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Human Services Economic Paper 3

Markets and Human Services

David Gilchrist & Clare Feenan

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The Working Paper Series on the Economics of Human Services

The Centre for Public Value is a research entity within the UWA Business School at the University of Western Australia. This economics paper is the third in a series of working papers focused on explaining the development, operation, and management of the economics of human services in a mixed economy such that in Australia or New Zealand. The series is funded by the Centre for Public Value.

The Centre for Public Value seeks to contribute to sustainable policy and practice as a foundation for efficient and effective human services systems operating in a mixed economy. Therefore, our research focuses on achieving sustainable outcomes for the human services sectors, governments, and service users.

This working paper series has been designed to provide people with skills outside of economics with explanations and commentary relating to important economics topics that effect the sustainability of the human services sector in a mixed economy. As such, these working papers draw on, and add to, research and commentary undertaken by the Centre for Public Value which is available via our website.¹ If you have any questions or comments, or simply want to find out more, please contact the authors directly.

Summary

This is a brief paper drawing attention to market economics terminology which is inappropriately used in policy and practice in human services systems. We challenge the description of human services provision as a ‘price’ clearing market. Economic descriptions which misrepresent the human services system as an opt-in consumer market rather than in terms of market failure and government response mislead decision makers and fundamentally undermine sound policy.

Indeed, this rhetoric misrepresents the nature of human services and hinders the effectiveness of the working relationship between service users, service providers, and funders. In doing so, policy and funding decisions are viewed through a market economics lens which suggests that suppliers will respond to economic signals in the interest of consumers and that those consumers have decision-making power that they do not actually have because the government is a monopsony purchaser and system creator. It is known that governments set policy and funding for service providers to deliver services to community members who are either in urgent or long-term need of those supports. Hence, the typical characteristics represented in markets economics—such as demand, supply, and purchase preference—do not apply. Rather, in this paper we seek to demonstrate the underlying economic model that applies to the human services sector.

Framing the human services system as a market is not reflective of the nature of the human services system and has implications for the development of inappropriate funding policy based on an incorrect understanding of the economics of the human services sector. This in turn alters the expectations and behaviours of the service providers and policy makers for these services as the description of the supply-side is at variance with how the current pricing and policy framework impacts the provision of human services and supports. Therefore, in order to achieve equitable, efficient and effective supply of human services and supports, there remains a need

¹ Website here: <https://www.uwa.edu.au/schools/Research/Centre-for-Public-Value/Publications>



for the collaborative development of an industry plan within a governance framework that allows for local resource allocation decision making in the context of a national policy framework.

Contact Information:

Professor David Gilchrist, Director, Centre for Public Value
University of Western Australia

David.gilchrist@uwa.edu.au

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Related Papers in this Series:²

Economic Paper 5: What is Sustainability in the context of Human Services?

Author Interest Statements

Professor David Gilchrist is Director of the Centre for Public Value at the University of Western Australia. He has received funding from governments, peak bodies and individual organisations for various research projects and consulting support predominantly related to the not-for-profit human services industry, Not-for-profit financial and performance reporting, sustainability and outcomes reporting, and policy and practice related to those areas. He has been a director and chair of a number of human services and policy organisations over past years and is currently chair of two policy-focused not-for-profits operating nationally in the education sector. He was made a Fellow of the Parliament of Western Australia in 2021.

Ms Clare Feenan is Research Manager of Centre for Public Value. She holds a Bachelor of Science (Statistics) from RMIT, Postgraduate Certificate of Business (Economics and Econometrics) from Monash University and is undertaking Master of Economics at University of Western Australia. Clare has extensive business operations and analytical experience including auditing, compliance, and profitability. Clare is passionate about the not-for-profit sector and achieving sustainable operations through data analytics.

² Available at: <https://www.uwa.edu.au/schools/Research/Centre-for-Public-Value>



Paper

Market economics is often used to describe human services provision and engagement. Terms such as “demand” instead of “need”; “supply” instead of “provision”; “market” instead of “system” and the lack of a direct and effectively working relationship between the funder and the service provider are all hallmarks of “quasi-market” economic structures.

Quasi-market economic structures are policy frameworks that apply market economics terms to government-funded service delivery in the hope of changing the behaviour of participants. Generally, quasi-markets are used with the intention of delivering choice and control to service users and encouraging market-style responses from service providers.

The idea behind the application of quasi-markets is that, if the human services provision and procurement system could be described in terms of a competitive free market, the system could then operate as such a market with market-style responses from service users (consumers or the “demand side”) and service providers (suppliers or the “supply side”). That is, suppliers are expected to become more client-centric, competing with each other for the most innovative and cost-efficient delivery process, as we believe free market suppliers do.

Additionally, economic efficiency is said to be achieved when market equilibrium is established. That is, when the buyers and sellers are all satisfied in terms of their service delivery and consumption at a particular price. That is, the market clears when all who want to sell at a particular price are able to sell to all who want to buy at a particular price.

The use of phrases from market economics, descriptions, and expectations is detrimental to the human services system because the supply of human services takes place within a government-funded system which is, by definition, is responding to market failure. Further, the system does not allocate decision making capacity to either service providers or the service users as government retains control of the service description, quantity supplied, and price. That is, government is a monopsony purchaser—it is the only purchaser in the system—and sets the rules accordingly.

Market Demand and Supply; Market Efficiency

When we consider a market, we describe the interactions of buyers and sellers in the context of price and the quantity of goods exchanged. Therefore, in using market economics language to describe human services delivery, it is implied that:

- Consumers and suppliers can decide the value of a purchase. This may be by reallocating resources for the purchase or by prioritising one purchase over another. This freedom of choice means that a consumer may decide to not make a purchase at all based on values or price. This is called a preference.
- Consumers calculate their price and purchase preferences based on expectations of:
 - Quality
 - Quantity
 - Timing
 - Alternative options



- While, in commercial terms, suppliers are concerned with:
 - Profitability
 - Opportunity Cost
 - Risk

If there is no available option which meets their desired criteria, service users will not purchase the service and service providers will not produce it. Incidentally, this is the reason that governments provide funding for these services – the market has failed to deliver the services without government intervention.

- The price at market equilibrium is decided on by both the consumer and supplier. A lower price would incite more consumers to purchase but deter suppliers from selling for a lack of profit. A higher price would reduce the number of consumers who could justify the purchase but increase the profit incentive for suppliers. When the price is struck such that consumers and producers are satisfied, the “efficient price” has been reached and the market clears as all goods available for sale have been bought. This is an efficient market because it represents the most efficient use of resources for consumer and supplier preferences. Additionally, this model is considered to produce “consumer sovereignty”—production is said to be driven by aggregate consumer demand.

Market failure occurs if an efficient price cannot be determined through this market model—the market is inefficient or fails because the number of goods produced is not to the number demanded at the price acceptable to both sides of the transaction.

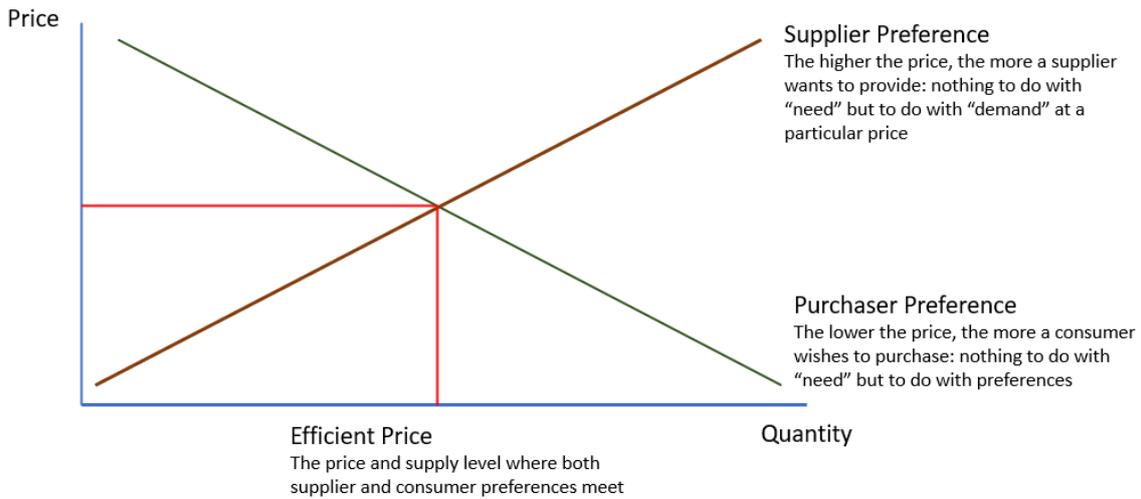
- If suppliers are not able to be sufficiently profitable in the market based on price, they will leave the market and consumers demand will go otherwise unmet. Human services are provided using government funding because the market cannot provide these services at a price people can afford to pay for them. However, they are services and supports that are critical to making it possible for people to live their lives. As such, the government is responsible for bridging his gap.

There are many competing theories and ideas relating to market economics. We do not intend to define the economic free market model and discuss it exhaustively but, rather, to establish that the underlying decision aspects are intended to be replicated in quasi-market policy frameworks.

However, it is usual to demonstrate these ideas using diagrams. The standard market supply and demand curve is shown in figure 1 below. As described above, increases in price cause increases in supplier production but reductions in purchaser preference. In figure 1, the suppliers and consumers have reached a price for a particular good that ensures both parties are trading at the level desired—it is the efficient price.



Figure 1: Traditional Supply and Demand Curve



However, achieving the efficient price is subject to the costs of service delivery and the extent to which consumers need or want the service they are being offered—the less consumers need the service, the more likely they are to reduce their consumption as the price increases. That is, in general economic terms, the consumer’s decision is based on preferences (what they are happy to pay and what other purchases they might make if they did not purchase this service) rather than need (what they have to have to live their lives). A further developed diagram can be seen in Figure 2 below demonstrating potential short falls in service delivery as a result of applying an inappropriate price.

Figure 2. Example Supply and Demand: Changes in Price

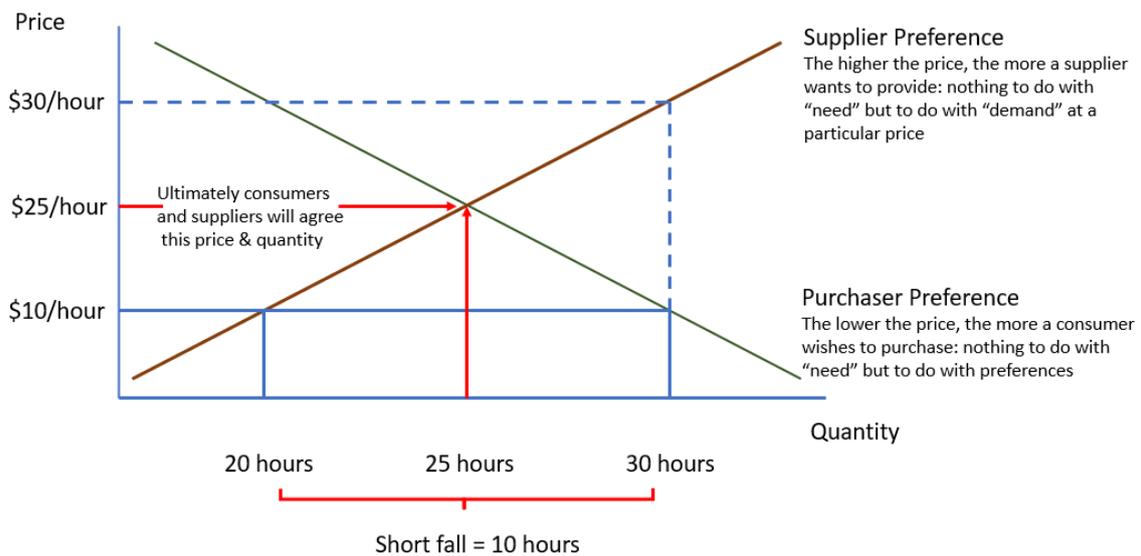


Figure 2 might represent the market for accounting services. In this example, people are willing to buy 30 hours of service when the price is \$10/hour. At this rate in a market, providers are only prepared to provide 20 hours of service and so 10 hours of demanded services go unprovided. This does not matter as the services required are not of such importance that consumers will pay a higher price and suppliers do not need to sell that many hours. Indeed, suppliers cut their cloth by hiring the staff required and purchasing other inputs in the context of the profit they are seeking.

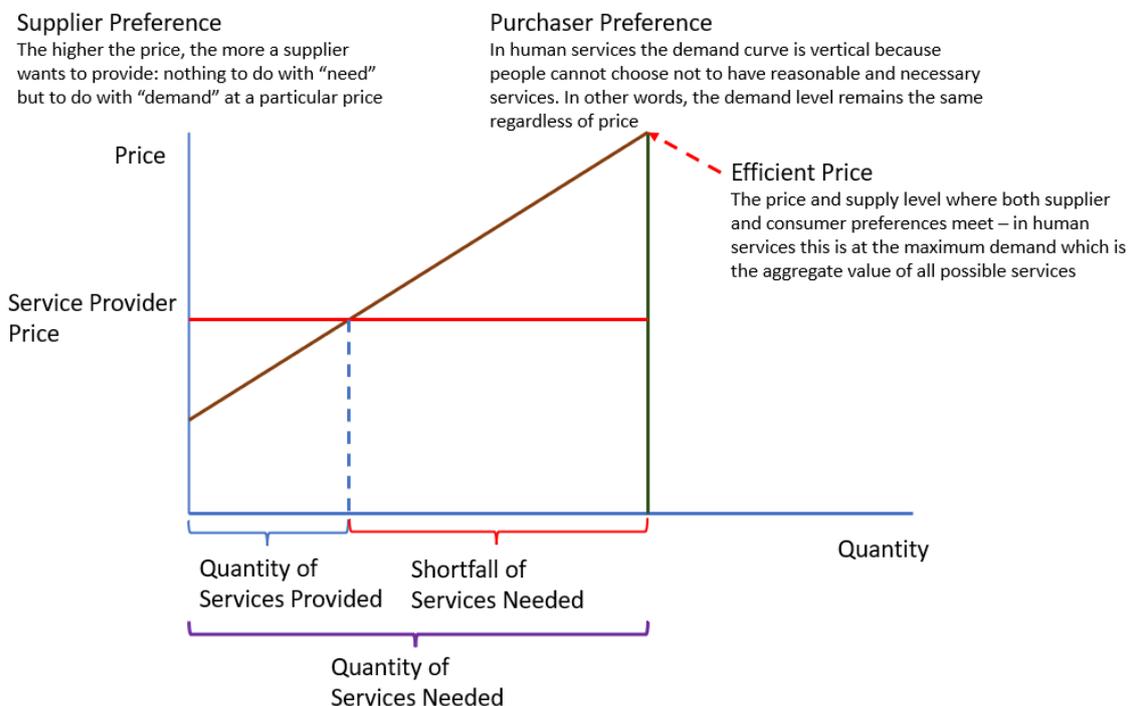
In reality, the efficient price is somewhere around \$25. This is the point where suppliers and consumers effectively agree on the quantity, quality and timing of services at a price that meets both their preferences. Other options—including not spending but saving—prevent further production and consumption of this service. Over time then, it is expected that the price and quantity exchanged will move to this combination.

Importantly, it is these two sets of decisions that a monopsonist³ purchaser like a state government department effectively makes by setting the price and quantity through policy and contractual agreement. Neither consumer nor producer have the ability to make these decisions and, therefore, the basis of market decision making is lost.

Further, it is worth noting that, in relation to human services, the consumers simply have to live with the unmet demand. In the case of chocolates, premium motor car brands or high-end fashion, this is not such an issue. If we are talking about the extent to which you are able to live your life as fully as possible because, say, you live with disability, application of this idea becomes a critical area for consideration and examination.

Indeed, it is where services and supports are needed to be supplied that the market model fails. When the community has come to agree that such services and supports are necessary in order for the people who rely on them to live their lives is also when the model market model framework proves inept. It fails because there is not sufficient profit for suppliers to divert their capital to deliver these services and/or because the price needing to be charged is not affordable to those requiring them. An example is shown in figure 3 below which may help to demonstrate this idea.

Figure 3. Example of Human Services Demand & Supply – Inelastic Demand



In figure 3, the demand curve representing the preference for this service is vertical. It is so because people who need this service are unable to do without it—they cannot choose to not purchase or to buy something else, or even to simply save their money. Their decision to consume

³ A monopsonist being the controlling buyer in a market with many different suppliers.

does not depend on price and/or other options—they need it to live their lives. In this scenario, demand is met where the price established is at a level where suppliers can afford to provide services in the quantity expressed as the aggregate of all funded service requirements. As such, there is a shortfall expressed here as being the difference between what the consumer can afford and what the supplier is prepared to supply.

As such, regardless of the terms used to describe them, the key economic attributes of human services are:

- While we talk as if there is a single market, in fact there are many supports and services being supplied within the human services system with many attributes, levels of need, and geographic and cultural restrictions that impact the capacity of suppliers to provide them and consumers to utilise them—we must consider individual services and supports, offered in individual locations and apply the most meaningful and culturally appropriate response in order to meet that need. In other words, a one-size-fits-all economic model will not work;
- Service users need these services to support them in either a moment of crisis or for day-to-day living—if they are not supplied, people will have adverse short-, medium- and/or longer-term outcomes which, in some cases, may include death—they cannot elect not to have the services or to reduce the service quantity or quality;
- Government must pay for the services because consumers cannot pay a price for them that allows suppliers to respond—this is especially the case for people in vulnerable circumstances who are also likely to be economically vulnerable, including as a result of the higher costs of living experienced by many with human services needs as compared to the general population;
- The fact that government pays for the services and sets the quantity of supply places it in the role of a “monopsonist.” Where a monopolist is the only seller of a service, a monopsonist is the only buyer, giving it power to set prices, quantity and quality. This is not to say it is a bad thing, as it is often a necessity. However, we need to develop policy and practice recognising this reality. In the case of human services, the government is a very powerful monopsonist as it sets the funding levels (via a price), describes the services available (via the policy process) and subsequently assesses quality (via state-mandated quality frameworks and audit processes). Thus, the government decides the entire economic structure leaving consumers and suppliers unable to make the traditional market economic decisions described above;
- Given that these traditional decisions cannot be made by consumers and suppliers in the economic context, and given that the government pays for these services, it is right and proper that the deployment of public funds should be as efficient and as effective as possible—it is not in anyone’s interests to waste public funds and, critically and appropriately, government departments in contract with service providers are responsible for ensuring this is the case with respect to human services. Government departments work hard to ensure the provision of services meet the need in communities and that money is not wasted;
- However, and importantly, “demand” and “need” are two different things. Demand is actually created by government funders when they describe services, eligibility frameworks and funding levels. On the other hand, need is the aggregate of service need within the community—whether identified and quantified or not;



- To achieve efficiency, the delivery attributes of services and supports must be planned, they cannot be left to market-style decision making when consumers and suppliers do not have market power. The monopsonist simply either leaves the risk with the consumer or the decision to participate with the provider (for instance, partly explaining the significant underutilisation of NDIS funding that has occurred year-on-year since inception) and uses their position as a monopsonist to save money in the short-term. Needless to say, the long-term prospects for people in need of human services are not good;
- The alternative is to accept that the long-term prospects for the delivery of human services are enhanced greatly by acknowledging and acting on the facts that;
 - Consumer choice and control can only be achieved where consumers actually have power to exercise choice and control;
 - Identifying need as opposed to acting on demand;
 - “Sustainability” means the continuing ability of suppliers to provide the right quantity, quality and timing of services that are required by consumers;
 - Reducing risk to service users requires the development of sustainability in service provision via positive, collaborative action rather than leaving things to the market—especially when that market does not exist;
 - Achieving sustainability in the supply of services requires the development of effective data assets that help us to understand the comprehensive cost of service delivery and investment required to ensure the supply-side remains fit-for-purpose in the long-term⁴; and
 - In order for consumer choice and control to be enabled, decisions pertaining to the application of resources need to be made at the service delivery level. The closer to service delivery decisions are made, the more fit-for-purpose those services are going to be and the more efficient will be the allocation of funds. This is especially so when we consider the impact of cultural, geographical, clinical, and other location/need-specific elements.

Therefore, the conception of human services as a market-based economic model is not supportable. The market is not making the decisions necessary to achieve delivery of the quantity and quality of services required.

To manage the human services system efficiently and effectively, the development of a collaborative industry plan is critical. This ensures a local decision-making framework in the context of a national governance policy framework can support true choice and control for the vulnerable individuals and communities whom the system is intended to support.

⁴See our green paper in relation to the area of data assets: Gilchrist, D. J., P. A. Knight & T. Emery, 2020, “Green Paper 1: Data Assets, Efficiency and the NDIS”, A Report of Not-for-profits UWA, Perth, Australia. It can be found at: <https://www.uwa.edu.au/schools/Research/Centre-for-Public-Value/Publications>

