

Market Forces for the Unemployed? Training Vouchers in Germany and the U.S.

by

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Abstract

Vouchers are meant to increase competition and consumer choice in public service markets. Using the example of training vouchers for the unemployed in the U.S. and Germany, we show, however, that deficits, both on the demand and the supply side of the market, create problems with preference alignment and market formation. Information asymmetries undermine choice by the unemployed and reduce government control over the training system. Ironically, restrictions meant to compensate for these information deficits further inhibit competitive market formation. Evaluation data on training vouchers from both countries show that voucher systems do not increase choice, but weaken the partnerships public employment agencies previously had with training providers, and may lead to a shortage of high quality and specialized training as well as creaming in the selection of training participants. Theoretical justification for vouchers is based on the notion of choice and consumer sovereignty. Using this framework to analyze the changed relationship between government, private training providers, and jobseekers we challenge the efficacy of vouchers as a delivery mechanism in complex public service markets such as job training.

Keywords

Consumer Choice; Privatization; Training; Vouchers; Germany; U.S.

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In recent years national governments have increased their reliance on private service provision when reforming their public employment services (Thuy, Hansen et al. 2001; Schmid 2004; Sol and Westerfeld 2005). Germany and the U.S., for example, have recently introduced training vouchers for the unemployed. In the U.S., the Workforce Investment Act (WIA) of 1998, reauthorized in 2003, requires local workforce agencies to use Individual Training Accounts (ITA) to provide training for unemployed persons. In Germany, training vouchers, the so called *Bildungsgutscheine*, were introduced as part of the *Hartz Reforms*¹ in 2003.

Recent reviews of vouchers in the U.S. and the U.K. (Steuerle, Ooms et al. 2000; Valkama and Bailey 2001; House of Commons 2005) find benefits of increased efficiency and competition on the supply side, and enhanced choice and voice on the demand side. These studies confirm the arguments made by early proponents of vouchers in the schooling and health care sectors (Friedman 1955; Seldon 1986) but at the same time raise concerns about adverse selection, information asymmetries, substitutability, regulation, and quality control. Such ambiguous effects also are found in the training voucher systems in Germany and the U.S. (Barnow 2000; Barnow and King 2005; German Bundestag 2006a, 2006b; GAO 2005; Kühnlein and Klein 2003; SPR 2004).

Based on initial evaluation studies, our analysis examines whether the purported benefits of training vouchers in Germany and the U.S. are realized in practice. We provide a theoretical framework to evaluate quasi-market mechanisms² for government services by analyzing the changed relationship between the three actors involved in provision, delivery, and consumption of job training for the unemployed. We first present a theoretical discussion that outlines the challenges to choice, competition, and social objectives when vouchers are used to deliver public goods. Next we provide background on the introduced job training voucher systems in the U.S. and Germany. This is followed by an analysis focused on problems on the demand side and on the supply side of voucher systems. We find that training vouchers do not increase choice or efficiency and may actually undermine the ability of governments to achieve social goals.

Choice, Consumer Sovereignty, and Vouchers from a Theoretical Point of View

Increased use of market mechanisms has been part of governmental service reform and reflects an important feature in the shift from government to governance, as in Clinton's "Reinventing Government", Blair's "Third Way", and Schröder's "Agenda 2010" (Rhodes 1996; Clarke 2004a; 2004b: 106-125). The reinvention reformers in public service delivery have argued that market based forms of service delivery can enhance efficiency and citizen choice simultaneously (Hood 1991; Osborne and Gaebler 1992; Savas 1982, Savas 2000). Market based provision of public goods offers the promise of competition as an incentive to reduce problems with governmental oversupply, enhance choice among consumers, and encourage efficiency among service providers (Niskanen 1971; Du Gay 2000; Savas 2000; Alford 2002).

While most public services may still be provided by government, they do not have to be produced by government. This separation of the *provision* decision from the *delivery* mechanism lies at the root of the privatization movement in government services and leads to a "declining publicness of public services" (Baldock 2003: 68). The use of quasi-market delivery mechanisms, such as contracting and vouchers, allows a wider mix of public and private providers in service delivery but it does not necessarily realize the promises of more choice, reduced discrimination, and maximized social welfare in general as Titmuss has outlined in an early discussion on choice in the welfare state (1968; chapter 12).

In job training services this quasi-market approach has been common for several decades. The innovation that has occurred recently is the extension of the market approach to allow more consumer choice in selecting training providers through vouchers. A voucher system represents a higher level of *marketization* than contracting-out (Savas 2000: 129), since on the supply side the provider loses authority over the delivery mechanism and on the demand side customers increase their private purchasing power. Recent literature emphasizes the importance of market based tools and the challenges of managing such tools where government shares control in a market network (Warner and Hefetz 2007; Goldsmith and Eggers 2004; Salamon and Elliott 2002). Vouchers are designed to increase choice on both the demand and supply sides of the market. Their success rests critically on competition and informed consumer choice.

In his early discussion of ‘consumer sovereignty’ Rothenberg (1962) identified two core components of the concept. First, consumer sovereignty means that in market economies production is aligned with consumers’ preferences, i.e., the customer is the ‘ultimate king’ (Rothenberg 1962: 296). Second, from a normative, utilitarian perspective, consumer sovereignty is also an indicator of economic performance, i.e., that the economy performs well if the consumers’ wishes are fulfilled (Rothenberg 1962: 271).

While the citizen as *consumer* may prefer convenience or other short term goals, the government, paying for the service and ultimately responsible for *provision*, focuses on social goals. In the case of job training these social goals are reintegration in the labour market and long term job stability. Based on this distinction, the literature has focused on government and citizen as the two types of consumers (e.g. Lowery 1998). We argue that there is a third party involved: the private provider, commissioned for *service delivery*, generally pursuing profit goals (see figure 1).

Insert figure 1 about here

When the preferences of these three actors diverge, as is often the case for public goods, preferences are no longer aligned and a critical element of the public good may be lost. While preference alignment problems lie at the core of the problem of using consumer choice to ensure efficient market provision of public goods, this is not the only potential failure.

Lowery (1998) outlines two additional forms of market failure for public goods: information asymmetries leading to preference error, and failure of competitive market formation. Consumer choice is restricted by insufficient information. However, if consumers lack the information needed to make the choices which reflect their preferences, efficiency and quality will suffer. For complex products, market formation can fail because information is not evenly distributed and the preferences of the providers who deliver the services, the government which is ultimately responsible for the services, and the citizens who “consume” them are not aligned. Higher complexity also makes the product more vulnerable to manipulation. Erroneous preferences, due to information deficits and misguidance, have long been recognized in the literature on market failure (see Lowery 1998: 147-52 for a discussion).

However, this problem does not just occur on the demand side. On the supply side information asymmetries create problems with contract specification and monitoring. Transactions costs economics provides a useful framework for understanding when to produce a service in house and when to contract out. In the public sector, the same considerations of contract specification, monitoring for quality, need for internal control and failsafe delivery apply (Hefetz and Warner 2004; Nelson 1997; Williamson 1996; 1999). Sclar (2000) has pointed out that for complex public services, contracts are typically incomplete and relational contracting is more common as a means to create a dialogue and partnership between government and its contractors. Recent literature on governing such networks emphasizes the importance of trust,

long term relationships and a strong principal to control potential principal-agent problems (Goldsmith and Eggers 2004; Milward 2000; Salamon and Elliott 2002).

The third problem is the failure of market formation. An efficient market needs enough providers on the supply side and enough buyers on the demand side to create competition. Lack of competition is especially pronounced for specialized services and in rural areas, where market based delivery schemes are less common (Warner 2006). As Lowery (1998) notes, private markets for public goods are usually quasi-markets with one buyer (government) and few sellers. Competition quickly erodes in public service markets (Sclar 2000), and problems with lack of competitive markets lead to contract failure. Because there are two different sets of “consumers” in a voucher system – government agencies who pay for the services and citizens who choose according to their preferences – such a monopsonistic situation does not occur. However, the public service market has to fulfil the requirement of being a “contestable market” (Baumol, Panzar, and Willig 1982). According to the logic of contestable markets, the efficiency of a market does not depend on the number of actual competitors, but on the opportunities for potential competitors to enter the market at little or no cost. This means, that a voucher system for the provision of training for the unemployed would only be adequate in cases where providers were able to enter and exit the market with neither major barriers nor long-term commitments. This condition is more restricted when government uses regulations to ensure quality and this further restricts competitive supply.

We hypothesize that the use of training vouchers for the unemployed will suffer from each of these forms of market failure: preference misalignment, information asymmetry, and failure of a market to form. Ironically, monitoring and regulatory controls to limit problems with preference alignment and information asymmetry can further undermine the formation of a competitive market of alternative providers. The market formation fails, either because informed customers are lacking or because an overregulated framework, compensating for a loss of control by public providers, increases transaction costs, especially for small providers or providers offering specialized training. In any case, instead of increased choice and a more efficient allocation mechanism, the U.S. and German voucher systems face problems with providing high quality training.

Publicly Financed Training for Jobseekers in Germany and the U.S.

In international comparisons, Germany and the U.S. represent the two opposing ideal types of welfare regimes and market economies. The classification of the two different regime types is based on the fundamentally different traditions and understandings of state intervention and reliance on the market. While interventions are characteristic for one type, a regulatory framework that does not encroach upon the individual and economic action is typical for the other type.

For Esping-Andersen (1990), Germany is *the* main representative of the family of “conservative welfare regimes” with its high, status related welfare benefits, and a high degree of decommodification, whereas the Anglo-Saxon states are *the* paradigmatic “liberal welfare regimes” with a low level of government provided benefits for the needy. In their analysis of the diverging institutional forms of market economies, Hall and Soskice (2001) reach analogous results. While the U.S. is characterized as *the* “liberal market economy”, Germany is classified as *the* prototype of a “coordinated market economy”. Liberal market economies display limited state intervention and coordination of market relationships. A reliance on market mechanisms, however, does not guarantee the economy the public goods of broad vocational training, and long-term job stability. A low average level of qualifications, huge wage differentials, and high fragmentation are characteristic of the U.S. liberal market economy. Germany’s “Rhineland

capitalism”, in contrast, bears the hallmarks of a coordinated market economy. Most companies are organized in trade associations, they automatically belong to the chambers of commerce and industry, and decisions relevant for social policies have traditionally been taken in consent between the state, the employees’, and the employers’ representatives. These arrangements, together with a traditionally high level of employment protection, make it possible to overcome collective action problems. Quasi-public goods such as vocational training and a sector-specific upskilling of the workforce are eased, and wages are more homogenously distributed (Estevez-Abe et al. 2001).

While the German Public Employment Service (PES) is – even after the ‘Hartz’ Reforms – very centralized, the U.S. is characterized by decentralized responsibilities and discretion at the state and local level. Yet despite all the dissimilarities, the intention to introduce more market forces into active labour market policies, including design of the training vouchers, is similar in the two countries. The old systems were considered inefficient and non-transparent and the introduction of vouchers was supposed to increase customer choice and lead to better employment outcomes (Bruttel 2005: 396; O’Leary, Straits et al. 2004: 292).

The implementation of the voucher systems in both countries took place in a similar context. Since the early nineties labour market policy in both countries has shifted towards a work-first approach. In the U.S., this ideological bent was already reflected in the enactment of the Personal Responsibility and Work Opportunity Reconciliation Act (PROWA) of 1996 and perpetuated in most workforce development areas (SPR 2004, VI 3ff; Zylan and Soule 2000). In Germany, *Fördern und Fordern* (“Nurture and Demand”), with the main accent on demand, was the overall theme of the enactment of the *Hartz* Reforms beginning in 2003 but was preceded by other cut-backs in welfare provision (Bleses and Seeleib-Kaiser 2004; Clasen 2005). The reduction of the annual budget for training as well as the number of training days in both countries reflects this general shift³. The fraction of public expenditure on training and linked labour market programs measured as a percentage of GDP fell by more than 20 percent in both countries from 2002 to 2004. However, the public expenditure on training and labour market programs as a percentage of GDP is more than six times higher in Germany than in the U.S. – typical for the two different regime types (OECD 2006: 272f, 76f).

Cut-backs are also reflected in a smaller number of unemployed starting a publicly financed training measure, i.e., in Germany a reduction of 64 percent from 523,000 in 2000 to 132,000 in 2005 (German Bundestag 2006b: 100)⁴. Even though data for the American side are considered unreliable (GAO 2005: 16) a decrease in training is also observable for the U.S. While the total numbers of participants only decreased from 163,223 jobseekers in 1998, the last program year of the Job Training Partnership Act (JTPA), to 160,429 in 2001 under the new WIA legislation, the cut-back in training was more significant. The incidence of WIA’s basic skill training decreased from 18 percent to 2 percent of the participants, on-the-job-training from 9 percent to 5 percent, and WIA’s other occupational training from 67 percent to 33 percent. Additionally, the average length of training provided was longer under JTPA than under WIA (D’Amico and Salzmann 2004: 109f).

Cut-backs, new eligibility criteria⁵ and changes in the training arrangements obviously make comparisons over time and between countries difficult. Differences in the number and composition of participants may occur not because of the new training administration through vouchers, but because of a new policy focus on work first strategies (Barnow and Smith 2004; Holzer and Waller 2003: 7). Moreover, differences within the U.S. concerning the individual states’ interpretation and implementation of WIA, as well as differences in data gathering for the two countries, limit comparisons. However, these data limitations do not prevent our focus on the structural mechanisms related to voucher systems.

Germany and the U.S. exhibit differences in unemployment rates (in 2005 11.5 percent in Germany vs. 5.1 percent in the U.S., OECD 2006, 249), expenditures for active labour market policies, and in the skill formations systems (firm provided and industry-specific skills in Germany vs. school provided and general skills in the U.S.). Given the diverging institutional arrangements, finding similar results in both regime types would lend stronger support to the theoretical claims of our analysis. Building on the varieties of capitalism approach (Estevez-Abe et al. 2001; Hall and Soskice 2001), we expect that vouchers will be more easily integrated in a liberal market economy with its market-based system of skill provision such as the U.S. than in a coordinated market system with a highly regulated vocational system such as in Germany.

In both countries, training has traditionally been provided by the private sector. Under the Job Training Partnership Act (JTPA), local officials in the U.S. purchased training from both private and public providers (such as community colleges) by means of grants and contracts. Training for the unemployed in Germany has never been delivered by the Public Employment Service itself but always by private, often non-profit training companies, frequently owned by the social partners⁶. Hence, it is inappropriate to talk about *privatization* of the jobseekers' training system (since it has always been privately delivered), but the new systems in both countries imply a greater degree of *marketization*, both on the supply and the demand side.

One major motivation for the changed provision of training for the unemployed was the wish to increase transparency and competition. In Germany the "old system was facing allegations ... that training providers linked to the social partners were being given preferential treatment" (Bruttel 2005: 399). The jobseeker was sent to a private provider, which had to be approved by the local employment agency. Both, the local employment agencies and training providers worked closely together. They developed the so-called *Bildungspläne* (training plans), which set the annual volume of training. Once its courses were approved, a provider could plan for a year at a time. This supply-driven system was suspected of – and actually provided the possibilities for – self serving on the part of the training providers while not meeting jobseekers' preferences and needs. That is, the employment agencies tended to assign unemployed persons to approved courses, even though the training provided did not meet their needs (ibid. 400).

Similarly in the U.S., one of the major criticisms of the earlier JTPA organization of training concerned the high training costs and restricted customer choice. Choice was "limited to a pre-selected vendor or set of vendors with which the local workforce area had worked out prior agreements" (D'Amico and Salzmann 2004: 103). This limited the training possibilities and did not enhance the jobseekers' employment opportunities, as "participants were sometimes assigned to a course of study by case managers primarily because a training slot in a program for which the local area had developed a contract needed to be filled" (ibid.).

In both countries, the introduction of vouchers was meant to put things right. Greater efficiency, more transparency and enhanced customer choice and hence better employment outcomes were intended by shifting the system from a supply-side orientation to a stronger focus on the demand side.

The Demand Side: Customer Choice Demands Information

We anticipated three potential forms of market failure under a voucher system: first, preference misalignment due to different preferences of public providers, private deliverers, and jobseekers; second, information asymmetries leading to high transaction costs and preference error; and third, failure of market formation leading to lack of choice.

Preference Misalignment

The triad – *Public Employment Service (PES), Jobseeker, Private Training Provider* – is characterized by two different types of consumers. As shown in figure 2, the Public Employment Service in Germany and the U.S. (including the Workforce Investment Boards and the Workforce Areas) makes the provision decision and sets the policy goals. Public interest in improved employment outcomes makes the PES an indirect consumer of the training as well. The PES pays for the training provided and is responsible for its efficiency, quality, and employment outcomes. The position of the training providers is somewhat less ambiguous because they are not directly concerned with the public good benefits of training. However, the training institutions have to satisfy the needs and desires of the two sets of consumers, the individual jobseeker (indirectly also the employer as the final judge of the adequacy of the training), and the Public Employment Service. We argue that the control of the PES over training providers is weakened under the voucher system, and question how much the increased choice of the jobseeker really contributes to system effectiveness (see figure 2).

Insert figure 2 about here

Theoretically the Public Employment Service and the jobseeker's preferences should overlap with those of the training provider. However, in practice we experience some difficulties in a voucher system due to the different sets of consumers and producers. Preferences are misaligned when jobseekers choose "training in low demand or low wage occupations". This is one of the General Accountability Office's⁷ findings in their analysis of the WIA's implementation challenges (GAO 2005: 26, see figure 5). If consumer sovereignty alone were the goal, the jobseeker would be sovereign enough to express a preference for training in low demand occupations. However, "some preferences count more than others" (Lowery, 1998: 160). Government's long term goals and interests in reintegration and long term employability are beneficial for society as a whole. This has two implications. First, it is the public good character that justifies the public investment in job training for individual workers, and governments are ultimately responsible for the provision of public goods and services. Second, this implies, in turn, that the preferences of the jobseeker should be bounded by the goals of the public provision decision. Only in this preference hierarchy is the public good component of training preserved. If the jobseeker is given full choice, training becomes a private good potentially devoid of the broader public benefits.

Information Asymmetry

As training for the unemployed is supposed to enhance the likelihood of quick reintegration into the labour market, it is important that by using a voucher, adequate and high quality training is purchased. Vouchers are meant to empower and motivate jobseekers; to allow them to express their preferences and maximize their utility. With direct purchasing power jobseekers get an exit option (Hirschman 1970) instead of the limited voice they had under the former system.

However, potential information asymmetries occur because jobseekers do not know what training is adequate for them, what qualifications are needed on the labour market and which providers offer high quality training. Preference error is more likely to occur with unconstrained vouchers like the Personal Reemployment Accounts, which were introduced by the Personal Reemployment Accounts Act in June, 2004 as a pilot project in eight U.S. states. In contrast to the Individual Training Accounts (ITAs), introduced by WIA in 1998, where the unemployed only participate in the training assigned by the case-manager, with a Personal Reemployment

Account the unemployed can purchase *any* measure⁸ facilitating reintegration into the labour market (see O'Leary, Straits, and Wandner 2004, for an overview on voucher designs).

Greater purchasing power does not guarantee greater access to training. Experience from Germany shows people's varying abilities to navigate the training market. Such differences among different portions of the population are consistently found by the *Further Training Reporting System*⁹ (BMBF 2001; BMBF 2005), which represents general public knowledge of further training possibilities in Germany and is published every four years. In 2004, only half of respondents claimed to have a good overview of the further training market; one out of three would have liked better information. The demand for more information, however, was stronger among those who usually face serious disadvantages in the labour market, i.e., unskilled workers (40 percent), foreign nationals (38 percent), non-working mothers with a child under 14 years (50 percent), as well as young adults between 19 to 24 years (55 percent).

Even though not all customers must be well informed to obtain an efficient market, the local and time sensitive nature of job training markets make information asymmetries especially critical. In the U.S., research shows social and cultural networks condition job training and career preferences, and this is especially important for women (Folbre 1994; Meyers and Jordan 2006).

Informed customer choice can theoretically be obtained in three ways: enabling jobseekers to make better choices via better information; limiting jobseekers' choices in the content and extent of the training, allowing choice only among providers and the specific training courses; or regulating the supply side by certifying the quality of the providers to prevent low quality training. Ironically, two of these three mechanisms enhance customer choice by limiting it. This shows how difficult the use of the concept of choice and consumer sovereignty is for justifying voucher systems.

Problems with Market Formation

Restricted choice appears to dampen jobseekers' demand for training. In Germany in 2004, only 73,800 training vouchers out of the 681,300 disbursed were actually used, i.e., eight vouchers out of nine remained unused (BA 2005: 99; German Bundestag 2006a), and jobseekers had problems finding training providers. Even though there are no data on the characteristics of jobseekers who did not use their vouchers, from the monthly reports of the Public Employment Service we know the proportions of the groups with the most severe problems reintegrating into the labour market. In Germany, nearly 40 percent of the unemployed are long-term unemployed, 40 percent are without vocational qualifications, 20 percent are foreign-nationals (BA 2006), and a high proportion of jobseekers is all three simultaneously. Furthermore, a survey of the executive managers in 163 of the 180 German Public Employment Agencies found one of the main reasons for not cashing in the training voucher to be the applicants' inability to find an appropriate provider (42 per cent, figure 3). These figures indicate the need for better information and the challenges to consumer sovereignty when the most disadvantaged in the labour market are not able to exercise choice in a marketized voucher system.

Insert figure 3 about here

In contrast to Germany, where training is reserved for the 'entitled deserving' as is typical of a conservative welfare regime, in the U.S. the selection of participants is not targeted. Nearly all U.S. workforce agencies require jobseekers to undertake a formal assessment of their basic skills or occupational aptitudes (more than 80 %, see figure 4). These assessment processes, a major motivation of WIA, can be more or less extensive depending on the employment area. In some areas jobseekers are required to conduct basic research by means of the Consumer Report System (CRS), a compendium of information on eligible training providers. Other areas go even

further, requiring jobseekers, for example, to visit prospective training programs and interview former trainees or employers (D'Amico and Salzmänn 2004: 119; Decker and Perez-Johnson 2004: 178; GAO 2005). Training participants also have to justify their training choices, gather additional information (required by around 70% of the agencies), and document the inability to find a job (required by around 50%, see figure 4)¹⁰.

Insert figure 4 about here

In addition, the training vouchers are limited in order to satisfy the preferences of government. First, the Individual Training Accounts in the U.S. as well as the *Bildungsgutscheine* in Germany are limited in money and duration. Second, the training must provide skills and proficiencies needed in the local economy – a requirement in both countries (D'Amico and Salzmänn, 2004: 107; so-called *Bildungszielplanung* in Germany, German Bundestag 2006a: 91). Jobseekers are free to redeem the voucher containing the details of the training with any approved provider and with courses relevant to the stated training aim. Thus, the jobseekers are limited to choosing from whom they will receive a specific training class. This practice applies only to training delivered in groups. For individual training, which often is on-the-job training, the jobseeker and the job counsellor jointly seek a suitable firm for the necessary training. This was common in the old system in both Germany and the U.S. and is still in place today.

The Supply Side: Managing Quality and Markets

Choice and consumer sovereignty are not only restricted by limitations on the demand side; failures due to preference misalignment, information asymmetry, and failure in market formation also occur on the supply side. To avoid problems with preference misalignment and information asymmetry, the Public Employment Service must establish careful regulations and monitoring guidelines. Monitoring systems in the U.S. and Germany reflect a move away from relational contracting (close collaborations based on trust), to formal evaluation criteria which increase the distance between private providers and government overseers. Such regulations increase transactions costs for private providers and can reduce the number of eligible providers. This has led to concentration in the market which in turn has reduced choice.

Preference Misalignment

In a voucher system, private providers have an incentive to reduce costs at the expense of quality while government has less control over training quality. The profit and cost saving goals of providers can undermine the quality objectives of the Public Employment Service. Additionally, the PES itself may find its goal of reducing unemployment dominated by monetary considerations. Lower expenses for training might then replace the PES' goal of improved employment outcomes.

To limit this form of failure, the introduction of training vouchers has been accompanied by a new quality management and certification system. Institutional mechanisms such as increased accountability and performance measures are meant to prevent preference misalignment. In both countries they are implemented to ensure that local workforce and employment agencies want jobseekers to make wise training choices – at low cost – since poor outcomes would negatively affect the local workforce area's performance. However, performance standards have been criticized for poor correlation with program goals and emphasis on cost criteria has negative implications for service quality (Heinrich 1999) – a form of preference misalignment within the public employment agency itself.

In Germany, the approval of private training providers is regulated according to legislative standards (BMWA 2004). The case managers in the employment agencies take the decision on the distribution of training vouchers according to the '70% percent rule', which helps to weigh the training benefits against its high costs. A voucher will only be handed out if there is a) a probability of 70 percent that the unemployed will immediately find a new job after finishing the training, and b) the training program he or she participates in has proved to have a 70 per cent placement rate in the past. In addition, private providers have to prove their capacities and experience to the new certification centres, which are in turn approved by the Public Employment Service.

A similar procedure of certification and quality management is common in the U.S. Unemployed persons awarded an Individual Training Account (ITA) in the U.S. can purchase training from an approved provider listed on the state's Eligible Training Provider list. Providers included on the list must be certified by the state and local workforce areas for predetermined performance criteria (Decker and Perez-Johnson 2004: 178).

In practice, in Germany the '70%-per cent rule', as one element of quality assurance, turns out to be difficult to realize in practice and is a pitfall for the neediest as a survey of German PES staff shows (German Bundestag 2006b: 101). It inhibits particularly 'weak groups', with a low prospect of immediate labour market integration, such as the elderly, single mothers, or low qualified persons, from participating in a training program. Because of the unrestricted eligibility criteria in the U.S., the PES' internal preferences for cost savings constitute less of a problem. However, on both sides of the Atlantic we have to deal with "creaming-effects". Providers are tempted to assess whether the specified performance criteria can be met depending on the participants' characteristics. Since jobseekers with multiple problems would downgrade the provider's integration rates, they might be declined.

In Germany, in addition, the local employment agencies are sceptical about the effectiveness of the certification centres. The certification centres are suspected of not being independent, since the potential certifying agencies are training providers themselves (German Bundestag 2006a: 93). A survey shows that only 16 per cent of the queried agencies were satisfied with this element of the reform (German Bundestag 2006b: 104).

Information Asymmetry

By introducing new evaluation measures the quality of the training programs is continuously assessed, and so information asymmetry and the preference errors it leads to are reduced by data on reintegration rates, consultation with jobseekers, and evaluation based on data from training providers. The focus in the quality assessment has shifted from a consultative evaluation to formal reports and management by objective (see figure 5). For example, a survey of German Public Employment Agencies found increased use of management by objective and compulsory reports but fewer on-site inspections and consultations with providers in 2005 than before the reorganization in 2003.

Insert figure 5 about here

The newly introduced quality management done by the German Public Employment Service is criticized by the training providers for focusing mainly on technical issues like size of the training venue and technical equipment (German Bundestag 2006a: 93). A survey of support for the reorganized training system shows that the majority of German training providers disapprove of the newly introduced steering mechanisms, quality assessment measures, and new eligibility criteria for jobseekers (German Bundestag 2006a: 94). Only 6 percent of the interviewees are satisfied with the total reorganization.

However, in the former system some training providers took advantage of the stable and more or less trust based contracting system. Providers suspected of having a self-serving mentality do not appreciate the reorganized system with more performance evaluation, less expenditure on training and more competition, but the public employment agencies themselves are also sceptical. In 2006, 47 per cent of the interviewed executive managers in 154 out of 180 employment agencies in total see the reorganization as (rather) negative or do not see any improvement (German Bundestag 2006b:105). The study finds similar results for their satisfaction with the new mechanisms for the annual “Bildungszielplanung” (the annual determination for the amount and type of training). Compared to the old system, 62 per cent rate the distribution of and access to vouchers as an aggravation, not an improvement (ibid.). Taken together, these figures indicate the difficulty in specifying performance and quality measures for highly complex services.

Furthermore, by placing choice of provider in the hands of the jobseeker, voucher programs attempt to reduce the close connections between the Public Employment Service and private providers. Because previous relational contracts between purchaser and provider led to intransparencies, the German staff in the local employment agencies is no longer allowed to make recommendations, but merely provide a list of approved courses. As these lists do not include vital information about the achieved reintegration rates, information gaps on the side of the jobseekers are filled by other institutions, such as trade unions or regional information centres. Large training providers have increased their marketing effort considerably and lobby these gate-keeping institutions (Bruttel 2005: 399). This may result in bias again.

In the U.S., establishing program eligibility requirements also has turned out to be a major problem. Although the administration of performance thresholds of providers varies across the states, there are some common legal requirements: The WIA legislation demands a subsequent eligibility for providers including quality measures based on how well the training program’s previous cohorts performed. These performance criteria take into account the performance of the ongoing program (e.g. program completion rates) as well as performance in the labour market thereafter (e.g. employment, retention, and wages). This is a major challenge in practice. The performance criteria involve thorny definitions and do not apply to the provider as a whole but to every single program. Thereby transaction costs for the providers greatly increase in both countries (Barnow and Smith 2004: 255; D’Amico and Salzman 2004: 121f; Decker and Perez-Johnson 2004: 182; German Bundestag 2006b: 103).

Preliminary outcomes show that a large number of public institutions such as community colleges, which played an important role under JTPA (WIA’s predecessor), are discouraged to make the comparably high effort to apply to be an eligible training provider for a comparably small number of clients (Decker and Perez-Johnson 2004: 189). This applies especially to small, community-based institutions, which were “an important source of contract training for hard-to-serve clients under JTPA” (D’Amico and Salzman 2004: 123). The low capitalization and small size of local institutions makes the challenge of irregular flow of training participants even more difficult than it is for large providers in the private sector (ibid.). “Experience to date raises questions about whether under its current structure the offered list provides sufficient valid information to justify its costs and inconvenience” (Barnow and King 2005: 40). A survey by the GAO shows (table 1) that 56 per cent of the local workforce development boards have problems getting providers on and off the eligibility list (Eligible Training Provider List, ETPL). Lack of quality data on provider performance under the new system is another important challenge that 65 percent of workforce boards encounter (table 1).

Insert table 1 about here

Efforts to address information asymmetries on the supply side fail because the formal quality management criteria are not necessarily a good indicator of the actual quality of the offered training programs, and providers decide not to participate in the voucher system because of the increased transaction costs associated with the new performance systems.

Problems with Market Formation

In a market in which information is inadequately diffused or simply not present, it is highly probable that the introduction of the training voucher system strengthens the biggest and most well-known – rather than the best – providers (O'Leary, Straits, and Wandner 2004: 307). Training for the unemployed usually consists of general measures like training in soft skills and information technology. Some providers have obtained economies of scale at the expense of local embeddedness and relations to local employers. In Germany, big or well-known providers, operating with scale effects apparently cope better with the new situation (IZA 2005: 7), whereas for small, more specialized providers “the certification process costs more than they are able to earn by offering courses” (Bruttel 2005: 399). In the U.S. D'Amico and Salzmann (2004: 125f) and the GAO (2005) report similar problems. Instead of the expected efficiency gains, a concentration of low quality providers appears as a consequence of introducing a voucher system. Problems due to failure of market formation because of high entry costs and low quality are detectable. The conditions of a “contestable market” (Baumol et al. 1982) are not met.

Since jobseekers in both countries can redeem their vouchers with any certified training institution, providers do not know whether a class might have enough participants to take place. If there are not enough participants, courses are cancelled and jobseekers can not – at least not immediately – start their training. In thinly populated regions with only a few providers or in specialized training fields a voucher system can thus have detrimental effects on the provision of training.

In Germany, almost oligopoly-like tendencies can be observed: Providers begin to cooperate with each other and decide not to offer similar classes in areas with restricted demand (Bruttel 2005, 400; IZA 2005: 8). Hence, instead of more efficiency and increased consumer sovereignty, such collusion may hinder market competition and reduce choice for jobseekers.

The decentralized administration in the U.S. reduces the problems with oligopoly, as decision makers can – under specific conditions – choose not to rely on the training vouchers and, instead, continue with contracting (Barnow and King 2005: 43; SPR 2004: VI-16). Workforce Development Areas that make use of the non-voucher alternatives reported lower unit costs for training; they consider specialized trainings (e.g. vocational training with English as second language classes) and customized trainings, geared directly to the employer's hiring needs, as more effective (D'Amico and Salzmann 2004: 125f; GAO 2005: 29). The lack of providers, however, also turns out to be a major challenge in the U.S. For example, “the area around one local board we visited in California faced a nursing shortage, but nearby training for nurses was difficult to obtain. Some area community colleges were opting not to provide nursing training because they could not recoup the costs” (GAO 2005: 28).

The lack of planning certainty for training providers and greater reliance on fixed-term contracts for the staff under vouchers undermine the social relationships and long-term perspectives for the development of training curricula. Even though such problems are not specific to vouchers and also may occur in a system of competitive contract bidding, a higher degree of uncertainty is implied under the voucher system. From other studies we know that service operators perform better in stable systems with longer term perspectives (Milward and Provan 2000: 368). In Germany, the introduction of the voucher systems led to a ‘fundamental

change in the relationship' (German Bundestag 2006a: 93) between the employment agencies and the training organizations. Training organizations complain that the information on the *Bildungspläne* provided on the internet – formerly announced in joint meetings – is not sufficient. They consider the process as non-transparent and complain about the competence of the Public Employment Agency employees (ibid.). It is difficult, especially for small training providers with less internal flexibility and a small financial base, to react flexibly to changes in policy during the ongoing accounting year (ibid.). Whereas the number of meetings and information exchanges between the employment services and the training providers went down, the number of formal regulations went up (see figure 5). A survey of the executive managers in the 163 German Public Employment Agencies found that 56 per cent thought that one reason for the high number of unused vouchers was a lack of providers (German Bundestag 2006a: 93, see also figure 4). Increased transaction costs and uncertainty may help explain the reduction in number of providers and array of program offerings.

Similar problems occur in the U.S. Because of the new performance and accountability requirements, some providers have opted out of the training voucher system. For them, the increased paper work and formal requirements are too costly in view of uncertain outcomes. As a result, Public Employment Services complain of the lack of providers in high demand occupations (44 percent), as well as the lack of qualified providers (32 percent) (GAO 2005, see table 1). Thus, market formation seems to be a problem in a partially restricted voucher model, as intervention may inadvertently reduce control by the employment agency and choice of the jobseeker.

Conclusion

Voucher systems were introduced to promote the twofold benefits of choice and efficient delivery through competition. We have explored the origins of market failures in job training voucher systems for two different types of market economies and welfare regimes, Germany and the U.S., by revealing the differences in preference and information among jobseekers, the Public Employment Service, and private providers on both the demand and the supply side.

In the old model the PES' case managers in Germany and the U.S. directed jobseekers to training providers with whom the PES previously had close relational contracts. In the new voucher models, jobseekers in both countries can chose a specific type of training from select providers. This restriction should ease the jobseeker's choice and compensate for information asymmetries. However, this guided model with its requirements for efficiency and formal certification restricts customer choice and runs the risk of overshooting the mark by allowing for creaming-effects and reducing quality and variety among training providers. Especially small and specialized providers lack sufficient resources to survive the increased insecurity linked to increased competition and consumer choice. The time and resource intensive quality management processes saddle them with an additional burden, which may lead to a shortage of specialized training. Transactions costs for government also rise as limited control in a managed market system is more difficult than the relational, trust based control present under the old partnership model. In addition, vouchers tend to reduce government's operational accountability. This suggests vouchers may be more appropriate for providing uniform (public) services with little outcome variation than for complex services such as job training.

Although both Germany and the U.S. are characterized as opposing types of market economies and skill formation systems, the shortcomings of a voucher system for delivering training for the unemployed are similar. While preference misalignment on the supply side, linked to the loss of governmental steering mechanisms and corporate self-administration, seem more likely to occur in a coordinated market economy like Germany, with its highly regulated

vocational training system and strong reliance on firm- and industry skills, the failure in a liberal market economy such as the U.S., with its decentralized school and market based skill formation system and strong reliance on universal skills, is more surprising.

Our analysis challenges the assumption of coherent regime types (Clemens and Cook 1999). The further training system deviates from the ideal type classification. Unlike the vocational training system, which is highly coordinated in Germany, further training appears to be almost as deregulated and atomized as in the U.S. This creates problems because a voucher system requires some coordination. While the formerly close relationship between the social partners and the Public Employment Service in the German system has been challenged as too close, for complex services it appears that close collaboration and planning offers greater potential for meeting long term social objectives than the vagaries of an atomized market system. The more decentralized model in the U.S. appears to better address the market failures analyzed above, because it allows for more flexibility, which is in fact used to revert to contracting (despite the *laissez-faire* logic of the liberal market economy). In contrast, Germany is characterized by a federal, standardized voucher system that does not allow such flexibility. Instead of more coordination the German voucher system, ironically, relies more heavily on market forces than the U.S.

The problems shown reside fundamentally in using a quasi market model for public goods. Vouchers require coordinating mechanisms regardless of the type of welfare regime or market economy. On the demand side information asymmetries prevent consumers from effectively exercising preferences. Instability in demand disrupts supply and undermines choice and quality in training options. On the supply side, managing the networks that result from introducing vouchers in job training is costly and complex. These are not simple management problems that can be addressed with more sophisticated management solutions, as argued by some network proponents (Goldsmith and Eggers 2004). Instead in the U.S., we can see the emergence of mixed systems which address market management while ensuring that social goals are met (Warner and Hefetz 2007, Hefetz and Warner 2007).

Differences in the implementation of the voucher systems in the two countries may offer insights on potential reforms. A better balance between consumer choice, quality control and government oversight is necessary. Jobseekers need better information and more stable, high quality choice. Providers need more security if breadth and quality in training is to be obtained. Public employment agencies need greater leeway in decision making and more flexibility in the implementation of voucher systems. Vouchers should be optional, especially in rural areas or for specialized occupations where markets are limited. Relying solely on a voucher market can not achieve these goals. Government must structure the market to ensure preference alignment, network management, and realization of long term social objectives.

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Notes

1 The so-called ‘placement - scandal’ of the German Public Employment Service in 2002 led to the formation of a commission on the reform of labour market services, named after its chairman, the former human resource director of Volkswagen, Peter Hartz. Beginning six months after the commission started its work, many of the proposals, including the introduction of training vouchers, became law between 2003 and 2005 in the *1. - 4. Gesetz für moderne Dienstleistungen am Arbeitsmarkt*. The reforms were heavily contested in the public and even lead to the formation of a new, leftwing political party, which entered the Bundestag in the parliamentary elections in 2005 (see Clasen 2005, Kemmerling and Bruttel 2006 for content and process).

2 A quasi-market is a market in which public goods and services are provided by private agents who compete for contracts. The purchasing power for these goods and services comes from the state rather than the final consumer (Le Grand and Bartlett 1993). Lowery (1998) distinguishes between the ‘provision consumer’ (government), who pays for the product to be provided to a third party, and the ‘production consumer’, of the finished product (the citizen).

3 Economic growth and better job opportunities at the beginning of W.I.A. implementation in the U.S. also led to less demand for training among jobseekers.

4 This cut-back in “Maßnahmen der beruflichen Weiterbildung” is less drastic when the increase in the short-term “Trainingsmaßnahmen” (2 to 3 days) is also taken into account.

5 In Germany, for example, training is assigned to unemployed only if they receive benefits and have a prognosis of at least 70 percent of an immediate reintegration in the labour market at the end of the training. For the liberal U.S. regime, by contrast, it is the other way around. Training for adult workers is theoretically universally accessible but limitations are set by the small amount of total available funds.

6 The tripartite structure – the state and the social partners, that is the employees’ and the employers’ representatives – is a basic institution of German social policy. The social partners, represented on the advisory board of the self-administered *Bundesagentur für Arbeit* (Federal Public Employment Service) determine strategy and budget policies in conformity with the legislative framework of the Ministry of Welfare and Labour (BMAS, formerly BMWA).

7 The General Accountability Office is Congress’ independent investigative arm charged with examining matters relating to the receipt and payment of public funds; more information can be found at <http://www.gao.gov/>.

8 This may be training as well as intensive services such as employment counselling and case management, or any other supportive service such as childcare and transportation. Using WIA demonstration funding, U.S. employment agencies can offer these Personal Reemployment

Accounts of up to \$3,000 and as an incentive. Recipients will be able to keep the balance of the account as a cash reemployment bonus if they become reemployed within 13 weeks (US DOL 2005).

9 The Further Training Reporting System (*Berichtssystem Weiterbildung*) is a survey of a representative sample of 7,000 German speaking persons between 19 and 64 years living in Germany.

10 Note to figure 3: Jobseekers can either be eligible for the Adult program (being unemployed and in need of services to find employment, or employed and in need of services to retain or obtain employment) or the Dislocated Workers program (being laid off and are unlikely to return to their previous employment, a displaced homemaker, or former self employed person unemployed due to economy / natural disaster).

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Figure 1: The Three Actors Providing, Delivering, and Consuming Public Services

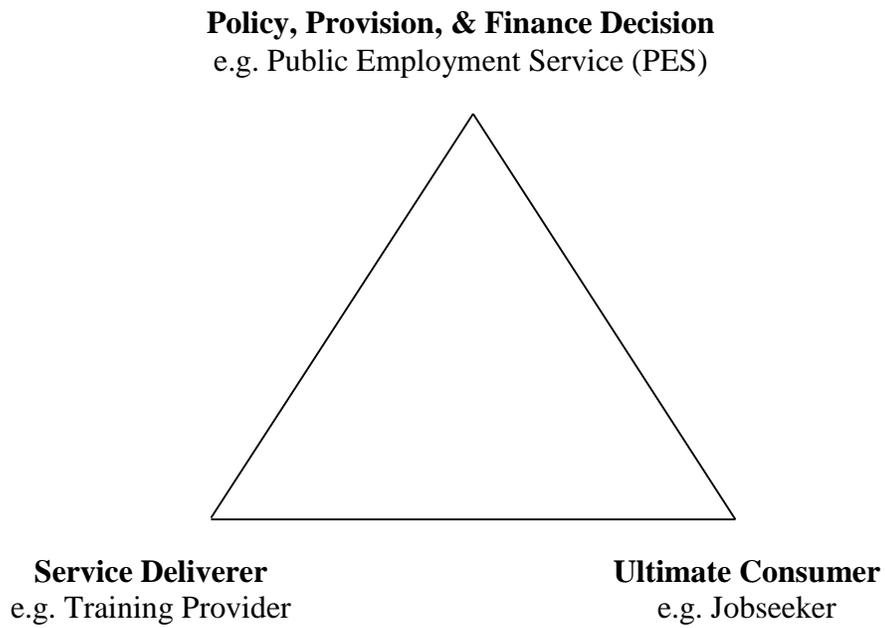


Figure 2: The Changed Relationship between PES, Private Provider, and Jobseeker

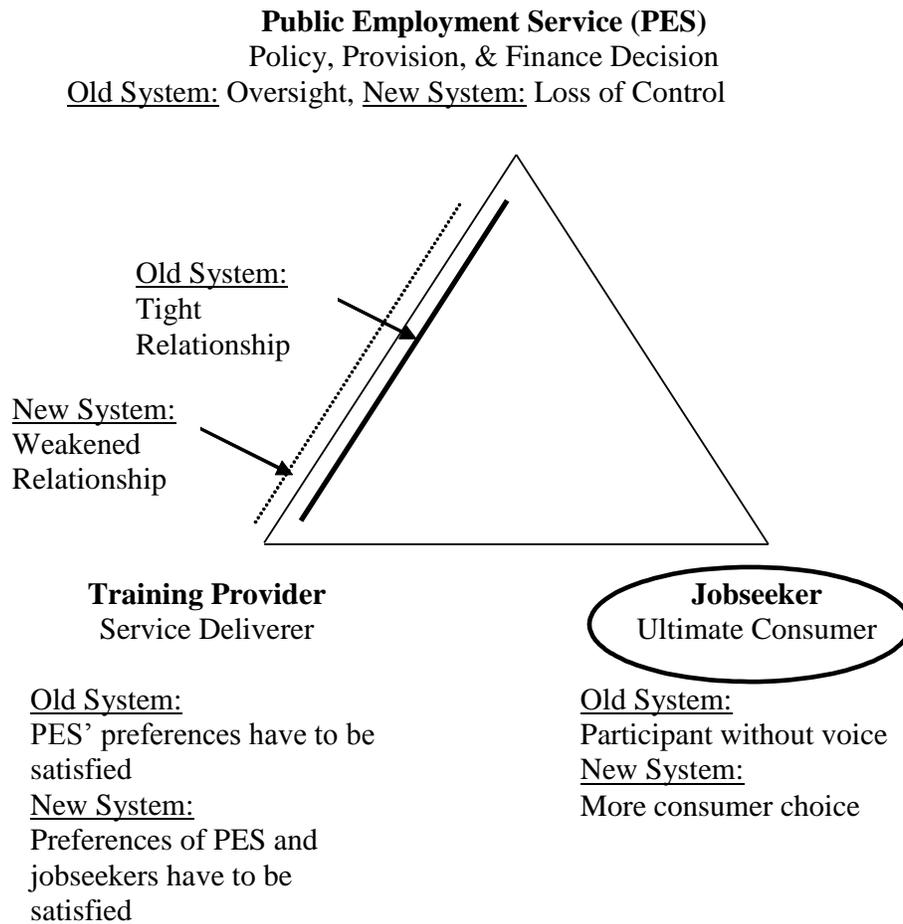
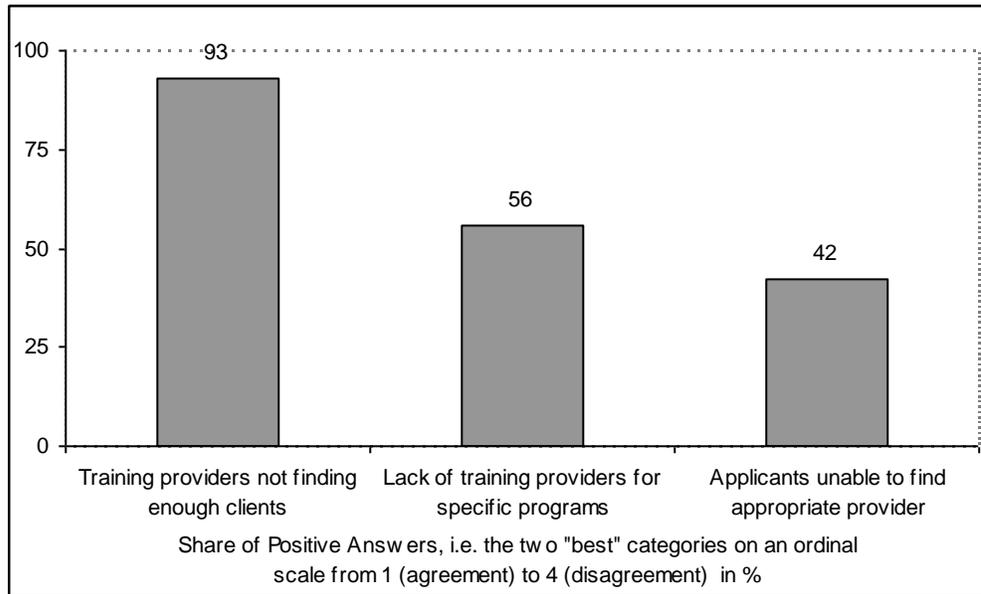


Figure 3: Reasons for the Non-use of Training Vouchers (Survey of Executive Managers in Public Employment Agencies)

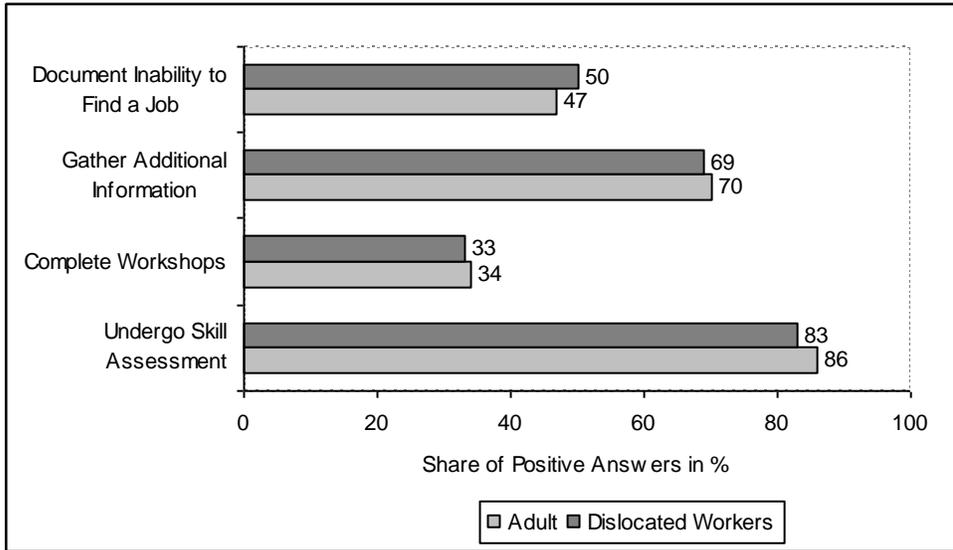


German Bundestag, 2006: 94

Evaluation 2005, Module 1b

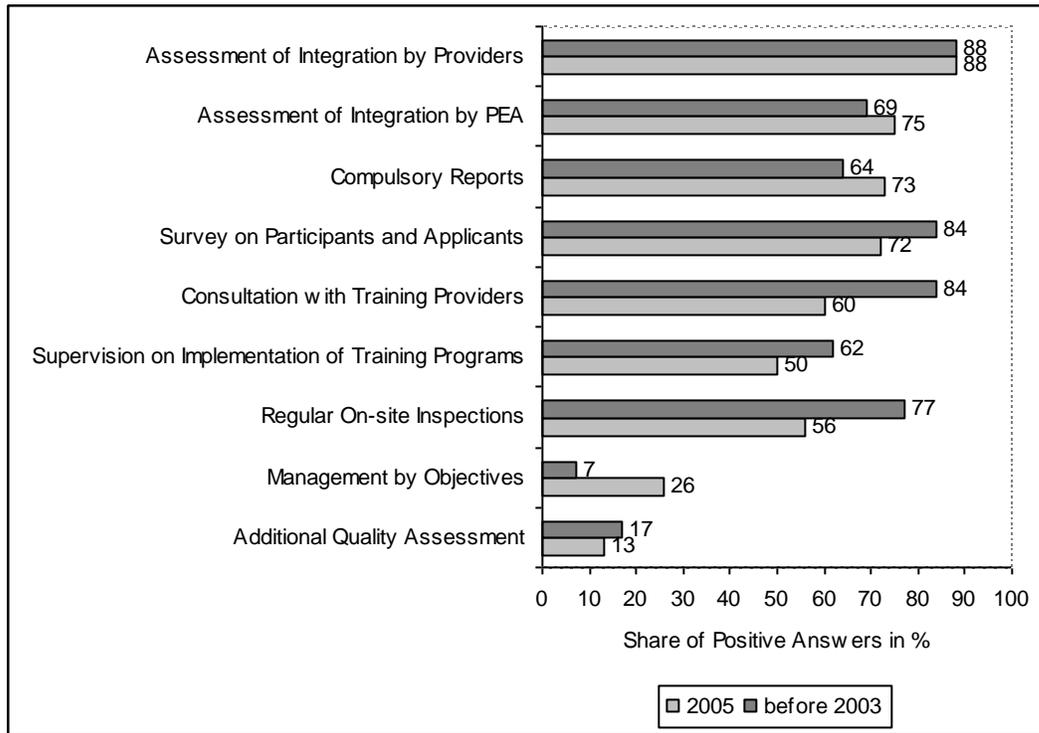
Survey of executive managers in 163 Public Employment Agencies

Figure 4: U.S. Local Workforce Boards Requiring Completion of Specified Activities for Adults and Dislocated Workers Seeking Training



Source: General Accountability Office (GAO), 2005: 21

Figure 5: Quality Assessment of Training Programs Provided By German Public Employment Agencies



Source: German Bundestag, 2006: 94
 Evaluation 2005, Module 1b
 Survey of executive managers in 163 Public Employment Agencies

Table 1: Challenges Encountered by U.S. Local Workforce Boards

Lack of Quality Data on Provider Performance	65
Timing of Training	60
Getting New Providers On ETPL*	54
Linking ITA** Systems with Local Economic and Business Strategies	52
Lack of Providers on ETPL Offering Training in High Demand Occupations	44
Communication Providers to Monitor Participant Progress	42
Clients Choosing Training in Low Demand or Low Wage Occupations	42
Management and Tracking of Obligations and Expenditures for Training	32
Lack of Qualified Providers	32
Lack of Local Control Over Participant's Selection of Training Provider	27
Federal Monitoring and Reporting of Local and State Spending	27
Getting Providers Off the ETPL	24
Formulating ITA Policies At the Local Level	22
Not Enough Guidance From Labour On Implementing ITAs	21

Share of Positive Answers, i.e., the third “best” categories on an ordinal scale from 1 (agreement in great extent) to 5 (agreement in no extent) in %

Source: General Accountability Office (GAO), 2005: 26

Web-based survey of all workforce investment boards in the 50 states, D.C., and Puerto Rico.

*ETPL = Eligible Training Provider List, **ITA = Individual Trainings Accounts