

Part II: What incentives does Job Network create?

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Introduction

Despite the hyperbole from all sides surrounding its introduction, the Job Network can be seen as a continuation of the broad direction that government involvement in the employment services market was following under the previous Labor government. For this reason evaluations of the labour market programs of the preceding Labor government provide information that is useful in assessing the prospects of the Job Network. Such evaluations are discussed in below.

There is insufficient information to make an empirical evaluation of the Job Network. For this reason I look at some of the incentives the Job Network creates drawing on data from evaluations of labour market programs. Of course, we will only be able to form an assessment of how these incentives influence outcomes when the Government releases information about performance of the Job Network.

Microeconomic evaluation of labour market programs

Micro economic evaluations¹² of labour market programs focus on three main measures. These comprise:

- The net proportional impact on employment. This measures the difference between the proportion of program participants who obtained employment and the proportion of a control group of non-program participants who obtained employment.
- The net cost per outcome. This is obtained as the ratio of the average cost per program participant to the net proportional impact on employment.
- The increase in post program earnings of participants.

The key measure here is the net proportional impact on employment. The quality of this measure depends on two main factors. The first is the extent to which the data set used for evaluation allows measurement of all the potentially observable relevant characteristics of people in the program and in the control group. The second is the extent to which the evaluation methodology controls for unobservable differences between program participants and those in the control group.

The importance of these factors is well illustrated by comparing the DEETYA (1997) evaluation with the Stromback (1998b) evaluation. The DEETYA evaluation was based on a data set in which program and non-program participants were matched according to gender, age and duration of unemployment. The Stromback evaluation was based on a data set

¹¹ I would like to thank Elizabeth Webster, Glensy Harding and Peter Dawkins for numerous helpful comments. However, the usual caveat applies, they are not responsible for the analysis, opinions or omissions of this paper.

¹² For a useful survey of microeconomic evaluations of Australian and international labour market programs see Webster (1998).

created through matching SEUP¹³ and DEETYA data on individuals. This data set allows Stromback to control for a much larger range of observable features than did DEETYA. As is shown in Table 2.2 the ability to control for a larger set of observable features matters for conclusions about the effectiveness of programs.

Table 2.2: Estimated net impact and cost per net impact of labour market programs

Program ¹⁴	Estimated net proportional impact on employment		Net cost per program participant (\$)	Estimated cost per net impact (\$)	
	1	2		3	4
	DEETYA estimates	Stromback <i>et al</i>		Column 3 /Column 1	Column 3/ Column 2
Skills training ¹⁵	7	0	970 to 1173	13,857 to 16,757	Infinite
Employment training ¹⁶	4 to 11	25	7,105 to 10,009	64,591 to 250,225	28,420 to 40,036
Employment support ¹⁷	12	1	625	5,208	62,500
Wage subsidy ¹⁸	28	20	1263	4,511	6,315

Sources: DEETYA (1997); Stromback, Dockery and Ying (1998).

The effect on policy conclusions is well illustrated in by comparing columns four and five which show the estimated net cost per outcome using the two methodologies. On the basis of the DEETYA evaluations wage subsidy and employment support appear to be the most cost effective. However, once the additional observable features of program participants are taken into account the employment support policies prove to be very costly at \$62,500 per placement. Both the DEETYA and Stromback studies suggest that wage subsidies are the most cost effective way of getting unemployed people back to work.

However microeconomic evaluations do not attempt to measure the complete economic impact of a program. In particular, they exclude the effects on non-participants who are displaced and disadvantaged by the process of pushing a participant ahead of them in the job queue. Nonetheless, microeconomic evaluations establish a useful ceiling for total benefits for unless we can establish a significant partial equilibrium effect, then a program is unlikely to have any effect on the whole economy.

Macroeconomic evaluations of labour market programs are more scarce and are significantly more complex and subjective to undertake. To date the only Australian macroeconomic evaluation which separately tests for

¹³ Survey of Employment and Unemployment Patterns.

¹⁴ Stromback uses the SEUP categories the footnotes below show how those categories match to the *Working Nation* program names.

¹⁵ Skills training includes Job Train and SkillShare.

¹⁶ Employment Training includes JobSkills and New Work Opportunities

¹⁷ Employment Support includes Job Clubs

¹⁸ Wage Subsidy includes JobStart

the effects of job placement programs does not find any significant effect (Webster 1998).

Analysis and evaluation of Job Network

Observed performance of the Job Network

At this stage, there is relatively little official information about performance of the Job Network program. However, the following three observations can be made.

First, it seems that fewer than expected eligible¹⁹ unemployed job seekers are registering with providers of job matching services. That is, eligible unemployed are relying on their own job search skills and on the job search tools provided by Centrelink rather than seeking third party job matching services. Moreover, job seekers that are ineligible for government assisted job matching seem to have a stronger demand for matching services than do eligible job seekers. In the following sub section we argue that this flows from a design fault in the Job Network program.

Second, there is less evidence of problems with the case management and job search training components of the Job Network program. However it may simply be that these programs offer less chance for the unemployed to vote with their feet and thus are less transparent. In the absence of useful and informative government statistics we simply don't know whether these components of the programs are achieving their objectives.

Third, many of the employment services providers have experienced financial difficulties and some have closed or are closing. As the Minister for Employment Services has observed, in any commercial venture some closures can be expected. But one cannot leave the matter there. It is of considerable public importance to know whether or not the closures have arisen because of commercial failure on the part of the providers concerned or because of design failures in the program. However, because of the secrecy and confidentiality provisions in the contracts, the public is precluded from hearing from the providers who have closed or might close.

Job Matching (Flex 1)

Earlier we observed that fewer than expected job seekers are using Job Network providers for job matching services. This outcome follows from the interaction of a feature of the job search market with a design fault in the Job Network.

The feature of search is simply that where the likely wage offers are close to the unemployment benefit (or government mandated minimum wage), the gains from job search are likely to be small. Similarly, where the firm is hiring from a largely homogenous pool of job seekers the gain to the firm from job search is likely to be small. Markets for low skilled and blue collar workers are likely to exhibit this characteristic of small benefits from search.

¹⁹ Eligible unemployed includes but is not limited to those receiving benefits.

This has two main implications. First, the small incentives for search on the part of unskilled job seekers is likely to comprise a significant part of the explanation as to why unemployment rates are disproportionately high for such workers. Second, the demand for job matching services is likely to be highly elastic in such markets. What this means is that small shifts in demand will have large effects on the demand for such services.

This aspect of the market for job matching services is particularly important when understanding why it is that some eligible unemployed are declining to use job service providers while the ineligible unemployed are clamoring for access to such services. The problem is that the eligible unemployed are benefit recipients. Job service providers have a legal obligation to enforce the job search activity test. Moreover, because they are paid on successful job matches they have an incentive to enforce the activity test more stringently than does Centrelink²⁰. Thus under the Job Network program the expected net benefit to an eligible unemployed job seeker from registering with a job service provider is the net expected benefit from getting a job less the expected cost from tighter application of the activity test. In short the move to the Job Network program most likely resulted in a reduction in demand (relative to the CES era) for job matching services by the eligible unemployed.

Moreover, because the ineligible unemployed don't receive benefits they are not influenced by the activity test and did not experience any change in their incentive to seek job matching services. However, in contrast to the CES era, unemployed who do not receive benefits are ineligible for government funded job matching services under the Job Network program.

Leaving aside this problem, Stromback's (1998) evaluation of job matching (employment support in Table 2.2) suggests that the money spent on job matching under the Job Network will yield few benefits to society and is largely wasted.

Intensive assistance (Flex 3)

Both the DEETYA and Stromback studies suggest that wage subsidies are a cost effective way of getting people back to work. This finding confirms our view that wages are the important factor affecting the employment decision. Under the case management component of the Job Network providers can use the funds provided by the government to provide a wage subsidy. An important question then, is whether the Job Network system provides incentives for providers to use the funds to pay a wage subsidy.

To answer this question it is necessary to combine information about payments to providers with information about the probabilities of success. A simple framework for doing this is set out below.

We start by calculating the revenue stream that a job provider could expect to obtain from attracting Flex 3 clients without giving any assistance to these clients. This is the sum of the up front payment plus the product of the probability that the person gets a job without assistance

²⁰ Actually, all that matters here is that they are perceived by job seekers to have an incentive to enforce the activity test more stringently than does Centrelink

with the sum of interim and final payments to the provider if the person gets a job. We have used the DEETYA (1997) estimate that 22 percent of JobStart clients would have got a job in the absence of assistance. The result of this calculation is presented in Table 2.3.

Table 2.3: Expected revenue to Flex 3 providers in the absence of any help to job seekers

Assistance level within Flex 3	Expected revenue to provider in absence of any assistance to job seeker (\$)
3.1	2094
3.2	3229
3.3	4320

The question of the effect on the providers expected revenue R of spending $\$z$ on assisting the job seeker can be obtained in two steps. First, we have assumed that the probability $p(z)$ that the job seeker finds a job is, over the relevant range, a linear function of expenditure z ,

$$p(z) = \begin{cases} a + bz & \text{for } 0 \leq z \leq (1-a)/b \\ 1 & z > (1-a)/b \end{cases}$$

Here a is the probability of Flex 3 job seekers getting a job without assistance and b is the effect that one dollar of wage subsidy has on the probability of Flex 3 job seekers getting a job.

Second we obtain the net expected revenue function, in which U denotes the up front payment, I the interim payment and F the final payment.

$$R = U + (a + bz)(I + F) - z$$

Thus the net revenue from doing nothing to assist the job seeker is $U + a(I + F)$. Let $D(z)$ represent the difference between the net revenue from doing nothing and the net revenue from spending z to help the job seeker. Then

$$D(z) = bz(I + F) - z$$

If $D(z)$ is negative for all z then in revenue terms the job service provider would be worse off after spending money to help the job seeker. Because of the simple structure here this depends solely on whether $b(I + F) - 1 < 0$. The crucial parameter here is b , which represents the change in the probability of getting a job per dollar of wage subsidy. To calculate a range for b we note that according to Byrne (1993) wage subsidies for adults under JobStart were between \$100 and \$200 per week depending on the job seeker characteristics. Moreover, DEETYA (1997) suggest (somewhat optimistically in the light of Stromback (1998)) that wage subsidies increased the probability of employment from about 0.22 to 0.50. Thus an upper estimate of b is the solution to

$$0.22 + b(100 * 26) = 0.5$$

$$b = 0.0001$$

A lower estimate for b is the solution to

$$0.22 \quad b'(200 * 26) = 0.5$$

$$b' = 0.00005$$

On our calculations, $b(I+F)-1$ is negative for all payment schedules in Flex 3 (see column 2 of Table 2.4). Thus $D(z)$ is negative for all values of z . We take this to mean that the Job Network incentive scheme does not provide incentives for providers to pay wage subsidies to Flex 3 job seekers.

Table 2.4: Estimated net incentive to provide wage subsidies to Flex 3 job seekers

Assistance level	Incentive to spend one dollar on wage subsidy $b(I+F)-1$	
	b=0.0001	b=0.00005
3.1	-0.73	-0.87
3.2	-0.56	-0.78
3.3	-0.38	-0.69

Of course, some providers will no doubt make use of wage subsidies even though they do not have an incentive to do so. This is because at least some of the providers are motivated by considerations other than profit. However, the rhetoric of the Job Network is that it harnesses the efficiencies of market processes. This rhetoric is not reflected in the design of the Job Network, since it provides no incentives for profit oriented providers to use wage subsidies which are the most cost effective method of getting unemployed job seekers back to work.

Conclusions

Several conclusions follow from the evaluation results and discussion presented above. First, it is unlikely that the cut in expenditure on labour market programs will have a noticeable effect on actual unemployment or equilibrium unemployment. One reason for this is that the evaluations clearly suggest that labour market programs were, in general, not cost effective in getting the unemployed into jobs. The exception here is wage subsidies that do seem to work on both DEETYA and Stromback (1998) evaluations. A second reason is that success at the micro level in creating jobs will not necessarily translate into success at the macro level: this is because success at the micro level can involve changing the mix of who is employed and unemployed without changing the aggregate number employed. Thus, the cutting in half of expenditure on labour market programs represents a major reduction in wastage of public funds and is therefore to be welcomed.

Some argue that society should accept this waste because of (unmeasured) equity effects. This seems a strange argument since by redesigning government involvement to avoid waste society could achieve its equity outcomes at lower cost.

Second, both the job matching (Flex 1) and intensive assistance (Flex 3) sub programs have major design faults that are likely to severely limit their effectiveness. Put simply, the Flex 1 program creates incentives that discourages participation by job seekers that are eligible for funding and encourages participation of those job seekers who are not eligible for funding. The Flex 3 program creates a strong disincentive for providers to

use wage subsidies that were found to be the most effective tool in the previous labour market programs.

Third, despite what at most are small direct gains, tendering out may well be worthwhile because of the indirect effects. As discussed by the Industries commission (IC 1996), the main source of efficiency gain from contracting out arises from improvement and reform to management and work practices. The most obvious failing of the previous labour market programs and of the CES was the inadequate procedures for evaluation. The tendering out process has the advantage of making the performance of the programs more transparent. This transparency also comes from the fact that there is more scope in the Jobs Network for job seekers and employment service providers to vote with their feet and thus provide evidence of areas where the program may not be working. This improved transparency, albeit small, is all the more valuable because Commonwealth and State departments and the governments they report to are obsessed with secrecy and confidentiality. This obsession limits the scope for public scrutiny and evaluation of programs.

Overall, the Job Network is severely flawed, but nonetheless represents an improvement over the previous labour market programs. However, the design flaws in the Job Network suggest that it will need to be reformed if waste of public funds is to be avoided. Such a reform that removed the design flaws of the Job Network would allow society to achieve its equity objectives at lower cost.

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