Are quasi-markets appropriate for delivering public employment services?

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1. Introduction

Struggling under the complexity and size of government, and besieged by the threat from neo-liberal ideology, the traditional bureaucratic and centrally controlled public sector model relented to the wave of New Public Management reforms that swept across developed countries in the 1980s (Peters & Pierre 2006). The same forces that broke open national economies, transforming societies and ending universal forms of mass production crashed through the public sector. No longer could governments deliver standardised and universal services organised through inflexible organisational hierarchies. The reforms introduced a host of alternative service delivery systems, reduced the size of the public sector, transferred power to markets and sought greater involvement from the private and non-government sector for the delivery of public services (Rhodes 1994).

The dramatic shift away from large government organisations offering uniform responses to social problems confronted many Western governments with the formidable challenge of finding alternative institutional models to meet the needs of its increasingly demanding and complex citizenry. The search for an optimal organisation design was informed by concepts primarily drawn from neo-classical economics that envisions a world where rational utility maximising individuals and profit seeking firms operate in a marketplace defined by choice, competition and price. Governments, it was argued, could achieve their social objectives through cost efficient and flexible markets while retaining features central to liberal democracies such as fairness and equality (Struyven & Steurs 2005, p. 214).

Nowhere have the reforms been more striking than in the provision of labour market programs. Across OECD countries public employment services have undergone radical changes with many governments moving away from direct service delivery by outsourcing the provision of services to private and not-for-profit organisations. The responsibility of governments is increasingly as an enabler and regulator of services through market design. This fundamental departure from standardized and universal services encompassed a change in employment policy, through the adoption of ‘activation’ or ‘work first’ strategies, and alternative mechanisms for administering and delivering services (Bredgaard & Larsen 2008).

The Australian government was one of the first to fully privatise its public employment services when it tendered out the delivery of services to hundreds of small to medium sized private and not-for-profit firms in the 1990s. It was not long, however, until the use of markets to deliver social services were criticised for failing to meet many of the expected benefits of a post-welfare state. There is evidence that the new market mechanisms have failed to deliver the innovation and flexibility in the provision of public employment services (Considine, Lewis & O’Sullivan 2011). Incentives reliant on payments by results have restricted the type and
diversity of services, with a shift away from education and training and toward low cost support, and failed disadvantaged groups by encouraging providers to focus on the job-ready with little or no support for job seekers further from the market (Shutes & Taylor 2014; Considine, 2003; van Berkel & van der Aa, 2005).

The findings have generally been interpreted in two contrasting ways. Proponents of the market-like approach to service delivery suggest the problems are temporary and will be solved over time as payment structures and market mechanisms are enhanced and refined to operate more like an efficient market. Others argue that the findings demonstrate that markets are inadequate for coordinating the delivery of social services and further government intervention in an already imperfect market only serves to compound market failure (van Berkel & Borghi 2005, p.395). These market failures question how governments should deliver public employment services and structure incentives to achieve good public outcomes. More fundamental perhaps is the question of whether markets are at all suitable for delivering services that are fundamentally different to those delivered by the private sector. That is, the neo-economic models used by researchers and scholars to inform early attempts at reform may not readily apply to many of the unique and complex features of the public service, such as multiple dimensions and ambiguous outcomes (Dixit 2000).

How effective markets are in delivering public employment services is of considerable interest to scholars, policy-makers and the public. Yet despite a large body of research literature, the effect of introducing marketization in employment services is not well understood. This can in part be attributed to the challenges of studying the implications of this change: the nature of the services, the complex operating environment, the ongoing reforms, and because changes are often implemented in a way that do not allow evaluation. Oftentimes these methodological limitations make meaningful comparisons across employment service systems and over time difficult. It therefore remains unclear how effective markets are in delivering public employment services and whether a more calibrated market design will be any more successful at helping the unemployed.

This dissertation seeks to answer the question of whether or not quasi-markets are appropriate for delivering public employment services. It does this by adopting a methodology that is less constrained by the research limitations of comparative and national studies. First, it adopts a theoretical framework based on the economic theories from which quasi-markets originate to question whether the expected outcomes of markets are conceptually achievable when applied to the unique characteristics found in public employment services. Second, it highlights the incompleteness of relying solely on neo-economic concepts when embarking on institutional reform of a public service that supports the disadvantaged. By developing a theoretical framework and applying it to the Australian experience of public employment services, the dissertation will argue that incentive effects are weak for the delivery of public
services, that market governance closes out the benefits of marketization and that this approach imposes quality costs by crowding out public service motivation, trust and cooperation. The findings are expected to demonstrate that markets are inadequate for delivering services for disadvantaged job seekers, and government intervention will likely serve to amplify existing market failures.

The dissertation begins by outlining the theoretical foundation of markets in employment services. The institutional context of public employment services and the theoretical underpinning for the introduction of quasi-markets, including principal-agent theory, market governance, transactional costs and the effect of marketization on staff motivation and not-for-profit organisations, are then discussed. The methodology and theoretical framework are then presented. The framework is then applied to the Australian experience by looking at public employment services in three stages: introduction of marketization (1994-2003), additional governance (2003-2009) and ongoing reforms (2009-2015). Finally, the implications of the findings are discussed, with a specific recommendation about an alternative design for public employment services based on job seeker needs.
2. The institutional and theoretical foundation of markets in employment services: a review of the literature

2.1 Public employment services

Public employment services in Australia were outsourced in the 1990s to overcome the perceived unresponsive and standardised services hitherto provided by government bureaucracy. The new service model separated the purchaser from the provider and steered performance using a payment structure that rewarded organisations that achieved better outcomes. Le Grand and Bartlett (1993) described this arrangement as a ‘quasi-market’ due to the introduction of market-like features such as competition between providers, choice for service users and the mode of payment transactions between service providers and the government agency. The prefix ‘quasi’ denotes important differences from a purely private market as prices and choice are usually determined between the government agency and provider, and entry into the market is usually restricted via a tendering or contract process. Quasi-markets are supposed to achieve the government’s social objectives through efficient and responsive markets, while retaining the equity and externality benefits of the traditional government system (Van der Veen, 1997, cited in Struyven & Steurs 2005, p. 214).

In Australia there is a division between the administration of benefit payments and job placement services. Centrelink is responsible for administering benefits and assessing job seekers, while the Department of Employment (formally the Department of Education, Employment and Workplace Relations) is responsible for contracting out job placement and re-integration services to providers. As part of laying the foundation for this dissertation, the next section describes the role of public employment services and the experience of outsourcing this function.

What are public employment services for?

In many Organisation for Economic Cooperation and Development (OECD) countries, unemployment remains unacceptably high and long-term unemployment continues to rise, with persistent unemployment among certain groups such as young and older job seekers, the less-educated and single parents (OECD 2013b). Unemployment has significant economic, social and personal costs. Direct economic costs are incurred through income support payments, loss of production and reduced spending. The impact to society and individuals include loss of motivation and confidence, poverty, social isolation, loss of skills and skill currency, and erosion of social and work relations (Australian Bureau of Statistics 2006). Long term unemployment is particularly harmful and is associated with poor physical and mental health (Butterworth 2009).
There are a number of factors that shape the labour market and drive unemployment. Frictional unemployment is the time taken for people to move between jobs or into new ones; real wage unemployment is when wages are pushed above the market clearing rate through such things as minimum wages; and demand deficit is related to the normal business cycle fluctuations where aggregate demand falls leading to a decline in output and a reduction in employment (OECD 2013b, p. 8). Economic down-turn can have a particularly harmful effect on disadvantaged groups as they are at greater risk of losing their jobs and of entrenched unemployment.

Perhaps most damaging is structural unemployment. This occurs when there is a mismatch between skills and new job opportunities, and is driven by structural changes in the economy, globalisation and technological change. Structural unemployment can have an adverse impact on those affected as they tend to remain unemployed even when economic conditions are good. This is due to occupational immobility which refers to the difficulty and time taken for some job seekers to learn new skills relevant for new jobs. The Australian economy has undergone significant structural change over the last three decades, becoming more service based and requiring higher skills. In the 1990s the Australian economy transitioned from a manufacturing to service based economy, driving high levels of unemployment among traditional blue collar workers. Structural changes impact differently on different groups of peoples, with young people, mature-aged and lower-skilled people particularly vulnerable.

Because of the severe personal and social cost, governments have an obligation to be actively involved in solving the unemployment problem. Employment services need to respond to the needs of those who are susceptible to the negative effects of structural change and who are at risk of extended periods of unemployment. Governments have traditionally done this by directly providing services that reintegrate a job seeker into the labour market: preparing job seekers for employment, job placement by matching job seekers with employers, gathering labour market information, employment programs, job counselling and case management for the long term unemployed (Bruttel 2005a, p.1).

Free markets alone will not deliver socially optimal outcomes. If governments were to withdraw entirely from employment services, there would be an under-provision of services, particularly for disadvantaged groups. What role government should play in providing employment services has been a point of debate for many years. Following a temporary consensus between the political Left and Right concerning the effect of passive welfare and claimed ‘dependency’, a wave of active labour-market policies were adopted by OECD countries (Considine & O’Sullivan 2014, p. 120). The new principles of activation were based on the outcomes from an evaluation of California’s Greater Avenues to Independence (GAIN) programme that found the most successful county focused more on placing job seekers immediately into work and less on education and training (Considine and O’Sullivan 2014).
The adoption of activation, together with the institutional reforms associated with New Public Management, saw changes to formal as well as operational policy. The notion of a universal entitlement to social benefits was replaced with policies that emphasised obligation, participation and activation of welfare recipients. Active labour-market policy was accompanied by changes in the management and administration of welfare with the outsourcing, privatisation and marketization of employment services (van Berkel and Borghi 2005).

It is not clear which forms of employment services assist the long-term unemployed as it is very difficult to measure the net impact of those services on individual job seekers. As a result, few studies have been done. It is generally accepted that there is a complex link between social and health issues and employment, and that job seekers have different needs depending on how job-ready they are. Some job seekers are likely to need intensive case management and integrated health, social and employment services. This complex interaction of problems means that getting people job-ready and into employment is not only hard, but the outcomes from these interventions are ambiguous. Complex problems mean solutions are not readily available and their effectiveness is largely unknown.

The Australian government was one of the first to fully privatise public employment services, with many other countries following soon after by introducing quasi-market based models. Evidence from different countries and various outsourced models has produced mixed results. A recent study by the OECD (2013a) on activation strategies for getting people into work found that the design and implementation of employment services are important drivers for unemployment and income support rates. The report found that institutional reforms have been a key part of activation strategies and the effectiveness of employment services can be improved through performance management. The Australian experience, according to the report, demonstrates that a quasi-market for employment services can operate effectively and, with an active management framework, rewards the right outcomes and ensures high performing providers remain in the market.

International research suggests Australia’s activation strategies are at the forefront of good policy and have been successful in contributing to low unemployment rates. These conclusions however do not go unchallenged, with findings from within the academic literature being less compelling. Considine, Lewis and O’Sullivan (2011) studied the impacts of privatisation on Australia’s employment sector using survey data taken from frontline staff operating in various contracted agencies in 1998 and again in 2008. The study found that contrary to the expected benefits of privatisation and New Public Management, flexibility had decreased with evidence of increased levels of standardisation and routinisation of service delivery. The authors concluded that contracting out of social services created a ‘herd of profit maximisers’ primarily focused on survival and managing risk (p. 826). This was in large part
attributed to the purchaser (the former Department of Education, Employment and Workplace Relations) requiring providers to enter into more detailed contracts and increased monitoring through performance oversight and audits. These measures were imposed on providers in response to firms maximising their profits in earlier contracts at the expense of job seekers and good public policy outcomes. Van Berkel and van der Aa (2005) find comparable evidence of standardization in the Dutch experience of employment service marketization. Using the terms allocative and dynamic efficiency, the authors find similar results to the Australian experience, including standardization and limited service innovation.

Shutes and Taylor (2014) examined the effects of contracting providers to deliver employment services when funding is almost entirely dependent on employment outcomes. Drawing on research from a number of countries where market-based models have been introduced to deliver employment services, they found that emphasising and funding employment outcomes may limit the type and size of providers in the system; limit the diversity and type of services – with more focus on job placement and reduced investment in education and training; and result in unequal access to employment services for some job seeker groups.

There is evidence that the introduction of the new form of service delivery has direct operational and cultural impacts on those organisations delivering services. Considine, O’Sullivan and Nguyen (2014) found that the boards of non-government organisations (NGO) adopted a more commercial like view of how their organisation should operate and recruited new board members that could fill these skills gaps. Together with evidence of ‘mission-drift’ – where the mission of an NGO shifts due to competitive pressures, these findings suggest that marketization of public services can affect an organisation’s purpose and how it goes about fulfilling it (Considine 2003).

The most common and serious risk cited in the literature and associated with the marketization of employment services is ‘creaming’ and ‘parking’. This describes a situation where providers focus on easy-to-place job seekers (creaming) and ignore the harder to place (parking). Creaming increases the deadweight cost to government as those receiving employment services are likely to have secured employment without assistance, while those with the greatest need go without. In addition to findings that show a convergence of service delivery strategies of providers and reduced attention to the needs of individual job-seekers, Considine (2003) found evidence of ‘creaming’ of the easiest clients at the expense of those more disadvantaged. Because providers are paid according to the number of job seeker placements, they are incentivised to focus on those who are easiest to place and ignore those that are furthest from the job market. The impact on long term unemployed is particularly pronounced. In Australia, for example, a recent report found that the number of long term unemployed has been growing with around 400,000 job seekers out of work for more than 12
months and of these 170,000 were unemployed for more than 36 months under the Job Services Australia program (National Commission of Audit 2014, p. 192).

The research literature indicates that public employment services are underperforming across a number of countries where market mechanisms have been introduced. There is evidence that marketization of employment services can reduce innovation and flexibility, limit the number and type of providers, narrow and standardize the types of services on offer, change the culture of NGOs and be ineffective at meeting the needs of various groups of unemployed.

Although these studies provide some evidence of a system that is underperforming and failing to meet the needs of certain unemployed groups, many policy makers from both sides of the political divide, and from both community and business groups, see enhanced and better market mechanisms as a possible solution to weaknesses in the current system. Findings from government evaluations of the employment system generally conclude that no major changes to the model are needed (Department of Education, Employment and Workplace Relations (DEEWR) 2013; National Commission of Audit 2014). Rather, the focus should be on building on the success of the existing system and improving the effectiveness of the current arrangement by adjusting payment structures to provide greater incentives to providers and increased payments for disadvantaged job seekers. The theoretical foundations of a market-based model for the delivery of employment services and social services generally, remain relatively firm. How we think about social policy is still largely influenced by economic ideals such as efficiency, choice and competition.

Despite the major shift to marketization, there are few formal models on incentive effects that can guide policy makers in developing strategies to mitigate the inherent risks of using market based mechanisms to solve social problems. This is in part due to the breadth of literature and disciplines that this area of study comprises, including the nature of the firm, institutional design, human behaviour, and the principal-agent problem. The literature is expansive, and getting a complete and coherent picture of the phenomenon from diverse theories and multiple approaches has proven difficult. This can also be attributed to the methodological limitations of comparative and national studies and the implicit acceptance of economic liberal ideas. These types of studies alone are unlikely to seriously challenge market based institutional arrangements or help find an optimal organizational design. To understand how effective markets are at delivering public employment services, and to overcome the current ‘better market’ versus ‘no market’ debate, any argument will be strengthened by including the theoretical framework from which markets emerge.

Drawing on the broad literature, this dissertation will seek to answer a simple question: are quasi-market based models appropriate for delivering public employment services? It will do
this by outlining the theoretical foundation from a range of disciplines pertinent to the provision of employment services through a contracted third party. From the literature, a unified and consistent theoretical framework will be presented from which the new model of service delivery can be analysed.

2.2 Theoretical foundation: Organisational design and governance

The days of big bureaucracy with its outmoded protocols, rigidity and standardisation has come to an end after underpinning advanced democratic countries for almost 200 years (Considine 2003, p. 132). However, despite a range of models vying for prominence, no coherent alternative has emerged to replace the old bureaucratic order. The search for an optimal organisational design for government encompasses a wide range of theories and scholarly disciplines. Elements of new institutional economics, with its focus on modes of governance, structure, principal-agent relationships, transactional costs and social values, converge around organisational arrangements that shape behaviour and structure interaction. Reshaping the public service extends beyond mere organisational arrangements by resetting the structure of social and economic institutions and the behaviour of individuals operating therein.

This section attempts to provide a theoretical foundation and historical context from which the new public employment arrangements can be analysed. It begins by briefly sketching the recent experience of various service delivery models in the provision of public services before examining market governance in more detail. The section finishes by reviewing emerging and alternative forms of governance with a particular focus on motivation, cooperation and trust.

Four ideal types of service delivery models

To understand the effectiveness of quasi-markets as a service delivery model, marketization needs to be considered in the context of ideal types of system formation. Considine (2001) outlines four types of service delivery models as they correspond generally to phases in the recent evolution of public institutions and the delivery of government services: procedural bureaucracy, corporate, markets and networks.

Procedural bureaucracy achieves coordination through formal rules and protocols overseen by strong managerial authority and supervision. Administration is seen as separate from policy making, and there is a reliance on structural hierarchy to control and coordinate work

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1 Considine refers to four ideal types of governance models. To avoid confusion with governance mechanisms described later in this dissertation, the four types will be referred to as service delivery models.
and to achieve outcomes. In large modern organisations, well-scripted tasks and effective
decision-making are achieved through information management technology (Considine and
Lewis 2003, p. 133). In the 1970s, these organisational structures were found to be too
inflexible, complex and inefficient to respond to the diverse and individual needs of a more
demanding public, and pressure to reform traditional bureaucracies to meet emerging needs
grew.

The first changes to the traditional hierarchical order came in the 1970s and 1980s with the
introduction of strict planning, budget and performance requirements (Considine and Lewis
2003, p. 132). Imitating large private corporations, public administrators assumed the role of
corporate managers focusing on goal-oriented planning and resource allocation. Corporate
governance included a strong focus on performance targets, management improvement and
program budget reform. Developing meaningful missions and coherent plans and
performance targets in a complex bureaucratic system proved challenging and the success of
linking strategy to operations under the corporate model proved difficult (Considine 2001, p.
27).

With the mixed success of the corporate approach to public administration, a new more
radical approach emerged in the 1990s involving competitive tendering of services to private
firms and the use of market-like incentives to steer outcomes and drive performance. The
principal-agent separation of government and providers profoundly redefined the role of the
state as a purchaser rather than provider of services. Contracts and competition replaced
hierarchies and planning (Considine 2001, p. 28). Market or entrepreneurial governance was
expected to bring greater flexibility, more individualised and responsive services and greater
efficiency. However, soon problems of accountability, transparency, goal displacement and
profit-maximisation began to emerge. These issues are central to understanding the
effectiveness of markets in delivering public employment services and are explored in greater
detail throughout the dissertation.

Considine (2001) identifies networks as a fourth emerging model. Although a relatively new
concept, networks are recognized as an important form of coordination in a multi-actor
system. New approaches to social policy have relied on network-type relationships between
policy makers and associated organisations, such as not-for-profit and private actors, that
come together and work on a common task (De Rynck & Voets 2006). This loose coupling of
strategic partners is viewed by some authors as a notable alternative to other forms of
governance as it can be effective at addressing complex social issues that require
collaboration and co-production (Considine & Lewis 2003, p. 133). Although networks can risk
exclusive and privileged access to those within the network, and assume providers are
motivated by altruism and can be trusted to know and act in the best interest of clients,
strategic partnerships can enhance learning and information sharing, increase commitment,
increase planning capacity and boost cooperation and trust. Tapping into specialised and broader knowledge can lead to better services for clients and customers (see Alter & Hage 1993; Brass et al. 2004; Huxham & Vangen 2005).

The emergence and persistence of quasi-markets is in part the result of the failure of alternative service delivery models (Hills, Le Grand & Piachaud 2007, p. 132). In practice, the ideal conceptual model emerges as something less pure, taking on many elements of the new while retaining remnants of the old system. Knuth (2014) correctly points out that in the complex world of public service, activities are organised using a mix of governance elements. Despite this, in many countries there has been a conscious effort to introduce market features to the delivery of public employment services. The next section details the theoretical basis for markets, the limitations of the theory and how those limitations are overcome.

**Quasi-markets: Benefits, costs and overcoming the principal agent problem**

Quasi-markets are theoretically able to deliver social goods through the efficiency and responsiveness of free markets while retaining the public benefits and egalitarianism of traditional government structures. Governments therefore have the dual objectives of creating a competitive market and delivering social objectives (Struyven & Steurs 2005, p. 214).

The conditions necessary to create a well-functioning market generally include competition, consumer choice, the removal of entry and exit barriers, and the right incentive structure. In practice this means separating purchasers and providers, and contracting out services to multiple private, not-for-profit and public entities. Separating purchasers and providers creates a market of firms, introduces competition and choice, and the possibility for more individually tailored services. Introducing payments creates incentives for providers that drive efficiency, and allows purchasers to align the objectives of providers with their own.

To achieve their social policy and public accountability objectives, governments retain control over the service delivery system by being actively involved in establishing and maintaining markets. This is a clear departure from a free market. Quasi-markets are further distinguished from free markets in that governments are generally the sole purchaser, either directly or via a voucher system, and the ‘rules of the game’ are set by the government agency through contracts. This determines price, entry into the market, the nature of competition, and often the level and type of demand (Struyven & Steurs 2005). This allows government to safeguard fundamental requirements for the provision of public goods such as equity of access and social justice.

Within this binary of markets and social policy emerge criteria from which the success of markets can be assessed. Le Grand (1991) offers the following criteria for evaluating the
benefits of quasi-markets: efficiency, responsiveness, choice, quality, equity and competition. This dissertation adopts a simplified set of criteria as an evaluation framework. It is expected that marketization of public employment services will achieve the market benefits of improved efficiency and responsiveness while maintaining the public benefits of equity of access. ‘Quality of services’ is considered central to ‘responsiveness’ as responding to the needs of job seekers should include both matching and meeting the needs of job seekers. ‘Choice’ and ‘competition’ are considered market characteristics that lead to system benefits rather than as ends in themselves, and are therefore not included in the evaluation criteria. The evaluation criteria are further defined in the theoretical framework section.

A market-based service delivery system involves the delegation of tasks outside direct government control to organisations, with their own unique structures, cultures and oftentimes conflicting objectives, and introduces new monitoring and control challenges. At the heart of these challenges is a fundamental question: How should institutions be designed to provide the right incentives for the provider (the agent) to act in the best interest of the purchaser (the principal). Principal-agent and incentive theory provide the theoretical foundation from which this problem can be viewed.

Achieving the benefits of quasi-markets is dependent on designing a governance system that can overcome the principal-agent problem. As this next section will highlight, implementing new governance systems comes at a cost.

Principal-agent theory

The principal-agent problem is a well-established economic concept that occurs when one party acts on behalf of another. Its primary focus is on how to get an agent (provider) to act in the interest of the principal (purchaser) (Bruttel 2005a).

A relationship where one party delegates a function to another is not new to the public service. Governments have long relied on well-defined hierarchical structures with well scripted tasks and routine procedures delegated from one layer of public authority to another to deliver services. This is done ‘under strict supervision and in conformity with high standards’ (Considine & Lewis 2003, p.133). The more recent contracting out of services and formation of strategic partnerships with service providers has created additional layers of agency problems and a network of principal-agent relationships. The principal authorises the agent to act on its behalf when the division of tasks offers some benefit, such as specialisation, or by overcoming bounded rationality in complex problems (Laffront & Martimort 2001, p.37).
Conflicting objectives and information asymmetry, known as moral hazard, are fundamental obstacles that prevent an agent acting in the best interest of the principal and from achieving the first best allocation of resources. Agents are at least to some extent going to pursue their own interest, and they can do this through actions that are unobservable to the principal (Laffont & Martimort 2001). The goal of providers, for example, is to maximise their profits; whereas the goals of governments can include producing social goods and reducing the cost of unemployment. In many instances fulfilling the principal’s objectives will be costly to the agent or the interests of the principal will be unclear. This occurs naturally in the formation of any contract as the principal may not know exactly what it wants at the time that the contract is made or at some point during the life of the contract, or the objective may not clearly be understood by the agent or those completing the task within the agency (i.e. co-ordination and cooperation problems) (Knuth 2014, p.256).

The misalignment of objectives only becomes a problem when the principal has incomplete information about the agent. Because the principal cannot directly observe or verify the action, the agent has an incentive or opportunity to behave in a way that benefits its own interests over those of the principal. The principal attempts to get information about the actions of the agent through forms of performance monitoring or making inferences based on the observed outcomes. However in many cases the action itself may not be directly observable or the principal may only have a ‘noisy’ measure of what the agent completes. Imperfect information about the actions of an agent can result from incomplete monitoring of the agent or because the outcomes depend on exogenous factors such as random or industry wide influences that are outside the control of the agent (Besley & Ghatak 2003, p. 5). Further, there may only be a weak link between actions and outcomes. The ‘observability’ of the action and outcomes has important implications for the principal-agent relationship and the effectiveness of incentives (Dixit 2000, p.3).

The principal-agent problem has bite if the objectives of the principal and agent are not aligned and the actions taken by the agent cannot be monitored (Besley & Ghatak 2003, p. 5). Without any intervention, the result of conflicting objectives and information asymmetry can be inefficiency, gaming and suboptimal outcomes for the principal. Bruttel (2005a) outlines three governance mechanisms that mitigate the problem of moral hazard and discipline the agent to act in the interest of the principal: incentive mechanisms, information mechanisms and control mechanisms.

Incentives

Incentives are the most common mechanism to align the agent’s objectives with that of the principal, and they play the most important role in marketization of services. The principal generally enters into a performance-based contract with the agent that includes the rules for
delivering the product and a payment based on verifiable outcomes. The classical principal-agent problem involves a single principal engaging an agent to undertake a task that is verifiable, even if the action taken is not (Besley & Ghatak 2003).

In a complex world, principal-agent relationships present themselves in a multitude of ways that vary from the classical model. Governments deal with some of the knottiest problems in society: from profound and abstract questions of social justice and equality, to practical problems of service design and delivery. Dixit (2000) offers three important ways in which the features of public services differ from that presented in the classical model: performance of multiple tasks; the occurrence of multiple principals; and the ambiguity of the outcome.

Governments often deliver services that involve several dimensions and the performance of multiple tasks. A good example is in education. Students need to do well in tests, but also need to develop creativity, morality, emotional growth, and practical life skills. Based on the insights provided by Holmstrom and Milgrom (1991), Dixit argues that the effect of multiple tasks is often a weakening of the incentive effect as more effort is directed toward one task at the expense of the other. Effort is directed away from the harder-to-measure task (in this example, creativity and the like) and toward the easier-to-measure (test results). If the tasks are substitutes in the agent's cost function – that is, more effort in one task increases the marginal cost in the other – then the agent will focus its effort on the task that provides the greater payment (Dixit 2000, p.12).

As the actions of governments and their providers affect many people and groups, public services often involve multiple principals. The provision of public goods generates externalities that benefit others who may not be the direct recipient of the good or service. These services are usually funded through taxes collected from the general public, who are represented by elected representatives. Include the network of principal-partner relationships that emerges under new outsourced service delivery models, and there are many principals attempting to simultaneously influence the action of an agent. Dixit (2000) shows that the existence of several principals weakens the overall incentive for the agent as each principal wants the agent to put more effort toward the outcomes which they are interested in and away from other tasks. The higher the number of principals and, comparable to the performance of multiple tasks, if the actions are substitutes, then the weakening of incentives is more pronounced.

Incentive theory assumes the actions taken by the agent are unverifiable but the outcomes are known (Dixit 2000). Public services are often complex, with both actions and outcomes being vague and unobservable. Wilson (1989) differentiates between organisations where the actions are verifiable but the outcomes are not (procedural organisations); where outcomes are observable but actions are not (craft organisations); and where neither actions nor
outcomes can be observed (coping organisations). The more ambiguous the outcome or performance measure, the weaker the incentive effect (Dixit 2000). Ambiguity affects the strength of the incentive because it increases the agent’s risk: the more an outcome is affected by factors other than the actions taken by the agent, the more uncertain the payment.

In situations where payments are linked to the achievement of ambiguous or uncertain outcomes, even if the agent works hard, due to exogenous and random factors, performance can be unsatisfactory and the agent will not receive a payment. For example in the case of incentive payments for the delivery of public services, the uncertainty comes from factors other than the actions of the agent affecting the outcome (exogenous uncertainty). Consider a job seeker with multiple barriers such as mental health, drugs or homelessness. There are many ‘exogenous factors’ outside the control of the provider that can vary the employment outcome. The further an unemployed person is from the job market, the more uncertain is placement. Agents ‘evaluate a risky income not in terms of the expected value but the expected value less a discount, the size of which depends on the variability of the income’ (Besley & Ghatak 2003, p.7). Oftentimes this uncertainty or level of chance is not known with any accuracy to the principal or the agent (e.g. placing someone into work who has many barriers). Payment for outcome incentive schemes puts too much risk on the agent. Even if he or she works hard, due to exogenous uncertainty, performance is sometimes going to be unsatisfactory and the agent will get ‘punished’ (Besley & Ghatak 2003, p.7).

In addition to the weak incentive effect and redirection of effort, contract management theory suggests that quality may be impacted if performance cannot be measured and therefore controlled through contract. Hart, Shleifer and Vishn (1997) developed a framework to study the relative advantage of in-house provision versus contracting out of public services. The framework is based on the allocation of residual control rights between public and private ownership, contractability, and the basic idea that providers of services can focus on reducing costs or improving the quality of services (Hart, Shleifer & Vishn 1997, p. 1129). In-house provision is preferable when ‘non-contractable cost reductions have deleterious effects on quality and when innovation is unimportant’. Contracting to the private sector is ‘stronger when quality-reducing cost reductions can be controlled through contract and quality innovation is important’ (p. 1159). That is, the private contractor damages non-contractable quality in order to reduce costs. In short, contractual incompleteness can compromise the quality of services.

The theory of incentives shows that incentives will generally be weaker in situations where there are multiple tasks and multiple principals, and where outcomes are ambiguous or unverifiable. The weakening is most pronounced if the tasks are substitutes and where there are a high number of principals. Ambiguity can reduce quality if it cannot be controlled through contracts.
Alternative governance: Information and control mechanisms

The second and third governance mechanisms that attempt to reduce moral hazard are information and control. Informational mechanisms attempt to eliminate information asymmetry by increasing the purchaser’s information about the actions taken by the provider (Bruttel 2005a). This can be achieved by benchmarking performance or by direct monitoring. Benchmarking is the process of comparing the relative performance metrics of providers to determine the best organisations in the market. To be effective, factors used for comparisons should be controlled for external variables. For example, the star rating system used in Australia is a sophisticated benchmarking system that uses regression analysis to determine the net-impact of providers by controlling for labour market and job seeker characteristics. When used to reward providers, benchmarking can provide an incentive for firms to focus on longer term issues rather than immediate profits.

Monitoring is used to obtain information about the actions taken by providers. In the Australian example, this is achieved by information technology (desktop reviews) and site visits. Walker (2000) has argued that introducing monitoring can lead to sub-optimal outcomes, particularly when some element of the agent’s performance cannot be measured, when service delivery is complex, and where the relationship was previously relational rather than contractual. Citing Frey (1993, p. 664), his argument is that monitoring breaks the ‘psychological contract’ between purchaser and provider and creates an adversarial contractual relationship (Walker 2000, p. 541). In a complex service delivery environment, the high cost of monitoring performance can be avoided if the provider is trusted to act consistent with the purchaser’s objectives.

Finally, control mechanisms are rules and regulation that providers need to adhere to when delivering services. Although they can be effective at ensuring a minimum level of service is given, they impose standardisation and restrict flexibility and innovation, which are important benefits of marketization.

The same limitations that restrict the effectiveness of incentives also apply to information and control mechanisms in some situations – outcomes and actions are ambiguous or unobservable. To benchmark performance, outputs need to be clear and measurable. To monitor and control the behaviour of providers, purchasers need to know which actions are most important and have the mechanisms to observe them. It is impractical for the purchaser to consider the individual circumstances of each job seeker, and by default, the purchasers must therefore impose uniform monitoring and controls, with the perverse effect of crowding out flexibility (Frey 1993).
Cost and benefits of marketization

Implementing market service delivery models comes at a cost. Understanding these costs is important as they can make up a significant share of the total cost of delivering services through contracted providers (Bruttel 2005b, p. 218). This section briefly describes transactional costs in the provision of public services. The purpose is to demonstrate that transactional costs differ between modes of governance and that costs can be much broader than the traditional transactional based costs generally considered. For example, institutional change can have a profound effect on the organisation and the people operating within the system. To provide a theoretical basis to the analysis of costs, this section begins by describing the role of governance arrangements in exchange relationships. The various quantitative costs of managing the contractual relationship are then considered. Finally, qualitative costs are discussed as a prelude to the analysis of the effects of marketization on staff motivation and not-for-profit organisations.

Williamson’s (1975, 1986) exploration of transactional costs and the firm concentrated on economic efficiency in exchange relationships. According to his research, costs depend on the characteristics of the transaction and the institutional governance arrangement. Matching the appropriate governance arrangement with the unique exchange requirements provides the greatest efficiency. Governance costs, according to Williamson, are also affected by the human actors involved in the exchange. Williamson assumes that material self-interest, bounded rationality and trustworthiness (negative opportunism) affect exchange and, any factors that increase complexity, uncertainty or trust can increase transaction costs. Exchange suffers if the governance mechanism does not reduce moral hazard and ambiguity. This overarching concept is useful for considering the quantitative and qualitative cost of marketization.

Adopting a more traditional and quantitative definition, Brown and Potoski (2003) describe transaction costs as the expenses incurred in managing all elements of the service delivery exchange (p. 156). These costs are incurred throughout the contract management process: ex-ante transaction costs include the search for information to identify what is needed and how it can be measured, locating and assessing firms capable of delivering the services and to the necessary standard, and drawing up, negotiating and entering contracts; ex-post transaction costs encompass implementing the contracts and monitoring performance.

Although few studies have attempted to directly measure the costs of private service delivery, transaction costs have been estimated to vary from between 3 and 33 per cent of total production cost (Furubotn & Richter 1998, cited in Bruttel 2005b, p. 218). Attempts to compare costs between different employment service models over time are frustrated by the need to standardise output quality, different system objectives, and by operating under
different economic conditions. While there is some quibbling over the figures and over the magnitude of the costs, there is a general consensus that outsourcing most public services reduces costs (Andersson & Jordahl 2011).

Because of these methodological limitations and nature of the research question under consideration, this dissertation does not attempt to measure costs. However, it is worth emphasising how the exchange relationship is affected by the nature of the governance arrangement. Brown and Potoski (2003) suggest that implementing contracts for public goods is generally more complex and difficult due to specialised knowledge, and monitoring and evaluation requirements. The unique challenges of entering contracts, gathering data and evaluating performance for public goods requires increased investment in contract-management capacity. As a result, not only are the contracting, information and monitoring costs of contracted services delivered by private firms likely to be higher for some public services, costs can vary significantly if the governance arrangement does not reduce ambiguity or foster trust (Brown and Potski 2003).

There are a host of other more difficult-to-measure costs that come from altering the existing institutional arrangements. Adopting a slightly broader and qualitative definition of costs, Furubotn and Richter (1998) suggest transaction costs encompass the multiple dimensions involved in exchange between imperfect economic agents, including market transaction costs, managerial costs within the firm and political transaction costs related to institutional change. As the marketization of public employment services involves making changes to the institutional landscape and introducing new contractual arrangements, it is critical these and other broader human and behavioural costs are considered.

Despite the radical change to service delivery and the pervasive influence it is likely to have on organisations and staff, the behavioural effects of marketization are not prominent in the research literature and are poorly understood. This is not surprising given that the concepts used to inform the approach to privatisation and markets comes from economic theories. For example, the basic building blocks of the transactional cost approach to analysing different institutional governance arrangements are bounded rationality, opportunism and self-interest. Similarly, incentive theory assumes that people are motivated primarily by self-interest.

As Simon (1991) has argued, any attempt at ‘explaining organisational behaviour solely in terms of agency, asymmetric information, transaction costs, opportunism and other concepts drawn from neo-classical economics ignore key organizational mechanisms…and hence are seriously incomplete’ (p. 42, cited in Walker 2000, p. 540). The attempt should therefore be to integrate changes in the behaviour of individuals and organisations with standard economic concepts. The underlying assumptions of human motivation in transactional cost and incentive theory can be challenged and replaced by any number of motivational theories.
Indeed, some researchers have questioned the assumptions regarding material self-interest, bounded rationality and negative opportunism in economic organisation. For example, Greinsinger (1990) includes the human element within the exchange framework to show that reducing uncertainty, and improving cooperation and trust, can improve overall economic efficiency.

The main point to come from this work is that the complexity of human motivation cannot be reduced to material self-interest. This departure from the general theory of incentives, agency, and transaction costs has important implications for the marketization of social services. Incorporating a broader set of concepts that can explain complex human needs allows a more complete picture of the cost of marketization. Two major implications are discussed: the effect on staff motivation and on not-for-profit organisations.

Staff motivation: Transaction costs or incentive differential?

A key assumption of many economic theories is that people are motivated by self-interest and profit. According to this theory, incentives matter because agents get utility solely from payments, and, accordingly, the higher the incentive the more effort is exerted (Dixit 2000, p. 25). In reality, people care about and are motivated by a range of complex factors. The direction and strength of human action is influenced by a variety of motives that go beyond mere profits.

Theoretical constructs used to explain human behaviour have long existed in the social and behavioural sciences. Only recently have these findings been used to study and inform economic exchange and become commonplace in economic theory. An area of study where one would expect non-monetary motives to be particularly important is in the provision of social services.

Public services are produced for the benefit of the public and provide external benefits to society. A healthy, well-educated population benefits everyone, not just those who receive education or health services. Oftentimes services are targeted at the most vulnerable - those who have suffered trauma, or misfortune and are least able to support themselves. In this sense, public service is about questions of equality and social justice. It is therefore reasonable to ask whether people working in the public service have a set of motivations that are different to those working in the private sector. And if so, what implications this has for the design of service delivery models.

The motivation of people working in public service has received much attention since Perry and Wise’s (1990) article ‘The motivational bases of public services’. Public service motivation is based on research that suggests people working in public institutions have a unique set of
beliefs, attitudes or values that motivate them to serve the interests of others (Perry, Hondeghem and Wise 2010, p. 682). Perry and Wise have defined public service motivation as ‘an individual’s predisposition to respond to motives grounded primarily or uniquely in public institutions’ (Perry and Wise, 1990, p. 368). There is a large body of evidence that supports other-oriented motivation and its prevalence in volunteerism (Segal and Weisbrod 2002), public servants (Alonso and Lewis 2001) and the not-for-profit sector (Rotolo and Wilson 2004).

Returning to the original work of Perry and Wise (1990), Perry, Hondeghem and Wise (2010) reviewed the previous 20 years of public administration and behaviour research to test three propositions related to selection effects, individual performance and incentives. They found that research was generally supportive of the proposition that the greater an individual’s public service motivation, the more likely that they will seek membership in a public agency. The findings demonstrated that those with higher other-oriented motivation were more attracted to government jobs, were more committed to public organisation, had higher job satisfaction levels and had lower turnover rates. Notably, many of these effects were dependent on their job providing them with opportunities to be useful to others (Taylor 2008; Steijn 2008).

They also found some evidence that public service motivation was positively related to self-reported performance appraisals, organisational effectiveness and performance (Perry, Hondeghem & Wise 2010, p. 684-5). Finally, the public sector is less dependent on monetary incentives to influence individual performance than the private sector. It is not clear whether this is because public employees assign less importance to rewards than private sector employees or if public agencies deem it less appropriate to use high-powered incentives (Perry, Hondeghem & Wise 2010, p. 688). The authors note that the relationship between public sector motivation and the outcomes described in all three propositions are complex and likely influenced by other factors. Nevertheless, there is strong rational and reasonable evidence to support the role of altruism in public service.

Although there is still debate about the exact motivational construct for those attracted to public service, the literature broadly defines two conceptually distinct but related types of motivation: other-oriented motivation and intrinsic motivation. Other-oriented motivation or output-oriented motivation more closely represents public service motivation as it is more outward focused. Francois and Vlassopoulos (2007) refer to this as output-oriented altruism, as the individual cares about the overall outcome or value of the public good. Pro-social motivation, according to some researchers, is driven by ‘meaning and purpose’ and refers to voluntary behaviour that benefits others including things such as co-operation, donating, sharing and volunteering. Intrinsic motivation, on the other hand, is more inward-looking and associated with a feeling of ‘pleasure and enjoyment’ from undertaking a task (Grant 2008).
Francois and Vlassopoulos (2007) refer to this as action-oriented altruism, as the individual receives an internal feeling of pleasure from the act of contributing to the public good.

Whether one form of motivation orientation is more prevalent for those delivering public services is still unknown. Research by Benabou and Tirole (2003) suggest that a combination of both forms of motivation is at play. This finding is supported by results from a multivariate study conducted by Houston (2000, p. 714) which indicate that public employees are more likely to place a higher value on the intrinsic reward of work that is important (outward focused) and provide a feeling of accomplishment (inward focused).

Successfully achieving the benefits of both free markets and traditional public agencies is the belief that quasi-markets rely on both altruism and self-interest to achieve public goods (Hills, Le Grand & Piachaud 2007, p. 135). Le Grand (2003) has argued that quasi-markets are effective as they harness altruistic motives of both public and private providers. These conclusions, which relied on formal models rather than empirical evidence, are challenged by recent research into motivation. Francois and Vlassopoulos (2007), for example, have argued that motivation has significant implications for the delivery of public services. Modelling motivation according to whether it is action-oriented and output-oriented, the authors suggest that there are advantages in delivering services through a government or non-profit firm when individuals are concerned about the overall value of the public good.

Motivation and the effect of incentives

Workers with altruistic motivation will derive benefit from working in the provision of social services because they care about those receiving the service. From an agency perspective, motivation enters into the agent’s utility function. The cost of an agent’s effort is lower if the agent identifies as estimable the service being produced.

In an overview of research on the role of pro-social motivation in the provision of public services, Francois and Vlassopoulos (2007) find that action-oriented altruism acts as a substitute for monetary compensation by lowering the need for incentives regardless of whether this is delivered by a government or private firm. The same authors draw very different conclusions for output-oriented altruism. They suggest that government agencies or not-for-profits have an advantage in the provision of social services as the worker is motivated to contribute effort toward the social good which s/he cares about knowing that any residual excess from the motivated worker is used in the delivery of services about which s/he cares. In a private setting, any extra effort by the motivated worker will be offset by reduced inputs under control by the residual claimant. Although a number of potential ways private firms may be able to overcome this problem are explored, such as allowing the worker’s extra contribution to go toward the desired output, solving the problem requires some operating
profit to accrue to the private firm. Francois and Vlassopoulos (2007) demonstrate through a complex example how this puts the government agency at a competitive advantage and should allow the public entity to produce the service at a lower cost relative to the private firm (p. 13). As the output-oriented employee cares about the output of the good irrespective of her/his own efforts, under private ownership the worker rationally knows that any additional effort will accrue to the private firm and not the issue which s/he cares about. Under these conditions, and consistent with moral hazard, the worker will choose not to contribute extra effort as this will crowd out the private firm’s contribution.

**Crowding out effect**

The crowding out effect, which describes a situation where intrinsic or pro-social motivation is reduced due to the presence of other factors, is relevant to both types of motivational orientations. There is a body of research that suggests extrinsic incentives ‘may come into conflict with other motivations’ and in doing so crowd out intrinsic motivation (Gneezy, Meirer and Rey-Biel 2011, p. 191). Benabou and Tirole (2006) offer an information-based model to explain how incentives may affect the effort applied by an agent. According to the model, incentives convey information (“bad news”) about how difficult or appealing the task is, the perceived ability of the agent and how much the principal trusts the agent (Gneezy, Meirer and Rey-Biel 2011). That is, incentives can convey information that the task is too difficult, unappealing, or that the agent is not fit or cannot be trusted to do the task.

Particularly relevant for this dissertation is the effect incentives have on pro-social behaviour. Incentives can break norms of social trust and shift a situation from a social to a monetary frame. For example, Heyman and Ariely (2004) found that monetary incentives used to help with a move lessened the perception that the interaction was social and reduced the amount of help given. The findings supported the idea that ‘people would expend more effort in exchange for no payment (a social market) than they expend when they receive low payment (a monetary market)’ (p. 787). Citing a number of studies involving donations in different settings, Gneezy, Meier and Rey-Biel (2011) suggest extrinsic incentives can affect an individual’s image motivation, presumably by changing the perception they have of themselves or that is signalled to others about their reasons for engaging in pro-social behaviour. The extrinsic reward creates doubt about whether the individual is executing the activity for her/his own sake or for pecuniary interests. Incentive effects depend on how rewards are designed and how they interact with other motivations.

The crowding out effect can have an adverse effect on motivation and by doing so affect the effort exerted by workers and on other important outcomes. Motivation, for example, is associated with creativity as it is assumed interest in the qualities of the task for its own sake increases creativity. The intrinsic motivation hypothesis states that ‘intrinsic motivation is
conducive to creativity whereas controlling extrinsic motivation is detrimental to creativity' (Amabile 1996, p.115). According to Collins and Amabile (1999) the use of rewards reduces intrinsic motivation. As outlined in the next section, the crowding out effect also has implications for the relationship between purchaser and provider.

**Marketization and not-for-profit organisations**

Not-for-profit organisations now play a large role in the delivery of employment services, making up approximately three quarters of the market (Considine et al. 2013). Not-for-profits have a long history of helping those most in need, treating people equally and responding to social injustice. In many cases, not-for-profits worked with the disadvantaged before government welfare services were available. This puts them in a unique position to understand and respond to the needs of particular groups of job seekers. Financial incentives are designed to align the interest of the provider and the purchaser through price signals and steer behaviour towards achieving government policy. Market-based structures are designed to improve efficiency and quality through competition. It is therefore reasonable to expect incentive payments and market competition to change the way not-for-profits operate and their goals.

A firm’s activities are influenced by the environment in which it operates and the multitude of inter-organisational influences that shape the decisions and activities of a firm (Pfeffer and Salancik 1978). The extent to which financial incentives influence the core principles and mission of the organisation is of interest. Any tension between the demands of government and the mission of the community organisation may influence its purpose and activities, and disrupt their relationship to the community and other not-for-profits.

There is evidence in the literature that this can occur. Rogers (2007) studied the impact of the privatised employment services in Australia on faith-based non-government organisations and found that the contractual requirements and dependence on government funding significantly influenced the behaviours, values and staff structure of the organisations. Considine (2003) looked at the extent to which the mission and service delivery style of non-government organisations is impacted by quasi-markets and competitive pressures. Based on focus groups and survey data from organisations involved in the Australian government’s employment services contract, the authors found that financial incentives and market competition influenced non-government providers who adopted a business culture in response to a competitive market (cited in Bredgaard and Larsen 2008).

Eardley, Abello and Macdonald (2001) looked at the shift in the relationship between government and not-for-profit organisations from a partnership to competitive contracts. They found evidence that competition was creating conflicts between traditional community-based
organisations and that they had changed their orientation toward information sharing and cooperation. The authors attributed this to the price mechanism and the need to protect market knowledge. The reforms to employment services, according to the authors, changed the way organisations interact with job seekers and undermined their advocacy role (Eardley, Abello & Macdonald 2001).

Considine, O’Sullivan and Nguyen (2014) examined how the governance arrangements in not-for-profits changed in response to the marketization of employment services. The researchers conducted focus groups and semi-structured interviews with board members, CEOs and staff and found that the composition, behaviours, characteristics and identity changed in response to the commercial and competitive nature of the employment system. Specifically, they found the board took a more businesslike view of how the organisation should operate.

Cooperation and trust is widely recognised as an important factor in relational contracting and for efficient conduct of economic activity (Walker 2000, p. 539). Reforms that change the nature of the relationship from a partnership to a contractual basis can undermine trust between provider and purchaser, and cooperation between providers. This is significant because trust and cooperation is critical to innovation and problem solving, and to high-performing service providers. In a study into the best practices of Australian employment service providers, the authors found that high-performing providers were ‘more likely to have a positive, problem-solving attitude; to find innovative solutions to the problems they encounter….and to use practices that lead to individually tailored services for job seekers’ (DEEWR 2012, p.1).

Significant to this dissertation and the question concerning the effectiveness of markets for delivering public employment services, we can summarise the key findings from the transactional cost theory and motivational literature as follows:

- **Transaction costs can be considerable when introducing and maintaining a market for the delivery of public employment services, and include both quantitative and qualitative elements. Although hard to measure and compare, increased transaction costs are generally offset by a greater reduction in production costs, resulting in a net reduction in costs.**

- **Factors that increase complexity, uncertainty or trust can increase transaction costs. Implementing contracts for public goods is generally more difficult and complex than for private exchange and therefore incurs greater costs. Deeper and more frequent intervention in the market through monitoring and tendering processes increases the market transaction costs.**
• The introduction of markets has broader institutional and human implications. It can crowd out pro-social and intrinsic motivation, increasing the incentive differential (production cost) and reducing cooperation and trust (transaction cost). Marketization can have a profound effect on the missions of not-for-profit organisations and their executive boards so that they act more according to self-interest, become more dependent on incentives, and reduce information sharing and cooperation between providers and the purchaser.

• Trust and cooperation have important links with creativity and innovation and can assist in developing new and responsive services through information sharing and openly sharing experiences about what works and does not work.

• Trust can also increase the probability that firms and staff will ‘do the right thing’. That is, transaction costs can be reduced if the defining dimensions of the transaction are matched with efficient governance relationships that will protect against opportunism. This is particularly important in situations where contracts between government department and providers are incomplete.

This section has set out the foundations for the dissertation by outlining the theories that will be used to evaluate the effectiveness of markets in delivering public employment services. The next sections outline the research design and theoretical framework that will be used to analyse the introduction of market mechanisms to deliver public employment services in Australia.
3. Methodology

This dissertation uses a theoretical framework to analyse the Australian experience of introducing markets to deliver public employment services.

The theoretical framework has been developed based on research literature from incentive theory, agency theory and motivational theory. The literature review was conducted primarily using academic sources including peer-reviewed academic journals. The breadth of literature extended across a variety of ideological positions, particularly concepts from neo-economics and behavioural science. Neo-economic concepts are the foundation for the introduction of market-based mechanisms in the delivery of government services.

The framework is applied to the Australian experience of privatising its public employment services across three stages in the marketization process: the introduction period between 1994 and 2003; the new governance period between 2003 and 2009; and the ongoing reform from 2009 to 2015.

The evaluation criteria are based on an adaptation of Le Grand’s (1991) conceptualisation of quasi-markets: responsiveness, efficiency and equity. A description of each criterion is provided as part of the theoretical framework.

The study compares findings with expected theoretical outcomes by drawing on survey data of frontline staff in Australia, evaluations conducted by the former Department of Employment and Workplace Relations, the Productivity Commission and academic research.

A major source of information was obtained from existing survey data taken from a series of questionnaires of people engaged in the provision of employment services in the Australian industry.

Considine, Lewis and O’Sullivan (2011) developed a set of survey questions to garner information from frontline staff about work practices and their interaction with the unemployed. Frontline staff from the employment services industry were asked to respond to a series of statements and questions about flexibility, autonomy and use of standardised tools in their day-to-day work (Considine, Lewis & O’Sullivan 2011, p. 817).

The first set of surveys were conducted between 1996 and 1999 (referred to as the 1998 survey) to elicit the views of frontline staff on a range of issues to do with the reforms of public employment services. A total of 585 individuals were sampled from a national list of contracted agencies (Considine 2001, p.32). A more detailed overview of the survey methodology can be found in Considine’s book Enterprising States: The Public Management of Welfare to Work (2001).
The 2008 survey was carried out online and involved 1,512 frontline workers from 33 Australian employment services agencies. The survey contained 98 questions and was adapted from the 1998 study. More details about the survey methodology can be found in the report *Activating States: transforming the delivery of 'welfare to work' services in Australia, the UK and the Netherlands Australian Report back to Industry Partners* (Considine, Lewis & O'Sullivan 2008).

The third survey was conducted in 2012 and used a survey instrument adapted from the original 1998 questionnaire and that closely resembled the 2008 survey. A total of 1264 usable survey responses (50% response rate) from frontline staff were obtained from 26 participating providers. More details about the survey methodology can be found in the report *Increasing Innovation and Flexibility in Social Service Delivery: Australian Report back to Industry Partners* (Considine et al. 2013).
4. A theoretical framework

The key observations from the research literature can be summarized in the following framework:

- Public employment services are activities designed to reintegrate job seekers back into the labour force. The system can be defined as having multiple tasks, multiple principals, and ambiguous actions and outcomes.

- Quasi-markets are expected to be more responsive, more efficient, and provide greater equity of access than former bureaucratic arrangements. They achieve this through a market structure that provides competition, informed choice and the right incentives.
  - Responsiveness is a system that can identify and respond to the individual needs of job seekers. This requires correct assessment and provision of services based on job seeker needs, and of sufficient quality to be effective. Critical to responsiveness is increased flexibility. That is, providers can decide how they structure their services and staff are can determine how to best meet the needs of clients.
  - Efficiency refers to cost-effectiveness and whether or not the marketized employment system can deliver employment outcomes at a lower cost. Measures of efficiency can include total expenditure on labour market programs and the average cost per employment outcome (the number of outcomes divided by the unit costs of job seekers assisted)
  - Equity refers to equity of access to assistance and in outcomes, especially by disadvantaged job seekers relative to others.
• Economic theory suggests privatisation improves allocative efficiency as private firms have a stronger profit incentive. Competition requires firms to seek a competitive advantage through greater efficiency or more effective services. This should lead to cost reductions, greater innovation and services tailored to individual needs.

• Outsourcing the provision of public employment services creates a principal-agent problem. Getting the provider to act in the interest of the purchaser is difficult because of moral hazard: conflicting objectives and information asymmetry.

• There are governance mechanisms to mitigate the problem of moral hazard, reduce goal incongruence and get the provider to act in the interest of the purchaser: incentives, information and control.

• The theory of incentives show that incentives will generally be weaker in situations where there are multiple tasks and multiple principals, and where measures of performance are ambiguous or unverifiable. The weakening is most pronounced if the tasks are substitutes and where there are a high number of principals.

• When contracts are incomplete and cost reduction and quality cannot be controlled, private ownership will lead to investment in cost reduction and insufficient investment in quality improvements.

• Alternative governance mechanisms are available but are subject to similar constraints as incentives when actions and outcomes are ambiguous.

• Implementing governance mechanisms comes at a cost. This includes both quantitative costs (establishing contracts and implementing and monitoring compliance) and qualitative costs (impact on staff motivation, interaction between actors in the system, trust, cooperation and the goals of organisations).

• Deeper and more frequent intervention in the market through monitoring and control increases the transactional cost, can reduce trust and cooperation between purchaser and provider, and restrict service flexibility and innovation.

• These costs can moderate the strength of the effect of quasi-markets on system performance.

• The cost of governance generally increases the more complex, uncertain or untrustworthy the exchange relationship. The motivation of agents has important implications for the principal-agent relationship and institutional design. Motivation theory suggests pro-social and intrinsic motivation can:
  o increase employee effort and act as a substitute for monetary compensation. This can reduce costs if the defining dimensions of the transaction are matched with efficient governance relationships that protect against opportunism, and increase trust and cooperation.
  o be crowded out by extrinsic rewards or when social services are outsourced to private ownership. This can increase the incentive differential (production cost) and reduce effort, cooperation and trust.
• Marketization and the use of incentives can affect the mission and governance of providers by focusing more on profit. This can reduce cooperation and trust between providers and with the purchaser. Transaction costs can be reduced if the defining dimensions of the transaction are matched with efficient governance relationships that will protect against opportunism.

The Australian public employment service has gone through a number of changes since privatisation began in the 1990s. Australia fully outsourced its core public employment services in 1998 through the launch of Job Network. Job Network was replaced by Job Services Australia in 2009. A new employment services called Jobactive started on 1 July 2015. A majority of employment services are delivered through these core programs with approximately 760,000 job seekers receiving support through Job Services Australia at a cost of $1.3 billion per year (National Commission of Audit 2014). Other employment service programs include Disability Employment Services, Indigenous Employment Program and Remote Jobs and Communities Program.

The Department of Employment (formerly Department of Education, Employment and Workplace Relations) contracts organisations to deliver employment services to job seekers in receipt of income support payments. There have been variations to the type of services, payment structure and monitoring across the iterations; however, most of the core system features remain.

- In the Australian system, the outcome-related payment is the single most important governance mechanism to drive performance and ensure providers act in accordance with the interests of the department. A mixed funding model includes a fixed service fee and outcome-based payments for placing a job seeker into work for 13 and 26 weeks. The outcome-based payment varies according to the level of disadvantage and location of the job seeker. There is also additional funding for certain groups of clients for specialised programs and more intensive assistance.

- Services to assist job seekers to find and keep a job differ according to the level of disadvantage of the job seeker. This has included minor job counselling, job search training, job matching and intensive assistance for job seekers classified as disadvantaged.

- Service providers are rated based on their performance in placing and keeping job seekers in work. A Star Rating system is used to benchmark performance, ranging from one (lowest) to five stars (highest). The ratings are calculated using a regression model that compares placement results that are adjusted for local labour market conditions and the personal characteristics of the job seeker.

Unemployment in Australia

The unemployment rate in Australia has fallen over the past decade from a high of 11 per cent in 1992 to a low of 4.3 per cent in 2008, rising slightly to 6.3 per cent in July 2015.
During this time, the proportion of payments to recipients out of work for over two years has steadily increased from around 10 per cent to approximately half (Department of Social Services 2014, cited in Davidson 2014). The number of people unemployed for more than 52 weeks in Australia has increased by more than 160 per cent since the global financial crisis in mid-2008 (Australian Bureau of Statistics 2015). Approximately two-thirds of payment recipients have been unemployed for more than 12 months.

When entering public employment services, almost half of all job seekers find employment within three months of participating in employment assistance and 56 per cent of job seekers assessed as work-ready were employed within 3 months (Department of Employment 2015, p. 4). These job seekers need little help to secure work; basic job counselling and matching for these people is sufficient, with any substantial investment being a deadweight cost to government.

At any point in time, over a third of all job seekers have been assessed as having complex problems or significant barriers to employment (Department of Employment 2015). Around two-thirds of job seekers with significant barriers to employment and three-quarters with severe non-vocational barriers to employment were still unemployed 3 months after participating in job assistance (Department of Employment 2015, p. 4). In the Australian experience, long-term unemployed are less well educated, indigenous, people with a disability or health problem, single parents and older (aged over 45) (Fowkes 2011a).

This next section analyses the evolution of the market features within the Australian public employment services using the theoretical framework presented in the previous chapter. It does this by looking at the public employment service in three stages: introduction of marketization (1994-2003), additional governance (2003-2009) and ongoing reforms (2009-2015).

### 5.1 Stage 1 – Introducing marketization (1994-2003)

The first wave of public employment services reform occurred between 1994 and 1996 under the Working Nation initiative introduced by the Federal Labor government. The aim was to ‘improve labour market equity and efficiency through a sustained reduction in the level of long-term unemployment’ (DEETYA 1996, p. V). It involved the creation of many market-like features with the introduction of private providers, the ability for job seekers to select an employment provider through which they would receive case management and negotiate their service contract, competition between providers, and payments based on successful placements (Finn 1997; Considine 2005; cited in Considine, Lewis and O’Sullivan 2011, p.
The Department of Employment, Education and Training (DEET) managed the employment system with a new public agency called Employment Assistance Australia competing with several hundred private providers.

Job Network commenced in 1998, with the first contract period between 1998 and 2000, and the second round of contracts from 2000 until 2003. The system was fully privatised leading up to the commencement of Job Network with the remaining public agencies closed. Job seekers were assessed using the ‘Job Seeker Classification Instrument’. This was used to determine their level of disadvantage and risk of long term unemployment, as well as to determine the level of fees payable to providers for successful outcomes.

Providers were required to deliver a number of services targeted at the needs of job seekers. The needs of job seekers vary depending on how far they are from the job market and the barriers they have to securing and maintaining employment. Job seekers assessed as having more barriers to employment attracted higher fees. Providers received an upfront payment per client and another fee when placed for 13 weeks in a job or training. The payment structure was based on few conditions and was largely silent on process. Instead payment was dependent on the job seeker attending an initial interview and registering with the agency. The outcome payments were dependent only on securing a placement. How this was achieved was at the discretion of agency staff (Dockery & Stromback 2001).

Theoretical framework

Central to the idea of privatisation is the belief that this form of service provision would deliver more innovation, choice, and flexible tailored service to meet client needs. The first stage of privatisation introduced competition between providers and choice for job seekers, which are expected to drive providers to compete through increased efficiency or more effective services.

Incentive theory suggests that the introduction of fee-for-service payments should be effective at driving performance if the activities to be performed have clear simple tasks and outcomes can be easily measured. In organisational settings where outcomes are verifiable, even if the actions taken to achieve the outcomes are not, the application of incentives should be effective. Principals can control and reward agents for directing effort to the delivery of their desired outcomes. If performance cannot be defined, measured and contracted with some intelligibility, oftentimes because of multiple tasks or principals, or if achievement of outcomes is ambiguous, then the incentive effect will be weak.

The Australian employment service is characterised by multiple tasks, multiple agencies and ambiguous outcomes for at least one key function: placing disadvantaged groups. Providers
deliver a variety of employment services, including job counselling, job search training, job matching, and programs associated with intensive assistance, including training and support for job seekers. These tasks can be divided between those services that support the ‘job-ready’ and assistance for disadvantaged job seekers. As the tasks are substitutes for one another in the agent’s cost function, providers will allocate effort toward the dimension that provides the more certain payment – placing the job-ready.

The delivery of public services involves multiple principals. The department and government of the day want to place people into work quickly to reduce the social and financial cost of unemployment; employers want timely and good quality job seekers; senior management within the service providers increasingly expect good financial outcomes; staff and job seekers bring a range of motives; and because employment reduces social and economic costs, and generates positive externalities, the community has an interest in the outcomes.

An optimal quasi-market would reward service providers based on their net impact on job seekers. This is, however, very difficult to measure and is particularly problematic for those further from the job market. Purchasers and providers are oftentimes not sure what services are most appropriate for an individual job seeker or what impact they will have on the clients jobs prospects. The delivery of these types of services would be what Wilson (1989) describes as a coping organisation: the actions and outcomes for many tasks are ambiguous and performance measures are inaccurate.

Incentive theory is instructive in this situation. Service providers will divert their effort toward the more accurately measured and less ambiguous task (placement for the ‘job-ready’) and away from the more ambiguous outcome (disadvantaged job seekers). Investing effort in job seekers that are further from the job market is a risk for service providers as the outcome is uncertain. The overall incentive effect in this situation is weak with effort being narrowly directed toward the more job-ready. Contract theory suggests that when contracts cannot control for quality, then private firms will invest more in cost reduction. This becomes a problem if cost reduction affects quality.

Low levels of information and control mechanisms should facilitate flexibility and more tailored services. Weak market governance will make it hard for the purchaser to discipline providers and ensure they act in the purchaser’s best interest. The inability to control providers and align the objectives of the provider with the purchaser will allow opportunistic behaviour such as creaming and parking.

The framework suggests that the strong reliance on market mechanisms and incentives will crowd out pro-social and intrinsic motivation. As these forms of motivation can act as a substitute for monetary compensation it is expected that this will increase the incentive
differential (production cost), reducing cooperation between providers, and increasing the focus on profit by turning a social situation into an economic one.

The following propositions can be made in relation to the evaluation criteria.

1. **Responsiveness – flexibility and quality**

Consistent with economic theory, introducing incentive payment for outcomes and allowing job seekers to select the agency from which they will receive employment services is expected to drive competition and deliver more flexible tailored services. Competition comes in the form of individual job seekers theoretically being able to make a choice about their preferred agency and through the tendering rounds where agencies compete for contracts with the government. In addition, the low levels of agency monitoring and control through the ‘black box’ approach is expected to lead to more flexibility and innovation as frontline staff can design tailored services to meet individual needs rather than following standardised processes.

Incentives will increase responsiveness for those tasks and outcomes that can be measured and reduce the responsiveness for those that are more ambiguous. The overall increase in responsiveness due to the market effects will be slightly offset by the weak incentive effect for those tasks that are more ambiguous, such as helping the long term unemployed. Offsetting will be strengthened by the ‘crowding-out effect’ which will reduce the response to specific hard to place groups of job seekers.

*Proposition 1: Overall responsiveness will increase during the first phase of the Australian employment services. Flexibility and quality will increase for the job-ready but will decrease for the groups of job seekers furthest from the job market.*

An evaluation of the new partially privatised system by the Department of Employment, Education, Training & Youth Affairs (DEETYA) found that the most significant development was in ‘providing job seekers with a more personalised service’ with clients and employers reporting that employment services were ‘more personalised and was an improvement on that provided by the Commonwealth Employment Service’ (DEETYA 1996, p.34). The report found that competition amongst providers increased in the second tender period and there was early evidence from clients, case managers and network staff of improved quality (DEETYA 1996, p.35).

Considine’s (1999) investigation of early forms of market reforms in the mid-1990s provides important insights to the effectiveness of the employment services and its impact on flexibility. The elements necessary for a competitive market system were present. There were a high
number of smaller sized organisations in the market with more flexible and entrepreneurial workplaces (Considine 1999, p.191). The increased number of providers operating in more locations contributed to a more responsive system with more choice simply by being more present in more geographic areas. The tendering process provided a mechanism for providers to enter the market, removing barriers of entry and exit.

In theory, clients were informed about quality and provider performance through the star rating system. In practice, however, it is unlikely job seekers were well informed. Job seekers were required to participate in the system and to register with a provider within two days. The system did not engage with job seekers as clients, and they had very little influence over the quality of services. Decisions were often made by chance or geographical convenience rather than according to the quality of providers. The effects of competition and choice are likely to have been stifled by the lack of informed choice (Bredgaard and Larsen 2008, p. 346). Choice for job seekers is likely to have increased largely because of the influx of new providers into the market.

Staff interviews and survey results indicated that the new service model improved flexibility. In response to a question about what they do with their client on a day to day basis, 82 per cent reported that they were ‘free to decide’ while only 17 percent indicated that client information systems ‘tell us what steps to take and when to take them’ (Considine 1999, p.191).

Figures show that frontline staff in organisations delivering employment services were more focused on financial outcomes and responding to commercial pressures in 1999 than in 1996 (Considine 1999). These findings were consistent across all types of agencies, with non-profits appearing to adopt for-profit strategies in relation to financial outcomes. This resulted in higher caseloads and less time spent with job seekers, jeopardising ‘individual support’ and time to engage with support agencies. Considine (1999) suggests the incentives system coerced organisations to adopt similar service delivery and cost reduction strategies in response to market competition.

The amount of time spent working with other service providers halved following the introduction of Job Network, from 10-12 per cent before the introduction of Job Network to 5 per cent in 1998 (Considine 1999). This suggests less cooperation between providers and other service providers. Cooperation amongst a network of providers is expected to lead to exchanges of information and ideas, better partnerships and trust, greater responsiveness to clients and improved service delivery flexibility (De Rynck & Voets 2006).

Finally, responsiveness requires the needs of job seeker to be correctly assessed. The Job seeker Classification Instrument is used to classify Australian job seekers, but has been criticized for its accuracy (Australian Productivity Commission 2002). That is, inaccurate
profiling tools make it hard to predict which job seekers will become long-term unemployed; resulting in deadweight costs when assistance is provided to ‘false positives’ and risk of long-term unemployment when the tool fails to correctly identify at risk job seekers.

2. Efficiency

Proposition 2: Efficiency will increase in the first phase of the Australian employment services due to the introduction of competition and choice and the allocative efficiency of the profit incentive.

It is generally considered difficult to assess the impact of marketization on costs and efficiency, and scant systematic knowledge on the effects of markets on public employment services exists (Bredgaard & Larsen 2008, p. 344). This makes it difficult to evaluate the efficiency of the private service providers compared with the previous system. There is some evidence that the shift to contracting out has produced cost savings in Australia, even though the discontinuation of some cost-heavy programs around the time of contracting out may also explain the savings (Bredgaard & Larsen 2008, p. 345).

Contracting out services incurs a number of one-off and ongoing transactional costs which are needed due to contract tendering, monitoring and compliance, and the information and performance management systems needed to support this process. This includes administrative costs associated with determining and making payments for the provision of services. The early stages of privatisation had three yearly re-tendering periods that were resource intensive, and which increased transactional costs. Higher transactional costs can be offset by lower production costs. That is, the increased cost from outsourcing and managing a market-like system is only a problem if it is more than the overall reduction in public spending or cost savings generated by the new model.

Dockery and Stromback (2001) conducted a preliminary assessment of the effectiveness and outcomes of the Job Network. The authors compared programs previously provided by government-run entities with similar Job Network programs and found contracted providers achieved higher placement rates at lower unit costs (p. 439). Although the cost and efficiency of programs under the privatised and government model are not perfectly comparable due to different inclusion criteria and approaches to measuring outcomes, the authors conclude that the privatised model under Job Network provided a lower average unit cost and lower level of expenditure per job seeker serviced (Dockery & Stromback 2001, p. 440). This was particularly evident in the basic job search program where providers under Job Network achieved significantly higher placement rates at around 50 per cent lower cost per unsubsidized employment outcome (Dockery & Stromback 2001, p. 439). The authors were unable to reliably compare the relative cost efficiency of programs aimed at disadvantaged
job seekers, concluding only that the ‘Job Network has delivered a lower level of expenditure per job seeker serviced’ (p. 443). Both outcomes are predicted by the framework. Marketization was expected to increase efficiency for outcomes that can be determined with some certainty, namely placing job ready candidates, whereas expenditure was redirected away from the ambiguous task of placing disadvantaged job seekers.

The marketization of public employment services led to substantial savings for the Australian government with the cost of labour market programs falling by over half between 1995-96 and 2001-02. This was largely achieved by stripping out $1 billion for more expensive labour market programs and job creation efforts (Fowkes 2011b, p. 5). As the net impact of employment services on job seekers remained largely unchanged, the reduction in cost can be attributed to increased efficiency rather than improved effectiveness (Struyven & Steurs 2005, p.220).

3. Equity of service allocation: Creaming and parking

While incentive-based payments are designed to increase efficiency through cost reductions, they can generate negative adverse effects such as the incentive to cream job seekers with the best chance of return and parking those that are harder to place. This is likely to occur in situations where the contracted services have multiple dimensions and the outcomes are ambiguous and difficult to control.

*Proposition 3: Creaming and parking will increase during the first phase of the Australian employment services due to the presence of multiple dimensions, ambiguity of actions and outcomes, the profit incentive and weak market governance.*

There is strong evidence to suggest that providers responded to price signals and achieved quick job placements at low costs. The adverse incentive effects created by the contract are particularly evident for the delivery of intensive assistance.

Incentive theory holds that the incentive to place higher risk job seekers will be low when the performance measures are ambiguous. There is evidence to support the notion that the requirements of employment services are ambiguous. Ramboll (2004, p. 344; cited in Bredgaard & Larsen 2008, p. 344) noted that purchasers found it difficult to ‘describe the services required in precise terms’ when developing tendering material. This finding supports the view that many tasks within public employment services are not easy to measure and are therefore hard to contract, and produce only a weak incentive effect.
There is also evidence that front-line staff were directing their effort toward job seekers who generate a profit. When questioned if their organisation 'pay's attention to the income I generate', 94 per cent of for-profit firms and 87 per cent of community organisations agreed or strongly agreed, compared with 24 per cent of government employees (Considine 1999, p. 197).

Another indicator of the level of support given to harder to place job seekers is the amount of time spent by frontline staff building relationships with other service providers in social services, education, training and employment. Those further from the job market need greater support from a variety of different providers. Despite this, the amount of time spent working with other service providers halved from 10-12 per cent to 5 per cent following the introduction of Job Network, suggesting a reduction in networking and a redirection of effort away from disadvantaged groups (Considine 1999, p. 196).

This strong focus on income proved to be detrimental to disadvantaged job seekers. The original ‘black box’ model that was expected to give providers the freedom to innovate and experiment with new services led to excessive profit-taking through ‘creaming’ and ‘parking’. Finding work for hard-to-place job seekers required more investment of time and resources, yet pay-offs were risky. Providers behaved exactly as economic and incentive theory predicts: they ignored hard-to-place job seekers and placed those that were job-ready.

The Productivity Commission (2002) found that providers ‘have an incentive to manipulate the system by ‘parking’ (providing little assistance to) clients with low employment probabilities’ (p. 3.13). Government evaluation reports also find evidence of unequal service allocation. Stage two evaluation of the Job Network found considerable variation in employment
outcomes for certain groups of job seekers. Older job seekers, the long-term unemployed, those with low levels of education and indigenous had poorer outcomes compared to other job seekers (DEEWR 2001). The Productivity Commission reported that ‘In any system designed around outcome payments, providers will work to the incentive structure built into the contract. Ideally therefore the contract should incorporate all important outcomes. This is not always easy to achieve. For example, it may be difficult to specify or measure an outcome or to balance one outcome against others’. The focus of providers was on ‘how can I get a payable outcome?’ rather than ‘what is best for the client’ (Productivity Commission 2002, p.3.13)

Job seekers who were unlikely to achieve an outcome received less assistance (DEEWR 2002). The third stage evaluation of Job Network found that the risks associated with assisting job seekers further from the market were too high. Again, providers focused on job seekers that were job-ready, required little assistance and who had the greatest prospect of being placed and generating an income for the provider. The payment structure discouraged investment in those who needed it most. Struyven and Steurs (2005) conclude that it is now ‘officially acknowledged that the financial incentives have the unintended effect’ of providing less support for those who need it the most (p. 222).

As predicted by the framework, there was little evidence that creaming in the first 15 months of Job Network was any more widespread than the public system for basic matching services, which targets a less disadvantaged group of job seekers, and whose members reported a reasonably high level of service (Dockery and Stromback 2001, p.444). For job seekers requiring intensive assistance, there is evidence that creaming may occur at the referral stage as referral rates decreased with duration of unemployment and increased with job seeker education. Many disadvantaged groups received lower referral rates than would be expected (DEEWR 2001; Dockery & Stromback 2001, p.445). Some job seeker groups such as indigenous job seekers, youth and sole parents were found to have low participation rates in Job Network and there was considerable variation in the outcome levels for different job seeker groups. Older job seekers, the long term unemployed (more than two years), indigenous job seekers, job seekers with low unemployment and those with a disability had consistently lower outcomes than other job seekers (DEWER 2002, p.19).

Front-line staff admitted that they divided long-term unemployed into two informal groups – those that receive support and those that received minimal or no support (Considine 2001, p. 130). Considine (2001) found that ‘in the earlier period 52 per cent of case managers had parked approximately one third of their case loads. By 1999 this figure had risen to 66 per cent’ (p. 136).
There is now overwhelming evidence that providers adopt a profit maximising strategy, that this results in underinvestment in the hard-to-place job seekers, and this has adverse effects for disadvantage job seekers.


The original ‘black box’ purchasing model gave providers the flexibility to deliver services at their own discretion. The government could pay providers for achieving employment outcomes without needing information about how the outcomes were achieved. This was expected to increase service innovation as providers could tailor services for the specific needs of job seekers. This service delivery autonomy was also linked to the problem of creaming and parking.

In 2003, the Government sought to resolve the problem of equity of service allocation by initiating fees for the delivery of specific services and introducing the Active Participation Model of the Job Network. This was a decisive move away from the ‘black box’ model. The Active Participation Model included a ‘fixed continuum’ of services’ and the quarantining of a third of total funding in a job seeker account to be used by providers to assist job seekers. Although the proceeding contracts included a fixed fee component, the ratio of funding linked to employment outcomes was reduced relative to inputs. The new contracts prescribed the delivery of particular services, such as face-to-face interviews, with information technology systems established to record activities, and the Job Network Code of Practice used to guide specific service requirements (Tergeist & Grubb 2006, p. 43). What this meant in practice was greater government direction over provider activity.

Another change for the 2003 contract was the move to fixed prices. Unlike the first two contract periods where price played a part in selecting successful bids, selection was based on a capacity to deliver services (Tergeist & Grubb 2006, p. 43). The third contract period involved a move from full to partial tendering. High performing agencies, based on the ‘Star rating system’ had their existing contracts automatically ‘rolled’ over into new contracts, while only small sections of the market were required to re-tender for new contracts.

Theoretical framework

The first two contract periods were devised according to classic incentive theory that assumes actions are unverifiable but outcomes are (Dixit 2000, p. 23). The special features unique to public sector agencies such as multiple actions, multiple principals, and ambiguous and unverifiable actions and outcomes meant the incentive effect was weak. Instead agencies
directed their effort toward the more certain and low-risk clients. To overcome the incomplete nature of contracting public employment services and the weak incentive effect, the second phase of developments in the marketization of public employment services saw the introduction of alternative forms of market governance.

The increased use of information mechanisms as a form of market governance saw a greater reliance on the Star rating system and the use of information management technology to collect details about the actions taken by service provider. This was an attempt to eliminate information asymmetry by increasing the purchaser’s information about the actions taken by the provider and benchmark performance (Bruttel 2005). The introduction of a fixed continuum of services under the Active Participation Model and a code of practice are control mechanisms. They are the rules and regulation that providers need to adhere to when delivering services and are a way of overcoming the problem of moral hazard.

A couple of problems emerge with the introduction of information and control mechanisms. The same limitations that restrict the effectiveness of using incentives also apply to information and control mechanisms. First, outcomes and actions are ambiguous or unobservable. Benchmarking does allow a broader range of factors to be included, and regression modelling can remove some of the external ‘noise’. For example, the star ratings are an outcome measure based on ‘net impact’ of employment services, and determine the survival of the organisation’s contract as it is used to award business share to high-performing providers, and therefore drives decision making. However, the star rating system is a blunt instrument and to benchmark performance, outputs need to be clear and measurable, which is not always the case for public employment services. This naturally leads to the second problem: what is the ‘right’ action? That is, to monitor, assess, and direct the behaviour of providers, purchasers need to know and specify which actions are most important. This requires guidelines and rules which leads to service standardisation – the very characteristic of the traditional form of public service delivery that markets were implemented to overcome.

The introduction of multiple governance mechanisms is expected to increase transaction costs and the use of informational and control mechanisms will reduce provider flexibility and result in more standardised services. Information and control mechanisms should reduce information asymmetry and provide greater certainty about the actions of providers, overcoming the adverse effects of markets on equity of access.

The framework suggests monitoring and control will change the nature of the relationship between provider and purchaser from a partnership to contractual relationship, reducing trust and cooperation. This will stifle innovation and reduce the responsiveness of services.
Evidence

1. Responsiveness: Flexibility and quality

Proposition 4: The introduction of information and control mechanisms will reduce service delivery responsiveness.

In 2008 Considine, Lewis and O’Sullivan (2011) conducted a repeat study by surveying frontline staff in the fully privatised Australian system. As outlined in figure 2, the 1998 survey results showed that 84.6 per cent of front-line staff surveyed agreed or strongly agreed with the statement ‘when it comes to day-to-day work I am free to decide for myself what I will do with each job seeker’. This figure had fallen 22.1 percentage points to 62.5 per cent by 2008, indicating a reduction in the capacity of staff to tailor services to the individual needs of job seekers (Considine, Lewis & O’Sullivan 2011, p. 817).

Figure 2. Proportion of respondents that agreed with the statement ‘When it comes to day-to-day work I am free to decide for myself what I will do with each job seeker’ over the three survey periods.

Flexibility is also reflected in the capacity of frontline staff to act with independence from supervisors. Between 1998 and 2008, the proportion of survey respondents that strongly agreed their supervisors ‘knew a lot about the work they do day-to-day’ tripled from 11 per cent to 33 per cent (Considine, Lewis & O’Sullivan 2008, p. 30). Figure 3 shows that in 1998, 11.3 per cent of those surveyed would refer a matter to their supervisor if it was not covered in the ‘procedural guide’. By 2008, that percentage had increased to 34.5 per cent (Considine, Lewis & O’Sullivan 2011, p. 819).
Figure 3. The proportion of respondents that agree with the statement ‘When I come across something not covered by the procedural guide, I refer it to my supervisor’ over the three survey periods.

Heavy reliance on IT systems can also reflect standardisation and process driven services. In 1998, 17.4 percent agreed or strongly agreed that ‘our computer system tells me what steps to take with job seekers and when to take them’. The figure had increased to 47.4 per cent by 2008 (Considine, Lewis & O’Sullivan 2008, p. 30). Furthermore, 70 per cent of surveyed frontline staff indicated that the IT system dictates how they do their jobs, suggesting a high degree of standardised and centrally scripted service delivery responses (Considine, Lewis & O’Sullivan 2008, p. 26).

Figure 4. The proportion of respondents that agree with the statement ‘Our computer system tells me what steps to take with job seekers and when to take them’ over the three survey periods.

Workplace controls through standardised assessment and classification tools increased between the first and second surveys. In 1998, about half of survey respondents indicated that standard questions were not influential; whereas in 2008 only 7.8 per cent believed this to
be true (Considine, Lewis & O’Sullivan 2008, p. 19). A more direct question was how influential is ‘your own judgement’ when working with job seekers. In 1998, 55.1 per cent said their own judgement was very influential compared to 26.3 per cent in 2008 (Considine, Lewis & O’Sullivan 2008, p. 19).

These survey results indicate that the employment service system became a much more regulated environment with evidence of convergent behaviour amongst frontline staff and agencies, increased levels of routinisation and standardisation of services, and decreased flexibility (Considine, Lewis and O’Sullivan 2011, p. 822).

These findings were consistent with a review conducted by Thomas (2007) of the Job Network and its effectiveness at dealing with the needs of disadvantaged job seekers. He concluded that:

> increased Government monitoring and regulation of Job Network providers have impacted on the ability of these providers to furnish the flexible and tailored support necessary to improve the employment outcomes of long-term unemployed and difficult-to-place job seekers.  
> (Thomas 2007, p. 1)

Not surprisingly, innovation is likely to have suffered during the second period of the privatisation of employment services. Bredgaard and Larsen (2008) suggest that ‘providers hardly ever come up with innovative solutions’, and attribute this to a payment model that creates too high a risk for providers to invest in new service models or innovative approaches. Instead providers focus on survival and approaches that produce quick and certain results (p. 354). In 2008, the proportion of time spent with other service providers had fallen to 2.75 per cent, almost half of the 1998 results and down from around 12 per cent prior to the introduction of Job Network (Considine, Lewis & O’Sullivan 2008, p. 21). This lack of interaction and collaboration with other providers may also have contributed to reduced innovation and responsiveness.

2. Efficiency

The positive effects of marketization achieved in the first stage are expected to be dampened by the introduction of additional governance mechanisms.

> Proposition 5: Efficiency will decrease between the first and second periods due to the introduction of information and control mechanisms. This will be partially offset by the simplified tendering model and standardised service delivery.

The introduction of measures to deal with the systemic problems of creaming and parking resulted in additional administrative and compliance demands being placed on service providers (Thomas 2007). Front line employees spent approximately a quarter of their time on
contract compliance to meet government requirements (Considine, Lewis & O’Sullivan 2008, p. 20).

It is difficult to determine whether this had a measureable impact on the cost and efficiency of services. Expenditure for labour market programs fell from over $2 billion in 1995-96 to around $1 billion by 2001-02, and increasing to around $1.4 billion in 2013-14 (unadjusted for inflation). Including inflation, the long-term trend in expenditure has remained relatively constant following initial privatisation in the 1990s (Australian National Audit Office 2005; Australian National Audit Office 2014; Cowling & Mitchell 2003, p. 217). Similarly, the average cost of an employment outcome has been between $4,000 and $5,000 since the introduction of Job Network (Australian National Audit Office 2005).

It should be noted that reliable and consistent evidence demonstrating changes in efficiency is not readily available. The National Australian Audit Office has been critical of the responsible department’s performance reporting and lack of transparency (Australian National Audit Office 2014, p. 78). The Department of Employment and Workplace Relations ‘was not using an indicator to enable it to assess the efficiency of the Job Network’, nor were counting rules clear for measuring performance information relating to employment outcomes (Australian National Audit Office 2005, p. 129). This was particularly relevant to expenditure on Job Services Australia program. Without improved indicators and explanations, it is hard to attribute outcomes to program performance or external factors, and makes it impossible to compare outcomes over time (Australian National Audit Office 2014, p. 15).

Although changes to the tendering process may dampen the competitive tendering model used in the earlier stages of outsourcing, the introduction of partial tendering, whereby a large number of contracts for higher performing agencies are rolled over, and the move to fixed prices, simplified the re-tendering process, reducing transaction costs and creating a more stable partnership. More standardised services may also improve efficiency by simplifying the service delivery process and producing low cost replicable services.

3. Equity of access - Creaming and parking

The primary reason for the re-regulation of employment services was to reduce instances of creaming and parking and improve service access for disadvantaged job seekers. This response is consistent with the theoretical framework which suggests information and control mechanisms will reduce moral hazard by decreasing information asymmetry and giving the purchaser greater insight and control over the actions taken by providers.

*Proposition 6: Equity of service allocation will improve in the second period through the introduction of information and control mechanisms.*
There is some indirect evidence that the introduction of information and control mechanisms did reduce creaming and parking. The proportion of frontline staff that agreed with the statement ‘I am aware that my organisation pays attention to the income I generate’ fell from 91 to 84 per cent between 1998 and 2008 (Considine, Lewis & O’Sullivan 2008, p. 31). Individuals were slightly less focused on payable outcomes with the proportion of frontline staff that ‘take note of those actions that will generate a payable outcome’ falling from 78 to 72 per cent between 1998 and 2008 (Considine, Lewis & O’Sullivan 2008, p. 31). The focus on generating income was still high and suggests that while the additional governance mechanisms did improve equity of access; frontline staff were still acutely aware of job seekers that would produce financial outcomes. For example, 68 per cent of respondents agreed that they use information technology to track priority job seekers (Considine, Lewis & O’Sullivan 2008, p. 31).

Figure 5. The proportion of respondents that agreed with the statement ‘I am aware that my organisation pays attention to the income I generate’ over the three survey periods

Regulation has also been ‘vital to overcome the adverse effects of markets and eliminate politically unacceptable outcomes’ (Bredgaard & Larsen 2008, p. 349-350). Despite this claim, there is little in the way of quantitative evidence to support any real or sustained improvement in equity of service allocation.

5.3 Stage 3 – The reform that never ends (2009 – 2015)

Job Services Australia was introduced in July 2009 with the explicit objective of assisting job seekers with the greatest disadvantage into employment. The government’s focus was on re-
designing the employment service model so it is flexible and can deliver tailored services to job seekers who most need assistance (DEEWR 2013, p.8).

Job Services Australia retained the core features of Job Network but strengthened service payments to ensure providers were actively managing job seekers through things such as regular interviews. There were some refinements to the previous model that allowed providers more flexibility in determining periods of intense activation, an employment pathway fund that replaced the job seeker account, and a risk based approach was introduced for categorising job seekers into streams. The Employment Innovation fund was established to assist highly disadvantaged job seekers to overcome vocational and non-vocational barriers to employment. These job seekers included people with a disability, the homeless, mentally ill, those in areas of entrenched disadvantage, and Aboriginal and Torres Strait Islanders.

These changes, however, occurred within the basic framework established under the former Job Network program. As Fowkes (2011b) aptly notes: ‘the system has been tweaked, not fundamentally changed. It should be expected to achieve results that are broadly comparable with the programs it replaced’ (p. 10).

Proposition 7: Employment services will become increasingly unresponsive and inefficient due to further constraints on the use of markets. Service allocation will remain more equal due to regulatory controls.

Evidence

The trends between 2003 and 2009 continued under Job Services Australia, with further dulling of market influences and slight moderation of the adverse effects of incentives. There is evidence that the system became increasingly unresponsive to the needs of job seekers as the governance mechanism dampened the market effects, while reducing creaming and parking.

Staff were increasingly unable to ‘freely decide for themselves what they would do with job seekers on a day-to-day basis’ (63 per cent in 2008 agreed with this statement compared to 60 per cent in 2013); were more reliant on the computer system on what action to take (47 per cent agreed with the statement ‘Our computer system tells me what steps to take with job seekers and when to take them’ in 2008 compared to 50 per cent in 2013); and less able to rely on their own judgement when deciding what activities are recommended for each job seeker (26.3 per cent in 2008 to 24.6 per cent in 2013) (Considine et al.2013, p. 24-25).

The effect of incentives on staff remained rather constant between the two periods, with some evidence that the role of incentives moderated. In response to the question ‘I do tend to take
note of those actions with job seekers that will generate a payable outcome for the office’, 66 per cent agreed or strongly agreed, down from 72 per cent in 2008 (Considine et al. 2013, p. 25).

The system became increasingly reliant on information and control mechanisms to ensure providers act in the best interest of clients, with a reduced role of incentive-based payments. The placement fee ranged from 36 per cent of total available funding for stream 1 job seekers to 73 per cent for stream 4 job seekers. Based on Job Services Australia expenditure in the 2009-10 financial year, outcome payments made-up just 13 per cent of total expenditure, compared to 62 per cent for service fees and 25 per cent for the Employment Pathway Fund (Senate Standing Committee on Education Employment and Workplace Relations 2012).

Preliminary findings from a 2011 review of the JSA program by the Advisory Panel on Employment Services Administration and Accountability (APESAA) observed that the system was administratively complex with a high reliance on regulatory controls (APESSA 2011). Consistent with a system that had moved away from incentives and market mechanisms, the panel found that ‘Compliance requirements are relied upon to do much of the regulatory heavy lifting’ (APESAA 2011, p.11). The panel found that performance measures were more focused on quantity than quality, and contracts and performance management tools were generic rather than tailored to individual job seeker needs.

The report also found that frontline staff face significant pressures and there is a need to professionalise the workforce with enhanced capability and competencies. This lack of professionalism of the workforce is consistent with the crowding out effects of profit incentives on public service motivation. In an environment where targets and performance are of greater importance than ‘doing good’, staff with high public service or pro-social motivation are likely to leave. The selection effects will reduce the number of altruistic staff in the public employment service.

Further evidence of the effects on staff selection and work practices can be found in the low levels of qualifications and relatively short tenure. The 2013 survey of front-line staff conducted by Considine and his colleagues found that just 15.9 per cent had a bachelor or undergraduate degree and only 44 per cent have worked in the sector for more than 5 years (p. 8). This compares with the average Australian Public Servant where 57.4 per cent of ongoing employees have graduate qualifications and 70 per cent have more than 5 years of experience (Australian Public Service Commission 2012). The new work environment created by the funding approach and governance mechanisms, together with unrealistic performance targets and high case loads, have been linked to low staff morale and high turnover of front line staff (Wright, Marston and McDonald 2011, p. 312).
As the risk profile of the system changes so too do the governance requirements. For example, a higher level of trust between the purchaser and provider signals a lower requirement for prescriptive regulation (APESAA 2014, p.7). Less regulation leads to more flexible and efficient service systems. Incentive schemes have the dual effect of driving providers to focus on outcomes that generate a payable outcome over what is best for the client; and crowding out pro-social motivation and an organisation’s commitment to community outcomes, both of which act to mitigate the risk of opportunistic behaviour.
6. Discussion

This dissertation examined the effectiveness of using quasi-markets to deliver public employment services. The outsourcing of public employment services through a market of providers can be interpreted using agency and motivational theory. The aim of this dissertation was to analyse the marketization of public employment services in Australia using a theoretical model informed by neo-economic concepts and behavioural science. Central to this framework is the role of incentives, information and control mechanisms to overcome the principal-agent problem. Re-interpreting existing research findings through this framework has demonstrated the inherent limitations of using quasi-markets to deliver complex social services. The strength of this approach comes from grounding the available research in the same conceptual framework from where markets emerge. As the evidence is supported by the conceptual framework, observations from past research can be stated with greater certainty than when considered in isolation.

The theory of incentives and governance mechanisms makes a strikingly accurate connection with the realities of the Australian public employment service. First, the evidence suggests that a market-based approach drives a corporate culture that is focused on commercial goals and performance outcomes. This initially improved the efficiency and flexibility of service provision, with providers focusing on low-cost service delivery options and placing job-ready candidates. Market models rely primarily on incentive payments to guide providers and ensure they act in the best interest of the purchaser and job seekers. This requires contracts that clearly specify what outcomes will receive payments. This poses no real problem when tasks are simple and outcomes are measurable. However, as evidenced in the Australian example, incentives are ineffective as a governance mechanism for delivering public employment services as providers are required to perform multiple tasks, there are multiple principals, and performance measures are ambiguous. Many elements of public employment services closely resemble what Wilson (1989) describes as a coping organisation: neither actions nor outcomes can be readily observed. This means providers allocate effort toward the easy to measure, more certain outcomes – placing the job-ready - at the expense of other harder to measure and riskier activities – finding work for those with more barriers to employment. This has had a profound effect on disadvantaged groups who received little or no support, and left governments with no effective way of measuring and incentivising providers to invest in job seekers who were further from the job market.

In response to the inherent but unintended by-products of markets, and to overcome the incomplete nature of contracting in public services and the weak incentive effect, the Australian government was compelled to re-regulate many aspects of the system by introducing monitoring and control mechanisms. This response is consistent with some theoretical concepts that suggest an integrated governance approach to contract
management is needed. Bruttel (2005) for example has argued that contracting of employment services should incorporate information and control mechanisms rather than relying exclusively on incentive mechanisms. The Star Rating system, audits and information technology increased transparency and reduced information asymmetry between purchaser and provider. While not necessarily demonstrable through available evidence, these additional measures had the perception of reducing the inequities of the early system and, in doing so, blunting the political criticism that comes with such undesirable outcomes. The findings from this dissertation suggest the introduction of additional regulatory mechanisms, while necessary, is a decisive move away from free market principles, and, as predicted by market concepts, dulled the benefits of a competitive market. The idea that an integrated governance approach that uses information and control mechanisms to complement incentives can be effective is not supported by theoretical concepts or the lived experience outlined here.

The third major finding steps beyond the concepts drawn from neo-classical economics, simultaneously exposing the limitations of these theories and demonstrating the significant impact major institutional reform can have on staff and organisations. A greater emphasis on incentives and a narrow conceptualisation of motivation in terms of self-interest crowds out collective and public values. Over time the role of altruism diminishes as pro-socially motivated people leave the sector or become more profit-oriented. What people care about matters in a system that exists to help others. The motivation of staff who have a common purpose of helping the unemployed and disadvantaged can foster trust to protect against opportunism when incomplete contracts fail; and can boost innovation through cooperation and information sharing when price incentives do not work. The complexity of human nature cannot be reduced to material self-interest, and any concept that assumes otherwise is incomplete and misses important detail. For not-for-profit organisations, the commodification of job seekers reduces trust and cooperation between providers and, with the purchaser, limits information sharing and creates an organisation environment that reduces motivation. The shift toward private and individualistic values crowds out the very beliefs that motivate people to help the less fortunate and protect against moral hazard.

These findings suggest that markets are not appropriate for delivering public employment services for certain groups of job seekers. The ambiguity that weakens the incentive effect and creates risk for providers emerges not just from a lack of tools to measure performance, but from the complexity and unpredictability of human behaviour. This creates a bind for governments; with two possible pathways out. Governments can attempt to further refine the market mechanisms and payment structures so that it operates more like a quasi-market. Or they can abandon the use of markets for the delivery of services for some job seeker groups. The results from this analysis indicate an appropriate incentive payment structure is unlikely to be found for the group of job seekers that are not job ready. The barriers are too diverse
and complex, and finding solution to overcome these problems is difficult and unpredictable. Developing an effective incentive payment in this ambiguous environment is doubtful, and the risk imposed on service providers to work with hard-to-place clients is too high.

The suggestion that problems with the public employment system are temporary and will be solved as payment structures are refined and market mechanisms become more efficient are not supported by the findings presented in this dissertation. Further minor adjustments to its design are unlikely to be of much value. The findings suggest that markets are inadequate for delivering services for disadvantaged job seekers that are not job ready, and any government intervention will only serve to amplify existing market failure. The only realistic pathway for governments is to find an alternative institutional design.

The focus of policy makers and service designers should be on administratively separating the provision of services for the ‘job ready’ and those further from the job market. The ‘job ready’ model can retain the market based approach with improved incentive effects due to the separation of tasks. The ‘non-job ready model’ would move away from a market-based approach. This would facilitate a cultural shift away from a transaction-based service and towards more individualised support for disadvantaged job seekers. Separating based on client needs not only benefits the unemployed who are not job ready, but should allow the job-ready model to function more effectively by removing the information and control mechanisms and allowing it to function more like an efficient market.

Client needs should determine the division of tasks. Interestingly, this notion appeared in the Working Nation White paper (Keating 1994, cited in Considine 1999) which initiated the reforms. It stated: ‘The key elements of the new strategy are an accurate assessment of the needs of job seekers and an intensive plan to assist disadvantaged people’. Closer attention to the needs of job seekers and the appropriate governance model to meet this need would have resulted in a very different service model. Disadvantaged job seekers face multiple vocational and non-vocational barriers to employment and research suggests they benefit from holistic and integrated services (Department of Employment 2013). Vocational and skills training, work experience and integrated services from a range of health, human, and employment services require a range of agencies to work together to provide the support needed for job seekers to enter and stay in the workforce (ACOSS 2012). By failing to look at the different dimensions of employment services and differentiating between the ‘job ready’ and ‘non-job ready’, the contracting difficulty and cost of administering employment services have been understated, and the role of altruistic and not-for-profit organisations diminished.

There are a number of service models, particularly relating to networks, which offer a more suitable alternative for meeting the needs of long term unemployed and highly disadvantaged job seekers. Knuth (2014) for example presents a study on a German programme for job
seekers aged over 50 that deviated from the standard marketized job centre operations by ‘insourcing’ staff, providing grant funding and creating networks. The author found that the programme was more effective and cost-efficient than the market based employment services. Although the success was attributed to the fundamental difference in the governance of the programme, the mechanism which would explain the success remained hidden in the governance of the programme. Many of the characteristics that would facilitate successful networking such as trust, openness and ‘doing the right thing’ are the very traits that markets and monetary incentives have been shown to crowd out (Knuth 2014, p. 256).

An alternative interpretation to the findings outlined in this dissertation is that job assistance programs are not very effective at improving the job prospects of the unemployed. As noted earlier, $1 billion of appropriations for labour programs and training assistance was stripped from the employment services system during the initial stages of privatisation with very little net-impact on the effectiveness of employment services (Cowling and Mitchell 2003, p. 215). This suggests that further investment in expensive labour programs for the long term unemployed and disadvantaged groups will only have a marginal net-impact on their job prospects. Despite this, because of the individual and social cost inflicted by long term unemployment, the ongoing search for better and more effective programs is necessary and important. More research is needed to understand the mechanisms within governance arrangements that harness the natural motivations of those who work in public service and how this can be used to improve innovation.

This dissertation is subject to many of the same limitations and methodological constraints faced by other studies in this field. The availability of reliable and valid results is constrained by the highly complex and variable environment in which these changes occur. The ongoing reforms and the way they are implemented do not allow effective evaluation. Further, the performance reports produced by government departments are oftentimes incomplete or lack sufficient descriptions to allow meaningful comparisons. This was particularly evident in evaluating the efficiency and cost of labour programs over time and the rates of creaming and parking in the second and third periods of the Australian case study. For these reasons, the research literature is overly reliant on formal models rather than empirical evidence. This dissertation attempted to limit the effects of these methodological limitations by interpreting findings from the research literature within a conceptual framework informed by market concepts.
7. Conclusion

The marketization of employment services was expected to improve the efficiency of services, encourage competition, increase responsiveness, and provide flexible, innovative and tailored services. Few would argue the Australian system has achieved these improvements. The results from this dissertation show that providing little or no services to disadvantaged job seekers cannot be mitigated by incentives; yet the introduction of additional governance mechanisms such as information and control only serves to compound market failure. Importantly, marketization has the perverse effect of crowding-out individual and organisational characteristics that naturally prevent opportunistic behaviour and promote assistance to disadvantaged job seekers.

Mechanical thinking in public policy results in the design of services and institutional structures that too often do not meet the needs of people. Focusing on the service delivery mechanisms does not allow policy makers to appreciate the complex needs of some of the most disadvantaged people in our community. This dissertation attempts to put people at the heart of social policy in two important ways. First, it highlights the importance of understanding the unique and sophisticated needs of people when developing social policy and designing services. The rigour and insights from economic and incentive theory play an important role, but they should only be applied after the needs of job seekers are carefully considered and as an instrument for improving the lives of individuals and increasing the rate of social return. In a very practical sense this means thinking deeply about the needs of the unemployed and understanding there is a marked difference between the needs of those that are job-ready and those further from the job market. This has important implications for the design of services and governance mechanisms. Critically, design should follow human needs. Second, this dissertation has attempted to integrate changes in the behaviour of individuals and organisations within traditional economic concepts. By understanding the role of altruism and civic values, policy makers can avoid the undesirable effects of crowding out pro-social motivation and quashing an organisation’s commitment to good community outcomes.

The inherent nature of market governance mechanism suggests quasi-markets are not appropriate for delivering public employment services. Either disadvantaged job seekers are parked or the system becomes over regulated until it no longer resembles a market. The focus of policy makers and service designers should therefore be on administratively separating the provision of services for the ‘job-ready’ from those further from the job market, and exploring alternative service delivery models that harness the natural motivational and community focus of not-for-profit organisations.
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