



# Effects of contracting out employment services: Evidence from a randomized experiment

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## ABSTRACT

In many countries welfare services that traditionally have been provided by the public sector are being contracted out to private providers. But are private contractors better at providing these services? We use a randomized experiment to empirically assess the effectiveness of contracting out employment services to private placement agencies. Our results show that unemployed at private placement agencies have a closer interaction with their case worker than unemployed at the Public Employment Service (PES); e.g., they receive more assistance in improving their job search technology. We do not find any overall difference in the chances of finding employment between private placement agencies and the PES, but this hides important heterogeneities across different types of unemployed. In particular, private providers are better at providing employment services to immigrants, whereas they may be worse for adolescents. Any effects tend to fade away over time.

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## 1. Introduction

Are private contractors better at providing welfare services than are public providers? In many OECD countries welfare services that traditionally have been provided by the public sector are increasingly being contracted out to private providers.

The motivation for contracting out is that private entrepreneurs—with residual rights of the asset—have stronger incentives to invest in cost saving technologies and quality improving innovations, as discussed in the framework of Grossman and Hart (1986), Hart and Moore (1990) and Hart (1995). But private contractors may have too strong incentives to reduce costs, which can impair on the quality of the services provided (Shleifer, 1998; Hart et al., 1997). Specifically, the scope for private provision is larger if opportunities to save costs by deteriorating non-contractible quality are limited; if innovations are a salient feature of the industry; and if there is a substantial reputation building and competition among producers that force them to uphold quality. A contrasting line of arguments suggests that many public sector activities are mission-oriented where employees are highly motivated and subscribing to the mission; it may thus be less costly to provide incentives in the public domain (see Besley and Ghatak, 2005). Hence, the case for contracting out differs across services and needs to be assessed empirically.

In this paper we use experimental data to empirically assess the case for contracting out job placement: if private providers are more efficient at placing unemployed; if private providers use different technologies; and if private providers generate a higher satisfaction among their clients. Even if private placement services are present in many countries,<sup>1</sup> evidence of its effectiveness is still scarce.<sup>2</sup>

In 2007 the Swedish center-right government gave the Public Employment Service (PES) instructions to use private contractors more actively as an alternative to in-house provision in order to improve matching and strengthen groups with weak labor market attachment (Swedish Government, 2007). As a result the PES, in July 2007, launched a trial scheme where private contractors were commissioned to match *hard-to-place* unemployed to jobs on the regular labor market. The trial was setup as an experimental intervention where unemployed were randomly assigned to either a private placement agency or to the PES. The private placement agencies faced high-powered incentives

<sup>1</sup> Australia and the Netherlands have gone as far as privatizing employment services, while private placement agencies provide services alongside the PES in Britain, Germany and Denmark (see for example Struyven and Steurs, 2005; Bruttel, 2005; Jahn and Ochel, 2007; Bredgaard and Larsen, 2007; Finn, 2008; Wright, 2008).

<sup>2</sup> Winterhager (2006) find small negative and Bernard and Wolff (2008) find positive, or no, general effects of contracting out placement services to private providers in Germany, whereas Winterhager et al. (2006) find positive effects for individuals utilizing job placement vouchers at private placement agencies in Germany. A potential worry in these observational studies is that there may be remaining differences across individuals at different providers of employment services.

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(60% of the full payment based on successful placements), as compared with no similar financial motivation for the PES.

Our results indicate that unemployed at private placement agencies receive more assistance in improving their job search technology and are more content with their placement worker than are the unemployed at the PES. While we do not find any overall difference in the probability of employment, our results show that immigrants at private providers get significantly higher employment probabilities and wage earnings up to 12 months after randomization. Private contractors also appear to be worse at providing such services to adolescents. An important additional finding is that absent the experimental variation we would have reached different conclusions about the effectiveness of private placement services, even though we have a rich set of covariates.

The procurement process in our setting is representative for public tendering of welfare services. Contracts are awarded based on a two-stage sealed bid tendering process where both price and quality are considered in the second stage; which is in line with EU directive (2004/18/EC) on public contracts. In general, the higher the complexity of the service supplied the more important are non-price attributes in contract awarding criteria (Carpinetti et al., 2006).

The incentives induced by the contracts are strong—as contractors are remunerated on the final outcome, i.e. successful placement—compared to contracting of welfare services in other settings which are often paid on some intermediate outcome (e.g. fee-for-service) or the demand attracted (e.g. voucher per client attracted). Moreover, our contracted outcome captures many aspects of quality and is observable and verifiable, thus further aligning incentives towards efficient production of the desired outcome.

Hence, by providing empirical evidence in a setting with strongly incentivized contracts and a well defined service, where the extent of non-contractible quality is limited; where there is a substantial competition for contracts; and where performance may have consequences for future procurement, we also contribute to the more general discussion on when a government should provide a service in-house and when it should contract out provision (see for example Hart et al., 1997; Dewenter and Malatesta, 2001; Duggan, 2004; Aizer et al., 2007; Lindqvist, 2008; Bloom et al., 2006 for work on private versus public in other settings).

## 2. Institutional setting

The PES in Sweden plays a central role for Swedish labor market policy. In addition to matching and general labor market counseling, case workers assign jobseekers to labor market programs and administer labor market related rehabilitation for those with reduced work capacity (e.g. disabled). The PES also has a control function in the unemployment insurance by monitoring that claimants fulfill the requirements in the insurance of actively searching for jobs (Sibbmark, 2008).

The role for private providers in implementing Swedish labor market policy has traditionally been limited; in fact, the PES had a monopoly on employment services on the Swedish labor market up until 1992 when commercial temping and recruiting agencies were allowed to operate (Olofsson and Wadensjö, 2009). These are still regulated and are, for example, not allowed to charge jobseekers for matching services.

### 2.1. Trial with private placement agencies

In 2007, the center-right government gave the PES instructions to more actively use private contractors to improve the matching between job seekers and employers (Swedish Government, 2007). The idea was that private providers could utilize improved technologies and offer more personalized services. As a consequence of this instruction the PES launched a trial scheme with private placement agencies in July 2007. Within the trial, unemployed within certain

target groups were randomly assigned either to a private placement agency, or to the PES. The random assignment is described in Section 3.1.

#### 2.1.1. Commission

In Early 2007, the PES posted a call for tenders to procure placement services from private contractors. The procurement included contracts in three different regional labor markets (the Malmö metropolitan area, Norrköping and Sundsvall) for three specific target groups with difficulties to reintegrate into the labor market. The groups covered by the procurement were:

- 1 Disabled with impaired working capacity;
- 2 Immigrants with an unemployment spell of at least six months (excluding individuals under age 25); and
- 3 Adolescents under 25 years with an unemployment spell of at least three months.<sup>3</sup>

The call for tender encompassed placement services for *matchable* individuals during a period of six months for disabled and immigrants, and three months for adolescents. The individuals covered by the procurement were matchable in the sense that they had professions, educations and experience that were in demand on the labor market. That is, they were assessed not to be in need of any labor market program to find employment. They were thus judged to be ready for the labor market, but suffering from difficulties in marketing their skill profiles.

In the procurement, the commissioned private placement agencies were contracted to find the assigned job seekers a full-time employment—or employment to the assessed level of work capacity for disabled—on the regular labor market with a duration of at least three months. The private providers were essentially allowed to choose their own technology to place the unemployed, but did not get paid for hiring them in-house. Also, unemployed who were assigned to private placement agencies did not have access to regular labor market programs during the contracted period.<sup>4</sup> Contractors could not refuse anyone assigned to them, so there was no room to cherry pick easy cases.

The contracted providers also took over the control function in the unemployment insurance from the PES. Private providers had to report to the PES violations in the requirement for unemployed to actively be searching for jobs, who would then initiate sanctions in the unemployment insurance. In this respect, the private providers had the same type of leverage towards the unemployed as the PES.

#### 2.1.2. Assignment of contracted slots

Unemployed covered by the procurement were randomly allocated to the contracted placement agencies in six waves: starting on July 10, 2007, and with the last wave in January 28, 2008. This means that the unemployed in the last wave were serviced by private placement agencies until July 2008, had they not yet transited into employment. As this trial was cast in the second half of 2007, with fairly low unemployment, it turned out to be difficult to fill the procured slots. Starting with the second wave of assignment (August 15, 2007) the required length of the unemployment spell for adolescents and foreign born was therefore reduced to 30 days.<sup>5</sup>

<sup>3</sup> The decision to contract placement services for these groups in the trial was taken by the head of PES, with the motivation that these were the PES's groups of priority. It should also be noted that the center-right came to power in the fall of 2006 on a ticket to reintegrate groups far from the labor market.

<sup>4</sup> There are some exceptions to this: Disabled could make use of programs involving technical aids and personal assistance at the workplace if the private provider and the PES agreed on this; All groups could get a certain wage subsidy if they were eligible; Individuals for whom the unemployment insurance was exhausted were transferred into a different benefit scheme.

<sup>5</sup> In the last wave of assignment on January 28, 2008, the required length of unemployment spell in order to be covered was raised to 50 days.

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