

SUPPLY OF PUBLICLY FINANCED SERVICES: MARKET AND NON-MARKET FAILURES

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Introduction

Publicly financed services (PFS) are those whose creation is financed entirely or partially by public resources (budget, target fund, etc.), it is provided by the state and the supply is offered on an alternative basis. The development of new governance approaches in the public sector in recent decades has boosted the scope of PFS, including also the traditional state cared sectors like social services, healthcare and education.

The significance of the analysis in this article comes from the fact that these are activities aimed at forming and maintaining human capital. It is not a coincidence that they are also subjected to an active public policy. The latter finds its expression in the dynamics of the aggregate expenditure on "education", "health" and "social security, assistance and care" funding. In Bulgaria, over the last 10 years, they range between 18% and 22% of GDP, and as a share of the consolidated fiscal program they exceed 50% of total public spending (<https://www.minfin.bg/bg/statistics/13>).

The analysis of the forms of provision of health, social and educational services is based on their economic understanding. On the one hand, they are treated as public goods, which has boosted public investment and the development of public institutions in the sectors since the 1960s of the last century; on the other, they are seen as public goods that generate extremely positive individual benefits (social and economic). The second aspect has provoked the growth of private payments and private sector developments in the sectors. All research over recent decades has led to a general trend, clearly outlined in EU countries – the expansion of the

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scope of private supply and development of forms of government participation, including through financial resources.

In this context we have to make the following clarifications:

1) As private structures are considered those that are directly or indirectly managed by business or non-governmental organizations. Their distinction from the public ones lies presumably in their direct management by state or local institutions and organizations. At the same time with the development of innovative public sector management tools (the "New Public Management"), mixed forms of supply (such as public-private partnerships) are formed and a mixed market for the supply of PFS is established. All this "blurs" the distinction between public and private supply:

- The social services sector is a typical example of the methodological difficulties faced in identifying the supply as "public" or "private" as related to the way of funding and the service delivery. Both public and private providers of social services are present on the market. At the same time funding is mainly from public sources (central and municipal budgets). The funds are distributed on a competitive basis among the service providers available in the respective communities. As a result, even the private supply-side entities operate primarily with public resources;
- The private sector in the healthcare in our country is growing under the influence of public funding. Most private hospitals work under a contract with the National Health Insurance Fund (NHIF), i.e. public funding stimulates the development of the private sector and creates problems for public health establishments that can hardly withstand the intense competition of the mixed health services market;
- Private provision in education is dealt with in two ways: in a broader sense it includes all educational structures, respectively all their units, centres, etc. that are independent of the central and local authorities. Therefore, these may also be public organizations, including also the political parties' ones. In a narrower sense these are private (or non-public) profit-oriented structures that are supported only by personal/individual payments and freely determine service prices and are independent in offering their curriculum/learning programs. (Popov, 2005; Piwowarski, 2006; Education-at-a-Glance, 2016);

2) In a number of countries (especially in Europe) the policies for the formation and development of human capital are based on equal treatment of public and private structures. Based on this, the public subsidy is being considered now as an instrument for stimulating private supply. This gives reason to consider the use of routine terms such as publicly funded and privately managed structures or publicly-funded private structures (Public and Private Schools, 2012). This requires, on the one hand, reconsideration of the mechanisms of interaction of the

state with the other economic entities and, on the other, an analysis of the positive and negative consequences. In economic theory the latter are often identified with market and non-market defects.

3) **Market failures** are defined as the market's inability to ensure an efficient and fair distribution of resources and their specific forms of manifestation are most often associated with the presence of: imperfect market structures, incomplete market, external effects, unfair social and territorial distribution of market goods and information asymmetry, imbalance between supply and demand.

4) **Non-market failures** arise from the nature of the public offering of services and often from the regulations that are not always efficient. They are relatively poorly researched in Bulgaria and are most often associated with: inefficient and unfair territorial distribution of resources and public goods, unnecessary and rising costs, financial deficit, grey sector market relations and derived external effects.

Research tools

The purpose of this article is to summarize the defects in the provision of PFS in the fields of education, healthcare and social services. The analysis is based on the experience in Bulgaria and the development of the respective sectors for the period 2006 – 2016. It is the result of an empirical research carried out within the framework of a research project of UNWE (NIS-NI 3/2016) "Market and non-market alternatives of PFSs" in which the authors took part.

The subject of the analysis in this article are the defects caused by the alternative forms of offering health, social and educational services.

This piece of research is based on the understanding that the driving force in making choice in the field of market and non-market alternatives is the interaction and the balance between market and non-market defects. Despite its popularity in some publications as a rational explanation of the need for change (for economic policy needs), the theory of market and non-market defects does not have enough sectoral empirical tests and is therefore not methodologically attractive to substantiate fundamental economic and political choices, such as choices of modes of production and provision of public services.

The hypothesis that the sphere of action of market and non-market failures inherent in the PFS is being expanded is explored. There is a transformation in the forms of manifestation of market defects caused by the expansion of the private supply as well as the development of mixed forms of supply. In this sense, the sharp boundary between market and non-market defects is blurred and one can speak of their diffusion.

The methodological framework of the analysis links two *research perspectives*. On the one hand, the types of defects grouped in the categories "market" and

"non-market", and on the other, the respective forms/alternatives of supply – public and private. On this basis, answers to two main questions are sought: 1) whether the defects are dependent on the form of supply, and 2) if there is a sharp boundary between private supply and market and public supply services and non-market failures. The matrix of the study presented in Table 1 tests previous defects found [1].

Table 1. Diffusion of market/non-market defects

Types of Defects	Forms of Supply					
	Public			Private		
	HS	ES	SS	HS	ES	SS
Market failures						
Information Asymmetry	g	g	g	g	g	g
Incomplete market	y	y	y	g	g	g
Territorial Imbalance	g	g	g	g	g	g
Non-market failures						
Rising Costs	g	g	g	g	y	g
Unfair Distribution	g	g	g	g	g	g
Low Quality	g	g	g	y	y	g

Remarks: 1) HS – health services, ES – educational services, SS – social services;

2) Private refers to private sector services using public resources

Legend:

g

Type of establishment	2012	2014	2016
Public	1.55	1.47	1.57
Private	0.4	0.4	0.5

Source: National Centre for Public Health and Analysis, 2017

A specific measure of the quality of social services is the *satisfaction* of consumers and their families. Over the observed decade it has persistently low indicators – 75% of people with disabilities believe they are not perceived as equal to others, 85.7% consider public transport inaccessible, 77% cannot attend cultural centres, etc. (Tsvetkova et.al., 2013).

The quality of school education as assessed by the national external evaluation has consistently lead to the fact of the growing advantages of private schools in all three areas: Foreign languages, Bulgarian language and literature and Mathematics. For example, private schools in Sofia prevail in the three areas in the "top 20" ranking of schools. At the same time, on an international scale

the Bulgarian education system is extremely uncompetitive. This is reflected in the low scores in the PISA tests and the lack of Bulgarian Universities in the reputable international rankings.

Conclusion

Alongside the identified defects and their diffusion, the empirical study of the forms of supply of social, health and educational services in Bulgaria for the period 2006-2016 gives sufficient grounds to arrive at several general conclusions.

First, there are clearly outlined trends in the expansion of private supply in all three sectors and mainly in services that operate with public resources (dental services, primary care, vocational training centers, crisis centers, etc.). This tendency is most pronounced in health services (see Figure 5) while the dynamics of private education services is the lowest. There is also a development of mixed forms of supply as is the case with social services.

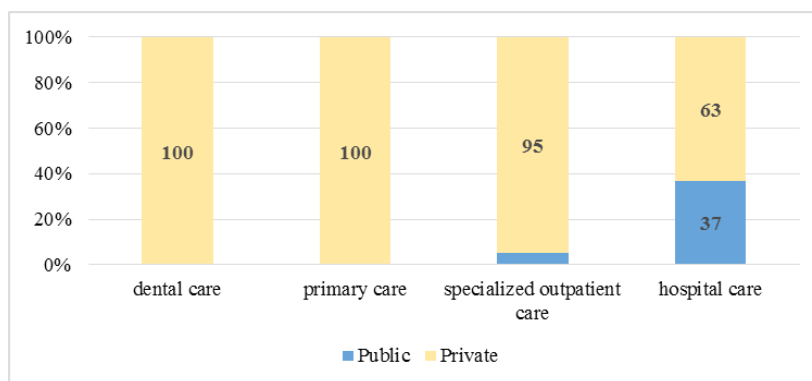


Fig. 5. Relative share of private health services by type of activity
Source: According to NCPH data, 2017

Along with the above trend (increasing the scope of private supply) the leading role of the public sector is retained in regard of the reach of consumers and the quantity (and for some activities the quality) of the services. This trend is most pronounced in the education sector and in particular in school education. The main reason for this may be identified as the non-efficient/dysfunctional regulation of public funding for private schools, which severely restricts demand. For this reason, 95% of the schools are still public and 88.5% of the students are educated/trained in state and municipal schools. Figure 6 illustrates the weak dynamics of market transformation in school education in Bulgaria for the period 2010-2016.

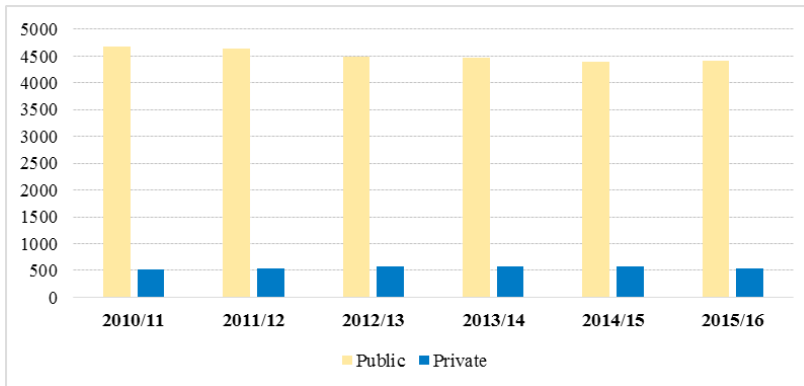


Fig. 6. Number of public and private educational institutions in school years

Second, demand is influenced by two different factors: on the one hand, demographic pressure and on the other – the change in socio-economic factors, e.g. increasing the share of people at risk of poverty and social exclusion, rising morbidity and disease, etc. Therefore, in health and social services there is a trend of increased demand, and in the case of education it drops.

The demand for healthcare services is rising as a result of the stimulating role of the supply. Resulting from the negative elasticity of the demand from the price (for the period the elasticity coefficients is from -3.93 to -8.93), a financial burden on the consumers is transferred. This is also confirmed by the exceptionally high growth and relative share of private healthcare spending (between 41% and 44% over the survey period) in the overall healthcare spending.

The growth of demand for social services is provoked by another factor that comes from the consumers. There is a high relative share of people at risk of poverty and social exclusion (between 42% and 50% for the period). Public funding for social services and the expansion of "suppliers' circles" can be identified as the second major factor for the increased demand.

The negative dynamics of demand in education is a result of the impact of demographic processes. For the period, students dropped by 11.8% and the school network shrank by 8.3%. Worrying trends are the decline and restructuring of higher education demand, which combined with the poor regulation, leads to significant disproportions between the two educational levels and is transferred onto the labor market. The data shows a negative elasticity of demand in terms of price (for the period the elasticity coefficient ranges from -1.42 to -5.52), which is justified by the significant state support through the uniformed spending standards and the normative for the expenditure per capita.

Third, the problem of service quality remains which, irrespective of the form of supply, lags far behind that in most EU countries. In this context the comparative

advantages of private supply in health and education services stand out. The latter cannot be generalized, as it is often the result of a selection of services (so-called "skimming the milk") by the private producers. The development of the sectors is also accompanied by strong indications of improving the quality of privately provided services in a number of areas where private providers have competitive advantages: luxury health services; school education, especially primary (1-7 grade), a number of higher education specialties in arts, public administration and audio-visual services; residential social services and social services in the community.

Fourth, the state is relinquishing its role as a direct provider of services and mainly performs regulatory functions including through financial instruments. A general finding is that a large part of the regulations is inefficient and there are non-operating ones, which further upsets the market and leads to the expansion of the sphere of market and non-market defects. Moreover, due to the development of a mixed market for the services under consideration and the general regulation:

(a) Some of the market defects are also transferred onto the public services offered. Such a defect is the information asymmetry (most pronounced in the healthcare) which is caused by the economic nature of the offered PFS. A reliable regulatory tool for overcoming this general defect is e-governance (e-health, e-education, etc.) which has been a policy priority for many years but is still not effective. There are sufficient indications for the transfer of other market defects to the sphere of public supply: distorted fairness in the allocation of public resources (standards for school and higher education and social services; increase in paid health services resulting in difficulty in accessing health care, etc.); the unfair territorial distribution of wealth (concentration of high-quality health, education and social services in several country regions and shortages in others, etc.). These findings warrant a further hypothesis of the study to be confirmed: the development of mixed forms of supply "accumulates" negative consequences and distorts the balance between market failures and the state.

(b) There are a number of market failures that go deeper to cause market incompleteness (shortage of prophylactic and psychiatric assistance in healthcare; lack of supply of half of professional fields in private higher education institutions; insufficient network of private social services for people with disabilities, etc.). With the development of market structures a parallel process of defect transformation is taking place. For example, the findings of previous studies on underdeveloped market structures and poor quality of services in all three sectors cannot be further confirmed. At the same time, the incomplete market is a fact and the supply of a product mix focused on solvent demand is a trend for the whole set of services studied (expensive and fast-moving health services – ophthalmology, cardiology, reproduction, aesthetic surgery, social services for the elderly, etc.) or those with

low production costs (professional fields in higher education, daily social centers of all kinds, etc.).

(c) The scope of non-market defects is expanding. For all sectoral services studied there is a growing public spending (nominal – as an absolute amount and as a differentiated unit price per service). This is accompanied by systematic non-financing of certain services (internally and as international comparisons): clinical paths, professional fields, etc. Therefore, the indebtedness of hospitals is growing and so on. The relevance of these processes to service quality (including the extremely poor international positioning) indicates low efficiency of public spending.

Notes

[1] The authors are participants in a series of research projects on these topics funded by the UNWE- SRF as follows: Market and non-market defects in the socio-cultural sphere, 1998-1999; 2) Market transformation in the socio-cultural sphere, 2005-2007; 3) Instruments for improving the quality of public services, 2011-2013; 4) Analysis of the macroeconomic and financial situation of Bulgaria in 2014 and 2015, theme No 9 "Publicly funded services", 2014 – 2016; 5) Market and non-market alternatives to publicly funded services, 2016-2018

[2] Social Assistance Act, prom. SG No.56 / 19.05.1998, last. ed. and ext. SG. 35/30.04.2019

[3] The register is compiled on the basis of Article 10 of the Higher Education Act and contains information about all accredited higher education institutions in a country by the following criteria: type of higher education institution, location, professional field/s, specialty, educational qualification characteristic.

[4] See. Register of Institutions in the System of Preschool and School Education, MES, 2017, <http://89.252.196.217/Schools/search>

[5] See. Register of Private Vocational Colleges in Secondary Education, MES, 2016, <https://www.mon.bg/?go=page&pageId=8&subpageId=78> . There is a discrepancy (with 5 colleges) in the NSI and MES Register data.

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Abstract

The article discusses the characteristics of the publicly financed healthcare, educational and social services with a special focus on their market and non-market failures. Traditional failures like informational asymmetry, incomplete market and territorial misbalances are tested. It becomes evident that those failures manifest not only in the cases of private supply, but also in the public sector. On the contrary, non-market failures become features of the private supply.

Keywords: publicly financed services, market and nonmarket failures, public and private supply

JEL: H42, H44