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Public service markets: competition priorities, oversight and regulation

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Overview

1. **Designing market mechanisms for Public Services (PS):**
   - Challenges;
   - Experience to date: need to understand outcomes to design and refine market reforms (case of commissioning Public Services)
   - Market mechanisms to be tailored to objectives
   - Golden rules for market design; problems arising from special characteristics of PS
2. **The case of the NHS**

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Designing market mechanisms for Public Services

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Designing market mechanisms for Public Services

The challenge

- Tightening financial constraints
- Increasing demand (e.g. education, health and social care)
- New models of delivery need to respond to the challenge by:
  - Expanding provision
  - Promoting choice
  - Increasing efficiency
  - Improving quality
  - Driving innovation

New models of delivery

- Need to understand outcomes to ensure objectives are met
- Example of commissioning
  - No single blueprint for what works
  - Commissioners unsure about their ability to understand outcomes and value for money, e.g. how to allocate public spending in health and social care; policing; and transport to obtain the best outcome for the public

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The market mechanism design needs to be tailored to the objectives

- Understanding outcomes is essential to design and refine market reforms
- Problem with multi-dimensional services which need to respond to complex needs.
- Which model?
  - Competition in the market/ Competition for the market /Cooperation
  - What role for regulation?
- Answer depends on characteristics and 'readiness' of sector
  - Is the outcome well understood?
  - Are there multiple providers in the public/private/voluntary sector with the necessary experience and expertise?
  - Is regulation in place to ensure that the correct outcome is delivered?
  - Case of education- multiple experienced providers and effective role Ofsted as quality regulator vs Healthcare: multi-layered service, some aspects can potentially be object of competition (e.g. management functions) whilst others are not (delivery of non-elective care)

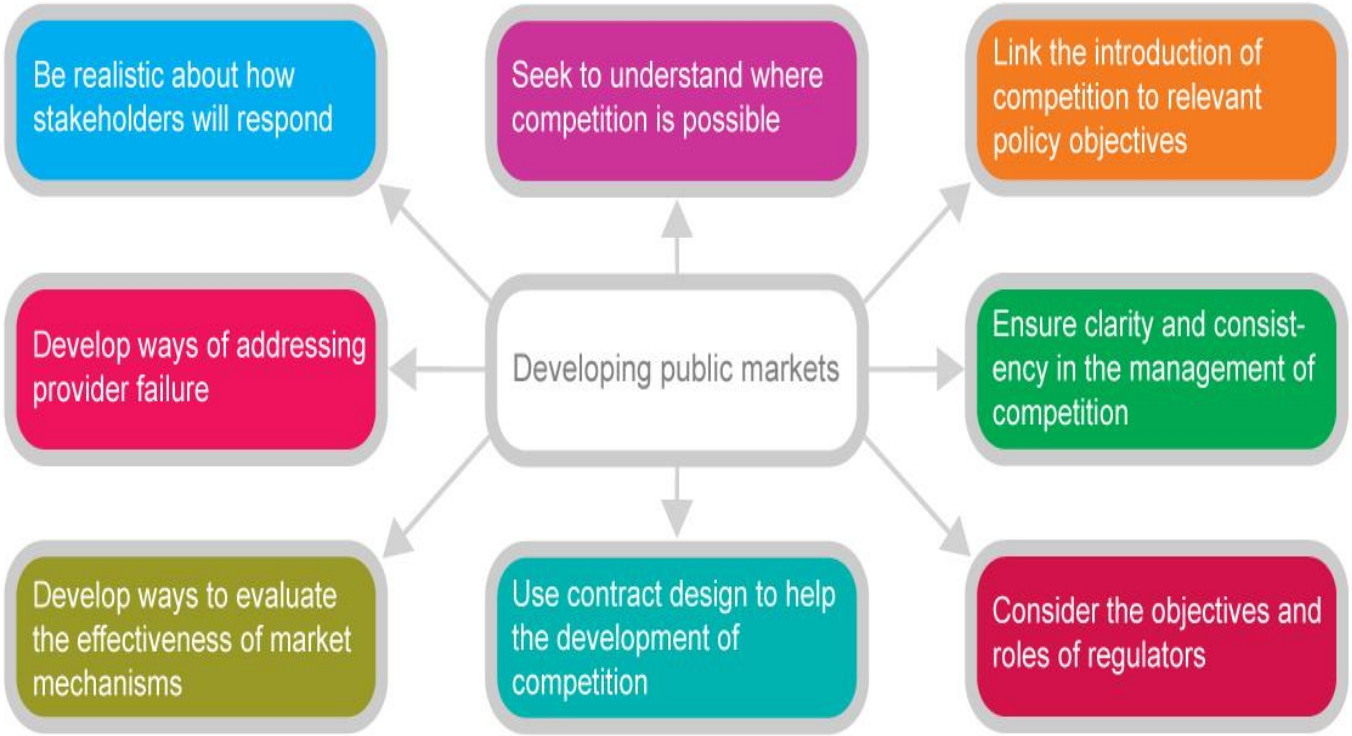
Golden rules for PS market design

Essential steps for design of PS markets broadly well understood

- What is the public interest objective?
  - Cleaner water? Better schools? Cheaper and more reliable train journeys?
- Outline vision for the market
  - Is this a market which can support multiple providers? Is competition feasible?
- Design market structure
  - Make sure that the structure of the market is correct and the incentives are aligned to achieve the desired outcome, e.g. trade-off efficiency vs choice: allow concentration to achieve cost reductions via economies of scale/scope or promote entry?
- Choose the appropriate regulatory model
  - Ex-ante vs ex-post. Depending on the stage of maturity and transition as markets develop (see telecoms, postal services).
  - The regulatory framework needs to be capable of adapting and allowing intervention to correct outcomes (e.g. financial sector). Able to evaluate the effectiveness of market mechanisms. The role of competition law needs to be clear and well understood (e.g. NHS) and its application drive to the right outcomes.
- Implement the reform
  - And be prepared to fine-tune as necessary

Golden rules for PS market design: OFT

Office of Fair Trading, Developing Public Service Markets August 2013, OFT1497



Golden rules for PS market design: IfG

"*For PS markets to drive improvements, users and commissioners who choose on their behalf need to be engaged and informed. Funding levels need to be appropriate. New providers must be given an opportunity to supply/compete and good suppliers to grow. Incentives should drive the desired providers behaviours and poorly performing providers should be able to exit the market without excessive disruption to service users.*" (Institute for Government)

- Often Public Services do not fit this ideal scenario
- Special features of Public Services demand/supply characteristics (nature of market failures; behavioural biases) raise real challenges
- The devil is in the detail: The case of the NHS

The case of the NHS

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Competition and regulation in healthcare

3 key issues make (the enforcement of) a pure competition model based on standard competition rules not perfectly suitable to this sector in its current state

1. Complex product/service
2. Price is not a signal
3. Barriers to exit

3 Key issues make sector unsuitable for standard competition rules

1. **Complex product/service**
   - Information asymmetries;
   - Credence good;
   - Competition focused on quality:
     - multifaceted variable
     - different aspects matter to different people eg GPs (waiting list) v patients (convenience, closeness to home).
     - difficult to assess and measure- which weight should be given to different quality dimensions when the ranking differs for different parties?
   - Behavioural biases:
     - herding behaviour;
     - resistance towards market exit of failing public-providers (see Mid-Staffs case)
   - Competition limited to some services/specialties

3 Key issues make sector unsuitable for standard competition rules

2. Price is not a signal

- Cannot be used to regulate supply and demand therefore fails to achieve best allocation of resources
- Tariffs set on the basis of limited (but improving) understanding of costs (similar issues in other sectors, e.g. rail)
- Price is not a signal that can be used to achieve efficiency - attracting entry of efficient operators and inducing exit of inefficient ones (presence of cross-subsidies)

3 Key issues make sector unsuitable for standard competition rules

3. Barriers to exit: Absence of a proper failure regime

- Failing Trusts propped up by further support creates biased incentives
- Reluctance to force exit of underperforming (public) providers out of the market
- A public sector philosophy in which failure is unacceptable? But the public bears the costs
- Too close to the heart of public opinion to be allowed to fail?
- Need to overcome stigma of failure (as in private sector)
- Focus on managing transition to ensure continuity of service while allowing exit: A lot needs to be done in this area.

Competitive model not realistic if we lack real market signals and levers

Can we rely on the application of the competition regime to deliver the desired outcomes? Example: Case of 92 NHS Trusts:

- **Mergers**
  - Facilitate mergers for failing NHS Trusts to share best management.
  - Failing firm defence- very stringent criteria. Allow contiguous mergers even if not 'least impact on competition'?
  - Non-contiguous mergers not quite as efficient as contiguous ones (specific understanding of local needs, possibility of sharing rotas, etc.).
  - How do we measure impact on competition? No reliable methodology to assess impact on competition, i.e. 'reduction in choice' not a proper indicator- what is the value of the lost choice? (Diversion ratios per se are not an indicator of lost value to patients, see behavioural biases - Mid-Staff example).
  - Have we got the correct framework to assess merger benefits? Standard regime test: merger efficiencies need to be realised within the short-term. But rationalising delivery of specialties will take significantly longer. And what is the correct welfare test? Consumer welfare test ignores that producer welfare in this sector equates to benefits to taxpayers.
  - Allow regional monopolies to be run by best performing Trusts and regulate? Yardstick competition a better interim model until we develop full understanding to be able to rely on full competition?

Competitive model not realistic if we lack real market signals and levers

Can we rely on the application of the competition regime to deliver the desired outcomes?

- **Agreements**
  - Need for healthcare providers to collaborate with each other in order to deliver integrated healthcare along the pathway and to achieve economies of scale /scope
  - Cooperation particularly needed for failing Trusts
  - Agreements amongst 'competitors'- Buddying: coaching and mentoring, but also direct intervention, management and delivery of services by successful Trusts for failing Trusts. Issue CA98- Ch.1: Efficiency defence? Case for exemption?
  - Efficiencies to outweigh potential harm to competition- how do we measure the effective reduction in competition (impact of agreements on quality)? And how do we measure efficiencies? Analogous issue as for mergers.
  - But preventing such cooperation might result in welfare loss.

Conclusion

"***The CMA has a role to play in considering whether recently implemented market-based reforms have delivered the benefits of choice and competition in practice***." CMA Strategic Assessment.

- This is extremely welcome
- Question: Could the CMA, in cooperation with Monitor, shed some light on the actual value of competition on outcomes for patients and help to take this into consideration in the re-design of market mechanisms to enable the healthcare sector to face the challenges ahead?