

MARKET AND NON-MARKET ALTERNATIVES IN THE PUBLIC-FINANCED SERVICES SECTOR IN BULGARIA: DISCREPANCIES OF BORDERS

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Abstract: The article presents results - theoretical summaries and empirical arguments from a study conducted in the period 2016-2018 aiming to make a snapshot of the processes of production and consumption of public services in Bulgaria. Authors are part of a team that has been implementing a research program for more than 20 years to study market and non-market failures their dynamics and interaction in the processes of market transformation in publicly funded services. The interaction and the relationship between them is a driving force in making a choice between market and non-market alternatives in their production and supply. Analyzes show that in recent years the scope of market and non-market failures inherent in publicly funded services has been growing thanks to the development of hybrid forms of organization of activities. The widespread use of mixed supply and financing mechanisms changes the role of public administration from a direct participant to a regulator of economic and social processes. When the state does not effectively perform this function the mixed forms of supply become a field for mutual penetration and superimposition of market and non-market failures that destroys the balance between the market and the state in this sector.

Keywords: market and non-market failures, publicly funded services, public and private supply

1. RESEARCH PROGRAM AT 20 YEARS

The study of market and non-market failures in publicly funded services their dynamics and interaction has been the focus of the scientific research of the authors part and a team of supporters for more than 20 years. The attention to the development of the sector of publicly funded services is worth the time and efforts. These are the activities created and financed in whole or in part by public resources (budget, trust fund, etc.) i.e. **they are backed/financed by the state and their supply is carried out on an alternative principle**. This is reflected in the dynamics in the total costs of the "culture", "education", "health" and "social security, support and care" functions. In Bulgaria for the last two decades they vary between 17% and 22% of GDP and as a share of the consolidated fiscal program they exceed 50% of the total public expenditures (МФ, 2019).

The introduction and development of new management approaches in the public sector in recent years has given impetus to the expansion of the scope of publicly funded services including the traditional for the country areas like social services, health care and education. Achieving a balance between the various forms of supply is the goal of the reform processes in these key areas of public management. The driving force in making a choice in the field of market and non-market alternatives is the interaction and the ratio between market and non-market failures. Despite its popularity in the economic literature as a rational explanation of the need for change (especially for needs of the economic policy) the theory of market and non-market failures still does not have enough sectoral empirical tests in the country and is therefore not methodologically attractive for arguing fundamental economic and political choices those for the production and delivery of public services. The study of market and non-market failures is an alternative approach for finding effective and sustainable political and economic solutions to common and inherent (endemic) problems for the public services sector (e.g. underfunding, inequality of access, territorial disparities and etc.).

A central argument for the "unification" of traditional state sectors such as health, education, culture and social services in a *common research field* that of publicly funded services is the idea that *they are part of a systematic socio-cultural process* with common principles and mechanisms of management. This fundamental idea was developed and argued in the Bulgarian research literature by P. Lulanski (Лулански, 1997; Лулански, 2000). The view of a "symbiosis between the social and the economics ones in the functioning of the socio-cultural process" is fundamental for the development of specific research perspectives like: study of government intervention, deficits and failures in the forms of distribution (market and non-market) of socio-cultural goods, market penetrations and the mechanisms of competition, and etc. (Лулански, 1997).

The studies of market and non-market failures in the sector of publicly funded services in Bulgaria covered four stages. At each stage they highlighted a dominant socio-political and economic process in the sector which provides a clearer picture and the leading features of public management reforms.

- The first study (1998-1999) identified and assessed for the first time in Bulgaria the typical for the socio-cultural sphere market and non-market failures (Делчева, 1999). This period can be characterized as a *period of market penetration into social systems*. The policy of pro-market initiatives is partial with a lack of a comprehensive and long-term vision of how these sectors will develop in a "coexistence" between public and private supply. The balance between them shows as the most typical market and non-market failures the presence of: imperfect market structures, incomplete market, unfair social distribution, uneven territorial distribution, unnecessary costs and production inefficiency, financial deficit and shady market relations.
- The second wave of the study (2005-2007) focuses on the sectoral reforms that began around year 2000 and finds an expansion of non-market failures (Делчева, 2007). Based on the understanding that the market is the necessary alternative this period can be characterized as a *period of market transformation in social systems*. However, private structures are still finding their way with difficulties, do not have a dominant presence in supply and are seen as a potential opportunity with proven risks to public governance and quality. Two problems are becoming increasingly important: the limited access to public systems and as a result of the growing financial burden on consumer a preclusion from consumption.
- Emphasis on the quality of publicly funded services is the third wave of the study (Делчева, 2014) which puts the quality as a leading problem of reforms in the sector after 2000. This period can be characterized as a *period of market reform of social systems*. Based on the summarized findings for lagging behind from the quality level of the public sector in the EU the study refers to various organizational and management models and solutions for improvement. The main reason for the lag is that the specialized instruments for improving the quality of publicly funded services are still poorly developed, applied under external (mostly administrative) pressure and often formally applied with unconvincing results.
- Two decades after the first study the issues for studying the dynamics in the development of the forms of offering publicly funded services and the derivation of competitive advantages of the private and public alternative are still relevant. The process of *market invasion is the dominant feature in the sector of publicly funded services*. This is the focus of the fourth specialized study which covers the period 2006-2016 (Пенкова, 2019). The study provides a number of empirical confirmations of the main hypothesis for expanding the scope of natural market and irreversible non-market failures inherent in publicly funded services. This stimulates the use of mixed supply mechanisms and creates a need for corrective measures on the side of the state.

2. THE CHOICE "MARKET – NON-MARKET ALTERNATIVE"

The modern understanding of economics as Joseph Stiglitz (Stiglitz, 2019) convincingly shows in his latest book is the economy which leads to a greater productivity as a result of increased knowledge, technological progress and better social organization and rejects the choice of type "markets *or* state regulations". Market imperfections are everywhere and markets left alone do not necessarily work well. Every capitalist economy contains a mixture of private markets and the state; the question is how best to combine the two alternatives. When this balance is impaired when markets do not work as they should, when economic inequalities turn into political ones and from there intensified and sharpened return back to the economy public policies, although not ideal but practiced reasonably, with measure, with clear, legitimate and transparent rules, and used in the public interest become important. In modern society the boundaries between economics and politics are too blurred, they are too dependent on each other. Thinking of them as two opposites impossible and intolerant ideological alternatives is an arrogance with deep (ethical and educational) roots (Tomova, 2019). Therefore, it is necessary to deeply revise the understanding of the fundamental role of the state in the modern market economy to ensuring universal prosperity (Stiglitz, 2019).

Why are markets when left alone not working well? The theory of market and non-market failures gives a clear answer to the reasons: when the information is incomplete, when competition is limited, when there is no (private market) interest in providing sufficient public goods. In summary the inability of the market to provide conditions for efficient and equitable economic decisions is defined as a market failure. Market failures are "legitimized" as the inability of the market to ensure efficient and fair allocation of resources and their specific forms of manifestation are most often associated with: imperfect market structures, incomplete market, externalities, unfair social and territorial distribution of resources. market goods and information asymmetry, imbalance between supply and demand. Similarly, the other mechanism for allocating resources the state one is also not immune to shortcomings. Inherent non-market failures stem from the nature of the public offering of services and often from regulations that are not always effective. Their study in the economic literature is most often associated with: inefficient and unfair

territorial distribution of resources and goods, unnecessary and rising costs, financial deficit, shady market relations and derivative externalities.

There is numerous empirical evidence that the transformations in recent years in public and private supply lead to the diffusion of market and non-market failures (Пенкова, 2019). It also has to do with how they are identified. The strict approach to their recognition takes into account the criterion of *"loss of efficiency"* when the market is not operating optimally or is blocking. The enlargement approach also includes the criterion of *"loss of justice"* as there is no sufficiently clear boundary between efficiency and justice (as indicated between economics and politics above). Efficient resource allocations are not necessarily fair; just as inefficient allocations may be more equitable than efficient. It is the social considerations with redistributive nature that are among the main arguments for the state intervention (Улф-младши, 1995; Stiglitz, 2019).

Table 1. Forms of manifestation and consequences of market failures

Market failures	Forms	Consequences
(1) Incomplete information	1. Unevenly (asymmetrically) distributed information 2. Opacity of information 3. Induced demand 4. Uncertainty of demand 5. Adverse selection (discrimination) 6. Moral (risk) gambling	1. Weak market signals and limited consumer control 2. High transaction costs 3. Increasing inequality 4. Increasing the risk of consumption 5. Inflation of rendering costs 6. Impossibility for comparisons and difficulty to determine the quality 7. Difficulties in forecasting demand 8. Incomplete coverage of needs (incomplete market)
(2) Restriction of competition	1. Market power (monopoly structures) 2. Non-price competition 3. Vertical integration	1. Monopoly on pricing, unjustified increase and price discrimination 2. Uneven territorial provision 3. Ignoring consumer satisfaction 4. Incomplete supply 5. Enhanced social regulation 6. Increase in administrative costs 7. Limitation of innovation and allocative inefficiency
(3) External effects and public goods	1. External costs / positive externalities 2. External benefits / negative externalities 3. Public goods 4. Special property rights	1. Weak market signals 2. Overconsumption 3. "Passenger without a ticket" 4. Overproduction and overuse of resources

Publicly funded services provide iconic examples of market failures as well as border blurring and the interpenetration of market and non-market failures. The table shows the most common forms of manifestation and the consequences of market failures identified in the series of studies (Делчева, 1999; Делчева, 2007; Делчева, 2014; Пенкова, 2019). Market failures are not mutually exclusive they can be mutually stimulating and their results can be manifested with an intensifying joint effect. For example, in health services there are strong failures such as information asymmetry and induced demand (forms of manifestation of group 1), vertical integration (from group 2) and positive externalities (from group 3). The first two - asymmetry and induced demand (characteristic of health services) are manifested in weak market signals, increased transaction costs and risks in consumption, stimulates opportunistic behavior (increased corruption, and etc.). Correction of these (market) failures in an attempt to "restore the spirit in the bottle", through appropriate non-market alternatives such as regulations, direct intervention / control, financial incentives and sanctions, "repair" of economic conditions, adjustment of property rights, directly participation in the production and provision, etc. they may not be effective and this cumulative network action of market and non-market failures can lead to a new situation - *market destruction* (as well as destruction of entire public sectors and systems). By market destruction we mean a persistent state of inability to perform coordinating functions due to the coherent manifestation of various forms of market failures. Such a situation is particularly dangerous and has long-term negative consequences.

The choice between the two alternatives - private / market and public / non-market is a *meta-choice* (gr. Μετά / μετά). It is a central choice that stands highest in the hierarchy of (political) economic decisions as it outlines the contours of two fields of collective life - one based on the coordination of different preferences through the market; the second, through politics as a mechanism for the expression and domination of preferences. In modern societies the two regimes of production and consumption coexist, compete and complement each other in the "shared" economic field. The border between them is the result of a *specific political and economic choice*, an opportunity to "reconcile" the systemic shortcomings inherent in the two alternatives. It outlines a new area- that of *mixed forms* of economic organization which are supposed to combine pragmatically the good sides of the two pure alternatives. The expansion of this economic zone is the most visible sign of the processes of reform and transformation of publicly funded services nowadays.

However, as the mixed forms of organization sublimate both advantages and disadvantages inherent in the market and the state, the main line "market - non-market alternatives" should include another integrating community center with its inherent regulatory mechanisms – the *civil society*. In general, the three social mechanisms - those of the state, business / market and civil society outline the public sphere and embody the main aspects and dependencies of social life - economic, political and social. This expands the idea of a balance between market and non-market failures. Achieving such in the actions of all participants / actors, and through them all three regulatory systems and their respective mechanisms for production / provision of goods is the subject of modern public policies. The rational expectation in their formation and implementation is that the inherent benefits of the three systems can be combined, and that the failures of any of the three sectors can be corrected and / or "fully compensated by the positive features of the *other two*" (Таhev, 2008). Of course this interaction is not strictly "technical", socially and politically "neutral", and policy-making is not a technological "routine management process". It must simultaneously avoid the extremes of the three systems but also take into account the normal distances between them as a result of their different functions, resources and management mechanisms. Achieving balance through public policies is a complex and multi-component creative process in which the political aspects are decisive and which recognizes that "any particular policy simultaneously costs money, has political significance and affects the lives of many people" (Таhev, 2008).

3. BLURRING OF THE BORDERS: SUMMARY OF THE TRENDS

The blurring of the boundaries between public and private forms of offering publicly funded services in Bulgaria is a trend that is "gaining momentum" in recent years. This trend is part of a process common to EU countries - expanding the scope of private supply and developing forms of state participation including through financial resources. A more general view shows that this process is not without problems. On the one hand, the treatment of health, social, educational and cultural services as public goods give impetus to public investment and the development of public institutions in them after the 1960s; on the other - treating them as goods that generate extremely positive individual benefits (social and economic). The second aspect provokes the growth of personal payments and the development of private initiative in the sectors. In this general plan the sectoral trends and specifics outline the following picture:

(a) Those structures that are directly or indirectly managed by business or non-governmental organizations are perceived as *private*. In contrast public ones involve direct management by state or local institutions or organizations. At the same time, with the development of innovative tools for public sector management mixed forms of supply are formed (e.g. public-private partnerships) and a mixed market in the supply of publicly funded services is established.

- Both public and private providers participate in the *social services sector*. In parallel, funding is mainly from public sources (central and municipal budgets). The funds are distributed on a competitive basis between service providers. As a consequence, private entities operate mainly with public resources;
- The private sector *in healthcare* in our country is growing under the influence of public funding. Most private medical institutions work under contract with the NHIF – i.e. public funding stimulates the development of the private sector. This creates conditions for intense competition between them and public medical institutions;
- Private supply *in education* is understood in two ways: in a broader sense it includes all educational structures or their units, centers, etc., which are independent of central and local government. They can be educational structures to public organizations, NGOs and others. The narrower interpretation is: private (non-public) profit-oriented structures. They are supported on the basis of user fees, donations, sponsorship, etc.

(b) The nowadays policy is aimed at *equal treatment of public and private structures by the "human capital development industries"*. For this reason, the public subsidy is affirmed as a tool to stimulate private supply. This

gives grounds to perceive as more correct the use of combinations such as *publicly funded and privately managed structures or publicly funded private structures*.

On this basis *two research perspectives can be outlined* which combine failures and forms of supply and looking for the intersections between them. This allows to look for answers to two groups of questions: first, whether the manifested failures depend on the form of supply; and second, whether there is a sharp boundary between private supply and market and public supply and non-market failures. The matrix presented in Table 2 systematizes failures identified in previous studies.

Table 2. Diffusion of market/non-market failures

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

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

2) Private refers to private sector services using public resources

Legend: ■ - presence of the failure; ⊖ - absence of the failure;

- *The categorization of market and non-market failures according to the form of supply is confirmed.* All tested non-market / market failures directly correspond and have full manifestation in the respective form of supply in the separate economic sectors;
- *Studies show a general trend - market and non-market failures lose their sectoral specificity as a reason for alternative service delivery.* For example, information asymmetry is a market and non-market failure that is theoretically related to market supply but its projection is also present in publicly offered services. Territorial imbalances which are also treated as a market failure are manifested in all three forms of supply. Typical examples are the non-optimized health and education network of public institutions which restricts consumer access. Conversely rising costs (traditionally associated with public supply) are a problem specific to the private sector when operating with public resources, i.e. in publicly funded services. For example, the growth of expenditures in pre-hospital and hospital care has escalated as a result of the normatively established access to the public fund of the National Health Insurance Fund.

The scope of both market and non-market failures is expanding due to the development of a mixed market for the services in question and the general regulation:

- *Some of the failures of the market are transferred to the field of publicly offered services.* A typical example is *information asymmetry*. A reliable regulatory tool for overcoming this common failure is e-government (e-health, e-education, etc.). There are sufficient indications for transfer of other market failures to the field of public supply: *impaired fairness in the distribution of public resources* (standards for school and higher education and social services; increase in paid health services, leading to difficulties in accessing health care, and etc.); *the unfair territorial distribution of goods* (concentration of high-quality health, education and social services in several areas and shortages in others, and etc.). This is a reason to assume *that the development of mixed forms of supply "imposes" negative consequences and disturbs the balance between market and state failures*;
- *A number of market failures are progressing* such as *market incompleteness* (lack of prevention, psychiatric care - in health care; lack of supply in half of professional fields from private structures in higher education; insufficient network of private social services for people with disabilities, and etc.). At the same time *the incomplete market* is a fact and the supply of a product mix aimed at solvent demand is a trend for the whole studied set of services (expensive and fast-moving health services - ophthalmology, cardiology, reproduction, cosmetic surgery; institutional social services for the elderly and etc.) or those with low production costs (professional fields in higher education, day care centers of all kinds);

- *The scope of non-market failures is expanded: a) in all analyzed sector services increasing public expenditures are found (nominal - as an absolute amount and differentiated maintenance per unit of activity); b) this is accompanied by a systematic underfunding of certain services and an increase in indebtedness (clinical pathways, professional fields in higher education, and etc.); c) the correlation of these processes with the quality of services (including extremely poor international positioning) indicates low efficiency of public expenditures.*

It can be summarized that *the scope of market and non-market failures inherent in publicly funded services is expanding*. There is a transformation in the forms of manifestation of market failures, caused by the expansion of private supply as well as by the development of mixed forms. *So the sharp line between market and non-market failures is blurred and we can talk about their diffusion.*

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