

Robert M.

La Follette School of Public Affairs

at the University of Wisconsin-Madison

Working Paper Series

La Follette School Working Paper No. 2010-021

<http://www.lafollette.wisc.edu/publications/workingpapers>

Cream-skimming, Parking and other Intended and Unintended Effects of Performance-Based Contracting in Social Welfare Services

Pierre Koning

CPB Netherlands Bureau of Economic Policy Analysis

Carolyn J. Heinrich

Professor, La Follette School of Public Affairs, University of Wisconsin-Madison

cheinrich@lafollette.wisc.edu

August 2010



**ROBERT M. LA FOLLETTE
SCHOOL OF PUBLIC AFFAIRS**
University of Wisconsin-Madison

1225 Observatory Drive, Madison, Wisconsin 53706

608-262-3581 / www.lafollette.wisc.edu

The La Follette School takes no stand on policy issues; opinions expressed in this paper reflect the views of individual researchers and authors.

Cream-skimming, Parking and other Intended and Unintended Effects of Performance-Based Contracting in Social Welfare Services

Pierre Koning

CPB NETHERLANDS BUREAU OF ECONOMIC POLICY ANALYSIS
P.O. BOX 80510
2508 GM, THE HAGUE
THE NETHERLANDS
(CORRESPONDING AUTHOR)

Carolyn J. Heinrich

UNIVERSITY OF WISCONSIN-MADISON
LA FOLLETTE SCHOOL OF PUBLIC AFFAIRS
1225 OBSERVATORY DRIVE
MADISON, WI 53706

August 2010

We thank the Dutch Social Benefit Administration (UWV) for gaining access the contracted cohort data that were used. Wim Zwinkels and Margaretha Buurman are gratefully acknowledged for gaining access to more detailed information on the contracts that were procured by UWV. Participants at the La Follette School of Public Affairs Seminar series, the CEPR workshop on “The Role of Incentives, Information and the Private Sector in the Delivery of Public Services” in Brussels on 10-11 December 2009 and the EALE/SOLE conference at UCL in London on 17-19 June 2010 are thanked for useful comments and suggestions.

Abstract

A growing number of countries are contracting out the delivery of social welfare services to private providers, and increasingly, using performance-based contracts. Critics of performance-based incentive contracts stress their potential unintended effects, including cream-skimming and other gaming activities intended to increase *measured* performance outcomes but not value added. We analyze the incentive effects of performance-based contracts, as well as their implications for provider job placement rates, using unique data on Dutch cohorts of unemployed and disabled workers that were assigned to private social welfare providers in 2002-2005. We take advantage of variation in contract design over this period, where procured contracts gradually moved from partial performance-contingent pay to 100%-performance contingent reward schemes. Using panel data that allow us to develop explicit measures of selection into the programs, we find evidence of cream-skimming and other gaming activities on the part of providers, but little impact of these activities on outcomes (job placement rates). Moving to a system with contract payments fully contingent on performance appears to increase job placements, but not job duration, for more readily employable workers.

Keywords: social welfare, performance contracting

JEL-codes: I38, H11, H53.

1. INTRODUCTION

The majority of empirical studies on the use and effectiveness of performance incentives address performance-related pay in private firms, reflecting their greater prevalence in the private sector relative to the public sector (see Prendergast (1999) and Chiappori and Salanié (2003) for surveys of the literature). Compared to private sector production technologies, public sector work is more likely to involve complex, non-manual work, multiple principals and group dynamics, political and environmental influences and interdependencies, and non-standardized outputs that make precise measurement of performance challenging and costly (Blank, 2000; Dixit, 2002; Heinrich and Marschke, 2010). In light of the additional noise and special challenges in performance outcome measurement in the public sector, incentive structures are more likely to be low-powered, that is, with relatively weak incentives or consequences (monetary or non-monetary) for achieving (or failing to achieve) high or target levels of performance (Burgess and Ratto, 2003; Heinrich, 2007).

In this context, our research is relatively unique in investigating a special case in which the delivery of publicly-funded social services moved to a system with very high-powered incentives, specifically, with payments to contractors 100% contingent on their performance. We are particularly interested in evaluating not only the effects of these incentives on client outcomes (job placements), but also the unintended effects of 100%-contingent performance-based contracting ('No Cure No Pay') on the delivery of welfare-to-work services. In other words, this public sector setting (in the Netherlands) presents a rare case where both the financial and service provision risks were fully transferred to the social welfare providers.

While performance-based pay has a long history, its use in public sector contracts for delivery of social welfare services by private providers is a more recent phenomenon, and one

that is increasingly common. Some of the first experiences with performance-based incentive schemes in the public sector date from U.S. employment and training programs, beginning with the Job Training Partnership Act (JTPA) of 1982 and continuing with the Workforce Investment Act (WIA), which replaced JTPA in 2000 (Barnow, 2000; Heckman et al., 2002). More recently, governments in Australia and the Netherlands switched to fully privatized systems with substantial performance incentives (Bruttel, 2004; Struyven and Steurs, 2005; Finn, 2008). Contracting out public social welfare services to private providers is less widespread in the United Kingdom and Germany but is gradually becoming more important in these countries as well (Bernard and Wolff, 2008; Tergeist and Grubb, 2006; Winterhager et al., 2006).

As the literature on contracting social welfare services has grown, concerns about the unintended effects of performance-based contracting have risen as well. There is some consensus that these contracts have increased *measured* performance outcomes, but they are frequently accompanied by various distortionary effects, such as cream-skimming and other gaming activities. In some settings, this has led to a retraction in the use of performance-based contract incentives, with some governments reverting to fixed-payment schemes for private providers or even contracting back in (Hefetz and Warner, 2004). Examples here include the reappraisal of in-house provision of welfare-to-work services to Social Assistance recipients in the Netherlands and changes in the contract design and management of the Wisconsin Works program (Koning, 2009; Heinrich and Choi, 2007). Clearly, these reappraisals and retractions reflect in part the challenges of getting incentives right and managing performance-based contracting arrangements. Still, there is little empirical evidence on the overall effectiveness of performance-based contracting schemes in social welfare programs that factors in both their intended and unintended effects and assesses their relative importance for program outcomes.

For example, providers that cream-skim workers with high a priori job placement rates may well be present, but if these groups of workers are also more likely to benefit from programs (Heckman et al., 2002), the efficiency costs of cream-skimming may be low.

We aim to help fill this gap in the literature by analyzing the implications of high-powered performance-based contracts (with private social welfare service providers) on job placement rates, as well as their distortive effects on program administration and outcomes. For this purpose, we use data on Dutch unemployed and disabled workers who were assigned to private welfare-to-work (WTW) providers in performance-based contracts in 2002-2005. Over this period, procured contracts gradually moved from No Cure Less Pay (NCLP) to No Cure No Pay (NCNP) reward schemes, the latter of which constituted a fully (100%) performance-contingent contract, with payments made only for clients placed in jobs. We analyze the impact of this change on (short and long-term) job placement rates, as a common measure of WTW program effectiveness, and investigate the importance of possible distortive effects of the incentives, using data from multiple contract periods with controls for worker types. To account for selection in the allocation workers across NCNP contracts, we estimate two-stage treatment selection models and fixed-effect models that control for worker characteristics affecting both the payment scheme and program outcomes.

In making this contribution to the literature, we first observe the numbers of workers that were assigned to WTW providers, including those that did not actually start programs, which allows us to develop explicit measures of pre-program selection. We then test whether the higher-powered incentives associated with NCNP (fully performance-contingent) contracting have changed the shares of clients that do not start programs, distinguishing between clients that do not show up at the program (i.e., client-induced selection) and clients that are returned to the

social benefit administration by providers (i.e. provider-induced selection). We also explore (empirically) whether client- and/or provider-induced selection is related to the job placement rates of contractors.

This paper is one of the first to explicitly address (in an empirical analysis) a phenomenon that we characterize as the “parking” of hard-to-place WTW clients. Within the context of our analysis, parking is defined as *not* providing services to hard-to-place clients who have been assigned to WTW programs. In other words, parking might be described as a form of cream-skimming *during* the program, in which WTW providers try to maximize placement rates and keep costs down by doing little to serve those with the poorest job prospects, and instead focusing resources on the most able clients with the best prospects for job placements. In the absence of detailed program administrative records, parking behavior may be difficult to observe directly, and spending per client may also be difficult to discern. If, in fact, program staff focus the bulk of their resources on clients with better a priori job prospects, we expect parking behavior to accelerate the rate of job placements among the more employable, thereby reducing their observed average job search duration, while simultaneously widening the gap in job placement rates between clients with better and worse job prospects. Accordingly, we develop a test statistic for parking that compares observed average job search durations of job finders in NCLP and NCNP (100% performance contingent) contracts, with the expectation that higher-powered incentives are more likely to encourage parking behavior.

Our analysis shows that the overall pre-program selection and parking activities were probably minimal. The results suggest that for groups of workers where the risk of failing to place clients in jobs is spread over a broader client base (i.e., the per-client risk is smaller), there is little effect of NCNP incentives on selection and parking behavior. Conversely, for smaller

contracted worker groups with greater risks of non-payment due to performance, the evidence points to more selection and parking. NCNP contracting also appeared to increase job placement rates for some workers, but it did not affect job duration, and it was not effective in raising job placement rates for those in disability insurance groups (with poorer employment prospects).

The remainder of the paper proceeds as follows. Section 2 briefly reviews the literature on cream-skimming, parking and other gaming activities, with special interest in the role of institutions in determining or incentivizing these phenomena. Section 3 describes the data and methods we use, while explaining the institutional context in which they originate. Section 4 presents the empirical analysis and findings, and section 5 concludes.

2. LITERATURE REVIEW

Research to date suggests that the nature and incidence of cream-skimming, parking and other gaming activities are strongly influenced by institutional settings. As Heinrich and Marschke (2010) explain, incentives should be used (and should be more powerful) in organizations where individuals are able to respond to them. In some public sector settings, workers are highly constrained by procedural rules and regulations that allow little discretion for manipulating or improving program processes or by environmental conditions that interfere with outcomes (e.g., a high unemployment rate or an economically disadvantaged population). Thus, imposing performance-based contractual provisions subjects them to greater risk of lower compensation. In other organizational environments, program implementers may have more leeway to try out innovative ways of increasing program value and may therefore be more responsive to performance incentives in intended ways. In the typical, relatively constrained social service setting, however, unintended practices such as cream-skimming, or the selection of

easier-to-place clients by providers, may increase if payments or rewards are performance-based, as workers with poor a priori job prospects will raise the risk of no (or lower) payments (Heckman et al., 2002). Of course, this response is conditional on the extent to which providers are able to select clients, and to select them in ways that influence performance outcomes.

In U.S. employment and training programs, for example, program participation is voluntary, with decisions on the part of both potential participants and gatekeepers (program administrators) determining access to services. In their study of cream-skimming in JTPA programs, Heckman and Smith (2004) analyzed multiple stages of the JTPA selection process, including eligibility, awareness, application, acceptance and formal enrollment. They concluded that applicants' progression through these stages toward enrollment was less influenced by cream-skimming on the part of program workers than by factors beyond the control of service providers (Heckman and Smith, 2004). Moreover, there is no strong evidence in the literature that social service providers routinely exploit the discretion they have to cream-skim, and in some contexts, the incentives to do so may be mitigated by formal adjustments to performance standards that reduce the risks of serving specific "hard-to-place" groups (Heinrich et al., 1999; Barnow and Heinrich, 2010; Courty et al., 2009). Courty et al. (2009) show empirically how formal performance standard adjustments compel providers to factor in not only how client characteristics affect performance outcomes, but also how they influence performance standards. Thus, incentives to cream-skim on observed characteristics that are accounted for in the adjustments are likely to be reduced, although cream-skimming may still occur on unmeasured characteristics within the hard-to-place groups.

In other settings, admission into programs may be compulsory, allowing little room for selection by providers. Examples of such programs include those in Australia, the UK and the

Netherlands, where participation in welfare-to-work (WTW) programs has been compulsory for unemployed workers (Finn, 2008). In these programs, all assigned clients do not necessarily enroll, as some prefer to risk being sanctioned or may find jobs prior to the program on their own. In Australia and the UK, the assignment of workers to WTW providers is fully compulsory, implying that providers have no discretion to return workers to the social benefit administration (i.e., to decline to serve them). In contrast, providers in the Netherlands are allowed to return clients assigned to them, but with the caveat that returning too many workers may decrease their chances of being contracted to provide services in the future (Koning, 2007).

The picture that emerges from these studies is that cream-skimming is probably less important and prevalent than suspected or stressed by policymakers, particularly in programs where selection occurs at earlier stages of awareness and application (with little leeway for selection by providers). Still, concerns have arisen about the possibility of other gaming activities that occur in the implementation of programs, such as limiting access to services or parking activities in WTW-programs (Bruttel, 2004; Finn, 2008). One view is that the parking of assigned clients (after the start of a program)—which results in a bare minimum of services for harder-to-place clients—may represent a substitute for cream-skimming, particularly in contexts where pre-program selection is effectively prohibited or restricted. Moreover, WTW providers may spend time in assessing the a priori job prospects of workers and use this information to determine how they will allocate “parking spaces,” rather than using it for selecting clients prior to the program. The experiences of some providers, clients and caseworkers, as well as anecdotal evidence, suggests an association between incentive-based contracts and parking activities (Finn, 2008).

Another public service area where a type of parking behavior allegedly occurs is in U.S. education systems that base performance assessments on specific standards for proficiency. In these systems, educators have been shown to exert or reallocate more effort to teaching “bubble kids,” or those on the cusp of reaching the performance standard (i.e., whose individual performance is more likely to influence attainment of the standard). For example, Figlio and Rouse (2005) found that Florida schools that faced pressure to improve the fraction of students scoring above minimum levels on comprehensive assessment tests focused their attention on students in the lower portion of the achievement distribution and on the subjects/grades tested on the exams, at the expense of higher-achieving students and subjects not included in the test. And in their study of school accountability systems in Chicago, Neal and Schanzenbach (2007) similarly concluded that a focus on proficiency standards left out students performing both far below and far above the standard. Still, empirical evidence on the importance of parking activities (in various forms) is very limited, most likely due to difficulties in observing provider (or teacher or other service worker) efforts and resource allocations at the client level.

Among other empirical analyses of gaming of measured outcomes in public services provision were those conducted by Courty and Marschke (1997, 2004), who analyzed how JTPA providers manipulated the timing of client exits from employment and training programs to maximize their rewards. Courty and Marschke showed that providers were more likely to postpone the exit of poorly performing clients in relatively unsuccessful program years and to increase the number of exits of these clients in good years when they were confident of achieving the minimum performance standards required to secure an award. In effect, these types of gaming activities increase *measured* performance but lower the efficiency of the system by diverting provider efforts to these gaming activities. In more recent work, Courty et al. (2009)

present a broader framework for detecting increases in distortions in performance measures associated with contract incentives, showing that the alignment between a performance measure and the true goal of the organization may decrease after a performance measure is introduced, as bureaucrats respond by exploring all strategies for raising it, not just those that also increase program value.

Heckman et al. (2002) also show that short-term outcomes of programs may bear little relationship to long-term outcomes. Thus, performance standards relying on readily available data on outcomes, such as job placement rates and wages at placement, may not necessarily advance the longer-term goals of public programs (such as employment retention or longer-run earnings gains). In many of these cases, the incompleteness of performance measures is inherent in social services provision, where longer-term outcomes are more difficult to measure, rather than an artifact of institutional settings (see also Dias and Maynard-Moody, 2006).

Similar to cream-skimming, it seems clear that the incidence and type of gaming activities are strongly determined by institutional settings. In the JTPA program, where the vast majority of studies have been undertaken to date, a combination of discretion over the timing of reporting on program outcomes and the use of performance thresholds triggered providers to game the system in these ways (Heckman et al., 2011). With linear contracts, however, like the NCLP and NCNP systems, gaming along these lines is less likely to benefit providers, particularly if client records are linked directly to the administration of benefits in a way that leaves no discretion in the timing of reporting “successful” program exits. Still, even with linear incentives and without discretion in reporting successful programs, providers may use their discretion in determining the end date of the program, that is, the reporting of “unsuccessful programs”. In particular, extending programs may result in additional windfall gains of job

placements on the one hand (a gaming behavior), while creating additional program costs on the other. The impact of optimizing the duration of program lengths (for unsuccessful clients) on job placement rates is not clear. And taking an even broader perspective, it remains unclear what the overall impact of the unintended effects of performance-based contracting in social welfare services may be relative to its intended effects.¹

3. DATA AND INSTITUTIONAL CONTEXT

In the Netherlands (the setting of this study), the Disability Insurance (DI) and Unemployment Insurance (UI) programs are mandatory for all workers. Both DI and UI are implemented by the social benefit administration. Similar to the New Deal in the United Kingdom, providers are expected to offer unemployed and partially disabled clients mediation, job training or subsidized employment within twelve months after the start of their benefit spell.² In the period under investigation (2002-2005), the Dutch social benefit administration³ contracted out the delivery of these WTW-services to private job training service providers only. In 2006, the delivery of social welfare services by the social benefit administration was replaced by a dual system, where clients could either opt for individual vouchers and were free to choose (preferred) providers or were assigned to groups that were allocated to providers, as in the system that was compulsory until 2005. In 2007 the privatization of social welfare services was reversed to some extent— that is, the social benefit administration resumed the delivery of social welfare services for their clients with relatively good job prospects, whereas those with poorer job prospects continued to

¹ Thus far, the only notable exception appears to be the study by Burgess et al. (2004), who investigated the effectiveness of performance-related pay for public employment offices. They find the effectiveness of incentive effects to be confined to small offices, but do not address the issues of parking and gaming.

² As of 2005, however, the New Deal approach has been relaxed in the Netherlands. This is mirrored by a decrease in the number of WTW-clients in 2005.

³ In Dutch: Uivoeringsinstituut Werknemersverzekeringen (UWV).

be contracted to private providers. Thus, both of these changes to the system caused the number of clients procured with NCNP contracts to decrease substantially from 2006.

< TABLES 1 AND 2 HERE >

Table 1 provides an overview of the characteristics of clients by worker types that were contracted out to WTW-providers in 2002-2005 and were registered by the social benefit administration, stratified by calendar years and contract payment schemes (NCNP and NCLP). Each year, the Dutch social benefit administration defined worker types at three digit levels in order to assign workers to private providers in groups and with separate contract conditions, both allowing for specialized services and decreasing opportunities to cream-skim.

The first digit level of worker types is a broad characterization of workers that holds for all years in the data and includes 18 categories. These gross worker types are observed in almost all years (see the second column of Table 2, which presents additional information on the structure, size and characterization of the various worker types.). For this reason, we also use this digit level in specifying fixed effects models (discussed in the next section). Gross worker types are characterized by specific client groups in the UI and DI scheme, but some smaller groups are defined by other strata. These client groups include immigrants, those with good or bad job prospects (after being profiled by social benefit administration caseworkers), disabled workers with special impairments, and older workers or young disabled workers without any work history.

The second digit level of worker types entails a more detailed description of the contract types and activities that have been contracted out in subsequent years—we therefore call them

worker program types. The designation of program types for the gross worker types has varied over the years, depending on the specific needs pertinent at a given time. Examples include programs aimed at guiding workers into self-employment, job training, job hunting and job mediation. The second digit code thus reflects the combination of gross worker types and specific program activities of those worker types, defined distinctly for each year. Moreover, contract conditions—particularly those regarding the payment schemes, NCLP and NCNP—also varied according to these contract types. Thus, it is important to stress that contract conditions did not result from negotiations between the social benefit administration and providers. Rather, these were set prior to the bidding process, with an increasing share of NCNP contract types over time.⁴ In total, there were 106 worker program types that were contracted out in 2002-2005, with the most observations in 2002, the year in which the most clients were contracted out as well. As WTW-providers complained about the administrative burden that came with the bidding process involving so many worker program types, the number was reduced substantially in 2003.

Finally, the third digit level indicates the actual group of workers that was assigned to a particular provider, in a specific region and at a specific time point.⁵ In effect, the contract conditions for these groups of workers were defined by contract types, with within-type-variation in group outcomes potentially stemming from group size, region and the provider.

As seen in Table 1, there is a steady decline in the number of WTW-clients in the period under investigation. In particular, the numbers of newly assigned program participants dropped from about 105,000 clients in 2002 to approximately 67,000 in 2003, and from about 48,000 in 2004 to 23,000 in 2005. We suggest two possible explanations for this pattern: business cycle

⁴ Koning (2007) discusses the bidding process for cohorts in more detail.

effects and a relaxation of the New Deal strategy from 2005 onward, where the social benefit administration no longer aimed to fully treat clients within twelve months after the start of their UI or DI spell (Groot et al., 2006; Finn, 2008). It also should be noted that the new procurement system in 2002 also applied to clients that entered in earlier years (when the New Deal strategy had not taken off yet), implying a backlog of clients may have been waiting for services in 2002.

NCLP and NCNP contracts

During the contracting process, individual clients within a particular worker group were not known yet by the WTW provider. Providers were only informed about the average characteristics of the worker types, the expected group size, and contract conditions. As Table 1 (line 7) shows, the share of NCNP contracting for contract types gradually increased, from close to zero in 2002 to more than half of the contracts in 2005 (weighted by the gross worker type size). Table 2 also shows that NCNP contracts were confined to four gross worker types, mostly consisting of workers with better job prospects. This largely explains why the average (expected) payment of NCNP contracts was lower than NCLP contracts in the period, an issue we return to in the next section. On average, about 50 percent of the NCLP contracts were paid as a fixed amount, with the other 50 percent paid at placement. All payments were made at the end of the program, at one and the same time.⁶

Provider and client-induced selection

In awarding contracts to particular providers, client addresses were transferred to the provider, who in turn had to contact the clients and make a reintegration plan together with them. This reintegration plan included a list of proposed activities to get the client back to work, as well as

⁵ Koning (2007) studies the performance of for-profit and non-profit WTW-providers, taking cohorts per provider per region as a relevant unit of investigation and aggregating cohorts that started at different dates within a year.

the rights and duties of the provider and the client. In order for the program to get started, the reintegration plan had to be approved by the social benefit administration. In practice, reintegration plans were not formulated for all individual clients and/or were not approved in all cases. Thus, we distinguish “gross” numbers of clients that were assigned to a provider from “net” numbers of clients for which reintegration plans were submitted and approved by the social benefit administration. The resulting difference between gross and net participation, shown in Table 1, therefore reflects both provider- and client-induced selection. As to the former, providers were allowed to send back some clients if they viewed them as “unsuitable” for the program. We suggest that this form of selection is most likely to be associated with cream-skimming. Over the years, the population-weighted fraction of provider-induced selection ranged from 1 to 3% of the gross worker types. Although there was no formal limit on the percentage of provider-induced selection, providers were aware that high rates of this type of selection would diminish their prospects of future contracts.

We define client-induced selection as the balance of assigned clients who did not participate in the programs but were not returned by the service provider either. This group most likely consisted of clients that already had found a job by the time the trajectory started or for whom the reintegration plans were not approved by the social benefit administration. In both cases, clients were no longer assigned to their respective job training service provider, and thus, did not affect providers’ future prospects for contracts. Client-induced selection increased from 11% in 2002 to 16% in 2005. In addition, it was about 4 percentage points higher for NCNP contracts than NCLP contracts, suggesting that clients assigned to NCNP contracts may have

⁶ When conditioning on the gross worker types, the (ex post) payments of NCLP and NCNP contracts did not differ substantially and significantly. This suggests that any risk premiums for the NCNP contracts were not higher than for NCLP contracts..

been more likely to find jobs in the time span between assignment and the actual start of the program.

Parking, gaming and job placement

Over the years, we observe a gradual increase in the job placement rates of new worker groups that join the WTW programs. This holds for both job placements with employer-employee contracts of 6 to 12 months and contracts for more than 12 months. Worker job placement rates were measured at the end of the program for all (net) assigned clients. Programs typically lasted one to two years; for clients that did not succeed in finding a job, outcomes were measured at the end of program participation. It should be noted that the variation in program participation length was predominantly driven by the gross worker types, which also are used as fixed effects in our empirical analysis. Moreover, job placements were typically realized in the first month of program spells. Thus, any variation in job placement rates that is due to variation in program participation lengths is likely small. Table 1 also shows that the share of NCNP contracts—with higher placement rates—has increased over time (see lines 7 and 14, respectively). We find more marked differences between contract types and the average duration of both “successful” job finders and “unsuccessful” clients (who haven’t found employment within the time span of the program) (see lines 12 and 13).

We also explore whether the shorter job search durations of clients in NCNP contracts corresponds to the presence of parking activities in these programs, that is, whether providers concentrate on shortening job search durations among clients with high a priori job chances, while letting hard-to-place clients languish in the programs. Heretofore, Figures 1 and 2 depict the distributions of (average) job search durations for successful and unsuccessful NCLP and NCNP worker groups, respectively. These figures suggest that the average job search durations

of both job finders and non-job finders were shorter (with less dispersion) for the NCNP contracts. More specifically, it appears that most WTW programs for unsuccessful participants end after two years for NCNP worker groups, whereas for NCLP worker groups, they continue for as long as three years. Still, a more formal analysis is needed to distinguish the role of payment schemes in these patterns of effects, as job search durations are undoubtedly driven by participant characteristics as well.

< FIGURES 1 AND 2 HERE >

4. EMPIRICAL ANALYSIS

General research approach

Above we described different stages in the contracting and provision of WTW services in the Netherlands. In this section, we analyze how the shift to NCNP contracting has influenced the responses (intended and unintended) of providers in implementing these programs, and how this in turn has affected overall program effectiveness.

We first analyze the decision process of the social benefit administration in choosing between NCLP and NCNP payment schemes. Second, we address pre-program selection responses—both provider and client-induced—to the new (100% performance-contingent) incentives. Supposing that pre-program cream-skimming would increase under NCNP incentives, we expect provider-induced selection—and to a lesser extent client-induced selection—to increase. Third, we study the effect of NCNP contracting on parking behavior for clients who actually started their programs and develop a test that uses information on the

average successful job search duration per worker group in our sample. Finally, we estimate the (overall) effect of payment schemes on performance outcomes—both for shorter employer-employee contracts and longer ones—focusing special attention on the role of pre-program selection. In particular, if NCNP contracting has increased such selection, this may have affected the job placement rates in an indirect way as well.

As Chiappori and Salanié (2003) point out in their survey study, it is essential to adequately control for unobserved heterogeneity and selection bias in empirical studies of the effects of contracting, and this holds for each response measure to the payment scheme. For example, the allocation of contract (worker program) types may be also driven by the (a priori) expected job prospects of the gross worker types. We therefore use two research strategies to control for possible selection effects. The first strategy takes explicit account of the allocation process of NCNP contracts by estimating two-stage treatment selection models. In this approach, we use data from 2002 (a baseline year) as exclusion restrictions, assuming, for instance, that placement risks of contracts affect the choice of payment schemes but not job placement outcomes themselves in a direct way. Thus, we do not rely only on the distributional (normality) assumption of the selection model itself, but rather on exclusion restrictions to estimate the effects of 100% performance-contingent contract incentives. The second research approach entails the use of gross worker type fixed effects (FE) to control for worker characteristics affecting both the payment scheme and program outcomes. In using gross worker types as fixed effects, we thus assume that all of these groups are affected equally by business cycle (and other calendar time) effects.⁷

⁷ Using (net) worker types as fixed effects here would yield more precise controls, but then the effects of payment schemes—which vary between contract types only—would no longer be identified.

In both of these research strategies, one should be aware that the size of the worker groups in our data varies substantially over time, affecting the variance of (pre-) program outcomes as well. Individual clients have a higher probability of being part of large groups than smaller ones, so equal weights for all observations may yield inefficient coefficient estimates. We therefore estimate model specifications with worker group size as relative (analytic) weights as well (see also Koning, 2007). Within the context of (conventional) fixed effects (FE) estimation, however, rescaling is cumbersome, since observed weights are not constant within contracts. We therefore follow Mundlak (1978), who proposes a specification for fixed effects with pooled data—that is, we re-specify the worker type-specific effect as a function of averages per gross worker types. Using this approach on pooled data yields estimates that are equivalent to those with FE estimation, at least for those variables with variation within gross worker types. In contrast to the conventional fixed effects specification, the pooled model thus allows for the use of worker group size as relative (‘analytic’) weights.

Assignment of NCNP contracts and provider responses

The use of performance-based pay is typically modeled as a classic trade-off between risk and incentives, a perspective that may also well apply to the choice of WTW contracts and the associated risk in payments stemming from the uncertainty of worker job placement rates (Burgess and Ratto, 2003). Adopting a standard concave utility function for WTW providers, where providers are more risk averse than the social benefit administration, it can easily be shown that the impact of this risk will be higher for worker groups with lower (expected) job placement rates; that is, WTW-providers will spend less effort on helping clients if there is no risk premium. As risk is transferred to the provider in the form of performance-contingent pay, a higher risk premium will thus be required for worker groups with lower job placement

probabilities, and the use of NCNP contracts will be less attractive for the social benefit administration. We also expect risk premiums per client to be lower if worker groups are larger, implying a lower variance of average placement rates. Without the use of these risk premiums, WTW-providers will exert less effort on these groups of (less employable) workers. Analogously, it could be argued that providers with high market shares will require lower risk premiums. Within the context of the Dutch WTW-system, however, it should be noted that payment schemes were fixed in advance, so there was no negotiating on risk premiums. Thus, if large providers are overrepresented in NCNP worker groups, this could be due to the fact that these providers were more likely to bid for and/or be awarded these groups of workers, with contract conditions being exogenous.

In testing these hypotheses, we first estimate a probit model that explains the use of the NCNP payment scheme (*NCNP*) with different worker types for 2003 to 2005, as a function of worker and (assigned) provider characteristics. In particular, we specify the use of *NCNP* as:

$$(1) \quad \Pr (NCNP_{ijk, t} = 1) = \Phi (\mathbf{X}_{i, t=2002} b_{NCNP} + \mathbf{Y}_{ij, t} d_{NCNP})$$

with i as an index for the gross worker type ($i = 1, \dots, I$), j as an index for the worker program type ($j = 1, \dots, J$), k indicating the worker group ($k = 1, \dots, K$) and t denoting years ($t = 2002, \dots, 2005$). Φ is the cumulative standard normal distribution function. Further, \mathbf{X} represents average values of the job placement rates and average risk proxies per gross worker type in 2002, which we are using as a baseline year (that is, where NCNP contracts were still almost absent and the social benefit administration decided on the assignment of NCNP contracts for the next year). We argue that these baseline observations are exogenous with respect to later program

outcomes, such as the job placement rates. Alternatively, Y includes explanatory variables that vary over time and per worker program type j . These are the market share of the assigned provider of the worker group observation, the (expected) reward per client, and an indicator variable for worker groups with disability insurance recipients only. Finally, it should be noted that payment conditions only vary between (106) contract types. Thus, standard errors for the estimates have to be adjusted for contract-type clustering effects.

< TABLE 3 HERE >

Generally, almost all of the coefficient estimates in Table 3 corroborate the standard risk-incentives framework. First, we find the probability of NCNP contracts in 2003-2005 increases with respect to the average job placement rate per gross worker type in 2002. In particular, a 10 percentage point increase in the job placement rate increases the probability of a NCNP payment scheme by about 14 percentage points. The proxy for risk involved with the contracted group—that is, the standard deviation of the average job placement rate of the observed worker group per client (in 2002)—is negatively associated with the probability of NCNP payment schemes. This is again in line with standard risk premium arguments. Interestingly, higher payments offered (per placement) for a given worker group is negatively related to the likelihood of a NCNP payment scheme, likely reflecting that higher payments per placement signal the difficulties of placing these groups of workers into jobs and the risk for job placement rate outcomes associated with serving them. In contrast, we do not find a relationship between the provider market share and the likelihood of NCNP schemes. This result is not surprising, in light of our earlier point that payment schemes were determined *ex ante* by worker characteristics and not by the

providers assigned to these worker groups. It may still be that selection of larger providers into NCNP contracts has occurred in the bidding process, after the release of contract type descriptions and corresponding payment schemes. That said, our results do not suggest that selection in the bidding process was important; that is, the probit model estimates do not indicate that the concentration of (large) WTW providers for these contract types has increased over time.

An alternative test for concentration effects of providers would involve a direct comparison between measures of market concentration of NCLP vis-à-vis NCNP contract types. Therefore, we calculated Herfindahl-Hirschman Indices (HHI), using the market shares of all providers per worker program type j and per year t .⁸ Over the years, the resulting (average) HHI scores are fairly constant, ranging between 0.25 and 0.30. We also do not find a significant difference between the HHI averages of NCLP and NCNP worker program types. Again, this suggests that large-scale providers did not expand their market shares in NCNP worker groups, crowding out smaller ones. Finally, we also compared the persistency of market shares of providers in gross worker types that switched from NCLP to NCNP contracting in 2003-2005 to those that continued as NCLP contracts. We found 57.6 percent of the providers in the first category to be awarded with contracts in 2003-2005 for the same gross worker types, and 50 percent in the second category to be awarded with contracts for the same gross worker types. This suggests that persistency rates were higher in the NCNP gross worker types.

Pre-program selection effects

As discussed above, we measure two types of selection effects with our data: provider-induced selection and client-induced selection. In addition to direct selection by sending clients back, providers may have also used more subtle ways to selectively treat clients, such as exerting less

effort in working with certain clients or even by discouraging them to fill in reintegration plans and/or start the program. As WTW providers were not formally held responsible for such indirect client-induced selection, this would not necessarily diminish their future prospects of being assigned new groups of workers. Providers may therefore have tried to influence client-induced selection as well. We model both of these potential effects, using the following specifications:

$$(2) \quad S^P_{ijk,t} = a^P NCNP_{ij,t} + \mathbf{Z}_{ijk,t} b^P + \varepsilon^P_{ijk,t}$$

and

$$(3) \quad S^C_{ijk,t} = a^C NCNP_{ij,t} + \mathbf{Z}_{ijk,t} b^C + \varepsilon^C_{ijk,t}$$

where S^P and S^C denote the observed provider and client-induced selection shares of the assigned clients to a provider. Both of these selection measures are observed per worker group k belonging to worker program type j and gross worker type i . The variables a^P and a^C describe the effect of $NCNP$ contracting on provider and client-induced selection, respectively. Again, it should be noted here that the payment scheme dummy $NCNP$ varies with (gross) worker type only. b^P and b^C are vectors denoting the effects of the matrix \mathbf{Z} on provider- and client-induced selection, respectively. The matrix \mathbf{Z} includes variables that all vary over i, j, k and t . Finally, ε^P and ε^C are i.i.d. residual terms with mean zero and variance σ_P^2 and σ_C^2 .

⁸ We also calculated HHI values per gross cohort type. Obviously, as gross cohort types are more heterogeneous than cohort types, this resulted in lower HHI-values, but again there were no significant differences between NCLP and NCNP gross cohort types.

Equations (2) and (3) can be estimated with standard GLS techniques, using worker group size as analytic weights. In addition, we have indicated earlier that we essentially follow two estimation strategies to control for selection effects. The first strategy is to estimate treatment selection models for NCNP, with equation (1) in the first stage and S^P and S^C (equations (2) and (3)) in the second stage. Thus, equations (2) and (3) are extended with coefficient estimates of the Mill's ratios that are obtained from equation (1). As equation (1) includes the exogenous baseline parameters for 2002 and is estimated for observations from 2003 to 2005, the time span for observations that are used to estimate equations (2) and (3) is limited to this period as well.

The second estimation strategy is a fixed effects estimation of equations (2) and (3), with gross worker types as the relevant units. Thus, our basic assumption in this model is that ε^P and ε^C consist of a time invariant, fixed gross worker effect that may be correlated with *NCNP* and a residual term that is assumed to be uncorrelated. Stated differently, we thus assume that business cycle and other time dependent effects affect the gross worker types equally and are captured by calendar time dummies. Thus, if business cycle conditions would affect the composition of the gross worker types, their effects do not vary between these in a systematic way.

< TABLE 4 HERE >

Table 4 shows the estimation results for equations (2) and (3), using GLS and the treatment selection model and fixed effects approaches. The coefficient estimates of *NCNP* have the expected (positive) signs in all cases, although only about half are statistically significant at $\alpha < 0.05$. As for provider-induced selection, both the magnitude and the range of estimates are

small (0.6 to 0.8 percentage -point), suggesting the potential for (any) cream skimming from this source is robust but also likely limited. As the (average) share of client-induced selection is much more substantial than that of provider-induced selection, the room for any differences between NCLP and NCNP worker groups seems higher as well. Still, the fixed effect estimates suggest that WTW-providers do not affect these outcomes to a large extent. The results also show that provider-induced selection is higher in DI worker groups, which is probably due to the higher degree of specialization of services that is needed for these groups. Finally, we only find the year dummy coefficients to be significant for provider-induced selection, with a downward time trend. It may be that providers became more aware of the consequences of high provider-induced selection rates over the years, and therefore attempted to keep these numbers low.

< TABLE 5 HERE >

Table 5 presents the (pooled) fixed effect estimates of NCNP schemes on provider and client-induced selection for subsamples with different worker group sizes (more or less than 50 clients) and benefit schemes (UI or DI).⁹ These estimates suggest that for both selection measures, the effect of NCNP schemes has been strongest in the (smaller) DI groups. It may well be that the risks associated with having DI clients with poor job prospects in smaller groups were exacerbated by the NCNP scheme. And as these risks were not compensated with higher risk premiums, WTW-providers were apparently more likely to cream-skim. Training and mediation costs were substantial for this group, whereas the risk of not receiving any (flexible) payments (due to failure to place) was substantial as well. Still, one should bear in mind that the

estimated effect of about 5 percentage-points was relevant for only 8 percent of the DI worker groups, so that the overall effect was limited.

Together, these findings on pre-program selection suggest that the effects of NCNP contracting (compared to NCLP) on the behavior of providers was probably limited. We offer several potential explanations for this result. First, high fractions of clients being sent back could damage the reputation and future contracting prospects of providers. Second, providers have little leeway to exploit any informational advantages over the social benefit administration. In particular, the time span between the assignment of worker groups and the actual start of the program was only a few weeks. It is likely that this period was not long enough for providers to make an accurate assessment of the a priori chances of their clients finding work. Furthermore, the contracted groups were intended to consist of fairly homogenous groups of workers, which likewise limited the room for selection behavior as well.

Parking effects

We argued earlier that parking might be an alternative device for pre-program selection, with the key difference that parking occurs after clients are assigned to providers. In the case of strict performance-based contracting arrangements (like NCNP), parking is unlikely to raise (average) job placement rates but may be beneficial if the value added of serving hard-to-place clients is low or when the program costs of serving them are high. Parking behavior typically cannot be observed directly, and spending per client may also be difficult to discern. Still, the data at hand allow us to derive a test on parking indirectly, essentially by focusing on its potential effect on job search durations of clients. That is, parking is characterized as providers concentrating their effort on clients with better job prospects, causing the prospects for this group to improve, while

⁹ We also estimated model variants for sub samples, using the two stage selection approach. This led to similar, but less efficient coefficient estimates, as cohort characteristics as size and benefit scheme largely explain the

hard-to-place clients receive less attention (doing little to affect or even decrease their job prospects). Stated differently, the job search durations of easy-to-place clients would become shorter, while those of hard-to-place clients would be unchanged or possibly even lengthen. In effect, our implicit assumption is that cream skimming operates through the a priori chances of finding employment, rather than on the value-added of programs. In the literature, this is referred to as the “common-effect” model, in which the value-added of programs is equal for all clients (Heckman et al., 1997). As Heckman et al. (1997) argue, this assumption can be justified by the fact that the variance in value-added is small compared to the variance in a priori job finding probabilities.

The test for parking that we implement entails a comparison of the average job search duration for clients in NCLP and NCNP worker groups that have found a job. Under the parking hypothesis, we expect job duration to be shorter for NCNP worker groups. In the appendix to this paper, we present the technical details of this test. Specifically, as the average job search duration of job finders is a function of the job placement rate (which may differ between NCLP and NCNP worker groups), a simple comparison between the truncated average durations—controlling for gross worker type fixed effects—may give biased results. We therefore control for job placement rate differentials by employing (and controlling for) a first order Taylor series expansion; this allows us to distinguish the variation in truncated average job finding durations that is associated with parking.

< TABLE 6 HERE >

Table 6 shows the estimated test statistics for parking differentials between NCLP and NCNP worker groups, with and without controlling for differentials in job placement rates (for

probability of NCNP payment schemes as well.

subsamples of our data). The table also contains coefficient estimates of (log) program length differentials between NCLP and NCNP worker groups, (again) after controlling for gross worker type fixed effects and year dummies. Clearly, the observed program lengths are shorter for NCNP worker groups, with estimates ranging from 8 to 21 percent shorter. The coefficient estimates obtained for program lengths are comparable in magnitude to those for differentials in the job search durations of job finders (that is, our test statistic for parking that does not correct for job placement rates). As the windfall gains of additional job placements within the program for NCNP contracts were larger, one may expect program lengths to be longer for NCNP contracts. Instead, it appears that NCNP contracting encouraged providers to concentrate on short term services for their clients, being less costly and requiring shorter program lengths. In UI groups, the opportunities for providers to respond accordingly were probably greater, which is reflected in the larger effect of NCNP contracting we find for this subsample. We return to this issue below when discussing the estimation results for job placement rates.

For the *full* sample, we find that we cannot reject the null hypothesis of “no parking.” Although the average job search duration of job finders is significantly shorter in NCNP worker groups (about 12%, or 35 days), controlling for job placement rates yields a coefficient estimate that is insignificant. Focusing on the subsamples in our data, however, we find evidence for parking in smaller worker groups (less than 50 clients) and weak evidence for DI groups, with estimated effects of 25 percent and 22 percent, respectively. Thus, similar to pre-program selection, it appears that parking is confined to worker groups where placement risks and program costs per client were greater. Parking may be one way to lower the (downward) financial risks in some contracts—particularly those for smaller DI groups—casting doubts on the likelihood of strong unintended effects of incentives induced by NCNP contracting.

Job placement rate effects

In estimating the impact of NCNP payment schemes on provider job placement rates, we essentially follow the same two estimation strategies as for the selection models in equations (3) and (4). An important difference now is that pre-program selection itself may have affected the composition of clients in the *net* worker groups, at least to the extent that this has, in turn, affected the job placement rates (compared to the *gross* worker groups). We thus add both provider and client-induced selection as additional controls, and specify the job placement rate (*JPR*) per worker group k at time t , for worker program type j and gross type i as:

$$(4) \quad JPR_{ijk,t} = a^{JPR} NCNP_{ij,t} + \mathbf{Z}_{ijk,t} b^{JPR} + d^P S^p_{ijk,t} + d^C S^C_{ijk,t} + \varepsilon^{JPR}_{ijk,t}$$

In equation (4), a^{JPR} and b^{JPR} describe the effect of NCNP contract types and other worker groups characteristics \mathbf{Z} on *JPR*, respectively. Moreover d^P and d^C denote the effect of provider and client-induced selection on the job placement rates of the (remaining) clients in the worker group. ε^{JPR} is an i.i.d. residual with mean zero and variance σ_{JPR}^2 . Similar to the selection models, we estimate treatment selection models for NCNP in the first stage, and equation (4) in the second stage, adding Mill's ratios that are obtained from equation (1). The second research strategy is the gross worker type fixed effects estimation of the model.

< TABLES 7 AND 8 HERE >

Table 7 shows the estimation results of equation (5) from GLS and the two estimation strategies that take into account potential endogeneity effects. Next, Table 8 highlights the

effects on (two) types of job placement rates—into short term and more durable jobs—and distinguishes the effects of NCNP with respect to worker group size (smaller or larger than 50 clients) and type of scheme (UI versus DI). It should be noted that all coefficient estimates in Table 8 derive from the (pooled) fixed effects estimation results.

The comparison of GLS and the other estimates in Table 8 makes apparent that the NCNP contracts were mostly used for groups of clients with better job prospects; without controlling for these selection effects, the NCNP effect would be overestimated. The overall picture that emerges is that the NCNP contracting has increased job placement rates, but with the effect being concentrated in short-term placements (with contracts from 6 to 12 months) and for (larger) UI groups. In particular, we find the overall effect of NCNP contracts on the job placement rates is equal to 7.5 percentage points in the treatment selection model and 2.5 percentage points in the fixed effects model.¹⁰ One may argue that parking decreased the effectiveness of the NCNP incentives in the smaller DI groups. We further find the positive effect of NCNP on the UI groups to be confined to short-term employment contracts only, suggesting that providers with NCNP incentives focused on short-term employment contracts for their clients. This confirms our earlier findings that indicated that NCNP worker groups had shorter program durations. It is probable that the opportunities for finding temporary work and cutting costs were greater in worker groups where the clients had better job prospects. At the same time, however, we also find evidence that providers took the opportunity to increase the number of short-term employment contracts in DI groups, at the cost of fewer longer-term contracts.

¹⁰ We also investigated the robustness of our outcomes by allowing the gross worker type fixed effects to be year specific. In this way, the effects of NCNP contracts were identified from variation in contract types within gross worker types per year. This yielded outcomes that did not differ substantially and significantly, but with standard errors that were markedly higher.

Table 7 shows that most (other) coefficient estimates for the controls in our sample are not statistically significant. In addition, we find in one model that pre-program provider-induced selection decreased the job placement rates of WTW providers. In the presence of cream-skimming, we would have expected this form of selection to increase the job placement rates of the remaining worker groups instead. A possible explanation for this result would be that provider-induced selection is high for low-quality WTW providers employing low-quality workers and/or with poorly managed programs. We therefore re-estimated equation (4) with (pooled) gross worker type fixed effects, extending the model with the addition of provider dummies as well. The resulting coefficient for provider-induced selection subsequently turns positive, increasing to 2.218 (4.438), whereas the estimated impact of NCNP remains almost unchanged (with an estimate of 2.831 (1.400)). Thus, it seems that high provider-induced selection in these worker groups is indeed associated with low-quality providers.

5. CONCLUSIONS

In this study we have explored both the intended and unintended effects of performance-based contracting in social welfare services, using rather unique data on groups of workers that were procured by the Dutch social benefit administration, some under 100%-performance contingent payment schemes. The results of our analysis are generally consistent with expectations of the standard theoretical framework of risk and incentives, where incentives are most likely to work when the (downward) financial risks of performance-contingent payments for providers are not too large to induce gaming (selection and parking) behavior (Burgess and Ratto, 2003). It is possible that the Dutch benefit administration designed the contracts with this knowledge in hand, as they used NCNP payment schemes primarily for worker groups in which clients had higher a

priori chances of finding work and job placement risks per client were low. At the same time, our analysis shows that the overall (additional) pre-program selection and parking activities associated with the fully performance-contingent contracts were probably minimal. For the UI groups, we find that the NCNP payment scheme contributed to about a 3 percentage point increase in job placements, whereas there is no evidence for pre-program selection and parking. Although this effect is smaller than those reported in previous research—with estimates ranging from 5 to 10 percentage points for these worker groups (Finn, 2008)—the NCNP schemes seem to have improved overall outcomes.

The downside of the story, however, is that NCNP contracting was not effective in raising job placement rates in DI worker groups, with evidence pointing to additional parking and provider- and client-induced selection here. Both forms of selection by providers are seemingly driven by risk and cost considerations, which are particularly relevant for hard-to-place DI clients. Although it is difficult to assess the exact magnitude of these effects, parking may well have harmed both the efficiency of the program—in terms of job placement rates—and equity in access to services.

The other concern that follows from our analysis is related to the duration of jobs that were facilitated through the NCNP programs. Additional job placements were almost fully confined to temporary employment arrangements of twelve months at maximum. With the data at hand, we cannot infer whether this was to the detriment of the efficiency of the WTW-programs, particularly for UI clients. The program might be viewed as highly successful if short-term jobs were a stepping stone to longer-term employment, and if shorter program lengths decreased the risk of lock-in effects for clients. The literature on the role of temporary employment as a stepping stone to better (longer-lasting) jobs reports mixed findings on this

question (see Heinrich et al., 2009), and other evidence seems to suggest that short- and long-term effects of programs are not strongly correlated (Heckman et al., 2002).

In general, the findings of this study suggest that in contexts where the risks to service providers of failing to meet contract expectations are greater, due to factors such as client characteristics that portend barriers to successful outcomes, performance-based contracts are less effective and are more likely to induce unintended effects such as parking that result in inequity in access to services. Alternatively, there may be some small gains to contractual arrangements that put a greater portion of provider compensation at risk when the uncontrollable risks to provider contract outcomes are lower. That said, these benefits of performance-based contracting appear to be limited to short-term outcomes, and thus, their effectiveness in increasing the long-run impact of public programs such as welfare-to-work services remains questionable and warrants more investigation. More research on the incidence of parking behavior in other domains of public services provision, such as education, would be valuable as well.

REFERENCES

- Baker, G. P., 1992. Incentive Contracts and Performance Measurement. *Journal of Political Economy* 100(3), 598-614.
- Barnow, B. A., 2000. Exploring the relationship between performance management and program impact: A case study of the JTPA. *Journal of Policy Analysis and Management* 19(1), 118–141.
- Bernard, S., Wolff, J., 2008. Contracting out placement services in Germany. Is assignment to private providers effective for needy job-seekers? IAB Discussion Paper 5/2008.
- Blank, R.M., 2000. When can public policy makers rely on private markets? The effective provision of social services. *Economic Journal* 110(462), C34-49.
- Brown, T. L., Potoski, M., 2003. Managing Contract Performance: A Transaction Costs Approach. *Journal of Policy Analysis and Management* 22(2), 275-297.
- Bruttel, O., 2005. Contracting-out and Governance Mechanisms in the Public Employment Service. Wissenschaftszentrum Berlin für Sozialforschung (WZB), Discussion paper 2005-109.
- Burgess, S., Ratto M., 2003. The Role of Incentives in the Public Sector: Issues and Evidence, *Oxford Review of Economic Policy* 19(2), 285-300.
- Burgess, S., Propper, C., Ratto, M., Tominey, E., 2004. Incentives in the Public Sector: Evidence from a Government Agency. CMPO Working Paper Series No. 04/103.
- Chiappori, P., Salanié B., 2003. Testing Contract Theory: A Survey of Some Recent Work, in: Dewatripont, M., Hansen, L., Turnovsky, P. (Eds), *Advances in Economics and Econometrics—Theory and Applications*, Eight World Congress of the Econometric Society, Econometric Society Monographs, Cambridge, Cambridge University Press, 115-49.
- Courty, P., Marschke, G., 2004. An Empirical Investigation of Gaming Responses to Performance Incentives. *Journal of Labor Economics* 22(1), 23-56.
- Courty, P., Kim, D., Marschke, G., 2009. Curbing Cream-Skimming: Evidence on Enrollment Incentives, *Journal of Labor Economics*, forthcoming.
- Dixit, A., 2002. Incentives and Organisations in the Public Sector: An Interpretative Review. *Journal of Human Resources* 37(4), 696-727.
- Finn, D., 2008. The British ‘welfare market’. Lessons from contracting out welfare to work programmes in Australia and the Netherlands, University of Portsmouth, <http://www.jrf.org.uk/sites/files/jrf/2306-welfare-unemployment-services.pdf>.
- Groot, I., Hollanders D., Hop, J., Onderstal, S., 2006. Werkt de re-integratiemarkt?, SEO rapport 946.
- Hart, O., Schleifer A., Vishny, R. W., 1997. The Proper Scope of Government: Theory and an Application to Prisons. *The Quarterly Journal of Economics* 112(4), 1127-1161.
- Heckman, J., Smith, J., Taber, C., 1996. What Do Bureaucrats Do? Effects of Performance Standards and Bureaucratic Preferences on Acceptance into the JTPA Program, In: *Advances in the Study of Entrepreneurship, Innovation and Economic Growth Volume 7, Reinventing Government and the Problem of Bureaucracy*, Gary Libecap, ed., Greenwich, CT: JAI Press, 191-218.
- Heckman, J., Smith, J., Clements, N., 1997. Making The Most Out of Programme Evaluations and Social Experiments: Accounting for Heterogeneity in Programme Impacts. *Review of Economic Studies* 64(4), 487-535.
- Heckman, J., Lalonde, R., Smith, J., 1999. The Economics and Econometrics of Active Labor Market Programs, in: Ashenfelter, O., Card, D (Eds.), *Handbook of Labor Economics*, Volume 3A, Amsterdam: North Holland, 1865-2097.
- Heckman, J., Heinrich, C. J., Smith, J., 2002. The Performance of Performance Standards. *Journal of Human Resources* 38(4), 778-811.
- Heckman, J., Smith J., 2004, The Determinants of Participation in a Social Program: Evidence from a Prototypical Job Training Program. *Journal of Labor Economics* 22(2), 243-298.
- Heinrich, C. J., 1999. Do Government Bureaucrats Make Effective Use of Performance Management Information? *Journal of Public Administration Research and Theory* 9(3), 363-393.

- Heinrich, C. J., 2007. False or Fitting Recognition? The Use of High Performance Bonuses in Motivating Organizational Achievements. *Journal of Policy Analysis and Management* 26(2), 281-304.
- Heinrich, C. J., Mueser, P. R., Troske, K. R., 2009. The Role of Temporary Help Employment in Low-wage Worker Advancement. In D. Autor (ed.), *Labor Market Intermediation*. Chicago: The University of Chicago Press.
- Heinrich, C. J., Marschke, G. M., 2010. Incentives and their Dynamics in Public Sector Performance Management Systems, *Journal of Policy Analysis and Management* 29(1), 183-208.
- Heinrich, C.J., Choi Y., 2007. Performance-Based Contracting in Social Welfare Programs, *The American Review of Public Administration* 37(4), 409-435.
- Hefetz, A., Warner, M., 2004. Privatization and Its Reverse: Explaining the Dynamics of the Government Contracting Process, *Journal of Public Administration Research and Theory* 14(2), 171-190.
- Johnson Dias, J., Maynard-Moody, S., 2006. For-Profit Welfare: Contracts, Conflicts, and the Performance Paradox, *Journal of Public Administration Research and Theory* 17, 189-211.
- Koning, P., 2008. Not-for-profit Provision of Job Training and Mediation Services: An Empirical Analysis Using Contract Data, *De Economist* 156(3), 221-239.
- Koning, P., 2009. Contracting Welfare-to-work services: Use and Usefulness, CPB Discussion paper 135.
- Mundlak, Y., 1978. On the Pooling of Time Series and Cross Section Data. *Econometrica* 46(1), 69-85.
- Ladd, H., 1999. The Dallas School Accountability and Incentive Plan: An Investigation of its Impact on Student Outcomes. *Economics of Education Review* 18(1), 1-16.
- Prendergast, C., 1999. The Provision of Incentives in Firms. *Journal of Economic Literature* 37, 7-63.
- Skedinger, P., Widerstedt, P., 2007. Cream Skimming in Employment Programs for the Disabled? Evidence from Sweden. *International Journal of Manpower* 28(8), 694-714.
- Struyven, L., Streurs G., 2005. Design and redesign of a quasi-market for the reintegration of jobseekers: empirical evidence from Australia and the Netherlands. *Journal of European Social Policy* 15(3), 211-229.
- Tergeist, P., Grubb, D., 2006. Activation Strategies and the Performance of Employment Services in Germany, the Netherlands and the United Kingdom, *OECD Social Employment and Migration Working Papers* 42, OECD Publishing.
- Van Slyke, D., 2003. The Mythology of Privatization in Contracting for Social Services. *Public Administration Review* 63(3): 296-315.
- Weber, A., 2008. Individual Incentives in Program Participation: Splitting Up the Process in Assignment and Enrolment, IZA Discussion paper 3404.
- Winterhager, H., Heinze, A., Spermann, A., 2006. Deregulating job placement in Europe: A microeconomic evaluation of an innovative voucher scheme in Germany. *Labour Economics* 13, 505-517.

APPENDIX: TESTING PARKING BEHAVIOR

Parking behavior typically cannot be observed directly. Still, the data at hand allow us to derive an indirect test for parking, essentially by focusing on its effect on job search durations of clients. The idea is that providers concentrate their effort on clients with better job prospects, causing the prospects for this group to improve, whereas for the hard-to-place, they remain constant or even decrease. Stated differently, parking shortens the job search durations of easy-to-place clients, while keeping constant or even lengthening those of hard-to-place clients. Thus, if one was comparing two providers with equal job placement rates, we would expect the one with more parking to place clients into jobs more quickly (i.e., they have shorter durations in the program). Eventually, the other provider will catch up (in terms of its placement rate), as it more gradually finds jobs for the hard-to-place clients.

Thus, an obvious test statistic for parking would entail a comparison of the average job search duration for clients in NCLP and NCNP worker groups that have found a job. Under this parking hypothesis, we expect job search durations to be smaller for NCNP worker groups. To formalize and develop such a test, we first introduce some notation:

- τ = program length, which we assume is the same for all worker groups.
- t = time, with $0 \leq t \leq \tau$.
- $P(t)$ indicates the job placement rate of a worker group at time t . We only observe P at time $t = \tau$.
- $S(t) = 1 - P(t)$, which is the fraction of clients that have not found a job at time t (or: ‘the survival function’).
- $\theta(t)$ is the job finding hazard in a worker group at time t . Thus, $S(t) = \exp[-\int_0^t \theta(s)ds]$
- $E(t|t \leq \tau)$ is the expected job search duration of clients that have found a job before τ .

We start by writing down the definition of the expected truncated job search duration:

$$(A.1) \quad E(t|t \leq \tau) = \frac{\int_0^\tau S(t) dt - S(\tau) \tau}{1 - S(\tau)}$$

As the RHS of equation (A.1) is a function of $P(\tau)$, a simple comparison between the truncated average durations of NCLP and NCNP worker groups may give biased results. In particular, if one of the worker groups has a higher placement rate, this would result in a lower value of the survival rate $S(\tau)$, regardless of whether this difference is associated with parking behavior. We therefore define “no parking” as a situation where all hazard rates $\theta(t)$ during the program are affected proportionately by the higher placement rate, perhaps with a (small) percentage increase in α . It can easily be shown that the new survival function would then be $S(t)^{1-\alpha}$ for all t . Next, we perform a first order Taylor expansion on the log value of $E(t|t \leq \tau)$, with $\alpha = 0$ as a point of reference. The first order derivative with respect to α for $\alpha = 0$ is:

$$(A.2) \quad \frac{\partial \ln E(t|t \leq \tau)}{\partial \alpha} = -\alpha \frac{S(\tau)}{1-S(\tau)} = -\frac{\alpha}{1-S(\tau)}$$

and the derivative of (1) with respect to $P(\tau)$ for $\alpha = 0$ is:

$$(A.3) \quad \frac{\partial P(\tau)}{\partial \alpha} = - \frac{\partial S(\tau)}{\partial \alpha} = \alpha S(\tau)$$

Dividing (A.2) and (A.3) yields

$$(A.4) \quad \frac{\partial \ln E(t|t \leq \tau)}{\partial P(\tau)} = - \frac{1}{S(t) (1-S(\tau))}$$

Equation (A.4) shows that the (log) truncated expected value of job search durations decreases with respect to the job placement rate at time τ , assuming constant concavity of the survival function (i.e., without parking). Thus, when comparing the (log values of) the truncated durations $E(t|t \leq \tau)$ for worker groups in NCLP and NCNP contracts, we control for differences in job placement rates as well. In doing this, we first calculate the average derivative value of equation (4) for each gross worker type i in our sample, measured for the “clean” baseline year 2002 when NCNP was still absent.¹¹ Similarly, we derive the average job placement rate per gross worker type i , also for 2002 only. Next, the “no-parking” effect of job placement rate differentials is estimated as the product of the average derivative value of equation (A.4) and the difference between the job placement rate of group ijt and the average job placement rate per gross worker type in 2002. We subtract this value from $\ln E(t|t \leq \tau)$ and then estimate the

¹¹ If we would perform a Taylor approximation within cohort types instead, we would not have the within variation that is needed to estimate the impact of NCNP contracting.

“clean” impact of NCNP on this value for 2003-2005, while controlling for gross worker type fixed effects and year dummies.

TABLES AND FIGURES

**Table 1: Sample statistics by year and contract type: observations and population averages
(Standard deviations in parentheses)**

	Years				Contract types	
	2002	2003	2004	2005	NCLP	NCNP
1. # Gross worker types	16	13	10	11	17	7
2. # Worker program types	52	20	17	17	93	13
3. # Worker groups	3,733	1,292	1,690	1,795	7,441	1,069
4. # Assigned clients	105,623	66,861	47,910	23,436	193,361	50,469
5. Participants per (gross) worker type	28.3 (42.3)	51.8 (62.8)	28.4 (32.7)	13.1 (19.3)	26.0 (37.2)	47.2 (66.0)
6. Participants per (net) worker type	24.2 (36.0)	43.0 (51.5)	23.7 (27.5)	10.9 (15.9)	22.1 (31.7)	38.5 (53.2)
7. NCNP contracting	0.000 (0.017)	0.351 (0.477)	0.296 (0.457)	0.546 (0.498)		
8. Disability Insurance (DI)	0.610 (0.487)	0.413 (0.492)	0.545 (0.498)	0.370 (0.483)	0.592 (0.491)	0.246 (0.431)
9. Payment per client (euros)	—	3,690 (1,167)	3,601 (784)	3,272 (1,293)	3,953 (1,015)	2,898 (917)
10. Client-induced selection	0.118 (0.073)	0.147 (0.075)	0.150 (0.107)	0.156 (0.135)	0.128 (0.089)	0.165 (0.088)
11. Provider-induced selection	0.028 (0.034)	0.022 (0.029)	0.014 (0.024)	0.013 (0.035)	0.023 (0.032)	0.020 (0.030)
12. Trajectory duration, job finders	272.8 (89.4)	291.8 (78.9)	276.3 (87.6)	207.7 (97.1)	288.5 (90.1)	215.2 (59.0)
13. Trajectory duration, non-finders	467.5 (91.0)	564.8 (102.)	526.2 (109.0)	418.0 (131.6)	514.3 (111.5)	451.7 (105.2)
14. Job placement (total)	0.327 (0.121)	0.334 (0.124)	0.368 (0.135)	0.351 (0.194)	0.316 (0.129)	0.429 (0.116)
15. Job placement: contract of 6-12 months	0.257 (0.107)	0.257 (0.106)	0.263 (0.117)	0.257 (0.162)	0.240 (0.112)	0.329 (0.100)
16. Job placement: contract > 12 months	0.070 (0.059)	0.077 (0.047)	0.105 (0.073)	0.094 (0.085)	0.076 (0.065)	0.100 (0.054)

Table 2: Gross worker types in the sample

Gross worker type	# Years	Worker program types	Worker groups	Clients (gross)	Fraction NCNP
Disabled immigrants, bad job prospects	3	9	1,157	10,583	0.000 (.)
Disabled, good job prospects	3	8	954	40,737	0.243 (0.439)
Disabled: mental impairments	2	6	805	31,517	0.000 (.)
Disabled: mild mental impairments	4	9	1,097	30,709	0.000 (.)
Disabled: work related impairments	1	5	49	722	0.000 (.)
Disabled: kidney patients	4	4	35	510	0.000 (.)
Disabled: visual and hearing impairments	3	4	152	1,988	0.000 (.)
Disabled: young workers, no work history	3	14	757	7,325	0.023 (0.151)
Unemployed immigrants	2	2	190	6,616	0.000 (.)
Unemployed, good job prospects	4	9	826	51,177	0.629 (0.483)
Unemployed, older than 50 years	3	9	537	20,358	0.000 (.)
Unemployed, bad job prospects	3	9	705	18,409	0.000 (.)
Unemployed: highly educated	2	2	52	962	1.000 (.)
Workers in graphical industry	1	5	49	722	0.000 (.)
Workers eligible for subsidized employment	1	1	89	767	0.000 (.)
Returned clients (“second chance” programs)	2	5	427	7,649	0.097 (0.296)
Trajectories aiming at self-employment	2	2	92	1,081	0.000 (.)
Other	3	7	586	12,720	0.508 (0.500)

Table 3: Probit estimation results for NCNP worker groups (2003-2005)
(Marginal effects; standard errors in parentheses; *, ** and ***
indicate significance at 10%, 5% and 1%, respectively)

	Coefficient estimate	Standard deviation
Average job placement rate (per gross worker type in 2002)	1.372***	(0.659)
Risk proxy (per gross worker type in 2002)	-0.119**	(0.083)
Provider market share	-0.095	(0.111)
(Expected) Reward per client	-0.090***	(0.039)
Disability Insurance (dummy)	0.026	(0.060)
Year = 2004	-0.054	(0.071)
Year = 2005	0.066	(0.100)
Number of observations	3,959	
Pseudo-R-squared	0.484	
Log likelihood	-1,010.2	

Note: we also included region dummies in our model, but do not report the corresponding estimation coefficients, which were all insignificant.

**Table 4: Estimation results of provider and client-induced model
(Effects in %-points; standard errors in parentheses; *,** and ***
indicate significance at 10%, 5% and 1%)**

	Provider-induced selection			Client-induced selection		
	GLS	Two stage selection model	Fixed effects; Mundlak	GLS	Two stage selection model	Fixed effects; Mundlak
NCNP payment scheme	0.572** (0.240)	0.847*** (0.191)	0.702* (0.398)	2.417* (1.362)	5.908** (2.760)	2.209 (1.530)
Disability Insurance (dummy)	0.748*** (0.204)	1.231*** (0.168)	1.123*** (0.191)	0.761 (1.264)	4.102*** (1.525)	2.818*** (0.809)
(Expected) reward per client	-0.040 (0.067)	-0.109 (0.086)	-0.055 (0.076)	-0.376 (0.341)	-0.101 (0.753)	-0.282 (0.338)
Log gross worker group size	-0.069 (0.089)	-0.012 (0.085)	0.118 (0.089)	0.234 (0.442)	-0.199 (0.312)	0.144 (0.317)
Year = 2003	-0.745*** (0.225)		-0.958*** (0.263)	2.268* (1.269)		0.988 (0.830)
Year = 2004	-1.560*** (0.184)	-0.848*** (0.152)	-1.641*** (0.239)	2.684 (1.859)	0.134 (1.429)	1.292 (1.116)
Year = 2005	-1.720*** (0.257)	-1.287*** (0.196)	-2.237*** (0.284)	2.144 (1.524)	-1.029 (1.068)	1.598 (1.388)
Constant	2.126*** (0.745)	1.658 (1.143)	11.705*** (4.477)	15.626*** (4.420)	7.589 (10.761)	34.824 (23.214)
Mill's lambda		-0.207** (0.094)			-2.122 (1.712)	
Rho		-0.077** (0.036)			-0.229 (0.183)	
Number of observations	8,508		3,919		8,508	
R-squared	0.091		0.103	0.083		0.139
Log likelihood		7,617.3			2,750.1	

Note that the regressions also included (6) region dummies as controls in all specifications.

Table 5: Fixed effect estimation results of NCNP on provider and client-induced selection
(Effects in %-points; standard errors in parentheses;
***, ** and *** indicate significance at 10%, 5% and 1%)**

	Provider-induced selection		Client-induced selection	
	coefficient estimate	standard error	coefficient estimate	standard error
< 50 clients	1.177***	(0.413)	4.588*	(2.445)
≥ 50 clients	0.519	(0.417)	1.115	(1.151)
DI groups	1.515***	(0.313)	5.285***	(1.981)
UI groups	0.047	(0.266)	-0.353	(1.121)

Table 6: Program length differentials and test statistics for NCLP-NCNP parking difference, using job search durations of job finders
(Standard errors in parentheses; *, ** and * indicate significance at 10%, 5% and 1%, respectively)**

	Effect of NCNP on Log Program Length		Test statistic, corrected	
	coefficient estimate	Standard error	coefficient estimate	Standard error
Full sample	-0.154***	(0.049)	-0.113	(0.088)
< 50 clients	-0.158***	(0.045)	-0.249**	(0.113)
≥ 50 clients	-0.163***	(0.048)	-0.067	(0.081)
DI groups	-0.086***	(0.038)	-0.221*	(0.122)
UI groups	-0.209***	(0.051)	-0.031	(0.081)

Coefficient estimates follow from (pooled) FE estimation with gross worker types as fixed effects and controlling for year effects.

Table 7: Estimation results for job placement rate model
(Effects in %-points; standard errors in parentheses; *, ** and ***
indicate significance at 10%, 5% and 1%, respectively)

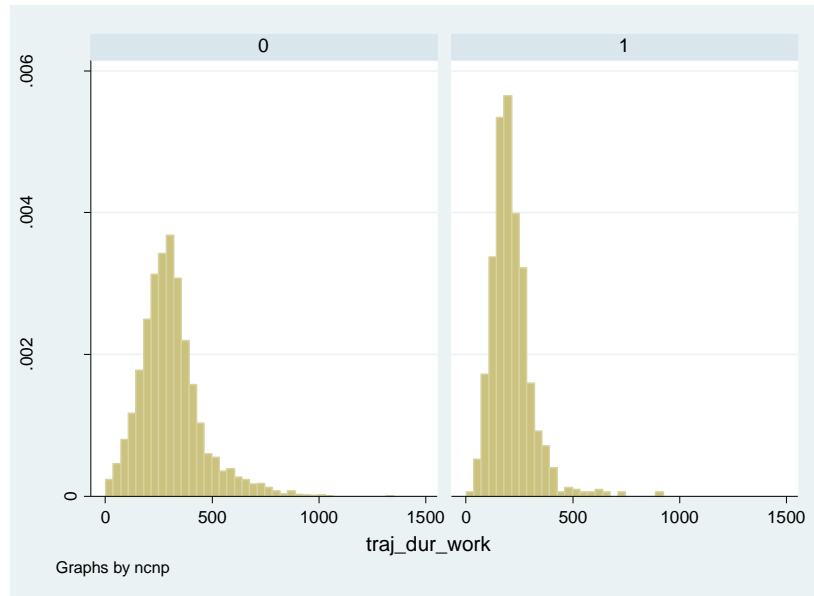
	GLS		Treatment selection model		Fixed effects (Mundlak)	
	coefficient estimate	standard error	coefficient estimate	standard error	coefficient estimate	standard error
NCNP payment scheme	11.115***	(1.999)	7.489*	(3.947)	2.555*	(1.436)
Provider-induced selection	-13.331	(8.835)	-10.995	(8.222)	-10.867*	(4.768)
Client-induced selection	2.331	(4.333)	-0.006	(5.310)	-2.623	(2.986)
Disability Insurance (dummy)	-4.578**	(1.795)	-4.949***	(1.769)	-8.005***	(2.761)
(Expected) reward per client	-0.839	(0.582)	0.298	(0.764)	0.399	(0.461)
Log gross worker group size	0.258	(0.532)	0.388	(0.769)	0.194	(0.348)
Year = 2003	-3.955	(2.402)			2.039*	(1.163)
Year = 2004	0.762	(2.104)	4.371***	(1.600)	6.041***	(1.103)
Year = 2005	-5.754*	(2.990)	2.117	(2.848)	5.292***	(2.019)
Expected job placement rate in 2002 per gross worker group.			80.205***	(20.01)		
Constant	47.333***	(6.681)	8.671	(13.847)	17.621	(35.602)
Mill's lambda			-3.542	(2.206)		
Rho			-0.315	(0.188)		
N	8,302		3,819		8,302	
R-squared	0.177				0.318	
Log likelihood			4,390.4			

Note that the regressions also included (6) region dummies as controls in all specifications.

Table 8: Estimation results of effects of NCNP on different job placement rate types and for subsamples (Effects in %-point; standard errors in parentheses; *, ** and * indicate significance at 10%, 5% and 1%)**

	Job contracts: 6-12 months		Job contracts: more than 12 months		Total effect on job placement	
	coefficient estimate	standard error	coefficient estimate	standard error	coefficient estimate	standard error
Worker groups with < 50 clients	1.723	(1.154)	-1.552	(1.113)	0.171	(1.594)
Worker groups with ≥ 50 clients	3.614***	(1.135)	-0.336	(0.664)	3.277**	(1.269)
DI groups	3.387***	(1.079)	-2.218*	(1.332)	1.117	(2.044)
UI groups	2.707***	(0.917)	0.544	(0.391)	3.250***	(1.012)
Total group	3.208**	(1.306)	-0.653	(0.753)	2.556*	(1.436)

**Figure 1: Distribution of average successful durations:
NCLP and NCNP worker groups (2002-2005)**



**Figure 2: Distribution of average unsuccessful durations:
NCLP and NCNP worker groups (2002-2005)**

