

# Randomization as an Incentive Device

## Evidence from Public Procurement of Immigrant Integration Services

Hanna Pesola, Matti Sarvimäki and Tuomo Virkola  
Aalto, VATT and Helsinki GSE

**Abstract.** We examine the effects of procuring immigrant integration services from a private provider under a contract where a randomized research design acts as an incentive device. Eligible immigrants were randomly assigned to either a private fund or public employment services, with the private provider's compensation tied to differences in average unemployment benefits and taxes between these groups. We find that the private fund outperformed the public alternative, raising earnings by 15%, improving job quality, and reducing the net burden on public finances by 12% over the three-year contract period. The positive effects extend to noncontracted outcomes and beyond the period during which the private provider's incentives were in place.

### Motivation

A fundamental question in social sciences concerns the appropriate division of labor between the public and private sectors: which tasks should be managed by the government, and which are best left to the market? In practice, this distinction is often blurred as governments procure services from private providers, typically motivated by the expectation that private firms face stronger incentives, and thus deliver services more efficiently than the public sector. However, **when service quality is not verifiable, procurement contracts may incentivize cost-cutting at the expense of quality.**

### Treatment

In 2016, Finland's Ministry of Economic Affairs and Employment and a private investment fund launched a joint initiative—the Integration SIB—where the fund took responsibility for arranging integration services for some immigrants. A central feature of the contract was an incentive structure built on a rigorous research design: **eligible immigrants were randomly assigned to either the private fund ( $n = 2,636$ ) or the public employment services ( $n = 1,026$ ) and the fund's compensation was partially tied to the difference between these groups in average unemployment benefits and income taxes over a three-year follow-up period.**

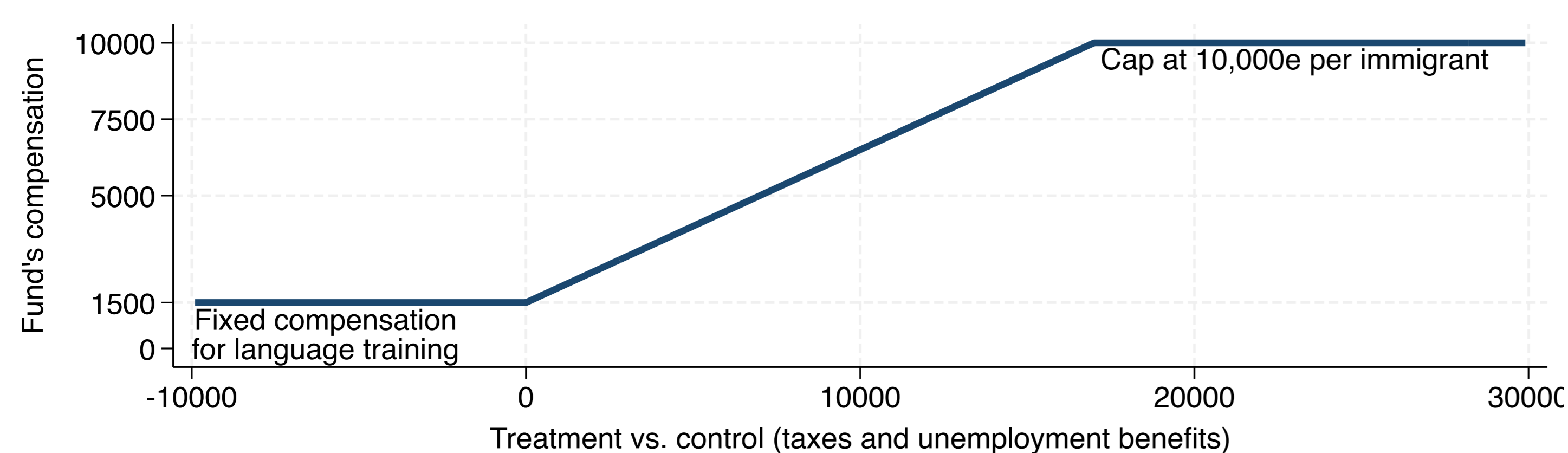


Figure 1: Compensation scheme

The treatment group was placed on a short language training designed for a specific occupation and then placed in jobs or on-the-job training in these occupations. The private fund recruited suitable employers, searched for good matches for each job, participated in onboarding, and sometimes helped employers and immigrants settle conflicts. The control group remained in the business-as-usual public employment services.

### Results

The private fund outperformed the public employment services. During the first three years after randomization, **cumulative earnings in the treatment group were, on average, 4,500 euros (SE: 1,200) or 15 percent higher** than in the control group.

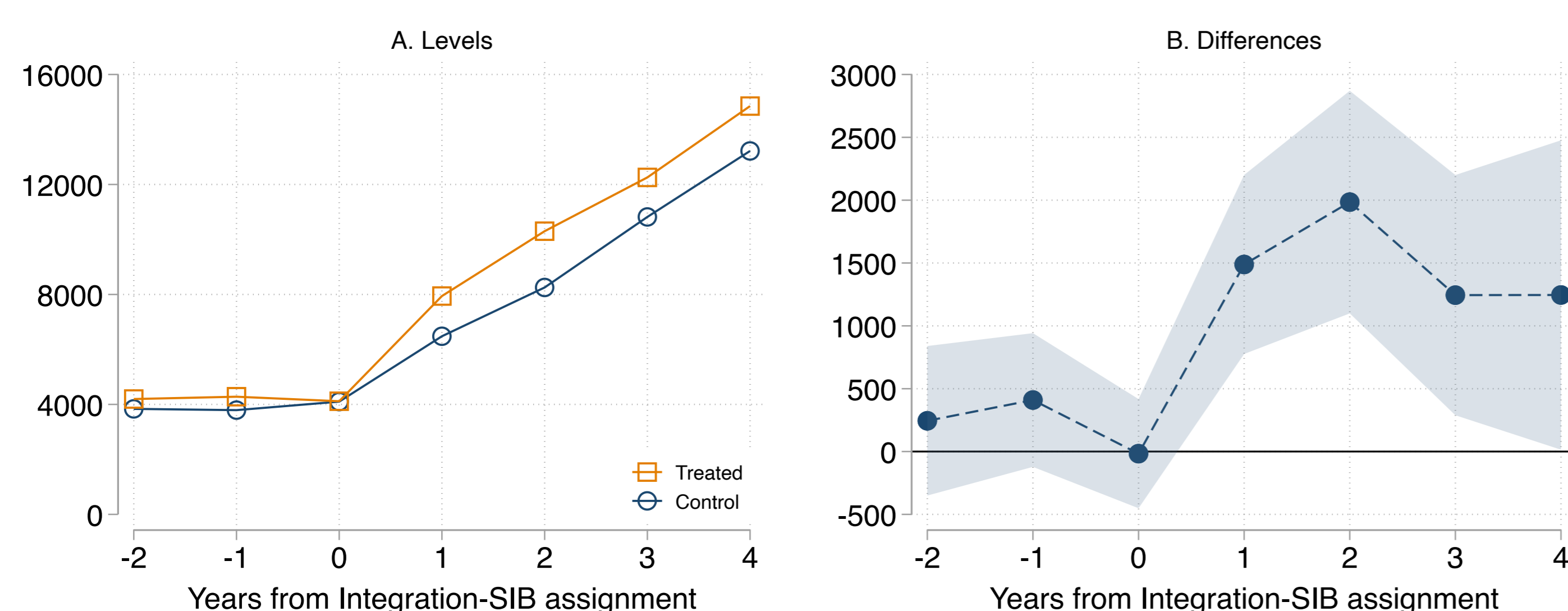


Figure 2: Effect on Annual Earnings

Consequently, participants' tax contributions increased and benefits decreased. On average, **the treatment group created a 2,700 euros or 12 percent lower cumulative net burden on public finances** over the three-year follow-up period than the control group.

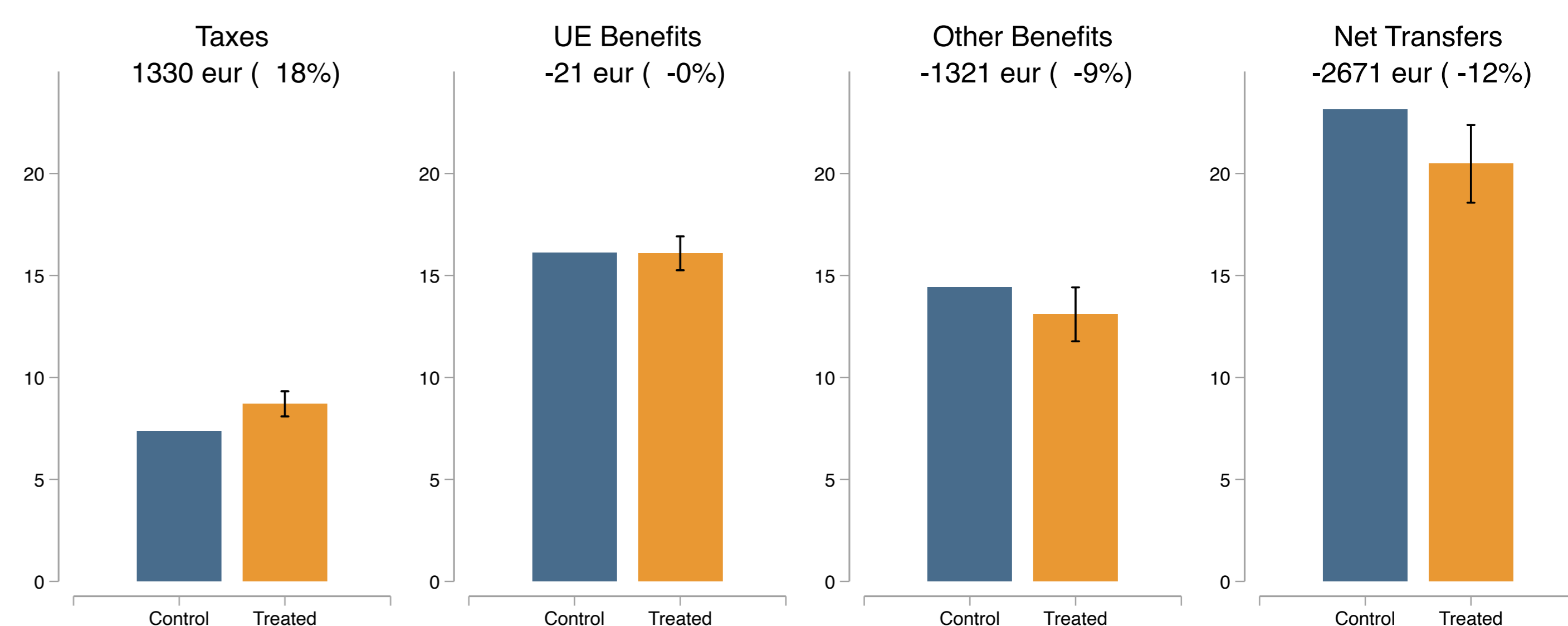


Figure 3: Effect on Taxes and Benefits (cumulative)

Importantly, the positive effects extended to noncontracted outcomes and lasted beyond the follow-up period. The effects are substantially larger for more educated and younger immigrants, while we find no differences by gender. Furthermore, the private fund was more successful in placing its customers in professional and higher-paying jobs and into larger and more productive firms.

	Annual earnings	Occupation quality		Firm quality	
		Expected earnings	Share with college deg.	Co-worker av. earnings	log(Sales per worker)
<i>A: Average Treatment Effects</i>					
Treated	1,548*** (385)	1,229** (423)	0.028** (0.009)	1,511*** (580)	0.088** (0.038)
<i>B: Treatment Effects by Job Seeker's Skill</i>					
Treated	729* (412)	150 (380)	0.005 (0.008)	69 (637)	0.057 (0.047)
Treated × College degree	2,608*** (917)	2,726** (1,264)	0.054* (0.030)	4,857*** (1,430)	0.120 (0.089)
Control mean	9,732	29,304	0.159	22,506	11.3
Non-college	8,812	27,084	0.098	20,220	11.3
College	12,088	34,742	0.308	28,314	11.4
Observations	10,667	4,071	4,071	6,409	5,256

Table 1: Effect on Earnings and Job Quality

### Interpretation

The positive effects are likely due to the contract structure, which incentivized improving service quality. Two features appear particularly important: (i) a randomized research design that made cream-skimming impossible, and (ii) cumulative, register-based outcome measures that could not be manipulated. As a result, innovations aimed at enhancing service quality became profitable. These innovations were particularly evident for highly educated immigrants, a group perhaps currently neglected by public employment services.

### Conclusions

We find that incorporating a randomized research design into a public procurement contract can act as an incentive device that pushes a private provider to deliver better service than the public sector. Similar approaches could be valuable for outsourcing other services where quality is difficult to verify. The results also highlight significant opportunities for improving integration services, particularly for highly educated immigrants and those who have resided in the host country for an extended period.