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# **Revitalizing Rural Communities through Institutional Reform of Quasi-Markets**

Niklas Elert and Magnus Henrekson

# Revitalizing Rural Communities through Institutional Reform of Quasi-Markets

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**Abstract.** Welfare services such as healthcare, elderly care, and education are key to ensuring quality of life generally, and vital for rural communities across urbanizing countries. While these sectors are largely tax-financed, several countries have established quasi-markets to achieve competition through private entry to unleash entrepreneurship, efficiency, and service provision innovation. The reforms notwithstanding, productivity improvements are modest, and the situation seems particularly bad in some rural communities. We argue that quasi-markets can only live up to expectations if the local institutional framework considers sectoral and local conditions. While competition and the profit motive are necessary conditions for local quasi-market entrepreneurship and innovation, they are not sufficient but require a set of complementary institutions that are epistemic in nature. These epistemic institutions enable users to make informed choices while simultaneously incentivizing entrepreneurs to compete and innovate along the dimensions that users value. Moreover, if the catchment area includes densely populated areas, rural communities may attract users from communities where costs are higher, thus creating new comparative advantages locally. As an illustration, we analyze the Swedish quasi-market for nursing homes for the elderly.

*Keywords:* Entrepreneurship, Innovation, Innovation policy, Marketized care, Quasi-markets, Welfare services.

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

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## 1. Introduction

Virtually all advanced economies have experienced decades of rapid urbanization, leading to major demographic and economic transformations. While metropolitan regions continue to attract investment, talent, and population growth, rural areas are facing a markedly different trajectory characterized by depopulation, economic stagnation, and increasing fiscal pressures (Hachadoorian, 2024; Okamoto, 2009). In rapidly urbanizing Sweden, for instance, more than two-thirds of the country's 290 municipalities are shrinking in population, with a growing proportion of elderly residents and a declining tax base. This demographic imbalance has serious consequences for the sustainability and quality of public services, particularly those that are tax-financed and labor-intensive, e.g., education, health care, and elderly care.

Rural municipalities are disproportionately affected because they face rising demand for services while their capacity to finance and deliver those services is eroding. These communities often struggle to recruit skilled workers, invest in infrastructure, or maintain institutional competence. As a result, service quality declines, further accelerating outmigration and undermining community vitality (Tiebout, 1956). This negative feedback loop threatens the fabric of rural life and challenges the legitimacy of the welfare state as a universal provider of services.

However, this trend is not irreversible. There is scope for institutional reforms that improve the alignment of interests of densely urbanized and rural communities (Adam & Dadi, 2024). Rules, incentives, and governance structures shape economic actors' behavior and the allocation of resources. Institutional arrangements that encourage entrepreneurship, innovation, and responsiveness can revitalize declining regions facing demographic headwinds. One such institutional innovation is the quasi-market: a system in which the government finances services, but provision is opened to competition among public, private, and non-profit entities (Ferlie, 1992; Le Grand, 2009).

Quasi-markets are designed to combine the equity and universality of publicly funded services with the efficiency, innovation, and flexibility typically associated with markets. In theory, they allow for user choice, stimulate innovation through competition, and create space for diverse organizational forms and business models (e.g., Shleifer, 1998). In practice, quasi-markets' success depends on how they are structured and embedded in broader institutional frameworks.

We examine the potential of quasi-markets—specifically in elderly care—to serve as a catalyst for rural revitalization, using the Swedish case as an illustration.<sup>1</sup> While quasi-markets have been adopted to varying degrees across the country, their transformative potential remains largely untapped, particularly in rural contexts. Most municipalities continue to rely on traditional procurement models, with limited competition and user choice. The approach constrains innovation and fails to leverage local entrepreneurial capacity.

By contrast, a well-designed quasi-market can do more than just improve service delivery. It can create jobs, attract investment, retain and upskill local labor, and restore agency to communities. It can provide a foundation for local economic development rooted in social infrastructure. To achieve these outcomes quasi-markets must be tailored to the challenges and opportunities that rural areas face. They require regulatory flexibility, institutional support, and mechanisms that facilitate knowledge creation and diffusion.

We develop a theoretical framework for understanding the role of quasi-markets in fostering rural entrepreneurship, review the evolution of Sweden’s elderly care quasi-market, and propose a set of institutional reforms aimed at enhancing innovation, responsiveness, and local impact. Our focus is not only on improving the efficiency of public services but also on expanding the developmental potential of the welfare state in peripheral regions.

## **2. Theoretical Framework**

The theoretical foundation for this paper lies in the intersection of institutional economics, entrepreneurship theory, and public management. Institutions—defined as the formal and informal rules that structure social and economic interactions—are critical in shaping economic actors’ incentives, capabilities, and behaviors (North, 1990; Williamson, 2000). In particular, institutional configurations influence whether entrepreneurship is productive or unproductive (Baumol, 1990).

In the context of public service delivery, the traditional dichotomy between government and market provision has given way to a more nuanced understanding that includes various hybrid arrangements. One of them is quasi-markets, i.e., publicly funded

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<sup>1</sup> The combination of increasing income and an aging population also creates an increasing demand for these services (Schünemann et al., 2022; Fogel, 2009).

systems in which public, private, and non-profit providers compete to deliver services. Unlike pure markets, the state retains a regulatory and financing role in quasi-markets; unlike bureaucratic provision, the delivery of services is delegated to competing entities. This structure aims to combine the equity of universal access with the efficiency and innovation benefits of markets. Quasi-markets are also often more flexible and responsive than centralized bureaucratic models, particularly in addressing diverse user needs and adapting to local conditions.

Theoretically, quasi-markets can improve allocative efficiency by aligning services more closely with user preferences. They are also thought to incentivize dynamic efficiency—innovation in processes, organizational forms, and service delivery. These benefits stem from three core mechanisms: (1) user choice, which pressures providers to be responsive and adaptive; (2) provider competition, which drives efficiency and innovation; and (3) the presence of for-profit motives, which can stimulate entrepreneurial behavior aimed at improving service quality or reducing costs. When functioning properly, these mechanisms can generate a continuous cycle of feedback and improvement: providers experiment with new approaches, respond to demand signals, and refine their offerings based on performance data and user feedback.

However, these mechanisms only perform well under certain institutional conditions. User choice, for example, requires meaningful options, adequate information, and low switching costs. Competition depends on the absence of entry barriers, enough providers, and a level playing field. Profit motives must be tempered by accountability mechanisms to prevent cost-cutting that undermines quality.

These issues are especially pronounced because welfare services are often complex, relational, and difficult to specify contractually. Services such as elderly care involve not only standardized procedures but also interpersonal interactions, emotional labor, and tacit knowledge. This makes quality hard to measure and monitor. While the complexity creates opportunities for opportunism, it also makes reputation and trust central to governance.

Entrepreneurs in these settings must navigate regulatory constraints, build legitimacy among diverse stakeholders, and deliver value under public scrutiny. Yet they also have opportunities to innovate by introducing new technologies, service models, and organizational forms. This is particularly relevant in rural settings; while traditional

markets may not function there due to scale limitations, community-based entrepreneurship can thrive under the right conditions. In these settings, quasi-markets create a structured yet flexible space for local actors—cooperatives, family businesses, social enterprises—to engage in service delivery. When supported by enabling institutions, these ventures can tailor services to specific community needs, build long-term trust, and reinvest economic surpluses locally.

Enabling institutions enhance the epistemic capacity of quasi-markets, i.e., their ability to generate, transmit, and utilize knowledge effectively. Such institutions include mechanisms for regular user feedback (e.g., structured satisfaction surveys), transparent data-sharing practices (e.g., provider performance comparisons), and systems that reward experimentation and continuous learning (e.g., pilot grants, flexible contracting). Without these mechanisms, quasi-markets may reproduce the inefficiencies and rigidities they were designed to remove. A lack of institutional capacity to interpret and act on feedback can result in stagnation or perverse incentives. Therefore, building epistemic institutions is a precondition for realizing the benefits of decentralization and competition in public service delivery.

In sum, the potential of quasi-markets depends on their institutional environment. When systems are poorly designed, they may lead to fragmentation, inequity, and inefficiency. Well-designed systems can foster entrepreneurship, innovation, and localized value creation. The challenge, especially in rural areas, is to design quasi-markets that are responsive to local conditions while still aligned with national policy goals. This requires a careful balancing of standardization and flexibility—ensuring that core service standards are upheld while allowing for local experimentation and diversity of provision.

### **3. The Swedish Nursing Home Quasi-Market**

The Swedish experience with elderly care quasi-markets provides an empirical context to explore both the promises and limitations of this institutional form. Sweden has long been viewed as a pioneer in social welfare provision, with a comprehensive tax-financed system guaranteeing universal access to services such as healthcare, education, and elderly care.

The average population of municipalities is roughly 36 500, but importantly, the population varies enormously from the City of Stockholm with close to one million

inhabitants to the 10 smallest municipalities, all rural, which have an average population of 2 970. With these enormous differences in size, it is not optimal for individuals in need of nursing home care to be restricted to what can be offered inside their own municipal borders.<sup>2</sup> Expanding the catchment area to regional or national levels would expose what are currently monopolistic providers in smaller rural municipalities to competitive pressures. Such contestability would encourage providers to attract users beyond their immediate locality, thereby improving services for local users and strengthening local labor market demand.

During the 1990s, concerns about public sector inefficiency and rising costs spurred a wave of reforms introducing competition, user choice, and alternative providers into the welfare system. These reforms were rooted in the belief that carefully structured markets could deliver better value for money, improve service quality, and empower users—particularly in sectors like elderly care, where personal preferences and individualized attention are critical to well-being. The goal was to modernize the welfare state by leveraging pluralism, decentralization, and the innovative capacity of diverse service providers.

Municipalities were given considerable autonomy in structuring their local elderly care systems. This resulted in significant variation in the degree to which quasi-markets were adopted and designed. Some municipalities embraced freedom-of-choice systems, enabling users to select from a set of approved providers. Others retained traditional procurement models, where a public agency selects service providers through tendering and assigns users accordingly.

As of the early 2020s, around 20–25% of elderly care services in Sweden are delivered by private providers, with higher shares in major cities.<sup>3</sup> Despite the enactment of the Free Choice Act in 2009,<sup>4</sup> municipalities are not obligated to introduce contestability for nursing homes. In many rural municipalities, public providers continue to dominate. The share of privately managed nursing homes in these areas is zero, reflecting both ideological resistance and practical barriers to entry. The bulk of privately provided

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<sup>2</sup> For another study discussing how inefficiencies arise when municipalities are too small, see Bárcena-Ruiz and Casado-Izaga (2018).

<sup>3</sup> In 2022, private organizations provided 24% of home care services and catered to 20% of nursing home patients (Vårdföretagarna, 2022).

<sup>4</sup> Government Bill 2008/09:29.

nursing home places are the result of winning a procurement contract; a mere 25 of 290 municipalities have introduced a choice system and roughly 5% of municipalities chose to discontinue their choice system altogether between 2011 and 2018 (Jordahl and Persson 2021).

Empirical studies provide a mixed but generally encouraging picture of the reforms' impact on quality and efficiency (Blix and Jordahl, 2021). Research by Winblad et al. (2017) and Broms et al. (2020) suggests that private providers perform comparably to or better than public ones in process-related quality measures (e.g., user satisfaction, individualized care planning), though public providers tend to perform better on structural indicators (e.g., staffing ratios). There is also evidence that the threat of competition alone can improve outcomes among public providers by encouraging internal reforms and higher responsiveness. Even without full privatization, the presence or possibility of private alternatives can serve as a catalyst for better performance in publicly managed facilities.

Despite these findings, the innovative capacity of Sweden's elderly care quasi-markets remains underwhelming. Most municipalities still use procurement models that do not enable real-time competition or reward innovation. Contracts tend to be rigid and short-term, discouraging providers from making long-term investments or experimenting with new service models. Moreover, procurement rules often require providers to take over existing facilities and staff, limiting their autonomy and entrepreneurial initiative. The consequence is often risk aversion, standardization, and minimal experimentation with new care models or technologies. The system's design, which prioritizes predictability and cost control, inadvertently discourages proactive improvement and creativity—two ingredients essential for sustained innovation in complex service environments.

The situation is even more constrained in rural areas, where market size is small, user populations are dispersed, and the costs of entry are high. In such settings, a single nursing home may serve an entire municipality, making competition infeasible. This creates a de facto monopoly, whether public or private, and undermines the benefits of a quasi-market. Without targeted reforms that address these structural limitations, rural municipalities will continue to operate under monopolistic or near-monopolistic conditions, which limit user choice, stifle innovation, and constrain the development of community-based care solutions.

At the same time, notable exceptions illustrate what one may hope for. Some municipalities have developed hybrid models that combine procurement with user choice or have partnered with non-profit providers to offer specialized services. In Stockholm, for example, a voucher-based system enables elderly residents to choose from a range of public and private nursing homes. The model has stimulated innovation and responsiveness, particularly in service design and user experience.

In summary, the Swedish case demonstrates both the adaptability and the limitations of quasi-markets in a decentralized welfare state. While some municipalities have used these tools to improve efficiency and user satisfaction, others have failed to move beyond the traditional procurement paradigm. Most importantly, rural municipalities remain structurally disadvantaged under the current system.

Unless reforms address the specific barriers facing rural regions—such as market size, cost structures, and institutional capacity—they risk being permanently sidelined from the innovation and quality improvements that quasi-markets can offer. A more inclusive and flexible framework is needed, one that actively supports rural participation and enables locally adapted solutions within a national system of equitable welfare provision.

#### **4. Institutional Reforms for Innovation**

To unlock the full potential of quasi-markets in rural Sweden with a similar situation, institutional reforms must focus not only on increasing efficiency but also on fostering innovation, responsiveness, and local entrepreneurship. The rural context requires sensitivity to issues of scale, accessibility, and institutional support. We propose four interrelated reforms that, when implemented in tandem, can significantly enhance the capacity of quasi-markets to deliver high-quality elderly care while contributing to wider regional development goals.

##### **1. Introduce and Expand User Choice**

Currently, the dominant nursing home model in rural Sweden is procurement-based, with little or no user choice. While this model may seem efficient for small municipalities, it often leads to rigidity and underperformance. Introducing user choice—even in hybrid forms—can foster accountability, innovation, and alignment with user preferences.

## **2. Broaden the Geographic Scope of Quasi-Markets**

The confinement of elderly care markets to individual municipalities severely limits competition and innovation, especially in sparsely populated regions; the default number of private nursing homes in rural municipalities is zero. Regulatory reform should allow for cross-municipal and even national user choice in areas where the market cannot support multiple providers. This would allow smaller providers to scale their operations regionally, make provider entry more attractive, and ultimately ensure that users in rural areas enjoy the same right to choose as those in metropolitan regions.

Importantly, the financial responsibility for elderly care should remain with the municipality of residence, even if the user chooses a provider in another locality. This would lower market entry barriers and make it feasible for providers to operate across several municipalities, achieving economies of scale and justifying investments in specialized services. It would also increase access to diverse care options for rural residents, who often face limited or no choice under the current system.

## **3. Enable Topping-Up and Service Differentiation**

Fixed-price systems are a hallmark of equality in Swedish welfare policy, but they also constrain innovation. Providers cannot tailor services beyond the basic package or invest in premium offerings if they are not allowed to recoup those costs.<sup>5</sup> Introducing a topping-up mechanism—where users can pay extra for additional services—would incentivize differentiation and allow providers to cater to diverse preferences. In rural areas, this could mean offering culturally appropriate food, personalized activities that reflect local traditions and preferences, or more flexible care arrangements that better align with users' lifestyles. This would not only boost user satisfaction but also stimulate service innovation and create space for niche providers to thrive.

## **4. Institutionalize Reputation and Feedback Mechanisms**

When direct price competition is limited, reputation becomes a key driver of quality. Yet many municipalities lack structured systems for capturing and disseminating user feedback. A national platform that collects, validates, and publishes user satisfaction data would provide critical information for both users and providers. This system could include metrics such as staff responsiveness, facility cleanliness, user well-being, and

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<sup>5</sup> A mere 4% of the total costs of elderly care is financed by user fees (Jordahl and Persson, 2021, p. 191).

the availability of personalized services.<sup>6</sup> Making this data transparent and easily accessible would enhance user empowerment, foster informed decision-making, and create incentives for providers to continuously improve. Over time, it would help establish a virtuous cycle in which quality is rewarded, underperformance is identified early, and best practices can be shared and scaled across the system.

We should stress that these four reforms are mutually reinforcing. User choice enables competition; geographic expansion increases provider viability; topping-up rewards innovation; and reputation mechanisms strengthen accountability. Facilitating greater differentiation in service provision would enhance the potential for rural municipalities to leverage their comparative advantages and for providers to establish distinct service profiles. These advantages might include lower property costs, advantageous or distinctive locations, reduced expenses for adapting premises to uniform standards, and the capacity to emphasize alternative quality dimensions such as superior food or frequent outdoor activities. For rural communities, their impact would go far beyond service delivery. They would support local entrepreneurship, stimulate job creation, and enhance the quality of life for elderly residents. Moreover, by introducing greater flexibility and responsiveness into the welfare state, these reforms could contribute to rebuilding trust in public institutions, particularly in regions that have felt marginalized by urban-centric policy agendas.

## **5. Summary and Conclusions**

We have argued that thoughtfully designed quasi-markets can serve as mechanisms for efficient public service delivery and rural revitalization. The case of Sweden's elderly care system demonstrates both the potential and the pitfalls of such markets. While privatization and competition have improved certain dimensions of care in urban settings, rural communities have largely been left behind. Structural constraints, limited market size, and administrative complexity have constrained their participation in new institutional models. Many small municipalities lack the administrative capacity,

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<sup>6</sup> Today there exists a web service for comparing nursing homes (*Åldreguiden*) provided by the Swedish National Board of Health and Welfare. However, this platform is not as comprehensive or user-friendly as the service we envision. Results need to be presented in a more standardized and easily accessible fashion. Such a system could also be a major component in a rating system along the lines suggested by Lundberg et al. (2022). They suggest establishing systems similar to online ratings for hotels, taxi services, and private home rentals, with room for subjective assessment of quality characteristics that are difficult to measure.

financial flexibility, or political will to implement quasi-market reforms, leading to uneven development and persistent gaps in service quality and innovation.

We proposed four institutional reforms that can collectively unlock the dormant potential of quasi-markets: expanding user choice, broadening geographic reach, enabling topping-up for service differentiation, and institutionalizing feedback and reputation systems. These reforms do not merely address administrative inefficiencies—they represent a shift toward empowering local communities, enabling bottom-up entrepreneurship, and fostering an equitable and responsive welfare system.

If paired with the right institutions, quasi-markets can become platforms for local actors to design and deliver services that reflect their own values and needs. This can help counteract depopulation, retain skilled labor, and attract new investment to local economies. By fostering environments where services are co-produced and tailored to local needs, these reforms can transform public service delivery into a driver of broader socioeconomic regeneration in rural regions.

From a broader policy perspective, Sweden's experience offers lessons for other countries grappling with spatial inequalities and demographic transitions. The balance between equity and efficiency need not be a zero-sum game. Institutional innovation makes it possible to design public service systems that are both fair and dynamic, both locally grounded and nationally coherent.

Future research should explore the implementation of these reforms in real-world settings, drawing on longitudinal data and qualitative insights. Particular attention should be paid to the governance challenges that arise in scaling up hybrid models, and to the mechanisms that ensure accountability in diverse provider landscapes. Additionally, cross-national comparisons could enrich our understanding of how different institutional environments shape reform outcomes.

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