

Department for Work and Pensions

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Differential pricing in contracted out employment programmes: Review of international evidence

Dan Finn

A report of research carried out by Associate Director, Centre for Economic and Social Inclusion, and Professor of Social Inclusion, University of Portsmouth on behalf of the Department for Work and Pensions

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Abbreviations

UK	
DWP	Department for Work and Pensions
ED	Employment Department
EZ	Employment Zone
FND	Flexible New Deal
LEC	Local Enterprise Company (Scotland)
NVQ	National Vocational Qualification
ORF	Output Related Funding
PES	Public Employment Service
TEC	Training and Enterprise Council (England and Wales)
TfW	Training for Work
YT	Youth Training
Australia	
APM	Active Participation Model
DEWR	Department of Employment and Workplace Relations
IA	Intensive Assistance
ISca	Intensive Support Customised Assistance
JN	Job Network

JSCI	Job Seeker Classification Instrument
JSKA	Job Seeker Account
PSP	Personal Support Programme
Netherlands	
CWI	Centre for Work and Income
IRO	Individual Reintegration Agreement
UWV	Institute for Employee Benefit Schemes
USA	
ESP	Employment Services and Placement
HRA	Human Resource Administration
JTPA	Job Training Partnership Act
NYC	New York City
PIC	Private Industry Council
SAP	Skills Assessment and Job Placement
WeCARE	Wellness, Comprehensive Assessment, Rehabilitation and Employment Programme
WIA	Workforce Investment Act

Summary

The Department for Work and Pensions (DWP) contracts with an extensive network of non-profit and for-profit providers for the delivery of employment programmes. Over the past ten years there has been significant change and the Government now has committed to a strategy of 'welfare market' reform. This will involve 'black box' contracts that are less prescriptive about processes and will reward providers on the basis of getting participants into sustained employment. The principles of this strategy will be applied first to the 'Flexible New Deal' (FND) and 80 per cent of funding for external contractors will be paid for placing participants into jobs.

Employment programmes are designed to provide enhanced assistance to service users with particular barriers to entering or staying in employment. Despite the positive impacts of many programmes, evidence suggests that most of them, whether delivered by public agencies or external providers, are less effective in meeting the needs of the 'hardest to help'. This outcome can be a function of poor programme design but it also reflects the reality that the front line delivery and intensity of employment assistance is impaired by the constraints of the available funding, the character and scale of job opportunities and the tractability of the barriers faced by some of the hardest to help. The particular risk of outcome-based payment systems is, however, that they may provide greater incentives for 'creaming' and 'parking', where providers work most with those who are more easily placed and provide a minimal service to the harder to help.

In this context the DWP Commissioning Strategy stresses the importance attached to overall '*excellent customer experience*'. It commits also to '*trial different models of outcome payments*' and work with providers to '*develop more sophisticated, differentiated models*' that identify service users who may be helped quickly and those who need more intensive support. Such a differential payment model may have the potential to increase the number of overall outcomes secured and target extra incentives at the harder to help.

The research

This study reviewed four countries which make extensive use of job outcome performance-based contracting. It assessed how the hardest to help were identified and variations in the use of differential payments and considered how such systems sought to reduce 'creaming' and 'parking'.

The transition to performance-based contracting in training and employment programmes started in the USA. Most federal and state programmes use measurable performance standards and include both positive and negative incentives to drive service delivery. There are variations in performance standards and contracts used throughout the different states. The contract models most relevant to British interest in differential pricing include those that 'pay-for-performance' and 'milestone' contracts, where providers are paid for a sequence of achievements and outcomes including job entry and retention.

The study reviews two such contracting systems – the pay-for-performance contracts used in New York City and the milestone payment system used in Oklahoma.

Significantly, findings from US evaluations show that the relatively short-term employment-related performance standards rewarded in programmes are not good indicators of long-term impacts. A review of welfare to work studies that measured three year effects found that average earnings levels were most closely associated with the largest impacts for the most disadvantaged. This suggests that performance standards that reward attainment of increased earnings levels could be an important indicator of effectiveness in a differential pricing system.

Other countries were influenced by US developments and GB was the first European country to extensively use 'output-related funding'. Training and Enterprise Councils (TECs) and Local Enterprise Companies (LECs) delivered a wide range of training and enterprise programmes and trainees were independently assessed and endorsed if they had 'special needs'.

Many TECs paid flat rate fees for training weeks delivered with differential payments for high cost occupational areas, such as engineering, and for those with endorsed special needs. Over time the funding system shifted the focus of programme activity towards lower cost provision that reduced places for higher cost trainees in general and special needs groups in particular. The additional incentives in the TEC funding system for ensuring such groups' needs were met were weak. Local flexibility resulted in significant variation in the availability and adequacy of provision for the most disadvantaged, even in neighbouring areas.

Differential pricing has been used too in Employment Zones (EZs). Initially, this meant a higher payment premium for long-term unemployed participants but subsequently involved higher payments for those who were re-referred after a prior period of EZ participation. The EZ funding model also contained incentives that encouraged speed of job placement and militated against parking. DWP

transferred 21 weeks of individual benefit payment to the provider who was responsible for paying the participant for up to 26 weeks. The provider retains any surplus not used within 21 weeks but is liable for the extra five weeks payment, thereby inducing the provider to work with all participants before they reach this point.

Job outcome contracts have been central to the design of the new market-based employment services systems introduced in Australia and the Netherlands. The fees paid to Australian Job Network (JN) providers reflect the intensity of service provided and the risk involved in placing the job seeker in work. Job seekers classified as 'highly disadvantaged' are eligible for immediate access to intensive assistance and the provider is able to draw down a higher payment from a Jobseeker Account. If job seekers have special needs (such as mental health problems) that cannot be met by the JN, they may be referred to a range of specialist performance-rewarded assistance.

In the Netherlands the reintegration market has undergone successive adaptations as the Dutch social insurance department has sought to improve the efficiency of its contracted provision, personalise support and target intensive services at harder to help participants. The initial tendering system involved relatively small contracts designed to tackle the barriers of particular groups with prices and outcome payment terms being differentiated according to assessed distance from the labour market. The tender system has now been displaced by a modular purchasing framework and Individual Reintegration Agreements. These 'IROs' give participants more personal control over services and pay contractors higher fees and outcome payments for working with more disadvantaged participants.

Key findings

The evidence reviewed suggests that minimising cream-skimming, creaming and parking is a key implementation and management challenge in performance-based and output-related funding systems.

In many programmes there is no differentiation in prices for employment outcomes. There are various ways, however, in which the systems reviewed have tried to target assistance. These include the definition or endorsement of eligible groups to be served; the requirement that particular quotas of participants with greater needs are represented amongst outcomes and the design of specific tenders that target services at particular hard to help groups. There is often specialist supplementary outcome-focused provision offering rewards to providers for achieving milestones and employment outcomes. Such provision is particularly important for groups who need to stabilise their circumstances as part of their involvement in, or progression to, 'work first' programmes.

Different fees and outcome payments were used in the two-tier system of employment service provision in New York. The initial tier was paid lower outcome fees on the assumption that early placements would be less costly. The second

tier paid higher outcome fees for those not placed in this first phase. There were problems, however, with fragmented service delivery and evidence of parking and creaming. A new service delivery model now integrates provision with significant bonuses for placing sanctioned participants into employment.

Australia's differential pricing system for highly disadvantaged job seekers has faced sustained controversy about creaming and parking, and playing of the system by some providers. The challenge remains how to devise an evidence-based classification and pricing system that targets the hardest to help, is relatively easy to administer and does not create perverse incentives. Policy makers have had to buttress such incentives with quarantined funds for employment barrier reduction, greater scrutiny of parking and adjustments to the Star Rating system.

Policy implications

There are contending views on the success of performance-based contracting in the countries reviewed. It is difficult, however, to make robust comparisons or to disaggregate the impacts of contract design from those of other policy changes. It is still harder to isolate the relationship between different contract prices and the impacts of employment programmes, although cost benefit analyses give some insight into financial effectiveness.

There is no simple model that DWP could import but there are alternative funding models that suggest ways in which the pricing and contracting system may be used to encourage providers to work with higher risk, higher cost participants. There is some evidence from the Netherlands, for example, that such a 'progressive pricing' system is in use where contractors receive increased premiums in relation to the proportion of a fixed cohort of cases they place in employment.

The Australian Productivity Commission proposed that its Government test a 'stepped' or marginal payment system that increases payment levels in line with outcome rates. Work Directions has proposed a 'target accelerator' with a sequence of differential fees for each segment of a specific claimant population. The financial viability and profitability of the provider would require them to '*dig deeper into the caseload*' whilst reflecting the extra costs involved. The Social Market Foundation advocates that providers be paid higher payments as the total percentage of participants entering sustained employment increases.

The proposed models are untested but address some of the key issues reviewed in this study. They appear to provide incentives that would result in more participants entering employment and avoid complex mechanisms for individual assessments and price enhancements for the harder to help. They balance risk and reward between purchaser and provider and, in the case of the target accelerator, remove the disincentives of capped budgets for over-performance. Notwithstanding the practical issues that need to be addressed, such a model merits experimental testing to gauge its impact on performance and costs, its potential to assist harder to help participants and whether it would militate against parking and creaming.

Whilst such models may incentivise providers to 'dig deeper into the caseload' many harder to help participants may still not be placed in jobs. There may also be merit in testing differential service fees and payments focused on particular hard to help groups, such as those with a combination of three or four easily identified significant barriers to employment. Such enhanced payments may encourage providers to undertake more intensive assessments of individuals' problems, needs and underlying barriers and so work harder with those most in need. Such a payment system may add to administrative complexity but it would potentially target resources specifically at the harder to help, meet the greater costs faced by providers, and reward such efforts.

More immediately it seems clear that minimising creaming and parking in the FND rests on a combination of policy design, including any identification and pricing for the most disadvantaged, and effective scrutiny and management of performance.

An immediate approach to the FND might be to identify and monitor the progress of the hardest to help. DWP should track participation and placement patterns for service users with characteristics that suggest they are furthest away from immediate employment. Such characteristics need to be carefully defined but could be selected from length of time on benefits, basic skill barriers, homelessness, criminal record, substance misuse, returners to the New Deal, or whether a person has been sanctioned. Jobcentre Plus already has markers in its management information system to identify some of these characteristics which would be still more accurate after an individual has been with Jobcentre Plus for as much as a year of unemployment.

Tracking providers' performance with these groups would discourage creaming and reinforce the message that providers must help all referrals to make progress towards a sustained job. This could be further supported by contract management and by recognition in the Star Rating system.

An equally pragmatic response to reduce parking in the system could be achieved through careful regulation of referral flows, so that providers and their case managers have more incentive to work intensively with those participants they already have rather than wait for more job-ready clients to arrive.

1 Introduction

The DWP contracts with an extensive network of non-profit and for-profit providers for the delivery of employment programmes. Over the past ten years there has been significant change and the Government now has committed to a strategy of 'welfare market' reform (DWP, 2008). The principles of this strategy will be applied first to the FND that will replace all existing New Deal and EZ provision for the Jobseeker's Allowance (JSA) unemployed from 2009 (DWP, 2007).

The DWP's Commissioning Strategy outlines its approach to contract management and how it will seek to ensure service quality for all participants. The strategy also contains a commitment to '*trial different models of outcome payments*' and for the DWP to work with its providers to '*develop more sophisticated, differentiated models*' to identify service users who may be helped quickly to return to work and those who need more intensive support (DWP, 2008, p. 22).

Employment programmes are designed to provide enhanced assistance to service users with particular barriers to entering or staying in employment. Despite the positive impacts of many programmes, evidence suggests that many of them, whether delivered by public agencies or external providers, are less effective in meeting the needs of the 'hardest to help' or the 'hardest to serve'. This group typically includes the homeless, ex-offenders, people with poor basic skills or language barriers, those with physical or learning disabilities, mental health or substance or alcohol misuse issues, debt and so on. Other groups may be hard to help due to factors such as location, domestic violence, ethnicity and/or discrimination. There is no commonly accepted definition of the hardest to help but several British reports have highlighted the relative weakness of standardised 'work first' programmes, such as the New Deals, to place such service users into employment (SEU, 2004; NEP, 2004; HoC WPC, 2007).

In this context, the DWP commissioned **Inclusion** to undertake a rapid review of available evidence on other countries that have used differential payments for the hardest to help client groups in their outcome payment systems with external providers.

1.1 Objectives of the review

This study identified countries which make extensive use of job outcome performance-based contracting and aims to:

- identify variations in the use of differential payments in performance-based contracting in the delivery of employment programmes;
- briefly consider the initial classification and referral systems used to identify the hardest to help and how such measurement is linked to outcome payment incentives;
- assess available evidence on the impact of such differential payments and the extent to which they have mitigated against 'parking' and 'creaming'; and
- extract lessons from the review that may be used to inform the further development of the British approach to differential pricing.

The research design combined an evidence and literature review supplemented by email correspondence and telephone interviews with informed experts in relevant countries. Electronic databases were searched using the key words – 'creaming', 'cream-skimming' and 'parking', linked with other search terms such as 'differential prices', 'outcomes funding', 'output related funding' and 'performance-based funding'. The literature identified included survey, case study and evaluation reports produced by policy institutes, academics and Government departments.

1.2 Structure of the report

The first section of the report reviews performance-based contracting, employment programmes and the issues involved in differential access to employment services. Subsequently, the report reviews evidence on those countries that have made most extensive use of performance-based contracting, with case studies of Australia, the Netherlands, the USA and GB. The final section considers the policy implications of the case study findings.

2 Differential access to employment programmes

In Organisation for Economic Cooperation and Development (OECD) countries the Public Employment Service (PES) provides a job matching service for job seekers and employers and generally provides enhanced services for people who have greater difficulty in making the transition into employment. These core services are typically supplemented by a variety of employment programmes including job search assistance and counselling; training and education; work experience and job creation.

In most countries access to employment services and programmes is differentiated on the basis of the specific cash benefit that people receive and the employment barriers of individual service users. The eligibility rules for particular services and programmes are designed, in part, to increase cost effectiveness by reducing 'deadweight'. This ensures that service users who get jobs with minimal assistance are not placed in more expensive provision that might also delay their entry into employment. Such rules also serve to target particular individuals or groups to ensure they are placed in appropriate assistance. Eligibility rules also are connected with conditionality. The relevant eligibility rules for some benefits will signal those service users who can voluntarily choose to participate in a programme; for other benefits such rules signal mandatory participation.

Simple eligibility rules have obvious advantages in terms of their ease of operation and equality of treatment but they are a *'rather blunt instrument'* and may be *'inefficient in terms of achieving a good match between individual client needs and provision of support'* (Hasluck, 2004, p. 5). In many systems, as in the UK, front line advisers may be allowed to exercise a degree of discretion when interpreting eligibility rules and referring service users to more expensive provision.

In other systems public agencies have more elaborate screening and profiling instruments to ensure individualised and effective targeting. Profiling methods have been used extensively in European countries, Australia and the USA to score and weight the barriers facing individual service users and to allocate them to unsupported job search, particular programmes and/or other forms of support

(Rudolph and Konle-Seidl, 2005). In Australia the results from such profiling also have been linked directly with the differential prices paid to contractors who deliver services in the JN.

2.1 Employment programmes and performance-based contracting

There are wide variations in the delivery of employment programmes and welfare to work services. In some countries they may be delivered by the PES itself. In others they are delivered through a more or less complex network of public, private and third sector organisations. An OECD review found that in many countries employment and training programmes are outsourced and it reported variations in purchaser identity, contract size and contract terms (OECD, 2007).

Traditionally, the public bodies responsible for purchasing employment programmes have specified the detailed design of the particular intervention and the criteria by which participants are to be recruited. The public body also determined the price to be paid, the terms of the contract, and typically awarded a grant to the provider or paid the contractor for services delivered.

The 'performance revolution' that has gathered pace in a number of countries since the 1980s has seen the public bodies responsible for organising these services adopting a wider range of management techniques. These have enabled the purchaser to shift the focus of their relationships with external providers away from 'inputs' and processes towards securing the specific results that governments want. Greater emphasis was put on measuring and paying for the 'outputs' and/or fees for services delivered, and, more recently, on the 'outcomes' secured. Outcomes seek to measure the impacts of service delivery which, in the case of employment programmes, usually refers to job entry and latterly sustained employment and earnings.

Such changes of emphasis have been reflected in the contracts with which the purchaser seeks to make their programmes more efficient and effective. Purchasers now are more likely to hold contractors accountable for collecting and reporting data on the services they deliver and to withhold payments or withdraw contracts from providers who do not meet service standards. In a number of countries performance payments have been made dependent on securing employment outcomes with a variable proportion of provider income related to success in placing and keeping participants in jobs.

In various evidence-based reviews, the OECD has highlighted 'optimal' conditions for managing such 'quasi-markets'. It recommends a mixture of incentives and safeguards – *'combining pay-for-results and the principle of selective contract renewal with arrangements for more rapid elimination of providers whose performance is exceptionally poor and regulations that enforce minimum levels of service provision'* (OECD, 2005, p. 221). In a seminal review a senior economist

involved in developing the OECD analysis stressed the importance of accurate performance indicators and retaining independent control of referral processes for reducing deadweight and minimising creaming (Grubb, 2004). The evidence and analysis suggested that the best outcomes that correspond with longer-term impacts are likely to include unemployment exit, job entry rates, sustained employment and earnings in work.

2.2 From measuring performance to rewarding outcomes

The transition to performance-based contracting in employment programmes took place initially in the USA, following the implementation of the 1982 Job Training Partnership Act (JTPA) (Steedman *et al.* 1993). This legislation devolved funding and purchasing power to a national network of Private Industry Councils (PICs) and linked explicit performance outcomes with financial incentives to motivate agency staff. Annual performance target levels were set by the Department of Labor and the outcomes rewarded were designed to measure the return on public investment. Over time these outcomes evolved to include placement in unsubsidised employment; retention for not less than six months in such employment; increased earnings; a reduction in welfare dependency; and skills acquisition – including basic skills and qualifications.

An important characteristic of the JTPA funding model was that when the Department of Labor set state-level performance targets it provided a regression model that states could use to adjust targets to reflect economic conditions and participant characteristics in the Service Delivery Areas served by PICs¹. At the end of each programme year the federal department calculated the performance measures for each delivery area, along with any bonus to which a state was entitled. The state could allocate the bonus as it saw fit. High performing PICs could receive a bonus amounting to as much as 20 or 30 per cent of its regular budget which it then could use with more flexibility than allowed with its mainstream funds. These incentive systems were reflected in the contracts and payment systems between PICs and sub-contractors and by the end of the 1980s, 80 per cent of PICs were making at least some element of payment dependent on outcomes (Felstead, 1998).

Within the US, performance-based contracts were extended into other programme areas, including 'supported employment' for disabled people and the welfare to work programmes targeted at lone parent families. They were consolidated in the Workforce Investment Act (1998) that replaced JTPA.

¹ The JTPA model was influenced by health care provision where purchasers used risk adjustment models to correct for patient characteristics before judging the quality or effectiveness of medical care.

The US approach influenced other countries. In the UK TECs (England and Wales) and LECs (Scotland) were modelled on PICs. Introduced in 1987, these private sector bodies were funded through performance-based contracts with an increasing proportion of funding dependent on job outcomes and qualifications gained. The British Employment Service also introduced job outcome performance contracts for some of the separate provision it outsourced.

Subsequently, Job-outcome contracts were central to the design of the new market based employment services systems introduced in Australia and the Netherlands in the late 1990s. Other countries, such as Denmark, Canada and Israel, have implemented equally radical market-based reforms (Gould, 2007; Lilley and Hartwich, 2008). Some European countries, such as Germany, France and Sweden, are experimenting with the introduction of job outcome performance contracts (Jordan, 2008).

2.3 'Cream-skimming', 'creaming', 'parking' and differential pricing

The transition to performance-based contracts offers potential for innovation, flexibility and efficiency savings but the difficulties of managing complex services through contracts pose risks to service access, costs, quality and accountability (Heinrich, 2004; Heinrich and Choi, 2007).

There are three particular risks commonly thought to be intensified by performance-based contracts. The first is 'cream-skimming', where contractors who are paid by results select more job-ready participants. This is a particular risk where the group eligible for a service exceeds the number of available places and/or where providers choose who they admit to a service. Creaming can occur even when the provider is required to take designated participants. The second risk is that a provider may overtly or covertly concentrate their efforts on those participants more easily placed in employment. The third risk is 'parking' where more costly to help participants receive only minimal services and make little progress in a programme. If such participants secure employment through their own efforts this represents a 'windfall' gain for the provider.²

Purchasers of employment services try to reduce creaming and parking and to target services at the hardest to help. Such efforts may include requiring that providers accept all service users referred to them, whether by front line advisers or by random assignment, thereby reducing the potential to cream the most job-ready. Purchasers may also mandate providers to service all participants and then scrutinise the delivery of such requirements through regular contract monitoring and/or customer surveys. They may set specific performance standards for assessing employment barriers and referring those who need specialist assistance to appropriate support.

² It is important to note that these risks are shared in public sector delivery systems that measure and reward performance standards or targets.

In many countries it appears that provision for the hardest to help is targeted through specific programmes that have different prices, funding arrangements and performance standards during which participants are prepared for work and/or entry to work first provision. There is evidence, though, that some purchasers also use differential pricing to provide an enhanced payment to a provider as a necessary incentive to work with more disadvantaged participants. Such differential prices are commonly calibrated with the characteristics of disadvantaged service users. In the Netherlands, for example, purchasers have targeted performance-based contracts at particular groups and the price agreed reflects the distance from the labour market of the individuals involved. Only in Australia was there evidence of a more complex pricing structure that sought to incentivise work with the hardest to help through differential pricing.

3 The Australian Job Network and differential pricing

The Australian JN was created in 1998. It is a managed quasi-market providing scope for competition, some degree of choice for job seekers, flexibility in the way services are delivered and financial rewards for successful providers. Prices have been determined through the tender and contracting process but are now set at fixed rates by the purchasing agency.

Currently, the JN is comprised of a core of 99 'generalist' and 'specialist' providers delivering a full range of services. These are supplemented by a wider network of licensed Job Placement Organisations which provide vacancy finding and job matching services. Nearly all Federal employment services are outsourced and regulated through JN-type tendering and performance arrangements with an estimated overall value of A\$2.1 billion for 2008/09.

The JN has experienced three distinct periods marked by different 'Employment Service Contracts' and is about to undergo further reform in a contracting regime to be introduced for 2009-2012.

The design of the JN has changed as policy makers adapted the model to secure greater efficiencies and redefined its services to enable providers to 'activate' more working-age benefit claimants. Many of the reforms have been implemented to deal with unanticipated effects, notably in response to criticisms about creaming job-ready claimants and parking the most disadvantaged.

3.1 Job Network Services and Star Ratings

The JN delivers a job placement and matching service and more intensive services for the longer-term unemployed. Most JN funding is allocated to intensive services. In most locations the federal Department of Employment and Workplace Relations (DEWR)³ ensures the presence of several agencies to induce competition and provide choice for job seekers.

In the first two contracting periods, employment assistance consisted of short 'Job Search Training' courses for people usually unemployed for six months, and 'Intensive Assistance' (IA) for those out of work for more than a year or identified as being at risk of long-term unemployment. Those referred to IA were eligible for assistance for 12 or 15 months, depending on their degree of disadvantage.

The first contracts (1998-2000) were based on fixed prices for more intensive services and a bid price for job matching services. JN providers received a combination of 'up front' fee payments and job outcome payments after 13 weeks (interim) and 26 weeks (final). In the second contracts (2000-2003) price competition was extended to the more intensive services subject to a minimum 'floor' price set by the Department. Bids were assessed on quality as well as price but providers typically submitted bids close to the pre-determined 'floor' price (PC, 2002).

JN services were reshaped in 2003 to provide an 'Active Participation Model' (APM), designed to deliver a 'service continuum'. Job seekers since have been required to register with one JN provider contracted to deliver initial registration, job placement and matching. The 'continuum' combined regular review interviews with periods of assistance, punctuated by periods when unemployed job seekers had to undertake part time mutual obligation activities, typically in the form of 'Work for the Dole'. The intensity of JN interventions increased with duration of unemployment.

The most expensive provision – 'Intensive Support Customised Assistance' (ISca) – is mandatory after a year of unemployment or earlier if the person is 'highly disadvantaged'. Unlike the previous IA phase, ISca requires fortnightly contact with a case manager who develops and monitors a back-to-work plan. To inject more intensity the JN provider must involve the participant in at least three days a week of structured activity for three months, with total ISca participation limited to six months.

³ For consistency this report refers to DEWR although the name of the Department has varied and in 2007 was further amended to the Department for Education, Employment and Workplace Relations (DEEWR).

The APM introduced other changes, including a Job Seeker Account (JSKA). The Account comprised a restricted pool of funds earmarked for spending only on employment barrier reduction. The highest amount is triggered for those entering ISca. The Account is not an individual entitlement and a provider can use the account flexibly across their caseload. They are not allowed, however, to retain any surplus as profit. Although providers may spend the funds on a wide range of activities all expenditure must be classified and reported (ANAO, 2007, p. 18).

Performance is also driven through a 'Star Ratings' system that has been revised in response to provider feedback and to reflect changing policy priorities, such as the increased involvement of job seekers with disabilities or childcare responsibilities.

The original aim of the Star Ratings was to inform participant (and employer) choice but the system has proved more effective in driving provider performance (PC, 2002; ANAO, 2005b). The Star Ratings methodology includes regression adjustments for labour market conditions and participant characteristics allowing a more rigorous comparison of provider performance. The regression formula gives most value to full time employment outcomes sustained for 13 weeks or more secured as soon as possible after service users enter assistance. The speed of placement weighting was introduced in 2006 to reduce parking and to serve as a counterweight to a fees system that gives relatively little incentive to providers to place people until they are 12 months unemployed (Lam, 2007, p. 23). There is some adjustment of Star Rating scores to reward placement of the most disadvantaged, such as, long term unemployed and indigenous Australians, and there is now an adjustment to capture the length of time a person is continuously registered with a provider.

Star Rating performance is critical as high performance may increase business and secure future contracts whereas under-performance can result in loss of business and contract.

3.2 Job Network differential prices and the Jobseeker Classification Screening Instrument

The fees paid to a JN provider increase in relation to the intensity of service provided and risk involved in placing the job seeker in work (see Table 3.1). Outcome fees are significantly higher for those entering intensive support for a second time.

Early entry to the more expensive intensive provision for the 'hardest to help' is determined through the use of a profiling instrument. On making an initial benefit claim the individual is assessed at Centrelink, a public sector agency responsible for determining eligibility and making benefit payments. Front line staff use a computer-based diagnostic tool, the 'Jobseeker Classification Screening Instrument' (JSCI). It consists of 30 questions (reduced from 60 in 2003) intended to be quickly answered about age, education, disability, language skills, and so on. The responses are used to identify the level of disadvantage and likelihood of long-term unemployment.

Job seekers classified as 'highly disadvantaged' are eligible for immediate access to ISca and the provider is able to draw down a higher payment from the JSKA. There is also access to a location disadvantage supplement for job seekers in remote areas. Job seekers may choose from a range of specialist providers, where available, who have expertise in delivering services to particular groups such as those whose first language is not English; indigenous Australians; young people and mature age job seekers. In the first two contracting periods specialist JN providers were likely to get higher prices, reflecting their additional costs (PC, 2002, p. 9.29).

The JSCI produces a measure of relative disadvantage. It is the Department that determines the proportion of job seekers who qualify as highly disadvantaged. The proportion of highly disadvantaged job seekers fell from as much as 33 per cent in the early phase of the JN to ten per cent by 2007 (NESA, 2008, p. 25). Over the same period, however, the proportion of the JN caseload receiving income support for more than five years increased from 10 to 25 per cent (DEEWR, 2008, p. 4). This change reduced the resources available to JN providers even though they had to work with a harder to help client group.

Another issue concerns the initial assessment of relative disadvantage – which now might be undertaken through a call centre – where a minority of users fail to reveal factors that would affect their classification. These often come to light after the person has registered with a provider. In the early phase of the JN this led to many re-referrals to Centrelink, for which providers were originally charged, but subsequently, JN providers were allowed to enter new data on participants to revise their JSCI score. This not only increased the support available for the individual but meant the provider would be paid a higher fee for a job outcome and it would improve the provider's relative performance. This flexibility had unintended consequences when it was found that some providers inappropriately reclassified their participants. In 2007 several providers had to make repayments, amounting in the case of one provider to A\$9 million.

Table 3.1 Active Participation Model: service and placement fees, 2003-2006*

Duration of unemployment	Service provided	Service fees	Placement fees
0-3 months	Job Search Support	A\$60 Registration	A\$165 – A\$275
3-6 months	Intensive Support Job Search Training or Intensive Support Job Search Training Refresher	A\$660 for JST (3 weeks) A\$220 for JSTR (1 week)	A\$275 + A\$550 interim if still employed after 13 weeks (applies after 4 months)
6-12 months	Intensive Support Mutual Obligation or Work for the Dole	A\$90 for Review Interviews (7 months)	
12-18 months	Intensive Support Customised Assistance Period 1	A\$800 on starting CA	A\$385 + A\$1650 interim + A\$825 final (26 weeks)
18-24 months	Intensive Support Mutual Obligation or Work for the Dole	A\$70 for Review Interviews	
18-24 months	Intensive Support Mutual Obligation or Work for the Dole	A\$70 for Review Interviews	
24-30 months	Intensive Support Customised Assistance Period 2	A\$475 on starting 2nd CA	A\$385 + A\$3300 interim + A\$1650 final
After 36 months	Periodic Contact A\$100 for Review Interviews		A\$385 + A\$4400 interim + A\$2200 final

* There were marginal changes to service fees but not outcome payments for the 2006-2009 contract.

Source: McNally, 2003, p. 8.

3.3 The Personal Support Programme

Job seekers with special needs (such as mental health issues) that cannot be met by the JN, may, following assessment through the JSCI, be referred for a 'Job Capacity Assessment'. This assessment is used also to determine eligibility for the separate 'Disability Support Pension'. Job seekers whose circumstances prevent them from working until certain barriers are addressed may be referred by the assessor to a range of smaller specialist programmes including specialist provision for young people, for those with disabilities, or to the Personal Support Programme (PSP). Once a person has commenced in the JN they also may be referred by the provider to other relevant and available programmes financed by state governments, but they still have to demonstrate active job search.

The PSP is targeted at the most disadvantaged job seekers. It is a flexible provision that provides individualised case management for up to two years when service providers help participants work towards economic or social outcomes. Economic outcomes include transferring to work, employment assistance programmes and study or vocational training. Social outcomes include stabilised circumstances, increased community engagement, stable accommodation and improved life skills. During their participation job seekers are exempted from job search activity testing.

Most PSP providers are non-profit organisations. Their contracts are outcome-focused but include also significant payments for commencements and milestones achieved during participation (see Table 3.2). These contracts were, in part, modelled on the US milestone and outcome payments system for supported employment programmes (discussed later).

Table 3.2 Personal Support Programme: Milestone and outcome payments

Payment	Amount
Commencement Payment	A\$660.00
Action Plan Payment	A\$660.00
Milestone Payment	A\$660.00
Interim Economic Outcome Payment	A\$1100.00
Final Economic Outcome Payment	A\$440.00
Post-Outcome Support Payment	Variable
Completion Payment	A\$220.00
Social Outcome Payment	A\$825.00
Remote Loading	A\$550.00
Remote Service Annual Block Payment	Variable
Remote Loading Special	A\$550.00
Interpreter Assistance Loading	A\$660.00
Reconnection Payment	A\$165.00
Exit Payment	A\$165.00
Recommencement Payment	A\$660.00

Source: DEWR, 2005, Part C, Schedule C4.

3.4 Creaming and parking in the Job Network

Evaluations of the JN indicate that it has been more cost effective than earlier arrangements, has achieved higher 'net impacts' and has created strong incentives for providers to secure job outcomes (OECD, 2001; PC, 2002; DEWR, 2006). As with programmes in other countries, however, evaluations also report that job placement rates for more disadvantaged job seekers are lower, reflecting both their individual and labour market barriers. There have been particular problems with creaming and parking.

In the first two contract periods, when providers had greatest flexibility in delivering IA, it was found that most employment assistance was given in the first few months of participation and that a large number of service users had little subsequent contact with their providers. Critics suggested that the impact of differential pricing was offset by other funding incentives which encouraged providers to take the up-front service fees, work with the most job-ready, and park the hardest to help (Considine, 2005).

The introduction of the APM was designed to ensure more regular contact between providers and their participants. It has been suggested, however, that the other performance incentives, especially the Star Ratings, continued to shape provider behaviour in ways that disadvantaged the hardest to help and the providers who worked with them (Murray, 2006). Commentators have been critical of service quality, pointing out that low cost job search assistance and motivational strategies are unlikely to reduce the employment barriers of the hardest to help and that JN providers make little use of more costly employment subsidies or training provision needed to tackle the barriers of the most disadvantaged (ACOSS, 2008).

3.5 'A Fresh Approach': The new Australian Employment Services model

The present Australian Government, elected in November 2007, accepts that the existing JN model is complex and 'rigid' and that existing incentives 'skew' provider behaviour towards short-term jobs. Consequently, it has announced major reform proposals to resolve these issues and meet new objectives.

The new Employment Pathways system will replace both the JN and other specialist provision, such as PSP, with a unified service delivery model (DEEWR, 2008).

Centrelink staff will use a revised JSCI to categorise service users into one of four 'streams', with the most job ready referred to stream 1 and those with 'severe barriers' referred to stream 4. Each service user will develop an Employment Pathway Plan with their provider and a more flexible Employment Pathway Fund will replace the JSKA. The level of resources for each participant, and outcome incentive for providers, will increase in relation to duration of unemployment and the severity of the barriers indicated by the JSCI and the stream to which they are referred (see Table 3.3). On completion of a stream, usually after 12 months,

the user may be reassessed and moved to another stream, or more commonly be required to participate in work experience activity.

Skills assessments and referral to training programmes are a new element of the proposed provision. The completion of referred accredited training will result in a 20 per cent bonus to the JN provider concerned if the participants are subsequently placed into employment in a related area.

Under the new model all service, job placement and outcome fees are fixed and not subject to price competition (DEEWR, 2008, p. 8).

Table 3.3 Australian Employment Services: 2009-2012

Work Ready		Disadvantaged job seekers	
STREAM 1	STREAM 2	STREAM 3	STREAM 4
5% of new job seekers	22% of new job seekers	10% of new job seekers	15% of new job seekers
<ul style="list-style-type: none"> • A\$11 in Employment Pathway Fund • £385-A\$440 in Job Placement fees • Up to A\$781 in service fees 	<ul style="list-style-type: none"> • A\$550 in Employment Pathway Fund • £385-A\$2800 in Outcome and Job Placement fees • Up to A\$885 in service fees 	<ul style="list-style-type: none"> • A\$1100 in Employment Pathway Fund • £385-A\$6600 in Outcome and Job Placement fees • Up to A\$1120 in service fees 	<ul style="list-style-type: none"> • A\$1650 in Employment Pathway Fund • £385-A\$6600 in Outcome and Job Placement fees • Up to A\$2736 in service fees
	Work experience including Work for the Dole <ul style="list-style-type: none"> • A\$330 work experience service fee • A\$500 in the Employment Pathway Fund • Up to A\$392 in service fees per year 		

Source: DEEWR, 2008, p. 3.

3.6 Conclusion

The creation of the JN illustrates strengths and weaknesses in using market mechanisms to deliver employment services. DEWR created a viable delivery network and competition between providers and the outcome-related funding system stimulated some innovation and focused providers and their case managers on entry into sustained employment rather than on inputs and programme commencements. The JN was mired, however, in controversies about creaming and parking, about some providers playing the system and about increased rates of sanctions as some job seekers failed to negotiate complex attendance, participation and reporting requirements.

Several features of the Australian model have been designed to reduce creaming and parking, and these have evolved as evaluation and provider feedback have identified problems. A detailed review of the Australian system suggests that the use of evidence-based profiling and differential pricing created *'incentives to provide truly intensive assistance to particular disadvantaged jobseekers'* even if this was not immediately apparent (PC, 2002). The system was also supplemented by other interventions to ensure more equitable service delivery. The key supplementary features that have characterised the Australian system include:

- recalibrating provider fees so that a greater proportion of funding is ring-fenced for service delivery and case manager contacts, with the JSKA or proposed Employment Pathways Fund used to quarantine a proportion of spending that may be used only to directly reduce individual employment barriers;
- the creation of separate programmes or funding streams with specialist providers, such as the PSP, for the most disadvantaged for whom work first provision is likely to be ineffective, at least initially. Such programmes have used an outcome payment system, but one that rewards process milestones and both economic and social outcomes;
- the use of a 'quality' key performance indicator that enables the purchaser to scrutinise activity levels with individual participants, especially the very long-term unemployed, and to intervene through contract management and reviews where parking is observed; and
- loading performance measures, such as the Star Ratings, towards outcomes for the most disadvantaged.

The Australian system is entering a new phase and testing new approaches to its outcome payment and performance management systems which seek both to retain the focus on employment and to integrate this with the Government's other skill development and social inclusion objectives. After implementation, these new approaches will merit further scrutiny to inform British policy development.

4 The Dutch Reintegration Market and differential pricing

The Dutch welfare system has changed radically and now has three distinct markets for its 'reintegration services'. These markets reflect the role and responsibilities of different purchasers and the systems of income support for working-age people.

The Institute for Employee Benefit Schemes (UWV) is responsible for the social insurance system which covers most people in regular employment. The UWV is responsible for paying relatively generous wage-related benefits to people who cannot work either because they are unemployed or they have a long-term health problem or disability. It is also liable for purchasing reintegration services for those with greater employment barriers.

The Work and Income Employment Capacity Act (2006) reshaped the role of the UWV. Employers must now pay the wages of any sick or disabled employees for two years and have to reintegrate such employees within their company or in other employment. One aim of the legislation was to stimulate a separate private market for rehabilitation, occupational health and reintegration services, purchased directly by employers or the private insurance companies with whom they insure such risks.

Municipalities, or local government, act as purchasers in a third market where they procure reintegration services and employment programmes for social assistance recipients for whom they are responsible. There are 443 municipalities. In 2004 the mechanisms by which they were funded by central Government were fundamentally changed – giving municipalities a powerful incentive to reduce the number of people claiming social assistance. Many have done so through the introduction of work first programmes (van Geuns and van Gent, 2007).

In 2001 legislation required the UWV to contract out the delivery of most of its reintegration services to private providers. Municipalities also had to contract out up to 70 per cent of their reintegration services, although this requirement has

since been abandoned. Municipalities enjoyed considerable freedom in designing their procurement strategies and, whilst influenced by UWV developments, followed no common framework for contracting out services (Vink, 2003).

The following section considers the experience of the UWV which is the largest sole purchaser in the Dutch market. It reviews the ways in which the UWV has sought to shape its contract incentives to both secure cost effectiveness and that services are targeted at those hardest to help. Recently, the nature of the UWV market has changed markedly. The system of formal tenders and specific delivery contracts was fragmented following the introduction of 'Individual Reintegration Agreements' (IROs), that permitted users much more choice in negotiating their own support with service providers. This led to the introduction of a new 'purchasing framework' in 2008.

4.1 Profiling and reintegration services

In the Netherlands, workless people must first register for benefits at a 'Centre for Work Income (CWI)'.⁴ CWI advisers undertake a formal assessment of an individual before they can submit a claim for benefit. Initially the assessment included use of a profiling instrument, the 'Kansmeter', which allocated service users into four phases, with phase 1 indicating those thought capable of getting a job without intensive assistance and phase 4 denoting those viewed as unable to enter employment within a year. Phase 1 clients were serviced by the CWI with those on phases 2-4 referred to case managers in either the UWV or the municipality who assigned them to more or less intensive reintegration services.

'Reintegration' services encompass case management, assessment, rehabilitation, vocational and/or job search training, mandatory work experience, extended work trials, and job placement and retention services. In the market, the service packages are often organised and purchased as 'trajectories'. When a municipality or agency purchases what is called a full 'reintegration trajectory', this includes contracting out the case management service. Alternatively, in-house case managers in the UWV or municipalities refer service users to shorter service components procured through 'modular purchasing'.

The 'Kansmeter' profiling system was abandoned following criticisms that it led to inappropriate referrals and parking. Initially, up to 70 per cent of phases 2-4 clients were classified as phase 4 and this was taken as a signal by UWV and municipal case managers to provide no services. The instrument was criticised for its poor predictive powers, often caused by key factors not being identified at the CWI assessment, with the purchasing agencies and their providers often compelled to undertake their own subsequent assessments. Later evaluations reported that 18 per cent of those classified as phase 4 actually found work unaided or with the

⁴ The network of CWIs has been delivered by a separate agency but in January 2009 it will be merged into, and thereafter operate as a division of, the UWV.

help of an employment agency within a year. By 2007 the Kansmeter had been replaced by a simpler two phase system based on the capacity for independent job search. Those users categorised as 'A' were 'immediately employable', and those classified as 'B' were in 'need of further preparation for work' and referral to UWV or the municipality. This was designed to avoid immediate categorisation and give more flexibility to a CWI adviser to reassess a user if they encountered barriers in their search for work.

4.2 The UWV reintegration market

The UWV has led the development of the reintegration market. During the late 1990s social insurance agencies began to contract with private providers but the first significant tender was issued in 2000. Subsequently, the UWV organised some 16 'tender rounds' between 2002 and 2008 with the annual number of trajectories involved falling from the 60,000 purchased in each of the first two years to some 40,000 by 2006.

Each tender invited providers to submit bids to deliver batches of trajectories and services targeted at particular client groups, sectors and regions. At one point this involved some 48 separate categories of participants. By linking the tendered price to the degree of difficulty of the targeted group the UWV sought to limit any potential for creaming.

The UWV continuously adapted the way in which it designed tenders and managed contracts. The initial tenders, for example, incurred high transaction costs⁵ for both the UWV and providers, and problems were experienced in producing and assessing high numbers of submitted tenders in short periods (Sol, 2003, p. 212). Subsequent changes sought to reduce administrative burdens, create more stability and increase the emphasis on 'pay-for-performance'.

Throughout the period there were some common elements in how tenders were awarded and delivered. When bidding for a contract a provider had to indicate the average costs for a trajectory and the proportion of participants they would place into sustained employment, with minimum job placement rates specified by the purchaser. The bidder was expected to make their own judgements about the costs of trajectories and the performance levels they would attain and the purchaser could then decide which bid they would choose.

Contracts were typically awarded for one year until 2004 when the UWV awarded two-year contracts for some target groups and introduced the possibility of contract extensions for high performing providers. These changes covered about a third of the trajectories put out to tender.

⁵ Transaction costs are the administrative costs incurred by purchasing organisations and providers throughout the procurement process, for example, the costs of developing a service specification as part of an invitation to tender.

A UWV contract did not guarantee a minimum number of referrals for a provider. Actual recruitment depended on the discretion of the UWV case manager and, to some extent, the choice of the service user. This process was itself thought to act as a safeguard against 'creaming'. In certain circumstances, the provider could refer the service user back to the UWV if the individual had been wrongly assessed or was judged unsuitable, but it was rare for a provider to refuse to enrol a participant (Struyven and Steurs, 2005).

Once the contract commenced the provider could recruit a participant for up to a year and delivery of a complete trajectory could take up to two years. One consequence was that overall job placement results from particular contracts would not be known for up to three years from the point of commencement.

The primary aim of UWV contracts was to reward providers for placing participants in sustained employment. In the first phase of contracts the key principle was that of 'no cure, less pay' which meant that the provider would not recover the full price of the trajectory they had given in their bid unless they placed someone into a sustained employment outcome. A job entry fee was usually paid after two months in employment where the participant had a minimum six-month job contract and the payment could be higher for a longer employment contract (Struyven and Steurs, 2005).

Other contract clauses were designed to provide incentives that encouraged providers to exceed the job entry rates they committed to, and to do so quickly. These incentives varied in line with the barriers faced by particular client groups.

After 2003 greater emphasis was placed on 'payment by results' with the introduction of 'no cure, no pay' contracts for the relatively easier to place. In 2004 this applied to about 40 per cent of the trajectories contracted for. The other trajectories continued to pay for services delivered and outcomes secured. Between 10 and 20 per cent of the price was paid on completion of an action plan, a fixed payment of about 40 per cent six months after commencement and another 40 or 50 per cent after placement in a job for two months, with a minimum six-month contract (Sol, 2008, p. 77).

The UWV emphasis on price competition ensured a reduction in the average cost per contracted trajectory that had fallen to between €2,800 and €3,500 by 2007. Providers and others argued that the fall in prices and focus on short-term results to secure outcome payments had a negative impact on the quality of trajectories as providers removed costly service elements, especially longer-term training (De Koning, 2007). In response to Parliamentary pressure, the Government and UWV reintroduced an additional training budget in 2004.

UWV contracts have been designed to promote competition and reduce potential barriers to entry for new providers, and portions of the budget in several tenders have been reserved for local providers, new entrants, or innovative projects. Nevertheless by 2004 it was argued that provision was dominated by larger providers delivering standardised services and few new entrants were bidding

in response to tenders (Morrell and Branosky, 2005). Providers maintained that service quality was good although it had been weakened by lower prices.

4.3 Individual Reintegration Agreements (IROs)

The legislation that created the reintegration market required that services should be tailored to the users' needs and that participants should have 'freedom of choice', subject to the objective of moving into employment (SZW, 2003). In particular, there was provision that users should be actively engaged in the analysis of the barriers they faced and that their opinion should be sought on important issues, such as the selection of a reintegration agency.

In response to criticism about the standardisation of reintegration services and the lack of choice available, the UWV introduced IROs from January 2004. These allowed eligible service users to negotiate an individual plan with a provider of their choice, subject to agreement with the UWV who subsequently entered into a contract with the provider.

An IRO trajectory can last for up to two years and the normal maximum price is €5,000. For users with more significant barriers the price may be up to €7,500 and, in exceptional circumstances, the UWV may increase this limit still further. The contract offers a no cure, less pay funding formula and the provider is paid 20 per cent at the start of an agreed plan, 30 per cent after six months' participation with 50 per cent of the agreed fee payable for sustained employment. This formula may be varied with higher service fees for those most difficult to place. Although the total amounts are maximal prices, the average reported price per IRO trajectory in 2007 was €4,500. Only half this cost is incurred should the participant fail to get employment.⁶

The individual budget was more popular than expected and within months more users were opting for IROs than were participating in tendered trajectories. The IRO led also to an influx of much smaller providers, and the number of companies with whom the UWV contracted increased rapidly from less than 100 in 2003 to 1,960 by late 2007⁷. About 1,700 of these delivered IROs only and some 1,500 were 'one person-providers' who might only serve between 10 and 15 participants. The

⁶ There have been no rigorous evaluations of the net impacts or costs of IROs. Anecdotal reports refer to the positive effects that IROs have on the motivation and engagement of users who themselves report higher levels of satisfaction with the services received. One evaluation of raw outcome results and costs found that whilst IROs cost more per trajectory, job outcomes are higher. In terms of crude cost per placement, IROs were more cost effective for those claiming disability benefits and marginally more expensive for those claiming unemployment benefit (Sol, 2008, Table 3.2).

⁷ Estimates provided by Boaborea, the association of Netherlands providers, to the author in August 2008.

provider registration requirements were minimal and there was concern about the quality of provision. The rapid increase in IROs also undermined the tender system. Larger providers who had incurred the costs of securing tenders saw recruitment fall and began to re-engineer their processes to deliver IROs.

These developments led to a major overhaul of the UWV contracting system with the introduction in April 2008 of a new 'purchase framework' (Sol, 2008).

4.4 The Netherlands 'purchase framework', pricing and the reintegration coach

The new 'purchase framework' requires that all providers have to meet specified process and performance requirements to be placed on a UWV 'approved list', implicitly removing many of the small operators currently delivering IROs. The UWV selects between 150 and 200 providers in each region whose bids offer to provide either complete trajectories, in the form of IROs, or to provide all or some of six specified services (see Table 4.1). The UWV specifies maximum prices for each of these services whilst the provider determines the level at which they charge their fees – which is one of the criteria used by the UWV in compiling the approved list.

All the services except job search and placement are funded on cost reimbursement with no job outcome payment element. The job placement service, by contrast, is completely dependent on outcomes, with additional bonuses for the speed of placement, for a longer-term job outcome, and for placement in a job whose wage removes any continuing benefit entitlement.

Table 4.1 Service durations and fees in the UWV reintegration market

Service	Duration	Maximum Fee
Assessment of physical barriers	4 weeks	€1,000
Strengthening physical capacities	14 weeks	€2,500
Assessment of mental health barriers	4 weeks	€1,500
Strengthening mental health capacities	14 weeks	€3,250
Orientation to the labour market	10 weeks	€1,750
Job search and placement	22 weeks	€2,500 for six month job contract Bonuses €1,250 if placed within 16 weeks €1,000 for twelve month contract €500 for 'off benefit'

Source: Provided by Boaborea, the association of Netherlands providers, to the author in August 2008.

Within the new system, the UWV case manager, or 'reintegration coach' has a pivotal role. They provide an individualised service for each service user. The coach uses a diagnostic model, such as the 'ankermodel', which assesses the 'chances and

risks' of the individual. Such models include statistical tests on compliance, labour market and reintegration possibilities and duration on benefit, supplemented, where necessary, by other motivation and competence tests. The results are used by the coach to inform their professional judgement on the in-house and external services required and on an action plan agreed with the individual. The primary group for more intensive services are those who the coach judges may be placed in a regular job within a year or within two years for younger people on disability benefits. Many of the less disadvantaged unemployed will not have access to an IRO but the coach is likely to negotiate such trajectories with those on disability benefits or those with more complex barriers. For those who are furthest from the labour market the coach may consider another social activation option, known as 'societal participation'.⁸

4.5 Conclusion

The Dutch reintegration market has undergone successive adaptations as the UWV has sought to improve the efficiency of its contracted provision, personalise support and target intensive services at harder to help participants. The evolution of the tendering system saw the development of relatively small contracts designed to tackle the barriers of particular groups with prices and outcome payment terms differentiated according to assessed distance from the labour market. Tender selection criteria varied according to the needs of particular groups, with much greater stress on the professional competence of contractors, rather than price, for those selected to work with more disadvantaged groups.

The other safeguard against creaming and parking rested with UWV case managers who monitor participant progress against their action plans. How well this has worked in practice has been controversial. Under the new system case managers have acquired a more central role and it is not yet clear how they will exercise the new forms of discretion involved. There already is some evidence that their caseloads are higher than planned and that available budgets are limited – factors which are themselves linked to parking and creaming within public systems.

One final development relevant to differential pricing is emerging in the private market created by the disability legislation. It appears that some employers/insurers and providers use 'progressive pricing' models. Under these contracts the provider is paid a certain outcome fee for placing the first 40 per cent of a cohort of service users referred to them. The outcome fee is then ratcheted higher for fixed proportions of the cohort placed over and above that first level, incentivising the provider to invest greater effort in those who might be more difficult to place. Unfortunately, there is scant evidence yet available but this development may warrant more detailed scrutiny as DWP develops its approach to differential pricing.

⁸ Details provided in email correspondence with Dr. Els Sol, University of Amsterdam, August 2008.

5 US welfare to work services, employment programmes and differential pricing

The US has been at the forefront of performance-based contracting, welfare reform and outsourcing the delivery of employment and welfare to work programmes. Most US federal and state programmes use explicit measurable performance standards and include both positive and negative incentives to drive service delivery. The focus of many performance measures may be on service inputs, activities and outputs but the last decade has seen a '*dramatic shift towards outcomes as the dimension that really matters*' (Smith and Grinker, 2003, p.9).

The transition to performance-based contracting has shaped the way in which US employment and training programmes are funded and outsourced to external providers. There are multiple variations in performance standards and employment and training contracts used throughout the states (Martin, 2005). The contract models most relevant to the current British interest in differential pricing include those that 'pay-for-performance', where providers are paid most for achieving employment-related outcomes, and 'milestone' contracts, where providers are paid for a sequence of achievements and outcomes, including job entry and retention. Pure pay-for-performance contracts transfer most risk from the purchaser to the provider. Milestone approaches involve a more moderate risk for the provider in the event of performance failure. In practice many contracts are hybrids that balance performance incentives, provider viability and payment for service inputs.

The following sections consider available information on two such contracting systems – the pay-for-performance contracts used in New York City for the delivery of welfare to work programmes and the milestone payment system used in Oklahoma to deliver supported employment services for 'developmentally disabled individuals'. Both contracting systems have been emulated in other US states,

with the Oklahoma model influencing the development of similar programmes in the UK and Australia (Corden and Thornton, 2003; DEEWR, 2007). Another section considers findings from the extensive literature on employment and training programmes delivered through JTPA and Workforce Investment Act (WIA). Whilst there is little direct evidence on the use of differential pricing, there are significant evidence-based findings on creaming and on the type of employment outcome indicator most closely associated with positive net impacts for the most disadvantaged.

5.1 Performance standards and welfare to work services

There has been no recent comprehensive review of the contracting out of welfare to work services in the USA, but there is evidence that the process accelerated after the passage of welfare reform legislation in 1996 (Finn, 2007). Nearly all states contract out some of their welfare to work services with several contracting out the delivery both of case management services and employment programmes. Typical outcome measures include employment, job retention, wages or earnings, and participation in work activities. Process standards measure, for example, the number of programme enrolments, completion of assessments and accuracy of referrals.

One detailed study of welfare to work contracting revealed no specific evidence on the use of differential payments but there was concern that the focus on performance standards might create perverse incentives such as creaming and parking. There was, however, '*no evidence that they were a serious problem at the time of the site visits*' (McConnell *et al.* 2003, p. 42). Providers pointed out, for example, that it was difficult to favour participants who were more likely to become employed, because they could not identify those people easily, and most of their participants faced employment barriers. Moreover, by including both outcome and process measures the contracts involved were designed to mitigate such perverse incentives. For example, the inclusion of measures related to job retention, wages and benefits, and earnings gains diminished the incentive to place participants quickly into poor quality jobs. Programme enrolment measures increased the providers' incentive to engage all service users referred to them. Measures indicating completion of assessments and activities also limited the ability of providers to service participants differently. The challenge was to balance such process measures in ways that kept the provider focused on transitions into employment and allowed them to innovate.

As US welfare caseloads have fallen there has been increased attention on the problems of the 'hard to help' or 'hard to engage' groups who now comprise a large proportion of those targeted through welfare to work programmes. There is an extensive evidence base on what works with such groups and on the design features of particular interventions (Brown, 2001). There is, however, little available evidence on the use of differential pricing.

5.2 Pay-for-performance contracts in New York City

New York City (NYC) is a useful comparator because it has few process measures, has made extensive use of pay-for-performance contracts and lets some of the largest value welfare to work contracts in the USA. This partly reflects its use of prime contractors, who are awarded three-year contracts, and the fact that the city has the largest welfare caseload in the USA. This is both because of the size and complexity of the local population and because the city continues to support lone parents and others who exhaust their time-limited entitlement to the federally funded Temporary Assistance for Needy Families.

In New York there are parallel systems for delivering employment and training programmes in the city. The Human Resource Administration (HRA) is responsible for delivering 'public assistance' cash payments and referring all eligible applicants to mandatory employment programmes via its network of local Job Centers. WIA employment and training funds are distributed through a network of Workforce 1 Centers, run by the Department of Small Business. In 2007 these workforce centres provided services to some 80,000 residents, some of whom would have been involved in HRA provision.

HRA Job Center staff assess benefit eligibility and employability and all job-ready applicants are referred to a jobsearch provider before a benefit claim is processed. The proportion of applicants deemed not ready for full engagement with work activities increased as the welfare caseload fell. By February 2007 the caseload had fallen to just under 370,000, down from over 1.1 million in 1995. Over 55 per cent of the caseload was assessed as partially or completely unable to work (Kasdan and Youdelman, 2007, p. 7).

Since 2000 welfare to work employment services have been contracted out and delivered through a network of prime contractors (Savas, 2005). Until 2006 separate prime contractors delivered either Skills Assessment and Job Placement (SAP) or Employment Services and Placement (ESP) services. SAP contractors were co-located in Job Centers and provided assistance during the first two weeks before an applicant received public assistance. SAP providers were paid standard fees for the initial assessment but mostly for job placements, 13 and 26 week retention, with more paid if the client's wages eliminated the need for public assistance (OC CNY, 2007). One study reported that SAPs were paid \$250 per person to diagnose potential work barriers, with between \$750 and \$1,750 per person for placement and retention (Fischer, 2001, p.8).

After an applicant was awarded public assistance they were reassigned randomly by Job Center staff to one of 11 ESP contractors. ESP provision commenced with a 'rapid work attachment' phase in the first two weeks after which the individual spent two days a week with the ESP provider and three days a week on a mandatory Work Experience Placement, usually with a city agency (most notably the City Parks Department). ESP provision could include short training courses or mandatory treatment programmes.

ESP providers were paid only for job entry and retention performance with similar milestones as those in SAPs (OC CNY, 2007). The rewards for ESP providers were higher. Between 2002 and 2005 they would receive \$1,227 for a job placement; \$2,209 after 13 weeks' retention or \$2,700 in the case of a higher wage job; and \$491 after 26 weeks' retention or \$1,473 if in a higher wage job and/or the case was closed.

The different prices in the two delivery models were designed to reflect the potential for creaming. The SAP providers were paid about a third of what an ESP provider was paid because they could '*cream the easy to place*'. This left the '*higher payments for the participants needing longer term help*' (Turner, 2001, p. 11). Those who had multiple employment barriers and for whom few job outcomes were likely had specialised intensive services paid for separately outside the performance-based system (Savas, 2005).

In 2005, alongside a major review of New York's poverty reduction strategy, it was decided to restructure welfare to work provision and to combine SAP, ESP and work experience provision into a single back to work programme. The new model was designed, in part, in response to criticisms that providers placed few participants in sustained employment and that contract incentives did not encourage them to invest in the hardest to place (Youdelman and Getsus, 2005, p.3).

Each Job Center works now with only one prime contractor who is expected to provide customised and flexible employment and work experience services and work with a service user 'from start to finish'. The contractor must develop a 'Job Retention and Career Plan' for each participant to document their efforts to 'advance' the individual through skill development and financial planning.

Contractors receive only a nominal administrative payment for participants not placed in jobs, and only partial payment for short-term job placements. The total annual funding for the HRA Works programme amounts to \$63 million and contracts reward the milestones outlined in Table 5.1. A significant feature of this model has been the introduction of an additional bonus payment for providers who succeed in placing sanctioned benefit claimants. There are few results yet available on the impact of the back to work model (Doar, 2007).

At the start of 2005 the city also implemented the WeCARE (Wellness, Comprehensive Assessment, Rehabilitation and Employment) programme, to cater for the increased numbers in the caseload with multiple and complex barriers to employment.

Table 5.1 NYC HRA back to work performance milestones

<p>Employment plans</p> <ul style="list-style-type: none"> • Completion of an Employment Plan (pre-employment). • Completion of an Employment Plan (post-employment). <p>Unsubsidised employment</p> <ul style="list-style-type: none"> • Placement into unsubsidised employment for 30 days (minimum 20 hours a week). • Retention in unsubsidised employment for 90 days after initial placement. • Retention in unsubsidised employment for 90 days with case closing. • Retention in unsubsidised employment for 180 days after initial placement • Retention in unsubsidised employment for 180 days with wage gain. <p>Incentive/disincentive payments</p> <ul style="list-style-type: none"> • Incentive payment for a decline in the number of participants who have failed to comply with work requirements and whose cases are sanctioned. • Incentive payment for an increase in the rate of sanction removal. • Disincentive for an increase in the public assistance recidivism rate. • Disincentive for a decline in administrative indicators (e.g. Employment Plan completion and timely attendance notification).
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Source: Youdelman and Getsus, 2005, Appendix A.

HRA allocated over \$200 million over three years to service about 45,600 benefit recipients each year. The programme is delivered by two prime contractors who deliver services through sub-contractors. Arbor is owned by the large US provider ResCare, and FEGS (Federation Employment and Guidance Service) is a large New York-based non-profit organisation. The programme has about 24,000 participants at any given point.

Job Center staff refer eligible individuals to the provider for a bio-psychosocial assessment and 'functional capacity outcome'. By 2007, 7.3 per cent of those assessed were found to be fully employable and referred to full engagement work activities. 45.7 per cent were 'employable within limits' and referred to a WeCARE provider for specialised employment services and a work assignment that accommodates their disabilities. 37.3 per cent deemed 'temporarily unemployable' were referred for 'Wellness Plans', involving referrals for health interventions to improve their condition. Just under ten per cent were considered not employable within a year and were assisted by a provider to apply for federal disability benefits. Only 3,500 participants had been placed in employment (Doar, 2007).

The contracts for WeCARE are hybrids. Two-thirds of the prime contractors' potential income is performance-based and milestone-driven; a third is paid for services claimed on a monthly basis. This payment system reflects the barriers faced by the client group, but remains performance-driven with significant payments for sustained employment outcomes. It is unclear from the available literature why the performance payments are higher for FEG (see Table 5.2).

There has been much positive comment on the design of the New York model and its potential to improve employment outcomes for some of the hardest to help welfare recipients. Critics suggest, however, that the prime '*contractors and their sub-contractors are not adequately translating a good programme into beneficial services and support*' (Kasdan and Youdelman, 2007, p.8).

Table 5.2 HRA payments to WeCARE contractors for services

	Arbor	FEGS
Services		
1. Phase I bio-psycho-social assessment	\$260	\$250
2. Phase II bio-psycho-social assessment	\$136	\$175
3. Complete wellness/rehabilitation	\$600	\$975
4. DVE/IPE completed	\$700	\$480
5. 12-week cycle of work activities	\$600	\$975
Performance-based milestones		
<i>Subsidised employment</i>		
6. Employed, 30 days after placement	\$600	\$2,000
7. Employed, 90 days after placement	\$850	\$2,400
8. Employed, 180 days after placement	\$1,950	\$2,960
<i>Unsubsidised employment</i>		
9. Employed, 30 days after placement	\$1,700	\$2,500
10. Employed, 90 days after placement	\$1,800	\$2,700
11. Employed, 180 days after placement	\$1,905	\$2,960
<i>SSI/SSDI</i>		
12. Attain federal disability benefits	\$805	\$750

Source: Kasdan and Youdelman, 2007, Appendix D.

5.3 Milestone payments: the Oklahoma model

The development of milestone payment systems in programmes for people with disabilities is closely associated with the Oklahoma model. Introduced as a pilot in 1991, it has been subsequently refined and extended to replace fee-for-service contracts for the delivery of vocational rehabilitation services. The milestone model was used as the template for reform in other states and countries and evaluations appear to show that such systems have improved outcomes and reduced costs (Corden and Thornton, 2003; O'Brien and Revell, 2005; Gates *et al.* 2005; DEEWR, 2007).

Oklahoma's milestone contracts specify a series of distinct and critical achievements that must be met prior to payment with the greater percentage (60 per cent) of contractor income tied to output, quality and job outcome performance. The structure of the milestones differed slightly depending on whether the participant had mental health or developmental disabilities, but the basic model is outlined in Table 5.3. The purchaser also created a two-tier system of payments through which service providers would be paid higher fees for service users designated as 'highly challenged'. This premium was typically about 30 per cent, from \$1,000 to \$2,000 more than the regular payment (Frumkin, 2001).

Table 5.3 Oklahoma Milestone Approach

Determination of need (process)	10%
Vocational preparation (process)	10%
Job placement (output)	10%
Job training (process)	10%
Job retention (quality/outcome)	15%
Job stabilisation (outcome)	20%
Case closure (outcome)	25%

Source: Frumkin, 2001, p. 12.

The new contracts were introduced with competitive bidding. According to the designer and implementer of the model, the bidding process forced service providers *'to compete against the average, bringing down the high, the very inefficient providers, pressuring them to move towards the average'* (Frumkin, 2001, p. 13). Once the bids were received, the purchaser evaluated them by looking at the per-user bid price and the average cost per closure, as well as past history and the geographical area served. The purchaser then agreed a final price with the provider. Case managers monitored delivery and documentation was required at each stage to ensure progress and trigger payments.

A 1997 survey found that 13 of the 16 providers on the new model showed improvements in all areas. Waiting lists had been reduced by half, time before job placement reduced by 18 per cent and cost per closure dropped by 25 per cent. There also had been a reduction of one-third in the paperwork required by the older fee-for-service system. By 2000 it cost the state \$10,740 on average to bring a case to closure compared with an average cost of \$22,000 in 1991 (Frumkin, 2001, p. 15, p. 18).

The new contracting process resulted in problems for some providers who chose not to bid or who struggled to meet performance standards and so lost contracts. An important criticism was that of creaming, with about a third of providers saying they were more selective (albeit two-thirds said it had no effect). The designer of the new model accepted the need for 'vigilance' but argued that higher payments for the 'highly challenged' offset creaming. The purchaser also had used a 'stochastic probability model' in the bidding process to calculate the risk that a provider faced.

This enabled them to incorporate into the payment the amount of risk involved and by making that risk more manageable reduced any pressure on the provider to cream. Some providers argued, however, that the larger payment did not offset the higher risk and cost involved and some were '*hesitant to work with difficult clients*' (Frumkin, 2001, p. 19).

Another weakness was that the number of people who could be recruited by a provider was capped. Once successful providers recruited the number specified in their contract they either had to stop accepting new participants or provide a free service until a new contract began. In some cases the purchaser brought forward the start date of a new contract but was reported, in the evaluation, to be considering longer-term solutions. One possibility was the creation of open ended contracts. Another was the introduction of a voucher system, allowing service users, or those able to act for them, to choose their provider (Frumkin, 2001, p. 20).

5.6 JTPA and WIA employment and training programmes and 'cream-skimming'

The performance standards established under the JTPA served as the 'prototype' for their extension into other federal employment and training programmes (Heinrich, 1999). JTPA performance standards evolved continuously between 1982 and 2000, when its services were incorporated into the reforms initiated by the WIA (1998). WIA brought together multiple federal funding programmes for coordinated delivery through a network of 'one stop career centres'. States, local delivery areas and providers are held accountable for their performance against standards that include job placement rates, earnings, retention in employment and skills and qualifications obtained. Failure to meet the standards can lead to financial sanctions whereas high performance is rewarded by incentives. Service providers must meet performance standards to remain eligible for WIA funds.

As with JTPA WIA training and employment services are targeted at disadvantaged groups, including the adult unemployed, young unemployed people and welfare recipients. Delivery is devolved to individual states with some latitude to modify and augment performance standards. Most delivery centres sub-contract service delivery to public, for-profit and non-profit organisations and use subsidiary performance standards systems in their contracts with providers.

From its introduction there was a continuous debate about whether JTPA performance measures motivated service providers to work with the more easily placed and whether services should be targeted at those most in need or those most able to benefit (GAO, 1989). Detailed evaluations found that managers of JTPA services responded to performance incentives by organising service delivery to maximise measured performance. These incentives were strongly reinforced in the performance-based contracts given to providers. Indeed, there was evidence that contracts with sub-contractors had higher performance standards to provide the purchaser with greater confidence that it would meet state standards (Heinrich, 1999).

The proportion of outcome payments in JTPA programmes tended to be far lower than that used in the UK. One review found that, typically, the proportion of funding that depended on outcomes ranged between ten and 20 per cent. The *'US performance system relies more on procedural sticks than [outcome] carrots'* (Felstead, 1998, p. 47).

Participation in JTPA services was voluntary and the resources available meant that no more than five per cent of potential user groups could participate. Federal eligibility rules themselves acted to check 'cream-skimming' but detailed econometric findings showed that strong performance incentives encouraged the selection of more job-ready applicants and less willingness to use more intensive and expensive training provision. Even when case managers indicated a desire to help the most disadvantaged, analyses of their actual referrals to services showed that the *'probability of meeting the standard was the most statistically significant and numerically influential factor in selecting applicants'* (Heckman *et al.* 1997, p. 393). Multivariate analysis of inter-state variations in incentive regimes and recruitment trends found that *'high incentive regions encourage enrolment of the more able individuals from the eligible pool'* (Cragg, 1997, cited in Felstead, 1998, p. 46).

The results from several detailed evaluations suggest, however, that fears of policy induced 'cream-skimming' were exaggerated, and that the creaming which occurred had *'no effect on mean impacts'* (Barnow and Smith, 2004, p.274). It appears rather that the lack of information available to eligible participants and the choices they made played the *'major role in accounting for demographic disparities in programme participation'* (Heckman *et al.* 2005, p. 392). Over time JTPA programme designers redefined performance standards to reduce opportunities for such 'dysfunctional behaviours' (Courty and Marscke, 2003).

In the US there has been continuing debate on performance measurement. The federal government has introduced 'common measures' of performance across a wide range of employment and training programmes, including welfare to work services. There remain concerns, however, that the measures will encourage cream-skimming with reform proposals calling for the development of an 'adjustment requirement' to allow for the economic or demographic characteristics, or known barriers to employment, of individual participants. In an interesting development individual states have proposed, and are testing, their own 'return on investment' performance standards that seek more accurate measurements of the net impacts and social returns of employment programmes, which can be used to drive provider behaviour (Rubinstein and Mayo, 2007). Such methodologies may merit further investigation.

5.7 Performance-based outcomes and the most disadvantaged

There is a trade-off between obtaining timely measures of performance and accurate ones. Programme managers and purchasers need shorter measurement periods than in more rigorous net impact evaluations, but the evidence from JTPA evaluations is that *'short term measures are especially vulnerable to manipulation'* (Courty and Marschake, 2003).

One significant finding from the JTPA evaluations was that the relatively short-term employment-related performance standards measured were *'either uncorrelated with or negatively corroborated with net value added, especially in the long run'* (Heckman *et al.* 2005, p. 392). In a comprehensive review of the JTPA evidence Barnow and Smith suggest that the revised approach to performance standards introduced by WIA has taken the delivery system *'farther away from the evidence than it was before'* (2004, p. 276). WIA has incorporated more programmes and established 17 performance standards that are now negotiated with individual states rather than based on a standard model as with JTPA. Evaluators discern that the implementation of these new standards appears to be *'generating inappropriate incentives for programme managers to improve measured performance rather than service access or quality'* (Heinrich, 2004). Amongst other recommendations Burnow and Smith emphasise the necessity for longer-term research to determine *'short-term outcome measures that are reliably correlated with long-run programme impacts and cannot be gamed by local programs'* (2004, p. 275).

With regard to high quality welfare to work evaluations, the evidence is mixed on the relationship between performance standards and longer-term outcomes. One Manpower Demonstration Research Corporation (MDRC) review of such evaluations suggested that many performance indicators *'appear to work poorly for a wide range of people'*. When the results from studies that measured three-year effects were disaggregated for the most disadvantaged groups it was found that average earnings levels *'are a fairly good, though not perfect, indicator of which programmes were most effective'* and that the programmes involved *'had among the largest impacts for the most disadvantaged'* (Michalopoulos, 2004, p. 29, p. 30). This suggests that performance standards that measure earnings levels could be an important signal of effectiveness in a differential pricing system.

6 Differential pricing in the British welfare market

The UK was the first European country to make extensive use of 'output related funding' (ORF). This was the culmination of a reform process aimed at increasing the effectiveness of employment and training programmes.

The most radical development occurred in 1988 when responsibility for purchasing training programmes was transferred from the public sector to a national network of local TECs in England and Wales and LECs in Scotland.⁹ These independent, employer-led companies were funded increasingly on the basis of achieved training or employment outcomes, a funding system they also used with their sub-contractors. The Employment Service continued to separately purchase job search assistance programmes and it too placed greater emphasis on competitive bidding and rewarding providers for securing job outcomes.

6.1 The TEC funding system

The TEC network delivered a wide range of training and enterprise programmes but most of the budget received was for the delivery of Youth Training (YT) and Training for Work (TfW). In 1993/94, for example, the overall TEC annual budget was £2.4 billion of which £1.8 billion was for YT and TfW. There was an endorsement process within both YT and TfW through which specific hard to help trainees were identified and attracted higher prices (see Figure 6.1).

The Employment Department (ED) of the Department for Education and Employment negotiated annual contracts with each TEC which agreed a contract price with targets for completed training weeks, volumes of participants and outputs. Young people were steered towards obtaining Level 2 National Vocational Qualifications (NVQs). In the case of unemployed adult trainees there was greater emphasis on

⁹ The review evidence was concerned mainly with the experience of TECs, although many of the developments described and issues raised applied equally to the training programmes of the Scottish LECs.

job outcomes, measured 13 weeks after a person completed training. Individual TECs had annual budgets of between £15 and £50 million (Bennett *et al.* 1994).

There was no variation in training week payments but ORF was introduced in 1990/91 when it comprised ten per cent of TEC budgets. It was assessed in relation to a points score weighted to reflect the policy value placed on qualification levels and job outcomes. The proportion of ORF funding increased to between 25 and 40 per cent in 1993/94. At this point seven TECs also moved to a 25 per cent: 75 per cent 'starts and outcomes' model for their TfW provision that was subsequently extended. By 1997 output payments accounted for between 25 and 35 per cent of the YT budget and 75 per cent of the TfW budget. ORF funding was also introduced to Scottish LECs from 1992/93.

There initially were other allowances covering certain expenses, such as workplace adaptations, trainee travel costs and childcare costs. These would often be paid as supplements to training weeks paid to providers but dissipated with the introduction of the ORF payment system.

TECs had considerable flexibility over their budgets including the capacity to generate surpluses, although these had to be spent in meeting wider TEC objectives. In addition, TECs were given a smaller allocation for a local initiative fund, often used, in part, for targeted provision for particular groups including, for example, minority communities or otherwise 'harder to help' populations.

The Government introduced a competitive performance related funding bonus that was paid into the initiative fund. This was allocated on the basis of how well the TEC had met wider strategic Government priorities including, for example, the number of trainees with disabilities who got a job outcome or the number of those assisted who lived in designated inner city or special areas. This funding accounted for a small proportion of TEC budgets. In 1992/93, £26 million was allocated to over 60 TECs (Finn, 1994).

Figure 6.1 Youth Training and Training for Work special needs endorsements

YT was largely for 16- and 17-year old school leavers and replaced the earlier Youth Training Scheme (YTS). YTS had distinct 'modes' of funding. Mode 'A' had lower unit prices to reflect the direct involvement of employers and was often delivered by private agencies. Mode B typically was delivered by local authorities and voluntary sector organisations with higher unit prices. The introduction of YT ended the formal separation of provision but introduced special arrangements for harder to place young people whereby the Careers Service would 'endorse' young people with special needs into three primary categories:

- Category A: trainees who require a period of initial training before being able to move into mainstream training.
- Category B: trainees who, even with additional support counselling and guidance, are unlikely to achieve a Level 2 NVQ within a reasonable time scale (approximately two to three years).
- Category C: trainees who, with additional support counselling and guidance, would be able to achieve a Level 2 NVQ within a reasonable time scale.

Young people who had literacy or numeracy needs which significantly impaired their opportunities in the labour market would be endorsed as Category L or N.

Young people endorsed as Category B could follow a programme leading to a Level 1 NVQ which, once awarded, carried a 50 per cent premium on the payment of a mainstream NVQ. Those young people endorsed as C or as 'requiring significant support and help' could follow non-NVQ basic skills courses which, once achieved, carried the same payment and points as a mainstream NVQ2 (Felstead, 1998).

TfW was introduced in 1992 replacing earlier programmes. It was targeted at adults who had been unemployed for over six months who would usually be referred to a contracted provider by the Employment Service following a Restart interview. The objective of TfW was to assist longer-term unemployed people into employment and/or improve their vocational skills. There was an endorsement process for TfW participants but only for those with self-disclosed literacy and/or numeracy barriers who would attract output points for achieving basic 'Wordpower' and 'Numberpower' certificates.

6.2 TECs and contracted providers

TECs acted as area-based prime contractors and within the limits determined by their own contract with the Department, had flexibility to develop contractual and payment terms with providers. By 1994 there was wide variation in TEC pricing strategies and in what they paid providers, both for training weeks and for ORF (ED, 1994; Finn, 1994). Many paid flat rate fees for training weeks delivered with differential payments for high cost occupational areas, such as engineering, and for those with endorsed special needs. Some TECs also differentiated prices by the nature of the provider, for example, paying different rates to local and national providers, or to employer-led bodies.

An ED survey reported that all the TECs contacted paid higher prices to training providers who recruited endorsed special needs trainees, but there was no consistent approach and they were incurring deficits on these allocations. This Departmental survey also concluded that there was *'little evidence to suggest that TECs derive their broader price range from a detailed knowledge of costs'*, or *'that any one method is more effective than another'* (ED, 1994, paras 39 and 53).

6.3 The impact of output related funding

The outcome funding model for TfW specified that 25 per cent of the agreed total amount for the trainee would be paid per start, with a minimum of 75 per cent for the total outcome payment. Outcome payments were weighted with job entries paid significantly more than qualification attainment or entry into full time education. TEC budgets included some extra weighting to reflect the duration of unemployment prior to entering TfW and whether or not a trainee had special training needs. In the seven areas where the new model was piloted, the 13-week rule for collecting evidence on employment status was relaxed, with TECs and their providers able to collect evidence *'on any day within 13 weeks of leaving the programme'* (Coopers & Lybrand, 1995, p.6).

The performance of these TECs was matched to other comparable TECs on the existing arrangements. There was a significant increase in outcomes under the new system, although the actual performance gain was lower when calculated from a wider survey of outcomes for ex-trainees. The evaluators attributed 20 per cent of the improvement to the new funding regime and 25 per cent to the 13-week rule change. Other tests showed that over 90 per cent of the jobs claimed for under the more relaxed evidence rule had lasted at least 13 weeks (Coopers & Lybrand, 1995).

This performance gain was associated with a greater degree of selectivity with *'a possible reduction in the proportion of [special needs] trainees recruited'* and signs that providers were targeting trainees who were *'6 to 12 months unemployed (and particularly those just over six months unemployed) who appear to be the most likely group to secure a positive outcome'* (Coopers & Lybrand, 2005, p. 59).

Whilst providers remained willing to recruit trainees with literacy and numeracy problems, where the risks involved in obtaining qualification outcomes were known and achievable, there was greater hesitancy about taking on the very long term unemployed. Providers suggested that the payment weightings that TECs passed on were not adequate to offset the risk (Coopers & Lybrand, 2005, p. 42). The evaluators suggested that provision available through other channels might be more appropriate because TfW was explicitly designed as a selective programme targeted at individuals who, with appropriate training, were likely to secure a job outcome.

When the full ORF system was extended to TfW nationally it intensified the debate about creaming and the adequacy of provision for special needs training. It was reported that the increased emphasis on outcomes, especially job outcomes, had forced many providers to be more selective, leaving specialist voluntary sector providers with the 'harder to place' participants thereby undermining their viability. This was intensified by budget reductions to TfW of 18 per cent between 1994/95 and 1995/96 (HoC EC SC, 1996, p. xi).

The Government argued that the impact was mitigated by the system of weightings and bonuses it had introduced requiring, for example, TECs to ensure that the absolute numbers of TfW trainees with special needs, disabilities or 18- to 24-years olds who were long-term unemployed was maintained in 1995/96. It rejected calls, however, to ring-fence budgets for disadvantaged trainees, although it subsequently conceded that these restrictions might be implemented for poor performing TECs (HoC EC SC, 1996, p. xli).

6.4 The demise of TECs

There are mixed reviews of the performance of TECs and of the impact of the programmes they delivered (for a review see: HoC EC SC, 1996). There was continuous controversy about the impact of ORF and expenditure reductions on the adequacy of TEC provision for disadvantaged trainees. The additional incentives in the TEC funding system for ensuring that their needs were met were weak compared with the greater outcome and funding pressures on mainstream budgets that were transmitted to providers through contracts. Over time the funding system shifted the focus of YT and TfW activity towards lower cost provision that marginalised provision for higher cost trainees in general and special needs groups in particular.

TECs had considerable flexibility in shaping their own priorities, including the discretionary funding they allocated for special needs and other disadvantaged groups (Meager and Honey, 1993). There were major differences in how each TEC determined its priorities, with some attaching little importance to special needs training (Bennett *et al.* 1994). The consequence was significant variation in the availability and adequacy of provision for the most disadvantaged, even in neighbouring areas. Given the political controversies that emerged, many

TEC directors themselves felt somewhat 'under siege' on these issues, subject to conflicting demands and pressures from different interest groups on the one hand and conflicting or ambiguous requirements from the Department on the other (Meager, 1995; HoC EC SC, 1996).

Other problems emerged about TEC-related payment systems with critical National Audit Office and Parliamentary reports (NAO, 1995, 1996). These highlighted poor audit practices and 'gaming' in the system with duplicated and incorrect payments, inadequate supporting evidence for claims from some providers, and high level TEC reserves (Bennett, 1994). There were high profile cases of providers registering non-existent trainees and placing trainees in temporary employment for a short time to trigger job outcome payments (Jones, 1999). There were also criticisms of the governance of particular TECs and in 1999 a White Paper criticised the complex funding, administration and contracting system for TECs and their providers which at its worst '*absorb[s] resources which would otherwise benefit the trainee*' (DfEE, 1999, p. 19).

The White Paper led to creation of the national network of Learning and Skills Councils and the decision to end TEC operating licences in April 2001. The Learning and Skills Council was made responsible for distributing funding for all post-compulsory school age education and training (apart from Higher Education), and Work Based Learning for Adults, which had replaced TfW, was transferred to the Employment Service.

6.5 Employment Zones and differential pricing

Since 1997 there have been changes in how the Employment Service, Jobcentre Plus and DWP contract with external providers for the delivery of employment programmes. Whilst the emphasis on outcome-related funding has been increased somewhat, for example, in the New Deal for Young People, the only significant use of differential pricing has been within EZs.

EZ providers have considerable flexibility in how they deliver services and the funding model rewards both sustained employment and the speed with which they place people into work. The core funding model for long-term unemployed participants combines a commencement fee for completing an action plan, with benefit transfer and output-related funding payments. It combined outcome payments with additional incentives. After completion of the action plan, the zone provider receives an average of 21 weeks JSA payment for each participant, but is responsible for paying the individual participant for up to 26 weeks. The transfer of responsibility for benefit payments provides an incentive to move participants into work quickly, as the provider would retain any of the surplus not used within 21 weeks, but the liability for the extra five weeks, payment was an incentive for the provider not to 'park' an individual. Different terms apply to voluntary lone parent participants but the reward system for 13-week job placements is similar to that for unemployed participants who must participate.

Initially the EZ model also included a higher payment premium for participants who had been unemployed for longer periods. This weighted mechanism was subsequently dropped in favour of higher payments for those participants who were referred again after a previous period of EZ participation. This was '*considered to be a more accurate indicator of the degree of difficulty*' the participant represented (Griffiths and Durkin, 2007, p. 16). The EZ synthesis evaluation report gives no further information on the impact of such differential payments.

The EZ evaluations typically contrasted zone impacts with those of the more standardised interventions delivered through New Deal provision for the long-term unemployed. The EZ model is seen as having somewhat better outcomes, largely attributed to their flexibility, the greater continuity and discretion of zone case managers and the performance funding model. The synthesis report found no evidence from the evaluations that zones achieved their better performance through creaming or parking participants than did comparator New Deals (Griffiths and Durkin, 2007, p. 57- p. 60).

This does not mean, however, that case managers, personal advisers or providers do not prioritise, in light of their objectives and resources, those with whom they work most intensively. Other evidence from the zones, and elsewhere, suggests that front line advisers rate new participants both on informal and formal employability scales deciding on those they can assist into sustained employment and those who are more responsive and committed to the support on offer (see, for example, Martin, 2002; Hirst *et al.* 2002; Griffiths and Jones, 2005). Front line rationing of employment assistance appears an inevitable outcome of the limits of the available funding, the available job opportunities and the tractability of the barriers faced by some of the hardest to help.

7 Conclusion: policy implications

There are contending views on the success of performance-based contracting in the countries reviewed, although evaluations suggest that the Australian, British and Dutch systems typically improve the short-term job prospects of participants by between five and ten per cent, and do so more quickly than more standardised programmes (ACOSS, 2008).¹⁰ It is difficult, however, to make robust comparisons or to disaggregate the impacts of contract design from those of other policy changes. It is still harder to isolate the relationship between different contract prices and the impacts of employment programmes, although cost benefit analyses give some insight into financial effectiveness.

The evidence reviewed suggests that minimising creaming and parking is a key challenge in performance-based and output-related funding systems. The challenge for policy designers is to construct systems that militate against such processes whilst maintaining the capacity of providers to manage the risks involved, achieve employment outcomes and be confident of securing returns on their investment.

In many systems it seems that employment outcomes are measured with little reference to participant characteristics but the different systems reviewed have sought to target assistance in different ways. These range from the definition or endorsement of eligible groups to be served; through to the requirement that particular quotas of participants with greater needs are represented amongst outcomes; through to the design of specific tenders that target services at particular hard to help groups. There also is evidence of the need for specialist supplementary outcome focused provision, as in the Australian PSP or NYC WeCARE. These

¹⁰ There are a number of reasons why micro-economic net impact studies may underestimate the longer-run and aggregate impact of welfare to work services and employment programmes, and there is evidence from the US that the impacts of such reforms have been greater than those captured in the results from randomly assigned control group evaluations (Grubb, 2004, p. 367).

combine rewards for providers who achieve necessary milestones and employment outcomes. Such provision is particularly important for groups who need to stabilise their circumstances as part of their involvement in, or progression to, 'work first' programmes, as already occurs in GB with 'progress2work' and was envisaged within the proposals for 'Building on New Deal' (DWP, 2004).

Differential payments were used in the two-tier system in NYC in anticipation of creaming, but this now has been replaced by unified provision but with significant bonuses for placing one particular group – those who have been sanctioned. Australia has a more comprehensive differential pricing system where highly disadvantaged job seekers attract premium payments for services and for the outcomes secured. The challenge has been to devise an evidence-based classification and pricing system that targets the hardest to help, is relatively easy to administer and does not create perverse incentives by, for example, encouraging a provider to delay job placement to attract a higher payment. Policy makers also found it necessary to buttress such incentives with quarantined funds for employment barrier reduction, greater scrutiny of parking and adjustments to the Star Rating system.

Alternative funding models have been proposed that suggest ways in which the pricing and contracting system may be used to encourage providers to work with higher risk and higher cost participants without such regulation. There is some evidence from the Netherlands, for example, that such a 'progressive pricing' system is being utilised where contractors receive increased premiums in line with the proportion of a fixed cohort of cases they place into employment.

The Australian Productivity Commission proposed that its Government consider 'a stepped or marginal payment system ... that increases payment levels as outcome rates increase' (PC, 2002, p. 10.6). It suggested that JN providers be offered a choice between an outcome contract in which prices were set administratively, or a more risky contract. The latter would allow higher prices for those providers to achieve higher outcome rates – but with lower returns than from administrative pricing should such higher outcome rates not be realised. This would mean that if the high risk provider secured the average outcome rate the rewards would be lower than under administrative pricing, but if they exceeded them they would secure premium payments (PC, 2002, p. 10.7):

Example

Providers achieving outcome rates below 20 per cent might receive payments that are only 80 per cent of the administrative price, but those achieving outcomes between 20 and 30 per cent might receive a ten per cent premium, those achieving from 30 to 40 per cent, a 30 per cent premium, and those achieving above 40 per cent, a 50 per cent premium.

Such a system might create the right kind of incentives to ensure that providers invest in additional services, such as smaller caseloads, enabling them to place more of the caseload into sustained employment. The Commission anticipated some of the weaknesses in the proposal, such as the loss of client choice, as participants would be randomly assigned between providers. Whilst the Commission suggested that these issues could be addressed and modelled more elaborate designs for the incentives, it still acknowledged the complexity of their implementation (see the Appendix). The Australian Department chose, however, not to take up the suggested proposal.

Another possible model – a ‘target accelerator’ – has been suggested by Work Directions. This envisages the potential of a long-term framework partnership agreement between DWP and a provider around agreed outcomes, such as moving a specified proportion of a particular claimant population into sustained employment. The flexibility of the agreement would encourage joint investment and innovation and be driven by a *‘funding gradient where financial rewards increase incrementally based on the percentage of the eligible population moved into work’*. The differential fees for each segment of the claimant population would require the provider to *‘dig deeper into the caseload’* to ensure their financial viability and profitability (Mansoor and Johnson, 2006, p. 12).

The scale of the outcome payments would escalate over time as various ‘triggers’ were reached and would be split between initial job outcome and at 13 and 26 weeks sustained employment. The authors outline how the proposed model would work, with two different scenarios of how the financial costs would accelerate in relation to job outcomes attained. They suggest that the model has the *‘potential to change significantly the appearance and consequence of social exclusion in a medium-sized city’* with much of the risk borne by the provider, *‘with reward for success mitigating that social risk’* (Mansoor and Johnson, 2006, p. 15).

In a critical review of the FND funding model, the Social Market Foundation argues for reforms that would better shape the balance of ‘risk and reward’ and induce providers to work with the harder to help (Mulheirn and Menne, 2008). They suggest, for example, that service providers might be offered higher service fees for working with the harder to help, but also face a fine – a ‘negative outcome payment’ – if the provider is unsuccessful. They propose also a version of the ‘accelerator model’ where providers would be paid higher payments as the total percentage of a cohort of participants entering sustained employment increases.

These proposed models are untested but address some of the key issues reviewed in this study. They appear to provide incentives that would result in more participants entering employment and avoid complex mechanisms for individual assessments and price enhancements for the harder to help. They balance risk and reward between purchaser and provider and, in the case of the target accelerator, remove the disincentives of capped budgets for over-performance. Notwithstanding the practical issues that need to be addressed such a model merits experimental testing to gauge its impact on performance and costs, its potential to assist harder to help participants and whether it would militate against creaming and parking.

Whilst such models may incentivise providers to '*dig deeper into the caseload*' they may still mean that many harder to help participants are parked. There may be merit also in testing differential service fees and payments focused on particular hard to help groups, such as those with a combination of three or four easily identified significant barriers to employment. Such enhanced payments may encourage providers to undertake a more intensive assessment of the individuals' problems, needs and underlying barriers and so work harder with those most in need. Such a payment system may add to administrative complexity but it would potentially target resources directly at the harder to help, meet the greater costs faced by providers and reward their efforts.

To ensure value for money the enhanced individual service and outcome payment could be conditionally linked to a measure of earnings gain as well as employment sustainability. The dilemma always remains, however, that the provider may not respond to such individual incentives and may simply reap a windfall gain if a designated participant secures the appropriate outcome.

7.1 Creaming and parking in the Flexible New Deal

It seems clear that minimising creaming and parking within FND rests on a combination of policy design, including any identification and pricing for the most disadvantaged, and effective scrutiny and management of performance.

An immediate approach to the FND, might be to track the hardest to help and adapt the differential pricing approach that has been used in EZs. To promote working with the hardest to help DWP should monitor participation and placement patterns for service users with characteristics that suggest they are furthest away from immediate employment. Such characteristics need to be carefully defined but could be selected from length of time on benefits, basic skill barriers, homelessness, criminal record, substance misuse, returners to the New Deal, or whether a person has been sanctioned. Jobcentre Plus already has markers in its management information system to identify some of these characteristics which would be still more accurate after an individual has been with Jobcentre Plus for as much as a year of unemployment.

Tracking providers' performance with these groups would discourage creaming and deliver the message that providers must help all referrals to make progress towards a sustained job. This could be reinforced through contract management and by recognition in the Star Rating system.

An equally pragmatic response to reduce parking in the system could be achieved through careful regulation of referral flows, so that providers and their case managers have more incentive to work intensively with those participants they already have, rather than wait for more job-ready clients to arrive.

Appendix

Productivity commission modelling of incentive contracts that allow price variations

Box 10.2 Incentive contracts that allow price variations

Design 1: Providers can choose to be paid under a default option at the prevailing administrative price (which might have variations for different costs in different regions). However, they could also be given the option to select an incentive contract that exposes them to some risk, but which provides higher prices if they secure outcomes that are higher than the counterfactual. Accordingly, the net revenue (R_1) would be:

$$R_1 = C.f + \theta.p.C + (z + \varepsilon - \theta)\tilde{p}.C - M(z) - F$$

where C is commencements, f is the commencement fee, p is the administrative price, θ is the counterfactual gross job outcome rate, z is the actual gross job outcome rate achieved, ε is a risk premium rate, \tilde{p} is the price premium for getting above counterfactual outcome rates, $M(z)$ are the variable costs of achieving a z outcome rate and F are fixed costs. θ is akin to the expected outcome generated by the star rating model. θ would take account of client characteristics and labour market conditions that applied over the relevant period that payment related to. Thus *realised* labour market conditions and job seeker characteristics would be used to set θ , not *ex ante* guesses of them. This is very important to avoid creaming, especially in a Job Network design that accentuated job seeker choice. However:

- providers need to be paid prior to calculating θ and so a guess of θ could be produced based on past labour market conditions and job seeker characteristics and then a reconciliation payment made when the 'true' θ is estimated; and
- while *ex post* labour market conditions and job seeker characteristics would be used, the coefficients that would be used to weight these would have to be *ex ante* ones. Otherwise, if many providers were to adopt incentive contracts, this would affect the coefficients that might be estimated *ex post* and eliminate the incentives for better outcomes.

ε is also important in the incentive contract, because it provides partial relief from the increased risk of being exposed to the incentive contract. The need for ε is demonstrated by what happens if it is absent. A provider that expected outcomes that were equal to the counterfactual ($E(z)=\theta$) would not write an incentive contract, because of its higher risk compared to the default contract. But the cost of that risk means that even a provider whose $E(z)$ was just above θ would also not write an incentive contract, though there are benefits from having them do so. ε overcomes this.

Design 2: This is similar to option one, but does not require the formal specification of θ . Instead, providers that elected an incentive contract would indicate a threshold gross outcome (T) they would achieve and would negotiate a premium price that would apply if they exceeded that threshold. Accordingly:

$$R_2 = C.f + z.p.C + (z + \varepsilon - T)(\tilde{p} - p).C - M(z) - F$$

Clearly the value of \tilde{p} that DEWR would be willing to pay would depend on how high T was relative to the counterfactual outcome rate. But that rate would not have to be specified and DEWR could use the negotiations as another way of gaining information on the underlying counterfactual, rather than just a pre-specified model.

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