Australian Government
Department of Employment and Workplace Relations

Market design principles for employment services

Internal discussion paper

Office of the Chief Economist – November 2024

Summary

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- Without careful design, providers' incentives may lead them to behave in a way inconsistent with the system's objectives, such as by 'creaming' easy-to-place jobseekers and 'parking' others.
- Increasing the number of 'streams' or categories of job seekers, could allow payment structures that better reflect the additional effort required to assist job seekers who are further away from secure employment. This comes at a cost of increased complexity.
- Providers should be rewarded for moving participants closer to secure employment, even if they do not attain it. This would be difficult in practice but is an important principle to strive for.
- Greater reliance on outcome payments could reduce 'creaming and parking' dynamics, but also may make operations more difficult for smaller not-for-profit providers that have less ability to smooth income across operations and over time.

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Market design fundamentals

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What makes a good market?

There are several key general principles of market design.[1] These are:

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- In quasi-markets like employment services, care must be taken to align the incentives of providers with government, reducing the adverse effects of the **principal-agent problem.**

Market design is about creating a system in which job seekers and providers are encouraged, incentivised, and assisted to behave in a way that is aligned with the overall objectives. Market design is not necessarily just about creating or maximising competition. Design details matter – small changes in payment structures or other design features can have big effects on market participants' behaviour.

The principal-agent problem

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[1] See Roth, A. 2008, 'What Have We Learned from Market Design?', *The Economic Journal,* 118(527):285-310. [Link]

The **principal-agent problem becomes apparent in employment services is through creaming and parking dynamics**. Government would like providers to expend less effort on job seekers who are highly likely to find a job anyway, and more effort on those who require support. But providers may maximise profitability by focusing on easy-to-place job seekers ('creaming') and expending little effort on those with a lower probability of finding employment ('parking'). Improving the alignment of providers' incentives with government's objectives should reduce (although is unlikely to ever eliminate) this behaviour.

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Core design choices

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Structure of payments

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Outcome-based payments are a key way that the principal-agent problem can be addressed, by incentivising providers to act in accordance with the system objectives. However, some drawbacks of over-emphasising outcome-based payments are:

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- Outcome-based payments create the possibility of gaming (eg. churning job seekers through short-term employment) if the outcomes are not well-designed.

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Pricing for different types of jobseekers

Overcoming creaming and parking dynamics is a key goal of employment services market design.

In an ideal system, a provider would receive the same expected financial return from a unit of effort (eg. an hour of staff time) to any given job seeker. This expected financial return is a function of how likely a person is to find work, and how much the provider stands to receive if they do so. Given some job seekers are much more likely to find work than others, providers will in practice face much stronger incentives to help the easy-to-place job seekers unless the outcome payment structure is highly differentiated, with much higher payments for hard-to-place job seekers.

The Workforce Australia system already features some differentiation, with higher employment outcome payments for job seekers with high Job Seeker Classification Instrument (JSCI) scores than those with moderate scores. s 22(1)

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Pages 7-9 removed under section 22(1)(a)(ii) of the *Freedom of Information Act 1982*.

These pages contain information that would reasonably be regarded as irrelevant to the request for access.