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University of Hertfordshire Business School Working Paper (2013)

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Forthcoming in *Competition & Change*

This Revised Version: January 2013

Abstract

Responding to seemingly intractable levels of long-term unemployment and more recently arising from fiscal austerity, many countries have re-examined their approach to activating the unemployed. This re-examination has altered the role of the public employment service from provider to commissioner of services and created quasi-markets in the delivery of labour market programmes. The purpose of this review is to examine the success of these markets and to determine if the design of Britain's *Work Programme* reflects lessons learned in other countries. We conclude that a thorough review of international experience and a measure of patience while the Flexible New Deal ran its course, would have informed the Programme's design and commissioning model. These flaws, combined with a depressed economic climate, will make it impossible for the Programme to demonstrate expected levels of additionality in terms of job outcomes.

JEL: D02, H11, H53, I38, L24

Introduction

Responding to seemingly intractable levels of long-term unemployment and more recently arising from fiscal austerity, many countries have re-examined their approach to activating the unemployed. This re-examination has challenged traditional models of welfare state delivery, altered the role of the public employment service from provider to commissioner of services and sought to redefine the rights and obligations of the unemployed themselves. The result of this new ‘contractualism’ has been the creation of quasi-markets in the delivery of employment services and labour market programmes (Nunn *et al.*, 2009; Sol and Westerveld, 2005; Finn, 2010). This process of marketisation describes the imposition of market forces on public services which have traditionally been delivered and financed by local and central government. In 2006 60 percent of employment services provision in the UK was in the public sector, with the remainder evenly split between for-profit and non-profit providers. In Germany, Poland, Sweden and the Czech Republic however, public institutions were responsible for 80 percent of such spending (EC, 2008, p. 37).

The performance of these quasi-markets in employment services has recently come to fore with allegations of fraud against a prime contractor on Britain’s flagship Work Programme. The purpose of this review is to examine the success of markets in outsourced employment services and to determine if the design of Britain’s Work Programme reflects lessons learned elsewhere.

The ‘Proper’ Scope of Government?

Welfare reform in the UK has proceeded apace since the election of a Conservative-Liberal Democrat coalition government in 2010. Elected on a mandate of fiscal responsibility, localism and of championing ‘big society’ (best understood as the antonym of ‘big

government'), their intentions for reform of the public services were recently outlined in the following White Paper on *Open Public Services*:

“To improve quality for all, and particularly for the most vulnerable, we are determined to open up the provision of the public services and target funding at the most disadvantaged... Improvements will be driven by putting the needs of citizens before producer interest, by using data transparency to put real information in people’s hands, and by decentralising power to ensure that public service providers are accountable to the people that use them rather than to centralised bureaucracies... This means replacing top-down monopolies with open networks in which diverse and innovative providers compete to provide the best and most efficient services for the public.” (HM Government, 2012, p. 3)

Oliver Hart *et al.* (1997) explored the issue of when government should provide a service in-house and when should provision be contracted-out. To proponents, contracting out enables the delivery of public services at lower cost (Savas, 1982; Logan, 1990), while critics assert that the quality of contracted-out services is often inferior to that delivered by public employees (Shichor, 1995).

The traditional approach within economics to the contracting out of public services usually dealt with issues of moral hazard, the form of competition in newly created markets and of information incompleteness between contracting parties (Laffont and Tirole, 1993; Tirole, 1994; Vickers and Yarrow, 1988; Schmidt, 1996; Shapiro and Willig, 1990). In the context of employment services, Koning *et al.* (2007) describes scenarios where the profit motive introduces moral hazard wherein a contractor knows the quality of its service is difficult to observe, where a large degree of information asymmetry exists between providers and their clients (who may participate on credence, or by mandatory referral) and where the

assessment of a provider's true additionality is confounded by external factors such as the business cycle or simply demand for labour.

While the problems of incomplete and asymmetric information are possibly endemic in agency, Holmstrom and Milgrom (1991, 1994) demonstrate that providing an agent with incentives to achieve a specific outcome is likely to result in the shirking of other – mandated but unrewarded – outcomes such as quality. This insight is critical as it speaks to the ability of open services initiatives to deliver improvements in service quality over and above that pertaining to direct provision.

Hart *et al.* (1997) hold that the cost and benefits of contracting out hinge on the assumption of contractual incompleteness given that the quality of service desired by a principal is often difficult to fully specify. In the context of labour market programmes a measure of political ambiguity tends exist around the justification for any intervention in the labour market. For instance, a socially benevolent programme may invest in training the unemployed to achieve a human capital outcome at the individual level; a less expensive programme might concentrate solely on matching candidates to vacancies and promote a 'work first' ethos. The end-to-end delivery of human capital type schemes is likely to be more difficult to contract as it would involve mandating training quality (and learning outcomes) over a wide spectrum of courses. On the other hand a 'work first' programme that places employment outcomes before job-match quality or sustainability of employment, carries less risk of contractual incompleteness as the desired level of service (i.e. immediate employment) is easily observed.

Hart *et al.* (1997, p. 1129) remark that, "a private contractor generally has a stronger incentive both to improve quality and to reduce costs ... but [their] incentive to engage in cost reduction is typically too strong since [it] ignores the adverse impact on quality." This observation is acutely relevant for a labour market intervention purporting to offer tailored

support to the unemployed, as the quality of this support will be closely tied to overall costs. They conclude, “in general, the bigger the adverse consequences of (noncontractible) cost cutting on (noncontractible) quality, the stronger is the case for in-house provision.”

Experiences of Contracting-Out of Employment Services

Finn (2011) reviewed the literature on employment services subcontracting in reform-minded European countries including the United States, Australia, Britain, Germany, and the Netherlands. He focussed on the development and characteristics of subcontracting relationships, the types of activities they deliver and the impact on employment outcomes. His findings suggest that private providers can, “under certain contractual arrangements, improve outcomes for particular groups and bring innovation to service delivery. The competitive pressure they bring may also prompt improved PES performance.” His findings are very much at odds with Hart *et al.* (1997) who maintain that the incentives arising from residual control rights (behaviour in uncontracted scenarios) are more important than any benefits arising from competition.¹

While the US Job Training Partnership Act of 1984 is usually cited as the first major example of performance-related contracting in employment services, the UK’s experience may also be traced to the Training and Enterprise Councils of 1987. These private sector bodies delivered a range of training and employment programmes with a portion their funding dependent not solely on job outcomes but on qualifications obtained during participation (Bennett *et al.*, 1994). New Labour continued the reform agenda by testing a number of outcomes-based contracts including *Employment Zones* (targeting the long-term unemployed)

¹ Hart *et al.* (1997) were writing in the context of proposed privatisation of prisons in the United States.

and *Pathways* (targeting those in receipt of disability benefits²). While the zone model was found to have “somewhat” better outcomes than other New Deal programmes, *Pathways* largely failed to secure job outcomes and thus contracts fell into jeopardy as revenue streams did not materialise. According to NAO (2010, p. 27), *Pathways* suffered from a poorly designed procurement process which had encouraged providers to over-commit, resulting in more conservative but realistic bids being written-off as outliers.

Since introducing a fully privatised market in employment services in 1998, Australia have worked on several iterations of their *Job Network* programme to improve its efficiency and adjust incentives for providers. While initial contracts adopted a ‘black box’ approach entailing large amounts of autonomy and the concentration of revenue in outcome-based payments, by its fourth iteration *Job Services Assistance* included access to a pathway fund encouraging providers to personalise services and the training needs of their clients. Arising from many controversies over gaming of the system, other adjustments to the Australian model have included: ring fencing of funds for services to job-seekers; loading performance measures toward outcomes for the most disadvantaged; capturing service quality as a key performance indicator; and intervening to review contracts where allegations of parking have been made (Finn, 2010, p. 295).

The Dutch social insurance agency, UWV, began contracting-out employment services in 2003. Reviews have shown that while their move from partial to full outcome payments did succeed in raising overall job placement rates, no effect was observed for harder-to-help clients including those transitioning from disability benefits (Koning and Heinrich, 2010). That many of these additional jobs lasted for less than a year indicates job-seekers may have been placed in poorly matched, unsustainable or even bogus employment. To overcome criticisms of standardised or generic trajectories employed by contractors, greater

² Multiple evaluations of each scheme are published on the National Audit Office website, <http://nao.gov.uk>

personalisation of treatment has been enabled by the introduction of individual budgets – equipping clients with greater power to negotiate their re-integration paths with case managers. More recently some Dutch local authorities have brought case management and initial assessment back in-house. While re-integration services are still contracted out, local authorities have come to favour a ‘modular’ commissioning strategy over end-to-end contracts as the former are easier to monitor and measure (Plantinga *et al.*, 2011).

Arising from a Commission led by Peter Hartz, Germany began a process of modernising labour regulations and reforming their public employment service, *Bundesagentur für Arbeit* (BA), over a decade ago. Among the changes to employment services have been the introduction of benefit sanctions for poor job-search or job avoidance and greater private sector contestability in service delivery. Following legal changes in 2003, local BA offices were obliged to follow public procurement rules when letting employment service contracts. According to Schneider (2008), BA responded to this by centralising contracting and controlling costs by emphasising price competition. However, the unforeseen consequences of centralisation and efficiency targets were a reduction in the number of local providers, the emergence of supra-regional providers and an actual decline in competition. Notwithstanding this, the UK Work Programme has adopted a centralised system of large-scale and high-value contracting.

Finn (2011, p. 5) proposes a number of lessons from his review of international best practice:

1. Implementing an effective contracting system is a developmental process and requires an iterative process of monitoring, evaluation and modification.
2. Selection processes that have given too much weight to the lowest priced bids have resulted in poor or unviable contracts.

3. Contracting requires comprehensive IT systems that enable contracting authorities to track participants, monitor provider performance and to verify the quality of service and delivery of outcomes.
4. Contracting agencies need to independently monitor customer experiences and ensure that robust systems are in place to deal with complaints of poor service delivery (e.g. parking).
5. Contracting large and complex systems involves a steep learning curve and it takes time to steer the system to minimise perverse incentives and to capture the efficiencies and innovation that contractors may offer.

Britain's New Work Programme

The current Work Programme owes its genesis to a commissioning strategy document published by the Department for Work & Pensions (DWP) in 2008, also under New Labour. The strategy, which responded to recommendations from the Freud Report and closely echoed Hartz reforms in Germany, explicitly aimed to marketise the provision of employment services by letting comprehensive, end-to-end contracts to a small number of 'prime' providers. Outlining their vision, DWP (2010) proposed that by 2011 the public service would handle benefit administration and early job-matching while more intensive assistance would be managed by prime contractors.

The Work Programme is an integrated workfare programme implemented in England, Scotland and Wales in June of 2011. It replaced around 20 pre-existing schemes, each operating under different delivery models, outcome definitions, and contracting and incentive structures (e.g. Employment Zones, Flexible New Deal, New Deal and Pathways to Work).³

³ The remainder of this section largely follows NAO (2012a).

The department has contracted eighteen prime providers to manage employment services in forty contract areas. The ‘primes’ may choose to operate services directly or to subcontract to an end-to-end agent who in turn may engage various specialist/spot contractors to fulfil specific training etc. In total there 785 separate organisations⁴ involved in the Work Programme’s diffuse supply chain.

Job Centre Plus refers a claimant to a prime contractor after handling their initial job search. Referrals are mandatory for those in receipt of Jobseekers Allowance (JSA) and prison-leavers, although more complicated referral criteria apply to those in receipt of Incapacity Benefits and Employment Support Allowance. Claimants are classified into one of nine groups depending on their perceived readiness to work, with prime providers receiving differential outcome payments based on the ‘difficulty’ of returning members of each group to work. The total payment for returning a job-seeker aged 18-24 to employment is £3,810, while larger payments of £13,720 attach to more difficult cases (i.e. those formerly in receipt of Incapacity Benefit and now transitioned to Employment Support Allowance).

Payments are made to providers under a payment-by-results regime and in a series of stages; each stage reflects the achievement of job outcome successes. Thus:

Attachment Payment: for taking a claimant on to the Programme. The attachment fee reduces to nil by the start of the fourth year.

Job Outcome Payment: When a claimant has been in work for either a continuous or cumulative period of employment.

Outcome Sustainment Payment: A further payment every four weeks for keeping a claimant in employment.

⁴ This figure was correct as of July 2012. See <http://www.dwp.gov.uk/docs/wp-supply-chains.xls> for updates.

Incentive Payment: For jobs delivered beyond a given performance level – defined by DWP as 30 per cent above non-intervention levels.

Early Reviews of the Work Programme

Commissioned by the Department for Work & Pensions (DWP), Newton *et al.* (2012) presented preliminary findings based on qualitative research forming part of the official evaluation of the Work Programme's first year in operation. They sampled six of the eighteen Contract Package Areas, interviewing staff and customers and observing frontline contact between providers and customers.⁵

Referring to the random allocation of customers to prime providers within a contract area, DWP staff acknowledged that while randomisation prevented selection based on a customer's profile (known as 'creaming') it prevented DWP staff from making referrals in the customer's best interest. For example, where a particular provider would have been preferred based on their experience of meeting specialist needs, their proximity to a customer's home or taking into account travel arrangements for rural dwellers.

Despite having the flexibility to tailor delivery by engaging specialist or spot contractors, the report finds that use of specialists varied widely and that this variation reflected attempts to control cost. Specialist subcontractors were typically engaged to deal with employability training, sector-specific training, work placement, vacancy searching health management and addiction counselling. Concern for targets and finance was found to come before participant needs in at least one of the provider interviews conducted. In cases where specialist subcontractors were engaged, the process of providing feedback to main providers was varied

⁵ The authors caution that care should be exercised in generalising their findings as the research is qualitative in nature and conducted at an early stage of the Work Programme. In all, several waves of research are being undertaken, employing a mix of cross-sectional and longitudinal designs. A subsequent report examining the programme's commissioning model is expected later in 2013.

and ranged from regular updates to no contact at all. While specialist contractors worked particularly well for specific groups of participants (e.g. new mothers returning to the labour force after childbirth), occasional relationship difficulties including underperformance and excessive cost did arise. Some spot providers, contracted by primes or their end-to-end agents, reported having no budget for specialist training and were instead focussing their help on job ready customers (known as ‘skimming’).

Newton *et al.* (2012) note that the discretion (‘black box’ approach) afforded to primes in how they manage contracts with end-to-end and spot providers, contributed to variation in the extent to which selective outcomes for job ready customers were promoted over more complex cases who may be furthest from the labour market (known as ‘parking’). In some cases, subcontracted staff had a lack of knowledge of the minimum delivery standards committed to by the prime provider.

The flexibility to provide personalised, tailored support has been vaunted as a core innovation of the Work Programme model. Referring to personalisation, Newton *et al.* (2012) find evidence of procedural – though not of substantive – personalisation in programme delivery. They report that providers’ initial assessments of customers varied in depth and quality, as did their technique of assessing job readiness. The report notes that action plans agreed during initial assessments were sometimes computer-generated or generic in nature, and that referrals to generic training did not always reflect individual needs. The report concludes that personalisation amounted to streaming at group level and to variation in the frequency of advisor meetings at the individual level. The report finds that in practice, job ready customers were more likely to receive weekly meetings with a personal advisor while customers originating from Employment Support Allowance (ESA) were seen at six week intervals or counselled over the phone.⁶

⁶ ESA customers were not subject to mandatory referral or benefit sanction.

“Meaningful contact is fairly vague. It doesn’t have to be face-to-face or an individual appointment, it could be a telephone call or participation in a group employability session. We like this, we can be more flexible according to customer needs. We don’t need to bring people into the office for the sake of it and it helps keep costs down.” (Manager, generalist end-to-end provider, quoted in Newton *et al.* (2012, p. 26))

Overall the report describes the Programme’s approach as being dominated by a ‘work first’ ethos with limited focus on developing customer’s human capital or employability. It cites examples of customers who were sent forward to interviews lacking basic certification in the relevant industry (e.g. Construction Skills Certificate, security licence, CRB check) in anticipation of these costs being met by subsequent employers. In other cases, training opportunities were withheld until candidates received a definite job offer. By contrast some providers adopted a hybrid model of combining active job search with work- or specific-skills training.

Newton *et al.* (2012, p. 111) are cautious of making any conclusions in relation to the creaming and parking of candidates as none have yet completed the Programme’s full cycle. However, they underscore earlier observations that job-ready candidates are seen on a more frequent basis by many providers. A potential implication of this bias is that those with high or multiple barriers to work may experience a lack of referral to additional support and training activities.

Complementing the work of Newton *et al.*, the National Audit Office (NAO, 2012a) conducted an early review of the design and commissioning of the Work Programme. While generally supportive of the move to consolidate the number of labour market programmes and to address weaknesses in earlier schemes (providing greater flexibility to providers, allowing for longer and earlier intervention, offering staged and differentiated payments for different

cohorts), they point to weaknesses in the commissioning model arising from hast and aggressive assumptions on the part of DWP and prime providers.

The NAO believes the Programme's feasibility is underpinned by assumptions about likely performance which are unrealistic, given the outcomes achieved on similar programmes and the current economic climate. DWP's expectation of an overall job placement rate of 36 percent has obvious implications for the viability of business models structured around staged payments related to job outcomes.

Looking at a specific cohort common to both the Work Programme and earlier Flexible New Deal (JSA aged 25+), DWP anticipate a placement rate of 40 percent but this cohorts' outcomes were typically half of that (26 percent) under previous programmes. Perhaps more sobering is that NAO's estimate is two percentage points higher than DWP's counterfactual outcome (the job finding rate without intervention) across all cohorts. NAO caution that if these optimistic targets and revenue streams are not realised, providers may be encouraged to protect their profits by over-looking hard-to-help claimants, reducing service levels and by placing disproportionate pressure on subcontractors.

The NAO is critical of DWP's use of a common non-intervention counterfactual nationwide, as this does not reflect the relative difficulty of achieving national targets in contract areas with a higher density of unemployment or greater incidence of long-term unemployment. It seems likely that the business models of providers in these high unemployment areas will come under most pressure, and that the specific risks identified by the NAO are most likely to occur in there also.

Whereas previous changes to employment services had been designed and tested over a four year period, NAO report that ministers "required" DWP to implement the Work Programme within twelve months. As a consequence, no business case was prepared until after ministers had committed to the Programme, no alternatives were considered, no pilot

undertaken, and no time was taken to await the evaluation of existing programmes. A further cost of the Programme's accelerated introduction has been £68 million in termination payments due to Flexible New Deal contractors – ten of whom are now prime providers on the Work Programme.

The NAO believes the “unprecedented levels of performance” and high price discounts promised by prime contractors increase the risk that they will be tempted to game the contract or to seek concessions from DWP. They believe it is likely that providers will attempt to recalibrate prices and other conditions during the contract period and that one or more providers may get into serious financial difficulties.

Conclusion

It seems reasonable that the performance of the Work Programme be judged against the putative benefits of letting outcome-based contracts. For Finn (2010), outcome based procurement offers the potential for innovation, flexibility and efficiency savings. Similar points are made by Pattison (2012) who also cites value for money (VfM) and flexibility in contracting, through the avoidance of public procurement rules, as key advantages of contracting out employment services.

Setting aside VfM which will be keenly watched by the National Audit Office in subsequent reports, we argue that certain features in the design of the Work Programme undermine the potential for other putative benefits to be realised. While subcontracts let by prime providers (and their agent's) are not subject to public procurement rules, evidence from Newton *et al.* (2012) shows this flexibility to engage spot training is hamstrung by restrictive (or absent) budgets, cost-saving and a preference for delivering as much as possible in-house.

Although the Work Programme is very much in its infancy and a comprehensive evaluation of individual outcomes will require many waves of longitudinal data, this review of early evaluations provides support for a number of tentative conclusions.

Firstly, many of the design flaws identified in NAO (2012a) and Newton *et al.* (2012) were foreseeable and should have been spotted in a review of international best practice. Notably, Finn (2010, 2011) was commissioned by the European Commission to report on sub-contracting in public employment services. The evidence contained in that review was collected during the Work Programme's design phase.

Secondly, the decision to restrict eligibility to tender for prime provider contracts was unjustifiably exclusive. Ostensibly the *Framework for the Provision of Employment Related Support Services* was used to assert that bidders would have the capacity and expertise to operate Work Programme contracts. A consequence of this approach has been that smaller operators/alliances (with a combined turnover below £20 million) and charitable bodies (whose deferred incomes inflated acid test liabilities) were excluded. An additional hurdle requiring successful bidders to demonstrate access to working capital of up to £50 million spread over several years, clearly favoured large, cash-rich firms. Successful bidders have been assured by DWP that future invitations to tender, including any opportunities that may arise from a mid-term review of the Work Programme, will only be extended to Framework bidders thereby locking-in current inequities.⁷

Thirdly, as a result of this exclusivity only three of the eighteen prime provider contracts were let to public or third sector bodies. In contrast to systems where the public employment service was allowed to compete with private providers, the only public sector representation

⁷ Response contained in *Question and Answer Brief*, available at http://www.dwp.gov.uk/docs/erss_qa.pdf.

among successful prime providers is Newcastle College Group and Working Links⁸. This raises a question as to why Job Centre Plus did not also join the preferred bidders Framework and compete against prime providers?

Fourthly, contracts awarded under the Work Programme are without precedent in terms of their value and duration. As described in Jones (2012), this was clearly done to facilitate innovative budget management. Final outcome payments will not fall due until programme completion at which point they may be offset by savings in annual managed expenditure (the benefits bill). While attachment and stage payments will be made to providers, their day-to-day running costs must be met by private working capital. A direct consequence of this approach (and Framework conditions relating to size, turnover and working capital) is the exclusion of smaller, regional and third sector bodies from the role of prime provider.

Fifthly, the intentional incompleteness of contracts concerning programme design (the “black box”), combined with the absence of adequate monitoring and IT systems in the initial year (NAO, 2012a), has invited fraud and hindered the enforcement of agreed ‘minimum service standards’ at all tiers. According to NAO (2012b, p. 4) there have been 126 investigations into alleged fraud in contracted employment services since 2006. They estimate the loss to public funds from fraud and abuse in contracted employment schemes amounted to over half a million pounds in 2010-11 alone. Prime Provider A4e identified nine possible cases of fraud and seven possible cases of improper practice following an internal audit of their New Deal contracts in 2009.

Lastly, the weaker than expected performance of the UK economy since the Programme’s launch has led to the undershooting of placement rates and outcome targets. Should the excessively optimistic targets proposed by DWP and prime providers undermine a provider’s business model, this will in turn accentuate a host of other risks endemic in employment

⁸ Working Links is a voluntary body, part-owned by the Shareholders Executive on behalf of the Secretary for Work and Pensions.

programmes contracted on a payment-by-results basis (e.g. skimming of the most able candidates, and the parking of complex cases facing multiple barriers to employment) and ultimately of provider exit.

It might reasonably be concluded that a thorough review of international experience and a measure of patience while live programmes ran their course, would have informed the design and commissioning of Britain's Work Programme and avoided large penalty payments to incumbents on pre-existing schemes. Given the current economic climate, it will almost certainly be impossible for the Work Programme to demonstrate the expected levels of additionality in terms of job outcomes. As is so often said in relation to labour market programmes, their surest achievement lies in re-ordering the queue of job-seekers – not in reducing it.

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