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PRIVATE SECTOR, PUBLIC SERVICES

Has the political consensus on competition broken down? UK Governments of all complexions have used the private sector to deliver some public services, including in the NHS. And in 2010, when Frontier produced a report for the Office of Fair Trading on the subject, all the main parties were committed to furthering competition and choice in the public sector. In the third of our election bulletins, we ask: how has the debate developed since?

By 2010, the use of competition in public services to drive down costs and drive up standards had become mainstream policy across the political divide. The Blair and Brown governments had gone further than their Conservative predecessors to introduce competition through “patient’s choice” in health and privately run “academies” in education.



Since then, however, the consensus seems to have been weakening. While the Cameron Government has opened more academies and independently-run “free schools”, and made further changes in the way health services are commissioned, the current Labour leadership has been promising to abolish “enforced” competition in the NHS, talking instead of “collaboration”.

WHAT WORKS?

Choice is valued by public service users (though inevitably less popular with public service unions) – and surveys show it is important to all socio-economic groups, not just the noisy middle class. It would be surprising (and regrettable) if the Labour Party were turn its back on the use of market mechanisms to improve public services. But of course not all attempts to introduce competition have been successful. Frontier’s work for the Office of Fair Trading in 2010 explored the practical pitfalls as well as the positive benefits, and sought to identify the conditions needed to make it work well.

In well-functioning commercial markets, competition puts downward pressure on prices and profits, makes suppliers more sensitive to consumers’ demands, allocates resources more efficiently and stimulates innovation – all effects we need to see in public services too. But public service markets have peculiarities that may blunt these effects. To begin with, the end-user or “buyer” is rarely the “payer”; so even if he or she can exercise choice, the price signal comes from somewhere else.

There is a key distinction between two types of competition in public services – that is to say, between:

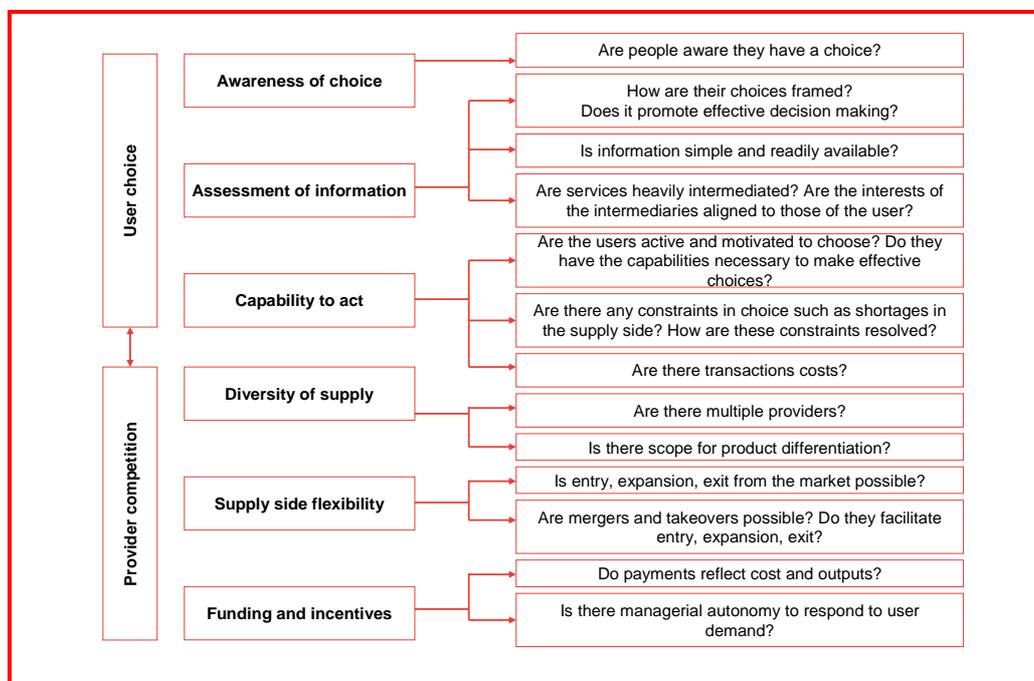
- **competition for the market**, as when public authorities (such as local councils) invite tenders to deal with refuse disposal or office cleaning; and
- **competition in the market**, as when parents and patients can choose between different schools and hospitals.

The first is long-established: “contracting-out” – tendering to save costs by breaking the monopoly of public service provision – gained momentum in the 1980s, and citizens are by now well used to seeing their rubbish collected by private firms. Competition “for the market” also works most like normal commercial competition, since the choice is made by the person who pays, and can therefore make the price-quality trade-off. Although the end-user may have a different view of that decision, this tension is no different from that involved in the direct supply of public services, and is similarly resolved through the ballot box.

Most of our work in 2010 was focused on the second type of competition, where the choice is made by the end-user. Some competition can be introduced even if all services are provided by the public sector, but clearly will not have the full

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dynamic effect unless customers can choose between providers. In our work, we identified a number of key factors for success acutely relevant to the current debate. The figure below illustrates the range of questions that have to be considered.



Design of choice and competition for public services

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

DEMANDING QUESTIONS

On the *demand* side, the key factors were:

- **Customer knowledge:** if public service users don't know they have a choice, there clearly won't be effective competition (the development of "patient choice" initially suffered badly from this). In 2014, under the banner "Open Public Services", the Government tackled this problem by providing much more information about the elements of choice it had introduced (e.g., in GP services). But there is way to go in getting some of the messages across.
- **Access to information:** some choices – e.g., of hospital treatments – aren't easy to make (even with the help of the internet) and may need intermediation. Also under "Open Public Services", much more user-friendly information has been provided across a range of services (e.g., the "schools performance dashboard" produced by Ofsted to supplement their somewhat wordy reports, or the excellent FE Choices website).
- **Hassle costs:** if public service choices are difficult to navigate, competition won't materialise (the introduction of direct payment for social care suffered

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from this problem, even though the idea was popular). Government has had to learn by doing, although the stickiness of some utility markets should have provided it with plenty of behavioural evidence.

- **Excess demand management:** services free at the point of use tend to suffer from excess demand, and systems needed to control this tend to blunt competition. Regulation may also blunt or limit competition, on the demand as well as the supply side, constraining providers from responding to user demand.

SUPPLY STUMBLES

On the *supply* side, the most important factors we identified were:

- **Provider diversity:** the risk is that new market entrants may be concentrated in some parts of the country, while others (e.g., rural areas) may be left with little real choice. In some areas, government has had to support supply to ensure some degree of competition, with more or less success.
- **Supply-side flexibility:** new providers need to be able to enter the market and leave it (fail) without severe disruption to public services. This is not easy to achieve in services where substantial capital investment is needed, and government has had to learn how to develop robust failure regimes to manage changes of control or closures of schools or hospitals. But hospital mergers and “special measures” in schools are providing experience in how to effect change while maintaining service, if not without “noise”.
- **Excess supply management:** if providers cannot easily expand supply to meet demand, choice will be limited, at least in the short term, unless there is some excess supply in the system. The cost of this has to be balanced against the savings and quality improvements generated by competition. But achieving a reasonable spread of new entry, so that the competition and potential excess capacity (e.g., of school places) is not concentrated in favoured areas, is clearly not easy.
- **Effective incentives:** if competition is to stimulate innovation, providers must have sufficient freedom to provide services in different ways. This freedom may be difficult to reconcile with national standards and universal service obligations. Regulation intended to maintain quality may deter entry and stifle innovation. On the other hand, without regulation some competition may result in a “race to the bottom” (a problem identified in, for example, the market for qualifications). However, the temptation to select a single provider of A-level exams, which would have led instead to all the problems associated with high fixed-cost monopolies, was fortunately resisted.

Some of the most innovative approaches to public service competition introduced by government in the past five years have involved the development of payments-by-results contracts (e.g., for prison services, hinged on reoffending rates). Outcomes-based competition is a step forward from cost-based tenders mitigated by a framework of standards. But serious appraisal of these innovations will obviously need time.

Moreover, appraisal of the strengths and weaknesses of competition in public services in general is still thin on the ground. Although the Competition and Markets Authority has signalled its intention to do more in this area, and has started with last year's inquiry into universities, there is need for more wide-ranging reviews of the impact of different market mechanisms as well.

CHECKS AND BALANCES

Both Labour and Conservative have, in practice, found competition a powerful tool to improve public services, and it is to be hoped they both continue to embrace it. Where “retail competition” has been introduced, they have, however, still found it necessary to provide frameworks of standards and inspection, rather than leave the success or failure of providers entirely to patient and parent choice. (In an ironic twist to the notion of “parent power”, media coverage of “failing schools” is often accompanied by school-gate interviews with parents proclaiming themselves thoroughly satisfied.)

So the debate must continue around the appropriate point at which competition should be introduced – whether for the market or in the market – in different services, who is best-placed to make the “purchase”, and how that choice should be regulated. This has been particularly contentious in the health service, where the structures are complex, and subject to frequent change. Choice and competition are not easy to achieve in health, or to reconcile with the need for “integrated care”, but there is already some evidence here, as well as in the United States, that competition between hospitals does drive up quality.

More detailed analysis of the results, here and elsewhere in public services, is needed to improve “market design” in the future. But meanwhile openness about performance, both of public and private providers, is essential to the exercise of effective user choice. And it is to be hoped that the stimulus to improvement offered by greater transparency on results, and greater focus on patient outcomes, that has followed from the introduction of competition, are not lost in the political debate.

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