

Analyzing modes of contracting in the Dutch private reintegration market

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1. Introduction

Over the last decade, many of the Western welfare states have found themselves under pressure to reform due to both exogenous factors, such as globalization and the ageing of the population, and endogenous factors, such as a shift in focus from passive welfare to active welfare policies (Pierson, 1998; Gilbert, 2002; Taylor-Gooby, 2004). An important aspect of these reforms has been the introduction of more private elements or use of market mechanisms in former public sectors such as health care, home care and social security. Moreover, over the years, many countries have chosen to contract out certain parts of their public service delivery (Domberger and Jensen, 1997; Majone, 1997).

In the realm of the welfare state, one of the elements that has increasingly been subject to contracting out is the provision of activation services or employment reintegration services. The Dutch employment reintegration market is regarded as a prototype of this type of contracting out. Since the implementation of the Work and Income Implementation Structure (SUWI) Act in 2002, the task of delivering employment reintegration services, that was previously carried out by the Public Employment Services (PES), is delegated to the Employee Insurance Agency (UWV) and the municipalities, together with the obligation to purchase employment reintegration services for their clients on the market using tender procedures. Similar reforms introducing market mechanisms in the delivery of activation policies have taken place in several countries such as the UK, Denmark, Germany, and Australia.

The contracting out of activation services has been investigated extensively (Bruttel, 2004; Struyven, 2003; Struyven and Steurs, 2005; Van Berkel and Van der Aa 2005; Grubb, 2006; Bredgaard and Larsen, 2007; Bredgaard and Larsen, 2008). What we know from this research is that the expectation that the introduction of market mechanisms brings gains of efficiency has not been fully realized. On the contrary, costs might have gone up due to increased transaction costs related to selection of providers and management and enforcement of contracts. Moreover, the employment reintegration market is subject to negative selection processes like creaming and parking and the net impact of (private) reintegration services seems to be modest. Problems regarding the contracting out of activation services have been attributed to several factors, of which the failure of the quasi market structure is one of the most important. However, a clear and more complete understanding of all factors that have contributed to the failure of the market mechanism to live up to its expectations seems to be still lacking. Indeed until now, most research exploring the introduction of the market mechanism in the provision

of activation services, has examined possible effects and problems related to this new way of policy delivery on the macro level by examining the functioning of the (quasi) market in relation to factors such as the existence of sufficient competition and the availability of suitable providers. Moreover, the assumptions are that when these aspects are fulfilled and a suitable provider has been selected, that subsequently many of the problems that surround the use of the market mechanism are overcome. However, even when the market functions well and a good provider is contracted there remain plenty of obstacles that can complicate service delivery. We believe that a better understanding of the choices that are made in the process of contracting out and the challenges this brings can contribute to help assess the value of expected improvements in efficiency and flexibility. In our paper, we therefore choose to explore the introduction of market mechanisms in to public bureaucracies in relation to activation policies on a different level, as we focus on the process of contracting out.

As previously mentioned, in the literature there has been a strong focus on examining the institutional arrangements and the functioning of these. However, the process of contracting out, the managing of the contractual relations including the monitoring and enforcement of contracts brings with it its own set of important challenges that need to be dealt with. These issues that are present at a more meso level are not yet examined in great detail. The challenges related to the process of contracting out seem to be especially complicated to overcome if the service output or outcomes are difficult to define or measure, as is often the case in relation to activation services. Another complicating factor is when the principal contracting out does not have the necessary expertise or capacities needed for managing contractual relations. In the contracting out of activation services this might also be a point of concern.

The goal of this paper is to identify some theoretical starting points for examining the process of contracting out in the delivery of activation services. For this we put forward a theoretical framework for the analysis of the process of contracting out for employment reintegration/activation services using insights derived from the framework developed and proposed by Brown, Potosky and Van Slyke (2006). We combine this approach with insights from literature covering the phenomena of contracting out for social service delivery (Deakin and Walsh, 1996; Peat and Costley, 2001; Savas, 2002; Van Slyke 2003; Van Slyke, 2007; Heinrich & Choi, 2007). In addition we draw on the growing body of literature on contractualism within the context of the activating welfare state (Sol and Westerveld, 2005; Sol and Westerveld, 2007) and more specifically the changing modes of governance in employment and activation services (Bruttel, 2004; Struyven, 2003; Struyven and Steurs, 2005; Van Berkel and Van der Aa 2005; Van Berkel and de Graaf, 2007; Van der Veen, 2008). This is followed by some preliminary findings regarding the practice of contracting out in the Dutch municipal reintegration market.

The paper is structured as follows. In section two, we will focus on the literature regarding the contracting out for service delivery, while section three offers a more specific examination of the process of contracting out for service delivery. In section four, we describe the empirical findings regarding the design of the contracting out process in the Dutch municipal reintegration market. Finally, section five concludes.

2. Contracting out for service delivery

2.1. *The contract as a mechanism for governing service delivery*

In this paper, we focus on the market mechanism as this was introduced in the Dutch context through the implementation of the Dutch SUWI act in 2002.¹ This reform introduced a prominent role for private actors within the domain previously dominated by the PES. With this reform and the mandatory contracting out, a quasi-market (Bartlett and Le Grand, 1993; Struyven, and Steurs, 2005) for the delivery of employment re-integration services was created within the Dutch context.

Within the institutional arrangement of the market, governing the relation between principal and providers brings specific challenges. One of the challenges of the use of the market relates to conveying preferences about how and which policy aims should be achieved. This seems to be even more so when private actors need to take decisions involving balancing of different private and public interests and where trade-offs in relation to these may occur during service delivery. An important issue in this respect seems to be how to steer such decisions or influence the outcome of these types of choices in such a way, that policy aims and objectives are achieved in a desirable manner. An important tool for achieving this in the context of the market is the contract. Once one enters the domain of the market, the primary governance relation is contractual. The contract and steering strategies applied to enforce compliance play an important role in conveying policy aims, priorities, and preferences to the agent (contractor) to ensure that desirable results are achieved.

In this paper, we examine the contracting out of employment services in the municipal part of the Dutch reintegration market. In accordance with the SUWI ACT of 2002, the Dutch municipalities operate as buyers of employment reintegration services for social assistance recipients. From 2006 onwards, the contracting out for service delivery is no longer mandatory for Dutch municipalities. The experience of Dutch municipalities with contracting out and the freedom that municipalities currently have to make or buy reintegration services, makes the Dutch case a good example for analyzing the process of contracting out for social service delivery.

2.2. *Factors influencing process of contracting out*

Once the governmental or public agency responsible for a certain public service has decided to explore the option of contracting out, the public entity responsible must overcome several important challenges. Brown, Potosky and Van Slyke (2006) distinguish three important phases of the contracting out process. The *make or buy* phase, the *selection* phase, and the *steering and monitoring* phase. In these phases, important choices have to be made and challenges need to be overcome. We believe this framework offers a strong starting point and therefore build on this threefold classification. However, we separate the monitoring from the steering phase. Although monitoring and steering are closely linked, each phase requires different capacities and brings different choices. A strongly developed ability or a strong emphasis on monitoring does not necessarily need to imply that the ability to steer a contractor is equally well developed or that effective steering occurs. Therefore, it seems that for a better understanding of the different choices and the consequences this may have for the success of

¹ Wet Structuur Uitvoeringsorganisatie Werk en Inkomen, SUWI (29 -11-2001), Stb. 2001, 624.

the contracting out process on the whole, it is preferable to split the monitoring and steering phase. We thus opt for a four phase contracting out model, consisting of the following phases:

- First: assess whether to make or buy a service
- Second: draw up specifications and select an appropriately suited vendor
- Third: develop and implement a monitoring strategy
- Fourth: develop and execute a steering and enforcement strategy

Each of these phases brings with it its own challenges. In section three, we will describe the choices concerning the four phases of the contracting out process. In these choices, four factors play an important role: the service characteristics, the specification capacity, the institutional context, and the characteristics of the market.

2.2.1. Service characteristics

One of the most important notions identified in the literature on contracting out for public services relates to the difficulty of specifying and measuring service outcomes. Most of the literature we build upon in this paper is based on experiences and research into contracting out for easily quantifiable services. There is, however, a significant difference between the delivery of utilities or public services such as refuse collection and the delivery of less easily quantifiable or measurable services such as social services (Van Slyke 2007). The activation and employment reintegration services contracted for encompass quite a wide variety of services, many of which do not have easily specifiable requirements or have easily measurable outcomes. The more difficult it is to define or measure an outcome or result of service, the more difficult it is to contract out for this service (Deakin and Walsh, 1996; Van Slyke, 2003; Van Genugten, 2008). Moreover, contracting out for complex services can also bring difficulties with disentangling short-term and long-term results and outcomes (Deakin and Walsh, 1996). In the context of reintegration services, the measurement of final service outcomes is, for example, in some cases not possible until long after contracts have expired.

2.2.2. Specification capacity

A second factor of importance in the contracting out process concerns the governmental or public agencies capacity for core management activities related to planning, resource allocation, monitoring, evaluating and handling of contractual relations. The development of these capacities is vital for ensuring successful managing of any form of service delivery and can have a profound impact on various aspects of the different phases of the contracting out process (Brown and Potosky, 2006). Not only is the ability to specify goals and objectives of great importance for being able to effectively steer a contractor or agent in relation to achieving these goals or objectives (Peat and Costley, 2001), a good understanding of what kind of service is being bought is also useful in the later stages of the contracting out process. Additionally, retaining some form of residual capacity for service delivery is of great use when contracting partners or the market fails in delivery, and direct public service provision is, albeit temporarily, required (Warner and Hefetz, 2004).

2.2.3. *Institutional context*

With regard to the legal institutional settings there are several areas of legislation (contract law, social security legislation, administrative law) influencing the extend and modalities of the process of contracting out. The first is legislation relating to the subject matter of the service being delivered; in the case of reintegration services the SUWI act and the WWB² act. These acts contain several important provisions regarding the requirements that need to be met, among which the obligation for the Employee Insurance Agency (UWV) and, until 2006, the municipalities to contract out for reintegration services. Second, the legislation related to procurement, which strongly influences and to some extent constrains the process of contracting out. In the Dutch case, the national legislation BAO ACT³ and the European Public Procurement (EPP) legislation (2004/18/EC) dictate, “*public sector procurement must follow transparent open procedures ensuring fair conditions of competition for suppliers*”.⁴ The EPP legislation prescribes that tender procedures above a certain threshold value and for specific services must comply with the stringent tendering requirements based on the principles of non-discrimination, transparency, proportionality and mutual recognition. The requirements dictated by the legislative regime for public procurement, emphasize the importance of thoroughly drafting and formulating the tender documents as procurement requirements leave little room for negotiations after the selection of a contractor has taken place.

2.2.4. *Market characteristics*

A final factor influencing the choices in the different phases of the contracting out process is the characteristic of the service market. A principal characteristic of the market in the case of social service delivery is that it is a quasi-market. The quasi-market structure goes together with a specific set of issues and constraints (Le Grand, 2001; Lowery, 1998), one of which relates to the availability of information on service delivery and achieved results. Due to its particular structure, where the principal buys a service to be delivered by the agent to a third party, the quasi-market exacerbates the information asymmetry between principal and agent, and this information deficiency poses an important challenge that needs to be overcome.

3. The different phases of the contracting out process

3.1. *The first phase: buy or make*

In the first phase, one must assess whether to buy or make a service. Service characteristics, the associated asset specificity, the reoccurrence of the need for the service, and the transaction costs associated with the type of service (Williamson, 1981) influence this choice. Furthermore, specification capacity is of great importance too. The actor considering contracting out needs to have the information and the capacity to specify what the service requirements are. For if the governmental or public agency responsible for service delivery is not able to specify the service requirements or the relevant service goals, it will not be able to make a sound decision on whether to buy or make a service. The buy or make decision is further in-

² Wet Werk en Bijstand, WWB (9-10-2003), Stb. 2003, 375.

³ Besluit aanbestedingsregels voor overheidsopdrachten, (16-07-2005), Stb.2005 408.

⁴ Council Directive No. 18/2004 , (30.4.2004), OJ L134/114.

http://ec.europa.eu/internal_market/publicprocurement/legislation_en.htm (27-02-2008).

fluenced by the capacity of the buyer to produce the service in house and the nature of the market (Domberger and Jensen, 1997; Brown and Potosky, 2003). Moreover, the freedom of choice in relation to the make or buy decision allows for the maintaining of residual capacity for service delivery. In house knowledge about service delivery may further strengthen the capacity to steer and monitor contractors (Provan and Milward, 2000). Additionally the possibility to provide services directly may contribute to disciplining providers on the market, as it allows for a credible threat of exit on the side of the buyer when the market fails.

3.2. *The second phase: specification and selection*

The second phase of contracting out involves the specification and selection process. This process involves a trade-off between the costs of specification and selection and the benefits such investments can have in terms of selecting the best supplier. Choices regarding such trade-offs are, however, influenced by the institutional context. When contracting out services above a certain threshold value, EPP legislation prescribes the use of a tender procedure. For this reason, in the specification and selection process in the Dutch context, the call for tender or procurement document is central. The call for tender may serve multiple purposes. First, it is intended a means of specifying and communicating to potential bidders the preferences about the desired service provision. Second, it might help in overcoming one of the important challenges of the contracting out process: that of aligning values of the contracting parties. The call for tender document can help in selecting a value congruent contractor. Finally, in a later stage the call for tender document might serve as the basis for monitoring and steering efforts.

The drafting of a call for tender document requires skill, good planning, and preparation. In the specification phase, both the service characteristics and the specification capacity are very important. Depending on the complexity of the service characteristics, the specification of service requirements requires more or less specification capacity: the more complex the service characteristics, the more difficult and potentially more costly the use of contracts can be as a governance tool (Deakin and Walsh, 1996; Brown and Potosky, 2003). Clearly specified service goals also form the basis on which to build any monitoring strategy at a later stage. In fact, there may be a trade-off between ex ante (specification and selection) costs associated with setting up a selection and bidding procedure, and the ex post costs associated with monitoring. The more one invests in the specification and selection phase, the less monitoring may be required. If monitoring is expected to be difficult, for example due to underdeveloped monitoring capacities or when the service characteristics are expected to bring high monitoring costs, principals might therefore prefer to invest more in the ex ante specification and selection strategy.

A possible strategy in the specification and selection phase is to select the most value and goal congruent contracting partner, that is, the contractor who is believed to share the same values and goals pursued by the public entity that is contracting out. The advantage of a value congruent selection strategy is supposed to be that the selection of a value congruent bidder involves less danger of adverse selection or moral hazard, and consequently may require less monitoring. Moreover, it may allow for a more cooperative steering relation that is strongly driven by shared values and aimed at finding solutions for problems together. However, such a strategy does necessitate the inclusion in the selection criteria of some kind of means to expose and assess the vision and values of the potential contractors with regard to service delivery. It is the question whether this is possible within the institutional context and to what ex-

tent the vision and values of potential contractors differ in the market. Nevertheless, the literature contains indications supporting the notion that ex-ante specification and selection processes of potential bidders contributes to achieving good contracting performance (Peat and Costley, 2001; Fernandez, 2007).

3.3. *The third phase: monitoring*

The third phase is the monitoring phase, in which the governmental or public agency responsible for service delivery will be monitoring contract compliance and service quality. As with any form of service delivery, when contracting out for public services, monitoring and steering are supposed to contribute to the success of the contracting out process (Warner and Hefetz, 2004; Brown and Potosky, 2006). Monitoring is all about reducing the information asymmetry between principal and agent with the aim of enabling the principal to reduce the risk of agent opportunism (Martimort and Laffont, 2001).

Several factors can influence the effort exerted for monitoring and the monitoring strategy chosen. First, the complexity of the service characteristics influences the effectiveness of different monitoring strategies, since the measurability of a service is a fundamental factor in determining whether monitoring efforts will provide useful information for the evaluation of the service delivery. Easily measurable services demand far less monitoring, while heavy monitoring may be applied in cases where measurability is very problematic. However, even an intensive monitoring strategy may not yield adequate information about service outcomes or effects. Moreover, different monitoring strategies come with different administrative and procedural requirements and this entails that each monitoring strategy comes with its own trade-off in relation to monitoring costs and the nature of information that is gathered.

Further important factors influencing the monitoring strategy are the capabilities and resources that the governmental or public agency, contracting out for service delivery, can employ for monitoring. In theory, a deficit in monitoring can be overcome by acquiring additional monitoring capacities. However, the constraints of the real world may not allow for this. In relation to each of the aspects of monitoring the principal must determine whether the costs associated with monitoring efforts are not likely to outweigh the benefits. For this reason, governmental or public agencies tend to focus on monitoring services that are moderately difficult to measure, as this seems to be most cost effective (Deakin and Walsh, 1996; Brown and Potosky, 2003).

3.4. *The fourth phase: steering*

The fourth phase concerns the implementation and execution of a steering strategy. Important factors that influence the choice for a specific steering strategy are the service characteristics, the capacities for management and bureaucratic activities of the governmental or public agency, the institutional context of the contracting relationship and the political context in which the contracting out takes place. Two different steering strategies can be discerned (Greve, 2000). On the one hand, a more classic contractual at arms length relation with contractors, where the contract and the specified results play an important role in the steering of the contractor. On the other hand, a closer steering relationship relying on frequent interactions with contractors, coupled with informal monitoring efforts regarding the process of service delivery (Van Slyke, 2007). The former steering strategy is sometimes described as a “hard” notion of contracting, while the latter type of steering relation is more in line with the

notion of the “soft” contracting and relational or trust based contractual relationship. Where there is an emphasis on fostering cooperation and a constructive approach to achieving certain common goals. The hard notion of contracting is deemed appropriate for less complex services that are easy to measure. The soft type of steering strategy can be argued to be useful when service results are difficult to measure and information is difficult to acquire through monitoring.

With regard to the four phases of the contracting out process, overall, it is likely that there are all kinds of interaction effects between each of the phases, as each of the four phases has elements that may strongly influence decisions taken in another phase. For instance, the shortcomings in the specification and selection phase will strongly influence the monitoring phase and monitoring costs, which, in retrospect, may alter the make or buy decision of the first phase. Moreover, to be able to adequately steer contractors, relevant information has to be gathered in the monitoring phase, which subsequently needs to be made available and usable for steering the behavior of the contractors.

4. Empirical findings

4.1. *Method*

In section three, we have described the challenges a contractor is confronted with in the three different phases of the contracting out process. In this section, we examine how some of the issues identified in previous sections are dealt with in the Dutch municipal reintegration market. For this we make use of two recent evaluation reports commissioned by the Council for Work and Income⁵ (RWI, 2008A; RWI, 2008B), in combination with some data obtained through a set of exploratory interviews with field professionals. We interviewed six professionals, responsible for the contracting out of reintegration services, from four different municipalities: the capital Amsterdam, the provincial capital of Zwolle, the city of Schiedam a satellite of Rotterdam, and the city of Purmerend in the urban region of Amsterdam.⁶ The municipalities are selected on the basis of their availability to cooperate and the size of the city. In addition, we analyzed 5 call for tender documents.⁷

4.2. *Findings relating to the make or buy phase*

With regard to the make or buy decision, overall a strong tendency to contract out for the delivery of employment reintegration services has remained, notwithstanding the fact that the legal obligation to do so has been annulled. However, at the same time, the data collected in the studies of the RWI and our own interviews indicate a growing predisposition to the re-internalization of direct service provision (RWI, 2008B). This finding is in line with results in

⁵ The Council for Work and Income (Raad voor Werk en Inkomen - RWI) is a consultative body, which exists of representatives from employers, employees and municipalities. It was created in the beginning of 2002 with the implementation of the SUWI act. The mission of the Council is to contribute to the functioning of the labor market and the employment reintegration market.

⁶ We interviewed professionals from Amsterdam (pop. approx. 740.000), Zwolle (pop. approx. 115.000), Purmerend (pop. approx. 78.0000), and Schiedam (pop. approx. 75.000). The interviews were topical semi-structured interviews and consisted of 29 open ended questions covering three topics: the procurement process, the contract, and the steering or contract management. The interviews were recorded and transcribed. The cities or municipalities covered in our interviews differ from the municipalities that were involved in the two RWI studies.

⁷ Two from Amsterdam and one from each of the other cities.

the United States, where reverse contracting (re-internalization) now exceeds the level of new contracting out (Warner and Hefetz, 2007). The activities and services internalized by Dutch municipalities mainly relate to diagnosing of clients, case management and setting up of internal provisions for providing job-brokering support. The RWI report (RWI, 2008 B) and the data collected in our interviews show, that the main reason for opting for in house service provision is the disappointment with the results achieved by private contractors. The main reason for the choice to make use of contracting out seems to be connected with the need for buying expertise that is not or not sufficiently available internally.

As a response to the previous contracting experiences, many Dutch municipalities adopt a modular buying strategy. This entails that the municipalities no longer tend to buy complete tracks or packages, whereby the operational responsibility almost entirely lays with the contractor and which are aimed at achieving the outcome of reintegration of the client into the labor market. These long tracks are believed to have brought with them considerable difficulties regarding the measurement of results. This is due in the first place to the long time span, up to two years, before results would be visible. In the second place due to difficulties surrounding the specifying and measuring of outcomes these type of tracks aimed to achieve. Instead, municipalities now buy shorter tracks with more measurable results. This modular buying strategy has gone along with a stronger and more active role of the principal in case management.

With regard to the make or buy phase, both the RWI reports and our own collected data show two contrasting developments: a process of reverse contracting internalizing part of the reintegration services and intensifying monitoring, and a modular buying process contracting out specific reintegration services. The underlying reason for these processes seems to be that the municipalities do not have the capacity to monitor the reintegration services when the whole process is contracted out, nor do the municipalities have the capacity to provide all the reintegration services in house. The development of in house monitoring capabilities combined with a modular buying strategy therefore offers more flexibility and the possibility to increase both types of capabilities. It may come as no surprise, that for the municipalities the availability of these capabilities is one of the most important factors influencing the make or buy decision.

4.3. *Findings relating to the specification and selection phase*

With regard to the specification of the services, the RWI report (RWI, 2008A) finds that in general the participating municipalities attempt to use SMART⁸ indicators for measuring service characteristics, output and outcomes. The data from our interviews confirm this finding. Furthermore, all tender documents state that the price quality relation forms the determining criteria for adjudication, which is in line with expectations, as the EPP legislation dictates that either price must be a determining criteria or the price quality relation. The specification of the price quality relation as the most important selection criterion, confirms the insights gathered through the interviews and findings from the RWI reports that the price is not the most important determinant for selecting a specific contractor.

All call for tender documents we examined, also included the requirement for potential bidders to operationalize in their proposal how they aim to achieve certain results and how these results should be measured. A factor that is helpful in the ex ante selection of better-suited

⁸ SMART: *Specific Measurable Achievable Relevant Time-bound*.

contractors. Additionally, in one way or the other, the notion of vision on service delivery or “vision on the process of employment reintegration” was part of the selection criteria stated in all call for tender documents. Even though in itself this may seem at odds with the EPP legislation, the use of such criteria can be helpful in the ex ante selection of contractors as it leaves room to select the most value congruent contractor.

With regard to the selection of contractors, the municipalities say that the procurement requirements are a bothersome factor as these consume too much administrative resources and entail constraints with regard to re-contracting contractors that have provided good service delivery in the past (RWI, 2008A). In the interviews, the same sentiments have come up. Municipalities find that satisfying legal procurement requirements can be a considerable constraint, bringing substantial costs and limiting selection possibilities and flexibility, especially when newcomers or smaller local contractors want to participate in the tendering procedures. The smaller local contractors often do not have the experience, resources and capacities in drafting tender proposals. Consequently, they may lose out to bigger contractors even though these contractors may not be better suited for service delivery or offer better quality. In fact, the municipalities in our interviews and the RWI report (RWI, 2008A) claim that the availability of knowledge of the local labor market on the part of contractors is an important factor for success.

4.4. Findings relating to the monitoring phase

With regard to the monitoring of contractors, the RWI reports find that the municipalities perceive difficulties in monitoring results and effects of reintegration services due to lack of information regarding the performance of the contractor. The difficulties in monitoring are, on the one hand, related to the service characteristics: the difficulties associated with service measurability and the lack of a well-developed set of common performance indicators. However, on the other hand, the limited monitoring capacities of municipalities play a role too.

Different monitoring methods are used some more direct such as analyzing acquired vendor performance data, others more indirect such as monitoring for citizen complaints. The latter was often accompanied by the use of client satisfaction surveys implemented either in the case management processes or periodically every few years. Moreover, all municipalities used the above-mentioned monitoring method of analysis of vendor performance data (input and output) as a monitoring tool. However, some stated that managing and checking the data retrieved through this type of monitoring entailed a significant burden. Only the biggest of the municipalities participating in our interviews, made use of field audits of vendor activities, whereby inspectors sampled the service delivery in the field to acquire information on service delivery.

4.5. Findings relating to the steering phase

With regard to the types of steering relations employed, the RWI report (RWI, 2008B) observes a tendency among municipalities to reduce performance related contract elements. Instead, municipalities increasingly make use of closer steering relations. The data from our interviews confirm the tendency to make use of closer steering relationships. Municipalities feel that steering based on tendering documents and contracts only, is too limited and inflexible. A close steering relation encompassing frequent contact and consultation between contracting parties is considered vital for keeping sufficient control over the service delivery

(RWI, 2008B). Moreover, the preference for closer steering relations is accompanied by an inclination to use more informal tools instead of formal sanctioning tools to achieve contract compliance. All the municipalities we interviewed, except the biggest, indicated that they did not want to damage the trust and close relationship with their contractors by being too rigid and formal in relation to contractual specifications. Because much time, effort, and resources have been invested in the selecting of contractors, only as a last resort option formal penalties or contract termination will be used to achieve contract compliance. Instead, informal tools are applied to maintain a strong and active role in the day-to-day operation of case management. According to the municipalities, the advantage of this approach is that it allows for earlier detection of problems when service delivery is unsatisfactory or unexpected complications arise. Consequently, interventions can take place during service delivery, offering the opportunity to solve problems before it is too late.

5. Conclusion

In this paper, we approached the topic of the introduction of market mechanisms into public bureaucracies in relation to activation policies by focusing on the process of contracting out. We have identified some factors and challenges contractors are faced with when attempting to contract out for (employment) reintegration services. We chose this approach because we believe that a better understanding of choices that are made in the process of contracting out and the challenges this brings can contribute to assessing the value of expected improvements in efficiency and flexibility, which the use of market mechanisms and especially contracting out may bring. This as presumed efficiency gains of using market mechanisms or contracting out may be eaten into or even lost in the different phases of the contracting out process. Efficiency may for example be lost when the transaction costs for selection are high, or when the procurement regulation requirements or difficulties in relation to the measurability of services prevent the selection of the most suitable provider. Moreover, even when the most suitable provider is selected then the transaction costs related to monitoring and steering needed to achieve desirable results may further eat in to presumed efficiency gains.

In order to gain insights into the process of contracting out for reintegration services and a better understanding of the choices and challenges this brings, we have analyzed the contracting out process of reintegration services using existing theory, literature and documentary evidence combined with a limited explorative analysis of data collected in practice. According to the theory, the following factors are of importance when contracting out for delivery of activation/reintegration services. First, throughout the different contracting out phases, it is imperative that the governmental or public agency responsible for service delivery has the capacity to specify the service goals. Second, having the freedom to choose whether to make or buy certain services means municipalities can be flexible in the choice of delivery means. This freedom also contributes to a maintaining of responsiveness of the market to the wishes of the buying party. The threat of exit on the side of the buyer when the market does not deliver well can increase the functioning of the market. In the Netherlands, the municipalities have the freedom to choose whether to make or buy reintegration services since 2006. However, in order to be able to make a sound decision between make or buy in house knowledge about service delivery is also required. Third, for achieving good contracting performance, it is recommended that the design of the specification and selection phase enables the selection of a value congruent contractor. Finally, the monitoring strategy needs to be suited to specific

service characteristics, and must be feasible in light of the capabilities and resources that the governmental or public agency has available.

Our empirical findings show that the possibility to choose between make or buy has induced two seemingly contrasting processes. On the one hand, a process of reverse contracting internalizing part of the reintegration services and intensifying monitoring. On the other hand, a modular buying process aimed at contracting out for shorter tracks intended to achieve more specific and easily measurable goals. This modular buying strategy by definition seems more flexible than the previous longer-term arrangements, as it allows for the selection of specific measures from a palette of possibilities, in order to find solutions that appropriately fit the needs of the clients. The municipalities make use of SMART indicators when specifying service goals for these shorter tracks. With regard to the specification and selection phase, the municipalities state that EPP legislation forms a constraint limiting their flexibility in the selection of the most suitable or value congruent contractor, especially when it comes to selecting smaller local contractors. Finally, regarding the monitoring and steering strategy, the municipalities perceive difficulties in monitoring due to lack of information regarding the performance of the contractors. To increase their monitoring capacity, they make use of closer steering relations, coupled with more informal compliance strategies. This may in itself allude to the existence of some flexibility as municipalities and contractors feel less bound by their contracts and look for a more cooperative way of interacting to achieve results. Furthermore, the closer steering relationships adopted offer earlier opportunities for intervention when things go wrong, which may also contribute to efficiency as problems can be spotted earlier and possibly resolved with less damage having occurred.

To conclude, the findings from theory and practice show that the process of contracting out comes with several challenges that can influence the dimensions of flexibility and efficiency in different ways. Given the complexity of reintegration services, the contracting out of this type services is not an easy task. For this reason, it is not a matter of course that the buy or make phase will always result in the choice for contracting out. In fact, since the Dutch municipalities have the option to make or buy, many municipalities have chosen not to buy (RWI, 2008 B). Indeed direct provision may in certain cases be more efficient especially when the market cannot deliver certain services in a satisfactory manner, although in some cases this may be the consequence of the underdeveloped capacities for managing the contracting out process at the side of the municipalities. As long as municipalities do not have well developed capacities for monitoring it will be difficult to really assess efficiency gains. The modular buying strategy adopted by the Dutch municipalities does, however, show that actors in the field can think of innovative ways to reduce the complexity of service characteristics and increase flexibility and efficiency. The institutional context is a further important factor that can support or undermine efforts of contracting out and successful strategies for improving different dimensions of delivering services. To this respect, contracting out parties need to operate strategically within the boundaries set by National or European legislation, such as the costly and restrictive European tender procedures. The municipalities can, however, make use of the freedom they have since 2006 when the mandatory contracting out for service delivery ended. The characteristics and development of the market offer a further challenge. Municipalities can, however, influence the working of the market by buying reintegration services together with other municipalities and by using the threat of providing the services in house.

All in all, it remains difficult to draw decisive conclusions about whether the introduction of market mechanisms into originally public bureaucracies has really improved the efficiency

and flexibility of the services delivered. The findings from practice show that the process of contracting out in the Dutch context is evolving as many municipalities find ways to overcome the challenges that contracting out brings. Nonetheless in this field significant room for further exploration remains and better understanding of the process of contracting out can certainly contribute in this area of research.

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