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## Public competition

### THE CHOICES FACING THE UK GOVERNMENT AFTER THE ELECTION

*Choice and competition have been increasingly introduced into the delivery of public services, and all the main parties' declared policies show at least some support for this trend. But will it be heightened or hampered by the need to cut public spending? Frontier was commissioned by the Office of Fair Trading (OFT) to analyse the conditions needed to make choice and competition effective tools for delivering better services at lower cost.*

Some choice – e.g., in further and higher education – has long been available to the users of public services, while the development of “contracting-out” in the 1980s introduced competition into service supply. However the idea of empowering the consumers of public services by creating or simulating “markets” has been gaining force since the early 1990s, with successive governments developing new techniques. The once-radical notion that competition and choice could be used to drive improvement in public services has therefore become mainstream policy. However, not all experiments have been successful, and questions remain as to how this trend in policy will be halted or accelerated by a spending cull. Frontier’s work for the OFT was



designed to provide insights into how these market mechanisms work in public services: both the potential benefits and practical pitfalls.

In well-functioning commercial markets, competition puts downward pressure on costs, forces firms to focus on customers' demands, leads to more efficient allocation of resources and encourages innovation. But markets for public services function rather differently, not least because most of them are free at the point of use. In such markets, there are no price signals or profit motive, and there are universal service obligations to complicate the picture. However, it is important to distinguish between two kinds of public service competition:

- “for the market”, as when local authorities invite tenders for cleaning or waste disposal services; and
- “in the market”, as when patients can choose which hospital to attend.

The first is much more like a “normal” commercial market, in that the customer (the local authority) pays directly for the service, and makes its choice on price and/or quality. Frontier's work for the OFT, and this bulletin, focus on the more difficult questions associated with the second.

The case studies for this report, which included secondary healthcare, schools, further education, social housing, direct payments for social care and employment services for the long-term unemployed, highlighted a number of factors influencing the effectiveness of competition and user choice. (These are illustrated in the chart on the following page.) Our key findings can be grouped into those relating to:

- the *demand* side – factors affecting the ability of users to make informed and effective choices; and
- the *supply* side – factors affecting the extent to which suppliers can or will respond to demand signals.

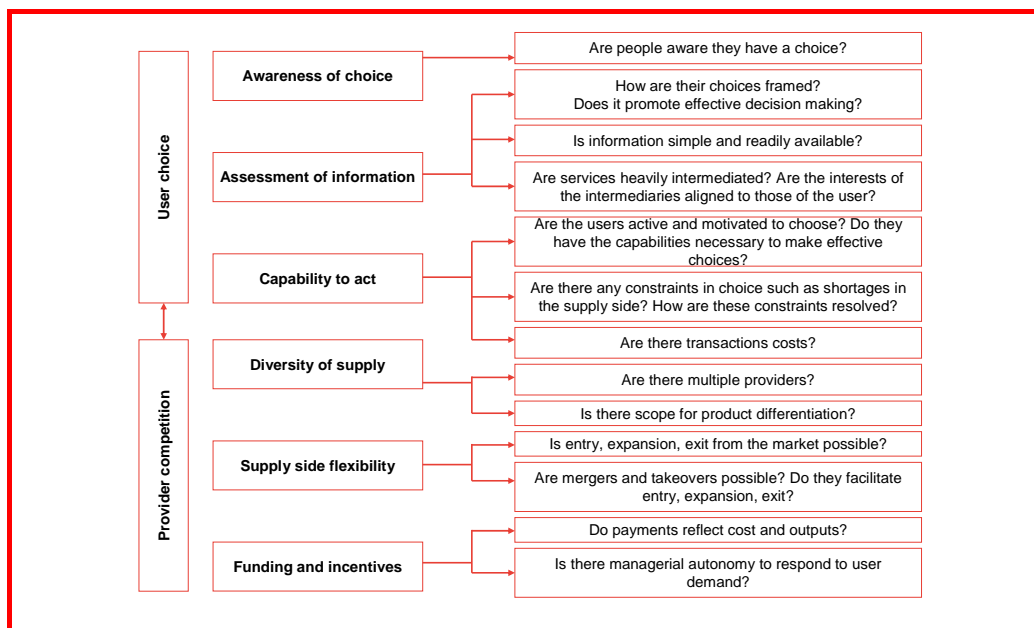
## DEMANDING CONDITIONS

On the demand side, the key factors were:

- **Awareness of choice.** Users often do not know the choices available. For example: since January 2006, patients needing a hospital appointment should have been offered a choice of providers (eventually including local NHS trusts, foundation trusts, specialist GPs and independent treatment centres). Yet a survey in December 2008 found that fewer than half recalled being offered a choice by their GPs.
- **Access to information.** Providing clear, useful information is obviously important. This is not always easy, when – for example – differences in hospital treatment quality are hard for the layman to assess. In such cases, effective intermediation is needed. For example, personal advisers in

employment centres play a crucial role in relation to the choice of service provider by the unemployed, while league tables, however imperfect, help parents choose between schools.

- **Capability to act.** Making the system easy to navigate is essential. High “hassle costs” will deter the exercise of choice. For example, the very low take-up of direct payments for social care, despite evidence that those who receive it are happier with the service they receive, is partly attributable to the complexity of setting up arrangements to employ carers directly. The low rates of payment for directly-employed carers also reduce the ability of the disabled to exercise the choice theoretically available to them.
- **Excess demand management.** Where services are free at the point of use, demand may rise to levels that public finances cannot bear. Finding mechanisms to restrain demand without blunting choice may be challenging, but the choice-based lettings system introduced into social housing offers one example of a method of transparently allocating limited supply.



Design of choice and competition for public services

Source: *Frontier Economics for the Office of Fair Trading (2010)*

## STRAITENED SUPPLY

On the supply side, the key factors identified were:

- **Provider diversity.** Government can offer choice in public services even when it is the sole provider, but the full force of competition will clearly not apply unless users can make their own selection between providers. For example, having multiple providers of employment services for the long-

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term unemployed, rather than contracting these out to a single provider, has been shown to drive up standards. Such choice may be difficult to provide universally: in rural areas it may be constrained by distance (e.g., to schools or hospitals). Nonetheless, the threat of market entry may act as a stimulus to standards even if the number of actual providers in some areas is limited.

- **Supply-side flexibility.** User choice will work best when providers can enter, expand within or exit from the “market” without high social or financial costs. Providing this flexibility in the short term (e.g., in secondary education) may not be easy, and may require the system to be run at some level of excess capacity – with budgetary implications. Without this, however, choice may be severely limited for some parents.
- **Incentives.** Plainly, unless users’ choices have some impact on popular and unpopular providers, they will do little to stimulate competition, or may even have perverse effects. Funding mechanisms have to be devised to reflect both activity and costs and to adjust quickly; but such complexity itself has costs. Competition works best if those in charge of units of provision – schools, hospitals – have some autonomy: freedom to innovate and change the way services are delivered. However, where such autonomy extends to, for example, pay scales, it may have the (short-term) effect of driving up labour costs throughout public services.

## CONCLUSION

In introducing choice and competition, there may be difficult trade-offs between providing short-term flexibility on the supply side, restraining public spending and delivering a universal service. In preparing this report, neither Frontier nor the OFT sought to pass judgement on past or future policies, but simply to contribute to improved policy making. For example, our work highlighted the importance of an effective “failure regime”; and the circumstances in which mergers and takeovers may be markedly preferable to closure.

As our report makes clear, it is not always easy to design funding mechanisms that ensure competition provides all the stimuli in public service “markets” that it does in commercial ones. But choice is, in itself, valued. Moreover – somewhat contrary to received wisdom – there is empirical evidence from questions in the British Social Attitudes Survey on hospital care that lower income groups are inclined to value it at least as highly as others. And where effective choice can be introduced, the case studies demonstrate its power to improve user satisfaction.

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