Catholic Social Services
Australia

Discussion Paper

A Job Network for Job Seekers

A report on the appropriateness of current services, provider incentives and government administration of Job Network with respect to assisting disadvantaged job seekers

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FOREWORD

Catholic Social Services Australia is the peak body for the Catholic Church's social services in Australia and official representative of the Australian Catholic Bishops on social policy and services. Catholic Social Services Australia participates in Job Network as "Centacare Employment". Centacare Employment's services are delivered from 18 sites in 15 Employment Services Areas (ESA) in most States and Territories.

Catholic Social Services Australia has a long history of offering high quality human services to people in need. Some of its member organisations have delivered employment related services for 30 years. This service history is built on a value base that has at its heart the best interests of each client in their right to live a dignified life.

A Job Network for Job Seekers results from a detailed analysis and reflection on some of the current circumstances of Job Network. In essence, the report challenges the appropriateness of some elements of the services, the current provider incentive structure and administrative requirements with regard to assisting job seekers, especially disadvantaged job seekers.

In focusing on these issues, Catholic Social Services Australia's primary concern is to ensure quality outcomes for job seekers, especially those who are disadvantaged including *Welfare to Work* priority groups who are among the most disadvantaged Australians. Consequently, Catholic Social Services Australia is concerned for the health of the Job Network itself, especially the future of those providers who are assisting job seekers most effectively and delivering on the Government's objectives for the program.

A number of perverse incentives are identified that are thwarting achievement of the Government's objectives for Job Network. These perverse incentives reduce the quality of service to job seekers, increase welfare dependency, distort the Government's perception of comparative provider effectiveness and lead to unwarranted Government outlays.

Essentially, Job Network arrangements have not responded to changes in job seeker needs nor the needs of providers in assisting job seekers, especially those with multiple barriers.

The choice is simple. Does the Australian taxpayer want Job Network providers to be focused on "playing the system" as a way of business survival, or on providing real assistance aimed at re-establishing unemployed job seekers in the workforce permanently with an accompanying reduction of public expenditure on allowances?

While providers should ensure their services are ethical and effective, ultimately, the Government must accept responsibility for establishing financial and performance incentives for Job Network that do more than pay lip-service to its stated objectives in support of job seekers. It is my hope that this report will assist the Government and industry in initiating improvements that will help make the Job Network an even better service for job seekers, especially disadvantaged job seekers.

Frank Quinlan
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EXECUTIVE SUMMARY

INTRODUCTION

The Job Network is the largest of the employment related services funded by the Commonwealth Government and plays a central role in the implementation of the Government's *Welfare to Work* reforms. If these reforms are to be successful in helping disadvantaged job seekers into sustained employment, the Job Network will need to perform at its best.

The Government's performance expectations of Job Network providers cover four primary dimensions of employment outcomes for job seekers:

- *quantity* of outcomes;
- *speed* of outcome achievement;
- *sustainability* of outcomes; and
- *equity* of outcome distribution.

There are also expectations with regard to *service quality* and *acting ethically* in assisting job seekers*.*

While embracing these Government expectations, Catholic Social Services Australia, in delivering its own services and advocating for improvements, is guided principally by Catholic social teaching – in the field of employment services, especially teaching related to the dignity of the human person and work – and therefore is motivated primarily by the needs of job seekers.

Using the only data available to individual providers, this report examines the adequacy and appropriateness of Job Network's current services, provider incentives and Government administration in supporting the Government's expectations of the Job Network with regard to assisting job seekers. It does so by comparing the performance of Centacare Employment with that of its notional average competitor in 14 of the Job Network's 137 Employment Services Areas (ESA). While acknowledging the limitations of this methodology, we believe this analysis effectively demonstrates faults in the system.

THE JOB NETWORK ENVIRONMENT

The report identifies three significant influences having a major impact on services to disadvantaged job seekers:

- Several trends in client characteristics point to a fundamental increase in the complexity of the needs of job seekers referred to Centacare Employment during ESC3 (and presumably those of other providers):

    - An especially stark indicator of this is marked increase in the proportion of Centrelink's Job Network referrals with low educational attainment. Referrals from this group to Centacare Employment have increased from 19% to 25% of total referrals over three years – an increase of 29%.

- The Star Ratings and Outcome Fee incentive systems for Job Network that drive provider behaviour demonstrate sharp variations in "effective" incentives. The incentives are biased strongly towards particular outcome types and job seeker groups but in many cases these are incompatible with the comparative likelihood of achieving outcomes for these types/groups. Therefore, the incentives inadequately support job seekers' needs and goals and Government expectations for providers with respect to assisting job seekers.

- The administration of Job Network is overly burdensome and costly:

  - DEWR's micro-management of detailed process arrangements (rather than outcomes) and the demands this places on providers have resulted in a large proportion of staff time devoted to administration instead of to direct client contact. DEWR's own administrative costs total over $250m and account for 15% of me resources.

  - While the proportion of resources devoted to administration is large and growing, the costs of service provision are increasing and not being met by compensating fee adjustments or indexation. Inflationary effects of more than 16% over three years were met with fee increases of less than 2%. In addition, more complex job seeker needs have increased the required intensity of services and their overall cost. The financial viability of the program is estimated to have fallen by at least 25% in three years.

  Services are being squeezed from above and below. For disadvantaged job seekers, whose needs are becoming more complex and whose service requirements are more extensive, there is evidence their needs are not being met adequately by the program.

ALIGNMENT OF EXPECTATIONS AND INCENTIVES

The report analyses the impact of this changing environment on provider behaviour in the competitive Job Network, and the subsequent impact on job seekers.

Significant systemic shortcomings are identified in the alignment of provider incentives (Financial and Star Ratings) with all five dimensions of the Government's expectations for Job Network with respect to assisting job seekers:

- The calculation of *quantity* of outcome expectations for Star Ratings is not taking adequate account of changed caseload characteristics that emerged during ESC3. As a result, inaccuracies have crept into the calculation of comparative provider effectiveness via Star Ratings.

- Poorly defined outcome definitions and the strong competitive drive for outcome *quantity* have led to questionable practices aimed at manipulation of recorded outcomes. These questionable practices distort comparative provider performance measurement at considerable cost to the taxpayer and downgrade benefits to job seekers. In turn, these artificial outcomes are now built into the historic calculation of outcome expectations for Star Ratings. As a result, providers who are committed to the best results for job seekers face revenue and Star Ratings reductions and potential closure.

- Star Ratings Weightings and Outcome Fee incentives work against the Government's expectation for *speed* of outcome achievement. These weightings reward providers that delay services and outcomes for significant numbers of job seekers. This effect is felt especially by job seekers in the 4-12 month category and contributes to long term unemployment.

- Star Ratings and Outcome Fee incentives focus too heavily on 13 Week Outcomes at the expense of 26 Week Outcomes. They do not support outcome *sustainability* adequately. For the 4-12 months group, there is no focus on *sustainability* as no 26 Week Outcomes currently exist for this group. As a result, too many job seekers are placed in poor quality and shorter term jobs that do not realise the aspirations of job seekers and cycle people back to allowance dependency.

- Outcome Fee and Star Ratings incentives for outcome *equity* for long term unemployed and very disadvantaged job seekers are inconsistent and inadequate. Adjustments in this area are urgently needed in view of the increased complexity of job seekers' needs as demonstrated earlier.

- There is evidence of a deterioration of Job Network's *service quality* in recent years. As competition has increased and financial viability has decreased, some providers are sacrificing service quality for outcome volume in order to survive.

The issue of outcome buying (high subsidies for poor quality, non-continuing or non-existent "jobs") receives close scrutiny. The report examines the costs and benefits to taxpayers from this practice, calculating the very high net costs of between $6,200 and $10,300 for 75% wage subsidies for 26 weeks at the National Safety Net minimum wage of $26,600. Subsidies of this kind are not the rule but are not uncommon. While this expense is justified in some cases and desired benefits realised, the desired benefits are less sustainable when outcome buying practices are involved.

Faced with a choice between meeting all Government expectations regarding assisting job seekers and maximising benefits from the provider incentives system, many providers in the cash strapped and highly competitive Job Network are finding that survival depends more on the latter despite the negative impacts for job seekers.

IMPACT OF PERVERSE INCENTIVES

Implications for Expectation-driven Providers

The report demonstrates how *expectation-driven* providers who pursue the Government's primary expectations conscientiously and effectively sometimes end up worse off than *incentive-driven* providers who focus more on the "bottom line". The effect can be measured by both revenue and Star Ratings. The perverse situation is demonstrated most clearly and accurately with respect to revenue:

- Centacare Employment's revenue for outcome *quantity* was higher than that of its average competitor (+3.4%), reflecting appropriately its higher *quantity* of outcomes (+3.5%) at essentially the same unit fee as its average competitor; however,

- Despite delivering better outcomes for job seekers and additional allowance savings through better *quality* outcomes (outcome mix in relation to *speed*, *sustainability* and *equity*), Centacare Employment's unit outcome fee for all outcomes was also the same as that of its average competitor.

Catholic Social Services Australia believes that the majority of providers pursue ethical practice. Without wishing to claim perfection, Centacare Employment certainly pursues high standards in this regard. However, *expectation-driven* providers are disadvantaged because of the perverse incentive system. During ESC3:

- Centacare Employment's caseload increased by 5% and its difficulty also increased considerably (on one important measure, educational attainment, by 29%); however

- Centacare Employment's unit costs rose by an estimated 16.5% through ongoing inflationary pressures (well above the CPI increase of 9.2% and fee increases of 1.8%) and its annual revenue remained stable, at best.

- As a result, financial viability is estimated to have fallen by at least 25%.

Faced with competition from questionable practices and outcome buying by some providers that are being rewarded by the Financial and Star Ratings systems, *expectation-driven* providers are faced with accepting progressively lower Star Ratings, shrinking financial viability and potential exit from the industry:

- It should be of considerable public concern that service models aimed at combining the best results for job seekers and the most effective pursuit of the Government's objectives, are becoming financially unviable.

Implications for Job Network

Ultimately, the only reward for providers is for outcome *quantity.* Potential rewards from financial incentives for outcome *quality* (*speed*, *sustainability* and *equity* of outcomes) perversely cancel each other out. The report demonstrates a similar effect with respect to Star Ratings that cannot be quantified as accurately by providers without additional data available only to DEWR.

The implication for the Job Network as a whole is very serious. Both Financial and Star Ratings incentive systems do not provide maximum support for the Government's stated objectives for assisting job seekers. Providers are not being encouraged to achieve the best outcomes for job seekers, even though these outcomes would result in higher savings for taxpayers. Instead, the current incentives encourage:

- delayed service and placement - to take advantage of higher subsequent provider incentives;

- shorter term placements – that achieve high provider rewards but lead to earlier return of job seekers to unemployment and allowance dependency;

- poorer quality placements – some of which are supported by the taxpayer through wasteful expenditure on excessive wage subsidies and that also lead to earlier return of job seekers to unemployment and allowance dependency; and

- fewer placements of very disadvantaged job seekers - who are most likely to be or to become allowance dependent.

Indeed, since incentives reward inappropriate and ineffective provider behaviour, comparisons among providers (including Star Ratings) are misleading. Business allocation and re-allocation decisions based on these comparisons are therefore flawed.

In addition, since questionable practices are being supported by the incentives systems they are sure to expand. Such practices should be stamped out. Catholic Social Services Australia believes most providers pursue ethical practice. However, in an increasingly competitive and fund-strapped industry, the pressure to stretch ethical boundaries is substantial. The problems are systemic and so the system needs adjustment.

The Need for Change

There is substantial scope within the existing appropriation to better direct services to disadvantaged job seekers. Substantial refocus of DEWR's monitoring towards quality outcomes and away from administrative processes will yield substantial savings in expenditure on DEWR and substantial reduction in the administrative burdens currently placed on Job Network providers. Such reform will see a shift of resources from administration to services.

RECOMMENDATIONS

The report makes a number of specific recommendations aimed at systemic improvements, including:

Primary Recommendations

<u>Affecting Job Seekers</u>

The most disadvantaged job seekers should have first call on program resources for as long as is necessary to realise desired outcomes. Access to services by disadvantaged job seekers should not be dependent upon political or bureaucratic whim but based upon defensible objective criteria. Given the considerable resources of Job Network, there can be no defence for denying access to personalised services for any job seekers with significant barriers to employment and personal issues. Objective-based access to Job Network for disadvantaged job seekers can be achieved by:

- Identifying Highly Disadvantaged job seekers as those within a Job Seeker Classification Instrument score band with a probability of achieving employment outcomes equivalent to that for a defined group of long term or very long term unemployed job seekers. Without access to more sophisticated data, Catholic Social Services Australia does not propose a specific benchmark, but believes this should be no higher than the outcome probability for job seekers unemployed for no more than 36 months;

- Providing early access to Intensive Support Customised Assistance for a second cohort of early disadvantaged registrants ("Disadvantaged") on the basis of the Job Seeker Classification Instrument score band immediately below that for Highly Disadvantaged job seekers that equates to a probability of outcome achievement that is the same as that for job seekers unemployed for no more than 24 months;

- Providing annual access to Intensive Support Customised Assistance for very long term unemployed job seekers who have exhausted their first and second entitlements to Intensive Support Customised Assistance.

Affecting Providers

- Revision of the current Outcome Fee structure to establish incentives that advantage providers achieving high *quality (speedy*, *sustained* and *equitable)* employment outcomes for job seekers (an indicative proposal is made). The new structure would provide Outcome Fees for Highly Disadvantaged and Disadvantaged job seekers that equate to those for 37 months plus and 25-36 months unemployed job seekers respectively.

- Revision of the current Star Ratings Weightings to establish incentives that advantage providers achieving high *quality (speedy*, *sustained* and *equitable)* employment outcomes for job seekers (an indicative proposal is made). The new structure would provide Star Ratings Weightings for Highly Disadvantaged and Disadvantaged job seekers that equate to those for 37 months plus and 25-36 months unemployed job seekers respectively. This revision should also ensure there is no perverse interaction between weightings and the regression formula.

Affecting Government

- Limiting DEWR's resources for administering Job Network to a set proportion of available program funds that should be no higher than 10% of total funds and utilising the $86m or more saved to invest in the Service, Outcome and Job Seeker Account payments necessary to fund the additional service elements outlined above.

- Re-focus DEWR's monitoring of providers, using a risk management approach, on achievement of quality outcomes for job seekers across the full range of job seeker groups at the same time withdrawing from micro-management of administrative processes and simplifying administration of the program overall and the Job Seeker Account in particular. The aim would be to ensure that provider savings in program administration and compliance management would be sufficient to offset the cost increases of the last three years so that these resources can be injected into improved *service and outcome quality* for job seekers.

Supporting Recommendations

Affecting Job Seekers

- Introduction of a 4-12 month Final Outcome to ensure 4-12 month unemployed job seekers are placed in sustained employment that is less likely to lead to long term unemployment.

- Re-emphasis on *service quality* including through the use of Job Seeker Account funds, built around investment in the needs and aspirations of job seekers. Note: This recommendation should be an issue for providers rather than the Government as providers should be left to develop their own processes.

Affecting Providers

- Review of the calculation of performance expectations for Star Ratings to take better account of changed job seeker characteristics, exemptions and non-disclosure of barriers to employment.

- Improved comparative performance reports from DEWR that appropriately and fairly compare real performance on all five areas of expectations (*quantity, speed, sustainability* and *equity* of outcomes and *service quality*).

<u>Affecting Government</u>

- Introduction of an automated "show cause" process for highly subsidised employment outcomes that result in return to allowance within 13 weeks of subsidy or outcome completion.

- Adoption of the new two-year rolling Star Ratings model should be: delayed until existing perverse incentives are corrected and historically allowable but unsatisfactory outcomes are purged from the current calculations; or introduced along with a moratorium on performance-based sanctions and business reallocations until these adjustments are made.

- Further analysis by DEWR of performance trends among variously performing provider groups to ensure comparative performance measures, such as Star Ratings, accurately and fairly measure comparative provider effectiveness on all four outcome expectations (*quantity, speed, sustainability* and *equity* of outcomes).

Funding the Proposals

Catholic Social Services Australia acknowledges that a number of the above recommendations would require significant resources and that sophisticated modelling is required to estimate offsets and therefore net costs. However, Catholic Social Services Australia also believes that the services sought are essential and that the job seekers needing them deserve first call on available resources.

Catholic Social Services Australia believes there is scope for considerable offsets that should ensure the proposals are cost neutral, through:

- transfer of $86m or more from DEWR's administrative costs to program delivery costs;

- reduction in 13 months Intensive Support Customised Assistance commencements (and subsequent second entitlements) as a result of some job seekers (the proposed "Disadvantaged" group) accessing these services earlier than otherwise;

- allowance payment savings and increased taxation revenue resulting from improvements to outcome *quantity* and *quality* (*speed*, *sustainability* and *equity*);

- elimination of outcome payments for questionable placements; and

- transferring any accumulating surplus within the program to fund the proposals. Catholic Social Services Australia understands that, in past years, underspending in the program has resulted in substantial surpluses being returned to consolidated revenue.

If more radical options are necessary, the Government could consider:

- A transfer of funds from the Job Seeker Account – as the account was 26% in surplus at the end of ESC3 (June 2006) and therefore carries an overall surplus of over $200m nationally, perhaps some proportion of the surplus (say, 50%) can be tapped and some reduction made to ongoing accumulations.

- A transfer of funds from programs that are aimed at less disadvantaged job seekers or are less effective in achieving real outcomes for job seekers – for instance: Work for the Dole or Job Search Training.

GOVERNMENT RESPONSE

The Government's and/or DEWR's responses to a number of the above concerns have not been positive:

- Citing continually improving Job Network outcomes as a sign of the adequacy of Job Network services and provider incentives – irrespective of evidence that these are inflated somewhat;

- Suggesting program changes could raise tender probity concerns – perhaps without considering Government responsibilities to contracted providers; and

- Indicating a preference for Star Ratings continuity – even if the policy objectives and job seekers they are meant to serve are negatively affected.

Certain recent Government decisions have inadvertently exacerbated the situation for job seekers and providers:

- Despite increased complexity of job seekers' needs, the Government has arbitrarily decreased the proportion of job seekers classified as Highly Disadvantaged and therefore gaining early access to Intensive Support Customised Assistance;

- Despite increased provider costs, the Government reduced fees in real terms by an estimated 14.7% (compared with Centacare Employment's estimated actual cost movements) thereby downgrading services to job seekers; and

- Despite evidence of perverse incentives, the Government decided:

    - that Outcome Fees and Star Ratings Weightings are to remain unchanged for another three years; and

    - to introduce two-year rolling Star Ratings in a way that further exacerbates the negative impact of these perverse incentives on *expectation-driven* providers, and through them, on job seekers.

The recent changes to wage subsidy arrangements flagged by the Minister for Workforce Participation are welcomed and are considered to be a step in the right direction. These changes require a scaling down of wage subsidies as the outcome period for a job seeker progresses.

PART 1: INTRODUCTION

The Job Network Services Request for Tender 2006 (p 56) described the objective of Job Network as follows (emphases added):

- "….to help job seekers into *sustainable employment*, *increase workforce participation* and reduce *dependency on income support* by providing *personalised assistance* to job seekers that involves ongoing job search and employment-focused activities".

With a 2006-07 budget of over $1.4bn constituting 61% of DEWR's employment related services outlays, the Job Network is the largest of these services funded by the Commonwealth Government and plays a central role in the implementation of the Government's *Welfare to Work* reforms. If these reforms are to be successful in assisting job seekers into sustainable employment, the Job Network will need to perform at its best.

1.1 Government Expectations

Flowing from this objective, Attachment 1 lists various aspects of the Government's expectations of Job Network providers, also outlined in the Request for Tender. From a practical point of view the key demands with respect to outcome performance cover:

- *Quantity*: Getting the maximum number of job seekers into jobs and off allowances;
- *Speed*: Getting job seekers into jobs and off allowances as quickly as possible;
- *Sustainability*: Keeping job seekers in jobs and off allowances for as long as possible; and
- *Equity*: Getting outcomes for all job seeker groups especially welfare dependent or welfare dependent prone job seeker groups such as those who are long-term unemployed or highly disadvantaged.

Government expectations also extend to *Service Quality* – giving proper attention to the individual circumstances and needs of job seekers and tailoring assistance accordingly – and acting *ethically* by avoiding outcome, performance model and service manipulation to maximise provider payments.

These primary expectations will form key elements of subsequent analysis of the adequacy of current provider incentives in Job Network with regard to assisting job seekers.

1.2 Catholic Social Teaching and Employment Services

In approaching its delivery of services to people in need and its advocacy on program and social policy, Catholic Social Services Australia is guided by the principles of Catholic social teaching. In the field of work, paid or unpaid, Catholic social teaching offers rich insights. Indeed, human work is at the heart of this overall body of teaching. Some important principles are:

- *Dignity of the Human Person*: All people are created in God's image and therefore, despite individual differences and uniqueness, all people share intrinsic value and rights.

- *Dignity of Human Work*: Work develops each person's unique giftedness and specific dignity. Through work, each person shares in, and assists in fulfilling, the Creator's work.

- *The Common Good*: Each person has a responsibility to contribute to society and a right to share in its natural and manufactured resources sufficient to maintain a dignified life for themselves and their dependants. For most, this occurs in large part through paid employment.

- *Preferential Option for the Poor*: The poor, disadvantaged and vulnerable have a right to first call on society's resources. Society, especially through the state, has a responsibility to ensure the needs of the poor are addressed preferentially.

Catholic Social Services Australia, therefore, suggests that Australia's employment related services should meet a number of *universal* expectations, including:

- Funding and services should be sufficient to ensure that the needs of those considered disadvantaged or vulnerable are met fully for as long as is necessary;

- Provider services should aim to realise, or progress towards, each job seeker's legitimate aspirations for employment, utilising and developing their natural gifts and enabling them to support their dependents in a dignified lifestyle.

- Each job seeker should be treated as a fellow citizen of equal worth who is encouraged – even challenged – but never forced, to fulfil their personal and social responsibilities.

1.3 This Report

A Job Network for Job Seekers follows a detailed analysis of Centacare Employment's experience in delivering Job Network services through its Employment Services Contract 2003-2006 (ESC3). In the context of the Commonwealth Government's *Welfare to Work* reforms, Government expectations of providers and universal social principles, the report:

- Questions the adequacy of some aspects of current Job Network services to job seekers, especially disadvantaged job seekers, and proposes improvements;

- Throws light on the adequacy of the Job Network's provider incentives with regard to achieving Government objectives for assisting job seekers and proposes necessary improvements to the alignment of Government expectations and provider incentives; and

- Criticises resource wastage associated with overly burdensome administrative and compliance processes and proposes that these be transferred to service delivery.

Of necessity, throughout the analysis, Catholic Social Services Australia has had to rely on data relating to its own contract and caseload in comparison with its notional "average competitor" in the 14 ESAs where Centacare Employment services were delivered in the first three years of ESC3. The comparison between Centacare Employment and its average competitor means a close "like with like" comparison is possible as caseload characteristics and labour market circumstances will be similar.

It is important to stress that the purpose of this comparison is not to highlight the performance of Centacare Employment or any other provider. Rather, it is to use this data – the only data available to providers – to highlight systemic issues that Catholic Social Services Australia believes the industry, DEWR and Government should be considering carefully with a view to improvement of outcomes for job seekers, especially disadvantaged job seekers.

PART 2: THE JOB NETWORK ENVIRONMENT

The Job network is a highly competitive industry from a provider's perspective. Catholic Social Services Australia has identified three factors that are having a profound influence on the Job Network service environment and therefore affecting both providers and job seekers.

2.1 Job Seekers: Complexity of Needs

Centacare Employment's caseload mix "toughened" considerably during ESC3, especially in 2005 and 2006 because:

- Strong labour market conditions and reduced unemployment meant that more skilled workers were more likely to be in employment such that remaining unemployed tended to be those with more significant employment barriers and personal issues;

- The changed pattern of Intensive Support Customised Assistance commencements has resulted in fewer but more highly disadvantaged job seekers entering Intensive Support Customised Assistance in later Milestones than in earlier Milestones. Indeed, the initial Intensive Support Customised Assistance numbers (Milestones 1 and 2) could be considered artificially high and probably artificially less difficult (on average) because of the transition to the ESC3 service continuum. The degree of difficulty of job seekers in later Milestones could probably be considered more "normal" except for the shift in the traditional referral base with regard to Disability Support Pensioners (DSP) and Parenting Payment recipients (PP) – see later.

- Centacare Employment's high success in getting job seekers into work from early ESC3 resulted in a tougher remaining caseload especially from late 2004 onwards. Again, these early successes were not sustainable given the changed Intensive Support Customised Assistance job seeker mix;

- The proportion of total referrals who were receiving Disability Support Pension or Parenting Payments increased from late 2004;

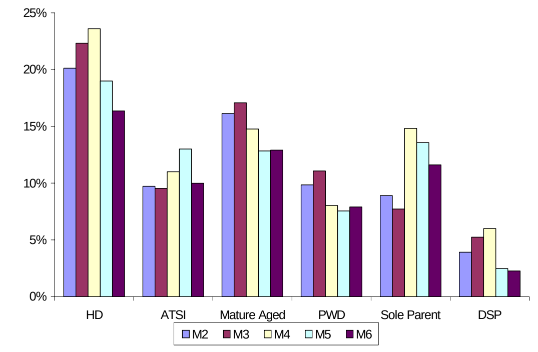
- Centrelink referrals, especially in 2005 onwards, included a proportion of "re-cycled or churned" job seekers for whom Job Network services had previously failed, including some resulting from "outcome buying" or poor placement by some providers. That is, providers had already been paid Outcomes for some of the returning job seekers; and

- Higher Centacare Employment business shares through performance rewards (about +10% overall from late 2004 onwards) meant Centacare Employment has probably received the latter two categories of tougher referrals in greater proportion than many other providers.

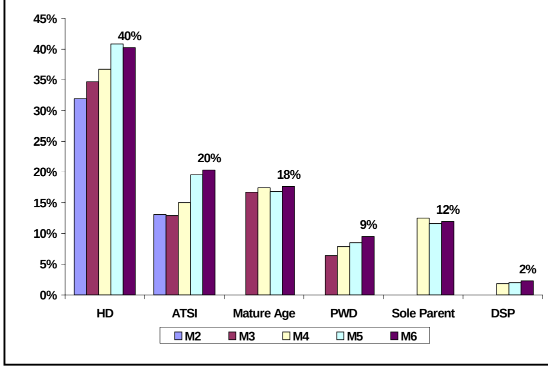
Graph 1 records the proportional distribution of Centrelink referrals to Centacare Employment for a number of Special Groups (including the primary *Welfare to Work* priority groups) for each of Milestones 2 to 6 (M2 to M6) – M1 is excluded because of the abnormal impact of the one-off referral of transition clients. Graph 2 shows representation of these groups in Centacare Employment's Intensive Support (IS) Active Commenced Caseload at the end of each Milestone (note that data on some groups are unavailable for earlier Milestones). The following indicate increasing placement difficulty and caseload complexity:

- Highly Disadvantaged (HD) referrals were increasing (Graph 1) until DEWR modified the qualifications for this group from the start of M5 after which it fell sharply, returning to its M2 level and then even lower. Nevertheless, this group continued to grow as a proportion of caseload until M6 when a slight fall was recorded (Graph 2).

Graph 1: Proportions of Special Groups in CE's Referrals – M2 to M6



Graph 2: Proportions of Special Groups in Total Intensive Support Commenced Active Caseload



- Indigenous referrals grew substantially in M4 and M5, and their share of caseload grew more quickly.

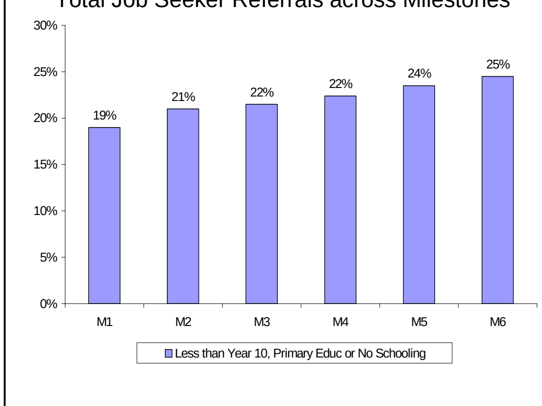
- Mature Aged referrals declined in M4 and M5 but their caseload share remained stable.

- Parenting referrals increased markedly from M4 to M6 and it is assumed that this would have increased their share of caseload significantly (comparison for earlier Milestones unavailable). Despite a significant reduction in referrals between M4 and M6, the caseload share for this group fell only slightly.

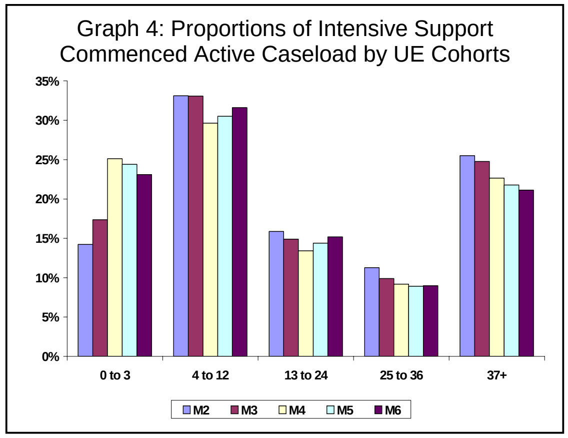
- Disability Support Pensioner (DSP) referrals increased in M3 and M4 but settled back in M5 and M6, also affecting the proportion of referrals of People with a Disability (PWD). The PWD caseload proportion continued to increase, probably reflecting its increased DSP content. DSP caseload is still increasing despite the slow down in DSP referrals.

- Graph 3 shows that throughout ESC3, the proportion of Centrelink referrals to Centacare Employment with low educational attainment (below Year 10) increased progressively from 19% to 25% (a 29% increase). Since education level has long been recognised as one of the most powerful determinants of realising sustained employment and a satisfying working life, Catholic Social Services Australia believes this trend is a definitive and conclusive indicator of Centacare Employment's toughening caseload. Presumably, other providers could demonstrate a similar trend.

Graph 3: Proportions of Low Educational Levels in Total Job Seeker Referrals across Milestones



- Graph 4 details the proportional distribution of Centacare Employment's Intensive Support Active Commenced Caseload from M2 to M5 in duration of unemployment categories:



  - In the longest two duration categories numbers fell progressively over time (reflecting Centacare Employment's successes), but flattened in recent Milestones as the most difficult clients remain;

  - In the 0-3 months group, the large increase commencing in late M3 and reaching full force in M4 reflects the Disability Support Pensioner/Parenting influx. Since these referrals began late in M3, they affected the 4-12 month and 13-24 months caseloads during M5 and M6 which increased for the first time. These can be expected to impact on the 25-36 months cohort from late 2006 and the 37 months plus cohort in 2007;

  - As the ranks of the 13-24 and 25-36 months cohorts grow during ESC3-Extended, increases in Intensive Support Customised Assistance commencements (first and second entitlements) can also be expected to occur, especially as the toughening caseload is likely to mean lower employment outcome rates. Importantly, the Job Seeker Classification Instrument scores of the increased flow of Disability Support Pensioners and Parenting Payment recipients are deceptively low as these job seekers are not credited with a period of unemployment when they first enter the system despite often not having worked for long periods (see later).

Clearly, the situation facing Centacare Employment has changed markedly during ESC3, with the overall impact of the above changes becoming most pronounced from late Milestone 3 to early Milestone 4. While other providers would have experienced somewhat similar trends, it is likely that initially high performers (such as Centacare Employment) experienced toughened remaining caseloads earlier than others as a result of their earlier successes. Centacare Employment is not concerned that Job Network's client group has become more difficult; indeed, Centacare Employment welcomes all job seekers, especially those in great need. However:

- Without increased service intensity, outcomes, and therefore outcome revenue, must fall when caseloads toughen as remaining job seekers need more assistance before placement can be successfully attempted;

- Further, job seekers with more complex needs are more costly to assist and "real" service will fall if fees remain unchanged and overall revenue does not increase;

- Therefore, if continued high performance is to be expected, it is imperative that incentive systems remain relevant to this changed environment.

2.2 Providers: The Incentives System

Unlike many other human services, Job Network is not funded by block grants but by a transaction-based funding model that requires completion of services and achievement of outcomes before individual claims for payment are made. This model provides both financial and performance incentives that drive competition among providers.

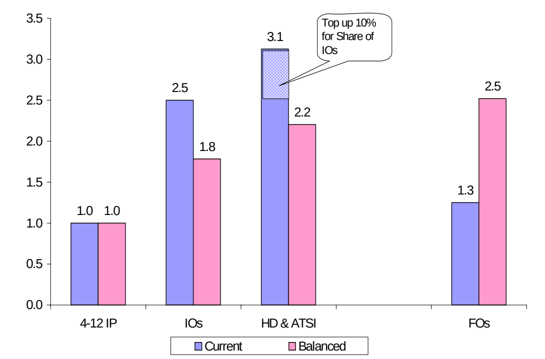
To maximise Job Network's achievements with respect to Government expectations (*quantity*, *speed*, *sustainability* and *equity* of outcomes), two forms of incentive drive provider priorities: Star Ratings and Outcome Fees.

Graphs 5 and 6 (based on data in Attachment 2, Tables 1 & 3) set out major elements of the current incentive system relating to both Star Ratings Weightings and Outcome Fees for different job seeker groups and particular outcome types. Both graphs are "relative" in that the weighting and fee for a 4-12 month Outcome are each set at "1" in their respective graphs and other weightings/fees are compared with this:

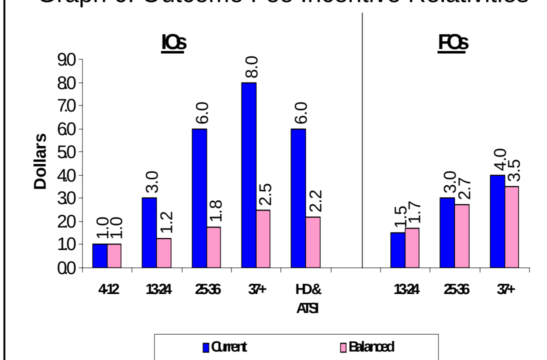
- The blue (first) column in each case records the "*Current*" relative weighting/fee; and

- The pink (second) column in each case shows a "*Balanced*" relative weighting/fee that would reflect "balanced" emphasis across the outcome spectrum in response to the relative probability of achieving each type of outcome. The basic principle is that job seeker groups/outcome types with lower outcome rates would need to attract higher incentives if it is considered desirable that providers focus on these areas – Centacare Employment's outcome rates are used in these calculations.

Graph 5: Star Ratings Incentive Relativities



Graph 6: Outcome Fee Incentive Relativities



It is important to note that in order to encourage appropriate provider responses, the Star Ratings and Outcome Fee systems need to be compatible; however, they should not be the same. While Star Ratings Weightings operate purely as incentives, Outcome Fees function both as incentives and resource allocators. With respect to the latter, Outcome Fees must take account of the cost of producing the outcome and should at least cover the respective costs before relevant incentives are in-built:

- Since the cost of producing outcomes is focused more heavily in the first 13 weeks of placement, Outcomes Fees should be more heavily biased towards 13 Week Outcomes in comparison with 26 Week Outcomes, but not so strongly that providers can afford to de-emphasise achievement of 26 Week Outcomes with negative effects on *sustainability*.

Graphs 5 and 6 both demonstrate sharp variations in "effective" incentives (the differences between "*Current*" and "*Balanced*" incentives) with respect to the Government's expectations on outcome *quantity*, *speed*, *sustainability* and *equity*. For several outcome types and client groups there is a significant disparity between incentives and the likelihood of achieving outcomes and this raises a question about whether, in the light of stated Government expectations, the incentive mix is appropriate. These are analysed in more detail in Part 3 of this report.

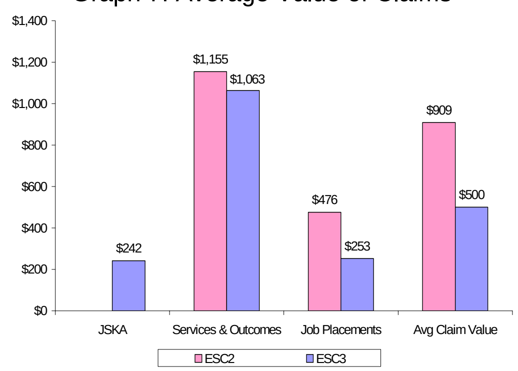
2.3 Government: Program Administration

Administration Costs

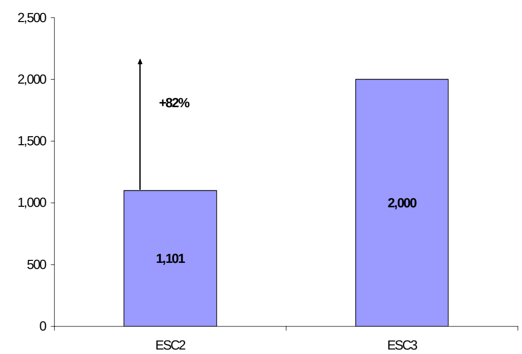
The cost to providers of administering their Job Network contracts has increased substantially since the commencement of Job Network and appears to be of ongoing, almost universal concern to providers.

An important indicator of this is shown in Graphs 7 and 8. To earn $1m in revenue, Centacare Employment has had to lodge 82% more claims for payment in ESC3 in comparison with ESC2 – 2,000 compared with 1,100. The greater part of this increase has come with the introduction of the Job Seeker Account; however, even non Job Seeker Account claims have increased to some degree. On average, Centacare Employment is open to scrutiny on every $500 claimed compared with every $900 in ESC2.

Graph 7: Average Value of Claims



Graph 8: Number of Claims to earn $1m (ex.GST)



Clearly, program administration has increased substantially along with the scope for DEWR's "investigations" into very small amounts of expenditure. Indeed, since early June 2006, Centacare Employment has received requests to justify 113 claims for payment at the rate of over five or six a week. A quarter of the claims were for under $200 with half of these under $100. The amounts of money involved vary from $17.93 to $4,400 – some resulted in partial recoveries as low as $9.81.

The cost to DEWR and a provider of investigating each claim is substantial involving:

- identification of claim by DEWR;
- issuing a show cause letter to the provider;
- receipt and registration of the letter by the provider;
- referral of the letter to the site for gathering of substantiating evidence;
- drafting a response to DEWR;
- approval of the response by the delegate;
- forwarding the response to DEWR;
- consideration of the response by DEWR and decision on any recovery action;
- issue of Debt Advice Notice to the provider if necessary; and
- Recovery of the amount from provider payments.

Clearly, the whole process is very resource consuming. Surely the value of recovering very small amounts must be questioned on efficiency and risk management grounds. What this situation reflects is a strongly risk-averse and controlling culture within DEWR that is at odds with contemporary business and risk management principles. This is a grossly wasteful use of public funds:

- Catholic Social Services Australia is not against accountability. Indeed, DEWR's recovery of wrongly claimed funds may be significant. However, on the assumption that most of this recovery relates to large amounts resulting from investigations into inconsistent or irregular practice, investigations into relatively small amounts would seem inconsistent with risk management principles;

- Furthermore, the fact that the funding model is so complex in that funding occurs in very small amounts and this gives rise to many small claims, suggests that the funding model itself needs redevelopment to minimise administration and avoid this very minute level of accountability and scrutiny.

In addition to this, DEWR has increased its scrutiny of providers' processes and its contract managers now regularly delve into and question minute administrative and service delivery processes, even recommending changes despite their lack of expertise in service delivery. The bureaucratic approach that the Government swept aside in abolishing the Commonwealth Employment Service (CES) has now re-emerged in the Job Network with the same costly and crippling effects.

This is possible because of the massive investment in DEWR's infrastructure as the following information makes clear:

- According to DEWR's 2006-07 Portfolio Budget Statements, the estimated total administered appropriation for all labour market programs this financial year is $2,298.7m.[1] Of this, the estimated total administered appropriation for Job Network is $1,405.9m[2] representing about 61% of total appropriations for all labour market programs.

- DEWR estimates that total departmental expenses to deliver all labour market programs are $411.5m.[3] Assuming that the proportion of departmental expenses to administer Job Network is the same as Job Network's share of the total appropriation for labour market programs, then the estimated cost to administer Job Network would be around $252m.

- Putting the two together, DEWR's administration of the total appropriation for Job Network would appear to account for $252m or 15.2% of the total of $1,657.9m.

Job Network members also must spend a proportion of their allocated funds on administration. Providers have observed this aspect increasing progressively during ESC3 partly because of a more complicated business model than existed in ESC2 and partly because of DEWR's trend towards micro-management. The scale of DEWR's administrative infrastructure makes this possible:

- Drawing on the above assumptions about the proportion of DEWR's staff involved in administering Job Network, around 1,200 DEWR staff oversight about 1,100 Job Network sites – around 1.1 staff per site. The off-site infrastructures that providers can afford are

[1] *Portfolio Budget Statements 2006-07, Employment and Workplace Relations Portfolio,* Budget related paper no.1.6, p.39
[2] Ibid, p.44
[3] Ibid, p.45

not so generous and they are responsible for detailed day-to-day delivery of the services and take the primary financial risks of running a very complicated and demanding business operation.

Anecdotally, Job Network members have indicated that up to 50% of the aggregated time of site staff goes in administration rather than direct client contact. The *Job Network Frontline Staff Survey* by Jobs Australia and the Brotherhood of St Laurence: Preliminary Findings found that:

- "Excessive administration reduces direct contact time and overall effectiveness" (page 8 of above report);

- "…80 per cent of staff considered the administrative demands of their work were excessive. Specific examples of unnecessary and time consuming red tape include paperwork surrounding the Job Seeker Account, the on-line vocational profile (which was seen to be of little use), and some aspects of the EA3000 computer system (mainly the time taken to refresh screens)" (page 5 of above report); and

- "Staff were asked what would be the most effective way to improve the Job Network system. Responses fell into three broad categories. Reducing administrative burden was seen to be the most important change: reducing paperwork which was also replicated on the EA3000 system; reducing the red tape around the Job Seeker Account; improving the EA3000 system and limiting changes initiated by DEWR to systems and processes" (page 7 of above report).

While administration is an essential element of any human services program, a level of anywhere near 50% of staff time suggests that the industry has lost its way – the program should serve job seekers not the other way round.

Not only are DEWR's administrative overheads substantial, they come at a disproportionately high unit employee cost. Centacare Employment's average employee cost is calculated at less than $50,000pa and it is assumed that this would be similar to that of most other providers. DEWR's average employee cost of around $77,000pa has been estimated in the following way:

- According to 2006-07 Portfolio Budget Statements, there was an average of 1,975 staff responsible for delivering Outcome 1, 'Efficient and Effective Labour Market Assistance' during 2005-06. Outcome 1 includes Output Group 1.2, Labour Market Program Management and Delivery.[4]

- Over the same period, total employee expenses for delivering Outcome 1 were $152.306m.[5] Employee expenses include wages and salaries, superannuation, leave and other entitlements, separation and redundancies and other employee expenses.[6]

- Therefore, the average employee cost per staff member to administer Outcome 1 is approximately $77,000. Since staffing levels for achievement of the Output Groups under Outcome 1 are not available, this figure has been used as an approximation for the average employee cost to administer Job Network.

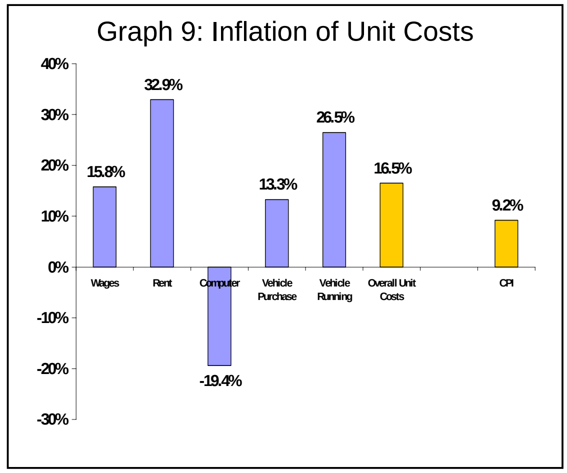
It is worth noting that DEWR's staff salaries will increase by 4% a year for each of the three years between 2005-08 – a cumulative total of about 12.5%.[7] This compares with fee

[4] Ibid
[5] Department of Employment and Workplace Relations Annual Report 2005-06, p.291
[6] Ibid, p.255

increases of 1.8% for Job Network providers for the three years of 2006-09. This is further evidence of the predominance of administration over services in the DEWR-driven Job Network.

Inflation of Costs

The employment services industry, as with all other businesses and DEWR, has been affected by ongoing inflationary pressures:



- Graph 9 provides an average of movements in particular underlying costs for 12 of Centacare Employment's 18 sites covering metropolitan, regional and remote locations. It is clear that most aspects, including high expenditure items (especially wages), have increased at levels above Australia's CPI increase of 9.2% over the three years of ESC3 (2006-09). Overall unit costs have inflated at an estimated 16.5% in three years, well in excess of Australia's CPI increase.

These, together with increased costs and reduced outcome revenue arising from more complex caseloads and the increased administrative costs related to Job Seeker Account expenditure and DEWR's micro-management of compliance processes, are estimated to have reduced the financial viability of Centacare Employment's Job Network services by at least 25%. Even if some benefit is assumed from artificially high revenue from Intensive Support Customised Assistance flows in the early part of ESC3, these have been more than off-set by the situation during 2005 and 2006 that appears likely to prevail until the end of the ESC3-Extended contract period.

2.4 Summary

The Job Network has changed radically during ESC3:

- Several trends in job seeker characteristics point towards a fundamental increase in the complexity of the needs of Centacare Employment's job seekers during ESC3 (and presumably of those of other providers). An especially stark indicator of this is that the proportion of Centrelink's Job Network referrals with low educational attainment to Centacare Employment has increased markedly from 19% to 25% over three years – an increase of 29%.

- The Star Ratings and Outcome Fee incentive systems for Job Network demonstrate sharp differences in "effective" incentives with those for some outcome types being at odds with the comparative likelihood of achieving outcomes. This raises concerns about the match between these incentives and Government expectations of Job Network providers in assisting job seekers.

- The costs of administering Job Network are extraordinarily high:

[7] *DEWR Certified Agreement 2005-08*, p.2

- DEWR's own administrative costs total around $252m – 15% of total program resources – and its average employee costs are around $77,000pa, probably more than 50% higher than those of providers;
- As a result of the overly bureaucratic business model of Job Network and DEWR's increasing micro-management that its huge infrastructure can support, providers spend a high proportion of program resources on administration – some estimates suggest up to 50% of staff time;

- As if that is not enough, providers face rising costs through inflation, that have not been compensated adequately with higher fees and so providers are forced to further restrict services to job seekers; and

- With increased caseload complexity, the intensity of services and associated costs of assisting job seekers have increased considerably placing further limits on the effectiveness of services to job seekers.

Services are being squeezed from above and below. It is anomalous that, at a time when job seeker needs are more demanding, the provider incentives system is problematic and program administration is consuming an increasing proportion of program resources. Before looking at means of addressing these concerns, the second issue, provider incentives, requires more detailed analysis.

PART 3: ALIGNMENT OF EXPECTATIONS AND INCENTIVES

Financial and Star Ratings incentives have an overwhelming influence on provider behaviour in Job Network. Incentives shape service models and therefore affect job seekers. Hence, it is important to understand:

- Whether the current incentives systems are aligned appropriately with the Government's expectations of Job Network providers; and

- The impact of current incentives on the quality and effectiveness of services to job seekers.

3.1 Drivers of Provider Behaviour

While there are many intrinsic and extrinsic factors that drive provider behaviour, there are two particular drivers important to this discussion: Government Expectations and Incentives. Providers differ in the relative importance assigned to these behaviour drivers:

- *Expectation-driven* providers, motivated primarily by the needs and best interests of "job seekers", put primary emphasis on achieving the program's stated goals because they are generally accepted as appropriate for job seekers; and

- *Incentives-driven* providers, motivated primarily by the "bottom line", give primary attention to the program's Financial and Star Ratings incentives in order to meet organisational business goals.

This should not be interpreted as a purely sectoral split. While the industry is a mix of community (not for profit – both Church based and non Church based) and private (for profit providers), both sectors include *expectation-driven* and *incentive-driven* providers.

Further, this is not a black and white division. All providers are motivated by both expectations and incentives – both "mission and margin" as is commonly expressed. *Expectation-driven* providers cannot ignore program incentives or organisational survival is put at risk. *Incentives-driven* providers cannot ignore Government expectations for the program or their organisational survival is put at risk.

The point is simply that different providers in both sectors of the industry place varying emphases on these drivers along a continuum. Both aspects are legitimate and providers have a right to expect that the incentives are aligned with expectations such that second-guessing of Government intent, and possibly hidden agendas, is not required.

Nevertheless, given these differing provider motivations, if the Government wants to achieve the Job Network's objective and its own expectations of providers, the incentive systems should be closely aligned with its expectations or achievement of objectives will not be maximised.

The sections below take each of the Government's four outcome (*Quantity, Speed, Sustainability* and *Equity*) and *Service Quality* expectations, one at a time, and test the alignment of the incentives systems with these expectations.

3.2 *Quantity* of Outcomes

Incentives

A focus on outcome achievement is a fundamental feature of Job Network:

- While accounting for caseload characteristics and labour market circumstances, Star Ratings Weightings solely reward placements and outcomes; and

- The Fee Structure includes a strong component for placements and outcomes, and these are the revenue streams over which a provider has most influence – 47% of Centacare Employment's ESC3 revenue (excluding Job Seeker Account) to end June 2006 was from placements and outcomes.

Both of these features along with rewards and sanctions through business allocation and re-allocation processes, make the Job Network a highly competitive industry from a provider's perspective. All providers are very conscious of the relative strengths of different incentives to perform and take account of them in making strategic and service level decisions.

The Employment Services Contract 2006-2009 requires that providers act ethically, noting that "an unethical manner constitutes any practice that manipulates outcomes, the performance model or Service to maximise payments to the Provider." (see Attachment 1)

Catholic Social Services Australia understands that the Star Ratings system calculates a "*quantity* of outcomes expectation" for each provider after accounting for the provider's caseload characteristics and labour market circumstances. Catholic Social Services Australia has identified two issues of systemic significance relating to the calculation of outcome *quantity* expectations:

- In the light of increased caseload complexity, does the current approach take adequate account of changed caseload characteristics?

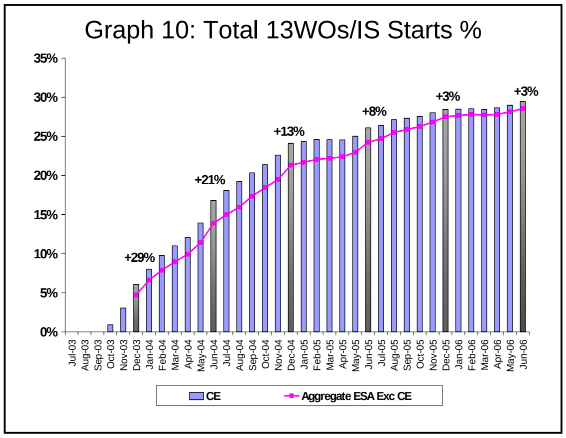
- Given high pressure to perform, how can "outcome manipulation" to maximise outcome *quantity* be avoided or minimised? In particular, to what extent should outcomes involving excessive wage subsidies (and employer incentives generally) at taxpayers' expense be considered "genuine" outcomes that attract Outcome Fees and Star Ratings credits identical with those of unsubsidised outcomes?

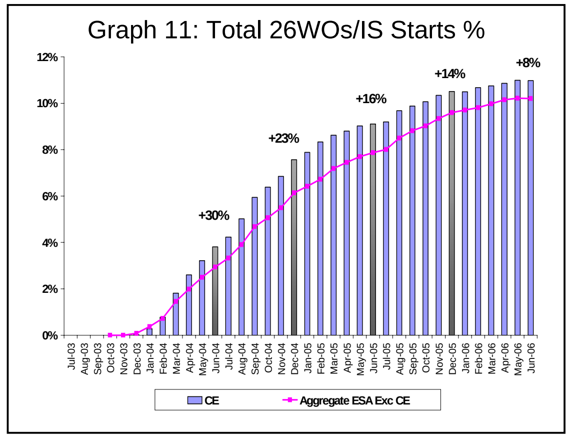
(i) Quantity of Outcomes Expectation

Provider Behaviour

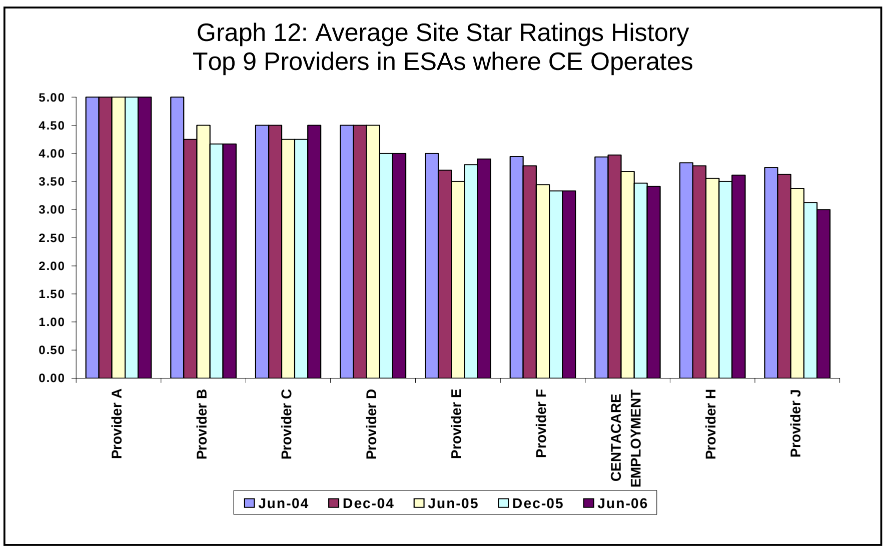
Graphs 10 and 11 show Centacare Employment's 13 Week and 26 Week Outcomes to IS Starts performance throughout ESC3 compared with the aggregate of its competitors (hence, Centacare Employment's notional "average competitor") in the 14 ESAs where Centacare Employment operated to end June 2006.

While Centacare Employment enjoyed a lead over its average competitor for the whole contract, the gap for 13 Week Outcomes closed progressively from December 2004. Although the gap for 26 Week Outcome performance also closed from April 2005, it proved considerably more resilient than that for 13 Week Outcomes, suggesting higher quality outcomes by Centacare Employment that lasted longer than those of Centacare Employment's average competitor (see later).





Graph 12 shows the average Site Star Ratings of the nine initially highest performers (there are 24 providers in all) in Centacare Employment's 14 ESAs in decreasing order of the first Site Star Rating results in June 2004:



- In keeping with the reduction in comparative outcomes performance, Centacare Employment's Star Ratings fell after December 2004; however

- Eight of the nine initially highest performers experienced similar Star Ratings reductions – one has since recovered and another has a clear recovery trend (the only exception is Provider A, a single-site PWD Specialist whose circumstances are obviously very different from those of all the others).

It seems strange that all of the initial top performers subsequently experienced reduced Star Ratings. Two possible explanations been advanced within the industry:

- Early high performers include those providers who lost a number of low performing sites between ESC2 and ESC3 such that remaining higher performing sites were able to get off to a strong start in ESC3 before new providers/sites had reached full performance. By the end of Milestone 3 or so, newer providers/sites had reached peak performance such that, in comparative terms, the performance and Star Ratings of the early high performers began to wane. This theory has been tested by examining the ESA Star Ratings of all 24 providers in the 14 ESAs in which Centacare Employment operated:

- New ESA services (23 averaging 3.6 Stars in June 2004) out-performed continuing ESA services (42 averaging 3.1 Stars in June 2004) by about 0.5 Stars;

- Three organisations, although they lost services in some of these ESAs, had a combination of continuing and new services in these ESAs. In total, new services (five averaging 4.1 Stars) out-performed continuing services (18 averaging 3.7 Stars) by 0.4 Stars.

This evidence does not support the theory that initial high performers could expect to lose ground once newer providers matured. Rather, in these ESAs, initial high performance was more prevalent in new services whether or not the new ESA services were operated by continuing or new providers to these ESAs.

- Early high performance results in a toughened remaining caseload that causes outcomes eventually to fall even if services remain highly effective. Early high performers subsequently experience falling Star Ratings because these circumstances are not accounted for appropriately in Star Ratings calculations:

  - This theory is supported by the findings of Section 2.2 of this report that showed how Centacare Employment's toughening caseload became most pronounced around the transition between Milestones 3 and 4, the time when Centacare Employment's comparative outcome performance and Star Ratings peaked and subsequently began to fall.

Given the similar Star Ratings reductions of all of the initially highest performing generalist providers, the question arises: *Did the effectiveness of all of the initially highest performing generalists fall (as suggested by Star Ratings) or are the outcome expectations calculated in the Star Ratings regression formula incorrect such that Star Ratings are misleading of comparative provider effectiveness?*

<u>Issues</u>

Since the Star Ratings regression is meant to take account of caseload characteristics, a more complex caseload, while understandably leading to reduced outcomes, should not necessarily lead to reduced Star Ratings. Therefore:

- Unless one assumes that *all* of the initially highest performing generalist providers in the 14 ESAs somehow became less effective, a question must be asked about the sensitivity of the Star Ratings system to provider circumstances of one kind or other; and

- If other initially highly performing providers have experienced a toughening of their caseloads similar to that of Centacare Employment (as might be expected), then their Star Ratings reductions may be attributable in whole or part to inadequate Star Ratings' sensitivity to caseload characteristics.

Catholic Social Services Australia suggests the following two possibilities:

- The changing mix of job seekers may have introduced new characteristics to the caseload that are not accounted for in the Star Ratings regression analysis, or altered the balance in the direction of factors not adequately accounted for or that are not reported accurately by job seekers. For instance:

  - There are many undisclosed or undiagnosed circumstances among very disadvantaged job seekers, and medical and other exemptions are a prominent feature among disadvantaged groups – these work against outcome achievement despite the system's including such job seekers in the calculation of outcome expectations;

  - The Job Seeker Classification Instrument (JSCI) scores of the increased flow of Disability Support Pensioner (DSP) and Parenting Payment (PP) recipients are deceptively low as these job seekers are not credited with a period of unemployment when they first enter the system despite often having been on allowance and not having worked for long periods. The provision of JSCI points for "Recency of Work Experience" appears to give some consideration to the circumstances of PP recipients but not to DSP recipients as the six points allocated for "Not in the Labour Force" relate only to "studying or caring". Further, the fact that this factor relates only to the previous two years may not adequately reflect the disadvantage experienced by many DSP and PP recipients with much longer periods away from the labour force;

  - Some job seekers have a long history of repeated bouts of unemployment punctuated by periods of employment – referred to as those "churning" through Job Network and other related services. After periods off allowance that exceed "allowable breaks", these job seekers are treated as if they are registering for the first time despite the residual damage and remaining disadvantage in realising sustained employment.

    In both cases, the current approach results in an inaccurate JSCI measure of their comparative disadvantage and incorrect assessment of their placement difficulty in Star Ratings regression calculations.

- The arbitrary weightings applied to the various outcome types in the Star Ratings calculations may be negating, overshadowing or distorting the impact of caseload characteristics in the regression formula, thereby delivering misleading results:

  - For instance, the regression formula would generally reward Interim Outcomes achieved for disadvantaged groups above those for less disadvantaged job seekers because duration of unemployment and various characteristics associated with disadvantage are included in the regression formula. However, the 40% weighting applied to all Interim Outcomes may distort that benefit by encouraging a larger overall *quantity* of Interim Outcomes that are achieved more easily by focusing on less disadvantaged job seekers. If the impact of the latter aspect is greater than the former, a provider would achieve higher Star Ratings by emphasising service to less disadvantaged job seekers.

<u>Proposals</u>

In order to ensure effective service to job seekers and avoid misleading reporting of provider effectiveness and unfair treatment with respect to business allocation and re-allocation:

- DEWR should undertake urgent work to test the adequacy of the Star Ratings system in accounting for changed caseload characteristics and introduce any necessary additional items prior to the introduction of two-year rolling Star Ratings, including:

  - Consideration should be given to the adequacy of the "Recency of Work Experience" factor in the JSCI in accounting for the disadvantage faced by job seekers who have had long periods on allowance and out of the labour force;

- The JSCI should make specific provision for the added disadvantage faced by job seekers returning to allowance and services after repeated failure to secure sustained ongoing employment;

- Since many personal circumstances of very disadvantaged job seekers are undisclosed and therefore are difficult to account for, perhaps one aspect of this could be an additional factor of “low socio-economic region”. This would acknowledge the prevalence of personal barriers which would be more prominent in low socio-economic regions, thereby accounting for such factors to some extent, even though individuals may not disclose all relevant information. The Australian Bureau of Statistics SEIFA (Socio-Economic Indexes of Areas including Index of Relative Social Economic Disadvantage and Index of Education and Occupation) may be suitable. It should be noted that such indices would desirably operate at sub-ESA level as there are identified “pockets” in particular ESAs with somewhat different socio-economic characteristics from the rest of the ESA; and

- DEWR should test the scope for using “dummy” variables to account for otherwise unquantifiable Star Ratings factors.

• DEWR should investigate the interaction between Star Ratings Weightings and the regression analysis: to determine whether the arbitrary weightings are having a perverse effect on the assessment of provider effectiveness; and to develop a system without such perverse effects.

(ii) Outcome Manipulation and Wage Subsidies

<u>Provider Behaviour</u>

Given that incentives systems are not perfect, they rely on providers acting ethically when inevitable clashes occur between the needs of a job seeker and the provider rewards offered by the system (expectations versus incentives). *Expectation-driven* providers are likely to do what is best for the job seeker – some *incentive-driven* providers may “play the system” despite contractual requirements to act ethically (see <u>Attachment 1</u>).

ESC3 fees for services and outcomes were fixed for the full three year contract. In the competitive environment of Job Network where the complexity of caseloads increased, operational costs increased, and both Financial and Star Ratings incentives reward outcome *quantity*, it should come as no surprise that some providers would push at the ethical margins to increase their credited *quantity* of outcomes.

While the Code of Practice is meant to minimise such behaviour, some unsatisfactory practices relating to “playing the system” are difficult to detect and police, for example:

• <u>Example 1</u>: Normally providers can claim two outcomes for a job seeker at 13 and 26 weeks of employment. The regulations allow for a third outcome in the circumstances where an initial 13 Week Intermediate Outcome (resulting from say, a part-time job) is followed by an upgrading of the position (effectively a placement in a new position). To encourage the best result for the job seeker, the system allows a restart such that the initial outcome can then be followed by a further 13 and then a 26 Week Outcome:

  - Some providers abuse this provision and adopt a “treble outcome” strategy by deliberately placing job seekers in second rate jobs initially in order to subsequently upgrade them and claim three rather than two outcomes. This also creates the impression of “speedier” placement and therefore has a further positive impact on

Star Ratings. A job seeker focused approach would be to seek to upgrade the position from the outset, wherever possible.

- *This is clearly a breach of the Code of Practice and not in a job seeker's best interests in most cases. It also increases unnecessarily expenditure on allowances, JSKA funded wage subsidies and unwarranted outcome payments.*

- Example 2: Full outcome claims depend upon keeping job seekers in unbroken employment for a full 13 weeks, as breaks in earnings can lead to some allowance payments and reduce full Outcomes (Interim and Final) to Intermediate Outcomes. These are much less strongly rewarded in Outcome Fees and Star Ratings Weightings:

    - Some providers are said to be doing deals with employers to avoid docking of pay when absent from work so that allowance payment does not resume despite the person's not working for the whole outcome period. These providers are said to make Job Seeker Account payments (at taxpayers' expense) to employers under the guise of wage subsidies or another form of employer incentive to cover employer losses arising from absenteeism and mislead calculation of outcome payments due to the provider.

    - *Catholic Social Services Australia considers this practice to be fraudulent*.

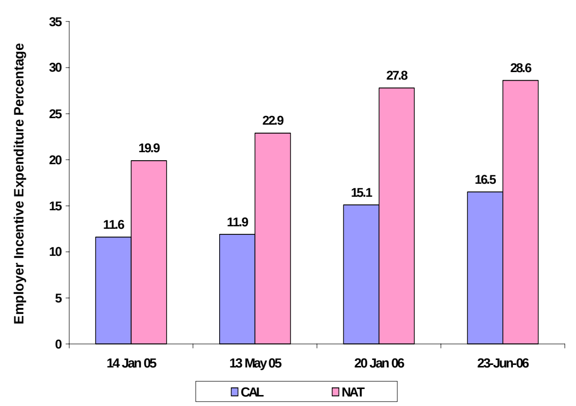
If providers use such practices, they improve their recorded performance against the calculated "*quantity* of outcomes expectation" and improve their Star Ratings and revenue:

- DEWR should be vigilant to ensure such practices are detected and stamped out; and
- Acknowledging the difficulty of detecting and policing such behaviour, outcome definitions and incentives systems should be designed in a way that minimises the risk of such inappropriate provider behaviour.

Catholic Social Services Australia is unable to quantify the impact of all of these practices accurately but an analysis of Job Seeker Account expenditure on Employer Incentives will go some way towards this. Indeed, Catholic Social Services Australia believes that the extent of use of the Job Seeker Account to fund wage subsidies, especially during 2005 as the deadlines for contract rollover and tendering drew nearer, is partly related to the emergence of practices with negative impact on job seekers.

Graph 13 shows that the Job Network's expenditure on Employer Incentives (mostly wage subsidies) averaged 20% for the first three Milestones but 28% for the first five Milestones of ESC3. This suggests that in 2005 (Milestones 4 & 5), Employer Incentives accounted for about 40% of JSKA expenditure – double that of the previous 18 months (as confirmation, DEWR's response to Senate Budget Estimates hearings in May 2006 indicated that 37% of Job Seeker Account expenditure between April 2005 and May 2006 was for wage subsidies). This probably meant an increase in both the proportion of placements subsidised and subsidy levels:

Graph 13: Proportion of JSKA Spent on Employer Incentives



- Given the novelty of the Job Seeker Account in ESC3, it took some time for providers to experiment and gain confidence with the use of these funds. Some of the increase in use of these funds for wage subsidies might therefore be explained by this learning process.

However, Graph 13 also shows that Centacare Employment's expenditure on Employer Incentives remained low in comparison with the Job Network average. Centacare Employment estimated the impact on its performance and revenue to end December 2005 if its expenditure pattern had mirrored the Job Network average (ESA averages are unavailable on this measure):

- 13 Week and 26 Week Outcomes to Intensive Support Starts ratios would have increased by 3.4% and 4.4% respectively;

- Average Site Star Ratings would have increased by about 0.2 Stars; and

- Revenue (including Job Seeker Account) would have increased by 1.3% ($1.0m).

Without wishing to claim that all of the difference between Centacare Employment and the Job Network average is accounted for by inappropriate use of wage subsidies, this nevertheless provides a measure of the extent to which *incentive-driven* providers can take advantage of perverse, and in some cases allowable, practices to manipulate recorded outcome *quantity* for Financial and Star Rating gains. Indeed, since the Job Network average reflects a range of high and low use of wage subsidies, the difference between Centacare Employment and some other providers could be double or more of that estimated above.

<u>Issues</u>

Catholic Social Services Australia is concerned about the perverse impact of excessive use of wage subsidies funded from the Job Seeker Account. Centacare Employment's experience is that when this occurs the quality of placement falls with many placements being inconsistent with job seekers' individual needs (therefore, inconsistent with the Code of Practice and *universal* principles).

There are many examples of detriment to job seekers and unnecessary cost to the taxpayer. The worst example is systemic abuse referred to as "outcome buying" where very high wage subsidies (up to 100%) are used to fund low quality "jobs" that could not exist without subsidy and therefore are not "real" jobs but nevertheless attract outcome payments; however, practices that offer less than ideal results are more prevalent and need closer attention.

While wage subsidies are a legitimate and beneficial *means* of improving job readiness and achieving subsequent employment outcomes, they are *means* not *ends*. The current system confuses "paid work experience" with a "real job" and rewards both as "paid outcomes". Incentive-driven providers are therefore able to prop up their revenue, performance and Star Ratings at taxpayers' expense by placing job seekers in so-called "jobs" of questionable benefit, whilst at the same time gaining a competitive advantage over expectation-driven providers.

Catholic Social Services Australia is not against paid work experience as a legitimate *means* of improving job readiness and also accepts that it is reasonable that subsidised placements leading to sustained employment should also qualify for outcome payments. However, Catholic Social Services Australia considers heavily subsidised placements in poor quality or non-existent "jobs" are not *ends* in themselves and therefore do not justify outcome payments to providers:

- It is noted that most other forms of intervention designed to improve job readiness do not attract outcome payments. Indeed, the only one of these that does is for educational attainment and this is rewarded at comparatively low levels both financially and in Star Ratings Weightings – unlike excessively subsidised employment outcomes.

DEWR's response to Senate Budget Estimates hearings in May 2006 throws light on this situation, indicating that:

- Only 20 100% wage subsidies had been approved between April 2005 and May 2006. However, DEWR was unable to report the number of subsidies in other bands of proportions of wages of 99% or less. Further, no account was given of the fact that some providers are said to split employer subsidies into wage and training (or other) subsidies to get around the requirement for DEWR approval of wage subsidies of 100% or more and that some contribute to subsidies from non Job Seeker Account revenue for the same reason; and

- 40,236 job seekers received a wage subsidy from the Job Seeker Account between April 2005 and May 2006 at a cost of $102.9m, therefore at an average of $2,560 each. At the National Safety Net Minimum Wage, this represents an average subsidy of about 20% over 26 weeks, if all outcomes lasted for 26 weeks. While that may not be regarded as excessive, without knowledge of the proportional distribution of subsidies and their relationship to the circumstances and needs of particular job seekers, firm conclusions about the extent of excessive wage subsidies cannot be drawn from this information alone.

Nevertheless, anecdotal evidence suggests that some organisations abuse the wage subsidy arrangements and the following example will throw light on the situation.

From a financial perspective, Outcome Fees are justified largely on the basis of allowance savings and income tax revenue that are often more than offset by the costs of employer subsidies and outcome fees. For example, a 75% wage subsidy from the Job Seeker Account at the National Safety Net Wage of $26,600pa ($13,300 over 26 weeks) would generate costs and benefits to the taxpayer as set out in Table 1.

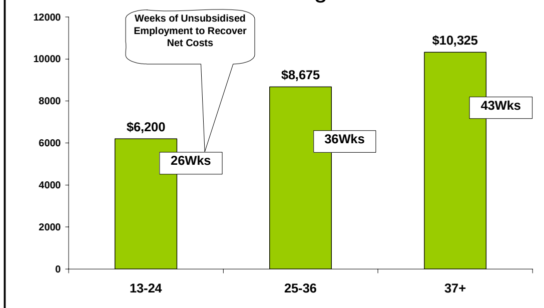
Table 1: Costs & Benefits to Taxpayer for 26 Weeks of 75% Wage Subsidies

	13-24 UE	**25-36 UE**	**37+ UE**
Costs			
Wage Subsidies	$9,975	$9,975	$9,975
Outcome Fees	$2,475	$4,950	$6,600
Benefits			
Allowance Saving*	-$4,550	-$4,550	-$4,550
Taxation Revenue	-$1,700	-$1,700	-$1,700
Net Cost	**$6,200**	**$8,675**	**$10,325**

* Based on DEWR's estimate (possibly outdated) of average allowance payment of $175 a week.

Graph 14 (see page 33) shows that when wage subsidies cease and paid outcomes are accrued, the initial allowance savings and income tax revenue associated with a 75% wage subsidy are well and truly outweighed by the costs of wage subsidies to employers and outcome payments to providers even at the minimum safety net wage of around $26,600pa:

Graph 14: Net Costs to Taxpayer for 26 Weeks of 75% Wage Subsidies



- For Intensive Support Customised Assistance clients, net costs range between $6,200 and $10,300. Allowance savings and tax revenue would need to continue for a further period of between 26 and 43 weeks for full recovery of these costs.

- Such benefits are very likely to accrue in many wage subsidy situations. However, this is unlikely where “outcome buying” is involved because “jobs” are frequently of poor quality and/or are not sustainable without subsidy. While the work experience gained may lead to other employment subsequently such that recovery of funds eventuates and non-financial benefits also accrue (see below), anecdotal evidence of job seekers “churning” through services suggests that failure is a common experience in these circumstances.

DEWR’s response to Senate Budget Estimates hearings in May 2006 indicated that:

- For subsidies of less than $1,000, 55% of job seekers remained off benefit 13 weeks later and this remained fairly stable at 54% and 56% respectively after 26 and 52 weeks.

- For subsidies of more than $1,000, 68% of job seekers remained off benefit 13 weeks later and this dropped a little to 64% and 64% respectively after 26 and 52 weeks.

Catholic Social Services Australia draws two conclusions from this data:

- Wage subsidies are about 60% effective at realising sustained employment for many disadvantaged job seekers – as such, they are an important and valuable component of service delivery. However, further thought is needed on what wage subsidy levels are necessary to achieve these results for particular job seekers and whether the same results are possible with lower subsidy levels; and

- In about 40% of cases, job seekers return to benefit within 13 weeks and this raises concerns about the effectiveness of wage subsidies in various situations that should be explored. This would be of even greater concern if the proportional subsidy in these cases was excessively high.

Catholic Social Services Australia believes that the 40% return to benefit result comes about for several reasons, including:

- Unfortunate circumstances that lead to discontinuation of the position for unforeseeable reasons – this cannot be controlled;

- Poor placement choice that does not meet a job seeker’s employment aspirations satisfactorily and so there is little desire or commitment on the job seeker’s part to remain in the job – controlled by better assessment of job seeker by service providers and more selective matching to jobs;

- Placement in a job that offers little prospect of ongoing employment – controlled by better assessment of employers by service providers; and

- Placement in a non-existent job that is funded largely from the Job Seeker Account for the required outcome period only – controlled by better outcome monitoring by DEWR.

Especially in the last three situations: *Why should such "jobs" attract outcome payments when available evidence suggests there is minimal benefit to the job seeker and considerable net cost to the taxpayer? These situations are better described as "work experience" rather than as "real jobs".*

Indeed, if the outcome definition excluded periods of wage subsidy, these placements (about 16,100 representing 40% of subsidised placements and 7% of all 13 Week Outcomes achieved over the period) would not attract outcome payments as they did not last for the required 13 weeks:

- Under this measure, Job Network's achieved outcomes could be overstated by up to 7%.

Note: Catholic Social Services Australia is not arguing for a purely financial consideration. There are important personal, family and social benefits associated with getting people into work – even work experience; however, these benefits are also minimised when "outcome buying" practices are involved:

- Catholic Social Services Australia's concern is that the practice of outcome buying is very costly for very little economic, personal, family and social benefit. Funds used for outcome buying would be better spent on measures that improved a job seeker's ongoing employability (such as skills enhancement) so that better long term results were realised.

Other implications of "outcome buying" strategies include:

- The misuse of wage subsidies is leading to the creation of jobs that are not economically viable without subsidy (therefore not real jobs and outcomes) and this is increasing the average cost of placing job seekers in employment as more employers expect subsidies.

- While acknowledging some benefit to job seekers in some cases, the "churning" of job seekers through heavily subsidised 13 week jobs ignores the principle of getting a sustainable placement right first time (in keeping with the needs and legitimate expectations of job seekers) and often leads to a further period on allowance and return to Job Network with the job seeker further alienated from employment. The "any job will do as long as an outcome is recorded" approach is clearly not in the job seeker's interests and not in the taxpayer's long term interests.

- Centacare Employment's experience is that better results for the job seeker and longer periods off allowance (hence, higher savings in Government outlays) are achievable with a shift of emphasis in Job Seeker Account expenditure from employer incentives to measures that improve the capacity of job seekers to obtain and sustain employment whether or not they remain with the "subsidised" employer – indeed, Centacare Employment's own Job Seeker Account expenditure pattern with respect to wage subsidies (see Graph 11) and comparative success in achieving 26 Week Outcomes (see Graph 9) demonstrate this clearly (examined in more detail below).

- Catholic Social Services Australia is also concerned that if current practices continue, expectation-driven providers – the ones most likely to effectively assist *Welfare to Work* job seekers – will be forced out of the industry.

Proposals

Given the difficulty of policing provider behaviour in this area (such as the requirement for "ongoing employment" with respect to wages subsidised via the Job Seeker Account) Catholic Social Services Australia believes more decisive action is needed to avoid systemic abuse and unsatisfactory results.

In earlier drafts of this paper put to the Government, Catholic Social Services Australia offered a number of options for consideration. Following discussions with the Government and some other providers on this issue and recent changes to wage subsidy guidelines by the Minister for Workforce Participation that responded to some aspects of Catholic Social Services Australia's concerns, the following proposal is advanced:

- Current arrangements requiring DEWR's approval of wage subsidies of 100% or more of the wage should be altered to cover *all payments made to an employer* from any source – Job Seeker Account or other funds (it is understood that some providers offer a combination of employer incentives including wage subsidies and, say, training, or contribute to subsidies from non Job Seeker Account funds, to avoid the necessity of seeking DEWR's approval);

- The current requirement that subsidy levels reflect the relative disadvantage of job seekers should also remain with providers setting their own levels in this regard;

- The Government's new requirement that subsidy levels be scaled down to ensure employers take responsibility for improving the job seeker's productivity over the life of the outcome period is supported (this had been suggested previously by Catholic Social Services Australia as a means of ensuring that employers take responsibility for improving the job seeker's productivity in the first 13 week period so that the likelihood of placement sustainability is improved);

- In order to encourage discipline with respect to outcome buying and wasteful subsidy levels (that is, high subsidies that are unjustifiable given the job seeker's needs) and to manage the risk of unsatisfactory practice, a show cause letter to the provider to justify the outcome payment should be automatically activated where both of two circumstances apply:

    - the combined subsidy over 26 weeks (wage subsidies and any other payments to the employer) is greater than 50% of the wage; and

    - the job seeker returns to benefit within 13 weeks of the cessation of the outcome period.

This reflects the principle that unless the employer is paying the majority of the wage, there is a significant risk that the position is a work experience opportunity rather than a real job, especially if the placement does not lead to a significant period of employment once the subsidy ceases:

- There may be labour market circumstances that warrant some variation from this approach. For instance, in depressed regional or remote areas where employment opportunites are scarce, an overall subsidy of more than 50% may be considered before the show cause process is activated;

- In justifying outcomes that fail within 13 weeks, satisfactory reasons may need to include outcomes in seasonal work that would normally not extend for 13 weeks following outcome achievement.

To give effect to these proposals, all providers should be required to declare the wage and extent of all employer subsidies (wages and other) when lodging outcome claims on system. These would be subject to audit.

Implementation of this approach would be expected to lead to some savings on Job Seeker Account funded employer incentives and inappropriate outcome payments:

- Savings on inappropriate outcome payments and administration could be directed to the Job Network fee structure to support the proposed extension of Intensive Support Customised Assistance for very long term unemployed job seekers, early access to Intensive Support Customised Assistance for a second cohort of Disadvantaged job seekers and addition of a 4-12 month Final Outcome (see PART 5: RECOMMENDATIONS); and

- Job Seeker Account savings would be available to enhance the skills of job seekers such that ongoing employability would be improved with additional longer term savings to the taxpayer.

3.3 *Speed* of Outcome Achievement

Incentives

- Catholic Social Services Australia understands that Star Ratings reward early placement as the time to placement/outcome from commencement in services is a feature of the regression formula.

- DEWR's performance data includes measures of speed of placement/outcome; however, since comparative data are not made available, providers are unaware of whether or not they need to improve in this area. Hence, providers cannot manage performance against this expectation adequately and, understandably, many choose to ignore it.

Graphs 5 and 6 (see page 18) demonstrate clearly that Interim Outcome incentives are much stronger for 13-24 months than 4-12 months, and the former are unnecessarily high with respect to outcome probability (with Star Ratings the Interim Outcome category covers the 13-37 months plus group). Catholic Social Services Australia has calculated that, once the full effect of Intermediate Interim, Final and Intermediate Final Outcomes (all are unavailable for 4-12 month job seekers) are taken into account (using Centacare Employment's performance and conversion ratios):

- In comparison with the 16% Star Ratings weighting for a 4-12 month Outcome, an average of 62% is achieved in the 13-24 month period – almost four times as much; and

- In comparison with the $550 fee for a 4-12 month Outcome, an average of $2,525 is earned in the 13-24 month period – almost five times as much.

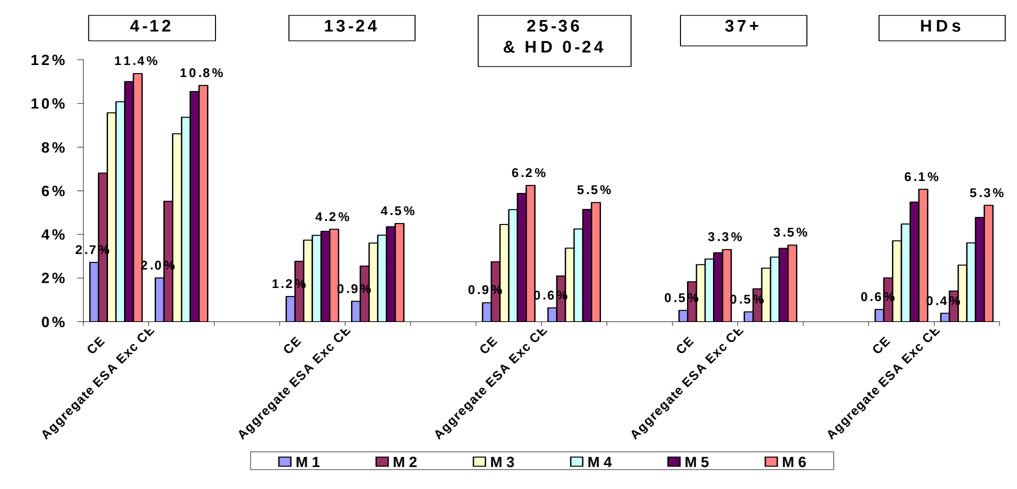
These are very powerful disincentives to assist 4-12 month job seekers and powerful incentives to delay placement of these job seekers whenever possible. Indeed, Centacare Employment's site staff have been informed by the staff of some competitors that their organisational policy is to minimise assistance to 4-12 month job seekers in order to reap subsequent higher rewards for later placement.

It is also noted that similar, though less powerful, disincentives (especially financially) exist with respect to delaying services in subsequent duration categories.

<u>Provider Behaviour</u>

To throw light on *speed* of outcome achievement, Graph 15 compares Centacare Employment's Interim Outcomes (excluding Intermediates that do not exist for 4-12 month job seekers and for which data is unavailable for Highly Disadvantaged job seekers) to Intensive Support Starts (%) for the four unemployment duration cohorts and Highly Disadvantaged job seekers with those of its average competitor in Centacare Employment's 14 ESAs (please note that 25-36 month and 37 month plus data include Highly Disadvantaged outcomes that cannot be disaggregated by unemployment duration):

Graph 15: Interim Outcomes to IS Starts % by UE Cohorts and Milestones



- From the beginning of ESC3, Centacare Employment out-performed its average competitor in all job seeker categories, Centacare Employment's successful service model focusing on *speed* of outcome achievement in *all* categories:

  - Inevitably, early outcomes favour the "easier to place" job seekers in each category as more difficult job seekers take longer to bring to job readiness and subsequent placement.

  - Effective early placement strategies reduce the movement of job seekers into later duration groups (preventing longer term unemployment), thereby leaving later unemployment duration groups smaller in number but harder to place.

  - Service strategies that do not emphasise early placement result in higher numbers of job seekers moving into longer duration groups. The provider is then in a position to improve outcome numbers in the longer duration categories and capitalise on the higher Outcome Fees and Star Ratings weightings available for these outcomes.

- Note that in Graph 15, because of this situation, Centacare Employment's average competitor gained progressively on Centacare Employment in the 13-24 month and 37 month plus groups, levelling in Milestone 4 and actually overtaking Centacare Employment in Milestone 5 in these categories – just when Centacare Employment felt the full impact of its toughening caseload. Importantly, this has not occurred in the 4-12 month and Highly Disadvantaged categories indicating that Centacare Employment is still focused on *early* outcomes while Centacare Employment's average competitor is more biased towards *later* outcomes. It is also noted that Centacare Employment's lead in the 25-36 month category can be attributed to early outcomes as about two-thirds of outcomes in this category are for 0-24 month Highly Disadvantaged job seekers but the two cannot be definitively disaggregated.

While this effect impacts upon all duration categories, by far the biggest impact relates to delaying 4-12 month outcomes until the 13-24 month period where the numbers are large, Outcome Fee earnings are five times greater and Star Ratings weightings four times greater than for the 4-12 month group (see page 36 of this report).

This analysis supports anecdotal evidence from Centacare Employment's site staff that Star Ratings and Outcome Fee incentives so strongly favour 13-24 month outcomes over 4-12 month outcomes, that some providers are minimising service to 4-12 month job seekers in order to minimise outcomes in this period with a view to having a bigger pool of job seekers to achieve more highly rewarded 13-24 month outcomes:

- This delayed placement is a poor outcome for job seekers, causes an increase in long term unemployment and allowance dependency, and costs the Government significantly in higher allowance payments and program outlays.

- Clearly, the current incentive system gives inadequate attention to "preventative" service strategies and early intervention.

Centacare Employment estimated the impact on its performance and revenue to end December 2005 if its outcome pattern had mirrored the Job Network average:

- 13 Week and 26 Week Outcomes to Intensive Support Starts ratios would have increased by 0.4% and 4.0% respectively;

- Average Site Star Ratings would have increased by about 0.1 Stars; and

- Revenue (including Job Seeker Account) would have increased by 1.9% ($1.4m).

This provides a measure of the extent to which *incentive-driven* providers can take advantage of current perverse incentives that discourage *speed* of outcome achievement and lead to Financial and Star Rating gains for providers.

<u>Issues</u>

Current Star Ratings Weightings and Outcome Fee incentives work against the Government's expectation for *speed* of outcome achievement by delaying services and outcomes for significant numbers of job seekers until they reach subsequent duration periods. This is of greatest significance with respect to 4-12 month job seekers. This perversely rewards inappropriate provider behaviour leading to increased welfare dependency, reduced workforce participation and increased Government expenditure:

- While Catholic Social Services Australia supports preferential incentives to assist long term unemployed job seekers, making these so strong as to actually *increase* long term unemployment is perverse.

The Star Ratings regression formula supposedly rewards early outcomes; however, the mechanism is *invisible* to providers and appears to be overshadowed by the impact of the *visible* rewards (Star Ratings Weightings and Outcome Fees). The visible rewards impact strongly on provider behaviour and clearly do not favour early placement. The imbalance is such that early placement can be overlooked with positive provider reward.

Proposals

Both Star Ratings and Outcome Fee incentives need revision to ensure *prevention* of long term unemployment and allowance dependency wherever possible:

- Star Ratings Weightings and Outcome Fees for 4-12 month outcomes should be increased in comparison with those for 13-24 month outcomes to provide incentives for providers to assist these job seekers; and

- DEWR should introduce standard comparative data reports (ESA, LMR and JN National averages) that measure *speed* of placement/outcome achievement overall as well as for various outcome types and job seeker target groups to enable providers to manage performance in this area.

In addition, Catholic Social Services Australia proposes two new features of the Job Network service model:

Feature 1

Earlier placement of 4-12 month job seekers should be encouraged:

- A 4-12 month Final Outcome should be introduced to encourage quality placements that reduce the likelihood of these job seekers reaching 12 months unemployment;

Feature 2

A second cohort of initial registrants should be selected for early access to Intensive Support Customised Assistance. Since the cohort of initial registrants with the highest Job Seeker Classification Instrument scores is referred to as Highly Disadvantaged (HD), the term "Disadvantaged (D)" will be used to describe the second cohort with a Job Seeker Classification Instrument score band immediately below the Highly Disadvantaged band:

- DEWR has reported that the current Highly Disadvantaged band selects about 15% of initial registrants for early Intensive Support Customised Assistance access, attracting higher Intensive Support Customised Assistance Commencement Fees, higher Job Seeker Account credits and Outcome Fees equivalent to those applying for 25-36 months unemployed job seekers;

- However, Centacare Employment's experience is that Highly Disadvantaged job seekers are as difficult to assist as 37 months plus job seekers as the outcome probabilities for the two groups are similar and considerably lower than those for 25-36 months job seekers (see Attachment 2). This suggests that funds available to assist this group are inadequate. It also suggests that there is a large number of disadvantaged job seekers (early registrants) with outcome probabilities similar to those of 25-36 months unemployed job seekers (very long term unemployed people) who need early access to Intensive Support Customised Assistance but are forced to wait 12 months unnecessarily and unjustly for such assistance;

- Access to Intensive Support Customised Assistance for Highly Disadvantaged job seekers is at the whim of Government or DEWR depending upon resources – the group can be re-defined at any time by arbitrarily altering the Job Seeker Classification Instrument score band. As these job seekers are arguably Job Network's most disadvantaged, this is an unacceptable situation as the most disadvantaged job seekers should have first call on Job Network's considerable resources. A more objective and fair means of selection is required.

- Catholic Social Services Australia suggests that the Job Seeker Classification Instrument score band for the "Highly Disadvantaged" cohort should be such that the group's average outcome probability is equal to that for 37 months plus job seekers. The Job Seeker Classification Instrument score band for the second "Disadvantaged" cohort should be immediately below that for the Highly Disadvantaged group and such that the group's average outcome probability is no higher than that for the 25-36 months group;

- The various commencement fees, Job Seeker Account credits and Outcome Incentives (Fees and Star Rating Weightings) should be set accordingly – Highly Disadvantaged should be matched to 37 months plus and Disadvantaged to 25-36 months job seekers.

3.4 *Sustainability* of Outcomes

<u>Incentives</u>

Both Star Ratings Weightings and Outcome Fees reward 26 Week Outcomes. However, Graphs 5 and 6 (page 18) demonstrate that in both cases Final Outcomes incentives are very much below those for Interim Outcomes despite the fact that outcome probabilities for Final Outcomes are much lower. The emphasis is very clearly on 13 Week Outcomes and therefore not on outcome *sustainability*. The best example of the perversity of the current incentive system is as follows:

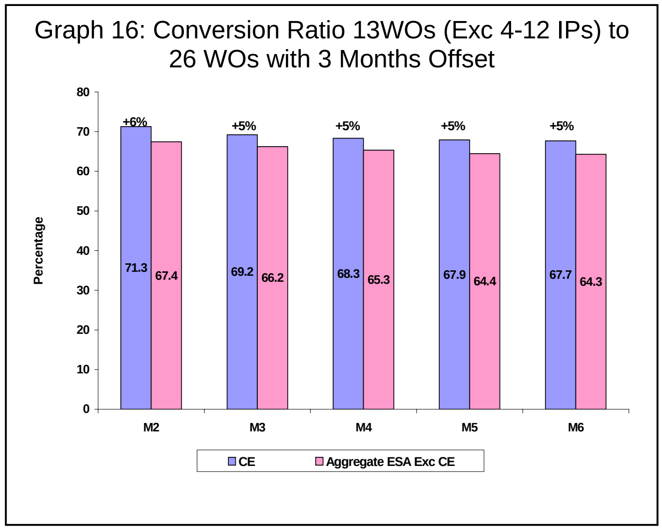
- An Interim Outcome (13-24 months as the example) followed by an Intermediate Final Outcome attracts 56% Star Ratings Weighting and Outcome Fees totalling $2200; whereas

- An Intermediate Interim Outcome followed by a Final Outcome attracts 36% Star Ratings Weighting and Outcome Fees totalling $1375.

The two situations result in the same amount of actual employment for the job seeker and produce the same initial savings to Government outlays on allowances, yet one is rewarded much more highly. Incredibly, the one rewarded less (the second example) is actually better for the job seeker and Government because the job seeker exits the Job Network in a much better job than in the first case and is therefore less likely to return to allowances subsequently such that eventual allowance savings are higher:

- *Clearly, this is a perverse outcome with respect to Government expectations, taxpayer costs and job seeker benefit.*

Provider Behaviour



Graph 16 shows that throughout ESC3 Centacare Employment has maintained a consistent 5% to 6% lead over its average competitor in the conversion rate of 13 Week Outcomes (excluding 4-12 month outcomes for which 26 Week Outcomes are not available) to 26 Week Outcomes (see also Graphs 10 and 11 showing that Centacare Employment's comparative 26 Week Outcomes performance exceeds its comparative 13 Week Outcomes performance). Centacare Employment keeps job seekers in jobs for longer periods than its average competitor, thereby reducing welfare dependency and Government outlays on allowances to a greater extent:

- The fact that many other providers are not keeping as many job seekers in employment for as long a period as Centacare Employment reflects the current incentives that focus more strongly on 13 Week Outcomes and probably use of excessive wage subsidies leading to poorer quality placements that do not last for 26 weeks. This is a poor outcome for job seekers, increases welfare dependency and therefore costs taxpayers significantly in higher allowance payments.

Issues

- Current Star Ratings and Outcome Fee incentives are working against the Government's expectation for *sustainability* of outcomes by focusing providers too heavily on 13 Week Outcomes at the expense of 26 Week Outcomes.

- For the 4-12 months group, there is no focus at all on *sustainability* as no 26 week outcomes currently exist for this group.

- The focus of incentives on 13 Week rather than 26 Week Outcomes is affecting provider behaviour perversely, rewarding behaviour that leads to increased welfare dependency, reduced workforce participation and increased Government expenditure on allowances.

Proposals

Both Star Ratings and Outcome Fee incentives should be revised to encourage outcome *sustainability*. In particular:

- A Final Outcome should be introduced for the 4-12 months group so that providers are encouraged to achieve *sustained* outcomes for this group. This would focus providers on better quality outcomes and reduce the likelihood of these job seekers returning to the system subsequently (this reiterates an earlier recommendation); and

- Star Ratings Weightings and Outcome Fees for 26 Week Outcomes should be increased in comparison with those for 13 Week Outcomes to provide incentives for providers to pursue *sustained* outcomes by ensuring that initial placements are appropriate, and effective post placement support to job seekers and employers is offered:

- It is noted that DEWR's Request for Tender for Vocational Rehabilitation Services 2007-2009 provides for 26 Week Outcome Fees that are double those for 13 Week Outcomes ($3,190 versus $1,595 for Employment Outcomes; $660 versus $330 for Intermediate Employment Outcomes). It is difficult to see why Job Network Outcomes Fees follow an absolutely reverse logic with Final Outcome fees set at 50% of Interim Outcome fees.

3.5 *Equity* of Outcome Distribution

<u>Incentives</u>

- The Star Ratings regression formula supposedly rewards outcomes for disadvantaged job seekers since "credit" is realised if a provider's outcomes exceed the predicted outcomes arising from the degree of difficulty of a provider's caseload.

- Star Ratings Weightings favour outcomes for Highly Disadvantaged and Indigenous job seekers by awarding an additional 10% weighting to the Share of Interim Outcomes achieved for these groups.

- The Outcome Fee structure is graduated towards outcomes for longer duration of unemployment categories and outcomes for 0-24 months Highly Disadvantaged job seekers are paid at the 25-36 months outcome rate.

Nevertheless, Graphs 5 and 6 (page 18) indicate that:

- Star Ratings Weightings are not graduated in favour of very long term unemployed job seekers in the overall 13 to 37 months plus group. Star Ratings therefore rely on the *invisible* rewards supposedly operating in the regression formula rather than on the *visible* rewards in the Star Ratings Weightings to encourage service to very long term unemployed job seekers. Given lower outcome probabilities for longer duration categories, the "effective" Star Ratings incentives from a Weightings perspective must be assumed to be lower for very long term unemployed categories since all of these groups attract the same Weightings (40% for Interim Outcomes and 20% for Final Outcomes);

- The additional Star Ratings Weighting of 10% for Highly Disadvantaged and Indigenous job seekers is about right in comparison with the lower outcome probabilities for these groups; and

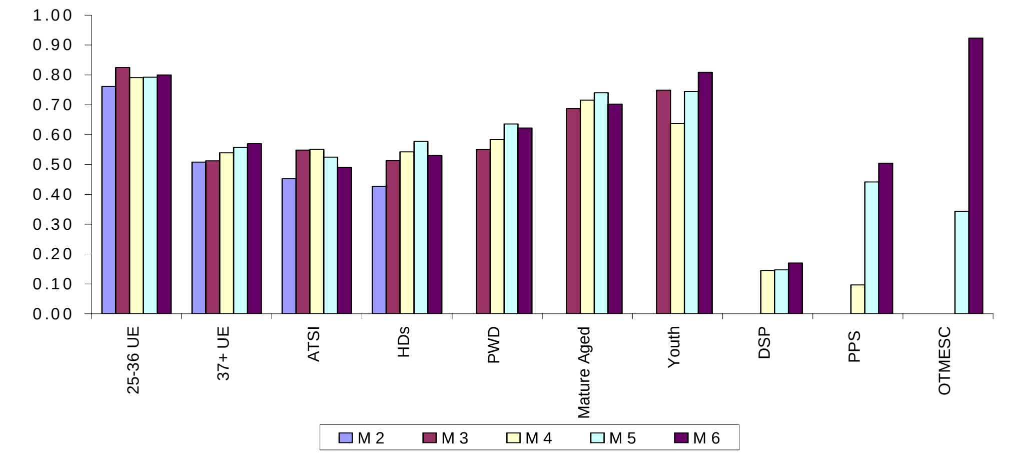
- The Outcome Fee structure is much more along the lines needed to encourage outcomes for very long term unemployed job seekers, as it is graduated in the right direction; however, effective incentives for Interim Outcomes are very high compared with those for Final Outcomes (see later).

Another issue affecting very long term unemployed job seekers is that after completion of the second bout of Intensive Support Customised Assistance (for most job seekers, after about two and a half years of unemployment) the service options are extremely limited. This acts as a disincentive to Job Network members to assist this group in comparison with others and so adds to their level of disadvantage. This is an appalling situation for this group of very disadvantaged job seekers that is inconsistent with universal principles of justice.

<u>Provider Behaviour</u>

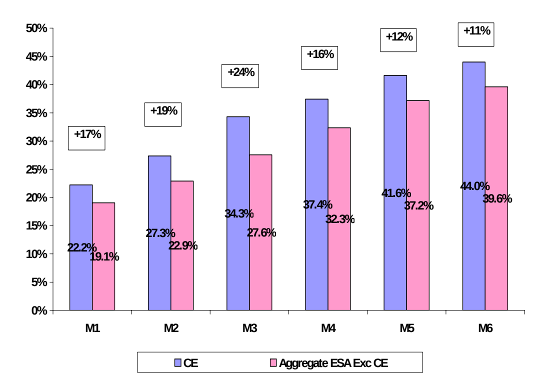
Graph 17 shows the ratio of Centacare Employment's Share of Interim Outcomes compared with average Share of Intensive Support Active Commenced Caseload for different job seeker groups. Although historical data is not available in all cases, Graph 17 demonstrates Centacare Employment's generally improving performance throughout ESC3 with respect to the main disadvantaged groups. This reflects organisational commitment and an expectation-driven approach. Unfortunately, in most cases, adequate comparative data is not made available on whether Centacare Employment is performing better or worse than its competitors in these groups.

Graph 17: CE's Improvement Trends in Special Groups Equity Ratios

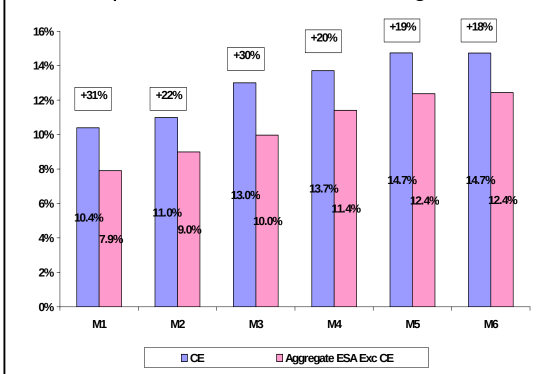


Graphs 18 and 19 show the only available comparative data in this area – Share of Interim Outcomes achieved for Highly Disadvantaged and Indigenous job seekers. Unfortunately, no comparative data exists on the share of Intensive Support Starts or Active Commenced Intensive Support Caseload for these groups – these would allow for more reliable measurement of comparative provider performance as Share of Interim Outcomes for any group depends to a considerable extent upon the share of those clients in a provider's caseload.

Graph 18: Share of IOs for HDs



Graph 19: Share of IOs for Indigenous



Nevertheless, acknowledging the data limits:

- On both measures, Centacare Employment out-performed its average competitor by a considerable margin throughout ESC3.

The fact that Centacare Employment's average competitor lags behind on this measure may appear somewhat puzzling given that additional incentives exist for these outcomes.

Catholic Social Services Australia believes this reflects mixed messages in the incentives system:

- Although outcome probability for Highly Disadvantaged and Indigenous job seekers approximates that for 37 months plus job seekers, Outcome Fees are set at the 25-36 month level (see Attachment 2, Tables 2 & 3 and Graph 3); and

- Despite the additional 10% Star Ratings Weighting for Highly Disadvantaged and Indigenous Interim Outcomes, the effective incentives (differences between *Current* and *Balanced* incentives) for 13-37 month plus job seekers are about the same. However, since outcome probabilities for Highly Disadvantaged and Indigenous job seekers are similar to those for 37 month plus job seekers, the effective incentives for 13-24 month and 25-36 month Interim Outcomes are higher (see Graph 5).

- Further, once job seekers exhaust their two bouts of Intensive Support Customised Assistance (for most, after about two and a half years on allowance), there are no further programmed services. This is a statement that the Government is not interested in assisting these job seekers and so many providers are less inclined to assist them – they are not money-earners for *incentive-driven* providers.

Issues

The primary issues in this area relate to inconsistency and comparative inadequacy in the current Outcome Fee and Star Ratings incentives for assisting long term unemployed and very disadvantaged job seekers and inadequate services for many very long term unemployed job seekers. As these groups include allowance dependent job seekers and those most prone to become so, the current incentives to assist them are not getting the best result against the Government's expectations in this area.

As the client mix has toughened (including through additional *Welfare to Work* reforms implemented from 1 July 2006), these incentives require urgent adjustment if *Welfare to Work* reforms are to be as effective as possible.

Proposals

- Intensive Support Customised Assistance services should continue for very long term unemployed job seekers who have exhausted their two entitlement periods. Eligibility for Intensive Support Customised Assistance should be renewed annually to ensure the needs of these very disadvantaged job seekers are addressed and providers have an incentive to assist them.

- Outcome Fees and Star Ratings Weightings incentives for Highly Disadvantaged and Indigenous job seekers should equate with those for 37 month plus job seekers, not with those for 25-36 month job seekers as at present. This would eliminate the need for the additional Star Ratings Weighting of 10% for Share of Interim Outcomes for these groups.

- Star Ratings Weightings for both 13 Week and 26 Week Outcomes should be graduated with respect to duration of unemployment categories, as is the case for Outcome Fees, but not in the same proportions, as fees, unlike weightings, need to also reflect the costs associated with particular activities.

- DEWR should make standard reports available that ensure providers can monitor their comparative performance with respect to outcome *equity* for the full range of job seeker target groups in a way that takes account of the relative number of clients in each group being serviced:

- Intensive Support Starts is an inappropriate base measure for duration-based groups (Intensive Support Starts mostly occur in short duration categories but job seekers may subsequently flow through all duration groups). Catholic Social Services Australia believes that "Average Intensive Support Active Commenced Caseload" is the appropriate denominator of performance ratios for all job seeker groups.

3.6 *Service Quality*

<u>Incentives</u>

The Job Network objective as stated in Request for Tender 2006 (p 56) requires "*personalised assistance* to job seekers that involves ongoing job search and employment-focused activities" (p 56). This is supported by a number of principles rather than incentives; however, failure to comply with these principles, in theory, may lead to sanctions. The principles include the following:

- The Code of Practice requires "considering clients' *individual* circumstances and backgrounds" (p 200) and "tailoring assistance to clients with consideration of their *individual* needs and participation requirements" (p 200).

- "An appropriate mix of services, products, and programs must be funded from the Job Seeker Account to reflect the *range of barriers job seekers face*" (p 67).

<u>Provider Behaviour</u>

There is no comprehensive measure of the service quality offered by individual providers. However, the pattern of expenditure of the Job Seeker Account offers important clues.

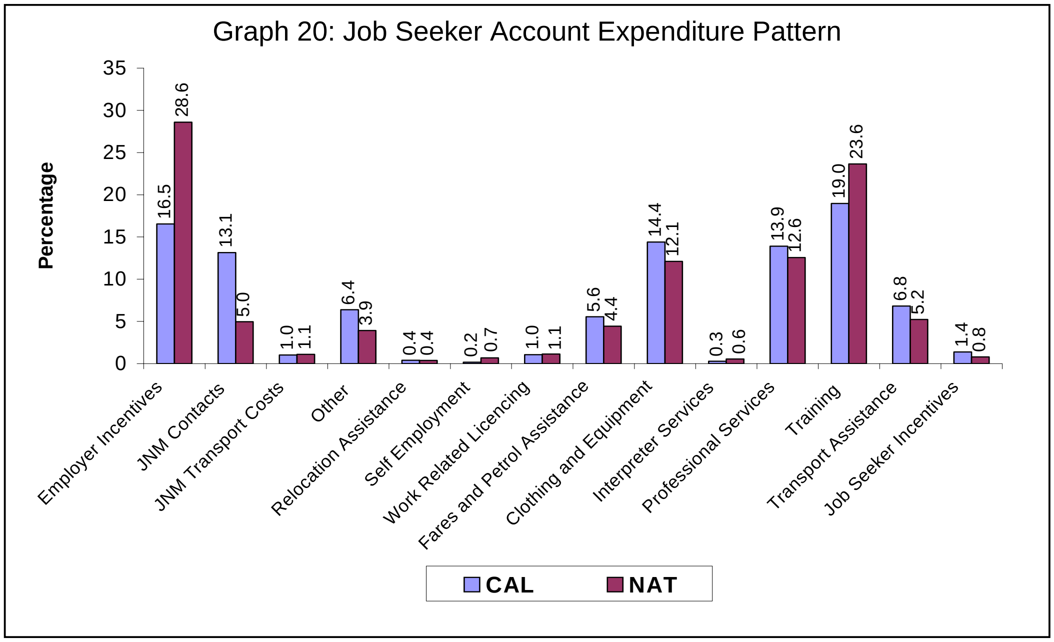
Graph 20 reports Centacare Employment's pattern of Job Seeker Account usage compared with the Job Network average (aggregate ESA averages are unavailable). There are clear differences between Centacare Employment's and the Job Network's patterns. Some broad comparisons are possible.

First, Centacare Employment's proportional expenditure on "Training" is significantly below that of Job Network. However, there is anecdotal evidence that variations in recording practices among providers exist. For example:

- Some providers distinguish between externally purchased and internally provided training and record the latter, perhaps incorrectly, in "Other";

- Some providers are believed to categorise some Employer Incentives as "Training" as a way of minimising their apparent expenditure on employer subsidies and getting around the requirement for DEWR's approval of 100% wage subsidies;

- If either or both of these practices are significant, the reported difference in the proportions spent on Training (Graph 20) may not be accurate.



Second, Centacare Employment's expenditure tends to be more balanced across the full range of job seekers' needs as is required. In particular, there is a primary difference in Job Seeker Account expenditure patterns between Centacare Employment and the Job Network average relating to Employer Incentives and JNM Contacts. This, combined with the smaller differences in Centacare Employment's favour on a number of items (such as Professional Services, Transport Assistance, Fares and Petrol Assistance, Clothing and Equipment and Other) suggest that Centacare Employment's service is more attuned to job seeker needs and more focused on personalised assistance that responds to them. Indeed, Centacare Employment would regard itself as an *expectation-driven* provider and its higher expenditure on JNM Contacts reflects:

- Deliberate efforts to interact regularly with job seekers both to improve understanding of needs and to maximise motivation and engagement in services; and

- More careful placement in jobs aligned as closely as possible with each job seeker's longer term employment aspirations that become more apparent through more regular contact with job seekers.

This strategy appears to be bearing fruit. As Graphs 10 and 11 (page 26) show, Centacare Employment is keeping job seekers in employment longer than its average competitor such that its comparative performance on 26 Week Outcomes exceeds considerably that on 13 Week Outcomes. Graph 16 (page 41) supports this showing that Centacare Employment's conversion ratio of 13 Week Outcomes to 26 Week Outcomes is a consistent 5% to 6% above that of its average competitor.

Catholic Social Services Australia believes this reflects fundamental differences in service models – one based more heavily on achieving outcome *quantity* less selectively, the other on outcome *quality* or achieving the best possible outcome for each job seeker. Indeed, the different expenditure patterns offer evidence of the different approaches of *incentive-driven* and *expectation-driven* providers.

Further, the significant difference reported above regarding Centacare Employment's very strong comparative performance on outcome *equity* would suggest that its more personalised service works better for more disadvantaged clients.

Issues

Catholic Social Services Australia observes that the above differences probably represent a shift in the Job Network's approach to job seekers in recent years. As competition has increased and financial viability has decreased, providers are finding that financial viability depends upon high Star Ratings and solid revenue that can only come about with increased outcome numbers, irrespective of their quality from a job seeker's perspective. It would seem that contractual requirements related to service quality have become of lower priority for many providers – the *incentive-driven* approach is taking increasing precedence over the *expectation-driven* approach:

- The fact that Centacare Employment has resisted that trend on ethical grounds helps explain its reduced Star Ratings and revenue – that is, the incentive system does not adequately support *expectation-driven* behaviour despite stated Government expectations in that regard.

Further, the fact that Centacare Employment's more personalised service appears to be especially effective with disadvantaged job seekers suggests that in the *Welfare to Work* environment, much closer attention will need to be given to developing more personalised services and these will need to be encouraged through appropriate incentives.

Proposals

- Catholic Social Services Australia would encourage the industry, DEWR and the Government to give further consideration to the relative merits of particular Job Seeker Account uses especially with regard to the underlying needs of individual job seekers that lead to quality, sustained employment and respective benefits to the taxpayer:

    - Either the industry or DEWR could conduct a best practice study in this regard.

- Catholic Social Services Australia would urge the industry, DEWR and the Government to review the impact of existing program parameters and incentives on the quality of service to and the value of recorded outcomes for job seekers with a view to giving renewed emphasis and commitment to service quality to job seekers:

    - Current program parameters allow too much focus on short term improvements that often do not impact adequately on the lives of job seekers in the longer term. As a result, short term gains to the taxpayer and provider are not always accompanied by benefits to the job seeker that will lead to more fulfilling and independent lives that have much greater economic and social benefits (including higher long term savings to the taxpayer).

3.7 Summary

There are significant shortcomings in the alignment of provider Financial and Star Ratings incentives with all five of the Government's primary expectations for Job Network:

- *Quantity*

  The calculation of quantity of outcome expectations for Star Ratings purposes appears to be inadequately considering changed caseload characteristics that emerged during ESC3 partly because of the changed *Welfare to Work* client mix.

- *Catholic Social Services Australia proposes that DEWR examine this issue thoroughly and consider upgrading the Job Seeker Classification Instrument points and Star Ratings caseload characteristics with regard to "Recency of Work Experience" and repeated failure to secure sustained employment as well as adding a new Star Ratings factor for "low socio-economic region". DEWR should also examine whether the arbitrary Star Ratings Weightings are overshadowing regression calculations.*

The competitive drive for outcome *quantity* has led to many questionable practices aimed at manipulation of recorded outcomes (such as "treble outcome" strategies, employee absenteeism concealment, excessive wage subsidies and outcome buying) that distort comparative provider performance measurement at considerable cost to the taxpayer and downgrade benefits to job seekers. In turn, these artificial outcomes become historically built into the calculation of outcome expectations for Star Ratings such that expectation-driven providers face revenue and Star Ratings reductions and potential closure.

- *Catholic Social Services Australia proposes closer scrutiny of various outcome manipulation practices and high employer subsidies that do not lead to sustained employment. In the latter situation, automatic "show cause" letters should be issued to providers where overall subsidies exceed 50% of the wage and such subsides are followed by a return to benefit within 13 weeks of the cessation of subsidy and outcome achievement.*

- *Speed*

  Current Star Ratings Weightings and Outcome Fee incentives work against the Government's expectation for *speed* of outcome achievement by delaying services and outcomes for significant numbers of job seekers especially those in the 4-12 month category, thereby increasing long term unemployment.

  - *Both Star Ratings and Outcome Fee incentives need revision to ensure prevention of long term unemployment and welfare dependency wherever possible. Catholic Social Services Australia proposes that 4-12 month Final Outcomes be introduced and early access to Intensive Support Customised Assistance given to a second cohort of "Disadvantaged" initial registrants.*

- *Sustainability*

  Star Ratings and Outcome Fee incentives focus too heavily on 13 Week Outcomes at the expense of 26 Week Outcomes and so do not support outcome *sustainability* adequately. For the 4-12 month group, there is no focus at all on *sustainability* as no 26 Week Outcomes currently exist for this group.

  - *To encourage outcome sustainability, a Final Outcome should be introduced for the 4-12 month group and Star Ratings Weightings and Outcome Fees for 26 Week Outcomes should be increased in comparison with those for 13 Week Outcomes for all job seeker groups.*

- *Equity*

  The current Outcome Fee and Star Ratings incentives for assisting long term unemployed and highly disadvantaged job seekers are inconsistent and comparatively inadequate. Adjustments in this area are urgently needed in view of the toughening caseload mix and the focus of *Welfare to Work* reforms.

- *Outcome Fees and Star Ratings Weightings for Highly Disadvantaged and Indigenous job seekers should equate with those for 37 months plus job seekers in view of similar placement difficulty.*

- *Star Ratings Weightings for both 13 Week and 26 Week Outcomes with respect to duration of unemployment categories should be graduated rather than equal.*

- *The earlier recommendation that early Intensive Support Customised Assistance access should be given to a second cohort of initial "Disadvantaged" job seekers is reiterated as also relating to outcome equity. Outcome Fees and Star Ratings Weightings for Disadvantaged job seekers should equate with those for 25-36 months job seekers in view of similar placement difficulty.*

- *Service Quality*

  There is evidence of a deterioration of Job Network's *service quality* in recent years. As competition has increased and financial viability has decreased, providers are sacrificing service quality for outcome volume irrespective of outcome quality, in order to survive:

  - *Catholic Social Services Australia advocates a re-emphasis on service quality built around addressing the needs and realising the legitimate aspirations of job seekers such that higher taxpayer benefits also accrue, especially in the Welfare to Work environment.*

PART 4: IMPACT OF PERVERSE INCENTIVES

4.1 Implications for Expectation-driven Providers

The above analysis draws a distinction between Centacare Employment and Centacare Employment's "average" competitor. This is not done to promote Centacare Employment as a better performer – indeed, according to Star Ratings to end June 2006, Centacare Employment is only the seventh best performer among the 24 Job Network providers in the 14 ESAs in which Centacare Employment operated and there is a variety of site performance within Centacare Employment's network. Rather, the only data Centacare Employment has access to are its own data and the average of its competitors. A comparison between the two is all Centacare Employment can do to demonstrate systemic issues that impact negatively on job seekers – and that is the purpose of the comparison and this report.

Centacare Employment regards itself as an expectation-driven provider with a genuine commitment to job seekers and the Government's stated program objectives. Throughout ESC3, Centacare Employment has outperformed its average competitor on all four dimensions of the Government's expectations of outcome achievement (other organisations will have a similar story, and some an even better story, to tell) and maintained an overall emphasis on more personalised *service quality* as required by the Code of Practice:

- *Quantity*: Centacare Employment has achieved higher 13 and 26 Week Outcome levels than its average competitor throughout ESC3 (therefore getting more people off allowance and delivering more savings to taxpayers than its average competitor). The average competitor has gained on Centacare Employment in this area since December 2004 which may in part be due to Centacare Employment's toughening caseload and the adoption of questionable wage subsidy and other practices by some other providers. Centacare Employment (along with many other providers) has maintained what it considers to be an ethical and responsible approach to the use of Government-funded wage subsidies and will continue to do so;

- *Speed*: Centacare Employment has achieved outcomes more quickly than its average competitor across the full client group spectrum from the beginning of ESC3 (and therefore removed people from allowance earlier and saved taxpayers more than its average competitor). Current data suggests Centacare Employment is maintaining its early outcome approach with the outcome balance of its average competitor favouring later outcome categories;

- *Sustainability*: Centacare Employment has converted its 13 Week Outcomes into 26 Week Outcomes at a higher rate than its average competitor throughout ESC3 (thereby keeping people off allowances longer and saving the taxpayer more than its average competitor);

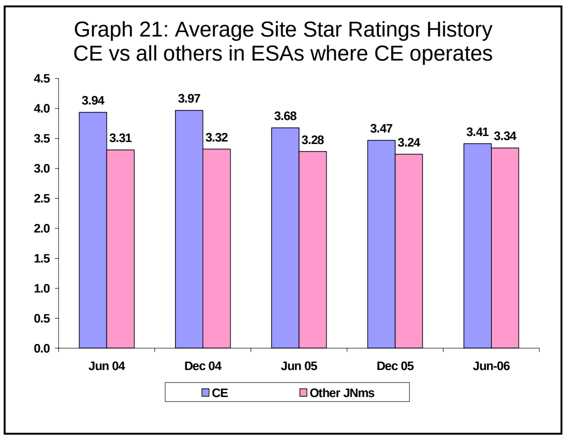
- *Equity*: Centacare Employment has achieved higher outcomes for welfare dependent job seekers (thereby saving taxpayers more than its average competitor);

- *Service Quality*: Centacare Employment's Job Seeker Account expenditure pattern lends support to the view that Centacare Employment's service is more personalised than average and therefore appears to be more consistent than average with contractual requirements for *service quality*. This explains in part the stronger than average results with respect to *outcome quality* (*speed*, *sustainability* and *equity*).

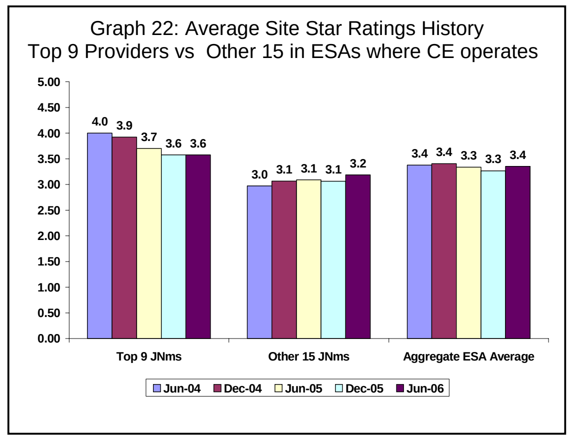
Given this record, and assuming the current incentive system supported the Government's stated expectations of Job Network, it would seem reasonable to expect that Centacare Employment (and other similarly performing providers) would have been rewarded significantly in both Financial and Star Ratings terms – however, such is not the case.

Graph 21 shows that Centacare Employment's Star Ratings have fallen progressively since December 2004 in comparison with its average competitor that remained stable (the result of norm referencing). During 2005, Centacare Employment's average Site Star Rating fell from 0.65 Stars above its competitors to 0.07 Stars above – a comparative fall of 0.58 Stars:

- Importantly, Centacare Employment is not alone. Graph 22 shows that the average Site Star Ratings of the nine initially highest performers in the 14 ESAs (see also Graph 12, page 26) fell from 0.85 Stars above the rest to 0.39 Stars above – a similar comparative fall of 0.47 Stars (rounding explains subtraction variation).



Graph 21: Average Site Star Ratings History
CE vs all others in ESAs where CE operates



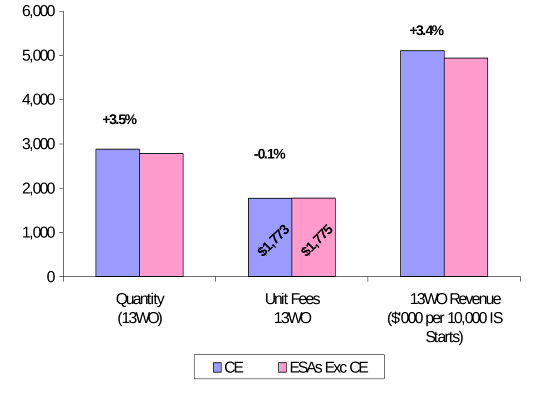
Graph 22: Average Site Star Ratings History
Top 9 Providers vs Other 15 in ESAs where CE operates

Graphs 21 and 22 suggest that the picture presented in this paper in relation to Centacare Employment's comparative performance is probably similar to those of other initially highly performing providers, indicating that systemic irregularities and perverse incentives affect Star Ratings calculations.

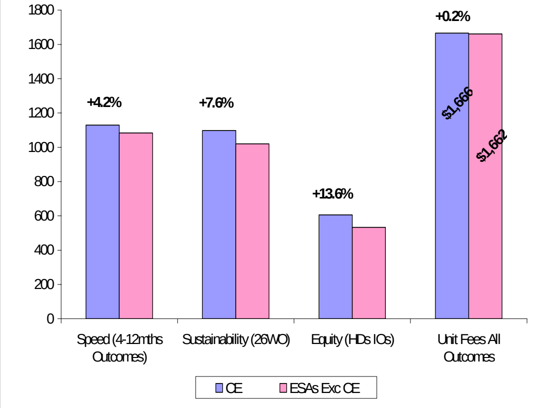
Similar irregularities exist with respect to financial incentives:

- Graph 23 (see <u>Attachment 3</u> for details) shows that for every 10,000 job seekers who commenced Intensive Support, Centacare Employment's revenue from 13 Week Outcome Fees was 3.4% higher than that of an equivalent sized competitor (equivalent Intensive Support Starts with the Outcome performance of Centacare Employment's average competitor). This was accrued because of higher outcome performance of the same order (3.5%) – an appropriate result since the additional outcomes generated additional savings on Government allowance outlays:
  - It is also noted that Centacare Employment's unit 13 Week Outcome fee is virtually identical with that of its average competitor. Once again, this is appropriate, the incentive for outcome *quantity* leading to additional revenue at the same unit rate.

Graph 23: Quantity of Outcomes & Revenue



Graph 24: Quality of Outcomes & Unit Fees



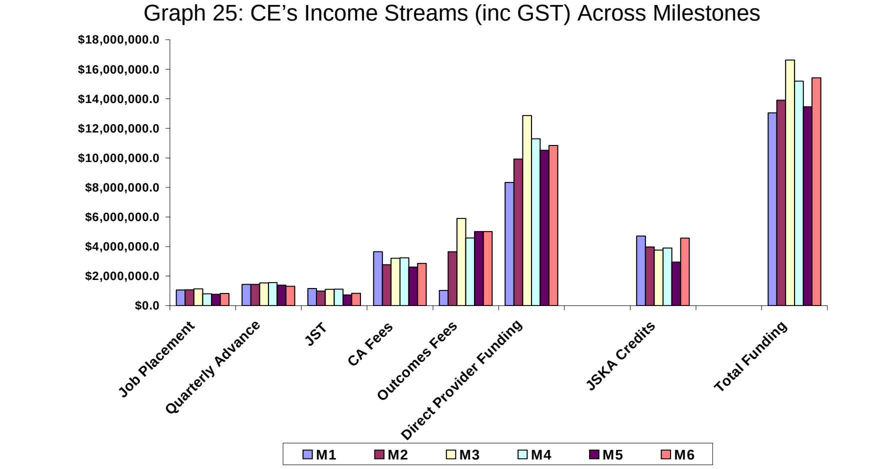
- However, Graph 24 (see Attachment 3 for details) reveals that Centacare Employment's performances on the other three expectations (*speed*, *sustainability* and *equity*) also exceeded those of its average competitor and these would have generated another layer of allowance savings beyond those relating to higher outcome levels (*quantity*):

  - If financial incentives were appropriate, this additional performance layer should have had the effect of increasing Centacare Employment's overall unit outcome fee for all outcomes to a level above that of its average competitor. However, Graph 24 reveals that it did not.

The incentives that are presumed to exist to encourage these additional Government expectations cancel each other out

This situation has contributed to worsening "real" revenue for Centacare Employment's services (Graph 25):

Graph 25: CE's Income Streams (inc GST) Across Milestones



- Total funding increased initially, peaked in M3, fell progressively in M4 and M5 and recovered somewhat in M6; however, this was mostly felt in the Job Seeker Account, the least flexible funding element that impacts much less strongly on provider financial viability unless a high proportion is used to support additional internal services.

- Importantly, "direct provider revenue" remained relatively low from M4 to M6 in comparison with the M3 peak. Direct provider revenue totalled $21.4m in 2005-06:

  - a reduction of 11.7% on the 2004-05 revenue of $24.2m; and

  - a slight improvement of 0.6% on the average of 2003-04 and 2004-05 combined of $21.2m.

  The most favourable conclusion is that revenue has remained about static throughout ESC3.

- The most dramatic fall in direct provider funding related to outcome funds from M4 onwards as a direct result of Centacare Employment's toughened caseload that came about for the reasons outlined above.

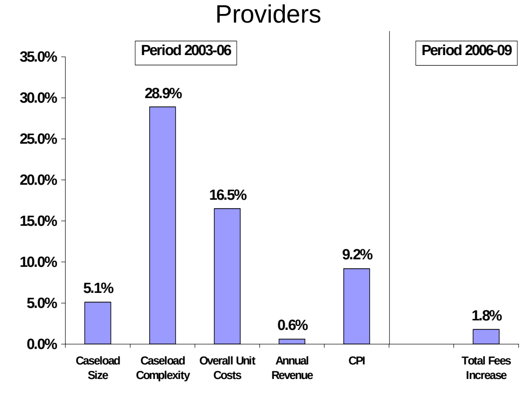
- Overall stability in direct provider funding occurred despite the fact that Centacare Employment's Contracted Business Share increased by about 10% through rewards for high performance. Indeed, Total Active Caseload increased from about 16,000 to 16,900 (+5.1%) between June 2004 and June 2006.

- As acknowledged above, earlier ESC3 revenue could be considered artificially high because of the initial high numbers of Intensive Support Customised Assistance clients associated with the transition from ESC2 to ESC3 services. Even allowing for this, at a time when additional funds are needed to assist a larger and more complex caseload, overall direct provider funding has been at best stable and *"real" provider funding has declined considerably.*

- The administrative costs associated with the program have increased markedly especially because of the rules governing Job Seeker Account expenditure and compliance costs associated with DEWR's intrusive micro-management of processes.

- In addition, during the three years of ESC3, operational costs of all kinds (wages, property, vehicles, office requisites etc) have inflated leading to a deteriorating financial situation (see Part 2.3).

Graph 26: Impact on Expectation-driven Providers



Catholic Social Services Australia believes that the majority of providers, *expectation-driven* and *incentive-driven*, strive to be ethical. Without wishing to claim perfection, Centacare Employment seeks to maintain the highest ethical standards. However, Graph 26 highlights the dilemma faced by Centacare Employment and other expectation-driven providers. During ESC3:

- Centacare Employment's caseload increased by 5.1% and its complexity also increased considerably (on one important measure, educational attainment, by 28.9%); however

- Centacare Employment's unit costs rose by an estimated 16.5% through ongoing inflationary pressures (higher than the CPI increase of 9.2%) and fees increased by only 1.8%. Centacare Employment's annual revenue remained about stable, at best.

Faced with expanding questionable practices and outcome buying by some providers that are being rewarded by the current Financial and Star Ratings incentives systems, *expectation-driven* providers are faced with “playing the system” or accepting progressively lower Star Ratings, shrinking financial viability and potential exit from the industry:

- It should be of considerable public concern that service models aimed at the best results for job seekers and greatest consistency with Government’s objectives are increasingly becoming financially unviable.

4.2 Implications for Job Network

The above analysis paints a very serious picture for the industry overall.

Ultimately the only real reward is for *quantity* of outcomes – Government expectations with respect to outcome *quality* and *service quality* are platitudes. Some providers would argue that, in reality, the Government and *expectations-driven* providers have different goals: the former is more concerned about short term reduction in allowance outlays; the latter are more interested in achieving the best results for job seekers.

As a result, despite explicit Government expectations in the areas of *speed*, *sustainability* and *equity* of outcomes and *service quality* that together generate higher savings in allowance outlays, providers who pursue these goals eventually receive the same unit Outcome Fees and Star Ratings as those who give little attention to them.

There are a number of serious implications for different stakeholders in Job Network.

<u>Job Seekers</u>

- Increasingly, job seekers are more complex with a wider range of more significant employment barriers, and most especially, increased personal barriers. Their needs require increasingly personalised, professional and long term attention.

- However, job seekers are frequently met by a “one size fits all” service from providers, focusing on “quick fix” and process orientated solutions (such as “outcome buying”) which often result in a mismatch between a job seeker and a job. Job seekers are increasingly obliged to accept second rate positions because of the participation reporting powers of Job Network members. Individual service appropriate to needs is becoming less frequent and second rate placement more frequent.

- Many disadvantaged job seekers are waiting for 12 months to gain access to the services they need to enable them to become fully productive citizens in sustained employment that enhances their lives and the lives of their dependants.

- Very long term unemployed job seekers who have exhausted their two entitlements to Intensive Support Customised Assistance are not being serviced adequately and therefore are increasingly unlikely to find sustained employment. Since providers’ funding to assist such job seekers is limited to outcomes fees (that are not highly likely) and the Job Seeker Account, the needs of these very disadvantaged job seekers are not being addressed adequately.

- If *expectation-driven* providers are forced to leave the industry, job seekers will have access to an increasingly hostile service. This is history repeating itself as it would re-establish the worst aspects of the former Commonwealth Employment Service.

<u>Employers</u>

- The attitudes of some employers are changing towards expectation of high employer subsidies from Job Network members before considering their referrals to positions. Of course, this lifts the cost of the program even further.

- Some employers are looking to wage subsidies to escape their responsibilities to employees – without a significant financial commitment to employing a job seeker, employers can afford to overlook development of the new employee because the subsidy ensures individual productivity is less of an issue.

- Genuine employers will lose faith in Job Network if the standard of service inevitably deteriorates.

<u>Job Network Providers</u>

- Job Network providers are under increasing pressure to push at the margins of what is ethical and responsible (towards job seekers and the taxpayer). Like it or not, the behaviour of many providers will follow the financial and business realities of the incentives system, not its sentiments. Today, this means some are following perverse Financial and Star Ratings incentives rather than focusing on achieving the Government's stated expectations and the best outcomes for job seekers.

- Job Network staff are working in an increasingly hostile environment. The pressure to perform along with increasing administration and micro-management of processes by DEWR are dehumanising the service and workplace such that morale is low and staff turnover high. This adds another layer to the risks related to unethical practice, imposes additional costs on providers and leads to lower service quality.

- *Expectation-driven* providers who refuse to be drawn into questionable practices despite the impact on their financial viability and competitive standing in the industry, are questioning whether they will be able to survive in Job Network beyond the next few years, and certainly beyond the end of the three-year extension to ESC3.

- *Expectation-driven* providers are losing faith in the Star Ratings system as an objective and satisfactory measure of comparative provider effectiveness as well as in the competitive neutrality, fairness and adequacy of program funding arrangements. Indeed, the *Job Network Frontline Staff Survey* by Jobs Australia and the Brotherhood of St Laurence: Preliminary Findings found that:

    - "Staff also expressed great scepticism about measures of performance such as the Star Ratings system, with 43 per cent stating that they did not believe these were a valid measure of performance. Almost nine in ten believed that other aspects of client service experience should be incorporated into the Star Ratings in addition to job outcomes. Only about a third agreed that job outcomes are the best single measure of the achievements of Job Network members" (page 6 of the above report).

<u>The Government (and Taxpayers)</u>

- The Government's stated expectations of Job Network with respect to *quantity*, *speed*, *sustainability* and *equity* of outcomes are not being met as effectively and efficiently as possible because Financial and Star Ratings incentives are not sufficiently supportive of these goals – indeed, some incentives actually work against stated Government expectations.

- Achievement of the objectives of *Welfare to Work* reforms are at risk as the needs of priority job seeker groups are being inadequately met under the current perverse incentives regime.

- Current Financial and Star Ratings incentives result in provider behaviour that keeps many job seekers on allowance longer than is necessary or causes them to return to allowances unnecessarily, thereby increasing allowance dependency and the cost of allowance payments and Job Network services to Government.

- Ultimately, the Government faces the prospect of an ineffective industry focused on provider self-interest rather than the interests of job seekers and the community at large.

4.3 The Need for Change

The effectiveness of Job Network is being restricted by the complex interaction of three primary influences:

- The needs of job seekers have become more complex and a greater proportion of job seekers need access to intensive and more personalised assistance earlier in their period of unemployment and, in many cases, for longer periods than are currently available in the program.

- In dealing with more complex job seeker needs, providers are being forced to work within an outdated and perverse Financial and Star Ratings incentive system that rewards service approaches that are in many ways inconsistent with the Government's stated expectations of providers and which lead to second rate assistance to and outcomes for the job seekers the Job Network was established to assist.

- Government administration has become so intrusive and top heavy that an ever shrinking proportion of program resources are committed to directly assisting the increasingly needy job seekers being referred to providers.

Simple tinkering around the edges with a view to minor savings will not do. More radical change must be implemented.

Catholic Social Services Australia believes there is substantial scope within the existing appropriation to better direct services to disadvantaged job seekers. Substantial refocus of DEWR's monitoring towards quality outcomes and away from administrative processes will yield substantial savings in expenditure on DEWR and substantial reduction in the administrative burdens currently placed on Job Network providers. Such reform will see a shift of resources from administration to services.

PART 5: RECOMMENDATIONS

In order to ensure continued improvement in Job Network's achievements with respect to the Government's objectives of *quantity*, *speed*, *sustainability* and *equity* of outcomes as well as *service quality* and *ethical practice*, in the context of *Welfare to Work* reforms, the following changes are necessary.

5.1 Primary Recommendations

<u>Improved Services for Disadvantaged Job Seekers</u>

The most disadvantaged job seekers should have first call on, and ongoing access to, the services required to address their needs fully. Access to services for disadvantaged job seekers should not be dependent upon political or bureaucratic whim but based upon defensible criteria. Given the considerable resources of Job Network, there can be no defence for denying access to personalised services to any job seekers with significant barriers to employment and personal issues.

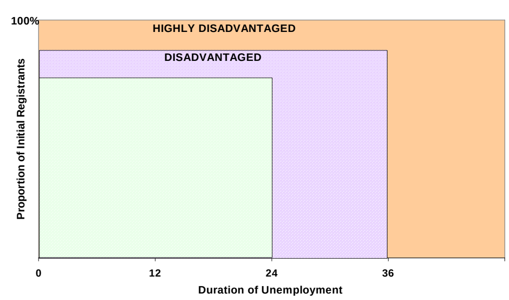
The more complex needs of the increased number of disadvantaged job seekers demand better access to more personalised services for longer periods. Objective-based access to Job Network for disadvantaged job seekers can be achieved by implementing the following:

- Very long term unemployed job seekers who have exhausted their first and second entitlements to Intensive Support Customised Assistance should be offered annual access to this service for as long as they remain eligible for Job Network services;

- Highly Disadvantaged job seekers should be selected on a more objective and meaningful basis than the present resource-driven approach. Catholic Social Services Australia would need access to more data to make a final proposal; however, it is considered that Highly Disadvantaged job seekers should be selected on the basis of the Job Seeker Classification Instrument score band that equates to an outcome probability that is the same as that for job seekers unemployed for no more than 36 months (Graph 27 is indicative). Fees and Star Ratings Weightings should be compatible with this;

- A second group of early disadvantaged registrants (referred to as "Disadvantaged") should be offered early access to Intensive Support Customised Assistance. This group should be selected on the basis of the Job Seeker Classification Instrument score band immediately below that for Highly Disadvantaged job seekers that equates to an outcome probability that is the same as that for job seekers unemployed for no more than 24 months (Graph 27 is indicative). Fees and Star Ratings Weightings should be compatible with this.

Graph 27: Matching Early Disadvantage with UE Duration Outcome Probabilities – Indicative Model



Revised Outcome Fee Structure

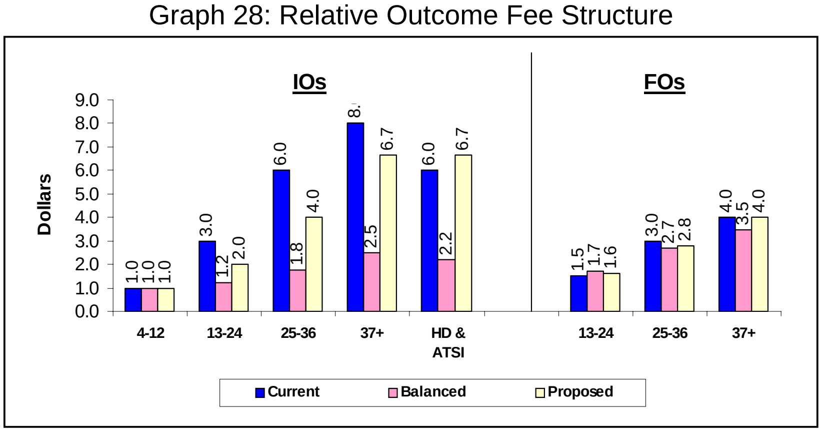
- The Outcome Fee structure should be changed to remove perverse incentives that work against full achievement of the Government's objectives with respect to *quantity*, *speed*, *sustainability* and *equity* of outcome achievement (especially the last three) and to establish appropriate incentives. The new structure would provide Outcome Fees for Highly Disadvantaged and Disadvantaged job seekers that equate to those for 37 months and 25-36 months unemployed job seekers respectively (based on indicative proposals for these groups). The following proposed "indicative" fee structure (Table 2) is based on a "zero sum" model except for the additional 4-12 months Final Outcome and introduction of an added Disadvantaged (D) cohort for early access to ISca services:

Table 2: Current and Proposed "Indicative" Outcome Fee Structure

	UE Duration	Current ($)	Proposed ($)
Interim Outcomes Payment (IOP)	4-12	550	600
	13-24	1,650	1,200
	25-36	3,300 (inc. HD 0-24)	2,400
	D	N/A	2,400
	37+	4,400	4,000
	HD & ATSI	N/A	4,000
Interim Intermediate Payment (IIP)	13-24	550	480
	25-36	550 (inc. HD 0-24)	960
	D	N/A	960
	37+	1,100	1,600
	HD & ATSI	N/A	1,600
Final Outcomes Payment (FOP)	4-12	Nil	480
	13-24	825	960
	25-36	1,650 (inc. HD 0-24)	1,680
	D	N/A	1,680
	37+	2,200	2,400
	HD & ATSI	N/A	2,400
Final Intermediate Payment (FIP)	13-24	550	480
	25-36	550 (inc. HD 0-24)	840
	D	N/A	840
	37+	1,100	1,300
	HD & ATSI	N/A	1,300

- Note that Graph 28 shows the impact of the proposed Outcome Fee structure on the distribution of relative incentives ("yellow" or third columns). A shift in emphasis towards *speed*, *sustainability* and *equity* of outcomes in comparison with the current system ("blue" or first columns) is evident:

Graph 28: Relative Outcome Fee Structure



Revised Star Ratings Weightings

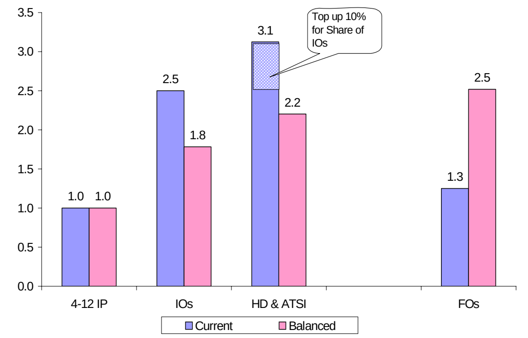
- Star Ratings Weightings should be changed to remove perverse incentives that work against full achievement of the Government's objectives with respect to *quantity*, *speed*, *sustainability* and *equity* of outcomes (especially the last three) and to establish appropriate incentives. The new structure would provide Star Ratings Weightings for Highly Disadvantaged and Disadvantaged job seekers that equate to those for 37 months and 25-36 months job seekers respectively (based on indicative proposals for these groups). This revision should ensure there is no perverse interaction between weightings and the regression formula. The following "indicative" weighting structure (Table 3) is proposed (note addition of a 4-12 months Final Outcome and inclusion of the D cohort):

Table 3: Current and Proposed "Indicative" Star Rating Weightings

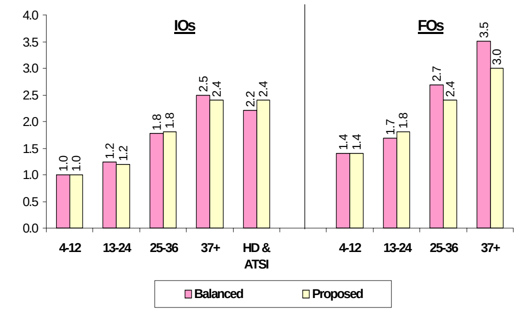
	UE Duration	Current	Proposed
Interim Outcomes (IOs)	4-12	16%	5%
	13-24	40% (Exc. D)	6%
	25-36 (inc. HD 0-24)		9%
	D		
	37+		12%
	HD & ATSI		
Share of IOs	HD & ATSI	10%	HD inc. in the 37+ group
Interim Intermediates (IIs)	13-24	(Inc. with 4-12 IPs; Exc. D)	2%
	25-36 (inc. HD 0-24)		3%
	D		
	37+		4%
	HD & ATSI		
Final Outcomes	4-12	Nil	7%
	13-24	20% (Exc. D)	9%
	25-36 (inc. HD 0-24)		12%
	D		
	37+		15%
	HD & ATSI		
Final Intermediates (FIs)	13-24	(Inc. with 4-12 IPs; Exc. D)	3%
	25-36 (inc. HD 0-24)		4%
	D		
	37+		5%
	HD & ATSI		
Education Outcomes		4%	Inc with IIs & FIs
JP FJNEs		6%	2%
JP JSSOs		4%	
JP Bonus			2%
	Total	**100%**	**100%**

- Graphs 29 & 30 show the impact of proposed Star Ratings Weightings on the distribution of relative incentives ("yellow" columns Graph 30) and a shift in emphasis towards outcome *speed*, *sustainability* and *equity* compared with the current system ("blue" columns Graph 29):

Graph 29: Current & Balanced Relative Incentives



Graph 30: Balanced & Proposed Relative Incentives



Transfer of Resources from Administration to Services

- Limit DEWR's administrative budget for Job Network to a set proportion of available program funds that should be no higher than 10% (an estimated reduction of 34%) of total program funds. Utilise the $86m or more of savings to invest in the Service, Outcome and Job Seeker Account payments necessary to fund the additional service elements proposed for Disadvantaged job seekers as well as improved financial incentives for providers aimed at better realisation of the Government's stated expectations for providers in assisting job seekers (especially outcome *speed*, *sustainability* and *equity,* and *service quality*).

- Re-focus DEWR's monitoring of providers, using a risk management approach, on achievement of quality outcomes for job seekers across the full range of job seeker groups. At the same time withdraw DEWR from micro-management of processes and simplify administration of the program generally, including that for the Job Seeker Account. The aim would be to ensure that provider savings in program administration and compliance management would be sufficient to offset the cost increases of the last three years so that these resources can be injected into improved *service* and *outcome quality* for job seekers. This change will significantly reduce the cost of administration to Job Network Providers.

5.2 Supporting Recommendations

Improving the Quality of Services to Job Seekers

- Introduction of a 4-12 months Final Outcome to ensure 4-12 months unemployed job seekers are placed in sustained employment that is less likely to lead to long term unemployment.

- The need for *service quality* built around the legitimate needs and aspirations of job seekers should be re-emphasised in a way that leads to better quality outcomes and higher taxpayer benefits in the longer term. This should include services funded through the Job Seeker Account.

Outcome Expectations and Definitions

- DEWR should improve its effectiveness in detecting various outcome manipulation practices. In particular, to reduce the incidence of wasteful wage subsidies and outcome buying practices, employer subsidies of more than 50% of the wage over the full outcome period that result in return to allowance within 13 weeks of the cessation of subsidy or completion of the outcome should be subject to automatic “show cause” processes.

- Calculation of “expected outcomes” in the Star Ratings regression formula should exclude periods of exemption for all job seekers as sites with higher than average exemptions especially those with above average proportions of very disadvantaged job seekers and in low socio-economic regions are unfairly disadvantaged in assigned Star Ratings.

- DEWR should examine the need for inclusion of new caseload characteristics in the Star Ratings regression formula to account appropriately for changes in the complexity of job seekers and their impact on calculated outcome expectations. This should include taking proper account of long periods away from the labour force for long term allowance recipients and repeated failure of some job seekers to achieve sustained employment despite periods of employment. Given the prevalence of non-disclosure of relevant factors among very disadvantaged job seekers, a new environmental factor of “low socio-economic region” could be tested - the Australian Bureau of Statistics SEIFA (Socio-Economic Indexes of Areas) may be a suitable measure but would need to be localised at sub-ESA level given the “pockets” of low socio-economic status within ESAs that impact on particular Job Network sites.

Two-Year Rolling Star Ratings

- It is inappropriate to use accumulated performance under the current system that incorporates perverse incentives and that have inadequately rewarded appropriate provider behaviour, especially with respect to *Welfare to Work* goals, for Star Ratings beyond 1 July 2006. If this occurs (as is intended under the two-year rolling Star Ratings model), the already negative impact for many *expectation-driven* providers will be exacerbated as a large proportion of outcome achievements from “early placement” strategies in ESC3 are removed from the calculations while many arising from “delayed placement” and outcome manipulation (such as outcome buying) strategies will remain.

- Either the proposed two-year rolling Star Ratings system should be introduced only under revised outcome definitions and a revised weighting system or it should be introduced along with a moratorium on performance-based sanctions and business reallocations until these adjustments can be made.

Performance Benchmarking

- In acknowledgement of negative personal, organisational and service pressures now dominating the Job Network as a result of excessive competition and micro-management by DEWR, the Government should consider replacing the current Star Ratings approach with one built around achievement of performance benchmarks. Given the maturity of the industry, DEWR’s extensive data base should now be capable of proposing such benchmarks with respect to particular ESAs.

Performance Reporting

- To ensure providers can manage performance effectively, all providers should have access to ongoing comparative data that measure, appropriately, performance on all four aspects of the Government's stated expectations with respect to *quantity*, *speed*, *sustainability* and *equity* of outcome achievement. In particular, information for each provider along with ESA, LMR and National averages should be available for:

  - *speed* of placement/outcome achievement overall as well as for various outcome types and job seeker target groups;

  - *equity* of outcome achievement for the full range of job seeker target groups in a way that takes account of the relative number of clients in each group being serviced. "Average Intensive Support Active Commenced Caseload" is recommended as the most appropriate denominator of performance ratios for all job seeker groups; and

  - *service quality* measures (KPI3) wherever possible. In particular, the results of DEWR's post program monitoring for each provider and the ESA, LMR and National averages should be provided on an ongoing basis. This should include information on the proportion of wages subsidised through the Job Seeker Account and the proportion of job seekers who return to benefit within three months of completion of subsidised outcomes for various proportional subsidy bands.

- To assist providers monitor the availability of the job seekers on their caseloads, DEWR should provide a standard report on the proportion of exemptions in pending and commenced caseloads for particular job seeker groups for each provider along with ESA, LMR and National averages.

Further Analysis

- DEWR should investigate the interaction between Star Ratings Weightings and the regression formula: to test whether the arbitrary weightings are having a perverse effect on the assessment of provider effectiveness; and to develop a system without such perverse effects.

- As mentioned above, analysis is needed with respect to new caseload characteristics in the Star Ratings regression formula to account appropriately for changes in the complexity of job seeker disadvantage and its impact on calculated outcome expectations. A new environmental factor of "low socio-economic region" has been suggested. This factor would need to be localised at sub-ESA level given the "pockets" of low socio-economic status within ESAs that impact on particular Job Network sites.

- Further review is needed of the impact of various wage subsidy arrangements on achievement of the Government's expectations especially with regard to outcome *sustainability*:

  - Comparative outcomes achieved by different wage subsidy levels for particular job seeker target groups should be tested in terms of *sustainability* of these outcomes for 26 weeks initially; and

  - The extent to which these outcomes extend beyond 26 weeks, and especially the extent to which these job seekers return to allowance payments subsequently.

- In order to test the *combined* impact of the various dimensions of the perverse incentives identified above with respect to the Government's overall expectations of providers (*quantity*, *speed*, *sustainability* and *equity* of outcomes), Catholic Social Services Australia suggests a comparative analysis, with results released for all providers, of the combined impact of these various matters on relative Government outlays (accounting for program costs and allowance costs/savings) unit outcome revenue and allocated Star Ratings. DEWR should test the respective impact on four groups of providers:

  - <u>Group 1</u>: Those with above average to high Star Ratings in the first 18 months of ESC3 where performance was and continues to be characterised by *strengths* with respect to outcome *speed*, *sustainability* and *equity* with *low* use of employer incentives;

  - <u>Group 2</u>: Those with above average to high Star Ratings in the first 18 months of ESC3 where performance was and continues to be characterised by *strengths* with respect to outcome *speed*, *sustainability* and *equity* with *high* use of employer incentives;

  - <u>Group 3</u>: Those with below average to low Star Ratings in the first 18 months of ESC3 where performance was characterised by *weaknesses* with respect to outcome *speed*, *sustainability* and *equity*, but whose performance has subsequently improved with *high* use of wage subsidies; and

  - <u>Group 4</u>: Those with below average to low Star Ratings in the first 18 months of ESC3 where performance was characterised by *weaknesses* with respect to outcome *speed*, *sustainability* and *equity*, but whose performance has subsequently improved with *low* use of wage subsidies.

<u>Timing</u>

- Irrespective of the need for longer term analysis, it is imperative that revised incentive structures (outcome definitions, outcome expectation formulas, Outcome Fees and Star Ratings Weightings) are in place as a matter of urgency to ensure better outcomes for all job seekers as quickly as possible, especially with the expansion of *Welfare to Work* initiatives since 1 July 2006. If further research is required on some aspects, it would be important to make changes urgently anyway using the best knowledge available and refine these later where necessary.

5.3 Funding the Proposals

Catholic Social Services Australia acknowledges that a number of the above recommendations would require significant resources and that sophisticated modelling is required to estimate offsets and therefore net costs. However, Catholic Social Services Australia also believes that the services sought are essential and that the job seekers needing them deserve first call on available resources.

Catholic Social Services Australia believes there is scope for considerable offsets that should ensure the proposals are cost neutral, through:

- transfer of $86m or more from DEWR's administrative costs to program delivery costs;

- reduction in 13 months Intensive Support Customised Assistance commencements (and subsequent second entitlements) as a result of some job seekers (the proposed “Disadvantaged” group) accessing these services earlier than otherwise;

- allowance payment savings and increased taxation revenue resulting from improvements to outcome *quantity* and *quality* (*speed*, *sustainability* and *equity*);

- elimination of outcome payments for questionable placements; and

- transferring any accumulating surplus within the program to fund the proposals. Catholic Social Services Australia understands that, in past years, underspending in the program has resulted in substantial surpluses being returned to consolidated revenue.

If more radical options are necessary, the Government could consider:

- A transfer of funds from the Job Seeker Account – as the account was 26% in surplus at the end of ESC3 (June 2006) and therefore carries an overall surplus of over $200m nationally, perhaps some proportion of the surplus (say, 50%) can be tapped and some reduction made to ongoing accumulations.

- A transfer of funds from programs that are aimed at less disadvantaged job seekers or are less effective in achieving real outcomes for job seekers – for instance: Work for the Dole or Job Search Training.

PART 6: GOVERNMENT RESPONSE

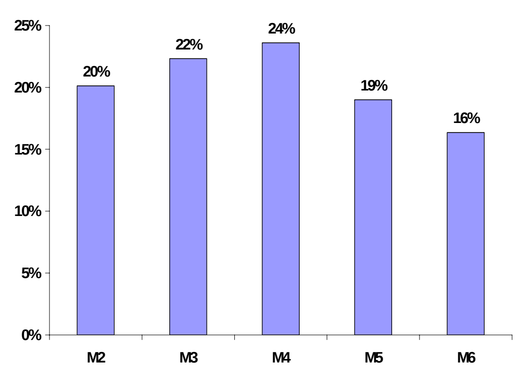
Catholic Social Services Australia has raised most of these issues with the Government and DEWR since early 2006 prior to the extension of ESC3 contracts from 1 July 2006 to 30 June 2009 (some issues from early 2005). The Government's and/or DEWR's responses to date have not been positive as follows:

- *Response 1*: Continually growing Job Network employment outcomes indicate that the Job Network remains effective:
  - <u>*Catholic Social Services Australia's View*</u>*: Outcome levels are overstated as they are artificially inflated by questionable practices related to outcome manipulation and outcome buying.*
- *Response 2*: The Government has contracted with providers under a fee structure that was part of its Request for Tender. To change it now would raise probity concerns, for instance, from organisations who opted not to tender because of the fee structure:
  - <u>*Catholic Social Services Australia's View*</u>*: The Government also has responsibilities to contracted providers who may face closure and substantial financial losses because of the current fee structure. Further, job seeker needs should take precedence over administrative issues – the Job Network is for job seekers, not job seekers for the Job Network.*
- *Response 3*: Changes to the current Star Ratings Weightings would disturb the continuity of the Star Ratings system in measuring provider effectiveness:
  - <u>*Catholic Social Services Australia's View*</u>*: Continuity has already been corrupted. The current Star Ratings system is inaccurately and unfairly measuring comparative provider effectiveness with respect to the Government's expectations of Job Network providers. To argue for continuity is to place the Star Ratings system above the policy objectives it is meant to serve along with the needs of disadvantaged Australians and the majority of providers who are actually committed to assisting them.*

Government decisions have inadvertently exacerbated the situation reported above:

- *In response to increased caseload complexity*, from July 2005 the Government redefined the Highly Disadvantaged (HD) category by increasing the qualifying Job Seeker Classification Instrument score for Highly Disadvantaged status. This decreased the number of identified Highly Disadvantaged clients and increased the number of disadvantaged clients forced to wait 12 months for needed access to Intensive Support Customised Assistance (see Graph 31):

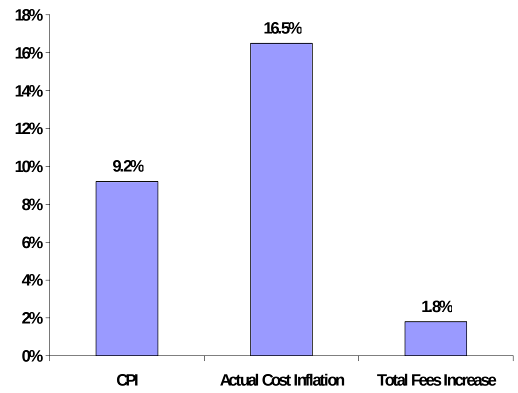
Graph 31: Decrease in Proportion of HDs in Total Referrals M2-M6



- Importantly, Graph 31 shows that the proportion of Centacare Employment's referrals identified as Highly Disadvantaged is still falling and in M6 was at a level well below that at the beginning of ESC3 – a perverse outcome given the evidence in this report that caseload complexity increased progressively and considerably throughout ESC3.

- *In response to increasing provider costs*, Graph 32 shows that the Government reduced fees in real terms by around 14.7% (compared with estimated actual cost movements). Since the new fees are meant to apply for a further three years, they will be the best part of six years out of date by the end of the current contract. When added to the additional costs of servicing more complex caseloads and associated reduced outcomes and revenue, provider financial viability is estimated to have fallen by at least 25%.

Graph 32: Increasing Costs vs Fees



- *In response to the perverse incentives* that operated throughout ESC3 and that have encouraged, and still encourage, ineffective and unethical provider behaviour, the Government, in the lead up to ESC3-Extended, decided that Outcome Fees and Star Ratings Weightings were to remain unchanged. Furthermore, the Government has decided to alter the Star Ratings system in a way that will exacerbate the negative impact of these perverse incentives on *expectation-driven* providers:

  - The new two-year rolling Star Ratings system, to operate for the next Star Ratings release to end December 2006 and beyond, will cause a further fall in the Star Ratings of many effective and ethical providers. This will occur because a large proportion of outcome achievements from genuine "early placement" strategies in ESC3 (consistent with Government expectations) will be removed from the calculations while many arising from ineffective and/or unethical "delayed placement" and "outcome manipulation" strategies (including outcome buying) will remain.

  - Expectation-driven providers have understandably lost faith in the Star Ratings system as an objective and fair measure of comparative provider effectiveness.

The recent changes to wage subsidy arrangements flagged by the Minister for Workforce Participation are welcomed and are considered to be a step in the right direction. These changes require a scaling down of wage subsidies as the outcome period for a job seeker progresses.

Attachment 1

THE GOVERNMENT'S EXPECTATIONS OF JOB NETWORK PROVIDERS

Job Network's Objective

The *Job Network Services Request for Tender 2006 (RFT)* included the following objective for Job Network services (Catholic Social Services Australia's emphases):

- "…to help job seekers into *sustainable employment*, *increase workforce participation* and reduce *dependency on income support* by providing *personalised assistance* to job seekers that involves ongoing job search and employment-focused activities" (RFT p 56).

Performance Expectations

In support of this objective, various expectations are also listed:

- "JN services must be based on strategies to achieve *sustainable employment outcomes* for *all job seekers* in the labour market" (RFT p 56);

- "Use of the Job Seeker Account must reflect a job seeker's *individual needs*" (RFT p 67);

- "An appropriate mix of services, products, and programs must be funded from the Job Seeker Account to reflect the *range of barriers job seekers face*" (RFT p 67);

- The list of allowable Job Seeker Account purchases includes: "wage subsidies, which are commensurate with the job seeker's level of disadvantage, for *employment which is sustainable and ongoing after the wage subsidy has ceased*
  - JNMs should not generally offer wage subsidies of 100 per cent (or more) of wage costs without the agreement of DEWR" (RFT p 69);

- "KPI 1 (Efficiency): To help job seekers find work *as quickly as possible* – particularly the time taken to place *long-term unemployed and those highly disadvantaged*" (RFT p 89);

- "KPI 2 (Effectiveness): To maximise outcomes for eligible job seekers – particularly the *long-term unemployed and those highly disadvantaged*" (RFT p 89);

- Code of Practice 2 includes: "considering clients' *individual* circumstances and backgrounds" (RFT p 200); and

- Code of Practice 3 includes: "tailoring assistance to clients with consideration of their *individual* needs and participation requirements" (RFT p 200).

- Clause 3.3 (c) of the Employment Services Contract 2006-2009, Part A General Conditions states that the Provider must "at all times act ethically and in good faith towards DEWR in the performance of this contract to maintain the reputation of the Services and the Commonwealth, acknowledging that an unethical manner constitutes any practice that manipulates outcomes, the performance model or Service to maximise payments to the Provider."

Table 1: Data for Calculating Star Ratings Incentive Relativities
Outcomes Data are cumulative to 30 June 2006

		Outcomes Achieved by CE	Avg IS COM Active Caseload	Probability of Outcome per Unit Caseload	Relative Probability (4-12 IPs set to "1")	Balanced Relative Incentives (i)	Current Star Rating Weighting	Current Relative Incentives (ii)
Interim Outcomes (IOs)	**4-12**	4,116	1,783	2.31	1.00	1.0	16%	1.0
	13-37+	5,024	3,882	1.29	0.56	1.8	40%	2.5
	HDs	2,210	2,110	1.05	0.45	2.2	10%	3.1
	ATSI	740	929	0.80	0.35			
Interim Intermediates (IIs)	**13-37+**	1,358					16% inc. 4-12 IPs	
	HD & ATSI	N/A						
Final Outcomes (FOs)	**13-37+**	3,558		0.92	0.40	2.5	20%	1.3
	HD	N/A						
Final Intermediates (FIs)	**13-37+**	342					16% inc. 4-12 IPs	
	HD	N/A						
Education Outcomes	**4 to 37+**	233					4%	
JP FJNEs							6%	
JP JSSOs							4%	
JP Bonus								
Total Star Rating Weighting							**100%**	

(i) The balanced relative incentives are the inverses of the relative probabilities.
(ii) 4-12 months IPs star rating weighting set equal to "1".

Graph 1: Current & Balanced Star Rating Weightings

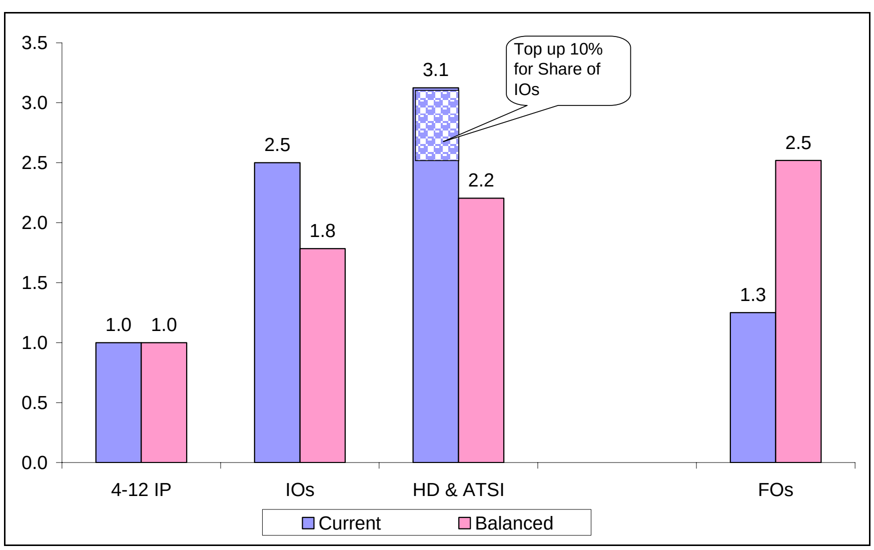


Table 2: Data for Calculating Star Ratings Incentive Relativities
Outcomes Data are cumulative to 30 June 2006

		Outcomes Achieved by CE	Avg IS COM Active Caseload	Probability of Outcome per Unit Caseload	Relative Probability (4-12 IPs set to "1")	Balanced Relative Incentives	Proposed "Indicative" Weightings	Proposed Relative Incentives
Interim Outcomes (IOs)	**4-12**	4,116	1,783	2.31	1.00	1.0	5%	1.0
	13-24	1,543	831	1.86	0.80	1.2	6%	1.2
	25-36 (i)	2,275 (Inc. HD 0-24)	1,748	1.30	0.56	1.8	9%	1.8
	D	N/A	N/A					
	37+	1,206	1,303	0.93	0.40	2.5	12%	2.4
	HDs	2,210	2,110	1.05	0.45	2.2		2.4
	ATSI	740	929	0.80	0.35		Mostly HD	
Interim Intermediates (IIs)	**13-24**	404					2%	
	25-36	515 (Inc. HD 0-24)					3%	
	D	N/A						
	37+	439					4%	
	HD & ATSI	N/A						
Final Outcomes (FOs)	**4-12(ii)**	2,840		1.59	0.69	1.4	7%	1.4
	13-24	1,114		1.34	0.58	1.7	9%	1.8
	25-36	1,546 (Inc. HD 0-24)		0.88	0.38	2.7	12%	2.4
	D	N/A						
	37+	898		0.69	0.30	3.5	15%	3.0
	HD	N/A						
Final Intermediates (FIs)	**13-24**	122					3%	
	25-36	182 (Inc. HD 0-24)					4%	
	D	N/A						
	37+	138					5%	
	HD	N/A						
Education Outcomes	**4 to 37+**	233					Inc with IIs&FIs	
JP FJNEs							2%	
JP JSSOs								
JP Bonus							2%	
Total Star Rating Weighting							**100%**	

(i) 25-36 month outcomes include most HD outcomes. If these were disaggregated, actual 25-36 month non-HD relative outcome probability would rise (probably to between 0.6 and 0.7)

(ii) Number of Final Outcomes for 4-12 is estimated based on the actual number of 4-12 month Outcomes and conversion rate between 13WOs to 26WOs.

Graph 2: Balanced & Proposed Star Rating Weightings

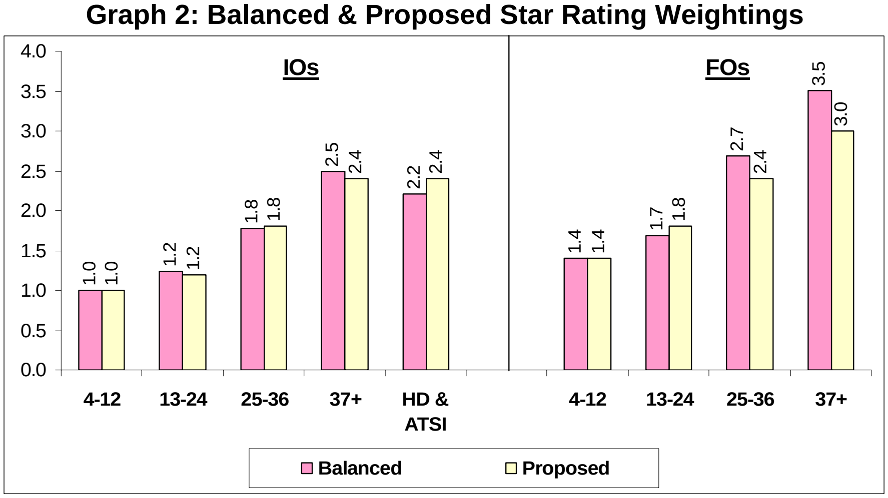
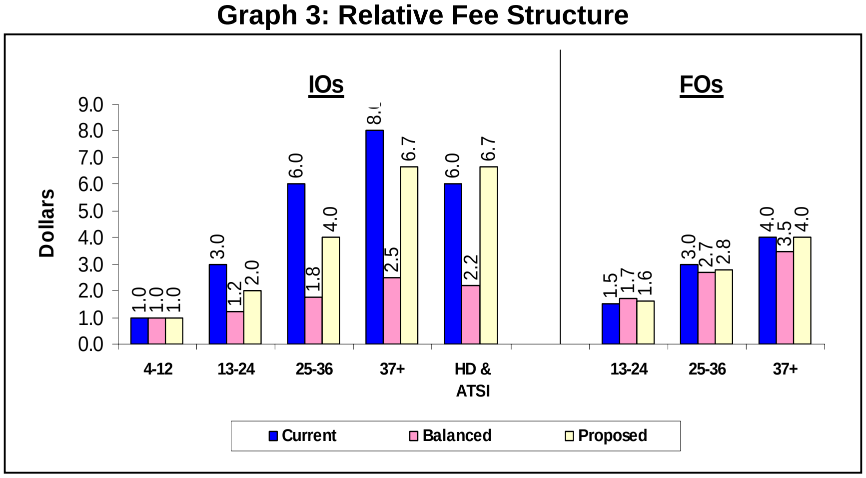


Table 3: Data for Calculating Financial Incentive Relativities
Outcomes Data are cumulative to 30 June 2006

		Outcomes Achieved by CE	Avg IS COM Active Caseload	Probability of Outcome per Unit Caseload	Relative Probability (4-12 IPs set to "1")	Current Fees $	Proposed "Indicative" Fees $
Interim Outcomes	**4-12**	4,116	1,783	2.31	1.00	550	600
	13-24	1,543	831	1.86	0.80	1,650	1,200
	25-36 (*)	2,275 (Inc.HD 0-24)	1,748	1.30	0.56	3,300	2,400
	D	N/A	N/A			N/A	2,400
	37+	1,206	1,303	0.93	0.40	4,400	4,000
	HDs	2210	2110	1.05	0.45	N/A	4,000
	ATSI	740	929	0.80	0.35	N/A	4,000
Interim Intermediates (IIs)	**13-24**	404				550	480
	25-36	515 (Inc.HD 0-24)				550	960
	D	N/A				N/A	960
	37+	439				1,100	1,600
	HD & ATSI	N/A				N/A	1,600
Final Outcomes	**4-12(**)**	2840		1.59	0.69	Nil	480
	13-24	1114		1.34	0.58	825	960
	25-36	1546 (Inc.HD 0-24)		0.88	0.38	1,650	1,680
	D	N/A				N/A	1,680
	37+	898		0.69	0.30	2,200	2,400
	HD & ATSI	N/A				N/A	2,400
Final Intermediates (FIs)	**13-24**	122				550	480
	25-36	182 (Inc.HD 0-24)				550	840
	D	N/A				N/A	840
	37+	138				1,100	1,300
	HD & ATSI	N/A				N/A	1,300
Education Outcomes	**4 - 36**	175				550	Inc. in IIs & FIs
	37+	58				1,100	

(*) 25-36 month outcomes include most HD outcomes. If these were disaggregated, actual 25-36 month non-HD relative outcome probability would rise (probably to between 0.6 and 0.7)
(**) Number of Final Outcomes for 4-12 is estimated based on the actual number of 4-12 month Outcomes and conversion rate between 13WOs to 26WOs.

Graph 3: Relative Fee Structure



Attachment 3

Centacare Employment's Outcome Revenue: Centacare Employment's Actual vs Centacare Employment's Nominal Average Competitor

Outcome Data is cumulative to 30 June 2006

			Actual		Prorated to 10,000 IS Starts Base		Income per 10,000 IS Starts	
		Outcome Fees	CE Actual	ESA Exc CE	CE	ESAs Exc CE	CE	ESAs Exc CE
IS Starts			**36,439**	**219126**	**10,000**	**10,000**	**10,000**	**10,000**
Total 13 Weeks Outcomes			**10,498**	**60,979**	**2,881**	**2,783**	**$5,107,714**	**$4,938,871**
4-12 Ms Outcomes		$550	4116	23750	1130	1084	$621,257	$596,118
Interim Outcomes	13-24	$1,650	1543	9868	423	450	$698,688	$743,052
	25-36	$3,300	2275	11960	624	546	$2,060,293	$1,801,155
	37+	$4,400	1206	7698	331	351	$1,456,242	$1,545,741
	HD (*)		2210	11694	606	534		
	ATSI (*)		740	3674	203	168		
Interim Intermediate	13-24	$550	404	2539	111	116	$60,979	$63,728
	25-36	$550	515	2795	141	128	$77,733	$70,154
	37+	$1,100	439	2369	120	108	$132,523	$118,922
Total 26 Weeks Outcomes			**4,000**	**22,360**	**1098**	**1020**	**$1,581,973**	**$1,446,434**
Final Outcomes	13-24	$825	1114	6915	306	316	$252,216	$260,347
	25-36	$1,650	1546	7737	424	353	$700,047	$582,589
	37+	$2,200	898	5180	246	236	$542,166	$520,066
Final Intermediate	13-24	$550	122	803	33	37	$18,414	$20,155
	25-36	$550	182	929	50	42	$27,471	$23,318
	37+	$1,100	138	796	38	36	$41,659	$39,959
Total Educational Outcomes			**233**	**1331**	**64**	**68**	**$43,923**	**$46,397**
	0-36	$550	175	1,179	48	51	$26,414	$27,902
	37+	$1,100	58	410	16	17	$17,509	$18,495
Total Outcomes			**14,731**	**84,670**	**4,043**	**3,871**		
						Total Income	**$6,733,610**	**$6,431,702**
						Unit Fee for 13WOs	$1,773	$1,775
						Unit Fee for 26WOs	$1,441	$1,417
						Unit Fees for Education Outcomes	$687	$687
						Combined Unit Fee	$1,666	$1,662

(*) Data is not additional to total 13 Week Outcomes