



# Productivity Commission Submission to the Interim Report of the Reference Group on Welfare Reform

*May 2000*

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## 1 Introduction

This paper is a response to the interim report of the Reference Group on Welfare Reform, *Participation Support for a More Equitable Society*. The Group was appointed by the Minister for Family and Community Services in September 1999 to assist the Government with the development of a Green Paper on welfare reform. The interim report was released in March 2000 and the Reference Group is due to deliver its final report in June 2000.

The Productivity Commission's interest in welfare reform is reflected in the attention given to the social dimensions of public policy in the Commission's research and inquiry program. For example, in its recent report *Structural Adjustment — Exploring the Policy Issues*, the Commission highlighted the importance of the adjustment and distributional aspects of economic reform (PC 1999a). It also emphasised that 'policy choices need to be based on the best available information and analysis of the costs as well as the benefits of specific reform proposals — not just for particular groups, but across the wider community and economy' (p. 2).

In the present paper, the relevance of the work of the Commission and its predecessor organisations to selected issues discussed in the interim report is highlighted. The Commission's comments focus on two areas where it has undertaken relevant work. This is not to deny the importance of other areas covered in the interim report. In the next section, the proposed reforms are summarised (section 2). A policy framework within which the reforms can be assessed is developed in section 3. Research undertaken by the Commission, particularly in the area of government service delivery, is drawn upon to assess potential delivery approaches for welfare services under the proposed system (section 4). Section 5 contains some concluding comments.

## 2 The reform proposals

The interim report identifies the need for change to the current welfare system to address the simultaneous problems of an increasingly unequal distribution of employment (creating a divide between 'work rich' and 'work poor' households) and a rising incidence of income support reliance.

These problems have emerged despite a decline in the aggregate unemployment rate over recent years, and are a reflection of economic, social, demographic and political change. Technical change has led to falls in demand for some types of less-

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skilled labour and more employment opportunities for skilled workers. Changes in social attitudes reflected in accommodating government policies have contributed to a rising number of lone parent families. Baby boomer cohorts are moving through their forties and fifties, with some associated growth in Disability Support Pension recipiency. Economic growth and policy changes have contributed to changes in the composition of Australian industry, and hence labour demand, requiring a mobile workforce and some transitional support as workers have adapted to the new structure.

Against the backdrop of these changes, the terms of reference for the Reference Group specify six principles to guide proposed reforms:

- ‘Maintaining equity, simplicity, transparency and sustainability;
- Establishing better incentives for people receiving social security payments, so that work, education and training are rewarded;
- Creating greater opportunities for people to increase self-reliance and capacity-building, rather than merely providing a passive safety net;
- Expecting people on income support to help themselves and contribute to society through increased social and economic participation in a framework of Mutual Obligation;
- Providing choices and support for individuals and families with more tailored assistance that focuses on prevention and early intervention; and
- Maintaining the Government’s disciplined approach to fiscal policy’ (Reference Group on Welfare Reform 2000, p. 63).

The terms of reference direct the Reference Group to consider policies to tackle welfare dependency among jobless people of workforce age where the term ‘jobless’ refers to all people without work, not just the unemployed. Accordingly, the proposed reforms target those who rely on income support for over 90 per cent of their income — an estimated 14 per cent of the working age population. Groups of particular concern to the Government include the long-term and older unemployed, lone parents and Disability Support Pension recipients.

### *Outline of proposed reforms*

The reforms proposed to address the terms of reference fall into a number of categories. These include:

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- individualised service delivery, which would require most income support recipients to accept a greater degree of one-on-one case management;
  - a simplified and more responsive income support structure, which would involve a move away from payments based on categorising recipients;
  - incentive and assistance changes, which would improve the return from paid work for recipients, and provide financial and practical support for participation;
  - social partnerships, which would engage government, businesses and communities in initiatives to tackle the consequences of joblessness and welfare reliance; and
  - mutual obligation requirements, which would commit government to providing an adequate safety net and participation assistance for income support recipients; business to fostering employment opportunities; and income support recipients to engaging in activities that would enhance their capacity for economic and social participation, as a condition for receiving continuing payments.<sup>1</sup>

As a background to discussion in section 3, the Commission has developed a stylised version of the Reference Group’s proposed system (Figure 1).

On first approach to the welfare system, a jobless person’s entitlement to income support would be determined and general assistance needs identified (component 1). At this stage, an individual might be assessed as unable to participate in the labour market because of a disability.

He/she would then receive personalised assistance (including advice) from a One to One Service Officer on how greater economic and social participation could be achieved. Activity consistent with ongoing income support payment would be agreed upon and with referral to appropriate activities (component 2).<sup>2</sup>

Participation activities (component 3) consistent with the receipt of continuing income support could take a number of forms. Those who are work-ready could be referred to job matching services or job search training. Other forms of education or training might be recommended for those who need to increase their capacity for economic and social participation. Assistance could be given for entry to the New Enterprise Initiative Scheme (NEIS). Referral to a work experience or volunteering placement could be made. Or it might be agreed that the income support recipient

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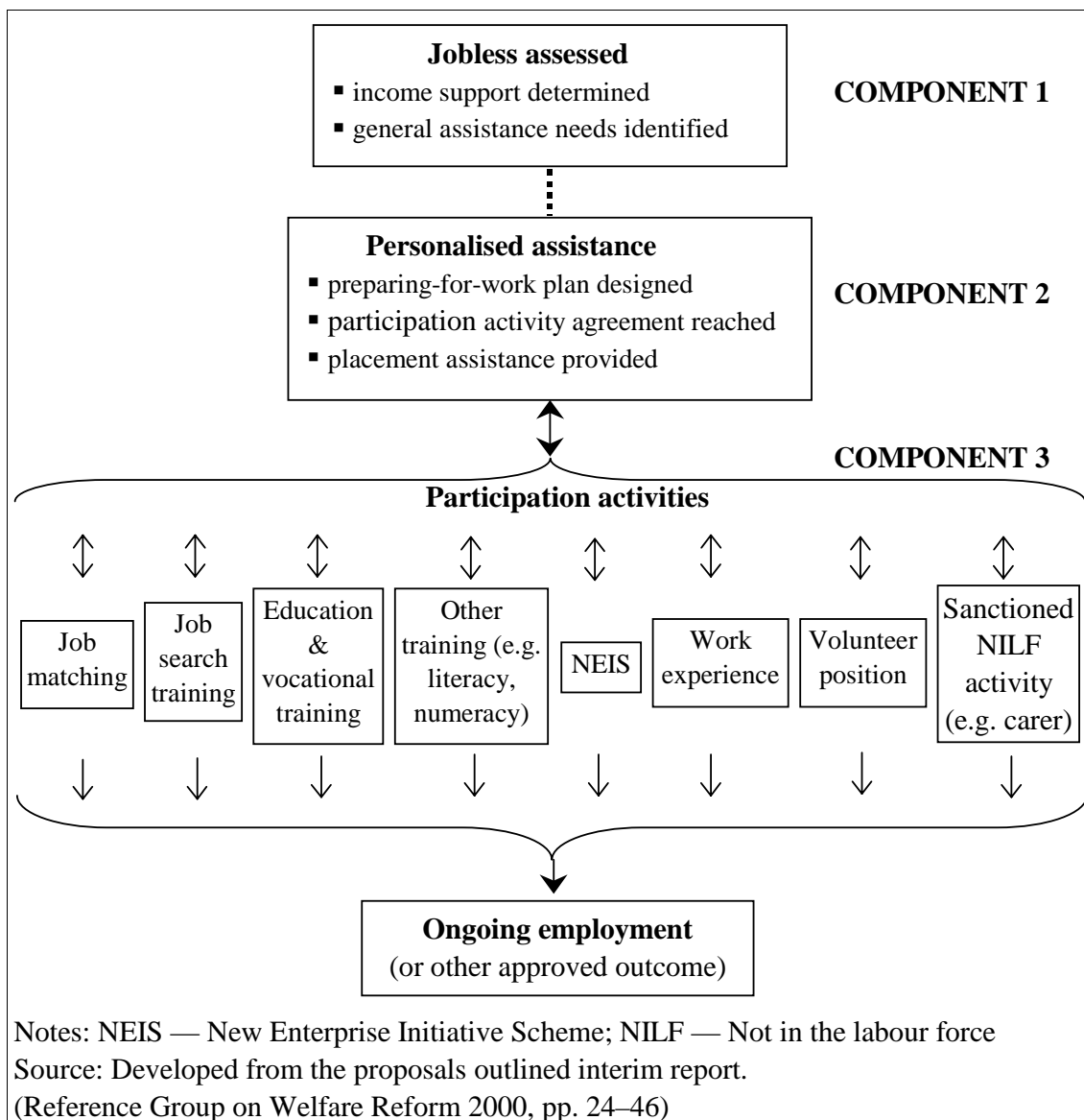
<sup>1</sup> Some income support recipients would be precluded by disability from a requirement of increased economic and social participation.

<sup>2</sup> The system of personalised assistance would see a single customer service office, a One to One Service Officer, responsible for all the needs of an income support recipient. This person would have ongoing contact with the income support recipient.

enters a sanctioned activity outside the labour force, like caring for children or someone with a disability.

Across the course of involvement in these activities the income support recipient might have ongoing contact with providers of advice to ensure compliance with activity requirements, or for referral from one activity to another. Most of these activities are consistent with the longer-term goal of entry into ongoing paid employment. Some income support recipients may be unable to find ongoing employment despite undertaking a range of participation activities. The proposed reforms allow for these recipients to continue to receive income support in return for ongoing participation in approved community activities—for example, in volunteer positions.

**Figure 1 A stylised version of the proposed system**



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### 3 Proposed evaluation framework

The proposed reforms could involve significant policy change. However, little mention is made in the interim report of the need for evaluation of these changes prior to or after their implementation. The Commission, in much of its previous work, has noted the importance of taking into account the effects of reform proposals on all the groups affected and the community as a whole (see, in particular, PC 1999a). The form of Government involvement and associated regulation in the welfare sector, as in other areas, needs to be guided by several criteria. These are summarised in *A Guide to Regulation* (ORR 1998). In outlining the best practice processes for regulation and good policy formulation, the *Guide* states:

‘Determining whether regulation meets the dual goals of ‘effectiveness’ and ‘efficiency’ requires a structured cost-benefit approach to policy development. The relevant problem to be addressed and subsequent policy objective should be identified as a first step in the policy development process, followed by consideration of a range of options (including no action) for achieving the objective.’ (ORR 1998, p. A1)

As part of the process to assess proposals for regulation, the Government has implemented an approach based on regulatory impact statements (RISs). It is mandatory for Government agencies to prepare RISs for a large range of proposals to introduce new regulation or to modify existing regulation<sup>3</sup>.

A RIS has seven key elements that set out:

- ‘the problem or issues which give rise to the need for action;
- the desired objective(s);
- the options that may constitute viable means for achieving the desired objective(s);
- an assessment of the impact (costs and benefits) on consumers, business, government and the community of each option;
- a consultation statement;
- a recommended option; and
- a strategy to implement and review the preferred option’. (ORR 1998, p. A2)

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<sup>3</sup> Further details on when the preparation of a RIS is mandatory is provided in ORR 1998, pp. A1-A3.

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A potential framework to analyse welfare reform is provided by these steps. In particular, this framework highlights the need to consider and take account of the effects of proposed reforms on all relevant groups. Those primarily affected would include income support recipients, governments, government agencies, Australian business and service providers, including community social welfare organisations. Other groups affected, but perhaps less immediately, would be families of income support recipients, the employed, persons not in the labour force (and not income support recipients) and taxpayers.

Consider, for example, the major changes for income support recipients. Compared with the current system, these include the compulsory nature of participation, increased advice and brokerage assistance, expansion and better integration of support programs and improved financial incentives to undertake paid work. It is possible that, while many recipients would welcome these changes, others would find compulsory participation and increased contact with assistance providers a disincentive to participate in the welfare system. In addition, differences between income support recipients, for example in terms of their age, ethnic background, literacy, location and gender, might mean that their reactions to changes in the welfare system would differ markedly. These differences are important to bear in mind when designing a service delivery system to implement any proposed reforms.

A potential technique for assessing the combined impacts, both positive and negative, of the changes on the range of groups is a formal cost-benefit analysis (CBA). This would involve the identification and quantification of all social and financial costs and benefits faced by these groups.

However, there are several limitations and caveats associated with CBA which are of particular relevance in the context of welfare reform. First, collection of the necessary information could be very costly. In this case, information costs need to be balanced against the benefit of better informed policy making. Second, there may be a lag between when the costs are incurred and when some of the benefits are realised. CBA therefore needs to incorporate a sufficient time period (and appropriate discount rates) when evaluating any proposed reform (ORR 1998). Third, CBA often treats the costs and benefits of a policy change symmetrically, so that it does not identify the distribution of these changes. Taking distributional effects into account is possible, but would involve potentially contentious comparisons of beneficiaries and general taxpayers. Finally, if CBA is to incorporate social or cultural matters, further contentious comparisons are involved.

Despite possible difficulties in applying CBA, there are major advantages of applying at least the broad principles of this technique in that it makes explicit and transparent all the effects of proposed reforms on different groups, and provides a framework to assess the trade-offs involved in the proposed reforms.

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## 4 Alternative delivery approaches — effects on recipient outcomes

Changes to incentives as a result of the proposed reforms do not appear to have been given sufficient attention in the interim report. Potential incentive effects can be considered from at least two angles: recipients' decisions to participate in the system; and the implications of the proposed reforms for the way services are provided, and thus on client outcomes. The Commission has considered the relationship between aspects of the welfare system and labour market participation in a number of its reports. For example, the Industry Commission inquiry report on *Impediments to Regional Industry Adjustment* (IC 1993) examined the importance of a range of welfare policies to locational decisions. In the present paper, the Commission has focussed its comments on the potential impact of reforms on service delivery, an area on which several of its more recent reports have focussed.

The Industry Commission, in its inquiry report *Charitable Organisations in Australia*, noted that 'one way of promoting quality outcomes for clients is to ensure that, wherever practicable, clients have a choice of a range of providers. Governments can also encourage quality outcomes and efficient service delivery by having open and transparent processes for the selection of providers to receive government funding' (IC 1995a, p. 385).

In its report *Implementing Reforms in Government Services* (SCRCSSP 1998, p. 173), the Steering Committee for the Review of Commonwealth/State Service Provision noted the imperative of seeking better ways of providing government services. The report highlighted the possibility for innovative approaches to enhance the efficiency and effectiveness of service delivery. The possibility of efficiency gains means that delivery approaches may play a role in ensuring one of the objectives of the Reference Group on Welfare Reform — maintenance of the Government's disciplined approach to fiscal policy — is met.

There are at least three approaches to service delivery:

- direct government delivery;
- competitive tendering and contracting (CTC); and
- demand-based funding.

The appropriateness of these approaches is evaluated below for the three components of the proposed system (outlined in Figure 1) — assessment of the income and assistance needs of the jobless, personalised assistance, and participation activities for income support recipients. It is also possible that a combination of approaches might be used for each component.



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## 4.1 Direct government delivery

Direct government delivery occurs where employees of a government agency directly provide a particular service. Government services currently provided in this way include policing and defence. Some elements of the current welfare system are also delivered directly by government, such as the benefit assessment and referral services offered by Centrelink.

However, as argued in the Industry Commission's inquiry report, *Charitable Organisations in Australia* (IC 1995a, p. 7), direct government delivery might not be the most effective means of delivering some welfare services. '[T]o ensure transparent and impartial treatment of individuals, governments are normally subject to stringent accountability requirements. These limit to some extent governments' flexibility, discretion and responsiveness, qualities that have an important place in welfare service delivery'. Other groups, like community social welfare organisations, 'are able to target services with flexibility and discretion'. They have 'a capacity to give expression to diverse values, to be close to supporters and clients and to target assistance to specific groups in specific ways'.

Nevertheless, some services are limited to government carriage by constitutional, legal or international commitment obligations. Other services have characteristics that might render them appropriate to this form of delivery. These characteristics might lead to:

- complexity or high costs involved in the writing of a contract that aligns government and service provider or recipient objectives;
- high costs of monitoring contract compliance; and
- high set-up costs and very low per unit costs of delivery — or elements of 'natural monopoly'.

But the characteristics of services that make it difficult to write contracts with non-government agencies and monitor them also have implications for government wishing to deliver those services directly. They would be reflected in the difficulty of directing and monitoring government managers and other staff so that their actions were aligned with government objectives. Writing and monitoring of contracts may make the difficulties of efficiently addressing objectives more transparent. Thus any problems associated with contracting do not necessarily imply that direct government provision should be preferred.

The third potential rationale for direct government delivery, elements of natural monopoly, is a traditional argument. Recent research, including the Productivity Commission inquiry report *Progress in Rail Reform* (PC 1999c), suggests that franchising can be used to generate competitive pressure in markets with

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characteristics of natural monopoly. Competition arises periodically when potential providers bid for the right to supply the service.

An alternative mechanism for providing services in remote areas where low population densities make set-up unattractive to multiple providers was suggested by the Industry Commission in the inquiry report *Charitable Organisations in Australia*. The Commission suggested that potential providers ‘could be required to define the level of services to be provided to the community. Under this option, the funding of a particular service would be determined by costs in other areas, with a premium added to account for the additional costs resulting from remoteness’ (IC 1995a, p. 389).

Similar approaches could be used for welfare services. Thus the Commission would argue that the existence of a natural monopoly in a particular service does not necessarily imply the need for direct government delivery.

In the following discussion, an evaluation is made of the extent to which components of the system outlined in Figure 1 embody characteristics which might lead to the contracting and monitoring problems specified above.

It is likely that objective criteria for assessing the jobless to determine their eligibility for income support and participation assistance (component 1) could be specified. Applicants could be grouped on the basis of assistance needs into relatively broad groups at this stage. An assistance rate for applicants within a group could be set by government to reflect the average cost of achieving a defined final objective for members of that group. That is, total funds available to provide services for individual applicants would be determined at this stage.

A set of detailed guidelines for different situations would need to be developed for use in the various offices around Australia where eligibility is assessed. However, these offices need not all be operated by a single Government provider. Other agencies could bid to undertake this assessment task, with auditing and appeal processes protecting the interests of government and clients respectively. If clients are given the choice of assessment agencies, then incentives to offer an improved service will be strengthened.

Thus the potential exists for non-government organisations to be contracted to assess applicants’ eligibility for assistance against specified criteria (component 1). Once assessed, recipients could be referred on for personalised assistance (component 2).

The personalised assistance component (component 2) of the proposed system has the potential to be complex. The ultimate objective is ongoing work for income

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support recipients. However, recipients, under the guidance of their personal assistance providers, may potentially pass through a number of interim steps before entering paid work. These include sanctioned ‘not in the labour force’ activities, training and engagement with a range of support services. As depicted in the interim report, some income support recipients could require many contacts with their personal assistance provider over a period of years as they moved through these interim steps and became work ready.

The interim report case study of ‘Veronica’, a recently separated mother, illustrates this situation. Under the proposed system Veronica initially receives information and referral to support services from a Centrelink officer and is placed on benefits. After six months, she is assessed by the Centrelink officer as too stressed for discussion of her future work plans and scheduled for review six months later. At that review she receives advice on entering training. A further 12 months on and she is given more advice on training, and referral to a training provider and an industry contact. Twelve months after that meeting she negotiates a participation plan and enters TAFE training.

It might be argued that the complex range of interim steps in a case like Veronica’s could preclude the writing of a contract and, therefore, provision of personalised assistance by a non-government supplier. However, the steps would also pose difficulties for government managers.

The funding of service providers in complex case studies such as that of Veronica also needs to be considered. One approach would be through output-based funding. Here, service providers are funded on the basis of defined outputs, but allowance is made for different levels and composition of inputs. The advantage of this approach is that it introduces incentives to increase efficiency. In contrast, funding inputs and processes directly may provide incentives to over-service. Output-based funding is already used in a number of areas of service provision, for example hospital casemix funding, rehabilitation of injured workers and the intensive assistance component of Job Network.

The Steering Committee for the Review of Commonwealth/State Service Provision (SCRCSSP) undertook a case study of the casemix (output-based) funding approach introduced into Victorian hospitals in 1993 (SCRCSSP 1997). This study describes the problems and solutions associated with specifying outputs, setting prices for those outputs, managing provider performance (including the potential for perverse incentives) and implementing the system.

The potential to specify outcomes from, and associated methods of funding for, component 2, while incorporating a complex set of interim outputs, suggests this component does not have to be delivered directly by government.

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In terms of component three — participation activities — a mixture of delivery approaches is currently employed. Job matching and job search training are provided through the Job Network for the unemployed. A large part of the Job Network is run under CTC arrangements. Education and vocational training are supplied by the tertiary education sector. Contracted providers offer other training, including in literacy and numeracy and English. The current extensive use of non-government organisations and the wide range of delivery approaches available indicate that these activities do not embody characteristics that require their direct delivery by government.

The body that delivered the personalised assistance (component 2) could act as a case manager and coordinate an income support recipient's participation activities. This body could be allocated the amount determined at the assessment stage (component 1) as needed for a recipient to achieve ongoing work (or the defined final objective), including an amount to reflect the cost of this coordination role. Actual payments to the personal assistance coordinator for each recipient could be staggered and related to attainment of defined interim steps towards the final objective. Again, some guidance on problems and solutions associated with this funding approach is given in the SCRCSSP's study of casemix funding in Victorian hospitals (SCRCSSP 1997).

## **4.2 Competitive tendering and contracting**

The second approach to service delivery is competitive tendering and contracting (CTC). The process involves the specification of service needs, a call for tenders to meet those specifications, the contracting of service provision to the successful tenderer(s) and the management of that (those) contractual arrangement(s).

In its inquiry report on *Competitive Tendering and Contracting by Public Sector Agencies* (IC 1996a), the Industry Commission noted that CTC has been adopted because of its potential to benefit clients, taxpayers and the broader community via improved clarification of objectives and desired outcomes; enhanced transparency and accountability of processes; and better service outcomes in both quality and cost effectiveness terms. It established a set of principles that should be followed in evaluating the suitability of an activity for CTC. These are outlined in Box 1.

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**Box 1: Key principles for determining the suitability of an activity for CTC**

1. Constraints to adoption should be identified. Some activities are precluded from CTC because constitutional or legal requirements or international commitments limit their carriage to public officials.
2. Current functions of the delivering agency should be reviewed.
  - The agency's function should be evaluated against policy goals.
  - Customers and other affected groups should be consulted about the services they require in order for the agency to meet its policy goals.
  - Existing services should be assessed for their capacity to meet current requirements.
  - The full costs and benefits of existing methods of delivery should be calculated.
3. Alternative delivery approaches should be evaluated against the existing method. Depending on the size and importance of the activity and the likely benefits to be gained, this might require formal processes such as benchmarking.
4. The suitability of CTC to the activity and the risks inherent in its adoption should be considered. A stronger case for CTC can be made:
  - the more satisfactorily contract terms can take account of considerations of accountability, privacy, security, consumer protection, access and equity;
  - the more easily service outputs can be specified and measured and the performance of the provider can be assessed;
  - the smaller the consequences and likelihood of service interruption;
  - the stronger is the established market for the service;
  - the more easily service providers can be penalised or replaced for unsatisfactory performance;
  - the more readily the contracting agency can access skills to draw up specifications, evaluate tenders and manage the contract;
  - the smaller the industrial relations disruptions that would accompany the CTC process; and
  - the larger the proportion of management time that would be freed up for more strategic thinking.

Source: Industry Commission (1996a).

The IC concluded that suitability of services for CTC should be considered on a case by case basis. It did 'not support the approach of categorising services into those which are and are not suitable for CTC, primarily because it could find no robust, generally applicable method of putting particular services into one or the other category' (IC 1996a, pp. 256–7).

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CTC for the supply of welfare services is not new. This approach to delivery has been adopted for many parts of the Job Network. Another example is the Job Placement, Employment and Training (JET) program for young people.

In terms of the proposed reforms, assessment of eligibility for income support and participation assistance (component 1) would appear to be a candidate for contracting. As described above, service providers could be given a set of guidelines on how different situations should be treated and could classify applicants accordingly. The income support recipients could then be referred on for personalised assistance.

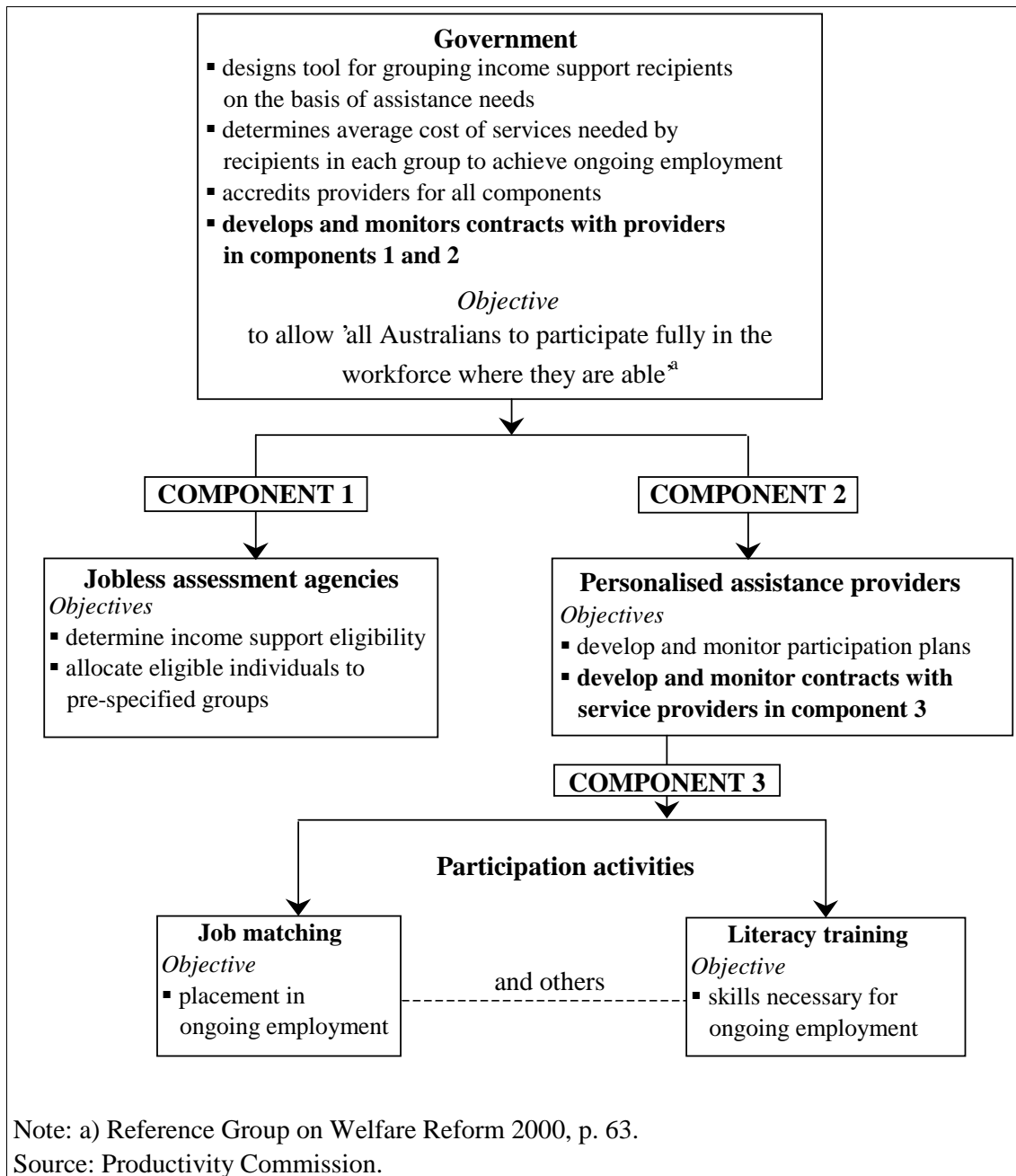
There are precedents for this type of complex assessment task being undertaken by many organisations, with the government setting guidelines and overseeing their implementation. Both government and non-government hospitals classify patients to determine the level of funding they receive, and this is subject to an audit process (SCRCSSP 1997, p. 58). In the European Union, a number of independent ‘designated bodies’ compete to assess the conformance of medical devices to EU Directives or guidelines, an approach supported by the Industry Commission in its inquiry report *Medical and Scientific Equipment Industries* (IC, 1996b, p. 77). As well, in its inquiry report on *Work, Health and Safety*, the Industry Commission noted that statutory inspections are provided by accredited private sector providers in several States (IC 1995b, p. 132).

The merits of introducing a choice of providers of personalised assistance (component 2) where feasible, and competition for monopoly franchises where it is not, could also be examined. This might be similar to the existing intensive assistance element of Job Network. Total payments to the personal assistance provider would vary with recipients’ assistance needs and location — determined at the assessment stage. The personal assistance provider would then contract with the individual service providers (component 3) to provide the necessary services to meet defined interim goals (which in turn contribute to the final objective, usually ongoing employment). Individual service providers would then receive payment from the personal assistance provider once the specified interim goals had been met. The Productivity Commission has developed a stylised version of such a contractual chain (Figure 2).

Contract terms for all components could specify how clients and information should be treated and privacy safeguarded; a complaints mechanism could be established to provide protection for income support recipients; and possible access to a wide range of providers could ensure that access and equity concerns were met. Monitoring could occur via spot checks of service providers. In its inquiry report into *Nursing Home Subsidies* (PC 1999b) the Productivity Commission examined similar issues concerning government subsidies for nursing home residents (who are

classified into one of eight care levels). It noted the importance of regular, transparent and independent reviews of costings, in consultation with affected groups (PC 1999b, p. 91 & p. 114).

**Figure 2 A possible stylised contractual chain between government and welfare service providers**



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In its inquiry report *Competitive Tendering and Contracting by Public Sector Agencies* (IC 1996a), the Commission also examined issues associated with ensuring quality of service provision under contractual arrangements. It recommended:

‘Agencies should ensure that successful tenderers have in place appropriate quality assurance systems. The systems chosen should be kept as simple and inexpensive as possible. Quality accreditation and quality systems certification should be required only where the risk and cost of quality failure is high. In other cases, a good performance record and/or evidence of appropriate internal management systems will be appropriate.’ (IC 1996a, p. 359)

The current system already demonstrates the scope for CTC under a reformed system. Markets for some services are already established and past experience means the skills for establishing and managing CTC arrangements already exist within government.

### **4.3 Demand-based funding**

The third approach to service delivery is demand-based funding. This approach links public contributions to the performance of service providers (as judged from the perspective of the income support recipient) by attaching entitlements to the recipient. Potential benefits from this approach include the provision of a range of services suited to recipient needs offered at lower cost and/or higher quality than would otherwise be the case, and innovation in service design and delivery.

In its *Submission to the Review of Higher Education Financing and Policy* (IC 1997) the Industry Commission described how this delivery approach might work for higher education. It outlined the potential benefits that could flow from adoption of a demand-based funding mechanism in this context: increased student influence on the range and quality of courses; stronger competitive pressures leading to improved performance of universities; and increased transparency in education provision (IC 1997, p. 144).

The Steering Committee for the Review of Commonwealth/State Service Provision (SCRCSSP) in its case study on the use of demand-based funding in the delivery of disability services in Western Australia reported that ‘the overarching philosophy of the scheme is to aim to improve consumer choice. Moving the decision making closer to individuals helps to ensure that the level and mix of assistance better meets the needs of individuals’ (SCRCSSP 1998, p. 91).

In the case of welfare support, demand-based funding could involve income support recipients being given access to portable entitlements that could be used to pay for



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activities that enhanced their economic and/or social participation. Recipients could only use these portable entitlements for prescribed activities such as career advice, job search services, education or training. Portable entitlements unused at the commencement of a paid position could be converted into a wage supplement. This approach has similarities with that proposed by Harding and Loundes (1999) to create an employment account for each unemployment benefit recipient and taken up in the interim report in the suggestion for a participation supplement (Working Group on Welfare Reform 2000, pp. 45–6).

However, demand-based funding as a delivery approach may prove more difficult to implement in welfare services than in higher education or other areas unless appropriate organisational and financial arrangements are in place. The suitability of this approach for any of the components of the proposed welfare system would depend on whether a competitive market for these services does, or could, exist. The presence of a range of suppliers (or potential suppliers) in competition with each other is necessary for the benefits to be realised.

At least two factors could preclude the formation and smooth functioning of a competitive market. First, if the number of potential income support recipients in a geographic region is small, it may not pay for a service provider to set up in that region. Even if one service provider starts up, potential recipients do not have a choice of providers so that a competitive market would not exist. (This point was discussed above as a potential rationale for direct government delivery, but previous Commission research has suggested approaches to introducing competitive pressure into the market.)

Second, limits to recipients' ability to obtain access to and use information about services supplied by different providers, and to their knowledge of how these services meet their needs, may mean that the market is not competitive. Recipients need to know what their needs are in order to choose a service. Also, their ability to choose the service provider that best suits their needs would be limited in these circumstances.

The Industry Commission (1997) paid considerable attention to similar problems in relation to higher education. These included a lack of student information on courses, the loss of high cost and low demand courses and a decline in teaching quality. It suggested in relation to informational concerns 'educational institutions, industry groups and client-based groups...provide a variety of information services to assist students in making informed decisions about courses and institutions. Students also rely on a number of informal sources including parents and friends' (IC 1997, p. 150).

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Similar sources — service providers and their peak bodies, groups that advocate for income support recipients and informal contacts — could help overcome information deficiencies associated with welfare service provision. Alternatively, were the personalised assistance providers to act as ‘agents’ for income support recipients, informational deficiencies would be largely addressed.

If competitive markets failed to form in sparsely populated areas with few recipients, it might be appropriate to develop an alternative delivery approach.

The assessment of jobless applicants’ eligibility for support (component 1) is clearly not a candidate for demand-based funding. It is at this stage that income support recipients would have their eligibility for funds determined.

The applicability of demand-based funding to components 2 and 3 is largely dependent on the organisational arrangements for the provision of personalised assistance and individual participation activities.

One approach could see income support recipients using their portable entitlements to buy services directly from the personalised assistance provider and providers of participation activities on a fee for service basis. Under this system, however, providers would have an incentive to give advice or provide services in a manner that increased the likelihood of the recipient returning. This would not be a problem if recipients knew what type of advice they needed, and could change providers at no cost if they were dissatisfied. But these conditions may not be met for income support recipients.

An alternative approach could involve income support recipients paying a flat fee to cover the potential outputs of personalised assistance — a participation plan, an activity agreement and placement in participation activities. Recipients could then pay (from their portable entitlement) flat fees for individual participation activities based on expected interim goals, or pay the personalised assistance provider a further amount to act as their agent in purchasing these services on their behalf. In the latter case, payment could occur on attainment of a job and fees could reflect the effort required on the part of the personalised assistance provider to achieve that end. To overcome *ex ante* uncertainty about an income support recipient’s service needs, providers could charge a price that reflects the average cost of assisting a recipient with a given set of characteristics. Portable entitlements allocated to a recipient for the purchase of services at the assessment stage would need to reflect these characteristics.

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## 5 Concluding remarks

Some issues of relevance to the interim report of the Reference Group on Welfare Reform (2000) have been considered within a public economics framework.

First, a stylised version of the proposed system was presented. The need for assessment of the net benefits of the proposed reforms, including the effects on the incentives on all groups affected, was then highlighted. The principles used to make, review and reform regulation, incorporating elements of cost-benefit analysis, were suggested as a potential framework for this purpose.

Second, the appropriateness of each of three service delivery approaches was examined for each of the components of the proposed system: direct government delivery, competitive tendering and contracting and demand-based funding. Considerable scope for the involvement of non-government organisations in service provision was identified. In developing proposed reforms to the welfare system, the relative benefits and costs of these alternative approaches would need to be considered.

Third, experience that has been built up in a range of other areas during the past decade has generated many insights into how the design elements can strengthen incentives for providers to deliver less costly and/or higher quality services. Moreover, the scope to provide service recipients with a choice of providers may be significantly greater than was envisaged in the past. These insights could be of relevance to the welfare reforms envisaged by the Reference Group.

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