

**Marketisation of Human Service Delivery:
Implications for the Future of the Third Sector in Australia.**

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While the worst effects of the recent Global Financial Crisis have been avoided in Australia, it is by no means immune to shocks to the economy and society. Of particular interest here is the squeeze on resources of not-for-profit human service agencies at the same time as increasing complexity of needs among their clients. This is against a backdrop of growing disparity in wealth and disproportionate rise in housing costs when compared with wages/benefits, with demand for emergency assistance outstripping capacity for agencies to provide, posing a threat to social cohesion and exacerbating social and economic exclusion. These issues are arising simultaneously, and against a backdrop of Australian Federal and State governments being innovative in contracting-out of service delivery and responsibility to Non-Government Welfare Organisations (NGO) over the past two decades. The need for NGO capacity building is evident.

Moves to outsource human services have, we argue, seen a hollowing out of government departments, with a concomitant reduction in capacity of those governments to adequately develop, monitor and evaluate the contracts with which they engage with NGOs. At the same time, increased demands on NGOs have reduced the opportunities for agencies to strategise and develop their own capacities. Nominal strategies to manage complex service delivery commissioning and monitoring, including Relational Contracting require more resources than are made available, often exacerbating third sector/government relations rather than facilitating them. Adding to this is that the quasi-market model itself has fragmented the Third Sector in Australia to the extent that it currently does not have a unified voice, vision or plan for its own future, is suffering from problems with morale, staff attraction and retention, and indeed a degree of inertia to change its *modus operandi* in ways that will challenge the current policy and funding regime and ultimately achieve better outcomes for its client groups.

The paper outlines three major Sector Reform initiatives in Australia over the past two years (covering contract negotiation and monitoring, financial reporting and wages) and reflects on their likely implications for the sustainability of the Third Sector in Australia within a continuing market model underpinning government funding of services by non-government organisations delivering human services.

Contractualism in the human services

Developments in human services delivery in Australia since the 1980s have been consistent with developments elsewhere in the western world, built on the premise that more market orientation in the public sector would lead to greater cost-efficiency for governments (Anheier et al 1997). They have involved withdrawing from the direct control of production of goods and services funded from tax revenue, by promoting corporatisation and outsourcing to third sector and private sector organisations, and encouraging the contestability of markets in which the government had previously been a monopoly provider. Governments moved to contract much of their program implementation to community organisations (predominantly not-for-profit) already undertaking closely related roles. The contracting-out of service delivery through a purchasing model that relies on competitive tendering by NGOs was held to be preferable and/or more efficient than government departments delivering those services. This is based on the premise that outsourcing can provide good value-for-money for public funds, not just because of the improved quality of service that mission-driven NGOs deliver, but because they can be more cost-effective as a result of the wage bill being lower than in either the private or public sectors (Hardy and Wistow 1998).

Considerable research worldwide, including in Australia, has focused on the capacity of contracted NGOs to meet contractual requirements to deliver services for which they were funded, as well as satisfying reporting and accountability requirements (Ohlin 1998). Arguments about the positives and negatives of a market-style model of human service delivery have been well-rehearsed over the past two decades. They include assertions that the project-based fixed-term funding arrangements typically associated with contracting-out have resulted in increased use of short-term employment contracts by most NGOs, and there are arguments by agencies that this can seriously undermine the potential for capacity building (Carson et al 2007).

Related arguments maintain that, increasingly prescriptive agenda-setting by governments is seen by NGOs to constrain their operations. For an organisation receiving funds from a combination of Federal, State and local governments, the administrative costs can seem disproportionately heavy. Many not-for-profit organisations consider the reporting requirements to be an impost, and managers view the assessment of their performance as a regulatory requirement of limited intrinsic value, rather than seeing rigorous reporting as a corollary of using scarce resources well in the interests of the community (Fernandez 2007, Shergold 2008). Internally, staff consider performance management to be a response to external accountability rather than a driver of mission or an impetus for service improvement (Carson and Kerr 2010). This is a point to which we will return.

In recent years, however, the marketisation imperative is less influential than it was in the 1980s and 1990s because New Public Management (NPM) peaked a decade or so ago and is now in decline, with the focus shifting to government departments and organizations in the public sector operating in a context of networked governance alliances with third sector organisations (Grubbs 2000, Langan 2000, O'Connor and Ilcan. 2005). That is, they now operate as complex adaptive systems with characteristics which are qualitatively different from the market-based forms and business principles as endorsed by NPM (Rhodes 2008). In recent years the intended role of contracted service delivery agencies is for them to work with government departments and other agencies and, most importantly, with citizens to co-create public value and to increase the trust that was eroded during the heights of NPM. An important element in this shift is an increased degree of decentralisation of managerial responsibilities, which includes an increased role for line managers in both NGOs and government departments in managing contracts between commissioning departments and agencies (Gregory and Hicks 1999, Otte and Dickey 2000).

This recent trend to reduce the market-style model of government departments contracting for human services is consistent with propositions generated over 30 years ago in Theories of the Firm and in Relational Contracting Theory (McNeil 2001, Williamson 1985). These theories emphasised the merits of generating a network of trusted agents to lower transaction costs in "incomplete contracts"; that is where contracts were for the delivery of services that were hard to quantify and assess. Where outputs are complex, traditional command-and-control approaches to accountability are difficult and costly to maintain so it makes sense to emphasise trust rather than formal arms-length tendering. This notion applies well to human services (Milward and Provan 2000) because, while all business relationships rely on a degree of trust, that degree is greater in situations of complexity typical of human services. In such situations, managers emphasise flexibility and discretion as a response to the complexity, rather than consciously scrimping on service delivery or renegeing on a contract, since this would weaken prospects of potential future contracts. Recent developments in public management literature (Bertelli & Smith 2009) highlight that, where agency capacity to supply specialised services is limited or volatile, if the government department does not retain the responsibility for delivery it must put in place a strong relational basis for the contract.

Moves to increase flexibility and trust in contracts are not, in themselves, a reason for confidence in efficiency and effectiveness, however, since evidence of implementation gaps persist. Alongside the critiques of contractualism and outsourcing from an agency perspective, a much less well-developed strand of research has concerned the capacity of

commissioning departments to develop and manage contracts with agencies (Cooper 2003, Fernandez 2007). This has the potential to render the purported advances in relational contracting as less effective in practice than in theory. Notwithstanding new models of government-third sector relationships, part of the difficulty of monitoring output of NGOs contracted to deliver human services on behalf of the government continues to derive precisely from the nature of complex matters that must be addressed by NGOs. More specifically, problems have persisted whereby agreements between governments and NGOs continue to be associated with significant implementation problems, including:

- an inability to define outcomes in contracts (Flynn et al, 1995)
- difficulties in defining appropriate measures of service quality rather than simply focusing on 'activities' or outputs (Ryan and Brown 1998)
- the difficulty in applying a cost/benefit analysis in a public sector context (Seddon and MacPherson, 2000).

Shergold (2008) has argued that the difficulties of implementing, managing and monitoring onerous contractual conditions are further exacerbated by a risk-averse public service. Despite exhortations based on theoretical precepts, often government department bureaucrats in the commissioning and funding departments behave as if they are managing a contract rather than a relationship. This, coupled with the attenuated lines of authority generated by continued outsourcing, potentially increases implementation problems. The critical issue now is to assess if recent administrative reforms applicable to the third sector in Australia have overcome the, by now, familiar concerns about continued implementation gaps in service delivery and contract management.

To that end, it is appropriate to outline three strands of sector reform in Australia and relate these to challenges that arise from tightly specified deliverables funded on short-term contracts, onerous reporting and monitoring requirements and competitive funding with low wage levels. We reflect on the promise of these reforms in light of a number of empirical research projects concerned with service delivery and workforce development in contracted not-for-profit community service organisations (Carson et al 2007, Carson and Kerr 2010). The first study involved organisational sustainability and workforce development in some 300 Third Sector Agencies in South Australia contracted to deliver a range of welfare services across the state (Carson et al 2007). The second investigated the service delivery and accountability issues in contracted NGOs offering employment services for residents of a particularly disadvantaged metropolitan region in South Australia (Carson and Kerr 2010).

The third examined implementation gaps in service delivery and in the reporting of services by contracted NGOs delivering support to victims of domestic violence (Carson et al 2012). While these were discrete projects, what was notable was a common theme of the need to understand implementation gaps by looking beyond the agencies to the government departments providing the funding. In part this was triggered by the need to develop indicators of effectiveness in the assessment and reporting models of the respective government departments, and in part it was triggered by the need to understand and theorise the issue of accountability in the devolved and attenuated lines of control operating between the hollowed-out funding departments and the contracted service delivery agencies.

Sector Reform – 3 aspects

The National Compact and relationship building in tendering and contracting

Notwithstanding difficult negotiations over funding and contracting security in recent years, the 2010 the National Compact: *Working Together* is an aspiration-based agreement setting out how government and the third sector can work together in better ways to improve service delivery and outcomes. The National Compact articulates the shared values and principles of the Government and the not-for-profit sector and outlines eight priorities for action:

1. Document and promote the value and contribution of the not-for-profit sector.
2. Protect the not-for-profit sector's right to advocacy irrespective of any funding relationship that might exist.
3. Recognise not-for-profit sector diversity in consultation processes and sector development initiatives.
4. Improve information sharing, including greater access to publicly-funded research and data.
5. Reduce red tape and streamline reporting.
6. Simplify and improve consistency of financial arrangements including across state and federal jurisdictions.
7. Act to improve paid and unpaid workforce issues.
8. Improve funding and procurement processes. (Australian Government 2010)

The implementation of the National Compact is a part of the Social Inclusion Agenda which is a whole-of-government approach, with all Australian Government departments committed

to the Compact's shared vision, purpose and principles. Not-for-profit organisations can sign up to the Compact on a voluntary basis, demonstrating a commitment to have a stronger, more collaborative relationship between Government and the not-for-profit sector (Australian Government 2010).

The conceptual shift is a good development that is consistent with the mission statement and preferred operating mode of most NGOs. Partnership concepts, such as outlined by McGregor-Lowndes and Turnour (2003), certainly have relevance, since NGOs in the human services and government agencies ostensibly have similar interests to some degree – namely achieving positive outcomes for clients – and NGOs are not likely to shirk away from attempting to provide quality services. Indeed, most agencies take responsibility for, and are committed to, providing quality services to their constituents/clients. They routinely see themselves being especially committed to clients despite operating within restrictive conditions of contract. Yet even though the National Compact is a significant step, the widespread use of partnership labels in recent years to refer to a multitude of organisational and funding arrangements has subsequently made it difficult to assess the actual responsibilities, roles and rights of participants in networked relationships (Carson and Kerr 2003). As a consequence, caution about the implementation of partnerships continues to be expressed among NGOs. Changes in nomenclature alone will not solve the uncertainty problems and, to date, the relational contracting statements are typically aspirational rather than reflecting the reality of recent contractual negotiations.

The aspirational statements are clearly in evidence in South Australia, where the State Government has reflected aspects of relational contracting in its recent relationship with the third sector (SACOSS 2010). It has declared a commitment to the sustainability of human services by proposing to provide longer-term rather than short-term contracts, a more collaborative relationship between purchaser and supplier, and recognition of history and service system needs. There is not the space in this paper to report in full on the findings of the authors' research that bears on this issue, which are available elsewhere but we have found continuing evidence of implementation gaps, notwithstanding the model of service delivery has moved beyond simplistic principal –agent models of contractual arrangements that characterised early iterations of New Public Management (NPM). In particular we refer, first, to problems of the iterative implementation of longer funding cycles and, second, to problems of monitoring agency program compliance.

For governments subject to an electoral cycle and reticent to commit to any particular course of action for a longer duration it has meant that funding agreements most often range

between one and three years. The declared move of the SA government to three year contracts is promising but the process of contract renewal is yet to be improved. The iterative development of this process promulgates uncertainty. It is still not an uncommon experience for an agency not to know whether or not the contract will commence, the month before a contract is meant to begin. At times a contract variation will be put in place for six months to a year in order for Departments to confirm and arrange a longer term contract however in that time a Government may change priorities and variations are put in place to provide time for redirection of funds.

The conditions under which agencies bid for, and accept, funding must also be reviewed to ensure that persistent under-funding does not generate a 'race to the bottom' and thereby exploit the sector. In all three studies that constitute the empirical underpinnings of this argument, it was evident that while the Government commitment to three year funding cycles was promising, the predominance of temporary and casualised positions in the human services was exacerbated by the uncertainty of program funding continuation. Some organisations at present are managing up to 100 government contracts from both state and federal levels and not all of these can access ongoing funding. This makes it difficult for agencies to provide certainty of employment, particularly for front-line staff. These workers have the greatest interaction with clients, where the majority of care work is undertaken and yet it is also this level of staff which can least afford uncertainty of employment. While this is occurring, service managers are attempting to deal with difficulty of recruiting and retaining casual and contract staff whose livelihoods depend on the contracts being in place.

In addition to the slow roll-out of longer term contracts, our research has found that the relationship between the department and the agencies when implementing contracts often proved to be problematic, in part due to turnover of staff in both the funding department and the agencies. Since the commencement of contracts, staff changes in both the department and the agencies meant that an initial underlying (and unspecified) commitment to trust and good-will were made increasingly irrelevant. We concluded that, paradoxically, the situation was a perverse outcome of relational contracting, rather than an absence of commitment to it. Initially, strong relations between department staff and staff in funded agencies, at the time of establishing the contracts, typically led to an insufficient degree of subsequent contract management and accountability rather than too much, as is more commonly reported in the literature. Poor monitoring was exacerbated by subsequent staff turnover in both the government department and the contracted organisations (due at least in part to the short-term contracts offered to staff), without adequate succession planning or handover. We therefore suggest that is important for commissioning departments to give increased

attention to the implications for human resources within the department, the administrative burden of the resulting implementation strategies and the demands of the ongoing management of programmes as the roll-out of the National Compact takes further hold in the sector.

Regulation and reporting

The proposed Australian Charities and Not-for-Profit Commission (ACNC) regulation and reporting changes propose a more streamlined process of annual reporting (predominantly financial) by NGOs (ACNC 2012). This is predicated on the principle of 'Report once, use often' to enable government departments to access verified data on NGOs without multiple departments specifically and repeatedly requesting minor variations on the information. The intention is that this will reduce regulatory burdens particularly for smaller NGOs, with a view to consolidating, over time, a variety of government compliance requirements and reducing unnecessary red tape associated with the number of interactions NGOs need to have with different government agencies. The ACNC Regulations, which will outline governance and reporting requirements, will be released for consultation on 18 July.¹ Preliminary drafts of the proposed regulations released on 2 July 2012 include a tighter specification about an organisation's charity status, to give the government and the community greater transparency on the benefits of foregone tax revenue and helping to reduce the risk of illegal activity and protect against the misuse of charitable funds. These aims are completely unobjectionable insofar as they can promote trust and confidence in the sector. The regulation of reporting on financial activity, including fundraising, is an important probity issue that could increase public confidence in the sector, in line with a purported benefit of the new regulatory environment to 'describe the front line delivery of service and benefits to the community' (ACNC 2012).

At the same time as the mooted increase in financial reporting, however, the issue of probity of financial management is affected by an increased degree of decentralisation of managerial responsibilities, emphasising an increased role for line managers in managing contracts between commissioning departments and agencies. However far this retreat from simple commercialism of early NPM recommendations has progressed in particular instances, it nevertheless means a significant increase in responsibility of middle managers for the expenditure of public money, ostensibly aiming to ensure probity in practice and the

¹ . The second exposure draft of the ACNC Bill is being sent to the House of Representatives Economics Committee in the week beginning 2 July. The Committee will consider the draft and is likely to hear evidence from the Sector before making its recommendations on the Bill.

fair and just delivery of services. The proposed regulatory changes do not yet have any definite flow-on to standardised agency reporting on contract deliverables and outcomes to the funding departments, nor any definite flow-on to the internal agency monitoring of practice against benchmarked standards of good practice. This raises questions about what the contracted agencies seek to do on behalf of the department. Is it literally to do as instructed, or do the agency manager and the worker use professional discretion to make sense of the instructions, or do they seek to realise the department's best interest (Brodkin 2011, Carson, et al under review)

In terms of the effect on direct practice our findings showed the extent to which the agencies that we observed continued to operate in relatively autonomous ways. Although each agency had a standardised contract with the funding departments, they were interpreting the contract – and then implementing their programs in ways which reflected their past practices with vastly differing results for jobseekers. The pre-existing organisational cultures and practices for managing contracts by the NGOs directly impacted on the type and quality of services provided by agencies (Carson and Kerr 2010). The ethos of caring, reflecting the personal and organisational values of the agencies we studied was commendable, but we found that this did result in staff saying in their 'comfort zone' of familiar practices, as staff sought to remedy perceived individual client deficits, rather than engage in the strategic approach to service delivery which would have been more in keeping with the (poorly specified) reporting expectations of the funding departments. Attenuated lines of accountability, and associated worker variability in service delivery, generated practices that raise concerns about compromising the quality of the service.

This was diametrically opposed to much of the critique of contracting, as being overly restrictive because of onerous reporting and accountability requirements (Gooden 1998, Austin 2003). But, according to our findings, as government departments became leaner, actors in them had even less knowledge of the agencies they were dealing with, or knowledge of which models and programs were effective in addressing the problem of unemployment and related disadvantage, and even how the success of a program could be measured. Public servants in the commissioning departments, with limited experience in writing contracts, continued to be part of the teams responsible for the preparation of tenders and contracts in the human services. Their solution seemed to be to measure what could be easily measured, namely a job outcome (as an output), not the complex steps it might take to get a disadvantaged jobseeker to the point of being employable and employed in a sustainable job, in an industry deemed to be a growth industry for that area (Carson and Kerr 2010).

In our studies, there was strong evidence of a need for commissioning departments to develop performance agreements that have more clarity and precision about what constitutes contract compliance, the consequences of non-compliance and the scope and mechanisms for review or renegotiation of contract conditions. What struck us most, however, in analysing our data was a consistent picture of overall lack of investment in worker development in both the commissioning departments as well as the contracted agencies. These and related wage level issues continue to bedevil government / third sector reporting arrangements.

The wages bill and *Fair Work Australia*

A recent major move has demonstrated that the human services sector in Australia, with the support of other stakeholders such as Trades Unions, can effect change for the benefit of NGOs and their workers. The outcome of concerted lobbying and advocacy to the Federal government has been an official determination (an 'award') on wage rates in the community services sector. Human service workers in NGOs will eventually be paid the same as those in the public service. Fair Work Australia found that Social and Community Services workers (the classification used for official specification of wages and conditions) have been paid lower wages than public sector employees doing similar work, and that gender played a role in creating this wage disparity.

Some workers, in larger NGOs with 'charity' tax status, are currently paid above-award wages and, can supplement low salaries through reliance on salary sacrifice of fringe benefits to minimise income tax. But most human service workers in the sector have been doing an important job in difficult circumstances for relatively little income despite the fact that this increasingly professionalised workforce, predominantly in the third sector, deserves better salaries.

The increase constitutes a \$2 billion agreement on equal pay for Australia's community services workers and it will affect about 150,000 workers across Australia, who will receive pay rises of between 19% for base level employees and up to 41% for the most senior level workers, albeit in pay rises over 8 years. While acknowledging that this is a step in the right direction, we point to several concerns. The first is that the increase in pay is over 8 years, and at the frontline level this will represent little more than workers would have probably got through normal CPI channels. The long lead time is justified by the government in terms of the effect the changes will have on finances of the contracting government departments.

Second, unless the increased funding that has been committed by State governments represents the full increases in costs to NGOs, the extra pay will have to be found from the normal operating budgets of the NGOs, placing even more strain on already strained resources and probably to even more casualisation of the third sector workforce. In other words, an entirely justifiable increase has the potential to have an adverse impact on community employers, the governments who tender out to them the delivery of their human services and those clients who depend upon them. Community employers now find themselves wedged between the 'rock' of higher salaries and the 'hard place' of inadequately-funded government service agreements. There are likely to be pressures for community organisations to restructure (perhaps altering the balance between volunteers and paid staff) and to 'work smarter'. It is also likely there will be renewed calls to rationalise the sector through collaboration, alliance or merger, but such measures will not be sufficient to offset the scale of the likely Award increase.

Third, it is as yet unclear how much funding will be available for worker development. In the third sector a small portion of funding may be quarantined for infrastructure and administration but the majority of funding in the sector is put toward wages, estimated to be approximately 70 per cent of all grant monies received by agencies in the sector (Cortis and Eastman 2012 p49). Unless an extra component of government funding is built in to all contracts to be used for staff development, the capacity of the sector is likely to decline further. This does not bode well for the sector's survival, for staff recruitment, retention and morale, or for the recipients of human services. Addressing these major issues in the third sector could substantially alter the current insecure work conditions that currently exist so that, ideally, flexible conditions can be in place for those who want them and protections be in place for those who need them.

Previous empirical work undertaken by the authors has found that workforce planning and development were poorly served by the prevailing funding arrangements (Carson et al 2007). Funding for workforce development was a major issue, with the majority of respondents (77%) highlighting tension between allocating all available funds to service delivery in order to meet satisfy conditions of contract, at the expense of the allocation of time and money to skills development for staff. The problem of limited funding for worker training was summed up by one respondent who said '*funding bodies don't fund workforce development, only fund outputs based on direct client service provision*'.

Finally, NGOs face the danger that their competitive advantage may be eroded by increased costs, further undermining the long-term sustainability of the sector if they do not continue to

win competitive funding, notwithstanding that contracts may be for longer periods, with more effective lead times to retain or recruit the necessary workers to continue to deliver the services.

Contractualism, quality assurance and reporting between contracted agencies and hollowed-out government departments

Will the three major elements of sector reform outlined above compensate for the workforce insecurity, under-development of service delivery capacity and the implementation gaps well documented in the sector?

Within the NGOs we studied, providing a quality service to clients was often cited as the reason for the organisation's existence and internal agency relationships existed to ensure that quality services were delivered. But the agencies relegated accountability to government departments for funds, and compliance with regulations, to a lesser status. The agencies were nevertheless obliged to divert resources to reporting that would otherwise have been devoted to service delivery or workforce development at a time when they, arguably should have been devoting more resources to this. Our observations were that the agencies were undergoing an increased degree of decentralisation of managerial responsibilities, highlighting an increased role for agency managers in managing contracts at the same time as the commissioning departments were being hollowed-out, leading to an increased need for workforce development, not less as has tended to be the case.

Moreover, at the same time, the agencies also relegated collaborative negotiations with other agencies to support sector wide progress in workforce development and sector sustainability. While, in the past, NGOs have had a tradition of sharing resources, including information, and collaborating for enhanced outcomes for clients, (which has now been diminished) the sector has not developed as a voice for itself nor has it developed the mechanisms to achieve outcomes for its constituent members. The 'compacts' that now exist between many governments and the NFP sector will be severely tested, as the consequences of the Fair Work Australia decision and the Sector Reform initiatives of the Australian Charities and Not-for-Profit Commission are played out. Moreover, there is a strong likelihood that the adverse social impact of cost-saving may fall on those least able to absorb the consequences – those who are poor, unemployed or live with a disability.

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