



# The economics of social services

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# Outline of this morning's presentation

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What is a social service?

- *personal services that society has decided that people should be able to receive aside from their ability or willingness to pay*

What makes them challenging to supply?

- making is problematic, but so is buying
- six other *service models* to consider

Choosing a model to match the service and its intended users



# What is a social service?

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*A personal service that society has decided that people should be able to receive aside from their ability or willingness to pay*

- E.g. education, health, family violence services, disability support
- Definition overlaps that of a “merit good”
- Very costly to supply
  - government expenditure averaged 9.3% of GDP for OECD countries in 2013
- Income support is a transfer, not a service, in this context

# Characteristics of a social service

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Cost and benefits (public and private) and willingness to pay (WTP) are specific to each individual  $i$  (Besley, 1988)

Target population is those whose consumption would create a net social benefit, i.e.

- $(\text{net public benefits})_i + (\text{net private benefits})_i > 0$ ; but
- choose not to consume because  $WTP_i < P_i$  [price]

$WTP_i < P_i$  because

- consumers are too poor (ie, budget constrained)
- consumers underestimate  $(\text{net private benefits})_i$ ; and/or
- actual  $(\text{net private benefits})_i$  is low or even negative

# Social services: options to induce demand

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- (i) Income transfers to relax budget constraints
- (ii) Efficiency improvements to reduce cost of production ( $C_i$ )
  - Or offer higher benefits, justifying an increased  $WTP_i$
- (iii) Increase competition (or regulate monopoly) so that  $P_i=C_i$
- (iv) A general subsidy reduces  $P_i$  ... but
  - A costly way to increase consumption if demand inelastic
  - May induce over-consumption by those with a higher  $WTP$ 
    - so the subsidy may need to be restricted to a target group
- (v) Improved information can increase  $WTP_i$ 
  - Marketing might only reach some of target population
  - Tailored (client-specific) information may increase  $WTP_i$  and  $C_i$

# Social services: typical government demand-side policies

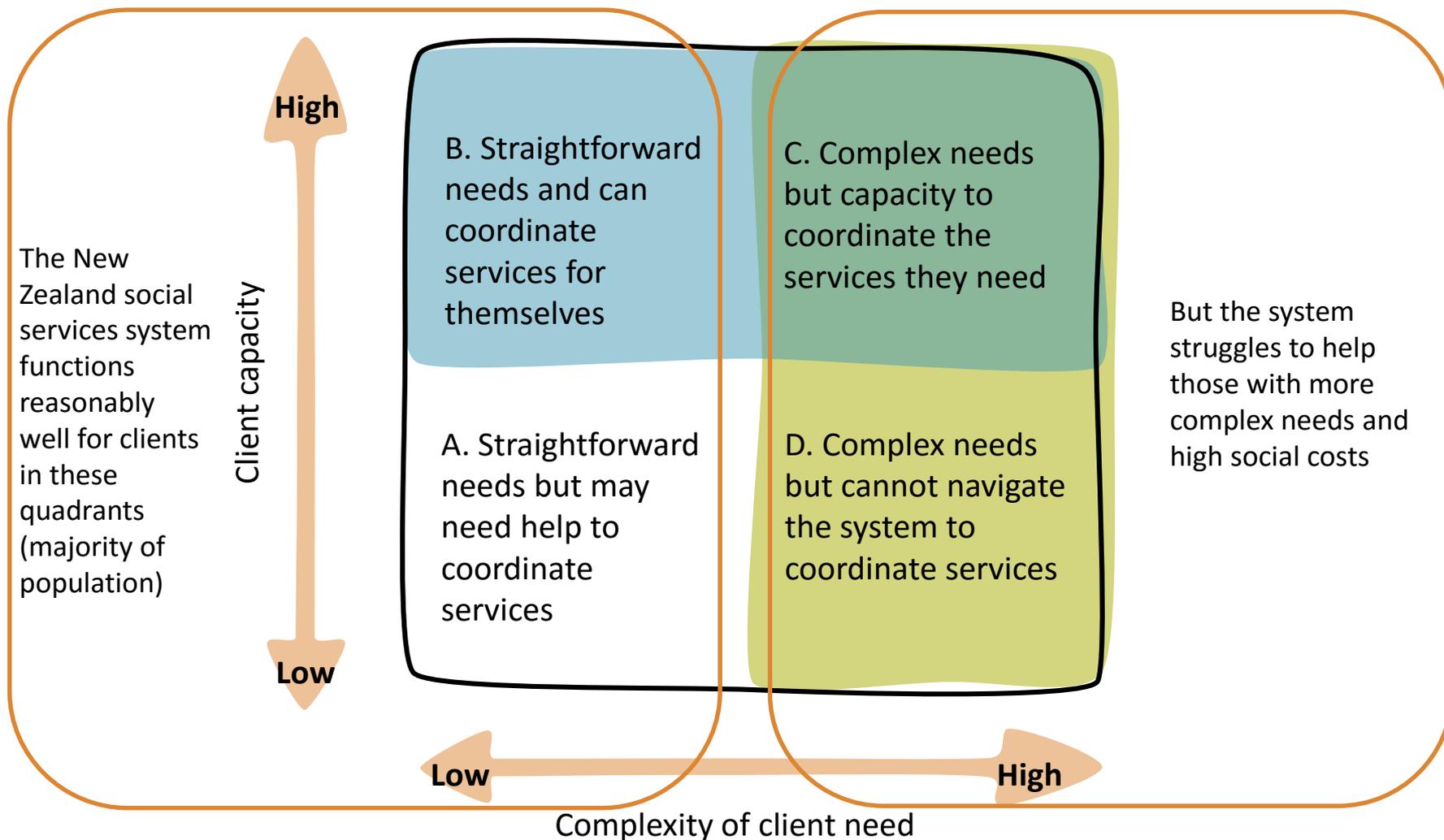
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- Income support to soften budget constraints
- State monopoly or not-for-profit supply
  - so  $P_i$  does not include a return to private investors
- Subsidies (general or targeted) - in many cases  $P_i = 0$
- Mass or targeted marketing to raise  $WTP_i$
- Compulsory consumption (eg, school education)

Such responses (in isolation or combination) sufficient to increase demand for many services; but often a “hard core” of individuals remain

- Those whose  $WTP_i < 0$  and/or (net private benefits) $_i < 0$   
(Note that below-zero prices risk perverse responses)

# Client segmentation





# Quadrant D clients often receive poor or inadequate services

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Client experiences vary. But those in quadrant D often face

- uncoordinated services
- services for individuals rather than families/whanau
- time-consuming and disempowering processes
- dropping out ... only to reappear with even greater needs

Leading all too often to “system” failure

- missed opportunities for early intervention
- symptoms treated rather than underlying causes
- nobody with visibility of the whole picture



# Meeting the needs of Quadrant D clients

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Clients require assistance in prioritising, selecting and sequencing services:

- Tailored to their specific needs and aspirations
- In context of their wider family, employment and social situation
- Not limited to those from a single funder, agency or provider

Resources expended should reflect the social costs of failing to improve their situation



# Potential gains for/from Quadrant D

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Relatively few people, but high social and economic costs

*The consequences for quality of life of having multiple disadvantages far exceed the sum of their individual effects (Stiglitz, Sen & Fitoussi, 2009)*

- A strong case for spending more on them

Government expects to spend \$6.5 billion in total over the lifetimes of the system's 10 000 highest-cost clients:

- at least \$500 000 on each client
- over 900 clients will cost the system \$1 million or more

(Unpublished data; cited in NZPC, 2015)

# Social services supply challenges: quality

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Social service quality can be difficult to assess ex-ante or even ex-post

$P_i=0$  typically means the funder, provider and client of social services are separate

- Funders have indirect relationships with clients
  - information about  $C_i$  often unreliable
  - find it difficult to judge  $Q_p$  [provider quality]
- Clients have little ex-ante knowledge of  $Q_p$ 
  - are typically unaware of  $C_i$
  - are offered few (if any) choices of service provider
- Providers may cherry pick lower-cost clients

This undermines the price and quality feedback systems that operate in conventional markets

# Social services supply challenges: political pressure

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Ideally, government would pay for improved client outcomes ... but politicians face pressure to be accountable, caring and responsive

- Being **accountable** for outcomes is high risk for both government and providers
  - so typical commitments are for inputs (\$ or staff places) or outputs (number of services delivered)
- The public debate conflates **caring** with spending
  - caring gets signalled through budget allocations to narrow-purpose programmes that each deal with a political problem or interest group
  - politically difficult (“uncaring”) to close down poor-performing programmes
- Being **responsive** leads to constant tweaking of policy and an accretion of prescriptive rules

# Social services supply challenges: siloed production

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Political pressure results in a siloed, over-specified and inflexible system

- Accountability mechanisms discourage cross-silo cooperation
- Decisions rarely based on reliable evidence of improved outcomes

Administrative silos an effective way of managing social services for those with needs that do not cross silos (quadrants A & B)

- Many such services highly specialised and have economies of scale
- Siloed delivery offers strong political accountability
- Success of system in meeting needs of majority of population make it resistant to change (Heatley, 2016)

# Social services supply challenges: clarity of responsibility

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Siloed systems perform poorly if responsibility is unclear

- Everyone and no-one is responsible for the “client”

A simple example (real-world quadrant D cases are more complex):  
a child traumatised through witnessing family violence

- Child is a client of a child welfare agency
- Parent A is a client of the corrections agency
- Parent B is a client of a social welfare agency

Family may be better off together (or not). Who is responsible for:

- making a holistic assessment?
- coordinating services?
- actual outcomes?

# *Make vs buy is too narrow*

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Extensive literature on make vs. buy in a non-government setting

- E.g. Coase (1937); Alchian & Demsetz (1972); Grossman & Hart (1986); Hart & Moore (1990); Williamson (2002)

... and its extension to government settings

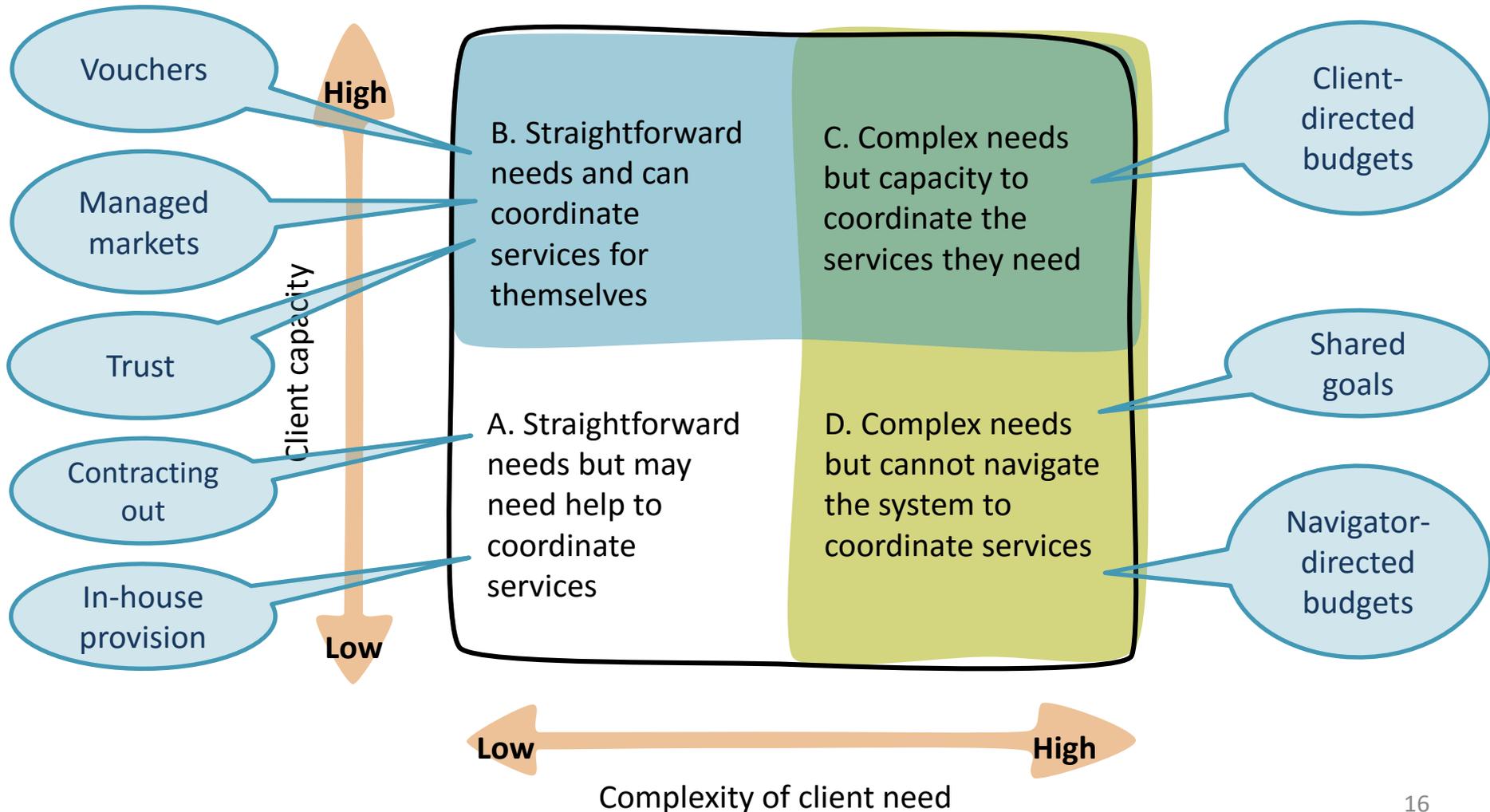
- E.g. Hart, Shleifer & Vishny (1997); Besley & Ghatak (2003); Acemoglu, Kremer & Mian (2007)

Le Grand (2007) described 4 models for quality government-funded public services

- *Targets & performance management* – central command and control
- *Voice* – users communicate their needs directly to service providers
- *Choice & competition* – users choose from competing providers
- *Trust* – professionals are trusted to deliver high quality

NZPC (2015) describe 8 *service models*

# Matching service model to client quadrant



# Service models suited to Quadrant A clients

Quadrant A: straightforward needs but may need help to coordinate services

Service model	Who judges quality	Useful when	Problems with
In-house provision	Government	Significant economies of scale; uniform delivery important	Capture by professions; inflexibility; risk aversion; lack of innovation; client trust; performance evaluation & improvement; overly responsive to political concerns
Contracting out	Government	Multiple non-government providers willing to supply; difficult-to-reach clients	Siloed delivery; specification and evaluation; government and 3 <sup>rd</sup> party opportunism (Spiller, 2008); underpayment; over-specification; weak incentives for innovation; political gaming; cherry picking

# Service models suited to Quadrant B clients

Quadrant B: straightforward needs and can coordinate services for themselves

Service model	Who judges quality	Useful when	Problems with
Managed markets	Government	Can stimulate improved performance and innovation	Administrative complexity; rule accretion; price setting; regulatory gaming; cherry picking
Trust	Providers	Intrinsic motivation high; provider interests match client interests; effective self-regulation	Capture by professions; adequate monitoring; services that cross professional boundaries; resource allocation is political
Vouchers	Clients	Multiple providers willing to supply; informed clients; private benefits correlated with public benefits	Political gaming; client lock-in; cherry picking (if $C_i$ varies significantly)



# Service models suited to Quadrant C clients

Quadrant C: complex needs and can coordinate services for themselves

Service model	Who judges quality	Useful when	Problems with
Client-directed budgets	Clients	Client (or agent) well placed to mix & match services; innovation & client-responsiveness important	Client decision-making capacity; needs assessment, budget setting & allocation are difficult and can be politicised

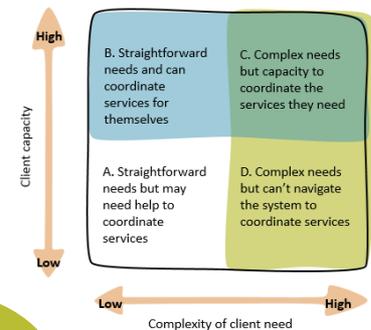
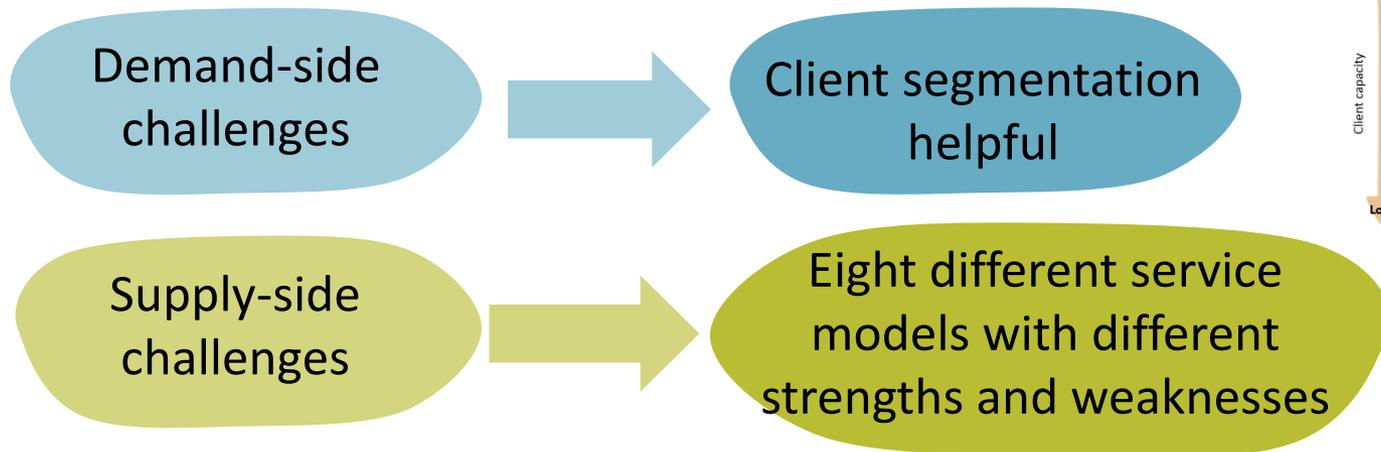
# Service models suited to Quadrant D clients

Quadrant D: complex needs but cannot navigate the system to coordinate services

Service model	Who judges quality	Useful when	Problems with
Shared goals	Providers	Intrinsic motivation high; provider interests match client interests; constructive & integrated problem solving required	Replication; sustainability (Ostrom, 2000; Love, 2015);
Navigator-directed budgets	Navigators	Navigator well placed to act as a coordinating and purchasing agent for a client (or their family); innovation & client-responsiveness important	Budget allocation? Navigator performance assessment & management?

# Summary & questions

Social services are *personal services that society has decided that people should be able to receive aside from their ability or willingness to pay*



Good service design (“commissioning”) should aim to match service models with client segments

For more information see

[www.productivity.govt.nz/inquiry-content/social-services](http://www.productivity.govt.nz/inquiry-content/social-services)

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# Additional detail on service models

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# 1. In-house provision

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- Government provides services directly
- Assumes government can best judge quality
- Responsive to political concerns
- Prone to capture by professions, inflexibility, risk aversion, lack of innovation
- Useful where significant economies of scale or uniform delivery important
- NZ example: employment services (Ministry of Social Development)

## 2. Contracting out

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Government purchases services from non-government providers

- Typically through an open tender process, drawing on general public sector procurement expertise
- Assumes existence of multiple non-government providers willing to supply
- Assumes government can best judge quality
- Programme-by-programme purchasing creates silos within silos
- Specification and evaluation problematic
- Government and 3rd party opportunism (Spiller, 2008)
  - Encourages government to under-pay and over-specify
  - Weak incentives for innovation
- Government is dominant purchaser – it gets the supply side it deserves

NZ examples: alcohol rehabilitation services, women's shelters

*Social bonds* are new form of contracting between a government agency, social services providers and investors, in which the agency commits to pay for improved social outcomes

### 3. Managed markets

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- A government-specified and created “market”
  - Multiple providers are licensed to provide services, and compete for market share
  - Market share is typically allocated administratively, based on performance against published standards
- Can stimulate improved performance and innovation
- Complex to set up and administer
- Examples: NZ social housing market, Australian employment services

## 4. Trust

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- Professional providers are trusted to design and deliver the service that clients need
  - Minimal oversight and control by funders
    - other than occupational licensing
  - Funding goes to providers
- Assumes the interests of clients, professionals, provider organisations and funders coincide
  - Can perform poorly when the services required span professional boundaries
- NZ example: general medical practice

## 5. Shared goals

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Some complex social problems are best addressed by providers and professionals near to clients working together for the benefit of those clients

Requires the collective specification of goals that are acceptable to those professionals and to their funders

- Needs to work across professional and organisational boundaries
- Slow to create and difficult to sustain (Ostrom, 2000)

NZ example: Canterbury Clinical Network

## 6. Vouchers

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- A voucher is an entitlement to a particular service offered by multiple providers
  - Assumes that clients are well-placed to choose their provider
- Government funding follows client choices
  - Variable-value vouchers may be necessary to reduce cherry-picking by providers if  $C_i$  varies significantly by client
- Provider market share depends on offering an attractive service to clients
  - Important to allow clients to switch away from providers offering poor service
- NZ examples: early childhood education, tertiary education

## 7. Client-directed budgets

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- Informed, motivated clients (or their trusted agents) can often make better decisions about
  - the mix of services they require
  - who provides those services
- Encourages service providers to be responsive and innovative
- Needs assessment, budget setting and allocation are difficult and can be politicised
- NZ example: Enabling Good Lives

## 8. Navigator-directed budgets

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- Quadrant D clients face complex problems requiring a tailored response
  - but lack the capacity to access and coordinate services themselves
- A “navigator” acts as a coordinating and purchasing agent for a client (or their family)
- Navigator better placed to make judgements about
  - the mix of services required
  - sequencing and prioritising services
  - who provides those services
- Should encourage service providers to be responsive and innovative
- An untried model, with open questions about
  - budget allocation
  - navigator performance assessment and management

# Examples of social services

