an agency called VDAB Consult. In addition, private temporary work agencies can register their job offers into VDAB's computerised self-service information system for a set fee per job offer.

The role of private employment agencies and a "market price" for placement

There has been a long-running debate in many OECD countries on the role of private employment agencies (PEAs). Yet in terms of placement activities, introducing them is one of the most direct ways to foster competition in the placement market. Some OECD countries, however, continue to restrict market activities in this area (Walwei, 1996). Restrictions are based on a number of considerations, including possible abuse by private sector firms, for example via excessive charges to unemployed jobseekers.¹⁵ Governments also typically do not want disadvantaged jobseekers to have to pay for placement, based on equity concerns.

In the past, OECD countries have typically assumed that the PES must take on the placement role for the most disadvantaged jobseekers because there is no private market interest in seeking to place them in jobs, and that this can best be achieved by cost-free placement services available to all jobseekers so that the long-term unemployed have a reasonable chance at competing for job vacancies. This argument has been extended to justify a monopoly on vacancies in some countries to ensure that the long-term unemployed had a reasonable chance at competing for jobs. And the fact that where private employment agencies do operate, they only tend to cover part of the market has also been seen as consistent with this view. Nevertheless, these arguments can be challenged. The government could, for example, stimulate such a market through payments of fees to private employment agencies to place disadvantaged jobseekers as opposed to solely funding the PES to place them. In the Netherlands, for example, the PES itself has paid a subsidy to temporary work agencies which take the long-term unemployed on their payroll. It may therefore be possible for the government to achieve both equity and efficiency goals without having a monopoly on either the design or delivery of placement services or indeed labour market programmes more generally, as the example of Australia shows.

Several different models exist in OECD countries in the area of placement activities:

- *Private-for-profit* employment agencies are banned in a few OECD countries. This is the case in a few OECD countries, but is likely to change after this year's adoption of the ILO convention.
- Private sector firms are allowed to compete with the PES. This is the situation in most other OECD countries. This tends to lead to a segmented market, either by choice or because government regulations limit activities in this area. For example, private suppliers tend to restrict their activities to certain profitable markets, e.g. high-skilled jobs and temporary work placements.

- Government funds both private firms, community organisations and the PES to place jobseekers to stimulate competition. This is the case in Australia, described below.
- The PES works in partnership with private firms and community organisations for placement (and perhaps temporary employment agencies). This is the case in the Netherlands, and has been attempted in Switzerland in the St. Gallen canton.

In the latter area, a recent OECD review of labour market policies in Switzerland found an interesting example of the PES working in conjunction with the private sector to place the unemployed.

Example: Switzerland and the St. Gallen experience

In 1993, the St. Gallen cantonal labour office, in the face of rising unemployment, commissioned 12 private employment agencies to place unemployed workers registered at the public labour offices. These agencies provide more intensive placement and counselling services than the public offices and establish and maintain contacts with employers (OECD, 1996c). They also report to the cantonal labour office observations regarding jobsearch and refusal of suitable job offers. Jobseekers had the choice as to whether they wished to avail themselves of the services of the private agencies or not. The agencies were not paid on outcomes but rather on time spent with the unemployed in order to offset the tendency to "cream". The OECD review of the Swiss labour market points to one critical flaw in this subcontracting: while the idea of subcontracting placement work from the PES to private firms deserves serious consideration, in the Swiss case, a lack of competition among private providers led to placement costs that were actually above what it would normally cost the PES to place individuals.

Denmark had strict regulation in the past curtailing the operations of PEAs, but recently it has liberalised the private placement market. Contrary to some expectations, however, private employment agencies did not gain substantial market share.

Example: Danish experience with liberalisation of PEAs

In 1990, Denmark liberalised the market in placement services by allowing commercial for-profit firms to enter the market. But contrary to expectations, they did not gain substantial market share. Walwei (1996) notes a few probable reasons for the slow take-up. First, there was a cyclical downturn in the late 1990s, and when firms are not recruiting, it would be difficult for the PEA market to develop. In addition, there will be a start-up period as both jobseekers and firms "learn" to use this new avenue as a means of jobmatching. Finally, a lack of licensing and regulatory provisions may actually have damaged the reputation of such firms as cases of abuse were widely publicised. Thus, although too much regulation can restrict entry and increase start-up and running costs, not enough may also be detrimental to the development of a market for PEAs.

It is not clear that the introduction of PEAs should necessarily lead to a fall in market share for the PES. It will depend both on how effective PEAs are in placement and their impact on how the PES is run. The introduction of PEAs may force the PES to

become more efficient and provide better services to jobseekers and employers. Indeed, this is usually one of the main objectives of such reform. In addition, PEAs may encourage greater vacancy notification to the PES than would otherwise be the case. On the other hand, they may work in areas of the market where vacancies would not otherwise have been notified to the PES anyway, for example in placement of highly skilled jobseekers.

Finally, the Netherlands runs a public temporary employment agency called START which competes with private sector firms. But this led to controversy, particularly with respect to charges of unfair competition.

Example: the Employment Service in the Netherlands and START

In 1977, the Netherlands set up START, an employment agency with a tripartite structure operating on a non-profit basis to help jobseekers find temporary employment (OECD, 1993c). Although in theory START is run separately from the PES, in practice its offices are often located in job centres of the PES and have access to the PES database on job vacancies (Dercksen and de Koning, 1996). In 1991, when the PES monopoly was eliminated, it was expected that links between the PES and private temporary employment agencies would further develop as the regional offices (RBAs) became more focused on local labour market needs. But this did not happen. Many RBAs preferred to deal with START which had the advantage of being located in the Job Centres. In reality, a level-playing field between the non-profit body and the private agencies did not exist. Dercksen and Koning's (1993) evaluation of the 1991 changes to the PES suggests that the statutory link between the PES and START be reconsidered. This was done and in the fall of 1996, the PES severed its formal links with START.

Summary

To overcome concerns of possible abuse by private employment agencies, an adequate regulatory structure is necessary. But the reputation of firms in the industry can also serve as an important regulatory mechanism if information on them is widely disseminated, as has been seen in Denmark.

Although PEAs typically operate only in certain sectors of the placement market, this does not necessarily indicate that they would not choose to operate in other areas, for example placement of the long-term unemployed. The government could, for example, decide to fund both PEAs and the PES to place disadvantaged jobseekers in order to encourage PEAs to enter all segments of the placement market, if this is a desired goal. Recently, Australia has taken such an innovative approach and it is discussed next.

C. THE COMPETITIVE FRAMEWORK IN AUSTRALIA

Introduction of the Working Nation in Australia

Against a background of wide-ranging microeconomic reforms, in 1994 the Labour government in Australia announced sweeping changes in its approach to labour market assistance for the long-term unemployed, and those at risk to it. The basis of this approach was case management: jobseekers who were judged to fall into these two categories would be offered individual counselling by a case manager who would determine the forms of assistance necessary to help the jobseeker get back to work. The unique aspect of case management was the introduction of competition into its delivery. As Maddock *et al.* (1997) note:

"the Australian government announced it would introduce an element of competition to the delivery of labour market assistance -- the community and private sectors would be used to provide a proportion of case management services to the unemployment people."

Abstracting from much of the detail, the innovative features of the new approach included:

- managed competition by allowing jobseekers to choose (to some extent) between case managers in the private and community sectors and those in the public sector;
- a tender, accreditation and contracting out process with outcome-based performance measures;
- a new regulatory framework under which case managers in the private and community sectors had to operate;
- a new legal framework to protect the rights of jobseekers;
- use of the private and community sectors to police job search, i.e. enforce the "activity" test;
- a new monitoring and evaluation process.

A recent evaluation of the Working Nation programmes found some problem areas in the framework and this has led to even further changes to the delivery of services to the unemployed (DEETYA, 1996b). The main thrust of these changes is to further increase contestability of placement operations, and they are also discussed below.

The new framework: ESRA and the EAA

In 1994, the passage of the *Employment Services Act* established two new organisations:

- the *Employment Services Regulatory Authority* (ESRA) as an "independent statutory authority" to accredit and contract to community and private-sector case management organisations, called contracted case managers, make payments to them and promote best-

practice in case management. In addition, it would monitor, regulate, evaluate and report on the operations of case management to the Minister for Employment, Education and Training.

- *Employment Assistance Australia* (EAA) as an organisation within the competent Ministry, the Department of Employment, Education, Training and Youth Affairs (DEETYA, 1996a).¹⁶ The EAA was set-up to be the public provider of case management.

The premise behind the new arrangements was a decision to focus more clearly on reducing long-term unemployment. This involved significant changes to the Commonwealth Employment Service.

- One major step in the effort to introduce contestability was the change in the existing purchaser/provider arrangements. Under the former arrangements, the Ministry, through the Commonwealth Employment Service, was responsible for placement of all long-term unemployed, i.e. it was a monopoly provider. Under the new system, both the private and public sector became providers, while the Ministry remained the purchaser. For example, public case management was provided by the EAA and private case management was contracted out by ESRA to various providers in the private and community sectors. Both ESRA and the EAA were to receive funding from the Ministry. Jobseekers would have some choice on the public vs. private sector for case management. It was hoped that through this choice, pressure would be put on the public sector to improve its placement activities although this was not the primary goal of the legislation.¹⁷
- The government decided that a public role in the provision of case management had to exist for a number of reasons. First, it was unsure how large the market would be the private and community sector interest in case management; second, it wanted to maintain a majority share until it could better evaluate how well the system was working; and third, the public sector would have to play a last-resort option in areas where no significant private or community interest existed.
- A new occupation -- that of case manager -- was created. Consultations with union representatives were required to clearly define the tasks and responsibilities of the new position in the EAA.¹⁸ The EAA was to be staffed by individuals formerly employed by the Commonwealth Employment Service.
- New responsibilities -- important to the functioning of case management -- were given to the Commonwealth Employment Service, including referral of jobseekers to case manager services; providing access for case managers to vacancy information; allowing private/community sector case managers to advertise their services in the Commonwealth Employment Service according to rules of conduct; assisting in arranging participation of jobseekers in labour market programmes; etc.

Tender, accreditation and a "market price" for placement of the long-term unemployed

A number of considerations had to be borne in mind when ESRA decided to call the first tender. These were:

- The tender process to be followed.

- Determination of the fee to be paid to case managers, and the basis on which it should be paid.
- Determination of how the fee should vary among type of jobseeker.
- How to specify the contract.

The contracting out process

There are a number of possible ways to conduct a tender. ESRA decided to proceed initially with a non-price tender, i.e. private and community sector organisations would indicate their interest in placing jobseekers based on the possibility of receiving a fixed fee set by the Ministry and ESRA. This fee would combine the expected degree of difficulty in placing the jobseeker, and the outcome achieved by the case manager (described below).

An alternative option that was not pursued was a price-based tender, i.e. interested case management organisations would indicate to ESRA the fee they would expect to place a jobseeker (and make a profit). Those with the lowest bids would then be selected. Although the hope was to eventually move to this sort of tender, it was not used initially because it was unlikely that possible providers could forecast accurately know the marginal cost of placement. In such a situation, bids that did not reflect marginal cost could lead to firm failure (or excessive profits) and could be detrimental to the jobseeker. More importantly, in such a situation, the quality of case management services offered might not be high. Therefore, to ensure quality, a fixed fee was paid, and bids were evaluated with respect to service ethics and standards, standards of premises and facilities, advertising, financial and resources management etc.¹⁹

Private and community sector case management organisations would then bid on the type of client that they wanted to help. For example, some organisations might wish to work with the most disadvantaged jobseekers while others might wish to work with those who face fewer barriers to employment. Some might wish to work with a range of jobseekers. They would indicate this choice in their bid, in addition to stating the regions in which they wished to operate. ESRA's goal was also to ensure "some" minimum number of competitors in each region.

Determination of the fee to be paid to case managers in the private/community sectors

The determination of the fee for placement of the long-term unemployed is difficult since there is no obvious "market" price. First, because the long-term unemployed are seldom placed by the PES, it is unclear how much it costs the PES to place them in jobs (including the cost of any preparation such as training). Second, since the PES is typically left to place the long-term unemployed, it is unclear how much the private sector would demand to place them if they had a role to play. And finally, the marginal cost of placement would be expected to change over time, varying for example with local labour market conditions, the characteristics of jobseekers, the different programmes in place to help jobseekers get work etc. The Ministry and ESRA therefore had to determine a fee. They agreed that in principle the fee paid to the private and community sectors should be no larger than the cost of placement to the public sector, to ensure competitive neutrality. But even then, the marginal cost of placement by the EAA was not known with any certainty (given, as noted above, the fact that many long-term unemployed are not placed), nor was it clear how the cost of placement might vary along with the degree of disadvantage of the jobseeker. In practice, therefore, ESRA had to consult with various private and community sector bodies to determine what sort of fee might encourage them to participate in case management. Interested

agencies included private employment agencies, community groups, training organisations and providers of occupational rehabilitation services (Maddock *et al.*, 1997). But given that such bodies might have an interest in inflating the fees through such consultations, it was apparent that only over time would the "marginal" cost of placement become evident.

How should the fee vary by jobseeker?

Long-term unemployed jobseekers vary in terms of the degree of assistance that they need. Fees paid to case managers had to reflect these differences to encourage case managers to participate in the placement of all long-term unemployed jobseekers. If the fee were the same for all long-term unemployed, it was likely that "creaming" would occur. To combat this problem, a method to categorise jobseekers based on a set of characteristics, and then to relate these characteristics to a fee was developed. This was done through a two-step process: first, a "profiling" mechanism to determine who was most at risk to long-term unemployment; and second, a classification process of all long-term unemployed jobseekers. To "profile" jobseekers, the Ministry developed a "Jobseeker Screening Instrument" that assigns weights to various characteristics of jobseekers -- such as age, education, region etc. -- to assess whether they were at risk. This was supplemented by Commonwealth Employment Service staff judgement. Those jobseekers judged to be most at risk or who were already long-term unemployed were then classified into four categories using a client classification questionnaire that gathered additional information on the jobseeker, i.e. they were assigned a client classification level. The higher the number (i.e. 1 through 4), the larger the fee that was to be paid. Although the fee would vary by jobseeker, it would not vary by region. This is an important point because job prospects would depend on local labour market conditions as well as jobseeker characteristics, and this could affect the number of bids.²⁰

The payments were set up to minimise creaming in three ways. First, the bulk of the fee was paid upon a successful outcome. Second, case loads were limited, and private and community sector case managers could only increase revenue by achieving an outcome recognised by ESRA. And third, case managers had to accept all clients referred to them.²¹

How the contract was specified

Importantly, the contract between ESRA and the private/community sectors was not specified in terms of the inputs that case managers should use to help the jobseeker, for example the type of active labour market programme. Rather, payment was to be based on a series of possible outcomes. Moreover, to ensure a focus on outcomes, a full fee was only paid after the jobseeker was in 13 weeks of continuous employment or training, with a higher fee paid for placement in unsubsidised over subsidised work.²² The aim was to ensure that the case manager had an incentive to tailor assistance to the specific needs of the client, i.e. the more effective the assistance, the more likely it was that they would get the largest fee. A constraint faced by case managers, however, was that the Commonwealth Employment Service had to approve both the back-to-work plan (called a Case Management Activity Agreement) and the use of any active labour market programmes that the case manager might suggest to the jobseeker, e.g. to ensure enough programme slots.

By contrast, public case managers in the EAA were not paid on an output basis, but rather on an input basis. But given that private/community sector fees were based on the cost of placement by the EAA, the system may lack the necessary competitive element to force down prices over time. And for competitive neutrality to exist, there also had to be an accurate and transparent accounting of EAA costs, in particular to make sure there was no cross-subsidisation from the Commonwealth Employment Service.

Protecting the rights of the jobseeker

In order to guard against possible abuses, a regulatory framework was set up as part of the process of introducing competition. It laid out a series of regulations to:

- set out the contractual framework surrounding the Case Management Activity Agreement, which lists the series of steps the jobseeker must take, in conjunction with support from the case manager, to get work; if not followed, the jobseeker may be sanctioned;
- set out the process by which jobseekers might be sanctioned;
- set out the regulatory framework surrounding the code and conduct of case managers, including privacy issues related to personal details on the jobseeker that they would be allowed to access;
- an appeal process for case managers in the private/community sectors should they feel that their clients were not correctly assessed.

However, a principle difficulty in this area turned out to be asymmetric information. Jobseekers did not always reveal all the necessary details to staff when they first registered. Furthermore, pertinent details were not always released to the case manager by the Commonwealth Employment Service due to privacy restrictions, which may have led to an inaccurate assessment of jobseeker needs. This in turn may have led to fewer positive outcomes, and also to unnecessary sanctions.

Case managers had to comply with a number of different acts, e.g. the 1988 *Privacy Act* which relates to handling of personal information; the *Crimes Act* 1914 which makes it an offence to disclose information gained in the course of official duties; the 1994 *Employment Services Act* which set out guidelines on case management procedures; and a number of other acts relating to discrimination and other matters (ESRA, 1995). Among other things, these acts contain rules on handling of sensitive information such as release of it or how it should be stored etc. ESRA would also handle complaints such as fraud and malpractice, unfair competitive practices etc. and was empowered to perform audits to ensure that these provisions were met.

Implementation of the work-test

An important control feature of unemployment benefit compensation is the work-test, i.e. enforcement of job-search rules associated with the receipt of unemployment insurance/benefits given the moral hazard involved in the provision of benefits. The traditional view is that this should be under government control for a number of reasons. For example, unemployment insurance funds are typically under government control and with the government committed to cover any deficits in these funds, it is vital that these be well supervised. In addition, only a public body should be able to cut off support to the unemployed and this should be based on a precise series of steps to protect the interests of the jobseeker. However, this view has been challenged in Australia where case managers in the private and community sectors have an important role to play in implementing the "activity" test.

When case management was introduced, case managers were legally obliged, as part of their contract, to enforce the activity test. This was to be based on the Case Management Activity Agreement signed between jobseekers and case managers. Case managers can recommend to the Commonwealth Employment Service that a jobseeker be sanctioned for lack of compliance. Only the Commonwealth

Employment Service can actually sanction, however, and an appeals process exists to protect the jobseeker.

For the activity test to be implemented in this manner implies that the rules concerning sanctions must be simple and transparent. It is unclear, however, whether the threat of a sanction would in fact be made. For example, case managers in the private/community sectors might be less willing to breach than those in the EAA because regardless of the outcome, they remain responsible for the jobseeker, i.e. they have quotas which include all clients, including those who have been sanctioned.

But an unforeseen side-effect was to create a bureaucratic process that made case managers reluctant to sanction because of the time involved and the likelihood of an appeal. Indeed, a recent audit of case management noted problems in this area. It recommended that "compliance effects of case management could be improved by ensuring, through adequate training, that case managers understand the role of compliance in returning jobseekers to employment, and know how to make a case management activity agreement an effective compliance tool by making sure activities are verifiable" (Golightly *et al.*, 1996).

Other important changes

Several other important changes were implemented with the introduction of case management. These include:

- *Information diffusion.* New information technology had to be designed and implemented to allow case managers, the Commonwealth Employment Service and ESRA to communicate with each other. Furthermore, this sharing of information was important to maintain competitive neutrality, for example case managers would need access to information on the availability of labour market programme slots for their clients.
- *Evaluation.* Collecting enough information to allow a comprehensive evaluation was important. But it was also important not to place an undue burden on data requests from case managers, which would detract from time spent with the jobseeker and perhaps increase the reluctance of those in the private sector to participate. ESRA developed a series of performance indicators against which to evaluate all case managers. These included proportion of cases which resulted in successful outcomes, the proportion of unsubsidised employment outcomes, the number of complaints lodged by clients and the use of labour market programmes (Maddock *et al.*, 1997). In addition, a longitudinal panel was set up by the Australian Bureau of Statistics, and increased use of administrative data was made, for example, the post-programme monitoring system that followed participants for 3 months after participation in a programme was extended to 12 months. Data on differences in outcomes between private and public case managers were also sought in order to assist jobseekers in making an informed choice among case managers, a crucial element in the competitive framework.
- *Staff Training.* To ensure that the new framework ran well required training for case managers. Not only did they need to be educated on their responsibilities under the various legal acts, they also had to learn how to access and use the Ministry's main database system, and increase their knowledge about the labour market programmes offered by it. In addition, case managers had to be fully familiar with unemployment allowances and eligibility criteria along with possible conditions for sanctions. It is probable that EAA staff knew much more about some of these provisions, such as ALMPs, because of their previous work experience

in the Commonwealth Employment Service. It was therefore particularly important that private/community sector case managers acquire similar training and knowledge quickly.

- *Transactions Costs.* These had to be identified for a proper cost accounting of the new arrangements. Two main types of transactions costs were associated with the introduction of case management. First, there were start-up costs associated with the creation of ESRA and the EAA, changes to the Commonwealth Employment Service and development of the new legal and administrative framework. Second, there are the on-going costs associated with contracting out, i.e. tendering, evaluating the tenders, monitoring of contracts and audits of private/community sector case managers. There are staff training costs and development and implementation of new information technology which may have both a fixed and a variable component. It is difficult to quantify, however, the relative magnitude of these costs and whether they would lead to net savings in the future.

Theory versus practice: problems with Australian innovations in case management

The first attempt at introducing a competitive element in 1994 suffered from a number of failings. A major problem concerned the so-called "playing-field" conditions between case managers in the private/community sectors and those in the public sector. As a recent audit of the new arrangements pointed out (Golightly *et al.*, 1996):

"...a truly competitive framework ... cannot be achieved within a structure where the public provider, purchaser and regulator sit within the one management responsibility. There is a need to achieve a greater separation either between the Ministry and EAA or between the Ministry and ESRA since .. the latter is reliant on the Ministry for funding and policy guidance and the EAA is a large component of the Ministry's network."

In other words, although providers and purchasers were split, the regulatory authority, ESRA, operated within a broad policy framework set by DEETYA and DEETYA managed the day-to-day operations of EEA. In addition, it was not clear whether the EAA had an advantage over the private case managers in access to information about labour market programmes which might benefit their clients. Moreover, jobseeker decisions on whether to turn to case managers in the public or private sectors may have been influenced because the EAA was located in the Commonwealth Employment Service. In practice, case managers in the EAA may have also had better access to programme information and the programmes themselves than their private-sector counterparts, which would help prepare the jobseeker for work. Case managers in the EAA also felt that they were under pressure by the Commonwealth Employment Service to place jobseekers in programmes given their close proximity (DEETYA, 1996a). This, in turn, could affect the performance of private/community sector case managers who might be denied programme slots for their clients as a result.

Another problem with case management raised in an evaluation of Working Nation was payment for outcomes (DEETYA, 1996a). Although payment was outcome based, and lower for subsidised vs. unsubsidised employment, there was still an incentive for some case managers to go the former route by accessing wage subsidy/training programmes in the package of ALMPs. Since they did not have to bear the cost of these programmes, it may have been easier for them to use these options to generate a fee -- albeit a smaller one -- than trying to place a jobseeker in unsubsidised work. Moreover, with only a 13 week follow-up period necessary to get the fee, there may not have been enough emphasis by case managers on sustainable employment gains. It appeared, therefore, that many of the jobs did not last long and simply led to churning of the unemployed (DEETYA, 1996a). Furthermore, only private/community

sector case managers were paid based on outcomes and they also had to pay to access information on labour market programmes (and for their own training). The EAA had no such constraints. And with fees based on EAA costs, it is also not clear whether -- over time -- competitive pressures would have led to lower fees. Indeed, a perverse feature of the system was how the unit cost of case management was calculated. Since it was based on EAA case manager workloads, large increases in their client numbers would drive down the unit cost of case management (given limited funding) and these falling costs would have no relation to outcomes (Golightly *et al.*, 1996). Finally, with no regional differentiation in fees, it was unlikely that case management organisations would set up in areas where local labour market conditions were poor.

There were also problems with ESRA's supervisory powers over case management. An audit of case management revealed that, although ESRA was supposed to oversee all case management, it in fact did not appear to have the legal right to oversee the EAA. The study noted, that although ESRA did have broad powers to regulate case management in both the EAA and the private/community sectors, in practice any decision to investigate case managers in the EAA was limited (Golightly *et al.*, 1996). ESRA could conduct one-off investigations of the EAA but could not require it to provide a constant stream of data that would be helpful in the monitoring process.

Finally, there appeared to be insufficient co-ordination among all actors, i.e. EAA, ESRA and the Commonwealth Employment Service and uncertainty regarding their respective roles. For example, the Commonwealth Employment Service had the obligation to help private/community sector case managers through the provision of information on labour market programmes etc. But the Service lost staff to the EAA and felt in some cases unprepared to take on new responsibilities.

The new competitive approach

In response to these "teething" problems, proposals introduced by the current Australian government will change the existing framework substantially (DEETYA, 1996b). With a view to streamlining services to income support recipients, including the unemployed, the Government is now establishing a new Commonwealth Services Delivery Agency (CSDA). The CSDA will operate within the Social Security portfolio and will be responsible to the Minister for Social Security. The CSDA will integrate the four main functions of registering job seekers, administering unemployment allowances, providing job seekers with self-help access to a National Vacancy Data Base and referring eligible job seekers to employment services. By May 1998, therefore, the current system of ESRA/EAA (and the Commonwealth Employment Service)) will cease to exist.

Private, community and public sector organisations, including a corporatised public provider, will be contracted to provide employment services under the new employment services market. The employment services market due to commence 1 May 1998 will comprise: *flexible labour exchange services*; *entry level training support services*; and the *new enterprise incentive scheme* to help the unemployed set up a business. Flexible labour exchange service providers canvass employers for jobs and place people in those jobs. It has three streams: job matching with no additional assistance necessary (FLEX 1); and two other options for jobseekers who need additional assistance: the provision of job search skill training (FLEX 2) or intensive, individualised job preparation and support (FLEX 3) to eligible job seekers depending on their level of need.

Organisations may choose to tender for specific employment services (through all FLEX providers must provide some labour exchange services); to specialise in assisting specific client groups or they may choose to tender to provide the whole range of employment services to eligible job seekers. In the first

round of tenders, services providers other than FLEX 3 providers will be paid fees set through a competitive tender process. FLEX 3 providers will be paid fixed price incentives (in addition to their competitively set labour exchange fee) for providing intensive job preparation and support to the most disadvantaged job seekers. Most incentives will be paid only after these job seekers have retained in ongoing employment. Indeed, with the full fee only being paid after 6 months of continuous employment, the provider should have the incentive to provide the necessary assistance. And, similar to current arrangements, the providers will not be able to refuse clients, which will limit their ability to cream jobseekers. In the second round of tenders, expected after December 1999, all fees will be set through a competitive tender process.²³

The corporatised public provider will operate under the same conditions as other service providers. It will also serve as a "last resort" provider of services to unemployed job seekers in regions where no other service providers will operate.

The changes provide a new role for DEETYA. It will become the purchaser of employment services, on behalf of job-seekers. It will also regulate and manage the tendering and contracting process and maintain its policy development and evaluation roles. Under this new structure, Australia has introduced an institutional structure where the Government is responsible for both the referral of eligible unemployed to employment services and the administration of unemployment benefits while ensuring that the delivery of employment services to the unemployed is subject to contestability by public, private and community providers. But clear and transparent tender guidelines and decisions for awarding contracts will be necessary to ensure that market participants are not unfairly treated.²⁴

Through these changes, Australia has introduced a major conceptual innovation which may change the role of the PES in the future and may boost the effectiveness of active labour market programmes. There now appears to be in place a framework that will generate genuine competition not only in the market for easy-to-place job-seekers, but also in the treatment of the long-term unemployed. It is too early to judge whether this competitive framework will lead to better labour market outcomes for the unemployed but it will be very important to monitor closely the results of this major innovation.

D. CONCLUSIONS

There are several ways to make the PES contestable. But a key requirement is to separate the purchasers from the providers of public services, although there are many different purchaser/provider arrangements that can be set-up. These arrangements in turn may be linked to the use of several market-type mechanisms and may reflect the structure of the market for services, or seek to adapt it. For example, one area that many countries have moved into is contracting out of the delivery of training. This typically requires a large number of providers. But it may also be possible to develop a training market by changing purchaser/provider mechanisms that lead to more opportunities for private providers to exist, for example through contracting out.

The introduction of competition typically requires significant changes to the structure of the PES, the adoption of new techniques to screen and sort jobseekers for referral to external providers, and new

methods of collecting information and evaluation. Furthermore, any recourse to the private sector raises a number of important issues that must be addressed, including whether the public sector has the necessary skills to manage new methods of delivery and control (such as contracting out), and legal issues related to the rights of individuals (such as privacy). Thus, making markets contestable is only one set of decisions that must be made to improve services offered to the unemployed. It must be accompanied by the necessary changes in "*policy*" infrastructure to support the new environment. In addition, all the services that an unemployed jobseeker may need must be considered as part of a package. For example, while contracting out training may be a worthwhile option in some circumstances, a jobseeker may need follow-up help and the PES would therefore maintain an important role in co-ordinating the "*package*" of aid offered. Alternatively, a more radical move might be along the lines of Australia's recent proposals to make provider's fees contingent on not only offering the appropriate services but also placement of the jobseeker.

The introduction of competitive case management in Australia -- and evidence from other countries -- however, suggests that a number of areas must be examined carefully when competition is introduced or expanded:

- Introducing competition in the delivery of services is not an easy process. The appropriate market conditions must be in place, or at least be possible, and an adequate regulatory framework must be set up to oversee the process. Moreover, measures to introduce competition can easily get quite complex, making the regulatory framework much more difficult to implement. Furthermore, making sure that the regulatory burden does not involve significant transactions costs for all participants, e.g. jobseekers, firms and government, is important to promoting the sustainability of the new arrangements.
- The appropriate skills must exist within the public sector (PES) or be acquired to oversee the competitive arrangements.
- If competition is desired, but a continued public sector role is necessary or desired, it is very important that a level playing field be created between the public and private sectors. This will usually require a change in purchaser/provider arrangements to ensure that there is a clear separation of the purchaser role (public sector) and provider role (public and/or private sectors).
- Even when the private sector delivers labour market programmes, the PES should maintain an important role in providing support to jobseekers before they are referred to external providers, and potentially afterwards too. Therefore, links between the PES and the private sector must be carefully considered.
- Initiatives to increase contestability, such as contracting out, will be subject to a learning curve before operating effectively.
- The quality of the service provided is important and may restrict how contracting out takes place, for example conditions may have to be attached to the contract to ensure that "quality" services are provided. Contracting out should, however, lead to more transparency in the actual costs to place a jobseeker.

- Increasing contestability will likely entail significant transactions costs, both "one-off" and on-going. These should be identified and costed, where possible, to determine whether there are in fact net social savings.
- It is most important to undertake continuous and rigorous evaluations of the regulatory framework to see if it is satisfactorily meeting its objectives. For example, this includes experimental or quasi-experimental evidence on outcomes of programmes, audits of the referral process etc.

Despite the fact that countries have experimented in a number of areas, the evidence on what should be done and how it can be done is still inconclusive. Considerably more experimentation -- and importantly, rigorous evaluation -- remains to be done.

ANNEX 1

RECENT EVALUATIONS OF THE PES

Canada

Osberg (1993) reviewed evidence on the effectiveness of the Canadian PES in the years 1981, 1983 and 1986. These three years are quite different in terms of the business cycle with 1983 being a major recession and 1981 and 1986 being a peak and recovery period, respectively. He notes that job-search strategies may vary over the business cycle and this may reflect in turn the changing returns to these search strategies. He finds that neither men nor women derived any benefit from using the PES in 1981 in terms of job-finding probabilities, and therefore by definition, social returns were zero. In 1983, during a deep recession, the PES increased the job-finding probability of long-duration jobless males, based on various assumptions, reduced UI payments by about \$340 million. In 1986, only long-duration unemployed women benefited from use of the PES, and given their smaller numbers, savings to the UI account were much smaller resulting in no net social benefit. This analysis can be criticised, however, because it ignores externalities associated with long-term unemployment such as health and crime -- albeit benefits which are difficult to measure -- but also because it ignores substitution and displacement effects which may be relevant, i.e. those who use the PES and are referred to it may displace job-seekers who do not use it.

Osberg (1993) also raises two important points in his analysis relevant to estimating the returns to the effectiveness of the PES in Canada:

- the need to correct for self-selection. It is highly likely that the jobseekers who use the PES are not representative of all jobseekers, for example they may have fewer informal contacts than those who do not use it;
- the effectiveness of the PES should be measured over a complete business cycle since the social returns are likely to vary in a recession vs. an upswing when output is growing strongly, and because the PES cannot be "turned on and off again from one year to the next".

United Kingdom

A recent study in the United Kingdom examines the effectiveness of state employment agencies (Gregg and Wadsworth, 1996). They indicate that most jobseekers use more than one method of jobsearch, averaging just over 2 over the period 1984 to 1992. The most common method of jobsearch by the unemployed is through newspaper advertisements, followed by the PES, followed by friends. They find, similar to the Canadian study, that use of the PES is counter-cyclical, being higher in recessions than otherwise. They find that Job Centres have the most beneficial impact for the less skilled and the long-term unemployed, groups who tend to make more use of Job Centres. Out of range of the job-search methods studied, Job Centres tend to perform less well than private agencies and direct contacts with

employers. But when split by duration, Job Centres had the strongest impact on moving into work men unemployed greater than one year than all other search methods except for direct contact. For women, private agencies resulted in more moves into employment. Overall, the more advantaged jobseekers tend to rely on Job Centres only during slumps in economic activity. Use of Job Centres resulted in higher transition probabilities reducing unemployment durations and increasing lifetime earnings. These benefits, however, should be weighted against the costs of employment services, an area not examined in the study.

Another study, using the 1987/88 British Survey of Incomes in and out of Work examines whether the apparent finding from non-experimental evaluations that jobseekers who use the PES tend to have longer spells of unemployment is related to such jobseekers turning to the PES only after other search methods have failed (Thomas, 1997). The author notes that experimental findings from the United States (reviewed by Meyer (1995) and discussed in Fay (1996)) tend to suggest the opposite, i.e. that more intense use of the PES results in faster transition to jobs. Thomas finds that jobseekers who turn to the PES over other methods of jobsearch after becoming unemployed have shorter unemployment spells than those who did not. He also finds that jobseekers who eventually turned to the PES after other methods had failed typically had the longest unemployment spells. His work suggests that encouraging some groups of jobseekers who would not normally turn to the PES initially to help find work would be beneficial. In particular, he notes the unemployment spell for workers aged 55-64 would be reduced by 68 per cent and that for workers aged 16-54 by 52 per cent.

United States

Jacobson (1994) raises four points of interest about the Employment Service in the United States. First, there is strong evidence that the Employment Service (ES) in the United States is used by workers who lack access to the best sources of information or have failed to locate suitable work using other sources. Second, United States studies suggest that mandatory registration of claimants impedes the operations of the ES labour exchange significantly. He indicates that although mandatory registration is supposed to support the UI work test, this remains an untested justification. Third, he notes that the ES reduces joblessness by about 2 weeks for those who have not exhausted unemployment insurance (UI), and by more than 13 weeks for the roughly 20 per cent of claimants exhausting UI. The effects tend to be greater for women than men; for jobseekers whose previous earnings are less than \$20 000, the ES is able to find jobs that generate similar earnings to those found through other means. In addition, on average each ES referral of a UI claimant saves about 1.25 UI payments or almost \$200. Finally, he notes that the available evaluations are partial equilibrium in nature, and ignore the potential negative effect of ES actions on non-users (e.g. through substitution effects of PES referrals vs. those who are not registered). There is also the problem of "congestion": the use of the PES by one person will affect other jobseekers, for example through less time spent determining their needs.

Another US study notes that the high priority the PES placed on the most disadvantaged jobseekers led many employers to abandon the ES as a source of referrals. In a review of studies that examine the effects of various recruitment sources and their links to turnover, job performance and absenteeism, Bishop (1993) notes that the few studies which exist in this area indicate that PES referrals performed as well as "walk-ins" and add respondents, but were absent from the office more often. A study of retail clerks found that referrals from both private and public employment agencies were 9 to 15 per cent more likely to be classified as unsatisfactory compared with walk-ins and new hires from newspaper ads. Based on a survey from the National Federation of Independent Business, Bishop (1993) found that firms that used the PES tended to be larger than average, more capital intensive, paid lower wages, and had higher turnover. Workers tended to be older and had lower educational attainment.

Workers hired through the PES were less likely to stay late and were less profitable (by about 16 per cent of average productivity, holding several factors constant). However, individuals recruited through private placement agencies were only slightly more productive. Bishop (1993) takes this to mean that problems with the PES cannot be solved by contracting the function to private employment agencies. Moreover, as Abraham (1993) notes in comments, it may not be possible to attach structural interpretations to the data based on Bishop's analysis since the quality and number of job applicants will vary over the business cycle.

NOTES

1. The author would like to thank Mr. John Martin, Mr. Peter Schwane and other members of the Directorate for their helpful comments.
2. This can be seen as an "economies of scale" argument, i.e. that the PES, by virtue of its size, can provide an efficient matching service for firms and jobseekers. See Bishop (1993).
3. Jacobson (1994) also notes that changes can increase consumer surplus. "Expanding the supply of labour by reducing disincentive effects of transfer programmes lowers the net cost of production and leads to increased output. Although some workers would suffer small reductions in earnings, society benefits because the net utility gained by consumers from expanding production is greater than the reduction in workers' purchasing power. Economists call that gain the consumer surplus".
4. In more technical terms, there is a moral hazard problem, i.e. that once insured, jobseekers may reduce search effort since they have an alternative source of income. There is also an "adverse selection" problem in that workers most likely to be unemployed would probably purchase insurance if it were available privately, driving firms that offered it into bankruptcy.
5. This can be seen as an "economies of scope" argument, i.e. that the PES has economies in providing a wide range of services, not just one particular service.
6. This tension is well illustrated in the United Kingdom where benefits administration was separated from the Employment Service in 1974 with the establishment of Job centres. However, problems co-ordinating the work-test with job offers and other assistance to the unemployed -- so-called "policing" -- led to their reintegration in 1988 under the Employment Service (King, 1995).
7. So-called "carrier-wave" theory works on the premise that if the PES makes a large number of good placements, it can rely upon its reputation to place the more disadvantaged with employers. In the Netherlands, at least, this has been shown not to work (Dercksen and de Koning, 1996).
8. Effective is taken to mean the extent to which it meets its objectives; efficient is the relationship between resources (inputs) and outputs (OECD, 1991).
9. A situation could arise where the marketplace may not be willing to provide a training course that the PES feels is necessary. It may therefore have to provide it itself. But it is unclear how often this situation would occur since training courses should be relevant to labour market needs and therefore providers should be able to realise some value in developing them. It may also be the case that the PES has a better idea of the training necessary than the private sector, particularly in situations where the market is not well-developed. But this could also give it a better handle on distinguishing among various providers in a contracting-out situation and should change over time as new providers enter the market.
10. Many of the points raised here derive more generally from the theory of contestable markets. Baumol *et al.* (1982) discuss some of the factors that are important to examine for *perfectly* contestable markets to exist: these include cost of entry and exit, strategic pricing responses where incumbents can deter entry, relevance of sunk costs, extent of cross-subsidisation and other inefficiencies associated with supply of products.

- 11 Double-dipping may also be an issue to the extent that employees receive payments from the government yet who are also transferred to the contracting agency, driving up costs in the short-run.
- 12 Over the past decade (and longer in some countries) there has also been a move towards decentralising the delivery of services to better meet local labour market needs. One question that arises from this decentralisation is whether it implies increased provision of services by the private sector. In some countries, for example Canada and the United States, public funds have been allocated to private sponsors to implement (and in some cases, design) labour market programmes (OECD, 1987). Clearly, one of the reasons to give more autonomy to local offices is because they may have a better idea of local labour market needs and can better tailor their assistance to meet these needs. This may involve recourse to external providers to the extent that this is allowed. However, it may not mean greater recourse to the private sector, but rather an expansion of the PES. For example, if a local PES office has no experience in contracting out programmes, it may be reluctant to do so. The local PES may also be under restrictions from central authorities on how they can allocate funds, or how they can allocate individuals to programmes. Furthermore, central authorities may still decide from who the local PES should purchase. For example, in the case of training, the central authority may purchase a certain number of slots by region and then allow local PES offices to use them as need be. Thus, decentralisation need not be a necessary or sufficient condition to contract out.
- 13 Another potential transfer is tax evasion by private contractors which would not exist under public provision (King, 1994).
- 14 One option that has not been explored is to make jobseekers who receive aid pay it back on an income-contingent basis, i.e. once employment is obtained, the jobseeker could pay back some of the cost of placement. Such a scheme, however, could be administratively complex although it could be collected through the tax system, and might deter some individuals from using the PES.
- 15 There has been a long-running debate among OECD countries on the use of private placement agencies in conjunction with the PES. See Levine (1969) for a summary of the issues.
- 16 ESRA began as a non-statutory organisation until legislation could be passed to establish it officially.
- 17 In the first round of tenders, it was anticipated that the EAA would maintain 80 per cent of the placement market with its share declining over time to 50 per cent. Therefore, when slots available in private and community sector case management organisations were "full", the jobseeker would have no choice but the EAA.
- 18 But in addition, it was expected that the contracted case managers would take on a larger share of the market as it "developed". This necessitated some immediate decisions on what would happen with EAA staff as their workload fell over time.
- 19 The criteria were: adequate infrastructure, financial and institutional stability, adequate insurance cover, general experience, management ability, expertise, suitable personnel, standards of premises, and ability to conform to ESRA's rules of conduct in relation to clients (Maddock *et al.*, 1996). Ensuring these criteria were met would have placed a significant burden on ESRA, particularly in the case of a large number of bids.
- 20 Only jobseekers assigned a client classification level 2 through 4 went immediately into case management. Those assigned a "1" had to wait 12 months.
- 21 There might be self-selection among jobseekers, i.e. the least or most motivated opting for the EAA or private/community sector case managers but it is difficult to say which way this would run.

- 22 Given that this was a "new" market, it was possible that it would need some nurturing. For example, many firms may not have the capital base on which to draw to set up a new enterprise. This was dealt with in two ways: payment of an up-front fee to the private case manager when the case management activity agreement was lodged with the Commonwealth Employment Service, and second, through loans to case managers in the private/community sectors. On the other hand, some private firms might be able to cross-subsidise activities from other work (e.g. the case of private employment agencies who moved into case management) while community based organisations might already be receiving subsidies from the government.
- 23 Critics have suggested that the current proposal could lead to corruption. A jobseeker could approach a provider and indicate that he/she has a job lined up already. The provider and the jobseeker could split any fee that the provider would be paid (perhaps even with the hiring firm) and all individuals would be better off. This abuse would entail substantial deadweight losses. But by limiting this assistance to the long-term unemployed, who firms are reluctant to hire at virtually any cost, this possibility should be very low.
- 24 In this context, it is not clear why ESRA was not maintained to provide the regulatory role over all aspects of case management and providers.

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