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MOTIVATION, AGENCY, AND PUBLIC POLICY

Of Knights & Knaves, Pawns & Queens



JULIAN LE GRAND

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Julian Le Grand

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For Zoe and Polly

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In contriving any system of government, and fixing the several checks and controls of the constitution, every man ought to be supposed a knave and to have no other end, in all his actions, than private interest. By this interest, we must govern him and, by means of it, notwithstanding his insatiable avarice and ambition, co-operate to the public good.

(David Hume, 'On the Independency of Parliament')

I wouldn't mind being a Pawn, if only I might join—though of course I should *like* to be a Queen best.

(Lewis Carroll, *Alice Through the Looking Glass*)

Fancy what a game of chess would be if all the chessmen had passions and intellects, more or less small and cunning; if you were not only uncertain about your adversary's men, but a little uncertain about your own; if your Knight could shuffle himself on to a new square on the sly; if your bishop in disgust at your Castling, could wheedle your pawns out of their places; and if your pawns, hating you because they are Pawns, could make away from their appointed posts that you might get checkmate on a sudden. You might be the longest-headed of deductive reasoners, and yet you might be beaten by your own Pawns. You would be especially likely to be beaten, if you depended arrogantly on your mathematical imagination, and regarded your passionate pieces with contempt.

(George Eliot, *Felix Holt: The Radical*)

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Preface

I first encountered the quotation from David Hume with which this book opens when preparing for my inaugural lecture as a newly appointed professor at the London School of Economics. University ‘inaugurals’ are rather daunting events when new professors deliver a formal lecture to an audience that includes not only their own department's colleagues and students but also staff and students from other parts of the university together with friends and relatives. Most of these know nothing about the area in which the lecturer is working or indeed his or her specialist discipline. So lecturers are supposed to lay out their wares in a non-specialised fashion that both informs and entertains—and that convinces the listeners that the university has made an excellent appointment.

The lecture was somewhat anaemically titled ‘New Visions of Welfare’, and my preparations for it were not going well. It was supposed to reflect upon the dramatic changes that at the time (the mid-1990s) had just transformed the welfare state. These included the break-up of the old state monopolies providing public services such as health care and education, and their replacement by so-called ‘internal’ or ‘quasi’ markets. In those parts of the welfare state concerned with cash benefits, such as social security and income support, there seemed also to be a desire to look outside the old ways of doing things, to question the usefulness of cash benefits as a means of achieving redistribution, and to find different ways of reducing poverty and inequality. It was apparent that all these changes represented some kind of cosmic shift in thinking about public services and the welfare state. But it was far from clear exactly what the nature of this shift was and where it had come from. The welfare state had been in existence for fifty years or so, and, despite numerous political and economic crises during that time, its basic form and structure had remained virtually intact during all that time. What was it that had led to these dramatic changes? Why were policy-makers now engaging in radical reforms? Was there a consistent pattern here, one that might give some insight into what really was going on?

The passage from Hume gave me a clue to part of the puzzle. In it, Hume appears to be recommending that public policy-makers ought to assume that all those involved with governmental organisations were fundamentally self-interested—knaves—and to design policies accordingly. Yet it was apparent from looking at the history of that prime example of a governmental organisation, the welfare state, that the architects who originally designed it had not followed Hume's dictum at all. So far from assuming that everyone was a knave, they seem to have believed that public service professionals and other

workers were in fact public-spirited altruists: not knaves but knights. Moreover, the people whom the welfare state was supposed to benefit were assumed to be neither knights nor knaves but something closer to pawns: passive recipients of services and benefits, supposed to accept what they were offered by the public service knights without demur.

What seemed to have happened in the 1980s and 1990s was a shift in both these sets of beliefs. Policy-makers now seemed to hold that public sector workers were more like knaves than knights. Moreover, perhaps in part because of subliminal fears of the sort to which the quotation from George Eliot alludes, they believed that the beneficiaries of the welfare state ought to be treated, not like pawns, the least powerful pieces on the chess board, but more like queens, the most powerful. Put another way, there were changes in policy-makers' beliefs about *motivation*—what motivated those working in the public sector—and *agency*—the capacity of individuals, especially the beneficiaries of welfare, to engage in independent or autonomous actions. And these changes led to profound shifts in policy-makers' views about the way that public services in particular and the welfare state in general ought to be designed.

With these insights, I rapidly revamped the lecture; and both it and a subsequent article based upon the subject seemed to go over quite well (Le Grand 1997*b*). But I felt unsatisfied. There were many questions left unanswered. These were not so much empirical or historical (what had actually happened?) but normative or policy-oriented (what should have happened, and what should happen now?). Were these changes in beliefs about motivation and agency well-founded? Should service users be pawns or queens? What does actually motivate those who work in the public sector? Are they really simply knights or knaves, or—as seems much more plausible—are they really both, with the balance of motivation depending on the context in which they are exercised? How should policies be designed that make appropriate use of that balance of motivation—and that turn pawns into queens, if that were indeed desirable?

My attempts to answer at least some of these questions have resulted in this book. It should, I hope, be of interest to academics and students in most areas of social science, including economics, public policy, social policy, politics, sociology, social psychology, and political philosophy. However, it should also interest those outside academia concerned about public policy and public services, including politicians, civil servants, public sector professionals, opinion formers in the media and elsewhere, and the interested lay public. To this end it is written in what I hope is a reasonably accessible style. Jargon is rarely used, and explained when it is. There is an annex to Chapter Four that uses demand and supply diagrams to illustrate some of the chapter's arguments. But those unfamiliar with graphical techniques need not worry: the arguments are explained verbally in the chapter's main text. References use the author-date abbreviated style, with full details of the reference concerned to be found in the bibliography at the end of the book.

Two points about the metaphor of knights and knaves should be made here. First, the *Shorter Oxford English Dictionary* gives as the main sense of the word ‘knave’ ‘an unprincipled man: a base and crafty rogue’. (Interestingly, it explicitly says that an earlier meaning of the word—a boy or lad employed as a servant—is frequently opposed to knight.) As I explain later, the way I use the term follows David Hume and other political philosophers in having a slightly broader interpretation: as simply one who follows his or her self-interest. Whether the individuals concerned are base or crafty in their pursuit of self-interest is not of direct concern.

The second point concerns gender. ‘Knave’ and ‘knight’ sound masculine; not surprisingly, given the *OED* definition above. But, in using them as metaphors, I do not intend to imply that the arguments concerned refer only to men. In fact, as we shall see in Chapter Four, significant gender issues arise in any discussion of altruism versus self-interest. Hence, as used here, each term is supposed to encompass both men and women.

As always in enterprises of this kind, my debts to colleagues, friends, and family are legion. Among colleagues and friends, three stand out. Nicola Lacey read the whole manuscript through several times. Her perspective as an intelligent and perceptive outsider was quite invaluable and made me rethink large parts of the book. Nicholas Barr and Geoffrey Brennan also read the manuscript. Nick Barr made some crucial suggestions concerning a reordering of the material, as well as making very useful detailed points. Geoff Brennan, irritatingly but quite correctly, pointed out a critical theoretical omission in an earlier draft, and suggested that another chapter be written to cover it—which it duly was. I am deeply grateful to all of them.

I am also grateful to Phil Agulnik, Dan Hausman, and David Nissan, each of whom has allowed me to use parts of the works that I originally wrote jointly with them, and from whom I have benefited from many conversations about the material. In addition, I owe particular debts to Howard Glennerster, John Hills, Martin Knapp, Elias Mossialos, Carol Propper, Ray Robinson, and other colleagues at the Economic and Social Research Council's Centre for Analysis of Social Exclusion (CASE) and LSE Health and Social Care, both at the London School of Economics. They have not only provided me with helpful comments, useful references, and psychological support when needed, but have had to put up with hearing endless repeats of, and variations on, metaphors involving knights and knaves, pawns and queens—which they have done with amazing grace.

During part of the period of writing the book, I was a member of the Fabian Society's Commission on Taxation and Citizenship and the Institute of Public Policy Research's Commission on Public/Private Partnerships. This had the cost of delaying the book but the benefit of significantly improving some key parts of it. The hypothecation chapter has particularly benefited from the contributions to the Fabian Commission of its Secretary, Michael Jacobs (who is also the General Secretary of the Fabian Society), and its Chairman, Raymond

Plant. Discussions with other members of the Commission, including Fran Bennett and Nicholas Monk, were also very helpful, although they will not agree with my conclusions. The Fabian Society also kindly gave me permission to reproduce material from a pamphlet of which I was co-author (Nissan and Le Grand 2000). The debates in the IPPR Commission about the provision of public services were also very helpful, discussions with its Secretary, Gavin Kelly, and the Director of IPPR, Matthew Taylor, being especially useful.

I am also very grateful to the following for comments, either on the chapters themselves or on earlier versions of the material in them, and for supplying useful references: Ros Altmann, Kate Baxter, Tessa Crilly, Bleddyn Davies, Alain Enthoven, Bruno Frey, Victor Fuchs, Robert Goodin, Andrew Healey, Gervas Huxley, Iona Heath, Jeremy Kendall, Amanda Killoran, Rudolf Klein, Stephan Leibfried, Penny Leonard, Rodney Lowe, Manos Matsaganis, Susannah Morris, Jenny Roberts, Claire Ungerson, Anne West, and Karen Wright. Financial support came from LSE Health and Social Care, and from the Economic and Social Research Council's grant to CASE under number RES-558-28-5001.

I owe a great deal to my editors at Oxford University Press. Andrew Schuller oversaw the whole process and provided some helpful comments on the text. Matthew Derbyshire looked after the production process and made crucial suggestions concerning presentation. And Michael James's excellent copy-editing saved me from many verbal infelicities and reference errors.

Last, but far from least, I must thank my family. This is not only for their patience in putting up with a book-obsessed husband and father but for the positive help that they have provided. In particular, my daughter Zoe assisted with the references, and her sister Polly helped me sort out the economics behind some of the ideas. So it is not just for the usual reasons that this book is dedicated to them.

Somebody—I believe it was Iris Murdoch, but I have been unable to track down the exact source—once said that you never finish a work of philosophy, only abandon it. As I regularly tell my Ph.D. students, this is a maxim that applies to all academic work, not just to philosophy. And it certainly applies to this book, which, although it has gestated for over six years, I have had to abandon well before it is finished. Some of the issues it addresses are of such a scale that I have had neither the time nor the energy to develop them to the extent that ideally they would need. I can only lay the baton down at this point and hope that some of those reading the book will be motivated to pick it up and take it further.

Julian Le Grand

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March 2003

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1 Introduction: Motivation, Agency, and Public Policy

It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner but their regard to their own interest. We address ourselves not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.

(Adam Smith, *The Wealth of Nations*)

The private market . . . narrows the choices for all men—whatever freedom it may bestow, for a time, on some men to live as they like. It is the responsibility of the state, acting sometimes through the processes we call ‘social policy’, to reduce or eliminate or control the forces of market coercions which place men in situations in which they have less freedom or little freedom to make moral choices, and to behave altruistically if they so will.

(Richard Titmuss, *The Gift Relationship*)

Should we leave the education of our children to the professionals on the grounds that teacher knows best? When ill, should we be patient and simply trust the doctor to make us well again? Should we have the right to choose the hospital where our illness is to be treated, or to choose the school where our children are educated? Or would such choice lead to destructive competition between schools and hospitals, competition that would damage not only the people making the choices but also those who work within those institutions and indeed the wider social interest? Would greater patient or parental power undermine professional and other forms of altruistic motivation? More generally, would empowering the users of public services destroy the so-called public service ethos, and would society be both materially and morally impoverished as a result?

Resolving these questions for public services such as health care or education is of crucial importance. But similar issues arise elsewhere in that collection of public policies often termed the welfare state, including those that more directly concern our personal incomes and expenditures. Should government compel us to save more in order to pay for our pensions? Should we be required to take out insurance against the possibility that we might need long-term care?

Or are there other ways in which savings might be encouraged? Is the best way to promote equality of opportunity for young adults through higher education, or should there be publicly funded schemes, such as stakeholder or capital grants to young people, that offer a wider range of choices? More generally, should we trust government to spend wisely on our behalf, or should we have a greater say over how our tax moneys are spent?

It is to these questions that this book is addressed. In fact, they are all among even broader issues concerning the design of public policy, issues that form the underlying theme of the book. These concern the roles of *motivation* and *agency*. Assumptions concerning human motivation—the internal desires or preferences that incite action—and agency—the capacity to undertake that action—are key to both the design and the implementation of public policy. Policy-makers fashion their policies on the assumption that both those who implement the policies and those who are expected to benefit from them will behave in certain ways, and that they will do so because they have certain kinds of motivation and certain levels of agency. Sometimes the assumptions concerning motivation and agency are explicit; more often they are implicit, reflecting the unconscious values or unarticulated beliefs of the policy-makers concerned.

Conscious or not, the assumptions will determine the way that public policies are constructed. So, for instance, a policy instrument designed on the assumption that people are motivated primarily by their own self-interest—that they are, in the words of David Hume quoted at the beginning of this book, *knaves*—would be quite different from one constructed on the assumption that people are predominantly public-spirited or altruistic: that they are what we might term, in contrast to knaves, *knights*. Similarly, a policy that took no account of individuals' capacity for independent action—one that treated those working in the public sector or those who received its benefits as passive victims of circumstance, or *pawns*—would be different from one that treated workers or recipients as active agents, that is, not as the least powerful piece on the chess board, the pawn, but as the most powerful, the *queen*.

These assumptions—or, more precisely, the relationship between the assumptions and the realities of human motivation and agency—are crucial to the success or otherwise of public policy. Policies designed on the assumption that those who work in the public sector are basically knights are likely to have disastrous consequences if in fact most of those individuals are predominantly knaves. But the same may be true for policies fashioned on the basis of a belief that people are knaves if the consequence is to suppress their natural altruistic impulses and hence destroy part of their motivation to provide a quality public service. Similarly, policies that, consciously or unconsciously, treat people as pawns, may lead to demotivated workers and disgruntled beneficiaries, again causing adverse outcomes for the policies concerned; while policies that give too much power to either workers or beneficiaries may result in individuals making mistakes that damage their own or others' welfare.

I return to these conceptual distinctions at the end of the chapter. There too I shall provide a road map for the rest of the book so as to guide the reader through its principal arguments. But first I want to illustrate the importance of beliefs about human motivation and agency in policy design by providing a concrete example. This is one of the most important developments in the welfare states of Britain and several other countries to have taken place since their inception: what might be termed the ‘quasi-market revolution’ in public service delivery. As will be explained, this was a shift from an essentially statist method of providing key public services such as health care and education to a more market-oriented method of service delivery: a dramatic policy change and one from which there are many lessons for policy design to be learned. Moreover, since most public services are still struggling with the legacy of that revolution, it is also one of direct relevance to current questions concerning policy reform—including those in the opening paragraphs of this chapter.

POLICY ASSUMPTIONS AND THE WELFARE STATE

In most countries, the state has historically played a major role in both the finance and the delivery of social services such as education, health care, housing, and social care. Often this role has taken the form of some kind of state bureaucracy actually providing the service, while simultaneously using state revenues to subsidise it such that it is free (or offered at highly subsidised prices) at the point of use. Thus in many countries governments—central, State, or local—run schools and colleges, usually providing school education free and college education either free or at a fee well below cost. Governments of countries with national health systems own and operate the principal medical facilities, and supply the health care offered by those facilities free or with low co-payments. Many governments also both finance and provide other social services, such as long-term care for elderly people, care for those with a physical or mental disability, and public housing for the less well-off.

During the 1980s and the early 1990s, there was something of a revolution in this kind of social policy. In several countries where a combination of state provision and state finance had been the norm, the state, while retaining control of finance, began to pull back from provision. Instead of providing the service through monolithic state bureaucracies, provision became competitive with independent providers competing for custom in market or ‘quasi-market’ settings.¹ These reforms were always controversial and in some countries there have been attempts to reverse them subsequently, although often more at the level of rhetoric than in reality.

¹ ‘Quasi-markets’ because, although they were markets in the sense that they involved competition, they differed from normal markets in a number of ways. On the demand side, the state not the consumer provided the finance, usually appointing a purchasing agent to act on behalf of the consumer; and on the supply side non-profit or even publicly owned agencies competed for custom instead of, or as well as, for-profit ones. See Le Grand and Bartlett (1993: 10).

The growth of these quasi-markets had a number of causes. A major factor was fiscal pressure leading governments to search for new ways of using increasingly scarce resources more efficiently.² However, underlying the whole movement was a fundamental shift in policy-makers' perceptions concerning motivation and agency. This I shall illustrate using the British case as a prime example, but referring to other countries as appropriate.

Knights Rampant: The British Welfare State 1945–1979

The mood of Britain immediately after the Second World War has rightly been regarded as a triumph of collectivism. The fact that the country had not only survived the war but had emerged on the winning side was widely ascribed to a spirit of national unity and selfless dedication to the common cause. As the historian Peter Hennessy (1992: 44) has noted, there was a 'widespread, if not wholesale, usurpation of individual greed by collective good'. He quotes a senior civil servant saying, 'It seems to me that the most remarkable of the many remarkable things about the Second World War is that it really was our "Finest Hour"'. There were, of course, some who were "private-spirited" . . . but they were never a large number . . . There was a sense of comradeship that spread right across the old class distinctions.'³

This spirit, of the importance of collective endeavour and the relative insignificance of individual self-interest, profoundly affected the shape of the post-war welfare state. As Corelli Barnett (1986: 11) put it in his anti-welfare-state polemic *The Audit of War*, as far back as 1940–1, 'members of the British cultural elite had begun to busy themselves with design studies for a "New Jerusalem" to be built in Britain after the war was won. Selfish greed, the moral legacy of Victorian capitalism would give way to Christian community, motivating men to work hard for the good of all.'

In fact, the social historian Rodney Lowe has argued that two types of collectivist approaches characterised the post-war welfare state.⁴ There were the reluctant collectivists, pre-eminent among whom were William Beveridge and John Maynard Keynes. And then there were the more full-blooded collectivists or democratic socialists, as Lowe terms them, who included T. H. Marshall, Richard Titmuss, and Anthony Crosland. Of these, Lowe says, 'despite the predominant influence of Beveridge and Keynes in the early post-war years, it was the democratic socialists which gave the British welfare state its unique international reputation. At home these ideals also infused the

² See Glennerster and Le Grand (1995) for further discussion of this point.

³ Dame Alix Meynell, senior civil servant, Board of Trade 1925–55, quoted in Hennessy (1992: 38).

⁴ Amateur historians of British post-war social policy such as myself are fortunate that three excellent histories of the welfare state since 1945 have been published in the past decade—by Rodney Lowe (1993), Howard Glennerster (1995), and Nicholas Timmins (1995)—as has a third edition of Rudolf Klein's (1995) superb study of the development of the National Health Service. What follows draws heavily on all four.

welfare legislation of the 1945–51 Labour governments and provided the logic for further advances which the Conservative ministers struggled to refute.’ And, Lowe argues, at the end of the day it was the social democratic approach, albeit tempered by that of the reluctant collectivists, which determined the evolution of the post-war welfare state: for ‘social democracy had history on its side’ (Lowe 1993: 18–20).

What then were the assumptions concerning human motivation and agency implicit in the social democratic welfare state? In answering this question, it is useful to distinguish three sets of actors. First, there were those who devised the welfare state and worked within it: the politicians and civil servants who devised its policies, the managers who administered it, and the professionals and others who delivered its services. Second, there were those who paid for welfare under the fiscal system: taxpayers. Third, there were those who received the benefits of the welfare state: social security recipients, doctors’ patients, school pupils and their parents, council house tenants, and so on.

Taking up the collectivist legacy of the Second World War, and following ideas of the public service ethos developed in the late nineteenth and early twentieth centuries by thinkers such as Jowett, Toynbee, Tawney, and Temple,⁵ the democratic socialists assumed that the state and its agents were both competent and benevolent (Lowe 1993: 23). It followed that the first group—those who operated the welfare state—could be trusted to work primarily in the public interest: they were knights, not knaves (Donnison 1982: 20–1). Professionals, such as doctors and teachers, were assumed to be motivated primarily by their professional ethic and hence to be concerned only with the interests of the people they were serving.⁶ Similarly, politicians, civil servants, state bureaucrats, and managers were supposed accurately to divine social and individual needs in the areas concerned, to be motivated to meet those needs and hence to operate services that did the best possible job from the resources that were available.

The second group—the taxpayers—were also assumed to be at least partly knightly in their willingness to pay taxes. Part of the collective view that ‘social justice would be guaranteed by a predominant altruism’ (Lowe 1993: 19), they were supposed to accept a ‘growing burden of progressive taxes . . . required

⁵ Ideas that were in fact themselves rooted in Plato and Hegel. See Raymond Plant’s (2001) illuminating paper on the public service ethic.

⁶ It is useful here to follow Klein (1995: 243) and distinguish between attitudes towards professionals as individuals and professionals as a collectivity. Few of the politicians who had dealings with the collective organs of the medical profession, such as the British Medical Association, would have regarded them public spirited altruists: indeed, in all probability they would have agreed with Enoch Powell (1976: 14) when he wrote ‘the unnerving discovery every Minister of Health makes at or near the outset of his term of office is that the only subject he is ever destined to discuss with the medical profession is money’. However, at the individual level the assumptions were different. For built into the concordat that provided the foundations of the NHS was the assumption of clinical freedom or autonomy whereby individual doctors could exercise their professional discretion in the way they used public resources (Klein 1995: 243).

to finance social services' (Donnison 1982: 20–1; see also Reisman 1977: 91). More specifically, it was assumed that the better-off would not only cooperate in collectivist enterprises such as national insurance and social services out of enlightened self-interest, but also willingly acquiesce in the payment of redistributive taxation that helped the disadvantaged, either because they empathised with the latter's plight or because they saw it as part of their civic responsibility to do so.

The democratic socialists did not assume that the third group—individuals in receipt of the benefits of the welfare state—were active altruists or indeed active egoists. Rather they were considered to be essentially passive: pawns. Those who used social services were supposed to be content with a universal, often fairly basic, standard of service. So one of the principal ideological supporters of the welfare state, the London School of Economics academic Richard Titmuss, spoke of the desirability of 'one publicly approved standard of service' (Titmuss 1968: 195). In practice, with respect to the National Health Service for instance, this meant that patients were supposed to live up to their appellation and be patient. They were to wait patiently in queues at general practitioners' surgeries or at outpatient clinics; if they needed further treatment they had to be prepared to wait their turn on hospital waiting lists. When the time arrived for them actually to go to hospital, they were supposed cheerfully to accept being on a public ward, being served horrible food and, most significantly, being treated by doctors too busy, or too elevated, to have time to explain what was happening to them. As Rudolf Klein has put it, in the early model of the National Health Service (NHS), 'it would be the doctor's judgement which would determine who should get what . . . It was the experts who would determine the need for health care, frame the appropriate priorities and implement their policies universalistically throughout the NHS' (Klein 1995: 248; see also Glennerster 1995: 69).

Similarly, the parents of children in state schools were expected to trust the professionals and to accept that teachers knew what was best for their children. The period between 1944 and 1975 has been identified as the 'golden age of teacher control'.⁷ Moreover, as with the NHS, especially following the comprehensive reforms of the mid-1960s, parents were supposed to concur that 'the overriding objective in [education policy] was equality' (Lowe 1993: 203) and hence to accept whatever degree of uniformity of educational provision that attaining this objective required.

In housing, council house tenants were expected to be grateful for the privilege they had been accorded in being granted a tenancy (Dunleavy 1981: 28–33). Their accommodation was standardised, with heavy restrictions

⁷ Chitty (1988), quoted in Lowe (1993: 227). This was not just because it was assumed that teachers knew best; there was also a fear of malign government influence. Nicholas Timmins (1995: 323) quotes the General Secretary of the National Union of Teachers arguing in 1954 that democracy was best safeguarded by 'the existence of a quarter of a million teachers who are free to decide what should be taught and how it should be taught'.

on their freedom of action over what could be done with it.⁸ And again the experts were presumed to know best about the housing that people wanted.⁹

Similar views characterised the beliefs of at least some of the democratic socialists about social security recipients. As Alan Deacon (1993) has argued, Richard Titmuss, for instance, assumed that the beneficiaries of social security had very little choice at all; that the economic and social system was so all-powerful that they were simply its victims; that they had no freedom of action and hence were simply passive recipients of state largesse.¹⁰

However, it has to be acknowledged that this view does not seem to characterise the actual delivery of social security policy. The post-war history of this policy (and indeed its entire history) is peppered with the development of different forms of checks and balances to control the perceived problem of the people variously termed the work-shy, loafers, or scroungers (Deacon 1976; Bryson and Jacobs 1992; Jacobs 1994). Here there seems to have been a constant tension between the assumption that welfare recipients were basically passive—pawns—and the assumption that they had some capacity for agency and hence responded (in an essentially knavish) fashion to the incentives with which they were faced.

Social security, therefore, is perhaps a partial exception. But it is not implausible to describe the bundle of implicit assumptions concerning human behaviour that characterised the rest of the democratic socialist welfare state as one designed to be financed and operated by knights for the benefit of pawns.

The Triumph of the Knaves: The British Welfare State After 1979

For much of the period following the Second World War, the democratic socialist welfare state reigned largely unchallenged. But, partly because of the fiscal crises of the early 1970s, in the latter part of that decade and in the 1980s there were serious assaults on almost all the assumptions that underpinned it, especially those concerned with motivation and agency.¹¹ The notion that, for the sake of the collectivity, everyone would passively accept standardised, relatively low levels of services was challenged by studies showing that in key areas of welfare the middle classes extracted at least as much as if not more

⁸ See Anthony Crosland who, writing in the *Guardian* in 1971, said that the Council 'decides what repairs are to be done, what pets may be kept, what colour the doors will be painted, what play areas there should be, where a fence should be put up. The tenant is not consulted. He has no right of appeal.' Quoted in Timmins (1995: 366).

⁹ Power (1993), especially chapter 19. Timmins (1995: 186) too illustrates the point with the story of Nicholas Taylor, an assistant editor at the *Architectural Review*. He 'proposed that some evidence should be sought on what people actually wanted, to go with an issue "on the best of current housing"'. He was scornfully dismissed by the proprietor with the words: "But we KNOW what should be done!"

¹⁰ Deacon (1993). For more on Titmuss's assumptions concerning motivation and behaviour, see Reisman (1977), including the preface by Robert Pinker.

¹¹ Glennerster (1995: 193–5); Lowe (1993: 23–7); Timmins (1995: Part V).

than the poor in terms of both the quantity and the quality of service (Le Grand 1982). More generally, it became increasingly apparent that many people—particularly, but not exclusively, the middle classes—wanted different kinds and different levels of service. Richard Titmuss (1974: 151) himself may have enjoyed being in a public ward; but many people did not. The length of waiting lists for medical treatment became a perennial political issue. Many of the better-off put their children in private schools and took out private health insurance; many more subscribed to private pensions. The consensus supporting comprehensive education began to break down, with influential voices encouraging an end to teacher control over the curriculum, a return to selection, traditional teaching methods, and a focus on excellence (Timmins 1995: 318–29). As council estates declined and tenants felt increasingly powerless, owner-occupation became overwhelmingly the preferred form of housing tenure.¹²

The assumption that knightly behaviour characterised those who worked within the institutions of the welfare state proved even more vulnerable. Fuelled in part by people's experience both of dealing with and of working within the welfare bureaucracies, many politicians and policy analysts grew increasingly sceptical of the view that bureaucrats and civil servants necessarily operated in the public interest, and that professionals were only concerned with the welfare of their clients (Glennister 1995: 193). Instead there was an increasing acceptance of the argument of the public choice school of economists and political scientists that the behaviour of public officials and professionals could be better understood if they were assumed to be largely self-interested.¹³

The idea that knightly behaviour characterises those who pay for welfare was also challenged. Political scientists and theorists Robert Goodin and John Dryzek (Goodin and Dryzek 1987) and, more comprehensively, social historian Peter Baldwin (1990) argued that the growth of welfare states funded by taxation or social insurance in a wide variety of developed countries was not the outcome of altruistic gestures by the better-off; rather it was directly related to the self-interest of the middle classes. Econometric studies by economists and sociologists came to similar conclusions (Peltzman 1980; Pampel and Williamson 1989). A more micro-level study undertaken by David Winter and myself of changes in public expenditure and tax relief under the first Thatcher administration, based on the assumption that politicians were vote-maximising, found a pattern of change that unequivocally favoured the better-off (Le Grand and Winter 1987).

Taxpayer resistance to redistributive welfare became an accepted political fact on the left as well as the right. For instance, social policy analyst David Piachaud (1993: 3) argued in a Fabian pamphlet that 'there is now virtually no

¹² Power (1993: 211–16). Tax incentives were also an important factor in the growth of owner-occupation; but the fact that these incentives were in place is itself an indication of the importance the political system attached to owner-occupation.

¹³ Plant (2001: 9–10); Lowe (1993: 22–3). For a useful review of public choice theory see Mueller (1989).

likelihood of further substantial redistribution of income through taxes and social security benefits'; a judgement he based not on technical impossibility or social undesirability but on political infeasibility. Frank Field (1995: 1–2), later to become briefly a Labour minister, went further, claiming that politicians who argue that the middle class will support redistribution to the poor are a 'public menace, distracting from the real task'.

The election of Mrs Thatcher's neo-liberal Conservative government in 1979 in Britain epitomised these changes in belief. The new government viewed the public sector in general, and public-sector professionals in particular, with great suspicion. It considered professionals and other workers in the public sector to be much more in the business of pursuing their own concerns than in pursuing the public interest: more knaves than knights. Moreover, because of the state monopoly in provision of social services, these knaves were able to exploit their monopoly position and treat the users of services as pawns. If users were dissatisfied with the service they received they had nowhere else to go; hence they could be treated as passive recipients with relative impunity. In the view of the new government, this situation was fundamentally undesirable: users ought to be queens or, to take a similar but more familiar metaphor, the consumer should be king.

Fundamentally, there were two changes in belief here. One was essentially empirical: a change in belief about the way the world worked, in particular about what actually motivated individuals, especially those who worked within the public sector. The other involved a shift in values: users of services ought not to be treated as passive recipients of welfare largesse but should have the lead role in determining the quantity and quality of the services they received.

These changes had a direct consequence for the view about the way in which public services ought to be delivered. As we shall discuss in more detail later, if it is believed that workers are primarily knaves and that consumers ought to be king, then the most obvious mechanism of service delivery is the market. For the market is the way in which the pursuit of self-interest by providers can be corralled to serve the interests of consumers. So the Thatcher government's instinct was to try to deal with what it perceived to be the major problems in the welfare state by injecting market mechanisms in one form or another into the delivery of public services.

Although that government flirted briefly with full privatisation of public services, it rapidly realised that there were both political and economic reasons why that would not be possible in the British context. These included the adverse consequences of private markets for equity: no British government could allow the distribution of, for instance, education and health to be left to be determined by the distribution of income. The government also became aware of economists' arguments concerning market failure in this area, especially those that derived from poor information on the part of users and the opportunities that this gave knavish providers to exploit their knowledge monopoly (Lawson 1992: 615).

Hence the chosen mechanism was the 'quasi-market'. In such a market the state retains control of financing the service. This divorces the distribution of the service concerned from the distribution of income and thus contributes to a more egalitarian distribution of the service. However, instead of also providing the service concerned, the state allows provision to be undertaken by independent providers competing with one another for custom. The state gives potential users a voucher to purchase the service concerned; alternatively, to overcome the problem of poor information for users, it appoints and funds an informed purchasing agent of some kind to purchase the service on behalf of the user.

Although they all had this basic structure, the quasi-markets actually put in place by the government took slightly different forms in different sectors. So the National Health Service had two kinds of state-funded purchasers: health authorities, which purchased on behalf of geographical districts, and GP fund-holders or primary-care practitioners who purchased secondary care on behalf of the patients on their lists. Providers were semi-independent non-profit units that provided hospital and other services.

In education, what was effectively a voucher scheme was set up. Parents were given free choice of school; schools were given budgetary independence and encouraged to compete for pupils through a funding formula that was based on the number of pupils they managed to attract. In social care, social workers were appointed as 'case-managers' and given a budget to purchase care on behalf of their clients from private, non-profit, or public providers. In housing, public housing tenants were given the option of changing their landlord to a non-profit housing association; they and private tenants were also eligible for a means-tested benefit to pay their rent: again, effectively a voucher.

These kinds of change were not unique to Britain. Mrs Thatcher's government was indeed an active agent in the process, but the shifts in attitude the changes represented were part of a much wider, more global movement. Fuelled by fiscal crises, disenchantment with large state bureaucracies and with their perceived inefficiency and unresponsiveness, and increasingly influenced by the public choice school of economists, many countries experimented with market or quasi-market mechanisms for delivering social services. Sweden introduced a quasi-market in health care in the Stockholm region, and the Netherlands planned a competitive scheme for public health insurers. Belgium has had a quasi-market in education for many years. Cleveland and Milwaukee and the State of Florida in the United States introduced fully-fledged voucher schemes in education. Many states in the US are introducing so-called charter schools: independent schools that receive a 'charter' from a state agency and, as in the British system, are funded on a per-pupil basis and so have to compete for pupils for economic survival.

New Zealand took some of the ideas even further. Health services were split into purchaser and provider in a similar fashion to the British and competition between providers encouraged. The providers became separate state-owned

enterprises and were required to operate as efficient businesses while exhibiting a sense of social responsibility. In education, operating responsibility for schools was transferred from the Department of Education to each school's board of trustees and full parental choice of schools was introduced, setting up a quasi-market for the state system.

So the shifts in governmental beliefs and attitudes described here were not peculiar to Britain but were worldwide. Moreover, despite changes of government, they endure. To return to the British case, the Labour government of Tony Blair that replaced the Conservative administration in 1997 has espoused many of the same values as its predecessor, especially with respect to the importance of having a responsive system for users and, with one partial exception, has done little to reverse the quasi-market changes that the Conservatives introduced.

The partial exception concerns the National Health Service, where the quasi-market was allegedly abolished in 1997. However, even then key elements of the market remained, at least in England, including the purchaser–provider split, the possibility that purchasers could shift their purchasing between competing providers, and secondary-care purchasing being undertaken by primary-care organisations. More recent policy developments have heralded a shift back to other aspects of the internal market, including the use of private providers, financial flows based on prices, the setting up of independent ‘foundation hospitals’, and the re-introduction of competition for elective surgery (UK Department of Health 2002; Lewis 2002; Le Grand 2002).

IDEOLOGY AND BELIEFS

This brief review of recent history suggests that there were at least two major ideological forces that have influenced the design of public policy, especially in the context of the British welfare state: what we might term social democracy and neo-liberalism.¹⁴ These ideologies differed in their attachment to both ends and means. So far as ends are concerned, social democrats prioritised social justice and other egalitarian objectives, while neo-liberals emphasised the importance of individual liberty and freedom. And with respect to means, neo-liberals advocated the operations of the competitive market; social democrats relied upon the benign intervention of the state.

Now the differences between neo-liberals' and social democrats' views about means, and in particular about the respective roles of the market and the state, arose in part because of the differences between their views about ends. Neo-liberals viewed the state as the principal threat to individual liberty; hence they were deeply suspicious of any extension of state power even when

¹⁴ Not everyone will agree with the way in which I use these labels. However, it is hoped that the rather stylised set of pictures that are painted here have enough accuracy so as not seriously to distort the scenes that they are trying to represent, however they are labelled.

it was apparently relatively benign. Social democrats, on the other hand, were appalled by the inegalitarian consequences of market outcomes, outcomes that they regarded as fundamentally unjust. Hence they were reluctant to rely on market mechanisms to allocate resources. This was especially so in areas that social democrats regarded as fundamental to social welfare, such as health and education, where they generally preferred to suspend the market completely.

However, their differences over means did not stem only from different views about ends. For even where they agreed on a social objective, such as the general importance of improving average levels of education and health care, they still differed over the relative merits of the market and the state as a means of achieving those ends. And, as our example of the recent history of the welfare state has illustrated, this in turn arose from another fundamental divergence: their different beliefs about motivation and agency.

First, motivation. Neo-liberals believed, and indeed still believe, that all human beings are fundamentally self-interested. For them, the safest assumption to make when constructing government institutions and formulating government policy is David Hume's maxim that everyone is a knave.¹⁵ Inevitably, therefore, they endorse the competitive market as the principal means for organising economic and social production; for, as we know from the works of David Hume's near contemporary, Adam Smith, the market is the method by which self-interest can be harnessed to serve the common good. Economic agents operating in a competitive market will find it in their self-interest to provide goods and services of high quality and at low prices; for, if they do not, they will lose business and therefore income and ultimately their livelihood. As Smith put it in the well-known passage from *The Wealth of Nations*:

He, generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it . . . he intends only his own gain, and he is in this . . . led by an invisible hand to promote an end which was not part of his intention. Nor is it always the worse for society that it was no part of it. By pursuing his own interest he frequently promotes that of society more effectively than when he really intends to promote it.¹⁶

¹⁵ In fact it was the philosopher and satirist Bernard Mandeville (1731: 332) who was the first to draw attention to the necessity of designing policies that 'remain unshaken though most men should prove knaves'. Mandeville was actually less cautious than Hume, although Hume is the one usually quoted in this context. For Hume (1875: 117–18) went on to muse that it 'appears somewhat strange that a maxim should be true in *politics* which is false in *fact*'. Hume's view is extended by James Madison (Hamilton, Madison, and Jay 1970: Nos. 10 and 51), and in recent years it has been defended at length by James Buchanan (1987). See also Brennan and Buchanan (1985: 45–61).

¹⁶ Smith (1776/1964: Book IV, ch. II, p. 400). Adam Smith himself would not necessarily have endorsed the self-interest view of human motivation. In fact one of his earlier works, *The Theory of Moral Sentiments* (Smith 1759/1976), shows a more complex understanding of human nature; see for instance the quotation at the beginning of Chapter Two of this book. Falkner (1997) has a more detailed discussion of Smith's views.

Not only does their belief about the fundamental self-centredness of human nature lead neo-liberals to endorse the competitive market, it fuels a parallel distrust of collective institutions, including—indeed especially—those of government. For, if the pursuit of self-interest promotes the common good in a market context, it is highly destructive in a collective one. In an environment where production is organised collectively, selfish individuals will try to ‘free-ride’ on the activities of others. That is, they will sit back and wait until others do all the hard work of production and only then come forward to consume its fruits. If everyone behaves this way—and, by assumption, everyone will, because they are all equally self-interested—then nothing will be produced; or, at best, only things that can be of direct benefit to the producer himself or herself will be produced.

The nursery story *The Little Red Hen* provides the perfect neo-liberal parable about the evils of collectivism. In the story the eponymous hen asks all the farmyard animals in turn whether they will help her bake a cake. In turn each of them refuses, pleading tiredness or other commitments. So she bakes the cake herself, and then asks the other animals if they will help her eat it. They all rush eagerly to the table, casting aside their alleged fatigue and salivating in eager anticipation. But she then refuses to give them any, saying she will eat it entirely by herself. And she does.

Many of those on the left, from socialists to social democrats, have a greater faith in human (and perhaps even farmyard animal) public-spiritedness. They would argue that individuals have a greater capacity than is acknowledged by neo-liberals for acting in ways that further others' interests as well as, or indeed even instead of, their own: that they can act as ‘knights’ as well as knaves. Hence collective, or more generally non-market, institutions can work. Moreover, in many circumstances, especially those associated with poor information or where social benefits and costs exceed private ones, collaboration will out-perform competition.

Indeed, for the social democrat it is not government that is to be distrusted, it is the market. For the market can be socially destructive, ‘narrowing the choices for all men’ as Richard Titmuss argued in the quotation at the head of this chapter. He went on: ‘If it is accepted that man has a sociological and biological need to help then to deny him opportunities to express this need is to deny him the freedom to enter into gift relationships’ (Titmuss 1971/1997: 310–11).

So their different views as to what motivates human beings—altruism or egoism—lead neo-liberals and social democrats to opposing views about the respective roles of the market and the state. But it is not only with respect to beliefs about motivation that the two ideologies of social democracy and neo-liberalism differ. There is also a divide concerning beliefs about agency: that is, about human beings' capacity for autonomous action. And this divide also contributes to their views about the appropriate use of market and state forms of resource allocation.

On much of the social democratic left it is believed that individuals are largely or wholly the product of their environment; indeed even the individual

as a concept is a social construct. Hence individual behaviour is best understood by focusing on the constraints under which individuals operate; in consequence, policy should focus on these. So the poor, for instance, are viewed as victims of the system: 'pawns' at the mercy of structural forces over which they have no control.

That the social democrats tended to regard individuals as inactive victims is a point well made by Alan Deacon and Kirk Mann (1999: 417), who point out its relevance to academic debates concerning public and specifically social policy: 'It is important to stress that the question of agency was not merely neglected in academic studies of social policy, but was consciously dismissed. For much of the post-war period it was not considered to be a proper subject for concern and enquiry.'¹⁷

They ascribed the predominance of this attitude to, again, Richard Titmuss. Reacting in part to the judgemental individualism that characterised much nineteenth-century policy towards the poor, Titmuss and his followers did not believe that the autonomous behaviour of individuals was relevant to social policy. As Deacon and Mann (1999: 418) put it: 'Above all [Titmuss] was resolutely opposed to anything that might appear to reopen the debate about personal responsibility for social pathology. Arguments about problem families or cycles of deprivation were an irrelevance or worse. Anyone who either could not or would not understand that was simply beyond the pale.'

Although rather more difficult to document, there also seems to have been an implicit belief on much of the social democratic left that, when recipients of public services or social security were not acting as pawns (that is, not acting at all), they would behave more like knights than knaves. So, if individuals or families were confronted with an incentive structure such as a means test that it would be in their self-interest to evade or avoid, they simply would not do so—even if they had the capacity and there was little risk of their getting caught. The belief in the essential goodness of human nature that characterised social democratic views of those who worked in the public sector carried over in large part to their views about the beneficiaries of the welfare state.

In contrast, policy analysts further to the right viewed individuals not as victims of unavoidable circumstance but as autonomous beings who did have a measure of control over, and responsibility for, their own lives. In other words, they were not pawns but queens.¹⁸ Such neo-liberal thinkers strongly rejected the determinism of the left. Thus Deacon and Mann quoted Lawrence Mead (1992: 129–30) castigating what he terms 'sociologism', which 'construes the personality as essentially passive' and where

The poor are seen as inert, not active. They are spoken of in the passive voice. They are people who are or have been disadvantaged in multiple ways. They do not do things

¹⁷ See also Deacon (1993) and Williams (1999).

¹⁸ Williams (1999: 669) uses the terms 'active welfare subject' and 'passive welfare subject' to make the same distinction.

but rather have things done to them. They are the objects, not the subjects of action. They are not to blame for conditions such as dropping out of school, AIDS, or drug addiction but rather 'at risk' for them. They 'experience' behaviours such as crime or illegitimacy rather than commit them.

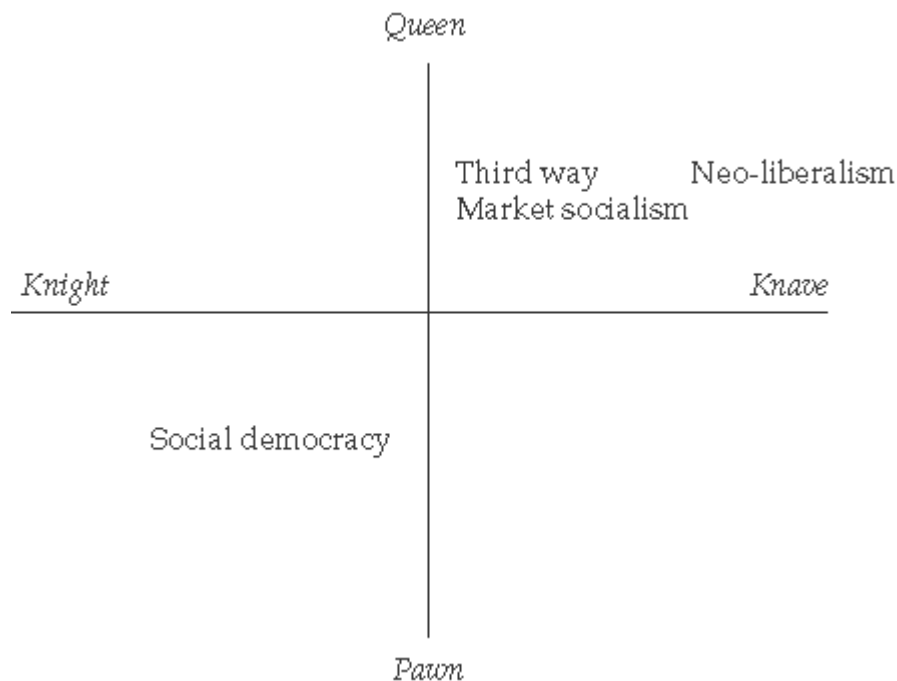
It is important to note that this belief in the autonomy of the individual appeared to be both empirical (individuals, even poor ones, in reality *do* have choices) and normative (individuals *should* have choices and should be held responsible for the choices they make). So policy-makers should not treat the people their policies are trying to help as pawns. This was partly because that would be empirically incorrect (welfare recipients are not pawns, but active agents who respond to incentive structures, probably in a self-interested way) and may lead to the policies concerned having perverse consequences. But it was also because it was the morally incorrect thing to do. It is simply wrong to treat people like pawns.

It is worth noting that, in the latter part of the period we reviewed above, there were several attempts to reconcile social democratic and neo-liberal views of the world, or even to replace them altogether by attempting to construct viable alternatives. One of these was market socialism: economic and social policies designed to achieve social democratic ends, such as greater equality and social justice, by neo-liberal means, such as a greater reliance on the market (Le Grand and Estrin 1989). Although the market socialists' beliefs about agency and motivation were not made explicit, the emphasis was on the effectiveness of market mechanisms and the relative failure of collectivist ones even to achieve social democratic ends. And this in turn derived in large part from a view of the world that incorporated the key actors as both self-interested and active agents.

More recently, there was an attempt to construct an ideological foundation for the centre-left governments of Tony Blair in the United Kingdom and Bill Clinton in the United States: a foundation that was to be neither neo-liberal nor social democratic (at least as the latter was conventionally understood). As part of this attempt, the sociologist and then Director of the London School of Economics, Anthony Giddens, and others developed the so-called third way. This had a number of differences from both social democracy and neo-liberalism with respect to the ends that it set out to achieve.¹⁹ The beliefs about means were less clear; hence it is more difficult to infer the implicit views about agency and motivation. But, as with market socialism, these seemed to be nearer the neo-liberal position than the social democratic one. The welfare state was described as an instrument not for redistribution but for 'pooling risk', and relabelled the 'social investment state' whereby the incentives were for the individual to build up the stock of human capital and to develop their capacity for entrepreneurial

¹⁹ I have argued that the ends that seemed to be implicit in the Blair Government's interpretation of the third way included commitments to community, opportunity, responsibility, and accountability (Le Grand 1998). Giddens has a slightly different list (1998: 66).

Figure 1.1. Motivation, agency, and ideology



activity and risk-taking (Giddens 1998: 116–18). And, although there was advocacy of community organisations, the voluntary sector, and the re-invigoration of civil society, there was also an explicit recognition of the overall desirability of markets, albeit social ones (Giddens 1998: 99–100).

AXES OF MOTIVATION AND AGENCY

It may be helpful to summarise some of these arguments in Fig. 1.1. This has two axes at right angles to one another. The horizontal axis represents the spectrum of views about what motivates human beings, from extreme altruism (the pure knight) on the far left to pure self-interest (the complete knave) on the far right.²⁰ The vertical axis refers to the spectrum of human agency, from passive individual (pawn) at the bottom to active, autonomous agent (queen) at the top. The axes bound four quadrants, knight/pawn, knight/queen, knave/pawn, knave/queen. The axes can refer to those who work within the public sector, or to recipients of public services, or both.

The changes in policy-makers' beliefs that we have been discussing can be illustrated in the figure. Suppose the horizontal axis refers to policy-makers' beliefs concerning the motivations of those who work in the public sector, and the vertical one to their beliefs concerning the capacity for agency of the recipients of public sector services. Then policy-makers established in the social democratic tradition are located in the bottom left-hand quadrant (knight/pawn).

²⁰ For the record, I should note that, in the article based on my inaugural lecture that introduced the terminology of knights, knaves, and pawns, I suggested that being a pawn was in contrast to being a knight or a knave (Le Grand 1997b). However, I now think that was incorrect. The true opposite of being a pawn is being a queen, not a knight or a knave.

Neo-liberal policy-makers on the other hand would be most comfortable in the top right-hand quadrant (knave/queen). So the shift that gave rise to the quasi-market revolution can be represented as a movement from the bottom left-hand quadrant to the top right-hand one. Market socialism and the third way can each be represented by a slight shift back along the horizontal axis, while remaining firmly in the top right-hand quadrant.

Many people could react to this figure, and indeed to the analyses underlying the whole chapter, by accusing them of being far too simplistic. The realities of human motivation and agency, they might contend, are far too complex to be adequately summarised by this kind of approach. There are many kinds of knights, lots of different types of knave. In fact, most human beings are in all probability some combination of both knight and knave, with different aspects coming to the fore in different circumstances. Also, individuals are not simply either pawns or queens. Although many people like to make their own choices much of the time, there are occasions (as when very ill, for instance) when it is a great relief to them to put their fate in the hands of trusted others: times when it is preferable to be a pawn rather than a queen.

But such a reaction would miss the point. The concern here is not with trying to represent reality; that discussion comes later in the book. Rather the aim is to capture *policy-makers' perceptions* of reality and to show how this has affected policy design. More precisely, it is to illustrate how the assumptions concerning motivation and agency, implicit or explicit, that are held by policy-makers and other policy analysts affect policy development and reform. These assumptions may indeed be simplistic or even simple-minded; but, as we have seen in our discussion of the developments in the welfare state, they can be very powerful.

THE REST OF THE BOOK

The remainder of the book is divided into three parts and an epilogue. Part I—‘Theory: Of Knights and Knaves’—is, as its title suggests, intended to provide the book's theoretical underpinnings concerning motivation. This is not to say that the discussion is entirely theoretical in the pejorative sense of having nothing to do with empirical reality; indeed far from it, for it includes a large amount of empirical material. Rather it is intended to provide the book's conceptual framework and to justify the fundamental analytical and philosophical stance concerning motivation that underlies the policy discussions that follow later in the book.

Chapters Two, Three, and Four are concerned primarily with motivation and public services. Chapter Two formulates more precisely what is meant by ‘knights’ and ‘knaves’ and examines the empirical evidence concerning the existence of different kinds of motivation in the public sector. It concludes that both self-interested and altruistic motivations exist and, more interestingly, that altruistic motivations often require that the individual himself or herself

performs the relevant act. Chapter Three considers the impact of the policy context on motivation, asking whether individuals' motivations are independent of the context in which they operate or whether they are in fact deeply affected by that context. Do market-oriented policies corrupt—turn knights into knaves? Alternatively, does government corrupt—or lead to moral atrophy? The answers are somewhat surprising, with both markets and governments devaluing knightly motivations on occasion but at other times rewarding or revaluing it. Chapter Four uses the material from the two previous chapters to develop what I believe to be a largely new theory of public service motivation. This allocates a key role to the sacrifice involved in performing altruistic acts. The chapter goes on to discuss some of the theory's implications for policy design and also its morality.

Part II—‘Theory: Of Pawns and Queens’—is intended to provide the analytic and philosophical framework for considerations of agency. It is more normative in nature. Chapter Five discusses the fundamental question as the relative balance of power between individual users and professionals with respect to public services such as health care and education, while Chapter Six examines whether individuals should be left to make their own decisions with respect to other areas of welfare, such as saving for their pension or long-term care.

Part III—‘Policy’—deals with some specific policies or proposals designed to address motivation and agency issues. They are discussed in some detail because, as the well-known phrase has it, therein the devil often lurks. Indeed, there is a broader point here. Academics too often get away with the enunciation of broad principles, leaving the hard choices involved in policy formulation and implementation to be made by someone else. But it is these hard choices that test and illuminate the underlying principles; choices that sometimes require the revisiting and revision of the latter. Certainly that has happened in this case: the policy analyses of Part III have not simply followed from the economic and philosophical analyses of Parts I and II, but have materially influenced them.

Chapters Seven and Eight review the experience of two market-oriented policies that have been tried in British health care and education: the holding of budgets for hospital care by organisations of primary-care physicians (General Practitioner practices and, more recently, Primary Care Trusts); and parental choice and competition in primary school education. They conclude that these schemes have been broadly effective, and, where the schemes have problems, offer some ideas for improvement.

The next three chapters look at policies outside the arena of public services but still within the general area of public policy and the welfare state. Each concerns a specific proposal that would turn pawns into queens, or that, when compared with alternatives, would affect positively individuals' capacity for agency. They are all proposals in which I have been heavily involved, as initiator, or advocate, or both. Chapters Nine and Ten discuss ideas for which I was an initiator: the idea of a universal stakeholder or demogrant to every

young adult in Chapter Nine, and ‘partnership’ matching grants to encourage savings for pensions and long-term care in Chapter Ten. Chapter Eleven considers increasing individual citizens' control over the fiscal system through hypothecation or the earmarking of particular tax revenues for specific uses, an old idea but one that needs reviving, as I have advocated in a variety of different contexts.

The Epilogue is a reflective piece on the theme of the book as a whole. It considers the effect of using markets in the public sector on society, and argues that they need not corrupt and can be beneficial for agency. In short, it is not necessary to turn knights into knaves for pawns to become queens. What are needed are appropriately designed public policies, ones that employ market-type mechanisms but that do not allow unfettered self-interest to dominate altruistic motivations: a form of ‘doux commerce publique’.

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PART I THEORY: OF KNIGHTS AND KNAVES

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2 Knights and Knaves in the Public Sector: What Do We Mean and What Do We Know?

No man giveth but with intention of Good to himselfe, because Gift is Voluntary; and, of all voluntary acts, the Object is to every man his own Good.

(Thomas Hobbes, *Leviathan*)

How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. Of this kind is pity or compassion, the emotion which we feel for the misery of others, when we either see it, or are made to conceive it in a very lively manner.

(Adam Smith, *The Theory of Moral Sentiments*)

You might not see one in a hundred with *gentleman* so plainly written as in Mr Knightley.

(Jane Austen, *Emma*)

The previous chapter spelt out how, in the closing years of the twentieth century, several countries, including Britain, saw some significant changes in policy-makers' perceptions about motivation and agency: changes that in turn led to radical reforms in the way in which public services were delivered. In particular, a belief that those who worked in a public service had as their principal aim not the satisfaction of their own desires but meeting the needs of the essentially passive beneficiaries of the service was replaced by a conviction that public service workers were motivated largely by self-interest and that users of services were (or should be) active consumers. This led to a policy drive to replace state-based delivery systems by market-based ones, which were viewed as better placed to harness the forces of self-interest to serve the (newly discovered) consumers of public services. Systems run by knights for the benefits of pawns were to be replaced by ones run by knaves

in the service of queens. Subsequently, although there has been a partial move away from market incentives in some areas such as health care, the essence has remained in others, such as education and social services.

But how soundly based were these policy shifts? Should we rely on knavish motivations to deliver our public services? Or, as Richard Titmuss has argued, are we thereby ignoring or damaging what is often termed the public service ethos, and hence actually damaging the services concerned? Should our health systems, our education systems, our social services incorporate incentive structures that reward (or penalise) the knave, or ones that encourage (or discourage) the knight?

It might seem that there is a ready answer to these questions and indeed a ready solution to the policy-makers' dilemma over which assumptions to make about human motivation: namely, to find out what actually does motivate people in the public sector. Surely, in a world of advanced scientific inquiry, we can establish whether those who implement public policy are in fact knights or knaves, self-interested egoists or public-spirited altruists? If so, once that is established, then we can design our policies accordingly, relying on self-interested incentive structures if individuals turn out to be knaves and on altruistic ones if they turn out to be knights.

Sadly, the world is not that simple. Philosophers, social psychologists, economists, evolutionary psychologists, and scholars from a wide range of other disciplines have all tackled the issue of motivation without achieving much by way of consensus. There is controversy over the meaning of terms such as self-interest and altruism, and over the extent to which either phenomenon can be found in the real world.

So this chapter explores the question of what kind of motivation is meant when we use terms such as 'knights' and 'knaves', 'altruism' or 'self-interest', and what evidence there is for the existence of such motivations in the public sector. The literature is large and I can review it only relatively briefly.²¹

Two general points before I look at knaves and knights separately. First, the terms are used here as a shorthand for describing individuals' motivations, not necessarily individuals themselves. So, in describing individuals as knights, for instance, I do not mean to imply that they are always motivated to perform knightly acts or that they will always behave in a knightly fashion. Rather, I mean that on occasion their acts have knightly motivations. It is perfectly possible for someone to be both a knight and a knave: that is, to have altruistic motivations for some of his or her activities or behaviour and self-interested ones for others.

²¹ Useful reviews of the literature on altruism in general from a variety of disciplines can be found in Batson (1991: ch. 2) and Page (1996: ch. 1). Rogers (1997) provides an anthology of philosophical writings on self-interest and altruism from Plato to the present day. More recent philosophical contributions can be found in Paul, Miller, and Paul (1993). The arguments concerning the possibility of altruism from the evolutionary psychologists'/biologists' perspective can be found in R. Wright (1994) and Ridley (1996).

The reference to 'behaviour' brings us to the second point. It is important to distinguish between motivation and behaviour. I use the term 'behaviour' to describe a set of actions or activities undertaken by an individual. Motivation is a psychological state that is one, but only one, of the factors that may determine behaviour. Other factors include the outside constraints that people face, including the availability of time and of financial resources, and their intrinsic skills and abilities. So an individual may wish to become a doctor in order to help patients, and may have the ability to pass the necessary exams, but cannot pay for the training from his or her own resources. So he or she borrows to finance it. The behaviour is the activity of borrowing to finance medical education. The motivation is the (knightly) one of wishing to help patients, the constraints are ability and financial resources. Behaviour is the product of an interaction between motivation and constraints.²²

WHAT WE MEAN: THE KNAVE

For the purposes of this book, the term 'knave' is used to mean simply an individual whose principal concern is to further his or her self-interest. Defining knaves this way follows the usage of David Hume in the quotation that opened this book, but also that of more modern political philosophers (see for instance Pettit 1996 and Hausman 1998). As noted in the Preface, this is a little broader than the common usage of the term, where it can mean individuals who indeed pursue their self-interest but whose activities in furthering that end take them to the borders of legality: people who bend the rules or who are in other ways slightly shady. But, although such individuals are certainly part of our canvas here, they are not its sole focus. Rather, the emphasis in this book is on individuals who pursue their own interest by any means, legal or illegal.

However, simply defining knaves in terms of the pursuit of self-interest is not sufficient. For, as many writers have noted, the concept of self-interest itself is not uncomplicated (see for instance Kavka 1986 and Hill 1993). Perhaps the simplest interpretation is that underlying the conception of so-called economic man or *homo economicus*. This is a genus of individuals whose self-interest is defined solely in terms of their own consumption: that is, such individuals are motivated entirely by the desire to acquire material wealth that they consume themselves for their own benefit. The clause 'that they consume themselves for their own benefit' is important because this excludes two categories of people who would be better described as knights: those who want to acquire material wealth primarily in order to benefit others (for instance, through giving the money away), and those who might consume

²² In this sense I am using the term 'motivation' in a fashion that comes close to economists' terminology of preferences. I use motivation partly because it is probably more recognisable in the context of this book to both economists and non-economists and partly because the term has associations with activity (one is motivated to *do* something) in a way that the term 'preferences' does not.

something they do not wish to in order to benefit others (for instance, wearing clothes that are not to one's own taste in order to please one's partner).

Homo economicus is the model that non-economists often believe—wrongly—underlies all economic analysis. It is true that many, perhaps most, economists would defend it as a helpful abstraction that under a wide variety of circumstances can yield useful predictions. However, there are few who would consider it an adequate representation of the complexity of human motivation, not even of that part which is purely self-interested; and several distinguished economists have developed models that incorporate much more sophisticated conceptions of motivation.²³

In fact, as many authors have pointed out, self-interest has a wide variety of elements that contribute to it. These include material wealth certainly, but also such important considerations as security, autonomy, status, and power. A full list might be even broader than this, including these but also pleasure, the avoidance of pain, liberty, glory, the possession of certain objects, fame, health, longevity, self-respect, self-development, self-assertion, reputation, honour, and affection (Kavka 1986: 42, quoted in Hill 1993: 1). It is this broader conception of self-interest that will underlie the way in which the term is used in this book. Again the rider needs to be added that some of these elements qualify as factors promoting self-interest only when they are used for personal benefit; some of them, such as power or high status, could be desired solely for the purpose of being in a position to confer benefits on others—in which case they become a knightly rather than a knavish motivation. This is a point to which I shall return.

WHAT WE MEAN: THE KNIGHT

The terms 'knight' or 'knightly motivation' will not be found in the relevant literature, which uses instead an eclectic bundle of nouns and adjectives to describe the individuals or the motivations concerned. Of these the most common are 'altruism' and 'altruistic behaviour'; but, as Janet Finch (1989: 223) has observed, 'altruism . . . can be used merely as a way of referring to behaviour whose nature we do not really understand, but of which we vaguely approve'. References can also often be found to 'moral', 'collectivist', 'public-spirited', or 'pro-social' behaviours. These terms are either left irritatingly undefined or defined in such a way that is too narrow for our purposes. So Robert Goodin (1993: 66) notes that, particularly, social psychologists use terms such as 'altruistic', 'moral', or 'pro-social' virtually interchangeably, much 'to a philosopher's chagrin'.

So how should knights be defined? It might seem as if we can simply do so as individuals who are motivated to help others. However, this immediately

²³ The pioneer was Gary Becker (1976; 1981). More detailed discussion of some of the wider theories of motivation now being developed by economists can be found in Rabin (1997) and Frey (1999: ch. 1).

raises the question as to the exact nature of this motivation to help others. Is it not itself an expression of self-interest? Famously, in the quotation with which this chapter opened, Thomas Hobbes (1651/1985) argued that everyone was fundamentally selfish even when engaged in apparently charitable actions. Other philosophers of the period agreed. So La Rochefoucauld (1678/1964, maxim 82): ‘the most disinterested love is, after all, but a kind of bargain in which the dear love of our own selves always proposes to be the gainer in one way or another.’ And Bernard Mandeville (1714/1989: 92): ‘the humblest Man alive must confess that the Reward of a Virtuous Action, which is the Satisfaction that ensues upon it, consists in a certain Pleasure he procures to himself by Contemplating his own Worth.’ So, in a Hobbesian/Rochefoucauldian/Mandevillian world, there are no knights—only knaves.

Actually, there seem to be two distinct versions of the Hobbesian view concerning the non-existence of altruism. One allows for the possibility of unselfish acts, but makes the empirical claim that they rarely, if ever, occur in practice: that when people profess unselfish motives for their actions they are generally being hypocritical and covering up a fundamentally selfish motive. The other is the more sweeping assertion that unselfish behaviour is logically impossible: that any freely chosen act, including an apparently selfless one, must have been motivated by the desire to undertake that act; and meeting one's desires is the definition of self-interest.

The first claim can be readily refuted by empirical investigation, as we shall see shortly. The second is harder to argue against (although some philosophers have tried, including David Hume, Adam Smith, and John Stuart Mill);²⁴ but it is not always necessary to do so. In fact, for the purposes of this book, the debate is relatively easy to resolve. The resolution is that proposed by another enlightenment philosopher, Joseph Butler (1997: 122–3), who argued ‘But this is not the language of mankind . . . There is . . . a distinction between the cool principle of self-love, or general desire for our happiness, as one part of our nature, and one principle of action; and the particular affections towards particular external objects, as another part of our nature and another principle of action.’

In our terminology, knaves can be defined as self-interested individuals who are motivated to help others only if by so doing they will serve their private interests; whereas knights are individuals who are motivated to help others for no private reward, and indeed who may undertake such activities to the detriment of their own private interests. Put another way, the distinction is between, on the one hand, those who are motivated to perform only those activities that are of direct benefit to their own material welfare, such as their own personal consumption of material goods, and, on the other hand, those that are motivated to engage in ‘other-directed’ activities, that is, activities which benefit others and which do not positively affect their own material

²⁴ See Batson (1991: ch. 2) and Page (1996: ch. 1) for reviews of their contributions and a more general discussion of the issues involved.

welfare. The fact that both kinds of individual may be 'selfish', in the sense that they both derive satisfaction or some other kind of positive feeling from their activities, is irrelevant for our purposes.

So a philosophical distinction between knights and knaves can be drawn. However, a rather different kind of challenge to the existence of altruistic motivations has come from evolutionary psychology. This relatively new area of scientific endeavour applies Darwinian principles to social behaviour, and argues that much, perhaps even most, such behaviour is ultimately determined by genetic factors. If this is accepted, then one possible implication is that, since genes are in Richard Dawkins's (1989) terms ultimately 'selfish', so must be the behaviour that is determined by them. Genes are intrinsically knaves; they cannot be knights.

However, most evolutionary psychologists would argue that such an implication would be too simplistic. It is perfectly possible for genes to be selfish but for the organism that embodies them to be altruistic. For altruistic behaviour by an organism may well serve the interest of the genes, that is, their long-term propagation and survival. So, for instance, the genetic pattern that causes parents to make sacrifices for their children is likely to dominate a genetic pattern that does not; for, other things being equal, more children of the sacrificial parents will survive than of the non-sacrificial ones. It is more difficult for the neo-Darwinians to explain altruistic acts to non-relatives. However, some have tried, arguing that, under many of the circumstances that human beings find themselves, genes that promote trust and cooperation with strangers are more likely to survive than ones that promote competition (for a full discussion, see Ridley 1996).

So both philosophy and evolutionary psychology allow for the existence of altruistic motivation. That is as well, because such motivation undoubtedly does exist.

This assertion is based not only on common sense but also on a large body of research undertaken by social psychologists, economists, and other social scientists. This I examine shortly. But before I do so there are three other areas of potentially confusing terminology that need clearing up.

First, the relationship between self-interest, altruism, and rationality. Self-interest is often identified with rationality, with the implication that only self-interested individuals are truly rational. Thus rational, self-interested individuals are often described as *homo economicus* on the grounds that the analysis of the behaviour of such individuals underlies contemporary analyses of economists.²⁵ However, as indeed many economists themselves have pointed out, rationality does not imply self-interested motivations or vice versa. There seems no reason why an individual engaging in a rational calculus of the costs and benefits of a particular activity should confine the analysis only to those costs and benefits that impact directly on the individual himself or herself. A knight who includes the costs and benefits to others as part of his or her calculations as to

²⁵ See, for instance, Fukuyama (1995: 17–20), and Pettit (1996: 62–3).

whether or not to undertake the activity is being as rational as a knave who includes only those that affect him or her personally. Both knights and knaves can be rational; both, of course, can also be irrational.²⁶

The second point concerns the relationship between altruism and collectivism or cooperation. Unselfishness is often linked with a belief in the importance of cooperation or of engaging in collective action; selfishness with individualistic or competitive actions. However, the link is not automatic. For self-interested individuals could believe that the best way to promote their self-interest is to work with others in a cooperative way; this, after all, is often the rationale behind joining a trade union. Results from game theory, including the well-known Prisoner's Dilemma, show on many occasions that self-interest can best be served by cooperation.

So not all collectivists are knights. But are all knights collectivists? Is a belief in collectivism a necessary condition for being a knight? At first sight, there may seem to be something odd about an altruist, say, deliberately engaging in competitive actions or supporting the operations of a competitive market, especially those which involve someone else's welfare diminishing (such as a small corner shop going out of business due to the competition with an out-of-town supermarket and thereby depriving a local community of elderly people of ready access to shopping). However, it is far from impossible. For an altruist may believe the operation of competitive markets will in the long run do more to further the interests of those whom he or she cares about than the operation of more collectivist systems (for instance, the supermarket could provide a delivery service for the elderly with goods at lower prices). And, as we shall see in subsequent chapters, in this the altruist who believes in competition may be right, even in the context of public services. To be a knight does not necessarily imply being a collectivist.

The final point concerns the currently fashionable issue of trust. Sometimes altruism and trust seem to be confused. Put another way, the pursuit of self-interest by an individual is taken to exclude the placing of trust in either him or her or in other individuals similarly motivated (see for instance Fukuyama 1995: ch. 2). But neither a trusting individual (one who places trust in others) nor a trustworthy individual (one in whom trust is placed) is necessarily a knight. I might know you to be a knave, but nonetheless trust you to pursue my self-interest in a particular situation simply because it is a situation in which both our self-interests coincide (bailing out a leaky lifeboat, for instance). In that case we can trust each other, even though we both are acting as knaves. Of course it may be easier on occasion to trust someone to pursue your interests if you think they genuinely have your welfare at heart; but feelings of altruism between two individuals are not essential to a relationship

²⁶ I am defining rationality here in terms of the consistent assessment of the costs and benefits of different actions. Andreoni and Miller (2002) have demonstrated that subjects behaving altruistically can conform in that behaviour to more general revealed preference rationality axioms.

of trust existing between them or vice versa. As with collectivism, there is no automatic link between knightly and trusting behaviour.

WHAT WE KNOW

In the eighteenth century Bernard Mandeville ran into a great deal of trouble for his contention that most men were knaves. For John Brown, Hobbes and Mandeville were 'detested names, yet sentenc'd never to die; snatched from oblivion's grave by infamy!' John Wesley wrote 'til now I imagined that there never appeared in the world such a book as the works of Machiavel. But de Mandeville goes far beyond it.'²⁷ But, in a more modern, possibly less idealistic, world, it is difficult to see what the fuss was about. That all individuals are to a great extent knaves—that is, motivated in large part by material self-interest—is almost uncontroversial. The issue is rather the reverse: do people engage in knightly acts in non-trivial ways? Or, put in a way of direct relevance to the concerns of this book, is the assumption of altruistic motivation fulfilled in enough instances to make it safe to construct public policies on that assumption?

That altruistic behaviour towards immediate family or other kin exists is so obvious that it needs little demonstration. What is of more interest is evidence of the existence of apparently altruistic behaviour that is directed towards non-related individuals, including in many cases complete strangers, and, more significantly, evidence of the motivation that lies behind that behaviour. This comes from a wide variety of sources, including interviews with those who have engaged in apparently altruistic behaviour, laboratory experiments, and empirical tests using observed behaviour. The range of such studies is vast.²⁸ But the conclusions drawn from them are unequivocal. As Matthew Rabin (1997: 13), an economist reviewing both the psychological and the economic literature, says:

It has been experimentally verified that people contribute to public goods more than can be explained by pure self-interest, that those free to allocate money as they choose do not universally grab all the money and that people sacrifice money to retaliate against unfair treatment . . . there is no debate among behavioural researchers about whether underlying preferences depart non-trivially from self-interest.

Of particular interest to this book is evidence concerning the altruistic (or self-interested) motivation of individuals involved in the provision of public services. This we should look at in a little more detail.

²⁷ Quoted in Harth (1989). Actually much of the critics' venom was stimulated by Mandeville's proposition that not only were most men knaves, but that it was actually better for the economy and indeed civil society that they were so instead of being virtuous moralists. This point is discussed further below.

²⁸ For reviews of the psychological and sociological literature, see Krebs (1970), Pialavin and Charng (1990), and Monroe (1994). A comprehensive literature review of the psychology and economics literature can be found in Rabin (1997: 13–26); see also Rose-Ackerman (1996) and, for earlier references, Phelps (1975). For some more recent references, see Andreoni and Vesterlund (2001) and Andreoni and Miller (2002).

MOTIVATION AND PUBLIC SERVICES

We begin with Richard Titmuss's reports in *The Gift Relationship* on interviews with apparent altruists in an area close to our public policy concerns: that of blood donation. The knights in this case were a sample of 3,800 people who had given blood to the British National Blood Transfusion Service. These individuals gave blood with no expectation of financial or other material reward (except for a cup of tea and a biscuit after they had made their donation); they gave anonymously; and they did not know the potential recipients of their donation. Of these, over a quarter gave compassion as a reason for their act. These included (reproduced as written):

'Knowing I mite be saving somebody's life.' 'I came forward in hope to help somebody who needs blood.' 'I felt it was a small contribution I could make to the welfare of humanity.' (Titmuss 1971/1997: 293)

Feelings of duty were also apparent among the Titmuss donors:

'My conscience—having served five years on active service in the war (1939–45), helping to destroy life, and during this period my wife was receiving blood to save her life, it occurred to me, after demobilisation, that I could at least ease my conscience.' 'Feeling of guilt at receiving so much in life and giving so little.' 'Sense of duty and community and duty to the nation as a whole.'

As were more personal factors:

'I felt this was a wonderful service I wanted to be a part of.' 'I wanted to do something to convince myself I was 18 and I always wanted to be blood donor—snob appeal.' 'Primarily to conform with teenage contemporaries.' (Titmuss 1971/1997: 297)

Two conclusions can be drawn immediately from these interviews. The first is that, undeniably, altruistic motivations exist. The second is that they in turn seem to take a variety of forms, including compassion, duty, and a desire to conform.

But it could be objected that these kinds of interviews are not immediately relevant to our concerns. Blood donors are not strictly workers in the public sector, although that did not stop Titmuss from drawing inferences from these interviews about motivations in the public services (or more widely). But there is also a range of evidence of more direct relevance.

A recent survey of the values of public and private sector managers was undertaken by Jane Steele (1999) of the Public Management Foundation. This involved in-depth interviews with seventeen top managers from the public, private, and non-profit sectors, followed by detailed telephone interviews with 400 more. The study found considerable evidence both that knightly motivations existed in the public sector and that they were much more pronounced than in the private sector. Out of sixteen possible personal goals, the most frequently named goal of public sector managers was to provide a service to the community, whereas this did not even appear among the top ten

goals for private sector managers. In contrast, for private sector managers the two (equally) most important goals were improving the financial performance of the organisation and achieving organisational goals or targets.²⁹ The first of these did not appear among the top ten goals for public sector managers, whereas the second appeared sixth. Moreover, these differences did not fade with age or experience; they were not a feature of only the older generations. In a later piece, Steele complemented this work by exploring the motivation of managers and doctors within the British National Health Service, together with Alison Graham (Graham and Steele 2001). This involved a survey of 125 NHS staff: 65 managers, 24 hospital doctors, 20 medical managers, and 16 GPs. Again, the researchers found a strong commitment to altruistic concerns. Among thirteen possible motivating factors, the 'desire to provide a good quality service to users' was ranked the highest by all groups, except GPs.³⁰ None of the groups was especially motivated by prospect of personal gain; 'the amount I earn', 'my status in the community', and 'my career development prospects' all ranked near the bottom. This is consistent with previous research concerning the motivation of hospital consultants (Shaw, Mitchell, and Dawson 1995).

The motivations of doctors working in the public sector are of particular interest, since the practice of medicine has traditionally been heavily constrained by norms other than direct self-interest, in both the public and the private sectors.³¹ These include both general moral principles of honesty, charity, and mutual respect and norms that are peculiar to the medical profession, to many of which its members swear solemn oaths. The effectiveness of these norms in influencing how health care providers behave (like the effectiveness of all norms) is controversial, but no one would deny that they have some potency, at least in influencing the way in which doctors think about their profession. So, for instance, a British Medical Association survey of 600 doctors'

²⁹ These goals and targets were left undefined, so it is possible that some of them were other-directed and hence altruistic.

³⁰ GPs ranked 'working in a productive team', 'a desire to help the community', 'working with able, motivated colleagues', 'my reputation amongst my colleagues' above the desire to provide a good quality service. See Graham and Steele (2001: Table 2.1, p. 7). Interestingly, another review of the factors influencing GPs' behaviour concluded that 'the evidence for societal interests and reputation/status being [factors] is . . . weak . . . as is the evidence for patients' interests being [a factor]' (Scott 1997: 33).

³¹ It is remarkable how little hard evidence actually exists concerning doctors' motivations with respect to the competing claims of self-interest and altruism, at least in the United Kingdom. A study by Nick Bosanquet and Brenda Leese (1989), promisingly titled *Family Doctors and Economic Incentives*, does not in fact deal directly with the issue of motivation, being more concerned with demonstrating the effect of area factors on GP behaviour. The British Medical Association has undertaken a number of surveys of doctors' core values (BMA 1995a, b, c) and has supported work by the Policy Studies Institute on the views of young doctors (Allen 1997). Although none of these directly addresses the question of self-interest versus more altruistic motivations, they do contain useful information. In an interesting recent contribution, Matthew Gothill (1998: S38) has argued that 'neither altruism nor egoistical self-interest adequately explain [General Practitioners'] motivation', arguing instead that 'process' satisfaction drives GPs in their behaviour, especially in the consulting room. However, he provides little evidence to support the assertion.

attitudes towards medicine as a career found only ten (2 per cent) who felt that medicine was 'a job like any other and that doctors have a right to work normal hours and forget about work when they get home' (BMA 1995*a*, part II: 11). On the other hand, the same survey indicated how difficult it was to find a balance between altruism and more self-interested concerns. Over half of the respondents (58 per cent) agreed with the statement that 'medicine is a major commitment, but doctors also deserve a decent family life and leisure time'; while a further 29 per cent felt that 'the practice of medicine must be organised in a way which allowed doctors to balance their career with family and other interests'. Only three considered that 'medicine is a vocation and only those who considered it their primary commitment should enter the profession' (BMA 1995*a*, part II: 5).

Tessa Crilly and I have explored the motivation and goals of NHS Trusts, using a survey of 1,500 hospital consultants and managers and a statistical analysis of the behaviour of 100 acute trusts over three years (Crilly and Le Grand, forthcoming). The results showed that consultants considered service (quality and volume) goals to be more important than financial break-even. While a financial break-even target was found to be the primary goal of managers on average, they proved to be a heterogeneous group, with quality ranking as the main priority among those managers who were closest to service delivery. Although a commitment to service goals cannot be automatically attributed to knightly motivations (it could also derive from more knavish concerns such as a desire for professional approval), the striking aspect of these results was how relatively little commitment there was among consultants and a significant group of managers to maintaining the financial health of the institution.

Peter Taylor-Gooby and colleagues (2000) investigated the motives of British dentists deciding whether to treat patients privately or through the National Health Service. They found that dentists were led to leave the NHS because of both knavish and knightly motives. By going 'private', they wanted to have a higher income and to have more independence for their personal benefit. However, an important motivating factor was that they also believed that by so doing they could give more time and attention to their patients, and hence provide a higher quality of care. As Taylor-Gooby and colleagues comment, the interpretation they gave of their patients' interests was heavily conditioned by their professional culture (emphasising restorative rather than preventive work, for instance); however, the fact remains that patients' interests appeared to be a significant factor in their decision.

Outside the medical arena, Jeremy Kendall has investigated the motivations of independent providers (profit and non-profit) of residential care and domiciliary care for elderly people. In 1997 he and colleagues interviewed just over fifty providers of residential care, asking questions about their principal motives for being in business. Of these, the most widely cited motive was meeting the needs of elderly people (85 per cent), while 87.5 per cent cited one or both

of two other knightly motivations: a feeling of duty and responsibility towards society as a whole, and similar feelings towards a particular section of society. This compares with the numbers citing apparently more knavish concerns of professional accomplishment (76 per cent), developing skills (67 per cent), a satisfactory level of personal income (58 per cent), independence and autonomy (40 per cent), and income or profit maximising (a mere 8 per cent) (Kendall 2001).³² When interviewees were asked to rank these priorities, the one ranked highest most frequently was the needs of the elderly (41 per cent), followed by professional accomplishment (15 per cent) and income (14 per cent) (see also Forder *et al.* 1997).

In 1999 Kendall and colleagues (forthcoming) asked similar questions of fifty-six providers of domiciliary care. Of the respondents nearly half gave as their most important motivation the knightly motives of meeting the needs of elderly people (29 per cent), duty/responsibility to society as a whole (11 per cent), and duty/responsibility to a particular section of society (9 per cent). In contrast, only 13 per cent gave priority to financial motives, while the remainder concentrated on professional accomplishment and creative achievement (21 per cent), independence and autonomy (11 per cent), and developing expertise (5 per cent).

Outside the UK, Gene Brewer and colleagues have reviewed some of the US studies on public service motivation (Brewer, Selden, and Facer II 2000: 255). Most of this is consonant with the UK evidence, and suggests that public employees report a greater concern for serving the community and helping others than private sector ones. However, one study of public, private, and non-profit sector employees did not find any significant difference between them in the commitment to service, helping, pay, or job security (Gabris and Simo 1995).

All the evidence quoted so far has been derived from interviews or responses to questionnaires. In these situations there may be what has been termed a 'halo' effect: people responding in the way they think they ought to respond rather than revealing their true motivations. Actual behaviour might be a more accurate guide to motivation than stated intentions. Julien Forder (2000) has examined such behaviour with respect to pricing of for-profit and non-profit providers of residential care for people with mental health problems. He found that both groups did not set prices as high as they could have done—or should have done if they were out to maximise their profits. Non-profit providers had lower mark-ups than for-profit ones; but even the latter did not fully exploit their market power.

Most of the other empirical studies of actual behaviour have concentrated on the effect of financial incentives in motivating public sector workers.

³² Kendall regards the desire for greater independence and control as neither knavish nor knightly but (keeping up the medieval metaphor) as 'mercantile'. Hence he coins the term 'merchant' to set alongside the knights and knaves.

A review of the evidence outside the health care sector by economists Simon Burgess, Carol Propper, and Deborah Wilson (2002) concluded that public sector workers do work harder and produce more output when they have a financial incentive to do so; they also manipulate the quality and timing of what they do so as to maximise their financial rewards, often in ways that the organisation neither intended nor wanted. However, Burgess, Propper, and Wilson cite evidence that public sector workers can also behave altruistically. Caseworkers in a job-training scheme in the United States took on hard-to-place workers even though their narrow financial interest would have been better served by accepting more employable workers.

There have been two systematic reviews of the literature on the impact of financial payments on medical practice and behaviour.³³ One reported on studies of primary care physicians in the US, Canada, Denmark, and Scotland. The researchers found that those paid on a fee-for-service basis provided more services than those paid by salary or by capitation (that is, according to the number of patients on their list) (Gosden *et al.* 2001: 53). The other examined a large number of studies (eighty-nine) in a variety of countries on the impact of financial incentives on medical practice. It concluded that financial incentives had an impact on the use of health care resources, including admission rates to, and length of stay in, hospital, on compliance with clinical practice guidelines, and on achieving a general immunisation targets (Chaix-Couturier *et al.* 2000).

Peter Dolton and colleagues have examined the impact of both pecuniary and non-pecuniary rewards for teachers. They found that relative earnings in teaching compared with non-teaching alternatives have a marked effect on graduates' choice of occupation, on teachers' decisions to leave teaching, and on the decision by ex-teachers to return to teaching. However, non-pecuniary factors were also very important—especially for women. But the latter appears to be the result not so much of more public service motivations in women than in men, but to familial concerns about the compatibility between teaching and family responsibilities (this work is summarised in Dolton, McIntosh, and Chevalier 2002). Reviews of the labour supply of nurses have come to similar conclusions (Antonazzo *et al.* 2000).

Overall, it is hard to dispute the view that altruistic motivations are prevalent among the providers of public services. But we must be careful how we interpret the evidence. Altruism exists alongside more self-interested motivations, and is combined with them to affect behaviour in different ways.

But the research shows more than the mere existence of altruism in the public sector. It tells us something about the nature of altruistic motivations that will be important for our subsequent analysis. More specifically, there appear to be two rather different kinds of altruistic motivation, or, in terms of the metaphor underlying this book, two different kinds of knight: the 'act-irrelevant' and the 'act-relevant'.

³³ I am grateful to Elias Mossialos for drawing these to my attention.

First, the act-irrelevant knights. These are individuals who are motivated to help a person in distress solely because of their reactions to their perception of the situation in which the person finds himself or herself. This reaction could spring from compassion or pity for the individual concerned. Or it could arise because they consider the individual's situation to be unjust or unfair.³⁴ The concept of altruism implicit in the idea of this kind of knight probably corresponds closely to many common-sense interpretations of the term.

Now act-irrelevant knights would be content if the person who is the focus of their altruistic concern were helped by someone else; they do not necessarily have to provide the help themselves. They are prepared to free-ride on others' actions. Who actually performs the helping act is irrelevant: hence their title. They may be distinguished from 'act-relevant' knights: people who have concern for an individual in distress but who are motivated actually to provide the necessary help themselves. This could arise from a feeling of positive reward from undertaking the helping activity: what has been described as a 'warm glow' (Andreoni 1990). This satisfaction could in turn arise from a number of internal factors, such as the individual's perception of himself or herself as a caring person, or external ones such as social recognition or peer approval (for further discussion see Piliavin and Charng 1990 and Rose-Ackerman 1996: 713).

Alternatively, act-relevance could be motivated not so much by feelings of positive satisfaction from performing a helping act but by a sense of duty or obligation to the individual concerned and the desire to avoid a sense of guilt if the individual concerned does *not* perform the act. Or it could be motivated by a sense of reciprocity: a motivation to help those who have been kind or thoughtful in the past. This kind of motivation might appear actually to be a form of knavery; and indeed, if it takes the form of requiring others to be helpful towards you in return for your being nice to them, then it is a self-interested act and not a knightly one. But it need not necessarily take the form of a direct exchange in this way. You could decide to be nice to people simply because they have been nice to you in the past and you therefore have good feelings towards them, not because you are expecting good things from them in the future. Reciprocal act-relevant knights are different from knaves.³⁵

This distinction between act-irrelevant and act-relevant altruism has also been described as a distinction between 'pure' and 'impure' altruism (Andreoni 1990). However, I prefer not to use these terms since they seem to imply some kind of moral judgement that one is better than the other: a judgement that, at least to me, has no obvious justification.³⁶ The only important question is whether both kinds exist and, if so, to what extent.

³⁴ Compassion and a sense of justice are often confused. However, they are quite different, one leading to generosity, the other to giving people their just deserts. The distinction is apparent in the proverb: be just before you are generous.

³⁵ This does not exhaust all the different kinds of knights. For discussions of other kinds of altruistic motivations see Margolis (1982), Collard (1978; 1983), and Sugden (1984; 1993).

³⁶ Nor to others: see for instance Rose-Ackerman (1996: 713).

Evidence concerning the extent of act-relevance and act-irrelevance comes from studies of charitable giving. Consider an individual giving £100 annually to charity who hears that a friend of hers is also about to start giving £100 a year to the same charity. If she were an act-irrelevant altruist, she would stop her charitable donation; for the beneficiaries of the charity would still be receiving the help that she thought was appropriate, albeit from the actions of her friend rather than herself. However, if she was an act-relevant altruist, she would not stop, since it would be the act itself that would be her motivating force, not—or not only—the situation of the people she was trying to help.

This argument has been developed in the context of the relationship between government spending and charitable donations. More specifically, it can be shown that, if individuals are concerned only with others' welfare—that is, if they are act-irrelevant knights—increases in government spending on those others should be matched dollar-for-dollar or pound-for-pound by falls in knightly help so that the total assistance given (public and private) will remain constant.³⁷ In other words, if individuals are act-irrelevant altruists, government spending on welfare should lead to a fall in charitable donations.

Casual observation of different countries' experiences might suggest that there was something in this view. Germany, Canada, and the United Kingdom all have much larger government welfare sectors than the US, but much lower levels of giving. The ratio of private giving to personal income in Britain fell by half between 1934 and 1975, a period of sustained growth in government (Clotfelder 1985: 96–8; Falush 1977).

However, there are other features of the real world that do not lend much comfort to the thesis. The US has consistently given an amount equivalent to around 2 per cent of its GNP, regardless of the growth of government. And roughly the same proportion of people give in both the US and the UK: 85 per cent give in the US, and 80 per cent in the UK (Pettipher and Halfpenny 1993).³⁸

More systematic empirical investigations also tend not to support the view that government activity seriously 'crowds out' knightly behaviour in the form of charitable giving. Reviewing these studies in 1985, Charles Clotfelder (1985: 274–5) concluded that 'the econometric evidence on this question [whether increased government spending reduces private giving] shows little if any effect of this sort, in spite of the apparent relationship observed among nations in the size of government and the strength of private giving'.

Moreover, little supporting evidence for crowding out has emerged since Clotfelder's review. Bruce Kingma (1989) found slight crowding out with

³⁷ Sugden (1982), Warr (1982), Roberts (1984), Bernheim (1986).

³⁸ However, it is worth noting that the pattern of giving is very different. As Karen Wright has pointed out, in the US giving is 'heavily interlaced with self-interest, either directly through tax benefits, benefits from the supported charity or social status; or indirectly through the social goals one might desire', whereas in the UK 'the British expect giving should be altruistic, even self-sacrificing'. Wright goes on to describe the US as an illustration of 'generosity' to be contrasted with the UK's 'altruism'. See K. Wright (2002: 21–2).

respect to US public radio, with 15 cents of donations crowded out for every dollar of government grants. Julian Wolpert (1993) found in a study of US local communities that local public generosity moves in tandem with private generosity, not in the opposite directions, as the crowding-out hypothesis would predict. In Britain, Jyoti Khanna, John Posnett, and Todd Sandler (1995) studied a sample of 159 charities from 1983 to 1990 (the height of the Thatcher period) and found no crowding-out effect on charitable donations of government grants to the charities; indeed, if anything there was a slight crowding-in effect, with a £1 increase in government grants being associated with a 9.4 pence rise in charitable donations.

A possible exception is a more recent experiment by James Andreoni. In a controlled laboratory setting involving 108 economics undergraduates he found quite a lot of crowding out (71 per cent). But as he noted:

The controlled setting of the laboratory deliberately eliminates other factors such as sympathy, political or social commitment, peer pressure, institutional consideration or moral satisfaction associated with particular cases that may influence contributions to public goods in general. The fact that crowding out measured here is much higher than in econometric studies indicates that perhaps these factors may also be having an important effect on individual contributions (Andreoni 1993: 1326).

CONCLUSION

What does this brief review of the literature tell us that would be useful for designing policy? There are three key conclusions. The first and most important—although perhaps the least surprising—is that altruistic behaviour exists. People can behave as knights, and indeed frequently do so, even in situations where their actions are diametrically opposed to those that would further their self-interest. Moreover, these motivations appear to be prevalent among providers in the public sector, although interacting in complex ways with more self-centred motivations.

Second, there are, at least in principle, different kinds of knights, motivated by different considerations. In particular, there are act-irrelevant knights, motivated by compassion or feelings of injustice but not necessarily by the need to perform knightly acts themselves. And there are act-relevant knights, individuals in part motivated by the same considerations as the act-irrelevant knights, but also motivated by the need to perform the helping acts themselves. This may in turn be motivated by ‘warm-glow’ feelings, by feelings involving the alleviation of guilt, or by feelings of duty.

Third, the evidence suggests that much altruistic behaviour is of the act-relevant kind. This is of great importance for policy design, as we shall see in subsequent chapters.

3 Motivation and the Policy Context

Today the key word . . . in economics is ‘character’ . . . [the reason] why individualist economists fear socialism is that they believe it will deteriorate character, and the reason why socialist economists seek socialism is their belief that under individualism character is deteriorating.

(Stefan Collini, ‘The Idea of “Character” in Victorian Political Thought’, quoting an unspecified socialist commentator from the 1890s)

Previous chapters have argued that, in the design of public policy, policy-makers have to consider how the people who implement those policies are motivated.³⁹ In doing so, consciously or unconsciously, they tend to work with either of two crude assumptions about human motivation. One incorporates the belief that individuals are fundamentally motivated by their self-interest: knaves, in our terminology. Alternatively, policy-makers assume that individuals, especially those associated with the public sector, are motivated by a self-denying altruistic ethic that puts the interests of the people they are supposed to be serving above their own: not knaves but knights.

It was also argued that in recent years we have seen a shift in policy-makers' beliefs about the motivation of those involved in the public sector in general and the welfare state in particular. There has been a gradual erosion of confidence in the reliability of the public service ethic as a motivational drive and a growing conviction that self-interest is the principal force motivating those involved in public services. Since the market is the quintessential mechanism for corralling self-interest to serve the public good, this in turn has led policy-makers to develop the use of quasi-market mechanisms in the delivery of public services. These are mechanisms that rely on taxation or other revenues to finance the service concerned but that use market incentives to ensure that the service is provided in the most efficient and responsive manner possible.

The extent to which these changes in belief were well-founded and, more generally, whether the market-oriented policy changes to which they gave rise have had the desired outcomes will be discussed in subsequent chapters, and I shall not dwell further on these questions here. Instead, I concentrate on

³⁹ An earlier version of some of the material in this chapter appeared in Le Grand (2000).

a slightly different issue. Both sets of beliefs about motivation actually incorporate another assumption, one common to them both. This is that the balance of motivation—the extent to which individuals are motivated to behave as knights or knaves—is independent of the policy structures themselves. As Philip Jones and colleagues have noted, economists and other social scientists, as well as policy analysts and policy-makers themselves, often take as given the proposition that individuals have a certain basic structure of motivation; and that the task of policy-makers is to accept that structure and to adapt their policies accordingly (Jones, Cullis, and Lewis 1998). But what if the assumption that motivation is exogenous or external to policy change is incorrect? What if motivation is actually endogenous or internal to policy? That is, what if policy reforms, whether in a market-oriented or a state-oriented direction, affect the balance of motivation itself? It is to this key question that this chapter is addressed.

I begin with an examination of some of the research relating to the introduction of market incentives into areas where they did not exist before. Interestingly, this work does not all point in the same direction. Some parts suggest that the introduction of the market ‘devalues’ knightly activity, leading to a reduction in that activity, while other parts suggest the opposite: that market payments ‘revalue’ or validate the activity concerned. I then discuss a parallel thesis, the irony of which is apparent in the quotation with which this chapter opens: that it is not market interventions but state ones that shift the balance of motivation. On this view, it is government, not the market, that corrupts; it is the state that turns the knight into the knave.

THE MARKET: DEVALUE OR REVALUE?

Many writers have claimed that the market corrupts, or, more precisely, that the use of market mechanisms reinforces the expression of self-interest and reduces the opportunities for altruism. So, for instance, Alan Ware (1990: 191) argues that, in societies that place a greater reliance on markets, ‘habits, conventions and principles which support aid for others are weakened’. Fred Hirsch (1977: 82) claims that ‘a market economy probably encourages the strengthening of self-regarding individual objectives and makes socially-oriented objectives more difficult to apply’. More fundamentally, the sociologist Richard Sennett (1998: 148) has argued in his book on the corrosion of character by modern capitalism that ‘a regime which provides human beings with no deep reason to care about one another cannot long preserve its legitimacy’.

But perhaps the most prominent among the advocates of the view that the introduction of the market ‘devalues’ knightly activity—that is, that it turns altruists into egoists—is Richard Titmuss. His key work in this area was the study, mentioned in previous chapters, that explored the supply of blood in Britain and the United States, *The Gift Relationship* (Titmuss 1971/1997). Two economists had argued in a publication for the Institute of Economic Affairs that the solution to the then acute problem of Britain's chronic shortage of

blood for transfusion purposes was to follow the lead of certain parts of the United States and to begin paying blood donors (Cooper and Culyer 1968). *The Gift Relationship* was Titmuss's magisterial response. There he argued that the introduction of cash payments into a system for supplying blood that previously relied upon voluntary donation, so far from leading to an increase in blood supply as the economists predicted, would lead to a diminution of altruistic motivation and in consequence to a reduction in both the quantity and quality of the blood supplied.⁴⁰

More specifically, Titmuss had four basic arguments. First, a market in blood products was what economists would call allocatively inefficient. It was highly wasteful; it created shortages and surpluses. It was also inefficient in production, being bureaucratic in operation and administratively costly. In consequence it provided blood at a much greater expense than a voluntary system would.

Second, the use of the market led to the production of contaminated blood; that is, it damaged the quality of the product, with potentially disastrous consequences. This was because in a market the suppliers of blood had an incentive to conceal any aspects of their previous health history that might have led to their blood being unsuitable for transfusion purposes (such as contamination by hepatitis B or, currently, HIV); for otherwise they would not be able to collect their payment. This was different from a situation where blood was freely given, since there the principal motive of the donors was to help recipients; hence the incentive would be to reveal any history of bad health in case the gift of blood turned out to harm, not to help.

Third, the market was redistributive, but in the wrong direction. It distributed blood and blood products from poor to rich, from the disadvantaged and exploited to the privileged and powerful. The rich would almost literally suck the blood from the poor.

Finally, and of most relevance for our purposes, a market in blood was ultimately degrading for society as a whole. It drove out altruistic motivations for blood donation, replacing them with the cruder calculus of self-interest. Titmuss (1971/1997: 310–11) extended this argument to a broader critique of market incentives, arguing that

the private market in blood, in profit-making hospitals, operating theatres, laboratories and in other sectors of social life limits the answers and narrows the choices for all men. It is the responsibility of the state . . . to reduce or eliminate or control the forces of market coercions which place men in situations in which they have less freedom or little freedom to make moral choices and to behave altruistically if they so will.

The Gift Relationship is now thirty years old and, as I have noted elsewhere (Le Grand 1997a), some of these arguments have not weathered the passage of time. For instance, the argument that markets in blood are always wasteful

⁴⁰ For a detailed analysis of Titmuss's relationship with economists and the Institute of Economic Affairs, see Fontaine (2002).

and necessarily create shortages and surpluses, and its corollary that the voluntary system always does better, has not been born out by experience either in Britain or in the United States. This part of the argument was always a little suspect in any case because of its lack of a theoretical base. Titmuss offered no theoretical explanation as to exactly why a voluntary system would closely match supply and demand, nor indeed why a market system would fail to do so: a striking omission given that economic theory would suggest precisely the reverse.

The excessive bureaucracy argument has also lost its power. Later analyses suggested that the British blood service was almost certainly heavily *under*-managed at the time of Titmuss's investigations, with damaging consequences that became apparent a few years later. Hence more resources devoted to management would probably have been desirable and would have contributed to greater efficiency rather than detracted from it (Berridge 1997).

The redistributive argument was incomplete. In particular, it ignored the fact that, although paid donation may result in blood and blood products flowing from poor to rich precisely because it would be a commercial operation, this flow would be matched by a flow of money the other way. While the idea of the poor selling blood to the rich may be morally offensive, it was difficult to claim that the poor were actually made worse-off by the transaction. Indeed, in their own estimation at least, they were likely to be better off; otherwise, they would not have undertaken the transaction.

However, the arguments concerning the impact of introducing market incentives on motivation seem to be more robust. Titmuss relied on international comparisons of the performance of existing systems of blood supply (especially between the paid donor systems of the US and the voluntary system in the UK) to provide indirect support for his proposition that the introduction of cash payments into a voluntary system would reduce both the quantity and the quality of blood supplied. More direct empirical support comes from a study in which a sample of the (American) public was interviewed to discover their attitudes towards blood donation (Upton 1973; see also Lepper and Green 1978: 72). Part of the sample was then offered a cash inducement to participate in a blood donation programme and part was not. Of those who indicated they were interested in donating blood, those in the group offered cash compensation were less likely actually to supply it than those in the group that was not. For those who were not interested, the offer of cash compensation made little difference.

Titmuss's position is also supported by some interesting findings by Bruno Frey (Frey and Oberholzer-Gee 1997; see also Frey 1997). He studied the use of monetary compensation to persuade residents of certain communities in Switzerland to accept a nuclear waste depository located in their community. A survey of more than 300 residents found that more than half (51 per cent) supported the siting of the facility in their community, despite a widespread knowledge of the risks involved. The question was then repeated with the

additional information that the government had decided to compensate all residents of the host community. Varying amounts of compensation were offered to different groups of respondents, some quite substantial (equivalent to 12 per cent of Swiss median income in the relevant year). Despite its magnitude, the offer of monetary compensation actually *reduced* the level of public support for the facility by more than half (to 25 per cent). This was not due to any change in the perception of risks involved as a result of the offer of compensation: the researchers checked respondents' perception of risk before and after the compensation was offered and found little difference.⁴¹

So it would seem that there is some empirical basis for the view that the introduction of market incentives does affect the balance of motivation and, moreover, that it does so in some way that turns the knight into the knave. However, other research suggests that things may not be quite that straightforward. In particular, there is a strand of literature in the area of informal care and voluntary work that points in a rather different direction. This literature discusses, among other things, the merits or otherwise of paying carers or paying 'volunteers' to care for people in need of such care (see for instance Evers, Pilj, and Ungerson 1994). Now some research on the payment of volunteers supports the Titmuss/Frey argument, showing that such payments erode the spirit of altruism. For instance, Frey himself, together with Lorenz Goette, has examined data on volunteering from the Swiss Labour Force Survey, and found that, while increasing monetary rewards led to increasing work, the mere fact of receiving a reward reduced work effort. The magnitude of this effect was considerable: at the median reward level, the volunteers, although working more than if they had received a smaller reward, worked less than if they had received no reward at all (Frey and Goette 1999; see also Evers 1994: 30).

But there is also some evidence to suggest that, in these situations, market incentives can 'revalue' or validate knightly behaviour.⁴² For instance, Diana Leat (1990) interviewed eighty-seven people (mostly women) engaged in caring activities of various kinds. These included child minders, foster parents, adult family placement carers (carers who took mostly elderly people in need of care into their—the carers'—own homes), and agency carers (carers who provided day care for elderly people in their—the elderly persons'—own homes). She found that the carers did not provide care for strangers solely for the money, but also that few would have done it without payment; they regarded it as something that should not be expected of them without payment. However, the fact of being paid was more important to them than the level of pay for the job. Moreover, carers did not necessarily expect the market rate for the job; and sometimes they preferred their payments to be labelled 'expenses'. Further, as caring continued,

⁴¹ It is possible, though, that respondents might have felt that, in agreeing to the offer, they would be signing away rights to further compensation.

⁴² I am indebted to Clare Ungerson for this point and for drawing my attention to the relevant literature.

carers did what they felt a client needed, not what they originally said they would or would not do—and they did not demand extra payment for it.

So payment here seems to encourage rather than discourage the supply of the service concerned. Further support for this comes from an earlier piece of work by Leat. She and a colleague investigated attitudes in ten local authorities towards paying volunteers for care, where the paid individual was an 'ordinary person': something between a completely unpaid volunteer and a salaried social worker or waged home help (Leat and Gay 1987). In all cases the payment was low and could not be thought of as in any sense a wage for the job; indeed, sometimes it was described as expenses. Some of the officials interviewed were aware of the possible discouragement effect on unpaid family care of introducing paid volunteers. So, for instance, one said that 'families may feel a bit resentful—we pay other people to care and not them. Payment may devalue altruism and duty.' However, there was no mention of any negative impact on the care supplied by the volunteers themselves. Indeed the majority of those interviewed were very enthusiastic about the scheme, clearly feeling that, even if there were problems with respect to unpaid family care, they were more than offset by the increase in care supplied by the 'volunteers'. In such cases, Leat and Gay argue, carers know that what they are doing is worthwhile, that they would not do it for the money alone, but that money was not irrelevant to them: indeed, rather the reverse.

So one set of research results suggests that market incentives devalue altruistic activities, another set that they revalue them. Is there any way in which these conflicting results can be reconciled? One possible explanation lies in the gendered nature of the caring activities researched. The vast majority of the individuals concerned in the carers' research were women; and, as Janet Finch (1989: 223) observes, 'Altruistic qualities, especially in family relationships, are more frequently associated with women than with men, and therefore altruism is a concept which legitimises the many self-sacrifices women make for other members of their family.'

The question whether women are in general more altruistic than men is an open one. As James Andreoni and Lise Vesterlund have noted, research suggests that males and females have different patterns of philanthropic giving, although women do appear to be more responsive to changes in the need for giving. Further, the results from controlled laboratory experiments yield a complicated picture, with either sex on occasion emerging as the more altruistic. The work of Andreoni and Vesterlund is an example. This was a modified version of the so-called 'dictator game' where subjects decide how to allocate fixed pay-offs between themselves and others, with different prices for the different pay-offs. The results of the experiment showed that men tended to be more altruistic when the altruistic gesture was cheaper (in terms of their own pay-off), while women were more altruistic when altruism was more expensive. Also, men were more likely than women to be perfectly

selfish or perfectly altruistic, whereas women were more likely than men to share evenly.⁴³

More specifically, some of women's caring activities could be viewed as examples of 'compulsory altruism' or 'coercive socialisation'.⁴⁴ In some cases of family caring, especially where violent men are concerned, women may be physically coerced into caring activities; in other cases they may be pressured by family, friends, or an overriding internal sense of responsibility, and there is no one else who will do it for them. In other words, the individuals concerned do not feel they really have a choice between altruistic and self-interested behaviour. In that case their behaviour will not change whatever happens. However, if a payment for their caring activities were offered, then it would be viewed favourably, either because it offered some kind of symbolic recognition of the work they are doing or because it provided some (doubtless inadequate) compensation for that work. The payment is not viewed as a kind of bribe, and therefore morally devaluing, as it might have been if it could have changed their behaviour.

However, although this undoubtedly is plausible as an account of the coercive situations described, it does not quite capture the situations investigated in the research with which we are concerned here. In most of these cases—child minding, caring for unrelated elderly people—the women voluntarily chose the caring activity. Hence they do not seem to be examples of compulsory altruism in the sense that they faced a total absence of choice. So we have to look elsewhere for reconciliation.

A second possible explanation concerns the differences in the magnitudes of the situations being investigated. Blood donation has some costs associated with it; it takes an hour or two, there is a certain amount of physical discomfort associated with the actual process, and some people experience a temporary feeling of lassitude after it. However, these costs pale into insignificance when compared with the costs associated with foster-parenting or looking after elderly people on a long-term basis. Hence it would not be surprising if, although people are willing to undergo the minor degree of self-sacrifice required in giving blood without compensation, they are not prepared to do so for the much larger sacrifices required by caring. In short, there might be a 'threshold effect' whereby people are prepared to make sacrifices for the sake of others up to a certain level of sacrifice, but beyond that point they require some compensation.

There is surely something to this argument. It was always a weakness of Titmuss's claims concerning the essential altruism inherent in human nature that they were based on examples such as blood donation that required relatively limited self-sacrifice; and one should be careful before generalising

⁴³ Andreoni and Vesterlund (2001). This also provides a useful summary of other research on the topic.

⁴⁴ Land and Rose (1985), Folbre and Weisskopf (1998). See also Leat and Gay's comment that women do not 'choose' to care (1987: 59).

from this to cases involving much greater sacrifices. However, again the argument does not wholly resolve the paradox. There remains the Frey case where, for the sake of the community, people did seem prepared to accept rather larger sacrifices (such as an increase in environmental hazards and the devaluation of property) than in the case of blood donation; although the costs in this situation are perhaps still not as great as those involved in caring situations, they are not offset by any benefits in terms of feelings of tenderness or gratitude that might accompany caring. Moreover, the level of support actually dropped when compensation was offered, which is precisely the opposite of the effect that the threshold argument would predict. Also, there are features of the caring situation that remain unexplained by the cost argument: for instance, the fact that some people did not expect to receive a market wage for their activities and indeed preferred payments to be labelled as compensation or expenses rather than as wages.

And I think it is here that we have the explanation that resolves the apparent paradox. In cases of knightly activity that involve large sacrifices, people do value some form of payment both as a form of recognition and as partial compensation for the costs involved. However, that payment should not be so great as to compensate fully for the sacrifice, for if it did there would be no satisfaction from making the sacrifice in the first place. In fact, if people were paid an amount that fully compensated them—or more than fully compensated them—the effect might be perverse, reducing rather than increasing the supply of the activity concerned. I develop this further in Chapter Four as part of a more general theory of public service motivation.

GOVERNMENT: MORAL ATROPHY OR ENCOURAGEMENT?

In an ironic counterpart to the ‘market corrupts’ thesis, it has also been argued that it is government rather than market activity that corrupts. More specifically, it has been claimed that government institutions such as the welfare state can lead to a reduction in knightly activity by individuals: what has been termed moral atrophy.⁴⁵

This reduction could arise for a number of reasons. First, government intervention reduces the opportunity for altruistic acts. So, by providing for the poor, the welfare state makes it less necessary for people to behave altruistically by helping them. This has been termed the ‘substitution effect’ in the literature. Second, through the taxation it imposes in order to finance its welfare activities, it reduces people's incomes and therefore the resources they have available for performing knightly acts such as charitable donations. This has been described as the ‘income effect’ (Abrams and Schmitz 1978). Third, it reduces the availability of the mechanisms for performing knightly acts. So,

⁴⁵ The arguments in this section owe a good deal to Goodin (1993).

for instance, it has been claimed that the introduction of state institutions providing welfare eroded the voluntary organisations and charities through which people used to express their charitable impulses (Coleman 1990: 321; Green 1993; 1996). Fourth, governments may actually change the motivation of people to perform knightly acts, making them more selfish. This could be done by conscious exhortation or example: a right-wing government could emphasise self-help, for instance, while denigrating so-called do-gooders in both its rhetoric and its policies. Or government could shift the balance of motivation by an unintended consequence of other policies. Thus, compulsory redistribution through welfare taxation and spending may make people resentful and thereby more concerned to protect their own interests.

Much of the discussion in the literature has concentrated on the first of these reasons: the substitution effect. If altruistic individuals' only concern is with the welfare of others—that is, in the terminology introduced in the previous chapter, if they are act-irrelevant knights—then any help those others get from government should lead to a reduction *pari passu* in the help provided by the knights. That is, government intervention would 'crowd out' individual altruistic actions. But, as we have seen in the previous chapter, in the cases studied in the literature this did not always occur.

One explanation for the failure of the substitution effect to appear in empirical studies is that actually there is an effect working in the opposite direction: governments have a positive, or demonstration, effect on knightly behaviour (Jones, Cullis, and Lewis 1998). Psychological evidence suggests that observing altruistic behaviour can encourage observers to engage in more such behaviour themselves (Bryan and Test 1967). In that case, public policies aimed at, for instance, helping the disadvantaged could serve as a model for potential knights. Again, this would be a shift in motivation, although in an opposite direction to that discussed above.

The state could influence the balance of motivation through its legislative activities. So the government could indicate through the legal system social disapproval of knavish practices, and thereby help internalise that disapproval within individuals. Thus the institution of a minimum wage could signal social disapproval of employers knavishly exploiting their employees by paying them low wages, and perhaps thereby affecting employers' attitudes towards their employees.⁴⁶

⁴⁶ Indeed, no less a thinker than Aristotle has argued that the legislators themselves could have a favourable moral impact on their citizens, thus: 'Legislators make their citizens good by habituation: this is the intention of every legislator, and those who do not carry it out fail of their object. This is what makes the difference between a good constitution and a bad one' (see Thompson 1976: 92). In fact, Aristotle was making three points: that legislators by their actions can influence the moral character of the people for whom they are legislating; that they do it by 'habituation'; and that this influence should be to improve the moral character of their citizens. I am grateful to Karen Wright for drawing my attention to this passage.

GOVERNMENT MODELS OF SERVICE DELIVERY

But there is another way, of more direct relevance to the concerns of this book, in which governments may ‘corrupt’ those who work within public services. Many governments historically have tended to reject market mechanisms entirely in their dealings with public services, and to use non-market models of service delivery. The two most common forms of these can be termed ‘command and control’ or ‘hierarchical’ models, and ‘network’ or ‘trust’ models.⁴⁷ And both of these have the potential for affecting the motivation of those who work within them, as we shall see.

The most widely known non-market model that governments have adopted is command and control. This relies upon the state both funding and providing the service concerned. A state-operated administrative bureaucracy organises and delivers services. The state owns all the relevant assets and employs, directly or indirectly, all staff. Those at the top of the hierarchy set the aims of the service. Resources are allocated to meet those aims according to managerial fiat. Service delivery occurs through administrative processes, via instructions given by superiors to those lower down in the managerial hierarchy. Classic examples are the forms of economic organisation that characterised the Soviet Union and eastern European countries before the fall of the Berlin Wall. But elements of command and control appear in many countries' systems of public service provision, including health care in several western European countries and education in many parts of the United States.

The network or trust model is perhaps less widely known, at least under those labels, but is becoming increasingly fashionable among some analysts and commentators. It is similar to command and control in some respects, but differs crucially in one key factor. Here again the state owns all the relevant facilities and assets and provides the funding, and to that extent the model is similar to command and control. But there is no direct command or instruction mechanism to allocate resources. Instead, service delivery on the ground is undertaken by qualified professionals who are trusted to make the right decisions in allocating the service among users. Resource allocation is undertaken through collaboration between the relevant individuals and agencies, through networks of more or less complexity, with the emphasis being on social relationships and trust rather than on hierarchical management, as in the command and control model, or on impersonal economic exchange, as in market-oriented models.⁴⁸

An illustration of this kind of model in action was the British National Health Service between 1948 and 1991. This has been described by many authors

⁴⁷ This classification has many parents. But key references include Williamson (1983), Ouchi (1980), and Thompson, Levacic, and Mitchell (1991).

⁴⁸ The term ‘network’ is used to describe many different forms of organisation, from the Sicilian Mafia to clinical networks among medical professionals. I shall use it only in the sense specified here. For further reading and discussion of the term, see OD Partnerships Network (2002).

(including the present one) as an example of the first model: command and control (Le Grand 1999*b*). However, this is misleading. For there were rather few commands and precious little control. It is better described as an example of the network model, one that relied upon politicians and civil servants to allocate resources at a macro level and gave medical professionals almost complete clinical freedom to make ground-level decisions as to which patients should receive what treatment. The British school education system pre-1989 is another case, with local authorities allocating the funds to schools but with teachers being given extensive freedoms to determine curricula and teaching methods.⁴⁹

What of the impact of these models on motivation? In the command and control model, for subordinates within the hierarchy motivation is irrelevant. It is assumed that subordinates will simply carry out the orders and instructions that emanate from the top. Non-compliance is met with punishment. Agents are neither knaves nor knights but something closer to pawns.⁵⁰

It does not need much insight to see that this kind of system can be directly demotivating—especially if the agents are knights. Systems that treat knightly providers as pawns risks demotivating them completely or turning them into knaves in an attempt to dodge the system, with potentially dire consequences for the public interest. Many of the classic illustrations of this can be found in the innumerable anecdotes that emanated from the old command and control economic systems in the former Soviet Union and eastern Europe. A more systematic study is that of H. G. Barkema (1995), discussed by Bruno Frey and Reto Jegen (2000). This study investigated the behaviour of 116 managers in Dutch firms in a variety of circumstances, and found that the closer the degree of personal supervision the greater was the (negative) impact on work effort.

In the network model, those who work in the service are essentially assumed to be knights. Their chief concern is supposed to be with the needs and wants of the clients they serve, and all their resource and service allocation decisions are made with those needs and wants in mind. There are no conflicts between different self-interested groups or individuals, or even between self-interest and the public interest, because none of the individuals involved is supposed to be self-interested. All have as their principal concern the same public interest; therefore the public interest will be served. Hence there is no need for an exchange or managerial relationship of any kind between them: trust will suffice. Policy-makers simply give agents resources and trust them to allocate them as they wish.

⁴⁹ In practice, most public service delivery systems incorporate elements of some or all of the models. Even in cases where one model is dominant, it may not take exactly the form spelt out here: there are not only quasi-markets but quasi-hierarchies and quasi-networks. See Exworthy, Powell, and Mohan (1999).

⁵⁰ An alternative interpretation is that the agents are knaves and the relationship is a contractual one. However, unlike in the quasi-market case, the contract is between employers and employees, where time, not a specific service, is exchanged for income. And the principal motivational tools are fear of punishment, such as job insecurity, not service-specific financial reward as in the quasi-market model: sticks rather than carrots.

But reliance upon trust in this way can create problems. A network system that trusts the providers of public services to put users' concerns ahead of their own will break down if the providers are really knaves; for there will be no mechanism for preventing them simply serving their own interests by their activities. But that is not all. Even if agents are knights, for the system to work as the policy-maker intends they have to be of a particular kind: that is, the kind that completely identifies his or her knightly interests with those of the policy-maker. They would have to share the same view of what constituted the public interest. But there would be little guarantee of this. A doctor whose principal concern was only for the welfare of his or her patients, for instance, would not necessarily work to the same agenda as a policy-maker whose concern was all the patients in a specific geographical area. For giving priority to the doctor's patients (as this particular knight would do) might result in patients with more serious needs elsewhere in the area being neglected—which could run against the aim of the policy-maker. Similarly, a teacher whose aim was the (non-selfish) furtherance of some fundamentalist religion might undertake activities that worked against a policy-maker's aim of wider social cohesion.

Faced with problems such as these, network models often end up having to develop systems of monitoring and regulation. Inspection and regulation units are set up aimed at ensuring that all providers (whether knights or knaves) actually do behave in ways that the policy-maker wants them to. This again has consequences for motivation. As Michael Power (1999: ch. 5) has argued, in circumstances where they are regularly audited professionals feel (rightly) that they are no longer trusted; they feel resentful at the auditing requirements imposed on them by the inspection agencies; they become less committed to the service and more inclined to pursue their self-interest.

So government can corrupt, not only through its own activities but also through the model of public service delivery that it chooses to adopt. Command and control, network, and quasi-market: all have the potential for shifting the balance of motivation among the individuals who work in the public sector. The direction of the shift will depend on the context; but some shift there is always likely to be.

CONCLUSION

As the epigraph of this chapter illustrates, concern about the impact of the policy environment on motivation (or 'character') has a long history. And, whatever the detail of the research results, it is clear that policy structures, whether governmental or market, can indeed influence the balance of knightly and knavish behaviour in the individuals affected. This is a truth that policy-makers must learn to recognise; for, if they do not, their policies are likely to fail, with unfortunate consequences both for those who implement the policies and for those who are intended to benefit from them. In Chapter Four I consider some of the theoretical and policy implications of this fundamental insight.

4 A Theory of Public Service Motivation

Oh good old man, how well in thee appears
The constant service of the antique world,
When service sweat for duty not for meed!
Thou art not for the fashion of these times
Where none will sweat but for promotion.
(Shakespeare, *As You Like It*)

Chapter Three illustrated how policy structures and context can change the balance of motivation in individuals working in the public sector. In this chapter I draw together some of the arguments into a theoretical account of public service motivation, and try to draw out some of its implications for policy.

A THEORY OF PUBLIC SERVICE MOTIVATION

As we saw in Chapter Two, most people, including and perhaps especially those involved with the public sector, are motivated to perform altruistic acts because they wish to help others and because they derive some personal benefit from performing the acts that help others. That is, they are act-relevant knights.

Now the benefit that an act-relevant knight derives from performing an altruistic act itself is likely to be related to a number of factors. These would include the extent of the help they can offer, the extent to which that help benefits the persons concerned, and, probably of no little consequence, the degree of approval that the activity concerned attracts from the outside world. However, and this is the possibly unexpected insight from the work we have been reviewing, the motivation to undertake an altruistic act also seems to depend positively upon *the degree of personal sacrifice associated with the act*. We might term this the act's opportunity cost: that is, the cost to the individual concerned of other opportunities for personal benefit that have had to be forgone because he or she has chosen to undertake that act.

The relationship between the benefit derived from an altruistic act and its opportunity cost will be complex. If the cost is too little, the benefit from making the sacrifice will also be relatively little and the individual's motivation to perform the act will be correspondingly reduced. For the activity to feel really worthwhile, people need to feel that they have made some effort to perform it—to have incurred some significant cost. Too great a cost, on the other hand, will also demotivate them; they will feel that there is a limit to the amount of sacrifice of their interests that they are prepared to make for the sake of others, and they will therefore feel less inclined to undertake the activity. In other words, there are cost thresholds such that, if the cost falls below the lower threshold or rises above the higher one, people are less likely to perform the activity than if the cost falls in between.

This 'threshold' account contains some simplistic psychological assumptions and is obviously quite stylised as a description of human behaviour. But it can offer some insights into the apparent contradictions in the research results concerning market incentives that we have discussed in the previous chapter. It will be recalled that these provided evidence from blood donation and public reaction to the siting of nuclear waste disposal facilities which indicated that the introduction of market incentives devalued that activity. This contrasted with evidence concerning voluntary carers' activities which suggested that they favoured some form of compensation and regarded it as revaluing, not devaluing, their activities.

Now the carers who welcome compensation and who do not reduce their activity when offered it (or even do more) may be in the situation where there is still some significant cost of the activity to them: that is, the payment does not fully compensate them for the opportunity costs they incur. Hence some sacrifice is still involved and in consequence they continue to 'value' the activity. Indeed, the compensation, through indicating a measure of social approval for the activity, may have actually increased the benefit they derive from it, and they may supply more of it. The paid blood donors and those offered compensation for the nuclear waste disposal facility, on the other hand, may be in the situation where the compensation is adequate or more than adequate to compensate them for their perceived sacrifice. Hence there is no net sacrifice, no altruistic satisfaction from the activity concerned, and supply is thereby reduced.

Of course, in the blood donation and nuclear waste compensation cases, if compensation were increased yet further, individuals' knavish instincts may begin to kick in and supply would increase again. In short, if financial payments for an activity are introduced at a low level where previously there were none, the supply of the activity may remain constant or even increase; as the financial payments are increased, the supply will be reduced; as they increase further, the supply will gradually increase again.

This theoretical account can be viewed as a special case of a more general theory put forward by Bruno Frey, whose pioneering work on community

reactions to the siting of a nuclear waste disposal facility has been noted above.⁵¹ This in turn is based on the psychological literature concerning the distinction between ‘intrinsic’ and ‘extrinsic’ motivation.⁵² There it is argued that there are two kinds of motivation for action: one intrinsic or internal to the individual concerned and one extrinsic or external. This is usually applied to the workplace, where intrinsic factors are taken to include interest in or enjoyment of the work for its own sake, while extrinsic ones include wages and salaries, promotion, the threat of losing one's job, and direct commands or orders.

It is argued that there may be a trade-off between the two kinds of motivation, such that too heavy an emphasis on extrinsic motivation can drive out intrinsic motivation. So motivations activated by external factors, such as monetary incentives or direct orders (as in the hierarchical model of service delivery discussed in the previous chapter), can ‘crowd out’ motivations that are internal to the individual, such as more altruistic concerns. In particular, they will do so if they are viewed as controlling by the individuals concerned—as reducing their sphere of self-determination and self-esteem. However, extrinsic motivational factors can also reinforce intrinsic motivation if they are seen as supporting self-determination or self-esteem. In that case external motivation is seen as ‘crowding in’ intrinsic motivation.

This theory has a number of problems, including the difficulty of satisfactorily distinguishing between ‘intrinsic’ and ‘extrinsic’. As Robert Lane (1991: 368) notes, ‘the “reward” for intrinsic motivation is the inner feeling, but the information that produces that feeling is often extrinsic—and indeed may be manipulated by another’. Moreover, although it is tempting to read directly across from ‘extrinsic’ and ‘intrinsic’ motivations to ‘knaveish’ and ‘knightly’ ones respectively, this would not be correct. Extrinsic motivational factors do include what we might consider to be the knaveish ones of cash payments or fears about job security, but could also include forms of recognition by the outside world of the merits of altruistic actions. On the other hand, many aspects of intrinsic motivation could include essentially self-interested factors such as enjoyment of the task itself, satisfying one's curiosity, and so forth, as well as the gratification received from performing knightly acts.

However, the concepts are nonetheless useful for our purposes. To return to Frey, he argues that changes in the supply of any activity (not just altruistic ones) in response to changes in the financial rewards associated with that activity will be the product of the interaction of two effects: what he terms the Crowding-Out Effect and the Relative Price Effect. The Crowding-Out Effect occurs when an extrinsic reward is introduced for an activity (such as the introduction of financial payments) and thereby undermines the intrinsic motivation to perform the activity (which may include altruistic motivations,

⁵¹ The best account of Frey's most recent thinking can be found in Frey (2000).

⁵² See, for instance, Lepper and Greene (1978), Deci and Ryan (1985), Lane (1991: 371–4).

but may not). The Relative Price Effect increases the 'price' of not undertaking the activity relative to that of undertaking it (that is, it increases the money forgone through not doing it) and hence encourages a greater supply of the activity. Which effect is dominant at any one time will determine the level of supply of the activity concerned.⁵³

In Frey's terminology, what we are suggesting here is the following. (For those comfortable with supply and demand diagrams, a diagrammatic explanation is provided in the Annex to this chapter.) The introduction of financial payments for altruistic activities can lead to a crowding-out effect because it reduces individuals' perception of the sacrifices they are making to engage in that activity. However, that impact is not continuous, but begins to dominate only as the value of the payment gets close to fully compensating the individuals concerned for their sacrifices. Below that level it is more likely to be 'crowding-in' that dominates, with the financial payment indicating social approval of the activity and hence encouraging them to supply more of it. If, on the other hand, the value of the compensation is larger than the monetary value of the opportunities forgone by undertaking the activity (the cost), the relative price effect begins to dominate and again more of the activity will be supplied.

The central idea in this account—that the amount of sacrifice involved in undertaking a knightly act is an important motivating factor for the act—is contrary to much economic intuition. Thus Geoffrey Brennan and Alan Hamlin say 'it is a matter of *basic economic logic* that an [altruistic] act will be undertaken more extensively . . . if it is less costly to the actor in terms of other desired things forgone'. And Nancy Folbre and Thomas Weisskopf argue 'a higher price cannot, *by definition*, elicit a greater supply of labour motivated by altruism'.⁵⁴ But, as we can see, in fact there is no logical or definitional objection to the idea that individuals may be motivated to undertake altruistic activity by the fact that a measure of sacrifice is associated with it—or indeed to the idea that the greater the sacrifice, the more of the activity that may be undertaken (at least up to a point).⁵⁵

The sacrifice account may not be consistent with 'economic logic' but it is consistent with some work done in a related context: the public perception of what constitutes a volunteer. Studies by Cnaan and colleagues show that the perception of who is or is not a volunteer is related to the extent to which the public sees the individual concerned as incurring a 'net cost' (total costs minus

⁵³ Frey has extensively reviewed the empirical evidence for crowding-out and crowding-in. See Frey (2000) and Frey and Jegen (2000).

⁵⁴ Brennan and Hamlin (1995); Folbre and Weisskopf (1998: 181). Emphasis added in both cases. See also Brennan and Hamlin (2000: 19): '[T]he desire to act morally will be more decisive the lower the opportunity cost.'

⁵⁵ The key factor for economists is that the amount of sacrifice involved is not simply a function of the constraints that individuals face, as is normally assumed; instead, the degree of sacrifice actually enters into their utility function and thereby affects their underlying preference structure for knightly and knavish activities.

total benefits) from the activity concerned (Cnaan and Amroffell 1994; Cnaan, Handy, and Wadsworth 1996). The greater the net cost—what we have termed the sacrifice—the more ‘pure’ is the volunteer. Although this does not say anything about what actually motivates volunteers, it does demonstrate that in the public perception there is a link between the amount of sacrifice and the exercise of altruism, at least as altruism is expressed through volunteering.

The theory is also consistent with the social psychologists' argument that crowding-in reflects a reinforcement of intrinsic motivations, and crowding-out a controlling of those motivations. It will be recalled that external factors can reinforce intrinsic motivation if they are seen as supporting self-determination or self-esteem. In that case external motivation is seen as crowding-in intrinsic motivation. In the cases where individuals value payment, it is plausible to suppose that this is because they feel reinforced in their actions because, through the provision of payment, the outside world is recognising—and appreciating—the sacrifices that they are voluntarily making. In the cases where individuals appear to regard payment as devaluing their altruistic motivation, they may be viewing the payments as controlling—as reducing their sphere of self-determination and self-esteem—and hence they will be demotivating. The individual is no longer making a sacrifice, and has thereby lost a measure of autonomy in what he or she is doing.

IMPLICATIONS FOR SERVICE DELIVERY

If this analysis is broadly correct, what are its implications for the discussions in the previous chapter, especially those concerning the corrupting effects of markets and financial payments? The analysis suggests that market payments can be employed to good effect but that they need to be employed with care. If they are small, then they need have no crowding-out effect on altruistic motivation; indeed, they might even complement it. If, on the other hand, they are too great, they may well erode people's sense of sacrifice and thereby reduce their intrinsic motivation to perform the activities concerned. Supply will fall. Of course, as market payments increase further, they will increase extrinsic motivation: that is to say, they will appeal to individuals' self-interest, and hence induce further supply of that activity that way.

The amount actually paid in any given situation will depend on the level of demand and on the positions of the thresholds for the individuals concerned. If these are known, then the payment issue is relatively simple. If the demand for the activity is relatively low, then the level of altruistic supply, coupled perhaps with a little extra supply crowded-in by some small extrinsic reward, may be sufficient to meet the demand. That might have been the situation in the 1960s for blood donation. If, on the other hand, demand is relatively high, then the amount paid will have to be sufficient to induce a level of supply through knavish motivations that is more than sufficient to compensate for any fall due to the crowding-out of altruistic supply (these arguments are illustrated diagrammatically in the Annex).

There are moral issues involved here. In the situation of high demand, is the social gain of having sufficient of the activity to meet the demand worth the social cost of a partial or complete crowding-out of altruism? In the situation of low demand, are the altruistic suppliers being exploited by receiving lower levels of reward than they would have done if they had been more knavish? These are important issues, but proper treatment of them at this point would deflect us from the main analytic argument. Hence I postpone that discussion to the end of the chapter.

So it is possible to use this kind of analysis to structure the payment system so as to induce the right amount of the activity—if the positions of the thresholds for the individuals concerned are known. But this condition is strong. In practice it may be far from easy to gain the information necessary to fulfil it. What if, as seems much more likely in real policy situations, the thresholds' locations are not known, or, at least, are not known with sufficient precision to enable the tailoring of payment structures in the manner proposed? How then should the incentive structure for the delivery of public services be constructed?

Knightly Strategies

One answer to the problem of ignorance concerning motivation and one that, as we have seen in the previous chapter, has often been adopted in the provision of public services through the use of the 'network' model, is simply to assume that everyone is a knight. Those working in the public sector receive flat salaries and are trusted to provide the service with little or no monitoring of performance.

The principal difficulty here, as discussed in the previous chapter, is that, if in fact all the individuals concerned are really knaves, then the provision of low-quality, high-cost services is inevitable. For the knaves will exploit their position of trust to further their own ends, reducing uncomfortable effort and thereby reducing outcome, lowering both the quality and the quantity of the service provided. Moreover, problems remain with this strategy, even if there are many knights and the knaves are only a few. For, as the knights observe knaves' exploitation of the situation, they may feel their goodwill is being exploited. They will feel exploited themselves and perhaps start behaving more knavishly. Knights will turn into knaves. And this process may be cumulative; for as more convert to knavishness the incentives for the remaining knights to do likewise become even more intense.

Peer pressure may alleviate this to some extent, especially in the early stages of the process. The knights may engage in verbal or other forms of social disapproval to keep the knaves under control. But the effectiveness of this will be hampered by the fact that much of the activity (or inactivity) of public services is not readily observable by peers, taking place as it may in the individual classroom or practice surgery, for instance.

Again as mentioned in the previous chapter, similar problems also arise if the individuals are indeed knights but different kinds of knights from the

policy-maker (the doctor concerned only with his or her patients, the teacher of fundamentalist religion). Again the public interest will not be served, at least in the policy-maker's terms. Here peer pressure is likely to operate in a way that exacerbates the problem, for an individual's immediate peers are likely to share his or her values and to resist the imposition of other values by outside authorities.

Now institutions have developed that attempt to address these problems (Arrow 1963). One is that of the profession, in which professional organisations establish codes of ethics designed to prevent exploitative behaviour and try to enforce those codes on their members. The problem here is that the professional organisations have a tendency themselves to become knavish in their approach. Although designed to protect the users' interests, they too often end up protecting those of their members. And, once they are perceived as doing that, the trust that they are supposed to be reinforcing has gone.

Another institution for trying to prevent exploitation is the government-appointed regulator or monitor. But, again as we saw in the previous chapter, monitoring, even with a light touch, can also have the effect of turning the knight into the knave. If people feel they are not trusted to provide a quality service and, moreover, are forced to undertake elaborate activities to prove that they are in fact doing a good job (such as filling out forms, writing reports, and so forth), they often become either demoralised and demotivated or else motivated to behave in a more self-protective manner. Regulation and trust are difficult to reconcile.

Knavish Strategies

An alternative that could be considered is that, in a situation of ignorance concerning the motivational structure of individuals, it would be safest to adopt public policies based on the assumption that everyone is a knave. For a knavish strategy will do little harm if people are actually knights; and it could pay off dramatically if they are knaves.⁵⁶

The point can be illustrated by an example. Take a particular group of people involved in some public service institution, say, doctors in a hospital. Now suppose that most of these doctors are in fact knights, doing the best they can for their patients, often at considerable personal sacrifice. Moreover, the reward structure of the hospital is actually based on that assumption, with automatic payment of salaries and with no monitoring of doctor behaviour or performance review. But suppose, too, that there are a few specialists that are knaves, spending their time on the golf course or managing their investment portfolios, to the obvious detriment of their patients. And suppose further that this behaviour, despite the fact that it is characteristic of only a small number of doctors, is damaging the performance and reputation of the hospital as a whole, and thereby threatening its survival.

⁵⁶ For a critique of these arguments, see Hausman (1998). See also Goodin (1996: 41–2) and Pettit (1996: 72–5).

Now suppose in this situation that a system is introduced of performance-related pay. Since they are not motivated by economic self-interest, it could be argued that this will leave the knights' motivational structure untouched: they will still derive the same reward as before from doing good to patients. They will therefore carry on undertaking to the best of their ability all the activities that are part of what they perceive as their duty to patients. The knaves, on the other hand, will see that it is now in their self-interest to perform their duties properly and will react accordingly. What the new structure will have done, therefore, is bring the knaves into line, ensuring that they perform as least as well as the knights. Everybody, knights and knaves, is now performing to the best of his or her ability; and the hospital is saved.

However, in practice things may not always be that simple. The principal problem with the example is that it assumes the introduction of the knavish strategy will have no impact on knightly behaviour. But if the effect is to reduce the sacrifice involved in their work for the knights, then, if their activity levels are such that they are between the two cost thresholds referred to above, then, as we have seen, this may crowd out their intrinsic motivation and lead to a reduction in activity.

Now it could be argued that in one sense, even if something like this does occur in these situations, it does not matter. Any fall in activity can be overcome by increasing the rate of performance pay (on the assumption that this is economically feasible) until the erstwhile knights have crossed the threshold where the relative price effect begins to dominate. Then, so long as the incentives for knaves are the right ones, performance will continue to improve.

But there is a problem. This argument assumes that the knaves' strategy is watertight; that there is no way of getting round the system in a way that furthers self-interest except, on this occasion, at the expense of the public good. So, for instance, a system of performance-related pay would require reliable and accurate procedures for measuring and monitoring performance: procedures that cannot be fiddled to indicate better performance than is actually happening or that more effort is being made than is actually the case. But such systems are often difficult, if not impossible, to construct or maintain, especially for services such as health or education, where quality can be difficult to measure. As we saw in the previous chapter, this was one of the central points of Titmuss's critique of the use of market incentives to increase the supply of blood. Because it was so difficult properly to monitor quality in blood donation, market incentives would inevitably lead to the provision of low-quality blood. So, by extension, for public services: if quality cannot be properly assessed by the purchaser of the service, the knave will have every incentive to lower quality.

Incentive Contracts

In recent years economists have developed mechanisms for contracting between the purchaser and the provider of a service that try to address some of these problems, especially those concerned with the asymmetry of

information concerning cost, quality, and effort between purchaser and provider. These mechanisms can result in the provider's revealing some of the necessary information and thus minimising some of the difficulties illustrated above. They are often termed 'incentive contracts' on the grounds that they are contracts that incorporate incentives for providers to reveal information. The analyses use the language of 'principal-agent' theory, where the principals are the purchasers or commissioners of services, such as health care, education, and social care; while the agents are those who deliver the service on the ground, such as medical professionals, teachers, or social workers.

Avinash Dixit has shown how incentive contracting can help resolve three kinds of information problem that principals face.⁵⁷ First is the so-called moral hazard problem. The agents are contributing to the production of an outcome that the principal values. The principal wishes to encourage the agents to produce more of the outcome and is prepared to pay them to do so. But the principal does not know how much effort the agents have to put in to achieve the outcome and how much is due to the factors outside the agents' control. Hence the principal does not know how much to reward the agents for improvements in the outcome. The principal also wants to make sure that the agents remain in the business of provision; they do not want to set up payment structures that result in people leaving to go to other work that, say, pays better or gives more security.

An example might be a situation where a government agency wishes to improve a school's exam results. A good set of exam results could be due to the teaching efforts of the school and its staff; but it could also arise from factors connected with the school's intake of pupils such as differences in the socio-economic area in which the school is located or in their innate ability. In this situation any reward structure that is tied too closely to, say, exam performance would not necessarily encourage more effort by staff in schools whose intake is such that already exam results are good; and it might actively demotivate staff in schools with a poorer intake who see little hope of achieving the results necessary for the rewards. Rewarding accorded to value-added might be one solution in those circumstances; but the information requirements for that are high.

One possible solution is to give the agent a fixed amount and then a bonus per unit of the outcome achieved. The fixed amount is to ensure that whatever happens to outcomes the agent still receives an income; in effect it partly shifts the risk of a poor outcome due to factors beyond the agent's control to the principal. The size of the bonus would depend upon the probability of outcomes being influenced by the agent's own efforts; the lower that probability, the smaller the bonus. And the size of both the fixed amount and the bonus would depend on the agent's likely income in alternative employment and on all the relevant parties' attitudes to risk.

⁵⁷ Dixit (2002). Much of this section is based on this very useful paper.

A second problem, known as adverse selection, arises where the agent has private information that would benefit the principal, but the principal cannot access that information. For instance, some hospitals or schools may have low operating costs but are able to conceal this from the purchasers, who could therefore end up paying substantially more for hospital or educational services than they need have done.

In this situation, one solution is to offer the agent a menu of contracts. If the contracts are properly designed, the choice of contract made by the agent indirectly reveals the information concealed. For instance, suppose a purchaser knows that a hospital's activity can be supplied at either of two cost levels: high or low. The purchaser wishes to make a contract with the hospital but does not know whether the hospital faces high or low costs. In the absence of any contractual sanction, the hospital, if managed by knaves, will obviously claim that it faces high costs and therefore should be paid a price for the activity that will cover those high costs, regardless of whether it is in fact low-cost or high-cost. For, if it really is high-cost, it will need the contract price to be at the higher level because otherwise it will lose money; and, if it really is low-cost, it will make a greater profit the higher the price.

Now suppose the hospital is offered a choice of two contracts. One is an agreement to buy a small amount at a price equal to, or slightly above, the high-cost level. The other agrees to buy a larger amount at a lower price. The lower price is set at a point where, if the hospital has low costs and accepts this contract, it will make a slightly larger overall profit than if it had accepted the other contract. If the hospital has high costs, it will accept the first contract; if it has low costs, it will accept the second. If the hospital actually faced low costs, the purchaser will not have done quite as well as it would have done in a world of perfect information, for it will have been forced to pay above that cost; but it will have done better than if it had paid the original (high-cost) asking price. And, either way, it will have forced the hospital to reveal the truth about its cost structure, information that will be useful for subsequent contracting negotiations.

Third, there is what Dixit calls the costly verification problem. This is the case where the principal can verify whether or not an outcome has been achieved only through some expensive auditing or inspection procedure. Examples might be the more qualitative aspects of hospital care, such as consideration to patients, or cases where there are opportunities for fraud, such as schools leaking exam questions to pupils before an exam. In such cases, one solution is to have a scheme that does not audit agents if they report their worst possible outcome, but in which the probability of an audit rises with the quality of the reported outcome. If the audit reveals that the agents told the truth they are rewarded; if it reveals that they lied they are fined. The probability of an audit for a given reported outcome and the rewards and fines are all calculated in a way so as to ensure truthful revelation by the agents at the least cost to the principal.

All of this assumes that the agent is a knave, or at least is concerned only with his or her own financial state. Martin Chalkley and James Malcolmson (1998) have analysed the situation where agents are wholly knaves, wholly knights, or partially knights and knaves. The knights are act-irrelevant; they have direct concerns for the users of the services they are providing, but they get no special satisfaction from performing the acts themselves. An additional complication of Chalkley and Malcolmson's analysis is that they postulate agents whose efforts can be directed in any of three directions: quantity increasing, quality increasing, or cost reducing.

If agents are knaves, all effort in their analysis has a purely negative effect on their overall utility. The problem then is similar to that described by Dixit but has the additional complication that the ideal contract would encourage not only the correct degree of effort but also the correct direction of effort (into cost reducing, quality increasing, or quantity increasing). Chalkley and Malcolmson's conclusion is that in fact it is not possible to construct a contract that will do both of these things and instead one must accept that either quality increasing or cost reduction will be minimal and construct a contract to maximise the other variable given that fact.

If agents are knights (that is, if their aims are identical to that of the principal), then the simplest thing for the principals to do is to give agents a fixed budget and allow them to spend that budget as they will. This is basically the network model discussed in Chapter Three. For if the hospital is given a fixed budget it will spend it in the same way that the purchaser would like it to without any additional incentives or scrutiny. Thus a simple block contract is the optimal solution in this situation.

A partially knightly hospital will be different from a totally knightly hospital in that it will get less satisfaction from efforts towards improving the quantity and quality of treatment and/or the balance it seeks between these two will be different. In this situation, Chalkley and Malcolmson conclude, it makes sense to have some cost reimbursement in the contract, so long as monitoring the actual cost incurred is not too inaccurate or itself too costly.

As the reader will readily recognise, these are highly stylised situations and there are many complications to be surmounted before these kinds of ideas can be usefully applied in the real world. These would include the fact that, in that world, negotiations are repeated over time, giving the opportunity for 'repeated games' and the opportunities for strategic behaviour and learning that these give; that there are usually multiple outcomes, multiple principals, and multiple agents; and that many public services have outcomes that are even vaguer and less measurable than in the examples used above. There are developments in principal-agent analysis that have tried to take some of these complications on board, and there is hope for more.⁵⁸ But the aim was not to argue that this kind of analysis yet has the answer to all the problems that we are addressing, but simply that it indicates a promising direction of travel.

⁵⁸ Again these are usefully summarised in Dixit (2002).

Non-profit Organisations

Another way of resolving some of the motivation problems that confront the delivery of public services that has been widely advocated is to place a greater reliance upon non-profit or voluntary organisations as providers of services.⁵⁹ To take two recent British examples, Ed Mayo and Henrietta Moore under the auspices of the New Economics Foundation have advocated converting hospitals and schools into what they term ‘mutuals’ or social enterprises, while the Public Management Foundation has advocated the setting up of ‘public interest’ companies.⁶⁰ In fact the non-profit label is a broad one, embracing not only mutuals, social enterprises, and public interest companies but charities, faith-based organisations, consumer and employee cooperatives, and—in the United States—public benefit companies.

These organisations are very diverse in their governance structures. Some are run by employees: workers cooperatives. Some are controlled by users: consumer cooperatives. Some are managed by representatives of the local community, some by large charitable or faith-based organisations, such as churches. Others are managed by some or all of these, with representatives of the various stakeholders on the board. But they all share one characteristic. This is not (as the non-profit label might seem to imply) that they do not make profits. Rather it is that any profits or surpluses which they do make are not distributed to shareholders. Instead, non-profits' surpluses are retained and reinvested in the business. This characteristic is often termed ‘the non-distribution constraint’.

The reason why organisations with non-distribution constraints are regarded as a possible solution to some of the problems that confront public service delivery concerns information and motivation. Those who run the organisation are by definition not motivated by the need to distribute profits to shareholders. Hence, it is argued, if contracted to provide a public service, they will not exploit their informational advantage to the detriment of the public interest. If users or purchasers (if the user is not the purchaser) cannot effectively monitor the quality of the service they are purchasing, they may prefer services provided by non-profits because they trust them not to reduce quality in search of shareholder profits. A related argument is that, because the people who work in non-profit organisations are usually prepared to take lower wages than those who work in for-profit ones, non-profits are likely to have lower costs of service delivery. For both reasons, principals contracting with non-profits could expect to get a higher quality of service for the same cost, or the same quality for lower cost, than if they contracted with for-profit firms.

⁵⁹ Rose-Ackerman (1996: 716). This article is the most comprehensive recent review of the literature on non-profits.

⁶⁰ Mayo and Moore (2001), Corrigan, Steele, and Parston (2001), and Brecher (2002). In fact this is all part of what Jeremy Kendall (2000) has called a ‘mainstreaming’ of the third sector into public policy in England in the late 1990s.

However, there is a problem relating to the motivational assumptions that underlie this argument. It seems to be assumed that the major reason why for-profit firms will behave in exploitative ways in a quasi-market situation is that they have to generate profits to distribute to shareholders. Hence organisations that do not have that possibility—that have a non-distribution constraint—will behave in a more altruistic fashion: that is, they will operate in the public interest. But this is a non sequitur. Whether in fact these organisations do conform to this assumption will depend crucially upon who actually manages them and what the motivational structure is for the managers. Employee cooperatives, for instance, will have a different set of motivations from consumer cooperatives, faith-based organisations different motivations from secular community ones, and so on. In each case there is no guarantee that they will be motivated to serve the public interest—or, if they are, it will be their own conception of the public interest, one which may be very different from that of the purchaser or principal.

Take employee cooperatives, for example. The aim of such an organisation must be the collective welfare of its members. The cooperative may have broader social objectives, but this would only be because those objectives are held by individual members, not because they are inherent to the organisation. And actions designed to maximise the collective welfare of the organisation may not be consistent with broader conceptions of the public interest. For instance, economic theory predicts that employee cooperatives will tend to restrict employment, to be less innovative, and to invest less than their for-profit counterparts. All these outcomes may be quite undesirable from a social perspective (Estrin 1989). Further, there is no reason to suppose that an employee cooperative pursuing the collective welfare of its members will be more reluctant to exploit an informational advantage it may have over the users or purchasers of its services than one driven by the interest of shareholders.

Or consider faith-based organisations. Their aim in, say, running a school may be altruistic in the sense that those in charge of the organisation are not motivated by the desire for personal gain. However, the form their altruism takes may not be consistent with the interest of the wider society. Thus, they may offer high-quality schooling, but in a fashion that is coupled explicitly or implicitly with a separatist moral or religious agenda that may be destructive of the wider community. It is possible that the morality associated with their faith may be such that they would not seek to exploit any informational advantage they may have over users; but there is no guarantee of this.

A possible way of overcoming some of these problems is to have no one specific group running the enterprise, but to have an organisational structure in which all stakeholders are represented. Attractive as this may sound at first sight, again motivational issues would have to be sorted out before it became a practical proposition. Different groups would have different motivations, some knightly, some knavish. Some mechanism would have to be introduced for reconciling these differences in a manner that was acceptable to all parties; and that may not be easy to find.

Another possible avenue is through the use of incentive contracts. Dixit (2001), for instance, has shown how to design a contract with a faith-based organisation, aspects of whose faith the principal dislikes. More specifically, he takes a case where an agent is producing both a product which the principal values but also a by-product from which the principal gets no or a negative value. The result is one in which the pay-off to the principal from the contract can be significantly reduced if the principal dislikes the by-product sufficiently, suggesting that the principal may be better-off contracting with an organisation with a different motivational structure (such as a for-profit firm) even if the latter has higher costs.

It is worth noting that non-profits may face other problems as service deliverers. They can raise capital only through issuing debts which may increase their vulnerability to economic downturns. Some forms of non-profits, especially those where no one 'owns' the surplus, may have little incentive to be efficient in their use of resources. And since there is no market in ownership shares, they lack the market discipline that the fear of takeover can provide. But at the end of the day it is the actual structure of motivation that will be the principal factor determining outcomes; and it is this that needs understanding before non-profits are judged to be the answer for public service delivery.

Robust Incentives

So strategies that appeal either only to knaves or only to knights are unattractive; and incentive contracting and the use of non-profit organisations have some way to go before they can be useful policy tools. Another approach, and one that seems preferable if we are ignorant about what actually motivates people, is to try to design what might be termed 'robust' incentive structures: strategies or institutions that align knightly and knavish incentives. Such structures would not be dependent on a particular assumption concerning motivation and hence are robust to whatever assumption is made.⁶¹

Put another way, any incentive structure for public sector institutions must nurture individuals' non-material concerns. It should avoid setting up opposition between altruistic rewards and the material self-interest of those working in the public sector. It must not be constructed on the assumption that altruism does not exist, both because the assumption is false and because such cynicism may be self-fulfilling. But incentive structures must also not assume naively that such altruism is unlimited, and not in need of encouragement and reinforcement.

Although finding a robust incentive structure in this sense of the term is far from easy, it is also far from impossible. I hope to demonstrate this in the first

⁶¹ To avoid possible confusion I should make it clear that this is a different terminology from that used by Robert Goodin when he deals with the broad issue of institutional design. For him, a 'robust' strategy is one that is robust to change, involving policies that are 'capable of adapting to new situations' (1996: 40–1). What I call a robust strategy is closer to what Goodin would term a strategy as 'sensitivity to motivational complexity' (1996: 40–1).

two chapters in Part III. However, some issues have surfaced in the discussions that have a moral dimension and it seems appropriate to conclude this chapter by looking at these in a little more detail.

MORALITY AND MOTIVATION

There are two moral issues that need addressing. First, we noted earlier that, in a situation of high demand for an activity, the 'price' of having sufficient activity supplied to meet that demand might be the partial or complete crowding-out of altruistic supply of the activity. If altruistic acts are regarded as socially desirable, then paying this price will have social costs. Are those costs sufficient to outweigh the gain from having a supply that is sufficient to meet demand?

The principal advocate of relying upon altruistic motivations to deliver public services, Richard Titmuss, was able to avoid this problem by using as his principal example the situation with respect to blood donation in Britain in the 1960s, where altruistic supply did appear to be sufficient to meet demand. However, as we have seen, there is no reason to suppose this will always be the case; and indeed it was not so ten years later when Britain had to import blood supplies from the United States.

The other moral issue concerns the danger of exploitation. Blood donation involves people giving for free a commodity that, had they been less altruistic, they could have charged for (assuming that they were in a system that permitted the sale of blood). This parallels the situation of public sector professionals where, because of their commitment to public service, they are paid less than they would have to be paid if they were more self-interested. Generally, is it morally correct to pay people less to provide a service than they would have been paid if they had been less altruistic?

More precisely, suppose there are two possible payment levels, each of which would generate enough supply of the service to meet the demand for it, but one of which relies on altruistic motivations and hence is lower than the other, which relies upon self-interest. Put another way, suppose that public sector workers motivated in part by knightly considerations are paid less than they would need to be to generate the same work effort if they were completely knavish. Are they being exploited?

Some are in no doubt. Thus Nancy Folbre and Thomas Weisskopf (1998: 186) argue that 'many workers in care service jobs are exploited in the sense that they are being paid less than they would be in a world entirely lacking in altruism, responsibility or intrinsic enjoyment of helping others'. And indeed there is evidence that this kind of phenomenon is widespread. Robert Frank (1996) has analysed the wage differentials of a cohort of graduates from Cornell University, concluding that a person employed by a private-for-profit firm earns a salary more than 13 per cent higher than she would if she was employed by government. Paula England and colleagues have shown that

the more caring a job requires, other things being equal, the lower the wages paid, and that care work in general is done by workers, mostly women, who earn less than they would in other jobs requiring the same education and experience.⁶²

It is apparent that, in dealing with both these issues, there is a potential clash of several moral principles. Relying upon financial incentives to deliver public services may reduce the number of altruistic acts and increase the number of self-interested ones, which would be morally undesirable. However, it may also lead to the provision of more public services, which, other things being equal, would be morally desirable. And it could be seen as being less exploitative, which again would be desirable on moral grounds.

Now unless one is prepared to assert unequivocally that one of these principles lexicographically dominates the others—that is, one principle has to be served in all circumstances even if in doing so all other principles are violated—there is no general resolution of this issue. So, if some people believe that the only moral value that has to be served is that concerning the intrinsic moral superiority of altruistic acts, then they will judge the use of self-interest to be morally inferior to the use of altruistic providers—even if the result is fewer (or worse) public services being provided. Motivation is morally valued; outcome is not. If, on the other hand, they believe that society's only concern should be about the level of public service provided and if they also believe that the use of self-interested providers will increase that, then they will support the use of these providers regardless of the impact this has on the stock of altruism in the society. Outcome is the only matter of moral concern. Or, if their only concern is to prevent exploitation, then they will support all arrangements that reduce exploitation, even if the result is both fewer public services and less altruism.

However, in practice few of us are that lexicographic in our moral judgements. Most people would recognise that different circumstances yield different answers. For instance, if the result of relying purely on voluntary blood donation or on low-paid nurses was that a large number of patients died from a lack of blood available for transfusion or from a lack of appropriate nursing care, then we might be prepared to sanction a change in those arrangements that resulted in a substantial improvement in outcomes, even if the result was less opportunity for the exercise of altruism. If, on the other hand, a switch to less altruistic modes of provision led to relatively little improvement, then we would be less likely to approve such a change. In the real world, each case has to be examined on its merits and a decision taken as to whether, in that case, the movement towards realising one principle more than outweighs any movement away from another.

The idea that moral principles or values may have to be 'traded-off' against one another is a major insight of modern philosophical discourse.⁶³ Yet it is alien to many people, especially, it would seem, some of those engaged in debates concerning the delivery of public services. Ideological stands abound,

⁶² England (1992), England and Folbre (1999), England, Budig, and Folbre (2001).

⁶³ For further discussion see Barry (1965: ch. 1) and Le Grand (1991: ch. 3).

brooking no compromise and allowing no possibility for trade-off. Yet in fact these kinds of trade-off are inevitable in all policy debate and implementation. In this case, it is impossible to say that, in all circumstances, the morality of altruism should always be in the ascendant over that of positive service outcomes, or that either should dominate the avoidance of exploitation. The exact balance will have to be a matter of judgement.

CONCLUSION

Individual motivation is complex, especially where those working in the public sector are concerned. The evidence concerning the relationship between financial rewards and the supply of public services suggests that there may be reward thresholds above and below which behaviour is rather different. Below the lower threshold, financial rewards may be viewed as reinforcing or crowding-in supply, since they signify social approval of the sacrifice the individual is making in pursuing his or her activities. Extra payments above that threshold, however, erode the magnitude of the sacrifice that he or she is making, and thereby partly erode the motivation for the act. Supply is crowded out. However, as payments increase further, another threshold is reached where the relative price effect begins to dominate the crowding-out effect and supply increases again.

If policy-makers know where the thresholds are for an individual or a group of individuals, it is relatively easy to design a payment system that elicits the supply of the activity that we want (although the impact of any payment system on quality as well as quantity has to be borne in mind). If we do not know the underlying motivational structure, then the best strategy is likely to be the adoption of robust incentive structures: ones designed to align knightly and knavish motivations and to appeal to both the knight and the knave. Although these may be difficult to design, it is not impossible to do so, as we shall illustrate in Chapters Seven and Eight.

ANNEX: A THEORY OF PUBLIC SERVICE MOTIVATION: DIAGRAMMATIC REPRESENTATION

Consider an altruistic activity that, if an individual undertakes it, he or she benefits others. An example could be blood donation; but it could also be the supply of any public service that has this property. Assume that he or she derives no direct personal benefit himself or herself for the activity and indeed incurs personal costs from undertaking it.

Suppose first that all individuals undertaking the activity are knaves: that is, they derive no benefit from the fact that the activity is of use to others. In that case, they will require some payment to undertake the activity, with the amount increasing as the amount of the activity increased. An aggregate supply curve for an activity might look as in Fig. 4.1: a conventional supply curve, with increasing activity as payment for the activity increases.

Figure 4.1. Knavish supply

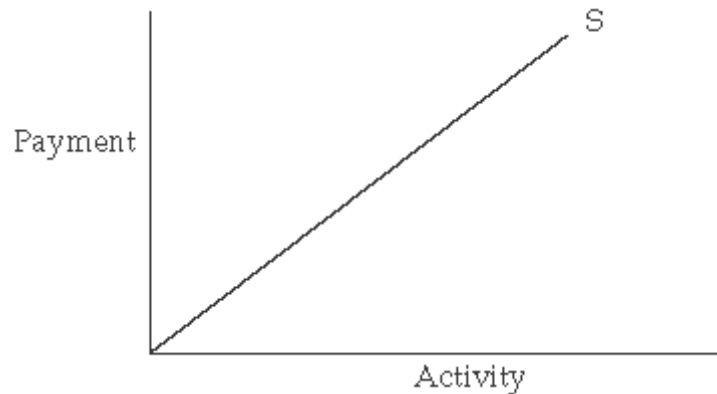
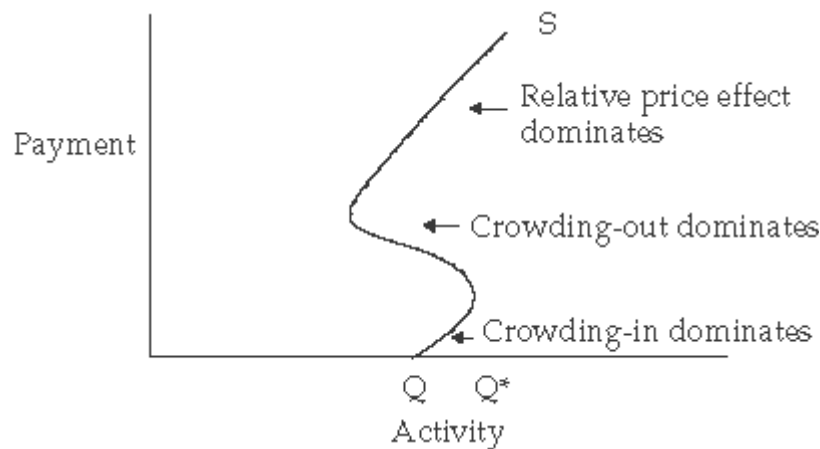


Figure 4.2. Knightly supply



Now suppose the individuals are all knights: that is, they derive some reward from the fact that others benefit from the activity. Suppose, too, that the reward they derive is related to the sacrifices that they themselves make to undertake the activity. In that case, the supply curve might look something like that in Fig. 4.2. That figure suggests that individuals are prepared to undertake some sacrifice and to supply a certain amount of the activity, Q , without payment. If they are then offered a small payment then they might regard this as a recognition or acknowledgement of their sacrifice and become even more favourably disposed towards the activity; hence supply is 'crowded-in', and increases to, say, Q^* . However, as payment increases further, the sacrifice they are making in undertaking the activity lessens, and they begin to derive less intrinsic reward from undertaking it. Hence supply is reduced, with a 'crowding-out effect' dominating. This may, as in the diagram, reduce supply to a point where it is less than the original amount, Q , that people were prepared to supply without compensation. As payment continues to increase, however, the relative price effect begins to dominate, and supply increases again. The two turning points of the curve are the cost thresholds mentioned in the main text.

Figure 4.3. Knightly supply and low demand

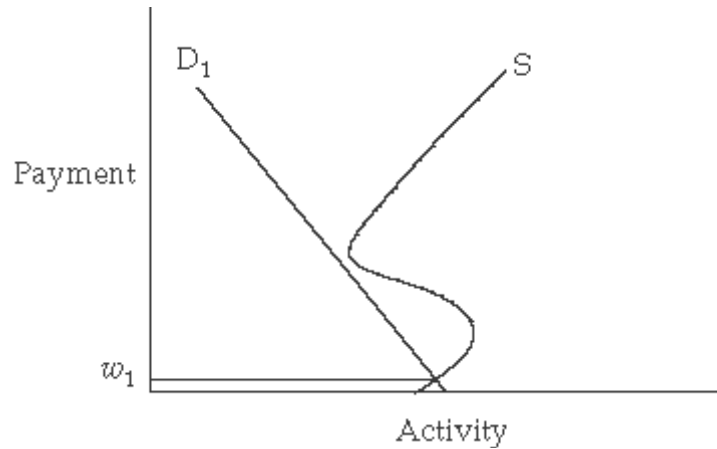
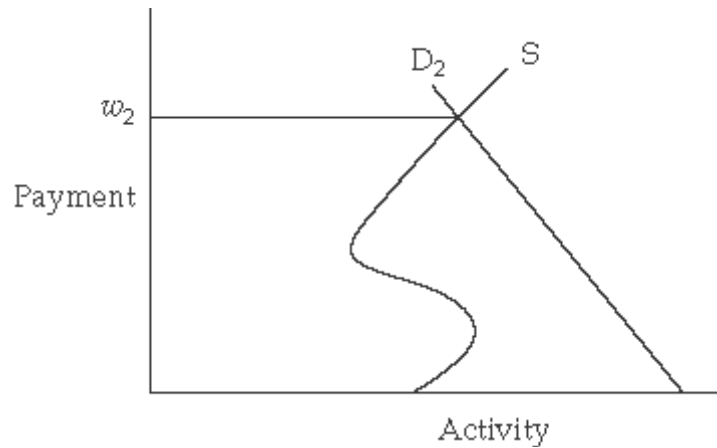


Figure 4.4. Knightly supply and high demand



If supply curves do look as in Fig. 4.2, then what are the implications for public policy? More precisely, how should altruistic activities be rewarded—or paid for? Unsurprisingly this will depend on the level for demand for the activity. This is illustrated in Figs 4.3, 4.4, and 4.5. At a relatively low level of demand where demand curve intersects the crowded-in section of the supply curve, the payment can be low: w_1 in Fig. 4.3. If demand is relatively high, so that it intersects on the relative-price-dominant section, the payment will be high: w_2 in Fig. 4.4.

If demand is such that, as in Fig. 4.5, the demand curve cuts the supply curve in several places, there is a dilemma. Should the payment be set at w_3 or w_4 ?⁶⁴ At w_3 , there is more provided and consumers pay a lower price; but, because of the altruistic nature of the suppliers, the pay is low. At w_4 , the suppliers receive a larger payment—which might be perceived as more ‘just’ and less exploitative—but consumers pay more and less is provided. In deciding

⁶⁴ The third intersection point is not an equilibrium and hence is uninteresting.

Figure 4.5. Knightly supply and moderate demand

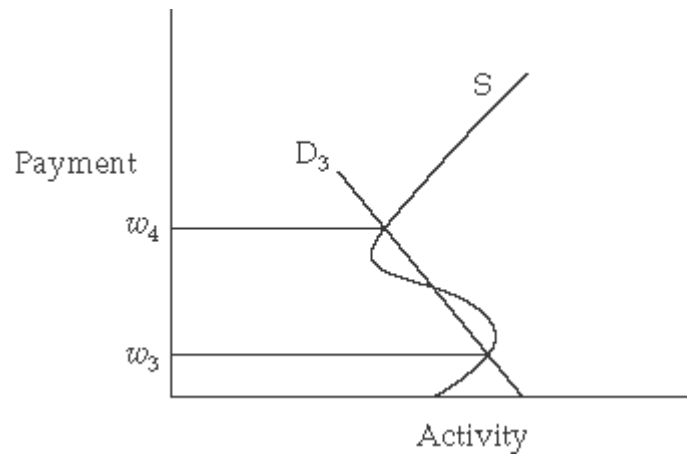
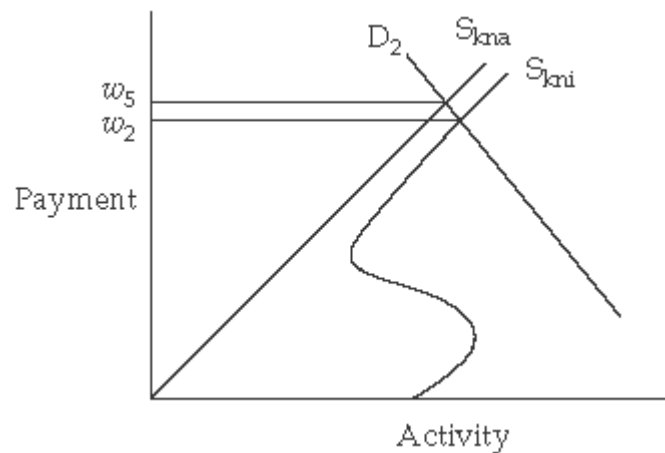


Figure 4.6. Knightly and knavish supply and demand



between w_3 and w_4 , the policy-maker will thus have to trade-off his or her principles concerning the undesirability of exploitation, and the desirability of encouraging both altruism and the supply of the activity.

Finally, it is of interest to compare knightly and knavish supply situations. This is done in Fig. 4.6. The diagram assumes that the 'crowding out' is not complete: that is, the section of the knightly supply curve dominated by the relative price effect is to the right of the knavish supply curve, allowing for a measure of knightly motivation to remain even at those levels of payment. In these circumstances, with demand relatively high the appropriate knightly payment is w_2 . This is lower than the payment, w_3 , that would have been necessary if suppliers were knavish (or if the crowding-out had been complete). Again, as discussed in the main text, the question of exploitation arises: is w_2 exploitative as compared with w_5 ?

PART II THEORY: OF PAWNS AND QUEENS

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5 Agency and Public Services

Your patient has no more right to all the truth you know than he has to all the medicine in your saddle bags. He should only get as much as is good for him.

(Oliver Wendell Holmes, talking to American medical students; quoted in Angela Coulter, *The Autonomous Patient*)

It is for the patient, not the doctor, to determine what is in the patient's own best interests. You may wish to recommend a treatment or a course of action, but you must not put pressure on patients to accept your advice.

(General Medical Council in 2002)

So far in this book we have been concerned primarily with motivation, and specifically with the motivation of professionals and other providers in the public sector. It is time now to turn to questions related to agency: individuals' capacity for action and choice. These questions are largely normative in nature: that is, they are not concerned so much with what is but with what should be. In the context of the public sector and indeed of wider social welfare, how much power should individual citizens have? Should users of publicly funded services have control over how much and in what way they make use of those services? Or should their use be largely determined by professionals or others involved in service provision, as often happens in areas such as health care and education? This chapter considers some of the more theoretical and philosophical issues concerned in trying to answer these questions.

The arguments differ from area to area, and any answers they generate will depend heavily on the contexts in which they are deployed. Hence I shall concentrate on the issues involved in the aspects of public policy that are the principal concerns of this book: publicly funded health care and education and (in the next chapter) personal savings and state provision for pensions and long-term care. In Part III, I discuss some of the practical issues involved in specific policies designed to empower individuals in the areas concerned: health and education quasi-markets, demogrants, partnership savings schemes, and hypothecated taxes.

PATIENTS, PARENTS, OR PROFESSIONALS?

It is currently fashionable to advocate user empowerment in the context of publicly funded services such as health care and education. Many analysts feel that in these areas the professionals and managers who deliver the service concerned—the doctor, the nurse, the teacher, the bureaucrat—have too much power over decisions relating to the people whom the service is supposed to benefit—the patient, the parent, or the pupil.⁶⁵ Patient empowerment relative to the professional is the watchword for health services; parent, or more radically, pupil empowerment for education.

But power over what? The objects of power can be divided into the nature or type of the service to be offered, the quantity of the service used, and the provider of the service. The question then is who should have the power to make decisions over what (the nature of the service), how much (the service quantity), and by whom (the provider). Should the nature of a patient's treatment, the quantity of that treatment, and the hospital that provides the treatment be decided by the patient himself or herself or by the doctor—or indeed by someone else such as a manager or a civil servant? Should parents, teachers, or local education authorities decide on the type of the education a child should get, the amount of that education, and to which school the child should go? More generally, should the decision over all or any of these choices lie with the user or elsewhere? Should the user be pawn or queen?

There are three possible approaches to these questions: what we might term the welfarist approach, the liberal approach, and the communitarian approach. The welfarist approach tries to resolve the issue by referring to the impact on individual welfare or well-being: that is, whether individual users should be pawns or queens in different situations depends on which increases their welfare the more. The liberal approach is concerned simply with the impact on the individual's freedom: that is, whether users should be pawns or queens will depend on what ultimately gives them more freedom of action. The communitarian approach concerns the impact on the wider society of extending individuals' power of decision: will such extension ultimately benefit or harm the interests of the community as a whole?

To begin with the welfarist approach. In most contexts, welfarists would follow John Stuart Mill (1859/1982) in his classic discourse *On Liberty* and argue that individuals are the best judges of what would contribute most to their own welfare. Hence they should make as many decisions concerning

⁶⁵ Professionals themselves often feel this way. A *British Medical Journal* survey of visitors to its website (mostly medical professionals) found that 60% considered that the principal consulting style currently was one of 'doctor decides'. Just 7% thought that this style ought to prevail, while 87% considered that the preferable style was one where 'doctor and patient decide together'. www.bmj.com, 24 October 1999. Quoted in Coulter (2002: xi). Coulter's monograph is a useful source of information and argument on patient power and this chapter has made extensive use of it.

the factors that contribute to that welfare as possible, and should not have those decisions restricted by others. Nor should others make the decisions for them, for no one knows what would contribute to their welfare as effectively as the individuals themselves. In general, people should be queens, not pawns.

However, welfarists often also claim that this type of argument would *not* apply to some of the public services that we are considering in this book, particularly health care and education. There are a number of possible welfarist reasons why patients should not be permitted to make decisions for themselves with respect to medical care or indeed other aspects of their health; and there are similar ones with respect to parents making decisions with respect to their children's education.

The first, relatively trivial, welfarist argument for treating users as pawns is where they choose to be so. Some patients might prefer to place themselves in the hands of the doctor because they feel incapable of making the relevant decisions even if they are offered the opportunity to do so. Parents may feel that they know less about the appropriate education for their children than the teachers of those children; hence they may be prepared to delegate authority to those teachers. Although far from trivial empirically, particularly in health care (there is evidence that not all patients want to be involved in decisions about their own treatment; see Coulter 2002: 31–4), it is trivial analytically, because these are not really individuals ceasing to be queens. Rather, they are exercising their royal powers by delegating authority to someone else. The voluntary pawn is not really a pawn.

The more difficult arguments for a welfarist are those that form the case for not allowing an individual to make decisions even when he or she might wish to do so. The most well-known of these arguments is when the individual has poor or imperfect information concerning the likely outcomes of those decisions. Poor user information is an obvious characteristic of health care and education (Arrow 1963). Both doctors and teachers are trained professionals, much of whose training involves the acquiring of specialised and often highly technical information. Users of medical or educational services could not hope to acquire all this knowledge without undergoing the same training themselves.

However, the presence of poor information is not sufficient on its own to justify treating patients and parents as pawns on welfarist grounds. For this would be the case only if there were no relatively low-cost way by which that information could be provided to users. If the information relevant to the particular situation of the user can be given relatively cheaply to patients or parents, then, other things being equal, they are likely to be better-off making their own, informed decisions than if someone else makes those choices for them. I return to this point below.

Other welfarist arguments in favour of treating patients or parents as pawns concern what has been termed 'individual failure' (to distinguish it from market

or other forms of system failure, such as poor information⁶⁶). Bill New (1999) has identified four of these. The first is a technical inability to complete the necessary mental tasks. This inability could arise because the quantity of information is simply too great relative to mental capacity, or because the technological or causal connections are too difficult to make, again relative to capacity. This appears to be a special problem with respect to health care. For decisions concerning the appropriateness or otherwise of medical treatment often involve assessing the probabilities of benefit or harm from alternative forms of treatment (or from no treatment at all). And experimental evidence suggests that individuals often find it difficult to make rational decisions where weighing up probabilities is concerned (Tversky and Kahneman 1982).

A second source of individual failure identified by New is weakness of the will. This is where individuals know what they prefer in the long term but still make decisions that are not in their long-term interest. Again, there are obvious examples relating to health and health care. Individuals who are in the process of damaging their health through overeating or smoking often assert that they would really prefer not to engage in those activities, but find it impossible to stop doing so. Long-term compliance with drug regimes or other forms of treatment is another area where weakness of the will is often apparent.

A third source of individual failure is emotional decision-making. Becoming attached to certain choices allows emotions to distort decisions. This might arise because of a strong attachment to a particular outcome even though one knows that it is very unlikely to occur; or the decision may be made in a period of stress, such as that following bereavement. Again, health care raises this particular issue in an acute form; often treatment decisions have to be made at a time of considerable anxiety or distress, or in other situations that are not conducive to rational deliberation.

The fourth problem raised by New concerns the relationship between preferences and experience. Preferences over a set of decisions might vary depending on whether or not the individual has had actual experience (as distinct from abstract knowledge or information) of the outcomes of the decision concerned. Thus the decision whether to smoke or not might be different if it were possible for the individual concerned actually to have the experience of dying from lung cancer before the decision was taken. At first sight this resembles the imperfect information concern, and as such might be thought a system failure rather than an individual one. But it is not quite the same; for in these cases no system can supply the relevant information—even at high cost—prior to the decision being taken. No one can experience what it is like to die before actually dying.

As the illustrations given suggest, most of these kinds of system and individual failure apply with rather more force to health care than education.

⁶⁶ The distinction between system and individual failure has been challenged: see Calcott (2000). However, it is not crucial to my argument.

This would seem especially true with respect to those concerned with the technicalities of information: both the amount of information needed and the ability required to deal with it seem rather larger in the case of health care. However, there is a significant problem that does not apply when individuals are making decisions about their own health care, but does apply in education, especially where early school education is concerned. That is what might be termed 'parentalism'. In the case of education, at least in the earlier years, it is not the users themselves who are making the relevant decisions, but their parents. And parents may make decisions with respect to a child's education that further their own (or the rest of the family's) interests more than the child's. Thus the head of an impoverished family may decide that it would be better for the family income for a child to leave at the school leaving age and go out to work than for that child to stay on at school, regardless of his or her potential. Or the family may keep a child out of school so as to look after another family member in need of care. Such cases may serve the welfare of the family, but the welfare of the actual user—the child—may suffer.

So welfarists have a number of possible justifications concerning both system and individual failure for treating patients or parents as pawns. What of the liberal approach? At first sight, it might seem difficult to find any such justification from a liberal point of view; for, from that perspective, the desirability of individuals making their own decisions about factors that affect their own welfare arises from deontological, not consequentialist, concerns. That is, the promotion of freedom of decision is a desirable end in and of itself; whether or not the exercise of such decision-making power has the consequence of improving welfare (or indeed any other consequence) is irrelevant.

However, even here there may be cracks in the argument. What if a particular form of medical treatment or of education improves the decision-making power of an individual or the choices over which decisions can be taken—as, it has to be said, most successful forms of health care or education are likely to do? Suppose it improves his or her capabilities or functionings, in the terminology of Amartya Sen (1985)? Then would not the short-term restriction of patient or parental decision-making power be a price worth paying for the consequence of a long-term increase in the ability to take decisions or in the availability of choices?

Actually, the answer from a liberal point of view is, I suspect, probably not. From that perspective, an individual's freedom to take decisions should also include the right to decide not to enlarge his or her ability to do so. It would be wrong to override that decision, even in the name of subsequently generating greater freedom for decision-making. Of course, as with the welfarist case, information is important; the liberal would want the individual in making the relevant decisions to be fully informed about their consequences. And parentalism is a problem: what rights do children have, and at what age do they acquire the right to make decisions on their own behalf? But in general, from a liberal perspective, informed or not, the patient, parent, or—if old enough—pupil, should always be queen.

Finally, the communitarian case. Here the argument is still a welfarist one in the sense that it is concerned with people's welfare, but in this case the welfare of those other than the patient or parent. The argument here is that the decisions made by a service user may have (beneficial or damaging) consequences both for other users and for non-users: what economists term external benefits or costs or externalities.⁶⁷ Thus individual decisions to be vaccinated against an infectious disease reduces the likelihood of the spread of the disease, thus benefiting not only the individuals themselves but also all those with whom they come into contact. Parents' decision to send their child to an exclusive school may reduce social cohesion and thus damage wider social welfare.

In passing it is important to note that these externalities are a problem not only for publicly funded services. In a private market for goods and services, individuals consider only the private costs and benefits to themselves of their activities, and do not take account of any costs and benefits that may impact on others. Hence, from a social point of view, they are likely to undertake too few of those activities that confer external benefits and too many of those that create external costs.

But with publicly funded services there is an additional complication, one that arises even if there were no externalities. In a normal market situation, users purchasing a service pay a price for it. Under competitive market conditions, that price will reflect the opportunity or resource cost of the service. Hence they have an incentive to limit their use of the service to only those parts of it that benefit them more than the resource cost of providing them with the service.⁶⁸ However, if the service is funded from public funds and provided free, they have no incentive to restrain their demand for the service in this way. Rather they will overuse the service: that is, they will demand more of the service than would be justifiable from society's point of view. Every doctor is familiar with pushy patients demanding attention for their relatively trivial complaints at the expense of patients with more serious illnesses; every teacher with the parent demanding personal attention for his or her child at the expense of others who could benefit more. Meeting this 'excess' demand involves employing resources that, if put to another use, could have created higher social benefits elsewhere. There will be over-provision of the service concerned.

Further, with a free service users have less incentive to seek out the most efficient or most suitable provider for their needs. They do not have to pay for the service, and hence have no reason to look for the most economical supplier. Moreover, the fact that they are getting the service apparently for free can render users less critical or demanding of the service provider. Hence inefficient and unsuitable providers can continue in existence, wasting resources that could have been spent in other, better ways.

⁶⁷ So-called because they are external to the individual actually making the decisions.

⁶⁸ Strictly they will purchase the service up to the point at which the marginal cost to them of further purchases (including the price charged) exceeds the marginal benefit to them.

So the case for partly or wholly overriding individual decisions with respect to their use of public services is fundamentally a welfarist one. Individuals, if left to make their own choices with respect to health care and education, might make the 'wrong' decisions, both from the point of view of their own welfare and from that of the welfare of the wider community. That is, they might choose a service that is not suitable for their needs, or for the needs of the community; they might choose to use too much or too little of it, either from their own point of view or from that of society; and they might choose inefficient or unsuitable providers, again possibly harming their own welfare and that of society.

However, none of this establishes on its own the case for treating users of public services as pawns. For, although individual users may make mistakes, there is no guarantee that others—and in particular those to whom the power is often delegated, the professionals who provide the service—will do it better. To this we now turn.

The welfarist case for doctors to make decisions about their patients' care and teachers over their pupils' education is in some ways the mirror image of that for not allowing patients or parents to make their own decisions. They can correct system failure; and they do not suffer from individual failure, at least not in the same way or to the same extent as users do.

First, system failure associated with poor information. Medical professionals and teachers do possess the information about the technology of their craft that the users of their services lack; indeed, therein lies their claim to be professionals. Hence they are obviously in a position to correct system failures due to poor user information.

However, it is worth noting that there is a difference in scale. In health care, the doctor has to have knowledge of thousands of potential ailments, whereas the patient has to know only about those potentially or actually affecting himself or herself. Medical handbooks can aid self-diagnosis; and, once their illness is diagnosed, especially in these days of the Internet, patients can—and indeed often do—'train' themselves in their own disease. Similarly with respect to teaching: teachers have to be able to assess the educational requirements of thousands of pupils, whereas parents have only to do so for their own offspring, about whom they have considerable knowledge.

Rather similar arguments apply to the first element of individual failure that we discussed: technical inability to make decisions. Doctors and teachers are trained to make the relevant decisions and, moreover, are well practised at them since they have to do them every day. Hence they are much less likely to suffer from this particular difficulty. However, again scale matters. Patients and parents have to make decisions only for themselves or their families, and can therefore devote more attention and decision-making capacity to them.

Another argument for doctors and teachers as decision-makers can be made with respect to the second source of individual failure: weakness of the will. Such weakness is not a problem for a doctor or teacher making decisions for others, for the temptation of ignoring long-term benefits to the user in favour of short-term

ones does not apply to them. There may be other, more self-interested reasons why a provider might adopt a short-term solution to a user's problem (such as a desire to get a demanding patient out of the surgery, or the complaining parent out of the classroom, so that the professional can get home). But they do not derive from the user's own inability to defer immediate gratification.

New's third concern was the role of emotion in distorting decisions. In this case it seems that professionals are likely to be as liable to this as anyone else. Considerations of professional pride, hubris, or maybe even excessive humility could all affect professional decision-making and thereby distort decisions made on behalf of users. This form of individual failure may be universal. However, since the emotional basis will differ, the kind of distortion induced will be different from that associated with users. Also, since again the professional will be making many decisions affecting many people, the emotional commitment to any one decision involving any one user may be diluted and therefore less damaging to rational decision-making than the emotions of the user himself or herself.

Fourth, the question of experience. Now both the doctor and the teacher will have a kind of experience of people making the 'wrong' decisions. So, for instance, oncologists will have seen heavy smokers dying of lung cancer; teachers will have seen some of their most promising pupils ruin their lives through ill-considered career or educational choices. However, they will still not have actually experienced the consequences themselves. Hence this aspect of individual failure is present in the professional himself or herself, albeit to a somewhat lesser extent than in the user.

So far the welfarist case for professionals making the relevant decisions has been based on demonstrating that they could do better than the users themselves. But it is also based on another assumption, rarely mentioned in this context, but crucial nonetheless. This is that they *will* do better, given the opportunity. And this brings us back to motivation. Specifically, for the case to stand, professionals have either to be something close to knights or perfect altruists or to have personal interests that coincide with those of the user. That is, if they are to take decisions on a user's behalf that are going to promote that individual's welfare, then they must have the individual's welfare at the forefront of their concerns, or they must face no conflict between their own interests and those of the user. If neither of those conditions is fulfilled, there is no guarantee that professionals will use their decision-making power in the interests of users.

This is related to the currently fashionable debate concerning the role of trust and the public sector. The argument recently employed by, for instance, Onora O'Neill (2002) in her BBC Reith Lectures that we should be trusting public servants more and auditing them less is based almost entirely upon the assumption that the public servants concerned are knights. For if they are not—if they are self-interested knaves—then trusting them will result in

users' welfare being improved only if the actions necessary to improve that welfare also improved their own welfare. So to trust professionals is to assume either that their interests and those of their patients coincide (or can be made to coincide), or that any situation involving a clash of such interests will always be resolved by the professional in favour of the patient.

What of possible liberal and community arguments in favour of professional power? It is difficult for the liberal to support professionals having control over users, except perhaps in cases where it is actually impossible for the user to make choices (such as a patient admitted unconscious into a hospital's accident and emergency department). The community arguments in favour of professional power depend upon the professionals taking the society's wider interests into account in making their decisions. The extent to which they do this will depend very much on the professional and the context in which they operate. The doctor will have a concern for all his or her patients, and the teacher for all his or her pupils. Hence he or she is likely to try to protect them from the consequences of any one of them being excessively demanding. However, there is no guarantee that their concerns will go wider than this, and that they will take into account the interests of the broader community or indeed of the nation as a whole.

FROM PAWN TO QUEEN IN PUBLIC SERVICES

It is clear that there are a variety of conflicting arguments as to whether power should lie with users or professionals in health care and education. It is also clear that the resolution of these conflicts depends in part on the context. As noted, a patient admitted unconscious into a hospital's accident and emergency department is not going to be able to make any decisions even if he or she might have wanted to. The teacher of a child with a single parent in prison may have to make decisions on behalf of the child and the absent parent.

However, it does seem as though there is a convincing case for the user to have a measure of power, possibly considerable, over public service provision. For welfarists the motivational issue is paramount. The person who is most motivated to improve his or her health is the user himself or herself. Professionals may not be entirely or even largely knaves; but they can never have the same degree of concern for users as users have for themselves.

That said, the user's decision-making power cannot be completely unrestricted. There are system failures, especially with respect to information; and there are also individual failures to contend with. As argued above, these seem to be more powerful in the case of health care than education; moreover, they would seem to apply more to some choices than to others. Thus decisions over the nature and quantity of medical treatment seem potentially more subject to information and technical capacity failure than the choice of the provider of that treatment. Hence, in the case of health care at least, there may be a better case for giving users greater power over the choice of provider than

over choices relating to treatment. It would still, of course, be necessary that the user had the appropriate information to judge the quality of the service offered by different providers.

What of the communitarian arguments? Again, these point against completely unfettered user power over decisions. But, as with the individual welfarist arguments, the communitarian arguments may lead to different conclusions depending on which kind of decision is under consideration. User choice over the nature of and how much treatment or education is provided is obviously subject to the communitarian objection concerning potential over-provision and hence overuse. The choice of provider for treatments of similar nature and amounts is not. User choice of provider, however, may result in the growth of selection and segregation damaging social cohesion, whereas this would seem to be a less likely consequence of user choice of treatment or education within the same institution.

So how should we design systems for public service delivery that offer an appropriate balance of power between user and provider? There are essentially two kinds of mechanism for empowering users: what are commonly termed 'voice' and 'exit'. These we must discuss in a little more detail.

VOICE AND EXIT

If we accept that there is some case for empowering users, what is the best way of doing so? In Albert Hirschman's (1970) well-known dichotomy, there are two fundamental ways in which users may be empowered: through 'voice' or 'exit'. Voice is where users address their concerns directly or indirectly to the service provider. They can be collective (through voting or through other mechanisms of collective decision-making) or individualistic (through mechanisms such as complaints procedures). Exit mechanisms involve the user being in a position to leave or exit from his or her provider and go to another.

Both types of mechanism have their merits and demerits. Collective voice mechanisms have the advantage that they are indeed collective: that they take account of the interests of the community. On the other hand, they are clumsy instruments for dealing with the kind of individual decisions with which we are concerned here. Parents who are dissatisfied with their local school, or patients with their local hospital, can vote for local politicians who are promising to provide better ones; but, for their votes to be effective, a number of conditions have to be fulfilled. There has to be an election in the offing; their views have to be shared by a majority of other voters; the issues concerning the quality of schools or hospitals have to be the principal factors affecting the election; politicians promising better schools or hospitals have to be among the candidates; and, if these politicians are elected, they have to have some effective method for ensuring school or hospital improvement. Only rarely will all of these conditions be met.

Further, despite their collective nature, these mechanisms still suffer from the communitarian problems of over-provision and social segregation. Voters are rarely faced with the costs of meeting their service requirements. When they are not faced with those costs, they can simply vote to increase or maintain services at other people's expense. Indeed, this often happens when school or hospital closure proposals are put to a vote; the voters concerned usually do not have to bear the costs of keeping the institutions concerned open and in consequence usually vote the closure proposals down. And a majority can also vote to segregate a minority, excluding them by formal or informal means from the service concerned.

Individual voice mechanism such as complaints procedures also have their problems. They require energy and commitment to activate; they take a good deal of time to operate; and they create defensiveness and distress among those complained against. They favour the educated and articulate. Users who complain are not necessarily those who have the most to complain about, thus contributing to the overuse problem; and adversarial relations between professionals and users, especially tied to a threat of lawsuits as they often are, can lead to expensive and inefficient defensive reactions on behalf of providers.

These problems with voice mechanisms are well known. However, exit ones also require certain conditions to be met if they are to work effectively. First, there has to be at least one alternative provider to whom the user can go. Second, if the aim is to provide an incentive for increasing the responsiveness of providers to users' needs and wants, there have to be consequences for the provider of the choices made by the user: that is, providers from whom the user exits have to be penalised in some way while those to whom the user goes for service have to be rewarded.

An obvious way of ensuring that the right incentives are present is for the money to follow the user. So providers losing users would also lose resources while those gaining them would gain resources. But this leads to a further danger: that of polarisation, whereby poor performers lose income leading to yet worse performance, while good performers are able to perform even better through their increases in income. This outcome may be reinforced if good providers can 'cream-skim': that is, they can select users whose needs can be met relatively easily or cheaply. All this may lead to a widening gap between good and bad providers, with poor schools and hospitals in a vicious circle of decline while good ones steadily improve. Equity in a provision would suffer.

Another problem concerns parentalism: what if some parents decided to exit the system altogether and take their children out of school? Yet other difficulties concern the communitarian objections to user power. What if users used their power of exit to segregate themselves: parents in a religious cult sending their children to a school that propagated the values of that cult and only the values of that cult, for instance? Or what if users demanded more services from their new provider than was justified by their level of need—the over-provision problem?

However, there are ways of dealing with these problems while preserving the possibility of exit. Ways of dealing with the cream-skimming problem are discussed in Chapter Eight. To overcome the parentalism problem, parents can be required to send their children to school (as they are at present); and, to reduce the impact of the voluntary segregation problem, every school can be required to offer the same basic curriculum.

The overuse issue could be addressed by charging for services, so that individuals do face some at least of the opportunity costs of their decisions. However, charging for public services raises well-known equity problems, not least the potential such charges have for deterring genuine use of the service concerned, especially by the poor. A more attractive alternative is for individuals or their agents to be given fixed budgets with which to ‘purchase’ health care or education from different providers, thus allowing them the choice of provider but restraining them from demanding too much of the services concerned. Measures of this kind are discussed in greater detail in subsequent chapters.

CONCLUSION

The arguments of this and earlier chapters lay the foundations for understanding what a successful system for a delivering a public service would look like. It would be one that treats the users of the service as queens not pawns: that is, it would have user power at its base. But it would also incorporate mechanisms that avoid the overuse or over-provision of the service concerned, or the use of the service in such a way that damages either the user himself or herself or the wider society. It would provide appropriate incentives for providers to deliver such a service, relying upon the appropriate balance of self-interested and altruistic motivations. Finally, it would do all this in as efficient a manner as possible, and in a way that did not violate equity or other social objectives that society might have with respect to the service.

The commonly used systems for delivering services, categorised here in terms of exit and voice, all have problems meeting these requirements. However, some of the more theoretical arguments sketched out in the penultimate section suggest that those with the most potential for doing so are the ones involving exit. But theory can only take an argument so far. Many of the issues involved are empirical ones that can be resolved only by a detailed examination of actual policies. That is the task of the next part of the book.

6 Agency and Public Finance

If I'd known I was going to live this long, I'd have taken better care of myself.

(Eubie Blake, on reaching the age of 100; *Observer*, 13 February 1983)

Old age is the most unexpected of all things that happen to a man.

(Leon Trotsky, Diary, 8 May 1935)

I now turn to a different set of questions, but ones that also bring up agency issues in the context of the public sector. They concern not the delivery of public services but what we might think of as the cash or financial side of the public sector: that is, that part which is concerned with financing the provision of services and of cash benefits designed to support or to supplement people's incomes or capital assets. Again the arguments vary with the context, and I shall concentrate on some particular cases. Specifically, I shall address the question of savings, old age pensions, and the finance of long-term care.

With the exception of those who are lucky to acquire substantial wealth through inheritance or some other windfall, everyone will need to engage in some form of savings or capital accumulation to cover their future needs. In particular, all of us will need to have some form of pension or other form of income to be able to support ourselves when we are too old to work; some of us may become mentally or physically disabled and need more intensive forms of personal care. Others may require capital at earlier stages in their lives, for instance in order to start a business or to acquire a home.

We saw above that there was a *prima facie* case for users of public services to be queens not pawns, but that nonetheless some restrictions on user power had to be accepted in case users demanded too much of, or the wrong kind of, the service concerned. The situation is similar with respect to savings decisions in that there is a presumption that individuals should be queens not pawns, but that again there is a case for some limited intervention from outside. One difference, though, lies in the basis for that case: the concern here is not that too much of the activity concerned will be undertaken but too little.

SAVINGS AND THE STATE

At first sight it might seem as though the case for intervention in individuals' savings decisions is difficult to make, especially from the perspective of turning pawns into queens. In particular, why should the state intervene to encourage savings for old age? *Pace* Trotsky, old age is after all eminently predictable. Except in the relatively unlikely event of early death, we shall all need an income to help support us when we are unable to work or when we are compelled to retire for other reasons; and there is a known probability of needing some form of long-term care as mental and physical infirmity take their toll. Since most people must know about both these eventualities, why do we not let people make their own arrangements for dealing with them? People can save for their old age; they can take out insurance against the need for long-term care. Surely the ultimate empowerment of individuals—the best way to turn a pawn into a queen—is to allow them to make their own decisions without any intervention at all from the state?

The presumption behind arguments such as these is that the principal threat to individual empowerment with respect to savings decisions is the state. But individuals operating in a free market can be disempowered too. This is partly because some individuals and households have too few resources to be able effectively to save. The appropriate strategies to explore in this case involve proposals for increasing those resources. The demogrant proposal of Chapter Eight is designed to do just this; and more details of the rationale for that particular proposal for turning pawns into queens are discussed there.

But there is a case for state intervention in the savings decisions of those individuals who are not disempowered through lack of resources. First, all individuals, wealthy or non-wealthy, face constraints and impediments in the relevant markets that limit their effective power: what are collectively known as market or system failures. Second, and perhaps more significant, there is an important group of individuals who are not directly represented in the current market and are therefore completely disempowered: our future selves. These arguments need to be discussed in more detail.

MARKET FAILURE

The first set of arguments concerning the case for state intervention—failures in the savings and insurance markets—have been explored extensively elsewhere and so will only be summarised here.⁶⁹ So far as the savings market is concerned, the principal concerns are imperfect knowledge or information and transactions costs (Banks, Dilnot, and Tanner 1997). Potential savers often have little knowledge of the rates of return from, and the risks associated with, different

⁶⁹ An excellent exposition of the principal arguments can be found in Barr (2001), especially chapters 5 and 6.

ways of saving; hence they may find it difficult to decide on their savings portfolio, both in terms of its size (the overall amount they should save) and in terms of its structure (how much to hold in different assets). Transactions costs are the administrative costs incurred by operating in the market, such as charges and fees: many of these have a fixed component (for example, share dealing), and this puts barriers in the way of savings, especially for small investors.

Although not strictly a form of market failure, it is worth adding that problems with saving also arise because of other aspects of the welfare state. In Britain, people with savings above a certain level are disqualified from receiving state income support and, as we shall see, from help with the costs of long-term care. Inevitably this acts as a disincentive to save.

It should be noted that, although these problems are not due to poverty per se, they are likely to apply with particular force to individuals living in households with low incomes. Poorer individuals are likely to have limited educational skills; hence they are likely to have relatively little information on savings vehicles and to find it more difficult to process such information as they can obtain (Kempson and Whyley 1999). Fixed transactions costs will impact more on those with low incomes; and they are more likely to make demands on the state social security system, especially those parts that are already asset-tested (such as income support).

The insurance market has similar problems, especially with respect to information.⁷⁰ There are information problems for both consumers and insurers, especially concerning the future. Consumers trying to decide whether to take out insurance face enormous uncertainty. How likely is it that they will need care? What sort of care will they need, and how expensive is it likely to be? Should they insure against the need for residential care, domiciliary care (care in their own home), or both? What about developments in medical technology? Will improvements in the future make it less likely that they will need care through finding cures or effective palliative treatments for disability-inducing disease—or make the need for care more likely through prolonging old age into infirmity?

Insurers have problems due to so-called adverse selection: that is, high-risk individuals may be able to conceal their risk from the insurers. They will also confront another common insurance problem: moral hazard. This is the fact that the presence of insurance makes it more likely that the person will demand care. There is an additional problem in the long-term care case; for the family of the person concerned is also more likely to be involved and to behave differently if there is insurance than if there is not. As Mark Pauly (1990) has pointed out, in these circumstances it could be rational not to insure so as to guard against being put into care against one's will.

⁷⁰ Barr (2001: ch. 6). See also UK, Royal Commission on Long-Term Care (1999). Not everyone accepts these arguments: see Lipsey (forthcoming).

Insurers also face similar problems to consumers relating to improvements in medical technologies. Ironically, the one area where there are predictable advances to be made, the human genome project, also creates problems for insurance markets. If information concerning bad genetic risks is withheld from insurance companies there will be adverse selection, with only bad risks taking out insurance; but if the information is available to them there will be risk selection, and bad risks may be denied insurance. Neither outcome is desirable.

MYOPIA AND FUTURE SELVES

But a more fundamental reason for state intervention concerns so-called myopia. Individuals may make wrong decisions about the best balance of present versus future consumption because they are too short-sighted to take proper account of the future. This argument needs closer examination.

Myopia is a common phenomenon. Those of a certain age may remember an advertisement for an insurance company of the 1950s called 'the five age view-points on a pension'. It consists of five line drawings of the same (male) individual at different ages, with captions expressing his attitude towards the pension arrangements associated with his job. At the youngest age (25), obviously about to take up the job, he is saying, with a smile on his face and a general air of insouciance, that 'they tell me that the job's not pensionable'. At age 35, he is slightly less sanguine, saying 'unfortunately, my work does not bear a pension'. At age 45, he is more worried, saying, 'How I wish I could look forward to a pension', and at 55: 'I dread reaching retiring age without a pension'. Finally, at age 65, his face riven with anxiety, he is saying 'without a pension *I really don't know what I shall do*'.

This advertisement captures the widely-held view that individuals' time horizons are limited. They do not consider the long term; they plan only on the basis of current events or on their predictions of the very immediate future; in consequence they do not make sensible savings or insurance decisions. In a word, they are myopic. Myopic individuals, as their lives unfold and they encounter unexpected vicissitudes such as unemployment or sickness, or even more predictable ones such as old age, have no personal resources with which to cope with them and experience massive drops in income in consequence.

It is important to distinguish between myopia and information failure of the kind already discussed. Working individuals may not save enough or take out enough insurance simply because they are not aware of the need to do so. They may underestimate how much they need to save out of current income in order to ensure that they have sufficient resources to provide for their retirement; similarly they may underestimate the probabilities of their need for long-term care and hence under-insure. If this is the situation, then the appropriate state response is simply to ensure that they have the correct information before they make the relevant decisions. But this is different from myopia, at least as I am using the term here. That refers to individuals' structure of

preferences: their desire for present over future consumption. In economists' terms, a myopic individual is one with a high personal rate of time preference; that is, someone who, in order to satisfy current wants, is prepared to sacrifice a great deal of future consumption.

Now it might seem that myopia in this sense is not a form of 'market failure' since it is not the market that apparently fails in this situation. If people actually are myopic in the way described—if, in economists' terms, they have a high marginal rate of time preference—then the market will respond to those preferences in the way it does to any other structure of preferences. If, because of myopia, there is no demand for sickness insurance schemes or for old-age pension plans, then the market will not provide them; but that will not be inefficient, because it is only a response to what people want (or, in this case, to what they do not want). If anything is 'failing' in this situation, it is the individuals themselves who are behaving in a way that outsiders might judge as irrational (although they themselves presumably would not).

If this is a case of 'individual failure' rather than market failure, then this provides no direct justification for government intervention. For if individuals are myopic, then government may also be myopic. Certainly, there can be no presumption that the distribution of lifetime income as determined by myopic individuals working in a market context will necessarily be worse or more irrational than that which results from intervention by a government elected and run by the same myopic individuals. Indeed, even if governments did behave in a non-myopic fashion, arguably they should not; for to ignore the preferences of their electors would be undemocratic and paternalist.

However, here some of the arguments of the philosopher Derek Parfit (1984) concerning the nature of personal identity have relevance. Parfit's thesis is both weighty and lengthy, and I shall not be able to do justice to it here. However, a helpful guide to some of his reasoning has been provided by John Broome (1985). Combining Broome's insights with my own interpretations, Parfit's argument runs something like this. We normally invoke the concept of personal identity to link a person in one time period with the 'same' person in another, later period. But what does the concept of personal identity actually mean? It presumably does *not* mean what a possible literal interpretation of the words in the term 'personal identity' would mean: that is, the person in the first time period is identical in every respect to the person in the second. The person will have aged physically; external factors (such as income or family status) may have changed; tastes may have changed; aspects of personality may have changed. The extent and magnitude of these changes may be small if the distance between the time periods is small, but they are likely to increase with that distance: compare the physique, income, personal relations, and personality of an eight year-old with that of the 'same' person eighty years later.

So if it does not mean actual identity, what does personal identity mean? As Broome describes it, Parfit's answer is a reductionist one: that is, the 'fact' of personal identity can be reduced to some other facts that can be described

without using the concept of personal identity. These facts, according to Parfit, are links of a psychological kind, principally those of intention and memory. For instance, a 20-year-old will have memories of her 19-year-old self; and certain features of her current existence will depend on the intentions and actions of that 19-year-old. These links are, according to Parfit, what makes the 20-year-old and 19-year-old the 'same' person. Similar phenomena would link the 8-year-old and the 88-year-old mentioned above; but here the phenomena (and therefore the links) would be much attenuated. Hence any argument that was based on the continuity of the self would be much weaker for the eighty-year gap than for the one-year gap.

What are the implications of this for the myopia argument? Simply that a certain degree of myopia may not be irrational. If people are related to their future selves by links that become progressively attenuated the more distant the future, then it seems quite rational to give those future selves less weight than their present selves. There is no individual 'failure' in the sense of irrational decision-making.

But this in turn means that there *is* a possibility of market failure. For there is now a group of people who are not participating in the market but who are affected by the decisions made by those who are participating in it.⁷¹ An individual's future self is a person who is directly affected by that individual's current decisions in the marketplace. A 65-year-old may be poor because of myopic decisions taken by her 25-year-old self. Hence the 25-year-old is imposing costs on the 65-year-old through her decisions; but the 65-year-old has no say in those decisions.

An individual's future self is, of course, someone with whom her current self is linked. But the link is not as strong as that to her present self. Hence, in taking those current market decisions she will not give appropriate weight to the interests of her future self, in exactly the same fashion as if her future self was actually a different person. More specifically, because she is not giving her future self the same weight as that future self would if the latter were present at the point of decision, she will undertake actions relating to the balance of interests between present and future selves that are not 'optimal', for instance, by saving too little or by taking out too little insurance to cover eventualities that might adversely affect that future self.⁷²

Again, one cannot deduce from this directly that government intervention is necessarily required. For, just as in the case of the irrational myopic individuals,

⁷¹ This is what economists term an externality.

⁷² This is a modified version of the argument I originally put forward in an earlier work (Le Grand 1995). There I argued that an individual's future self actually was in some sense a different individual from her present one. A personal correspondence with John Broome has convinced me that (1) Parfit would not have claimed that current and future selves are actually different people and (2), in any case, it is not necessary to make that claim. All that is required for the argument put forward here is that, for reasons that cannot be described as irrational, current individuals treat their future selves *as though* they were different individuals.

a democratic government will be elected by 'present' individuals who may give too little weight to their future selves in their collective decision-making, just as they do in their market decision-making. So governments may perform as badly as the market. Moreover, again, a government that overrode current preferences could be viewed as being unacceptably paternalistic.

However, the paternalism point is not exactly the same as that for 'irrational' myopia. There a government which overrode individuals' myopic preferences would be doing so only on the paternalistic grounds that it knew its electorate's interests better than the electorate itself did—a procedure that is indeed disempowering. But, if the absence of future selves point is accepted, a government could justify overriding present individuals' preferences on the grounds that those individuals are treating their future selves as though their future selves were different individuals, and hence not giving their interests sufficient weight. But those future selves have just as much right for their interests to be respected as present individuals, even if, for obvious reasons, they are not around to be able to express those interests.

CONCLUSION

So, overall, there is a case for government intervention in individuals' savings and insurance decisions. This case is based, not on some individual failure, but on various forms of market failure: information problems, transactions costs, and the fact that all relevant interests, notably future selves, are not being represented in the market. All of these problems suggest that, if left to themselves, people will save, or insure for, too little. Hence the state needs to adopt methods of increasing people's savings. The exact forms this might take are discussed in Chapters Nine and Ten.

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PART III POLICY

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7 Health Care

What is the use of discussing a man's abstract right to food or medicine? The question is upon the method or procuring and administering them.

(Edmund Burke, *Reflections on the Revolution in France*)

In Chapter Four I developed the proposition that, if policy-makers were largely ignorant about the exact form of the motivational structures of those who worked in the public sector, they should try to design policies that incorporate robust incentive structures: structures that align knightly and knavish motivations in a fashion that direct the individuals concerned towards producing the desired outcomes. Chapter Five argued that policies should also be designed so as to empower users of public services, on the assumption that users were queens not pawns. But it was also pointed out that there were problems concerning users' poor information base, their possible reasoning incapacity, and their potentially excessive use of the service concerned: problems that meant that unfettered user choice would not always be appropriate.

In this chapter and the next, I put some empirical flesh on the philosophical and economic bones of those arguments by discussing some specific policies in health care and education from their perspective. As noted in Chapter One, it is important to analyse specifics in this way: for only by so doing so can academic analysts escape the charge of avoiding the difficult decisions. So, for instance, it is relatively easy to say that we need robust incentive structures, or to say that user choice needs to be partly restrained; but it is much more difficult to specify what form the incentive structures or choice restrictions might take.

This chapter deals with health care and with two areas where these issues are important: the interface between primary and secondary care, and the payment of hospital specialists. Although the discussion is centred on British institutional structures, the problems addressed, as well as the proposed solutions to them, are of more general application.

PRIMARY AND SECONDARY HEALTH CARE

Many of the recent debates on the organisational structure of the British National Health Service (NHS) have concerned the issue of incentives,

motivation, and empowerment.⁷³ How can incentives be structured so that the agents who work within the NHS are motivated to use its resources to achieve the best possible health and health service outcomes? How many choices should patients have over their own treatment? And will increasing their choices lead to the best possible health and health service outcome? In particular, how should incentives operate at the interface between primary and secondary health care? Since, except in emergency, in Britain patients see their general practitioners first, these GPs inevitably have a large role in making the relevant decisions at that interface; and it is at this interface that there have been some interesting experiments with incentive structures.

General practitioners in the NHS are private contractors who provide primary health care for patients in exchange for a capitation fee paid by the government.⁷⁴ As independent businesses, GP practices are enmeshed in market relations. They sell their services—although the government rather than the patient pays and they are paid per patient rather than per service—and they purchase supplies and premises while hiring their own staff. The organisation is a delicate one, with many conflicting norms and motives. GPs have some monetary incentive to sign up as many patients as possible.⁷⁵ They also have a knavish material interest in limiting the services they provide to their patients.⁷⁶ This interest in neglecting patients is constrained partly by a (knavish) fear of losing them and the capitation fees they bring, but, probably more importantly, by strong norms governing the proper conduct of a GP and, in many cases, by personal ties to patients and a genuine knightly concern for them.

Incentive Structures Pre-1991

In the NHS GPs serve not only as health care providers but also as gatekeepers who, except in cases of emergency, control patient access to secondary care. They also act as gatekeepers for patients' access to prescription drugs. Prior to the 1991 quasi-market reforms of the NHS, this gave them an inefficient set of incentives. The workload and cost of treatment that GPs provided fell on the GPs themselves, while the cost of treatments provided by others did not (and the costs of waiting for those treatments fell on the patient). So GPs had a material incentive to refer patients to others for treatment rather than providing treatment

⁷³ Much of this section is based on Hausman and Le Grand (1999). I am grateful to Dan Hausman for allowing me to use this material here.

⁷⁴ They also receive payments for certain specific services. They are in fact rather a peculiar form of private contractor; for instance, they are members of the NHS pension scheme. Many of these arrangements may change in a new GP contract that is being negotiated at the time of writing.

⁷⁵ Bosanquet and Leese (1989: 13) hypothesise that these incentives are weak. However, the results of their survey suggest that in fact 'list size had an important effect on practice net income' (1989: 83).

⁷⁶ GPs also have an interest in finding healthy patients who need little care. Government policy recognises this incentive to select undemanding patients and attempts to counter it by adjusting capitation fees for some demographic and socio-economic factors such as age and deprivation.

themselves.⁷⁷ In many cases this was reinforced by the knightly or caring concerns a GP might have, especially if he or she lacked confidence in his or her ability to provide adequate treatment for the patient concerned. Knightly and knavish motivations were aligned—but not necessarily in a direction that led to the most efficient use of health service resources or the best health outcomes.

In practice GPs were constrained from over-referring (and over-prescribing) by a number of factors. There was the worry that they might be seen as over-referring by the local consultant; more generally they had a need to 'keep in with' the consultant.⁷⁸ There was their sense of self-worth as doctors; thus the referral decision has been modelled as the outcome of a conflict between a GP's concern that he or she could not diagnose or treat a patient and the impact on his or her self-esteem of admitting this.⁷⁹ There was a concern that patients might have to wait too long for treatment. And knightly motivations did not always indicate hospital referral in cases where the best interests of the patient lay in his or her receiving treatment in a primary care setting.

Even when referrals were unquestionably appropriate, there was still a problem because GPs had little interest in economising on their patients' use of outside medical resources. A GP would be no richer or no better-off in other ways if a patient in need of hernia surgery waited only a few weeks rather than a few months or saw a more skilled rather than a less skilled surgeon; and, although a complaining patient was a personal hassle, so was bargaining with hospitals and specialists. If GPs were only self-interested, this system would have neglected the interests of patients. Even if a fear of losing patients would keep self-interested GPs from neglecting their primary care, knavish GPs would have relatively little incentive to promote their patients' interests with hospitals and specialists. Moreover, even if GPs were knightly, the situation was not much better. GPs who identified with their patients might, in fact, have created a stronger bias toward unnecessary increases in medical costs than GPs who are materially self-interested. Given a choice between one treatment and another that is slightly more effective and much more expensive, GPs who cared about their patients and who did not have to bear the costs would choose the more expensive treatment. Patients, if offered the choice, would have agreed.

To summarise, prior to the service reforms of 1991 the NHS had a serious institutional flaw. Although GPs had an incentive to economise on the services

⁷⁷ Since investment in new equipment and costly innovations in GP practice brought no higher capitation fees and often were unlikely to pay for themselves in time saved or in case-load increases, the system also created a bias toward under-investment within GP practices. Policies were instituted to combat this tendency toward under-investment, for instance by giving relatively generous grants or loan subsidies to encourage the improvement of premises or the purchase of new ones and for the installation of information technology, but these arguably distorted the structure of investment towards the subsidised areas (especially premises).

⁷⁸ Good relationships with consultants were very important, and indeed still are (Clemence 1998).

⁷⁹ Dowie (1983). In this context it is of interest to remember that not all referrals are for hospital admission. For instance, Coulter, Noone, and Goldacre (1989) found in a study of referrals in the Oxford Regional Health Authority that 28% were simply to establish diagnosis.

they provided, they had little incentive to economise on secondary care. Given a choice between reaching into their own pockets and into other pockets to pay for services, GPs had an incentive to reach into those other pockets. And since what GPs individually did had little effect on what was left in the other pockets for them to spend, GPs had little incentive to spend that money carefully and sparingly. Identification with the NHS itself, and recognition that an unwise use of resources for one patient diminished the resources available for others, might have mitigated the problem to some extent, but it would be unrealistic to suppose that this general identification would have solved the problem. Not only are such motivations typically weaker than more specific concerns for patients and self, but they also do not provide the information and institutional structure that facilitates the necessary economising.

General Practitioner Fund-Holding

Among the quasi-market reforms of 1991 introduced by the Conservative government of the time, the institution of GP fund-holding was in part an attempt to address these problems (Glennerster, Matsaganis, and Owens 1994). Under the scheme, GPs could volunteer to become fund-holders. GP fund-holders were given a budget with which to purchase drugs and certain hospital and specialist treatments for their patients. The treatments concerned were chiefly elective surgery and comprised about 30 per cent of total referrals to secondary care. The size of their budget was determined by the GPs' patterns of referral in the year preceding their taking up of the fund-holding option.

Fund-holding created a new institution for rationing health care. The hard rationing choices that every health-delivery system has to make—is cataract surgery for Mrs Jones more important than a hernia operation for Mr Brown?—were decentralised and assigned to individual GPs who knew Mrs Jones and Mr Brown and who were supposed (in many cases correctly) to have the interests of them both at heart. Although rationing by GPs must of course be constrained by centrally determined priorities and by norms requiring consistency, impartiality, and fairness, there are tremendous advantages in decentralising decision-making in this way. In so far as patients trust their GPs, such a system should make patients more willing to accept waits or denials of service than if these decisions are made by an impersonal bureaucracy. Knowing individual patients, GPs can be sensitive to details that a bureaucracy could not know or respond to. The decentralisation itself provides a measure of flexibility and encourages patient choice, since patients can move to practices with different priorities.

But more important from the point of view of this chapter was the change in the incentive structure. Knightly fund-holders who were concerned about their patients' health consequences now had a strong incentive to use the funds as efficiently as they could. Since the fund was fixed, more needs could be met if the fund were used efficiently. But even self-interested GPs had some incentive

to use the funds efficiently, partly because they would wish to limit complaints and bother for themselves, and partly because, since patients could move, their case load and ultimately their incomes depended on the level of regard for their practice, including the success of their hospital referrals.

An important element of the incentive structure was that GPs could spend on their practices whatever portion of their funds they did not spend on outside services. This surplus was supposed to be used for the benefit of the patients but, since investments in the practice would otherwise come out of the GPs' pockets, the fund surpluses could easily redound to the income and comfort of GPs. Optimists could take comfort from the fact that the arrangement diminished the incentive to refer patients to others for services rather than providing them oneself, while pessimists were alarmed at the possible incentive to restrict access to secondary care. But, however one saw the arrangement, it bridged the gulf separating the costs of services provided within a practice and services provided outside it. If GPs could keep the surpluses, then referring a patient for treatment out of the practice, like treating the patient within the practice, had to be paid for and, whether self-interested or concerned for patients' well-being, GPs had an incentive to be economical in their referrals. The incentive structure was robust, in that it appealed to the knight and the knave, and also created incentives for economising on expensive treatments.

If we refer back to the opening of this chapter, it should be apparent that the scheme met the requirements for good policy design in the health care area that were specified there. The incentive structure was robust. With respect to patient choice, patients had the choice of primary-care provider, the GP; and through that choice, although they did not have the direct power of choice over secondary-care provider or over the nature and amount of treatment, they could choose the agent who would make those choices for them. Moreover, those agents—the GP fund-holders—had a fixed budget, which meant that they had an incentive to avoid overuse of the system by one or more of their patients.

Fund-Holding in Practice

The health care quasi-market evolved over time, especially on the purchasing side. In particular, fund-holding moved from being largely a fringe activity to one that took centre stage. By the time the Conservative government lost office in 1997, over half of all GPs were working in fund-holding practices. Many of the remaining GPs were part of so-called commissioning groups: groups that did not hold a budget but that nonetheless advised their local health authority on purchasing decisions. The fund-holding scheme itself changed to allow different levels of fund-holding. At one end, small practices were allowed to purchase only community services; at the other extreme, some experimental 'total purchasing pilots' were introduced where a practice—or, more commonly, groups of practices—were allowed to purchase all forms of secondary care, including accident and emergency treatment.

So what were the effects of the scheme? Although there was some anecdotal evidence of abuse, in practice the surpluses of fund-holders were small and seem to have resulted more from shortages of specialist services and the need to ration the funds so as not to run out at the end of the year than from any desire to run a surplus for personal benefit (Goodwin 1998). Indeed, in many cases the surpluses were used to reduce waiting lists in the following year.

More importantly, there were improvements in the quality of treatment (Glennerster, Matsaganis, and Owens 1994; Goodwin 1998). There was a greater provision of outreach services by fund-holders than non-fund-holders. They obtained quicker admission for their patients, significantly reducing waiting times (Dowling 1997; 2000; Propper, Croxson, and Shearer 2002). Fund-holders also kept down prescription costs relative to non-fund-holders (Harris and Scrivener 1996; Goodwin 1998: 45–8). In fact, generally fund-holders appeared more successful than other forms of purchasers in obtaining responsiveness from hospital providers. However, on the more negative side, there was no evidence of increased choice for their patients (Fotaki 1999).

Whether the improvements in quality generated by fund-holding outweighed in value terms any associated increases in costs (and thereby led to an increase in efficiency, properly defined) is not known. There is also controversy as to whether fund-holders' relative success derived from their being more generously funded than health authorities. However, the best evidence suggests that this was not so, and that in fact it was their ability as purchasers, not increased resources, that led to their success (Dowling 1997; 2000).

One of the expectations of the fund-holding scheme was that fund-holders would find it cheaper (and arguably more effective) to treat patients out of hospital than in it, and hence would reduce the number of patient referrals to hospital. The evidence as to whether this actually occurred is mixed. Early work suggested that it did not (Goodwin 1998: 48–50); but a recent sophisticated study by Mark Dusheiko and colleagues showed that fund-holders did reduce referrals and, moreover, did so by a significant amount (Dusheiko *et al.* 2003). Of course, it is controversial whether a difference in referral rates represents a positive or a negative difference in the quality of care; but in some ways the interest for our purposes lies not so much in this question as in whether the financial incentive structure underlying the GP fund-holding scheme actually changed doctors' behaviour.

Reinforcing the view that the incentive structure did lead to a change in GP behaviour is an interesting study by Bronwyn Croxson, Carol Propper, and Andy Perkins (2001). This found that potential fund-holders 'gamed' the system, increasing referral rates in the year before they became fund-holders in order to get a larger budget (their initial budget being determined by their pattern of referrals in that year) and reducing them after they became fund-holders.

Finally, it is worth noting that there was little evidence of cream-skimming: the deliberate selection of patients by fund-holding practices who were easier or less costly to treat in order to protect budgets (Scheffler 1989). Given that

fund-holding offered incentives for engaging in this kind of selection, it is not immediately obvious why it failed to materialise. It may have been the result of knightly motivation. Alternatively, the absence of cream-skimming may have been because there was an 'insurance' scheme by which fund-holders were not liable for the extra costs associated with very expensive patients: a fact which significantly reduced any incentive they may have had to exclude such patients from their lists.

On balance, then, it would seem that the robust incentive structure for GP fund-holding did change GP behaviour and did so in a fashion that, mostly, led to tangible benefits. In this it was an improvement on the previous structure of GP incentives that did have elements of robustness about it in that some knightly and knavish motivations were aligned, but that, due to the division of budgets between primary and secondary care, had undesirable consequences. One lesson to be learned from this is that it is not sufficient for incentives to be robust for there to be desirable outcomes; they must also be coupled with appropriate budgetary design.

Primary Care Trusts

Finally, it is worth comparing the incentive structure of GP fund-holding with that of its successor: the primary care trust. When the Labour government took power in 1997, it officially abolished the internal market. The purchaser/provider split was retained, but the emphasis was now to be on cooperative relationships, not competitive ones. However, as a last resort, purchasers could still switch their purchasing away from their providers. New purchasers were introduced: Primary Care Groups, soon to evolve into Primary Care Trusts (PCTs).

PCTs are now in place. They are independent trusts, directly providing primary and community care services and purchasing other services, including hospital care, from specialist providers. They are funded by central government, and will control up to 75 per cent of the NHS budget. All GP practices are required to join PCTs. They are geographically specific, often serving large populations (350,000 or more).

The PCTs can keep any surpluses they make on their budgets. These can be shared between the PCT itself and the individual practices within the PCT. The PCT has considerable freedom in how it can spend its share; the only real requirement is that it spend 'strategically . . . to develop primary care' (UK Department of Health 1998*a*: 23). Practices, on the other hand, are more constrained: they may spend the share of their surplus only on a prescribed list of activities including the purchase of equipment used for patient treatment, investment in existing premises, and non-recurring staff costs. There seems to be no uniform procedure for sharing any surplus between the practices and the PCT itself.⁸⁰

⁸⁰ One was suggested in a Department of Health circular at the beginning of the process (UK Department of Health 1998*b*: 24–6). Under this scheme, each practice would have its 'activity share' of the secondary-care budget calculated on the basis of its existing use of secondary care in its area. If it managed to spend less than its share, then it would be entitled to the whole of the first £10,000 of any surplus, half of the next £70,000 with the other half going to the PCT, and nothing from any surplus over £80,000. The maximum it could earn from making a surplus would thus be £45,000. If the PCT overall was in deficit, then all its part of the practice's surplus would be set against that deficit; however, the practice could still keep its share. So far as I am aware no PCT has implemented this scheme.

Although supposedly replacing fund-holding, the PCTs can be viewed as in many ways a partial successor to the scheme. In fact they bear many similarities to the total purchasing pilots: groups of fund-holders who, as mentioned above, were given a budget to purchase all hospital and community health services for their registered populations (Mays *et al.* 1998). Hence many of the arguments above concerning fund-holders' incentives should carry over to PCTs. However, the incentive structures are different in some key ways, notably in the sharing of surpluses and in the external environment.

If one supposes that the most important concern of GPs in a PCT is the caring one of promoting the health of *all* the patients for whom the PCT provides services, then the PCT will have an incentive to use its resources efficiently, regardless of how the surplus is shared out. In particular, it will allocate its budget in such a way that it will equalise the marginal health gain from each use of its fund, whether the use involves purchasing secondary services or investing the surplus in primary care. In principle the outcome could be more efficient than fund-holding, since all the relevant resources (including all primary and secondary care as well as community services) will be under the same budget. Under fund-holding, in contrast, there were separate budgets for primary care, secondary care, and community services, and the secondary-care budget for most forms of fund-holding did not cover the most expensive categories of secondary care. In addition, PCTs should avoid the inequities in care that resulted from the fact that some GPs were fund-holders and that some were not.

However, even knightly GPs may not be motivated by an impersonal concern for the welfare of all patients. Both the norms governing medical practice and their personal attachments are likely to make them more concerned with the health of *their* patients than with the health of others. So, even without material self-interest, there would be conflicts of interest among the GPs in a PCT, and these could give rise to problems, with GPs tempted to free-ride on others' activities. This will, of course, be even stronger for purely self-interested GPs.

However, a structure of incentives that involves a sharing of the surplus is one that should appeal to both the practice-interested GP (whether knightly or knavish) and to the GP whose concern is with the general PCT interest. Of course, some problems will remain. Very successful practices may resent not receiving all of their surplus, especially if it is used to offset others' deficits. Less energetic practices may be tempted to free-ride if they know that deficits

will be covered. Resources devoted to adjudicating the resulting disagreements and to implementing the administrative machinery needed to minimise and regulate the conflicts are resources that are not being used to treat patients.

But on balance the principles underlying the internal incentive structure seem to have merit. However, the external situation seems less satisfactory. What is to prevent a PCT that consists of largely self-interested GPs from exploiting its capacity to generate surpluses at the expense of patient care? An external disincentive to such behaviour that *was* present for fund-holders will not be there for PCTs. Fund-holders, unlike PCTs, faced the risk of losing their patients to another commissioner. Since a particular PCT covers all the population of a particular area, patients who are unhappy with the treatment they receive (or the lack of it) can only complain. In Albert Hirschman's (1970) terminology discussed in Chapter Five, they can exercise their voice, but they will not be able to exit. Although in practice patients of fund-holders rarely used the exit option, GP fund-holders were aware of the possibility, and it undoubtedly helped to align the self-interest of GPs with the interests of their patients.

The absence of the exit option will be partly addressed by government monitoring through a regulatory agency.⁸¹ However, here the impact of policy on motivation becomes important. Heavy monitoring and the threat of penalties associated with failure may shift the balance of motivation in the wrong direction: towards greater self-interest. If people are treated as though they need to be whipped to achieve results, then they may behave as though they do need to be. As we have seen earlier, the threat of sanctions can debase a previously voluntary activity, arousing resentment and lowering morale. It encourages the development of evasion and avoidance techniques, and it leads to concentration on whatever is monitored at the expense of what is not, regardless of the relative importance to patient care.

An alternative way of coping with the absence of an exit option is to rely on a more conventional interpretation of Hirschmann's voice: patients' complaints procedures. But, as we saw in Chapter Three, these are blunt instruments for motivating change. They require energy and commitment to activate; they take time to operate; and they create defensiveness and distress among those complained against. Patients who complain are not necessarily those who have the most to complain about, and an adversarial relation between doctors and patients, especially if it is accompanied by threat of lawsuits, leads to expensive and inefficient defensive medicine.

Overall, it is here that the biggest weakness of the PCT structure is to be found. The methods that will be used to try to hold largely self-interested PCTs accountable to their patients are likely either to be ineffective or to encourage more of the kind of self-interested motivation that led to the

⁸¹ Currently the Commission for Health Improvement; soon to become the Commission for Healthcare Audit and Inspection.

problem in the first place. It would be better to reinstate the exit option: to allow patients to choose their own PCT, as they could choose their fund-holder.⁸² This has the obvious danger that PCTs could cream-skim; however, this could be prevented by putting restrictions on PCTs' ability to turn people away.

THE PAYMENT OF HOSPITAL CONSULTANTS

Hospital consultants in the British NHS are currently paid on a salary basis to work a number of sessions per week in the NHS. However, if they are prepared to work (and be paid) for one fewer session per week, they are allowed to work in addition as much as they like in the private sector—where they are paid on a fee-for-service basis. Other countries have similar arrangements.

Such systems can create perverse incentives, at least from the point of view of the public service. This applies particularly to situations where physicians are paid for fee-for-service in the private sector and on a salary basis in the public sector. Thus a British consultant confronted with a public sector patient who needs an operation has a (largely knavish) incentive to encourage the patient to 'go private'. For if the patient remains in the public sector the consultant will have to do the operation without any extra reward whereas, if the patient goes privately, the consultant will be paid.

And the best way to encourage the patient to go privately is to have a long wait for a publicly funded operation. So, if the aim of policy is to have public sector waiting lists as short as possible, the existence of the private sector running alongside the public one directly undermines the latter's ability to achieve that aim.⁸³

Can this be rectified? Can a robust incentive scheme be devised that would overcome these problems? Suppose that, instead of being paid exclusively by salary, the physicians concerned were paid on a fee-for-service basis for treating public sector patients above a baseline case load. So, for instance, for each case treated above the baseline, they would get 80 per cent of the current private rate. The extra payments could be made in addition to the present pay structure or could substitute for some aspect of it.

Why 80 per cent of the private rate and not 100 per cent? This is to allow for an element of knightly motivation. By opting for public sector work under this scheme, physicians would be better-off than if they did not do the extra work, so there would be a direct gain to themselves from working harder. But they

⁸² As has been suggested by one of the original architects of the internal market, the economist Alain Enthoven (1999).

⁸³ This is not a theoretical danger. These perverse incentives do appear to distort consultant priorities in practice. For instance, a study of the extent of private practice by the UK Audit Commission (1995) found that the 25 per cent of consultants who do the most private work carry out significantly less NHS work than their colleagues.

would also be making a sacrifice through not doing the same work in the private sector at a higher rate, thus meeting public service objectives but at some opportunity cost—a feature of the scheme that as was argued in Chapter Four should appeal to the knight. So both altruistic and self-interested motivations would be working in the same direction.

Would changing the payment system in this way empower patients? In one sense it would, for, under fee-for-service, consultants' incomes would depend on the amount of services they provided for patients, in a way that it does not under a salary system. So consultants would have a direct incentive to meet patients' needs and wants or, as under the primary-care budget-holding scheme, their primary-care physician's interpretation of those needs and wants.

But there is a danger. Any fee-for-service system in medical care may encourage what economists term 'supplier-induced demand'. That is, physicians have a (knaveish) incentive to encourage patients to have more medical care than they need: pressure that patients, from their position of relative ignorance concerning their actual need, may find difficult to resist. However, the fact that the system allows for an element of knightly motivation would act as a brake on this tendency. In addition, if the system were coupled with primary-care budget-holding, this would be a source of further restraint. For the cost of meeting demand would fall on the relevant budget, thus providing primary-care physicians with a strong motivation to approve only treatments that were strictly necessary.

There are two other possible objections. First, there is a fundamental assumption underlying the scheme (and indeed the primary-care budget-holding schemes discussed in the previous section): that doctor behaviour responds to changes in financial payment schemes. This could be challenged. But, in fact, there is overwhelming evidence from an enormous variety of studies that financial incentives do impact on physician behaviour and, moreover, that they do so in the manner that would be expected (Chaix-Couturier *et al.* 2000; Rodwin 1993).

Second, the shortage of specialists in the private sector could result in an increase in private sector rates. In consequence, if the price paid were always 80 per cent of the private rate, the scheme would end up being more expensive for the public sector. However, fixing the price as a high proportion of the private rate would discourage private rate rises, since it would be apparent to the private sector that this would be largely self-defeating. Further, the private sector is limited in the extent to which it can raise rates because of the knock-on effects on private health insurance premiums and out-of-pocket payments.

CONCLUSION

This chapter has demonstrated that it is possible to design policies for publicly funded health care that offer robust incentives to medical professionals, that go some way towards empowering patients, but that avoid the problems of

unfettered patient choice. Devices such as allowing budget-holding professionals to keep surpluses on their budget, providing those surpluses are spent in a way that improves patient care, or paying professionals fee-for-service at a rate that incorporates some sacrifice compared with alternatives, help align knightly and knavish motivations. Primary-care budget-holding coupled with fee-for-service for hospital consultants allows decisions concerning patients' treatment to be made closer to the patients themselves. At the same time it makes use of professional knowledge and expertise, and confronts decision-makers with the opportunity costs of their decisions. Although, of course, there are many ways of designing public health care systems, one that incorporates these kinds of features—or, at least, features that take proper account of motivation and agency issues—is likely to be more successful in creating appropriately motivated professionals, satisfied patients, and ultimately better health care than one without.

8 School Education

Headmasters have powers at their disposal with which Prime Ministers have never yet been invested.

(Winston Churchill, *My Early Life*)

The previous chapter discussed the design of policies aimed at motivating professionals to produce quality services that balanced user and professional power with respect to decision-making in the context of health care. This chapter undertakes a similar task with respect to school education. It will be seen that, although there are fundamental similarities between the two cases, some of the more detailed proposals are rather different. Again, the chapter concentrates on the British case; again, though, the ideas and policies discussed are capable of more general application.

PRIMARY EDUCATION

As outlined in Chapter One, state school education in England and Wales, like health care, underwent an organisational transformation in the late 1980s. Prior to that, the school education system in England and Wales relied upon a combination of command and control and professional trust. The local government of the area where a school was located had control of all schools' budgets and admissions. Budgets were set essentially on a historical basis and admissions were determined according to the local government's own criteria (usually related to geographical proximity and capacity). Schools had little flexibility in the way they could spend their budget; they had little control over who attended their classes. On the other hand, they had considerable freedom over what and how they taught. Parental choice was heavily constrained, with little choice over where their children went to school and what their children were taught when they were there.

The motivational and agency structures were thus a combination of knight and pawn. Local government officials were assumed to be knights, making budgetary and admissions decisions in the public interest. School head teachers and their staff were supposed to be pawn-like in their acceptance of these decisions but knightly in the way that they devised and implemented their

curricula and teaching methods. Any head teacher or a member of staff who was essentially a knave thus had considerable freedom to exploit the situation to serve his or her own interests. Even those who were knights could freely indulge their conception of knightly behaviour, untrammelled by worries about users' concerns. For those users—parents and children—were essentially pawns, their power limited to an occasional exercise of 'voice' through complaints to the head teacher or the governing body. Finally, since the school had no control over budgets, neither knight nor knave had any interest in promoting efficiency in the way that resources were used.

All this changed following the 1988 Education Reform Act passed by the Conservative government of Mrs Thatcher.⁸⁴ Under the so-called LMS (Local Management of Schools) initiative, control of schools' budgets and other important decision-making responsibilities were taken away from local governments and given to schools themselves. School governing bodies were to decide upon the numbers and composition of staff and became responsible for hiring and firing decisions (including those relating to head teachers). If they so chose, schools were allowed to opt out of local government control altogether. Schools could keep surpluses on their budgets provided they used them to hire staff or improve facilities.

Under the new system, schools' budgets were predominantly determined by the number of pupils they had on their rolls, with the school concerned receiving a fixed amount per pupil depending on the pupil's age. Parents could choose where to send their child to school—in theory at least. All schools, except for religious and selective ones, had to accept as many pupils as their physical capacity would allow. However, an oversubscribed school was allowed to use published admissions criteria. The most frequently used criteria were geographical (proximity of the child's home to the school), sibling-related (the child's siblings already attending the school), and medical; but schools were also allowed to select a proportion of their pupils according to academic criteria.

In effect, this set of arrangements amounted to the equivalent of an educational voucher system. Under such systems, parents are given a voucher with a monetary value that they present to a school of their choice for educating their child. The school then redeems the voucher for cash from the relevant government department of education. The resources that a school can attract therefore depend on the choices made by parents. So, too, in these quasi-market reforms. In theory at least, parents could choose their child's school and the money would follow their choice. Schools that were successful in attracting pupils would thrive; those that were not would decline.

In addition to these changes encouraging parental choice, information systems were set up to enable parents to make more informed choices. Performance testing of children at ages 7, 11, and 14 was introduced, with the results by

⁸⁴ For more detailed descriptions see Barrow (1998), West and Pennell (1997; 1998), and Woods, Bagley, and Glatter (1998: ch. 1).

school to be published. Each school's results in national examinations at ages 16 (GCSEs) and 18 (A-levels) were also published.

These changes led to a significant shift in the structure of motivation towards one that both involved robust incentives and empowered users. Parental choices were the driving force. The possibility of competition means that a school whose head teacher and other staff were driven primarily by knavish concerns would now have an incentive to meet the wishes of parents and children and thereby encourage pupils to attend the school. For that would bring in more resources and perhaps more status, and their self-interest would thereby be served. Moreover, they would want the school to be run efficiently so that a surplus could be generated: a surplus that could be used to improve facilities that could make their working lives more comfortable or to hire extra staff so as to make their work less onerous. But a school run by knights would also wish to generate a surplus in order to provide a better service for pupils and parents. This would be true especially of altruistic teachers whose concern for the welfare of users took the form of wanting to meet their expressed needs and wants. Even other kinds of knights would want to attract pupils; for they would want the school to stay in business so they could exercise their knightly concerns.

It is worth noting that the Labour government that took power in 1997 left these arrangements largely untouched. Indeed, as Howard Glennerster (2002: 126) has argued, 'the Thatcher education reform package was retained and, if anything, strengthened. More of the budgets were devolved to schools. There was no let up in performance testing or publication of results.' This is not to imply that the Labour government was inactive. Glennerster listed sixteen major government policy initiatives in school education between 1997 and 2001. However, none of them involved rolling back the quasi-market reforms (Glennerster 2002: Annex 1). Indeed some of them could be interpreted as designed to improve the operation of the quasi-market, such as the Fresh Start programme aimed at closing failing schools and opening new ones on the same site. Others were mostly adding non-competitive measures to the quasi-market such as Education Action Zones (clusters of schools working with local businesses and others to overcome barriers to learning in areas of high social and economic deprivation) or command and control ones such as the Numeracy and Literacy Hour in primary schools (compulsory time to be set aside in the school week specifically to teach numeracy and literacy).

PERFORMANCE

So how did the quasi-market perform? In an early study, Anne West and Hazel Pennell (2000) found that the average point score of pupils at GCSE and GNVQ (national exams taken by most pupils around the age of 16) went up between 1992/3 and 1996/7 in England by 8 per cent. Interestingly from the point of view of equity, the score for the top tenth of pupils increased by 7 per cent, but

that for the bottom tenth fell by 13 per cent. Overall, there has been a steady improvement in performance in GCSE and A-level results over the period, as measured by the percentage of the age group achieving good passes. However, these trends have been apparent since the early 1970s; and there is also an (unresolved) controversy as to whether standards have changed over that time (Glennerster 1998).

In work that is of more direct use for our purposes, Howard Glennerster (2002) used the performance of pupils in the relatively new national attainment tests (tests taken by all pupils at ages 7,11,14, and 16) to assess the effects of the quasi-market. His conclusions were striking. First, the percentage of pupils reaching a given level of achievement in England steadily increased from 1995 (the first full year of tests) to 2001, especially at the end of primary school. Some of the improvements were remarkable; for instance, the percentage of pupils gaining the expected level of competence in maths at the end of primary school moved from 45 per cent in 1995 to 70 per cent in 2001. This should be set against the fact that the best available evidence suggests that there was no improvement in the maths skills of children in the early years of secondary school for thirty years prior to 1995. Second, these improvements were not confined to good schools; in fact, the lowest-performing schools in 1995 were the ones to show the greatest improvement by 2001. The same is true of schools ranked according to the wealth of the area; over the period schools in poor areas were catching up with schools from rich ones.

Some caution in interpreting these results is needed here. There are anecdotal stories of 'teaching to the test' and indeed of outright fraud. Unpublished results from the University of Durham found little improvement in reading skills for year six pupils from 1999 to 2002 and in vocabulary between 1997 and 2002. However, they assess only reading, whereas the national tests include assessments of writing, spelling, and handwriting as well as reading. Moreover, the same team did find a 5 per cent improvement in science and a 9 per cent improvement in maths between 1997 and 2002.⁸⁵

A less desirable potential outcome of the quasi-market concerns selection by schools: what we have earlier termed 'cream-skimming'. Cream-skimming occurs where an oversubscribed school selects pupils of high intrinsic ability so as to improve the school's performance in examinations at relatively low cost.⁸⁶ The problem with cream-skimming is that it can lead to polarisation or segregation in terms of ability, with able pupils being increasingly concentrated in high-performing schools and less able pupils in low-performing ones.

A summary of some of the evidence on the operation of the quasi-market in its early days cites several studies that show evidence of the growth of cream-skimming practices (Whitty, Power, and Halpin 1998).⁸⁷ Notable among these

⁸⁵ <http://cem.dur.ac.uk/pips/StandardsOverTime.asp>

⁸⁶ For a description of the various ways in which schools can select and an elaboration of the potential consequences of that selection, see West, Pennell, and Edge (1997).

⁸⁷ See Perri 6 (2003) for a more recent review of the literature.

is the work of Sharon Gewirtz, Stephen Ball, and Richard Bowe (1995), who studied the development of quasi-markets in London. They found evidence that schools sought students who were able, motivated, and committed, with girls from middle class and South Asian backgrounds particularly favoured. However, they did not find any indication that less able pupils were being disadvantaged. Nor did they find overt cream-skimming in admissions policies. But there was what they described as 'social targeting': the promotion of the school to middle class and more able pupils. There did also seem to be a greater openness of schools to families and the local community, and an increased sense of their accountability. But the researchers were agnostic as to the extent to which these changes could be attributed to the quasi-market.

Stephen Gorard and John Fitz (1998*a, b*) examined the proportion of pupils eligible for free school meals in South Wales from 1991 to 1996 and found that while there was an initial increase in social segregation (as measured by a widening in the differences between schools in the proportion of pupils eligible for free school meals) this was followed by a significant decrease. They argue that the overall decrease in social segregation may reflect a kind of catching-up effect. That is, middle class families responded more quickly to the quasi-market changes than poorer ones, thus generating an initial increase in segregation, but with the poorer families gradually learning how to take advantage of the new freedoms and thus improving their children's ability to get into high-performing schools.

Philip Noden (2000) investigated segregation in English secondary schools from 1994 to 1999 and has challenged Gorard and Fitz's results. He used two measures of segregation: that used by Gorard and Fitz, and an 'isolation' index that again measures the spread of eligibility for free school meals but gives a greater weight to the existence of heavy concentrations of such eligibility. For both indices, he found an increase in segregation over the period, although the increase was not uniform over time or between local authorities. Noden now believes that his index has unsatisfactory properties, but, following comments by Gibson and Asthana, has shifted his criticism of Gorard and Fitz to one of using eligibility for free school meals as an indicator of segregation. The latter varies with the economic cycle, and this in turn could bring about changes in the index even if the underlying distribution did not change.⁸⁸

So the micro-evidence on cream-skimming is mixed. But it is worth returning to Glennerster's more aggregated evidence summarised above, and noting that the improvements to which he draws attention applied to poor schools (whether defined in terms of poor performance or of the poverty of the areas in which they are located) as much as if not more than to good ones. If cream-skimming in relation to educational attainment were a serious problem, this would not have been expected.

⁸⁸ Gibson and Asthana (2000), Gorard (2000), Noden (forthcoming).

Whatever the doubts about the detailed statistics, it seems hard to deny that there have been some kind of performance improvements in English school education in the last decade. This was the decade following the quasi-market reform and the introduction of robust incentives; so, at first sight, it might seem reasonable to ascribe the improvements to that change. But would this really be justified? Might the changes not be due to increases in public expenditure on education over the period or to other changes in policy, such as the introduction of the numeracy and literacy hour or increased prominence of the regulatory agency Office for Standards in Education (Ofsted)?

Glennister (2002: 122–4) examines the issue of resources and points out that public expenditure per pupil in England increased only a little over the period at primary school level, and was virtually static at secondary school; public education spending as a whole actually fell as a percentage of GDP. So not only were there improvements in outcomes over the period but, since these were achieved with little if any increase in resources, it seems as though there was also an increase in the efficiency with which those resources were used.

The question whether these improvements in both outcomes and efficiency were attributable to the operations of the quasi-market or to other policy initiatives is more difficult to resolve. There has been no systematic study of the impact of Ofsted on performance. Such work as has been done has concentrated on how parents, governors, and teachers feel about Ofsted, concluding that they did not find it effective in helping to develop schools;⁸⁹ but this is far from conclusive. Nor has there been any systematic study of the numeracy and literacy hour; but it is hard to resist the impression that its impact on performance has been considerable. Also, the instrument by which the quasi-market is supposed to create its behavioural effects is through the exercise of parental choice; and there is little evidence that parents actually shifted their children from school to school in search of better educational outcomes.

However, parents do not need to exercise choice in the simple sense of actually moving children to have an impact on school behaviour. Simply the possibility of choice and the threat that it might be exercised—what is often termed ‘contestability’—may be sufficient, especially in a world where that threat can be informed by Ofsted reports and the publication of test and exam results. Also, professionals dislike being low down a league table, even if they are not losing custom as a consequence; and this on its own can act as pressure to lever up performance.⁹⁰

Certainly most parents are aware of the possibility of choice and approve of it. A detailed review of both national and international evidence on school choice by Perri 6 (2003) found that the scheme ‘appears popular with many parents and has achieved good satisfaction ratings from majorities’.

⁸⁹ The evidence is summarised in Propper, Burgess, and Shearer (2002).

⁹⁰ I am grateful to Will Cavendish (personal communication) for this point.

Whatever the exact mechanism through which competition exercises its effects, micro-studies of the performance of schools suggest that some at least of the efficiency improvements can be directly attributed to the competitive pressures arising from the operations of the quasi-market. Stephen Bradley, Geraint Jones, and Jim Millington (2001) investigated the performance of all secondary schools in England over the period 1993–7. They measured the performance of each school on two dimensions of ‘output’: school exam performance and attendance rates. They then related these outputs to various input measures, including the proportion of pupils ineligible for free school meals and the proportion of qualified staff, to calculate the relative efficiency of the schools concerned. These relative efficiency scores were related to selected characteristics of the school and the local area, including local education authority expenditure per pupil, staff/student ratio, type of school (local, selective, grant maintained, and so forth), gender composition (co-educational, boys-only, girls-only), the local unemployment rate, and the proportion of adults in profession and managerial occupations. Finally they were related to the extent of competition in the area, as measured by the number of schools of different types (including selective) within a two-kilometre radius.

The conclusions of the study were quite unambiguous. The relative efficiency of the schools was directly related to the amount of competition they faced. The greater the degree of competition, the more efficient they were. Moreover, the strength of the effect increased over time, corresponding to the evolution of the quasi-market. Competition also encouraged changes in efficiency over time: the greater the competition, the faster the rate of change.

Stephen Bradley has taken the argument further. With Jim Taylor he has used data from the Schools' census, the School Performance Tables, and the Youth Cohort Study to study the impact of competitive pressures within the English quasi-market on schools' exam performance (as a measure of allocative efficiency) and on exam performance per member of staff (as a measure of productive efficiency) (Bradley and Taylor 2000). Again they found an unambiguous positive impact of competition on both indicators, even when all other factors that might affect school performance were controlled for. Other studies of what could be interpreted as outcome improvements are less direct but nonetheless suggest an effect arising from competition. Philip Woods, Carl Bagley, and Ron Glatter studied three areas with eleven schools during a period from 1993 to 1996. They interviewed head teachers, other teachers, business managers and governor and parents. They concluded that there was a ‘sharpening of focus on the academic in most schools and . . . further than this, a privileging of the academic. Significantly this is considerably less marked in East Greenvale [one of their study schools] where there are fewer competitive pressures’ (Woods, Bagley, and Glatter 1998: 162).

As well as investigating efficiency, Stephen Bradley and Jim Taylor (2000) in their paper mentioned above explored the selection consequences of the quasi-market. They found that schools with good exam results experienced

a reduction in the proportion of pupils coming from poor backgrounds (as measured by the proportion eligible for free school meals) while those with poor exam results experienced the reverse. However, the effect was not large. Moreover, the direction of causation is not unambiguous, with the results possibly arising in part because the reduction in the proportion of pupils coming from poor backgrounds promoted good exam results rather than the other way round.

Finally, it is worth noting that there is international evidence concerning the importance of competition in affecting school outcomes, both positively (in the sense of improving educational outcomes) and negatively (in the sense of encouraging segregation). Caroline Hoxby (2002; 2003) has reviewed the evidence on the impact on the performance of public schools in Milwaukee, Michigan, and Arizona of competition from 'choice' schools. All three of those areas have experimented with allowing parents to choose schools other than their local public schools through the mechanisms of either vouchers (Milwaukee) or charter schools⁹¹ (Michigan, Arizona). It had been widely predicted that, because of cream-skimming, public schools in the areas concerned would suffer an overall drop in performance as the better students were sucked into the choice schools. However, Hoxby found evidence of strongly improved performance by the public schools, from which she concluded that the efficiency-inducing effects of competition were more than enough to offset any potential effects of cream-skimming. She also examined the effects of competition with private schools on public schools and of competition between public schools through parents choosing place of residence. Again she found that competition had a positive impact on performance.

New Zealand also experimented with competition in education, offering full parental choice of schools. However, in one difference from the British case, neither the costs of teachers' salaries nor all central support services were devolved to individual school budgets. An experimental fully funded option was opened up to all schools for a trial period.

There does not seem to have been any direct study of the impact of competition on the outcome and efficiency results of the New Zealand experiment, with most researchers concentrating on the effects on parental choice and the consequences thereof.⁹² A summary of the earlier evidence found that parents were given more information about school programmes and children's progress, and parents did indeed exercise their right of choice over schools.

⁹¹ Charter schools are similar to Britain's foundation (previously grant-maintained) schools, being within the public system but funded separately. Individuals, non-profit, and for-profit organisations can apply to a local school board for a 'charter' to run a school. The charters are renewable but depend on targets set out in the charter being met. The funding is on a per-pupil basis. There are currently around 350,000 pupils in nearly 2,000 schools in 36 States.

⁹² A partial exception is Lauder and Hughes (1999: ch. 7). However, they did not investigate the direct effects of competitive pressures on school performance. Rather, they examined the effects on school performance of the polarisation that they claimed was due to markets.

However, a consequence of this was increased polarisation with schools in low-income areas suffering from decreasing resource and enrolment problems (Whitty, Power, and Halpin 1998). This has been confirmed by later research. Thus Helen Ladd and Edward Fiske (1999) in a study of the country's three major urban areas for the US Brookings Institution found that the effect of choice was to generate a system in which the gaps between the successful and the unsuccessful schools became wider and in which minority and poorer pupils were concentrated in the unsuccessful schools, a result confirmed by Hugh Lauder and David Hughes (1999).

Belgium and the Netherlands have long had a quasi-market system of education, with school choice coupled with public funding organised on a per capita basis according to school rolls. Again there have been no studies of the relative efficiency of the Belgian or Dutch systems in terms of educational output per unit of input. However, Vincent Vandenberghe (1998) has studied the impact of parental choice on school segregation by ability in the French-speaking community of Belgium. He found that the variation between the output of schools (as measured by the number of pupils who did not have to repeat a grade year) was not related to the degree of socio-economic inequality in the area, as might have been expected, but was directly related to the degree of school competition in the area (as measured by a concentration index). In other words, the more the competition, the more schools were segregated by ability: a result he described as both inequitable and inefficient.

Finally it is worth noting that a recent paper in the *Economic Journal* has claimed that, in most OECD countries over the past twenty-five years, pupil performance has remained broadly constant, even though spending per pupil in real terms has risen (Gundlach, Woessman, and Gmelin 2001). The researchers conclude that this suggests a significant fall in the efficiency with which resources are used, a fall that they suggest is due to the lack of competitive pressures in the countries concerned. But, as Glennerster (2002) has noted, none of this is now true for the UK.

THE POSITIVELY DISCRIMINATING VOUCHER

So it would seem as though the motivational and empowerment structures implicit in the quasi-market in primary education in Britain and in similar competitive systems in other countries can succeed in raising standards overall. However, even if some of the critics' worse fears about cream-skimming may not have always materialised, there is clearly a danger here. Head teachers do have an incentive to try to manipulate the entrance requirements to their schools so as to further the school's and its staff's interests. Under certain funding structures, this could lead to their trying to select pupils from wealthier socio-economic backgrounds, which, perhaps because of better support systems at home or more highly motivated parents, could improve their schools' exam results for minimum effort.

But not under all funding structures. Several years ago I proposed what I termed the ‘positively discriminating voucher’ (PDV) (Le Grand 1989: 202–4). This would be a form of education voucher that favoured poor families. Under the scheme those living in poorer areas would receive a larger voucher, thus creating a positive incentive for schools to take them in. Schools that contained a high proportion of children from poor families would then have more resources per pupil on average than those with a low proportion. They would also have better premises and equipment and could attract higher-quality staff. The outcome would be either selective schools, with those that specialised in the education of the children of the poor being better equipped and staffed than those that specialised in the education of the children of the rich, or, if head teachers or staff did not want to engage in such specialisations, schools that contained a reasonable proportion of children from all parts of the social spectrum.

A difficulty with the PDV is that it would be necessary to find some way of identifying families from poor backgrounds. This could be done by means tests; but these have well-known difficulties, including administrative complexity and stigmatising effects. An alternative would be simply to give larger vouchers to families who lived in poorer areas. The wealth of the area could be determined by a sample survey of the value of the houses in the area. This would have the advantage of stopping the better-off from moving into a poor area simply to benefit from the higher value of the voucher. For if they did so in any numbers, house prices would rise and the value of the voucher would fall.

Samuel Bowles and Herbert Gintis (1998: 43; see also Brighouse 1998) have proposed an interesting variant on this idea. This is to make the value of the voucher depend not only on the socio-economic status of the family but also on the socio-economic composition of the school. Thus a voucher presented by a low-income pupil to a school with predominantly high-income pupils would be worth more, giving the school an incentive to attract such pupils. Similarly a voucher presented by a high-income pupil to a school with predominantly low-income pupils would also be worth more, again giving an incentive to the school to attract such pupils.

CONCLUSION

It is of interest to conclude this chapter by comparing the policies discussed therein with those relating to health care of the previous chapter, especially primary-care budget-holding. Overall, both the GP fund-holding scheme and the quasi-market in state school education appears to have done a better job than the systems that preceded them. They appear to have changed the behaviour of providers, and to have done so for the better. Outcomes seem to have improved, as does the efficiency in the way that resources have been used. In education, at least, choice and responsiveness appear to have increased, as, on a less positive note, has cream-skimming, although the evidence on the latter is mixed.

The reasons for the success lie in the 'robust' motivational structure of the key actors. In a school, the relevant decision-makers are head teachers. In the quasi-market, they are motivated in large part by a desire to preserve or improve the financial health of the institution. This could be in part a knavish motivation: a desire to preserve their own jobs, and an awareness that this depended in large part on their ability to control the finances. But it also could have knightly components; head teachers believing that by improving the financial health of their institutions they would thereby benefit their pupils and staff. What is indisputable is that head teachers also have direct managerial control over their staff, with considerable freedom to hire, fire, and promote. They also have considerable autonomy over admissions and exclusions (West, Pennell, and Edge 1997). Hence they have both the motivation and the ability to respond to market pressures.

And those market pressures are quite intense. Parents, armed with the latest published examination results, seem prepared to exercise the choices open to them, even if they did not always do so. They are much closer to queens than pawns. And any school that faced the threat of losing pupils would lose resources; while schools that succeeded in gaining pupils would gain resources. Schools that gained resources had considerable freedom of action how to spend any surplus they generated. Schools that lost resources went into financial difficulty; head teachers in charge of schools that were in financial difficulty were in risk of losing their jobs.

GP fund-holders were under less market pressure, although some was exerted by patients' freedom to change their GP. But their incentive structure was clear: to spend their budget in a fashion that made the best use of hospital resources. They had an obvious knavish motivation for this, in that any surplus they made on their budget could ultimately be used to serve their self-interest. However, this would not necessarily conflict with a knightly desire to do the best for their patients, since that too could be served by not wasting resources on unnecessary hospital treatment. And, as with head teachers, they had considerable autonomy and thus were well-placed to undertake the necessary activities to meet their ends.

There is a clear difference, though, in the extent of user empowerment in the two schemes. In both cases users have a budget associated with them: one that limits potential overuse. However, in the education case, the parents are the active agents in charge of that budget, making choices on behalf of their children. In the health case, the active agents were the GPs: quite close to patients in many ways but not clearly in the same relation to them as parents are to their children. This in part seems to be a sensible reflection of the differences between the two cases in the extent of system and individual failure. As was argued in Chapter Five, the information available to users and their capacity properly to process that information is arguably less in the case of health care than education. Hence appointing an informed agent to make

choices on behalf of users seems more appropriate for health care.⁹³ However, it is important that users can choose their agent: hence the recommendation at the end of Chapter Five that patients should be able to choose their primary-care trust.

Finally, what conclusions can we draw from all the discussion so far about the way to design policies aimed at improving the delivery of public services? There seem to be three major ones. First, we are unlikely to be able to rely solely upon pure knightly motivations—upon the public service ethos—to deliver public services to the level of quality and quantity that we require. However, rewards for public service should not be such that all elements of sacrifice are removed—otherwise we are content to have all public services provided by knaves. Second, knavish and knightly incentive structures should not work against one another but should be aligned in a ‘robust’ fashion. Third, and perhaps most controversially, if the aim is to have a service that treats its users more like queens than like pawns and, moreover, is relatively efficient in its use of resources, then it would seem that a system of quasi-market competition with independent providers run by public sector professionals and with users or their agents having fixed budgets is the best—or perhaps the least bad. There is a danger in such a system that providers will exploit any informational advantages they may have to lower quality or to cream-skim. However, this is likely to be restrained in part by their knightly instincts and in part by the judicious design of policy, incorporating such measures as the positively discriminating voucher.

ANNEX: GOLDEN HOUSING

This is not a case involving the motivation of public service providers; nor is it about education or health care. But it illustrates the point about robust incentive structures so neatly that I cannot resist including it: a pioneering scheme by a housing association to improve the service and behaviour of its tenants.

Irwell Valley is a housing association: a non-profit organisation providing more than 6,300 homes in Greater Manchester.⁹⁴ In 1998, it pioneered a new way of dealing with the relationship between landlord and tenant: one that appeals to both knightly and knavish motivations in the tenant and, not coincidentally, goes some way towards turning pawns into queens.

Prior to 1998 the Association had most of the problems associated with social housing in poor areas. Low demand, property abandonment, anti-social behaviour by tenants, drug dealing, vandalism, and high turnover rates characterised a small proportion of the housing stock; but that proportion dominated the

⁹³ Another difference between the two situations is that the budget is individual in the case of education whereas in health care the budget for many patients is pooled. This arises because of the uncertainty associated with the need for health care, necessitating some form of risk pooling.

⁹⁴ What follows is drawn from Irwell Valley Housing Association (2001). I am very grateful to John Hills for bringing this to my attention.

business. Around 80 per cent of resources were being spent on 20 per cent of the tenants. The Association's general management performance was in the median quartile of comparable performance indicators published by the housing corporation. Void rates and rent arrears were above average.

In 1998, the Association introduced what it termed 'Gold Service'. Tenants could apply to be Gold Service members if they met certain criteria for acceptance. These included payment of rent in full for six consecutive weeks and no breaches of their tenancy agreement. In return, they received a range of benefits, including a faster repairs service, various discounts at local stores and entertainment facilities, and a cash bonus every year. With respect to the last of these, if the tenants wished they could choose to have it paid into a tenants' association or group, in which case the Housing Association would match it with a grant of its own. The money would then be used for the benefit of the community.

The aim was thus to reward good tenants and, in effect, bring them into the business of running a successful housing project. The incentives were largely knavish, but not entirely: knights could pay their bonus into a fund for group benefit and indeed would be rewarded by a matching grant for doing so. So both knights and knaves had an incentive to behave.

The results have been remarkable. Rent collection has increased substantially; rent arrears as a percentage of rent receivable has been halved, from nearly 10 per cent to less than 5 per cent. Nearly 70 per cent of the Associations' tenants have no arrears at all, compared with 40 per cent at the start of Gold Service. Average arrears of those in debt were reduced by 13 per cent during the eighteen months of Gold Service. The average time for re-letting property has fallen to just over three weeks, at a time when that for other social housing providers was increasing.

Although this is not an example of incentivising public service providers (rather it is motivating the tenants), it is an illustration of what a mixture of knavish and a (small) dose of knightly incentives can do to change behaviour if they are properly aligned.

9 A Demogrant

Money is like muck, not good except that it be spread.

(Francis Bacon, 'Of Seditions and Troubles')

Higgins. I suppose we must give him a fiver.

Pickering. He'll make a bad use of it, I'm afraid.

Doolittle. Not me, Governor, so help me I won't. Don't you be afraid that I'll save it and spare it and live idle on it. There won't be a penny of it left by Monday: I'll have to go to work same as if I'd never had it. It won't pauperise me, you bet. Just one good spree for myself and the missus, giving pleasure to ourselves and employment to others and satisfaction to you to think it's not been thrown away. You couldn't spend it better.

Higgins. This is irresistible. Let's give him ten.

Doolittle. No, Governor. She wouldn't have the heart to spend ten; and perhaps I shouldn't neither. Ten pounds is a lot of money: it makes a man prudent-like and then goodbye to happiness. You give me what I ask you, Governor: not a penny more, and not a penny less.

(Bernard Shaw, *Pygmalion*)

Income only maintains consumption, but assets change the way people think and interact in the world. With assets, people begin to think in the long term and pursue long-term goals. In other words, while incomes feed people's stomachs, assets change their minds.

(Michael Sherraden, *Assets and the Poor*)

The previous two chapters concentrated upon the delivery of public services and the questions raised by considerations of motivation and agency. I now turn to another, equally important set of issues concerned with the public sector: those associated with the cash benefits it provides and with its finance. Again I shall select a number of specific policy areas for detailed analysis: the finance of pensions and long-term care, hypothecated taxation, and, in this chapter, capital grants to young people: what I term 'demogrant'.

The demogrant idea is directed at changing the distribution of power, opportunity, and wealth within society. That the ownership of financial assets or wealth confers power—political and social as well as economic—is an

obvious truth. From it follows the equally obvious truth that inequalities in asset ownership create inequalities in power of all kinds, and that reducing those inequalities would contribute to the goal of increasing the power of the relatively powerless: of transforming pawns into queens, in the metaphor that informs this book. Yet many proponents of equality or of the empowerment of the poor have paid relatively little attention to policies designed to reduce differences in the ownership of assets or wealth. Instead they have concentrated more on the distribution of income and on policies such as income taxation or the provision of cash benefits designed to reduce inequalities in that distribution.

However, there is now a growing interest in what is called ‘asset-based egalitarianism’ and in the policies associated with it. These are measures aimed at increasing the wealth-holdings of those with few assets and/or at reducing the holdings of those with a large amount. Examples include an annual wealth tax, inheritance and estate taxes, tax reliefs or partnership grants to encourage savings, and universal demogrants (also known as ‘baby bonds’ or ‘stakeholder grants’). This chapter focuses on the universal demigrant proposal, Chapter Ten on partnership grants.⁹⁵

DEMOGRANTS

The idea of the demigrant is a simple one. It is that each individual at birth or on attaining the age of majority should receive a grant of capital from the state that he or she can use as a springboard to accumulate further wealth.

Although it may seem radical, the proposal has a long history. As with a number of other imaginative innovations in social policy (such as education vouchers), it seems to have originated with Tom Paine. He proposed that everyone reaching the age of 21 should receive the sum of fifteen pounds sterling out of a ‘national fund’ financed from a tax on inheritances. ‘The subtraction will be made at the time that best admits it, which is, at the moment that property is passing by the death of one person to the possession of another . . . The monopoly of natural inheritance to which there never was a right, begins to cease’ (quoted in Ackerman and Alstott 1999: 182).

In more modern times in the UK, similar ideas were discussed by Cedric Sandford (1971: 250–4) and A. B. Atkinson (1972: 233–6). Both explored the idea of a demigrant, although not one necessarily provided at birth or at the age of majority: Atkinson, for instance, discussed the possibility of including a capital element in the state pension.

⁹⁵ Those interested in some of the other measures for affecting the distribution of wealth, such as wealth and inheritance taxation, should consult the classic treatment of the subject by Atkinson (1972), and, for a more recent review, Fabian Society (2000: ch. 12). Tax reliefs and partnership grants are discussed in Chapter Ten. Much of and the material is taken from Nissan Le Grand (2000). I am grateful to my co-author, David Nissan, for allowing me to use the work in this way.

Unaware of these predecessors, a few years ago I published a proposal for a grant to everyone on reaching the age of majority financed out of a reformed inheritance tax, terming the idea a ‘poll grant’ (Le Grand 1989: 210). At that time, there was relatively little interest in the idea. But, in recent years, the proposal has acquired momentum in British policy circles. In 1995, Eamonn Butler and Madson Pirie of the Adam Smith Institute proposed a ‘fortune account’: a tax-subsidised savings account for every individual started by the government paying in £1,000 at birth (Butler and Pirie 1995). In 1999, a demogrant at the age of majority was discussed in several contributions to the *New Statesman*.⁹⁶ A few months later, Gavin Kelly and Rachel Lissauer (2000) of the Institute of Public Policy Research (IPPR) reviewed schemes designed to promote asset ownership and proposed a ‘baby bond’: a grant of £1,000 made at birth.

At the same time the Fabian Society produced a pamphlet by myself and David Nissan advocating a demogrant of £10,000 to every 18-year-old, to be financed from a reformed inheritance tax (Nissan and Le Grand 2000). It would be paid into a special ACE (Accumulation of Capital and Education) account. ACE accounts would be handled by a set of trustees, whose purpose would be to approve the spending plans of individuals before releasing any capital; hence individuals would be able to draw money from the account to spend only on approved purposes, as defined by the trustees. These purposes would include higher and further education, down payment on a house or a flat, the start-up cost of a small business, or beginning a pension fund.

In what is perhaps the most important development of all, the British government has committed itself to the introduction of a ‘child trust fund’. The illustrations used in the government's consultation documents on the proposal suggest that the government will set up a child trust fund for each newborn child into which it will pay £400 in tranches: £250 at birth, followed by three payments at ages 5, 11, and 16 (UK Treasury 2001*a, b*). Children born to parents below a threshold income will receive more, up to £800. Parents can pay into the fund, which will be invested in a wide range of vehicles including equities. Neither parents nor children will have access to the fund until the child reaches 18; there will then be no restrictions as to use. Financial education will be provided to both parents and children.

The idea has also attracted attention in the United States and elsewhere. Robert Haveman has advocated a universal demogrant to young individuals to be used for human capital investments of their choice. The grant could be used to purchase education or medical services and, provided that it was not exhausted by retirement, could then be used to supplement other income sources. Roberto Unger and Cornel West have advocated a ‘social endowment account’ on which every individual should be able to draw at major moments

⁹⁶ These included an article by the ex-US Secretary of Labor Robert Reich (14 June), an editorial endorsing the idea (13 September), and articles by me and David Nissan (26 July, 4 October).

in their lives, such as going to college, making a down payment on a house, or starting a small business.⁹⁷ The government of Singapore has announced a ‘baby bonus’ scheme, where second and third children are entitled to a capital grant at birth with regular supplements in later years.

Bruce Ackerman and Anne Alstott (1999) have recently put forward a more ambitious proposal. They recommend what they call a ‘stakeholder grant’ of \$US80,000 to everyone at the age of 21 with a high-school diploma and no criminal record. Dropouts would still receive an annual return on their stake of \$4,000 or so (at current rates); but they would not be able to use the principal except for a limited set of purposes (such as extraordinary medical expenses). Those convicted of an offence might be able eventually to claim their stake but only after a long period of rehabilitation. For everyone else the grant would be unrestricted in use; but it would be paid in tranches of \$20,000 over a four-year period from the age of 21. The scheme would be financed by a 2 per cent tax on wealth paid into a ‘stakeholder fund’. The grant plus interest would be paid back on death out of an individual's estate, if it was large enough; these payments would also go into the stakeholder fund.

Finally, it is worth noting other ideas that have underlying similarities. Samuel Brittan (1998: 29) proposed that shares in privatised industries should be allocated equally among the citizenry. John Roemer (1988) has suggested a demogrant, but one where recipients have access only to the income from that grant. John Hills (2000; see also Hill *et al.* 2002) has proposed that tenants of social housing should build up a capital stake in their homes through an equity share that reflects the value of their current expectation of paying rents that are below market value.

The demogrant idea is also related to that of a basic income, as championed in recent years by Philippe Van Parijs and others, whereby each individual receives an unconditional cash income every year (Van Parijs 1992; 1995; see also Fitzpatrick 1999). In their most unrestricted forms, the two ideas of a basic demogrant and a basic income are very similar, for, if capital markets were perfect, one could be readily converted into the other. Thus a demogrant can be used to purchase an annuity, thus generating an income for life; and a basic income could be mortgaged or borrowed against, thus creating a capital sum available for immediate use.

So the idea of a universal demogrant has several parents (and indeed many siblings). But is it a good idea? Answering this question will preoccupy the rest of this chapter. A major part of the case for the universal grant rests on the more general case for asset-based egalitarianism, so that is where the discussion begins; it then moves on to specific issues raised by the proposal itself.

⁹⁷ Haveman (1988), Unger and West (1998). I am grateful to Stuart White for drawing my attention to these; see White (forthcoming).

ASSET-BASED EGALITARIANISM

The ownership of assets is currently very unequal in Britain, as indeed it is in most Western countries. The top half of asset-owners in the country own over nine-tenths of marketable wealth; the top 10 per cent own over half. And this inequality is growing. The Inland Revenue estimates that the share of marketable wealth of the top 10 per cent rose from 49 per cent to 54 per cent between 1982 and 1999, while the share of the top 50 per cent rose from 91 per cent to 94 per cent.⁹⁸ Alongside this the proportion of households with no wealth at all is also increasing; a recent study by the Institute of Fiscal Studies estimates that twenty years ago only 5 per cent of households had no assets, whereas a decade later 10 per cent had none (Banks and Tanner 1999). An already heavily unequal distribution has become even more so.

Moreover, the trend is set to continue. An increasing proportion of already relatively wealthy owner-occupiers are now inheriting the houses of their parents. Equity-sharing schemes and share options, encouraged by government policy, are likely to boost personal wealth further. But inevitably many will miss out. These will include not just the low-paid and the unemployed but also workers in the public and voluntary sectors, where there are no profits to share or equity to hold.

The sheer scale of this inequality, and the trend towards its getting even greater, are facts that almost on their own provide a *prima facie* case for some degree of asset redistribution. However, the case is not (completely) clear-cut. Some of the observed inequality is age-related. Over a working lifetime assets are built up through saving and other forms of investment, and then, at least partially, consumed in retirement. And some of the observed inequalities result from different patterns of work and effort, and hence might be thought to be justified on those grounds. Asset redistribution needs a more sophisticated rationale than can be provided by a simple knee-jerk reaction to the stark figures of wealth inequality.

In fact, asset-based egalitarianism and the measures associated with it can be justified on grounds that emanate from all parts of the political spectrum.⁹⁹ From the right, it forms part of the conventional arguments for a property-owning democracy or popular capitalism. Asset-ownership gives people a stake in a society. Spreading asset-ownership, especially to those who have few or no assets, makes society more stable and less prone to revolutionary upset. On the left, asset-based egalitarianism can be seen as a move towards reducing inequality, in the sense both of equality of opportunity and of equality of outcome. In particular, the current process of transmitting assets from one generation to another through family gifts or inheritances is both unequal and unfair, with some individuals, through no efforts of their own, starting life

⁹⁸ www.inlandrevenue.gov.uk/stats/personal_wealth/dopw_t05_1.htm

⁹⁹ See Sherraden (1991), Ackerman and Alstott (1999), and White (2001).

with far greater advantages than others. Hence any move towards enabling children from asset-poor families to acquire assets themselves will contribute to greater equality of opportunity. Moreover, so the argument runs, most asset-based welfare policies are likely to result in a reduction in the overall inequality in wealth-holdings, and thereby contribute to greater equality of outcome as well as of opportunity.¹⁰⁰

More neutrally from a political point of view, several studies, both in the US and the UK, have shown asset-ownership to be associated with favourable outcomes in terms of individual and family welfare. Thus individuals and families who own assets tend to have better health, lower mortality, higher marital stability, less domestic violence, more self-employment, better educational outcomes for children, and higher savings when those children become adults.¹⁰¹ Hence spreading asset-ownership more widely is likely to result in improvements in all these areas.

But the most fundamental justification for asset-based egalitarianism from the point of view of this book is that the ownership of assets contributes to greater capacity for agency. Indeed, although hard evidence on this is difficult to come by, it seems quite plausible to suppose that it is the psychological impact of these feelings of agency and independence that leads to the favourable outcomes reported in the previous paragraph. More specifically, asset-ownership gives individuals a greater degree of economic independence; it enables them better to weather the vicissitudes of life, and puts them less at the mercy of others' decisions. The tenant of a property can be evicted at the whim of the landlord unless he or she is legally protected. But the home-owner cannot be evicted by anyone (so long as any mortgage is paid). Individuals with significant savings, if made unemployed, do not have to rely on the state or on charity to find the wherewithal to feed themselves and their families. Elderly people with assets do not have to depend for their well-being entirely on a Chancellor of the Exchequer's decisions concerning pension uplifts or on a local authority's willingness to pay for domiciliary or residential care.

Of course, asset ownership does not confer complete independence. The usefulness of any asset will depend in large part on its market value and, except in rare cases, that will not be under the control of the owner. Shareholdings in a firm that goes into liquidation, a private pension from a financially precarious institution, dropping house prices, savings accounts with

¹⁰⁰ Samuel Bowles and Herbert Gintis (1998) have argued that asset-based redistribution is not only socially just but also productivity-enhancing. However, this claim seems to be based, not on a general proposition that this must be true in all circumstances, but on the potential for productivity enhancement of certain specific policy proposals (workers' cooperatives, education vouchers, home-ownership, and the assignment of limited property rights to children over the income streams of their parents). For an exposition and critique of their arguments, see the contributors to Wright (1998).

¹⁰¹ For a summary of the US literature, see Kelly and Lissauer (2000: 9). The UK evidence is discussed in the next section of this chapter.

falling interest rates: all of these will reduce the owner's economic resources, and the immediate cause of the reduction in value—say, a downturn in the economy or a crooked director of a corporation—may be something about which he or she can do little. However, even in such situations asset-owners have some autonomy. In particular, they can affect the incomes they receive and the risks they take by managing their portfolio of assets appropriately. There may be cases where people's savings are completely locked into an asset that they cannot sell, but such situations are rare and usually temporary; moreover, they often follow asset-price bubbles where the owners concerned had previously made substantial windfall gains. Autonomy goes with responsibility; and, although asset-owning individuals cannot be held responsible for the price changes in any specific asset, they do have a measure of responsibility for the pattern of assets in which they invest.

This could be challenged on the grounds that proper asset management requires skills and knowledge that the average middle-class individual does not possess, let alone the poor or very poor. However, even if this is true, it is in part a result of the current situation where asset-ownership is relatively concentrated. There is no incentive to acquire knowledge or skills if there is no cause for using them. Indeed, this argument can be turned on its head: a major justification for asset-based measures is that they will encourage the spread of the skills and understanding of asset-management.

A more substantial argument against asset-based egalitarian policies is that their implementation may reduce popular and political support for other welfare measures. So, for instance, it might be thought that, if individuals receive help in acquiring assets, they do not need other forms of help, such as cash benefits or assistance with education and training. Further, acceptance of asset-based measures might induce a certain harshness towards those who fail to take advantage of them or who 'blow' any advantage they get, so that their eligibility for further help is reduced.

It should be noted that the first part of this criticism is one that could be levied against almost any proposal for improving a specific item of welfare provision. Any improvements in one area may weaken other areas, partly because they will consume resources that may have gone to those areas and partly because they may weaken support for them in the manner suggested. But such arguments cannot be used on their own as trump cards against the proposal under consideration. For their force depends on two conditions being fulfilled: whether the phenomenon of reduced support elsewhere is really likely to occur to a significant degree, and whether, even if it does, any consequences for the programme or programmes concerned will result in welfare losses that outweigh the gains from the asset-based programme.

With respect to the first of these conditions, as we shall see when we come to discuss them below, several of the asset-based proposals concerned are so small that it seems unlikely that they would pose a threat, in either resource or support terms, to other major welfare programmes; while the larger ones are

usually accompanied by proposals for financing mechanisms that do not directly threaten those other programmes. Fulfilment of the second condition will depend on which programme is under threat and cannot be decided a priori. But it should be noted that there is a respectable case for saying that the two broad programmes mentioned—cash benefits and education and training programmes—may be, at current levels of spending, both close to the limits of their effectiveness even with respect to their own aims; that neither of them addresses the issue of wealth inequality; and hence that diverting extra resources from them into asset-based programmes could well yield higher returns in terms of overall welfare gains.

With respect to the harshness point, again it is useful to distinguish between large- and small-scale programmes. Small-scale ones seem unlikely to induce the kind of backlash predicted. Large-scale ones could do so, although not necessarily. But even if they did, this might not be so undesirable. It is not clear that those who, out of their own free choice, waste one form of generous state aid should be automatically entitled to another form. Of course, if ‘blowing their grant’ is not a result of their free choice but of factors beyond their control, then that is another matter. In those cases they should be entitled to as much additional aid as anyone else. However, with genuine empowerment comes responsibility; and if individuals do waste an opportunity then they may have to accept the consequences.

DEMOGRANTS: SOME SPECIFICS

I now turn to a number of specific issues relating to the demogrant proposal, both theoretical and practical, that need examination. They concern: whether there should be a particular focus in turning pawns into queens on empowering the young; whether conditions should be imposed on the way the grant is spent; whether it should be offered on a universal or means-tested basis; how it should be financed; its timing (at birth or at the age of majority); and whether giving the grant might have adverse consequences for incentives to work and to save.

Pawns and Queens

As noted above, the principal argument in favour of asset-based egalitarianism from the point of view of this book is that the policies concerned help turn pawns into queens: that is, they help empower individuals. This is particularly important in the early years of adult life. For it is then that lack of capital is a major factor inhibiting an individual's ability to take control of his or her own life. Starting a business, paying for higher education, putting a down payment on a house: all are ways of enhancing individual autonomy. But all require capital, a requirement that many cannot fulfil. A demogrant would help individuals to get their feet on the rungs of the mobility ladder: to help them help themselves.

Few young adults have pension schemes or equity in owner-occupied housing. What counts for them is financial assets, which can readily be used for any number of worthwhile purposes. Huge numbers have no access to such capital. James Banks and Sarah Tanner estimate that in 1997–8 in Britain, of the 22–29 age group, 45 per cent did not have a deposit account, and the median wealth of those that did was just £750. Fifteen per cent had National Savings, holders of these having median wealth of £1,050. Holdings of other financial assets such as shares and unit trusts were practically negligible. Moreover, the few owners of these more sophisticated savings did not have very much; their average wealth was between £3,500 and £5,000.

The impact of asset poverty among the young on their subsequent life chances has been graphically demonstrated by John Bynner of the Centre for Longitudinal Studies in London, using the National Child Development Study. This has data for a cohort of individuals on their savings and investments at the age of 23 and various social and economic outcomes for those same individuals at the age of 33. Bynner and Despotidou (2001) demonstrated that there were strong positive links between holding assets and time spent in full time employment between ages 22 and 33 for both men and women, between asset holding at 23 and earnings at age 33 for men, and between asset holding at 23 and general good health ten years later for both men and women. These relationships remained even when other possible causal factors were controlled for, including income, class, and indicators of personality type.¹⁰²

So increasing the asset holdings of the young is likely both to empower them, not only directly by increasing their command over resources but also indirectly, through its beneficial effects on other factors that are themselves empowering, such as earnings and health. But how much empowerment is desirable? Is it always desirable to convert young pawns into young queens? More specifically, should a demogrant be given to the young with restrictions on how it should be used or should it be unconditional?

Conditionality

The intention of a demogrant scheme is to encourage investment and hence the accumulation of assets (financial, physical, or human). Hence it would be desirable for the grants to be spent on investment opportunities. But, unless their use is restricted in some way, they may be used for current consumption instead. Indeed, some almost certainly will be; it is unlikely that each and every 18-year-old will be able to resist the temptation to spend some or all of an unrestricted grant on something offering immediate gratification. But is anxiety about this sufficient to justify the imposition of conditions on use, and, if so, what form should they take?

¹⁰² See also Bynner and Paxton (2001) and, for a critique, Emmerson and Wakefield (2001).

The size of the grant may in itself be of importance here. While it may be tempting to launch such a scheme with a small grant to introduce the idea, as the British government is doing, there is a danger then that it is seen to be insignificant by the recipient, who might then feel quite justified in blowing it for a bit of fun. The sum needs to be seen as significant, providing a one-off opportunity that justifies careful consideration. Instinct says that a grant of a thousand pounds or so may fall between stools, being insufficient for most worthwhile investments. Hence my and Nissan's suggestion of a £10,000 grant.

Now it would be possible to make a respectable case for this level of grant to be given unconditionally on the grounds that ultimately adults do have to take responsibility for their own lives, and that young adults have to learn to do so. As it is, there would be plenty of social pressure on 18-year-olds not to blow their grants; to add to that pressure by confining the grants to only certain kinds of spending might be seen as unacceptable state paternalism.

Indeed, this is the argument put forward by Ackerman and Alstott, who do not put any restrictions on how their grant is to be used. Their argument is essentially a libertarian one; imposing conditions on use 'smacks of welfare state mentality inconsistent with the liberal spirit of stakeholding' (Ackerman and Alstott, forthcoming). However, they do make their position somewhat easier for others to swallow by setting the age of receipt for their stakeholding grant at 21 and restricting the recipients to those with a high school diploma and without a criminal record.

Interestingly, the possibility of the latter kinds of restrictions has not been raised in the British case. Nor should they be; for they would have the consequence of excluding precisely those who would most benefit from the scheme. However, the idea of delaying the age of receipt from 18 to 21 (or even later) is perhaps worth considering. It would create difficulties in paying for activities that usually begin at 18, such as higher education; but this could be overcome by allowing people to borrow against future receipt of the grant. A more fundamental objection is that it is not obvious why the receipt of a grant should be delayed beyond 18, when the age at which young people are allowed to engage in other responsible acts such as voting is not.

Although I find the arguments on both sides quite persuasive, on balance I favour the imposition of restrictions on the use of the grant. This is largely for political reasons: there would be no surer way to lose popular and political support for a system of demogrant than a few well-publicised cases of young people blowing their grants on cocaine or wild holidays. It is also possible that restrictions might also be preferred by the young people themselves; like everyone else they may perceive themselves as occasionally subject to weakness of will, and hence prefer to have the temptation of immediate gratification removed.¹⁰³

¹⁰³ For discussions of the behavioural phenomenon of weakness of will and some of its implications for policy, see above Chapter Five and Elster (1989).

Currently the British government is proposing no restrictions on the use of its child trust fund at age 18. In that case, it is largely for practical reasons: the impossibility of policing the restrictions, an argument also used by Ackerman and Alstott. So it is important for those who advocate restricting use to spell out how the restriction process might work. As noted above, Nissan and I have suggested that the grants could be paid into a special ACE account held in the individual recipient's name either in a local commercial bank or in a local branch of a network of publicly owned savings institutions set up by the government specifically for this purpose and managed by a set of trustees.

Having quality ACE trustees would clearly be important to this aspect of the scheme. For they would have not only to vet the spending plans but also to ensure that the money was spent in the way proposed. They could be specially employed by the local institution to vet the spending plans of all the grants being given out by that branch; alternatively they could be drawn from panels of local business people and other community leaders on a voluntary basis.

What sort of investment purposes should they approve? One obvious possibility is higher and further education: a way of accumulating human capital and hence increasing an individual's value to the labour market. The grant could be used to contribute to the fees and maintenance costs for a university education or to the costs of more vocational forms of training. To ensure compliance, it could be paid through the educational institution concerned, in much the same way as the present student grant and loan scheme.

Another use for the grant might be for the down payment on a house or flat purchase. Unpublished research by Gavin Smart suggests that for many poor people the down payment is the biggest obstacle to home-ownership; once the down payment is made, people have a commitment to their homes and usually manage to keep up the mortgage payments regardless of any income or employment problems they encounter. Again, to ensure compliance the payment could be made directly to the vendor.

The grant could also form part of the start-up costs of a small business. The development of a business plan and its approval by the trustees would be essential—which makes it the more desirable to include local business people among the trustees.

What should happen if no worthwhile uses are proposed for an individual's ACE account? One option would be for the grant to be put towards a personal or stakeholder pension. The pension schemes could be drawn from an approved list, and payment made directly from the ACE account to the scheme.

Such arrangements could not prevent all abuse, and it would be pointless to pretend otherwise. Assets bought through trustee-approved distributions must at some future date be saleable, and use of the proceeds could not easily be monitored. It is not unheard of for the offspring of the wealthy to fritter away their fortunes; and it will always be in the nature of some of the recipients of our demogrant to do so. What counts is for everyone to get his or

her opportunity. Thereafter, as in many other aspects of life, it should be up to them.

One way of minimising the role of the ACE trustee would be to ensure that each individual on receipt of his or her demogrant received training in asset management, as advocated by Stuart White (forthcoming). White draws attention to the success of financial education classes attached to the Individual Development Account schemes developed in the United States (discussed in Chapter Ten), and suggests that attending something similar could be a condition attached to receipt of the grant.

Indeed, this idea could be taken further. The grant could be combined with the allocation of voting rights and viewed as part of a larger coming-of-age event. Attendance at other classes could also be made a condition for grant receipt, including classes in citizenship and political awareness. A demogrant and the right to vote then become tangible expressions of young adults acquiring a stake in society while at the same time getting the training to exercise that stake effectively.

Universal or Means-tested?

The children of the wealthy can look forward to help with assets throughout their adult lives, in the form of payment of university fees, housing deposits, and start-up capital for business ventures. But others, especially those brought up in poverty, are significantly disadvantaged by their lack of access to capital. Not only do their parents not have the wherewithal to supply them with that capital, they also find it difficult to borrow from other sources. Banks and other financial institutions are reluctant to lend to poor families, and indeed even to the non-poor if they live in poor areas.

These reasons would be enough to justify a demogrant to the children of the poor. However, there is also a case for a broader, universal grant: one going to the children of the poor and non-poor alike. This is partly because of the general case for universal benefits over ones targeted on the poor. Universal benefits contribute to the sense of national community, whereas targeted ones can be socially divisive. Also, targeted benefits require a cumbersome apparatus for determining eligibility: one that is expensive to administer and can be demeaning to the recipient. In contrast, universal benefits require only the information necessary to determine that the individuals concerned fall into the relevant category: in our case, simply their age.

In fact, targeting a demogrant would pose greater problems than are encountered with the array of means-tested benefits currently available. As its purpose is to distribute capital, the wealth of potential recipients would be the appropriate criterion. But if the grant were to be distributed to young adults, it is likely that almost all would have no capital, unless they had benefited from parental or grandparental gifts, or an inheritance. A means test based on wealth would be far more likely to lead to the gifts being deferred until after any deadline for assessment than to the exclusion of a sizeable number of

beneficiaries. Other assessments could be made on, say, parental wealth or even grandparental wealth. But then there would be difficult and expensive problems of assessment, and, in denying someone a grant, an implication that their parents should make capital available.

But there is an additional, more fundamental reason for a universal grant at birth or at the age of majority. Everyone born into a developed country benefits from a share in a common inheritance: a set of capital assets, including buildings and other physical infrastructure, transport links, capital equipment, and agricultural land. The vast majority of these are the results of the labours and efforts of previous generations, whose members have struggled together to produce what is in effect a gift of wealth to the next. It is largely because of this inheritance that the current inhabitants of any developed country are as wealthy as they are; without that enormous accumulation of capital over the centuries, no amount of efforts by the current generation could generate the levels of current production that maintain our standards of living.

This idea, that the wealth of one generation is a common asset to the next, is important, for it cuts across the argument that individuals who have created wealth should be free to give it all to their children. Ownership gives personal command of resources, but it is not easy to justify this persisting beyond the grave, especially when, as we have seen, the life chances for many are reduced by lack of access to start-up capital. How can one argue that people have as great a right to inherited wealth as to, for instance, the income or profits that result from their own efforts? It would seem fairer if the right to our national patrimony were more equally distributed—as would happen if the proposal for a universal demogrant were implemented.

A standard argument used against any universal benefit concerns the rich: should the benefit be paid to the better-off, who are unlikely really to need it, as well as to the really needy? The answer is, in general, ‘yes’: for this is a price that has to be paid if the other advantages of universality are to be obtained and the problems of means-tested targeting avoided. Moreover, if, as I go on to discuss, the grant is financed through inheritance tax, so parents pay the tax, a significant portion of their wealth will now be going to pay for the start-up costs for thousands of other children as well as their own.

It is also worth noting that the children of the better-off already receive a form of grant through subsidies to higher education. Although with the introduction of tuition fees and student loans these subsidies are being reduced, they remain considerable. Most students come from middle-class backgrounds. Hence our proposal can be viewed as simply a means of extending an already existing subsidy to the better-off to those less fortunate. It also has the implication that higher education subsidies can be further reduced without making anyone worse-off, since one potential use for the grant could be to pay for tuition and living expenses while acquiring further education.

Timing

Should the grant be given at birth in the form of a ‘baby bond’, as the British government and the IPPR have proposed, or at the age of majority, as Paine, Ackerman and Alstott, and I have argued? There are arguments on both sides. In favour of a grant at birth, less can be given up front since the money is to be invested for eighteen years. This would make the grant allocation easier politically because it apparently saves the government money (in reality, of course, there is no saving, since the government is simply losing the income that it could have earned by investing the grant itself). Another advantage is that the fund can be seen to accumulate by both parent and child, thus serving a useful financial educational purpose. On the negative side, this very visibility may make the fund unpopular with parents, especially poor ones, who will see money accumulating that they might feel they could have put to good use but which they are unable to touch. Also, depending on how each of the funds is invested, children may end up with different amounts on reaching the age of majority—an outcome that could be regarded as unfair.

This last point raises questions as to the appropriate investment strategy for a ‘baby bond’ and the related issue of who would manage the investment. Should the funds be invested in savings accounts, equities, or government bonds? Should government or private sector financial institutions manage the fund? What should be the role of the parents in managing the investment—or indeed of the children themselves?

As yet these questions have not all been settled in the British case. The government would prefer the private sector to manage the funds; the private sector, on the other hand, although interested for long-term reasons, is worried about the small size of the amounts involved and the difficulty of covering their fixed costs. This may be resolved by confining fund management to a few finance institutions from whose offerings parents would choose.

Finance

Where would the money to finance the demogrant come from? The British government does not specify this in its proposals. Ackerman and Alstott (1999) finance their much more generous scheme from an annual wealth tax. Kelly and Lissauer (2000) finance their baby bond through reducing tax reliefs for pensions.

I have argued that the best way to finance this potentially popular spending proposal is by linking it to reforms to a hitherto unpopular and inefficient tax—inheritance tax (Le Grand 1989; Nissan and Le Grand 2000). Hypothecating, or earmarking, inheritance tax revenues to demogrants could provide the means for rehabilitating a much despised tax. As I shall argue in Chapter Ten, hypothecation in and of itself is often desirable, especially when viewed from the perspective of turning pawns into queens. Hypothecating the inheritance tax for demogrants in particular has an obvious popular appeal. For it takes

the wealth of one generation and, in the spirit of Francis Bacon's quotation that opens this chapter, spreads it around like manure to fertilise the growth of the next.

Inheritance tax is a misnomer in the United Kingdom. What that country has is a tax on estates that bears no relation to the amount any individual inherits, either from the estate in question or over a lifetime. And the tax is largely voluntary. The Inland Revenue estimates that in 1999 total marketable personal wealth stood at £2,594 billion.¹⁰⁴ This measure excludes wealth that cannot be realised, such as accrued pension rights. In contrast, the yield from inheritance tax is pitiful, just £2 billion in 1999–2000.¹⁰⁵ Wealth passes almost untaxed between generations through lifetime gifts, through exempt items such as agricultural land and forestry, and through devices such as discretionary trusts which can defer tax liabilities for decades.

It is against this scale of wealth transfer that suggestions such as demogrants should be measured. In any one year, there are currently approximately 650,000 18-year-olds in Britain, so it would cost £6.5 billion to give them each £10,000. The inheritance tax yield in 1999–2000 of £2 billion would only pay for about £3,000 per 18-year-old, but, although this might be better than nothing, I have argued above that a demogrant may need to be bigger if it is to be used wisely.

Yields, and hence the grant, could be increased in subsequent years by reforms that have long been on economists' agendas but that have lacked popular support. These include shifting the basis for the tax from the donor to the recipient, and extending it to include lifetime inheritances and gifts. This would encourage the wealthy to pass on their wealth to those who have not already been substantial beneficiaries, as by so doing they could reduce the taxman's take. The system would require that everybody had a lifetime gift and inheritance allowance, say of £50,000, which could be received free of tax. Thereafter tax could be levied at progressive rates to maintain incentives for wealth to be spread around. A review of exempt items and trust law should also be undertaken to broaden the base of the tax.

In theory, receipts could collapse with such a tax if bequests were directed only to those who had not used up their inheritance tax allowance. However, if that occurred a fairer distribution of inherited wealth would have been achieved, and there would be less need of an additional system of grants. More likely, however, is that wider bequests would happen mainly at the margins, as people would continue to want to help their own children first. As they did so they would be taxed to pay for grants for those less fortunate.

It would not be necessary to impose penal rates of inheritance tax to finance a substantial reallocation of capital. Indeed, an ideal system would have rates that most regarded as reasonable, to minimise incentives for avoidance or evasion. What might such rates be? The inadequacies of the existing inheritance tax

¹⁰⁴ www.inlandrevenue.gov.uk/stats/personal_wealth/dopw_t04_1.htm

¹⁰⁵ www.inlandrevenue.gov.uk/stats/tax_receipts/g_t02_1.htm

mean we have very limited information indeed about the extent of wealth bequeathed or given on a year-by-year basis. But, following the methodology used by Nissan and myself in the Fabian publication, we can produce a crude estimate. Suppose we assume that all wealth is held by people over the age of 25 and that wealth is evenly spaced between the cohorts from 25 to 75.¹⁰⁶ In that case one fiftieth of personal wealth would be passed on in one form or another every year: £52 billion in 1999. Then a reformed inheritance tax would need to be levied at an average rate of around 12.5 per cent to finance £10,000 per young adult. If higher education subsidies were reduced *pari passu* (as they should be if equity is to be maintained), the savings from this could also be used to finance the grant and the inheritance tax rate could be lowered yet further. Since the participation rate of the relevant age group in higher education is now running at around one-third, this means that the inheritance tax rate could be lowered to 8 per cent. Alternatively, the rate could be kept at 12.5 per cent and the savings in higher education spending could be used elsewhere within the education budget or for other public services. In short, there is every opportunity here to levy a modest tax on gifts and bequests, and still make sure every young person has the capital needed to get off to a good start.

The insignificant contribution of inheritance tax to financing public spending, and the sense of the state as inherently wasteful, have meant that avoiding such tax has never attracted much moral opprobrium. The ease of avoidance of inheritance tax reflects the lack of public support for it. But if the proceeds of the tax were visibly distributed through demogrants, perhaps that perception could change.

Contributions

One possible objection to the scheme is that receipt of the demogrant does not depend on any actions on the part of the recipient. It might be thought better to have a scheme that requires some form of matching contribution to the ACE account from the individuals themselves or from their families. So, for instance, the government could offer to match personal or family contributions at a rate of, say, a £1 grant for a £1 contribution, or at a higher (or lower) rate.

I discuss matching grants as a means of encouraging savings in Chapter Ten and so will not dwell on them here. But it is worth noting that they have the advantage of encouraging people to help themselves. They also mobilise private resources and thus can reduce the cost to the state of any given level of grant.

However, matching grants favour those who can contribute more and who are likely to be (although not necessarily) among the better-off. To overcome this, the matching rate could be varied with the income of the family (as in

¹⁰⁶ This assumption is of course unrealistic. Most studies of wealth distribution suggest that wealth is accumulated through a lifetime, so on average the elderly hold a higher proportion of the nation's wealth. Hence the qualification of the estimate in the text as 'crude'.

some US schemes): higher for poor and lower for better-off families, and perhaps even dropping to zero for the very well-off. Varying the matching rate in this way might make the scheme more politically acceptable but would have the disadvantage of requiring a means test. It might be better to have the same matching rate for all, but to cap the total amount of grant received by any one individual and to count it for lifetime inheritance and gift purposes. The well-off would repay their grants as further bequests came their way and were taxed at progressive rates.

Disincentives

We have seen that the scheme could offer a number of positive incentives, especially towards greater capital accumulation by the poor. But are there also major disincentives associated with the scheme that would discourage otherwise socially or economically desirable behaviour? For instance, might not the tightened-up inheritance tax discourage parents from saving for their children, or even from working quite so hard to benefit their families? Might not the existence of the grant itself lead parents to cut back on what they were planning to give to their children? And might not the recipients of the grant be discouraged from saving for themselves?

These seem unlikely dangers. For effective inheritance taxes to weaken the economy in this way, taking care of the next generation would have to be the main motive for individual achievement. The tendency of the ambitious to delay having children and forge their careers first would seem to suggest that other factors matter more. Also, the amounts involved are not that great, especially when compared with the massive inheritances received by a few lucky children under the current situation, which almost certainly do have a discouraging effect on their subsequent work and savings activities.

CONCLUSION

As we have seen, there are many possible ways in which a demogrant scheme could be set up. The amount, the age at which it should be received, the restrictions imposed on its use, if any, the contribution regime, the method of finance: all of these can vary and indeed do among the alternative schemes proposed. But all of these schemes do share a common core that it is worth re-emphasising. All are aimed at increasing the ability of a young person entering adult life to control his or her own destiny. Children in many ways are the ultimate pawns in our society; and one of the tragedies of that society is that too many of them stay as pawns on becoming adults. Demogrants at the age of majority are one way of encouraging everyone to develop from a passive to an active citizen.

10 Partnership Savings

To be a prodigal's favourite—then worse truth
A miser's pensioner—behold our lot!
O man, that from thy fair and shining youth
Age might but take the things that youth needed not!

(William Wordsworth, *The Small Celandine*)

In Chapter Nine I presented an asset-based welfare scheme aimed at helping people to acquire assets at the start of their adult lives. This chapter examines schemes that help individuals accumulate assets throughout their working lives: schemes that help them to save. I concentrate on proposals for helping them save for their old age: for their pension and for their long-term social care, should they need it.

Again the focus will be on measures aimed at turning pawns into queens: that is, on schemes that increase the power of individuals and the sense of control they have over their own lives.

COMPULSION VERSUS PARTNERSHIP

Traditionally, most developed countries have endeavoured to increase people's savings, especially for pensions, through some form of compulsion. This usually takes the form of compelling individuals to contribute to a pension fund administered either by governmental or by private organisations. So, for instance, in Britain the government compels all employees (and their employers) to save towards a pension by putting aside a proportion of their earnings for this purpose, either through occupational or private pension schemes or through the state earnings-related pension scheme.

The British government also taxes individuals through the national insurance system and uses the revenue to provide a basic flat-rate pension. However, this is not a savings scheme since, contrary to many people's perceptions, there is no savings fund into which payments are made and out of which, once savings have accumulated, pensions are paid; instead, current contributions are used to pay for current pensions. In fact the state basic pension is really an income-support device for alleviating the poverty that would

otherwise ensue because people had not saved enough for their pensions. But its existence reinforces the case for other government interventions to encourage savings: for the presence of a state safety net to help people who reach retirement age with little or no pension of their own can have disincentive effect on pension savings (the so-called 'moral hazard' effect).

Now compulsion as a means of raising savings has a number of problems. First, there are transition difficulties. Almost by definition, compulsion really works only for people entering the labour market now; it would not be until people entering the labour market today had retired that the transition to a compulsory system could be said to be complete. Second, compulsory contribution systems do not fit well with changes in needs over the life cycle. So, for instance, compulsion makes no allowance for the costs of child rearing, and, given the introduction of student loans and the culture of owner-occupation, would tend to exacerbate the 'front-loading' of life-cycle burdens. Some have gone further, arguing that, if people cannot borrow against their savings due to capital market failures, compulsion will tend to reduce individuals' ability to invest in education as financial resources will increasingly be directed towards retirement.

More fundamentally, the fact that contributions are compulsory means that they infringe individual liberty. As an instrument for reducing individual power, it moves away from the goal of turning pawns into queens. The only kind of independent action that it encourages is the exploitation of techniques for avoidance and, ultimately, evasion—with heavy social costs in terms of legitimacy, policing, and reduced revenue. It helps turn the welfare state from what should be a noble enterprise helping people to help themselves into a repressive apparatus compelling people to do things that they otherwise would choose not to do.

An alternative to state compulsion is what might be termed state partnership. Here the state provides a positive incentive for people to save based on financial assistance rather than a negative incentive based on penalties for failure to comply with state-set requirements. Partnership thus does not suffer from the incentives to avoid and evade associated with compulsion. More generally, the state takes on the role of partner rather than that of policeman.

As with demogrants, academics and policy-makers in both Britain and the United States are already exploring a number of ideas of this kind. Michael Sherraden (1991: ch. 10) of Washington University in St Louis has proposed setting up what he calls Individual Development Accounts. These would be optional, earnings-bearing, tax-benefited accounts in the name of each individual initiated as early as birth and restricted to specific purposes. The grant would come from the federal government, matching or otherwise subsidising deposits made by the account holders themselves or, in the case of young children, by their families. The subsidy would be confined to the poor. It would be paid for by closing various tax loopholes, especially those in the welfare area directed at the non-poor, such as the tax reliefs associated with

medical insurance premiums, mortgage interest, and social security benefits. IDA programmes of various kinds are in fact now being implemented on an experimental basis in several US States and have been rather successful (see Boshara 2001 and Beeferman 2001).

Moreover, the British government has begun to take tentative steps in this direction. It has proposed what is termed a 'Savings Gateway'. This is a single interest-earning account to be targeted at low-income individuals. The government will match any deposits made by the account holder at a rate to be decided up to a maximum. The consultation document discussing the idea suggests a 1:1 matching rate up to a £50 maximum per month. The account would be time-limited; the consultation document suggests three years (UK Treasury 2001*a*).

Elsewhere, I have developed more ambitious matching grant schemes for pensions (with Philip Agulnik) and for long-term care (Agulnik and Le Grand 1998*a, b*; Le Grand 1999*a*). These I now examine in more detail.

PARTNERSHIP PENSIONS

The British government does already provide a kind of partnership scheme through an elaborate structure of tax reliefs for pensions and indeed for other forms of savings. Tax reliefs can be applied at various stages in the savings process: to contributions to the relevant savings fund; to income accruing from those funds (including income from interest payments, from dividend payments, and from capital gains); or to withdrawals from the funds. The current system of tax relief for pensions basically exempts the first of these (contributions); that for Individual Savings Accounts (ISAs) exempts the last two stages (accruals and withdrawals).

However, tax relief is a highly unsatisfactory way of getting the benefits of partnership. It is opaque; it appears in the form of tax not being paid, and the people who receive it may well be unaware that there has been a reduction in their tax bill because of it. Moreover, even those who are aware of the tax reduction usually do not see it as a form of state assistance; rather, they often view it as simply the government taxing 'their' money less and hence as involving a reduction in governmental malevolence rather than as an example of state beneficence. Also, tax reliefs are inflexible, with the amount of aid not determined by policy towards pensions but by parameters of the tax system, such as the structure of tax rates. Thus, if the Chancellor of the Exchequer decides that, because of, say, a surplus in the government's budgetary position, he or she will reduce income tax rates overall, then the amount of tax relief for pensions will fall; and this may reduce pension savings although that was not part of the Chancellor's intention.

Also, tax reliefs are less accountable than public expenditure programmes since, unlike those programmes, they are not subject to the annual Treasury spending round or any systematic analysis of value for money. And they

undermine democratic oversight of the government's tax and spending priorities by departmental select committees and the like, leading to an excessive policy concern with the costs of direct public spending to the relative neglect of tax spending (Kvist and Sinfield 1996).

But perhaps the biggest problem with tax reliefs as an instrument of state assistance concerns their impact on the income distribution. They are open only to those who pay taxes; partly because of this, partly because of the existence of increasing marginal tax rates with income, and partly because the wealthy save more, they are highly regressive. For instance, it has been estimated that half the benefit of pension tax reliefs go to the richest 10 per cent of households and a quarter to the top 2.5 per cent (Agulnik and Le Grand 1998*a*).

A partnership scheme that would avoid most of these problems involves abolishing the tax relief system and using the revenue raised to finance a system of matching grants. That is, instead of giving tax relief on pension contributions, the government would match individuals' contributions with a direct grant. The matching rate could be pound for pound; alternatively, it could be lower, say, 66 pence or 50 pence of state assistance per pound contributed by the individual. To allay possible Treasury fears of an open-ended commitment, there could be a cap on the amount of contribution that could attract this assistance.

Partnership schemes involving matching grants have many advantages, especially when compared with the existing structure of tax reliefs. They are transparent; those who received them would know both that they were in receipt of state aid and how much aid they were receiving. As a form of direct public expenditure, they would be subject to Treasury and Parliamentary scrutiny. And they would be flexible, with all their parameters (such as the matching rate) under the direct control of the funding agency; hence the amount of aid could be tailored more exactly to the requirements of pensions policy.

Moreover, such schemes would be much more progressive than the present system of tax reliefs. Agulnik and I have made estimates of the distributional impact for two variants of the partnership scheme as applied to pensions. One, a less redistributive scheme, provided matching grants at the rate of 50 pence per pound contributed, and the other, more redistributive, used a 66 pence per pound matching rate.¹⁰⁷ Either version of the scheme would be much more

¹⁰⁷ The calculations are based on the assumption that abolition of the current tax relief system will result in a long-run increase in revenue of around £9 billion, a little over 1% of GDP. In fact, the amount of revenue yielded through abolishing the current tax relief system is a matter of considerable controversy. In essence it depends on what one considers to be the counterfactual: that is, the type of tax regime that would be in place if pension tax reliefs were abolished. In keeping with the Inland Revenue's own estimates of the cost of various tax reliefs, we assumed that this regime would be a 'comprehensive income tax', where all income, including investment income, is subject to tax. So abolition of this particular tax relief would not result in savings being diverted into other tax-exempt vehicles. The effect of alternative assumptions is discussed in Agulnik and Le Grand (1998*b*).

progressive than the existing system of tax relief. Under the 66 pence per pound scheme, the top 10 per cent of taxpayers would receive 18.5 per cent of the benefit (a quarter under the 50 pence scheme), as compared with half the benefit under the current scheme. The top 2.5 per cent would receive just 3.5 per cent of the benefit (5 per cent under the 50 pence scheme) instead of a quarter as they do now (Agulnik and Le Grand 1998*a*).

There are other possible variants of matching grant schemes. The matching grant could be confined to poor households, as with the British government's Savings Gateway proposal. More generally, the matching rate could vary with the income of the household, gradually tapering off to zero as that income increased. Such variants would be cheaper than a universal scheme (or, if the total cost were kept the same, would allow for greater help to the poor; but they would necessitate a household means test).

Alternatively, as has been suggested by Ros Altmann (2003), the matching rate could vary with the amount actually saved. Thus, the first tranche of savings would have a high matching rate associated with it, the second tranche a lower rate, the third a yet lower one, and so on, until the matching rate dropped to zero and any extra savings received no help. By concentrating help at initial levels of savings, this would help overcome any kind of threshold effect whereby people are deterred from making the jump from being a non-saver to a saver. It would also again allow the overall budget to be spread further than under matching grant schemes involving a flat rate for all savings; and, again as compared with those schemes, it would reduce the help given to the better-off (who, other things being equal, would be saving more).

Overall, therefore, there is a variety of ways in which matching grant partnership schemes could be applied to pensions, each of which seems fundamentally superior to other means of encouraging pension savings such as compulsory savings or tax relief. But the idea can be applied outside the pensions field to other forms of savings, and indeed to other forms of social assistance such as paying for long-term care. To this I now turn.

PARTNERSHIPS FOR LONG-TERM CARE

There is an approximately one-in-four chance that anyone currently under the age of 65 will need some form of long-term residential care after passing that age. Not surprisingly, since it covers board and lodging costs as well as the provision of social care, such care is very expensive. In Britain, state aid is available to meet those costs; however, it is means-tested, with both an income and a savings cut-off.

It is clear that, in order to provide an adequate level of long-term care, it will be necessary to continue relying on private resources, both in financial terms and in terms of time and effort provided by informal carers. The trick is in some way to mobilise those resources (or to continue to mobilise them) in a fashion that (1) generates enough combined resources (public and private) to

provide at least a minimum level of care and preferably a higher level if appropriate, (2) allows for users and carers to make appropriate choices over the kind and level of care provided (that is, enables them to be queens), and (3) does not provide incentives for evasion and avoidance.

The problem with the present means-tested system of state assistance is that it meets none of these conditions. The level of provision of long-term care is universally regarded as inadequate, especially for the less well-off, and offers little by way of choice to those involved. At the same time the means test, which requires the running down of assets until their value falls below a certain level, seems to penalise those who have had the foresight to save for their old age or for their children's inheritance. It is viewed as punitive and exploitative and encourages evasion and avoidance.

A royal commission has recommended that Britain follow the lead of Germany and Japan and introduce a system of social insurance to finance long-term care (UK Royal Commission on Long-Term Care 1999). Employers and employees would both make contributions to a fund that would pay for care for those who need it. However, several analysts, including members of the royal commission itself in a note of dissent attached to the main report, have criticised the proposal on the grounds of cost. Moreover, as we shall see in Chapter Eleven, social insurance has problems of its own, notably the narrowness of its tax base and the problem of non-contributors.

An alternative scheme would involve a partnership funding arrangement of the kind discussed above with respect to pensions. This could take either of two forms. It could involve grants matching individual contributions to an insurance policy to cover long-term care. Alternatively, the scheme could involve matching contributions made out of an individual's own resources, including her savings, to costs at the time of needing care. Either would involve removing the disincentives to save implicit in the present means-tested system.

The idea of the state matching an individual's contributions to an insurance policy for covering long-term care is broadly similar to the idea of matching contributions to a pension fund discussed in the previous section. Hence I will not examine that further here but concentrate instead on the second idea: that of matching contributions made at the time of care. This would involve a minimum level of public funding coupled with a system of matching grants for expenditure over that minimum. Under this system each person assessed as being in need of care would be entitled to a minimum level of care met from public funds. This minimum, although adequate, would be basic. For the payment of care above the minimum, the state would undertake to match pound for pound (or at some lower rate) the resources that individuals or their relatives can mobilise for their own care.

To keep spending under control, there would be an overall limit on the total amount of grant that could be received by any individual. However, this would not be sufficient on its own to ensure the scheme remained within cash

limits; it would also be necessary to have some mechanism for limiting the number of individuals who were eligible for the scheme. This could best be done through the assessment process by which individuals are judged in need of care, and needs are compared with available resources. Indeed, in the spirit of case management, the people who undertake the assessment process could hold the budget for the scheme. They would then have a strong incentive to ensure that eligibility decisions were compatible with available resources.

Take the following example as an illustration of how the scheme might work. An elderly person currently living at home is assessed by a social worker as in need of residential care. For everyone so assessed, the state will automatically pay a minimum of, say, £250 per week. There are a number of possible homes in which she could be accepted, each offering different standards at different charges, from one providing a basic level of care at the government rate of £250 per week to others offering higher quality but charging above that rate. If she (or her relatives) opt for the home with the lowest charge, the state minimum payment will meet the charge and she does not have to pay for anything out of her own resources. However, if she chooses a more expensive home, then the state will match any extra resources she puts in herself.

Now suppose she chooses a home somewhat superior in quality to the minimum but which charges £400 per week. Then the state will pay £250 (the minimum) per week plus half the difference between the minimum and the charge, that is, £75 per week; the total amount paid by the state would then be £325, with the elderly person contributing £75 out of her own resources.

In this case the state is matching contributions at a pound-for-pound rate. However, it could choose to do so at a lower rate: say, 50 pence or 25 pence per pound personally contributed. In the 50 pence per pound case the elderly person paying an overall charge of £400 would contribute £100 out of her own resources while the state would contribute £250 (the minimum) plus £50 as a matching contribution. In the 25 pence per pound case, she would contribute £120, while the state would contribute £250 plus £30 as a matching contribution.

A major advantage of schemes such as these is that participation in them is cooperative rather than, as with a means-tested scheme, adversarial. People have no incentive to hide their assets, to give them away, or to engage in other forms of evasion and avoidance. Rather, they have an incentive to produce their own resources, resources that can be used in partnership with the state to improve their long-term care situation. If, on the other hand, people preferred not to contribute everything to their own care but to set aside some of their resources for their children to inherit or whatever, then they are at perfect liberty to do so; the only penalty is not benefiting from the matching grant that they otherwise would have received.

A related advantage of such a scheme is that the means test would be completely abolished. The intrusive, demeaning, and costly administrative apparatus of means tests could be dispensed with entirely. More importantly, those who did have the foresight to save and were prepared to contribute,

instead of simply losing their savings as under the means test, would be rewarded for doing so by getting better community care. The carrot would replace the stick: arguably both better social policy and better politics.

The scheme is also quite practical. It is hard to see many difficulties in either introducing the system or administering it. It does not require an elaborate apparatus for assessing people's means; for these are contributed voluntarily. It does not require any information concerning contribution records, as social insurance schemes do. Again unlike social insurance, it does not require a waiting period while funds are built up; it could be introduced tomorrow.

The scheme would provide more benefit to those who paid more, and thus will be less targeted on the poor than the present means-tested scheme. But *any* reform proposal that involves a move away from means testing (including the introduction of social insurance as advocated by the royal commission) will have this feature. Moreover, this scheme would be 'progressive' at least in the sense that, the more expensive the care chosen, the lower would be the proportion of the cost met from public funds. For instance, in the pound-for-pound example given above, four-fifths of the cost is met from public funds. If the elderly person had chosen a home that charged £500 instead of £400, then she would have paid £125 and the state would have paid £375: three-quarters of the cost.

There is an extra point here. Strictly, it is not correct to say that the partnership scheme automatically gives more to the better-off. Rather, *the scheme gives more (in absolute terms) to those who are prepared to contribute more of their own resources to their own care*. Indeed, this is one of its perceived advantages: it helps those who help themselves. Now often, of course, those helped in this way may be the better-off; but they will not always be so. For instance, relatively poor childless individuals may decide to spend more on their care than better-off individuals with a family who wish to keep their children's inheritances intact. Spending on care, as with spending on anything else, is determined by needs and wants as well as by income; and the distribution of support under the scheme will depend on that spending, not on income per se.

A possible disadvantage is that, under the scheme, the state might end up funding aspects of care of which the state would not approve. If this did look like being a problem, institutional accreditation or 'approved expenditure' procedures could help resolve it. However, it is also important to recognise that people do have different needs and wants for long-term care. In this situation most universal schemes are faced with an unpalatable choice. They can provide a very basic minimum to everyone, thus keeping costs down but satisfying nobody; the consequence is likely to be a residualist scheme with the poor unhappily left at the minimum and with those who can afford it trying to buy themselves out. Alternatively, a universalist scheme can provide a higher quality and quantity of care, meeting the requirements of those who want or need rather more than the basic minimum, but at an exorbitant cost to the public purse. In contrast, the partnership scheme offers a minimum *and*

help to those who want or need a higher quality and quantity of care; and, since it encourages people to volunteer their own resources, it can do so at less expense than a high-quality system with full state funding.

A final concern is over provider incentives. Would not providers have an incentive to raise their prices in the knowledge that the state would be meeting some of the cost? This is a problem for any system of state aid. However, the partnership scheme is less subject to it than most other forms of aid. Many of the latter involve the state (eventually) meeting whatever charges are levied, and thus isolating the individuals themselves from any increase in cost. But, even under the most generous version of the partnership scheme (the pound-for-pound matching rate), an individual would have to bear half of the cost of any increase in charges; under the less generous versions, they would have to bear two-thirds (the 50 pence per pound scheme) or four-fifths (the 25 pence per pound scheme) of the increased cost. These costs would be sufficient to constrain providers from any system-busting increases in charges and also to prevent users and providers colluding to defraud the system.

The scheme could be refined in various ways. One possibility, designed to help those with few or no financial resources, would be to allow for *non-financial contributions* that could wholly or partly substitute for financial contributions. These could involve time or effort put into caring; either by the relatives of the individual concerned or by the individual himself or herself caring for others at an earlier period. So, for instance, an individual could put in a year or more of community service of one kind or another, which could supplement or replace entirely his or her financial contribution. Obviously an exchange rate specifying how non-financial contributions could be nominally translated into financial ones would need to be determined.

Another refinement concerns the progressivity of the scheme. This could be enhanced by dividing the difference between the charge and the minimum into different bands and reducing the matching ratio from band to band, perhaps eventually to zero. For instance, instead of being uniformly 1:1 as in the above example, the public/private matching ratio could be 3:1 for the first £100 of the difference, 1:1 for the second £100, 1:3 for the third £100, and zero for the fourth £100. In that case, the elderly person in the example would pay £50, and the government £350:87.5 per cent of the cost. If she had chosen the £500 home, then she would have paid £112.50 and the government would have paid £387.50:77.5 per cent of the cost. This is more progressive than in the example with a uniform 1:1 ratio, with the government paying a higher proportion of the total cost for the cheaper option and a lower proportion of the more expensive one.

A problem could arise under this scheme if the individual ran out of her own resources to provide the matching contributions. If nothing were done, she might then be required to leave her residential home and move into one paying the state minimum: a traumatic change, especially since at the point where she runs out of resources she might be at a very advanced age. This

danger could be overcome by making it a condition of the matching grant that the individual or her family use their own resources to purchase an annuity of a value sufficient to cover the costs of her contributions. In that way there would never be a shortfall in contributions and she would never be forced to move.

CONCLUSION

Asset-based partnership schemes of the kind proposed here would have many advantages as a means of providing government help towards accumulating sufficient funds for a pension and for the funding of long-term care. It would provide a strong incentive for individuals and their families to mobilise their own resources. Unlike compulsion, it treats individuals more like queens than pawns. Unlike the present system for long-term care, there would be no means test with all its disincentives and distortions. Unlike tax relief, the schemes would be transparent, flexible, and accountable; and, since they would benefit non-taxpayers as well as taxpayers and because their value would not depend on the marginal rate of tax, they would be much less regressive. They would be relatively easy to implement. The details need refinement; but, overall, the ideas involved seem worthy of serious consideration.

11 Hypothecation

Moderator: What comes into your mind when someone says ‘tax’ to you?

Man: Nicking my money

Woman: Sadness at the end of each month

(Fabian Society focus group)

‘You’ve stolen my **** budget!’

(Chancellor Gordon Brown to Prime Minister Tony Blair on hearing that the latter had committed the British government to spending the European average on health services in a television interview; Andrew Rawnsley, *Servants of the People*)

One of the most obvious ways in which a country's citizens are treated as pawns is with respect to taxation. In large part this arises because of the nature of taxation itself. In the language of the libertarian right, taxation is coercive; and coercion is by definition inconsistent with individual freedom of action. Put less pejoratively, paying taxes is a legal obligation, and fulfilling that obligation necessarily restricts the autonomy of individuals to act as they wish.

The general question of the morality of taxation—more specifically, the moral legitimacy of the legal obligation to pay taxes—is beyond the scope of this book.¹⁰⁸ Instead, I want to focus on another important way in which governments' taxation and expenditure systems treat their citizens as pawns: as lacking the capacity for agency. This concerns the use of tax revenues.

TAX REVENUES AND AGENCY

Outside of election periods, individuals are given little choice in how the income raised in taxation is used. The revenue disappears into the black box of

¹⁰⁸ For the record, I must make it clear that I do think there is a legitimate moral case for taxation, and that the fact that it involves ‘coercion’ does not thereby invalidate that case. There are occasions when it is morally correct to restrict individuals' autonomy, such as by imposing taxation for certain purposes (such as redistribution or to ensure an optimal provision of collective goods). For a discussion of these issues, see Fabian Society (2000: ch. 4) and Nagel and Murphy (2002).

government. True, it reappears as government spending programmes; but the way in which it is allocated between those programmes is determined by a complex web of governmental and parliamentary procedures, with little or no direct reference to the preferences of the people who paid the taxes in the first place.

Of course, this situation can be defended as simply part of the process of representative democracy. Practicality considerations mean that citizens cannot be involved in every decision concerning the governance of the state. Hence a system has evolved whereby every few years citizens elect representatives who make decisions on their behalf, including those concerned with taxation and spending. If citizens do not like the decisions made by their representatives, then they have an opportunity to vote out those representatives at a general election. In that way individuals' preferences and concerns about taxation and spending are taken into account.

However, elections are a blunt instrument for registering individuals' wants and needs. The choices are few. The election is usually between two or three major political parties that offer packages of policies that often differ from one another in relatively minor ways. Further, the packages are not just about taxation and spending but incorporate policies relating to other, non-fiscal areas such as civil rights and foreign policy. Hence the choice between the parties is as likely to be determined by preferences concerning those matters as much as by tax or spending issues. Perhaps even more importantly, elections are relatively infrequent; and the system offers little opportunity for citizens to express their preferences between elections.

These problems with elections as a tool of accountability for taxation and spending decisions would matter little if there were a high degree of trust between citizens and their representatives. If individuals felt that, even in the absence of direct electoral sanction, their representatives would broadly make the 'right' decisions—that is, the decisions they might have made themselves in the circumstances if they had all the relevant information—then the system could work effectively and citizens would feel connected with the decision-making process. Even if representatives on occasion made the 'wrong' decisions, but did so in a transparent and open way so that the reasons for the decisions were clear, it is probable that the connections between representative and citizen would be maintained. However, if even those levels of trust and openness do not exist—if representatives are viewed as making opaque decisions and ones that are probably more in line with their own agendas than with citizens' wants or needs—then citizens are likely to feel disconnected from the process and resentful of the decisions that emerge from it. More generally, they are also likely to feel relatively powerless in the face of those decisions: more pawns than queens.

Although to some extent these feelings may pervade citizens' attitudes to all decisions by governments where elections are relatively infrequent, they are likely to be particularly acute with respect to taxation. For people in modern

societies are continuously reminded that ‘their’ money is being taken from them through various forms of taxation: income tax via their pay slips, value added tax (VAT) or other sales taxes through their sales receipts, local taxes through their annual tax demands. The powerlessness associated with both the manner of extraction and the way the money is subsequently used that citizens face is in stark contrast with the power they retain over their post-tax resources. Only if they fundamentally trust the government to do the right thing will they feel more like queens than pawns.

Unfortunately, in many countries it does seem that the predominant feelings among the citizenry with respect to government and taxation are not trust and connection but rather distrust and alienation. In Britain, as part of the work of its Commission on Taxation and Citizenship (of which I was a member), the Fabian Society undertook some extensive research into public attitudes towards taxation. The research used a number of techniques including focus groups, a large-scale quantitative survey, and a question in a separate opinion poll. The researchers found that:

Taxes were not merely unpopular: they were perceived as an unpleasant subject to discuss altogether, invoking negative feelings even among those who accepted their legitimacy in principle. Almost everybody acknowledged that taxes were necessary to pay for public services; but a commonly used phrase was ‘necessary evil’ with the emphasis on the evil. Taxation, it was widely remarked, had an almost punitive feeling with the Inland Revenue in particular regarded as a coercive or even threatening body.

Few people experienced taxation as payment for services rendered. Whereas everyone could say what they would do with the money if they had to spend it themselves, few felt that they knew what the government does with it. On the contrary for many people taxes seem to disappear into a ‘bottomless’ pit (others used the phrase ‘black hole’) with almost no visible connection at all to the things it pays for. (Fabian Society 2000: 45)

The Commission concluded that people did feel disconnected both from the taxes they pay and from the public services they finance. This disconnection arose partly from a lack of knowledge of what taxes are paid and where the revenues from those taxes are being spent, and partly from a sense that the revenues are not being spent properly. Both of these are well illustrated in the following dialogue from one of the Commission's focus groups (Fabian Society 2000: 51):

Woman: Do you ever believe anything they say?

Woman: I think the older I get the less I—I get quite a jaundiced view.

Moderator: But in principle, if you really believed that it was going into the Health Service, you wouldn't mind paying an extra penny in tax?

Man: No, nobody would.

Woman: No, I wouldn't, I wouldn't mind at all.

Woman: No not at all, no.

Woman: If I knew where it was going, not at all.

That individuals feel disconnected and hence relatively powerless with respect to government taxation and spending cannot be good for the health of

the wider society. It fosters a resentment of government itself. It can provoke people into endeavouring to compensate for their lack of electoral power by elaborate schemes for tax avoidance and evasion. It may also ultimately lead to socially disruptive action outside the electoral process: demonstrations, strikes, go-slows, blockades. These in turn may panic governments into trying to buy off the protest through ill-considered concessions that serve only the interests of the protestors and ignore those of the wider society. Alternatively, they may provoke governments into a stern inflexibility, a refusal to be intimidated, which in turn may lead them to ignore genuine concerns and grievances over taxation, thereby fuelling even deeper popular resentment and perhaps even greater civil disorder. Either way, the public good is not being served.

So what can be done better to increase individuals' sense of power in relation to their taxes and government spending—in the terminology of Chapter One, to move up the agency axis from pawn to queen? One promising course of action is to earmark tax revenues for particular spending purposes: what is known in the jargon as *hypothecation*. The remainder of this chapter explores the justification and implications of this idea.

HYPOTHECATION

A hypothecated tax is one whose revenues are earmarked for one particular purpose. The idea has a long history. The word itself comes from the Greek *hypotithenai*, meaning to give as a pledge, via the Latin *hypotheca* (pledge or deposit), and has as its original meaning the act of pledging (property) as security.¹⁰⁹ In fact, in classical Athens and imperial Rome all taxes were hypothecated, largely because of administrative convenience (Webber and Wildavsky 1986: 121). In medieval Europe, again most taxation was hypothecated: monarchs raised money to fund their armies. More recently, in Britain the road fund licence was a hypothecated tax, with its revenues being earmarked for road building; but this earmarking was ended in 1937 (Bracewell-Milnes 1991). In local government, separate rates funded different services until the 1930s. More currently, the BBC licence fee is a classic form of hypothecated tax: a poll tax whose revenues go only to the BBC and which is the sole source of tax funding for the Corporation.¹¹⁰

A more prominent current example of hypothecation, used extensively both in Britain and elsewhere in Europe, is national or social insurance. Employers and employees make contributions towards a fund that is used to pay for certain social services and benefits such as old age pensions, unemployment

¹⁰⁹ Definitions from the *Shorter Oxford Dictionary* and the *American Heritage Dictionary*. Interestingly, neither dictionary gives the meaning of the term as it is used here and more generally in the tax debate. The Fabian Commission preferred the term 'earmarking', reserving 'hypothecation' for what I term 'strong hypothecation': see below.

¹¹⁰ The BBC has other, non-tax sources of funding, notably the income from its commercial arm.

benefits, and (in some countries in continental Europe, though not in Britain) health services. Here hypothecation is usually combined with some form of contributory requirement: the benefits funded from the hypothecated tax revenues are available only to those who meet certain conditions concerning the amount of contributions they have made.

Recently, as the Fabian Tax Commission noted, hypothecation has undergone something of a revival in Britain (Fabian Society 2000: 156). When John Major's Conservative government introduced the National Lottery in 1994, the revenues raised for the public purse were allocated to supporting the arts. The first tax measure of the Labour government elected in 1997 was to introduce an earmarked tax: a windfall tax on privatised utilities to pay for the New Deal programme for helping the unemployed get back to work. Subsequent budgets have earmarked increases in tobacco duties for increased health spending, and various environmental taxes have had their revenues earmarked for improving the environment. Outside of government, over the last decade various versions of the idea have been advocated by the Liberal Democrats, the Institute of Economic Affairs (1991), the BMA (1994), and the leading journalist and commentator Samuel Brittan (2000).

So hypothecation is an idea with a pedigree, and one in which there seems to be increasing interest. But it is far from uncontroversial. Proposals for extending it to other areas of government funding, such as health care and education, invariably arouse vigorous opposition. The Treasury and other ministries of finance strongly resist the idea; and it has little support among public finance economists. So what are the relevant arguments?¹¹¹

WHY HYPOTHECATE?

There is one good argument and one bad argument for hypothecation. To begin with the bad. This is the common belief that hypothecating tax revenues for some popular services, such as health care and education, would lower the electorate's resistance to tax increases. Now the reason why this is a bad argument is not that it is incorrect. On the contrary: that certain kinds of hypothecation would lead to a reduction in taxpayer resistance is indeed quite likely, at least in the current British context. This is again borne out by research done by the Fabian Tax Commission.

In the survey undertaken by the Commission on attitudes to taxation, respondents were asked their reactions to specified increases in the rate of income tax. In each case the implications for the absolute amount of extra tax payments that they would have to pay were spelt out. The results were striking. If the extra tax revenue raised were to be spent on unspecified areas, then 40 per cent of respondents supported a one percentage point increase in the

¹¹¹ Useful reviews of the principal arguments for and against can be found in Teja and Bracewell-Milnes (1991), Jones and Duncan (1995), and, especially, Fabian Society (2000: ch. 8).

standard rate of tax and 34 per cent a two percentage point increase. But if the money were to be spent on the National Health Service, the proportion supporting the increases virtually doubled: to 80 per cent for a one point increase and to 71 per cent for a two point increase. If the money were to be spent on education, then the proportions were 68 per cent for a one point increase and 61 per cent for a two point one (Fabian Society 2000: Table 2.3). Nor is this simply a phenomenon specific to Britain; there is evidence from other countries to suggest that similar results would hold there too, at least so far as health spending is concerned (Hoffmayer and McCarthy 1994).

So, if it is not factually incorrect, why is the lowering of taxpayer resistance a poor argument for hypothecation? There are two reasons. First, the factual conclusion that hypothecation would lower such resistance is time- and context-specific. At other times, and with spending being allocated to different kinds of uses, it could well be that revealing the cost of spending in this way could increase taxpayer resistance rather than lower it. Further, even if taxpayer resistance were reduced for rises in a hypothecated tax for one popular service, it might be reduced for taxes perceived to be funding less popular ones. And such attitudes exist. So, for instance, analysis by John Hills and Orsolya Lelkes (1999) of the 1999 British Social Attitudes Survey found that more respondents thought that the government should spend *less* on unemployment benefits (35 per cent) than those who thought the government ought to spend more (22 per cent).¹¹² More generally, an analysis of the 1995 British Social Attitudes survey found that, when people were given the specific tax consequences for themselves of higher spending on particular programmes, a majority remained for increases in health and education spending; but this was not the case for other items such as police, the environment, and defence (Brook, Hall, and Preston 1996).

So the claim that hypothecating taxes will automatically lower tax resistance, while perhaps correct at the time of writing in Britain for certain specific programmes, is not necessarily true in general. But there is a second, more fundamental, objection to the argument. It is unprincipled. For it simply assumes that raising spending is a good thing and hence anything that furthers that end has also to be good. But there can be no presumption that, at all times and in all situations, raising public spending is desirable; there are going to be occasions when even the most ardent advocate of the public sector might feel that reductions in expenditure would be appropriate (defence spending after the conclusion of a war, for example). And, even on occasions when more spending is desirable, it cannot simply be assumed that the end justifies the means, especially when, as we shall see, this particular means has costs associated with it.

So what is the good argument for hypothecation? The fundamental reason why hypothecation is desirable is related to the central theme of this book: that it turns pawns into queens—or at the least that it goes some way towards

¹¹² 40% thought that the same amount should be spent.

doing so. It does this in two ways. First, if properly administered, it makes citizens aware of the costs of public services, both in general and to them personally. The opaqueness consequent on the pooling of revenue would be lifted. Information is an essential element to being an active and autonomous citizen, and hypothecation is a way of ensuring that a key part of that information is available. Second, it restricts the power of government relative to that of its citizens. Governments cannot simply do what they like with the tax revenues; instead, they have to allocate those resources in a pre-specified way. The balance of power between citizens and their government is shifted in the direction of citizens.

It could be argued that hypothecation, although increasing the relative power of citizens by reducing government flexibility, does little to increase citizens' absolute power. For they can still express only their preferences for changes in the hypothecated taxes and the associated levels of the public services that the taxes fund every few years at a general election, and then only via voting on a bundle of services and taxation. To rectify this, we could follow the suggestion of some analysts of combining hypothecation with a system of popular referendums on spending (see, for instance, Buchanan 1963). So individuals could be asked in a set of binding referendums how much tax they were prepared to pay to fund a particular service or services via taxation. Government decisions would then become even more representative of citizens' views. Continuous referendums have their disadvantages, however, not least in terms of their practicality; and, although attractive as a means of increasing citizen power, it is probable that, at least in the short term, the practical difficulties involved in implementing such a suggestion rules it out.

So the case for hypothecation rests fundamentally on the increase in the power of the citizen relative to that of the government. What of the case against? There are a number of more or less powerful objections.

First, there is an argument in favour of government flexibility. Spending needs change, the economy fluctuates, there are all kinds of outside events and shocks that affect both spending and the economy in the long and short term. Governments, it is argued, must be able to respond to these changes and hypothecation reduces their ability to do so. However, this argument can be turned on its head. It is precisely the intention of hypothecation to reduce government flexibility. It is governments' use—or, as some would argue misuse—of that flexibility that has sown the seeds of mistrust between government and people. Losing the benefits of flexibility may be the price we have to pay for restoring a measure of power to individuals and thereby reducing a source of disconnection between them and their government.

Of course, this raises the question as to how far the hypothecation would go. How many government programmes should be funded by hypothecated taxes? Clearly the greater the number of such programmes—more accurately, the higher the proportion of revenue that is earmarked in one way or another—the less flexibility the government has in disposing of revenue. It

may be that hypothecation or earmarking comes to a point where the costs of extending the process further begin to outweigh the benefits. But where this point is reached is impossible to decide a priori. Rather each hypothecation proposal has to be assessed not only on its own merits but also in terms of its impact on the overall budget position of the government.

A second objection relates specifically to the fluctuations in the economy. An important role of taxation is to stabilise the economy over the economic cycle. In boom times, other things being equal, tax receipts increase, consumer demand is curbed, and the boom is moderated. In recession, tax receipts fall, consumer demand is stimulated, and the recession alleviated. But if a substantial portion of the tax system is hypothecated there is no guarantee that this stabilisation role can be properly fulfilled. On the contrary, during a boom tax rates may have to be lowered or expenditure will have to be increased to keep tax receipts in line with expenditure; either would add fuel to the boom. In a recession, tax rates might have to be raised or expenditure cut, thus exacerbating the recession.

This is part of the more general argument in favour of government flexibility. So in large part the counter-argument is simply that, as observed above, the loss of this flexibility is a price that has to be paid in order to get the benefits of hypothecation. Moreover, given that the use of fiscal tools as an instrument of macroeconomic stabilisation in this way is no longer thought to be as important as it once was, the price might not be all that great.

However, if it is felt to be a serious problem in a particular case, then it can be handled by a stabilisation fund. This would be a fund into which any excess of revenue over expenditure was paid in boom times, and which was used to top up expenditure during recessionary periods when tax receipts fall. The hypothecated tax budget would be balanced not over a particular year but over the economic cycle. In that case it would not be necessary to change tax rates in line with the cycle; stability could be maintained.

It has to be acknowledged that the idea of a stabilisation fund is not unproblematic. The principal danger of such funds is that, as they accumulated in good times, they would be raided by government to be used for other purposes. This happened to the British Road Fund in the 1930s and led to its eventual demise. Constitutional safeguards against this kind of raiding would have to be built into any stabilisation fund proposal.

This problem is actually part of a third source of objection to the idea of hypothecation: the genuineness or otherwise of the hypothecation. On this argument, hypothecation, whether or not accompanied by a stabilisation fund, is almost invariably a cosmetic exercise. What happens in practice, the argument runs, is that, if funds are earmarked for a particular use, then government notionally allocates the funds to that use. But it does not relate the revenue raised to the amount of spending it makes, deciding that amount independently. If the revenue raised by the hypothecated tax is more than the expenditure requirement, then it siphons off the extra revenue for use

elsewhere; if the revenue raised is less, then it uses general revenues to make up the difference. Either way, effectively the government is simply using the hypothecated tax as part of general revenue, and the hypothecation is a sham.

In responding to this, it is useful to distinguish between two kinds of hypothecation: strong and weak. Hypothecation is strong when the revenues from the tax concerned are used only for funding one particular government programme or area of expenditure, and when there is no other source of tax funding for that programme. Hypothecation is weak when either or both of these conditions do not hold: that is, either when any surplus revenues from the tax are used to fund some programme other than the one for which it was earmarked, or when revenues from other taxes are used to top up spending on the designated programme. Of the examples given earlier, the BBC licence fee is an example of strong hypothecation. Most of the others are forms of weak hypothecation, either because they are supplementing revenues raised from other sources, as with the revenues from the National Lottery for the arts and the increases in tobacco duties for the National Health Service, or because the programmes funded receive on occasion top-up funds from other sources, as with the UK national insurance fund.

The distinction is important in this context, since the 'sham' objection refers only to weak hypothecation. This is obvious in the case when the revenues are used to fund services in addition to those specified in the hypothecation arrangement. Then the government is simply using the tax as one way of raising revenue for general purposes and all the transparency and other disadvantages of that way of doing things will come to the fore. But it is also the case when other revenues are used to fund the service in addition to the hypothecated tax. Then there will be no automatic link between changes in expenditure on that service and changes in the hypothecated tax and again the transparency and other benefits will be lost.

This suggests that, for a hypothecated tax to succeed, the hypothecation must be strong. The revenue must be genuinely circumscribed. That is, it must be the sole source of funds for the service concerned; and it must be used only for funding that service. A surplus in the hypothecated fund should not be used to fill gaps in the funding of other services. Rather, it should be carried over for use in the next year (perhaps through the mechanism of a stabilisation fund) either to increase the level and quality of the service concerned or to reduce the hypothecated tax rates. The corollary also holds: if there is a deficit in any one year, revenue from other sources should not be used to fill the funding gap. Instead the deficit should be carried over and rectified by appropriate changes in the hypothecated tax rate the following year. Again this is crucial for maintaining individuals' trust in the system. If there is no automatic link between the hypothecated tax payments and the level of service delivery, then the allegedly hypothecated tax becomes simply one among a battery of government fund-raising measures and the advantages of hypothecation are lost. For, with weak hypothecation, individuals can no longer be sure that the

money they pay through the earmarked tax will be used in exactly the way they have been told it will; and, once that certainty is gone, the trust that the hypothecation is meant to cement between individuals and government will disappear.

A fourth potential difficulty concerns the impact of earmarking revenues for one particular programme on other programmes paid for out of general revenues. We have seen earlier that some programmes, such as health and education, are more popular than others, such as unemployment benefits. Hypothecating revenues for the popular programmes could reduce political support for general taxation, and hence reduce the potential for supporting the less popular programmes.

However, here there are two points. First, the argument is predicated on the presumption of deception. Political support for taxation is generated by fooling taxpayers into thinking that their taxes are largely going to service the programmes they favour—whereas in fact many of the revenues are siphoned off to fund programmes that they do not. This is not an argument that would commend itself to those who wish to turn taxpayer pawns into queens.

Second, the ‘nesting’ of popular programmes within a budget funded from general taxation could actually have a similar effect to that feared by opponents of hypothecation: the driving down of funds available for unpopular ones. There is a danger that ‘nesting’ acts as a cuckoo in the nest, with the political imperative of the popular programmes being so dominant that little room is left in the budget for the remainder. That this danger is a real one is graphically illustrated by the quotation from Gordon Brown, the Chancellor of the Exchequer, at the beginning of this chapter, namely, that the Prime Minister had stolen his budget through committing the British government to matching continental European levels of health spending in a television interview.

A final concern about hypothecation is ideological. Hypothecation is said to be anti-collectivist in nature: an advantage to some on the political right, but a demerit to those more sympathetic to government involvement in the economy. In their history of taxation and expenditure in the Western world, Caroline Webber and Aaron Wildavsky put the point as follows: the use of earmarking ‘indicates strong tendencies towards competitive individualism. Separation of revenues by source and allocation of receipts by function in modern governments in effect converts collective goods into individual ones, for such specificity permits calculations of losses and gains by private people’ (Webber and Wildavsky 1986: 121).

But, although this sounds plausible at a rhetorical level, it is not clear what it really means. In particular, it is not obvious how earmarking or hypothecation turns collective goods into individual ones. Roads were not any less collective goods when they were funded by the road fund licence than they are now; nor is the BBC any more or less a collective good through being funded by the licence fee. The collective insurance function of the National Health Service would remain if it were funded by a hypothecated tax. The nature or

otherwise of a collective good does not depend on whether it is funded from general or hypothecated taxation.¹¹³

What perhaps this argument is expressing is the fear that, once the purpose of a tax is made clear through hypothecation, people may prefer not to pay it, especially if they perceive themselves as getting no direct benefit from the service concerned or if they think they could get a better deal outside the public sector. In effect, to use terminology from earlier in the book, hypothecation may turn collectivist knights into individualistic knaves.

But this is not a necessary consequence of hypothecation. Even if people do not get any immediate personal benefit from a service, they may be prepared to continue paying for it, either because they have altruistic concerns for the actual beneficiaries of the service or because they perceive themselves as possibly needing the service themselves in the future. And those who do get an immediate personal benefit may not necessarily think they will get a better deal outside. In Germany, where wealthy individuals are offered a choice of remaining in the statutory health insurance sector or opting out and taking private insurance, a large majority stay with the public sector—largely because they think it is better (Thomson, Busse, and Mossialos 2002). In general, the danger that people might opt out can provide a useful competitive pressure on the public service, helping to lever up the quantity and quality of the service provided.

But, more fundamentally, it does not seem a bad thing if people do become aware of the losses and gains to them associated with public services. Indeed, as we have argued above, this contributes to transparency and thereby goes some way towards turning pawns into queens. If a consequence of this is that some people prefer to opt out from the services concerned, then this has to be accepted. Advocates of increasing individuals' power and sense of control over their lives cannot complain if on occasion that power is exercised in ways of which they might not approve.

Overall, therefore, when the arguments are viewed from the perspective of this book, hypothecation has many merits. But can it work in practice? The remainder of this chapter considers two practical examples: one, national insurance, an illustration of how not to hypothecate, and the other, a health tax, an illustration of how it might be done better.

HOW NOT TO HYPOTHECATE: BRITISH NATIONAL INSURANCE

We noted above that the British system of national insurance was a kind of hypothecated tax; indeed, it is the most prominent example of hypothecation in the British system. Unfortunately it is a poor example; but, as so often with

¹¹³ A 'collective' or 'public' good is usually defined in economics as one whose consumption is non-rival and non-excludable. Neither of these characteristics is affected by its system of funding.

poor examples, it is useful to examine them to see what lessons can be learned from their relative failure.

National insurance in Britain is a system of cash benefits paid out of an account that is financed by compulsory contributions by employers and employees. The account is not a fund that is cumulative; today's benefits are financed by today's contributions (sometimes known as pay-as-you-go). The benefits are designed to meet various contingencies all associated with loss of income: sickness, disability, unemployment, and old age. With the exception of the (now much reduced) state earnings-related pension scheme (SERPS), all the benefits are flat rate. The contributions are levied on earnings between a lower earnings limit (LEL), now aligned with the starting point of income tax, and an upper earnings limit (UEL).

The first problem with the national insurance system is that its aims are neither clear nor consistent. There is no clear statement of purpose; no articulated view of its aims and objectives. Most observers actually see it as trying to do two things at once: to provide insurance against loss of income due to sickness, unemployment, or old age, and to redistribute from rich to poor. Having two aims is in itself not intrinsically a bad thing; many policy tools have more than one function without necessarily losing their effectiveness in consequence. However, multiple purposes are tolerable only if the pursuit of one of the purposes does not militate against the achievement of the others. But this condition is not fulfilled for national insurance. If it were the proper insurance system that its name implies, it should ensure that those who encountered the misfortunes against which it is providing insurance would not suffer major losses of income, as continental European social insurance systems do. Thus it would levy earnings-related contributions and provide earnings-related benefits. However, as indeed the experience of continental social insurance systems demonstrates, it would not be redistributive; for, although those on higher incomes would pay more by way of contributions, they would also receive more by way of benefits. If on the other hand the system were designed to be an effective instrument for redistribution, its benefits should be concentrated on the poor while more contributions were paid by the better-off. But this would vitiate its insurance function for the middle classes, whose incomes would fall very sharply as soon as they were on benefits.

In the impossible attempt to resolve this dilemma, the British national insurance system unsurprisingly performs neither function properly. Since, except for SERPS, benefits are not earnings-related, they do not provide adequate insurance against the drop in living standards caused by the misfortunes they are supposedly protecting people against. In fact in most cases they do not even provide a decent floor to the drop in living standards. So, for instance, since its inception in 1948 those reliant upon the national insurance basic pension have had to have their income topped up by mean-tested benefits—a situation exacerbated (but not created) by the removal of the link between state pensions and earnings in the early 1980s.

Moreover, recent policy changes by both Labour and Conservative governments have eroded the insurance function in other ways. The Conservative government not only ended the link between rises in earnings and the value of retirement pension and other long-term benefits, and abolished earnings-related supplements for short-term benefits, but also introduced the Jobseeker's Allowance, which cut contributory benefits during unemployment from twelve to six months and aligned contributory and means-tested benefits more closely. The process of attrition has continued under the Labour government. In particular, incapacity benefit is to be partially offset against any private pension received, and its eligibility rules are being tightened; and state pensions above the basic pension are to become flat-rate rather than earnings-related, virtually ending earnings relation of benefits altogether.

Whilst some benefits have been cut, national insurance contributions have been increased, especially during the 1980s. More recently, the structure of contributions has been partially aligned to that of income tax. The 'entry fee'—effectively a flat fee for entrance to the system, payable once earnings reached a lower earnings limit—has been abolished for both employees and employers. For employers, the upper earnings limit on contributions has been abolished. The lower earnings limit for employees has already been aligned with the personal tax threshold; this alignment took place for employees in April 2001, but with benefit entitlement preserved on the slice of earnings then exempt from contributions. Although there is currently no move to abolish the UEL for employees or the ceiling on contributions for self-employed people, the UEL is being increased by more than prices.

So the current system of national insurance is far from a proper insurance system. Unfortunately, it is not a very effective instrument for redistribution either. It is a proportional tax on a particular slice of earned income (between the lower earnings limit and the upper earnings limit). It is not levied on income from savings or on other forms of unearned income. As well as thereby being much less effective in redistributive terms than the regular income tax, this creates oddities and anomalies in the system; for instance, the effect of the UEL is to make marginal tax rates actually fall for incomes over a certain range.

Nor are the benefits that national insurance finances an effective instrument for redistribution. The prime function of national insurance contributions is to finance the state pension, which takes up about three-quarters of the revenue raised. But this is a flat-rate benefit and one whose value relative to other forms of income is steadily declining. Hence it does little to dent the inequality in the income distribution, especially when the latter is considered from a lifetime perspective. Indeed, since the rich live significantly longer than the poor, it is only slightly caricaturing the system to describe it as one in which working-class contributions are used to finance middle-class benefits.

So the current National Insurance system has neither clarity nor consistency of purpose—a failing that means that it does not perform any function that it might have very well. Partly as a consequence it does not meet another mark of

good hypothecation: consistency. Taxpayers do in fact perceive it as a kind of insurance system and are puzzled (and often angry) when it fails to deliver. Public opinion research shows diminishing confidence in the benefits which will be paid out in future, especially the basic retirement pension—although generalised (if fairly uninformed) support for the contributory principle remains.

Many commentators predict that, if nothing changes, this sense of disillusion will get worse. Nicholas Timmins (1999), noting that the national insurance system has become complex, confused in its purpose, and progressively undermined, has argued ‘if the penny drops with the electorate that they are progressively paying more for less, a political rather than merely a structural crisis over NI may yet arise’. As awareness of the difference between the system's ostensible aims and its actual performance increases, it is likely that the erosion of confidence and credibility that it generates is in danger of affecting other parts of the tax system, undermining faith in the fiscal system and in government more generally—and thus exacerbating the problem of ‘disconnection’.

Finally, the current system for national insurance fails to meet the criterion of strong hypothecation. Over the years since its inception, the national insurance fund has often had to be supplemented by revenues from general taxation. Currently, with the decline in the relative value of national insurance benefits and the rise in national insurance contributions, this problem has become less acute, and indeed the fund is currently in surplus. Although under current rules any surplus is in fact carried over to the following year, given the likelihood of continuing and ever-growing surpluses it is difficult to imagine future chancellors denying themselves the opportunity to exploit the fund for other purposes.

What lesson can be learned from the experience of national insurance regarding successful hypothecation? First, if the aim is to promote greater knowledge of public spending generally, the purpose for which the hypothecated revenue is to be used must be clear. A mishmash of confused policy aims associated in a vague way with a particular tax or set of taxes will do nothing to further the cause of citizenship. Both clarity and consistency would be best served by having just one overarching aim or purpose. This may not always be possible; but, if the tax is intended to serve more than one aim, then it is important that the several aims are not only clear but also compatible with one another.

Further, however many there are, the nature of the purpose or purposes of the tax should be apparent to the people who pay it. Clarity is obviously a necessary condition for this, but not a sufficient one. A set of goals that are clear and consistent but are known only to policy-makers or policy analysts will do little to motivate citizen taxpayers to comply with the requirements of the tax; indeed, if they have any suspicion that there is some kind of hidden agenda they are more likely to engage in revolt than compliance. Also, the route for channelling the revenue raised towards the service for which it is earmarked must be clear to taxpayers; there should be no misconceptions about the nature and role of the hypothecated fund and the way the revenue is used.

A HYPOTHECATED HEALTH TAX

As we have seen, there are good arguments for hypothecated taxes in general. But there are two special reasons why hypothecation is particularly appropriate for health services. One of these derives from a concern with citizenship. Many countries take pride in their health services. In particular, the National Health Service occupies a unique place in Britain and in the identity of Britons. When British citizens are asked what they are most proud of about being British, one of the elements to which the overwhelming majority refer is the NHS.¹¹⁴ They persist in their pride despite their perception of the service's ongoing difficulties. The collectivity of the NHS is part of the national collectivity.

Hence linking hypothecation to health services would link taxation to an intrinsic part of identity and citizenship—especially in Britain. Although they would probably not express it precisely this way, most Britons are proud that health care is available to everyone largely free of charge; that access to medical treatment does not depend on ability to pay; that the country has made a collective decision to help those with the misfortune to be struck by down by illness or disability in the most direct way possible: by providing health care paid for out of taxation.

The second reason why health services are *sui generis* at least as far as hypothecation is concerned concerns the relationship between the demand for the service and the volume of resources devoted to it. The demand for health care is widely regarded as income-elastic (that is, it rises more than proportionately with income) and in most countries spending has been steadily increasing as a proportion of GNP over the longer term. That being the case, governments of countries with publicly funded health systems are faced with an uncomfortable choice. Either they continue to increase the volume of resources going into publicly funded health care relatively slowly, with all the damaging political consequences that this would entail, or they engage in some dramatic increase in expenditure—which in turn would either involve some sharp falls in other areas of public spending or a large increase in general taxation. As we saw earlier, health spending can be a cuckoo in the nest. A hypothecated non-general tax earmarked for health care would seem to be the obvious way around this dilemma.

What tax? It is often assumed that hypothecated taxes must be taxes on income. But this is not necessarily the case. Other taxes could equally well serve the purpose of raising revenues for the NHS, such as VAT, taxes on

¹¹⁴ Witness two recent media reports: 'What exemplifies Britishness? In a recent survey 91% said the NHS', *BBC News*, 10 December 2001. And Patrick Wintour wrote in the *Guardian* on 28 March 2000, under the heading 'Labour tries to reclaim the flag', that '[Gordon] Brown's group had gone so far as to commission qualitative and quantitative polling to find out what values and institutions had come to represent Britishness in the public mind. They discovered that the NHS was the single most cherished and unifying institution in Britain and even emblematic of British values'.

tobacco, and alcohol (the so-called sin taxes), or environmental taxes. In fact, for some of these a positive case could be made for hypothecating them to expenditure on health care. In the British case VAT currently raises almost exactly as much as is spent on the NHS. Sin and environmental taxes are levied on activities that actually damage health; so there is a logic in tying their revenues to funding activities that promote health.

However, there are compelling arguments against using these taxes for this purpose. It is only coincidence that the sums raised by VAT currently match desired levels of spending on the NHS. If the latter changed, as it undoubtedly will, then either the rates or the base of a hypothecated VAT would have to change as well; and this raises much bigger issues, not least with respect to the requirements of the European Union. Each of the sin taxes raises less than a quarter of the revenue required; and the one existing environmental tax (on hydrocarbon oils) raises much less than half. Moreover, none of them is as progressive as the income tax; indeed, the tax on tobacco is actually regressive.

The only realistic alternative to the income tax would be some form of social insurance. However, social insurance is an unsatisfactory form of hypothecation for health care. This is for a number of reasons. First, the tax base for social insurance—earned income—is smaller than that of the full income tax. Second, the burden falls disproportionately on employees and employers. Third, social insurance systems tend to be much less progressive than those financed out of more general forms of taxation (van Doorslaer, Wagstaff, and Rutten 1993). For all these reasons, many countries that have previously relied upon social insurance as a means of financing health care have moved away from it. Italy and Spain have both largely replaced the funding of health care out of social insurance by funding from general taxation; France, under strong pressure from employers, is doing the same. In short, if we are to hypothecate tax for health care spending, the most suitable candidate seems to be the income tax.

CONCLUSION

The systems of taxation and expenditure current in the Western world are classic examples of treating individuals as pawns, not queens. This arises not only because of taxation's nature as a legal obligation (unavoidable if revenue is to be raised in this fashion) but because of the way in which tax revenues are used. The revenues are paid into a central pool. Decisions on the use of that pool are taken by government, with only the threat of a potential electoral defeat acting as a check to governmental power. Hypothecation can act as a restriction on government's freedom of action, thus shifting the balance of power back towards individuals. The gains could be considerable: more accountable government, more autonomous individuals, and a restoration of trust between government and its citizens. For such ends, the price of less government flexibility would be worth paying.

Epilogue : *Doux Commerce Publique*

Act in such a way that you always treat humanity, whether in your own person or in the person of any other, never simply as a means, but always at the same time as an end.

(Immanuel Kant, *Groundwork of the Metaphysics of Morals*)

Organise policy until self-interest does what justice requires.

(Anon.)

Let me conclude on a more reflective note. It will not have escaped the attentive reader of this book that I believe that public policy should be designed so as to empower individuals: to turn pawns into queens. As I hope to have shown in the last three chapters, innovative fiscal measures that would further this end include demogrants, matching grants to encourage savings, and the hypothecation of certain taxes. Obviously, these do not cover the full range of fiscal measures that a society could adopt to empower its citizens; but they are ones currently on the policy agenda and that could be readily implemented without excessive political or economic upheaval.

Earlier chapters concentrated on reforms to public services: specifically, the use of competitive quasi-market mechanisms of one kind or another to deliver those services. Again the argument was that, suitably designed, these were a good way to turn pawns into queens: that they empowered service users. Motivation issues were also important; the incentives in such markets would have to be appropriately structured so that they were robust, appealing to both the knight and the knave.

Now some readers, including those sympathetic to the general aim of turning pawns into queens, may find the part of the argument involving quasi-markets unacceptable. The essence of a public service, they might feel, is that it is not provided through markets of any kind. Markets rely upon the pursuit of knavish self-interest by service providers; and the pursuit of self-interest in the context of public services can only be destructive both to service users themselves and to the wider society. Better to rely upon ways of service delivery that rely upon different forms of motivation for providers: specifically, ones that utilise providers' knightly or altruistic feelings or, more generally, rely upon trust and the 'public service ethos'. This would not only produce superior service outcomes but would also be morally preferable. A society that

regards those engaged in public service as knights is better than one that treats every one involved in the public sector as a knave.

This book has considered these arguments and demonstrated, using both theoretical arguments and empirical evidence, that these doubts are misplaced. In terms of outcomes, services delivered by appropriately designed quasi-market mechanisms can be empowering, efficient, and equitable. Moreover, they can even be moral: market-type reward structures can reinforce altruistic motivations and reduce exploitation. But there is a further, even more fundamental argument in favour of quasi-markets, and this I want to develop here.

As Albert Hirschman (1977; 1986) has pointed out, in the seventeenth and eighteenth centuries many philosophers saw the pursuit of financial interests in a market context as having a positive merit in and of itself. This was because financial interest acted as a countervailing power against other, more destructive 'passions', such as pride, envy, and the lust for power and glory. The process of market exchange was itself viewed as a largely innocuous activity, especially when contrasted with the activities of the marauding armies and pirates of the time. Hence Dr Johnson's famous assertion that 'there are few ways in which a man can be more innocently employed than making money'.¹¹⁵

This view in turn led to the idea of 'doux commerce', whereby commercial activity acted as an instrument of civilisation. As Montesquieu put it, 'commerce . . . polishes and softens barbarian ways' (quoted in Hirschman 1977: 60). William Robertson and Condorcet both endorsed this view, as did Thomas Paine in the *Rights of Man*. So Hirschman (1986: 108) quotes Paine:

[Commerce] is a pacific system, operating to cordialise mankind, by rendering Nations, as well as individuals, useful to each other . . . the invention of commerce . . . is the greatest approach towards universal civilisation that has yet been made by any means not immediately flowing from moral principles.

These ideas are not unique to the eighteenth century. They were taken up by much later writers such as John Maynard Keynes in the 1930s and Francis Fukuyama in our own time. As Keynes (1935/1964: 374) put it:

Dangerous human proclivities can be canalized into comparatively harmless channels by the existence of opportunity for money-making and private wealth, which, if they cannot be satisfied in this way may find their outlet in cruelty, the reckless pursuit of personal power and authority, and other forms of self-aggrandizement.

And Fukuyama (1992: 316):

It would seem not entirely a bad thing . . . that economic activity can preoccupy [the most talented and ambitious] natures for an entire lifetime. This is not simply because such people create wealth which migrates through the economy as a whole, but because such people are kept out of politics and the military. In those latter occupations, their

¹¹⁵ Boswell (1934: 323). Letter to William Strahan, 27 March 1775.

restlessness would lead them to propose innovations at home or adventures abroad, with potentially disastrous consequences for the polity.

Few would argue for a return of marauding armies to Europe (or indeed anywhere else); and, if the pursuit of financial interest acts as a bulwark against that return, then it has to be applauded. However, that is not quite the dilemma that faces us here. Rather, it is the question as to whether there is any positive moral virtue attached to market or quasi-market processes as they are applied in public services, especially when they are compared to other forms of delivery that apparently place less reliance upon financial interests as a motivating force. In this context, it is not cruelty or the lust for glory but knightly motivations that eschew financial considerations and concern themselves only with the public welfare that are to be set against financial interest.

Yet this historical debate is not irrelevant to the public versus financial interest issue. For the earlier contributions led directly to a defence of market exchange by later philosophers and economists such as James Steuart, Adam Smith, Immanuel Kant, and G. W. F. Hegel that does about directly on our question.¹¹⁶

As Rupert Gordon (1999) has pointed out, both Steuart and, to a greater degree, Smith argued that a key feature of market exchange was that it led to a respect for other people. To offer something in exchange is to make an effort to understand the needs and wants of the other party to the potential exchange and to persuade them that what is on offer will meet those needs or wants. This is unlike forcible acquisition through robbery or war, where no effort is made to understand and no attempt is made to persuade. Efforts to understand and persuade are both a cause and a consequence of respect for others; hence, since respect for others is morally desirable, so are understanding and persuasion, and so is the mechanism that brings them about: market exchange.

As we can see in the epigraph to this chapter, Kant agreed about the importance of respect. He argued that, in the ideal society, individuals must treat others as ends, not only as means. This incorporated his fundamental belief that individuals must respect others. This belief in turn formed part of his 'categorical imperative': something that was necessary in and of itself apart from its relationship to a further end.

Hegel shared with Kant the view that individuals must respect each other. However, he argued that the route to ensuring this lay not in an appeal to some metaphysical categorical imperative but through the educative processes of the free market. As with Smith and Steuart, he argued that market relationships foster mutual respect and counter human impulses to dominate others. A merchant must respect the dignity of his or her customers, or they will turn

¹¹⁶ See Gordon (1999), on which much of the following three paragraphs is based. I am grateful to Jeremy Kendall for drawing my attention to this article and to the arguments it contains.

elsewhere. Similarly, customers must respect the dignity of the merchants from whom they purchase or the merchants will not sell to them.

The proposition that market systems can encourage mutuality of respect and indeed even other virtues such as equity or altruism is supported by some recent behavioural experiments concerning the so-called ultimatum game. In these experiments, one person is given a fixed cash sum, say, £10, and told to split it in some way with another individual. If the other person accepts the proposed division, they both get the share of the money proposed. If he or she rejects it, both get nothing. If both pursued only their knavish self-interest, the outcome would be quite unequivocal: the first person would offer one penny and the second would accept it. However, the experiments consistently yield quite different outcomes. Even when played on a one-off basis, the acceptors reject what they consider to be unfair offers; whereas the proposers, either because they suspect that this may happen or because they themselves have an innate sense of fairness, tend to make fair offers.¹¹⁷

The particularly interesting thing about these experiments is that the results are *not* replicated when they are tried out in non-market societies. Anthropologists have experimented with these games with Peruvian Amazon tribes, Orma tribes in east Africa, and Quichua communities in Ecuador. They found that the less market-oriented the society was, the less likely were the experiments' participants to make more generous (or more egalitarian) offers. Thus, out of \$100, the Orma, used to trading cattle and work for wages, would offer \$44 on average, whereas the subsistence slash-and-burn farmers, who engage in little trade of any kind, would offer \$25 on average (Henrich 2001). Overall, the anthropologists suggest, experience of market transactions may make people fairer or less exploitative when dealing with strangers.

Now to some eyes, especially to those versed in Marxist and other critiques of capitalism, these assertions might seem incredible. Surely market exchange encourages exploitation, particularly of strangers? The operations of capitalist markets, far from conferring respect on individuals, actually robs them of dignity through their monopolistic exploitation of labour. Also, the poverty that all too frequently accompanies unfettered capitalism is itself demeaning and disrespectful, quite apart from the misery it creates through deprivation.

But, whatever their force as part of a more general critique of capitalism, these criticisms would not apply to the quasi-market mechanisms for delivering public services that are under review here. The quasi-market experiences we have reviewed did not seem to result in exploitation of users. Perhaps this was because of the impact of 'doux commerce', as the anthropologist experiments would suggest; or perhaps it was because the quasi-markets concerned had competitive purchasers and providers, and hence the monopolistic exploitation of either labour or consumers was not an issue. Indeed, arguably the state is potentially more exploitative when it acts as a monopoly provider

¹¹⁷ For a detailed discussion of these experiments, see Rabin (1997).

of services or a monopsony purchaser of labour.¹¹⁸ And individuals do not come to the quasi-market with their own, unequal resources (the source of poverty and deprivation); the state provides the funding on an egalitarian basis for all. And the positive arguments from Smith, Steuart, and Hegel can be transferred directly over to the case for competitive quasi-markets in public services. It is often remarked that the problem with state monopolistic systems of public service delivery is the degree of power that they give to providers of services. Arrogant doctors, insensitive teachers, uncaring social workers, overweening bureaucrats: these are the stuff of the standard critique of state-provided services. There often seems to be little mutuality of respect; instead there is deference and resignation on one side, and arrogance, indifference, or condescension on the other.

This insensitivity may arise among providers because the providers are in fact knaves, not knights. However, it could arise even if the providers were altruists imbued with the public service ethos. For, although to undertake an altruistic act requires a compassionate interest for the welfare of the beneficiary of that act, this does not necessarily imply a respect for the person concerned. Indeed, rather the reverse; the altruist at least in his or her own perception often feels he or she is in a superior position to the beneficiary. Feelings of superiority are difficult to reconcile with mutuality of respect. Some knights need pawns if their knightly impulses are to be properly satisfied.

An interesting illustration of this is provided by Hartley Dean (forthcoming), who explored the attitudes of social workers and benefit administrators to the idea that their clients might have rights. He found that, although they were more committed to the public service ethos than the public they served, they felt their clients should be good: that is, cooperative or compliant. Demands based on rights were viewed as threatening.

So a positive case can be made that, appropriately structured, competitive quasi-markets for the delivery of public services have the moral virtue of encouraging respect for users in a way that other systems do not. Users operate as queens, not pawns. Further, such quasi-markets do not suffer from the corrosive effects on mutual respect of the poverty and exploitation that accompany pure markets.

Moreover, the use of quasi-markets does not have to rely upon knavish motivations. For the quasi-market to work effectively, the agents concerned do have to be interested in the financial health of the institution that is providing the service. However, this interest need not be entirely or even partly knavish. Providers of the service may have a genuine commitment to the welfare of users, and feel that they themselves and the institution in which they work are contributing materially to that welfare. In that case it would be rational for them to fear that that welfare would be seriously damaged if their own

¹¹⁸ 'Monopsony' is a technical term describing a situation where there is only one purchaser—as distinct from the term 'monopoly', used where there is only one seller.

financial health or that of the institution suffered, or to expect improvements in user welfare if finances improved. Quasi-market pressures would then operate as effectively as if the providers were knaves and purely self-interested. And the spirit of caring for others, which writers from Richard Titmuss to Richard Sennett have claimed is an essential part of the decent society, would be retained.

Indeed, if it is to work in the true interests of users, the quasi-market system has to have this kind of knightly concern. For, as we have seen in earlier chapters, providers of public services often (though not always) have superior information to users, especially about the quality and the costs of the service they are providing. They are therefore in a position to exploit that information for their own ends at the expense of the user, if they are so motivated. This can be overcome to some extent by the use of informed purchasers to act on behalf of the user and/or by systems of contracting. But often even expert purchasers cannot be fully informed; and contracts, however detailed, can never be complete. New developments in incentive contracting may help here in the long run, but there is still a long way to go before the models that have been developed are operationally useful. Hence we must rely upon some degree of knightliness among providers so that they will not set out to exploit their informational advantage to the detriment of the user.

However, the danger of introducing financial incentives where previously they did not exist is that, as Richard Titmuss and others have argued, they will turn the knight into a knave—or at least allow self-interested motivations to dominate or even suppress altruistic ones. However, as we saw in Chapter Four, this is not an automatic consequence of introducing market reward systems, provided these are properly designed. At the least, they must not be arranged so that knightly and knavish incentives do not operate to motivate actions in different directions. More positively, they should be designed in such a way as to be *robust*: that is, so that the same action appeals to both the knight and the knave. This can be achieved by systems that offer personal (or institutional) rewards for activities that are perceived to benefit users, but for which the rewards are not so great as to eliminate any sense of personal sacrifice that is associated with the activity concerned.

In short, it is not necessary to turn knights into knaves for pawns to become queens. What is needed is well-designed public policies, ones that employ market-type mechanisms but that do not allow unfettered self-interest to dominate altruistic motivations: a form of ‘doux commerce publique’.

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