

The failure of for-profit competition in the provision of human services

Submission to Productivity Commission inquiry into introducing competition and informed user choice into human services

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Summary

This submission is a response to the Productivity Commission Preliminary Findings Report entitled *Introducing Competition and Informed User Choice into Human Services: Identifying Sectors for Reform*

In this submission, it is argued that:

1. The terms of reference are fundamentally misconceived. The implicit assumption that contestability and competition will promote informed user choice and better outcomes is not supported by economic theory, and is contradicted by evidence of the impact of competition and contestability in human services in Australia and elsewhere.
2. The Commission's dismissal of concerns about for-profit provision, and of arguments in favour of mission oriented public and non-profit provision is not supported by either argument or evidence. All that is presented is a statement that 'The Commission considers that maximising community welfare from the provision of human services does not depend on adopting one type of model or favouring one type of service provider'. No basis for this position is presented. Rather, it reflects the inadequacy of the Commission's analytical framework to address the issues raised by a comparison of mission oriented and profit oriented provision, a question central to the problem at hand. This inadequacy makes it impossible for the Commission to undertake a proper assessment of the policy issues.
3. The Commission's assessment that, in key areas 'introducing greater competition, contestability and informed user choice could improve outcomes for people who use human services, and the community as a whole' is a mistaken inference reflecting prior beliefs that have not been properly updated in the light of the evidence. The Commission notes the expansion of the for-profit sector since 1990 but (with the last-minute exception of for-profit vocational education) does not refer to the numerous failures that have emerged during that period.

4. The inadequacy of the Commission's approach is illustrated by the disastrous failure of contestability and competition in the case of for-profit vocational education in Australia. The Commission now presents the reform of vocational education as an illustration of 'the potential for damaging effects on service users, government budgets and the reputation of an entire sector if governments introduce policy changes without adequate safeguards.' However, previous Commission reports, as recently as 2014, presented a much more favorable view.

5. Long experience has shown that the notion of 'safeguards' is essentially vacuous. If a public policy is designed in a way that encourages gaming and regulatory arbitrage, the presence of safeguards will serve only to obscure this fact, without improving outcomes.

6. Rather than expanding competition and contestability in the provision of human services, the most important policy goal in this sector should be the strengthening of public and private providers with a mission of service rather than profit maximization. This would entail the (further) unwinding of existing failed policies based on a model of competition for consumers, notably in education, training, childcare and employment services

1. Contestability, competition and user choice

The terms ‘contestability’ and ‘competition’ are drawn from microeconomic theory. The associated framework is one in which profit-maximising firms compete in markets for goods and services. Consumers with well-defined preferences are assumed to face known, common prices. The relevant case here is that of markets for differentiated products.

Competition in this context is not interpreted in the strategic terms common in ordinary usage (where, for example, two firms in a duopoly market might be seen as engaged in vigorous competition). Rather, competition refers to the existence of a large number of suppliers, offering either the same commodity bundle or differentiated products that are close substitutes in consumption. Contestability refers to the idea that, even if there is only one supplier (or only a few) in a given market, pricing is constrained by the possibility of entry by firms currently supplying similar goods in other markets

The primary positive finding from this literature is that, under appropriate conditions, contestability and competition will lead to lower prices and the elimination of monopoly profits. Contrary to the assumption implicit in the terms of reference, there is no reason to suppose that competition and contestability will expand consumer choice, in the sense that consumers will have access to a greater variety of substantively different goods. On the contrary, in a wide range of circumstances, competition predictably reduces consumer choice.

The standard theoretical model is that of Hotelling (..) and the standard illustration is that of two ice-cream sellers on a beach, where consumers are evenly spaced along the beach. Welfare, as measured by the average distance a consumer has to walk to buy an icecream, is maximized when the icecream sellers locate at two points one-third of the beach length from each end, with one-third between them. However if two competing sellers located at these points, either one could gain market share by moving closer to the centre. The competitive outcome, as observed by Hotelling is that the two sellers would locate next to each other in the middle of the beach. By contrast, a monopoly supplier operating two stands would locate them optimally.

Evidence from the human services sector supports the view that consumer choice is likely to be reduced rather than expanded by the introduction of competition and contestability. The case of higher (that is, post-secondary, non-vocational) education is illustrative. Before the reform era that began in the 1980s, the Australian higher education sector was characterized by a wide variety of institution types: universities, colleges of advanced education, institutes of technology and specialised institutions of various kinds.

Within the university sector there was a great deal of diversity. The long-established 'sandstone' universities offered a traditional higher education derived from British models. By contrast, the universities established in the Menzies era pursued a variety of more innovative approaches. Regional universities had specialised offerings reflecting their student base. Finally, the Australian National University was *sui generis*.

The Dawkins reforms abolished the institutional distinctions and reduced the number of institutions through mergers (a likely outcome of competition and contestability). Institutions were encouraged to compete by selecting 'flagship' offerings and through entrepreneurial approaches to restructuring. Fee competition was also encouraged, with the idea of offering consumers a trade off between cost and quality. The results were entirely consistent with the predictions of the Hotelling model. Almost uniformly, the selected flagship offering was a Master of Business Administration. The organization model, in which discipline-based departments were replaced by heterogeneous schools, faculty governance was replaced by executive deans and the administrative hierarchy was greatly expanded was similarly uniform. Finally, as regards fees, all institutions chose (with a brief delay in some cases), the maximum allowable level, an outcome replicated under similar circumstances in the UK.

To sum up, there is no reason better than alliteration to suppose that competition and contestability will be positively associated with choice.

2. For-profit versus

The Report cites a wide range of arguments put forward in submissions to the effect that mission-oriented providers (public and non-profit) will do a better job than for-profit providers and will be less likely to engage in destructive regulatory arbitrage and

No attempt is made to assess these arguments or respond to them in any way. Rather, the Report presents a statement of an *a priori* view, uninformed by evidence of any kind

'The Commission considers that maximising community welfare from the provision of human services does not depend on adopting one type of model or favouring one type of service provider'. No basis for this position is presented. Rather, it reflects the inadequacy of the Commission's analytical framework to address the issues raised by a comparison of mission oriented and profit oriented provision, a question central to the problem at hand. This inadequacy makes it impossible for the Commission to undertake a proper assessment of the policy issues.

The inadequacy of the Commission's begins with a failure to give serious consideration to the potential for regulatory gaming and arbitrage by for-profit firms, despite extensive experience of such outcomes, most notably in relation to the VET sector (the problems in this sector are mentioned in a box, but do not inform the analysis as a whole). This failure reflects a bias in favor of the 'reform' agenda implicit in the terms of reference and in the long-standing policy positions of the Commission. However, a correct application of the Commission's analytical framework would have led to a more serious consideration of these issues

The more fundamental problem is that concepts such as mission-orientation, service ethics and professionalism are excluded in advance from the Commission's analytical framework which begins with a bedrock assumption that economic agents of all kinds act in pursuit of rational self-interest. It follows that the distinction between profit-oriented and mission-oriented providers is meaningless. If there are incentives to engage in gaming and regulatory arbitrage, these will be pursued by profit-oriented and mission-oriented providers alike.

The Commission's analytical incapacity even to consider these issues mean that it is incapable of addressing the fundamental questions raised by proposals for competition and contestability. If the Commission is to work in this area, it should engage in a comprehensive reassessment of its analytical framework.

3. Treatment of evidence

The Commission has rightly, been a strong advocate of evidence-based policymaking. Yet, with the unavoidable exception of the VET fiasco, the report makes little or no reference to evidence on the past performance of for-profit providers of publicly funded human services. This is most obvious in relation to childcare. The report makes repeated mention of this sector but says nothing about the collapse, in 2008, of the leading for-profit provider, ABC Learning, nor about the concerns raised by the recent resurgence of for-profit provision.

Similarly there is no discussion of international evidence, which provides numerous instances of policy failure. I have listed some of these in a recent article in *The Guardian*

<https://www.theguardian.com/commentisfree/2016/sep/12/face-the-facts-competition-and-profit-dont-work-in-health-education-or-prisons>

along with a recitation of the standard economic arguments as to why competition may be problematic and a restatement of the case for mission-oriented provision

<https://www.theguardian.com/commentisfree/2016/sep/23/why-cant-our-leaders-learn-from-30-years-of-failure-in-health-and-education>

Many of the economic arguments are mentioned in the Commission's report. However, the treatment of evidence is such as to indicate a strong and tight prior belief that these problems are minor and manageable. No effort has been made to update these beliefs in the light of the extensive contrary evidence.

As noted above, a more fundamental problem is the Commission's analytical incapacity to address the issues raised by mission-oriented provision.

4. The vocational education disaster

The report correctly notes (Box 1) that

Reforms to the vocational education and training (VET) sector illustrate the potential for damaging effects on service users, government budgets and the reputation of an entire sector if governments introduce policy changes without adequate safeguards.

However, the report gives no indication of how the potential for such damaging effects can be recognised, and mitigated, in the future. The Commission's own track record in the case of VET gives no grounds for confidence in this regard.

The problems in for-profit provision were well known as early as 2011. Quiggin (2012) drew on evidence from the Victorian sector

An ABC investigation has alleged that some of the most prominent providers in Victoria have provided low-quality training, and engaged in outright fraud, such as the provision of staged photos purporting to show on-the-job training that did not in fact take place (Australian Broadcasting Corporation 2012). This follows the deregistration of Vocational Training Group earlier in the year, following allegations of illegal kickbacks, and the refusal of applications by at least 100 of the 600 providers operating in 2011 for access to government-funded training places (Ross 2012).

to conclude

attempts to restructure education as a competitive industry, in which market signals play a central role, have proved almost entirely unsuccessful or counterproductive. Many of these initiatives have been abandoned and others have been characterised by chronic problems of fraud and exploitation of regulatory loopholes.

By 2014, the problems had massively expanded, and were a matter of public scandal. Yet, the Commission's 2014 submission to the Harper Review was strongly supportive, mentioning only some problems regarding international students

The Commission's study into the vocational education and training (VET) workforce (2011f) found that there had been a rising trend to harness market forces in the allocation of VET services, with principles such as user pays and user choice increasingly underpinning VET policy. The Commission suggested that, as the VET sector becomes increasingly competitive, a move towards greater managerial independence for public providers would give them the autonomy and flexibility they need to respond.

The Commission (2011f) also noted that opening up of the VET sector had not been a complete success, with some stakeholders raising concerns about quality assurance, monitoring and enforcement (especially in the international student sector).

Reference to the 2011 report, shows a box referring to problems with international students, which were a matter of public concern at the time. These problems included the misuse of training programs as a device to obtain permanent residency .There were also broader social concerns arising from a number of reported assaults on Indian students, which became a matter of international controversy in 2009. But the box says nothing to suggest any awareness of the broader problems with for profit provision, which were already apparent, let alone any capacity to predict them using the PC’s analytical framework.

The Harper Review was even less satisfactory in this respect. Apart from briefly mentioning a critical submission from the Australian Education Union, the Review, published in March 2015, gave no indication that there was anything problematic in the changes being made to VET and TAFE, which were described in clearly favorable terms, particularly with respect to the separation of provision and funding.

Given the failure of both the Commission and the Harper Review to discern the already realised potential for abuse in the VET sector, there is no reason to place any reliance on judgments that other human services are appropriate targets of ‘reform’ interpreted as the introduction of for-profit competition.

5. Safeguards

The report relies heavily on the idea that the adverse effects of for-profit provision can be prevented or mitigated by the use of appropriate ‘safeguards’, the specification of which is deferred to the second part of the inquiry. Long experience of public policy suggests that ‘safeguards’ against tendencies that are inherent in the design of a policy framework are rarely effective.

The discussion of safeguards in the present report illustrates this. The need for safeguards is referred to in the context of the admitted failure of the for-profit competition in vocational education. However, the report fails to mention the fact that the for-profit system was subject to elaborate formal safeguards, embodied in the work of the Australian Skills Quality Authority (ASQA). The ASQA website states

The Australian Skills Quality Authority promotes quality training so that students, employers, and industry have confidence in Australia's training sector.

The website reports numerous enforcement actions taken by ASQA in pursuit of this goal. The website and other ASQA publications give every indication of the existence of an active and effective system of safeguards. There is no hint of the reality of a system in such chaos that the Federal government has been forced to take emergency action to halt a budget blow-out and where tens of thousands of students have been left in the lurch by the failure of enterprises devoted to regulatory arbitrage rather than education.

If the Commission is to place any reliance on ‘safeguards’ in mitigating the obvious defects of a for-profit model, it should explain how its proposed safeguards will differ from those that have failed so catastrophically in the case of vocational education.

6. Conclusion

The evidence of the past 25 years suggests that the erosion of professionalism and mission-oriented service delivery in the pursuit of profit-oriented ‘reform’ has had overwhelmingly negative effects. Rather than considering the extension of this failed agenda, the urgent task for policy is to work out how professionalism and mission-orientation can be reconciled with the broader policy framework of neoliberalism, which remains dominant in Australia. Unfortunately, the terms of reference of this inquiry preclude consideration of such a task and the Commission is analytically ill-equipped to handle it. However, given the likelihood that these issues will arise in the future, the Commission should learn from past failures, and seek to develop a broader analytical capacity, capable of implementing a genuinely evidence-base approach to public policy.