Outsourcing government: the use of outcome-based payments in UK social policy

OUTSOURCING GOVERNMENT: THE USE OF OUTCOME-BASED PAYMENT IN UK SOCIAL POLICY

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Declaration: I declare that the enclosed work is my own original research.

Signed:

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Abstract

The aim of this thesis is to examine the interaction between policy and implementation choices, by tracing the adoption of outcome-based payments in UK welfare-to-work policy. New Labour's flagship welfare-to-work programme, the New Deal for Young People, was delivered by civil servants and private and voluntary sector providers working under highly-specified, fee-for-service contracts. The programme was then reformed to introduce elements of outcome-based payment, rewarding job placements. The Coalition government's Work Programme extended this approach further. The use of financial incentives was presented by government, and largely accepted by the policy community, as a measure to improve efficiency and effectiveness in achieving policy outcomes. However, the literature based on transaction cost analysis and principal-agent theory has shown that the use of high-powered incentives in contracts to provide complex public services involves sacrificing some policy goals, even while it rewards others. The thesis uses process-tracing methodology to examine the factors which led successive governments to switch towards outcome-based payments. It finds evidence that the shift was only possible because of significant changes in policy, and that the outcome-based approach addressed political concerns beyond the aims of achieving efficiency and effectiveness in welfare-to-work policy.

Note on Usage and Abbreviations

The case study involves the delivery of policy by private and third sector organisations. Whether for-profit or not-for-profit, they are operating under a commercial contract with the government, and it is this commercial relationship which is relevant to the thesis. I have therefore referred to them collectively as 'contractors', to distinguish them from public sector bodies without specifying their profit status.

The government department at the centre of the case study began as the Department for Education and Employment and ended as the Department for Work and Pensions. To avoid confusion, I have referred to it throughout as the Department. Other government departments are referred to by their full title. When referring to government departments as a class, I have used lower case.

The public employment service and benefit administration (i.e. the network of jobcentres and benefit offices) has undergone a number of reorganisations over the last few decades. During the period covered by this thesis, welfare-to-work policy was delivered first by the Employment Service and latterly by Jobcentre Plus. To avoid confusion, I have referred to both as the employment service (lower case). In quotations, however, I have retained the proper names.

The three programmes involved in the case study are the New Deal for Young People, the Flexible New Deal and the Work Programme. There were other programmes in existence at the time that used the New Deal label (e.g. New Deal for Disabled People, New Deal for Older People). I refer to the New Deal for Young People or the Young Peoples' New Deal. Other New Deals are referred to by their full official title, even where, as in the New Deal 25plus, that title is clumsy.

I have tried to avoid abbreviations as much as possible. The few that were unavoidable are:

DVLA	Driver and Vehicle Licensing Agency
ES	Employment Service
OBP	outcome-based payment
RSA	Royal Society for Arts, Manufactures and Commerce

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Introduction

The Puzzle of Outcome-based Payment and the Thesis

‘What matters is what works’ has been a mantra of successive British governments. It proposes that quasi-markets can be embraced, and private business practices borrowed, in order to advance a policy agenda. ‘What works’ embeds an assumption that decisions about efficient implementation can be made independently of choices about the aims of a policy. The aim of this thesis is to explore how policy goals and implementation choices interact in public sector management, focusing on a major innovation in implementation called outcome-based payment and its use in the welfare-to-work field. This innovation has been proposed as having the potential to improve the efficiency with which the government's policy goals are delivered. The central proposition of this thesis is that the quest for efficiency cannot fully explain the adoption of outcome-based payment. This mode of implementation conceals important political choices, even though it purports to identify the government’s policy goals clearly and ensure that effort is oriented towards them.

The theoretical approach adopted here is rational choice institutionalism. The thesis draws on two leading approaches to understanding delegation: principal-agent theory and transaction cost analysis. Both are heavily oriented towards identifying efficient institutional choices, in the sense of choices that achieve the policy goals of the principal. However, as will be shown here, they also offer insights into the ways that policy goals and implementation choices might interact. They widen the calculus of implementation costs and benefits to include political costs and spell out what those political costs may include. For example, they propose that a delegated mode of implementation may be adopted because of the opportunities it provides for blame-shifting if the policy fails, or because of beliefs about the alignment of the principal’s and agent’s goals, or because the principal seeks to optimise the response to an uncertain policy environment.

These theories have not been much explored in the context of British public management. There are several reasons for this. Much of the literature is based on institutional conditions in the United States and examines delegation to agencies with explicit policy functions. The application of this literature to British politics is limited because there are not multiple principals, or they cannot be identified readily by their different institutional locations. Instead, there is rather clear linear authority in most policy areas from the relevant minister, through the civil servants who answer to that minister, to the agents who put the policy into practice. Of course, it is widely understood that there is plenty of slippage in this process, or 'drift' from the original policy intentions, but it is quite another matter to propose that the mode of implementation itself shapes policy choices, and that the preferences of the minister over policy outcomes are from the start entwined with plans for implementation.

This introduction proceeds as follows. First, outcome-based payment is defined and compared with other established modes of implementation. Two features of outcome-based payment - contracting with commercial providers and the use of high-powered incentives - are widespread in the management of public service delivery in the UK. The distinguishing characteristic of outcome-based payment is that it combines these two features with the specification of high-level policy goals ('outcomes'), to which high-powered incentives are geared.

Second, the puzzles presented by the adoption of outcome-based payment in the welfare-to-work field are summarised. One puzzle is about timing. Why did government previously manage these policy areas with multiple outcomes and low performance incentives, and then change its approach by adopting high-powered incentives attached to a single quantifiable outcome? If it is possible to identify a clear shift in policy preferences, this puzzle is readily solved, but no such clear solution presents itself in the case studied here. A second puzzle is about the acceptance of risk. The risks attached to high-powered incentives are well-known: they may distort agent behaviour and lead agents to ignore other outcomes which are not attached to high-powered incentives. If the government's policy preferences did not change, then perhaps its attitude to risk changed, but, if so, why?

Finally, this introduction indicates the reasons for selecting welfare-to-work as a case study for exploring possible answers to these questions.

Outcome-based payment: definition and significance

The RSA (Royal Society for Arts, Manufactures and Commerce), in one of a series of documents, calls outcome-based payment 'one of the hottest new ideas in public service management today' (Sturgess and Cumming, 2011:12). In this approach, non-public sector bodies - whether private companies or not-for-profit organisations - are contracted to deliver policy outcomes and are promised large-scale payments when those outcomes are achieved.

The Flexible New Deal, a welfare-to-work programme introduced by New Labour in 2009, provides a good example of the approach. Rather than design a programme of intervention to help people back to work and arrange for either civil servants or contractors to deliver it to the government's specifications, the government undertook to pay outside contractors if they helped an unemployed person into a job which lasted a specified number of weeks. Beyond some minimum provisions, it was up to the contractor what help they offered to their clients, how much they invested in the effort to get them into work, and how they allocated resources between clients[1].

Of course, it is common practice for governments to delegate tasks to outside bodies or enter contractual relationships for the delivery of goods and services. Outcome-based payment shares many of the characteristics and features of these arrangements. It is distinctive in the particular way it combines several features which appear in other instances of delegation. It is the combination of a commercial contract, payment-by-result and the use of high-level policy outcomes which sets outcome-based payment apart. All of these features appear commonly in other examples of delegation or governmental contracting, but rarely in combination:

(i) A commercial contract between government and a non-public sector contractor – this is, of course, widespread where government is procuring goods and services, such as military equipment or computer support. However, in most cases, the goods or service being contracted for are what might be described as inputs: clearly defined products, of a kind bought and sold in the private sector from day-to-day, which are easily specified. Examples might be the building of a new road, or an administrative process such as the collection of fees or the issuing of

[1] Contractors in the Flexible New Deal were paid a minimal service fee, but the majority of their payment depended on placing people into sustainable jobs (DWP 2009).

licences. More and more of these activities have been outsourced by government over the last thirty years to companies such as Capita or Serco. Where the activity that is being delegated is less generic and less easily defined, government is more likely to delegate to some form of public body, such as a government agency or non-departmental public body, and much of the literature about delegation focuses on these bodies. It is true that, increasingly, government in the UK has been contracting more sensitive operations – such as administering the capability tests for Employment Support Allowance - to private or third sector contractors. However, these contracts have generally not relied on payment-by-result or outcome-based measures of results – the number of outcome-based payment arrangements is actually small (NAO 2015:13).

(ii) Payment-by-result – the linking of payments to performance. While this is often a feature of commercial contracts, including those entered into by government, it is not a necessary element. After all, even commercial contracts can be based on upfront payments or payments linked to activity, rather than to results. Furthermore, governments do use payment-by-results in contracts and delegatory relationships other than outcome-based payment. For example, a payment to a road-building contractor might be made conditional on the road being completed on time and to certain quality standards. Again, however, payment-by-result in contracts involving the delivery of sensitive services to the public is rare.

(iii) Outcome-based policy – the use of increasingly high-level and broad definitions of success to judge policy development and delivery. The reference to 'outcomes' draws on the terminology of policy design common to governmental policymakers which distinguishes between inputs, outputs and outcomes. As expressed by the Cabinet Office's Centre for Social Impact Bonds: 'To understand what these are, consider a health programme: inputs are resources, like doctors or operating machinery. Outputs are resulting actions, like the number of operations. Outcomes are the success results, like the number of people healed from a successful operation' (Cabinet Office 2016). Outcome-based policy is advocated as an approach which focuses policymakers on the real desired outcomes of a policy, rather on the intermediate outputs. This should reveal where current outputs are not actually achieving the desired outcomes or are not achieving them with optimal cost-effectiveness. 'Outcome-based government means focusing on those

Commented [SM1]:

> initiatives that genuinely change people's lives: more often than not, tackling root causes rather than simply treating symptoms.' (Brien 2011).

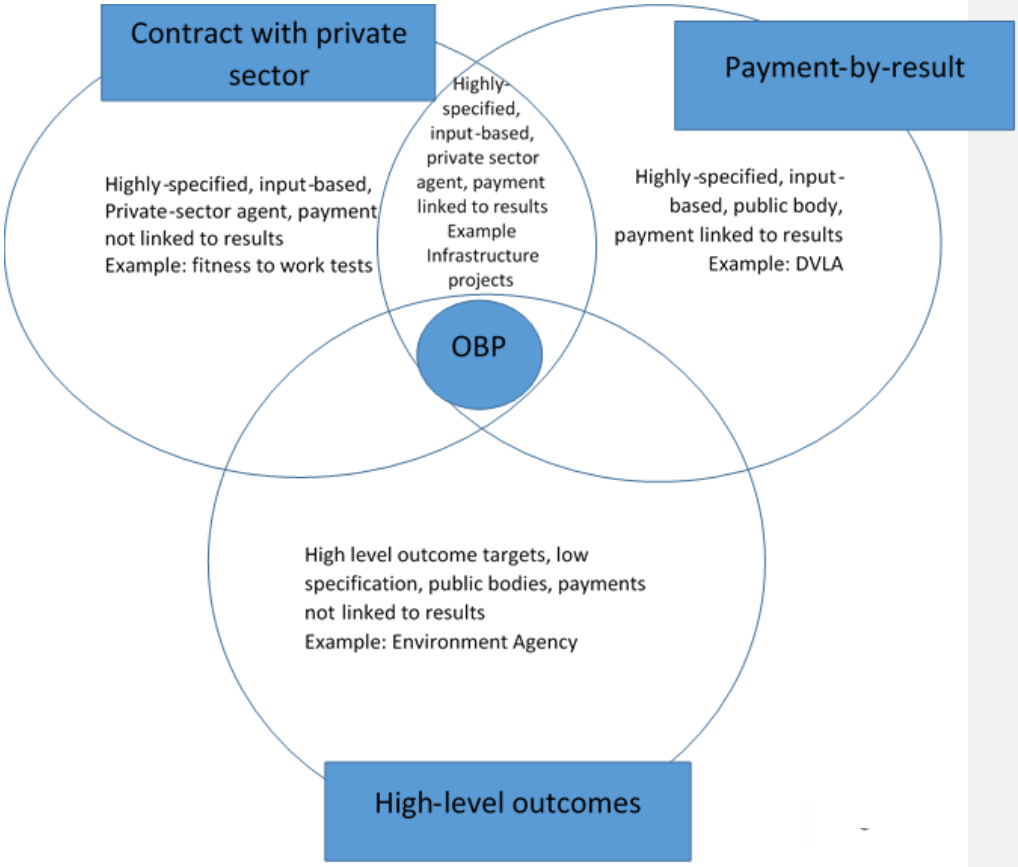
As with the other two features described above, the setting of high-level outcomes is not unique to outcome-based payment, but the government usually entrusts such tasks to a public body or one of its own agencies. The Act setting up the Environment Agency, for instance, defined its purpose as 'to protect or enhance the environment' so as to contribute 'towards attaining the objective of achieving sustainable development'. The Agency is then given considerable discretion to decide how it should achieve its aim. In effect, some of the responsibility for developing policy to achieve the government's environmental outcomes is delegated to the Agency (Environment Act 1995, Section 4).

On the other hand, where government is delegating to an outside contractor through a commercial contract, it will generally set much lower-level, input- or output-based contractual requirements. It will specify the product it wants in terms of scale, quality, timeliness, and compliance with defined processes. For instance, a company building a road for the government is not given the outcome of reducing congestion, improving air quality and generating economic growth, though those are the policy outcomes which the government hopes to achieve by having the road built. Instead, government keeps to itself the responsibility for achieving those outcomes, develops the roads policy (i.e. deciding how many miles of road will be built and where they will go), and delegates to the contractor only the narrowly-defined task of building a road to its clear specifications. In the case of the Employment Support Allowance work capability tests, while the tests are carried out by a contractor, the decision on benefit entitlement is actually taken by a Civil Service decision-maker and the test itself – the criteria, exemptions and so on – are set by regulations agreed by Parliament (Kennedy 2012). The government does not simply delegate the responsibility for ensuring Employment and Support Allowance is only paid to people who are unable to work, allowing the contractor to decide how that is to be done.

None of these three features then, when taken alone, are unique to outcome-based payment, but outcome-based payment is unique in combining all three. Other commercial contracts which government enters into with private and third sector contractors may feature payment by result, but they do not make the contractor responsible for high level policy outcomes. Where government does delegate responsibility for high-level policy outcomes, it is to public

bodies and does not involve payment-by-result. The unique nature of outcome-based payment is illustrated in the diagram below.

Figure 1: The three features of outcome-based payment



This approach is not unique to the UK. A number of programmes introduced at state level in the US use some or all of the elements of outcome-based payment, while welfare-to-work programmes of the kind which will be examined in the comparative case study have been operating in Australia since 1998, and the Netherlands since 2011 (Finn 2008, Bredgaard and Larson 2008). In the UK, versions of the outcome-based payment approach are being pursued in a small number of policy areas, including welfare-to-work, offender management, foster care, and long-term condition management. A number of social impact bonds have also been

developed, which build on the use of outcome-based payments. These are discussed in Chapter Eight.

The way outcome-based payment combines the three elements set out above has obvious implications for public policy, as the delegation of policy responsibility to private and third sector contractors raises serious questions about accountability and democratic scrutiny. However, this thesis focuses on a different question, which is why a government would rationally choose this combination of strategies.

The puzzle presented by outcome-based payment in welfare-to-work policy

The use of outcome-based payments is notable for two reasons. First, it creates risks for the government, putting control over design in the hands of outside contractors. Obviously, the outcome-based payment approach also has a number of advantages for governments. They choose to use it when they judge the benefits to outweigh the risks. The case of welfare-to-work, however, does not appear at first sight to be one in which the benefits will outweigh the risks. The second issue which the approach raises is the question of variation in approach between apparently similar policies and programmes. The programmes which the Flexible New Deal replaced, and which it resembled in many ways, had not used outcome-based payment. While most of the elements of these programmes were delivered by outside contractors, they were delivered under a service fee model, where the provision was highly-specified and controlled by the government. These previous programmes – which formed the major part of the Department's welfare-to-work policy - ran under that model for twelve years, during which time the same Department had used outcome-based payments in other, smaller, programmes and pilots. Why, during that twelve years, had the Department decided outcome-based payment was the best approach for some programmes, but not for its flagship programmes? What changed, when the Flexible New Deal was introduced, to alter the calculation between risks and benefits and lead the government to switch to outcome-based payment? In fact, the questions about institutional choice in the welfare-to-work field begin even before the New Labour era. The previous Conservative government introduced market-based institutional forms such as the Training and Enterprise Councils - companies set up by and under contract to government - which in turn used outcome-based payment in their relationship with their sub-contractors (Price 2000, Finn 2005). At the same time, however, it decided against the privatisation of the jobcentre network, despite expressions of interest from major private recruitment agencies (Price, 2000 p199). New Labour, similarly, turned

down approaches from the same companies to take over day-to-day jobcentre operations, while encouraging them to get involved in other welfare-to-work programmes (Reed 2012:152).

The puzzle about outcome-based payment also applies to policies beyond welfare-to-work. While, during the Coalition government, outcome-based payment was being hailed as the new best practice, it was not in fact widely used. In its study into the approach in 2015, despite noting that 'its use [had] increased in recent years', the National Audit Office could find only fifty-two examples of its use, many being small pilot projects (NAO 2015:5,13). An examination of the reasons for the variations in its use in the case of welfare-to-work may, then, yield insights which apply across government.

A number of theories exist to explain the use of approaches, such as outcome-based payment, which employ the logic of the market and the price mechanism to incentivise private contractors. The sociological approach focuses on the logic of appropriateness rather than the rational logic of the utility-maximiser and explains the adoption of outcome-based payment as a process driven by societal pressures to conform and achieve legitimacy. Historical institutionalists ascribe the adoption of certain institutional forms to path dependencies created by decisions taken years before. Other theories suggest motivations including the furtherance of neo-liberal principles, collusion with profit-seeking would-be contractors or the creation of high-status roles for bureaucrats. These will be discussed in more detail in Chapter One. These theories share a tendency, however, to suggest motivations that apply across all policies in a government. They are not designed to explain why a government would use an outcome-based payment approach in some policies and programmes, and not in others.

This thesis will consider whether an answer to the question of variation can be found in principal-agent theory and transaction cost analysis. While much of this literature is normative, exploring the ways in which incentives can be shaped to be most effective, there is also an empirical strand which seeks to explain why governments choose the institutional forms that they do, why they sometimes delegate and sometimes do not, and why they sometimes use private sector contractors to implement their policies and at other times choose public agencies. This approach may therefore help to explain the diversity of choices in a single field. In addition, principal-agent theory and transaction costs analysis stem from rational choice theory, the same theory which provides the justification for using financial

incentives and the price mechanism for delivering public policy, and which claims that government actors make decisions based on rational strategic calculation. The argument made by governments for the outcome-based payment approach - that it is an effective way to incentivise their agents – is itself based on the principles of rational choice theory. It is therefore a fair test of the theory that it should explain why a rational government chooses this approach in some cases and not in others.

The aim of this thesis, then, is to explore whether an explanation for the adoption of outcome-based payment can be found within rational choice institutionalist theory and, in doing so, to throw light on both the theory itself and on the phenomenon of outcome-based payment. It argues that a wider perspective on transaction costs in British government can help to explain why outcome-based payment has been attractive in some circumstances, specifically under conditions of austerity.

Welfare-to-work as a case study

One way to approach the research would be to create one or more testable hypotheses and then apply them across the set of outcome-based payment cases and a control group of cases in which outcome-based payment had not been chosen. This is the approach taken, for instance, by Epstein and O'Halloran (1999). However, such an approach would not work in this case. First, given the broad nature of the transaction cost analysis and principal-agent frameworks, the range of possible hypotheses is large. Epstein and O'Halloran were building on an existing body of work focussed on the particular Congressional institutions they were testing. They were able to formulate a plausible and specific hypothesis based on this body of work and then test it against a large number of cases.

In the case of outcome-based payment in the UK, there is little existing study of the phenomenon. Moreover, there are not a great number of outcome-based payment cases which are fully developed, and which have been sufficiently scrutinised for there to be data. Those that exist are very different. They cover different policy areas, different government departments and different types of policy objective. Formulating and testing a single, rigorous hypothesis from this landscape would be difficult and the result somewhat arbitrary.

This thesis therefore adopts the alternative approach of examining a single case and testing several hypotheses against its specific features. The aim will be to provide an initial test of the hypotheses, establish which variables seem to be relevant and produce a more refined

hypothesis which can then, in future work, be tested against other cases. Process-tracing is used to examine the decision-making episodes in detail in a bid to identify the factors which determined the use, or not, of outcome-based payment.

While the question of institutional choice applies across the area of welfare-to-work policy over the last thirty-five years, this thesis will focus on three specific programmes: the New Deal for Young People, the Flexible New Deal and the Work Programme. Taken together they provide a useful case study representative of the field as a whole. They have a number of advantages. First, they were introduced in series between 1997 and 2010, each being explicitly labelled by the government which introduced it as a replacement for the previous one. They share a common format and, for the most part, are focused on the policy problem of long-term unemployment. The principal difference is the change in delivery model with the first in the series – the New Deal for Young People – using a service fee model, while the second two - Flexible New Deal and the Work Programme - represent two of the purest cases of outcome-based payment in the UK. As outcome-based payment was introduced into an area of policy which had been operational for more than a decade under different (and more conventional) arrangements, the pre-outcome-based payment and post-outcome-based payment stages can be used as comparative cases. Thus, there is valuable intra-case variation. Second, the programmes have been fully developed, implemented, evaluated and terminated. Third, the move to outcome-based payment was first decided upon under the New Labour government, introduced in a diluted form, and then introduced in a purer from by a Conservative government. The case therefore offers some partisan variation without being susceptible to an obvious partisan explanation. Finally, there is a reasonable amount of primary and secondary documentary research material, including detailed scrutiny by a Parliamentary Select Committee. This has been supplemented by a small number of interviews with civil servants involved in the policy process.

In Chapter One, I will consider other theories of institutional choice and explain why principal-agent theory and transaction cost analysis can answer questions about the welfare-to-work case study that these other theories cannot. In Chapter Two, I will consider in detail the insights that the rational choice institutionalist literature can contribute to explain the use of outcome-based payment in the UK and use these insights to develop three specific hypotheses to test. In Chapter Three, I will prepare for the process-tracing exercise by detailing the processes to be examined and the evidence that will be sought. Chapters Four to

Six test the three hypotheses in turn against the case of the Flexible New Deal, Chapter Seven looks at the Work Programme and Chapter Eight draws some conclusions.

Chapter One

Explaining Institutional Choices in Welfare-to-Work: a literature review

The literature around welfare-to-work policy offers a number of explanations for the delivery choices made by governments. More widely, insights can also be drawn from the theories on bureaucratic motivation and on the sociologically-driven spread of institutional design. This chapter identifies these hypotheses and insights and explains both how they help to explain the choice of outcome-based payment in welfare-to-work in the UK, and where they fall short of a full answer to the puzzle. It then explains why principal-agent theory and transaction cost analysis offer the possibility of a more satisfactory explanation.

Literature on welfare-to-work and institutional choice

The literature focused specifically on welfare-to-work is principally concerned with policy. In particular, it focuses on the fact that the overarching objective of promoting individual access to employment can hide considerable policy variation, particularly over the following dimensions:

- Does the programme have a 'work first' orientation or are resources also directed to improving participants' skills and education?
- To what extent is the programme linked to benefit policing and conditionality, i.e. checking that those receiving unemployment benefits are really actively seeking and available for work, and demanding programme participation in return for benefits?

As the following chapters show, decisions around the design and adoption of outcome-based payment are relevant to the answers to these questions. However, the literature primarily treats the answers as matters of policy rather than implementation. The distinction between 'positive' policies to improve the skills of the workforce and 'negative' measures to put pressure on benefit recipients to get a job has preoccupied many commentators (Taylor Gooby 2004). Rather than the help to unemployed people that the governments claimed them to be, these measures were seen by many as part of a wider attack on the workforce, alongside the reforms to employment rights and trade union powers. The aim, critics argued,

was simply to lower wages and thereby create a pool of cheap labour for the private sector (Jordan 2014:223).

The similarities between the programmes adopted by the Conservative government and those introduced by New Labour led many critics to conclude that the two governments were pursuing the same objectives. Tonge argued that 'Labour's New Deal [represented] employment policy continuity between governments' and that the new government's policy was 'rooted in the supply-side and based upon the themes of the previous government' (Tonge 1999:229). The New Labour government certainly sought to avoid connotations of 'workfare', but it nonetheless promoted a 'rights and responsibilities' agenda that justified compulsory participation in programmes. It was criticised for taking its lead from the Clinton-era reforms to welfare, a lead which Prime Minister Blair openly acknowledged (Peck and Theodore 2001:428). Writers such as Jordan (2014), Tonge (1999), Jones (1997), Gray (2001) and Jessop (2002) characterised the New Deal as part of a neoliberal tendency to promote employment through labour market 'flexibility' rather than through investment in people.

Peck and Theodore (2001) highlighted several indicators of 'negative' activation in the New Deal itself. These indicators are largely discursive, including the use of language around welfare dependency and an expressed desire to promote a work ethic and engagement with the workplace. They also point to the role of compulsion: participation in the New Deal was compulsory for young people on benefits. However, they hedge their critique by pointing out that there can be carrots as well as sticks in welfare-to-work programmes, if they offer services that are valued by participants. These contributions to the literature were part of a wider critique of the direction taken by 'New' Labour and other social democratic parties that moved to the centre, or even the right, during the 1990s. Comparative studies of labour market policies have not produced clear findings about partisan effects on welfare-to-work programmes. The firmest conclusion that can be drawn is that the devil is in the detail of policies, details which the available international data do not necessarily capture (Clasen *et al* 2016).

Most of those commenting on UK welfare-to-work policy focused on these policy questions but, when they did mention delivery, they tended to see the use of the private sector or contractual approaches generally as 'all of a piece' with the introduction of activity

requirements for claimants (Mabbett 2009:137). Jordan, for example, quotes the head of the CBI advocating '"a productive partnership [with] the private sector"', and remarks 'workfare, in other words'. (Jordan 2014: 228). They appeared to take for granted that a neo-liberal government which is imposing requirements on claimants will prefer to administer those through the private sector. The involvement of the private sector was also seen to be driven by profit-seeking behaviour, accommodated by government. Programmes under the Conservative and New Labour government, with their subsidised work placements, were criticised as a way for some companies to profit from providing cheap labour to others. (Tonge 1999:223). The reference to political philosophy again raises the possibility that preferences differed between political parties and their voters. In the present study, the adoption of outcome-based payment under Labour and its continuation and expansion by the Coalition government immediately rules out a straightforward explanation based on those. Nonetheless, the following chapters show that political factors and policy preferences do bear on the adoption of outcome-based payment.

A few writers in the welfare-to-work field do look at the relationship between policy and implementation, and they find the situation to be more complex and nuanced than most critics of neo-liberalism assume. King (1995), whose analysis ranges from the early 20th century to the mid-1990s, advances a historical institutionalist explanation for entrenched preferences favouring 'work first', conditionality and policing. At the creation of the labour exchange network in the early years of the twentieth century, the administration of benefit and its policing were linked with the job placement function. This conjunction was institutionalised and shaped policy in the following decades. The labour exchange network, or employment service as it became known, 'expressed' and perpetuated the policy assumptions which had led to its foundation. When, in the 1970s, attempts were made to reform the policy to focus on a longer-term strategy for the re-skilling of the workforce, there was institutional resistance.

At first sight, this argument stands in direct opposition to the rational choice institutionalist approach taken in this thesis. Rational choice institutionalism generally proposes that implementation decisions about benefit administration and job placement are taken in pursuit of pre-defined policy objectives, whereas King proposes that the implementing institutions shaped those policies. But, as developed in the following chapters, choices about

implementation in the welfare-to-work policy area had the effect of re-ordering policy priorities, causing some to be set aside and elevating others.

Jayasuriya, on the other hand, suggests the link between policy and implementation is a functional choice, rather than a product of path dependency. He argues that there is a 'chain of contracts'. The 'contract' that active labour market policy creates between the unemployed claimant and the government bureaucracy, through job-seeking requirements and other conditions for receiving benefit, is repeated in a contractual relationship between the government and the agents it uses to enforce these requirements. Jayasuriya claims that this chain of contracts is a 'requirement' if active labour market measures are to be implemented successfully, though he does not give explicit reasons for this statement (Jayasuriya 2002).

Considine also draws on the idea of the 'chain of contract' in his account of the institutional choices of four countries in the welfare-to-work field in the mid-90s. However, he concludes that it was the use of a contractual approach to manage its bureaucrats, rather than the involvement of the private sector, which enabled the Conservative government to impose requirements on claimants. He interviewed more than a thousand senior bureaucrats and frontline staff in employment services in Australia, New Zealand, the UK and the Netherlands in the period 1996-98. His research revealed that, when the reality of front-line delivery and the experience of frontline staff was examined, the 'neo-liberal' or 'new public management' labels hid a diversity of approaches. Each of the four countries, while following the general direction of new public management, had chosen different institutional arrangements. In the UK there had been a number of 'corporate' or managerialist reforms with the creation of Next Steps agencies and the formulation of contractual relationships between departments and agencies. In addition, some 'market' elements involving the use of the private sector and price incentives had been added, but the government had stopped short of privatisation and elements of hierarchical control still existed, such as the use 'scripts' by the employment service staff in their dealings with claimants. These scripts were devised at a high organisational level to police access to benefits and impose conditions for benefit receipt.

Considine argued that the Next Steps reforms allowed the government, without the need for full privatisation, to overcome the natural reluctance of civil servants to implement their tougher benefit regime. Paradoxically, the creation of Next Steps agencies, while putting the

employment service at arms-length from Whitehall, had introduced a contractual relationship which allowed central government to control them through targets: 'the corporate mission of the ES [employment service] became a more overt extension of Conservative party doctrine than would otherwise have been possible in a 'neutral' generalist civil service.' (Considine 1999: 61). He argues, in other words, that the choice of a contractual form of management was driven by the need to deliver a tougher benefits regime against the resistance of the existing bureaucracy. If Considine argues that privatisation may not be necessary to implement an active labour market policy, Mabbett draws on experience in Australia and the Netherlands to suggest that the public sector may, in any case, be more effective than the private sector in policing benefit conditions:' financially-constrained public authorities may have a stronger incentive to enforce 'illiberal contracts' than private providers' (Mabbett 2009:146).

Finn (2000, 2001a, 2001b, 2003, 2005, 2008, 2010, 2011, 2015) provides further evidence that the link between policy and implementation is not straightforward. He stands out for his critical but not ideological evaluations of the creation of a 'welfare market'. His starting point is that private providers have been present in employment services for decades, and thus any critique of their involvement must be based on a close examination of the contractual forms adopted and their effects on incentives and behaviour. An early evaluation of the New Deal (Finn 2003) based on interviews and focus groups with Employment Service advisers and young people highlighted that the programme had led to significant numbers signing off (leaving benefits), suggesting that there was an important element of benefit policing through conditionality in the programme. It also detected early indicators of 'cream-skimming', with advisers facing a lack of appropriate services to offer the most disadvantaged clients.

The study largely dismissed fears that the programme was designed to force young people into low paid and insecure 'McJobs'. Advisers reported having to address the unrealistic expectations of some young people, but at the same time they believed that forcing someone into an inappropriate job would not result in a sustained placement. However, Finn (Finn 2003:715) also reported that advisers felt that the introduction of new job entry performance targets would have an effect on the way the programme worked. It was becoming less personalised, more routinised, and more oriented to achieving targets.

Finn (2003:718) also reported that advisers were often frustrated by centrally prescribed measures which they felt to be of limited effectiveness. In particular, the sanctions regime (loss of benefits for failure to comply with programme requirements) was viewed negatively by many advisers. They wanted more discretion to address the varied motivations, circumstances and (sometimes) multiple problems of their clients. As we will see, this desire for more scope to exercise discretion and judgment has influenced the evolution of the programme, although benefit sanctioning remains a highly prescribed and rule-based process.

The detailed studies undertaken by Considine and Finn challenged the widely held assumption that the involvement of private actors necessarily bring with them more workfare and policing (Considine 2001; Finn 2002). So, while some assume a link between active labour market policy and the choice of private sector delivery because of the 'chain of contracts', this link is under-explained. This thesis explores the complex interaction between policy objectives and delivery mechanisms.

Dunleavy's concept of bureau-shaping suggested a different motivation for the adoption of outcome-based payment (Dunleavy 1986). Dunleavy accepted rational choice institutionalism's premise that bureaucrats are utility-maximisers, motivated by self-interest, but argued that the wish to create the right kind of high-status role is a greater motivation for them than the maximisation of budgets envisaged by, for example, Niskanen (Dunleavy 1986:16). He saw the choice of contracting out as driven by these self-interested concerns, rather than any wish to further policy objectives or even a governmental concern with being re-elected. This desire explained, for him, what he identified in 1986 as a 'boom' in privatisation (by which he meant contracting out) under the Thatcher government (Dunleavy 1986:13). He described this as a 'blanket' approach, spreading across government, even into areas where privatisation was 'inappropriate' because it did not serve the public interest (Dunleavy 1986:15, 22). Privatisation was not being pursued, in other words, because it was more efficient as a way of government delivering policy objectives, but because it served bureaucrats' personal interests. Dunleavy presents this concern for high status roles as universal among senior civil servants (Dunleavy 1986:20,21).

This bureaucratic motivation may well have played a part in the decision-making calculus when the delivery models were chosen for the various welfare-to-work programmes. The

same can be said for the other motivations identified by the welfare-to-work literature: the furtherance of neo-liberal principles, profit-seeking or a concern to implement active labour market policies. However, these concerns tend to apply across the board – to all welfare-to-work policy or, in Dunleavy's case, to every decision made by senior civil servants. More is needed to explain why outcome-based payment was chosen for some programmes, while service fee contracts, or public sector hierarchy, were the chosen mechanisms for others. The debate over the exact nature of the policy objectives behind the Conservative and New Labour welfare-to-work programmes may point to a more nuanced explanation – that different delivery approaches might be driven by different objectives hidden underneath superficially similar policies. The power play between different bureaucratic actors may also have a role in producing a variety of choices. In its discussion of decision-making costs, the thesis examines the role of different parts of the bureaucratic machine.

A sociological, rather than functional, approach can provide more in the way of explanation for the diversity in the institutional choices made by governments in the welfare-to-work field. Institutional isomorphism suggests that institutional forms spread not because of the rational strategic decisions made by a series of individuals and organisations, but as a result of societal pressures which drive them to adopt the forms whether or not they are efficient. The adoption of these forms meets other needs than efficiency – it allows individuals and organisations to 'fit in', or achieve legitimacy (Di Maggio and Powell 1983). The spread is not instantaneous, and so the theory would predict that different institutional forms would co-exist for a period of time.

The theory suggests three ways in which forms spread. The first is coercion – broadly defined – which may mean legislative diktat but can also mean pressure to conform to the desires of a main funder, or to a growing pressure in the society surrounding the organisation. The second, mimesis, comes about when organisations in an uncertain environment, with no clear information about what institutional form will be the most efficient, seek to imitate other more successful organisations. Finally, professional communities can create normative standards which drive the adoption of certain forms (DiMaggio and Powell 1983:152). The exact nature of the organisational field across which the institutional forms are spreading will determine which of these mechanisms is at work, and the speed of the spread.

This theory certainly seems to offer an explanation for the spread of market and contract-based approaches from the US and across the government in the UK from the mid-1980s. However, it falls short of a complete explanation for the rather hesitant and wandering nature of that spread. Outcome-based payment was first used in welfare-to-work policy by the Conservative government in the 1990s, but, at the same time, the same government was deciding against using the private sector to run jobcentres. In the period examined by this thesis, the Young People's New Deal – the government's flagship employment programme – was run under a service fee model, while at the same time other smaller programmes were being introduced by the same department using outcome-based payment. The New Labour government showed a clear and consistent interest in the outcome-based approach from its arrival in power in 1997, and yet it was twelve years before it replaced the Young People's New Deal with a programme – the Flexible New Deal – which used it.

The theories discussed above, then, offer a number of valuable insights into the motivations for choosing a market-based, outcome-based approach. The process tracing which takes place in Chapters 4-7 will reveal whether these motivations were present in the welfare-to-work case. Where these theories struggle, however, is in explaining why the same ministers and bureaucrats would choose outcome-based payment in some places and not in others. This thesis will test the ability of principal-agent theory and transaction cost analysis to fill this gap.

The contribution of principal-agent theory and transaction cost analysis

There are three reasons to doubt, at initial sight, whether transaction cost analysis and principal-agent theory are able to solve the puzzle presented in this thesis: a tendency towards normative rather than positive analyses in the literature; a preference for hypotheses-building rather than testing; and the focus on the US system. In this section, I will tackle these questions and show briefly how the theories are nonetheless able to offer some possible answers. Chapter Two will then describe the theories in detail and derive testable hypotheses from them.

The positive approaches in the literature

It is true that many of the rational choice institutionalist analyses which pervade public management literature treat the theory as normative rather than positive. Economists draw on principal-agent theory and transaction cost economics to evaluate reforms and make recommendations about the institutional designs that the government should choose. For example, LeGrand (1991) uses transaction cost economics to point out a number of issues in the design of quasi-markets, but offers only a few random thoughts about the reasons why quasi-markets are being introduced. New technology, disillusionment with large organisations, and industrial relations considerations are mentioned, but '[w]hatever the reason, the very universality of the phenomenon suggests that there are perhaps fundamental forces at work' (LeGrand 1991: 1262). Clearly, this is not helpful in understanding why a reform is introduced in some places and times but not others.

However, this thesis draws on the work of those writers who use the principal-agent and transaction cost frameworks to address the apparent contradiction between the principles of rational choice, which would appear to make the use of market-based solutions the preferred approach for rent-seeking politicians, and the pervasiveness of non-market institutions in government. To answer this puzzle, transaction cost analysis and principal-agent theory look to the behaviour of private sector firms, which also often choose internal bureaucratic hierarchies to carry out their activities, rather than outsourcing them to the market. Drawing an analogy between a government's decision to delegate or privatise and a firm's decision to outsource, these theories assume that, whereas firms are motivated by the search for profits, governments are motivated by a combination of policy objectives and electoral success. As rational actors, governments must be choosing the institutional forms that they believe are most likely to deliver policy outcomes or electoral success. Proponents of principal-agent theory and transaction cost analysis, therefore, see variation in institutional choice as a product of rational calculation, and one that is explicable using their rational choice approach.

This approach has yielded a number of insights into the institutional choices of politicians. Williamson led the way by identifying a whole range of costs arising from different institutional models and explaining government's choices as a result of the balance of these costs in any particular situation (Williamson 1999). Others followed with studies into particular choices, seeking to identify the most the particular costs and risks which motivated governments. Epstein and O'Halloran, for instance, showed that Congress chose to keep or

delegate power according to the degree of its political alignment with the executive, retaining power to itself when the risks of delegating to an unaligned executive were considered too great. Huber and Shipan (2002) conducted a comparison across different countries and levels of governance to confirm their prediction that "the institutions for cabinet control of bureaucracy [would] vary in systematic ways with the type of problems that cabinet ministers face in different parliamentary systems" (Huber and Shipan 2002:p404). Peltzman (1989) explained the wave of deregulation that occurred in the US in the 1980s by arguing that the rents available for extraction had fallen relative to the efficiency gains from deregulation, and that a political coalition could assemble around those who benefited from the latter. His hypothesis led to highly differentiated account of developments in banking, telecomms, airlines and other industries (Peltzman 1989: 20-21). Horn used the concept of the 'commitment problem', drawn from transaction cost analysis, to explain the puzzling ubiquity of certain institutional forms – public sector agencies and state-owned enterprises – despite the fact that they are widely seen as inefficient and that they weaken the power of politicians. He suggested that governments choose these forms rationally as an attempt to honour their contract with their voters by preventing future governments from reversing their policies.

These studies have thrown up a number of insights which could help explain the different choices made in the welfare-to-work field, which are examined in greater detail in Chapter Two. These insights are not, however, in total opposition to the other explanations set out in the first half of this chapter. The various motivations suggested by these other theories may well feature in the calculations made by the rational actors that rational choice theory envisages. Indeed, the case study will show that bureaucratic politics, specifically disputes between the policy department and the Treasury, were key to the choice of outcome-based payments. The approach used by principal-agent theory and transaction cost analysis emphasises the balancing of numerous risks and benefits. Even the non-rational motivations offered by sociological analyses may play a part in the creation of the preferences of rational actors, and transactional cost analysis acknowledges that rationality is bounded.

This thesis does not intend to argue for transaction cost analysis and principal-agent theory at the expense of other theories. It aims, rather, to use the insights of these rational choice frameworks to expand our understanding of the motivations of governments, helping to explain some of the choices they make.

The potential for testable hypotheses

Transaction costs analysis and principal-agent theory are frameworks rather than full, tested theories and much of the literature generates hypotheses from these frameworks without providing a great deal of empirical backing. Some writers, however, have succeeded in finding empirical confirmation of their hypotheses. Epstein *et al* and Huber *et al* found ways to test their hypotheses through quantitative studies of legislation. Horn, Dixit, Tirole and Williamson used case studies to test their ideas. Horn acknowledged the limitations of his approach, saying that '[i]n a great many instances, the case material does little more than illustrate the point being made' (Horn 1995:34). However, he defended his position with reference to Jensen's weak test: '[a]ny theory in its early stages of development "that is likely to be useful or worthy of detailed consideration should not be vastly inconsistent with the readily available institutional evidence".' (Horn 1995: 34). He also undertook to 'improve on existing explanations' (Horn 1995:34). While this is a fairly modest enterprise, it is also a fair description of the approach taken by Dunleavy or those critics who ascribe the choice of market-based mechanisms to neo-liberalism.

Applying principal-agent theory and transactional cost analysis in the UK

Much of the principal-agent theory and transaction cost analysis literature focuses on the US Congress, and this raises the question of its application to the UK (Moe 1984, Epstein and O'Halloran 1999, Bawn 1995, McCubbins, Noll and Weingast 1987, Weingast and McCubbins 1989, Fiorina 1982). Indeed, Epstein and O'Halloran discuss how far the hypotheses which they have developed would apply in parliamentary systems and conclude that, while they could offer some insight into the situation in certain parliamentary systems, those operating the Westminster model are too different for their model to apply in any meaningful way. (Epstein and O'Halloran1999: 242ff).

However, the fact that there are differences in the institutional environment in the UK should not make the insights from work in the US unusable. Huber and Shipan's study compared experience across different countries and levels of governance (Huber and Shipan 2002). Obviously, the countries and US state legislatures which they compared had very different institutional arrangements, but they were able to isolate common factors driving delegation decisions across these different environments. Horn included non-US case studies in his examination and made what he acknowledged was 'a very modest attempt to apply the

political economy approach to countries, like New Zealand, that have a Westminster system of parliamentary government' (Horn 1995: 39).

So, can the insights from this work throw useful light on the workings of the UK government? The first aspect in which the UK system differs from the US Congress is the existence of multiple principals. Certainly, the arrangements of ministerial responsibility for portfolios, collective responsibility in Cabinet and executive dominance of the legislature mean that multiple principals are not a formal feature of UK government. However, Mitnick makes clear that the notion of a principal is wider than simply the person or body in direct contractual relationship with the agent (Mitnick 2019). Parliament, other government departments and agencies with a stake in the policy, media, the judiciary and so on can all be considered principals, if the agent experiences some requirement to take their views into account and act in accordance with them (Mitnick 2019, Moe 1984, Tirole 1994).

Moreover, in government, there is a chain of principal-agent relationships, beginning with the electorate as principal of the government (Moe 1984:765). All but the most anodyne of policies in the UK, then, should create a cast of principals – from sections of the electorate, through influential interest groups to various statutory bodies who generate desired outcomes for the policy and vie for influence over the agent.

The second aspect in which the relevance of the literature to the UK context might be questioned is the concept of decision-making costs. At first sight, this seems difficult to apply to the UK, given the relative lack of veto points compared with the US system. However, the UK government is not a complete monolith. Decisions are made within a department in which there will be several ministers and a number of influential civil servants. That department will discuss and agree the decision with other government departments such as the Treasury, the Cabinet Office, and the equalities department. While some of these departments are seen as more powerful than others, each is a potential veto player if enough is at stake.

There are also costly decision-making processes around the budget. Annual and triennial processes seek to reconcile the competing plans of government departments with the overall spending 'envelope' or planning total. Patashnik (1996) applies transaction cost analysis to the US budget process, arguing that transaction costs explain several notable features. Of particular interest are strategies to hypothecate funds, thereby protecting them from the general competition over the allocation of the fiscal common pool. Hypothecation strategies

have been effective in protecting particular spending programmes in the US. In the UK, Treasury has generally successfully resisted hypothecation, in effect demonstrating how powerful Chancellors have been able to keep spending programmes within the ambit of the regular budget process, instead of being forced to concede exceptions in order to reconcile competing claims and get the budget agreed (Thain 1990).

Nonetheless, all spending programmes are not equal in the UK budget process, indicating that decisions may be structured in ways that facilitate budget decision-making by reducing transaction costs. One device which reduces such costs is to create entitlement programmes, whereby expenditure is automatically allocated to ensure that legal entitlements are honoured (Patashnik 1996: 199-200). This simplifies the budget process and implies that departments may try to protect their programmes by creating entitlements, or linking spending plans to entitlements.

It is true that the detailed conclusions reached in the US environment may not be directly transferable. For example, Epstein and O'Halloran's theory of Congressional delegation is difficult to translate onto any UK case, as it involves delegation by a policy-making legislature to executive agencies. There are simply no actors making delegation decisions in the UK who face the same institutional choices or incentives as those faced by Congress in Epstein and O'Halloran's cases (Epstein and O'Halloran 1999). However, political actors in any democratic polity will act from the same range of motivations - to achieve policy outcomes and electoral success - and so be vulnerable to the same risks to those objectives. The risks which affect political actors' decision-making in the US will, therefore, also be relevant to the UK situation, though the institutional specifics of the system in which delegation choices are made will affect the scale of the various risks. Those institutionally created differences are, after all, the very focus of principal-agent theory and transaction cost analysis.

Conclusion

The welfare-to-work policy field in the UK presents a puzzle – why was outcome-based payment used in some cases, but not in others? The literature offers functional and sociological theories for the choice of outcome-based payment. The functional explanations

certainly identify motivations which must form part of the political actor's calculations. However, these are 'across-the-board' explanations, applying to all decisions made by neo-liberal governments, by governments pursuing active labour market policy or by bureaucrats. They struggle to explain why different decisions are made by the same governments at the same time in different welfare-to-work programmes, or why similar decisions are made by governments of different colours. Institutional isomorphism goes further in explaining why a particular form – such as outcome-based payment – will progress gradually through a government's policies, rather than being adopted universally all at once. However, according to this theory a government department introducing a number of welfare-to-work programmes would seem to offer an environment in which a favoured institutional form would spread rapidly. It is difficult to explain why it would take so long for outcome-based payment to spread from smaller programmes to the government's flagship programme.

All these theories provide useful insights. The various motivations they identify could certainly have formed part of the assessment of costs and benefits that drove the institutional choices that were made in welfare-to-work. Moreover, they suggest that the detail of policy objectives lying beneath the superficial format of the programmes may be part of the explanation. This thesis will build on these insights and then look further, to principal agent theory and transactional cost analysis, to offer a fuller explanation. These frameworks emphasise the importance of the specific circumstances in which each institutional decision is made, and so may provide the level of detail lacking in the other theories. The next chapter will look more closely at these theories and will formulate hypotheses.

Chapter Two

Deriving Hypotheses from Principal Agent Theory and Transaction Cost Analysis

A rich and varied literature explores the institutional choices which political actors make. This thesis draws upon those strands of thought which try to explain these institutional choices using principles and insights developed in economics – the approach which has dominated the field of delegation theory (Pollack 2003). As Moe described in his influential 1984 paper, this 'positive political theory' is characterized by 'a contractual approach to relationships, an interest in the nature of hierarchical control, rather than market-based systems, and formal analysis using principal-agent models' (Moe 1984:739).

This approach addresses a number of questions: what choices do political actors make about delegation and in what circumstances; what are the motivations behind their choices; and do they make the best choices on behalf of the electorate which they are supposed to serve? While the body of work is built on a number of shared assumptions drawn from its economic origins, it contains several different schools of thought which reach very different answers to these questions. Before examining these differences, I will briefly explain the economic theories which inspired the various analyses. These are the principal-agent theory, as mentioned by Moe, and the related field of transaction cost analysis (Moe 1984).

These theories are concerned with the ways in which economic actors structure their relationships, and specifically why they choose market relationships in some circumstances and hierarchical structures in others. In the 1980s, the potential for applying these ideas to the political arena was increasingly recognised, including the application to decisions that politicians made about delegating and contracting out their functions. In describing these original economic ideas, I will draw on the summaries provided by Moe (1984) and Epstein and O'Halloran (1999).

Transaction cost analysis and principal-agent theory were developed to explain how firms in the private sector make decisions about their institutional arrangements. Specifically, the theories focus on which activities a firm keeps in-house; which are outsourced; and how, having outsourced an activity, firms seek to control the performance of their agents. Both Moe, in his 1984 article, and Epstein and O'Halloran (1999), describe them as reactions to, or

elaborations of, the neo-classical approach to firms and to organisations more generally. Moe characterises the neo-classical conception of the firm as 'simply a black box that produces optimal choices automatically as a function of any given environment' (Moe 1984:740). The world of the neo-classical economic model is a simple and certain one. Competition is perfect, while economic actors are perfectly rational and operate on perfect information. Economic transactions are driven by the laws of the market and ensure that the costs and benefits are properly allocated among the various parties (Epstein and O'Halloran 1999:35).

Principal-agent theory and transaction cost analysis examine, from different angles, the implications of introducing realistic imperfections into this model. They consider how these imperfections affect the behaviour of economic actors and shape the institutional arrangements that they create to cope with them, such as corporate structures, contractual models or employment practices. In doing this, they retain the neo-classical belief in a world of rational actors seeking to maximise their utility, though this chapter will show that the transaction cost analysis view on this is more nuanced than that taken by, for instance, Huber, who assumes that 'principals respond optimally to the problems they face' (Huber and Shipan 2002:398, also Pollack 2003, Weaver 1986, Voigt and Salzberger 2002).

Principal-agent theory

Principal-agent theory is, in fact, not a unified theory at all, but a field of enquiry into the relationship between a firm (the principal) and a second economic actor (the agent), who the first firm contracts with to carry out activity or make decisions on its behalf. While the contractual relationship between the two should, according to neo-classical economic principles, allocate the costs and benefits of the interaction fairly between the two, in the real world there are imperfections in the arrangement. Principal-agent theory focuses first and foremost on the problem of asymmetric information (Moe 1984, Epstein and O'Halloran 1999). Agents know far more about the effort they are expending and the costs they are facing than their principals. While principal-agent theory is used extensively to examine the relationship between firms, or between a firm and its employees, it has also, from its beginnings in the 1970s, looked beyond the firm to all sorts of principal-agent relationships (Mitnick 2019, Moe 1984).

This principal-agent relationship creates two risks for the principal. First, because agents always know more about their own expertise and capacity, a principal may choose incorrectly an agent who is not best qualified for the task (adverse selection). Once chosen, agents can hide information from their principals about the amount of effort they are actually investing in the task. Principals are then vulnerable to the risk that they will overpay an agent relative to the effort that agent is investing (shirking) (Alchian and Demsetz 1972:780).

A principal will try to shape the exchange with an agent, through the contractual arrangements, to manage these 'agency costs', but the risk of shirking and adverse selection will be greater where the activity of agents is more difficult to observe and verify (Hart *et al* 1997). In some circumstances, then, a firm will decide to escape the costs created by the contract, and bring an activity in-house, to be carried out by direct employees. These employees are agents of the firm, just as an outside contractor would be, and agency costs arise in this relationship too (Alchian and Demsetz, 1972). The difference between delegation to an outsourcing firm and to a firm's own workforce is the measures available to the firm to reduce these agency costs. In delegating to its own workforce, the firm's tools are the range of management controls – supervision, performance pay and so on. It is difficult to create, in-house, the strong financial incentives created in the market by the price mechanism (the 'high-powered incentives') (Williamson 1981). Employees do not have ownership rights to the product of their labour, and do not profit directly from it. They cannot, therefore, increase their financial rewards directly by being more efficient. Performance bonuses, share schemes and so on are imperfect attempts to recreate this type of incentive. (Jensen and Meckling 1976).

On the other hand, the instruments of in-house management allow for a more finely tuned control of the agents (in this case, employees) because of the constant and close contact between employee and manager. Performance which is less easily reduced to quantifiable targets may be more easily managed by these methods. So, the choices available to a firm boil down to a range of institutional arrangements, each of which carries costs (Acemoglu *et al* 2008). The scale of the costs will be determined by the type of activity being delegated and the economic and organisational environment in which the delegation is being made. The principal-agent framework can, therefore, be used to explain the institutional choices which firms make in certain circumstances and the factors which have led to the development of

those institutions - such as contract law, tendering processes, performance management systems in firms, and the structure of organisations.

Transaction cost analysis

Transaction cost analysis came to prominence due to the work of Williamson (1981), drawing on earlier work by Coase (Coase 1937). The aim of the theory was to explain the boundaries of firms. Firms exist to produce goods and services through a chain of value-adding activity. Why is it, Williamson asked, that companies decide to carry out some of these activities in-house using direct employees controlled through the management structure, while they contract out other activities to separate firms and govern those relationships through commercial contracting? In one case, the firm chooses the institution of employment law and, in the other, it chooses the institution of inter-firm contracts. What factors drive that decision?

These are, obviously, similar to the questions addressed in principal-agent theory. Transaction cost analysis, however, identifies a wider range of costs than those concerned with control of an agent. These are the 'transaction costs' (Williamson 1981). They are the costs which arise in economic transactions above and beyond the price of exchange. Dixit defines a transaction cost as 'anything that impedes the specification, monitoring or enforcement of an economic transaction' (Dixit 1996:38). These costs vary depending on whether a firm outsources activity or carries it out in-house.

Transaction cost analysis recognises the agency costs identified by principal-agent theory, but adds further considerations, including the relative costs of developing in-house expertise and capacity, against managing a relationship with an expert agent. If the firm expects to undertake the activity for an extended period, and the outsourcing market is limited and expensive, it may be less costly for a firm to develop the expertise to carry out the activity in-house, saving it the costs of sourcing in the market. On the other hand, a firm will prefer not to invest large amounts in an activity which it does only rarely or for a limited period and will try to outsource it to a firm which specialises in the activity. If the investment is very specific to that one activity, however, outsourcing raises risks for both parties. The firm to which it is outsourced may invest heavily only to lose the contract before the investment is recouped. It will consequently seek to tie the outsourcing firm into a long contract. Such a long contract creates risks for the outsourcing firm. Even without the legal ties of a contract, the outsourcing firm may find that no other firm in the market is willing to make the necessary

investment, effectively binding it to the firm to which it initially outsourced the activity. The need for asset-specific investment, then may make a firm vulnerable to being 'held up' by its agent, which can exploit the lack of competition (Epstein and O'Halloran 1999:41ff).

Additional transaction costs arise from the incompleteness of contracts (Epstein and O'Halloran 1999:37-8). In an ideal world, when a firm outsources activity to another, the contract which is drawn up between them would cover every eventuality and set out clearly the respective responsibilities and liabilities in every case (for instance, what happens when bad weather prevents deliveries of goods from the contracted firm). However, in a realistically imperfect and uncertain world, it is impossible to foresee all eventualities and contracts are, therefore, generally incomplete. This creates risk for both parties to the contract – they cannot know, in advance, what their liabilities will be if an unforeseen event should happen. In such an event, the question of which part holds the residual rights becomes key. In other words, who can dictate the terms between the two parties in circumstances unforeseen by the contract? (Epstein and O'Halloran 1999:38)

In line with principal-agent theory, Williamson assumes that firms will choose between the available institutional arrangements in an attempt to control and manage these various risks. (Williamson 1981). Transaction cost economics, however, emphasises the bounded nature of rationality. Firms will balance the costs of each imperfect option and try to pick the best. However, they are not gifted with perfect information or perfect rationality. They will 'satisfice', rather than optimise (Williamson 1999). Nonetheless, we can assume that an institutional arrangement chosen by many firms, who have carried on trading, must at least be serviceable, if not optimal (Moe 1984).

The principal-agent and transaction cost schools, then, build on economic principles in order to develop explanations for the institutional structures within which firms work. While they developed from different seeds, principal-agent theory and transaction cost analysis have cross-fertilised each other as they have developed. In his account of the development of principal-agent theory, initially written in 2006, Mitnick describes how he drew on Williamson's observations (Mitnick 2019). This is not to say the terms principal-agent theory and transaction cost analysis are completely interchangeable. Mitnick describes principal-agent theory as 'vertical rather than horizontal'(Mitnick 2006). Transaction cost analysis also lays a far greater emphasis on the implications of bounded rationality (Moe 1984). However,

the hypotheses generated by the two streams of work are compatible and mutually reinforcing.

Together the two schools characterise the institutions of the market and of hierarchical organisations as the result of the efforts of rational (if only boundedly so) actors to manage the costs produced by an imperfect world – uncertainty, unevenly distributed information, and the various expertise and investments required for different activities. These actors create a range of institutions – both in the market and in organisational hierarchies – to manage these costs and then choose between them according to the particular circumstances in which they find themselves. Moe in 1984 encouraged his fellow political scientists to consider the potential which this thinking had to shed 'interesting new light on bureaucratic behaviour by focusing on hierarchical control' (Moe 1984 p772).

Transaction cost analysis and principal-agent theory applied to government

The ideas developed in economics and organisational studies came to the attention of political thinkers in the 1980s. Moe's 1984 paper was an explicit call to his fellow political scientists to use the framework. He identified three questions for which it could be useful: '(1) Why do public bureaus exist, as opposed to alternative arrangements for the provision of public services? (2) How can bureaucratic superiors control bureaucratic subordinates? (3) How can politicians, as principals, control their bureaucratic agents?' (Moe 1984:758)

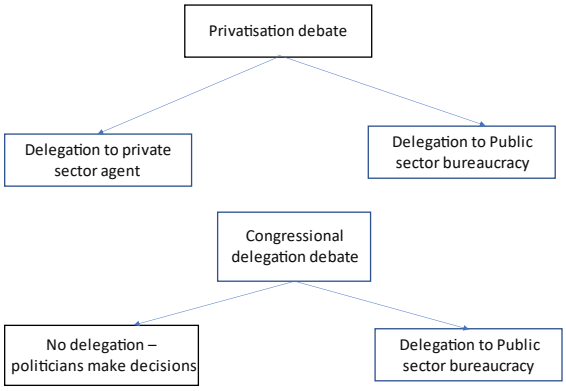
As the interest in the field increased, certain writers and certain arguments leaned more heavily on principal-agent theory or on the transaction cost analysis framework, but the two were sometimes conflated. For example, Pollack, in his review of the literature in his 2003 book (Pollack 2003) refers exclusively to principal-agent theory but includes in his description of it concepts, such as incomplete contracts, which emerged from the field of transaction cost economics (see Grossman and Hart 1986).

In the following years, a debate on the merits and limits of privatisation developed round Moe's first question: why do public bureaus exist, as opposed to alternative arrangements for the provision of public services? His second and third questions, on the relationship between political actors and bureaucracies, were explored by Congressional scholars debating the

extent of Congress' delegation of its powers to bureaucrats and public agencies. Both lines of enquiry are relevant to this thesis.

The two lines of enquiry in fact consider two different choices. The privatisation debate focuses on the choice between (a) delegating to private sector agents managed though market contracts, and (b) delegating to public sector bureaucrats managed through a hierarchy. The Congressional delegation debate, on the other hand, looks at the choice between (a) delegating decisions at all, and (b) keeping decisions' in-house' (i.e. in Congress or, more generally, in the hands of politicians). When it considers delegation, it looks exclusively at delegation to public sector agents i.e. bureaucrats.

Figure 2: The privatisation debate versus the congressional delegation debate



Despite the different focus, the two debates – on privatisation and on delegation within government - have a number of aspects in common. First, both start from a critique of the relationship between political actors and public sector employees/agencies who carry out their will (or are supposed to). A range of views on that relationship, ranging from negative to positive, can be seen in both debates. The view that the relationship between political actors and bureaucrats is unsatisfactory and symptomatic of an entirely self-serving attitude in political actors is shared by North in the privatisation debate (North 1990) and Lowi in the debate on bureaucratic delegation (Lowi 1969). The more optimistic view, that political actors are in fact seeking for policy outcomes in good faith and making institutional choices in the pursuit of them is expressed by Williamson in the privatisation debate (1999) and

Weingast and Moran in the discussion about bureaucratic delegation (1983). Finally, all of the contributors to both debates share a vision of political actors as rational (if perhaps only boundedly so) and making deliberate choices in pursuit of their desired objectives.

In the following sections, I will examine these two debates in detail, drawing out the insights which are relevant to a study of outcome-based payment. The discussion of privatisation suggests that common features of the public policy environment, such as multiple principals and incomplete contracts, may sometimes make it more efficient to manage certain policies by delegating to a traditional bureaucratic hierarchy, rather than by managing agents through market. The debate on the delegation to bureaucrats suggests two alternative motivations for delegation and identifies some of the factors which would influence political actors' decisions on delegation and the way they arrange it.

Privatisation

Writing in 1998, Shleifer notes that 'In recent years, … the evidence on the failures of state ownership in economies around the world has begun to accumulate (reference omitted), and advances in the theories of ownership and contracting have reopened the question of state versus private provision' (Shleifer 1998:135). The attack on state provision stemmed from a neo-classical critique of the public sector machine, bolstered by elements of principal-agent theory. It was argued that the public sector bureaucracy was inescapably inefficient, simply because it created no incentives towards efficiency. Principal-agent theory had shown that 'the principal's optimal incentive structure for the agent is one in which the latter receives some share of the residual in payment for his efforts, thus giving him a direct stake in the outcome' (Moe 1984 p.763, see also North 1990 (quoted in Williamson 1999:309)). Bureaucrats had no ownership rights to reward them for efficiency, and so could only increase their utility by shirking or producing 'slack' – 'the difference between the true minimum cost of service provision and what the bureau actually spends (the budget).' (Moe 1984 p.763).

Given this analysis, economists asked why government did not privatise services, putting them into the market where those delivering them would be properly incentivised. The answer some of them settled on was that governments were not motivated by achieving efficiency for the taxpayer or service-user, but by electoral concerns. They could win elections by 'prompt concern for constituency service, pleasing interest groups, rewarding

contributors, avoiding conflict, taking symbolic stands, and claiming credit for popular outcomes' (Moe 1984:761). In other words, politicians were making choices about the delivery of services – whether to deliver them in the market or within the public sector hierarchy - driven not by efficiency but by political motives.

This analysis was behind the campaign to privatise large sections of the public sector, of which Prime Minister Thatcher's government was seen as the leading light (Shleifer 1998). However, reservations were expressed about the analysis within the field of economics itself. Economists of the transaction cost analysis school brought to the debate their view that no institutional arrangement - even privatisation - was perfect or universally superior to all others, as each involved transaction costs. Being at least boundedly rational, actors would generally choose the arrangements that they thought was best – that is, that minimised transaction costs in their particular circumstances.

The fact that government generally chose public sector hierarchical arrangements, rather than markets, suggested there were benefits to them (Moe 1984) and the adherents of transaction cost analysis allowed for the possibility that these benefits might be in terms of efficiency, rather than the more cynical self-serving concerns identified by the privatising faction. They rejected the idea that because the public sector bureaucracy could be shown to be less than perfectly efficient, it must be chosen by politicians for reasons other than efficiency. Williamson used, instead, the notion of 'remediableness' – if there is no other arrangement that would remedy the inefficiencies of the public sector bureaucracy without introducing even more problematic inefficiencies of its own, then, despite its flaws, it is the efficient choice. As Williamson put it: 'public bureaucracy, for some transactions, is the best feasible response - its apparent inanities notwithstanding.' (Williamson 1999:310). The transaction cost analysis theorists therefore looked for the costs which arose from using market-based arrangements, and which would explain governments' preference for bureaucracy. They identified several costs arising from the very high-powered financial incentives which are created for agents by market-based contracts, and which privatisers cite as the main advantage of the market.

The first problem in using high-powered incentives is the nature of government projects. Tirole (1994) argued that 'we would expect, and do observe, low powered incentives to prevail in government' (Tirole, 1994:6). He concludes that it is because 'while private enterprises are in a first approximation instructed to maximize profits, government agencies

generally pursue multiple goals'. He argues that high-powered incentives are most effective when a principal is using an agent to achieve a simple, quantifiable, observable outcome. By attaching a high-powered incentive to such an outcome, and using competitive tendering, the principals reduce agency costs arising from shirking. They do not need to observe the effort made by the agent or monitor their costs – they simply observe the achievement of the outcome and pay accordingly.

However, in comparison to private sector activities, Tirole argued, government activities tend to have multiple outcomes, generated by multiple principals (Tirole 1994). This is generally a point made about US agencies, who may answer to the President, one or more Congressional committees, the courts and so on. However, the phenomenon can be seen in all political systems. Tirole points out, in contrast to private corporations, the principals of a government agency are 'the people' whose tastes are 'quite diverse and furthermore changing' (Tirole 1994: 5). These different principals have different goals for the activity which is being delivered, and that multiplies the outcomes being set for the agent that delivers it. The problem with these multiple outcomes is that it is difficult, if not impossible, to construct a high-powered financial incentive structure which rewards the achievement of each of these various outcomes to just the right degree. Instead, certain outcomes will be over-rewarded and others under-rewarded, resulting in a misallocation of the agent's effort.

Moreover, Tirole says that 'many of these goals are hard to measure' (Tirole 1994:1). This creates risks for government principals. It will be difficult for the principal to ascertain whether ill-defined, qualitative outcomes have actually been met, and so agents will have no incentive to achieve them. They will focus only on those outcomes which the principal can verify and pay for. Finally, the existence of multiple principals gives the agent the opportunity to play one principal off against another and earn excess rents that way (Tirole 1994, Holmstrom and Milgrom 1991, Dixit 1997).

High-powered incentives also tend to compromise quality in government projects (Laffont and Tirole 1991; Tirole 1994), because 'the government is mandated to internalize the effect of quality on consumer's surplus while the managers of a private corporation are not. '(Tirole 1994:7). Hart, Shleifer and Vishny point to a particular aspect of 'quality', which is equity in the allocation of resources. They mention the concern that, in pursuit of profits (i.e. the high-powered incentives) agents will avoid spending on particularly expensive cases. They give the example of private schools, which might 'find ways to reject expensive-to-educate

children, who have learning or behavioural problems, without violating the letter of their contracts.' (Hart *et al* 1997:1128) Alternatively, they might cut corners, for example by hiring less-qualified teachers. The problem is that 'the quality of service the government wants often cannot be fully specified'. If quality is not fully specified, leaving the contract incomplete, the agent is able to ignore these concerns in pursuit of cost-efficiency and bigger profits (see also Holmstrom and Milgrom (1991). This is particularly problematic in areas, like education or health, where equitable distribution of resources is an aspect of quality, because there is a 'danger that expensive-to-treat consumers [will] be denied care if the government pays less than it costs to treat them' (Hart *et al* 1997:1157).

Finally, Williamson argued in a 1999 paper, that the prime requirement for certain types of government activity was 'probity', by which he meant 'loyalty and rectitude'. His 'abiding concern was that, above a (relatively low) threshold, added incentive intensity undermines probity' (Williamson 1999:325). Some government activities require probity in their agents more than others. Where they do, the appropriate governance for that activity involves: '(1) very low-powered incentives, (2) extensive administrative controls and procedures, (3) appointment and termination of the leadership of the agency by the president (and confirmed by the legislature), and (4) an elite staff with considerable social conditioning and security of employment. As between public and private, those attributes were best realized by a public bureau' (Williamson 1999:338). He went on to explain that transactions for which probity was necessary were 'very long term (of a self-renewing, ongoing kind) and are highly incomplete', but that they also required loyalty (to the leadership and to the mission) and process integrity (Williamson 1999:324)

Transaction costs analysis, then, proposes that an essential part of what the government wants to achieve – parts of its ideal policy outcome – may be lost under a high-powered incentives regime, and is more easily achieved within the public sector hierarchical structure. It follows that governments may choose not to privatise for reasons of efficiency. Hart *et al* argue that 'the weak incentives for cost reduction under public ownership are socially efficient' while 'the incentives for cost reduction under private ownership are inefficient, since the private owner ignores the substantial damage' (Hart *et al* 1997:1142). Williamson takes issue with the position of privatisation advocates like North, saying that while North interprets the use of bureaucratic structures as evidence of inefficiency, he believes that the problems North identifies arise from the inherent difficulty of the policies themselves rather than from the

bureaucracy and that, for these policies, ‘public bureaucracy…is the best feasible government response.’ (Williamson 1999:130)

Taking foreign policy as his case study, because it is the hard case which everyone agrees cannot be privatised, Williamson identifies three contractual ‘hazards’ which arise in governmental principal-agent relationships and which can make a government activity difficult to privatise: cost control, asset specificity and probity. While the need for cost control would favour an institutional arrangement which gave the agency autonomy to manage its operations and find cost efficiencies, the latter two hazards are best managed by a cooperative structure, giving the government ongoing involvement in the agent’s decision-making (Williamson 1999:322). Applying these insights to other government functions, he notes that procuring office supplies presents hazards of cost control, but none of asset specificity or probity. Defence procurement presents hazards of cost control and asset specificity. While foreign policy is the only area he identities as having significant probity hazards, he suggests tax collection and the administration of prisons involve probity hazards ‘of intermediate’ degree. While office supplies can be procured in the market unproblematically, therefore, tax collection may require some form of regulation. When it comes to prisons, the government should own the physical asset and, while the operation of the prison could in theory be franchised out, ‘quality considerations - herein reflected as probity - signal precaution.’(Williamson 1999:339).

In summary, Williamson, Tirole and others do not rule out privatisation as an efficient way to deliver government objectives, but describe a number of circumstances in which it will actually be more effective – that is, it will achieve more of the desired outcomes – to deliver that policy or programme through a traditional public sector bureaucracy. These circumstances include the presence of multiple principals and therefore multiple objectives, the existence of incomplete contracts where government cannot define in advance the decisions it will want to be taken in the future, and policy areas where the desired outcomes cannot be clearly defined and quantified (such as quality).

Delegation to bureaucrats

While the privatisation debate considered the choice between delegating to public sector and private sector agents, the second major debate in the literature considers the reasons that a government would consider delegating decisions at all. It examines the costs and benefits of delegating decisions to an agent, compared to the costs and benefits of making decisions

within the government itself. Although it is almost exclusively focussed on delegation to public sector bureaucrats, rather than private sector agents, it may still have relevance to outcome-based payment. In choosing to use outcome-based payment, a government is not just choosing to use the market mechanisms of high-powered incentives. It is making a prior decision to delegate important decisions about which outputs to pursue and how much to invest in them. It has the alternative of making those decisions itself by specifying the outputs. The bureaucratic delegation literature identifies the costs and the risks of delegation, and the methods governments use to mitigate those risks. The insights it has produced may, therefore, throw light on the choices which UK government made in choosing outcome-based payment and designing the payment systems and contracts.

Like the discussion on privatisation, the debate on delegation to bureaucrats grew out of a critique of Congress' choices about delegation, before splitting into two broad strands of thought. The first strand built on concerns which had long been expressed about the extent to which Congress delegated the decision-making powers which it was granted in the Constitution (Epstein and O'Halloran 1999:19.) The debate was revived in the late 1960s by contributions such as Lowi's *The End of Liberalism: the second republic of the United States* (1969). Because this critique emerged in the political science field, its concern was less about the cost-efficiency which the privatising debate focussed on and more about democratic control. Lowi argued that Congress was carelessly abdicating its responsibility to make policy for the benefit of its electorate, and leaving decisions to a bureaucratic machine that it could not control (Epstein and O'Halloran 1999:19, Huber and Shipan 2002:22).

One of the reasons cited for Congress' willingness to delegate decisions was the wish to avoid blame for unpopular decisions or failed policies. Weaver (1986) suggested that politicians were principally driven by fear of the loss of electoral support and that they would delegate decisions which were likely to inflict concentrated losses on their own electoral constituency. A typical example might be a decision to site a dangerous chemical plant in an MP's constituency, or a change in taxation which falls particularly hard on the section of the electorate from which the decision-makers' party draws its support. Politicians will only want to keep decisions in-house where the possibility of getting credit for a policy outweighs the risk of blame. Only if neither blame nor credit is a factor will politicians consider the impact of the delegation choice on policy outcomes (Weaver 1986:379).

Hood (2002) raises a further factor in the calculation that government actors make with regard to blame. He claims that, if delegation is to protect governments from blame, the distance between principal and agent must be significant and visible to the public. Otherwise, the public will simply not be persuaded by the arrangement and will blame the government anyway. If the government principal retains the ability to influence decision-making after the delegation, it will find it harder to wash its hands of decisions made by the agents. Even if the principal deprives itself of ongoing power over the agent, it may be criticised for making the delegation decision in the first place (Hood 2002:23).

A second politically-driven reason for delegation is the avoidance of decision-making costs. These are not simply the administrative costs of assessing policy options. They are the costs generated by the political decision-making process. When a decision is kept in-house to be made by political actors, there are other actors whose agreement they need to secure. If the decision to be made is contentious, obtaining this agreement may be time-consuming and costly in terms of political capital spent in the bargaining process. This is a political opportunity cost because it uses up resources that could be used, instead, to achieve other, more politically important, policy outcomes (see Voigt and Salzberger 2002:297, on cycling). Thus the adoption of indexation for social security benefits, described by Weaver as 'automatic government' (Weaver 1986), not only avoided the blame that could periodically arise from allowing benefits to erode in real terms, but it also created a mechanism that avoided the need for periodic Congressional decisions that were costly to achieve. Epstein and O'Halloran give the example of the Base Realignment and Closure Commission which not only shifted unpopular decisions away from Congress where blame would accrue to those who allowed base closures in their districts, but also created a decision-making structure in which necessary decisions to close bases could finally be made after years of decision-making blockage (Epstein and O'Halloran 1999:1ff).

This negative, not to say 'cynical' (Epstein and O'Halloran 1999:22), view of delegation was challenged in the 1980s. The challenge was two-fold. First, it was argued that Congress could and did control the bureaucrats to whom it delegated powers. The reason that Congress often seemed to be inactive in its relationship with its agents was precisely because these methods were effective and the agencies were working within Congress' desired boundaries (Weingast and Moran 1983). Second, it was claimed that the purpose of the

delegation was not a self-interested search for political advantage, but a pursuit of better policy outcomes.

A political actor might decide to delegate the task of formulating a policy to take advantage of the greater expertise of the agent to achieve a better policy outcome. Of course, the political principal could decide to acquire the necessary information to make decisions herself, on the basis of information provided by close advisers, but in doing so she would incur costs. The balance of costs and benefits would be weighed up by the government actor in the same way that a private sector firm weighs up the cost and benefits of outsourcing activity (Williamson 1999; Huber and Shipan 2002:2; Voigt and Salzberger 2002 p297).

Another concept taken from transaction cost economics, that of incomplete contracts, suggested a further reason for delegating to obtain better policy outcomes (Epstein and O'Halloran 1999:37). A political actor cannot guarantee that the policy she pursues will remain in place for ever. She may lose power, or political pressures may strain her ability to hold to the policy. Such uncertainty can damage the effectiveness of the policy. In response to this problem, the principal can delegate certain policy decisions to an agent to put them beyond the vagaries of the political environment (Voigt and Salzberger 2002:296; Hart *et al* 1997). An obvious example is the delegation of interest rate-setting to the Bank of England in order to assure the markets that monetary policy would be free from short-term politicking. Horn argues that incumbent governments will deliberately delegate decisions to agents, depriving itself of the ability to control them, in order to prevent future governments from reversing its policies (Horn 1995).

As in the private sector, there are agency costs when activity is delegated. The agent may shirk and deliver fewer outcomes than needed. In addition, when the agent is a public sector body operating in the political sphere, there is an added agency cost. The agent may have policy outcomes of its own which are not aligned with those of the principals. 'A new public agency is literally a new actor on the political scene. It has its own interests, which may diverge from those of its creators, and it typically has resources—expertise, delegated authority—to strike out on its own should the opportunities arise.' (Moe 1990 :121). Its behaviour as an agent will not be driven only by economic considerations, but by a preference for one policy outcome over another. The delegation of information-gathering and expertise, then, creates the risk of policy drift – that is, the risk that the decision which the agent finally makes will not reflect the ideal policy outcome of the principal. It will not be the

policy which the principals would have settled on had they been making the decision themselves. As McCubbins and Page put it: 'Agency losses come in two forms: slippage and shirking' (McCubbins and Page 1987: 410–11).

Political actors have to weigh up the benefits of delegation for achieving better policy decisions or credibility against the risk of agency drift. They can try to reduce the risk of drift by limiting or controlling the agent's behaviour. First, they can simply constrain the discretion of the agent – ruling out certain courses of action, mandating others, or setting a range within which the agent's decision-making must fall. (Epstein and O'Halloran 1999: 26). This has the merit of certainty. Alternatively, they can seek to shape the decisions made by the agent through *ex ante* methods, such as specifying the administrative procedures by which the agent must make its decision, listing the bodies it must consult, the information it must take into account, or the issues it must consider (McCubbins, Noll and Weingast 1987; 1989). On a more fundamental level, they can shape the bureau – by selecting its personnel, setting its 'mission' or making it legally accountable to certain groups – so that it will permanently develop preferences which match the principal's own (Bawn 1995). *Ex post*, political actors can continue to influence the agent through continued rights of hiring and firing, fixed reviews and monitoring processes ('police patrols') or ensuring access and a voice to interest groups who can flag up problems or under-performance ('fire alarms') (McCubbins and Schwarz 1994). Some of these controls work through the 'mechanism of anticipation'. They do not actually need to be used, because the agent will modify its behaviour to prevent their use.

However, if, at the point of delegation, there is less than full information about the way in which the policy activity ought to be undertaken for the best result, then limiting the discretion of the agent may lead to a sub-optimal outcome (Bawn 1995). In these cases, it is more effective to give the agent discretion to use the information which subsequently becomes available to make the best decisions. As Bawn expresses it: 'the degree of agency independence on any particular policy reflects the legislature's willingness to trade uncertainty about policy consequences for uncertainty about agency behaviour' (Bawn 1995:63; Epstein and O'Halloran 1999).

The choices political actors make about whether and how to delegate, then, are influenced by a number of factors. They will be more likely to delegate when the information needed to make good decisions is held by the potential agents (i.e. the agents have more expertise than

the principal) and costly to obtain in-house, and when the information available at the time the delegation decision is taken is likely to change in the future. Their willingness to delegate may be reduced if they fear that the potential agents have objectives which may cause them to drift away from the politician's own desired path (Epstein and O'Halloran 1999). In that case, the politicians will consider whether they have the necessary means to control the agent without fettering their discretion to the point that their ability to make good decisions is compromised (Bawn 1995; McCubbins and Schwarz 1984; McCubbins, Noll and Weingast 1987; Weingast and McCubbins 1989). If, on the other hand, delegation is being considered to allay stakeholders' fears of politicking, the politicians will want to put visible distance between themselves and the agent. As Thatcher and Stone Sweet observe, 'where delegation takes place in order to secure credible commitment, principals cannot impose many *ex post* controls over the agent without undermining the very purpose of delegation' (Thatcher and Stone Sweet 2002).

In summary, then, the hypotheses that can be drawn from the debate on bureaucratic delegation are that governments may choose to delegate either to maximise policy effectiveness – i.e. to obtain the best policy outcomes, or to manage political risks to themselves. The objectives which drive them to delegate will also influence the particular way in which they delegate - the distance they put between themselves and the agents, the kind of agents they choose and the methods they use to control the agents' behaviour post-delegation.

This divide between the two objectives of effectiveness and political risk management cuts across both debates – privatisation and delegation to bureaucrats. One side of the argument sees politicians' motivations as basically political – they are concerned about their electoral prospects and will choose institutional arrangements that are sub-optimal for policy outcomes in order to manage risks to their political chances – such as blame, or the diversion of their time and energy to politically unimportant policies. The other side of the argument portrays politicians as making institutional decisions in order to maximise the chance of successful policy outcomes.

Figure 3: Motivations for privatisation and delegation to bureaucrats

	Motivated by efficiency	Motivated by political risk
Privatisation	Use of high-powered incentives to drive agent's performance	
Delegation to bureaucrats	Balance of efficiency advantages of delegation against agency costs	Avoidance of blame and decision-making costs

The role of efficiency or effectiveness versus political motivations is key, as these fundamental preferences drive all government action. In the original private sector application of transaction cost analysis and principal-agent theory, the question of motivation is simpler, as firms are assumed to have a fundamental preference for profit. Governments obviously do not have the same profit motive, and so electoral success and the desire for efficient achievement of desired policy outcomes are the two suggestions for what replaces profit in the public sector version of the theory.

Epstein and O'Halloran (1992), Weaver (1986) and Fiorina (1982) assume that the ultimate goal of any government – its 'fixed preference' – is electoral success, and so governments seek to gain credit for successful or popular policies and escape blame for unsuccessful or unpopular ones. The political actor adopts whatever policy goals she thinks will please her voters. Tirole also observes, in discussing the policy goals of the Environmental Protection Agency (EPA) that 'what is meant to be 'optimal' depends on what the EPA perceives to be its constituency' (Tirole 1994:4). On the other hand, political actors may also have an intrinsic interest in the achievement of particular policy goals. For ideological reasons of their own, politicians may value a policy goal for its own sake, rather than for its potential to deliver electoral advantage. Voigt and Salzberger (2002) go further and turn the argument on its head, seeing the pursuit of electoral success as a strategy for eventually achieving the ideal policy points which are the rational actor's ultimate preference.

Whatever view is taken of politicians' ultimate preferences, it is the case that, for any particular policy, a government may perceive and care about risks to its electoral chances, and it may pursue in good faith the successful achievement of policy outcomes. Whether it chases electoral success in order to achieve its ultimate policy aims, or pursues policy

outcomes simply to court voters, every government must care about both politics and efficiency. Which it places higher in its priorities in any particular policy area will depend on the circumstances.

Outcome-based payment as a case of privatisation and delegation

Principal-agent theory and transaction cost analysis, then, have contributed to two strands of thought. The first - privatisation - deals with the choice to contract with private providers rather than rely on hierarchical authority within a public sector bureaucracy. The second - delegation to the bureaucracy - examines politicians' preferences for leaving decisions to actors in the public bureaucracy, rather than make them themselves in the political arena.

Outcome-based payment straddles the two scenarios. In deciding to use outcome-based payments, the government is contracting with private providers rather than relying on hierarchical authority within a public sector bureaucracy. This is a type of privatisation akin to many of the examples considered by Williamson (1999) and Hart *et al* (1997) such as the privatisation of garbage collection or prisons, and similar issues about the use of high-powered incentives arise.

It is also, however, a delegation decision. By setting broad outcomes, rather than specifying inputs and outputs, the government is deciding to delegate decisions that it could have taken itself. It is simply that the agents to whom the government has chosen to delegate are in the private (or third) sector, rather than being public sector agencies.

The choice of outcome-based payment as an act of privatisation

As an act of privatisation, outcome-based payment uses the power of competitive contracting and high-powered financial incentives (high-powered incentives) to drive the performance of agents. The higher the level of outcomes they achieve and the lower they push their costs, the greater the agent's profits will be. However, Tirole (1994) points out that it is unusual for government activities to have the sort of simple, quantifiable outcomes which lend themselves to a market-based contractual arrangement. The outcomes sought by government are often difficult to define, measure or verify, such as 'quality' or equity. If these cannot be captured in the contract and attached to the high-powered financial incentives, they will be ignored.

This is not an insurmountable problem for the privatisation explanation. There <u>are</u> government activities which have simple quantifiable outcomes – Hart *et al* (1997) suggest

garbage collection as an example. For these areas, the use of the market and its high-powered incentives makes sense for efficiency. We would expect, then, to find that the policy areas in which outcome-based payment is used fall into this category. If they do not, some further explanation is needed for the choice of high-powered incentives**.**

The choice of outcome-based payment as delegation

As well as being an act of privatisation, outcome-based payment is also an act of delegation. Decisions which could be taken by ministers are delegated to an agent, either in order to maximise policy outcomes (i.e. effectiveness), or to manage political risks. If it is a matter of effectiveness, the government will first weigh up the costs of making decisions in-house. As well as the cost of gathering information and spending time deliberating on it, the government must factor in the cost of sub-optimal decisions taken without the higher quality information and expertise available to a specialist agent. It then considers the costs of delegating the decision. These are the agency costs of shirking and of policy drift. The assumption, if delegation is chosen, is that the benefits of delegation outweigh these agency costs.

This might be because uncertainty surrounding the policy is particularly high and the information needed to make the decision is as yet unavailable. The government therefore delegates to an agent that can more efficiently gather the information as and when it becomes available in the future and make the necessary decisions in the light of it. Also, it could be that the agent is very much more expert than the government – that is, it holds more information than the government could feasibly gather for itself. In this case, the government could employ the expert personnel directly, bringing that expertise 'in-house' so that it can call on it continuously over an extended period. However, it may, as a private sector firm might, conclude that it is more cost-efficient to procure the expertise from the market through a commercial contract that can be ended or re-tendered as necessary. A further possibility is that the agency costs in a particular case are low. The nature of activity may make it relatively easy to monitor effort and outcomes and keep agents in line. The government principal may see the agent as well-aligned with its own preferences and so unlikely to shirk or drift. In these circumstances, delegation could deliver increased policy effectiveness.

On the other hand, acts of delegation may be taken not to further the achievement of policy outcomes, but to manage political risks created by the decisions themselves. The aim might be to avoid blame or decision-making costs. The government would have concluded that it

must use outcome-based payment to push out to its agents decisions that would otherwise make it vulnerable to criticism from its voters or supporters, either because the decisions imposed losses on the voters, conflicted with their policy preferences or because there is a risk of failure in a policy dear to the voters' hearts.

Alternatively, delegating may be a way to save politicians the effort of debating the decision through the political process, using up their own time, civil service resources and political capital with their colleagues in debating the issue. This, in contrast to the blame avoidance scenario, might particularly be the case where the policy is not seen as particularly important to its voters - the government would prefer to spend its resources on other issues. The risk that the agent drifts away from the government's desired policy outcomes is therefore seen as lower than the opportunity costs of making the decision themselves. The government sacrifices some policy effectiveness to achieve other political goals.

Neither the effectiveness-based or politics-based accounts of delegation explains why delegation to a private sector, rather than bureaucratic, agent was chosen in the outcome-based payment case. The benefits of delegation could after all potentially be gained by delegating decisions to public sector agencies or to departmental civil servants. In other words, in choosing outcome-based payment as an act of delegation, the government makes two decisions – first to delegate policy decisions, and second, to choose private sector agents. Like the first decision, the decision to use private sector agents could be driven either by effectiveness or political risk. The private sector agents might be seen as more expert or better aligned with the policy goals than the civil service. Alternatively, the private sector nature of the contract might be in some way better for the avoidance of blame or reduction of decision-making costs.

In summary, the rational choice institutionalist approaches reviewed in this chapter offer three broad explanations for the choice of outcome-based payment, based on motivations of efficiency, policy effectiveness and political calculation:

a. the private sector arrangement, with its high-powered incentives, was used to drive the efficient achievement of policy outcomes;
b. the goal was to achieve effective policy outcomes by delegation to expert and or well-aligned agents, who happened to be in the private sector;

c. the goal was to avoid political risks inherent in the decisions by delegating them – and delegating through private sector contracting was the best option in the circumstances.

Of course, these explanations are not mutually incompatible. It is at least theoretically possible that all three apply - a government could have the opportunity to delegate internally controversial and potentially electorally damaging decisions to an expert and well-aligned agent using high-powered incentives attached to simple, quantifiable outcomes which perfectly encompass the government's aims for the policy. While possible, this seems an unlikely scenario. It is, however, easier to imagine a situation in which two of the three explanations apply to some extent. It is also possible that a government will want to pursue policy outcomes while also being concerned about political risks. They may then choose an approach which is a compromise – not optimal in terms of either effectiveness or political goals, but the best balance between these objectives. The question for this thesis to explore, then, is which of the objectives– effectiveness or political risk management – was the primary motivation.

Three hypotheses to explain the outcome-based payment puzzle

The hypotheses, then, need to explain the move from a service fee model in the Young People's New Deal to an outcome-based payment model in the Flexible New Deal and the Work Programme. As Pollack argues: 'the institutional design of … mechanisms (for controlling agents) can be considered as a dependent variable, which in turn reflects other factors of the political environment, which are the independent variables for the purpose of explaining institutional choice' (Pollack 2003:28). In this thesis, the dependent variable is the choice of outcome-based payment and the hypotheses suggest the independent variables which drive that choice.

The first hypothesis is that the private sector arrangement, with its high-powered incentives, was used to drive the efficient achievement of specified outcomes. The challenge, or puzzle, presented by this hypothesis is why the adoption of a private sector arrangement involving high-powered incentives was considered efficient for Flexible New Deal and Work Programme, but not for the original New Deal. The principal reason offered by Tirole, Williamson, Dixit and Shliefer for the rejection of high-powered incentives is the multiple and often difficult-to-measure outcomes desired from public sector programmes. Thus, the

hypothesis can explain the within-case variation if it can be shown that the New Deal had multiple outcomes while, by the time the Flexible New Deal and Work Programme were introduced, policy preferences had changed so that a single outcome indicator could be used.

The single outcome to which high-powered incentives were attached in Flexible New Deal and Work Programme was jobs (held for a number of weeks). The puzzle is solved if it can be shown that the New Deal arrangements favoured additional outcomes beyond that of jobs, making it too complex to use outcome-based payment. These additional outcomes were then discarded for the Flexible New Deal and the Work Programme. This might happen because the government no longer desired these outcomes and was happy for them to be ignored. Alternatively, the contractual arrangements for Flexible New Deal and Work Programme might actually provide incentives for the agents to pursue these other outcomes, by means other than attaching payments explicitly to them. For instance, the payment system might be structured to ensure that contractors could claim payments only if secondary outcomes were honoured, or there might be elements of the contract – other methods of *ex ante* or *ex post* control - which ensured that the secondary outcomes were met, even while the agents pursued the high-powered incentives attached to job entries.

The first hypothesis, then, is that the choice of outcome-based payment is an act of privatisation, for the purposes of efficiency. Outcome-based payment was chosen for Flexible New Deal and Work Programme to gain the benefits of using high-powered incentives to incentivise the agents, but was not chosen for New Deal because

a. the government desired outcomes for New Deal that would have been compromised by the use of high-powered incentives, but which were not desired for Flexible New Deal and Work Programme; or
b. by the time Flexible New Deal and Work Programme were introduced, the government had gathered data and/or developed techniques which allowed them to incentivise the agents to pursue all their desired policy outcomes, even though high-powered incentives were only attached to the job entry outcome

The other two explanations for outcome-based payment focus on it as an act of delegation. The first was that the government wished to delegate certain decisions to ensure that they were made most effectively, and the private or third sector agents were the most effective agents available. This factor drove the use of commercial contracts and this, in turn, entailed the use of high-powered incentives. They were the only way to incentivise the performance

of the agents while giving them freedom to use their expertise in selecting outputs. The high-powered incentives were not the motivating factor, but a consequence of the delegation decision.

If this were the explanation, we should expect to see a change in the factors which drive the costs and benefits of delegation between the Young Peoples' New Deal, and the latter two programmes. This could happen either because the benefits of delegation increased, or the risks of agency drift reduced. Delegation would become more beneficial if there were greater uncertainty: that is, that the information needed to make good decisions was not available to the government at the point that decisions would need to be made. Alternatively, if there were greater expertise among the available agents then the benefits of delegating to them would increase. Either new agents entered into the market, or the existing agents became more expert. On the other side of the scale, agency costs would reduce if agents became available who were more 'trustworthy', that is they were less likely to shirk, or were more in alignment with the principals' objectives and so less likely to drift away from them.

The second hypothesis, then, is that the choice of outcome-based payment is an act of delegation, for the purposes of policy effectiveness. Outcome-based payment was chosen for Flexible New Deal and Work Programme, but not for New Deal, because, between New Deal and Flexible New Deal/Work Programme, the balance of costs and benefits shifted in favour of delegation, due to:

a. Increased uncertainty raising the difficulty of making effective policy decisions in-house.
b. Newly available expertise in the provider market increasing the benefits of delegation;
c. Newly available providers who were less likely to drift from government's desired outcomes.

The final explanation for delegation is to do with political, rather than policy, costs and benefits. The hypothesis is that the goal was to avoid political risks or costs inherent in the decisions by delegating them, and delegating through private sector contracting was the best strategy for achieving this goal. If this were the case, then the risk of blame, or the decision-making costs, must have increased between New Deal and Flexible New Deal/Work Programme.

The third hypothesis, then, is that the choice of outcome-based payment is an act of delegation, for the purposes of managing political risks and/or costs. Outcome-based payment

was chosen for Flexible New Deal/Work Programme, but not the New Deal, because, between the New Deal and Flexible New Deal/Work Programme:

a. The potential for blame increased
b. The costs of making decisions internally increased.

Conclusion

The literature built on principal-agent theory and transaction cost analysis presents a number of factors which might lead a government to choose to privatise, or not, or to delegate, or not, driven by fundamental preferences for policy objectives and electoral success. This could help to explain why outcome-based payment is used in some welfare-to-work programmes and not in others. The literature also produces a puzzle of its own, however. Transaction cost analysis predicts that outcome-based payment will not be used in policy areas where objectives are complex, and this would seem to apply to welfare-to-work. There are therefore two questions to answer: why did the government use outcome-based payment for some programmes and not others, and why did it choose to use outcome-based payment at all in a policy area where it seems inefficient?

An examination of the literature has yielded three hypotheses to answer these questions, and these will be tested in the following chapters.

Chapter Three
Preparing for Process-Tracing: the process and the evidence

This chapter will explain how process-tracing will be used in this thesis to provide an initial test of the three hypotheses; establish which variables seem to be relevant; and produce a more refined hypothesis which could then, in future research, be tested against other cases.

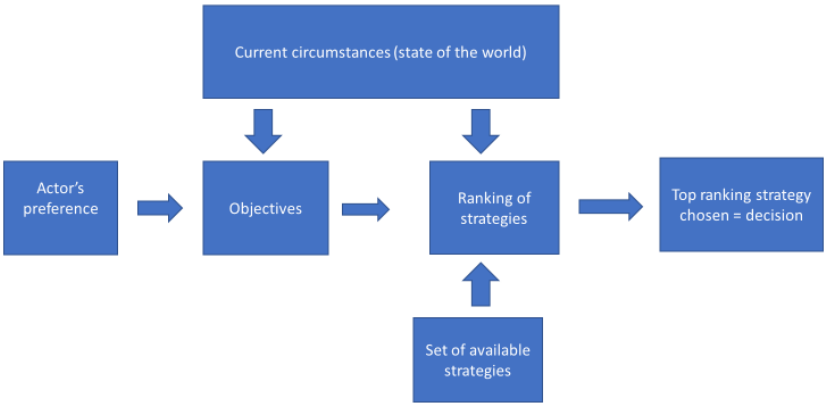
Empirical strategy: the process-tracing method

Rather than look for a correlation between independent and dependent variables across a number of cases, process-tracing looks for evidence that the causal chain implied by a theory actually exists in a single case (Beach 2017:1). Hancke's description makes clear that this methodology is well-suited to exploring the factors behind government decision-making: 'such case studies will go down the causal chain, reconstructing the steps in the chain, and then demonstrating, for example, how, at particular critical junctures, the decisions or choices that were made confirmed or disconfirmed the basic mechanisms that the argument is exploring'. (Hancke 2009:67). He goes on to point out that process-tracing 'means not just looking at the material but also making explicit what type of material is suggested by different theories and searching for that evidence'(Hancke 2009:68). Further detail on the methodology is in Annex C.

In this thesis, I am looking for the causal chain which led to the decision to use outcome-based payments in welfare-to-work programmes. The transaction cost analysis/principal-agent framework that I am drawing on explains every decision as the outcome of a rational process of the same shape. First, rational actors formulates objectives. These are defined by the interaction of the actors' fundamental and permanent preferences and the current circumstances in which they are making the decision. For example, it is widely assumed that any government has an unchanging preference for electoral success, but their objectives at any particular moment will be dictated by the current circumstances. If they need to attract younger, environmentally conscious voters, their objective may be to reduce the UK's energy consumption. If their younger voters become more concerned about their education, the government's environmental objectives may give way to an objective to expand university provision.

Having formulated an objective, the government then surveys the strategies available to it for achieving that objective and ranks them in order of their expected utility. The ranking is affected by the circumstances in which the decision takes place, as these alter the utility of each strategy with regard to the objective. For example, grants for home insulation will be effective in reducing energy consumption where the majority of houses are cavity wall construction. If, instead, most people live in old solid wall housing, where insulation is disruptive and problematic, the grants will not work so well. A public information film about saving energy might be better. Having ranked the strategies according to their utility in achieving the desired objective – in this case, reducing the UK's energy consumption – the government then chooses the top-ranking strategy. The process is illustrated in Figure 4.

Figure 4: Choosing a strategy to achieve policy objectives



This does not immediately look like a causal chain – there is no chronological train of events in the real world which can be observed. Unless the actor writes down, honestly and without self-delusion, the whole of their thinking, how can we know why they chose one strategy over another? However, there is a chain of logic, each step in the process of reasoning driven by facts and a set of clear assumptions and rules. The decision which is taken is determined by three things: the rational actor's objectives; the set of available strategies; and the surrounding circumstances – the 'state of the world' – which affects the strategies' relative

utility. If we can observe the final decision, the set of available strategies and the surrounding circumstances, we can then deduce the objectives which the actor was pursuing in choosing the strategy that she did. This is how hypotheses derived from rational choice theories can be explored through process-tracing.

In fact, there is also a chronological aspect to the thesis. Decisions are taken at particular points in time, when certain circumstances are in place and certain strategies and information are available. Previous events will have an effect: they may rule out certain strategies, or change circumstances. This thesis, then, needs to look at both the logical and chronological aspects of the decision to use outcome-based payment. It needs to ask: what does the decision to use outcome-based payment, taken at a certain point of time, in certain circumstances, tell us about the objectives of the actor who took it?

By definition, the factors which lead to the choosing of a strategy are not binary – either being present or being absent. The choice of strategy is a question of weighing up the relative risks and benefits of each available strategy. The risks and benefits may all be present for all the potential strategies – the question is their relative magnitude. However, it is difficult to judge the magnitude of the sort of risks governments face, such as the risk of political damage.

The welfare-to-work case study offers at least a partial solution to this problem. It offers more than a snapshot of the state of the world at the point a decision was taken. It allows us to compare episodes when different decisions were taken, even though much about the situation remained constant. For one welfare-to-work programme – the original New Deal – a decision was made to operate without outcome-based payments. For two other, very similar, welfare-to-work programmes – Flexible New Deal and the Work Programme – outcome-based payment was chosen. This implies that the ranking of the possible strategies changed between the decisions, and we can look for changes which explain that. The evidence that is being searched for, then, is not just the presence or absence of factors which would influence the decision. Observable changes in the magnitude of those factors will also be significant and are easier to find. The evidence we are looking for, therefore, is that the state of the world changed, either to introduce risks or potential benefits which might impact on the government's objectives, or to change the ranking of the available strategies. To prepare for this exploration in future chapters, we need, first, to identify the points at which the crucial

decisions were taken, set them in a timeline, and specify the evidence that we should expect to find if each of the three hypotheses is correct.

Key decision points to be studied

The object of study in this thesis are the three decision-making episodes which resulted in the choice of either a service fee model or outcome-based payment for the New Deal, Flexible New Deal and Work Programme. The point at which these decisions were made needs to be identified, and the surrounding events set out as a context. The events leading up to and surrounding these decision points are set out below, and the key dates are summarised in the timeline in Figure 5.

New Deal for Young People

The New Deal for Young People formed a central part of New Labour's offer to the electorate in the 1997 election. The Manifesto promised that 'we will give 250,000 under-25s opportunities for work, education and training' (Labour Party 1997). Moreover, the New Deal was one of the five pledges, printed on a 'pledge card' which was widely distributed during the election campaign, sharing equal prominence with promises on such headline issues as education, crime, the NHS and the economy (BBC 2010). The programme, which they predicted would cost £3bn in the next parliament, was to be funded by a windfall tax on privatised utility companies (Labour Party 1997).

Much of the detail of the programme was set out in the manifesto. The objectives of the programme were to reduce the level of unemployment in the target group by increasing the employability of the participants, reflecting a continuing commitment to the supply-side philosophy that had characterised the previous government's policies (Tonge 1999:229). However, the New Labour government's New Deal was different from previous interventions in scale and structure. It was a universal, mandatory programme which all 18-24-year olds passing the six-month unemployment threshold would enter, with a threat of benefit sanctions if they did not agree to participate. Unlike the previous one-dimensional interventions it was a portfolio programme, designed to contain a variety of help to meet the various needs of the client group. Participants would enter one of four options for six months' of intensive activity: a subsidised work placement in the open labour market, a training or education course, a temporary work placement with a voluntary sector body, or work with the

Environmental Task Force. Jobcentre officials would decide which option they should attend (NAO 2002).

The critical decisions around the use, or not, of outcome-based payment are set out in the timeline in Figure 5. The decision to use a service fee rather than outcome-based payment model was, in effect, made when the manifesto was issued in April 1997. The fact that a place on one of four defined options was guaranteed to every participant in that document ruled out the possibility of delegating the decisions about the type of intervention and the distribution of resources between individuals. Outcome-based payments were, therefore, not possible. It is in the period leading up to the publication of the manifesto, therefore, that we can expect to see evidence of the factors which would lead Labour to reject outcome-based payment, or simply fail to consider it seriously.

While the manifesto had focussed on a New Deal for Young People, and this programme took up most of the money raised from the windfall tax, the Department followed it up with New Deals for lone parents, people aged 25 and over, older people (over 50) and disabled people. These were more modest in scale and in the intensity and sophistication of the help they offered. New Deal remained the 'flagship' programme (Robinson 2000, Finn 2000:4, 2002:Table 1). While the New Deal for Young People operated on a service fee basis, with contractors delivering highly-specified provision, the government introduced elements of outcome-based payment into other programmes, including the New Deal for Disabled People and a different welfare-to-work model, piloted in high unemployment areas, called Employment Zones. The Zones offered a portfolio of help to long-term unemployed people, just like the New Deal for Young people (though they catered for all ages). However, there was more of an emphasis on the provision of temporary work through Intermediate Labour Markets – a hybrid of subsidised work in the open labour market and job creation (Haughton 2000a: 37). The government also experimented with giving private sector contractors full control of the Young Peoples' New Deal, with elements of discretion and outcome-based payment, in ten pilot areas, known as Private Sector Leads.

The New Labour government was active in the employment and welfare field beyond the introduction of programmes. It continued to impose conditions on unemployed benefit claimants, and gradually extended this approach to those who had previously been on other benefits. With the ONE pilots, it required attendance at a work-focused interview for all those

making a claim to benefit, including the sick, disabled, lone parents, carers and widows (WPSC 2002:para 5). New legislation followed, requiring lone parents to seek work actively after their children passed certain age thresholds and, from 2005, the voluntary New Deal for Disabled People was gradually replaced by the mandatory Pathways to Work (NAO 2010b) . Accompanying the stick of these new requirements, however, were the carrots of measures to make work more rewarding, such as the introduction of the minimum wage, help with child care and the strengthening of employment rights for workers.

Flexible New Deal

The Flexible New Deal was introduced in 2009, replacing the Young People's New Deal and the other New Deals for those aged twenty-five and over (DWP 2007). It shared many of the design features of the Young People's New Deal – it was a mandatory, universal, portfolio programme designed to address the barriers to unemployment faced by individual participants. However, there was much less uniformity about the help each participant would receive. The only activities that were guaranteed for each participant were an in-depth assessment, help in formulating a job search plan and four weeks of work experience or work-related activity. Beyond that, the activity would be tailored to the individual and the local labour market (DWP 2007).

The proposal for the Flexible New Deal had developed slowly over a four-year period, beginning with the Five Year Strategy in 2005. This period was marked by frequent changes of political leadership in the Department and a change of prime minister; by major shifts in the economic environment, as the financial crash in 2008 sent unemployment rising again; and by a growing interest in outcome-based payment among the welfare-to-work policy and provider communities. The largest contractors stepped up their efforts to persuade the Department to adopt a 'prime contractor' model, built round a small number of large contractors who would sub-contract to smaller organisations and bear the risk of large, long outcome-based contracts.

When in the mid-2000s, discussion began about a reform of New Deal and the other original New Deals, the idea of a bigger role for the private and voluntary sectors, with greater flexibility for them to innovate, was there from the beginning. The strongest case for a move to an outcome-based payment system, specifically a prime contractor model, was the publication of the Freud Report, commissioned by the Department and published in March

2006. The first public commitment to outcome-based payment in the Flexible New Deal then appeared in the 'In Work, Better Off' green paper, published in July 2007, which said there would be a 'flexible new deal', which would be an 'outcome-focused service, funded on the basis of results' (DWP 2007a:13). Six months later, the Pathways to Work pilots – an employment programme for people with disabilities – was rolled out nationally, with 60% of its provision operating under a prime contractor model (NAO 2010b:5). Two months after that, the DWP issued its Commissioning Strategy, committing to the prime contractor model for all its future programmes (DWP 2008c). Flexible New Deal was, therefore, in the vanguard of a wider move towards outcome-based payment and the use of large prime contractors.

The details of the payment regime for the Flexible New Deal were negotiated with Treasury over the next six months, with the personal involvement of the Secretary of State for Work and Pensions, James Purnell (Interview One). These details of the Flexible New Deal system were finally announced in the invitation to tender in July 2008. Flexible New Deal contracts would be longer and bigger, covering all provision in a geographical area. 80% of the payment was tied to performance (though that was later reduced), specifically to the number of participants who went into work and stayed there for thirteen or twenty-six weeks. After the financial crash in the summer of 2008, concern grew that the contractual terms offered in the invitation to tender were not sustainable in the declining economic environment. Revised terms were issued in February 2009, reducing the proportion of payments which was attached to performance. The period during which the decision to move to an outcome-based payment system for the Flexible New Deal, then, was between the publication of the Five Year Strategy in 2005 and the green paper in July 2007.

Work Programme

In 2010, the Conservatives campaigned on a manifesto which promised to 'scrap Labour's failing employment schemes and create a single Work Programme for 'everyone who is unemployed, including the 2.6 million people claiming Incapacity Benefit who do not get enough help from existing programmes'. The Work Programme would offer participants 'targeted, personalised help' at an earlier stage of unemployment than the Flexible New Deal (Conservative Party 2010:15).

The principle of introducing a welfare-to-work programme with greater emphasis on outside contractors had appeared as early as the 1997 Conservative manifesto, which had promised to 'develop an innovative 'Britain Works' scheme which used the experience and ingenuity of private and voluntary sectors to get people off welfare into work.' (Conservative Party: 1997). The use of outcome-based payments to incentivise these private sector and voluntary sector actors was not made explicit at this point.

Detailed work was kicked off some years later by the Centre for Social Justice think tank and was fed into 'Breakthrough Britain', the review of Conservative social justice policy which Iain Duncan-Smith chaired from 2006. In January 2008, and under Chris Grayling's direction, the Conservative party issued a policy 'green paper', proposing that those on Incapacity Benefit would receive increased help to get back to work and be subject to increased conditionality (Haddon 2012). The ideas in the green paper again drew heavily and openly on the same Freud report that had influenced New Labour's Flexible New Deal, including the prime contractor model. The Conservatives announced that they would adopt the Freud report in all its radicalism and bring it in at speed. The paper also drew inspiration from market-based innovations in the US and Australia (Haddon 2012). In fact, in early 2009, and apparently as a result of the bad blood between him and the Chancellor of the Exchequer Gordon Brown, Freud left his advisory role for the Labour government and joined the Conservatives. He helped with the development of their final statement of policy – Get Britain Working – issued in 2009. (Haddon 2012).

When the Conservatives failed to achieve an overall majority and formed a coalition government with the Liberal Democrats, the Work Programme appeared in the Coalition Agreement as a 'single programme to help all unemployed people back to work' (Cabinet Office 2010). Under the Work Programme, there was even less involvement of jobcentre officials and a greater role for the outside contractors. New groups of people were targeted by the programme: people on Employment and Support Allowance and those switching to Jobseeker's Allowance from Incapacity Benefit, having been deemed capable of work, could be required to attend the programme after claiming JSA for three months. In contrast to the prolonged development phase of Flexible New Deal, the Work Programme was introduced at speed. There were no white papers, and the invitation to tender was issued within 7 months of the initial announcement in the Coalition Programme (DWP 2010).

In considering the circumstances which led to the adoption of outcome-based payments, then, the crucial period is 2008/9, when the Conservatives adopted Freud's prime contractor model. This commitment fed directly into the Conservative manifesto, the Coalition agreement, and the eventual shape of the Work Programme. Therefore, we need to look at this stage for evidence of the information which informed Conservative's strategic decisions – information about risks, opportunities and the varying potential effectiveness of different strategies.
The continuity between the ideas developed within the Conservative party of opposition, and the policy that was eventually delivered by the Coalition was assured when the three architects of the approach were brought into government. Iain Duncan-Smith became Secretary of State at the Department, with Chris Grayling as Minister for Employment and David Freud as Minister for Welfare Reform. The details of the contractual and tendering arrangements were released in Dec 2010 in the invitation to tender.

In Autumn 2015, the Department announced that the Work Programme would be replaced by the Work and Health Programme, a smaller programme focussed on those with disabilities who had been unemployed two years or more, and costing around £130m a year (Powell 2020:5).

Figure 5: timeline of key decisions

Timeline

New Deal

April 1997 New Labour manifesto published, containing commitment to centrally-specified New Deal

July 1997 – Details of New Deal announced in Budget

Oct 1997- 'Design of New Deal' document published

Flexible New Deal

Jul 2004 –New Deal funding until 2008 agreed in CSR 2004 without the adoption of outcome-based payment

July 2007 - Commitment to outcome-based payment and proposal to use prime contractor model contained in 'In Work Better Off ' green paper

Nov 2007 – prime contractor model proposed for all future welfare-to-work programmes in Commissioning Strategy consultation document

Dec 2007 – decision to use flat-rate payments (implicit) in Flexible New Deal Evidence Paper

Feb 2008 – DWP Commissioning Strategy published, committing to prime contractor model

July 2008 – Flexible New Deal Invitation to tender published with remaining details of payment system – level of payments, 80% performance-related element, capped budgets

Feb 2009 – revised contractual terms issued to take account of worsening economic situation, allowing larger up-front service fee

The Work Programme

April 1997 - Conservative manifesto commits to working with private and voluntary sectors, though no mention of outcome-based payment

July 2007 - Breakthrough Britain published with commitment to outcome-based payment

Jun 2008 - Grayling's group publishes Green Paper committing to Freud's prime contractor model

Sept 2009 - Grayling's Get Britain Working paper published

April 2010 Manifesto states Work Programme will be delivered by private and voluntary sector providers, paid for ' getting people into sustainable work'

May 2010 - Coalition agreement commits to reforming " the funding mechanism used by government to finance welfare to work programmes to reflect the fact that initial investment delivers later savings through lower benefit expenditure, including creating an integrated work programme with outcome funding "

Dec 2010 – Invitation to tender announces details of payment system – variable payments, minimal upfront service fee

Process-tracing for the three hypotheses

Having established the key decision points, the next stage of process-tracing is to consider the factors whose existence at any of these decision points would support each hypothesis. In other words, what independent variables, according to each hypothesis, brought about the change in the dependent variable - the choice of payment system?

Hypothesis One

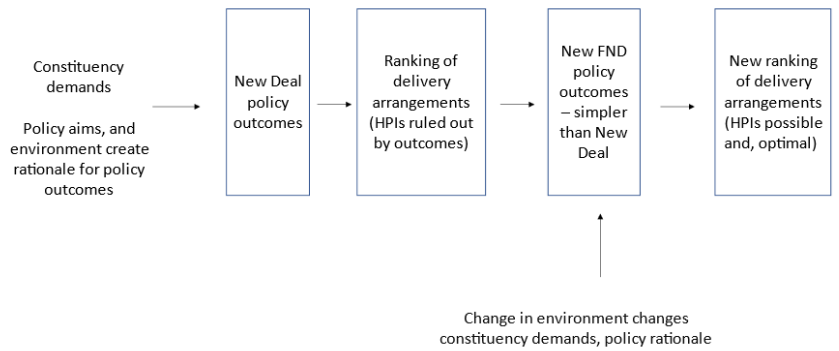
As set out in Chapter Two, the first hypothesis is that outcome-based payment was chosen in the Flexible New Deal and the Work Programme as an act of privatisation, to use price incentives to drive performance. The government chose not to use it for the New Deal for Young People because it did not have the data or technique to manage target-setting for the programme's multiple outcomes, without distorting performance or creating perverse incentives. By the time the Flexible New Deal was introduced, that concern had reduced, either because some of the multiple outcomes pursued under the Young Peoples' New Deal had been dropped, or because the government felt it had developed the ability to manage multiple outcomes efficiently.

For the first variation of this hypothesis, One (a), the process is as set out in Figure 6. In this process, the independent variables which produced the change to outcome-based payment are those changes in the state of the world (including the state of policy knowledge) which led the government to redefine its desired policy outcomes.

The policy outcomes which a government desires from a programme are chosen strategically to help their electoral chances or serve their own intrinsic policy aims. The outcomes of a programme will often just be a step on the way to an ultimate policy aim, for example, a sustained reduction in long-term unemployment. For most of the discussion in this thesis, this ultimate policy aim is taken as given, although the priority given to it may change, and the means chosen to achieve it certainly change. The chosen intermediate outcomes are related to the ultimate policy aims by a policy rationale. The government chooses to pursue certain outcomes because it believes, in the environment in which it is acting, those are the outcomes best suited to achieving its ultimate electoral and policy aims. This could mean, in the example of long-term unemployment, a 'work first' intermediate outcome or an intermediate outcome of increased levels of education and skills in the workforce. Having set its policy outcomes, the government then chooses the institutional arrangements that it believes are most likely to deliver those outcomes. It follows that a change in institutional arrangements

for delivery could occur because of a change in the outcomes which the government desires, arising from a rethinking of the policy rationale linking those outcomes to the ultimate aim. Alternatively, a government may pursue certain outcomes from a programme or policy because it believes its voters favour them, and will reward it for pursuing them. Both these reasons for the change in delivery between the New Deal and Flexible New Deal are shown in the diagram below.

Figure 6: Hypothesis One (a): implied process and independent variables

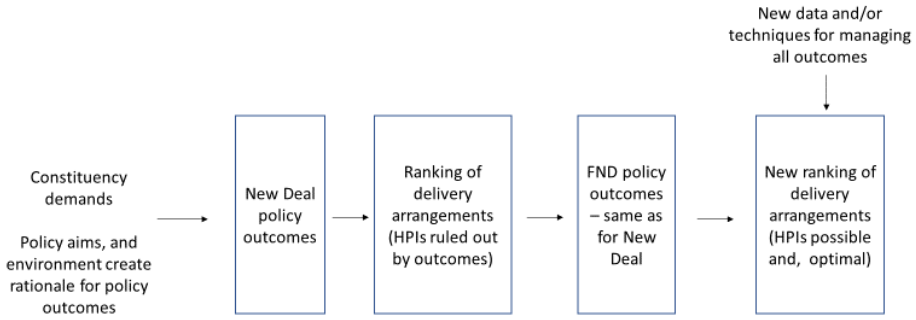


Process tracing goes beyond identifying the independent variables to looking for evidence of the mechanism which links these to the final dependent variable. I will, in this thesis, then, look for evidence that these independent variables actually affected the delivery choices made by government. As well as the decision to use outcome-based payment, there were detailed decisions to make about the details of the payment system and contractual terms – these will need to be examined too.

In the second variation of the first hypothesis, 1(b), the policy outcomes do not change. The independent variable in this scenario is the information which the government can use in managing its agents. As in the previous scenario, the government, at the time the New Deal was introduced, did not feel able to use a private sector arrangement with high-powered incentives, because it did not believe it could incentivise its agents to pursue all of its desired policy outcomes. In trying to attach high-powered incentives to the various outcomes that it was pursuing, there was too much of a risk that some outcomes would be under-incentivised and would be ignored by the agent. The more principals know, however, about the costs of achieving their various outcomes, and the ways agent may try to shirk or drift, the more

chance they have of setting high-powered incentives at the correct level, or introducing other controls into the contractual arrangement. The independent variables in this case, then, are data about the costs and incentives faced by the contractors which allow the government to set the payment system and the contractual arrangements accurately.

Figure 7: Hypothesis One (b): implied process and independent variables



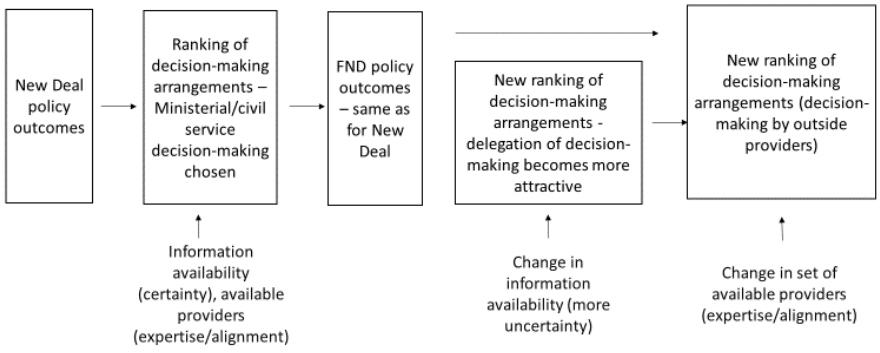
The second hypothesis is that the choice of outcome-based payment is an act of delegation, for the purposes of effective policymaking. Outcome-based payment was chosen for Flexible New Deal and Work Programme, but not for New Deal, because, between New Deal and Flexible New Deal/Work Programme, the balance of costs and benefits shifted in favour of delegation, due to:

a. Increased uncertainty raising the costs of making effective policy decisions in-house.
b. Newly available expertise in the provider market increasing the ability of providers to make effective policy decisions;
c. Newly available providers who were less likely to drift from government's desired outcomes.

Under this hypothesis, the independent variables are those which affect levels of uncertainty (the availability of information) and the benefits and risks of delegation (the expertise and alignment of providers). These variables, however, are not sufficient to drive delegation to the private sector rather than to public sector agents. In the case of welfare-to-work, the

government had an employment service ready to take delegated decisions. If more expert or aligned agents became available, however, and they happened to be in the private sector, that would explain the choice of agent.

Figure 8: Hypothesis Two: implied process and independent variables



The third hypothesis is that the choice of outcome-based payment is an act of delegation, for the purposes of managing political risk. Outcome-based payment was chosen for Flexible New Deal/Work Programme, but not the New Deal, because, between the New Deal and Flexible New Deal/Work Programme:

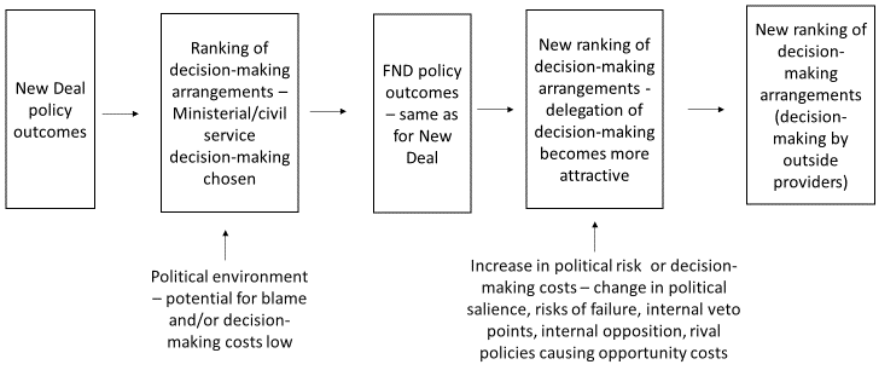
a. The potential for blame increased
b. The (political) costs of making decisions internally increased.

The independent variables for this hypothesis are those which increase the risk of blame or decision-making costs. These could be an increased risk of concentrated losses for the government's voter base, or a more general risk of failure and consequent electoral damage. Decision-making costs might increase if the decision-making processes changed between New Deal and Flexible New Deal/Work Programme and there were veto points, or if opposition to the programme increased.

Again, however, the hypothesis needs to explain not just the decision to delegate but the decision to delegate to the private sector. This specific delegation arrangement might help to guard against the risk of blame if it ensured that damaging information was concealed under

commercial confidentiality. As far as decision-making goes, the use of outcome-based payment would suggest that the decisions which are likely to be particularly difficult internally, and so which need to be delegated, are of a sort which are more easily delegated to private sector rather than public sector agents. The use of commercial contracting and outcome-based payment, for instance, also allows the government to delegate decisions about investment. It transfers the decision about how much money to spend on the policy, in the hope of future savings, to the private sector agents, along with the risk. Funding decisions like this involve costly decision-making within government, as part of the budget process.

Figure 9: Hypothesis Three: implied process and independent variables



Sources

Beach suggests that, in process-tracing exercises, evidence is 'any empirical material potentially left by the operation of a causal process that increases or decreases our confidence in the existence of an underlying causal mechanism or mechanisms.' (Beach 2017:13). The kind of material that can act as effective evidence depends on the specifics of the case and falls into one of four categories: patterns, sequence, traces and accounts (Beach 2017:13).

Patterns are 'statistical patterns in the empirical record' (Beach 2017:13). This is not relevant for most of the causal factors this thesis is considering, though ONS unemployment statistics have been used in one instance. Sequences, on the other hand, are central to the thesis. The

point at which decisions are made, and the 'state of the world' in the lead up to those decisions, are key to testing the hypotheses.

> 'if we are testing a causal mechanism about rational decision-making in a given case, certain evidence would be that decision-makers would first collect all available information, followed by an assessment of the information, and finally they would make a decision that maximizes their utility based upon this assessment.' (Beach 2017:13)

This thesis establishes the timeline of decisions through reference primarily to official government policy statements such as green and white papers, parliamentary statements, press releases and invitations to tender. These are supplemented by facts on timing drawn from academic articles, think tank papers, parliamentary papers, evaluation reports and media articles.

The third category of evidence, traces, are 'pieces of evidence the mere existence of which provides proof' (Beach, 2017 p13). This thesis will look for evidence that the factors predicted by each of the hypotheses – e.g risks, information, fiscal and economic circumstances, expert agents - are present in the environment in the period leading up to the key decisions. Many of the documents I have used for sequential facts are also, in themselves, traces. Government documents are produced to achieve an effect, whether that is to please the government's supporters, or win support for a policy. Their publication at a particular time, and in a particular form, is an indication of government's intentions and of its own assessment of the political risks and opportunities present at that particular moment. They also show the rationale for policy decisions which the government considers to be the strongest available, and the information that it wants to show was taken into account in making the decisions. Government documents cannot show what the government did not want to reveal, but they can show what information and rationale it definitely possessed at the time a decision was taken.

Academic articles, papers by think tanks, policy and evaluation studies, reports by international organisations and press articles also form part of the environment that surrounded, and perhaps informed, government decisions. Of course, there is no guarantee that those making decisions inside government were aware of all of these publications.

Chapters Four and Seven lay out the process by which ideas circulating in the policy community influenced policy development in opposition. Once in government, we can be fairly certain that decision-makers knew the contents of the evaluation studies that government itself had commissioned, and that accounts for the majority of evaluations of the welfare-to-work programmes in the UK. Results from these evaluations were used to justify government policy in green and white papers and documents such as the Flexible New Deal Evidence Paper (DWP 2007c). All of these documents are signed off by senior officials and ministers before publication. Similarly, green and white papers and government-commissioned reports such as the Freud and Gregg reports also cite international experience (DWP 2007a, 2007b, Freud 2007, Gregg 2008). Finally, the select committee process is a conduit for ideas and information to filter into government. Select committee enquiries involve the gathering of contributions from the policy and contractor community in the UK and beyond. Ministers and senior officials are expected to respond to questioning on the evidence gathered by the committee, including their own reports, and the government is required to submit a written response to the committee's final report. These processes of publication and scrutiny bring ministers and senior officials into contact with the reports, evaluations and statistics surrounding the policy area, even if their own officials have not kept them briefed.

The final of Beach's four categories of evidence is accounts, which 'deal with the content of empirical material, be it meeting minutes that detail what was discussed in a meeting or an oral account of what took place in a meeting' (Beach 2017:13). These present a difficulty for case studies dealing with decisions made in Whitehall. Internal decisions and agreements, within or across departments, may not be recorded and any evidence which emerges through the National Archive will be, effectively, 'convenience sampled'. That is, it will be the material that is accessible, rather than a full account of events. A record of an agreement reached between departments on a certain date, for instance, may actually have been superseded by a subsequent meeting of which there is no record in the accessible archive.

This is less important, however, for hypotheses based on a rational decision-making model. It is not necessary to find direct evidence of motivation of the various individuals involved. The motivation of the government can be deduced by observing the strategies they choose in particular circumstances. Rather than try to recreate the day-to-day detail of internal Whitehall discussion, then, this thesis assumes that the date that a government statement was

made or White Paper published is effectively the date on which the decision was made. The weeks and months running up to that date are, then, considered to be the decision-making period, during which the various factors in the environment will influence what decision is made.

As an account of events, interviews and biographies even more unreliable. They are not contemporaneous and the longer the gap between the events and the account, the less they can be relied on. However, following the Bayesian approach, this thesis uses some informal sources to supplement the documentary record (Beach 2017). I have used sources which were themselves based on interviews, such as Haddon's report for the Institute for Government on the development of the Work Programme (Haddon 2012), and I have examined biographies of the main actors for background information. Finally, I interviewed five people who were at or near the centre of decision-making. These include four civil servants or ex-civil servants, who asked to be anonymous, and Chris Grayling, the Minister of State for Employment when the Work Programme was introduced. The officials were:

- A senior member of the Department's contracting team for Flexible New Deal, later involved in market development under the Work Programme (Interview One)
- A senior strategy adviser in the Department through the years of Flexible New Deal and the Work Programme (Interview Two)
- A senior economist at the Department during the development of Flexible New Deal (Interview Three)
- A senior policy adviser at the centre of the development of the Work Programme (Interview Four)

I was encouraged to interview Chris Grayling by two of the officials, who stressed his sustained personal involvement in the development of the Work Programme. The ministers who were involved in the development and implementation of Flexible New Deal, on the other hand, were so numerous, and each had been involved for so short a time, that interviews would have yielded little information. The interviews I carried out were unstructured, as each interviewee had had a particular, unique role in the process and the interview had to follow that individual experience. I used the interviews to test my emerging hypotheses, identify factors or circumstances which I had not taken into consideration and check facts which were not covered in the official record. The interviews were recorded.

Conclusion

This chapter has established the key decision points to be examined and the independent variables whose presence will provide support for each of the three hypotheses. In Chapters Four to Six, I will look for evidence of these independent variables. These chapters will focus on the introduction of the Young Peoples' New Deal and the Flexible New Deal. In Chapter Seven, I examine all three hypotheses in relation to the adoption of the Work Programme.

Chapter Four
Hypothesis One: privatising for outcomes

This chapter examines the evidence that, as predicted by Hypothesis One, the change to outcome-based payment was made possible when it became possible for the Department to sum up its policy objectives in outcomes which would effectively incentivise its contractors. This new opportunity could be thanks either to a simplification of the desired outcomes, or to improvements in the Department's data and techniques for defining and managing them. An examination of the policy development and implementation process for the New Deal for Young People and the Flexible New Deal suggest that the government did, indeed, simplify its desired outcomes, making outcome-based payment easier to implement. There is much less evidence that, between the two programmes, it acquired the data and techniques it would need to adopt outcome-based payment while continuing to pursue multiple outcomes.

Hypothesis One (a): the simplification of outcomes

Hypothesis One (a) explains the change in mode of delivery between New Deal and Flexible New Deal as a response to a change in desired policy outcomes, specifically the abandonment of multiple outcomes in favour of a single job entry outcome.

An examination of the lead up to the introduction of the Young Peoples' New Deal shows that the New Labour government had reason to pursue multiple outcomes for the programme and did so through the policy development and initial implementation process. However, the Department's behaviour in the subsequent years indicates a loss of interest in outcomes other than jobs, a shift which was further enabled by changes in the economic and political environment in the lead up to the adoption of outcome-based payment in the Flexible New Deal.

The New Deal for Young People: multiple outcomes in the development of the policy

The first evidence that the government was pursuing multiple outcomes through the Young Peoples' New Deal can be found in the process by which the programme was developed while Labour was in opposition. There are three aspects to this evidence. First, it was clear from the policy rationale that informed the programme that Labour believed that policy success would be dependent not only on the number of unemployed people who were moved

into jobs, but also on delivering quality provision, improving skills and delivering a similar level of help to every unemployed person (that is, on equity of resource allocation). Second, the policy development process revealed an appetite, in the activist and policy community, for equity and quality outcomes, regardless of their contribution to the achievement of the ultimate policy objectives. Finally, the way the policy is presented in the manifesto shows that Labour believed these additional outcomes - of skills, quality and equity - to be important to voters.

The rationale behind the policy and the views of Labour's supporters are evident in the most significant element in the policy development process: the Commission for Social Justice, set up by the Labour party leader John Smith to review Labour's approach to social policy (Haddon 2012b:5). In its 1994 report, the Commission drew explicitly on thinking that had emerged in a fierce debate during the 80s and 90s over the causes of and remedies for unemployment. The terms of this debate provided the rationale for the New Deal, and so it is worth an examination.

The debate arose round the high and persistent levels of unemployment in the 80s and the Conservative government's policy response to it (Finn 2000:2). This was influenced by thinking from the US which argued that unemployment was a structural problem caused by the welfare system, which led people to linger in unemployment as their employability decayed, and that the effective response was a 'work first' approach which put unemployed people back into work – any work – as quickly as possible (Mead 2008). The Conservatives therefore introduced a number of measures designed to re-attach the unemployed to the labour market. Alongside these measures, the requirements placed on people receiving benefit were progressively increased. Unemployed people were, from 1986, required to attend Restart interviews at job centres every 6 months. In 1987, the government introduced the stricter benefit regime, which increased conditionality, and facilitated it by bringing job centres together with unemployment benefit offices. The final act of the Conservative era was the introduction of a new benefit, Jobseeker's Allowance, which brought a further set of requirements for claimants to meet (Price 2000:299ff).

These Conservative policies, and the analysis which informed them, drew much criticism, and inspired a body of literature proposing alternative approaches. Cyclical unemployment was put forward as an alternative cause of unemployment, resulting in calls for Keynesian

demand stimulation (Gordon 1988:134-5). Some argued that the unemployment was indeed structural, but was caused by de-industrialisation. Workers' skills, particularly the skills of older men from the manufacturing industries, had been made obsolete and the new service jobs which replaced them were lower paid, part-time and were going disproportionately to women (Philpott 1997:7,11). The motives of the government were questioned: the employment programmes were seen as crude work tests, designed to push people off benefit. Alternative strategies were proposed, involving re-training and job creation (Philpott 1997:20,21).

Richard Layard, who became influential in Labour's policy-making (Finn 2000:2), acknowledged that there was some merit to the arguments of the government's economists that stimulation of demand without action to improve the supply of labour would result in inflation. He devoted a significant part of his book 'Unemployment: Macroeconomic performance and the Labour Market' (Layard *et al* 1991) to the concept of the Non-Accelerating Inflation Rate of Unemployment or NAIRU, and agreed with right-wing economists that measures would need to be taken to re-attach the long-term unemployed to the labour market. He had been arguing since 1979 for more active job search. '[i]f more people are forced into active job search, real wages will tend to be pushed down and more jobs will thus be provided' (LSE CLE Discussion, quoted in Price 2000: 204).

Layard advocated a programme of activity for the long-term unemployed which gave them work experience and prepared them for work in the open labour market. This idea was echoed and supported by other writers and lobby groups (Philpott 1997). They were concerned, however, to avoid any suggestion that this programme would be 'workfare', by which they meant requiring unemployed people to work for their benefits. Some argued that the programme must be restricted to public sector work, so that private sector employers were not profiting from cheap labour (Gordon 1988). Layard, on the other hand, believed that the private sector must be involved. He also reluctantly conceded that the programme might need to be compulsory for some groups of the unemployed. It was felt that this would be justified as long as the policy was 'working well' and led to 'serious work with a prospect of stable employment' (Layard 1986:110; 1997:58).

Layard's analysis therefore combined the demand and supply side theses, proposing that government should stimulate the economy to create jobs but that, as argued by more right-

wing economists, there would also need to be programmes to prepare the unemployed for the labour market, if the stimulus were not to result in runaway inflation. While he advocated government investment in skills to fill gaps in the labour market, he considered training for unemployed people to be first and foremost a route into work (Layard and Philpott 1991:25).[2]

Layard and Philpott's ideas were drawn into the work of the Commission, being cited in the final report (CSJ 1994:177). The report proposed a number of ideas that had been championed by Layard and others. As well as an active employment service (CSJ 1994:6), it advocated a Jobs, Employment and Training programme, designed to 'get the long-term unemployed and lone mothers back to work' (CSJ 1994:6). This programme would include a mix of public and private work. There would be subsidies to private sector employers to offer work placements to unemployed people, and intermediate labour markets in areas of 'the greatest economic hardship' (CSJ 1994:172).

Regarding the outcomes it expected to see from these policies, the Commission's report emphasised the welfare of unemployed individuals as well as the benefits to the economy. It quoted a group of Norfolk school children who, when asked to 'to name the biggest problem facing the country, …said, unanimously, "Unemployment'' '(CSJ/IPPR 1994:151). Work, the Report said, was 'a source of personal identity and individual fulfilment, social status and relationships. It is the heart of wealth and welfare. For us, employment is inseparable from individual opportunity.' (p151). 'Without jobs' there could 'be no justice.' (p151). As well as the wellbeing of the individual, it was essential to 'the cohesion of society as a whole'. This focus on the social justice goals of the policy implied a commitment to equity in the distribution of the resources devoted to the policy: everyone suffering the impacts of unemployment should receive the help they needed to get back into work.

The report also made a clear commitment to a skills outcome (CSJ 1994:6). However, like Layard, it linked this clearly to the entry into work: 'a reintegration of the long-term unemployed into one labour market… will require high quality help with education, training, and personal development through a re-employment service'. The wider issue, of re-skilling

[2] In 1987, Layard founded the Employment Policy Institute with Philpott as a Director (John Philpott - Economist and consultant - The Jobs Economist | LinkedIn). Layard and Philpott also co-wrote Stopping Unemployment where they argued for a 'job guarantee' for long-term unemployed people (Layard and Philpott 1991)

the workforce to address the changed industrial base, was tackled elsewhere in the report, with discussion of education, and workplace training (CSJ 1994:5). Finally, the necessity for quality was acknowledged, when it noted that 'there is good evidence that high-quality training for the unemployed helps people to find work' (CSJ 1994:175).

The Commission's report, then, which reflected the views of Labour's policy-making officials and the Labour-supporting policy community around them, presented a policy rationale which linked outcomes of quality, skills and equity to the ultimate policy aims of reducing unemployment and increasing individual and social well-being. It advocated a programme which helped every unemployed person to get back to work with high quality provision, including training where their lack of skills was a barrier to employment. The Commission's work bore fruit. When the Labour manifesto was published in April 1997, the proposals for the New Deal reflected the Commission's approach and Layard became a key figure in the development of Labour's welfare-to-work policy, (Labour Party 1997; Finn 2000:2).

The way the writers of the New Labour 1997 manifesto presented the Young Peoples' New Deal showed that the multiple outcomes were designed to appeal to voters, as well as being part of the policy rationale. The manifesto promised to 'give 250,000 under-25s opportunities for work, education and training' and that a Labour government 'will get 250,000 young unemployed off benefit and into work'. However, as well as a target based on overall jobs, it also contained a pledge to each individual: the programme would put 'every young person unemployed for more than six months in a job or training' (Labour Party 1997). There was, in fact, some confusion over the numbers, but it is clear that the New Labour government-to-be was committing itself both to certain ends – job entries and long-term employability, and to means – an offer of work, education or training to every young person.

While only some participants were to be offered full-time training, every option would involve 'day-release education or training leading to a qualification' (Labour Party 1997). The manifesto also reflected the debate about compulsion, and the need for quality of provision to justify it:

> "The unemployed have a responsibility to take up the opportunity of training places or work, but these must be real opportunities. The government's workfare proposals - with a success rate of one in ten - fail this test' (Labour Party 1997:20).

The process of policy development, leading up to the announcement of the New Deal in the manifesto, therefore provides evidence for the existence of multiple desired policy outcomes. A concern for quality was seen to distinguish New Labour's mandatory programme from the Conservative's 'work test' programmes and to be necessary for the policy to work. Equitable distribution of resources and a concern for the welfare of unemployed people was built into the promise in the manifesto of an option for every young person. There was a clear belief in the value of training, but a focus on providing the skills necessary to get people back into work, rather than a more general upskilling of the unemployed workforce. The proposed design of the New Deal, with four options only one of which was focused on training, reflected this nuanced position. These additional outcomes of skills, quality and equity, then, emerged from a policy rationale set out in the Commission for Social Justice report, and were considered sufficiently attractive to Labour's voters to be presented as a manifesto commitment.

The Young Peoples' New Deal: the multiple outcomes reflected in implementation

The Young Peoples' New Deal continued to be central to New Labour's government programme after they won power. Shortly after his electoral victory the Prime Minister suggested that the 'greatest challenge' for his 'welfare to work' government was 'to refashion our institutions to bring the new workless class back into society and into useful work' (BBC 1997). There was continuity between the internal governmental policy development process and the work that had taken place in opposition, with Layard being brought into the Department to help implement the proposals (Finn 2000:2). The choices that the New Labour government made as it implemented the New Deal provide further evidence of its desire for multiple outcomes, as they show that it kept firm control over the elements of the programme which determined quality, distribution of resources and the amount of skills training. However, these choices also provide further evidence that, regardless of the views of its supporters, the Labour government's interest in the skills outcome was as a contributor to the jobs outcomes, rather than as an outcome desirable in its own right.

The outlines of the programme were announced in the Chancellor's Budget speech in July, two months after the election. The speech echoed the themes of the manifesto. First, there

was the promise of equity (my emphasis): ‘we will create a new ladder of opportunity that will allow the many, by their own efforts, to benefit from opportunities once open only to a few. Starting from next year, every young person aged 18 to 25 who is unemployed for more than six months will be offered a first step on the employment ladder’ (Hansard 1997a). The importance of training was also emphasised, but primarily as a way to remove barriers to employment. All of the four options being offered to participants would involve ‘training leading to qualifications’, but the full-time education and training option was only to be for those ‘without basic qualifications’ (Hansard 1997a).

The detail of the programme was published in *The Design of the New Deal for 18-24 Year Olds* (DfEE 1997) three months later. It set out clearly the government’s intention to control the design and content of the programme. The four options would be competitively tendered, but the nature of the provision would be specified by government in detail. For example, it was stipulated that placements on the voluntary sector and environmental task force options must last for a minimum of 30 hours a week, consisting of five full days; that the qualifications pursued on the Full-time Education and Training option must be among those listed in a schedule to the Further and Higher Education Act 1992; and that work done on the Environmental Task Force option must ‘contribute to the improvement of the local, regional or global environment and be compatible with sustainable development in line with the government's policies and objectives’ (Jarvis 1997:10,11).

The nuanced position on training which was apparent in the manifesto was still evident in the implementation. First, the programme’s focus on immediate job entries had been strengthened by a new element: each participant on the programme would start by spending up to four months in a job search ‘Gateway’. They would be supervised by a job centre personal adviser – that is, a Departmental civil servant. Only if they failed to get a job would they move onto one of the four options set out in the manifesto. On the other hand, each of these options, even the three ‘non-training’ ones, must include a training element. However, contractors providing the Full-time Education and Training option were reassured that, should one of their participants have the opportunity to leave early to go into a job, they could continue their training part-time and the provider would be still paid when they received their qualification (DWP 1997). This seems to be a signal that the possibility of going into work should not be sacrificed for the sake of training.

The effort to control the design and content of the programme continued through the contracting process. While New Deal was ostensibly rolled out through 144 local partnerships of public, private and third sector organisations, the partnerships actually had little say over what they delivered. Finn commented that 'while some diversity was encouraged the flexibility that exists in the New Deal has mainly been in the delivery not the design of the programme'(Finn 2000:6). Peck described 'nationally standardised elements, little budgetary flexibility and … little scope for linking or re-sequencing the various options and processes' (Peck 1998 – quoted in Finn 2000:6). Once up and running, the partnerships continued to be closely managed by the Department. Each Unit of Delivery was set targets, and the training elements of each part of the programme were scrutinised by the Training Standards Council (Finn 2001b:7).

The ways in which the centre controlled the training content gives an indication of the place the skills outcome held in the government's priorities. The Department exerted control over the proportions of New Deal participants being referred to each of the four options. The Full-time Training and Education option was, to begin with, the most popular with participants. However, when the numbers entering the option grew, supplementary instructions were sent to job centre staff to reduce referrals and increase the focus on 'job placement' (Hasluck 2000:34). For the employment service as a whole, the government set down its expectations in the annual Public Service Agreement which laid out the outcomes the organisation had to meet. This included a target for people moving into work, but no targets for skills attained or qualifications achieved (HMT 1998). Moreover, the NAO noted that 'The Employment Service does not routinely gather and monitor data on improvements in employability, such as the number of qualifications gained' (NAO 2002:13).

The detailed design of the programme, then, along with the measures which government took to control its delivery, seem to serve all the outcomes which were apparent in the policy development process: jobs, equity, quality and skills. The programme must, first and foremost, get people into jobs, but it must also ensure that every participant received a roughly equivalent intensity of provision (at least until they received a job offer); the quality and intensity of that provision must be maintained; and there should be an element of skills training. However, that training, and the skills outcome it served, were clearly subordinate to the jobs outcome.

Learning the lessons of New Deal and the increasing focus on job outcomes

Despite the evidence of a commitment to multiple outcomes in the initial implementation of the New Deal, the government's interest in any outcomes other than jobs seemed to weaken in the subsequent years. As the programme was implemented and results started to emerge, questions were raised about the policy rationale, and the government reacted by emphasising the jobs outcome at the expense of the others. The early results of the programme were in fact positive. The government achieved its manifesto target of putting 250,000 young people into jobs by 2000 (Finn 2002b:10). In fact, much of this was judged to be attributable to the improving economic conditions, though a macro-economic evaluation in 2000 concluded that New Deal had had a modest impact. There were, it estimated, 30,000 fewer young people in unemployment as a result of the New Deal (Hasluck 2000:59).

However, there were signs that the various elements of the programme were not equally effective. First of all, evaluation showed that the full-time training and education option was less successful than the other programme elements in getting people into work. While the initial Gateway period that had been added to increase job search activity had been shown to increase the rate at which people moved into jobs and the subsidised work placement option was performing well, the other three options were failing to meet expectations. By 2000, evaluation showed that at most 15% of participants leaving those three Options were going into jobs (Finn 2001a:9).

Qualitative research suggested that the low job entry rate from the full-time training option might arise from ambiguity around the desired outcomes of the programme. Some contractors felt that the job entry target was in conflict with their attempts to increase skills and motivation. One complained: 'What are the priorities of New Deal? It seems to be about targets for jobs and less about employability and a client-centred approach. The government needs to make up its mind. I'm getting mixed messages'. Others argued that 'sometimes it's not the job that is the priority,' and 'jobs can't be the only test. We have helped change people's lives' (Finn 2003:717). A review of all the emerging evidence in 2000 noted that only half of the participants on the education option had been actively seeking work and concluded that 'there is the most overt conflict of interest between the New Deal requirement to engage in active job search and the aim of finishing the training and obtaining a qualification that will enhance future employability' (Hasluck 2000:41).

The Gateway, on the other hand, was exceeding expectations, moving 58% of entrants off benefit before they reached the Options, rather than the 40% target that had been set for it (Finn 2001a:8). Information about the destination of leavers was scarce, but it was estimated that 60% of those leavers were going into jobs. The evaluations suggested this was partly due to the threat of benefits sanctions, but also a successful attempt to increase motivation and job search (Finn 2001a:8). A qualitative study found little evidence that participants were being forced to take jobs, though some reported discontent that they had been moved out of the job search gateway and into an Option against their will (Finn 2003:714).

Beyond the issue of training, there seemed to be a problem with the equitable design of the programme. It became clear that the effectiveness of the programme in moving people into off benefit and into jobs varied hugely between individuals. Some young people left the programme almost before they had begun. About 10% didn't even attend the first interview, and nearly 60% of those who did left before they reached the point of joining an Option. Most of them went into jobs (Finn 2003:714). Those who did not find a job during the Gateway period and entered the Options, however, were unlikely to leave for a job at all. Overall, by March 2003, only 36% of those leaving to a known destination had gone into work, and one in five of those were back on JSA three months later (Finn 2003:720). New Deal advisers in job centres reported that those young people who were difficult to place into work had multiple employment barriers, including homelessness, childcare issues, learning and behavioural problems (Finn 2003:715).

Problems with performance grew as the programme progressed. The rate of entry into unsubsidised jobs dropped from 47% to 38.3% between 1998 and 2003 (Finn 2003:720, quoting TUC figures). There was also an unevenness in outcomes between geographic regions – some critics suggested that certain local labour markets needed a different mix of interventions, while the government argued that the geographic factor was limited to logistical issues such as transport links, rather than structural economic issues (Wells, quoted in Finn 2003:720).

The variation in outcomes between individuals and regions threw into question the standardized New Deal model which, if not as crude as 'one size fits all', could be characterised as 'four sizes (or Options) fit all'. The Gateway-plus-Option model of the New Deal was more intensive than many young people needed, and not enough for others. Of course, those people who were the most job-ready simply flowed out of the programme

without using the intensive provision. This, however, made difficulties for contractors, because the numbers flowing into the options were 33% lower than anticipated and contracted for (Finn 2001a:9). The planning assumptions were obviously flawed. Moreover, for the 'hard cases', who cycled round the programme several times, a large investment was having no effect at all, and this raised questions of cost-efficiency. Cycling was also a problem in the smaller New Deal for those aged 25 or more (known as the New Deal 25plus). In carrying out successive surveys on Employment Zones and the New Deal 25plus, Hales found that half of those who had left the programmes to enter work in the first stage of the survey were unemployed again by the second stage, a year later (Hales 2003:80).

The government reacted to these signals with a series of measures, which were indicative of its priorities. In case studies carried out between 1999 and 2002, New Deal advisers in job centres were reporting a change in the expectations being place upon them:

> 'The message has changed now. We were trying to get at their issues, trying to understand their problems, build up the relationship, but that's gone now. They just want them off the register' (NDPA, London, quoted in Finn 2003:715).

In 1999 and 2000, the government took a number of actions to put the programme on track, most of which seemed designed to increase job outcomes at the expense of other outcomes. It increased the sanctions for non-attendance (Finn 2001b:8, 2003:717) and focused contractors more firmly on job entries by cancelling poor performers' contracts and threatening others with cancellation if their job entries did not increase (Finn 2001b:9). It also put more resources into the job search Gateway, developed new diagnostic tools and aimed to develop a new class of contractors, known as 'intermediaries'. These intermediaries - based on a model which seemed effective in the US - would create links between employers and the New Deal partnerships in inner city areas and were 'expected to secure better job outcomes' (Finn 2001b:8). Finally, it developed new diagnostic tools to identify the particular barriers to work which each participant faced (Finn 2001b:8).

Perhaps most significantly, in June 1999, it reviewed its job entry targets. All 144 New Deal Units of delivery (that is the geographical areas led by the partnerships) were asked to increase their job entries by at least 6% by mid-2000. The government put more emphasis on sustainability of jobs, with targets for jobs which lasted 4 weeks. There was also more of a focus on the lowest-performing areas and on achieving parity of outcomes for ethnic minority

groups. The results were mixed. By 2001/2, around 80 of 144 areas had achieved their 6% increase, but only 1/6 of inner city areas were on target (Finn 2001b:8).

The evidence emerging from the programme, then, suggested that training was not contributing to job outcomes and, indeed, might be in conflict with them. It also suggested that providing the same level of help to every participant (i.e. distributive equity of provision) was inefficient and might be depressing job outcomes. In response to this information, the government took action to focus the programme on job outcomes in a way which risked compromising other outcomes.

Employment Zones – an illustration of changing priorities

The introduction and development of Employment Zones offers a further illustration of the way in which the implementation of the government's welfare-to-work policy raised questions about the policy rationale and the government's reaction to them. Employment Zones were mentioned in the manifesto, alongside New Deal, as a 'new and innovative ' programme in which 'personal job accounts will combine money currently available for benefits and training, to offer the unemployed new options - leading to work and independence' (Labour Party 1997). When the first Prototype Employment Zones were set up, with the express purpose of informing the design and implementation of the future 'fully-fledged' Zones (Haughton 2000b:673), the approach was markedly different from that of New Deal.

There were several differences. First, the Zones offered different provision. As well as training and help toward self-employment, they included intermediate labour markets, designed for the economically-depressed areas they were planned to sit in. Second, they were voluntary for participants. This was seen as significant.

> 'The voluntary nature of Prototype Employment Zones was held by partners, clients and advisers to be a central feature of the success of the zones, improving the qualitative nature of relationships between clients and advisers, and clients and potential employers'(Haughton 2000a:vii)

Third, they took a consciously client-centred approach, emphasising the tailoring of help to individuals through a relationship with a named personal adviser, with a focus on the hardest-to-help. They were to be focused on 'people not programmes' (Haughton 2000a: iii). Haughton described them as 'prioritizing socially excluded groups first and foremost, rather

than the usual political priority to reduce the unemployment count first and foremost' (Haughton 2000b:675). They were 'aimed at empowering individuals more than ever before in determining how to improve their employability '(Haughton 2000b:670). Overall, the Zones seemed to be designed to pursue softer, 'quality' outcomes alongside the concrete outcome of job entries.

As well as offering additional elements such as intermediate labour markets, Employment Zones differed from the New Deal in their funding and delivery arrangements and the level of flexibility they offered. They were to be delivered by local partnerships made up of a mixture of public, private and voluntary sector bodies in the local areas. Unlike the New Deal, Employment Zone partnerships were primarily led by the public, rather than private, sector and had genuine executive control over their Zone, rather than performing the rather ill-defined consultative function of the New Deal partnerships (Haughton 2000a:10,11). The funding arrangements made this a necessity. For the five Prototype Employment Zones, the Department offered only part of the finance for the projects. The rest was to be paid for by pooling existing funding streams, including other central government schemes (such as New Deal for Communities), local government grants and the European Social Fund (Haughton 2000:25). The Department set targets for moving participants into work but could not, of course, tie these to the funding, which it did not fully control. Innovation was encouraged. Partnerships were free to introduce whatever features or variations they wished as long as they offered the three elements of training, self-employment help and intermediate labour markets, and provided a personal adviser and action plan to each participant (Haughton 2000a:2).

However, very early in the implementation a difference of approach became apparent between contractors and government. The Department began to ask the Zones 'for a more focused approach' (Haughton 2000a iv). By the second half of 1998, the Department had increased the pressure to produce job outcomes and the partnerships responded that they were focusing on the hardest-to-help and were aiming to get them into good, sustainable jobs, which took time (Haughton 2000a vi). Before the two-year life of the Prototypes had come to an end, the Department announced its plans to launch fifteen 'Fully-fledged' Employment Zones which would be radically different to the Prototypes. First, they would be mandatory for participants; second, they would be delivered by a single contractor in each area rather than the looser public-sector-based partnerships which had delivered the Prototypes; and finally, these contractors would be paid according to the job outcomes they achieved.

The help offered to participants would also change. The programme would last only six months rather than the previous twelve, and contractors would no longer be required to offer intermediate labour market placements. Haughton considered that the payment system provided contractors with 'an incentive to provide cheap rather than appropriate training or other forms of provision' (Haughton 2000b:676), and to place people into jobs before their training was completed. He identified a preoccupation with shorter-term outcomes (Haughton 2000b:676—9). Certainly, reporting on these new Fully-Fledged Zones two years later, Hirst felt able to describe them as 'the most consistent application of a work-first approach yet seen in the UK' (Hirst 2002:iii).

In a qualitative evaluation commissioned by the Department and carried out as the transition to the Fully-Fledged Employment Zones was announced, Haughton reported a 'widespread feeling among partners … that the Employment Zones were 'blighted' by shifting national priorities' (Haughton 2000a:v). These concerns were echoed by the Education and Employment Select Committee, who reported that the plan to pay on the basis of outcomes had 'attracted some criticism' and that the 'Unemployment Unit suggested that the structure of the incentive scheme encourages operators to move people into employment at the earliest opportunity. This might not always be in the best interests of the clients' (EESC 2000: 75).

Haughton reported that the changes to the Employment Zone model were being seen by those on the ground as 'substantial shifts in philosophy and practice'. The pressure to move people into work as quickly as possible conflicted with the view of local advisers that it was 'appropriate to devise 12-month action plans for many of the early Employment Zone recruits in order to improve their long-term employability'. They argued that 'it was a powerful part of the Employment Zone ethos in their early days not to 'cream' off the most job-ready clients in order to reduce costs' (Haughton 2000:5,32). The view of those on the ground provides further evidence that the government's approach to Employment Zones was not just an adjustment, but a definite change in direction.

It is not clear whether the move to this approach from the original partnership, voluntarist, client-focused model had been planned from the start, or was a reaction to the under-performance of the early Prototypes. An evaluation commissioned by the Department puts forward both theories without comment on their incompatibility. On the one hand, it claims that Employment Zones were an example of 'incremental implementation' (Griffiths and Durkin:11) in which features such as outcome-related funding were used to create a

‘contested market’. Elsewhere, however, it simply notes that: ‘commentators have speculated as to the reasons why the Fully Fledged Employment Zones which subsequently emerged bore little resemblance to the prototypes’ (Griffiths and Durkin 2007:13).

The direction the government was taking in both the New Deal and Employment Zones was noted at the time and drew criticism. White argued the need for an ‘ethical’ rather than ‘instrumental’ employment policy (White 2000:285). To meet this standard, he stated, the New Deal programme would need to be ‘rights-based’, prioritise ‘increased well-being for disadvantaged individuals and groups’ and be run with a recognition that ‘some cost trade-off’ is acceptable between economic efficiency and equity’(White, 2000: 285). Finn, in 2003, responded that the New Deal met these standards and was not ‘the monolithic instrument of social control suggested by some critics’ (Finn 2003:721). Instead, it contained multiple, sometimes contending, objectives aimed both at promoting labour market efficiency, controlling benefit payments, and enhancing the welfare of individual unemployed people. He acknowledged, however, that its effectiveness in dealing with the most disadvantaged groups was compromised by the ‘hierarchy of options’ (i.e the prioritisation of work-based options), ‘increased emphasis on unsubsidized job entries and the often blunt application of benefit sanctions’. He concluded that ‘the employment service faces a major challenge to integrate and sequence job search and placement alongside the other services necessary to tackle social exclusion’ (Finn 2003:721).

It is evident that the implementation of the New Deal and Employment Zones was an episode of policy learning for the government. It learned that its priority jobs outcome was not always compatible with the additional outcomes it had pursued in designing the programmes. However, the path it took in increasing the focus on jobs to the detriment of the other outcomes was not the only one available to it. The problem that the other outcomes threw up was really one of cost. When required to increase job outcomes within existing resources, job centre staff and contractors would focus on the most job-ready clients and use the interventions that would get them into work as quickly as possible. With more resources, those choices would not have to be made. The approach the government took, in the light of the policy learning, then, was a deliberate choice, rather than just a correction. In the New Deal and in Employment Zones, the Department decided to sacrifice the outcomes of skills, quality and equity in favour of jobs.

The Flexible New Deal: the influence of lower unemployment and changing public attitudes

The policy learning described in the last section would obviously influence the development of the Flexible New Deal. This was not the only influence, however. There was additional impetus and opportunity for change from economic and political developments in the years following the New Deal's introduction.

First, the economic environment in which the Flexible New Deal was developed was very different to that which had surrounded the developing Young Peoples' New Deal. In the years between the introduction of the Young Peoples' New Deal and the Flexible New Deal, unemployment continued to drop until, by 2001, it reached lows not seen since the mid-70s (ONS 2021). The concerns about the effects of long-term unemployment, particularly on young people, which had driven the creation of the original New Deal in 1997, therefore gave way to an anxiety about the ageing population. The dependency ratio of over-65s to 16-65s had increased, and, with the rate of employment among adults of working age now at 75% (DWP 2005), the supply of workers for the growing economy was dwindling. Since the enlargement of the EU in 2004, a new source of workers had come onstream, but it had not solved the problem. In 2005, the Department published a Five Year Strategy (DWP 2005), which set the goal of an 80% employment rate to restore a viable dependency ratio. This, however, would mean getting into work not only those who had remained unemployed even after six years of the New Deals, but also a sizeable proportion of those on Incapacity Benefit, of lone parents, and of older people. These were people who had not until that point been required to make themselves available for work, and who would not necessarily be willing or able to work.

The strategy for achieving this goal was two-fold. There would be more support to help people into work, and to break down barriers of discrimination keeping older people, people with disabilities and people from ethnic minorities out of the labour market. On the other hand, there would also be greater obligations placed on people to make themselves available for work and take action to obtain employment. Alongside the reform to employment programmes, then, there would be reform of the benefit system (DWP 2005).

It seems clear that the rationale for the welfare-to-work policy was changing. Rather than a concern for the damage wrought on individuals and society by unemployment – the social justice case for action - the new policy was driven by the needs of the economy for more workers. This would tend to make the jobs outcome even more important to the government

relative to the other outcomes of equity, quality and skills. Those outcomes - particularly those of equity and quality – could not be given up lightly, having been adopted to appeal to Labour's supporters, and to justify the element of compulsion. However, the drop in unemployment which was driving the change in policy rationale also made it less politically risky for Labour to move away from its commitment to equity.

First, the whole issue of unemployment had largely disappeared from the electorate's list of priorities. In fact, it had already been falling when the New Labour government was elected in 1997, but, during the 2001 and 2005 elections, it dropped to levels not seen since before the Conservatives came to power in 1979. Over the period covered by this thesis, IPSOS Mori carried out regular surveys of voters' key concerns. Compared to the 49% who named unemployment as an issue 'that will be very important to [me]]in helping [me]to decide which party to vote for' in April 1997, only 25% named it in 2005 (IPSOS 2015).

Moreover, alongside the drop in the perceived importance of unemployment as a national issue, the public's attitudes to unemployed people claiming benefits hardened in the years after the introduction of the New Deal. In the 1998 British Social Attitudes Survey, for the first time since the data was first gathered in the early eighties, more people thought that unemployment benefits were too high and discouraged work than believed that they were too low and caused hardship. After a brief convergence in 2000/2, the gap between the two views continued to increase during Labour's time in power (Clery 2012:10). In successive British Social Attitude surveys, while the majority of respondents continued to believe that the government should support unemployed people, fewer and fewer supported an increase in unemployment benefits. The support for an increase fell by a third between 2002 and 2004 (from 22% to 15%) and remained at that reduced level throughout Labour's period in power (Clery 2012: 9). These attitudes seemed to reflect a belief about the state of the economy and the availability of jobs. The numbers claiming that 'unemployed people around here could find a job if they really wanted one' jumped from 39% in 1996 to 54% in 1998 and rose to 68% over the next ten years (Pearce and Taylor 2013:45).

Further, these hardening attitudes were reflected among Labour's own voters. Between 2003 and 2007, 36% of those described in the British Social Attitude survey as having a party affiliation to Labour agreed that 'unemployment benefits are too high and discourage work'. By 2007, that number had risen to 49% (Clery 2012:16). In the same period, the percentage of Labour supporters believing that 'if benefits were lower people would stand on their own

feet' rose from 36% to 46% (Clery 2012:17). There appears to be evidence, then, that Labour's voters had less of an appetite than before for a welfare-to-work programme, driven by social justice concerns, that addressed the needs of all unemployed people. This would reduce the incentive for Labour to pursue, and invest in, such a policy.

The changing outcomes in government: the Freud report

The Labour Party manifesto for the 2005 election, published three months after the Five-Year Strategy, showed signs that Labour had taken account of the changing priorities of its voters and core supporters. The question of employment did still feature in the document. There was mention of the 'major contribution' that the New Deals had made, a commitment to full employment and a pledge to 'build on Pathways to Work' (the back-to-work programme for Incapacity Benefit claimants, then a small pilot). However, there was no mention of further or new approaches to long-term unemployment. The New Deals were mentioned as achievements of the government's record so far, rather than areas of future innovation. The emphasis was instead on the people on 'inactive benefits' such as people with disabilities and health conditions, and lone parents. Following the publication of the Five-Year Strategy and the election, the path to the Flexible New Deal can be traced through a series of reports and green and white papers. These should, if Hypothesis One(a) is right, show the new policy rationale and changed political situation feeding into the design of the programme.

The first, and most influential, contribution was the publication of the Freud Report in March 2007. This document made the case for the adoption of outcome-based payments across all the Department's welfare-to-work programming and set out the precise model for delivery that the Department would go on to adopt. Freud set out a new, explicit rationale linking the wider policy goals set out in the Five-Year Strategy, through the potential policy outcomes, to the delivery model.

The terms of reference, set by the Department, required Freud to:

> 'review progress on the Welfare to Work programme since 1997, taking account of evidence from the UK and international experience, and make policy recommendations on how the Government [could] build on its success in using policies such as the New Deal to continue to reduce inactivity and in-work poverty, and meet the Government's 80% employment aspiration.' (Freud 2007:1)

In the report, Freud echoed the concern voiced in the Five Year Strategy over the need to increase the employment rate to maintain the dependency ratio in the face of demographic changes and the forces of globalisation. As well as reform of the New Deals, he advocated stronger obligations on benefit claimants and argued for a major overhaul of the benefit system, producing a single benefit for all (ideas eventually taken up in the development of Universal Credit) (Freud 2007:9,10).

His diagnosis also mirrored that which had gone before. He restated the success of the New Deals and the reform of the employment service but emphasised the need, now, to tackle those people who were still far from the labour market. These were the hardest-to help, whom he identified as those who have been out of work for more than a year (3.1m in all), 95% of whom were on inactive benefits such as Incapacity Benefit or benefits for lone parents (Freud 2007:4).

This, he argued, would be far more difficult than the work already done by the New Deals, as these people faced multiple disadvantages and barriers to work and would each need help tailored to their particular circumstances. To achieve this, it was necessary to change the approach. He noted, with approval the Employment Zones' 'work first' approach. Employment Zones 'emphasise[d] getting people into work and supporting them to stay in work. Training [was] focused on changing clients' attitudes to work and on job-search skills.' (Freud 2007:56). He concluded that 'a "work first" approach, alongside the New Deal for those with longer durations, had worked for the mainstream unemployed' (Freud 2007:9).

Next, he noted the powerful incentive created by outcome-based payment and recommended that the government contract out the work to organisations outside the Department. In fact, he did not recommend that only jobs outcomes should be rewarded in this system. He pointed out that government could choose to reward a range of outcomes, listing as possibilities:

- The initial move off benefit
- Continuous, or near continuous employment for 13, 26, 52, 104 and 156 weeks
- Personal pay progression, possibly reflected in a lower requirement for tax credits
- Improvements in the person's qualifications
- Bonus payments linked to targeted outcomes across all client groups
- Bonus payments for specific outcomes linked to wider Departmental objectives (such as the Child Poverty target). (Freud 2007:69)

The Freud Report then, while setting out the arguments for a ’work first’ approach, left it to government to decide which outcomes to reward.

The first concrete proposal for a Flexible New Deal to replace the original New Deals, using outcome-based payment, came in the green paper, *In Work, Better Off* (DWP 2007a, published four months after the Freud report. It echoed the social justice concerns of the original New Deal, saying:

> ‘The goal of full employment matters for people because the chance to work opens up the chance to progress, to develop and to participate fully in society. We know that people in work are often healthier, and more fulfilled, than people who are not. It matters for society because the poverty linked to worklessness divides our communities and deprives too many children of a fair chance in life.’ (DWP 2007a:5).

However, it also acknowledged the economic case, that getting people into work mattered ‘because sustained economic growth depends on an active growing workforce.’ (DWP 2007a:5).

As far as outcomes were concerned, it seemed to suggest that there were desired outcomes beyond simple job entries. First, there must be:

> ‘retention and progression, not just job entry: the system must do more to help people stay in work and move up the ladder through better in-work support – through advice, financial incentives and training; (DWP 2007a:9)

There was also a lot of discussion of skills, though the focus was still on their role as a route into work. Training would be there for the ‘lowest skilled’ because ‘people with a lack of skills or qualifications[were] amongst the most disadvantaged in the labour market’. The government planned a new system in which ‘customers for whom a lack of skills [was] a barrier to work get faster access to the right training’ (DWP 2007a:14) This, however, was outside the Flexible New Deal.

The direction the government would actually take on outcomes for the Flexible New Deal was set out in its Evidence Paper, five months later (DWP 2007c). It was explicit about the government’s approach to outcomes other than jobs.

> ‘Many labour employment programmes focus on improving employability, which is essential for helping jobseekers into work. However, the evidence points to paying for

> job and sustained job outcomes rather than for soft outcomes like building greater confidence, because building sustained employment is the ultimate aim of the Department's employment support.'(DWP 2007c:3)

The desire for retention and progression, then, expressed in the green paper five months before would be pursued, not by rewarding 'softer' outcomes but by making the payment for job entries conditional on sustained employment. The Evidence Paper stated that:

> 'there are two broad emerging conclusions from the evidence: first, providers should target sustained job outcomes longer than the current thirteen week definition, and second, "you get what you pay for"'(DWP 2007c:3).

The logic was that, if a contractor was only paid when a job lasts for thirteen weeks, that contractor would have to deliver a quality service and raise the employability of the participant to achieve that payment. However, this payment system would, inevitably, discourage contractors from investing in participants who might benefit and progress as a result of the help they got, but would not actually move into work during their time on the programme.

Six months later, the Department issued the invitation to tender for what was now known as the Flexible New Deal. It stipulated that a maximum of 20% of the total contract value could be paid as upfront service fees (i.e. linked to starts rather than outcomes), while at least 50% must be linked to a thirteen week employment outcome and at least 30% to a twenty-six week employment outcome. No other outcomes were paid for. The minimum intervention, which all participants should receive, was limited to an in-depth assessment, a back-to-work plan and four continuous weeks of full-time work experience or work-related activity (DWP 2009:7,8). The move away from the multiple outcomes of the Young Peoples' New Deal, first driven by the lessons of the New Deal, had thus been further enabled by changes in the economy and public attitudes, culminating in a commitment to a single jobs outcome in the Flexible New Deal.

The evidence for a simplification of outcomes

The evidence uncovered in the previous sections suggests that in developing the New Deal, the New Labour government-to-be had reasons to pursue outcomes other than job entries – namely, quality, skills and equity. There was reason to pursue them as outcomes in their own right

because their voters valued the ethical aspects of a policy built on social justice and welfare. New Labour also had instrumental reasons for pursuing quality and skills because the economic thinkers that influenced its policy believed that high quality provision including a certain amount of training was necessary to get the young unemployed back into work.
Once in government, Labour continued to pursue these additional outcomes through its highly-specified design and the targets and monitoring it used to control the implementation process. However, data emerging from the New Deal and Employment Zones suggested to the government that skills training was not necessary for the achievement of job outcomes. Furthermore, equity in distribution of resources and softer 'quality' outcomes appeared to be in conflict with the most efficient achievement of job entry outcomes. The decisions the government took in its overhaul of the Young Peoples' New Deal and Employment Zones suggest that its commitment to outcomes other than jobs had weakened.

Changes in the political and economic environment then shifted the government's policy goal from the reduction in socially and individually-damaging unemployment to the increase in the labour supply for the economy. This put a premium on maximising job outcomes and gave the government further reason to adopt the highly-focused, 'work first' approach that had seemed to increase job outcomes in the New Deals and Employment Zones. As the skills outcome had only ever been in service of job entries, it made sense to remove any requirement to include training in the Flexible New Deal. The Department would also have been aware that a sharper focus on the jobs outcome, driven by financial incentives, would be likely to compromise softer quality outcomes and distributional equity. While these had been important to their voters in the 1997 election campaign, the falling political salience of unemployment gave the government space to sacrifice quality and equity.

Hypothesis One(b): refining the management of outcomes

This section will set out the evidence in support of Hypothesis One(b). It will show that, at the point that the government decided to adopt outcome-based payments for the Flexible New Deal, it still lacked the data and techniques to ensure that contractors continued to pursue the additional outcomes of skills, equity and quality. All the information at its disposal suggested that a move to outcome-based payment, with payments made for job entry outcomes, would have a negative impact on these additional outcomes. This impact would come, first, from the practise of 'creaming' and 'parking' – that is, a focus on the most employable participants ('creaming') at the expense of the harder-to-help ('parking'). Contractors were also likely to cut costs wherever they could do so without affecting the number of job outcomes, so softer outcomes, such as those which had been pursued in the Prototype Employment Zones, would be ignored.

Evidence about the use of outcome-based payments was produced by the experiments that the Department had been carrying out: the New Deal Private-Sector Led Pilots, Employment Zones and the New Deal for Disabled People. The government could also draw on international evidence – it had specifically asked Freud to review this in his Report (Freud 2007:1). Further evidence came from a lively debate within the academic and policy community about the design of a payment system which could tackle problems such as creaming and parking. All this evidence confirmed that high-powered incentives would affect the allocation of effort and gave little indication of approaches which could be taken to avoid this. The next section will tackle these sources of information and ideas in turn. It will then show the approach the government took in designing the payments systems.

Problems with outcome-based payments in the New Deal Private Sector Led Pilots

As mentioned in Chapter Three, the government introduced into the New Deal, from the very beginning, ten areas in which it handed control of the programme to outside contractors. It explained this as a pilot to explore the benefits of private sector innovation and creativity (Hansard, 1997c) and so would presumably have looked to its experience in these areas to inform the development of the Flexible New Deal.

In fact, the Private Sector Led areas of the New Deal for Young People could give only indicative information as the models used were not pure forms of outcome-based payment, but there was certainly an element of market-based incentive. Finn observed that 'the key point is that the greater the success that the private sector organisation has in moving clients quickly through the process and into jobs, the greater the profit they can secure and/or the greater funds they have to divert to those clients who are harder to help'. (Finn 2001b:12). However, the degree of performance-related funding was modest compared to the levels proposed under the Flexible New Deal.

Neither did the contractors have the same degree of flexibility to move funding between participants as they would have in the Flexible New Deal. They certainly had more scope to shift resources between participants than was possible under the mainstream New Deal, but their discretion was limited by the fact that they still had to honour the government's pledge of a place on one of the four options for everyone who reached the end of the Gateway without employment (ESC 1999:249). However, they were able to adjust some aspects of the option – such as the amount of money paid to employers for a subsidised job.

Finally, the results from the experiment were difficult to interpret as there was little consistency across the ten areas. Each area negotiated its own agreement (ESC 1999:24). Though all the agreements involved payments triggered when participants passed certain thresholds and monthly payments connected in some way to performance (Rodger *et al* 2000:7), the trigger points, payment levels and performance element varied from area to area.

Notwithstanding these caveats, there were some indications of what the government could expect from rolling out an outcome-based payment model. First there were effects on the sub-contractor base, with some private sector leads pushing down on their fees or introducing 'vertical integration', where sub-contractors were dropped to be replaced by the lead contractor's in-house provision (Rodger *et al* 2000:17).

There was also some evidence that the private sector leads were focusing on getting people into work through job search, rather than using the more expensive options – more of a 'work first' approach. In private sector areas only 36% of those leaving the Gateway entered options, compared with 42% in the other areas (Finn 2001b:13). The Private Sector Leads seemed, indeed, to be lengthening the Gateway. The evaluation report notes the 'financial

advantages' of placing clients into jobs before they enter the (more expensive) options (Rodger *et al* 2000:12). While these fall short of robust findings, they do suggest that the contractors were acting according to economic principles: using their market power to push down suppliers' prices, vertically integrating where it made economic sense for them, and focusing on the cheapest inputs (i.e. job search activity) to maximise their profits.

Similar issues with outcome-based payment in Employment Zones

Results from the second, reformed phase of Employment Zones also provided the Department with an indication of whether the introduction of high-powered incentives would increase job entries and/or depress the pursuit of the other outcomes. In fact, the evaluations which became available to the government from 2000 gave a mixed picture. There were consistent indications that contractors were 'creaming' off the easiest to help participants to get results, while 'parking' the people with more intractable problems to avoid spending resources on them. Hirst *et al* found that the incentive system 'forced contractors to estimate their future income stream from clients so that they could concentrate adviser support on those who were the 'key to making profits' (Hirst *et al*, 13 2002: vi). Advisers working in the Zones run by Reed and Working Links told those working on a Department-commissioned evaluation that they used a 'motorway' system to sort clients.

> "Well we have a system called a Motorway system. We've got a fast lane, a middle lane and a third lane … the ones in the fast lane you see them once a week because they're job ready, the second lane maybe once a fortnight just to motivate them, and then as you move off your fast lane you move them up, and your third lot minimum contact … So I think that's quite good, that's something the company have actually said to do and we call that a Motorway." (Working Links adviser, Plymouth) (Joyce and Pettigrew 2002:15)

Finn reported that participants were being segmented into ''job ready', 'near job ready', 'not job ready', or 'unemployable', groups' (Finn 2005). The 'unemployable' category was estimated to make up between 25% and 40% of the client group. These harder-to-help groups were then being 'parked' (Finn 2005:13). Stephen Martin, who worked for Reed, commented that Employment Zones were unlikely to invest in more intensive support for these participants (Finn 2005:13). By 2005, when the government started to develop its plans for the Flexible New Deal, Finn was warning that the evidence had also exposed the rationing

and targeting of employment support that 'takes place at the 'street level' of the employment assistance market' (Finn 2005:14).

There was some evidence, too, of a loss of quality for those that the Employment Zones did help. The quality of jobs achieved under Employment Zones were 'typically worse than that of jobs achieved through mainstream New Deal programmes' (Mulheirn and Menne 2008:15). While Employment Zones showed better performance in job entries than New Deal in the early period, this performance gap reduced by the third year of the programme (Hasluck 2003, Hales 2003). One other significant finding to emerge from the participant surveys was that in both Employment Zone and New Deal areas many of the jobs that had been sustained for over thirteen weeks 'had not lasted in the longer term' (Hales 2003:1).

There were counter-indications, however. Qualitative research at local level suggested that the incentives were affecting Employment Zone behaviour as they were intended to. It was mentioned, in particular, that the contractors were focussed on achieving the thirteen week sustained employment payment and so were incentivised to search out durable jobs (Hirst *et al* 2002). There was also evidence that the tendency to 'cream' and 'park' was not limited to outside contractors working under high-powered incentives. Case studies found evidence that New Deal personal advisers in job centres were also incentivised by performance targets to focus on those thought to be most 'job-ready' (Finn 2003:714)

Griffith and Durkin found that Employment Zone contractors would try to maximise the numbers of job-ready clients that were referred to them by job centres and minimise referrals of the hardest-to-help (Griffith and Durkin 2007). However, they doubted that creaming and parking accounted for those areas in which Employment Zones were achieving better outcomes. They commented that 'while a focus on clients for whom there is a realistic prospect of sustained employment is an inevitable consequence of output-related funding', there was evidence from the early period that Employment Zones were placing more 'disadvantaged' individuals into work than New Deal 25plus, though New Deal 25plus was being 're-engineered' at that point. Their view was that incentives to cream and park operated in both public and private sectors. 'Advisers nevertheless respond to incentives whether they happen to be job points in the employment service, thirteen-week sustainability payments in Employment Zones, or job entries in Private Sector Led Action Teams'. They argued that creaming and parking would result from any kind of performance incentive, rather than just 'Outcome Related Payment (ORP)' or private sector delivery (Griffiths and Durkin,

2007:58). Nonetheless, they issued the warning that 'Given the sensitivity of provider behaviours and performance to funding and contracting arrangements, the importance of getting the system of tariffs and incentive payments right at the outset cannot be overestimated' (Griffith and Durkin 2007:5).

A final piece of evidence from the government's own programmes is the evaluation of the New Deal for Disabled People. It was not directly comparable to New Deal programmes as it began as a voluntary programme and only adopted elements of compulsion in later years. The client group was also different to that of the New Deal for Young People or the New Deal 25plus, facing much greater barriers to work. However, the programme had employed a version of outcome-based payment from its introduction in 2001 and so could provide lessons in its use. While the evaluation reported generally positive results, finding the programme to have a net positive impact, it also found evidence of creaming and parking by the contractors, some of whom were reported as having 'strategies' to avoid clients with the most severe health problems. (Stafford *et al* 2004:6).

By 2005, when the development of Flexible New Deal began, the government was also able to look to almost a decade's experiences in the Netherlands and Australia for lessons. Australia had introduced a 'fully contestable' placement market and privatised their employment service in 1998 (Finn 2002a:2), while the Dutch market in 'reintegration' services was established in 2001 (Bredgaard and Larsen 2008:342). Bredgaard and Larsen stated baldly that '[i]n both Australia and the Netherlands, extensive creaming and parking of jobseekers is a fact' (Bredgaard and Larssen 2008:347). Finn reported that the Australian funding model tended to prevent contractors from funding expensive provision, such as training courses, or paying for the kind of support required by the most disadvantaged participants (Finn 2002a). The Netherlands and Australia had taken a number of steps to combat these problems, introducing more specification into their contracts (i.e. constraining discretion) and shortening the period during which jobseekers remained under the supervision of contractors (Finn 2008). Freud, who had specifically been asked to take account of international experience in his Report observed that' it may be that these payments are …not high enough to incentivise providers to deliver the service required to every participant, leaving some 'parked' as too difficult to help.' (Freud 2007:58).

The data emerging from the New Deal Private Sector Leads, Employment Zones, New Deal for Disabled People and international experience, then, suggested that outcome-based

payment linked to jobs outcomes would encourage creaming and parking and a 'work first' focus which compromised outcomes other than immediate job entries. It was true that setting performance targets for civil servants focused on job outcomes seemed to have similar effects. However, it was certainly the case that the government had not, in any of its programmes, successfully managed to reward job outcomes without compromising other outcomes. The next section will consider whether, by the time it was designing the Flexible New Deal, the government had accumulated enough data and learning to create a more effective incentive system.

The Flexible New Deal: an incomplete solution

Freud, in proposing an outcome-based payment system, flagged up the lack of data to operate it. He argued that the government knew too little both about the costs of getting individuals into work, and about the benefit savings they could expect from moving into work people from the different sub-groups. He suggested that it should 'build a coherent outcome-based model against which it can assess all interventions in the labour market'(Freud 2007:67). He felt that 'significant' work was needed, covering segmentation of the client base, market testing of the level of payments, 'recession-proofing', and an 'analysis of the contractual incentive structure to minimise "creaming" and "parking"' (Freud 2007:75). He foresaw a long implementation period, involving the 'prototyping' of contracts and the building of the costs and savings model, and suggested a timeframe of six years (Freud 2008:10).

In fact, as we know, the Department committed to using an outcome-based payment system for Flexible New Deal within four months of the publication of the Freud report. Five months later, in an 'Evidence Paper', published to show the rationale behind its approach (DWP 2007c), it gave its first indication of the type of payment system it would use. It rejected the idea of variable payments – that is, paying more for outcomes achieved from harder-to-help participants. Instead, it would pay a flat fee for every job entry achieved, regardless of the circumstances or job-readiness of the individual involved.

This plan was met with concern in the welfare-to-work policy community. The Social Market Foundation, publishing nine months after the Evidence Paper, said that 'uniform payment to contractors for each job outcome achieved has serious implications for harder-to-help jobseekers, who will require more support at greater cost. Under the proposed uniform payment structure, those furthest from the labour market will inevitably not be offered services appropriate to their needs – they will be "parked"' (Mulheirn and Venne 2008).

The Work and Pensions Select Committee took evidence on the Department's Commissioning Strategy, published in 2008, which set out the government's intention to increase the use of outside contractors under outcome-based contracts. After hearing from contractors, economists and think tank members, the Committee welcomed the move to outcome-based funding, but voiced serious doubts that 'the current design of Flexible New Deal will discourage the creaming and parking of customers on the programme' (WPSC Commissioning Strategy 2008:4).

Their concerns were shared by the commercial team in the Department, responsible for negotiating with contractors, who felt that the criticism of the flat-rate payment was 'a very sensible argument'. A senior member of the team said:

> 'one failure I think we had with Flexible New Deal…a lot of suppliers were saying you needed to have gradations of reward … having a flat output isn't providing the right incentives…it's opening the door to parking and creaming and we never actually really resolved that. … We were with suppliers on this, but we had to defend the line saying this is what's been decided' (Interview One).

The most commonly advised solution to the problem was variable payments – that is, offering a bigger payment should a contractor put a more disadvantaged person into work. The problem was the lack of data that would allow the government to define these 'disadvantaged' groups. The simplest way to define them was by the benefit they claimed - the government could simply pay more for people who had been claiming benefits for longer, or who had been receiving benefits for sickness or incapacity. This would be a proxy for disadvantage in the labour market. According to Gregg, however, 'this generalisation is likely to be inaccurate since each claimant group encompasses individuals with a wide range of labour market readiness' (Gregg 2008:85). An alternative would be to assess each participant's job-readiness according to a range of characteristics, and set the payment for their job entry accordingly. However, said Gregg, 'evidence from a range of countries suggests it is very difficult to assess accurately in advance how much support a claimant will need' (Gregg 2008:85).

Some further solutions to this conundrum were proposed. The Social Market Foundation suggested a 'negative outcome payment' – i.e. a penalty – for each participant who left a contractor at the end of the programme without a job (Mulheirn and Menne 2008:13). The

same report repeated the idea of accelerator payments first proposed by Mansoor and Johnson in 2006 (Mansoor and Johnson 2006). Gregg also advocated this in his government-commissioned report a few months later (Gregg 2008). In the accelerator model, the amount paid for a job entry outcome increases, not with the 'disadvantage' of any particular participant, but simply as more participants are put into work. Assuming that the contractor will place the easiest participants first, and with the least financial outlay, the outcome payments at the start of the programme are small. As the programme progresses and the most job-ready people leave for work, contractors begin to tackle those with greater disadvantages, and at a greater marginal cost. The payments, then, will rise to acknowledge that fact. This avoids the need to gather and process lots of data on the characteristics which make a participant easy or hard to place. However, Gregg himself acknowledged that, as a new and untried method, the accelerator model carried risks of its own. It would make the procurement exercise much more complicated and could not be expected to prevent all creaming and parking. Given these uncertainties, he recommended piloting the idea (Gregg 2008).

Commenting on a variation of the idea which involved paying bonuses when a certain proportion of the target group had been placed into work, a member of the Department's commercial team said:

> 'it sounds fine, except what bonuses at what levels? If you have a sort of tag on each individual, in a sense the higher the proportion that gets placed, the higher the amount that gets paid - that avoids the idea of somebody central deciding what the threshold for a bonus is and what the bonus should be. The onus…the incentive is on the supplier to do as much as they possibly can' (Interview One).

It appears that the decision to use flat-rate payments emerged not so much from a view that it was the best solution, but that it was the only feasible one given the state of the Department's current information and capacity to set payments. The Department acknowledged this in the December 2007 evidence paper, pointing out that 'further analysis is needed to understand the cost of supporting the most disadvantaged jobseekers into work, in order to identify how much more resource should be given to providers for helping disadvantaged jobseekers achieve sustained job outcomes' (DWP Flexible New Deal evidence paper 2007c:32).

If, in developing the Flexible New Deal, the government hoped to pursue the same outcomes of quality, skills and equity that it appeared to pursue under the Young People's New Deal, the data emerging from its own programmes, the international experience and the policy community would have given it little reason to believe that it had yet obtained the data or developed the techniques to do so under an outcome-based payment system. David Freud had highlighted the issue at the point he recommended the use of the private sector and outcome-based payments. While he urged a cautious, slow approach, gathering all the necessary data before moving ahead, the government decided to implement an outcome-based payment model with practically no safeguards against parking and creaming, though it could argue that the focus on sustained jobs (thirteen and twenty-six weeks) would provide some incentive to quality.

Conclusion

By tracing the process leading to the introduction of the New Deal, this chapter has provided some support for Hypothesis One, particularly Hypothesis One(a). The choices made by Labour in designing the programme, presenting it in its 1997 manifesto and controlling its implementation confirm that it was interested in outcomes beyond simple job entries, though jobs were its priority. When it moved to increase the focus on jobs in response to the results emerging from the first few years of its welfare-to-work programme, there was a perception among contractors, Jobcentre staff and commentators that this was, indeed, a change in direction.

In subsequent years, the independent variables which had led Labour to choose multiple outcomes changed. The welfare arguments for giving resources to all unemployed people were overtaken by economic arguments for increasing the supply of labour, which made it more important than ever to maximise job outcomes and focus, efficiently, on those most likely to move into the labour market. Moreover, the issue of unemployment had become less important to voters, reducing the political risk for the government in moving away from the additional outcomes, particularly equity.

The government knew that adopting outcome-based payment would compromise the additional outcomes. The evidence emerging from its own experiments and international experience was consistent. While it might theoretically be possible to design a payment

system which controlled creaming and parking, the government had not yet developed one, and it did not have the data or systems to use the more sophisticated models that were advocated.

The fact that the government took the decision to move to outcome-based payments without further data-gathering and experiment would suggest that it had other reasons for adopting outcome-based payment that outweighed these disadvantages.

Chapter Five

Hypothesis Two: delegation for efficiency

The second hypothesis explains the decision to adopt outcome-based payment as an attempt to achieve better outcomes by improving decision-making. Decisions which had been taken by government were delegated to agents who would make more effective choices. This is certainly one of the arguments which the government used to explain its decision to use outcome-based payment. It argued that the delegation of decision-making to outside contractors would bring innovation and more effective performance (see, for example, DWP 2007b:87; 2008b:13), and, as the previous chapter has shown, the government had demonstrated its interest in exploring private sector innovation by introducing a number of experiments and pilots.

Under this hypothesis, the move from a service fee model in the New Deal to outcome-based payment in Flexible New Deal was driven either by a change in the policy environment, which created greater uncertainty and made delegated decision-making more efficient, or a change in the contractor base – the available agents. Faced with more expert contractors, or contractors who were more aligned to their own objectives, government reasoned that it would achieve better performance by delegating to them and need not be concerned about agency drift.

The evidence set out in this chapter suggests that the government did indeed obtain information which showed delegation would be an effective strategy to deal with uncertainty in the policy environment, but that it did not have robust evidence that outside contractors would be more effective agents than the government's own civil servants. Neither can the government's choice to delegate decisions to outside contractors be fully explained by the entry onto the scene of new, more trustworthy, or 'aligned' contractors. Instead, the discussion in the Freud Report suggests that certain providers were favoured because they could operate under outcome-based contracting, so the choice of outcome-based payment drove the preference, rather than the other way around.

Uncertainty in the policy environment and the case for delegation

The government was certainly presented, in the years preceding the introduction of the Flexible New Deal, with evidence that it could improve performance by delegating decisions

that it had previously kept ‘in-house’. This was not, for the most part, as a result of new uncertainty in the policy environment, but a growing awareness of a source of uncertainty that had been there from the beginning, and which was found to be compromising performance. As Chapter Four set out, data emerging from the New Deal suggested that the original, inflexible, model was less efficient than the government had hoped. While effective with the short-term unemployed, the New Deal was found to be under-performing with the hardest-to-help groups, and to have a diminishing effect over time because its client group was increasingly those hard-to-help people cycling through the programme for the second or third time (Hasluck 2000:22). This under-performance could have been ascribed to various factors, such as the level of investment or the quality of provision. However, those delivering on the ground sent a consistent message to the government that the lack of delegation - or flexibility as it was usually called - was curbing their effectiveness, as it prevented them from tailoring provision to individual circumstances. The ‘uncertainty’, then, related to the specific nature of the barriers which were keeping individual claimants from moving into work. The centre of government could not anticipate every response or intervention which might be necessary to tackle these barriers, but agents on the ground, if given discretion, could gather information about each individual’s situation and react accordingly.

There was a consistent call for such discretion from those at the frontline. The New Deal partnerships that had been set up in 144 units across the country to ‘oversee’ the New Deal (but without any actual control over design, budget or the contracting process) began to lobby for discretionary powers almost from the launch of the programme (Peck 1999:357). Contractors too, commented that they felt hidebound. A senior member of the Department’s contracting team remembered that contractors had ‘been complaining about contract length and about the degree of specificity for a long time, particularly the larger ones, the Reeds and the SERCOs, who wanted to innovate’ (Interview One). Personal advisers in the public employment service also wanted more discretion. They felt that the targets they were set ‘prevented them from delivering a fully client-centred service and meant that too many people ended up in programmes unsuitable for their needs’ (Finn 2001:3). They asked for flexibility, for instance, to keep participants in the job search Gateway for longer than 4 months, rather than requiring them to join an option against their will (Finn 2003:718). While the need for flexibility had existed from the beginning of the New Deal, changes in the client group exacerbated the problem. The government was changing the conditions for claiming benefits for those other than the unemployed, including lone parents, and people

with health conditions and disabilities. This was obliging more of them to claim Jobseekers Allowance where they became eligible for the New Deal. They generally had greater barriers to work and were more difficult to help.

The evaluation evidence emerging from the various experiments gave some support to the call for greater discretion on the frontline. Gregg, in his government-commissioned report on the welfare system in 2007, noted that Employment Zones, 'which offered a more flexible package of support' helped 'significantly' more people into jobs than the New Deal (Gregg 2008:33). An evaluation in 2003 found that Employment Zones had achieved a higher rate of job outcomes than would have occurred if the New Deal 25plus had operated in those areas and attributed this to the Employment Zones' innovation and flexibility (Hasluck quoted in Finn 2005:13). Hirst, commissioned by the Department to deliver a qualitative evaluation of Employment Zones, recommended that 'policy should support discretion and flexibility at the point of delivery in such a way that the personal advisor can drive a very effective job search process and access all the support necessary to overcome the clients' barriers to work' (Hirst 2002:viii).

A report for the Department looking at the impact of flexibility on personal advisers across a number of the Department's programmes and pilots concluded that 'small but significant improvements in the volume and pace of job outcomes, evident across a number of pilot programmes including Tailored Pathways, Employment Zone's and PSLs, have been attributed to greater discretion and flexibility' (Griffiths *et al* 2003: iii). It was less sure about improvements to cost-effectiveness, noting that there 'no evidence to suggest that flexible delivery [was] any more or any less cost effective than traditional approaches' (Griffiths *et al* 2003:iii).

Government showed some willingness to respond to these calls. In the New Deal 25plus, personal advisers were given a discretionary fund to spend on clients. Advisers on the ground welcomed this, but felt they were still too constrained by the central design of the programme (Griffiths *et al* 2003:ii). Their counterparts in the Employment Zones, run by outside contractors, agreed that they benefited from more flexibility:

> '"People in Jobcentres work extremely hard with both hands tied behind their backs basically. There are so many rules and regulations and what you can and you can't do,

> that with every will in the world you want to help someone but you can't - whereas here we have the flexibility to be able to do something practical to help people, so that's the difference" (Working Links adviser, Middlesbrough)' (Joyce and Pettigrew 2002:9)

The process leading to the adoption of Flexible New Deal shows that the government had heard the message about flexibility and was already moving to embrace it. As early as 2002, the Prime Minister was hailing the success of Employment Zones and attributing it to local flexibility, discretion, the focus on job outcomes, and a front line 'can do' mentality (Finn 2005:14). In the Five Year Strategy which kicked off the review of the New Deal, and the eventual development of the Flexible New Deal, the government announced that the New Deal would be replaced by 'a wide range of modular provision that cater[ed] for all client groups in the case of employment programmes such as the New Deal' with training and support 'tailored to [their] needs' (DWP 2005:2.24), and also referred to flexibility for those delivering provision.

Notably, the first mentions of plans for flexibility and discretion mention job centre staff, rather than private or voluntary sector providers. In 2005, the Department stated its intention to 'devolve more power to [employment service] district managers and personal advisers to choose provision to meet local and individual requirements and allow them to work imaginatively with local partners' (DWP 2005:2.24). Indeed, in response to the evidence about the effectiveness of flexibility and delegation, the government could have chosen to delegate decision-making simply by introducing more flexibility into its original New Deal model. It could have given Jobcentre Plus advisers more discretion over the length of the Gateway and the way they allocated individuals to options. Jobcentre Plus contracting teams in the regions could have been given a freer hand to commission the services that were most suitable to their local labour market, and contractors could have been released from the highly-specified New Deal options model to design more flexible and more tailored help.

The model which the government chose instead - known as the prime contractor model - removed decisions about allocation and commissioning from the employment service and decisions about design from the Department's policy teams and gave them to a new tier of outside contractors – the prime contractors – who would sit between the government and the existing contractors delivering on the ground. Figure 10 shows how decision-making was

distributed in the original New Deal (column a), how it could have been distributed in a modified New Deal (column b) and how it was actually distributed by the prime contractor model chosen for the Flexible New Deal (column c).

Figure 10: Levels of decision-making and delegation in different delivery models

STAGE	DECISIONS	Decisions taken by		
		New Deal (column a)	New Deal model with more delegation (column b)	Flexible New Deal (column c)
Policy Outcomes	Targets for the programme, investment	Ministers – decided amount to be paid for inputs	Ministers – decided overall budget	Ministers - decide amount to be paid for outcomes Prime Contractors decide investment in inputs
Design	Length and intensity of programme (training, jobsearch, temporary work etc)	Ministers, advised by civil servants	Local civil servants commission locally-relevant provision, giving frontline contractors some discretion over design	Prime Contractors
Delivery	Initial Jobsearch oversight	Frontline Civil servants	Frontline civil servants with additional discretion	Frontline Sub-contractors
	Distribution of resources between individuals	Built into design decided by Ministers	Frontline Contractors	Prime contractors
	Delivery of activity	Frontline Contractors		Frontline sub-contractors

The prime contractor model also meant that these decisions would most likely be delegated to large private sector companies, rather the small and medium-sized voluntary sector contractors that made up a large part of the Department's contractor base. This was an intentional effect. In its Commissioning Strategy, the Department said 'the core providers should be capable of delivering multiple contracts across the country' and 'we envisage a market where smaller providers will mainly act as sub-contractors' (DWP 2008c:10, 11). In other words, the government decided not just to delegate decisions, but to move them into the private sector, and, specifically, to large private sector organisations. The evidence about the benefits of flexibility does not explain the choice of this particular model. The government had, of course, been experimenting with the use of private sector contractors in various ways over the previous decade. The evidence from these experiments, however, was inconclusive.

No clear evidence of the benefits of delegating to private sector contractors

The evidence for the effectiveness of contractor-led provision was sparse and its reliability was compromised by the confused design and implementation of the 'experiments'. The first set of evidence came from the ten (and later twelve) areas in which the New Deal was led by outside contractors, rather than the employment service. The data showed that the Private Sector-led areas struggled in the early years of New Deal, though their performance picked up, and by 2001 they were performing as well as the other New Deal areas (Finn 2001b:12). In some aspects, they seemed to do a little better. The Department-commissioned evaluation reported that 7 out of 10 of the private sector led areas achieved more job entries than equivalent mainstream New Deal areas (Rodger: 2000:vii). The amount by which performance differed is not given, though later in the report it is stated that 'private sector led areas as a whole do have a slightly higher unsubsidised job entry rate than non-private sector led units of delivery' (Rodger 2000:29).

Modest as these results were, it was difficult to extrapolate from them to any clear conclusion about the potential performance of a contractor-led outcome-based payment system. The Private Sector-led areas were comparable neither to the proposed prime contractor model, nor to the employment service-led areas against which they were being measured. They had much less discretion than was envisaged for the prime contractors, being required to follow the basic New Deal structure of a job search Gateway and four intensive Options (Finn 2001b:12). However, they had more discretion than their employment service counterparts and were allowed to depart from some of the New Deal specifications. The comparison between public and private sector was made even more difficult by the profusion of delivery structures on both sides of the divide. The payment methods for the Private Sector Leads varied, as noted in Chapter Four, and there were differences in the exact nature of the responsibilities that they were given. In some areas, the private sector contractor took over the whole New Deal process, while in areas, it acted as a 'consultant' to the employment service which retained the Gateway role and the job of managing the providers of the various options (Rodger *et al* 2000:5,6). The roles of the employment service and contractors were entangled in different ways in different areas, making it impossible to discern the inputs that each were making. The employment service-led areas to which these Private Sector Leads were being compared also varied considerably in the distribution of responsibilities. In some areas, the employment service managed all the contacts for provision, in some it managed as part of a joint venture with other organisations and in others it managed one large contract

with a lead external organisation, which then sub-contracted for all the separate intensive options provision (Finn 2010:5). It was impossible, therefore, to draw robust comparisons between the private sector-led and employment service-led areas, especially given the modest differences in performance that were observed. Finn concluded in 2002 that 'there is little substantial evidence that [the private sector led areas] have "out-performed" comparable employment service-led districts.' (Finn 2002:14).

Attempts to compare the performance of Employment Zones – delivered by outside contractors – to employment service-led programmes such as the New Deal 25plus were also undermined by the lack of a robust design for the evaluation. The overall conclusion on Employment Zones was mixed. In a synthesis of all the evaluations carried out on the Zones, Griffith and Durkin concluded that 'Employment Zones consistently outperform comparative New Deals for mandatory customers both in respect of immediate and sustained jobs'. However, the difference in the employment rate of participants narrowed over time as people who had been placed in work returned to unemployment. Moreover, 'because of high tariffs and the outcome-related funding regime, EZs are more expensive, less fiscally cost-effective and achieve poorer value for money than comparative New Deals'(Griffith and Durkin 2007:30).

It is true that the Employment Zones could be seen to be making the most of private sector institutional advantages. They paid their advisers more than was possible in the civil service pay structure, and gave them significant financial bonuses for performance (Joyce and Pettigrew 2002:47). They had flatter, 'leaner' structures and less bureaucracy (Griffiths 2003:ii; Griffiths and Durkin 2005:13; Joyce and Pettigrew 2002:ii; Hirst 2002:52). These were exactly the kind of benefits that proponents of privatisation hoped to see.

It was almost impossible, however, to ascribe any differences in performance to the greater efficiency of the private sector because the two models also differed in the level of discretion and resources they were given. Employment Zones could contract for whatever kind of provision they thought would be effective and distribute their resource between participants as they wished. This flexibility extended to all aspects of the programme. Job centre advisers complained that, unlike advisers in Employment Zones, they did not have control over their own diaries and the length of interviews (Joyce and Pettigrew 2002:32; Johnson *et al* 2006:87). They also had smaller discretionary funds to buy, for example, interview clothes, bus passes etc (Johnson *et al* 2006: 48).

The employment service was keen to point out that it was not possible to say whether the small observed difference in performance was down to the choice of agent – (outside contractor versus bureaucrats), or the model – (flexibility versus central specification). A job centre manager told the team conducting an evaluation of Employment Zones for government that 'I'm sure if I had the level of resource and flexibility that the Providers do… I would do as well, if not better, than the Employment Zones Providers have done.' (Johnson *et al* 2006: 31). Gregg qualified his favourable comments on Employment Zones' better performance by noting that 'this effect could not be separated out from the higher funding they received' (Gregg 2008:33). At most, the Employment Zone experience allowed the government to say that, if outside contractors were given more discretion and money than the employment service, their results would be a little better.

Another set of pilots, introduced in the same period, also placed outside contractors in competition with the employment service, and did so with more rigour. The ONE pilots were actually mainly concerned with bringing together the administration of all working age benefits, but they gave a (mandatory) work-focused interview and a personal adviser to every claimant, and they included a private and voluntary sector variant involving outcome-based payment. Among the objectives set for the pilot areas were 'increasing the level of sustainable employment by helping more people into work' and 'putting more benefit recipients in touch with the labour market'. The three private and voluntary sector pilots (all of which were actually delivered by private sector companies) had an additional objective: 'to work in partnership with each other in developing innovative and flexible ways of delivering ONE'. This mirrored government statements that they hoped to 'harness the enthusiasm, experience and knowledge of the private and voluntary sectors.' They ran alongside the project to merge the Employment Service and the Benefits Agency into one working age agency called Jobcentre Plus. The privatisation of some parts of Jobcentre Plus' business was an implicit potential outcome from the pilots, and the relative performance of private versus public was a focus of the evaluation. Disappointingly, the evaluation showed no impact at all on entry into work, or even on motivation and confidence levels, from either the public or private sector variants.

The New Deal for Disabled People had also been operating through outside contractors paid for outcomes since 2001. Its results were positive. It was found to be saving between £2900 and £3100 of benefit for every long-term unemployed participant. However, it could offer no direct comparison with the employment service.

Finally, there was international experience to draw upon. Freud, arguing for a more flexible approach in his report, referred to the Australian programme which delegated almost all welfare-to-work activity to contractors with large amounts of delegation and outcome-based payment. However, he declared that 'the evidence on the effectiveness of the approach was 'less clear-cut than many of its proponents suggest.'. There were some good points. The private and voluntary sector had helped to 'secure good outcomes' and 'costs have been considerably reduced'. Despite all this, he concluded that 'the system has proved less successful at preventing long-term unemployment' (Freud 2007:57)

These experiments, then, failed to provide convincing evidence of the case for delegating decisions to groups of prime contractors with high-powered incentives rather than providing more flexibility with low-powered incentives under the existing New Deal model. There is no doubt that the government was aware of this. In his report, Freud concluded that the research showed that 'the greater flexibility in Employment Zones also [led] to improved outcomes – but at a higher price' (Freud 2007:54). He conceded that the comparison between Employment Zones and the New Deal 25plus from which this conclusion was drawn was not a direct one, but argued nonetheless that, because both public and private sectors were responsive to incentives and targets, there were 'potential gains from contesting services, bringing in innovation with a different skill set, and from the potential to engage with groups who have traditionally been beyond the support of the welfare state' (Freud 2007:6). The Australian experience, he admitted, was also 'less clear cut' than some suggested. The system had been less successful with the long-term unemployed than it had with the mainstream services (Freud 2007:57).

In the Evidence Paper which backed up the announcement of the Flexible New Deal, the Department refers to Employment Zones' superior performance, but also acknowledges that 'the greater effectiveness of [Employment Zones] cannot, however, be separated from the higher funding they receive' (DWP 2007c:22). Finally, when challenged over the move to prime contractors in the Work and Pensions Select Committee inquiry, the Minister of State, Tony McNulty admitted:

> 'from what we have seen in the mix already between private and public sector there is, as I say, not a marked difference in terms of performance' (WPSC 2009:vol ii, Ev39)

Changes in the contractor base: growth and maturity

In the face of the lacklustre evaluation data, it could be argued that the government's continuing faith in the innovation and creativity of the private sector owed more to the non-rational, societal factors suggested by sociological analysts, rather any rational calculation. Freud, having acknowledged the weakness of the evidence for private sector performance, rests on a general implication that new blood will bring new ideas, and that this tough challenge will require all hands at the pump. He talks of the need to ensure that 'the expertise that exists across the public, private, voluntary and community sectors is fully utilised' (Freud 2007:1).

Certainly, in the years following the introduction of the Young Peoples' New Deal, the contractor base increased in number and gained in experience, both of the client group and - for those involved in Employment Zones or the New Deal Private Sector-Led pilots - of working under an outcome-based payments system. The largest contractors also became a more cohesive voice and lobbied with increasing professionalism for the adoption of an outcome-based payment system (Finn 2009: 13; Davies 2008:140). A professional organisation, the Employment Related Services Association, was founded in 2005 (Linked-in 20201a) with a membership of thirty-three of the largest contractors (Davies 2008:140) and energetically advocated for a move to larger contracts with more discretion and more risk – the type of contract which favoured them over the small, voluntary sector contractors and the model to which the government eventually moved. Annual Welfare-to-Work Conventions were staged by the Centre for Economic and Social Inclusion which brought policy-makers into direct contact with the contractors who had previously dealt with the employment service or the Department's contracting teams. This may have helped to create the momentum that was building round the idea of outcome-based contracting and, particularly the prime contractor model. The Flexible New Deal was not the only, or even the first, programme to use prime contractors. Pathways to Work, an employment programme for people with disabilities, introduced prime contractors across 60% of its operations in early 2008 (NAO 2010a).

The large, private sector contractors, in particular, could offer government the third benefit which Hypothesis Two identifies: alignment. These large firms had a sole objective - to make profits. This made them highly responsive to financial incentives, and so well-designed payment schemes could be used to 'align' their activity with the government's policy aims.

The many, often small, voluntary sector providers that had formed a large part of the contractor base since the days of the Conservative government, on the other hand, had their own policy objectives and values and were less likely to follow the government lead simply because of the financial incentives involved. This all forms a persuasive case for the suggestion in Hypothesis Two that the government, looking for more effective agents to whom it could confidently delegate decisions, was won over by the private sector contractors that were increasingly available and adopted outcome-based payment as the best way to engage with them.

On the other hand, the extent of the change in the contractor base can be exaggerated. The supply of contractors for welfare to work programmes was healthy even when New Labour came to power in 1997, and as it introduced the New Deal it could already call on a 'diverse mixed economy of for profit and not for profit organisations' (Finn 2005:101). The Conservative government's employment programmes had fostered the growth of a public and voluntary sector industry, and there were also a number of public and voluntary sector organisations working independently on programmes to get unemployed people back to work. Turok and Webster identified a 'broad range of local and non-governmental organisations which had developed their own smaller-scale local training and employment initiatives' (Finn 2001b:62). The government reported in 1998 that the private recruitment industry had 'tripled in size since 1992' (Finn 2001b: Annex). Certainly, New Labour's programmes developed the sector further, encouraging more organisations to enter or return and creating 'a large mixed economy of private, public and voluntary sector organisations delivering a complex array of employment and training programmes through a myriad number of sub-contractors and placement providers' (Finn 2001b:67).

While new entrants were attracted to the market, there was considerable continuity between this existing body of contractors and the successful bidders for the Flexible New Deal. Half of the contractors to whom the government eventually awarded Flexible New Deal contacts had held contracts for Employment Zones or New Deal Private Sector-led areas. Moreover, of the seven new contractors, all but one had been in existence, and working in some kind of public sector projects (albeit not in the UK,) since before the introduction of the New Deal in 1997. These were not 'new 'agents. It cannot be argued, either, that the government had only recently become aware of the opportunity to move to a prime contracting model. A senior contracting official confirmed that large contractors had been making their availability clear for some time, and that the government's own contracting teams had been advising a different approach:

> ‘We’d been applying the New Deal contracting model, but under duress, saying this was too specified…weren’t giving enough opportunity for two things: for suppliers to bear more risk, also for suppliers to innovate. What we were doing was partly what we felt as commercial people, but also reflecting the message we were getting from potential suppliers in the original New Deal and actual suppliers once contracts were let and we were looking at developing future models. They’d been complaining about contract length and about the degree of specificity for a long time, particularly the larger ones, the Reeds and the SERCOs, who wanted to innovate and wanted to take risk because they could afford to do so.’ (Interview One)

It appears, from this evidence, that Department might have been in a position to move to outcome-based contracting earlier than it did. If that is the case then, contrary to Hypothesis Two, the Department did not adopt outcome-based payment in order to engage with new and more effective agents. Instead it reached out to large private sector agents at the point that it wanted to use outcome-based payment.

Figure 11: The Flexible New Deal contractors

Wise Group: a Scottish social enterprise, operating intermediate labour market placements to long-term unemployed since 1986, and had held contracts for Employment Zones (Wisegroup 2017.).
Remploy: a social enterprise that had been providing work for people with disabilities since 1946 (Remploy 2020).
Dudley Metropolitan Council
Working Links: a public-private consortium consisting of the government's Shareholder Executive, Manpower and Ernst and Young Consulting, which had been set up to deliver some Employment Zones in 2000 (Haughton 2000b:678).
A4E: founded in 1991 to deliver training to redundant steelworkers in Sheffield, with experience in employment and training provision under both Conservative and New Labour governments including the delivery of a New Deal Private Sector Led area (Morrison 2012).
TNG: founded in 1983 to deliver government-funded training programmes, and had held an Employment Zone contract (Training Standards Council,1999)
Pertemps: grown into one of the biggest private recruitment agencies in the UK since its founding in 1961 and had both led a New Deal Private Sector area and delivered an Employment Zone (Pertemps 2020).
Seetec: founded in 1984 and had been a New Deal Private sector Lead (Seetec 2020)
Work Directions: an Australian welfare-to-work company founded in 1989, and had been a New Deal Private Sector lead and delivered an Employment Zone (Ingeus 2020).
SERCO: no previous experience in welfare-to-work, but had been delivering other government contracts since 1987. Brought in as its lead director for the Flexible New Deal programme the previous CEO of Work Direction's UK Division, who had also run an Employment Zone for Working Links (Linked In 2020a).
Maximus Employment and Training : an American company, set up in 1975, which had been delivering public services in the US, including contracts with Medicaid, since the 1980s (Maximus 2020).
Mentor Employment and Skills: an American 'human services' company, which had set up a UK division specifically in order to bid for Flexible New Deal (carleyconsult 2011).
Calder Holdings: a Dutch company founded in 2004 with experience of delivering welfare-to-work programmes in the Netherlands, which had bought into the UK market in 2008 with their purchase of a small private UK employment agency (Linked-In 2020b; Dun and Bradstreet 2021).
Skills Training UK: a private training company operating in the UK since 1992 (Skills Training 2020)

(List of providers: Finn 2001b, DWP Press Release 2002, Finn 2005:8)

Conclusion

The process-tracing shows that, as Hypotheses Two predicts, the Department had good reason to want to delegate more decision-making to the frontline. However, there was only weak evidence for superiority of delegation through the prime contracting model. Moreover, it appears that the Department could have moved to the new approach earlier. This suggests that the outcome-based payment model drove preferences about providers, not that the desire to use new providers or utilise new experience drove outcome-based payments.

Chapter Six

Hypotheses Three: delegation for political risk management

The third hypothesis explains the decision to adopt outcome-based payments for the Flexible New Deal as a strategy for avoiding political risks involved in taking decisions about the programme that did not exist for the original New Deal. The decisions which would, under outcome-based payment, be delegated to contractors were those concerning overall levels of investment, the nature and intensity of interventions and the allocation of resources between participants. The hypothesis would be supported, then, by evidence that these sorts of decisions held greater political risks for the government under the Flexible New Deal than under the Young Peoples' New Deal.

This chapter will show that, while there was little risk of blame in the implementation of the Flexible New Deal, there was a new risk of damaging internal disputes over funding, which outcome-based payments had the potential to solve. The sequence of events does not support the hypothesis that outcome-based payments helped to solve these disputes for the Flexible New Deal itself. However, the use of outcome-based payments for the Flexible New Deal could be seen as the first step in a long-term strategy which involved using outcome-based payments to handle funding problems for the Department's future programmes.

Risk of blame was insignificant

The evidence is that there was minimal risk of political blame for the government from the decisions involved in either the New Deal or the Flexible New Deal. There is every indication that New Labour considered the New Deal programme to be a likely source of political credit. It was a highlight of the 1997 manifesto, and its design, including its potentially controversial mandatory aspect, was set out fully in that document, and highlighted during the campaign (Labour Party 1997). The manifesto also contained the target figure of helping 250,000 into work, which suggests the government-to-be felt confident about being held to account for achieving it.

According to Weaver (1986), the government should fear blame if the decisions that are to be made would cause concentrated losses in its 'constituency', that is, the voters and supporters it relies on for electoral success (Weaver 1986:373). In the case of welfare-to-work programmes, the question of loss is complicated. As the programmes are supposed to help people back to work, they would on the face of it be a benefit to anyone who participated in

them. However, the benefits of employment programmes were disputed. What some saw as a programme of support, others saw as a punitive measure designed mainly to force people off benefit (Peck 1999; Gray 2001; King 1995). For the latter group, the requirement to participate in a welfare-to-work programme such as the Flexible New Deal could be seen as a loss. However, this was no different to the situation in which the New Deal was developed. The government had obviously not found its stance on the New Deal to be electorally damaging. It featured the New Deal among the achievements that it highlighted in its 2001 and 2005 manifestos (Labour Party 2001, 2005).

There was some cause for discontent for the government's supporters, however, in the fact that, in the Flexible New Deal, the government was planning to move away from its New Deal commitment to equity, skills and quality outcomes. It could be expected that those voters and supporters that New Labour had appealed to with its commitment to equity and skills in the New Deal would be unhappy with the increased emphasis on jobs outcomes and the consequent risks of creaming, parking and cost-cutting. The act of delegation could, therefore, have been a way to push these potentially unpopular decisions away from government. There was also some risk of failure - i.e. that the programme would fail to put as many people into work as planned - because the targets for the Flexible New Deal were deliberately stretching.

This potential risk of blame, however, was offset by the fact that, as shown in Chapter Four, unemployment was not the central issue for the government's voters that it had been in the 1990s. The reduced prominence of the issue in the election literature of the two parties is an indication of its declining importance. In 1997, the New Deal was one of the five top pledges in Labour's manifesto (Labour Party 1997). The Conservative manifesto, while pointing out that unemployment was already falling, pledged to expand the Conservatives' Project Work pilots and introduce 'Britain Works' 'which (would use) the experience and ingenuity of private and voluntary sectors to get people off welfare into work' (Conservative Party 1997). By 2005, when the move towards Flexible New Deal was just beginning, the Labour manifesto was declaring that 'long-term youth unemployment has been virtually eradicated ' and the focus was turning to those on sickness and incapacity benefits (Labour Party 2005). There were no new promises on help for those claiming unemployment benefits. There was no mention at all of unemployment in the Tory manifesto (Conservative Party 2005). At the point that outcome-based payment was adopted in July 2007, the issue was not salient for

either party's voters, reducing the electoral risk involved in any decisions around welfare-to-work.

It is also doubtful that contracting out decisions to the private and voluntary sectors would have been an effective blame avoidance strategy. It is true that accountability is muddied by the contracting process, not least because information is hidden under the cloak of commercial confidentiality. Finn considered that contracting out 'pose(d) challenges for political accountability 'with considerable scope for blame-shifting' (Finn 2008:8). However, as Hood points out, a delegation mechanism is only effective as a blame-shifting strategy if it convincingly pushes the decisions beyond the government's control. Further the government must hope that their voters do not spot their attempt to shift blame, as this will attract criticism in itself (Hood 2002:24). In the event, the fact that the Flexible New Deal model involved the delegation of decisions to outside contractors did not go unnoticed. It was the subject of extensive discussion and scrutiny, not least in parliament (WPSC 2009). Had the policy community or parliament concluded that the delegation was simply a cover for hiding unpopular decisions, the strategy would not have worked. In fact, the Select Committee supported the approach wholeheartedly, saying it welcomed 'the use of outcome-based contracts for Flexible New Deal that will reward providers for getting people into jobs without prescribing the best way of doing this' and that it had 'received considerable evidence which supported this approach' (WPSC 2009:3).

In summary, then, it appears that the government had less reason to fear blame from the introduction and implementation of Flexible New Deal than it had from the New Deal, because of its lower salience with the public. Furthermore, outcome-based payment would not have been an effective strategy for avoiding blame in any case.

The increase in some decision-making costs

A more convincing case can be made in support of Hypothesis Three(b), that outcome-based payments were a way to delegate to contractors decisions which would create unacceptable decision-making costs if kept 'in-house'. As discussed in Chapters One and Two, these decision-making costs are not the straightforward costs of gathering information, assessing options and arriving at a preferred course of action. They are the costs of the making collective agreements which need to be made within the government machine for the policy to progress, but which may involve disputes and lengthy negotiations. While, for Hypothesis One and Two, it has been possible to treat the government as a unitary actor, Hypothesis

Three requires an examination of the internal processes and the various actors which play a part in them. It is assumed that the actor making the decision to delegate decisions is the Department, which may see delegation as a way to solve the internal disputes which threaten its policy. This chapter will therefore examine the process by which policy decisions were made for New Deal and Flexible New Deal to see whether, in fact, there were reasons for the Department to wish to avoid these processes by delegating decisions to outside contractors. The hypothesis would be supported by evidence that, when the department was deciding on the design of the Flexible New Deal payment system in early 2007, it had reason to expect greater resistance to its policies within the decision-making system than it had faced under New Deal, and that the model of outcome-based payment that it eventually adopted would be an effective strategy for avoiding difficult and draining negotiations.

In the UK, government programmes have to pass through three processes: legislation, the policy approval process, and funding negotiations. Each of these contain obstacles for the programme's progress. Some are veto points, such as the decision of Treasury to fund the programme. Others fall short of being absolute veto points. Parliament and the policy community, for example, cannot always stop a policy decision, but they can bring political pressure to bear. It might be more accurate to call them 'points of potential resistance'. Hypothesis Three, then, would be given support if there were evidence that ministers developing Flexible New Deal were anticipating greater difficulty in getting agreement to decisions than had been the case for the New Deal, either because they faced new 'points of potential resistance' (e.g. they needed more legislation to be passed), or because the decisions they needed to make had become more controversial. If the difficult decisions related to the areas which would be delegated to contractors through outcome-based payment (investment, allocation of resources and type and intensity of provision), then choosing outcome-based payment might be an effective strategy for side-stepping these difficult negotiations. It would further strengthen the case for Hypothesis Three if there were evidence that the choices made by the government about the specific detail of the delegation arrangements between July 2007 and July 2008 seemed to be designed to avoid these actual or potential decision-making problems.

Legislation

In the UK system, a government can usually be confident that its majority will secure it any legislation it needs and deal with any opposition or resistance in parliament. However, it may have to compromise to get it through parliament without unacceptable delay. In the case of

the Young People's New Deal and Flexible New Deal, the legislative hurdle was not high. The only approval they required from parliament was the passing of the regulations to make the programmes mandatory, using existing primary legislation (Social Security Amendment (New Deal) Regulations 1997; Social Security (Flexible New Deal) Regulations 2009). Moreover, these were to be passed by the negative procedure – that is, they are only debated if an MP 'prays against' them (United Kingdom Parliament website, 2021). There was a further process which had the potential to create minor resistance by delaying the laying of the regulations: before putting the regulations before parliament, the government had to submit them to the Social Security Advisory Committee, a statutory body that scrutinises all social security regulations and can ask for the regulations to be 'referred' to them if they see problems. They do not, however, have the power to prevent regulations being laid (SSAC 2002:preamble).

The legislative process, then, offered little risk of real resistance, but the government might still have sought to minimise opposition which could have been picked up by the media or critics outside the parliamentary process. For the New Deal, which was a high-profile policy, it would be expected that significant numbers of MPs would be interested in the policy, and in the conditions under which it was made mandatory. However, the government had just been returned in 1997 with a landslide, and ministers could expect support from parliament for a policy which had featured so prominently in the manifesto, along with a clear statement of the intention to make it mandatory (Labour Party 1997). In the event, neither the Social Security Advisory Committee nor parliament raised an objection.

The Flexible New Deal was not a key manifesto pledge, as the Young Peoples' New Deal had been, and this could have made it more vulnerable to parliamentary opposition, perhaps from the government's own backbenchers. The contentious issues which were delegated out to contractors under outcome-based payment (on investment, allocation and type of provision) did not actually require legislation, and so outcome-based payment was not needed to remove them explicitly from the legislative process. However, if MPs or the Social Security Advisory Committee had been concerned about the implications of these decisions for quality and equity, they might have resisted the mandatory provisions in the regulations. It might be argued, therefore, that it would help the government's position in parliament that such potentially controversial decisions were to be taken by outside contractors out of the public eye.

The events show that, if hiding these decisions during the parliamentary process was part of the reason for adopting outcome-based payment, it did not work. While the Social Security Advisory Committee had nodded through the New Deal regulations, this time it exercised its right to take the regulations 'on formal referral' and issued an invitation for outside views. As a result, it submitted a report raising fourteen points of concern, including areas of the programme that were to be delegated to contractors, such as the quality of the provision and the extent to which it would be tailored to individual needs. It also noted the risk of creaming and parking created by outcome-based payment itself (SSAC 2009). Outcome-based payment not only failed to prevent these contentious issues being debated, it became an issue for debate itself. The events following the Social Security Advisory Committee's report, however, only showed how little the government had to fear from resistance within the legislative process. It simply responded to the report, accepting four of the recommendations in full, two in part and rejecting two others (SSAC 2009). The only consequence was a slight delay in the legislative process, but the regulations were then passed through parliament without debate (Hansard 2009b).

The progress of the Flexible New Deal through the legislative process, then, confirms the existence of some opposition to the nature of the programme, but shows that the government had little reason to adopt outcome-based payment as a way of avoiding the debate. The powers which opponents had to resist the passage of the legislation were weak, and the delegation of the contentious decisions to contractors failed to prevent what modest resistance there was.

Policy design

The internal policy design process, within Whitehall, presents a number of 'points of potential resistance'. While much of the detail of policy can be decided by a departmental minister, major statements of policy – e.g. green and white papers – and all legislation put before parliament need to be agreed by the relevant Cabinet Committee (Cabinet Office 2011: 33ff). There will also be public consultation exercises round green papers and strategy documents, when the policy community and wider public can put pressure on the government to alter its policy direction. Finally, major policy statements will often attract the scrutiny of the department's select committee, who will seek to influence ministers' decisions. While these committees have no formal power to stop government policy, government will generally seek to avoid difficult confrontation that generates bad publicity and may spark off further resistance.

The government faced more hurdles in the policy process when developing the Flexible New Deal than it had with the Young People's New Deal. The main planks of policy for the Young Peoples' New Deal policy had been decided in opposition through the process set out in Chapter Four, leaving only the details to be fleshed out once in government. Most of this did not require agreement outside the Department itself, though the Treasury insisted on being involved, '[staking] a claim to real involvement in designing and implementing New Deal' (Robinson, 2000:61). Though there was a consultation process focusing on the way New Deal would be rolled out through local partnerships (Peck 1999:354), there was little scope for consultation on policy which had already been decided. The Employment and Education Select Committee conducted a scrutiny of the plans for the New Deal and published a report in November 1997. It expressed its support for the New Deal, while emphasising the need for flexibility in delivery and underlining the importance of quality of provision and a solid education and training element. It also called for more sub-contracting to outside contractors (EESC 1997:D). Notwithstanding these caveats, the New Deal passed smoothly from proposal to implementation.

By contrast, all the details of the Flexible New Deal were passed through the inter-departmental, parliamentary and public consultation channels, with the publication of two strategies, three green papers and two white papers (DWP 2005,2006,2007a,2007b, 2008b, 2008c, 2008e). All these documents would have required the agreement of each member of the relevant Cabinet Committee, who would also have to agree the regulations before they were laid (Cabinet Office 2011:33). The In Work, Better Off green paper and the Commissioning Strategy also went through formal public consultation processes (DWP 2007a, 2008b). Although a public consultation does not create an actual veto, it generates political pressures which can influence policy. Further, the Commissioning Strategy was the subject of the Select Committee investigation. The question is, first, whether government expected effective resistance during this process and, second, whether the decision to delegate decisions to contractors through outcome-based payment was an effective strategy to avoid costly arguments.

First, there was no reason for the Department to expect resistance within the Cabinet policy approval process. While Flexible New Deal lacked its predecessor's status as a manifesto commitment, neither did it threaten the policy interests of other departments. The department that had previously had the greatest interest in employment programmes, the Department of

Social Security, had since merged with the Department for Education and Employment to form the Department of Work and Pensions. The implications which the programme had for the benefit system were therefore intra-, rather than inter-, departmental and under the control of one Secretary of State.

There is certainly evidence of a dispute between the Department and the Treasury over the Freud Report. The hostility of the Chancellor to the report was loud enough to reach the ears of the media and seems to have led to the eventual resignation of David Freud as adviser (Driver 2009). However, it appears that the dispute was actually over the parts of Freud's report that dealt with Universal Credit (Haddon 2012) and may have been exacerbated by tensions between the Chancellor of the Exchequer, Gordon Brown, and the Secretary of State for Work and Pensions, James Purnell, who was being seen by some as Brown's rival in the competition to succeed Tony Blair as Prime Minister (Ashley 2008). A Department official remembered that Purnell was 'having rows with Gordon Brown about various things' (Interview One). In any event, Brown went on to endorse the outcome-based payment model for the Flexible New Deal once he was Prime Minister (DWP 2008d:74).

In the policy and contractor community, and as noted in Chapter Four, there had been some unease about signs of creaming and parking and the move towards a 'work first' approach in Employment Zones and the New Deal Private Sector led areas and the Department might have been anticipating that these would filter into the select committee investigation or surface in consultations. Indeed, the various consultation processes and the Select Committee debate do show some fairly consistent concerns about creaming and parking, quality and consumer choice (WPSC 2009:32-35) There is also concern that the payments to contractors are too low and that there may not be enough flexibility. However, the only consistent hostile note comes from the small contractors concerned about the effect of the prime contractor model on their business. The majority of contributors to the Select Committee's investigations and the Select Committee itself express solid support for the programme and the way it is being design and delivered (WPSC 2009: 15, 79; DWP 2007b:111; DWP 2008b:35,36).

It is, therefore, difficult to make a convincing case that outcome-based payment was adopted as a way to sidestep the level of resistance that the government had reason to expect in the policy process. Not only was the resistance relatively mild, but it is unlikely that outcome-based payment would have helped the Department to avoid it. The decision to use outcome-

based payment was itself scrutinised and discussed (WPSC 2009). Had there been any suspicion that outcome-based payment was being used to push contentious decisions out of the policy process, there should be evidence of objections to outcome-based payment itself. In fact, the Work and Pension Select Committee was concerned that contractors were not being given enough freedom from Whitehall interference and 'urge[d] DWP to ensure its system remains focused on measuring the outcomes providers deliver, rather than the processes by which they are achieved' (WPSC 2009:17).

Funding

The most convincing evidence for significant decision-making costs is in the funding process. Ministers need to agree the funding for their programmes as part of their department's negotiation with the Treasury. However, while the funding negotiations are done bilaterally between each government department and the Treasury, departments are, in fact, in a cross-government competition for a share of the available funds. These funding negotiations can be long-drawn out and costly. Departments may need to expend political goodwill with the Treasury ministers (and with rival spending ministers) to win funding, and they may also face opportunity costs as the Treasury responds to bids for funding for one programme by suggesting that the department finds savings elsewhere in its own agenda.

The same competition exists within departments as the department's overall settlement is shared out among the department's various functions, policies and programmes. The distribution of the department's budget is not entirely within the gift of the secretary of state, as the allocation of funds to different departmental programmes will be agreed with Treasury, and put to parliament for approval. However, the intradepartmental push-and-shove will determine which programmes the secretary of state fights for, and which she concedes. For a programme to win funding, then, requires the support of the centre of government, agreement – or at least acceptance – from other departments, and the sponsorship of the secretary of state within the department itself.

The Young Peoples' New Deal was in a much better position in this competition than the Flexible New Deal. Money had been ring-fenced for it before the election and announced in the manifesto, which said that the New Deal would be funded: 'using money from a windfall levy on the privatised utilities' (Labour Party 1997). It is true that the details of the financial package still had to be negotiated after the election. Geoffrey Robinson, who as Paymaster-General developed the details of windfall levy, reports discussions about exactly how much money could be raised, and explains that there were other claims on the £5.5-6bn the tax was

expected to deliver (school buildings and hospitals). In the end £3.5bn was made available for the New Deal, but the hospital programme had to be sacrificed (Robinson 2000:83) It seems likely that, given this competition for the funds, the Department would have been pressed hard on their costings. Nonetheless, the New Deal could count on solid support from the Treasury, first as a manifesto commitment, but also because Treasury ministers felt a sense of personal ownership for the policy. Robinson tells how, determined to 'badge' the New Deal as a joint product of the Department and the Treasury, his officials made sure, by 'some clever photocopying' that the announcement of the programme's launch went out on paper headed by the crests of both departments (Robinson 2000: 61).

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Once in government, then, and at the point that delivery mechanisms need to be considered, the Department already had agreement to, and electoral endorsement of, its main policy design and funding, along with strong central support for the programme as a government flagship. However, the manifesto commitment to funding the programme was finite. The initial funding from the windfall tax began to fall in 2003/4 and disappeared altogether in 2004/5 (HMT 2006: 95), and new funding had to be secured in the 2000 and 2004 Comprehensive Spending reviews (HMT 2001, HMT 2004). However, the Young Peoples' New Deal's good fortune in financial matters held out. Even though its importance to the government declined with the electorate's declining interest in unemployment, the two funding rounds coincided with a relatively comfortable period for UK government finances generally. There was a budget surplus, estimated at £15bn, in the 1999-2001 period, and, in the 2004 CSR, the Treasury still felt able to increase public spending as a proportion of national income (Schifferes 2001, HMT 2004).

The Flexible New Deal faced greater challenges in securing funding. The Department negotiated its budget for 2008-11, from which it would need to take the funding for the new Flexible New Deal, between July 2005 and March 2006 (HMT 2006, 2007, TC 2007, DWP 2007d), and the background to the negotiation was less favourable for the Department's negotiating position than before. The political salience of unemployment continued to fall and the government was experiencing new fiscal constraints (HMT 2007). In the light of these, and bearing in mind the relative buoyancy of the labour market, the Treasury announced a cut in the Department's Programme budget of 5% in real terms over the 2008/11 period (TC 2007).

To add to the financial pressures, the economic environment changed dramatically with the financial crash in the summer of 2008.The immediate implications for the Department looked, on the face of it, positive. Because of its central importance in dealing with the expected rise in unemployment, the Treasury announced an extra £3bn over three years for the Department to enable it to cope with the increased numbers, including those entering the Flexible New Deal (HMT, 2009). However, the extra funding simply maintained the status quo, rather than raising the funding per head (WPSC 2009:22). The problem of achieving challenging outcomes with a more difficult target group in a less buoyant labour market remained.

In summary then, the area in which it appears that decision-making became significantly more difficult in the period between New Deal and Flexible New Deal is funding. The next section will, therefore, examine the evidence that the risk of internal disputes over funding actually shaped the decisions on outcome-based payment. First, I will set out the way in which an outcome-based funding model can help resolve internal funding disputes.

How outcome based-payment reduces the cost of making funding decisions

The use of outcome-based payment and outside contractors effectively delegates to those contractors the decisions on the appropriate amount to invest in the programme, thus avoiding difficult discussions on these issues across Whitehall. Under outcome-based payment, the government decides how much it is happy to pay for outcomes. It leaves contractors to decide how much to invest in inputs. If they get it wrong, invest badly, and the outcomes are not forthcoming, they bear the financial costs. If the outcomes are achieved, the government pays exactly as much as they are worth and no more. The financial risk of the programme is therefore transferred out to the contractor. This is known in government as the invest-to-save principle (Sturgess and Cumming 2011).

It is significant for this hypothesis that the risk that is transferred out, when dealing with welfare-to-work programmes, is not a risk borne primarily by the spending department, but by the Treasury. The Treasury retains the budget for welfare benefits (referred to in government as Annually Managed Expenditure or AME), while granting the Department the money to spend on welfare-to-work programmes (as part of its Departmental Expenditure Limit or DEL). If the welfare-to-work programme is successful in getting people into work, the Treasury will see savings in its welfare spending budget to offset the cost of the programme. Without an outcome-based payment regime, however, and if the programme

fails, the Treasury will have paid the Department to deliver it but will see no drop in its welfare spending. The risk of failure is, therefore, borne by the Treasury, not by the Department.

If outcome-based payment is used, however, the calculus is changed. The Treasury gives the Department the money to pay the providers, as part of its DEL settlement. If the programme succeeds, and the money is paid out, the Treasury sees a fall in the bill for welfare benefits. If the programme fails, and participants are not put into work, then the programme money is unspent and can be recovered from the Department. The loss is borne by the contractor.

This possibility of outsourcing the financial risk should transform the internal Whitehall discussion over funding. The Department no longer has to convince Treasury of the wisdom of investing a certain amount in the hope of future savings. It does not need to make a case for the design of the programme and the way in which decisions about allocation of resources between the millions of individual participants will be made for maximum cost-efficiency. The contractor will make these decisions, at its own risk. The arrangement 'de-risks' the programme for the Treasury, as an ex-senior Departmental official put it (Interview Four).

The arguments set out above show that outcome-based payment could, in theory, provide a way to solve funding disputes inside government. This is not evidence, however, that this was what motivated the choice of outcome-based payments. To support Hypothesis Three, there would need to be evidence of a logical sequence (Beach 2017) leading from a dispute over funding, through the choice of outcome-based payment to a resolution of the dispute. There would then be evidence that the detail of the payment system, as it was designed over subsequent months, served the purpose of de-risking the programme for the Treasury. The next section will examine this evidence.

Evidence of outcome-based payment being used to resolve funding disputes

The timeline of events is certainly compatible with the hypothesis that outcome-based payment was adopted at least partly to resolve a dispute over the funding of the Flexible New Deal., although the public record contains no 'smoking gun' evidence of such a dispute. The department's general proposal to replace the original New Deal only began to take shape as the Flexible New Deal after the reduced overall funding package for the Department had been announced in the March 2006 Budget. If indeed the Department had discussed with Treasury additional funding for the new programme, the discussions would have happened after that

Budget and before the Flexible New Deal was announced, in name, in the 2007 green paper (DWP 2007a).

Given the overall fiscal situation, any discussion about additional funding would have been difficult. The Department might have expected some central support for the Flexible New Deal, as the proposal for the programme had emerged from the Five Year Strategy, which was a personal initiative of the Chancellor of the Exchequer (Interview One). However, the Budget report in which the Department's settlement was announced made clear that the real focus for the Chancellor was the claimants of Invalidity Benefit and lone parents, rather than the hard-to-help Jobseekers' Allowance claimants who had failed to find employment through New Deal, and who were the target for Flexible New Deal (HMT, 2006:75)

If Hypothesis Three is correct, then, we should expect to see suggestions of outcome-based payment emerging during the period that any discussions about funding would have taken place – that is between March 2006 and July 2007. In fact, the strongest case for the use of outcome-based payment emerged from the Department in this period, in the shape of the Freud Report.

The Freud report, commissioned by the Department nine months after its reduced funding package had been announced in March 2006 and published in March 2007, made a strong and explicit case for the use of outcome-based payments, and devoted considerable space to the invest-to-save principle. Freud argued that, given that the effort required to get the hardest-to-help into work would be intense, (and his report encompassed not just the eventual target group of Flexible New Deal, but those on sickness and disability benefits too), finding the necessary resources to fund the project would be a problem (Freud 2007:6). He gave no indication of cost, pointing out that competition through the tendering process would set the price the government paid. However, he spent an entire chapter setting out some (admittedly broad brush) calculations of the benefit savings which would accrue to the government were these contracted providers to be successful in moving people into work (Freud 2007:Chapter 4).

He was, therefore, suggesting a major investment, to be made in the hope of savings to come. This was where he saw a role not just for the private sector, but for major private sector firms that could bring the upfront finance (from their own coffers or the banking sector) and would be prepared to bear the risk of failure in the hope of greater rewards. He had, after all, in his Foreword, set himself the task of 'reducing the number of socially disadvantaged people at

minimal cost and risk to the State'*(*my underlining – Freud 2007:v). Bringing in the private sector in what he called explicitly 'a public-private partnership' was the way to achieve this goal (Freud 2007:7). By contracting to large private sector companies on the basis of payment-by-result, the government would pay little or nothing towards the effort of moving people into work. Costs would only arise if the effort was successful and the government could set those costs against guaranteed benefit savings (Freud 2007:69).

In his discussion of the form of the contracts which should be let, it is clear that the need to bring in upfront finance was central to his proposals. It was the need for large-scale investment that he gave as a reason to reject the idea of contracting directly with the existing market of experienced, specialist contractors, and to conclude that the prime contractor model was the only option, saying that 'the "prime contractor" route should ameliorate the issue of funding because the main operators [would] be able to arrange private finance', while 'it [was] simply not feasible to envisage the kind of financial market support to allow the smaller and particularly non-commercial organisations to be able to take the financial risk implied' (Freud 2007:62).

Four months after the publication of the Freud report, the Department announced the new Flexible New Deal, adding that it would use outcome-based payment and proposing to move to Freud's prime contractor model. The announcement was made in a green paper which sought views on how the prime contractor model should work, but not on whether it should be used at all (DWP 2007a:61).

This sequence of events gives some support to Hypothesis Three. During the working out of the financial details of Flexible New Deal, in an environment that was financially constrained, the Department commissioned a report which made the case for outcome-based payment and the prime contractor model as a way to transfer risk, and then committed to the use of outcome-based payment and the prime contractor model. This sequence would fit an effort to persuade Treasury to release money, additional to the amount given to the Department in its overall settlement in March 2006, by releasing it from the separate benefits budget kept within Treasury through the invest-to-save principle.

A difficulty for Hypothesis Three is the lack of evidence that the commitment to outcome-based payment actually persuaded the Treasury to release funding and so resolved the dispute. A member of the Department's commercial team remembered 'Treasury officials were very nervous from day one, really, as to whether they weren't being taken for a

ride…end up paying for all this welfare-to-work and still end up paying lots of people claiming benefits, so they would be losing' (Interview One). Indeed, no invest-to-save arrangement was ever made between the Treasury and the Department (Interview One). If the adoption of outcome-based payment and the prime contractor model was an attempt to persuade the HMT to be more generous with its funding, it did not seem to work.

However, the Commissioning Strategy and the Freud Report suggest another way to interpret the evidence. Both documents proposed outcome-based payment for all future departmental programmes, not just the Flexible New Deal. The Department twice pointed out, in its submission to the Work and Pensions Select Committee inquiry into the Commissioning Strategy, that the Flexible New Deal was simply 'the first programme to be commissioned using the new Commissioning Strategy principles' (WPSC 2009: Vol ii. 2.7, 3.6). The Department went on to introduce Work Choice, the first specialist disability programme to be designed under the Commissioning Strategy principles (Inclusion 2013:62). The adoption of outcome-based payment in Flexible New Deal might, therefore, have been only part of a longer game to use outcome-based payments to secure funding for future programmes. In that event, the fact that the strategy did not work to elicit additional funding for the Flexible New Deal itself was less important than adopting the outcome-based system and building an evidence base on its operation to support future bids. The sequence of events, then, though it falls short of offering definitive proof that outcome-based payment was used to persuade the Treasury to fund the Flexible New Deal, is still compatible with the hypothesis that outcome-based payment was proposed by the Department as a way to secure funding for all its future programmes, and that the Flexible New Deal was just the first step in that strategy. The hypothesis would be further strengthened if the specific form of outcome-based payment that was adopted was particularly suitable for reducing the financial risk to the Treasury.

Designing the payment system to reduce risks to the Treasury

Once the overall decision has been made to use outcome-based payment, the detailed decisions that are made about the level and structure of payments can give clues to the Department's primary motivation – whether it was to de-risk the programme for the Treasury (i.e. Hypotheses Three) or to incentivise the contractors to achieve as many outcomes as possible (as in Hypothesis One). These clues are not immediately obvious. After all, both these motivations - maximising outcomes and transferring the risk - were claimed by Freud as reasons to adopt outcome-based payment (Freud 2007:69). The implication is that the outcome-based payment system with its high-powered incentives delivers against both

objectives: it incentivises contractors and transfers the financial risk to them. This implication creates a problem for a process-tracing approach. If it is the case, then it will not be possible to ascertain which motivation drove the government. There is observational equivalence between the two hypotheses: the same evidence supports both.

However, it is actually difficult, if not impossible, to design an outcome-based payment payment system which both incentivises contractors and reduces financial risks for the government. There is a complex relationship between the costs of getting someone into work and the savings which accrue to the government when they do so. To minimise the financial risk for the government, the payments made to a contractor when a person goes into work must be equal to, or less than, the benefit savings that will result. To incentivise a contractor, on the other hand, the payments must be greater than the investment necessary to get the person into work. The benefit savings for the government are irrelevant to the contractor's motivations. For the payment system to work for both government and contractor, then, the cost of getting people into work needs to be less than the returns to government from the outcomes. In an ideal world, this would be the case, but there is no necessary connection between the two figures. The government, therefore, needs to make a choice. It can set payments at a level which incentivises contractors to put as many people into work as possible, maximising outcomes[3]. Alternatively, the government may choose to keep the cost below the level of direct cash savings to make the programme as near as possible to being cash-neutral for the Treasury. However, that will mean foregoing some outcomes, because they would cost more to achieve than the benefit savings they produce.

The problem for Flexible New Deal was that neither the government not the contractors had full knowledge of the numbers on either side of the equation. They knew the average amount spent on getting individuals into work in previous programmes. This, however, was a crude indication of the costs of getting the harder-to-help group targeted by Flexible New Deal into work. Judging costs for a particular individual was even more difficult. While the government had some data on factors which increased an individual's risk of remaining in unemployment, it was unable to predict with accuracy which individuals would remain unemployed without intervention (Gregg 2008:85). These problems, and the way they

[3] No government, of course, should fund programmes beyond the point where the costs equal the benefits. However, the benefits to the country of putting people back into work go beyond welfare savings, including improvements in the economy, health, communities and general wellbeing. For a government concerned to maximise outcomes, it would be rational to invest up to the level of these wider benefits.

compromise the government's ability to set outcome payments that would properly incentivise contractors, were discussed in Chapter Four.

On the other side of the equation, the returns to government were also difficult to predict. First, the calculations had to take into account the 'non-intervention rate' – the number of people who would have found work anyway, without the Flexible New Deal. Then, the returns to government from moving the remainder into work depended on a number of factors:

- The level of benefit that the individual was being paid – this could range from less than £100 for a single person living with family, to several hundred pounds for someone with a large family and a rented house.
- The salary the individual could be expected to get when they moved into work – which affected tax and National Insurance revenues, and in-work benefit costs
- The amount of time that the individual would have stayed on benefit without the programme
- The length of time the individual was likely to remain in the job that the Flexible New Deal had found for them before returning to benefit

This complexity led the Social Market Foundation to conclude that 'it is difficult to measure the counterfactual: how many of the provider's clients would not have sustained employment for a year without the extra support, and how much is this worth to the exchequer? Calculating the value of that 'additionality' for different groups of jobseekers has always been problematic' (Mulheirn and Menne 2008:90).

In the face of this uncertainty, an outcome-based payment system had to tread a narrow path between underpaying and failing to provide sufficient incentive to contractors to invest in helping people back to work, or overpaying for outcomes from people who, despite their apparent barriers, would have got into work without intervention (i.e. deadweight). In the first case, Treasury cash would be protected at the cost of foregoing possible outcomes. In the second case, more outcomes might be achieved, but the spending could easily exceed the savings.

In fleshing out the details of the outcome-based payment system, the Department made three major choices: to pay a flat-rate fee for every job outcome, to cap the total amount of money available and to set the performance-related element of the payments at 80% (DWP 2009:4.16-4.20). What do these choices indicate about the Department's priorities?

The creaming and parking problems caused by flat-rate payments have already been discussed in Chapter Four. Creaming and parking affect equity outcomes, because harder-to-help people get less help, but they also depress job outcomes, as those harder-to-help people remain in unemployment when they could, with more help, have moved into work. There is an advantage to flat-rate payments for the government, however, which is that they protect it against overpayment. Variable payments create financial risks. If the government offers a significantly higher payment for getting harder-to-help people into work – which it needs to do to incentivise contractors - it has to be very sure that it has set that payment at the right level. If it is too high, relative to the costs the contractors face, they will be incentivised to put lots of these people into work, taking an excessive payment each time and making excess profits. If the payment is too high relative to the savings or financial returns the government can expect to make from getting these individuals into work, it will end up paying out much more money than it saves.

It seems likely that this is, in fact, the risk that worried the Department. After all, the fact that variable payments could not be calibrated perfectly to create a perfect incentive should not, in itself, have been a reason not to use them. They did not have to provide a perfect incentive. Even if imperfect, they would still be likely to offer more effective incentives to contractors than the flawed flat-rate payments. They would also, however, increase the financial risks for the government. Discussing the reasons for the use of flat-rate payments, a senior commercial team member said:

> 'again it's back to this thing of having an open-ended cheque book …if you specify the amount, you're still taking a risk with the outcomes that can be achieved, but you are providing a bit less risk of it going out of control if the suppliers are very successful.' (Interview One)

Of course, flat-rate payments only offer a protection against over-spending if they are low enough. But the lower they are, the less of an incentive they offer. The Department, in its own Evidence Paper (DWP 2007c) had cited Beale (2005), who 'concluded that driving better value by lowering payments could risk increased creaming and parking as provider margins are reduced and they look to maintain their profitability' (DWP 2007c:32). The level at which Flexible New Deal flat payments were set should, therefore, give some indication of the government's priorities: maximising outcomes or protecting the Treasury from overpayment.

The government did not actually set a specific level of payment for outcomes, but it set capped budgets for each region of the country, and asked would-be contractors to bid on the number of outcomes they could achieve within that budget (Mulheirn and Menne 2008:37). The Social Market Foundation estimated the payment per outcome implied by these budgets and a 'reasonable' rate of job outcomes based on previous programmes' performance. The payment per outcome ranged between £2900 and £6700 in London and the South East. In most areas of the country, the payment lay between £3000 and £4000. These rates are considerably below the costs per job outcome for Employment Zones and the New Deal for 25plus of £5110 and £5130 respectively (Mulherin and Menn 2008:41; Freud 2007:55).

The flat-rate payments, then appear to have been adopted in the face of concerns from the policy community and the Department's own commercial team, and set at a low level compared to previous programmes. While there were obvious problems with the alternative models, the choice of flat-rate payments does suggest that a wish to keep payments below the level of expected savings outweighed the desire to maximise job outcomes. This would support Hypothesis Three, that outcome-based payment was driven more by a wish to de-risk the programme for the Treasury than by a wish to incentivise contractors.

The second decision the Department took - to cap the total amount of money available - suggests a wish to protect the Exchequer, but it also indicates a scepticism in the Treasury about the invest-to-save model. With the payment per job outcome set as low as it was, the government should have been happy for the contractors to achieve as many outcomes as they could. After all, each outcome would make a saving for the government. The caution seems to have come from the Treasury:

> 'Treasury didn't trust us not to blow the budget. Treasury said we don't want any model that might potentially commit us to an unknown final outcome. ….OK we'll make the total fixed and then what we'll vary is what you get for that fixed amount. They just didn't trust us. ' (Interview One)

It appears, from this evidence, that the Treasury simply did not accept the Department's invest-to-save calculations. It was not confident that the money that was paid out to contractors would be offset by equally large benefit savings. Capping the programme budget, then, is not risk transfer under the invest-to-save model. It is, rather, classic tight cash control.

The last choice that the Department made in designing the payment system was to set the performance element at 80% of the overall payment. This high level is certainly in line with

an aim of transferring risk to the provider. It also, of course, incentivises the contractor, who stands to lose money if outcomes are not achieved. The situation changed, however, when the financial crash affected the labour market. The Department itself estimated that the number of people becoming eligible for Flexible New Deal could increase by 300%. There was great concern among contractors and in the parliamentary select committee that providers would be swamped and outcomes would suffer (WPSC 2009). Nonetheless, the government was reluctant to make commitments about increased funding. While the Treasury granted the Department an additional £3bn to deal with the consequences of rising unemployment, this had to cover a range of costs, including a moratorium on the closure of job centres, and an extra 6000 jobcentre staff. When pressed at the Work and Pensions Select Committee inquiry, Tony McNulty (Minister of State for Employment and Welfare Reform) declined to say how much of the new money would go to the Flexible New Deal. Instead, the Department offered contractors the option to reduce the performance element of their payment (WPSC 2009). This, of course, transfers risk back onto the Treasury, while reducing the contractors' incentive to achieve outcomes. It therefore flies in the face of both rationales for using outcome-based payments. However, it may have been the most pragmatic decision in the economic circumstances.

Overall, then, all the choices the Department made in designing the payment system – and which seem to have been pressed on it by the Treasury - reduced the incentives for contractors, and so were bad for the achievement of outcomes. They also all reduced the financial risk for the Treasury, but not so much by transfer of risk as by traditional cash control. The design of the payment system suggests that the Department's decision to use outcome-based payments did not convince the Treasury to loosen its traditional tight hold on the purse strings.

Conclusion

There is little evidence to support Hypothesis Three(a). The aspects of policy which Flexible New Deal shared with New Deal had not become more blame-worthy than before. The apparent move away from equity and skills outcomes could in theory have attracted blame from the government's voters, but in practice the whole issue of unemployment had become less politically important, and it is not clear that delegation to outside contractors would have been an effective way to shift blame anyway.

However, Flexible New Deal faced several hurdles in the decision-making process which New Deal had not. In the main, it continued to meet with widespread support. It is possible that moves away from the equity and skills outcomes could have met with resistance from the policy community and possibly Parliament. In delegating to outside contractors decisions about the type of interventions and the distribution of resource between participants, ministers may have avoided difficult and prolonged debates in its public consultations and in front of the select committee. On the other hand, there was strong support across the board for the very 'flexibility' which handed these decisions to contractors, even though the risks of creaming, parking and cost-cutting were well-known. By delegating, therefore, the government was following the evidence on the effectiveness of flexibility, pleasing its policy community and, only perhaps incidentally, avoiding difficult discussions on equity and the skills agenda.

More significantly, there was evidence of new financial pressures which had not existed before, and the Department did adopt the Freud model of outcome-based payment and prime contractors during the period that the shape of Flexible New Deal – and its financial implications – was being firmed up. However, the evidence suggests that the Treasury was not convinced by the argument that outcome-based payment would reduce its risk. Moreover, the decisions made about the detail of the payment scheme – and apparently imposed by the Treasury – do not show consistently that the motivation was to transfer risk. While the flat-rate payments are in line with the de-risking motivation, the capped budgets which the Treasury imposed are more in keeping with classic budget control than an invest-to-save approach. Neither did the reaction to rising unemployment make sense in terms of transference of risk. By maintaining the budget caps and reducing the proportion of payments which were linked to performance, the government both suppressed outcomes and took risk back from the contractors.

If the Department did not adopt outcome-based payment in Flexible New Deal in order to secure more funding for that programme, an explanation of its actions could lie in the fact that the prime contractor model was not adopted only for Flexible New Deal, but as part of the Department's long-term commissioning strategy. In other words, outcome-based payment and the prime contractor model did not solve funding problems for Flexible New Deal, but may have been adopted for Flexible New Deal as a first, hopeful, step by the Department towards wider use in the future, when they might help secure funding for larger programmes if the outcome-based payment model could be proved to work as a de-risking strategy.

Chapter Seven

The Three Hypotheses and the Work Programme

This chapter sets out the evidence for each of the three hypotheses in the process of developing and implementing the Work Programme. There is an obvious difference between the circumstances in which the Flexible New Deal was developed, and those which surrounded the development of the Work Programme. Flexible New Deal was developed by the same government which had developed the New Deal, and outcome-based payment was a new introduction into a policy area marked by continuity. The Work Programme, on the other hand, was developed by a different government and was introduced using outcome-based payments from the start. The Conservative government may have had different policy objectives and have faced different political risks. Despite these variations, Flexible New Deal and Work Programme are notably similar in their design and delivery. The two cases, then, have similar dependent variables in terms of the choices made by the government, but with apparently different independent variables.

In terms of design, both Flexible New Deal and Work Programme were universal programmes, mandatory for all those passing certain unemployment thresholds, and offering a portfolio of help to meet individual needs. In delivery terms, as we know, both were delivered through prime contractors who were paid for job entry outcomes. In both design and delivery, therefore, there was definite continuity between the two, despite protestations to the contrary from both Labour and the Coalition government (Haddon 2012a:10).

There were some changes, however. The Work Programme was considerably bigger than Flexible New Deal, because it would cover not just unemployed people claiming Jobseeker's Allowance, but everyone of working age on benefits who was deemed capable of work. That included many of those claiming Incapacity Benefit and Employment and Support Allowance. These people could be expected to face greater barriers to work. Flexible New Deal had dealt with just over 200,000 entrants a year, while the Coalition government estimated that entrants in the first year of Work Programme would number more than 600,000, falling to 335,000 in the fifth year of the programme (NAO 2012:25).

The offer to contractors was also different. Rather than the flat rate payments offered in Flexible New Deal, there would be variable payments, with more paid for the harder-to-help

participants. A higher proportion of the payments would be linked to performance. Under Flexible New Deal, the upfront service fee had amounted to more than 20% of the total payment. In the Work Programme, the £400-600 upfront 'attachment' payment that contractors were initially offered represented some 10% of the maximum payment they could expect for getting the most job-ready category of participants into work and 4.6% of the total payment available for the hardest-to-help[4]. This attachment payment was then reduced each year of the contract, falling to zero by the fourth year (DWP 2010), at which point 100% of the payment would be dependent on performance. This amounted to what an ex-DWP interviewee involved in the design of the payment system called 'another spin of the wheel' on outcome-based payment, compared to Flexible New Deal (Interview Four). In return, the contractors would have even more freedom than they had had under Flexible New Deal. In place of the Flexible New Deal requirement for an interview and a job search plan, the contractors were asked to propose their own minimum service level (DWP 2010).

Finally, unlike Flexible New Deal, the programme was funded by a formal 'invest-to-save' arrangement between Treasury and the Department, of the sort that had been envisaged by Freud and discussed for Flexible New Deal, but had never been formally put in place (Interview Four and Five).

The Coalition government, then, chose a strategy similar to that chosen by the New Labour government for the Flexible New Deal, but in apparently different circumstances. The case of the Work Programme, therefore, offers an opportunity to re-examine the three hypotheses to see whether they hold. This chapter will examine the process leading to the development and implementation of the Work Programme to see which factors in the environment might explain the choice of outcome-based payment as the optimal strategy.

The question to be asked is largely the same as it was for Flexible New Deal: was the decision to include outcome-based payment in the Work Programme driven by:

- the benefits of privatisation in achieving policy outcomes, suggesting the risks of high-powered incentives had been reduced or eliminated (Hypothesis One)?
- the wish to delegate to expert agents who would deliver better outcomes and accept the high-powered incentive risks (Hypothesis Two)?

[4] Based on figures given in the Work Programme Invitation to Tender (DWP 2010:10)

- a wish to manage political risks by delegating difficult decisions (Hypothesis Three)?

We need to look for evidence to support one or other of the hypotheses in the process of policy development, and in its subsequent implementation. The timeline of decisions on outcome-based payment was set out in Chapter Three (Figure 5). Briefly, the Conservative party had advocated greater involvement of the private and voluntary sectors in welfare-to-work programmes in the 1997 manifesto. It explicitly backed outcome-based payment, and specifically Freud's prime contractor model, in 2008, following a focused period of policy review while in opposition. This commitment fed into the Conservative manifesto and then into the Coalition Agreement.

It is clear that the choice of an outcome-based payment model was made alongside the development of the policy outcomes and, indeed, was almost as important to the Conservative party as those outcomes themselves. This could be evidence of a commitment to a market-based approach which was ideological, rather than a choice based on a rational assessment of the options. However, we can still look for information that would have led Conservatives to believe that outcome-based payment was the best strategy to fit with their policy outcomes, or that it was the best strategy to manage political risks that arose from the programme.

Hypothesis One – multiple outcomes and continuing difficulties with incentives

Hypothesis One suggests that the Coalition government was able to use outcome-based payment for the Work Programme because either:

(a) it desired simple outcomes that would not be distorted by the use of high-powered incentives, or
(b) it had the data and techniques to control agents' behaviour and overcome those distortionary effects.

If either of these were the case, the problems predicted for governments using high-powered incentives – distortion of effort, abandonment of secondary outcomes and so on – would be avoided. The use of high-powered incentives would then be an attractive strategy because of their effectiveness in incentivising agent behaviour.

Hypothesis One(a) – evidence of multiple outcomes

The first version of Hypothesis One would be supported by evidence, in the development phase, that the Conservatives favoured a single, simple quantifiable desired outcome. The commitment to a jobs outcome is clear through the whole process of development, and so it is unsurprising that the Work Programme outcome-based payments were eventually attached to that. However, a second outcome is also emphasised: conditionality, that is, requiring activity of benefit claimants. The importance of this outcome was reiterated at each stage of the opposition policy development process (Haddon 2012:9). It was this emphasis that enabled the Conservatives to claim their approach was 'more radical' than Labour's apparently very similar policy in Flexible New Deal (Haddon 2012:11).

The puzzle is that the outcome of conditionality - of requiring activity from all benefit claimants - is not entirely compatible with an outcome of maximising job outcomes as efficiently as possible. This is a variation of the equity dilemma, which New Labour faced when moving between New Deal and Flexible New Deal. Conditionality implies a set of conditions being applied to <u>all</u> claimants regardless of their effectiveness in promoting job outcomes. Chris Grayling, prominent in the development of the policy in opposition, promised in a newspaper article in 2008 that a future Conservative government would 'contact every single one of those 2.6 million people on Incapacity Benefit, carry out face-to-face interviews with all of them, to assess what they can do, and how we can help them back into work' (Grayling, 2008).

If a contractor is required to engage with every claimant to a similar degree, that contractor cannot at the same time pursue a target for job outcomes with the utmost efficiency. Time and resources will, inevitably, have to be spent on some people who are unlikely to get back to work. If, on the other hand, the jobs outcome is prioritised and attached to a generous payment for performance, it is inevitable that a contractor will concentrate on those who are most ready to move into work, and 'park' those who are the hardest-to-help. These 'parked' people will not be required to undertake activity. They will receive less help and - expressed in the terms of the conditionality debate - they will be allowed to 'rest' on benefit. Mabbett (2009) finds evidence that the policing of benefit conditionality was weakened in Australia by the contracting out of provision: the private sector contractors had no financial incentive to pursue it and the voluntary sector providers did not support it (Mabbett 2009:145). It would appear that Conservative policy was directed to two conflicting policy outcomes: an increase in the numbers flowing into work, and tougher universal conditions for claiming benefit. The

terms in which the Conservative party and then the Coalition expressed their aims for the Work Programme, then, seem to suggest they were following two outcomes which were not entirely compatible. This should have made it more difficult to use outcome-based payments.

Hypothesis One(b) – continuing problems with data and techniques for setting incentives

According to Hypothesis One(b), the Conservatives believed the use of outcome-based payment in the Work Programme to be an effective strategy, despite the potentially distortionary effects of high-powered incentives, because they felt they had the necessary data and methods to construct high-powered incentives, or other control measures, which would overcome these distortions. They could, therefore, design an outcome-based payment system which would incentivise contractors to deliver against all their desired outcomes – i.e. not just jobs, but also some kind of conditionality which would provide activity for all claimants. Essentially, according to Hypothesis One(b), they believed they could prevent creaming and parking.

However, the data which the Conservatives had to draw on as they developed the Work Programme was the same data which was available to the New Labour government as they developed Flexible New Deal, and which was set out in Chapter Four. They would therefore have evidence that high-powered incentives were tending to encourage creaming, parking and cost-cutting wherever they were used. Indeed, as we have seen, Freud was explicit about the problem in his report, and about the fact that the data which would allow the proper setting of high-powered incentives was missing (Freud 2007:75).

As the Work Programme was implemented, and the outcome-based payment approach fleshed out, the Coalition government focused only on job outcomes – payments were offered for immediate job entry, and for jobs sustained over twenty-six weeks. This was not the only option. Freud had listed a whole range of potential outcomes that could be paid for. If benefit reduction was a priority, the government could simply have paid contractors when a participant moved off benefit and stayed off for a number of weeks, regardless of whether or not they moved into work. In fact, this would have been much easier to verify and administer. Contracts could also have set some minimum activity which all participants were required to carry out to fulfil the implied promise in Grayling's statements about conditionality. However, all that was required of contractors was that they formulate, themselves, a minimum level of service and deliver it to every individual.

Unlike Flexible New Deal, the Work Programme did use variable payments figures, paying more for the harder-to-help participants. This was certainly a step forward in tackling creaming and parking. However, the Coalition government had little more data available to them, in setting the levels of these payments, than the Labour government had had when it was designing Flexible New Deal. The Department produced a 'rate card' (Interview Four) setting out the maximum it would pay for each outcome (Figure 12).

The Department was aware of the lack of data to inform this process and the limitations of the approach. A senior policy official described the offered payments as 'a set of approximations'. They carried, he said, a number of risks. First, there was not enough information to predict accurately which participants would be easy (and cheap) to help and which would be difficult. The payments were varied by the type of benefit a participant was claiming (an unemployment, or a health-based benefit), their age and the length of time for which they had been claiming. These three variables are certainly all correlated with the propensity of an individual to move into work. However, the relationship is not strong enough to predict confidently the chances of a move into employment for any one individual on the basis of these variables alone. Second, there were variations in local labour markets which affected the level of job entries, as well as fluctuations in the national labour market. A certain amount of creaming and parking was accepted as the price for the use of outcome-based payments. Indeed, it was welcomed by one interviewee, who argued that there were some cases in which the costs of moving a particular individual into work were so great as to be unjustifiable (Interview Four).

Figure 12: 'Rate Card' for the Work programme showing payments for outcomes (DWP 2010:10)

Benefit Type	Customer Groups	Payment Group	Year 1 attachment fee	Job outcome fee Maximum – to be competed	Job outcome paid week:	Sustainment payment per 4 weeks	Sustainment payment (4 weekly) from week:	Sustainment: maximum amount of 4 weekly payments	Incentive payment
JSA	Aged 18 to 24	1	£400	£1200	26	£170	30	13	£1000
	Aged 25 and over	2	£400	£1200	26	£215	30	13	£1000
	Early Access	3	£400	£1200	13	£250	17	20	n/a
	Ex-IB	4	£400	£1200	13	£250	17	20	n/a
ESA	Contribution-based volunteers	5	£400	£1000	13	£115	17	20	n/a
	Work-related activity group – unlikely to be fit for work in short term (income related) - volunteers								
	ESA flow – Work-related activity group – likely to be fit for work within 3 months (income related)	6	£600	£1200	13	£235	17	20	£1000
	Support Group								
	Ex-IB – work-related activity group – likely to be fit for work within 3 months (income related)	7	£600	£3500	13	£370	17	20	n/a
	Ex-IB Support group								

The evidence, then, offers only partial support to Hypothesis One. The policy development process focussed not only a jobs outcome, but on conditionality, which implied the need for a minimum level of intervention for every claimant. The payment system that was adopted, offering financial rewards only for job outcomes, would not have incentivised the contractors to provide this uniform level of intervention. It appears, then, that the Work Programme did not have a single, simple outcome, making the use of high-powered incentives

unproblematic. Neither is there evidence that the government had the kind of data or techniques to overcome this problem and provide contractors with a real incentive to pursue both outcomes – jobs and conditionality.

Hypothesis Two - delegation for better outcomes

According to Hypothesis Two, the use of outcome-based payment is a way to delegate decisions to agents who will make better decisions (i.e. decisions more likely to lead to desired policy outcomes) than government can make itself. The decisions which were delegated under the Work Programme were the same as those delegated under Flexible New Deal: the investment in inputs, the type of interventions and the allocation of resources between individual participants.

Again, the data available to the Coalition when it was making its decision about a delivery model for the Work Programme was the same as the New Labour government had. All the evaluation data from New Labour's experiments - New Deal Private Sector-led areas and Employment Zones – were publicly available. It would have been useful, given the Work Programme would be taking clients from sickness and disability benefits, to learn lessons from Work Choice, the first specialist disability programme to be contracted under the New Labour's Commissioning Strategy, and Pathways to Work, which introduced the prime contractor model across 60% of its provision more than a year before the Flexible New Deal was introduced. However, at the point that the Conservatives committed to the prime contractor model, very little data had been made available. The National Audit Office report into Pathways to Work, published just as the Conservatives were arriving in office, noted that private sector contractors were under-performing both against their targets and in comparison to the employment service (NAO 2010a:9). As with New Labour and the Flexible New Deal, then, the available information supported a decision to delegate decisions closer to the front-line, but offered less justification for believing that large, private sector prime contractors would make better decisions than the employment service staff in the regions and the jobcentres, or the smaller, often voluntary sector, frontline contractors.

Efforts to bring new blood into the contractor base had continued since the tendering of the Flexible New Deal. The Department's strategic market development team was actively selling the Department's outcome-based payment-based programmes as an opportunity to City firms such as Barclays Capital (Interview One). A Department-commissioned evaluation of the Work Programme's commissioning strategy characterised the market, at the point that

the Work Programme was tendered as a ‘unconcentrated, competitive oligopoly’ (Foster 2014: 30). Nonetheless, ten of the seventeen successful bidders for the Work Programme had already held Flexible New Deal or New Deal Private Sector contracts.

Figure 13: The successful bidders for the Work Programme

JHP Group: had been in the training field since 1983 when it was set up as an offshoot from the Pitman business training empire (Business Live 2010)

Newcastle College Group: created by the merger of a number of FE colleges, and had since acquired other training companies (Newcastle College Group 2020).

CDG: a not-for-profit working in the back-to-work field since 1982 (Tonkin 2012),

Prospect Services: formed in 1997 by the privatisation of several South London career services (Prospect 2020).

G4S

Rehab Jobfit: a joint venture between Rehab, a charity provider of services to people with disabilities set up in the post-war years to rehabilitate TB sufferers (Rehab Group 2020), and Interserve, the giant multinational support service and constructions firm (Insider Media 2011;Interserve 2020).

ESG: a private training firm, had been formed by the acquiring and merger of four small training companies by a private equity group (Crunchbase 2020; FE Archive 2001).

There were three contractors who fitted the model of new, large financial corporations that Freud had hoped would enter the market. The most obvious was G4S. The other two were Rehab Jobfit, a joint venture between a UK welfare-to-work charity and Interserve, the giant multinational support service and constructions firm (Insider Media 2011;Interserve 2020); and ESG, a private training firm, formed by the acquiring and merger of four small training companies by a private equity group (Crunchbase 2020; FE Archive 2001). While some new financial weight came into the contractor base, then, there was a significant degree of continuity.

The conclusion on Hypothesis Two is therefore largely the same as that for Flexible New Deal. Although the Conservatives showed an early preference for a market-based solution in their 1997 manifesto, they explicitly committed to outcome-based payment in 2008/9. At that point, they had the same information about the effectiveness of delegation to outside contractors that was available to the New Labour government as they developed Flexible New Deal. This suggested that more delegation of decisions would indeed improve outcomes, and was more necessary than ever because of the more challenging client group. However, it gave little reason to expect better performance from delegation to prime contractors, rather than to employment service regional and local management or smaller, frontline contractors.

Hypothesis three : decision-making costs over funding

Hypothesis Three predicts that, at the point they committed to high-powered incentives in 2008/9, the Conservatives were anticipating blame or decision-making costs. This section shows that they faced no significant risk of blame, but did face potential decision-making costs, specifically in the negotiations over funding. They used outcome-based funding and the risk transfer that it involves, to ease these discussions.

Little risk of blame

The Work Programme does not appear to meet Weaver's criteria for a policy carrying risks of blame, as it did not create concentrated losses for key Conservative, or Coalition, voters (Weaver 1986). First, and as we have seen in Flexible New Deal, there is an ambiguity around the impact that the programme had on individuals. Was the help it offered an advantage, or was it a negative experience for participants, who are required to undertake activity under threat of benefit sanction? If it was seen as a positive intervention, then the inequity in the design, which meant that those who were harder-to-help might be parked, could create discontent among those who did not receive help. If it was largely seen as a punitive measure, then those who were required to participate may have felt unfairly targeted. Whatever the policy motivation for the programme, the participants were a small group in society, neither prominent among Coalition voters nor likely to be a priority for those voters, and so lacked political influence. It seems unlikely that the Conservatives, when they committed to delegation to outside contractors while in opposition, did so in an attempt to avoid electoral damage from disgruntled Work Programme participants.

Could the Conservatives have been anticipating a broader form of blame, from a public that simply did not like the policy, or would blame them if it failed? The Work Programme

appeared in the Conservative manifesto in 2010, as key policy commitment in its chapter on employment, which is evidence that the Conservatives saw the policy as a vote-winner. However, there are several reasons for doubting that the potential for blame from failure of the programme, or the discontent at the way it was implemented, represented a sufficient risk to the Conservatives that they would delegate decisions about the programme to protect themselves from it.

First, while its appearance in the 2010 manifesto suggests it was seen as an electoral asset, it was a modest one at best. We have already seen, in the examination of Flexible New Deal, the decline in the salience of unemployment as an issue for the electorate. In the 2005 election – two years before the Conservatives committed themselves to the Freud delivery model – the issue of unemployment had failed to appear in the Conservative manifesto at all.

The 2008 crash had caused a rise in unemployment, of course, but this was not reflected in a greater concern among the electorate. By March 2010, before the election which brought in the Coalition and the Work Programme, IPSOS asked about unemployment in its election survey (IPSOS 2015). This time, only 11% of the sample volunteered unemployment as an issue, compared to 25% in 2005. 7% mentioned 'benefits', which had not been on the list of issues in previous years (it is not clear whether they considered benefits to be an issue because they were too miserly or too generous).

There is a final reason for doubting that blame avoidance was the principal driver behind the decision to delegate decisions to outside contractors. The only delegated decision which might involve controversy or blame among Conservative supporters was the allocation of resource between individuals. As the discussion of Hypothesis One showed, the outcome-based payment system was likely to encourage creaming and parking by contractors, which would mean many benefit claimants would not actually face the requirement to participate in job-seeking activity. The constant references to conditionality in speeches, papers and the manifesto suggest it was seen by the Conservatives to be important politically. The fact that it would not actually be delivered under the outcome-based payment system could be seen as a risk. However, this does not stand up as a reason to delegate decisions, because it is the very delegation of the decisions under the outcome-based payment system which creates the possibility of creaming and parking. If the Conservatives really feared this risk, they could have kept more of the decisions about allocation in-house by setting a minimum level of required activity for everyone, or given contractors other incentives to impose activity on

every participant. In choosing the outcome-based payment system that they did, the Conservatives created the risk of parking, showing that they were not overly concerned about the electoral consequences.

In summary, if the government had kept in-house the decisions which it delegated to providers as part of outcome-based payment, it would not have faced significant political risks. There is therefore no support for Hypothesis Three(a), that outcome-based payment was adopted as a way of avoiding blame.

Hypothesis Three(b): funding disputes and invest-to-save

There is some evidence to support the explanation offered by Hypothesis Three(b), that the Conservatives chose outcome-based payment in anticipation of high decision-making costs once in government. Certainly, they had little reason to anticipate resistance in the legislative or policy processes. The Work Programme required no more onerous legislation than the New Deal and Flexible New Deal. While the Coalition government had the potential to make policy agreement difficult, the writers of Get Britain Working would not have anticipated that, and so could not have chosen outcome-based payments as a way of avoiding it. The fact that the policy featured in the Conservative manifesto demonstrates its comfortable fit in the Conservative vision. In the event, the Work Programme won a place in the Coalition agreement, and the speed with which the programme was developed and implemented suggests there was little resistance even within a government which was not purely Conservative (Cabinet Office 2010:23). Funding, however, was clearly an issue from the start.

Grayling and his colleagues, when developing the proposals in opposition could not have predicted the specifics of the Chancellor of the Exchequer's post-election austerity strategy. However, the financial crash, and its implications, were already evident. Moreover, the Conservative party being traditionally fiscally prudent, anyone proposing a large and expensive programme must always expect some resistance and pressure to justify the spending. As the Institute for Government noted, 'Making the fiscal case had been at the heart of Freud's original proposals and it was no less important by the time of the Conservatives' Get Britain Working paper' (Haddon 2012:12). Get Britain Working explicitly linked the Work Programme to the need to reduce the deficit, saying 'the public

finances are in a critical condition and the size of the benefits bill is just not tenable' (quoted in Haddon 2012:12).

In summary, then, the Conservatives, in choosing to adopt the Freud model of outcome-based payment had little reason to expect resistance in the areas of legislation or policy, but could have been anticipating difficult discussions over funding. Grayling was explicit, in interview, about the central importance of funding in the approach he developed:

> 'the principle was that in order to fund the kind of programme that we thought we needed…the aim was to pay for the programme through the benefit savings that we generated. The whole policy in opposition and policy in government was structured round that.' (Interview Five).

The next section will consider the process of securing funding for the programme once in government, to look for evidence that outcome-based payment helped to resolve potentially damaging disputes.

The negotiation over funding

Once in government, the Work Programme faced the most financially unwelcoming environment of the three programmes in the case study, as the new coalition government that came in 2010 had introduced a programme of austerity in response to the economic aftermath of the 2008 financial crash. The Department's funding difficulty was exacerbated by the fact that, within the Department itself, the Work Programme was competing for funding with the proposals for Universal Credit. The Department was therefore in a vulnerable position in seeking funds for the Work Programme as it was at the same time seeking funding for the expensive Universal Credit programme in the face of Treasury scepticism (Timmins 2016:28). The Treasury, however, eventually agreed to a budget of £3-5bn over 5 years for an ambitious programme which would cover more people than Flexible New Deal: those on Employment and Support Allowance deemed to be ready for work would also be eligible on top of the Flexible New Deal target group of unemployed Jobseeker's Allowance claimants. It was predicted that around 605,000 people would go through the programme in 2011-12 and 565,000 in 2012-13 (NAO 2012:25). The Treasury also agreed to a formal invest-to-save agreement with the Department, of the sort that Freud had advocated in his 2007 Report (NAO 2012:17). A budget was given to the Department, in the normal way, sufficient to

cover the predicted level of performance. If, however the contractors over-performed, the Department could call down extra funds (Interview Four). The agreement that was reached with Treasury, then, appeared to hinge on the outcome-based payment model and the risk transfer that it enabled.

There is evidence, however, that Treasury remained unconvinced by the idea.

> 'The Treasury's first view was "you're trying to pull a fast one…..you need to prove this scheme is going to somehow deliver more bang for same buck before you can get any more money"... They basically had to be told by No 10, "this is a manifesto commitment, get on and do it"…' (Interview Four)

The evidence from the budget negotiating process, then, is mixed. The agreement of an invest-to-save arrangement suggests the Treasury were prepared to finance the Department to take risks with over-performance in the hope of offsetting benefit savings. Outcome-based payment had, therefore, unlocked at least some of the funding the Department needed. However, there is also evidence that the Treasury did this reluctantly, and were not entirely convinced of the invest-to-save case.

The Payment System and Contracts

As set out in Chapter Six, because of the imperfect link between programme costs and benefit savings, the choice made in designing the detail of the payment system and contracts can throw light on the motivation of the Department. Was the payment system designed primarily to maximise incentives to contractors to achieve outcomes (i.e. Hypothesis One), or to keep the programme costs at, or under, the level of benefit savings (Hypothesis Three)?

The payments system set out in the invitation to tender consisted of:

- an attachment fee - an upfront payment to assist prime contractors with the initial costs of setting up their provision and providing initial support to clients. This fee would be phased out over the first three years of the five-year contracts.
- A job outcome fee, paid once a provider has secured employment for a client. This would vary according to which of the eight defined sub-groups the individual belonged to, and Department would set a maximum payment for each group (the 'rate card' – Figure 12).
- A sustainment fee, paid for keeping a participant in work for two years. This would also be variable and fixed for the length of the contract.

- An incentive bonus, payable if providers delivered outcomes for 30% higher than Department's non-intervention performance level.
- A minimum performance level, set at 10% above the non-intervention level.

The payments system, then, shared with the Flexible New Deal system a focus on job outcomes and payments for sustained jobs. There were several new aspects, however. The first, as has been observed earlier in the chapter, was the use of variable payments rather than the single rate payment that had been used under Flexible New Deal. Taking the maximum fees set by the Department into account alongside the attachment fee, the maximum payment a provider could expect ranged from ranged from £4,050 for keeping a 18-24 year old Jobseeker's Allowance claimant in work for two years, to £13,120 for achieving the same outcome for an ex-IB claimant. Bidders were invited to offer lower payments as part of their bid (DWP 2010:10).

As discussed in Chapter Six, the use of flat-rate payments in Flexible New Deal had been seen as a concern by members of the policy community, the Work and Pensions Select Committee and even the Department's own commercial team (Mulheirn and Menne 2008:73, WPSC 2009:4, Interview One). Variable payments were seen as a better way to incentivise providers, prevent creaming and parking, and avoid over-paying for the easier outcomes (Mulheirn and Menne 2008:73). However, as Chapter Six also explains, they did raise financial risk for the government, because of the difficulty of matching payments both to contractors' costs and to expected benefit savings.

The Department acknowledged that its proposed rates of payment – which had been arrived at by modelling carried out by the Department's economists, were approximate.

> 'It wasn't perfect – all prices are a set of approximations – you had to be pretty brave to say they were real benefit savings.' (Interview Four)

Without sufficient information about the costs the providers would face, the government was less able to protect itself against over-payment. The fact that the contractors had little idea of the costs created the opposite risk, that, in an attempt to win the contract, they would underbid and end up in financial straits. The government would then have to deal with the fallout as contractors collapsed and left them without provision. It was this latter risk that concerned the Work and Pensions Select Committee (WPSC 2009:59, Mulheirn and Menne 2008:39).

The government could have taken a number of approaches to the bidding process. In the event, it decided to specify the maximum payment it would make for each outcome (all set out on the rate card – Figure 12) and invite bidders to offer discounts on these payments. This approach would protect the government from overpayment, but would tend to encourage a 'race to the bottom' by bidders (Mulheirn and Menn 2008).

The biggest concern for the Department was 'deadweight' (Interview Four): that it would end up paying for outcomes which would have happened anyway. Nonetheless, ministers and officials in the Department felt that it was better to pay for outcomes than simply pay a service fee, even if the payments were not set at the optimal levels. The view of Chris Grayling (then Minister for Employment), that it was self-evidently sensible to make payment dependent on performance, was echoed by other interviewees (Interviews One, Four and Five). The accelerator model, proposed during the development of Flexible New Deal, was mentioned as a solution, theoretically, to the deadweight problem, but was considered to be 'too complicated' (Interview Four).

The payment rates were linked to the type of benefit the participant received and the exact amounts were worked out by the Department's economists and discussed with Chris Grayling. The economists' model took into account the difficulty (and therefore cost) of getting someone into work, the level of benefits they were receiving (and so potential savings) and the state of the labour market (to establish the likelihood of people moving into work without government intervention) (Interview Four).

In making the 'approximations' necessary in setting payment rates in such a complex model the government faced the same choice as the New Labour government did when introducing the Flexible New Deal: to set the payment levels low, reducing financial risk, or high, to maximise outcomes. The business case for the Work Programme gives a clear indication of which path the Department took. It states that the expected benefit savings (i.e. direct cash savings in terms of social security benefits not paid) will equal 95p for every £1 spent. The total societal benefits, including the cash savings, will be £1.95 for every £1 spent (NAO 2012:16). In other words, the Department is only making available to providers a budget just slightly more than the expected benefit savings, and roughly half of what it expects to gain in societal benefit. This model gives the government (and the Treasury) maximum assurance that the programme will be cost-neutral in straightforward cash terms. It stops short, however, of achieving all the job outcomes which could be achieved if the government were prepared

to spend up to the level of the total returns to society. If these wider societal returns were taken into account, the Department could almost double its average payment. In practice, this would mean offering even higher payments for the hardest-to-help. Some people who could be moved into employment, if enough were invested in them, will not be helped because the Department's budget is being effectively 'capped' by the level of direct benefit savings.

In summary, the evidence for the blame variant of Hypothesis Three(a) is lacking. There does not seem to have been a significant risk of blame. As for Hypothesis Three(b), there does not seem to have been significant risks of high decision-making costs in the legislative and policy processes. There is clear evidence, however, that the Conservatives, in adopting outcome-based payment and the prime contractor model, did so in anticipation of funding issues and in order to produce a cost-neutral programme. In the event, the possibility of transferring risk under outcome-based payment does not seem to have fully convinced the Treasury, but large-scale funding was secured and an invest-to-save arrangement put in place. The detailed design of the payment system provides evidence of a concern to incentivise outcomes, in the use of variable payments, but an accompanying concern to keep payments below the level of benefit savings.

Conclusion

The evidence for Hypotheses One and Two – which assume that outcome-based payment is adopted primarily to achieve more policy outcomes – is incomplete. The Conservatives did not have a single, simple desired outcome for the programme. As well as job entries, their own statements set a desired outcome of conditionality, which involved requiring some level activity from every participant. Outcome-based payment did not allow them to pursue that. As with Flexible New Deal, the evidence for Hypothesis Two is partial. There was information available to the Conservatives that would justify their decision to delegate decision-making in pursuit of better outcomes. However, they had little data which showed that prime contractors, under the Freudian model they adopted, would be more effective in making these decisions than civil servants and smaller contractors.

As for Hypothesis Three, there was little evidence that the Department faced a risk of politically damaging blame if it did not delegate the decisions, but there was significant evidence that it could expect a difficult internal negotiation on funding. The detail of the payment system it adopted suggests that, while it was concerned to achieve policy outcomes,

it was prepared to forego some potential outcomes to create a payment system which gave the Treasury the best assurance that spending would stay below the level of benefit savings.

Chapter Eight
Conclusions and Implications

This chapter summarises and assesses the evidence for each of the three hypotheses, formulates a final hypothesis which explains the choice of outcome-based payment in the welfare-to-work field, considers the implications of the thesis for theory and policy, and sets out possible future lines of work.

Summary of the evidence from process-tracing

This thesis asked whether hypotheses based on the principles of transaction cost analysis and principal-agent theory could explain why outcome-based payment was chosen in an area of UK social policy which would seem to be vulnerable to distortions and misallocation of effort arising from the use of high-powered incentives. Specifically, can any of these hypotheses explain why outcome-based payment was chosen as the preferred strategy for delivering the Flexible New Deal and the Work Programme, when it had not been chosen for the New Deal – a programme with, apparently, the same desired outcomes?

The first two of the three hypotheses that were examined in the thesis assumed the choice of outcome-based payment was chosen as the best strategy for maximising policy outcomes (i.e. effectiveness). This was the rationale that governments used to explain their choice of outcome-based payment – that it would incentivise better performance from outside contractors while giving them freedom to innovate and use their expertise. Process-tracing, however, revealed evidence which contradicted this position.

According to the first hypothesis, governments were able to choose to use outcome-based payment in Flexible New Deal and the Work Programme for the straightforward reason that the outcomes they desired from these programmes were so simple, or their knowledge of how to design the high-powered incentives so sophisticated, that the problems which principal-agent theory predicts for the use of high-powered incentives did not occur. This is, in fact, the reason offered by four of my five interviewees for the fact that welfare-to-work is one of the few areas where outcome-based payments have been adopted in such a pure form and used consistently. It was, they said, because the outcome of a welfare-to-work programme is simply the entry of its participants into jobs (Interviews Two, Three, Four and Five). This is

something that can be defined, observed and verified, and that makes welfare-to-work programmes unusually suitable for outcome-based payments.

However, process-tracing revealed that welfare-to-work programmes can and did have other, secondary, outcomes. The New Deal, as it was developed and described to the public, had an aim of raising skill levels (if only to remove barriers to work), a concern for quality and a very clear equity outcome – it promised to give help of a roughly equivalent intensity and cost to every participant. These outcomes had been important in the development process and the equity outcome, in particular, was emphasised in the manifesto and other government literature. The Work Programme also had an outcome related to equal treatment of all participants, this time around conditionality – the requirements made of people claiming benefit. Again, this outcome was prominent in the development of the programme and underlined by statements which the Conservatives made in opposition and then as part of the Coalition government.

Adopting high-powered incentives for the Flexible New Deal, New Deal's successor, and for the Work Programme involved a decision to accept their negative impact on these secondary outcomes. This may have been a sign that they were never important to the decision-makers. There is evidence that the skills outcomes became less of a priority for New Labour as evidence emerged that it did not contribute to the job entry outcome and, in fact, conflicted with it. There seemed to have been an understanding that secondary outcomes were important to the electorate and public, however. Both governments emphasised the issue of equitable and equal treatment in their presentation of the New Deal and the Work Programme. Whatever the reasoning behind successive governments' positions, it appears that welfare-to-work is not a policy area which, fortuitously, happens to have only a single, simple outcome. The simplification was a deliberate act by policymakers.

According to the second part of Hypothesis One, the governments did not actually abandon these secondary objectives, in spite of appearances to the contrary. Although they attached high-powered incentives only to the job entry outcomes, they did so knowing that the structure of the payment system and the rest of the contractual arrangements would ensure that contractors had to respect these other outcomes. Certainly, the many experiments with private sector agents and outcome-based payment (Employment Zones, the Private Sector-led New Deal and so on) suggest New Labour was trying to master the use of such techniques. However, the evidence emerging from these experiments, and from projects in other

countries, could have given little reassurance to New Labour or the Conservatives that the problems with the use of high-powered incentives had been solved. Concerns about creaming and parking surrounded the development of the Flexible New Deal and the Work Programme (WPSC 2009, Gregg 2008) and the creator of the outcome-based payment system that they adopted, David Freud, had explicitly advocated a six-year period of piloting and data collection to try to address the problems (Freud 2007).

Hypothesis Two is also about effectiveness in achieving outcomes. It explains the choice of outcome-based payment as a case of delegation to get better decision-making. The governments decided that the outside contractors would make better decisions than the government and its civil servants would, and so delegated the decision-making to them. The outcome-based payment system, with its high-powered incentives, was a way to give those outside contractors discretion, while incentivising them to perform as well as possible.

There was some evidence to justify increasing the delegation of discretion to those actually managing and delivering the programme. There were constant calls for flexibility in earlier programmes, such as the New Deal and its variations. However, the governments could have met these calls by giving the contractors more freedom through less closely-specified contracts, as well as giving their own civil servants in the employment service regions more freedom in commissioning provision which was appropriate to their local labour market and in allocating help to individuals.

In fact, the model that both governments chose for Flexible New Deal and the Work Programme failed to deliver this kind of delegation. Instead, it delegated decisions around investment and allocation of resources to a new tier of management – the prime contractor. These prime contractors, who sat between the government and the usual contractors who actually delivered the programmes, were not chosen for their labour market expertise (though many of the bidders were actually veterans of the policy field). They may have been expert in commissioning provision from sub-contractors, but the evidence which the governments had from experiments such as the New Deal Private Sector-led areas and the Employment Zones did not suggest that delegating this role to outside organisations was any more effective than giving more discretion to the government's own employment service management. In fact, Freud, the instigator of the prime contractor model, was explicit in stating that the key role of the prime contractor was to bring in investment and carry financial risk (Freud 2008:62).

The evidence therefore, suggested that the case for outcome-based payment as the optimal strategy for maximising policy outcomes was incomplete. This could suggest that, in fact, outcome-based payment was not a rationally chosen strategy, but an ideologically driven choice. In other words, hypotheses based on transaction cost analysis and principal-agent theories, with their assumption of rationality, could not explain its use. However, there was another possibility – that the choice of outcome-based payment was explained by a wish to manage political risks, rather than maximise policy outcomes. This was the basis of Hypothesis Three.

Hypothesis Three explained the choice of outcome-based payment as a strategy for managing political risk of blame or decision-making costs. There was little evidence that the governments had any reason to fear the risk of blame for the policy – the issue of unemployment was declining in salience among the electorate, the group affected by the programme were not important electorally and the wider public was unlikely to disagree with the decisions taken to implement the programme. In fact, the greatest risk of blame arose from the delegation itself, as it would compromise equity.

There was, however, evidence of funding constraints surrounding the development of both Flexible New Deal and Work Programme, so the potential for a draining funding dispute existed. In Flexible New Deal, the Treasury appears to have been unconvinced by the invest-to-save argument and did not agree to the release of extra funds under the invest-to-save principle. Its approach seems to have been based on traditional budget control. On the other hand, the adoption of outcome-based payment and the prime contractor model for all programmes, rather than just Flexible New Deal, provides some support for Hypothesis Three, as it could indicate a plan by the Department to return to the invest-to-save argument in future negotiations with Treasury, perhaps bolstered by evidence from the operation of Flexible New Deal.

For the Work Programme, the rationale for outcome-based payment as a risk transfer instrument was there at the start of policy development, as was an anticipation of funding constraints. This time, the agreement of the budget came with an invest-to-save agreement - the promise of risk transfer seems to have persuaded Treasury to allow the Department to take more risks round the payment system. This was achieved despite continuing Treasury scepticism, raising the question of how influential the risk transfer argument was. However, some outcomes were sacrificed, because payment levels were set at a level which kept

spending within the limit of expected benefit savings. Outcomes which could have been achieved had payments and incentives been higher, were foregone. This would appear to have been arranged to protect the Treasury from any risk of overpayment.

The emerging hypothesis

In summary, the choice of outcome-based payment for Flexible New Deal and the Work Programme can be explained by hypotheses based on the transaction cost analysis/principal-agent framework in the following way. First, the use of high-powered incentives became possible when governments decided they could accept the negative impact on secondary outcomes, including equity. Second, though delegating to outside contractors using high-powered incentives was not the only, or even the most effective, way to delegate decisions from the centre and increase policy outcomes, it had an added advantage for the Department. It had the potential to transfer financial risk from the Treasury to outside contractors and, therefore, to enable the Department to obtain more funding from the Treasury, as the welfare-to-work policy, which had enjoyed "flagship" status under New Deal, declined in importance with voters and funding became harder to secure. In fact, the Treasury was sceptical of the arguments, because of the difficulties of calibrating the payment system so as to avoid over-spending, but the Department adopted outcome-based payment as a strategy for all its programmes under Labour in the hope of winning the Treasury over in the future. With the arrival of the Conservatives, the Treasury, while still cautious, was persuaded to provide financial cover for the more financially risky Work Programme model. In both the Flexible New Deal and the Work Programme, the Department adopted a form of outcome-based payment to improve their chances of funding from the Treasury which required them to sacrifice some potentially achievable outcomes by holding payments below the level of expected benefit savings.

This explanation suggests four independent variables were the cause of the change in the dependent variable i.e. the choice of outcome-based payment. These are: a fall in the public salience of the issue; a politically weak target group; a tight fiscal environment; and the potential to link direct Exchequer savings to a verifiable outcome. The government judged that it could allow the secondary outcomes it had adopted in the policy development to be compromised without provoking significant public displeasure. The declining salience of the policy between the high of the New Deal and the low of Flexible New Deal and the Work Programme could explain this. In theory, one might expect some resistance - potentially

politically embarrassing - from the target group. They, after all, would suffer the consequences of the lack of equity, either by missing out on valuable help, or being subjected to mandatory conditions. However, benefit claimants are a politically weak group, with no national organised voice. In the face of a worsening fiscal environment, outcome-based payment became attractive as a way of sustaining funding for welfare to work, because it was possible to construct a verifiable outcome which was firmly linked to direct Exchequer savings.

Generalisation

To test the general application of these independent variables, we would need to examine all government programmes to establish the extent to which the independent variables and the dependent variable were present and the patterns in their appearance. This is a massive undertaking. However, for an initial test of credibility, we can look at the projects which have been launched recently using outcome-based payment, to see whether the independent variables which the thesis predicts are in fact present.

There is no comprehensive register of government projects using outcome-based payment in the UK. However, it is possible to construct a list of around projects which use outcome-based payment from the NAO's 2015 report, the RSA's 2011 programme, "Payment by Outcome" and the website of Government Outcomes Lab (www. golab.bsg.ox.ac.uk/knowledge-bank/case-studies/). Some of these are considered to be social impact bonds, in which the government pays for outcomes just as with other outcome-based payment schemes, but the upfront investment comes from a third party. This is very close to the design of Flexible New Deal and the Work Programme, where several contractors went to the City for finance (in fact, a senior Departmental official expressed the view that the Work Programme was 'a giant social impact bond' – Interview Four). These sources yield a list of sixteen projects, or groups of projects, that claim to be using outcome-based payment, but six of these have been dropped from the exercise because they have only negligibly low levels of outcome-based funding or do not provide a proper test of the thesis. The remaining ten

Figure 14: Other Programmes using outcome-based payment and relevant to the thesis

Programmes which display the same independent variables as Flexible New Deal and Work Programme

Helping benefit claimants into work (3 projects in addition to Flexible New Deal/Work programme) – a marginalised group which costs the government money, and an outcome which is matched directly to fiscal savings (NAO 2015)
Ex-offenders (5 projects) – outcome payments linked to savings in the judicial process from reducing recidivism (NAO 2015)
Adoption of looked after children – a Social Impact Bond through which local authorities paid independent agencies when they successfully placed children with families, matching payments against the reductions (estimated at 90% of payments) in the continuing costs of looking after the child. (Government Outcomes Lab 2020)
Family therapy in Essex – a Social Impact Bond. Essex County council undertook to pay Action for Children for reductions in care placement days compared to the predicted baseline, over a 30-month period for each child. There were secondary outcomes of educational engagement, offending and personal wellbeing, but these were not linked to payment. (Government Outcomes Lab 2020)

Programmes with weak target groups and low political salience but lacking verifiable outcomes

Drug and alcohol users - a cross-government Social Impact Bond involving the Departments of Health and Work and Pensions, Ministry of Justice, Home Office and the National Treatment Agency for Substance Misuse. Local area consortiums were paid for outcomes such as ending drug dependency, reducing re-offending, job entries and improved health and well-being (DHSC 2011). Some of these outcomes are difficult to define and quantify.
Supporting people – non-statutory housing support for vulnerable people. Vulnerable people are definitely a marginalised group and create costs for central and local government. However, those costs are scattered and not easily verified. The outcomes for the project could not easily be linked to a verifiable saving. The performance element was, it should be noted, modest – starting at 20% of overall funding. (DCLG 2014:10, 44).
3 projects for troubled families. Again, the issue here is that, while troubled families cost the government in all sort of ways, they tend not to do so in ways which can be tidily captured in a outcome-based payment system. Savings from helping the families stay out of the justice system, find employment, be healthier etc will appear all across government, and are less verifiable. Moreover, the programme seems to suffer hugely from the problem of complex outcomes. Helping a troubled family cannot be summed up in one, payable, outcome. (NAO 2015)
Mental health and Employment Partnership – Local authorities, Clinical Commissioning Groups, Cabinet Office and Big Lottery undertook to pay a trio of not-for-profit organisations for job entries by people with mental health issues and sustainment in those jobs. The most obvious direct savings – benefit payments – accrued to the Department, which was not part of the project. The other savings are scattered and vague. (Government Outcomes Lab 2020)
Supporting children at risk in West London - A Social Impact Bond in which local authorities, Big Lottery and schools undertook to pay a consortium of local not-for-profit organisations for outcomes in the area of positive relationships, emotional and mental wellbeing, progress at school and confidence and aspiration (Government Outcomes Lab 2020)
London Rough Sleepers – a Social Impact Bond. GLA and DCLG paid the Thames Reach charity for reductions in the overall level of rough sleeping and for placing and keeping individual rough sleepers in accommodation (Government Outcomes Lab 2020)

projects, or groups of projects are described in Figure 14. The question is how many of these display the four independent variables drawn from the thesis:

- low public salience of the issue;
- a politically weak target group;
- a tight fiscal environment;
- and the potential to link direct Exchequer savings to a verifiable outcome

Figure 15 lists all the projects and assesses each of the remainder against these variables. As all of them were initiated under the post-2010 austerity regime, the third variable listed above – a tight fiscal environment – can be assumed to apply to them all.

Figure15: Programmes using Outcome-based Payment and the independent variables

		Independent Variables		
		Politically Weak Target Groups	Low Political salience	Direct Exchequer savings
Meet the same conditions as Flexible New Deal and the Work programme	Benefit claimants (5 projects)	x	x	x
	Ex-offenders (5 projects)	x	x	x
	Adoption of looked-after children	x	x	x
	Family therapy	X	x	x
Lacking verifiable outcomes or clear link to savings	Drug and alcohol (1 project)	x	x	
	Troubled families (3)	x	x	
	Children at risk	x	x	
	Rough sleepers	x	x	
	mental health	x	x	
	International aid projects (19 projects)	x	x	

Four projects seem to feature all the independent variables which were identified in the welfare-to-work programmes: a group of three DWP projects to help benefit claimants into work; a set of five ex-offender projects and two Social Impact Bonds, one dealing with the adoption of looked-after children and one with family therapy.

These projects all focus on marginalised groups with low political power and have outcomes which directly link to savings for the sponsoring government body (whether central or local). They offer support for my thesis, therefore, by displaying the independent variables which I have suggested may lead to the use of outcome-based payment even in cases where complex objectives make its use problematic.

The remaining six groups of projects in the table, however, raise questions about my thesis' tentative conclusions, because they do not display all the independent variables that the thesis predicts. While their target group seems to fit the description of marginalised or politically weak, the programmes do not seem to have easily verified outcomes linked directly to savings. First of all, there are many international aid projects. These deal with problems that will not, in the absence of intervention, cost the UK government any money. Arguably, however, these are a special case as the UK government does not have the option to use its own civil servants to deliver projects in other countries. It must delegate to outside organisations and it will have few people on the ground to monitor compliance with any specifications it makes. The circumstances surrounding the choice of outcome-based payment in these cases are different from those surrounding the case study and the other projects listed in this chapter.

The other projects which fall into this category deal with drug and alcohol users, vulnerable people and people with mental health issues, troubled families and children, and rough sleepers. Each has objectives which are difficult to quantify and measure, and which are linked to costs that are scattered across a variety of organisations and public bodies. The motivation for adopting outcome-related payments in these cases cannot have been to offset identifiable costs with identifiable direct savings. My thesis cannot fully explain why they are using outcome-based payment.

Conclusion on the general application of the hypotheses

This collection of projects gives support to the proposition that outcome-based payment will be easier to use in projects dealing with marginalised groups without the political power to resist the inequitable treatment which is likely to result. There also seems to be some confirmation of the central role of off-setting savings in making the use of outcome-based payments worthwhile.

More investigation is needed, however, of those projects where the savings are indirect, scattered and difficult to collect and verify. It seems unlikely that negotiations with reluctant funders would be smoothed by the promise of such nebulous returns. This might suggest that the notion of invest-to-save is one which helps to "sell" projects – to the public, stakeholders, and so on - even where the reality is that the payments and the savings will never be properly reconciled. In several of the projects where there were multiple sponsors, such as that dealing with drug and alcohol users, the notion of linking payment to outcomes, even if the link to savings was rather nebulous, may have eased the process of agreeing cross-organisational funding for the project. ie. the project does not meet the criterion of offering verifiable savings but does reduce the transaction costs involved in gaining funding for projects in a budget environment dominated by departmental silos.

Implications for theory

While this initial look at other outcome-based payment cases raises questions, it offers a measure of confirmation to the hypothesis that governments will sometimes choose high-powered incentives for a project in circumstances where the efficient achievement of (all possible) outcomes could be jeopardised. The conditions under which they are more likely to do this are, the hypothesis suggests, where the resistance to an inequitable allocation of resources is likely to be weak, and where the use of outcome-based payment can help resolve political disputes over funding, or at least make a more attractive case for funding the policy. The new hypothesis emerging from the case studies might, after further investigation and testing, join the set of hypotheses which use the transaction cost analysis and principal-agent theory frameworks to explain governments' choice of institutional arrangements.

It could also add to the literature more generally by suggesting a political, rather than efficiency-driven, reason for privatisation. This possibility does not appear in the literature, as we saw in Chapter One (Figure 3). The privatisation debate tends to assume that privatisation is always chosen reasons for effectiveness (or efficiency). It is only a decision not to privatise that can be driven by political reasons (rent-seeking or pork barrel politics). Of course, many of the protagonists in this debate are of the view that privatisation is always more efficient than delivery in the public sector. However, critics have challenged that view, using principal-agent theory to argue that the choice of public sector delivery is sometimes taken because it is more efficient. This thesis takes the further step of arguing that privatisation may be chosen, even where it is not the most efficient option, because it meets political goals.

Specifically, it offers the opportunity to push difficult funding negotiations out of government and onto contractors, making them bear the risks of deciding levels of investment and allocation between individuals.

The literature of Congressional dominance and abdication, on the other hand, has focussed closely on political, rather than efficiency, motivations for delegation, such as blame-avoidance. However, that literature deals more or less exclusively with delegation to public bodies. The possibility of delegation to the private sector is mentioned briefly by Hood (2002:2), but Epstein and O'Halloran rule it out altogether, saying 'politics has no equivalent of the free market or price system in economics. Private sector firms cannot compete freely for the right to receive delegated authority' (Epstein and O'Halloran 1999:44). This is, of course, exactly what is happening in outcome-based payments systems. Because the literature focuses on public sector delegation, the motivations for delegation to private sector bodies were simply not examined. There is, in the literature then, an empty set – the political motivations for privatisation. The hypothesis emerging from this case study would populate that empty set, as shown in the amended Figure from Chapter One (Figure 20):

Figure 16: The 'new' motivation for privatisation

	Motivated by efficiency	Motivated by political risk
Privatisation	Use of high-powered incentives to drive agent's performance	*Emerging from this thesis: Use of high-powered incentives to transfer financial risk and solve internal disputes over funding*
Delegation to bureaucrats	Balance of efficiency advantages of delegation against agency costs	Avoidance of blame and decision-making costs

There are questions raised by thesis, however, which could be usefully explored:

- the behaviour of the Treasury is of particular interest. Why did the Treasury agree to an invest-to-save process for the Work Programme and release funds if it was not convinced by the case? Are invest-to-save projects continuing to be set up? Is

Treasury's attitude to invest-to-save softening? Or have the Treasury's fears about the approach been justified?

- does the theory work in reverse? Would government stop using outcome-based payment and revert to other delivery mechanisms if a policy area which had been of low political salience and constrained in funding became high-profile and well-funded? An interesting case study would be the recent Kickstart employment programme, designed to cope with the expected mass youth unemployment caused by covid-19. Given the relatively high salience of the issue and the willingness of the Treasury to fund it, should we expect the programme to move away from delegation and outcome-based funding towards a more highly-specified, service fee model?

Implications for policy

Outcome-based payment tends to be presented as a win-win solution. It is claimed that the payments incentivise performance, free up contractors to innovate and allow governments to fund policy from future savings. The welfare-to-work case study, however, suggests that these goals are not entirely compatible. Equity will always be jeopardised when high-powered incentives are used in any programme where resources are allocated to individuals (rather than invested in public goods), and those individuals have different needs (and so costs). In this situation, when a contractor is rewarded for the number of outcomes it achieves, it will always be rational to focus on the cheaper, easier cases and park the expensive ones. Theoretically, payments could be differentiated to reward effort directed to the expensive cases, but this would require good knowledge of claimants' needs and circumstances. It is notable that even in welfare-to-work policy – an area which most of my interviewees characterised as unusually, perhaps uniquely, simple – it is actually very difficult to calibrate effective incentive payments. In the Work Programme, contractors could make a profit if they achieved job outcomes for about one third of participants. It was, therefore, rational for every contractor to identify the two thirds of participants least likely to give them an easy and cheap outcome and park them. There would, therefore, be people referred to the programme who could have benefited from it but would in fact receive no help.

The use of outcome-based payment will always, then, be more suitable where governments are primarily interested in a specific valued outcome, rather than in delivering a service to a target group. It will be more inviting to governments in policy areas which are of low interest

to the general public and where target groups are politically weak. Finally, it will be more attractive when money is scarce, or government is pursuing a strategy of austerity. Further, even when all these criteria are met, the cases of Flexible New Deal and Work Programme show the complexity of designing outcome-based payment systems, even when there is one, apparently simple, outcome. The difficulty of estimating the counter-factual and so dealing with deadweight, creates risks of over-payment and under-payment. This suggests that, despite its apparent promise, true outcome-based payment will continue to be a rarity in social policy: However, a number of issues would be worth further examination:

- First and foremost, are there principles to guide the design of outcome-based payments system to minimise the damage to equity?
- Second, are those scrutinising policy – parliament, for example - sufficiently aware of the risks which outcome-based payment creates? The equanimity of the select committee and much of the policy community in the face of the use of outcome-based payment in welfare-to-work suggests they are not
- How likely is it that funding constraints in a post-covid world, changes in public perceptions of certain groups and lobbying by potential contractors will bring purer forms of outcome-based payment into highly sensitive areas such as health and education, where the damage to equity will have serious implications?
- What is the process by which a group becomes one from whom the equity objective can be removed without political cost? Do discussions about the cost which certain groups impose on the rest of society (e.g. the obese) advance that process? For example, if obesity is increasingly discussed in terms of the costs it imposes on the National Health Service, will it begin to be seen by policy-makers and the public in terms of total money saved and total pounds lost, opening the door for the abandonment of any idea of equitable treatment of the individuals involved?

Annex A – List of Interviews carried out

Name	Role	Date of Interview	Reference
Anonymous	Senior Departmental commercial manager	29 August 2019	Interview One
Anonymous	Senior strategy official	15 November 2019	Interview Two
Anonymous	Senior government economist	24 January 2020	Interview Three
Anonymous	Senior policy official	18 February 2020	Interview Four
Chris Grayling	Minister of State	26 February 2020	Interview Five

Annex B - Timeline

Apr 1997	Labour manifesto and pledge cards published
May 1997	New Labour wins election, Blunkett appointed Secretary of State
July 1997	Budget – details of New Deal announced
	Design of New Deal published
Nov 1997	Education and Employment Committee report, *The New Deal*, published
Jan 1998	New Deal Pathfinders launched
Feb 1998	Prototype Employment Zones launched
July 1998	Education and Employment Committee report – *The New Deal Pathfinders*
Apr 2000	Fully-fledged Employment Zones launched
July 2000	*NDYP Two Years On* published (Hasluck 2000)
March 2001	Education and Employment Committee report: *New Deal – an evaluation*
July 2001	New Deal for Disabled People launched
Feb 2002	NAO Report: *New Deal for Young People* published (NAO 2002)
Sept 2004	Alan Johnson appointed Secretary of State
Feb 2005	DWP 5-year Strategy published, announcing 80% employment rate (DWP 2005)
May 2005	David Blunkett appointed Secretary of State
Nov 2005	Hutton appointed Secretary of State
Jan 2006	*A New Deal for Welfare* - Green Paper (DWP 2006)
Mar 2006	80% employment target incorporated in Budget, DWP settlement agreed for 2008-11
Dec 2006	Freud Report commissioned
2007	*Employment Zone Evaluation Synthesis* (Griffiths and Durkin 2007)
Feb 2007	Work and Pensions Select Committee Report on *Government's Employment Strategy*
Mar 2007	Freud Report published (Freud 2007)
May 2007	Welfare Reform Act gains Royal Assent
Jun 2007	Hain appointed Secretary of State (G Brown becomes PM)
Jul 2007	Breakthrough Britain reports published by Conservative party
July 2007	Grayling becomes shadow Work and Pensions Secretary

Jul 2007	*In Work, Better Off* - Green Paper – announces Flexible New Deal (DWP 2007a)
Dec 2007	*Ready for Work* White Paper (DWP 2007b), *Flexible New Deal Evidence Paper* (DWP 2007c)
Dec 2007	Grayling endorses Freud's ideas at Policy Exchange seminar (IfG)
Jan 2008	Purnell appointed Secretary of State
Jan 2008	*10 Years of New Deal* (DWP 2008a)
Jan 2008	Conservative party paper - *Work for Welfare*
Feb 2008	DWP *Commissioning Strategy* published (DWP 2008b)
Feb 2008	Freud re-hired by Purnell
Jul 2008	Flexible New Deal *Invitation to tender*
July 2008	*No-one Written Off* Green Paper (DWP 2008d)
Sept 2008	Social Market Foundation – *FND: Making it Work* (Mulheirn and Menne 2008)
Oct 2008	Work and Pensions Select Committee takes evidence on Flexible New Deal and Commissioning Strategy
Nov 2008	Pre-budget report – extra money for the Department, for rising unemployment
Dec 2008	Department gives evidence at Work and Pensions Select Committee inquiry
Dec 2008	*Realising Potential* published including accelerator model (Gregg 2008)
Dec 2008	*Raising Expectations* White Paper (proposing ywo pilots of Gregg's accelerator model in 2011) (DWP 2008e)
Jan 2009	May replaces Grayling as Shadow Secretary
Feb 2009	Work and Pensions Select Committee Report on *DWP Commissioning Strategy* (WPSC 2009)
Feb 2009	Department announces pause in the bidding process, because of rising unemployment
	Freud announces will work with Conservatives
March 2009	Ministerial written answer on revisions to Flexible New Deal contracts because of rising unemployment
May 2009	Government response to Work and Pensions Select Committee report on Commissioning Strategy
Jun 2009	Yvette Cooper appointed Secretary of State: Freud becomes shadow Conservative frontbencher
Sept 2009	Conservatives publish *Get Britain Working*

Oct 2009	Flexible New Deal Phase One launched
May 2010	Election; Iain Duncan-Smith appointed Secretary of State; Freud appointed Minister of State
	Coalition programme agreed with commitment to Work Programme
Nov 2010	Grayling PQ answer: 'Flexible New Deal has failed'
June 2010	Bidders invited to become part of framework
Oct 2010	FND Phase 2 delivery of Flexible New Deal had been due to begin
Nov 2010	Work Programme business case – first version
Dec 2010	Work Programme invitation to tender (DWP 2010)
Apr 2011	Final Work Programme business case
Jun 2011	Launch of Work Programme
Jan 2012	NAO – I*ntroduction of the Work Programme* (NAO 2012)
July 2014	NAO – *The Work Programme*
Autumn 2015	Work Programme to be replaced by Work and Health programme
Apr 2017	Referrals to Work Programme stop

Annex C – Process-tracing: notes on methodology

A number of different variants of process-tracing have been developed. This thesis uses both the minimalist and systematic approaches identified and described by Beach (Beach 1997) to look for evidence to support the three hypotheses.

The minimalist approach: Looking for evidence of the cause

The minimalist approach, as described by Beach (Beach 2017) and used by Tannenwald (Tannenwald, 1999), stops short of a full examination of the causal chain implied by a theory. Instead, it looks for evidence of the initiating cause – the first link in the chain. Beach suggests it is valuable at an early stage in the development of a hypothesis. It is also useful to whittle down the list of possible initial causes before undertaking the work of unravelling the chain which leads from them. That is how it will be used in this thesis.

The next stage is what Beach calls the 'systems understanding' of causal mechanisms (Beach 1997:5). This involves a more in-depth exploration of the assumptions within the theory – for example, why exactly should a wish to maximise policy outcomes lead to the choice of outcome-based payment? This should produce a chain of causation. Each step in this chain should leave behind evidence – or 'data'. That is what we look for.

The systems approach: Unravelling the causal chain

As noted above, in the rational choice institutionalist framework used here actors derive their objectives from an interaction between their fundamental preferences and the circumstances they are in. We should therefore, by observing the circumstances and taking a preference for electoral success as axiomatic, be able to draw some conclusions about their objectives. Say, for example, we see that a government has decided to launch home insulation grants. Evidence that they are lacking votes from young people, and that these young people put environmental issues at the top of their priorities would suggest the government has adopted the policy to reduce the country's energy consumption and please the young electorate. If, however, the evidence shows that young people are much more concerned about the lack of employment, and that the grants are expected to create thousands of jobs, we have some reason to speculate that the government's objective in pursuing the policy is not primarily to affect the environment, but to create employment.

In practice, such clarity and conclusiveness will be difficult to achieve. Beach suggests that any evidence should be measured against the standards of certainty and uniqueness. 'Certain' evidence must be present if a particular causal chain is in operation. That is, there is a necessary condition without which the causal chain will not work, and that condition must leave behind a particular, observable, trace. If that trace is not found, the condition is not present, and that causal chain cannot be in operation. This is a negative condition. Conversely, if the trace is found, its existence is not a positive proof of a specific causal link, unless there is also 'uniqueness'. Uniqueness is a positive condition because, if 'unique' evidence is found, only one specific causal link can be the source of it, and so that causal link must definitely be in operation.

These are difficult standards to meet. The standards of certainty and uniqueness are more easily applied to the analysis of change. We may be able to identify changes in circumstances which must be present if the ranking of strategies is to change in relation to a particular objective. We may also find evidence which would argue definitively for one objective (uniqueness). However, it is likely that, even when we focus on observable changes, we will find evidence which points in a certain direction but does not definitively confirm or rule out any hypothesis. This is a known problem for process-tracing, and Beach advocates the use of Bayesian logic to tackle it, 'using new evidence to update our confidence in causal theories'. (Beach 2017:10). Rather than look for definitive proof for or against a theory, a Bayesian approach will involve looking for evidence which adds to the strength of the case for the theory.

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