

COMPETITIVE TENDERING AND CONTRACTING OF TEMPORARY WORK AGENCIES IN GERMANY

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Introduction

In the wake of the general trend towards privatisation and deregulation in the last few years, public employment services have also been privatised in various OECD countries. After the OECD promoted privatisation in their “Jobs Study” of 1994 as a means to increase efficiency, Australia, in 1998, replaced its public employment service with a private “Job Network” of approximately 200 firms. Placement contracts were awarded to these companies in a tendering procedure. Performance is remunerated with state premiums based on placements (Lundsgaard 2002, 109; OECD 2001). In 2000 the Netherlands followed Australia’s example – to name the two most important countries (de Koning 2004).

In addition to matching job-seekers with vacancies, counseling etc., hiring out of the unemployed can also be a means of procuring a permanent job. In Germany the placement-oriented hiring-out by private firms has been used since 1994, in particular since the implementation of the Hartz Commission’ proposals by the federal government in 2003, as an instrument of labour-market policy. In order to ensure efficiency, private hiring-out is regulated and promoted in a way that has not been previously tried anywhere. In addition to a tendering procedure to select temporary work agencies, a degressive lump-sum per case and placement premiums are paid by the government for their services. The question arises as to whether the regulations and incentives selected lead to an efficient placement of the unemployed in regular employment. As initial results are now available, it is possible to make a provisional evaluation.

Private temporary work agencies and the public authorities’ interest in placement

Inefficiencies that arise when public authorities hire out the unemployed can be counteracted –

aside from internal administrative organisational and structural reforms – by having private temporary work agencies hire out the unemployed in a competitive market. Temporary work agencies endeavour to provide appropriate information with respect to the availability and quality of positions and applicants to those looking for work as well as to (potential) hiring-in firms. They bring together job offers and job seekers and thereby increase the matching efficiency. Competition between agencies contributes to increased efficiency.

The placement results of private temporary work agencies, however, can hardly satisfy the public authorities in times of high unemployment. There are, in particular, three reasons that have induced the labour office to exercise influence on the behaviour of private temporary work agencies in the form of regulations and financial incentives:

- From the point of view of hiring-in firms, the attractiveness of hiring-in depends largely on the fees they have to pay. In Germany experience has shown that temporary work agencies calculate twice the gross salary of their workers. With better-qualified workers the fee is somewhat higher, with less qualified workers somewhat lower. A certain demand for agency work develops with a given level of fees. By providing state subsidies the fees are reduced, the demand for agency work rises and thus the chances for final placement of the unemployed in the hiring-in firms are increased.
- In addition to the hiring fees, it is the quality of the offer that makes hiring-in attractive. As a result of market failure the quality can be quite low. Market failure exists if when placing a worker there is an information gap with respect to the quality of placement between the temporary work agency and the customer. This is likely to happen quite often, as the hiring-in company is only able to determine in the course of the working relationship whether the work agency has chosen and hired out a worker who meets his expectations. But if one market side has an information lead and thus a strategic advantage, the quality of the offer can deteriorate, as was shown by Akerlof, for example, in the used automobile market. A reduction in demand for agency work is the result, and temporary work agencies experience a loss of reputation. Such a

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development can be counteracted on the part of the temporary work agencies by self-regulation and building up a reputation (for example, in the form of quality seals). The state, on the other hand, can contribute to an increase in quality by establishing regulations for professional practice, by requiring licenses for private temporary work agencies or by selecting suitable agencies through tendering (Konle-Seidl 2002).

- In addition to the expansion of agency work, public authorities are particularly interested in final placement of the unemployed in the hiring-in firms. This, however, is not a goal followed by private temporary work agencies. They are not interested in their manpower being hired away. They prefer relatively short working periods in the hiring-in firms and thus hinder permanent placement. They also do not invest sufficiently in handling and qualifying their workers and do not keep up the contact needed for successfully integrating them in the hiring-in firms (Schröder 1997, 299). Furthermore, as they recruit only 30 percent of their employees from the reservoir of registered unemployed in Germany, they only partially fulfil the task of finding regular work for the unemployed (Jahn and Rudolph 2002).

In view of the dissatisfying results of private temporary work agencies, from the viewpoint of the public authorities, their activities have been supplemented since 2003 by so-called Personal Service Agencies (PSA), which are regulated and subsidised by the federal government. According to Art. 37c of the Social Security Code, Third Book (SGB III), all of the 180 local labour offices are obligated to set up at least one PSA. Its task is to hire out workers with a view to integrating them in the hiring-in firms as well as to provide further training for staff in work-free periods. The PSA contracts are tendered for in public competitions. The number and professional make-up of the PSA employees is determined largely by the local labour office and is described in the invitation to tender. The activities of the PSA are subsidised.

The tendering procedure

The tendering procedures involve the discretionary awards of PSA contracts by local labour offices according to the German regulations governing invitations to tender. The procedure involves three stages.

The pre-selection of agencies begins with an invitation to tender published in the *Bundesausschreibungsblatt* (Federal Register) and in the press. Based on this description, interested parties may submit applications to participate in the competition to the local labour offices. They must prove their reliability. Furthermore, they must also show evidence of their experience in commercial or non-profit hiring-out, private job search assistance or their involvement in active labour market policies. Having carried out such an activity in the last twelve months is sufficient proof. Lastly they must provide evidence of their performance. In general, this requirement is fulfilled if a private temporary work agency has employed at least 30 agency workers in the last twelve months. From the list of applicants the labour office selects suitable candidates, who are then given the opportunity to submit a tender.

The tender must include an offer with a basic fee (see below) as well as a detailed concept for the PSA, which clearly shows the quality of the competing tender. This concept must include specifics concerning the personnel and structure of the planned PSA, the collective agreement to be used, the strategy for acquiring contracts, the expected extent and use of work-free periods, as well as the achievable integration/placement rate, which can be used as a measure of success when deciding on contract extension. The offers are evaluated according to criteria connected with price and quality. It is thus a kind of beauty contest. The tender price is given a weight of 60 percent, the quality of the offer based on the PSA concept 40 percent. The PSA concept is summarily evaluated on a scale between one and ten. The joint evaluation of the tender price and the PSA concept is based on a formula that reflects the tendering price of the firm in question and that of the lowest offer as well as the quality points received for the firm in question and that of the company with the highest quality rating.

After the evaluation has been completed, the labour office negotiates with up to five bidders who have submitted the most economical offers. Finally a contract, which is usually limited to 24 months, is signed with one of the bidding companies.

This awarding procedure has advantages and disadvantages. By setting up a qualifying competition in advance, the number of bids and thus the variety of bids is restricted. Newcomers have a reduced

chance of participating. On the other hand, a restricted invitation to tender increases the success chances of the bidders so that they take greater care in preparing their bids, which in turn increases the quality. Furthermore, restricted tendering involves cost savings for the businesses as well as for the labour offices, as they have fewer bids to prepare or evaluate, respectively.

Different criteria are used for the evaluation of the applicants and the bidders. In the qualifying competition, criteria are used that evaluate the characteristics of the companies (reliability, expertise, performance) and determine their basic suitability as a PSA. The standards for the selection in the tendering procedure are process criteria that characterize the intended behaviour of the PSA as well as the expected placement rate (for more on the criteria, see Dykstra and de Koning 2002). Too little weight is placed on criteria that indicate the success the bidding firms had in the past of finding permanent work for the unemployed.

The evaluation of the applications and the bids is based on criteria that are not always clearly formulated and in some cases are not measurable. Price and quality of the offers are evaluated together, using a formula in a relationship of 60 to 40. Experience so far, especially the bankruptcy of the firm Maatwerk, makes it advisable to place more weight on the quality of the bids. The awarding of points for the quality of the PSA concept is based on the subjective evaluations of the responsible employees in the local labour offices. Thus the bidders do not know what standards are used to evaluate the individual parts of their PSA concept.

Size and make-up of target groups

In the tendering procedure it is the task of the labour offices to determine the number of people to be employed by the future PSA and the characteristics they have. The goal is to ease the decision on the part of the firms to participate in the competition and to provide information they need to calculate their bid. A specific size makes it easier for the *Bundesagentur für Arbeit* (Federal Employment Agency), which is responsible for the financing of the local labour offices, to estimate the funds needed for the PSA. It also reduces the costs for negotiating and thus the transaction costs for the individual labour offices.

The target groups for the PSA are the unemployed who are fit to work and have skills suitable for agency work. The target groups are selected by the local labour office. Labour offices tend towards a narrow selection of the target groups based on occupations characteristics, following their traditional administrative structure (for example, unemployed in commercial areas) and to vary this selection only on the basis of personal characteristics (old/young, well/poorly qualified). A homogeneous group of agency workers in occupational terms will in fact reduce “cherry picking”. On the other hand, the PSA will not have the flexibility to react in a suitable manner to differentiated personnel demands. This can lead to more work-free periods for the PSA employees. Temporary work agencies thus argue that the target group should be professionally mixed with an emphasis on the commercial-technical professions that are in high demand. The demand on the part of the PSA to define the target group more loosely is now being met by more and more labour offices. As a result they not only support the temporary work agencies in their work, but they also make it possible for the hiring-in firms – at least in larger labour office districts – to approach a number of PSAs, each with a wider range of personnel, instead of having to deal with only a few specialized PSAs.

The target number of agency workers as agreed between the local labour offices and the PSA is to be achieved within three months. Initially the labour offices pursued this goal energetically, insisting that those who cannot be hired out be trained instead. To reduce the cost burden for the PSA, more and more labour offices have accepted that the unemployed are only hired by the PSA when a contract with a hiring-in firm is available. The future PSA employees are suggested by the labour office. The PSA has the right to reject applicants. The unemployed are hired by the PSA for a limited period of nine to twelve months, during which time they are subject to social insurance contributions. During this period the PSA employee is to be hired out and placed in permanent employment as quickly as possible.

Financial support

Control of the PSA is achieved by subsidies and premium-oriented incentives. This system is based on but not identical to suggestions made by the

Bertelsmann Foundation et al. (2002) and Hartz et al. (2002). It is meant to prompt the PSA to a rapid placement of their employees in the regular labour market.

The PSA receives a monthly lump sum per case from the labour office and a premium for placement in a regular job. The lump sum and the placement premium are based on the basic fee cited in the bid. The bidders have calculated this amount so that the PSA can make a profit but at the same time have good chances of obtaining a contract. The basic fee varies according to occupation and the placement difficulties of the target group as well as the nature of the regional labour market.

To ensure rapid integration into the regular labour market, the lump sum and the placement premium are degressive. The monthly lump sum amounts to 100 percent of the basic fee for the first to third month of PSA employment, 75 percent of the basic fee for the fourth to sixth month of PSA employment and 50 percent of the basic fee for the seventh to ninth month of PSA employment. After nine months the PSA no longer receives a monthly lump sum per case. The monthly lump sum is not paid if the PSA employee is hired in by a previous employer with whom he held a position subject to social insurance contributions for more than three months in the last four years.

The placement premium amounts to 200 percent, 150 percent or 100 percent of the basic fee if the PSA employee takes on employment during the first three months, the fourth to the sixth month or after the sixth month, respectively, with a hiring-in firm or another firm through the efforts of the PSA. The premium is paid in two instalments. The first half is due when a job subject to social insurance contributions for at least three months is begun and the second half after an employment period of six months. It is the task of the PSA to provide documentary proof.

PSA contracts

To document the effectiveness of the PSA as an active instrument of labour market policy, the *Bundesagentur für Arbeit* (BA) has published a few indicators of PSA activities in their labour market statistics. This information covers the time period from April 2003 to March 2004. In addition the BA

has developed together with the *Institut für Arbeitsmarkt- und Berufsforschung* (IAB) an evaluation system that reports on the activities of the PSA. In April 2004 this report was not yet accessible to the public. IAB employees have, however, manually evaluated the following information for April to November of 2003 (Jahn and Windsheimer 2004a and 2004b; referred to below as JW).

In March 2004 there were 919 PSAs in Germany with some 40,000 places for the unemployed (BA). In October 2003 there were almost 43,000 PSA places available (JW). With respect to the size of the target groups from April to November 2003 the following situation prevailed: in 455 cases, almost half of all contracts, the number of places to be filled was between 40 and 60. 32 percent of the PSAs had a size of between 20 and 40, and around 15 percent of the PSAs were able to employ between 60 and 80 unemployed. The average size was 45 (JW). For 41 percent of the contracts the basic fee was set at between €1,100 and €1,300. Nearly one-fourth of the PSA contracts stipulated a basic fee of between €900 and €1,100. In 14 percent of the cases there was a basic fee of between €700 and €900, and for 13 percent a basic fee of between €1,300 and €1,500. The average basic fee amounted to €1,099 (JW).

Performance

In March 2004 PSAs employed just under 27,000 jobless (BA). In October 2003 some 1,000 PSAs with about 30,000 agency workers were active in the labour market (JW). It is noticeable that PSA employees are somewhat better qualified than traditional agency workers. Nearly 61 percent of the former had absolved an in-company training programme compared to 54 percent of the latter. Also in terms of other socio-economic characteristics PSAs offer those unemployed a position that have "normal" placement difficulties (JW). This choice of personnel runs counter to the goal of the subsidies, namely to promote employment of those with greater placement obstacles.

Of the average number of those employed by the PSA from April to October 2003 (14,091), a good 43 percent were hired out. This number is based on the relationship of actual hiring-out days to the possible hiring-out days without taking account of non-working days, such as illness, holiday, etc. (in nomina-

Rates of integration and placement for PSA employees, in percent

	Exits and entry into regular employment subject to social insurance contributions / all exits			Placement/hired out-agency workers
	April 2003 to March 2004 ^{a)}	April 2003 to February 2004 ^{a)}	April 2003 to October 2003 ^{b)}	April 2003 to October 2003 ^{b)}
Employment subject to social insurance contributions				
- in hiring-in firms	} 31.3	} 40.1	11.0	16.3
- in other firms			25.1	
- placed by PSA			11.3	
- employee's own initiative				
Denominator, absolute	29,117	19,141	9,005	6,073

Source: ^{a)} Bundesagentur für Arbeit (<http://www.pub.arbeitsamt.de/hst/services/statistik/detail/a.html>).
^{b)} Jahn and Windsheimer 2004b; calculations by CESifo.

tor and denominator; JW). Low figures like this would strongly endanger the economic viability of 'normal' temporary work agencies (Ochel 2003). As the bankruptcy of Maatwerk at the beginning of 2004 shows, PSAs can not manage low rates either.

The *Bundesagentur für Arbeit* does not publish placement rates in hiring-in firms, only the average integration rates. These compare the number of agency workers withdrawing from PSAs and taking on regular employment subject to social insurance contributions and that of all withdrawals from the PSA. The withdrawals and entry into regular employment include positions with the hiring-in firms and other firms. Between April 2003 and March 2004 the integration quota was 31.3 percent; until February 2004, before the bankruptcy of Maatwerk was included in the calculation, the figure was 40.1 percent (Table).

The figures provided by Jahn and Windsheimer are more detailed. They have the disadvantage, however, that only the first six months of the PSAs' activities have been evaluated – a period in which the effectiveness of the PSA had not yet been fully developed. As the Table shows, the integration quota from April 2003 to October 2003 amounted to 47.4 percent. Placement in hiring-in firms was, however, only 11 percent, a figure that is not surprising for the first six months of PSA activities. If placement refers to those hired out and not to withdrawals, then the placement rate rises. At 16.3 percent the rate is, however, considerably lower than the standard 30 percent achieved by private temporary work agencies in Germany (Ochel 2003). It is expected that the placement rate will be considerably higher in the future. The low placement in hiring-in firms was compensated

partly by the placement of PSA workers in other firms. 25.1 percent of the exits found regular employment subject to social insurance contributions in this manner. Thus, in the beginning phase the PSA tended to function more as normal placement agencies than as temporary work agencies. In the end quite a few PSA employees found work through their own initiative.¹

Summary

Since 2003 private temporary work agencies – so-called Personal Service Agencies – have been increasingly used as an instrument of labour market policy. In each of the 180 German labour office districts at least one PSA has been set up. They are regulated and financially supported in a way that is unknown in other countries.

The PSAs are selected by the individual labour offices in a discretionary tendering procedure preceded by an open competition in which candidates are chosen to participate. This is basically a kind of "beauty contest". The bidders have to suggest a basic fee on which the financial support is based and present a concept for the PSA. The labour offices set the number of workers to be employed by each PSA. The average target group size for 2003 was 45. The labour offices also decide on the characteristics of the unemployed who are employed by the PSA. The PSAs receive for each unemployed they employ a degressively declining monthly lump sum and a placement premium. The sum of both amounts is based on the basic fee cited in the bid.

¹ The 52.6 percent of withdrawals from the PSA for other reasons have been excluded (JW).

Initial results of the PSA activities are now available for a preliminary evaluation. In March 2004 there were 919 PSAs with approximately 27,000 employees. Contrary to performance expectations of subsidised agency work, it was primarily the unemployed with relatively few placement obstacles that were employed by the PSA. This bias could have to do with the pressure to succeed with which the PSA as a new instrument of labour market policy was introduced. Only 43 percent of the average number of agency workers were hired out. The placement rate in hiring-in firms was still quite low in the beginning phase but should rise in the future. The effectiveness of the awarding procedure and the financial support of the PSA have, as yet, not been questioned by the general public in Germany. An exact evaluation is only possible when sufficiently detailed information is available for a longer time period.

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