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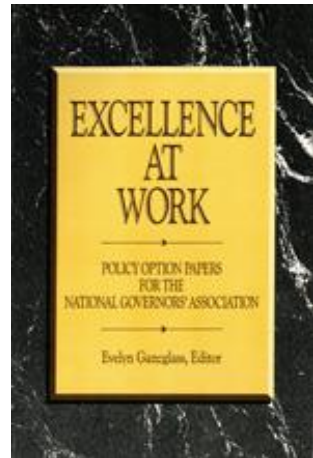
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# State Strategies for Building Market-Based Workforce Preparation Systems

Robert G. Sheets  
*Northern Illinois University*

David Walter Stevens  
*University of Baltimore*



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# 3

## **State Strategies for Building Market-Based Workforce Preparation Systems**

Robert G. Sheets  
*Northern Illinois University*

David W. Stevens  
*University of Baltimore*

Industry and occupational shifts, technological advances, growing international competition, and labor force changes in the face of tight government budget constraints and concerns about the efficiency and effectiveness of government programs have forced states to rethink how they fund, administer, and deliver vocational education and employment and training programs. States have undertaken a diverse set of initiatives to develop a more comprehensive and integrated set of workforce preparation programs that are more responsive to labor market changes and are more consumer-oriented and performance-driven.

In conjunction with federal performance standards initiatives, most states are reshaping their workforce preparation programs through the use of performance standards systems that define and report performance outcomes on publicly funded programs. Some states are experimenting with other types of market-oriented strategies to improve efficiency and flexibility, including competitive contracting policies, consumer information and counseling, performance sanctions, business tax incentives and grant programs, and voucher systems.

The challenge for states in the 1990s is to put these market incentives together into comprehensive market-based workforce preparation systems. Although most states have implemented performance standards systems and have experimented with other related market incentives, they have yet to integrate these market incentives into

comprehensive market-based systems. Performance standards systems and other types of market-oriented strategies are likely to be ineffective and to produce negative side effects unless they are integrated into comprehensive market-based delivery systems. We propose that states can build these systems through a practical six-step approach that begins with strategic planning and performance standards systems and ends with new state programs that provide businesses and workers with greater consumer control and choice.

We use Kolderie's (1986) distinction between provision and production to describe the major design principles for building comprehensive market-based workforce preparation systems. We then review issues related to providing services; namely, how states can establish strategic policy objectives and performance expectations for these programs. We then shift to issues related to producing services, and discuss four types of market incentives that should be used together in delivering workforce preparation services.

We follow with a review of six potential problems and constraints that states can address through the integrated and refined use of market incentives. Throughout this discussion of provision and production issues, we provide examples from federal and state workforce preparation programs, including the public employment service, vocational education, and employment and training programs for the economically disadvantaged. The paper concludes with recommendations for how states can build effective market-based workforce preparation systems.

### **Provision and Production in Market-Based Workforce Preparation Systems**

What are the most difficult challenges for vocational education and employment programs in the 1990s? Why do we need market-based systems to meet these challenges?

## **Challenges for Changing Workforce Preparation Programs**

The following market pressures are some of the challenges that are likely to stretch current vocational education and employment and training programs to their limits.

### *Higher Standards and Limited Public Funds*

The major economic development challenge facing states is establishing a world-class workforce with which businesses can achieve productivity and quality levels superior to those in other states and abroad. These competitive pressures will impose higher quality standards on public vocational education and employment and training programs. More people must be produced who have world-class basic and vocational skills. Public programs are faced with the difficult task of meeting these international standards without major increases in federal and state funding. This can only be accomplished with effective leveraging of private resources and productivity increases and cost reductions in public programs.

### *Changing Customer Requirements*

Changing skill requirements in the workplace and an aging workforce will require more emphasis on adult retraining (Office of Technology Assessment 1991). This will require public program developers to work more closely with employers, industry and professional associations, and unions to provide education and training services designed especially for adults, and to deliver these services closer to home and work. This also will require more flexible types of funding and delivery strategies between the public and private sectors.

### *Shortened Training Life Cycles*

The shortened training and technological life cycles in the private sector as described by Flynn (1988) will make it difficult for public programs to recruit trained instructors and purchase instructional equipment in order to respond to changing industry skill requirements within the necessary time frames and cost constraints. This will force

managers of public programs to develop new strategies to respond more quickly to market changes.

### *Work-Based Learning*

Comparisons with our international competitors have shown that applied work-based learning is critical to the success of school-to-work transition systems and adult vocational education programs (U.S. Department of Labor 1989). The introduction of work-based learning in the United States will require states to rethink their entire secondary and postsecondary vocational education systems as well as their funding and regulatory control over private sector training.

### *Instructional Technology*

Innovative instructional technologies, such as computer-based instructional systems and distance education offered through integrated video and satellite transmission, has been shown to be a cost-effective approach for worker training (Office of Technology Assessment 1991). These new instructional technologies will increasingly dissolve the competitive advantages of school-based classroom instruction and provide states with the opportunity to restructure public sector delivery of vocational education and employment and training programs.

### *Growing Private Sector Industry*

The growing private sector education and employment and training industry serving the needs of American businesses will present new opportunities for public programs to utilize private sector organizations to deliver publicly funded services (Carnevale et al. 1990). It may also provide stiff competition for postsecondary education and training programs serving adult workers. This growing sector will require new government policies to promote efficient coordination between public and private programs.

## **Institutional Limitations of Public Programs**

### *Ambiguous Policy Goals and Performance Objectives*

The first major limitation in vocational education and employment and training programs is the lack of clear public policy goals and performance objectives. The Job Training Partnership Act (JTPA) was implemented with unresolved language as to who was to be served—those who are most in need or those who could most benefit from employment and training services (Bailey 1988). The United States Employment Service has never been given specific policy goals. It has been hampered by vague and shifting priorities throughout its existence (Cohen and Stevens 1989).

When goals are ambiguous, policy decisions become extremely decentralized and fragmented. Policymaking is put in the hands of service producers ranging from public educational institutions and state agencies to private nonprofit organizations and businesses. As a result, public and private service producers use public funds to pursue their own goals without clear state performance objectives.

### *Regulatory Systems Based on Design Standards*

In the United States, the specification of quality standards for accreditation and credentialing purposes has been delegated to public service deliverers and their public administrative agencies or quasipublic regulatory boards. Vocational education and employment and training programs traditionally have emphasized design over performance standards as a basis for regulating the quality of services among service producers. Design standards address detailed aspects of the internal administration and operation of a program (Salamon 1981). They include process issues such as administrative structures and procedures, service mixes, service approaches and methods, staff qualifications, and financial accounting and reporting. In contrast, performance standards address the outcomes or results of the program, leaving issues of internal operation to the producer.

Regulatory systems based on design standards deflect attention from performance outcomes and result in ineffective regulatory systems that

encourage state administrative agencies to micromanage local programs based on their own design standards or to develop very weak regulatory control systems. The problem with design standards is that we do not always know what works in achieving different goals with different client populations in different contexts. We do not know what combination of factors will produce the greatest output. Performance standards simplify state quality standards by only judging the performance of the service producer.

The most serious problem with the current accreditation and credentialing system is that service producers establish their own credentials that many times are incompatible with the credentials of other service deliverers. This makes it difficult for customers to make full use of public and private service producers and imposes significant switching costs on people in moving between public and private education systems, or between different levels of the public educational system. It also results in confusion among employers as to the meaning of education and training credentials from workforce preparation programs.

#### *Public Funding and Consumer Control*

Most public service producers have no direct incentives to improve services to customers. These service programs are operated through government and educational bureaucracies, with funding systems that insulate them from external market pressures exerted by private customers (Sheets 1989). With the exception of student grants and loans, most federal and state funding of vocational education and employment and training programs is channeled directly to public administrative agencies and their service producers, who then must market their services to targeted consumer groups.

Performance is defined in terms of client enrollment and service levels as opposed to effectiveness in serving clients. This results in the formation of strong public spending coalitions of administrative agencies and service deliverers who direct more effort to lobbying for increased public funding than meeting the needs of consumers (Sheets and Stevens 1989). This strong orientation is reinforced by professional sheltering arrangements, such as profession-dominated licensing

and accreditation systems, faculty tenure systems, and complex civil service systems. Strong consumer control and market responsiveness are lost in most cases.

These institutional arrangements make traditional efforts at coordination ineffective (Sheets and Stevens 1989). Federal and state efforts to establish state or local coordinating councils or boards have not been successful in the past and will likely encounter the same problems in the future. Government agencies and educational institutions again have no direct incentives to work with other public programs to improve their performance with their customers. A new approach to coordination must be fashioned from a larger institutional transformation of the public delivery system.

### *New Systems for New Challenges*

Existing government agencies and educational institutions have served us well in the past. However, there is no obvious reason why the public institutions that arose from yesterday's needs should be expected to be optimal for today's and tomorrow's needs. The historical luxury of being able to mount new initiatives through institutional innovation, without direct action toward already existing agencies, is no longer viable. This has been the predominant American strategy with new generations of programs being created in a spirit of free-wheeling policy entrepreneurship outside the normal channels of government (Smith 1983).

The War on Poverty created a new delivery system that circumvented traditional public educational institutions and the public employment service. State customized training programs were created to meet the training needs of businesses that were not being met through public secondary and postsecondary schools (Creticos and Sheets 1989). If we continue to protect existing public service producers, we simply will not have enough public resources to meet today's workforce preparation challenges. We need major changes in how we finance and deliver virtually all workforce preparation services.



## **Market-Based Provision and Production**

How should states build comprehensive workforce preparation systems? Strong international competition from Japan and Europe has lead public and private leaders in the United States to look to other industrialized countries for more effective national models of workforce preparation systems. Although comparisons with our international competitors are extremely useful, we must build our own model. The states' challenge is to achieve world-class standards in workforce preparation through government policies that work best within the structure of American political and economic institutions.

American institutions are unique in their commitment to individual choice and responsibility, a market economy, a strong and active voluntary, nonprofit sector, and decentralized pluralistic government under state and local control (Smith 1983). These institutional characteristics should be weighed heavily as we reshape public education and employment and training programs in the United States.

The American commitment to private markets and increasingly tight budget constraints will require that states leverage private education and employment and training resources wherever possible. Building a comprehensive workforce preparation system in the United States requires careful consideration of how best to utilize private education and employment and training programs and how best to integrate public and private programs.

The private vocational education and job-training system accounts for over one-half of all organized instructional activity in the United States (Carnevale 1986). It is funded and delivered by a variety of private organizations, including employers, industry associations, unions, professional associations, and community-based organizations. The public employment service handles only a small fraction of job placements, with the remaining managed by a variety of private for-profit and nonprofit organizations (Cohen and Stevens 1989). Federal and state programs traditionally have used private organizations to deliver education and employment and training services.

States should build their workforce preparation systems through a comprehensive market approach that utilizes market incentives to improve the use of the private sector in public programs and improve the interaction between public and private systems. This approach also uses market incentives to transform public sector producers into more market-responsive organizations that better approximate the efficiencies and flexibility of private, for-profit organizations operating under competitive market conditions.

Kolderie's (1986) distinction between provision and production is useful in rethinking the public and private roles in a market-based workforce preparation system. *Provision* involves decisions about whether to have a service, how much of it to have, what quality standards it should meet, and to whom and under what conditions of availability and cost it should be offered. It involves the basic decision on what service should be provided to achieve what public policy goal. *Production* involves the assembly and maintenance of the resources needed to deliver a particular good or service and satisfy the provider's requirements. It involves decisions regarding what forms of government action (e.g., government grants, tax incentives, social regulations) and what organizations should be used to deliver a product or service to a client population.

The American system for vocational education and employment and training services contains a diverse mixture of public and private provision and production. For example, public employment services are publicly provided and produced through a state agency—the Public Employment Service. This public system is complemented by a parallel privately provided and produced job search and placement industry. In contrast, public postsecondary vocational education and employment and training programs for the economically disadvantaged are based on public provision, with a mixture of private and public production through public educational institutions, proprietary schools, and nonprofit community-based organizations.

The market approach would require states to restructure their approach to the public provision of workforce preparation services.

Market-based provision of these services requires renewed emphasis on the following issues:

1. **Strategic planning:** establishment of public-private consensus-building mechanisms to address workforce preparation problems and government goals and priorities
2. **Performance objectives and quality standards:** establishment of clear and measurable performance objectives and quality standards for all workforce preparation programs
3. **National-state competency-based credentialing systems:** establishment of national-state occupational credentialing systems based on skill competencies
4. **Policy coordination:** coordination of government programs through consistent and compatible performance objectives and measures and statewide credentialing systems

The market approach would also require states to restructure their role in the production of workforce preparation services. This requires a restructuring of the traditional service delivery system based on four market principles:

1. **Consumer choice:** encouragement of informed choices by consumers
2. **Contestability** encouragement of competition among public and private service producers
3. **Performance management:** insistence on the adoption of performance outcome measures and quality standards
4. **Performance sanctions:** uniform enforcement of meaningful sanctions for unsatisfactory performance

Specific market incentives fashioned from these four market principles will be most effective when (1) they are utilized within a comprehensive provision framework that establishes state policy and performance objectives; and (2) they are used in conjunction with

other market incentives to give equal emphasis to each of the four market incentives.

### **Public Provision: Strategic Planning, Performance Standards, and Policy Coordination**

The strong American commitment to private markets and an active voluntary, private nonprofit sector has resulted in a decision that federal, state, and local governments should provide or produce workforce preparation services only when the private sector fails to deliver publicly valued services according to acceptable quality standards at a fair price to the appropriate people. What are publicly valued goods? What are acceptable quality standards and fair prices? Who should be given these services? These provision questions are matters of continual public policy debate.

Successful state governance in the 1990s will require that governors take a leadership role in addressing and clarifying government policies on these provision questions. It will also require an astute ability to sense when markets are not working without government enticement or prodding, a commitment to take full advantage of changing private markets for reducing or redirecting government action, and an unflinching resolve to step in with creative initiatives to compensate for unacceptable market outcomes.

This means that market-based workforce preparation systems require strong government presence in labor markets; not less government action and unfettered private markets. The market approach requires a different type of government intervention. It requires strong state leadership in building public awareness and public-private consensus on workforce preparation problems and government goals and measurable objectives.

Effective government intervention means sending clear and easily understood market signals that communicate what the workforce preparation system should produce and what government is willing to pay for. It requires strong state leadership in establishing a comprehensive

set of public policy objectives and funding priorities, as well as a set of measurable quality standards and performance expectations for all publicly funded and regulated vocational education and employment and training programs.

### **Strategic Planning and Policy Objectives**

Strategic planning is one promising mechanism for states to use to reach public-private consensus on policy problems and objectives and establish measurable performance expectations. Some states are confronting the problems of integrating federal, state, and local programs through strategic planning efforts that establish state policy goals and the major strategies for reaching those goals. These efforts seek to identify how public programs can improve and complement private employment and training systems. They also seek to define state roles and responsibilities within an integrated public and private workforce preparation system.

Van Horn et al. (1989) reviewed a number of states that are using strategic planning processes to put together workforce preparation programs. New Jersey's public and private sector leaders have begun a long-term project to develop a strategic plan for government intervention in the labor market. A governor's cabinet task force in early 1987 made recommendations for new programmatic initiatives and the reorganization of the current delivery system.

Other states including Indiana, Maine, Maryland, Michigan, North Dakota, and Washington have used strategic planning processes to build a public-private consensus on a set of clearly defined policy goals. These strategic planning frameworks possess the common components of (1) a clearly defined statement of labor market problems requiring government action, (2) recommendations on government policy goals, and (3) the systemwide application of these policy goals to all programs in the state.

## **Policy Objectives and Performance Standards**

Strategic planning will be most effective when it results in the establishment of a comprehensive set of policy objectives and performance outcome measures. Some states have taken promising steps to actually translate state policy objectives into sets of measurable performance outcomes. Although the JTPA was ambiguous on the major client group to be served, it was the first federal program to implement a federal-state performance standards system that specified the program outcomes to be achieved. Some states have taken a leadership role in establishing JTPA performance outcome measures and adjustment models that best reflect state policy priorities. Illinois, Indiana, and Ohio have developed their own performance standards models (Baj and Trott 1988).

One promising strategy is the use of unemployment insurance wage records in measuring employment and earnings outcomes (Stevens and Haenn 1992; Hoachlander, Choy, and Brown 1989; Baj and Trott 1991). The National Commission for Employment Policy is conducting a research and development project with 20 states to explore the use of unemployment insurance wage records as a basis for tracking the postprogram employment and earnings experiences of JTPA participants (Baj and Trott 1991). Florida was one of the first states to utilize unemployment insurance wage records for both JTPA and vocational education performance evaluation.

These innovative state efforts are likely to be supported by new federal legislation that requires the development of performance standards in virtually all workforce preparation programs. The reauthorization of the Job Training Partnership Act will shift greater emphasis to skill standards and long-term employment and earnings. The 1990 Amendments to the Carl Perkins Vocational Education Act require states to develop performance standards and measures in at least two performance areas including academic skills, vocational skills, program completion/continuation, and employment and earnings. The Job Opportunities and Basic Skills (JOBS) program of the Family Support Act requires the development of performance measures in skills devel-

opment, welfare dependency, and employment and earnings. The student grant and loan programs in the Higher Education Act and new adult education and workforce literacy legislation will likely follow along similar lines.

Federal research and development projects and state efforts suggest that it is feasible to define and measure performance outcomes in at least five major areas: (1) academic and basic skills competencies, (2) vocational skills competencies, (3) program completion and/or continuation, (4) employment and earnings outcomes, and (5) productivity or company performance improvement (Hoachlander, Choy, and Brown 1989; Creticos and Sheets 1990).

### **National-State Competency-Based Credentialing Systems**

The hallmark of the market approach is the separation of provision and production decisions, with performance outcomes and quality standards always defined independently of existing production arrangements. Performance standards systems for basic and vocational skills require national-state competency systems for awarding credentials. These competency systems are based on performance outcomes rather than program design standards. They award credentials based on what people know or can do rather than how they learned it and what program they completed.

The Commission on the Skills of the American Workforce (1990) in the report, *America's Choice: High Skills or Low Wages*, has called for the creation of a national board for professional and technical standards to develop a national system for examination standards leading to professional and technical certificates of mastery across a wide range of occupations. Each occupational program would be organized through a system of school- and work-based learning, consisting of a combination of general-education and industry-specific requirements. The system would allow participants to move freely between occupational programs and public and private service producers and would define clear paths for further education and training, including entry into four-year degree programs.

The United States Department of Labor, through its Office of Work-Based Learning, has launched a similar initiative to expand the apprenticeship concept in the United States (U.S. Department of Labor 1989). The new office is working with national industry and labor groups to develop national occupational standards and curricula. It is funding pilot projects in adult upgrading and retraining and school-to-work transition systems to promote the establishment of state and local programs.

These national initiatives are a promising start in establishing a national-state framework for competency-based credentialing systems. This national-state framework should be based on national occupational or professional competency systems developed and maintained by national governing boards consisting of federal and state vocational education and employment and training agencies and national industry, education and labor associations. These occupational or professional governing boards should establish and continually update the core basic and vocational skill areas or modules and the minimal competency standards for certification. These skill standards should be endorsed by industry and professional groups as the common currency for all labor market transactions.

The major state role in national-state competency systems is in redirecting state regulatory and credentialing systems to support these national skill standards. States should clearly communicate these standards to public educational institutions and private service producers and incorporate these criteria into state credentialing systems, including postsecondary degree programs. States also should work together with federal agencies and national governing boards to build these credentialing systems to serve as the basis for performance standards systems in basic and vocational skills competencies.

### **Policy Coordination and Performance Objectives**

Since the 1960s, federal and state governments have undertaken numerous attempts to coordinate federal, state, and local vocational education and employment and training programs. These coordination efforts have come from federal and state mandates that require service



providers and producers to work together. They have been based on a corporate or bureaucratic model of coordination which attempts to establish clearly defined roles and responsibilities through state and local negotiation without the authority of a formal superior-subordinate hierarchy (Whetten 1981). This approach tries to minimize duplication of government services and maximize efficient communication and resource exchanges between service producers receiving public funding through government programs.

This corporate approach has been extended in new federal legislation for establishing centralized coordinating boards—called human resource investment councils—in states for integrating JTPA and vocational education programs. It also can be seen in efforts to integrate workforce preparation programs within a superagency at the state level or labor market boards and one-stop service centers at the local level.

Although this corporate approach can be effective under some conditions, it should not be the first step in addressing coordination problems. We advocate that states take a different approach to coordination. Consider three interdependent types of coordination activity (Sheets, Baj, and Harned 1988):

1. Policy coordination refers to the development of consistent program objectives, quality standards, and program terminology with a major emphasis on common measurable performance outcomes by which each program will evaluate effectiveness.
2. Administrative coordination refers to the development and implementation of administrative agreements that define the respective roles and responsibilities of each program and the administrative procedures to carry out these agreements.
3. Case coordination refers to the development and implementation of case management systems that define client and program responsibilities in the development, implementation and monitoring of a comprehensive intervention plan for each participant in the system.

The market approach emphasizes policy and case coordination and deemphasizes administrative coordination. Policy coordination

through the establishment of common or compatible performance objectives and measures should be the first step states take in building comprehensive workforce preparation systems. This type of policy coordination is essential in coordinating JTPA and JOBS programs in reducing welfare, and JTPA, JOBS, and vocational education programs in establishing performance objectives in adult basic and vocational skills.

Some states are integrating their workforce preparation programs through standardized performance outcome systems. Michigan's Human Investment Fund Board has established general measures for each performance objective and outcome for the Michigan Opportunity System (MOS). Illinois is utilizing its Employment Tracking System (ETS) to develop and utilize unemployment insurance wage records as the basis for a combined evaluation of all education for employment programs.

Case coordination is essential in establishing consumer control and choice in market-based workforce preparation systems. Case coordination encourages consumers to assume greater decisionmaking responsibility in the system. Case coordination could vary tremendously depending on the resources and needs of the consumer. It could range from independent career counseling services for students and adult workers to intensive case management systems for welfare recipients and other hard-to-serve populations targeted by state policy goals. Case coordination will be discussed further in the next section on service production in workforce preparation systems.

### **Production Through Market Incentives: Consumer Choice, Performance Management, Contestability, and Performance Sanctions**

After states have established a comprehensive strategic planning framework, they will be left with the difficult decision of how to structure and integrate public and private organizations in delivering publicly provided services within a state workforce preparation system.

States have many alternatives. The remaining sections of this paper focus on how states can use market incentives to restructure their handling of the production of vocational education and employment and training services within workforce preparation systems. We recommend that states consider four types of market incentives.

### **Consumer Choice: Empowering the Customer**

Market incentives should be used to increase the choice and control that customers—mainly employers and workers—can exercise in purchasing services from alternative public and private producers within workforce preparation systems. Consumer choice creates strong incentives in service producers to conduct customer outreach and marketing and develop innovative and cost-effective services for different consumer populations within a state.

Consumer choice can be increased by shifting more public funding from service producers to customers. The majority of public funding in vocational education and employment and training programs is channeled directly to public service producers to serve consumers. The major exceptions are student loan and grant programs and G.I. Bill benefits. This shift could be accomplished by putting greater emphasis on discretionary grant programs that provide funding directly to employers, industry associations, and joint labor-management apprenticeship committees and public voucher systems that provide funding directly to individual students and workers to purchase services from both public and private producers.

#### *Workplace-Based Training Programs*

States should encourage private employers to establish their own employment and training systems and coordinate these systems with the same national-state competency standards used in public programs. States should promote the expansion of workplace-based training programs in the private sector. Most American businesses—especially small and medium-sized firms—underinvest in employee training relative to their Japanese and European competitors (Office of Technology Assessment 1990). They also have not established formal employment

and training systems, including employee testing and assessment, employee development plans, in-house training programs, and competency- and performance-based evaluation systems. States should provide incentives to businesses and industry associations to establish formal training systems and become better consumers of vocational education and employment and training services from both public and private producers.

States have taken a leadership role in providing funds directly to private industry for adult education and training. At least 44 states have established customized training programs for attracting and retaining businesses (Ganzglass and Heidkamp 1986; Creticos, Duscha, and Sheets 1990; Stevens 1986). Some programs, such as California's Employment Training Panel and Illinois' Prairie State 2000 Authority, provide training grants directly to employers and allow them to choose the most appropriate training vendor for their company. These programs many times provide grants to industry associations for administering training programs for small employers.

Other states have established community colleges and vocational-technical centers as the administrative agents and preferred service producers in efforts to encourage closer education and business linkages. State programs that contract directly with businesses provide the best example of market-based programs that establish stronger consumer control and choice by making public entities compete for government funds.

To be effective, these state programs must have clear policy objectives and performance expectations, with the major client being the business or businesses receiving the grant (Creticos and Sheets 1990). Some states have chosen to put additional requirements on these programs, including earmarking funds for targeted populations and special industry-school partnerships. These ambiguous or contradictory policy goals are likely to result in poor program performance and reductions in business interest.

States also should promote the expansion of work-based training systems based on the apprenticeship model. Apprenticeship systems are another way to build private sector employment and training pro-

grams based on national competency systems. These work-based programs provide a structured transition between school and work and provide alternative paths to upgrading and retraining for employed workers. Some states, such as California and Wisconsin, provide matching funds to apprenticeship programs for theory-related instruction. States such as Pennsylvania and Illinois are sponsoring school-to-work demonstrations that build closer linkages between vocational education programs and work-based learning systems fashioned after the apprenticeship model.

### *Consumer Choice and Voucher Systems*

States should complement these workplace-based training programs with individual grant and loan programs that allow people to combine public and private resources in buying vocational education and employment and training services. The foundation of consumer choice must be established in statewide voucher programs for primary and secondary schools. Chubb and Moe (1990) present a strong and compelling case for giving option and choice to parents and students in choosing public or private service producers. Minnesota has become a leading state in putting choice to the test in schools. States should expand the principles of consumer option and choice by making all state and local funding to secondary and postsecondary school districts (e.g., community colleges) portable throughout the state.

The Commission on the Skills of the American Workforce (1990) has called for the establishment of guaranteed funding for four years of postcompulsory schooling for students and adults. Students and adult workers could take this training from a wide variety of public and private producers including community colleges, comprehensive high schools, regional vocational centers, magnet schools, four-year colleges, proprietary schools, and apprenticeship programs. Similar models have been proposed by others under names such as Individual Investment Accounts (Thurow 1985) and Individual Training Accounts (Choate 1985).

These models provide useful illustrations of statewide voucher systems that could be established with competency-based credentialing

systems. These individual voucher systems could be structured to complement student grant and loan programs, G.I. Bill educational benefit programs, and other targeted programs that address special populations or occupations experiencing skill shortages, such as machinists or nurses.

Some states, such as Kentucky, have turned to voucher systems as an alternative delivery mechanism for serving dislocated workers. These vouchers could be combined with company outplacement funds and other company-union programs to provide additional resources for distressed workers. Federal and state programs and demonstration projects also have experimented with voucher systems for serving the economically disadvantaged (Sharp et al. 1982). These programs provide states with many models for developing special voucher systems for disadvantaged and hard-to-serve populations.

#### *Career Counseling and Case Management Systems*

Consumer choice also can be increased by providing customers with the necessary information and technical assistance to make their decisions among service producers. States first should establish consumer information systems that report state performance standards and performance information on all public and private service producers in the state. (See following discussion on performance standards.)

These systems should be supported by independent counseling services that provide technical assistance to customers at arm's length from service producers. Most publicly funded career counseling in the United States is provided by public schools in preparing students to enter college and by postsecondary educational institutions in preparing students to enter their own programs. The only independent career counseling is provided to special targeted populations in federal and state programs for the economically disadvantaged and dislocated workers. Other counseling services are available to people who can pay.

States should establish independent career counseling systems that provide assessment and counseling services to both students and adult workers. These systems should be coordinated with statewide creden-

tialing and voucher systems. Some states may wish to establish community-based programs operated through public employment service offices. Others may want to contract with other public or private organizations.

States should establish more comprehensive case management services for special targeted populations. Case management systems have been used extensively in JTPA, work-welfare, and adult education programs to empower participants and provide them with needed advocacy assistance and supportive services. States have many models to choose from in establishing their own programs.

### **Performance Management: Consumer Information and Producer Standards**

Consumer choice by itself will not be a sufficient market mechanism to improve system responsiveness and efficiency. It will need to be complemented by a state-managed reporting system that provides policymakers, interest groups, and administering agencies with performance information on public programs and furnishes consumers with performance information on public and private service producers.

#### *Performance Management and Program Reporting Systems*

Consumer information systems should include performance-standards reporting systems that disseminate program performance information at the state and substate levels relative to state policy objectives and performance standards, that is, the expected levels of performance on specific outcome measures.

State agencies administering JTPA programs report the performance of local service delivery areas (SDAs) on an annual basis. This information is available to local public officials, business organizations and unions, state legislatures, and a variety of public interest groups. Some states, such as South Carolina and New Jersey, have established school performance reporting systems that provide information on school districts.

States also should require all state agencies and other public providers to report the performance of their public and private producers in

relation to state performance objectives in state strategic plans. Such reporting requirements would insure the infusion of state strategic goals into operational goals of programs and provide necessary state policy coordination.

### *Producer Management and Consumer Reporting System*

This program reporting system should be complemented with a comprehensive consumer information system that integrates producer performance information into existing labor market planning and career information systems. States already have invested considerable resources in maintaining career information and occupational supply and demand data to support better consumer decisionmaking and guide state investment in new programs (Stevens and Duggan 1988).

One major problem encountered by state labor market information systems is that public and private service producers are not required by states to report basic information about their programs, including information on program enrollments, completions, and placements. As a result, this information is difficult for consumers and counselors to find and utilize.

States should require all public and private service producers who use public funds to report this information to the state on an annual basis. States should then publish and disseminate this information in a form that makes it easy for consumers and career counselors to compare and contrast alternative service producers. This information should display producer performance information relative to state performance standards.

### **Contestability: Competitive Contracting and Capacity Building**

Contestability refers to a market condition in which all production arrangements can be contested either by providers who are dissatisfied with producer performance or by other public or private producers who want to deliver competing services. The supply of a workforce preparation service is perfectly contestable when public and private producers face no barriers to entry or exit. Contestability is a broader market condition than competition in that it does not require the presence of



alternative service producers, but only the threat of competition and the potential of strong challenges to production rights.

Contestability enforces a certain degree of market rigor and market responsiveness and flexibility that has not been duplicated by command and control alternatives such as administrative, legislative, or private sector monitoring and oversight. When contestability is low, incumbent producers usually act opportunistically by not complying with contract terms, exploiting bargaining power when unforeseen contingencies appear, and becoming complacent about maintaining high quality at reasonable costs (Vining and Weimer 1990).

One major problem in most workforce preparation programs is that existing production arrangements are not highly contestable. In some programs, such as the public employment service, administration and delivery are done by the same agency without any consideration given to alternative production arrangements. In other programs, only certain types of service producers, such as vocational schools and community colleges, are eligible to receive federal and state funds or deliver services. In still other programs, state and local administrative agencies have not clearly specified the service and quality standards to be produced and have not developed a sufficient contractor network to insure an effective level of contestability. This has created a patchwork of producer monopolies, restricted production arrangements, and preferred producer designations in workforce preparation programs.

### *Competitive Contracting Programs*

States can establish a sufficient degree of contestability in their workforce preparation systems through two actions. First, states should review administrative arrangements in workforce preparation programs and insist on a systematic separation between administration and service delivery. This would insure that all programs have clearly defined their public and private producers. In the case of state agencies, such as the public employment service, this would require defining regional or local offices as separate service producers whose operations could be contested if performance standards are not met. Second,

states should require competitive contracting procedures that solicit proposals from both public and private producers.

States should establish proactive certified producer programs that provide the necessary support for the development and maintenance of a competitive pool of public and private producers. The privatization initiatives of the Armed Forces and state and local governments have produced model contracting procedures that could be applied in state vocational education and employment and training programs (Crosslin, Neve, and Cassell 1989; Hatry, Voytek, and Holmes 1989). These contracting procedures provide a method of writing requests for proposals that insures adequate levels of specificity based on a clear understanding of the cost and quality issues in the industry. These contracting procedures provide some degree of contestability even with a small producer pool because they continually search for alternative producer arrangements and continually review and update competitive cost and quality standards for the industry.

*Capacity Building: Professional Training and Program Research and Development*

States should support competitive contracting programs through training programs for professional staff in public and private service industries and promote competitive grant programs that encourage program innovation, risk-taking, and a demonstration of new approaches to workforce preparation.

State programs can insure a competitive pool of public and private producers only if these producers are able to hire professionally trained staffs. Professional staff training has been a persistent problem in public and private programs, especially programs for the economically disadvantaged (U.S. Department of Labor 1989).

States should work with federal agencies and professional associations to establish professional development and certification programs for staff in vocational education and employment and training programs. These programs should be coordinated with new state policies on teacher training and certification, state civil service upgrading pro-

grams, and national efforts to establish professional credentialing systems for employment and training professionals.

Performance and cost pressures in market-based systems may result in underinvestment in developmental activities by service producers and risk-taking in new program ventures. States should establish research and development programs that give incentives to public and private producers to try innovative program approaches and adopt new instructional technologies. These research and development programs should be targeted to specific labor market problems, special populations, or promising service approaches.

### **Performance Sanctions: Rewarding and Penalizing Producers**

Consumer choice, performance standards, and contestability will be most effective when states are successful in establishing sanctions for nonperformance. The public sector seldom has termination mechanisms that replicate those operating in private markets. In market systems, redundant costs and inefficiencies are reduced because organizations that persistently fail to compete effectively or perform at minimal standards eventually go out of business. By contrast, nonmarket systems are usually unable to hold public or quasipublic organizations accountable for poor performance or reward exemplary performance. They rarely, if ever, put these organizations out of business for poor performance.

The easy route to implementing performance standards systems is to introduce well-defined performance expectations, but make little effort to enforce these standards or apply sanctions for noncompliance. The introduction of effective enforcement procedures and sanctions can be expected to require an increased commitment of resources to carry out the new administrative responsibilities with both public and private service producers.

States have begun to establish sanction policies and procedures in education and employment and training programs. All states have established sanctioning policies and procedures for SDAs in JTPA programs, although sanctions have rarely been used. Some states have established sanctioning policies for vocational education programs.

Florida's Placement Standard Law provides that any job preparatory program in which the placement rate is less than 70 percent for three consecutive years is ineligible for future state funding. New federal regulations for Guaranteed Student Loans will require the Department of Education to suspend, limit, or terminate public or private educational institutions with student loan default rates above 20 percent.

States should implement performance standards systems that contain strong sanctions for nonperformance. The ultimate penalty should be loss of eligibility to receive federal and state funds for a probationary period, an approach not unlike the death penalty imposed by the National Collegiate Athletics Association (NCAA). Public and private producers should be allowed to receive public funds only after reporting performance outcomes into a consumer information system and maintaining a record of performance above minimum state standards.

### **Preventing Potential Problems Through the Integrated and Refined Use of Market Incentives**

The utilization of market incentives in public programs, including vocational education and employment and training programs, has generated considerable debate. This debate is centered on six potential problems and constraints with market incentives. These problems can only be prevented through integrated and refined use of market mechanisms in both the provision and production of workforce preparation services.

#### **Producer Monopolies and Competitive Markets**

One potential problem is that market-based systems may encounter barriers in dissolving natural monopolies based on the small number of potential producers in many local areas—especially rural areas—and the advantages gained by contractors who receive first-round contract awards.

The first defense against producer monopolies is a strong competitive grant program that attempts to develop a diverse contractor community and provide potential public and private contractors with extensive information on program specifications and competitive cost and quality standards. This competitive grant program should be complemented by consumer information and voucher systems that allow consumers to buy services from alternative service producers.

The second defense against producer monopolies is the establishment of strong performance standards and sanctioning policies. Contestability does not require alternative service producers to be present as long as states report producer performance and enforce performance sanctions. This insures the threat of competition or challenges to production rights even in rural areas where there is rarely more than one public service producer. Producer information and sanctions may result in the reorganization of the only public producer in the area, such as an employment service office or community college, or signal other potential producers of the opportunity to offer competing services.

### **Opportunism and Excess Profit-Taking**

Market-based systems raise suspicions of opportunism and excess profit-taking in government. Critics of privatization initiatives in government contend that the complexities of contracting procedures and contract administration, combined with the profit motive, will result inevitably in a loss of cost-effective controls. In addition, the likely emergence of monopoly power will result in abusive actions by major service producers.

Opportunism is a risk that exists in both market and nonmarket systems. Critics of nonmarket systems argue that these systems result in excessive and redundant costs, poor quality, and market nonresponsiveness because of monopoly power and the lack of bottom-line performance measures (Wolf 1988). Public producers can make and disperse profits in government programs by diverting funds to other uses and wasting resources. There is no obvious reason to expect competitive contracting procedures or the profit motive to further exacer-

bate this problem. Market-based systems would not require any additional monitoring and oversight to control this problem.

The first defense against opportunism and excess profit-taking is a strong competitive contracting program that establishes clear performance objectives and quality standards and builds a competitive producer network through capacity-building and research and development programs. The second defense is a strong performance standards system that puts ceilings on allowable program costs. Competitive contracting policies would reduce the probability of excessive profits because of the risks of losing future contracts on cost criteria. Cost ceilings based on recognized cost parameters in the state would prevent abuses from temporary monopoly situations or advantages gained by being awarded the first contract round. The final defense is a strong performance sanctions policy that requires public producers who hold monopoly positions to reorganize their programs if they consistently fail to meet performance standards and exceed cost ceilings.

### **Client Creaming and Access of the Hard-to-Serve**

The second potential problem with market-based systems is that they run the risk of client creaming and reduced access to programs and services for hard-to-serve populations, especially minorities and people with limited education and work experience.

In order to be effective, states must build market-based systems in conjunction with strict enforcement of federal and state legislation that forbids discriminatory practices of businesses, schools, unions and other labor market entities. States can insure access of the hard-to-serve within market-based workforce preparation systems by integrating three types of market mechanisms: (1) economic incentives for serving hard-to-serve populations, (2) adjustments in performance standards based on the added risks and costs in serving these populations, and (3) case management systems that provide advocacy and counseling support to targeted populations.

States could encourage greater access by putting more resources into the hands of the most disadvantaged. This higher price could encourage greater service through reduced risk and uncertainty and the

potential for higher profits. It would also drive up the opportunity costs (i.e., forgone revenues and profits) to those producers not providing equal access. States should implement such incentives through voucher systems that provide larger direct grant amounts to disadvantaged populations. These voucher systems could be supplemented by matching grant programs or special cost reimbursements for service producers serving disadvantaged populations. These incentives would make the voucher dollar of disadvantaged populations more valuable to service producers.

The second refinement should be to develop state-based performance standards systems that provide additional resources or rewards for achieving state performance expectations with disadvantaged populations. The groundwork for such systems has already been established for the JTPA performance standards system (Barnow 1988). States now can use this groundwork to develop adjustment systems that best reflect state policies toward targeted populations (Baj and Trott 1988).

The third refinement should be to use case management systems to provide disadvantaged populations with the support needed to assume greater responsibility in making career choices and selecting service producers. Case management services should include assistance in using consumer information systems to select the service producer with the strongest track record with targeted populations.

### **Excessive Transaction and Information Costs**

A fourth potential problem is that market-based systems would create excessive transaction and information costs for states in ensuring that consumers are sufficiently informed to make appropriate choices among competing producers. The fear is that these costs would outweigh any efficiencies that may be realized through a market-based system.

Federal and state governments already have made a considerable investment in labor market information. The problem in building market-based systems is setting the appropriate level and distribution of

investment in producer performance information and setting precise targets for eradicating consumer illiteracy.

The first defense against excessive information costs is establishing clear public policy objectives and performance standards that define what should be reported by all public and private producers. The second defense is a strong performance standards reporting system that simplifies consumer information and reports producer performance relative to state performance standards. Producer information could be further simplified by a strong performance sanctioning policy that indicates to consumers which producers have been put on probation and are ineligible to receive public funds. The third defense is a strong competitive contracting program that assists public and private producers in understanding these performance objectives and using information technology to lower reporting costs to the state and consumers. Service producers can be expected to invest more of their own resources in consumer information to attract customers. These costs will not be borne directly by government.

Government costs in maintaining a state consumer information system are largely unknown. However, these outlays could be held to a minimum by maintaining and disseminating information through already existing labor market and career information systems. These systems have already established distributional networks that could be expanded to serve market-based systems.

### **Goal Displacement from Performance Standards**

Another potential problem of a market-based approach is that performance standards systems will divert government-funded programs from major policy objectives toward a preoccupation with meeting narrow performance measures (Starr 1985). If this occurs, it would result in unintended goal displacement and ineffective government programs.

Valid criticisms have been made of past practices in defining and applying performance standards in the JTPA, the public employment service, and in vocational education. However, states can address these criticisms through a broader set of outcome measures that emphasize



intermediate (e.g., basic and vocational skills, program continuation) and long-term (e.g., postprogram employment retention) program outcomes.

The first defense against goal displacement is a clear definition of government policy goals and performance objectives. Performance measures will always be criticized in the absence of clear policy decisions. The second defense is state policy coordination that articulates state programs based on their differing policy goals and performance objectives. The final defense against displacement is to have a strong performance standards system and capacity-building program that clearly communicate performance objectives and measures to service producers and assist these producers in improving their programs to meet state performance expectations.

### **Coordination Problems from Market Incentives**

Market-based systems raise the fear that they will undercut federal and state efforts to improve the administration of vocational education and job-training programs through the reduction of duplication and the promotion of coordination in program development and delivery. Some critics fear that those systems would promote duplication in the name of competition and undercut cooperative relationships among competing service producers.

Market-based systems have a different approach to coordination (Sheets 1989). As discussed earlier, the market approach emphasizes policy and case coordination and deemphasizes administrative coordination. This approach argues for establishing common or compatible performance standards and related producer information. It also argues for improving case management by encouraging clients to assume greater control and decisionmaking responsibility in the system.

The market approach encourages service producers to make their own administrative coordination decisions at the lowest jurisdictional level in pursuit of common or compatible performance objectives. It assumes that contractual arrangements will develop naturally between public and private producers, depending on complex “make or buy” decisions made under competitive market conditions. Administrative

coordination is not always cost effective. In the market approach, duplication of services is expected because of the substantial transaction costs that would be incurred in achieving administrative coordination to eliminate such overlap. However, the market approach does assume that inefficient duplication will be eliminated as service producers identify and nurture specialized market niches in which they have distinct competitive advantages.

States can insure that market systems will not drive out efficient administrative coordination through three integrated uses of market incentives. The first defense is the establishment of clear policy goals and strong performance standards systems that establish clear performance expectations and sanctions for all producers, and successfully drive out poor performers. The second defense is a comprehensive consumer information system that allows public and private producers to monitor the performance of their competitors and other producers from whom they could potentially buy services to improve their own performance. The third defense is a strong competitive contracting program including capacity building in which producers are given detailed program specifications and industry quality standards and are encouraged to explore innovative coordination strategies to achieve state performance objectives. This combined use of market incentives insures that public and private producers will have the necessary information and training for developing cost-effective make or buy strategies.

### **State Strategies for Building Market-Based Systems**

Market-based systems should be built through a step-by-step approach with certain market incentives preceding others. We recommend that governors take the following six steps:

### **Step 1: Strategic Planning for Developing Public-Private Consensus on Workforce Preparation Problems, Policy Goals, Funding Priorities, and Performance Objectives**

Market-based systems require a conscious and sustained commitment to an integrated set of public-private provision decisions and actions. When governors take office, they inherit a workforce, an employer community, state administrative agencies and regulatory boards, and both public and private service producers who must be mobilized in the pursuit of common objectives and performance goals. The market approach emphasizes strategic planning and policy coordination rather than administrative coordination as the means to insure concerted public-private action.

Governors in cooperation with private sector leaders should undertake a strategic planning process that builds a public-private consensus on workforce preparation goals and strategies. This plan should clearly address the most important workforce preparation problems and deficiencies, state government policy goals and performance objectives, and a policy coordination plan that articulates all publicly funded programs through common and compatible performance objectives.

### **Step 2: Statewide Performance Standards and National-State Competency-based Credentialing Systems**

Market-based systems should be predicated on clearly defined performance objectives and quality standards that are common or compatible across all publicly funded workforce preparation programs. This requires the development and operation of a unified statewide credentialing system based on national competency standards for basic and vocational skills.

We recommend that governors mobilize private and public groups in their states to work with national efforts in building national-state skill standards systems for secondary and postsecondary professional and occupational preparation programs. Governors should also work with state administrative agencies, public educational institutions and governing boards, state licensing boards and regulatory groups, profes-

sional associations and unions, and private employers in establishing a unified statewide credentialing system based on these national skill standards. These efforts should include working with public educational institutions to recognize these credentials for credit toward advanced degrees.

We recommend that governors convene all state administrative agencies and governing and regulatory boards to develop a common or compatible set of performance measures and standards for workforce preparation programs in at least five areas: (1) academic and basic skill competencies, (2) vocational skill competencies, (3) program completion and/or continuation, (4) employment outcomes, and (5) productivity or company performance improvement.

### **Step 3: Statewide Program Performance and Consumer Information Reporting Systems**

Governors should develop a statewide information system that supports the development of competitive contracting systems, provides program performance feedback on strategic objectives, and provides consumers with sufficient information on the performance of public and private service producers to make informed labor market decisions.

Governors should establish a statewide program performance and consumer information reporting system that requires all public and private service producers receiving public funds to report information on enrollments, completions, and performance outcomes. This reporting system should also produce information on the aggregate performance of public programs such as JTPA, JOBS, and secondary vocational education relative to state performance goals.

This reporting system should be administered through existing state labor market information systems in order to insure the coordination of producer information with existing labor market and career information. The selection of an institutional home for this information system is likely to be different in each state. However, this system should be administered by an independent organization that operates at arm's

length from state agencies and other public and private organizations who operate publicly funded workforce preparation programs.

#### **Step 4: Competitive Contracting Program for Public and Private Producers, Including Capacity Building and Research and Development**

The hallmark of the market approach is the separation of provision from production decisions. After governors have established strategic goals and performance standards, they should then turn their attention to how to achieve these standards through competitive contracting programs with public and private service producers. They should require all state administrative agencies to establish competitive contracting policies and procedures that include separation of administration and service delivery in all workforce preparation programs.

Governors should establish a technical assistance program for all state agencies in developing their own competitive contracting policies and procedures based on state guidelines. In order to encourage risk taking and innovation in workforce preparation programs, this effort should involve statewide capacity building in public and private service producers, including professional training, technical assistance in informational technology upgrading, and research and development programs.

#### **Step 5: Performance Sanctions for Public and Private Producers**

Once governors have established performance objectives and quality standards, competitive contracting programs, and program performance and consumer information systems, they should focus on establishing a system of incentives and punishments for success or failure in meeting state performance expectations.

They should establish financial incentives for public and private producers who exceed state expectations on the most important performance goals in state strategic plans. In order to improve access and equalize performance, these financial incentives should focus on successful educational, employment, and earnings outcomes for hard-to-

serve populations. In addition, states should establish programs to disallow public or private producers to continue to receive public funds if they consistently fail to meet minimum state performance standards. These sanctions should be strictly enforced with equal treatment of both producers.

### **Step 6: Direct Consumer Funding Programs for Building Workplace-Based Training Systems and Individual Voucher Systems**

The keystone of market-based systems is empowering consumers—businesses and individual students and workers—to make their own labor market decisions. Governors should redirect a significant share of public funding to consumer grant and loan programs. They should expand the scope of current customized training programs and provide additional funds to apprenticeship systems. In addition, they should establish individual financing systems that complement existing student grant and loan programs and private financing sources. These individual financing systems should provide comprehensive coverage of the state workforce, but should target a greater share of state funding to the economically disadvantaged and other hard-to-serve populations targeted in state strategic plans. These direct consumer funding programs should be supported by a state system of consumer counseling operated at arm's length from public and private service producers. Governors should establish comprehensive case management systems for the economically disadvantaged and other hard-to-serve populations.

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