

Elert, Niklas; Henrekson, Magnus

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Incentivizing Innovative Entrepreneurship in Quasi-Markets: Theory and Evidence from Sweden's Schools and Nursing Homes

Niklas Elert and Magnus Henrekson

Incentivizing Innovative Entrepreneurship in Quasi-Markets: Theory and Evidence from Sweden's Schools and Nursing Homes

Niklas Elert[‡] and Magnus Henrekson^{*}

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Abstract: Many countries have implemented quasi-markets to enhance entrepreneurship and innovation in welfare service provision. However, the benefits have generally been limited; this can also be observed in Sweden, a country which stands out for its extensive use of quasi-markets. Based on the Swedish experience, we contend that quasi-markets can unlock their innovation potential only under a suitable institutional framework. By analyzing the development of quasi-markets in schools and eldercare nursing homes, we demonstrate that competition and profit incentives, though crucial, are insufficient catalysts for innovation in quasi-market contexts. Such markets demand a set of supporting institutions of an epistemic nature. These institutions should enable users to make knowledgeable choices and motivate entrepreneurial providers to compete and innovate in ways that align with user preferences.

Keywords: Entrepreneurship; Innovation; Innovation Policy; Marketized care; Merit goods; Quasi-markets; Welfare services.

JEL Codes: H42, H44, H75, I22, I28, L88, O31.

[‡] Institute of Retail Economics (HFI), Regeringsgatan 60, 103 29 Stockholm.
E-mail: niklas.elert@hfi.se.

^{*} Research Institute of Industrial Economics (IFN), P.O. Box 55665, 102 15 Stockholm.
E-mail: magnus.henrekson@ifn.se.

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1. Introduction

The entrepreneurship literature acknowledges the importance of institutions for economic behavior (Baumol, 1990; Henrekson, 2007; Bjørnskov and Foss, 2013; Minniti and Lévesque, 2008; Bylund and McCaffrey, 2017). In their seminal contribution of a theory of public entrepreneurship, Klein et al. (2010, p. 5) stress that “any change in the institutional environment brought about by public-sector entrepreneurship changes the setting in which private-sector (and public-sector) entrepreneurship takes place” (cf. Ostrom, 1990, p. 127). Thus far, however, entrepreneurship scholars seem to have had little to say about an institutional phenomenon of growing empirical importance across the globe: quasi-markets in the welfare sector. A search for quasi-markets and similar terms in the key entrepreneurship journals yields few relevant results.¹ This dearth of research is puzzling, given that the trend towards such markets for the provision of welfare services, e.g., education and health care, shows no sign of abating (Le Grand, 2009; Blix and Jordahl, 2021). The purpose of this paper is to remedy this knowledge gap by approaching quasi-markets from an institutional and evolutionary perspective, to sketch an answer to the question of how quasi-markets’ regulatory framework can be made to incentivize value-enhancing innovative entrepreneurship in the welfare sector. In our view, this is an important yet underappreciated research area for entrepreneurship scholars.

In quasi-markets, the state “is to become primarily a funder, purchasing services from a variety of private, public and voluntary providers, in competition with each other” (Ferlie, 1992, p. 81). The documented and/or perceived failure of the public monopoly model to deliver and improve welfare services was a key motivation for many governments worldwide to institute so-called quasi-markets for many welfare services starting in the 1980s (Hood, 1991; Le Grand, 2009), and commonly stated reasons why governments turn to them is to unleash creativity, efficiency, and innovation through competition between public and private providers without jeopardizing equality for users. Entrepreneurship scholars should have important things to say about such markets; one way to appreciate this is to relate quasi-markets to three key characterizations of the entrepreneurial function in the literature—alertness to opportunities (Kirzner, 1973), the importance of ownership for judgmental decision-making (Knight, 1921), and product, process,

¹ Relevant results are also scant in the management literature, even though Ferlie (1992) identified quasi-markets as an important research topic for strategic management more than 30 years ago. That said, management scholars have made important contributions such as the potential advantage of for-profit firms in advancing social welfare (Ghatak, 2007; Luo and Kaul, 2019), the importance of public-private hybrid governance forms and alliances to generate desirable outcomes (Rangan et al., 2006; Cabral et al., 2013), and the strengths of different organizational forms in different contexts (Quelin et al. 2017; Luo and Kaul, 2019).

and market innovation (Schumpeter, 1934). To this, we can add an institutional perspective emphasizing the importance of society’s rules of the game for productive entrepreneurial venturing broadly (Baumol, 1990; Minniti and Lévesque, 2008).

First, the mere size of welfare markets is relevant as a source of entrepreneurial opportunities (Kirzner, 1973); the average share of government spending on education and care as a percentage of GDP is currently 14 percent in seven OECD countries (*Table 1*). When such welfare sectors are quasi-marketized, which they have been to a large extent in many countries (Blix and Jordahl, 2021), ample entrepreneurial opportunities follow. As a simple diagnostic, the share of government-financed welfare services produced by private (usually for-profit) providers in Sweden ranges from 16.1% in primary schooling to 44.0% in private health centers (*Table 2*). Clearly, for-profit entrepreneurs have recognized and exploited the ample scope for entrepreneurial opportunities in these welfare sector quasi-markets, Schools and nursing homes—the focus of this article—are no exception.²

Table 1 Government spending on education and care as a percentage of GDP in selected OECD countries (latest available year).

Country	Child-care	Primary school	Secondary school	Tertiary educ.	Health care	Elderly care	Total
Canada	0.23	1.97	1.22	1.2	8.70	1.50	13.31
France	1.32	1.14	2.19	1.1	10.34	0.39	16.09
Japan	0.69	1.12	1.28	0.5	9.28	1.85	12.86
Netherlands	0.64	1.14	1.82	1.1	9.47	0.83	14.18
Sweden	1.58	1.94	1.97	1.3	9.79	2.53	19.11
UK	0.56	1.64	1.78	0.5	9.90	0.31	14.38
U.S.	0.32	1.52	1.69	0.9	8.50	0.01	12.93
Average	0.76	1.49	1.53	0.94	9.42	1.00	14.33

Source: OECD.

Second, the entry of private firms underscores that quasi-markets are relevant to understand the importance of ownership for productive resource use (Knight, 1921; Foss and Klein, 2015). Crucially, rules in many quasi-markets limit owners’ control in potentially detrimental ways. For example, in the case of the procurement quasi-market model that dominates the Swedish nursing home sector, private providers who win a contract essentially become custodians of a previously government-run facility. Understanding and overcoming such challenges is likely paramount for increased innovation in these sectors.

² In fact, Sweden stands out for its considerable presence of for-profit actors in welfare quasi-markets in general, whereas many other countries prohibit for-profit actors in these markets. That said, countries that do allow them, e.g., the Netherlands and Australia, have seen a sizeable increase in the number of for-profit actors in recent years (Karlson and Lundbäck, 2022).

Table 2 Share of government financed services produced by private providers (latest available year)

Service	Year	Share (%)
Primary school	2022/23	16.2
Secondary school	2022/23	31.3
Private health centers	2020	44.0
Home help services for elderly	2021	25.3
Nursing homes for elderly*	2021	20.8
Purchases from private firms by regional and municipal authorities as a share of total spending	2020	13.2

* We have replaced the National Board of Health and Welfare’s clumsy term “special housing for elderly” with the more familiar term “nursing homes” throughout.

Source: Swedish National Agency for Education and National Board of Health and Welfare (2022).

Third, quasi-markets are relevant from a perspective emphasizing entrepreneurship as necessary for innovation (Schumpeter, 1934). To best appreciate this, consider the fact that government spending on welfare services as a share of GDP in the aforementioned countries reveals a troubling pattern: The trendline in all of them is increasing (OECD, 2021) and a back-of-the-envelope calculation suggests that these growth-rates are not sustainable in the long or even medium term. Yet innovations, commonly defined as new combinations of (new and old) knowledge, are seen as “the only way for the most developed countries to secure sustainable long-run productivity growth” (Bloom et al., 2019, p. 163), and the welfare sector is no exception (Torfing and Triantafillou, 2016, p. 10). Suppose, therefore, that there are ways to use quasi-markets to create the “right” conditions for entrepreneurial venturing, increasing the general level of innovation in the welfare sector. In that case, the productivity-enhancing effect could substantially alleviate the financing pressure and increase the quality of such services. Nonetheless, researchers have so far only scratched the surface of the conditions for innovation in quasi-markets (whether in entrepreneurship or other fields, such as economics).

Finally, but relatedly, studying quasi-markets is relevant from a perspective emphasizing the rules of the game necessary for productive entrepreneurial venturing. In fact, the mere size of welfare markets obviously has an allocative effect: if there are profits to be made in marketized welfare sectors, many talented individuals will devote their talents to making money there rather than in “traditional” sectors (Baumol, 1990), and as mentioned, this is indeed what we seem to observe. A key challenge is thus to ensure that the institutional framework in quasi-markets is such that the pursuit of individual wealth does not end up being one in which for-profit firms pocket money that should go to, e.g., students and elderly care users. Rather, the rules should encourage continuous improvements and cost-efficiency. Yet, for quasi-markets to deliver on

their innovative promise, the challenges to “get the incentives right” (Williamson, 2000; Klein et al., 2010) and provide the requisite conditions for continuous innovation are formidable. Moreover, the conditions will likely differ depending on the quasi-market in question. This fact highlights the need for a thorough institutional analysis informed by theory and empirical evidence. Here, again, entrepreneurship scholars should have plenty to say.

This paper aims to offer a sketch on how policymakers should set up (and continually revise) the regulatory framework of quasi-markets if they wish to incentivize value-enhancing innovative entrepreneurship through competition between public and private providers without jeopardizing user equality. We argue that two necessary conditions must hold for innovative pressures to be continuous and long-term in any market or non-market model. First, that there is competitive pressure, i.e., that several actors compete to provide a service, or if one actor provides the service, that this actor faces contestability (Kirzner, 1973; Baumol et al., 1982). Second, while many of the actors can be public and/or non-profit private entities such as foundations, a sizeable presence of for-profit firms will be beneficial. For-profit firms are, after all, well-positioned to innovate and devise new solutions in the face of uncertainty and realize economies of scope between commercial and non-commercial activities (Luo and Kaul, 2019).

These two conditions sometimes hold in welfare service quasi-markets, but even when they do, they are rarely sufficient to usher in innovation. The challenge to “get the incentives right” and provide sufficient conditions for continuous innovation goes beyond them. Moreover, the conditions will likely differ depending on the quasi-market in question. The devil is, in other words, in the details. Yet, a reading of the vast literature on quasi-markets in various sectors suggests that the most common problem in such markets is that users and providers find themselves in a disadvantaged epistemic position compared to actors in regular markets (Haeffele and Storr, 2019). This limits the beneficial effects one can expect from competition and the presence of for-profit-driven, lest epistemically conducive institutions are put in place. An epistemically conducive system is a system that is better at creating the kind of information actors need to make sense of the world, better at providing them with this information, and better at generating the incentives they need to construct the knowledge necessary for action.

We illustrate how policy can strengthen innovation incentives in quasi-markets by drawing on our knowledge of the Swedish quasi-markets in elderly care and schooling. That Swedish entrepreneurs have recognized these sectors as a source of entrepreneurial opportunity is evident from *Table 2*. At the same time, research to date suggests that the overall qualitative and innovative gains from the establishment of these quasi-markets have been relatively

modest. Each sector faces its unique challenges: For example, the Swedish school system has yet to fully recuperate from a dramatic fall in its ability to impart knowledge to students, whereas the elderly care sector is overshadowed by a considerable financing concern; the number of Swedes over the age of 80 will increase by more than 50 percent between 2019 and 2030.

However, welfare quasi-markets are different from ordinary markets. This is particularly clear if they are considered from an epistemic point of view, i.e., in terms of their ability to generate knowledge and make sense to the actors operating in them. First, fixed prices make it difficult to convey information, signal quality and compete. Second, companies' revenues do not come from users but mainly from taxes. Third, the lion's share of providers are still government actors with weaker incentives for innovation and cost control. Moreover, the targets set by the public sector are inevitably conservative in nature; there are strict limits to how innovative a provider can be. There are good reasons for these limitations, but the flip side is that it becomes more difficult for quasi-markets to generate the kind of information and knowledge that providers need to innovate and improve. However, there is plenty of room for reforms that would improve the situation by strengthening the epistemic position of actors and positively influence quasi-markets' innovation capacity. Epistemic reforms are reforms that help users make informed choices, ameliorating the matching between user preferences and available options (an increased static efficiency). Simultaneously, they enable and incentivize providers to compete and innovate along the dimensions that users value, in a process generating new knowledge (increased dynamic efficiency). All proposals are relevant to both sectors, albeit to varying degrees. They are likely to be applicable to be relevant for other welfare quasi-markets as well.

1) Introduce and/or strengthen freedom of choice. While relevant for both sectors, this is especially so in the case of elderly care: the dominant procurement model in this quasi-market should be complemented with or supplemented by user choice, so that the elderly and their relatives have a greater say in guiding providers in the right direction. The city of Stockholm is one of the pioneers in introducing such a combination of procurement and freedom of choice for special housing and has seen good results. Yet, at present, a mere 25 out of 290 municipalities complement their procurement model with a freedom-of-choice model. One way to achieve this is to give the user a voucher that accompanies them to the accommodation they choose. Like the upper secondary school allowance, this elderly allowance should be paid by the home municipality but could be used throughout the country. This would mean real choice even for residents in smaller municipalities and create larger catchment areas for operators who

want to establish themselves. Efforts should also be undertaken to strengthen de facto freedom of choice in the school market in municipalities where this is only the case on paper.

2) *Provide reliable and relevant information and evaluation criteria.* While relevant for both sectors, this is especially the case for the school system. Operators in the school market have incentives driven by the objectives set by curricula and government directives. With vague and ill-conceived objectives, the willingness of companies to compete and pursue profit does not lead to desirable outcomes. The key here is to inflation-proof grades and ensure that schools compete to provide knowledge, rather than high grades for little effort. This requires curricula and syllabuses with well-defined knowledge content and a grading system that guarantees that a certain level of achievement is graded equally across schools. In addition, both the school and nursing home markets would benefit from making information from user surveys easily accessible and understandable. Consideration should be given to introducing rating systems of the kind that have emerged for many private services. The establishment of such reputation mechanisms would provide future users with a better basis for decision-making while requiring the provider to be even more responsive to the dissatisfaction of current users.

3) *Ensure that exits do as little harm as possible.* If schools or elderly care homes—public or independent—are seriously underperforming, it should be possible to outsource their operation to an external operator with proven expertise in this area. In the case of schools, the new operator should be granted greater freedom in terms of both regulation and pedagogy.

This paper contributes to the entrepreneurship literature by adding concreteness and real-world relevance to institution-entrepreneurship relationship, by highlighting the previously overlooked importance of quasi-markets. Additionally, we show how such markets can increase their innovation potential by tailoring complementary institutions that steering for-profit competition towards desired social goals. In summary, there is likely ample room for enhancing quasi-markets' capacity to generate information and knowledge. Ultimately, this may mean a lot for their innovation capacity and entrepreneurial actors' ability to deliver low-cost, high-quality welfare services.

2. Institutional and theoretical background

Klein et al. (2010, p. 5) stress that “any change in the institutional environment brought about by public-sector entrepreneurship changes the setting in which private-sector (and public-sector) entrepreneurship takes place” (cf. Ostrom, 1990, p. 127). The creation and fine-tuning of a quasi-market is obviously a crucial example of such an institutional endeavor, yet as we

have seen, this has thus far barely been mentioned in entrepreneurship literature. Moreover, much of the economists' standard analysis of private provision and quasi-markets take the conditions dictating them as given rather than as malleable (e.g., Shleifer, 1998), as a choice between public or private provision, rather than between a host of hybrid forms (Cabral, 2013). While theory is an important guide to understand quasi-market effectiveness, the devil is in the details regarding the predictions researchers can make. To guard against irrelevant generalizations, theory must be honed to the particular institutional context.

2.1. Two quasi-market models

While the Swedish shift towards quasi-markets coincides with the trend towards what is usually called New Public Management (NPM), the development also has clear roots in local initiatives, undertaken by entrepreneurial actors challenging extant legal frameworks (cf. Elert and Henrekson, 2017). This is particularly evident with regard to preschools and elderly care (Blix and Jordahl, 2021), and it is conceivable that the reforms would never have come about without these initiatives.³ The welfare privatization that began in the late 1980s has resulted in two main quasi-market models: the contracting model and the freedom of choice model.

The *contracting model* is the quasi-market model mainly used in Swedish elderly care, but also in care for the disabled, in specialist health care and in youth and substance abuse care. The model is “top-down” in nature: politicians choose between public and private service production and which activities may be relevant, after which the provider is appointed through a procurement procedure in which actors can submit bids. The winner receives a time-limited monopoly; thus, competition in the procurement model is *for* the market.

If a private company wins the contract, the entire production unit shifts from government to private management, which can be considered as a (admittedly temporary) privatization. The incentive provided by the profit motive is what is considered to stimulate innovation and better service quality. However, the profit motive also risks tempting the provider to make savings that reduce quality, at least when it comes to the kind of quality that is difficult to pinpoint and nail down in a contract (Shleifer, 1998). Requirements and regulatory supervision are therefore seen as central to ensuring that the profit motive is appropriately channeled. External control is

³ In the mid-1980s, a major political confrontation arose regarding the existence of tax-funded private preschools, centered around the establishment of the private preschool company Förskolan Pysslingen AB. The long-standing dispute ultimately led to free establishment in childcare in 1991, and freedom of choice in the school sector likely wouldn't have happened if not for this regulatory battle. Moreover, before Danderyd's municipality hired a private contractor in 1989, the existing interpretation of the law was that municipalities had a monopoly on the provision of (fully or partly) tax-financed elderly care. The Court of Appeals ruled that what Danderyd did was not illegal, which paved the way for the subsequent privatization of elderly care (Bergman and Jordahl, 2014).

also needed for government providers, but the problem in this case is that the provider has too weak incentives for any kind of change. Regardless of the provider, there is also always a risk that control becomes demoralizing, stifling attempts at change in their infancy.

The *freedom of choice* model is used to organize the Swedish school system, but also preschool, home care, and primary care. The model is “bottom-up” in that users are the ones who choose, equipped as they are with a publicly funded voucher while providers compete *within* the market, to which access is relatively free. Providers can be either public or private, and private providers are either for-profit or non-profit. If a user chooses a private alternative, this implies a more gradual privatization—one user at a time—than in the contracting model. Competition is considered to give providers in the freedom of choice model the incentive to constantly improve their operations, as they would otherwise lose the voucher that users bring. Crucially, the loss is unattractive for the profit-driven provider driven *and* the selfless provider who wants to use the money to help each user as much as possible (Le Grand 2009).

Seen through an institutional lens, establishing a quasi-market is a political activity, or an act of public entrepreneurship (Klein et al., 2010), that takes place at the level of formal rules and regulations (L2) in Williamson’s (2000) institutional hierarchy. Its most obvious effect on the governance level (L3) will be the emergence of new organizational forms, notably private entrepreneurial firms. Once the public monopoly has been abolished, the newcomers compete with public entities either for the market (in the procurement model) or in the market (in the freedom-of-choice model). These activities take place on the resource allocation level (L4). Yet, whether this process creates continuous innovation depends on additional institutions, which take effect at various levels of the institutional hierarchy, ranging from L1 to L4. To understand what these complementary institutions should entail, it is important to understand how free markets and quasi-markets fare in epistemic terms. To this effect, we continue by examining the (wholly implicit) epistemic throughline in the standard economics’ quasi-market analysis.

2.2. Standard economics: Necessary conditions for innovation in quasi-markets

Shleifer (1998) discusses the general conditions of private and public ownership (drawing on Hart et al., 1997). His perspective is, at its core, epistemic: he describes procurement as unproblematic when the government knows what it wants. The service then has high contractibility, i.e., the required quality can be defined so clearly in a contract that there is no doubt what the supplier should provide. Garbage collection is a frequently cited example of such a service. Problems arise when the government cannot predict, describe, stipulate,

regulate, and enforce exactly what it wants. For-profit providers may then be tempted to lower quality in dimensions that are difficult for users and regulators to specify, observe, and verify. Thus, the lower the degree of contractibility of the procured service, the greater the risk of negative effects on quality if a private contractor is engaged. Andersson et al. (2019) review the empirical procurement literature in the area and show that this prediction is generally correct.

To illustrate the dilemma, Shleifer focuses on what is effectively a contracting quasi-market where providers have two investment incentives: (i) investments that reduce costs and (ii) investments that improve quality or lead to innovation. Since a private provider, as an owner, appropriates the return on its investments, it has much stronger incentives to innovate than a public provider. However, the incentives to implement cost reductions that have negative effects on quality are also stronger, especially the kind of quality that cannot be laid down in a contract with the client. One example could be a situation where a for-profit nursing home allows cost savings to impair care quality. If such temptations are substantial, weaker incentives may be preferable. Advocates of government ownership often invoke variants of this argument, but Shleifer emphasizes that this risk is significantly reduced as long as one of the following conditions is met. While we outline them, we note i) that all criteria capture epistemic aspects of the market in question, and ii) that no criterion is written in stone. At least in theory, institutional changes can influence all three.

The *first criterion* states that private ownership is likely to be preferred in sectors where innovations play an important role. For-profit providers' stronger innovation incentives can then compensate for negative quality effects from cost reductions. Yet, it is an open question whether sectors such as elderly care are breeding grounds for innovation. The answer depends on the form of ownership (Klein et al., 2010) and on details in the model used, not least what kind of information the parties involved—providers, clients, and regulators—have access to.

Shleifer's *second criterion* states that freedom of choice reduces the risk of quality being negatively affected. Here, Shleifer's reasoning meets that of Le Grand (2009), who, based on his experience as a practitioner and researcher, argues that (p. 14)

in most situations, services whose delivery systems incorporate substantial elements of choice and competition have the best prospect of delivering a good local service. Properly designed, such systems will deliver services that are of a higher quality, more responsive and more efficient than ones that rely primarily upon trust, command-and-control or voice. Moreover—contrary to much popular and academic belief—they will also be more equitable, or socially just.

In other words, Le Grand prefers a freedom-of-choice quasi-market model. The key difference compared to a regular market is that a publicly funded voucher equalizes purchasing power across users. The equal purchasing power is what, in Le Grand's eyes, means that the freedom-of-choice model can avoid the injustices that would occur if welfare service provision were left to regular markets. Moreover, he argues that competition for users (and for their resources) will make providers strive for innovation and better quality, and that this holds irrespective of whether providers are self-interested, altruistic, or somewhere in between. The altruistic provider wants more resources to help more people, while the self-interested provider wants more resources because that would make the enterprise more profitable. And for those who are both selfish and altruistic (like most of us), these motivations will reinforce each other.

Both Shleifer's and Le Grand's perspectives suggest that it may be a good idea to "temper" the profit motive with freedom of choice in quasi-markets. In view of this, it seems relevant to point out that the Swedish nursing home quasi-market is generally not of this variety. In a report on how to improve the institutional conditions governing the Swedish contracting model, Lundberg et al. (2022, pp. 56–57) maintain, e.g., that an important way to generate the knowledge necessary to protect non-verifiable quality is "customer selection systems ... that cause demand to vary with subjectively perceived quality."

That said, freedom of choice is only likely to produce genuine benefits if users have practicable and substantive choices. Moreover, even if alternatives are available, ranking them can be challenging. Shleifer's *third criterion* addresses this epistemic issue by stressing the value of reputational mechanisms, or what Le Grand (2009) calls the voice tool. Private contractors who must safeguard their reputation will be less inclined to engage in cost-cutting that degrades non-contractible quality. To be sure, this epistemic dimension can also be influenced, e.g., by introducing a rating system modeled on those used for hotels, taxi services, and subletting.

Shleifer (1998, p. 140) argues that one of these conditions usually holds, which means that the normative argument for public production is generally weak. One does not have to fully buy into this conclusion to (i) acknowledge the epistemic line running through each criterion for successful welfare production under private or-profit management, and (ii) acknowledge that no criterion is written in stone. Instead, it seems highly plausible that policymakers can influence a particular quasi-market's epistemic capacity by introducing complementary institutions that are informational and knowledge-conducive in nature. But before we dig into the details of how specific quasi-markets should be reshaped to this effect, it is useful to complement Shleifer's and Le Grand's perspectives with a more evolutionary view. Again,

there is an epistemic throughline, but this time, we examine how quasi-markets fare compared to regular (free) markets.

2.3. Addressing the epistemic problem: Sufficient conditions for innovation in quasi-markets

Certain conditions must be met for quasi-markets to function well. One way to understand whether these conditions are met is to apply an evolutionary perspective to quasi-markets, comparing them to regular markets. In the latter, the importance of competition and profit-seeking is evident in the generation, selection, and replication of innovations. In addition, there is a specification problem in quasi-markets that has no real equivalent in a regular market.

In regular markets, positive profit constitutes the selection criterion. Only profitable firms survive in the long run and firm owners have an incentive to continue operations as long as their business is profitable (Holcombe, 2013, p. 102). This is evident from a perspective associating entrepreneurship with profit-oriented ownership following Knight (1921), according to whom the pursuit of profit is entrepreneurs' major motivation in introducing innovations and that they can only exercise such entrepreneurial judgment when they own productive resources. In contrast to Schumpeter, Knightian scholars argue that entrepreneurship *presupposes* ownership of a business firm, modeling "entrepreneurs as owning, controlling, and combining heterogeneous assets ... and deploying these assets within a firm to produce goods and services in anticipation of economic profit" (Foss and Klein, 2015, p. 585; cf. McMullen, 2015). As Wennekers et al. (2007, p. 138) state, "[t]here is agreement that entrepreneurs (in the sense of business owners) make judgmental decisions in the face of uncertainty, reap the rewards of perceiving and utilizing opportunities and in the process also run the risk of losing their money and their reputation."

Pure profit only pertains to the part of accounting profit that exceeds the market's risk-adjusted rate of return. This can be labeled an entrepreneurial rent, which arises because the innovation gave the entrepreneur a temporary monopoly (Henrekson and Stenkula, 2017). The entrepreneurial rent is compensation for bearing the uncertainty (incalculable risk) associated with innovations. Normally, this rent will gradually erode. This may happen because the entrepreneur voluntarily lowers prices to reach more customers. A more important reason is that other firms and entrepreneurs discover the new profit opportunity, a fact that highlights the entrepreneurial rent's epistemic value. The rent is a driving force for allocating resources to their highest-valued ends and for attracting competitors who, spurred by the rent, challenge the entrepreneur through imitation and further improvement of the innovation. Such replicative entrepreneurs play an essential role for economic development in the phase following the

introduction of an innovation when wider application and diffusion of knowledge takes place (Baumol, 2010).

Over time, replication in a free market erodes the entrepreneurial rent and the value of being first on the scene. The benefit from the innovation does not disappear but shifts into a consumer surplus. One can scarcely overstate the size of this surplus: Nordhaus (2005) estimates that inventors, entrepreneurs, and producers receive on average less than three percent of the value that their activities contribute. The rest goes primarily to consumers in the form of lower prices and higher quality. While these numbers may be somewhat lower for personalized services, there is no doubt that competition and the possibility of making profits convey useful epistemic knowledge that contributes to efficient resource use. Conversely, sustained high profits suggest competition is weak (Holcombe, 2013).

Regarding the *generation* of innovations, an evolutionary perspective suggests that quasi-markets will necessarily be more conservative than normal markets. For example, a principal/bureaucrat who wants to safeguard quality and taxpayer funds must declare what should be provided, a specification that (even if very generally formulated) limits the scope for innovation because it closes off (hitherto unknown) avenues for the discovery and development of valuable knowledge. That this can be a significant problem is underlined by the fact that most product and distribution markets are virtually unrecognizable compared to just a few decades ago. Nevertheless, the specification of service content by the government is inevitable. It must therefore be broad enough to give users and providers real choice, yet sufficiently concrete and meaningful so that competition and choice—and therefore efforts at improvements—become focused on the most important dimensions.

Replication can (and should) play a significant role for innovation in quasi-markets with user choice. After all, the critical reason why competition should have fortuitous and disciplining effects is that service providers will strive to imitate and surpass whoever discovers a new clever way to attract users and their vouchers. Yet, one of the clearest epistemic “disadvantages” of quasi-markets compared to ordinary markets is that prices are not allowed to perform the same function as in ordinary markets. The absence of freely variable prices is a feature, not a bug, as a key “egalitarian” motivation behind freedom-of-choice quasi-markets is that purchasing power be equal (Le Grand, 2009), with providers often receiving a fixed remuneration “per unit,” e.g., per patient. Therefore, providers cannot use higher prices to signal higher quality, so they usually only compete in terms of quality. It is less obvious, however, that they can do so in a meaningful way in quasi-markets without user choice. In the eyes of Le Grand (2009, p.

54), government-funded vouchers make the freedom of choice model a “fundamentally egalitarian tool” compared to if the service was offered in a regular market where customers pay for the service themselves. Yet, this equality in terms of purchasing power weakens the epistemic position of the actors compared to a regular market and thus considerably hampers the system’s ability to innovate.

Moreover, a fixed price system is likely always inferior to a free price system because it does not allow economic coordination via the signals that changing prices send. Consequently, a fixed price system lacks the ability “to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know” (Hayek, 1945). By dampening knowledge signals, fixed prices limit quasi-markets’ ability to generate and disseminate innovations whose benefits primarily accrue to users. As Haeffele and Storr (2019) put it, “entrepreneurs in an unhampered market enjoy a privileged epistemic position compared to actors in non-market settings.” This also puts the presence of queues, usually seen as a symptom of inefficiency by economists, in a different light. In systems with fixed purchasing power, queues convey at least part of the knowledge that prices convey in regular markets (cf. Hayek, 1945). Thus, a long queue to a nursing home or a school signals high quality and is also a key decision basis for providers and their investors considering expansion, overcoming some of the epistemic disadvantage.

Moreover, replication rests on entry and expansion (and exits and contraction), which underscores the importance of profits. As mentioned, the existence of for-profits remains highly controversial in Sweden (Blix and Jordahl, 2021, p. 171). Still, freedom-of-choice proponents like Le Grand (2009) are careful not to favor one organizational form over others. According to him, the competition for users’ resources in a quasi-market provides good incentives for both selfish and unselfish actors to do a better job. A contrasting observation is that (too much) soft-powered incentives risk hampering quasi-markets’ functioning. While profit-seeking companies should reasonably expand their operations when demand increases, other actors may not react that way. Long-suffering public providers may even appreciate a reduced demand, and foundations and non-profit providers do not follow any easily defined profit logic (Chatterji, 2018; Hoxby, 2003). It is unclear, therefore, whether non-profit entities would respond to increased demand by expanding their operations. And even if the desire for such expansion existed, non-profits’ difficulties in raising capital could make further expansion impossible.

One interpretation of the argument is that quasi-markets would function better the more for-profit actors there were because the mechanisms enabling new establishments and closures, expansion, and contraction would perform better then. However, the interaction between actors may be what matters the most; as Mahoney et al. (2009) observed when discussing the interdependence of public and private interests, sustainable value creation is more likely achieved through pluralism and a diversity of institutional and organizational forms. For example, while non-profits may lack strong driving forces to grow, they can act as role models and convey valuable knowledge about what works, inspiring for-profit actors to spread their ideas and methods through imitation (SOU 2019:56, p. 13). Arguably, non-profits also wish to defend their “market position,” i.e., maintain their current level of operations. Moreover, as Haeffele and Storr (2019, p. 231) point out, non-profit private actors may still have “the ability to coordinate plans and bring about social progress in ways that governments cannot” and “mechanisms available to nonprofits—such as reputation and competition for donors, volunteers, and customers—can and do enable knowledge discovery and social learning, and therefore, can direct nonprofits toward better coordination over time.” For the same reasons, government entities forced to compete with private actors in a quasi-market should be better placed epistemically than monopoly providers.

The need for appropriate *selection* mechanisms remains when we leave free markets, but selection usually differs depending on the choice of quasi-market model. While selection in the contracting model is carried out by a civil servant who awards a contract to a certain provider, the freedom-of-choice model is more reminiscent of selection in regular markets. The freedom-of-choice model, which is only modestly used in the Swedish nursing home market, thus appears more attractive precisely because its experiments are carried out on a smaller scale. One failing elderly care home or one poor match between home and user may have devastating consequences. Yet they will be isolated, and easier to handle and learn from than if a large procurement gives a rogue or incompetent actor a de facto monopoly on a municipal service for several years (cf. Harford, 2011). Returning to the epistemic point above, we note that when a single (public or private) actor “owns” the local market, there are few points of comparison and users are unable to vote with their feet. Thus, it may even be difficult to know whether outcomes are good or bad.

An additional wrinkle to the selection-related problem when it comes to user choice is that it is (often) someone other than the one who benefits from the service who chooses: legal guardians, not pupils, in the case of schools; relatives, not the elderly, in the case of residential care. The

costs (mainly non-monetary) of changing both elderly care providers and schools are also high, underlining the need for a system that generates the kind of information users need to reduce the risk of making a bad choice.

Each of these problems will likely worsen in quasi-markets where profits are banned or restricted. A government-mandated profit restriction would effectively abolish entrepreneurial rents in the welfare sector, dampening crucial knowledge signals, transformative pressures, and incentives to innovate and replicate successful innovations. A profit restriction would also make it more difficult to raise external equity, thus forcing welfare companies to expand largely through retained earnings. Major negative consequences for both competition and freedom of choice would ensue. The main lesson is that market legislation must establish clear rules *and* try to keep the door open to hitherto unexplored knowledge pathways, i.e., what legislators, producers, or users had not previously envisaged.

2.4. In summary

For quasi-markets to have innovation potential, the transformation process driven by the existence and creation of entrepreneurial rents is likely crucial. Because government providers with weaker innovation incentives still dominate most welfare sectors, it is critical that existing private providers in these sectors are willing to act entrepreneurially, i.e., to bear uncertainty and innovate in the hope of future returns. Yet, as quasi-market theorists have shown, the profit motive is far from uncomplicated in quasi-markets, a fact which, in no small measure, relates to epistemic issues. As Cabral et al. (2013, p. 7) state, when discussing the presence of private actors in prisons, the “fundamental question is, therefore, not whether private entrepreneurs will be able to execute complex public services adequately, but what the relevant public-private interactions that may help attenuate the aforementioned cost-quality trade-off are.” That said, while competition within the market (rather than just for the market) appears as one important way to “temper” the profit motive, it is unlikely sufficient to solve the epistemic issues that stand in the way of continuous innovation in such markets.

3. Illustrative evidence: Two Swedish quasi-markets

Opening a previously closed market to private options can have two potential quality effects: (i) a direct effect resulting from some modes of operations delivering better care than others, and (ii) an indirect effect where the increased competition causes all or most providers to shape up. Moreover, the competitive effect can work differently depending on whether providers are chosen through public procurement, user choice, or a combination of the two modes. To get an idea of the extent to which these two effects are at play we examine the Swedish quasi-markets

for elderly care and schooling. When these effects are not present or appear muted, we ask whether they *could increase* if the rules of the game were improved.

3.1. Swedish nursing homes in an international perspective: Quality and innovation

Surveys of the international literature show that for-profit nursing homes generally perform worse in terms of quality than private non-profits and government providers (Comondore et al., 2009; Xu et al., 2013; Bos et al., 2017). For-profit contractors also seem to do worse in terms of employee satisfaction but better in terms of cost efficiency (Bos et al., 2017). A survey by Tran et al. (2019) report partially contrasting results, namely that large for-profit nursing homes are more efficient than non-profit counterparts. Regarding the competition effect, Yang et al. (2022) find mixed results when reviewing the international evidence on how prices and quality are affected by competition among nursing homes. However, most studies find that greater competition results in lower prices. Among institutional factors likely to contribute to the unclear picture, the authors highlight an information problem; if relevant information is easily accessible and reliable, they suggest, nursing home competition will more likely have favorable effects, which suggests that the establishment of epistemically conducive institutions may be critical in this welfare sector as well.

The Swedish picture looks less bleak. Private providers do worse in terms of structural quality (e.g., staffing level and housing standard) but better in terms of process quality (such as user participation in the development of care plans) (Stolt et al., 2011; Winblad et al., 2017). Bergman and Jordahl (2014, p. 50) even argue that private providers outperform public providers in most quality dimensions that they can reasonably influence. Broms et al. (2020) differentiate between the direct and indirect effect and find that, on average, Swedish private nursing homes provide services of comparable quality to public providers.

In their review, Yang et al. (2022) point out that competition plays a limited role in Sweden because the procurement model dominates so strongly. Nevertheless, Bergman et al. (2016) show that nursing home mortality (a highly relevant measure of non-contractible quality) is lower in municipalities where the market has been opened for private actors (they make no distinction between procurement and freedom of choice). The authors attribute the beneficial effect to a combination of private ownership and for-the-market competition. Their conclusion receives some support from Broms et al. (2020), who find that the threat of private competition (measured as the presence of private firms in the market) prompts government providers to improve. Furthermore, they find that staff quality is higher among private nursing homes in

municipalities with freedom-of-choice competition. However, they find little evidence that greater competition for the market (measured as more tenders) would lead to higher quality.

A cautious interpretation of the results is that the establishment of quasi-markets for nursing homes in Sweden has been successful in an international perspective. This is also what Blix and Jordahl (2021, p. 114) note when summarizing the evidence concerning the Swedish elderly care reforms:

... it seems that privatized elderly care has distinct cost advantages. Some quality improvements are also observed with privatization: reduced mortality rates and better process quality measures in nursing homes. Public nursing homes on their part have an advantage on structural quality measures, although this is less evident than the private advantage in process quality measures.

As regards innovations, there is considerable potential for cost savings and quality and safety enhancements if elderly care becomes better at adopting new technology (SOU 2020:14). However, new technology may be a double-edged sword that either strengthens or hampers the co-production between providers and users (Gallouj and Savona, 2009). To date, few studies have investigated the preferences for the introduction of welfare technology in elderly care, suggesting that a one-sided focus on welfare technology risks missing the target to the point of being counterproductive. The risk increases, for example, if the technology undermines control, independence, and other aspects that users value (Persson and Olofsson, 2022).

However, technology is not the only innovation route; in a systematic review study Brodtkorp et al. (2019) conclude that leadership is key to successful innovations that lead to more patient-focused care in nursing homes. There also appears to be a clear connection between management and organizational form: Angelis and Jordahl (2015) use the interview method developed by Bloom and Van Reenen (2007) to compare management practices in 500 private and publicly owned Swedish nursing homes. They find that the management function is consistently superior in private nursing homes. The authors also find some support for a positive relationship between management quality and care quality, noting that the results align with the international management literature in other areas (Angelis och Jordahl, 2014).

3.2. Swedish schools in an international comparison: Quality and innovation

The international evidence suggests pupils' school results benefit from quasi-market reforms (Shakeel et al. 2021; Cohodes and Parham 2021) and that the beneficial effects occur both because private providers do well (Chabrier et al. 2016) and because competition encourages all providers to improve (Figlio et al. 2023). In view of these facts, it is noteworthy that international tests unambiguously reveal that the Swedish school system experienced a severe

decline in knowledge combined with grade inflation shortly after the freedom-of-choice reforms of the 1990s (Henrekson and Wennström 2022). However, the decline appears to have started before the enactment of the quasi-market reforms (Holmlund et al. 2014), and the school system changed in other ways during the same period. In addition to the free school reform, Holmlund (2020) lists decentralization, new curricula, new grading systems, changed teacher training, stricter entrance requirements to upper secondary school, digitization, and a plethora of state aid to principals. For this reason, Holmlund (2020, p. 6) notes that it is, in principle, “impossible to sort out the reasons behind the fall and rise of Swedish students in the PISA study. Too many changes have been implemented more or less simultaneously for it to be possible to isolate direct causal relationships.”

Blix and Jordahl (2021, pp. 135–136) nevertheless venture a cautious interpretation, summarizing the effects of the Swedish school quasi-market as follows:

[T]he introduction of independent schools has increased the productivity of the Swedish school system. This is evident for the compulsory level (with students aged 6 to 15) where competition from independent schools has raised student performance without raising costs. ... At the upper-secondary level, the evidence is more mixed. Students at independent schools have higher grades and test results and are more likely to graduate on time and to continue to tertiary education. However, when comparing internally and externally graded tests, students of independent upper-secondary schools actually perform worse but benefit more from lenient grading. ... Finally, it should be stressed that the gains from competition have been relatively modest in size and have not prevented the decline in the PISA ranking.

In these authors’ assessment, the free school reforms probably did not contribute to the Swedish knowledge decline. There is also little to indicate that the result would have been noticeably better if all the changes that Holmlund (2020) enumerates had taken place except for the free school reform. Indeed, things could have been worse without this reform, as suggested by the poor student results in those areas of the country where parents have low education and the school remains a de facto local monopoly because there has been no entry of independent schools (Heller Sahlgren 2021).⁴ Still, it seems clear that any gains from the Swedish school marketization have, at best, been modest. This lack of progress is noteworthy given that no other country has marketized children’s education so systematically and to the same extent (Blomqvist 2004; Klitgaard 2008). If competition and the presence of actors with high-powered incentives were unambiguously beneficial to the provision of education, one would expect

⁴ Heller Sahlgren (2023) finds that increased local competition has improved TIMSS scores, which is driven by for-profit schools. A simulation based on the estimates indicates that Sweden’s average score in TIMSS 2019 would have been 0.24 standard deviations lower without the expansion of the independent-school sector.

Sweden to have seen more consistent and continuous benefits than any other country, yet this has been far from the case.

The impetus behind greater technology use in the classroom is that technology could advance student learning by enabling more hours of high-quality, individualized learning (Chatterji 2018). Unfortunately, the scant evidence on technological classroom innovations that lead to knowledge-enhancing outcomes is not encouraging (Bulman and Fairlie 2016). In a Swedish study, Hall et al. (2019) examine the effects of a so-called 1:1-program aiming to make information and communication technology an essential part of education in all subjects. The only demonstrable effects are deeply problematic: 1:1-programs risk increasing school inequality by *worsening* math skills and future admission prospects for students with low-educated parents. On the other hand, the use of so-called CAL (computer-assisted learning) software can be compatible with sizeable positive learning effects, though they are expensive (Biasi et al. (2021, p. 12). The mixed results highlight the fact that a key characteristic of service production and service innovations is that they are co-produced (Aligica et al. 2019, Ch. 6; Ostrom and Ostrom 1991), by teachers and students in the case of schools. New technology can strengthen that co-production but also risks deteriorating it. This risk appears particularly great for weak students. These facts should encourage caution but also sound evaluation strategies—one example is Chatterji and Jones' (2016) EDUSTAR platform, which quickly evaluates digital learning activities in the classroom using randomized experiments. Rapid evaluations of software and hardware could result in a safer introduction of knowledge-enhancing technology.

However, new technology is only one type of innovation. An earlier review of the international evidence on school quasi-markets and innovations finds that they primarily promote management and marketing innovations (Lubienski (2009, p. 43). In his more recent overview, Chatterji (2018) also discusses the great potential of organizational innovations and the extensive literature on new forms of organization and management in schools. That these kinds of innovations are significant is confirmed by international evidence on the connection between management/school governance and educational results (Bloom et al. 2015). The study covers eight countries, including Sweden, and the connection turns out to be strongly positive: better school management has a considerably stronger association with school results than do factors like teacher density and class size. The link was also strongest in England, where the most reliable measures of educational quality are available, but weaker in Sweden, where student grades, as we have learned, seem unreliable quality measures. Other studies confirm the connection between better school management and good educational outcomes (e.g., Dobbie

and Fryer 2013; Angrist et al. 2012; Bloom et al. 2020). Fryer (2017) also shows that management training of principals has a causal, positive effect on student learning.

Moreover, Bloom et al. (2015) show that half the variation in management quality is at the country level—significantly higher than in similar studies the researchers have carried out regarding other parts of the economy, e.g., manufacturing. Publicly funded independent schools also have a significantly better management function than public schools and fully private alternatives. Bloom et al. (2015, p. 2) conclude that “differences in the institutional environment have particularly important effects on the way schools are managed.”

4. Epistemic reform proposals: Making quasi-markets more innovative

As we have argued, the criteria for beneficial welfare provision are not written in stone. Rather, the outcome depends on the quality of complementary institutions, which take effect at various levels of the institutional hierarchy. Again, these institutions can be described as *epistemically* conducive, since the single biggest problem for elderly care innovation is an informational market imperfection. In essence, our suggestions, drawing on theory and extant empirical evidence, amounts to the following epistemic reforms to strengthen the quasi-markets in question. All proposals are relevant to both sectors, albeit to varying degrees.

4.1. Introduce and/or strengthen freedom of choice.

From an institutional perspective, the most apparent effect of the establishment of a quasi-market in L2 was the emergence of new organizational forms (L3), i.e., private (not-for profit and for-profit) schools and nursing homes. As seen, these private entrepreneurs entered the market in substantial numbers following the reforms in the early 1990s. Yet, the dominant procurement model for nursing homes implies that these private entities compete with public entities *for* the market. Providers are not competing for users in L4, except in the small fraction of municipalities that already combine procurement with freedom of choice. Thus, potential providers generally compete for the favor of the procurement official, not the continuous favor of users. The situation is different for the school sector, where the freedom of choice model is paramount; that said, there are municipalities where there has been no *de facto* entry. This absence of within-market, L4 competition is problematic for several reasons.

First, while there is arguably something akin to an entrepreneurial rent here—the winner of a procurement gets a *de facto* monopoly—this rent cannot be eroded by subsequent imitators because they are effectively blocked from entry until the tender offer (Henrekson and Stenkula, 2017; Holcombe, 2013). Second, but relatedly, the low degree of actual competition removes the epistemic and disciplining effects of continuous competition. In the extreme, a sole provider

has no challengers and therefore no guidance as to what users value; there is, therefore, a considerable risk that the provider either focuses efforts along dimensions users do not value, or even undertakes cost savings that reduce quality (Shleifer, 1998; Le Grand, 2009).

The stronger incentives of private ownership are a double-edged sword when it comes to procurement. This is not least the case in elderly care, where it is simply difficult to define, specify and measure many important quality aspects, and the very driving forces that can result in care-promoting innovation also risk lowering the non-contractable quality of the operations. As Lundberg et al. (2022, p. 13) note, the regulatory framework that exists for public procurement emphasizes transparency, equal treatment, predictability, openness and proportionality. These basic principles make it more difficult to safeguard quality that is difficult to “put your finger on,” what economists call unverifiable quality, which could be described as “soft” quality aspects.

An important step towards solving, or at least mitigating, these epistemic problems would be to strengthen freedom of choice when it exists on paper (in the case of schools) or complement a pure procurement model with a system of choice (in the case of nursing homes). Such a mechanism would allow demand to vary with users’ subjectively perceived quality; in other words, users would become involved in steering the service content in the right direction. With a voucher that follows the individual user, their assessment of what constitutes good quality would guide providers. However, this hinges on the market being large enough for it to be profitable for operators to enter the market, which, in the case of nursing homes suggests opening up for a national elderly care law or at least larger catchment areas as this greatly reduces the risks for new operators. A user in the big city could then choose a nursing home with nice surroundings in the countryside (where operating costs are lower), but without changing the user’s domicile so that the municipality that granted the service pays the care allowance to the provider in the rural municipality. As regards schools, attempts should also be made to improve competition and user choice in municipalities where this is lacking.

In addition, many private nursing homes already offer their residents additional services at a reduced price thanks to tax deductions for household-related services. For epistemic reasons, the right to offer such topping-up should also be extended to government-run nursing homes. As Karlson and Lundbäck (2022) put it when discussing such supplementary services in home care, they can function as “a kind of experimental workshop and a gauge of what the elderly really need help with.” The improved opportunities to compete on both price and quality would be crucial to improving the innovation climate in elderly care, so that it becomes progressively

better for everyone. That said, a policy introducing similar topping-up in the case of schools is subject to considerable fairness concerns, which are beyond the scope of this paper.

4.2. Establish reliable and relevant information and evaluation criteria

Public specification of service content is, as mentioned above, inevitable in a quasi-market. At the same time, it is inevitably conservative in that it closes off certain possibilities that producers in a free market may explore. The specification must therefore be sufficiently broad to give users and providers real choice, and at the same time sufficiently concrete to focus improvement efforts on relevant dimensions. While relevant for both sectors, this suggestion is illuminating in its concreteness as regards the Swedish school system.

Operators in the school market have incentives driven by the objectives set by curricula and government directives. With vague and ill-conceived objectives, the willingness of companies to compete and pursue profit does not lead to desirable outcomes. In the case of Swedish schools, it is clear that the current specification of the mission channels profit interests and competition in partly the wrong direction; in fact, as seen in section 3.2., Bloom et al. (2015), found that the relationship between school management quality and student performance was the strongest in England, where the most reliable measures of educational quality are available but much weaker in Sweden, where student grades are not reliable measures of quality. The discrepancy between the actual knowledge level and knowledge indicators such as grades is related to how these indicators are “created,” which exposes a major systemic flaw. This is the epistemic problem in the Swedish school quasi-market in a nutshell, and it is no hyperbole to describe it as the foremost obstacle to realizing knowledge-enhancing innovation. We can trace it back to two changes that coincided with the introduction of the freedom-of-choice model in the early 1990s (Holmlund 2020): an alteration of the *view of knowledge*, which profoundly affected the national curriculum and pedagogical practice, and the introduction of a new grading system. Below, we describe each of these developments in turn.

First, a postmodern view of knowledge had been gaining ground for decades and took hold with the 1994 curricula, i.e., was institutionalized in curricula and syllabuses and in the instructions of the relevant authorities. This new view did not entrust teachers with a real, knowledge-promoting mission (Henrekson and Wennström 2022). This is hardly surprising, given that this view of knowledge questions the very existence of objective knowledge and deprives the teacher of the mandate to convey the kind of knowledge students need by insisting that the

students should construct this knowledge themselves.⁵ By undermining any claim to a common foundation of knowledge, the postmodern view's role as an epistemic obstacle was and is immense.

Second, Sweden also transitioned from a relative grading system to a goal- and criterion-based one in 1994. The new system meant (at least on paper) that students were not compared with their peers, only assessed based on whether they achieved the teaching goals (Nordin et al. 2019). At the same time, grading was decentralized to the teachers so that they were allowed to set grades practically without any external oversight (Wennström 2020). This new design of the grading system ended up making grades unreliable measures of knowledge, which has manifested itself both in grade inflation and in dramatic differences in grades between schools for comparable performance. The grading system thus becomes an obstacle for schools to compete in terms of knowledge. These distorting control measures, in turn, channel the profit motive and competitive incentives in (partly) the wrong direction. In addition, the pressure on teachers to give higher grades than justified given the governing documents increased, not least because of the free school choice competition (SOU 2020:43). Together, these factors resulted, and still result, in upward pressure on merit ratings.

It is hardly surprising that a system that rewards and enables high grades for low effort is not knowledge-enhancing: Research shows that students learn less when it is easy to get high grades (Betts and Grogger 2003; Figlio and Lucas 2004). Competition may create incentives for innovation, but since the system does not reward knowledge, it is not in the field of knowledge that schools will innovate. The creative potential is thus channeled in the wrong direction. Reforms that improve knowledge beliefs and inflation-proof grading systems would create a self-reinforcing effect between trust and control. The epistemic problem would be significantly reduced, which would build sound incentives for knowledge-enhancing innovation into the system of choice. Moreover, the positive consequences would be quickly felt. For once, it is also a kind of “free lunch”—student achievement would improve across the board, as would the potential for knowledge-enhancing innovation in the school market. By contrast, implementing only an isolated grading reform is likely to have limited effects.

⁵ According to the view that was replaced—the classical view—traditional subject delineations and fact-based learning are the best way to build the knowledge needed to solve problems, think critically, and develop one's creativity (Kirschner et al. 2006; Willingham 2010; Tricot and Sweller 2014). Thus, creativity, problem-solving, and critical thinking are considered (important) side effects when studying subjects at a successively more advanced level.

In addition, both the school and nursing home markets would benefit from making information from user surveys easily accessible and understandable. One obvious way to improve the information base for school choice is to require municipalities to provide all parents and guardians with transparent and easily understandable information about the schools in the catchment area well in advance of school choice. There is broad research support for the idea that such comparative information should be based on a few well-chosen quality measures, while those who wish to delve deeper are given the opportunity to do so. This should apply both to schools and to elderly care (Bergman and Jordahl, 2014). Consideration should also be given to introducing rating systems of the kind that have emerged for many private services. In their procurement report, Lundberg et al. (2022) argue that Sweden can ensure quality in procurement by "promoting a European rating system that takes into account previous deliveries and leading the way by introducing it for Swedish procurement". According to the authors, this system could be modeled on the systems already used for hotels, taxi services and subletting. There are good reasons to strengthen reputation mechanisms in the elderly care sector in this way, but also in the school market and other areas with user choice. If (prospective) users are better informed by reviews from users with experience of a provider, the voice of existing users would become a powerful force, precisely because it can help prospective users with their choices. The establishment of such reputation mechanisms would provide future users with a better basis for decision-making while requiring the provider to be even more responsive to the dissatisfaction of current users. Also, purchasers of residential care (and other services) must be enabled to take into account the past performance of potential providers, which is not at all obvious under current procurement law.

4.3. Ensure that exits do as little harm as possible

The logic of choice in quasi-markets is that providers who do not attract enough users should be financially penalized. Ideally, choice acts as a feedback mechanism that gives weaker providers the opportunity and reason to correct their course. Nevertheless, failures are inevitable in a competitive system, but it is important that they do not affect users more than absolutely necessary. First, it may therefore be desirable to minimize the risk of dramatic failures occurring at all. This could be achieved, for example, by requiring a bank guarantee from the operator of a school or an elderly care facility. The guarantee would provide an incentive for another actor, the bank, to monitor the operator's finances. On the other hand, it would protect users against sudden closure by ensuring that a triggered guarantee amount accrues to the operator who is required to take over. This also puts a price tag on the municipality's obligation to ensure

without delay that all users in the municipality have a place, which is valuable information improving the epistemic position of both providers and the municipality's principals.

The failures that do occur should be costly, but not for the users but for the providers who must not be saved from the consequences of their bad behavior. In the area of schools, one approach would be to give the Inspectorate the right to put underperforming schools under compulsory administration rather than simply closing them. In such a situation, it should be possible to outsource the operation of the underperforming school to an external actor with documented competence. At present, the regulatory framework is such that the municipality itself has to run a school after a closure, regardless of how ill-equipped it is to do so. Reasonably, the provider who takes over a school in crisis should also be given greater degrees of freedom in terms of pedagogy and rules of order to remedy a poor educational environment. There is U.S. evidence of beneficial effects when chronically underperforming schools are replaced by a charter school, likely because the takeover often emphasizes discipline and intensive student-focused instruction (tutoring) (Cohodes and Parham 2021).

5. Conclusion

We conclude that private entrepreneurs have an important role to play in quasi-markets for welfare services, but that frameworks need to be reformed to realize the full potential of their entry. Nevertheless, some details in the rules governing these quasi-markets will fall short initially and some of the positive effects of the reforms may be delayed. To ensure that the interests of profit-seeking firms and society coincide, policymakers need to safeguard the stability of the system by taking a long-term view and continuing to emphasize the value of competition and for-profit companies while adjusting the regulatory framework in response to weaknesses that emerge. This will also reduce the temptation to exploit weaknesses in the system. Instead, companies can think about their long-term commitment and all providers can focus on developing better welfare services.

No one benefits from micromanagement. The point of the reforms we have proposed is to make it easier for welfare markets to generate the necessary information and knowledge themselves. Providers are then better able to compete on the basis of what users value, which stimulates innovations that, if they prove valuable, are then copied by other providers. Precisely because these markets are still dominated by government providers with weaker incentives to innovate and improve, it becomes even more important that the private providers that do exist can take risks in the hope of future returns. With well-balanced regulations, the interest of profit can then be made to coincide with the interest of society.

This paper contributes to the entrepreneurship literature in two crucial ways. First and foremost, we add considerable concreteness and real-world relevance to the discussion of the relationship between institutional frameworks and the resulting entrepreneurial action, and how activities at the intersection of public and private interests are best organized, by highlighting the previously overlooked importance of quasi-markets. Additionally, we show how such markets can increase their innovation potential by essentially tailoring complementary institutions that are epistemically conducive, in the broad sense, so that they provide information that help entrepreneurs make sense of the world and construct knowledge necessary for action. The importance of such institutions for steering for-profit competition towards desired social goals has hitherto been overlooked.

Like any study, ours has its limitations. Our key motivation has been to shed light on what we see as an underappreciated topic for entrepreneurship scholars, drawing on entrepreneurship theory and two Swedish illustrative examples to underscore why entrepreneurship scholars should care about quasi-markets, and, crucially, demonstrate what scholars in this field can contribute. Hopefully, future entrepreneurship studies will approach this topic using all the tools in the qualitative and quantitative analytical toolkit.

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