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Budgeting and Pricing Public Procurement Tenders for Welfare Services: An International Review of Performance-Based Pricing

Adi Arad Yaniv Reingewertz

Editor: Raya Dash

English translation (Abstract): Ami Asher

Graphic design: Anat Perko-Toledano

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Myers JDC Brookdale Institute

P.O.B. 3886, Jerusalem 9103702, Israel

Tel: 02-6557400

brookdale.jdc.org.il/en | brook@jdc.org

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Abstract

Background

Public procurement is a process whereby a public entity purchases goods (such as computers or books), development projects (such as roads or hospitals), or services (such as therapy) from external suppliers. In 2018, public procurement represented 12% of global GDP (OECD, 2019), and it constitutes a significant portion of government expenses in Israel and other OECD countries.

There is an inherent difficulty in measuring and assessing the service quality and performance of welfare service suppliers. Consequently, the pricing of services and payments to the supplier are typically made according to inputs the supplier is required to provide, independent of the level of performance (which includes the quantity and quality of outputs and services). Nevertheless, in many countries, attempts are made to tie payments to performance, in order to incentivize suppliers to provide services optimally.

Objective

To learn about the pricing and budgeting of welfare services and gain insights into the process of procuring welfare services in OECD countries. This review focuses in particular on service tenders that include components based on payment by performance and price-based competition.

Method

This review is based on a variety of global information sources: current research literature on public procurement, policy papers, strategic planning manuals and work plans related to ten test cases from three countries: the Netherlands, UK and US.

Findings

- Overall, the review suggests that the most prevalent approaches to the procurement of welfare services are (1) selecting the supplier based on quality and payment by inputs; and (2) selecting the most cost-effective proposal, based on a weighted assessment of price and quality factors.
- The use of payment by performance in procuring welfare services is on the rise, but still limited in scope.

- According to the EU's purchasing rules, above a certain cost threshold (which varies by state), member states need to apply the criterion of the most cost-effective offer.

According to the international experience with payment by performance, its main advantages are streamlining public spending and ensuring better results for the public. The danger in this approach is that sometimes the course of action undertaken by the supplier to achieve the desirable outcome could be less suitable for the target population. Other dangers include "cream skimming" and other attempts at profiting in a manner not helpful to the designated service recipients. In general, outcome-based procurement is better suited as a complementary rather than exclusive approach, and most suitable in cases where the outcome measures may be assessed with relative accuracy, as well as in cases with a limited number of outcomes.