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What is This?
Contracting-out employment services: temporary agency work in Germany

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Summary Since 2003, the German Public Employment Service has been experimenting with the contracting-out of various services. One of the new labour market programmes is Personnel Service Agencies (PSAs), which provide client firms with jobseekers on a temporary assignment basis and are responsible for integrating jobseekers into non-subsidized employment. By contracting-out employment services, the Public Employment Service seeks to exploit efficiency gains characteristic of enterprises that compete in quasi-markets. In order to integrate jobseekers as rapidly as possible, a result-oriented system of incentives has been developed. This article describes the institutional setting and examines its appropriateness for efficient job placement services.

Key words contracting-out, personnel service agency, quasi-markets, temporary agency work

Introduction

In the wake of the general trend towards privatization and deregulation in the last few years, employment services have been contracted-out in various OECD countries. The primary objective is to use market forces to improve the effectiveness and efficiency of the employment services. In this way, disadvantaged jobseekers should be reintegrated into the labour market more quickly. In 1998, Australia replaced its Public Employment Service (PES) with a private ‘Job Network’ of approximately 200 firms. Performance is remunerated with state premiums based on placements (Lundsgaard, 2002; OECD, 2001; Struyven and Steurs, 2005). In 2000, the Netherlands followed Australia’s example (De Koning, 2004; Struyven and Steurs, 2005). In the same year, the British government also began to commission private service providers with the integration of hard-to-place jobseekers (Hales et al., 2003; Hasluck et al., 2003). In order to involve private actors in employment services, Denmark abandoned any constraints regarding the type of activities used to reintegrate the unemployed into the labour market (Bredgaard et al., 2005). The ongoing criticism of the efficiency of the PES is one reason why Germany has recently started to experiment with the contracting out of employment services. The contracting-out approach contrasts sharply with the way employment services have been handled in Germany. Under traditional procurement, the PES specifies the inputs and retains control rights over how the service is delivered. With the new approach, the PES specifies the service standard, but it is the firm which decides on how to deliver the service. While Australia and the Netherlands – which serve as prototypes for the application of the principle of market competition in employment services (OECD, 2005; Struyven and Steurs, 2005) – have to a large extent privatized the PES, Germany merely seeks additional channels to integrate jobseekers into the labour market.

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market. In Germany, as from 1994, temporary agency work is being used for the first time as an instrument of active labour market policy. The pilot project came to an end in 1996. Microeconometric evaluation confirms the success of the programme. Participants showed an integration rate of 27 percent; that was 13 percent higher than that of the control group (Almus et al., 1999; Jahn, 2002).

The idea of using the stepping-stone function of temporary agency work to integrate the unemployed in the labour market was taken up once again in 2003 by the federal government. All 180 local employment offices are required to set up at least one personnel service agency (PSA). The task of the PSA is to integrate jobseekers as quickly as possible into the labour market by assigning them temporarily to client firms. While being on assignment, temporary agency workers should increase their human capital and develop labour market contacts that lead to stable employment. Apart from the temporary assignment, training, individual counselling, close contact between the PSA and the client firms and their knowledge of regional labour markets are factors which ought to improve the reintegration chances of the programme participants. PSA contracts were to be given with priority to commercial enterprises. In this sense the PES has contracted-out the former public sector function to market competition. The political responsibility, however, continues to be borne by the PES, which defines the institutional design. In order to introduce ex-ante competition (Domberger and Jensen, 1997), the PSAs are chosen in a public tendering process. Thus conditions were created which are typical for quasi-markets (Bartlett and Le Grand, 1993).

By contracting-out labour market services, the PES seeks to take advantage of the efficiency gains arising in a competitive environment. But it is by no means certain that the providers will pursue the social objectives laid down by the PES. To avoid conflicts and opportunistic behaviour, a system of result-oriented incentives has been put in place. This system of regulation and incentives is very likely unique in the world.1

The aim of the article is to describe the institutional framework within which the PSA operates and to analyse whether this setting is suited to integrate the unemployed as quickly as possible into regular employment. Because the PSAs are just being put in place it is not feasible to make a final assessment of their achievements. Therefore our attention here is focused on a preliminary empirical assessment of the extent to which the conditions of quasi-markets appear to be fulfilled. The second section defines the criteria for evaluating the efficiency with which services are provided and describes the quasi-market in which the PSA operates. In the third section, the tendering procedure is described and evaluated. The fourth section examines the referral system for the selection of the unemployed. The fifth and sixth sections analyse whether the financial incentives are suitable to integrate them quickly into the labour market. The seventh section concludes.

The quasi-market for the PSA services

As Domberger and Jensen (1997: 68) point out, a distinctive feature of contracting-out is the element of ex-ante competition. This means a competition for the market through competitive tendering as opposed to competition in it. Therefore the tendering procedure for PSA is primarily restricted to outside providers and is a precondition for market access. By this means, conditions are created which are typical for quasi-markets. Le Grand (2001: 3) defines a quasi-market as a ‘market where independent agents compete with one another for custom from purchasers, but where, unlike in a normal market, purchasing power comes not directly from consumers but from the state’. Quasi-markets differ from conventional markets in a number of ways (Le Grand and Bartlett, 1993: 10):

1 They are ‘quasi’ because service providers do not necessarily aim at maximizing profits, nor are they necessarily privately owned.

2 The purchasing power of the final consumers is not expressed in monetary terms; instead it is centralized in a single purchasing agency which chooses the service provider.

3 The final consumers are represented in the market by the purchasing agency instead of acting on their own account.

The quasi-market in which the PSA operate (Figure 1) shows the following characteristics: based on a public tendering procedure the employment offices

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choose the potential PSA. Privately owned enterprises – among them temporary work agencies, educational institutions and professional placement agencies – engage in an ex-ante competition for the award of a concession. Contrary to the assertion of Le Grand and Bartlett (1993), the PSAs are primarily interested in maximizing their returns.

The demand for the services of a PSA comes from the employment office, which refers suitable registered jobseekers. The unemployed cannot choose between different providers so they have no ‘purchasing power’ in this respect. Every two years, the employment office decides on the number of vacancies per contract and the number of block contracts to be advertised. The contract parties specify the target group of the block contract, the training to be undertaken during periods without assignment and the expected integration rate, which is defined as the number of integrated PSA jobseekers over all exits of PSA jobseekers. The providers receive declining subsidies from the employment office, which are related to the period of employment within the PSAs. In contrast to professional placement services, which concentrate on the placement of the unemployed and receive in return placement premiums, the PSAs obtain additional revenues through a base subsidy and their assignment activity. In this activity they compete with commercial temporary work agencies. The PSAs are thus confronted with an ex-ante competition in the tendering procedure and by ongoing competition for potential client firms.

According to the theoretical framework of Bartlett and Le Grand (1993: 19ff.) quasi-markets can only function efficiently if the following five requirements are met.

1. **Market structure** The market structure has to be competitive. There should be many providers and many purchasers, each of them unable to influence the aggregate output or the price, respectively. Both market entry and exit have to be relatively costless and otherwise unimpeded. Non-competitive providers should be driven out of the market by bankruptcy. Finally, prices should react to changes in demand and supply and act as signals for the efficient allocation of resources. These conditions are only partially fulfilled in the quasi-market in which the PSAs operate. As the PES has decentralized the tendering procedure, the local employment office has regional monopoly power and decides on the access to the market for a limited period. The tendering procedure involves three stages in which the employment offices select the most suitable bidders (see ‘The tendering procedure’ below). As we shall see in the fifth section (‘Financial incentives’), the prices are not formed by the interplay of demand and supply, but rather are negotiated prices.

2. **Creaming** A second requirement of the theory of quasi-markets is that creaming among the jobseekers should be avoided. Bartlett and Le Grand (1993: 32) define creaming as discrimination against more expensive users. Creaming is seen when the employment office refers to the PSA easy-to-place jobseekers, or when the PSAs hire such people preferentially. In distinction to a conventional market, in the quasi-market, the local employment office as purchasing agency and the PSAs as service providers decide which jobseekers participate in the programme (see ‘Recruiting the unemployed without creaming?’ below).

3. **Motivation** The third condition focuses on the motivation of the purchasing agency and the service provider. The purchasing agency must respond to the wants and needs of the unemployed and increase the choices open for their clients. The service providers should pursue economic objectives. The PSAs employ the referred

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**Figure 1** The quasi-market for PSA services

Source: own design.
jobseekers and assume all the obligations of an employer: remuneration, continued payments in the event of illness and vacation payments. They also have to bear these fixed costs during periods without assignment. Hence, if they are to cover these fixed costs, they must assign their employees to client firms. A risk-averse PSA will be reluctant to conclude a contract with the PES unless the latter is prepared to assume a sufficient part of the risk (see ‘Financial incentives’ below).

(4) Information The purchasing agency as well as the service provider should have access to accurate information at low cost. Information asymmetries together with interest conflicts between the parties give incentives to engage in opportunistic behaviour. Among the various types of information asymmetries that are found in the principal-agent theory, the literature on contracting-out emphasizes two problems arising from information asymmetries subsequent to the conclusion of a contract (e.g. Sappington, 1991): first, the agent’s activities may not be observed by the principal (hidden action) or second, the agent may have information unavailable to the principal (hidden information) (Arrow, 1985). Monitoring the agent and obtaining information both involve high costs. This is one reason why information asymmetries can arise. The second source for information asymmetries is that the characteristics of the service are both difficult to specify in advance and difficult to identify. The same problem arises with respect to the abilities and the motivation of the referred jobseekers, because it is scarcely possible to lay down their characteristics contractually. But this information is necessary for the providers to price their service appropriately.

Another source of asymmetry is related to the fact that the principal is unable to determine whether the integration obtained is due to the efforts of the PSA or whether it is simply the result of chance, perhaps abetted by a prior creaming process. Therefore, information asymmetries may encourage opportunistic behaviour. It occurs where providers put fewer resources into the provision of the service than is consistent with the contract terms; for example, by not offering any training or assisted placement activities to their jobseekers in periods without assignment.

Opportunistic behaviour can be avoided first of all if the purchaser puts in place a perfect monitoring system, which, however, entails considerable transaction costs; secondly, if the financial incentives of the quasi-market are compatible with the integration goals. In order to reduce monitoring costs, the PES has developed a system of regulation and financial incentives which is based on the integration rate and the integration speed. PSAs that do not achieve adequate placement results not only receive lower payments but also run the risk of not having their fixed-term contracts renewed (see ‘Placement incentives’ below).

(5) Transaction costs Relational contracts involving complex services are a typical feature of quasi-markets. In such contracts it is often very costly, or even impossible, to specify all possible adaptations to unforeseen circumstances. Therefore the contracts are incomplete. At the same time, the extent of the demand for services is uncertain ex ante. This is particularly the case when a new instrument of active labour market policy is under development. For these reasons, contract negotiations give rise to high transaction costs. On the one hand, there are the costs of tendering and of drawing up, negotiating and securing contracts (ex ante transaction costs). On the other hand, there are the costs of monitoring the outcomes of contracts (ex post transaction costs) (Williamson, 1985). Establishing a quasi-market is only successful if the improvements in efficiency are higher than the increase in transaction costs (Bartlett and Le Grand, 1993: 26ff.). To reduce the ex ante transaction costs, the tendering procedure involves three stages and contracts are tendered as block contracts (see next section).

The tendering procedure

The stepwise tendering procedure should ensure that only those firms operate as a PSA whose qualifications meet the standards set by the PES. The pre-selection of agencies begins with a public invitation to tender. Interested parties must prove their reliability and capability, and must show evidence of their experience as a commercial or non-profit
temporary work agency or some other former involvement in active labour market policies. Success in carrying out such an activity in the last 12 months is sufficient proof. From the list of applicants the employment office selects suitable candidates, who are then given the opportunity to submit a bid.

In the second stage, the bidder must specify an offer price on which the amount of base subsidies and placement premiums will depend (‘Financial incentives’ below). Furthermore, the tender must provide information on how the PSA will be run. The concept must include details concerning the personnel and structure of the planned PSA, the collective agreement to be used, the strategy for acquiring commissions from client firms, the expected extent of assignment periods, training activities and the achievable integration rate. The bids are ranked according to the price and quality. Between April 2003 and April 2004, the tender price was given a weight of 60 percent, while the quality of the offer based on the PSA concept was given 40 percent. The bankruptcy of the largest PSA firm in February 2004 has made it advisable to place more weight on the quality of the bids. Now, the tender price is given a weight of 40 percent and the quality of the offer 60 percent. Based on subjective assessments of the employment office the quality is evaluated on a scale between one and ten. Thus the bidders do not know in detail what standards are used to evaluate the individual parts of their concept.

In a third stage, the employment office enters into negotiations with up to five bidders who have submitted the most economical offers. Finally, a fixed-term contract, which is limited to 24 months, is signed with one of the bidding companies; one extension is possible.

This tendering procedure has advantages and disadvantages. First, the decentralized tendering procedure allows the employment office to determine the number of contracts and vacancies according to conditions in the regional labour market. This makes the task of keeping in touch with the needs of the unemployed easier. However, the relationship between both sides will be too intimate, so it will be difficult to maintain the distance which a market process requires. This is even more the case since many employment offices have been cooperating for quite some time with the tendering firms. Secondly, a restricted invitation to tender increases the success chances of the bidders so that they take greater care in preparing their bids, which in turn increases the quality. Furthermore, restricted tendering involves cost savings. However, by setting up a qualifying competition in advance, the number of bids and thus the variety of bids is restricted. The renewal option means that newcomers have only a reduced chance of participating.

Apart from the choice of suitable enterprises, a further task of the tendering procedure is to determine the ‘efficient’ level of subsidies under competitive conditions. The subsidies have to respond to four requirements: first, they must ensure that the PSA do not suffer losses so that they have an incentive to take part in the tendering procedure; second, the subsidies have got to be sufficient to cover training activities; third, the subsidy must allow a reduction of the assignment fees in order to increase demand for difficult-to-place jobseekers; finally, the subsidies must satisfy the ‘principle of cost-effectiveness’ of the public sector. Crowding out effects and deadweight losses should be avoided. Quantifying the subsidies that just fulfil these conditions represents a scarcely solvable problem for the employment offices. In contrast to the PSA, employment offices have only partial knowledge of the market; hence they have difficulty in estimating the profitability of the PSA.

Recruiting the unemployed without creaming?

The success of the contracting-out is multidimensional. Dimensions are the choice of the most productive PSA, the number of PSA jobs created, the integration rate and, finally, the avoidance of creaming. Up to the end of March 2004, the PES instructed the employment offices to create at least one PSA vacancy for 100 unemployed jobseekers. The number of vacancies per contract and the target groups could be decided by the employment office itself taking into account the regional labour market tightness. Since April 2004, the employment offices have been able to fix the number of PSA contracts and vacancies at their discretion, subject to their budget constraints. By February 2005, 1,235 PSA contracts had been concluded; of these 821 contracts were still in force. A contract covers on average 43 vacancies. Nearly half (44 percent) of
the contracts provide between 40 and 59 vacancies, typically tendered for low-skilled unemployed that are considered as easy-to-place; 36 percent provide between 20 and 39 vacancies. Contracts with less than 20 vacancies (3 percent) are typically concluded for hard-to-place jobseekers (\textit{Bundesagentur für Arbeit}). The PSA offers the jobseekers a fixed-term contract for nine months and assumes all the obligations of an employer. The employer can dismiss the jobseeker at any time during the probation period of six months, and thereafter with good reason.

Up to April 2004, the PSAs had to fill their vacancies within three months. As Figure 2 shows, only a few PSAs were able to meet this requirement. In October 2003, just 60 percent of the vacancies had been filled. The reason for this is that the PSAs initially seek to acquire requests for workers from client firms before they accept referrals of unemployed. In reaction to this, the PES has changed the terms. Since April 2004, the PSAs have been contractually obliged to fill 25 percent of the vacancies during the first month, and this target applies to the following months as well. After four months, the contractually agreed number of vacancies must be filled, or at a minimum 90 percent of them (Jahn, 2004: 5). Despite this requirement, the share of filled vacancies comes to about 75 percent; it has not as yet proved to be possible to enforce full compliance with the conditions of the contracts in this respect. The reason is that the PES has scarcely any sanctions which it can impose for non-compliance. Although it can terminate a contract with a notice period of three months, the local employment offices have been reluctant to apply this drastic measure. Reasons are that a new tender is costly and that there is an element of legal uncertainty if a fixed-term contract is terminated prematurely.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{Figure2.png}
\caption{Stock, inflow and share of filled vacancies}
\textit{Source}: Bundesagentur für Arbeit (2005); own calculations.
\end{figure}
Figure 2 shows that up to February 2004, the stock of PSA jobseekers climbed steadily, reaching a peak of 33,000. In that month the largest provider became insolvent and as a result there was a marked dip in the number of PSA jobseekers. By the following month they were down to 27,000. As a reaction to the modest integration rates (see ‘Placement incentives’ below), many contracts were not renewed, so that in February 2005 only 25,700 jobseekers were still employed by PSAs.

If providers and employment offices concentrate on those jobseekers who are easiest to place or to assign to a client firm, then creaming is taking place. This occurs if the target groups are defined ambiguously. The preferred target group is jobseekers who have only low-level impediments to placement and thus are potentially employable and suitable for temporary assignment. Furthermore, they have to be eligible to receive unemployment benefits. In the tendering procedure, the employment office specifies the target groups with respect to occupational and personal characteristics; such a specification might be in terms of young unemployed, under-25, with vocational training in a technical area. The employment offices tend to define target groups which are as homogeneous as possible (Hagemann and Sörgel, 2003).

The employment offices make a first selection of the unemployed they want to refer. The PSAs, however, can refuse to accept a jobseeker. It is obvious that the PSAs prefer unemployed people who are easy-to-assign or easy-to-place. Furthermore, they prefer heterogeneous target groups arguing that broadly defined groups make it easier to respond to the needs of their clients. However, there are objections to acceding to this wish (Jahn, 2004). First of all, there is no compelling reason why PSAs ought to restrict their efforts to referred jobseekers, and why they should not attend to specific demands for ‘temps’ (in temporary work) by recruiting workers in the regular labour market. The intention behind establishing PSAs was not to subsidize the entire market for temporary agency work. Secondly, by defining heterogeneous target groups one is making it easier for the PSAs to engage in creaming (Ochel, 2004). Especially large temporary work agencies, when they are operating as a PSA, apply the same standards when deciding whether or not to accept the unemployed selected by the employment offices as they do when they recruit temps in the free market.

In order to prevent creaming, the employment offices have to ensure that they only refer jobseekers who belong to the contractually defined target groups. However, PSAs are able to enforce their ideas. In interviews carried out in October 2003, the employment offices reported that only 22 percent of the jobseekers referred were accepted by a PSA. The PSAs not only select their jobseekers in the context of the referral procedure, but also subsequently, when they dismiss their employees. Of the jobseekers leaving the PSA between June 2003 and February 2005, 31.6 percent were dismissed for economic reasons or misconduct.

A further indication that creaming is taking place can be derived from a comparison of the socio-economic characteristics of PSA jobseekers as compared to non-subsidized temps. Table 1 shows that the PSA jobseekers differ very little from temps. Older employees (over 50 years) have less chance of being employed by a PSA than by a commercial temporary work agency (9 percent versus 11 percent). Furthermore, participants in the PSA programme are more likely to have had vocational training than ordinary temps. Only 14 percent of the PSA jobseekers (compared to 11 percent of the temps) were classified as long-term unemployed. Women, however, are more likely to be employed by a PSA than by commercial agencies. Nevertheless, it must be borne in mind that Table 1 sheds no light on whether an accumulation of impediments to placement is found more often among PSA jobseekers than among temps.

Financial incentives, balancing of risk and assignment activity

The PES subsidizes every PSA jobseeker. The PSAs receive a monthly base subsidy for every jobseeker hired; for every placement in dependent employment they receive a placement premium. The amount of both subsidies depends on the offer price negotiated before the contract is concluded; it varies according to the target group and the conditions in the regional labour market. Table 2 provides information on the amount of the base subsidy and the placement premium as a percentage of the offer price.

For a PSA jobseeker who was, for example, employed for seven months, the PSA receives 100 percent of the offer price for the first quarter, 75 percent for the following quarter of employment, and 50 percent for the remaining month. The placement
premium depends on the successful placement of the jobseeker. Since it is better to place a jobseeker in a sustainable rather than a temporary job, the placement premium is broken down into two equal parts. The first instalment is due at the beginning of any period of regular employment which is programmed to last at least three months. The second instalment is paid when the PSA can prove that the jobseeker is still employed after six months. Up to February 2005, 38 percent of the contracts had an offer price of between €1,100 and €1,300; in a quarter of the contracts an offer price of between €900 and €1,100 has been agreed upon. The average offer price was €1,084 (Bundesagentur für Arbeit).

In paying a base subsidy, the PES covers a part of the risk of the PSA. Their risk arises because they hire jobseekers with slight impediments to placement for a period limited to nine months. In comparison to commercial temporary work agencies, the combination of narrowly defined target groups

### Table 1  Individual characteristics of PSA jobseekers and temps in Germany (%)

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>PSA jobseekers</th>
<th>Temps</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender (female)</td>
<td>33.3</td>
<td>27.2</td>
</tr>
<tr>
<td>Jobseeker with health problems</td>
<td>11.7</td>
<td>n.a.</td>
</tr>
<tr>
<td>Age in years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt; 20</td>
<td>3.9</td>
<td>2.1</td>
</tr>
<tr>
<td>20–24</td>
<td>33.0</td>
<td>20.9</td>
</tr>
<tr>
<td>25–34</td>
<td>23.8</td>
<td>30.9</td>
</tr>
<tr>
<td>35–49</td>
<td>30.4</td>
<td>35.1</td>
</tr>
<tr>
<td>&gt; 50</td>
<td>8.9</td>
<td>11.1</td>
</tr>
<tr>
<td>Vocational training</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Without vocational training</td>
<td>27.2</td>
<td>30.2</td>
</tr>
<tr>
<td>With vocational training</td>
<td>71.1</td>
<td>52.4</td>
</tr>
<tr>
<td>University degree</td>
<td>1.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Unknown</td>
<td>1.0</td>
<td>14.6</td>
</tr>
<tr>
<td>Unemployment duration in months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 6</td>
<td>45.8</td>
<td></td>
</tr>
<tr>
<td>6–12</td>
<td>28.8</td>
<td>50.8</td>
</tr>
<tr>
<td>Long-term unemployed</td>
<td>14.4</td>
<td>11.2</td>
</tr>
<tr>
<td>Unknown</td>
<td>3.9</td>
<td>–</td>
</tr>
<tr>
<td>Registered as jobseekers</td>
<td>7.1</td>
<td>–</td>
</tr>
</tbody>
</table>

Notes:

* Sources: Bundesagentur für Arbeit (2005); Arbeitnehmerüberlassungsstatistik, as of 30 June 2004; own calculations.

### Table 2  Amount of base subsidy and placement premium as % of offer prices

<table>
<thead>
<tr>
<th>Job tenure in PSA (months)</th>
<th>Base subsidy</th>
<th>Placement premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>1–3</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>4–6</td>
<td>75</td>
<td>150</td>
</tr>
<tr>
<td>7–9</td>
<td>50</td>
<td>100</td>
</tr>
<tr>
<td>&gt; 10</td>
<td>0</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Own compilation.
and fixed-term employment gives rise to longer periods in which the jobseekers are not on assignments. The base subsidy is supposed to cover not only these costs, but also the costs involved in training and coaching (Jahn and Windsheimer, 2004a: 3). The idea behind the base subsidy is thus to guarantee employment for at least nine months. Unstable employment, which is confined to a temporary assignment, should be avoided.

Table 3 examines the amount of subsidies a PSA can receive per year and vacancy. The amount of subsidies depends on the job tenure of the PSA jobseekers within the PSA. Four cases are distinguished: periods of employment of three, six, nine and 12 months. These periods have been chosen because the subsidy formula varies at intervals of a quarter year. The calculations are based on an hourly wage of €10. This corresponds to hourly wages in Wage Group 4, including wage supplements in the main collective agreement for temporary agency work in 2005. The employer's share of social security contributions comes to 20.6 percent of the gross wage. The personnel costs related to placement efforts and training amount to 25 percent of the gross wage (Bertelsmann Stiftung et al., 2002: 30). In addition, it is assumed that the PSAs incur fixed costs of €600 when they hire a jobseeker. The calculations are based on an offer price of €1,100, which corresponds approximately to the average offer price. We further assume that every vacancy can be filled immediately; in view of the 5.2m unemployed that confronted 33,000 PSA vacancies in February 2005, this assumption seems reasonable. In addition, the calculations take into account that between April 2003 and February 2005, more than 81,000 employees had left the PSA programme (Table 5). Approximately 25 percent of the PSA jobseekers were placed in a job by a PSA or were taken over by a client firm where they were working on a temporary assignment. Only in such cases are PSAs entitled to a placement premium.

The amount of the subsidy depends on both the job tenure within a PSA and the probability of reintegration. If the PSA jobseekers are employed for three months, then the PSA can fill a vacancy four times a year, and in this case the PSA will receive 12 monthly base subsidies each equal to 100 percent of the offer price. If a PSA employs two jobseekers per year, each for six months, then the monthly base subsidy per jobseeker will amount to 100 percent of the offer price for three months and for a further three months to 75 percent of the offer price. Table 3 shows that if a PSA jobseeker is employed for 12 months, then the base subsidy covers 28 percent of costs and for three months 46 percent. The PSA can count on these subsidies without having successfully integrated a single jobseeker. If the PSA succeeds in placing the jobseeker, then they are entitled to a placement premium. Assuming an integration rate of 25 percent, the share of costs covered by the base subsidy and the placement premium comes to a minimum of 29 percent and a maximum of 54 percent, respectively. Table 3 proves that the PSAs cannot cover all their costs through subsidies.

<table>
<thead>
<tr>
<th>Job tenure of a PSA jobseeker within a PSA (months)</th>
<th>12</th>
<th>9</th>
<th>6</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total payments, of which (€)</strong>:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>gross wages</td>
<td>26,808</td>
<td>27,008</td>
<td>27,408</td>
<td>28,608</td>
</tr>
<tr>
<td>social security contributions</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
<td>18,000</td>
</tr>
<tr>
<td>personnel costs</td>
<td>3,708</td>
<td>3,708</td>
<td>3,708</td>
<td>3,708</td>
</tr>
<tr>
<td>fixed hiring costs</td>
<td>4,500</td>
<td>4,500</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td><strong>Total subsidies, of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>base subsidy</td>
<td>7,700</td>
<td>10,267</td>
<td>12,375</td>
<td>15,400</td>
</tr>
<tr>
<td>PP (with integration rate 25%)</td>
<td>7,425</td>
<td>9,900</td>
<td>11,350</td>
<td>13,200</td>
</tr>
<tr>
<td><strong>Coverage:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>without PP (in %)</td>
<td>28</td>
<td>37</td>
<td>42</td>
<td>46</td>
</tr>
<tr>
<td>including PP (in %)</td>
<td>29</td>
<td>38</td>
<td>45</td>
<td>54</td>
</tr>
</tbody>
</table>

Source: Own calculations.
The subsidies allow the PSAs to reduce the fees they charge for jobseekers temporarily assigned to client firms; this increases the attractiveness of these jobseekers. This can be seen when one compares the calculation with the fees of a commercial temporary work agency. Such firms charge a fee for temporary assignments amounting to approximately two-and-a-half times the gross remuneration of their employees. This fee covers the personnel costs incurred when the employees are not on assignment. This downtime typically amounts to approximately 25 percent of the regular working year. With time on assignment amounting to 75 percent, and an average job tenure of three months, a temporary agency will have a yearly profit per employee of €5,142. For a PSA receiving subsidies, the profit will work out at €20,542 per annum. Assuming constant time on assignment, the PSA could reduce its assignment fee to €13.60 an hour, before its profits would fall below that of a commercial agency (Table 4).

In February 2005, the average duration of assignment of PSA jobseekers was 49 percent of the working schedule. This low share, as compared to assignments of commercial agencies, was the result of the requirement to fill their posts quickly, even when there was no prospect of assignment for new jobseekers. Another factor was that the PSAs were required to train their jobseekers when they were not on assignment. Commercial temporary work agencies, however, could synchronize new hirings with the beginning of new assignments. Nevertheless, there are grounds for supposing that the PSAs could increase assignments by reducing their fees. The bottom line of Table 4 shows that assuming constant time on assignment, the PSAs could reduce their fees to €14.98 without fear of incurring losses. Lower assignment fees can be justified with human capital arguments. Productivity deficits are often attributed to persons participating in active labour market programmes; their performance is thought to be below average, or it is thought that they present themselves badly or that they have occupational qualifications for which there is little market demand (Jahn and Windsheimer, 2004b: 5). As a result, unemployed jobseekers have difficulty finding employment at the prevailing wage rate. Only if the fees of the PSA are below the prevailing market price are client firms willing to accept such people for temporary assignment. But very few PSAs differentiate in their pricing between PSA jobseekers and their commercial employees hired on the open market. The reluctance to scale down the fees may be due to the fact that many PSAs are run by commercial temporary work agencies. If a PSA gives a rebate for PSA jobseekers, although its productivity is comparable to that of the commercial temps, then there is a risk that the fees charged for the non-subsidized temps will be subject to downward pressure. And finally, the reason for this reluctance could also lie in an unwillingness on the part of the PSAs to pass on the subsidy to their clients. Assuming that the PSA jobseeker is on assignment 49 percent of the time, and assuming a fee for temporary assignment of €25, the profits of the PSA per jobseeker will amount to €8,842 per annum (Table 4).

Table 4  Assignment fees and duration of assignment

<table>
<thead>
<tr>
<th>Duration of assignment</th>
<th>Fee/hour</th>
<th>Revenue from temporary assignments</th>
<th>Cost / jobseeker</th>
<th>Subsidies</th>
<th>Profit or loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>€</td>
<td>€</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>75</td>
<td>25.00</td>
<td>33,750</td>
<td>28,608</td>
<td>0</td>
<td>5,142</td>
</tr>
<tr>
<td>75</td>
<td>25.00</td>
<td>33,750</td>
<td>28,608</td>
<td>15,400</td>
<td>20,542</td>
</tr>
<tr>
<td>75</td>
<td>13.60</td>
<td>18,350</td>
<td>28,608</td>
<td>15,400</td>
<td>5,142</td>
</tr>
<tr>
<td>49</td>
<td>25.00</td>
<td>22,050</td>
<td>28,608</td>
<td>0</td>
<td>–6,558</td>
</tr>
<tr>
<td>49</td>
<td>25.00</td>
<td>22,050</td>
<td>28,608</td>
<td>15,400</td>
<td>8,842</td>
</tr>
<tr>
<td>49</td>
<td>14.98</td>
<td>13,208</td>
<td>28,608</td>
<td>15,400</td>
<td>0</td>
</tr>
</tbody>
</table>

Notes:

a Per year.
b Assuming an average job tenure of the PSA jobseekers of three months (Table 3).
Source: Own calculations.

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Placement incentives

Monitoring the activities of PSAs involves high transaction costs. To avoid moral hazard, PSAs are obliged to provide regular information concerning their activities. Furthermore, the objective behind the declining payment structure is to ensure that the PSAs reintegrate their jobseekers as quickly as possible in the regular labour market. The payment of the placement premium in two instalments should avoid short duration of the new job of the PSA jobseekers.

The incentive structure is shown in Figure 3. The job tenure within a PSA is depicted on the abscissa. The corresponding subsidy factor, expressed as a multiple of the offer price, the marginal subsidy factor, and the marginal costs are shown on the ordinates. For the sake of simplicity we assume that each PSA jobseeker is successfully placed, that vacancies can be refilled immediately and that the PSA contract is open-ended. The amount of the subsidy per vacancy varies directly with the number of placements and increases with shorter job tenure within the PSA. If the jobseeker leaves the PSA after six months, the total subsidy comes to 13.5 times the offer price for an entire year. If the job tenure is one month, the subsidy comes to 36 times the offer price.

Given an average offer price of €1,100, the PSA can count on a revenue of between €14,850 and €39,600.

The bold grey line in Figure 3 marks the marginal subsidy which is highest during the first month and decreases with increasing job tenure. That the marginal return function is not monotonically decreasing follows from the declining discrete payment structure. From the tenth month on, the base subsidy is no longer paid, and the placement premium remains constant. The marginal return is nevertheless positive because the PSA can fill the vacancy immediately with a new jobseeker and thus receive new subsidies. At first sight the payment structure represents an incentive to place the jobseekers as rapidly as possible. This incentive remains in force even if the PSA is not able to place every jobseeker successfully. If the placement premium increases in relation to the base subsidy (the premium structure being given), then the incentives to place the jobseekers as quickly as possible become stronger. Yet, there are fewer resources available to compensate PSAs for the risks they bear.

In order to determine the profit-maximizing point in time for placement, in addition to the marginal return, the marginal costs associated with different

![Figure 3](total subsidy factor and marginal costs)

**Figure 3** Total and marginal subsidy per PSA vacancy

*Source: Own calculations.*
turnover rates must be taken into account. First, the turnover increases if the PSA intensifies its contacts with potential employers. Secondly, the PSA can increase the attractiveness of its jobseekers by providing them with training. In both cases, the marginal costs of its services increase. But increasing turnover rates also lead to increasing hiring costs. The PSA will only be interested in speeding up placement as long as the marginal return is higher than the marginal costs. Figure 3 assumes a convex marginal cost function. It shows that as a result of the declining discrete payment structure, a unique profit-maximizing employment duration does not exist. In February 2005, the average job tenure in a PSA was approximately six months. There are two possible interpretations for this result: first, the financial incentives were not sufficient to bring about a rapid integration of PSA jobseekers in the labour market; secondly, the point in time of the placement was not a parameter of managerial action (in opposition to the assumption underlying Figure 3). The low labour demand in Germany and its weak growth support the second interpretation.

Table 5 provides a further indication of the low absorption capacity of the German labour market. Between June 2003 and February 2005, the average integration rate came to 32 percent. Direct placement in client firms amounted to 9 percent. This low rate was, however, compensated by the placement of PSA jobseekers in other firms (16 percent). Thus, the PSAs tended to function more as professional placement agencies than as temporary work agencies. Quite a few PSA jobseekers (8 percent) found work through their own initiative. In interpreting these figures, it should be borne in mind that the integration rates presented in Table 5 do not shed any light on the causal treatment effect which is estimated in micro-econometric evaluations. It is conceivable that the jobseekers might have found regular employment without the placement efforts made on their behalf.

Can the integration rates documented in Table 5 be considered a success? In order to answer this question it is instructive to compare them with the integration rates obtained by commercial temporary work agencies. Antoni and Jahn (2006) estimate an integration rate of 21 percent for temps who left the temporary help sector in 2003. Taking into consideration the fact that among the PSA jobseekers are probably quite a number with one or more impediments to placement, the integration rate of PSA jobseekers is quite respectable. The higher integration rate achieved for PSA jobseekers, as compared to employees in temporary work agencies, indicates that the system of incentives and regulation is having a positive effect in helping to get the unemployed back into a job. The integration effects were also higher than those achieved in the pilot projects in the 1990s. Nevertheless, the PES does not consider the integration rate to be satisfactory. When the programme was conceived, an integration rate of 50 percent was assumed; this is the reason for the restraint which has been exercised since the middle of 2004 with respect to putting new contracts up for tender.

Conclusions

Recently the German PES contracted-out employment services. This article analyses the operation of PSAs and investigates whether the conditions for quasi-markets to operate efficiently are fulfilled. In order to create ex-ante competition for the market, the employment offices publicly invite tenders for PSA contracts. The decentralized tendering

<table>
<thead>
<tr>
<th></th>
<th>East</th>
<th>West</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employed, total</td>
<td>24.5</td>
<td>36.2</td>
<td>32.2</td>
</tr>
<tr>
<td>Client firm</td>
<td>5.1</td>
<td>10.9</td>
<td>8.9</td>
</tr>
<tr>
<td>Placed by PSA</td>
<td>14.4</td>
<td>16.6</td>
<td>15.8</td>
</tr>
<tr>
<td>Employee’s own initiative</td>
<td>5.0</td>
<td>8.8</td>
<td>7.5</td>
</tr>
<tr>
<td>Self-employed</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>All exits</td>
<td>27,431</td>
<td>53,721</td>
<td>81,152</td>
</tr>
</tbody>
</table>

Source: Bundesagentur für Arbeit (2005); own calculations.
procedure has the advantage of taking into account the local labour market situation and the needs of the jobseekers. However, the unemployed cannot choose between different providers and therefore cannot influence the price and quality of the service. After acceptance of the bid, the PSA no longer faces competition for the contract. However, the PSA is still faced with competition from other temporary work agencies to assign their jobseekers to client firms because subsidies only partly cover their costs. The insolvencies suffered by many PSAs document the fact that this market mechanism is indeed working.

Although the referral process is designed to avoid creaming, we demonstrate that the PSAs are able to select easy-to-place jobseekers. The selectivity results primarily from the lack of possibilities to sanction the providers but may also be a consequence of the fact that the employment offices were subject to extreme pressure to produce favourable results. Therefore they were inclined to refer easy-to-place jobseekers. Australia tries to avoid creaming, which is possible to the extent that jobseekers exert their right to choose a provider. It differentiates fees according to the Job Seeker Classification Instrument score. This encourages providers to welcome more disadvantaged jobseekers (Grubb, 2003). Those clients who do not exert a choice are assigned by the public Centrelink to the private providers. This, however, is not a guarantee for avoiding creaming (Struyven and Steurs, 2005).

As a rule, providers are motivated by financial incentives. The purpose of the declining subsidies is to cover a part of the risk and to ensure that quality and quantity standards are met. There is some doubt that the subsidies have adequately influenced the provision of services. The share of temporary assignments achieved by the PSA is much lower than that prevailing among commercial agencies. Many jobseekers are parked, a phenomenon which is common to private employment services in Australia and the Netherlands too. Investigations based on sampling have furthermore shown that some PSAs do not provide any training. The assignment rate is one measure of the services provided and is below what was expected. It may be an indication that especially the high base subsidy, which is not directly related to success, is not suitable to promote rapid integration via assignments.

To reduce information asymmetries and to enhance placement services, the PES uses, in addition to a monitoring system, declining placement premiums. Putting more emphasis on the incentives than on monitoring, the German system is more in line with the Dutch than with the Australian system (Struyven and Steurs, 2005). The integration rate represents another quantification of the services delivered and provides information on the quality of the placement. Most PSA jobseekers are placed in jobs directly, although this activity is a new field for firms principally engaged in the provision of temporary help services. Because of these direct placements, the integration rates achieved by PSA compared to those of commercial temporary work agencies were somewhat higher. Empirical evaluation seems to confirm that the placement premiums are an especially suitable instrument for the promotion of rapid integration via direct placements.

In order to limit transaction costs the tendering procedure comprises three stages. By defining block contracts for different target groups, negotiations concerning the referred jobseekers can be avoided. But since the PSA can refuse jobseekers, high transaction costs nevertheless arise when the process of designating PSA jobseekers goes into a second or third round.

Although most of the conditions for a functioning quasi-market are fulfilled, nevertheless the PSAs were subject to vehement criticism from the outset. The continued criticism of the programme is surprising since until now there has been no systematic evaluation of the programme. In autumn 2005, modifications of the institutional setting were put in place. The tendering procedure is now centralized. It is up to the employment office to use the programme. Furthermore, the base subsidy is paid as a flat rate, which is much lower than the negotiated one and independent of the job tenure within the PSA as well as the target group. Finally, the placement premium has been increased and is to be made the subject of negotiations within the tendering procedure. It is doubtful whether this reform will enhance the efficiency of the programme. Furthermore continual changes in the institutional settings risk reducing the political acceptance of what was, at its inception, a good idea.

Acknowledgements

We are grateful to two referees and the editor for their valuable and helpful comments.
Notes

1 Experience with temporary agency work as an instrument of active labour market policy was first made in the Netherlands and Sweden. However, both of these pilot projects were broken off.

2 In comparing the socio-economic characteristics of PSA jobseekers with non-subsidized temps one must bear in mind that the data are taken from different statistical sources.

3 There is no systematic information about downtime in temporary work agencies. However, we calculated the downtime using results of a case-study by Kvasnicka (2004: 20).

References


