

# **Blueprint for a revolution**

**By**

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*“The whole, or almost the whole public revenue, is in most countries employed in maintaining unproductive hands.”*

**Adam Smith**  
*The Wealth Nations*  
**Volume I, Book II, Chapter III**

# 1. Introduction

Four of the most important initiatives undertaken by the governments elected since 1979 have been concerned with a transfer of power in society. Although they might seem to outsiders to be unrelated activities, in fact the policies of privatization, internal markets, the creation of executive agencies and the Citizen's Charter form part of a common approach to the public sector. They aim to redistribute power downwards from government and its bureaucracy, and into the hands of ordinary citizens.

Of the four, privatization was the earliest and the most dramatic in terms of the results it achieved. It has enabled several dozen state industries and utilities in Britain to be taken out of the public sector and turned into private sector businesses. Although its economic benefits have been manifold, it could be argued that its social impact has been wider. In taking industries out of state hands and putting them into the sector where profits, costs and consumers have to be attended to, privatization has demonstrated very vividly that state control is a dead end. It ultimately destroys the industries it intends to operate for the public good.

Margaret Thatcher, who as Prime Minister presided over the first two of these policies, once remarked that the public control the private sector, but nobody controls the public sector. This is a truism. The public have more control over the output of private corporations than they do over that of the state industries. This happens because the private firms need their custom in order to survive and prosper, whereas the state industries do not. Financed from taxation, they have a lien on the public purse which makes them largely independent of consumer choices.

Although the state industries are theoretically controlled through the political process, experience has shown this control to be ineffective. The public sector has a life of its own which defies political control, as successive governments learned while trying to make them less costly and more efficient.

Privatization cut like a knife through the political problems which beset state industries. In returning them to the private sector, it returned them to the influence of consumers. Making them competitive wherever possible, and commercial always, it made them behave in ways which responded to the pressures of the market instead of the political process.

The experience which Britain gained by the application of this policy proved hugely beneficial to other countries heading down the same road. The implications for the developing world were spotted early on. Many of them had seen their economies ruined by state control and state ownership, much of it learned, it should be said from British Universities which their future leaders had attended. If privatization could unloose the stranglehold which state intervention had locked upon them, then their economies could perhaps develop and prosper in the free market. Britain offered not only the rationale behind the rejection of state control, but the mechanisms by which it could be undone. The result of this was that British expertise in privatization became a major export industry, with British advisers leading the world as those with skill and experience to oversee the transfer of industries from government to private hands. As the numbers countries following this course mounted, it became increasingly hard to name countries where privatization is not a fact of economic life. They now include Cuba, Iran and North Korea, and few others.

While the impact upon the developing world was anticipated, no one expected the communist countries to become chief centres of privatization in the 1990s. Since the collapse of socialism across the world, though, it has been the post communist countries who have embraced privatization most eagerly. With economies crippled by decades of socialism, they have the greatest need to restore private sector initiatives and to get a private market operating again as quickly as possible. Of all of the international customers for privatization, the post communists have proved to be amongst the most enthusiastic. They know, after all, what socialism and central planning mean in practice.

The demise of socialism on the world stage has critically blunted the enthusiasm of those in Britain who argued for state ownership. They feel unable to sustain the drive at home for something which has been so thoroughly discredited on the world stage. By driving out communism from their own countries, the peoples of central and Eastern Europe have driven the threat of socialism from ours. The reformed Labour Party in Britain no longer threatens to undo what privatization has achieved.

It should be pointed out that privatization only became a popular policy after it succeeded. Virtually no individual sale commanded popular support in advance. Only when it was done and had been seen to succeed did it attract popular support. It takes a brave government to lead so determinedly from the front, and Britain had the advantage of a brave leadership during this period. Other countries which try to gain popular support for privatization in advance find their leaders cowering behind opinion polls when they could be leading the way. Privatization won its support in practice, not in theory. Its transformation of ailing state industries into vibrant private ones is what won it support.

The leadership, brave as it was, did not attempt the privatization of the human services in Britain. The process of reforming them started with the probably correct assumption that they could not be privatized in the conventional sense. People had grown so used to "free" health and "free" education that any attempt to make people pay in a private market was thought to be doomed to political

defeat. Even if people were better off as a result, even manifestly better off, still it was thought that "free" human services were totems too holy to be assaulted.

In the absence of privatization, government settled for internal markets in education and health. The markets were "internal" in the sense that people did not pay with their own money. The services remained free to users at the point of consumption, and financed out of taxation. But where the allocation of resources had flowed through a bureaucratic network, it was now changed to follow from consumer choices. In selecting a school or a doctor, individual members of the public were now taking decisions which had financial consequences. The state money followed in the wake of those decisions.

The innovative aspect of the internal markets was that people were allocating resources when they made decisions, even though those resources were not their own. The new structure meant that the state's money followed the individual's choice.

Although internal markets have only just started in Britain, it is already apparent that they have succeeded in making the human services responsive. They are bringing those state services into the realm of activities which people control by their decisions. In place of a uniform state supply which emanated from the centre, there is now a reactive system which responds to the demands made upon it, and in which the supply has to be constantly geared to what members of the public ask of it.

The paternalist state, which gave the public the education and health services which it thought were best for them (and which were often best for the producers of the same) is being replaced by the entrepreneurial state, in which public sector producers vie with each other to make their product more attractive to a public which can not only choose between them, but can determine by its choices where the funding is to be directed.

In both education and health the internal markets are in their early stages, and will require subsequent measures to improve them. But the principle is already well established: that people make choices, and that those choices have financial consequences upon producers.

The third policy change is the setting up of executive agencies (or *Next Steps* agencies, a name taken from the original discussion document that led to their creation).

The intellectual breakthrough here was to consider the civil service not as a seamless bureaucracy, but as a series of administrative functions; to concentrate not on what it *is*, but what it *does*. When the problem was thus re-cast in terms of outputs rather than inputs, it became possible to reform the civil service in more rational ways that would serve the convenience of the taxpaying customer rather than the contentment of the bureaucratic producer.

And now, under the Next Steps reforms, the civil service has indeed been divided like this, into discrete units (or agencies), each with independent management, clearly delineated functions and responsibilities, and full accountability for its operations. They work much like commercial contractors to the policymaking core of the civil service. Pay is attuned more and more to output instead of seniority. There are clear contractual agreements on the price and the quality of the work done. Today, the majority of the civil service is divided into agencies or is working along agency lines. But it is no mere bureaucratic change. Management freedom has enabled the agencies to break out of the traditional civil service mould. Many have expanded their role to take on more work from private sector customers, and have developed new income-generating service products. A few are even thinking about whether they might be better off if they detached themselves from the civil service entirely, and privatized themselves so that they could serve a mixture of public and private clients in ways of their own choosing.

The fourth of the policy initiatives which form part of this strategy of reforming the public sector is that which is now known as the Citizen's Charter. Essentially it represents an attempt to make the state industries behave more responsively toward their customers. They do not face the commercial and competitive pressures which make the private sector behave in this way, so other pressures are applied.

The Citizen's Charter uses legislation and statute to require appropriate behaviour from the public services. Specifically, it draws up a contract between each state service and its public, a contract which contains mechanisms to make it enforceable. In place of a vague public duty to provide some undefined and unspecified level of performance, the Charter substitutes specific performance targets which each service is pledged to achieve. These are quantified in terms of waiting periods and maximum acceptable delays.

Furthermore, the Charter requires each of these contracts to have built into it a mechanism under which members of the public have access to some form of redress if the promised performance does not materialize. That redress may range from a formal apology to financial compensation; the important thing is that the procedure for making complaints and following them through must be a simple one which members of the public will have no difficulty in using.

The Citizen's Charter is even more recent than internal markets, yet it, too, has already shown signs that it can achieve at least a part of what it was designed to achieve. The public services have already responded with key initiatives to upgrade their levels of service and their accessibility to the general public. They are becoming more user friendly.

The test of internal markets and the Citizen's Charter will be the same as it was for privatization. They will be judged on what they achieve in practice. While the early indicators are good, it will be some years before anything other than an interim verdict can be given. That interim verdict suggests for the moment that, like privatization, they are proving effective in reversing the top-down structure



of the state industries. In its place they are substituting structures which send signals from consumers and enable members of the public to have a direct influence on their output and performance.

The common thread linking the four policies is Public Choice Theory. They arise from a desire to make society interactive and spontaneous instead of command driven, but the methods they choose are specifically linked to an analysis of society which applies the methods of economics to social affairs. Public Choice Theory uses the premise that politicians, civil servants, interest groups and ordinary electors, behave as if they were economic participants, each trying to maximize their advantage, and acting rationally to secure their objectives.

Many political reforms are thwarted, despite their apparent worthiness, because they are seen as hostile to interest groups sufficiently powerful to derail them. Governments which fail to push through their reforms in such circumstances are frequently derided as "too weak," whereas a more valid criticism might be that they are using the wrong methods. However strong willed a government might be, there are limits to its ability to ignore political reality.

It is all very well saying "make government smaller," but if the pressures are all conspiring to make government larger, and if most of the key interest groups see a bigger government as one which enhances their own advantage, strength of will by itself is probably not enough to overcome those tendencies.

The policies which are formulated in the light of Public Choice Theory are more complex and more sophisticated than their rivals precisely because they take account of interest groups and attempt to circumvent the opposition which might be generated by them in the normal course of events. Like antibodies, these policies have elements designed to target those interest groups and to neutralize their opposition.

The policies of privatization, internal markets, executive agencies and the Citizen's Charter are all horses from the same stable; they have arisen in the light of Public Choice analysis. They all attempt to engineer a society which will be determined spontaneously by the interaction of its citizens, and to transform those elements of it which are planned and directed from the centre.

That these policies have proved effective in Britain and have enjoyed considerable success there since 1979 is now a matter of historical record. That they could succeed in achieving similar objectives in other countries is less certain, but there are few reasons to suppose that they could not. Certainly, privatization has now spread to the world stage with some striking successes.

In the 1980s representatives of other countries came to Britain to learn about privatization and to see how it might be applied in their own countries. It is significant that a similar interest is now being shown in both internal markets and the Citizen's Charter. Several countries have launched studies to see how

the British experience might be used to advantage to develop similar policies suited to their own circumstances.

It could well be that, just as privatization became a world phenomenon, so too could the other three policies which followed in its wake in pursuit of similar objectives. Internal markets in health and education, the creation of more businesslike executive agencies and a Citizen's Charter for public services could well become the normal means by which most countries seek to control an overgrown and unresponsive public sector.

## **2. The privatization record**

The first phase in the downward transfer of state power consists of the privatization of state industries and utilities. This process involves placing their ownership and control within the private sector of the economy. Although it has been the huge public stock issues which have attracted international attention, the reality since 1979 has been of the transfer of several hundred public enterprises by a variety of different methods. Public stock issue is one such method, and one which attracts attention, but it is only one among several techniques which have been found appropriate for different types of enterprise.

### **THE BRITISH EXPERIENCE**

The process began in Britain with the privatization of the state owned oil firm British Petroleum in 1979. Some of the shares were already in the private sector, sold at the request of the International Monetary Fund. The state remained the major shareholder, however, and under Treasury rules this made BP a public corporation. The technique used for that first attempt in November 1979 was the direct sale of a sufficient percentage to take the government's share below 50 percent.

When the sale took place government became a minority holder, no longer principally responsible for BP's debts. This meant the firm could now attract investment or loans without this being counted as government borrowing. It was free to behave commercially.

Following this success, the British government's next move toward privatization was the sale of British Aerospace in February 1981. Here they chose to sell 51.6 percent of the aircraft manufacturer to put ownership into private hands. In the case of BAe, as with BP, the residual shares were sold later.

In November 1981 it was the turn of Cable and Wireless. Only 49.4 percent of the shares were put up for sale, with about 5 percent going to the workforce. Although Cable and Wireless remained in public hands because of the 50.6 percent public holding, the government declined to take up a rights issue in 1983, allowing its share to fall to 45 percent, effectively privatizing the company by the back door. As before, the government later sold its residual shares.

The first 100 percent sale was of the radiochemicals company Amersham International in February 1982. The Amersham sale also pioneered the sale of shares to workers on the basis of a free one given for each one purchased. More than 4 out of 5 workers took up the offer.

The same year (1982) witnessed another innovation: the sale of a company to its management and workforce. The National Freight Consortium (NFC) was sold in this way. Some 9,000 employees and 1,300 pensioners of the state trucking corporation took part, with an average purchase of 700 £1 shares. So spectacular was the improvement in performance that when the new owners floated the company on the stock market seven years later, each £1 was by then worth £100. Some of the workers became suddenly very rich, and one driver left Britain to become a tax exile.

When Associated British Ports was sold by a 51.5 percent sale in February 1983, some 91 percent of its workers took up share offers, buying 12.2 percent of the company in the process. The shares opened at a huge premium of 28 percent above the issue price, leading to the by now familiar charge that the government had sold "precious assets" too cheaply. A weak performance by ABP silenced the critics, but the package had been well constructed with sufficient land and property assets to help finance the refitting of the ports with modern equipment, and ABP subsequently showed good profits and growth.

The same year also saw the transfer completed of 27 of Britain's publicly owned hotels to the private sector. These had been part of British Rail; now they were separated off and sold. The workforce was involved in several of the successful bids, including for the first time the use of union pension funds.

The year 1984, which witnessed the sale of Jaguar cars and the ferry service Sealink saw two remarkable pieces of privatization, totally different in scale. The cross channel hovercraft ferry service was effectively given to its management. Despite huge previous losses the new owners turned it around and were able to sell it themselves in 1986 for £4.3 million.

The real trail-blazer of 1984, however, was the sale of the British telephone industry under the name of British Telecom (BT). This was the largest stock market flotation in history, and was a major leap into the unknown. Some analysts cautioned that there was simply not enough capital out there to invest in a £4 billion flotation.

The sale of Telecom clocked up several firsts. It was the first use of saturation mass advertising to attract members of the public to become first time shareholders. By the day of the sale some 2.4 million had applied for shares. The government also pioneered the use of customer incentives, with telephone users offered a choice between reduction on their telephone bills, or bonus shares later on if they bought and held onto their shares. It was also the first major credit sale, with purchasers required to put up only one-third of the price for shares, and the remainder to follow in later calls made in subsequent years.

A further innovation introduced in the Telecom sale was the inclusion of competition, in the shape of Mercury, a private firm licensed to provide business telecommunications. Also pioneered was the use of a regulatory body (OFTEL) to exercise the function of overseer of the industry in the future, and to protect the consumer from abuse by BT of its near-monopoly powers until such time as more competition could be brought to bear.

Rather than follow the US regulatory model for price controls based upon a "fair" return on investment, the British government pioneered instead a price formula based on RPI, the retail price index (called in some countries the Consumer Prices Index). The agreed formula was  $RPI-X$ , where  $X$  was a factor under which the introduction of new technology was expected to cut prices. The rule for any Telecom price rises started at RPI-3, but soon rose by agreement to RPI-4.5, then RPI-6.25. By 1992, the regulator in charge of OFTEL was proposing a rule of RPI-7.5. Similar formulae followed in other sales.

Only 50.2 percent of BT shares went in the initial sale, just enough to privatize the company. When trading opened and the part paid 50 pence shares rose to 95 pence, the government was once again accused of selling too cheaply. The reply, made with some justice, was that no one knew what the telecommunications network was worth because no one had sold one before. In any case, by selling just over half, the government was able to make more money from the subsequent sale of its remaining tranches than it did from the original sale.

The success of the Telecom sale emboldened the British government to undertake the even larger sale of British Gas in 1986. Valued at £5.7 billion, British Gas was controversially privatized as a single vertically integrated unit, instead of being broken into competing units, or separating distribution from production. The government used all of the innovative techniques pioneered during the Telecom sale, and attracted applications from 6 million persons, corresponding to one in five of the adult population of Britain.

The discounted worker shares, with the number they could purchase depending upon their years with the firm, attracted 98 percent of the workforce, despite union opposition. The public offering was over-subscribed three times over and, as with the Telecom sale, applications were scaled down to favour those who applied for small numbers. The opening premium when trading opened was about 30 percent, which was counted as a success by the government, but which attracted the usual criticism.

More serious criticism was directed at the monopoly status. The government's defence was that at the time any other method would have failed. This may indeed be correct, but it is significant that this was the last privatization of a state industry as a monopoly.

A much smaller sale of 1986 was that of the Vickers shipyards, but it was significant in its own way. It was bought by a consortium led by management which included the workers, local banks, and residents of the communities in which the ships were built. Significantly, it was the second highest bid, and was

chosen in preference to the higher bid from Trafalgar House. The government reckoned that a bid involving management, workers and the locality was more likely to make a go of the business, whereas a conglomerate might be tempted to engage in asset stripping or industry wide rationalization.

One of the few serious political embarrassments over the privatization programme was suffered when the government tried to sell British Leyland, the state manufacturer of automobiles, buses and trucks. When word leaked in 1986 of secret talks to sell parts of Leyland to the US Ford Motor Company, talks had to be broken off.

Despite this setback, only a year later the government was able to sell the truck division to the Dutch Company DAF, and the bus maker went to a management led buy-out. Two years later the auto division, by now called the Rover Group, was sold to British Aerospace. Even this deal raised a storm later on, when it was discovered that secret "sweeteners" had been written into the deal to make it attractive to BAe. All of this no doubt confirmed the government in its view that the sale to a single buyer is the least attractive and most politically risky method of privatization. Only worse, perhaps, is the sale to a single foreign private buyer.

The privatization of the National Bus Company in 1987 provides an example in which competition is introduced first, followed by the sale of the state company into a by then competitive market. In 1980 the monopoly of National Bus was broken when an Act of Parliament opened inter-city (long distance) bus transport to competitors. New companies stepped in with lower fares and improved standards of comfort and service. They quickly captured a share of the market.

National Bus responded by improving its own services and making its own fares more attractive. It reacquired a dominant position in the market, but not a monopoly any more. By 1986 it was possible to privatize National Bus, and the decision was taken to sell it in components. The first 13 were sold in 1986, with 12 of them going to management buyouts. Several dozen more went in 1987, with over two-thirds being bought by management. The government duly took note that in some cases, especially of service industries, it is appropriate to introduce competition first, and privatize later.

The general election of 1987 did not stop the privatization process. The government had grown so confident of its skills that one industry, British Airports Authority (BAA), was privatized on schedule in the middle of the election campaign. This was a sophisticated sale, in which the government successfully sold to different buyers at different prices.

The argument was that while fixed price sales were suitable to attract small investors, they were not necessary for the institutions, and tended to give them too attractive a price. The sale of BAA therefore took place in two parts. There was a fixed price sale intended mainly for the general public, and a sale by tender aimed at the institutions.

The issue was over-subscribed ten times over, and all applicants who applied for 1,000 shares or less were allocated 1 00each. Those who applied for more received none at all. The opening price represented a premium of 30 percent, but not a gigantic profit on 100 shares after dealing charges had been paid. The government had the satisfaction of seeing the price of the tender sale strike quite close to the actual opening price of the fixed price shares.

With the sale of Rolls Royce, also in 1987, the novel device of "clawback" was employed. Some 60 percent of the shares were set aside for institutional buyers, with 40 percent for the public and employees. In the event of a heavy over-subscription, shares would be "clawed back" from sale to the institutions, and put into the sale to the general public and employees instead. In the event, the issue was over-subscribed 9.4 times over, triggering the clawback. So 51 percent went to the public and the employees, and only 49 percent to the institutions. Once again, the government had targetted its buyers.

Following the experience with British Gas, the decision was made to privatize the electricity industry in competing sections. The transmission system, the National Grid, was divided between 12 regional supply companies, each responsible for supplying power in their areas. The production was divided between two new companies, National Power (70 percent) and Powergen (30 percent). The reason for the disparity was that National Power was to carry the nuclear generating element (about 20 percent), and needed size to absorb the risks.

In the event, when the accounts were done on nuclear power for the first time ever, it was found to be unsaleable. No private company, it was reckoned, could carry the potentially unlimited costs of decommissioning the nuclear stations when their production life had expired. Accordingly the nuclear element was withdrawn from the sale, leaving National Power at about 50 percent and Powergen at 30 percent.

New generators were to be admitted into the market, and the 12 regional supply companies were to buy from competing generators, with a sophisticated computer-driven bidding system called "the pool" striking the price at which each half-hour of electricity would be bought.

The sale went ahead successfully on schedule in November 1990 for the regional companies and February 1991 for the generating companies, attracting wide support for all of the companies involved. The support has been justified by the subsequent success of the companies at cutting costs and raising profitability, but prices are regulated as with Telecom. There was public concern fanned in the press about the way in which the various chief executives raised their own salaries to figures nearer to the norms for private companies, but this had negligible effect on costs. It was more of a political embarrassment during a recession.

The water industry was privatized in 1989. It was divided into regional water companies, each with a monopoly in its area, but subject to regulation, and with

a national league table of performance to enable comparisons to be made. A National Rivers Authority was created, independent of the private companies.

The sale was heavily criticized in the British press, but went ahead on schedule and, to the visible relief of the government, attracted huge popular support. The shares did not open at huge premiums on the asking price, but the activities of French water companies soon raised the price of the shares as they started buying a stake in several of the new companies. Most of the criticism died with the sale, but the same happened as with electricity, with the increased salaries of chief executives attracting widespread criticism in the popular press.

A significant feature of the water sale and the sale of the electricity industry, was the extent to which recapitalization was built into the privatization. Both industries required extensive refitting, partly to meet tighter standards for cleaner air and purer water. The price formula for each industry requires a proportion of operating surplus to be ploughed back into recapitalizing the industry before profits are distributed to shareholders.

In this way the government has secured extensive capital inputs to modernize each industry without drawing upon public money to do so. Furthermore, the reinvestment takes place over many years, and at a rate which does not make excessive demands upon consumers. This is reckoned to have lessons for countries whose capital industries were run down by decades of socialism.

By the time of its fourth consecutive General Election victory in 1992, the British government, after 13 years in office, had privatized virtually all of the state industries and utilities. Only British Coal, British Rail and the Post Office remained, and there were plans for all three already under discussion. Rail was the first to go to Parliament, a detailed measure designed to separate the track authority from the operating services, and to admit private firms to run services competitively on a franchise basis. The government took powers to privatize the different elements at a later date. The plans for British Coal and the Post Office were still to come.

The UK privatization programme was overwhelmingly successful. In place of losses and subsidies, the former state companies now made profits and paid taxes. Most important of all, they were out of the central domain of politics, and into the world of commerce. They operated more efficiently, gave better service, and were more responsive to their customers. It was a major change in culture, and one which placed them into the market place, exposed to the pressure which consumers and competitors bring to bear. Instead of being directed from the top by the state, and administered through layers of bureaucracy, they now had to attend to the signals which the market carried from below, and to respond accordingly.



### **3. Solving privatization's problems**

A transfer of power and privilege away from the state inevitably arouses the opposition of the interest groups which benefit from the central concentration. The civil servants and the managers of state enterprises will be reluctant to see their position of importance diminished. The politicians might not view with equanimity the departure from their immediate sphere of control of major state enterprises. The workforce of state industries will fear the loss of a strong bargaining position, and will doubtless be reinforced in this fear by the leaders of public sector unions which face a reduction in their own influence.

Even the general public which stands to gain most from the redistribution of power cannot be expected to show solid support for the move. They see only the threat to their established supply, and its replacement by something unknown, untried, and perhaps unreliable. Whether it be telephone services, water, gas, electricity or rail and bus services, they fear the possible loss of supply. However unreliable, unresponsive, inefficient and costly the state services may have been, they fear that the new ones may be worse, and their fears will be fanned by those whose own loss will be more immediate and more direct.

This means that privatization must be done in ways which take account of these sensitivities. It cannot forge ahead relying only upon political will, for the latter proves too often to be a feeble reed which bends and breaks under the storm of opposition. Instead privatization has to be implemented by a strategy which solves the problems in advance. It is a political strategy, not an economic one.

The first problem for those intent on privatization is to build in the support of those whose opposition might thwart it. This means in practice that all of the interest groups which could perceive themselves to be the losers from privatization must be appealed to by measures which benefit them directly. There are those who take the view that the private benefits conveyed by state power are unjust and should be confiscated. Unfortunately they rarely tell us how to succeed with such confiscation, or how to survive the political storms which accompany the attempt.

It is usually better to buy a benefit back than to confiscate it: that is, to offer a greater benefit in exchange so that the parties concerned will freely trade. This principle has figured throughout the privatization programme in the United Kingdom.

The civil servants who administer the industry concerned become the management board of the newly private company. What they surrender in authority as state employees in charge of a major industry they gain as managers of a successful private corporation. Moreover they gain flexibility. In the private sector they can really manage, without the heavy hand of the politician on their shoulder. They gain the freedom to make commercial decisions, to expand and to retrench where they think appropriate. They gain the chance to show what they can do. Years of chafing under the inept interference of the political process, and years of being denied sufficient resources are swept away. The fact that they gain the higher salaries and rewards of the private sector is probably a factor as well.

It is important to appreciate that the incentives and rewards to be gained within the private sector are achieved under very different standards from those which motivate public employees. In the civil service status is more dependent upon length of service, and salary and position determined much more by the size of the department and the number of employees beneath one. The incentives are thus to expand the size, the scope and the budget of one's department.

It is more common in the private sector to promote the person who succeeds in containing the costs of his or her department, and who makes savings by reducing manpower. Length of service plays a smaller role than proven talent and ability. People take chances in order to prove their worth and advance their careers, whereas in the bureaucracy the tendency is to play it safe, knowing that the rewards and advances will come with time.

It could be argued that the qualities required of the management of a private corporation are very different from those needed to run a bureaucratic department, and that the state managers are simply not suitable to undertake the transfer. This sounds plausible in theory, but in practice the pressures to which private businesses are exposed make the personnel behave differently. Civil servants are then highly talented and capable; it is the nature of their job which makes them behave as they do. When the circumstances are changed, as they are with privatization, the behaviour changes accordingly.

There is thus no need to replace management in advance of privatization. If there are those incapable of making the transition to the private sector, the market itself will rapidly sort them out. After only a short time in the private sector the time-servers will find themselves sidelined to unimportant, if impressive sounding, positions, while newer and more thrusting types will be promoted to the jobs which matter.

The one key job is the one at the top. It is necessary to have a chief executive who believes in privatization and is motivated accordingly. It is sometimes necessary, therefore, to bring in a new chairman of the state enterprise to prepare for privatization and to steer it through. That one person will impose his or her stamp upon the company, and will inspire the promotions policy within it, and will motivate the rest of the management team.

As well as bringing the management on side, it is critically important to secure the goodwill of the workforce. Labour relations in state industries are often notoriously bad. The unions have gained benefits for their members which have accumulated over the years. The fear that interruption of service will provoke public hostility makes state managers more likely to concede benefits which private industry cannot afford, in the knowledge that costs can always be passed on to the customer or the taxpayer without fear of bankruptcy.

Privatization threatens those accumulated benefits. It threatens the job security, in that while governments rarely go bankrupt, it is an ever present risk in the private sector. In the absence of other inducements, therefore, the workforce is acting quite rationally in being suspicious of privatization.

Government and management have a two-fold job. They have to educate the workforce, and show them what privatization actually means. This will go some way to neutralizing the scare campaigns which militant union leaders often undertake. Secondly, and more importantly, they have to secure the support of the workforce by making them part of the process. The easiest way to do this is by allowing and encouraging the workers to become part owners of the new enterprise.

The British government decided very early into the privatization programme that worker share-owning was to be encouraged. This achieves several aims simultaneously. It involves the workers and negates their possible opposition; it spreads wider share ownership; it makes for better industrial relations; and it makes the company more saleable and raises its value.

If the workers in a state enterprise have the opportunity to gain individually from privatization, serious opposition has much less chance of developing. The theoretical benefits of privatization can be underscored by a direct gain to each worker who chooses to participate. This extends share ownership in general, since workers in few societies have acquired the habits of stock market investment as a form of savings.

Workers who own shares in their own company are less likely to engage in strikes or disruptive labour practices. After all it is their own dividends and the value of their own shares which will be hit. In other words, the confrontational relationship has been replaced by a co-operative one. Workers feel themselves to be part of a team, to be co-owners of the enterprise, to have a stake in it's future and in its success. This is a recreation of the relationship which existed to some extent in Victorian England, when workers and owners felt themselves to be part of a team, even a family, which faced the world together. There is no doubt from the record of British industries after privitization that this makes for better industrial relations.

There is a further gain for government. Many state enterprises have a record of union militancy and industrial strife. When workers own shares, it reassures prospective investors that labour disputes will be greatly reduced, and this

makes companies more saleable, as well as increasing its worth to potential buyers.

A technique developed early on in Britain is to allocate a proportion of shares for the workforce at discounted prices. This often takes the form of a reserved allocation which workers can purchase on the basis for a free share for every one which is bought. This means half price shares. Sometimes the number of shares available to each worker is made dependent on the number of years of employment with the firm. Sometimes there is a free offer of perhaps 200 shares, as with British Gas, with the option to buy more on a one-for-one basis.

The actual proportion available to the workforce varies. For Cable and Wireless it was 5 per cent; for British Telecom 4.6 per cent. The British Aerospace sale saw workers scaled down to 7.1 per cent of the 10.6 per cent they applied for. The workforce took 12.2 per cent of Associated British Ports, and 10 per cent of Rolls Royce. In general, the worker share has increased as the programme has developed, with a rough average of perhaps 8 per cent as the figure to aim at.

One very important point which the government noted at the outset is that the offer must be made individually to each worker. It is not something to be negotiated collectively with unions. Union leaders are elected for a different purpose, and do not represent the interests of their workforce in this respect. Government and management always went over the heads of the unions and communicated directly and individually with each worker. This might help to explain why the average take-up rate of worker shares has been over 90 percent, often reaching over 98 percent for individual companies.

The paradox of this fairly generous treatment of the workforce is that it probably costs nothing. One might suppose that to sell workers 8 percent of the shares at half price meant giving away some 4 percent of the company, and that this would cost money. The paradox is explained by the fact that the remainder of the shares rise in value because of this action, probably by more than the amount given away. A company with workers as co-owners is worth more because there will be less strikes and disputes, and more co-operation with cost saving practices.

A further way of gaining the support of the workforce for the privatization process is to complete most of the restructuring of the company ahead of privatization. If during the process of preparation the major rationalization moves are put through, the workforce will not be as vulnerable to scare stories about what might happen afterwards. This process usually sees the company move from losses into profitability, and reassures workers that the company faces a profitable and successful future in the private sector. Indeed, it reassures prospective buyers to much the same effect.

Where job losses are necessary to complete this restructuring process, it is advisable, wherever possible, to achieve them without forced redundancies. In some cases this is not possible. In the case of British Steel, it was so over-manned and over-produced to such an extent that the industry had to be severely

trimmed over a period of several years before it became viable. It was, when finally sold, one of the few profitable steel companies in the entire world. In this case the government's effort went into retraining and relocation, trying to help those displaced find other jobs, giving help where appropriate with the expenses of moving house.

More commonly it is possible without forced job losses, and cash is provided to those willing to take voluntary early retirement. Outside recruiting is replaced by internal relocation until natural attrition has slimmed down the workforce. British Airways had to trim its workforce down from 59,000 to 39,000 to make it turn huge operating losses funded by the taxpayer into profits which paid tax into the Treasury. None of them was fired. The cash sums offered for early retirement were set high enough to promote sufficient voluntary exit to achieve the target.

Of course it costs money up front; but this can be regarded almost as a capital investment. The company pays money now so that it can run at lower costs in the future. And the cash which has to be allocated is more than repaid in the augmented sale price of the company when it is privatized. Many of the former employees of BA were reported to have set up their own businesses with the cash injection they gained from early retirement. Some bought shares in BA, and took advantage of the 50 percent premium they opened at.

It has been common for government and management to encourage workers to hold onto their shares for at least a minimum period in order to get them used to the idea of share ownership, dividends and capital growth. It also prevents a sudden glut on the opening market caused by workers trying to unload their half price shares for ready cash.

Sometimes there is a minimum holding period, as with the Jaguar sale when workers had to keep their shares for at least two years. Sometimes there are incentives and inducements to persuade workers to hold on. These can take the form of bonus shares for those who retain their own shares for a specified period. In the case of Jaguar, there were tax advantages for workers who held on after the minimum two years. When the two years expired, hardly any workers sold. They benefited when the company was later bought.

The principal of buying back benefits, rather than trying to confiscate them, also helps bring workers around to support privatization. Many British Airways workers, as state employees, had been given index-linked pensions in the 1970s. This meant that their pensions would rise to keep pace with inflation, whatever that might be in the future. No private owners could reasonably be expected to face such a potentially unlimited liability. The BA workers were offered cash sums to trade the index-linked pensions for conventional ones. Once again, this was equivalent to a capital input designed to lower future costs.

It says much for the policy of attracting worker support by such methods that one of the few industrial disputes provoked by privatization occurred when BA workers threatened to strike if privatization were delayed yet again. It had been

held up by disputes in the American courts, and the workers were impatient to see it done.

As well as winning the support of management and workers, it is important to allay the fears and win the support of customers, who are often virtually synonymous with the public at large. This is done partly by taking them into the process, and partly by responding with specific measures to deal with each concern identified.

The customers of state services can be offered the opportunity to benefit directly from privatization. In companies such as British Telecom and British Gas, telephone and gas users were offered a specially reserved share allocation which would allow them to purchase a guaranteed number of shares, irrespective of how heavy the demand for shares turned out to be. In the case of the water and electricity privatizations, customers who registered not only received a priority allocation in their local water or electric company, but were also allowed to buy into the others.

To encourage people to hold onto their shares, British Telecom offered customers the choice between bonus shares or vouchers to use against their telephone bills if they retained their shares for the specified period. This policy, plus the rising value of the shares in the market, seems to have worked. Of the 2.3 million successful share applicants in December 1984, 1.41 million still held them two and a half years later, by which time their worth had risen from the issue price of £1.30 to a market price of £2.90.

The many millions who invested in the big issues including telephones, gas, water and electricity shows that the public was involved on a large scale. The number of share owners in Britain rose more than threefold over this period, leading them to outnumber trade unionists, who had been more than four times their number in 1979.

It was alleged that some who opposed privatization nonetheless bought shares because of the very attractive offers. If this is true, the personal stake they took, and the rise in its value, must at least have consoled them in their opposition. Government wisely took on board some of the alarms and criticisms which were voiced, and took steps to deal with them.

There were public concerns that privatized utilities in pursuit of profit might trim uneconomic services to outlying communities, and might jack up prices to consumers. Government responded in three ways. It specified *legislative preconditions*, it sought to introduce some elements at least of *competition*, and it established *regulatory oversight* of the newly private industries.

Legislative preconditions require the newly privatized company to perform some activities whose future might otherwise be in doubt. This includes providing full services to outlying or remote rural dwellers. This reassures the "country lobby." They might require the company to provide services for the disabled no less comprehensive than those it provided while in the state sector. They might require it to address environmental concerns. The point is that each

individual group which might have objections can be identified and taken on board.

All of the legislative requirements upon the new company to engage in and provide services which might not be profitable no doubt impose liabilities upon it which marginally reduce its future profitability and hence its value. But they virtually ensure that privatization will be popular and successful by taking account of potential opponents and building in their support or acquiescence. Similarly, by introducing competition wherever possible, the government gives future consumers not only some degree of choice, but also the benefit of competitive prices and services. There are cases where the industry can be split into competing sections, as with electricity. There are cases in which competition can be introduced some time ahead of privatization, as in the case of National Bus. There are cases in which full competition is not practical at the outset, but in which at least peripheral competition can be brought to bear.

When Telecom was privatized, the much smaller company Mercury was licensed to provide business telecommunications. This was quickly extended to domestic services, with BT itself required to permit its lines to be used by its competitor for terminal access into offices and homes. The BT cellular telephone service Cellnet faced a competitor in the shape of Vodaphone.

When there was a public outcry about telephone box payphones not functioning because of slow repairs to vandalized equipment, Mercury was licensed to provide payphones. When the seven years of the telephone service duopoly expired, the British Department of Trade and Industry decided to admit six more competitors in the first instance, and perhaps more later.

British Gas remains the least competitive of the big utilities, and faces mounting calls for the split at least between generation and supply, as was done in the case of the electricity industry. The fact is that competition is the best regulator.

The regulatory oversight which the government has chosen to allay public fears is one based on promoting competition. The assumption has been that the more competition there is, the less regulation will be needed. Public fears over price rises are allayed by the RPI-X formula which relates price increases on the rate of inflation.

Since Telecom was privatized, telephone charges have risen by 17 percent, against inflation in excess of 50 percent. Gas prices are up 20 percent since privatization, versus an inflation rate of 40 percent. Electricity charges have kept pace with inflation, and water prices can be raised by 5 percent above inflation. But both electricity and water industries have a heavy commitment to reinvestment in new infrastructure.

The regulatory framework provides a location to which complaints can be directed, and a mouthpiece which can not only express popular disquiet, but can require action to be taken. The government committed itself in 1991/92 to

raising the powers of all the new regulatory bodies to equal those of the strongest.

The combination of these three measures seems to have proved effective in disarming criticism in advance, and providing a framework which put to rest the alarmist concerns that were raised. The customers, the general public and the specific interest groups seem to have been sufficiently reassured to make opposition to privatization somewhat muted and low key. Those who could have opposed it were brought round in support by specific measures aimed at their concerns.

It is because of this approach that privatization has come so far in Britain, and has become a model for the world. The government which implemented it has carried it right through the state industries and utilities, and has been re-elected three times since it began the privatization programme.



## 4. The lessons of experience

In the course of its progress through the public sector of the economy, the British government and its private sector advisers have accumulated a body of wisdom concerning privatization, and an armoury of special techniques which make it easier to do, and more likely to be successful in attaining its objectives. No one ever suggested that it would be easy. It is not. There is, however a learning curve which can be climbed, and from the top of which the problems look easier to solve than they did from below.

One thing the British government learned early into its programme was that it made sense to employ financial specialists. While it might be possible for civil servants to learn how to package and sell companies, the learning period might be expensive. Since there are private firms which buy and sell companies every day on the stock markets of the world, it is easier for government to buy their skills than to acquire them for itself.

Government in Britain developed the practice of hiring advisers. Because the interests of the new company are not identical with those of government, it engages two sets of advisers, one for each. In addition to the financial advisers who are usually drawn from the ranks of the big merchant banking and accountancy firms, the government also engages public relations consultants and advertising specialists to help market the sale.

When the sale is to be made by stock market flotation, government will usually arrange, sometimes through its advisers, for underwriters to cover the issue. In the event of the sale failing to attract sufficient investment, the underwriters pick up the issue and place it with institutions at a later date. This means that the Treasury gets its money regardless. This was critical in the case of high risk issues, notably oil stocks.

When Enterprise Oil was floated in June 1984, the issue was under-subscribed so that only 70 percent was taken up. The remaining 30 percent was covered by underwriters, who took a loss when the issue opened at par and moved downwards in price thereafter. In the flotation of Britoil in 1982 the sale was called a failure because only 30 percent of the issue was taken up by investors. The rest went to underwriters after opening at a 20 percent discount on the offer price.

A similar result took place when government sold the first big tranche of Cable and Wireless shares after the backdoor privatization. Only 70 percent were taken, leaving the shares to open at a discount of 2 percent, which moved rapidly down to 3 percent. The point is that in all of the cases the government gained its money because the issue was underwritten. The taxpayers did not lose, the underwriters did.

The underwriters were even more important in 1987, when the stock market crash hit an issue of residual BP shares right in the middle of the sale. The then Chancellor Nigel Lawson stepped in with an innovative buy-back scheme to set a base price of 70 pence for the part paid shares. Only 2 percent took up the offer, but the underwriters took heavy losses. Lawson's sanguine view was that risks are what underwriters are paid for.

In the event, the British firms had spread the risk as is customary, but some US and Canadian firms lost heavily by keeping the risk in house. A further saving factor was the activity of the Kuwait Investment Office which took the opportunity to build up a 20 percent stake in BP, thereby holding up the share price to a degree.

One lesson learned as the programme unfolded was that advisers need not be paid at conventional market rates, since they are not doing a conventional market job. Government started by paying the going rate, and was widely criticized for giving too much to its "city friends." One feature of the 1984 sale of Enterprise Oil was the relatively low cost of the sale, estimated by the government to have been 2.3 percent of the issue.

The government was roundly criticized for paying 4.9 percent to Kleinwort Benson in the 1984 sale of Telecom, and 3.2 percent of the sale of British Gas to N M Rothschild, particularly since the latter figure exceeded £200 million. While these were on a par with city rates, the argument was that these were blue chip enterprises sold at attractive prices, and with nothing like the risk which attached to comparable private deals.

The defence was that these were unique first-of-a-kind deals, and no one could know what the risks were. Both Telecom and Gas were the biggest stock flotations in history. No one knew if the capital was out there to buy them. The argument over commission was resolved when the Treasury began the policy of holding what is now termed a "beauty contest" for each sale.

This involves the potential advisers presenting schemes to the Treasury, including price, and having the selection made between them. The competitive element has succeeded in shaving the price ever lower, as bankers try to get a toe-hold in the privatization process. By the time of the Rolls Royce sale in 1987, the fee set a record low at 0.061 percent of the sale value. Since then the "beauty contests" have become routine, and the prices are much lower than they used to be.

Critics have charged the British government with sanctioning the massive blitz of popular advertising for the utilities, in the knowledge that the TV and newspaper advertisements were not only promoting the issue itself, but share ownership and privatization in general, and the role of the Conservative government in particular. Indeed, the saturation campaign of popular advertising to sell British Gas in 1986, some months ahead of the general election of 1987, was called by opponents "the most expensive party political broadcast in history."

Interestingly, the mass advertising method works elsewhere. The sale of the state-owned National Investment Bank of Jamaica took place in late 1986 with N M Rothschild advising. Some 51 percent of the shares were made available to local investors. This constituted 5 percent of the total capitalization of the local market. There was doubt if that kind of money existed, and Rothschild's services included not only a mass promotion, but timing motorcycle runs from remote villages to see how long to allow for share applications. The success of the flotation proved that the method can work in developing countries as well as in advanced economies.

Another early lesson concerned the value to put on a company, and the price to ask for it. Many governments of other countries about to embark upon privatization programmes spend a great deal of time worrying about the right price. The lesson learned in Britain is twofold. It is that government will probably not get the price right whatever it does, and that this is fortunately not very important.

The price will not be right because no one knows what these companies are worth. Many have traded for years, even decades, without any idea of their operating costs. In most cases no proper accounts have been kept. There has been no concept of a capital account or of depreciation. If more money was needed they simply presented a bill to government and started to bargain with the Ministry or the Treasury.

Accountants can be sent in to estimate the trading position of the company, but it should be stressed that even with the world's finest accountants, these are only estimates. The only real way to know what a thing is worth is to put it on sale. The value can be estimated by examining discrete sections of the company which do things comparable to those of private firms, and which can have value assigned. This is one of the things that financial advisers are paid to do. But no one should take their estimate as holy writ. When the company comes to market they are wrong as often as not. At least their error is an informed one; the government's own error would be an ignorant one.

Certainly no attempt can be made to assign a value based on what has been "invested" by taxpayers in the past. All too often it was not invested at all, simply spent. Governments which try to use privatization as a means of recovering past investment are almost certain to fail. Privatization can remove a constant drain on resources; it may even bring cash to the Treasury; what it will not do is recover the millions or billions which have gone before.

The process of privatizing an individual state firm normally has to begin with a massive write-off of past debts. Few companies can enter the private sector carrying the crippling burden of accumulated public debts. There are exceptions, of course, as there are to most rules. When British Gas was privatized it was deliberately done so with debt, in order to restrain it from predatory acquisitive take-overs. This was a rare exception: the usual rule has to be a clean slate, a fresh start.

The fact that the price will not be right is relatively unimportant. The aim is not first and foremost to make money. This is a side achievement, and one which helps to motivate political leaders and governments which would rather reduce taxes than raise them. The main aim is to create viable private sector businesses, to place state enterprises into the domain where they have to heed the signals which their customers send them through the market. It is to make their actions directed from the bottom, rather than from the top. It is to transform consumers of public subsidies into taxpayers. It is to turn political bodies into commercial ones. The price gained is a bonus; it is not the main motive for the activity.

Given the best advice the private sector can offer, and the opinion of the experts as to what price the market will bear, government is best to aim at a premium of between 10 and 15 percent. That is, it should deliberately under-price the shares by that amount. This is designed to encourage small investors to buy the shares, at least in the event of a blue chip flotation.

It is good for government if large numbers of its citizens buy shares and perceive themselves to have gained by doing so. It means they will be more likely to do so again, and will regard the privatization programme as one which is sharing out the wealth of the country with its people.

It is good for the company to have its shares dispersed into millions of small hands rather than concentrated within a few big ones. It makes it less likely to become the target of a hostile take-over, and less likely to have to pursue the short term interests of the institutions as opposed to the long term needs of the company.

One feature of deliberate under-pricing is that it encourages investors to over-subscribe for the shares. This means that applications can be scaled down to satisfy selectively the small investors. The case of BAA with its 100 shares for everyone policy was perhaps the high point of this policy. But if only a few shares are allocated to each, millions can be satisfied with at least a small piece of the action.

The fact that first day opening prices have ranged from premiums of 90 percent to discounts of 20 percent shows how difficult it is for government to hit the target. One way of being more accurate is to sell just over 50 percent of the company to start with at the estimated price, and unload the remaining tranches in later years when a real market price has established itself. When this has been done in Britain, government has usually made more from the sale of subsequent

tranches than it did from the original flotation. This is partly because the company by then has a proven record to attract investors.

The eventual price which the company will fetch is undoubtedly determined to some extent by the corporatization, that is, by the package which is put together for sale. Government has several interests to balance. The more of a monopoly the company enjoys the higher the price it will fetch to investors, but the more political flak it will generate from consumers. The more competition is introduced, the better will customers be pleased, but the lower the price will be. The desire to bring cash into the Exchequer has been a factor in British privatization. Owing to a peculiarity of public accounting, Britain has no capital account. This means that when government invests, the cash must come out of a current year's budget. The fortunate converse of this is that when government sells, the proceeds can be spent within the current year's budget. In the peculiar parlance of Treasury language, the yield from sales counts as "negative expenditure."

In practice this has meant that by increasing its yield from privatization, the British government has been able to maintain spending without raising taxes, and even to reduce taxation by record amounts. By the late 1980s the annual revenue from privatization sales was already running at 5.5 billion each year, and it has not declined since then.

Politically this has meant that every sale has seen a contest and a balancing act. In general the consumers and the electorate have won, in that the philosophy of the government was inclined toward competition and choice, rather than toward raking in massive sums by selling state firms with monopoly status. But a balance had to be struck each time. Overseas governments face the same problems: whether to go for an easy sale and a quick one, or to hold out for one which might bring more cash later: whether to privatize as is for whatever can be brought in, or whether to attempt to restructure into enterprises with higher intrinsic value.

There are no rules to provide answers. Each case has to be taken on its own. The only rules are that you learn about it by doing it rather than by studying it, and that almost anything does better in the private sector than it did in state hands. The private sector shows a remarkable ability to cut costs and innovate, and to make profits where the state made only losses. The supposition that only profitable firms can be sold is an incorrect one. Loss-makers are bought and sold every day on the world's stock markets.

Countries with a huge programme of state industries to privatize would be well advised to opt for quick solutions in order to get a group of industries operating in the private sector and generating the growth and business experience needed in the rest of the economy. They should privatize the easy ones first. The experience and confidence gained with the early sales will enable them to tackle tougher projects further down the road.

The easy ones are usually those which do things easily recognized as similar to what private firms do. Hotels, retailers, restaurants and small bus groups are all familiar in the private sector, and relatively easy to privatize. After that the medium sized companies can be tackled, again, preferably ones which already have private sector counterparts. Then will come the time to tackle some of the big ones, starting perhaps with the state airline and the telecommunications service, both of which have now been successfully privatized in sufficient countries to provide a choice of model solutions.

The question of potential buyers has to arise at some stage. Government must ask two questions. The first is who would buy the enterprise concerned, and the second is who would the preferred buyers be. If there is the luxury of choice, government can target its buyers by a variety of techniques. It may decide that an industry would be better run as a management led buyout, or even one wholly owned by its workforce. This solution certainly solves most of the problems with labour relations. It makes for smooth cost saving operation if the workers are making profits for themselves instead of for absent shareholders. This is one reason why worker share allocations are useful even if a wider sale is decided upon.

Government has to look at the political risks. It does not want elderly grandmothers putting their savings into volatile and high risk industries such as oil or steel. By selecting a more complex method of sale and demanding a high minimum purchase, government can keep the grannies away and attract professional investors in their place. Similarly, by fixed price sales, easy payments spread over the years, and a low minimum purchase, government can sell its blue chip utilities to its ordinary citizens, secure in the knowledge that they will not turn sour on the government as a result of losing their savings.

When sale to a single corporate buyer is the only valid option, government is faced with a situation in which only one party, namely the buyer, is seen to gain. The careful balance of interest groups is less possible, and the risks are high. Given economic nationalism, the sale to a foreign buyer is to be handled the most carefully of all. It will attract less opposition if it is made clear that liquidation is the only alternative.

The difficulties faced by the US government in attempting to sell Conrail to the private buyer Norfolk Southern illustrate the difficulties with a corporate buyer. After facing opposition which stalled the sale for two years, the government finally succeeded only by changing tack and opting for a public sale instead, with worker participation.

While general principles such as these can guide those who under take the process, the experience of Britain is that each sale is different. There is no formula, only a set of principles and experience which has been acquired. This is obviously even more true of different countries with different problems and a different culture and tradition. Each must find its own methods of privatization, unique to each country and to each company.

Britain did not start with a master plan; it learned as it went along. What there was instead was a determination to change the orientation of the economy, to move more of it into the private sector, and to bring it back into the realm of events which people can influence by their choices and their actions. The skills appropriate to this were acquired along the way.

The British privatization programme succeeded because it was a pragmatic one which learned from and adapted to each new experience. It also succeeded because it took careful account of the political factors at every stage, and struck a balance between the short term needs of the government and the long term needs of society.

## 5. Internal markets — education

While state industries and utilities can be reorganized through privatization to become responsive to consumer inputs from the bottom rather than producer inputs from the top, the human services present problems on a different scale. The tradition in Britain for decades has been one of funding through taxation for services which are not charged for at the point of consumption. This is widely perceived as "free" education and "free" health services.

The intellectual knowledge that these services are not free, but are simply paid for in different ways does nothing to blunt the perception. People think of them as free. They know that the actual finance comes from taxation, but there is a widespread, if mistaken, supposition that much of this is paid for by "the rich." In fact there are not enough rich people to make a substantial difference; most taxation in Britain is paid by most people.

The problems with the human services stem not so much from their finance by taxation as from their production within the public sector. The state decided not merely to finance the needy so that they could obtain their required health and education, it went into the production of these services. By 1979 state health and education services accounted for roughly 90 percent of the supply of each. Only 10 percent of people in Britain bought private health or private education.

One reason for this is that everyone has to pay for the state supply, whether or not they choose to make use of it. This means that private users must pay once through taxation for the state supply which they do not use, and once through fees for the private service which they do use. Not surprisingly, only the well-to-do can afford such luxury. The system was thus one in which only the comparatively wealthy had choice. The funds which others might have used to express preferences and make choices were pre-empted by the state to finance the public services.

The main problem with the state services is that they were directed from the top to meet the needs of producers. Education, for example, was notoriously captured by its producers and used to make children the guinea pigs for social experimentation. In the name of a dubious egalitarianism, the high quality grammar schools were largely wiped out. These had been the traditional means for children of talent and merit to get ahead regardless of how humble their background. They were the ladder to careers in the professions for families whose wealth or birth gave them no other access. Their one failing, perhaps, is that there were too few of them. The schools which supplemented them were



not of a high average standard, and there was very much of a two tier state system. What might have been attempted was the creation of vocational schools with the same ethos and high standards as the academic grammar schools. Instead the grammar schools were nearly all abolished.

They were replaced by the huge comprehensive schools, which continued to teach according to principles which stressed neither achievement nor measurement. Despite overwhelming evidence of declining standards, and of increasing dissatisfaction by parents and employers with their output, the educational establishment of the Ministry, the local education authorities (LEAs) and the teachers' unions persisted with this trend.

The system was directed from the top, in that the tax funds available for education were directed through several layers of bureaucracy, giving the parent a free place in the local state school chosen by the officials. Typical of producer-directed operations, the quality of its product was measured only by inputs. Education was called better if it had more money spent on it, if it had more teachers with degrees, if it had smaller class sizes.

The point is that none of these factors correlates with quality. The quality of education can only be assessed by its output, by whether children can read and write and add up, by the number who pass exams, by the amount they can be shown to have learned to prepare them for life and careers. The input measures might raise the salaries, the comfort and the quality of life for administrators and teachers. What they do not apparently do is to raise educational standards in the children.

It was against this background that advocates of the voucher system had been pushing for decades. The voucher system represents an attempt to reintroduce consumer choice into education. There are several variants, but basically under a voucher scheme parents receive a voucher equal to the cost of a year's education to spend at the school of their choice. Schools are thus funded by vouchers instead of by block grants, and have to make their product attractive to parents. Thus the voucher system is designed to bring consumer pressure to bear.

The problem with voucher schemes is that no-one was able to introduce one, not even on an experimental scale in a small area. The administrators and teachers unions knew quite well that this would lead to a considerable decline in their power, and were determined to thwart any voucher scheme. They successfully ran scare campaigns whenever voucher experiments were proposed, persuading parents that they would lose their right to free education, and would be charged extra fees which they could not afford.

Of all of the attempts to introduce education vouchers in Britain, not one came near to success. The same is true, incidentally, for the same reasons in the United States. Even the presence in the early 1980s of such strong voucher exponents as Sir Keith Joseph (now Lord Joseph) as Secretary of State for Education, and of Dr Rhodes Boyson (now Sir Rhodes) as junior minister made no difference. Vouchers were resisted and firmly ruled out.

It was this defeat which led the Adam Smith Institute to conclude that vouchers, for all their theoretical strengths, had practical weaknesses arising from Public Choice theory. They threatened loss, or appeared to, to most major interest groups, and made all of their enemies simultaneously. This led the Institute to construct an alternative which would be free of these defects.

That alternative, first called the "tripod" or the "virtual voucher," rested upon three precepts. Parents must have choice between state schools; schools must be able to opt for self-government with parent governors; and finance must be allocated according to the numbers of children enrolled.

It was thought that parents would value the choice between state schools and, since education would remain tax-funded and "free" to parents, they would not fall prey to scare campaigns orchestrated to protect producer interests. There would be no point in having choice without something to choose between, so the second precept follows from the first. Schools must be free to pursue independent policies and express different approaches to education. This makes choice meaningful. The third element is crucial: it is that state resources shall be allocated according to the choices made by parents.

This is the policy which was taken to Downing Street by the No Turning Back Group of Conservative MPs and ministers, and which formed the basis of the 1988 Education Reform Act constructed and passed by Education Secretary Kenneth Baker. It is in essence a voucher scheme without vouchers. The vouchers are invisible (or "virtual") to allay opposition.

Its political strengths are that reform is gradual and voluntary in the initial stages. For parents who want no more than a free place for their child at the local state school, it is still there. The education remains tax-funded and free at the point of consumption. No school has to choose self government, no parent is compelled to become a governor. For those who prefer a comfortable status quo, it remains an option.

Yet the seeds of reform are sown. Parents who want to choose can do so; schools which seek the freedom to manage their own budgets and to pursue independent education philosophies can do so. Parents who wish to become involved can do so. And the ones who do make these choices will change the system for those who do not.

It is a voucher scheme because the effect of moving a child out of a bad school and into a good one is to transfer the state's funding along with the child. The voucher floats invisibly above the child's head, directed by the key principle: that the money must follow the child.

The one aspect of a voucher scheme which is not yet achieved is the transferability of the state funding for a child to the private schools. This was an important concession to gain the acquiescence of the Treasury. If state funding could suddenly be transferred to private schools, the first to take advantage of it would be parents presently paying for their children's education. This would

mean that the state would immediately have to spend 10 percent more on education in order to give it to the wealthier members of society. Regardless of the fairness of it, this was not practical politics in 1980s Britain.

This, then, is the essence of the internal market in education. Funds which have been directed by the decisions of administrators are to be directed instead according to the choices made by parents. Education policies which have been made either centrally at the Ministry or regionally by the Local Education Authority Committees, are to be made instead by individual schools which are locally self-managed, and with a very large parental input into the governing and decision making process.

Funding, which came by committee allocation, comes now by the school's success in attracting pupils. It must make itself attractive to parents. The only way in practice that a school can do this is by acquiring a reputation for providing a good education. Schools which impart knowledge and skills in a structured way within an orderly environment are the ones which parents have overwhelmingly preferred. The others have to copy this formula or risk going under.

The 1988 Act set these reforms in motion. Its principal measures are that it gives parents choice over the school their child shall attend. There was a theoretical choice before, but since the LEA was allowed to overrule it in the interests of what they perceived to be the "wider needs" of education in the area, it was worthless. Good and popular schools were declared to be full when they were not, in order to send children to schools the bureaucrats had chosen rather than the ones the parents had chosen.

The new act laid down very strict conditions. Parents had choice unless the school was bursting at the seams. The get-out clauses in which the LEAs had taken refuge were swept away. Choice was now a factor, and a meaningful one. This was popular with parents. Critics actually charged that parents were incapable of choosing, that they would not want the burden, and should not be allowed to "interfere" in the education of their children. Presumably it was to be left to the experts who had made such a good job of it already.

In the event parents embraced the choices eagerly, and every sounding of opinion since then shows that they like these choices and will not willingly surrender them. Overwhelmingly they choose the schools which have a reputation for imparting a high quality of education and a good grounding in ethics and social values. They choose, in other words, the schools which obtain the best results from their children, and which also teach them to be good mannered and well behaved.

The second and most controversial element of the 1988 Act is that it introduced procedures under which individual schools can opt out of the authority of their LEA and elect instead to adopt self-managed grant-maintained status, receiving its funds direct from the Ministry and by-passing the local bureaucracy.

The procedure is spelled out. The application for grant-maintained (GM) status is made by a ballot of parents. This can be initiated by two successive votes at a meeting of the board of school governors, half of whom must be parents. Or it can be set in motion by a petition signed by at least 20 percent of parents with children at the school. If more than half the parents who vote are in favour, the application goes to the Secretary of State for a final decision.

As an incentive, schools which opt for GM status receive the share of administrative spending which had previously gone to the LEA; and the LEA loses that sum. This gives each school about 15-17 percent extra to spend, providing for itself the services which it used to get from the LEA.

Schools which opt for GM status are funded according to a capitation formula based on a set amount for each child, which more for older children, and more for children with special needs. The school can attract more funds by expanding and taking in more pupils. Indeed, schools are required to expand to their capacity.

As well as the grant maintained (GM) status, there is also Local Self Management (LSM), under which even LEA schools can exercise much more control over their own budgets, and allocate resources according to their own priorities. The difference is that all grant maintained schools have to be locally self managed, but not all locally self managed schools have opted for grant maintained status.

The other element of the 1988 Act, and one which attracted a great deal of heat and a little light, was the National Curriculum. The state decided that if schools were receiving public funds to perform public work, the state was going to set down a description of what that work ought to include.

The National Curriculum consists of ten subjects. There are three core subjects: English, Mathematics and Science. Then there are a further seven subjects: Geography, History, Art, Music (until 14), a modern foreign language (for secondary schools), Physical Education and Technology. Furthermore, and even more controversially, these subjects are accompanied by regular testing at ages 7, 11, 14, and 17.

The 1988 Act thus set in motion the complete transformation of the British School system. The Baker Act was every bit as visionary and far-sighted as the famous Butler Act of 1944. Indeed, it is already being talked of by some as one of the three great Acts of British educational history (along with the Education Acts of 1870 and 1944). It sets about the systematic transformation of a system directed by administrators, local politicians and teachers' unions, into one directed ultimately by the free choices of parents. It does so by allowing choices at various points: the choice of which school to select, the choice to become a school governor, the choice for a head-teacher to lead the school into GM status, the choice of parents to initiate a ballot.

From the choices made voluntarily, the 1988 Act constructs a taxpayers' system under which funds are sent to follow in their wake. In other words, consumer choice has been made effective by backing it with resources. The fact that the

resources are tax funds from the state, rather than the individual funds of parents, makes it an internal market.

The national curriculum is there to reassure the state and its taxpayers that their money is indeed being spent on what it was intended for. Teachers are now to be examined by their product; in that instead of knowing only what is taught, we are now to find out what has been learned. The role of objective examination is crucial. While course work and teacher assessment have their value, the test of the reforms will ultimately be measured by the success they achieve in practice. They will be rated as successful only if education improves, and can be seen to have improved.

## **6. Progress on schools**

Between the passage of the 1988 Education Reform Act and June 1993, some 493 schools had achieved grant maintained status. Another 71 were about to begin operation. The Secretary of State was considering applications from a further 181, and awaiting applications from 84 schools which had voted positively in parental ballots.

Some 20 percent of all secondary schools had either held a ballot to opt out of their Local Education Authority, or were about to do so.

Although this meant that there were grant maintained schools in over half of all the Local Education Authorities, two factors were reckoned to have held back the number of schools going to a ballot. One was the fierce opposition of some local authorities, and the other was the imminence of a general election which might have led to a change not only of government, but of education policy.

The Local Education Authorities, especially the majority under Labour Party control, were not prepared to surrender their empires without a fight. They knew that if local schools opted out of their administrative powers, they would lose their ability to control education and to impose their ideology of society upon it. Many of them resisted ferociously when schools under their aegis began to move toward parental ballots.

When the governors of Small Heath School in Birmingham led the parents toward an opt out ballot, they were called "irresponsible" by the LEA. They were taken to court in an attempt to stop the vote. Parents of children at the school, which caters for a mostly Muslim immigrant population, were bombarded with leaflets from the Local Authority. The head teacher was subject to personal character attacks. Parents were threatened with the loss of everything from teachers to school meals. When the parents rallied to the school, its head teacher and the governors, and voted to opt out, there was a further legal challenge in an attempt to have the result voided.

The LEA did not hesitate to spend vast sums of public money trying to stop the school from opting out of its control. Indeed, the unsavoury spectacle of public employees spending public money to protect their public jobs was to become a familiar one. Other Labour controlled authorities were no less virulent in their attacks on schools which sought to exercise their new choices.

The message went out in plain terms that any school whose governors or parents started along this road faced a bruising battle with their local authority, a battle in which one side had virtually unlimited access to taxpayer funds to fight its case, and in which threats and delaying legal ploys would be used to the maximum.

One of the common scares put about is that once the school leaves LEA control, it will widen its catchment area in order to be more selective, and will cease to cater for local children. There is not a shred of evidence for this, and a great deal to indicate that it is simply not true. The opted out schools have chosen overwhelmingly to keep their secure roots in the community as local schools for local children.

Most school headteachers are not politicians by nature; they are there to teach and to run schools. The prospect of a vitriolic campaign of sustained abuse, with the LEA attempting to stir up parents against the school, can only deter schools from seeking to exercise their new rights. In many schools the local authority and trades unions have representatives on the governing board, who can be used as plants to stir up trouble within the school if opt out ballots are pursued. The surprising thing is that so many schools did choose to follow this course and were prepared to see it through.

The other deterrent was undoubtedly the uncertainty brought about by the general election. There had to be one before the summer of 1992, and the Labour Party was pledged to repeal the option of leaving LEA control, and to take back the schools which had already gone that way. Many schools which wanted grant maintained status decided to wait until after the election. There seemed little point in a prolonged and bitter battle if it were all to be taken from them by a victorious Labour government.

Labour's policy was basically the status quo with more resources. It was to reverse all of the school reforms introduced by the 1988 Act, and to revert to the top-down, centrally planned system administered by local bureaucracies.

The outcome of the election, which took place in April 1992, would thus determine the future shape of education in Britain. When the Conservatives were returned yet again with a working majority, many schools which had been holding back decided to go ahead. The Labour Party reacted to its setback with remarkable speed, abandoning within weeks of its defeat its pledge to take back the opted out schools.

The signs are now that Labour has been dragged by public opinion into an acceptance, albeit a reluctant one, of the reforms and the choices they offer. Moreover, because the schools which opted out early are beginning to show impressive results, other schools are anxious to follow the trailblazers down the same road. All the indications are that the opposition will not be as intense or as vituperative, now that the election win by the Conservatives has confirmed the reforms.

The numbers seeking to opt out were expected to show their big increase late in 1992. This is because Ministry policy was to advise against ballots in early Spring and Summer, but to recommend Autumn ballots when the parents of the new intake would be eligible to vote in them. These parents, whose children were just starting their school career and would be there the longest, had the biggest stake in the outcome. There is also the factor that school governors, some of whom act on behalf of the LEAs, face re-election at the beginning of the school year. This gives the school more chance to embark upon the enterprise with a united team of headteacher, parents and governors.

The figures confirmed the predicted rush to opt out. In the last quarter of 1992, some 242 schools held a ballot, more than twice the equivalent 1991 figure; and another 308 schools did the same in the first five months of 1993.

The nearly 500 schools now operating under grant maintained status, and the 350,000 pupils they represent, have come largely from Conservative controlled LEAs. Although 60 percent of all schools are from areas control led by Labour LEAs, there have been twice as many ballots in schools from Conservative LEAs. The ones which do come from Labour areas are also more likely to have been motivated by the threat of closure.

It was widely predicted by opponents that schools scheduled to be closed by their LEAs would be the ones voting to opt out and thus remain in existence. In fact only 35 percent of ballots took place with this in the background; but, significantly, it was 45 percent of the schools from Labour LEAs and only 29 percent of the schools from Conservative LEAs.

The prospect now is that large numbers of schools will begin the process of initiating a ballot, and that most of them will be motivated by the desire for more independence, more self-government and more discretionary resources, rather than by the simple desire to escape the threat of closure.

The point is that a grant maintained school controls all of its budget. It can decide its own priorities and spend accordingly. Many schools regard the LEA bureaucracy as oppressive, and consuming of time and resources. LEA rules require schools to spend inefficiently, whereas GM status gives them the freedom to seek savings in one area to spend in another. In particular, they can save in administration to spend on the school and its education.

The LEA administrative services, which include teacher training, inspection, counselling and curriculum development, are withdrawn from GM schools, and have to be contracted for and paid for instead. Many GM schools place low value on such services, and prefer to get better deals somewhere else. This is especially true concerning maintenance. Baverstock School in Birmingham had their fifth request rejected by the LEA to fix a roof leak. The estimated cost was £35,000. After opting out the school called in its own contractors and fixed it immediately for £1700.

The annual survey of the Grant Maintained Schools Centre studied 41 of the opted out schools. It showed that 88 percent had increased the number of pupils,



82 percent had increased the amount spent on books and equipment, and 72 percent had increased the number of teachers. Birmingham's Great Barr School, which is one of the largest comprehensive schools in Britain, reported that one term of GM status brought them 70 percent more spent on the curriculum, an extra five teachers, three specialized assistants, and extra music provision.

In the GM schools overall, the pupil/teacher ratio is lower than that for the LEA schools. Moreover there is considerable competition to work at them. The hostility of the local administrators and the teachers' unions does not prevent advertised vacancies receiving 50-100 responses.

LEA schools have very little control over their teaching staff. It is extremely difficult to fire a bad teacher, and recruitment has to keep to tight LEA guidelines, giving the headteacher virtually no control over the character, the composition or the competence of the teaching staff. Under GM status the headteacher can quickly stamp his or her character upon the school and its staff, replacing less adequate ones, and picking the best from a wide range of applicants.

Not surprisingly, applications for admission as pupils have also increased for the GM schools. Parents vote with their feet; they want their children to attend. Baverstock school received 530 applicants this year for its 240 places, and nearly all of those accepted live within a mile of the school. It is not unusual. The GM schools are over-subscribed because they provide what parents want: a structured education within an orderly environment. And they are local

Running parallel to Grant Maintained Status is the push toward Local Management of Schools (LMS). The LMS schools which have not yet gone down the route to opted out GM status can opt to control the greater part of their budgets, with the rest handled by the LEA. Under the government's proposals all LEAs have to allow schools to become locally self managed, and to delegate 85 percent of their funds to schools by April 1993. Many have already done so.

Once again, the opportunity to exercise autonomy is not wasted. The wasteful ways of the LEA are replaced by a more enterprising determination to get value for money and to free extra resources for the things that matter. The headteacher of Churchill Gardens School in Westminster found himself in charge of a £350,000 a year budget. When the school caretaker retired he rewrote the job specifications to include plumbing, carpentry and glazing, and assigned the accommodation to teachers instead. This saved the school between £7,000 and £10,000 to spend on higher priorities.

Local Management of Schools is giving the headteachers of the LEA schools a taste of the freedom of action which the GM schools enjoy in full. It cannot but whet appetites for the total independence which opting out brings. It is a kind of half-way house, a training station on the road to free standing status. It allows headteachers to test their ability to administer their own budgets and follow their own priorities. It can only lead to increased numbers choosing the opt out path to full independence later.

From its early successes it is already clear that opted out GM status will become the norm for British schools. Schools will choose this road in greater numbers; many are already making their first moves in that direction. It may be that the government will legislate at a later stage to put all state schools onto this footing. Certainly in its paper Choice and Diversity of July 1992 it envisaged GM schools becoming the norm. It introduced measures under which small schools could cluster together to gain GM status, and measures to curb the resistance of LEAs to opt out ballots.

The same paper promised the creation of a new Funding Agency for Schools (FAS) to administer the payment of grants to the growing number of GM schools. It also introduced the idea of Minister appointed Education Associations to take over the running of poor schools and to upgrade them and lead them toward GM status.

There is, however, a deficiency in the 1988 Education Reform Act, in that it makes insufficient provision for the establishment of new schools. If an internal market is to work effectively, there must be a mechanism under which bad and unpopular schools would have to close, and be replaced by newly started schools which provided the kind of education and environment which parents preferred.

The government did make tentative moves in this direction with the establishment of the new City Technology Colleges (CTCs). These are state schools which are free to parents and which teach the national curriculum. What they add is an emphasis on technology, specializing in high quality technical education. They are superbly outfitted with modern equipment, with the emphasis not only on technology, maths and science, but on computers and information processing and on links with industry.

There were to be 20 of these, partly funded by the private sector, and they were to add a new dimension of choice to parents of city children. There are 13 of them so far in place, with 2 more to follow soon, making 15 of the planned total.

The CTC are the antithesis of LEA thinking. They offer a specialized education to those who might benefit from it. They are quite demanding, rigorous, and disciplined. The intention is to provide an avenue and an alternative for parents of poor, inner city children. They promote diversity where the LEAs seek homogeneity. They are newly opened schools, where the LEAs are amalgamating and closing schools.

As such they are successful. There are three applicants for each place in them. This is hardly surprising since they are so vocationally oriented. They offer precisely what parents of deprived but talented children are looking for, the chance of an education which equips children for life in a modern economy and society.

They make demands upon their pupils which require and reinforce high motivation. Their children have to study 5 extra hours per week, and 15 extra

days per year beyond what normal schools require. They do not select socially, but aim at attracting committed parents from deprived areas.

It is not only pupils and parents who clamour to get in. Amid talk of chronic teacher shortages, there were 2,000 applicants recently for so advertised teaching posts in them. The ethos is that education should be interesting. Modern technical equipment is sited in unorthodox classrooms. Innovation is the norm. Students are often trusted to simply get on with assignments. Attendance levels are far higher than for LEA schools, and at least 80 percent are expected to continue schooling until the age of 18.

The problem is that there are too few to make a real impact. Each one costs millions of pounds to open, and private sector funds have not been forthcoming as was hoped. In part this is probably because they have started up when an economic recession was developing, in part it might be that Britain does not have a highly developed tradition of donations to state schools. Even when the full 20 are open, they will cater for a tiny proportion of pupils in Britain, and will never be a realistic option for most parents.

This is why attention must now turn in Britain to the means whereby the founding of new state schools can be facilitated. Many parents feel frustrated because there is often only one good school in the area. Once that is full, the other parents have no real choice except between the bad and the incompetent. What is needed now as a logical corollary of the 1988 Act is a system whereby parents and teachers can get together, perhaps with local businesses to found new state schools which can be rapidly accepted for grant maintained status.

The problem of founding new schools is not one of capital costs. Schools can start cheaply in rented premises, and capital costs are relatively easy to attract support for. It is the annual running costs which form a hurdle. Grant Maintained Status provides a solution, in that the per capita spending provided by the state would enable new schools to pay their way and prosper.

Clearly the next step in the reform of schooling in Britain has to be a mechanism under which new schools can be started small, supported early by the award of GM status, and nurtured until they grow. In this way, new and good schools will replace old and bad ones. Parents whose children have no good schools available can join with teachers to copy what the successful GM schools are doing. They can follow the same route, expanding to provide more places for local parents.

Meanwhile the schools which do not provide an education which parents regard as worthwhile will face declining rolls and be forced either to change their ways or to close. This was always implicit in the 1988 Act, and is needed now to complete the move towards an internal market. The legislation promised in the White Paper *Choice and Diversity* will go some of the way. It does introduce Education Associations to take over bad schools, with the prospect that they might be closed if they cannot be improved.

The same paper proposes that voluntary bodies will be able to propose the establishment of new GM schools once 10 percent of the area's children have gone over to GM status. It further proposes to meet 85 percent of the capital costs of such schools, leaving the voluntary association to meet only 15 percent. Once the schools are established, they will be funded for both capital and recurrent expenditure on the same basis as other GM schools.

While these measures take small steps toward making it possible for poor schools to be closed and for new GM schools to be founded, they need to do much more to make it easier for potential founders to go ahead. The Department for Education may decide to prepare and issue a guidance manual for parents and teachers wishing to start new schools.

The important aspect is that the process of recognizing new schools and admitting them to GM status must be a rapid one. While government naturally has to be assured that the per capita funds for each child are being spent appropriately for the purposes intended, they could hardly be spent worse than at some of the existing state schools which the newly founded ones would replace.

Once this is in place, the moves towards a full internal market will be automatic. All schools will eventually have grant maintained status and be independently managed. Parents, in choosing between them, will be deciding where the state's resources will be spent. Bad schools will close because of a lack of demand for what they provide, and new schools will open in response to an unsatisfied demand in the area for a high quality education.

In a few short years, and using voluntary mechanisms, the initiative will have transformed British education beyond recognition. It will have ceased to be a system directed from the top according to the priorities of the producers, and will have become instead a system directed by the choices of parents from the bottom. It will change education, and with it the attitudes that are shaped by education, including the self esteem of the citizenry. It will rank as one the most astonishing achievements ever made by a state education service.

## 7. The Health Service reforms

Britain's National Health Service ranked alongside its education system as a major tax funded provider. Like the education service it was financed out of taxation. Patients, like parents, were not required to pay anything for receiving the service. While standard charges had crept in for ancillary health items such as prescriptions and eye tests, the basic service remained completely free, and even the ancillary charges found a majority of users exempt from their incidence.

Like the education service, the National Health Service (NHS) was a top-down organization dominated by politicians, administrators and producers. The general public had few if any choices to make, and little chance of making their views felt, except through the fog of the political process in messages confused with all of the other signals which are transmitted through it.

While the NHS had many of the problems associated with state industries, it was and remains fairly popular with the British public. As with education, the public thinks of health as a "free" service rather than one they pay for through taxation. There is little appreciation that the health service costs nearly £12.50 per week for each man, woman and child in Britain, or that the amounts actually paid by working adults are at least twice that, bearing in mind that the elderly pay few taxes, and children even less.

Even more than with education, the public shows every sign of valuing and not wishing to relinquish its "free" service. Since its 1946 inception, Britain's NHS has achieved some things of enormous value. It has brought security, in that people feel that they will receive treatment no matter how poor they are, and no matter how sick they are. It has bought financial peace of mind in the sense that no one need fear that catastrophic medical needs will be beyond their financial means.

The NHS offers coverage to everyone. As with education, some 10 percent who can afford to pay twice use private medical services instead, mostly for elective and acute conditions rather than for chronic ailments. It is basically a system divided between general practitioners (GPs) and hospitals. The 27,000 GPs act as gatekeepers. Each has an average of 1,900 patients who visit, on average, four times a year. The GPs treat what they can, and refer patients to hospitals for what they cannot.

The hospitals, which were administered by Regional and District Health Authorities (RHAs and DHAs), use the services of 45,000 hospital doctors to deliver surgical and residential care. As one would expect with a politically controlled system, the NHS delivered basic help to the many rather better than it delivered massive help to the few. Thus it took care to ensure that basic needs such as mass immunization were taken care of before it started spending resources on exotic surgery. It combined a strong primary care system with lower concentrations of expensive equipment such as CAT scanners, and lower frequencies of expensive treatments than in comparable developed countries.

One of the strong points of the NHS which should not be underestimated has been its ability to control costs. The NHS is funded by 5.7 percent of the GDP, up from 4.7 percent in the late 1970s. This compares with figures of about 9 percent for France, 8 percent for Germany, and a current 13 percent for the United States. The NHS has given and continues to give a large amount of health care for its money.

Despite these good points, the NHS was perceived to be in serious need of reform by the late 1980s. Attempts to introduce greater efficiency were seen as a threat by medical personnel to their traditional independence in diagnosis and treatment. The growing input of managerial methods provoked unrest among doctors, some of whom started to use the political process to demand more resources.

The NHS behaved like a classic producer-dominated state industry. No serious attempt was made to consult patients or to ascertain their preferences. The producers delivered the health care they thought appropriate, and the public had to be grateful for it. Hospital consultants had lifetime contracts, with merit pay determined entirely by peer review, without any regard to the services they delivered. These distinction awards could double salaries and augment pension benefits.

It showed the characteristics common to most state industries, in that it was controlled from the top through layers of hierarchy and the imposition of rigid national rules. National wage agreements were the norm, for example, allowing no flexibility for areas to attract recruits by paying more. There was no way in which the system could adjust to local patient demands.

Most seriously, there was no accountability or concept of efficient use of resources. No one knew what anything cost, much less how to get better value. There were no incentives to cut costs, or to rate treatments by cost effectiveness. There were no penalties for inefficiency. Control was by cash limits from the top, with no rational way of allocating resources within those limits. This meant that health was rationed by queuing. Treatment was characterized by waiting lists, with over 1 million patients on waiting lists by the late 1980s.

All of these factors caused increasing political embarrassment to government. It was spending record amounts on health, yet receiving little but abuse and criticism. With the planned economy in retreat virtually everywhere, and state

industries starting to be privatized all over the world, here was a top-down, centrally planned system which exhibited all of the faults of the public sector and which seemed impervious to reform. The NHS was politically protected because of the popularity which it brought with the basic security it imparted.

The government's health review, launched at the end of 1987 and taking over a year to complete, examined all of the options in turn. As with the education service, the model finally chosen was one which would use internal markets to make the flow of resources correspond to the choices and the needs of those involved as consumers and suppliers.

The aim was to alter the incentive structure so that those engaged in the process, be they health managers or medical personnel, would be stimulated not only to provide the type of service which people wanted, and of a quality which they desired, but to do so in cost effective ways. The aim was, in other words, to turn the hierarchy upside down, and to make the system respond to signals from the periphery instead of to commands from the top.

This had to be done in ways which would not be seen to threaten the basic achievements of the NHS which were so valued by the public. It must continue to be free at the point of consumption, and available to everyone.

The technique chosen to restructure the NHS drew upon two sources of inspiration. It combined ideas articulated by the American health economist, Alain Enthoven, with those which had inspired the reform of the education service. From Enthoven it took the notion that the purchasing agency should be separated from the suppliers, and that there should be a tension between the two to keep costs down and efficiency and quality up.

From the schools reform it took the notion that individual units should be able to opt for local self management and full financial control, and that customers should be able to shop around and choose between such units. It also incorporated from the education reforms the voluntary element; that this kind of local independence and budgetary control should be an option rather than a requirement, at least in the initial stages.

The reforms which emerged in the 1989 White Paper "Working for Patients" wove an internal market in the NHS by combining these separate strands. From April 1991, the inception date of the new reforms, the District Health Authorities ceased to combine the roles of purchaser and provider. Instead of funding the DHAs according to the work that they did, they were now to be funded according to the estimated needs of their population. The new formula took account of the numbers within their area, and of the demographic make-up of that population. It was a system, like that which funded the GM schools, of weighted capitation.

The DHAs were now to buy services on behalf of their patients from several competing suppliers, both in their area and, if necessary, outside it. These suppliers would usually be drawn from among the local NHS hospitals, but they

did not have to be. They could be from the private sector or from distant areas. The point of the exercise is that the suppliers compete to sell their services to the purchasing authorities. If one hospital delivers a higher quality of kidney operation at lower prices, the DHAs will have an incentive to shop there.

Just as in the school reforms the principle was *that the money should follow the child*, so in the health reforms it is that *the money should follow the patient*. In selecting where to buy its health services, the DHA sends its patients to the hospitals which it chooses, and with them goes the money to pay for that work. The DHA naturally tries to get the best deal for its patients, so that it can provide the best quality and the most treatment within its allocated budget.

This means that costs must now be known. If DHAs buy, and hospitals sell, they must know the price of each treatment. In knowing the price, they learn which hospitals are efficient at that type of work, and which are not. Resources go further because DHAs will no longer be wasting precious resources by paying expensively for that which can be bought more cheaply elsewhere.

The criticism that this might cause quality to be sacrificed as DHAs try to stretch their budgets is not borne out in practice. DHAs are not required to seek the lowest cost treatment; quality is a factor to be taken into the reckoning. And it is often the case in the medical profession that quality and efficiency go hand in hand. The efficient controls which keep runaway costs in a firm grip also keep quality under a tight rein.

It will be seen straight away that some degree of specialization is likely to result, as hospitals are able to sell that which they do best. Chose operations which are done better and more efficiently at other locations should perhaps be concentrated there, with each hospital doing more of what it does best.

From April 1991 NHS hospitals could elect to have free standing status within the health service, controlling their own budgets and making their own decisions. They could opt to become NHS Trust Hospitals, employing their own staff at locally negotiated rates and conditions. They would be able to borrow capital, to acquire or sell assets, and to make decisions about what services to offer.

Just as the schools which opt to be independent of LEAs remain as state schools free to parents, so do NHS Trusts remain as state hospitals free to patients. Managers acquire the freedom to actually manage, to innovate, to be entrepreneurs. The DHAs, as purchasers, receive the benefit of efficiencies, cost savings and improvements which the Trusts pioneer. The Trust Hospitals compete with each other and with other hospitals to sell their services to the DHAs who are buying on behalf of patients.

By enabling more services to be bought for patients within a fixed budget, the NHS Trusts are supposed to shorten the waiting lists. The supposition is that now they have both the freedom and the incentive to seek innovative ways of improving delivery and keeping costs under control by eliminating inefficient



practices, they will be able to deliver more health care for the same cash, and cut into the waiting lists.

The third element of the internal market is the introduction of budget holders among general practitioners. GPs who have more than 7,000 patients on their rolls (either in a single group practice or in an association of smaller practices) can elect to receive the larger health allocation for their patients, and assume the responsibility for a specified range of inpatient and out-patient services.

The GP budget holders receive the enlarged capitation fee for their patients, and then have to buy on their behalf such treatment as they might require. They buy competitively, as do the DHAs, from different suppliers. The minimum number is set at a level believed to be sufficiently high to spread the risk factors. The original proposal was for 11,000, but this was lowered to 9,000 and then to 7,000.

The incentives are for GP budget holders, like DHA purchasers, to buy the best value for their patients. They want to stretch their budget to provide the maximum health care that it can. So they agree contracts with local hospitals and consultants who can supply services of high quality at competitive prices. Since individual patients can now easily transfer to other GPs, taking their capitation with them, the budget holders have an incentive to keep their patients satisfied.

There is now an incentive for GP budget holders to perform at their own clinics various day treatments which would previously have involved hospital referral. This is not only less costly, but is vastly preferred by patients to a hospital visit and a possible residential stay.

The reforms of April 1991 crucially alter the flow of resources within the NHS, and they alter the relationships between the various parties. Money is no longer paid for work done. It is paid on the basis of the anticipated needs of the local population, whether to the DHA or the GP budget holder. These act now as purchasers, buying from the hospitals and their consultants, among others.

Wherever the patients go for treatment, the money for that treatment goes too. There are incentives now to obtain better value because the money saved is retained by the purchaser to buy more patient services with. Under the old top-down system there would have been no benefit gained by directing the work to a more efficient supplier.

The costs of each treatment within the NHS were opaque; now they have to be transparent so that there is a basis for decisions to be made. Managers now have every incentive to examine the costs of every service provided, and to compare them with what others manage to achieve. There is competition for both quality and efficiency.

The relationship between the hospital and the consultants is changed. Trust hospitals now employ their own consultants. DHAs reach contracts with consultants acting as agents of the Regional Health Authorities. The contracts are more specific than they used to be, setting out in much more detail the work

which is required and the conditions under which it will be done. The distinction awards now have inputs by managers based on service, instead of depending solely upon peer evaluation.

The reform of the NHS thus set in motion the beginnings of an internal market, with the aim of transforming the command directed service into one which responds spontaneously to the needs and inputs of its customers and suppliers, and from the interaction between purchasers and providers.

From the government's point of view the aim is to achieve a better job with scarce resources, to secure more health services within a set budget, and to ease the constant demand for more resources without regard to the efficiency with which they are spent. It is also to depoliticize the NHS to some extent, to remove it as a constant battle ground to be fought over and made an issue of contention at every election. By giving people choices, they are given an alternative to complaint: they can take their custom elsewhere, and with it the funding which the government provides on their behalf.

The NHS reforms currently fall short of all of these targets; this is hardly surprising since they are only just getting into operation. The first wave of NHS Trusts and the first batch of GP fundholders have only had a year of experience. Many more are scheduled to follow.

One other reform should be noted, although it is not part of the internal market. The 1991 changes included a provision which gives tax relief on private medical insurance for the elderly. Those over 60 who enter or remain in private medical insurance can deduct the premiums from pre-tax income.

The theory behind it is that it gives an extra choice for the over 60s, the choice to go private. This would be very costly for the general population, but is affordable for the elderly because this is the group which proves increasingly costly to treat. By taking their demand to the private sector, they take away the burden which they would otherwise as a group impose on the NHS.

It might be argued that the relief is insignificant because few of the elderly pay much tax, and few would therefore be tempted to enter private insurance at that stage. The relief applies, however, to any taxpayer who pays the premiums for an elderly person, and could include a working son or daughter paying for a retired parent.

It is also true that retirement is the point where many who are in private insurance have to leave because they can no longer afford the premiums. Tax relief is an incentive to keep them in, and to have them consuming private resources instead of using NHS funds. This tax relief is not part of the internal market, but it does provide an extra choice for a carefully targeted group, and a choice which helps stretch NHS resources further.

When the reforms were announced in the 1989 White Paper and the 1991 Act, the Labour Party orchestrated a campaign of opposition, as it had done with the

education reforms. It did not hesitate to organize opposition within the medical profession as it had done within the teaching profession. Its policy alternative was the same: status quo with more resources, and the repeal of all of the changes. As with education, the electorate gave it no chance to do this.

## 8. Results of the health reforms

Few changes were fought more bitterly than the 1991 NHS reforms. The profession correctly saw in them a crucial shift in the balance of power, a shift which would make medical staff much more accountable for their decisions and their actions. The British Medical Association fought a sustained campaign against the reforms, but was ultimately undermined by the decision of large numbers of doctors and health service personnel to take advantage of the choices which the reforms introduced.

The Labour Party saw a two-fold threat. First, the political pressure brought to bear on the government by health service waiting lists would be undermined, as would the demand for more resources, if the changes brought about more treatment within existing budgets. More seriously, the introduction of market decisions by health service managers threatened what Labour saw as the socialist ethos of the NHS. By bringing incentives to bear, the NHS was in effect abandoning the notion of "to each according to his needs," and substituting self interest and capitalist calculation to make the system work.

The two pronged attack made every decision a contentious one. Like the opt-out schools subjected to a hail of abuse by LEAs, the hospitals which decided to take Trust status and the GP groups which decided to become budget fundholders, faced an orchestrated campaign of bitter opposition which questioned their motives, accused them of abandoning patients, and exposed them to organized demonstrations and attacks in the media.

Despite this, the reforms went ahead. In April 1991, a first wave of 55 hospitals were granted Trust status in response to their application to the Secretary of State. A further 98 joined the movement a year later, and another 139 in April 1993. Another 146 units are expected to become Trusts in the April 1994 wave, whereupon some 95 percent of NHS provision will be in the hands of Trusts. By the 1995 wave, this figure is expected to reach 100 percent.

The early results were very favourable. A survey of the first 55 Trusts was reported by *The Economist* with the words: "The reformed NHS is beginning to deliver the goods." It spoke of "striking improvements in organization and efficiency." The Trusts were reported to "have increased their workload and speeded up patient treatment, cutting waiting lists by up to a quarter." It also referred to the Trusts extending performance related pay and flexible working hours, raising their attractiveness as employers.

The year in which the first Trusts started saw a very large increase in the numbers of patients treated. Between April and September of their first year (1991), the Trusts treated 6.5 percent more patients than they had done during the same period of the previous year.

An independent survey was conducted among more than 900 patients who had been treated by NHS Trusts, and was published in January 1993. It showed that 96 percent of patients were either very satisfied or quite satisfied with the quality of service they had received. Of those who had visited the hospital both before and after it became a Trust, those who thought the overall quality of service had improved outnumbered those who thought it worse by a factor of seven to one.

From the satisfaction levels and from the number of hospitals choosing this option, the reforms are clearly popular with patients and increasingly popular with staff. Dr Lee-Potter, the Chairman of the British Medical Association Council, which opposed the reforms, reported in April 1992 that for the first time more letters were coming in to him from doctors in support of the reforms than against them.

The Trusts' ability to treat more patients within their budgets has spearheaded a major reduction in waiting lists. Between March 1991 and April 1992 the number of patients waiting more than a year for treatment dropped by half, and the number waiting for two years dropped by 96 percent. In the following year, the number of patients waiting more than a year fell by another 30 percent, and waits of over two years were eliminated entirely.

The NHS Management Executive report of January 1992, *The NHS Reforms - The First Six Months*, attests to impressive results. 80,000 extra in-patients treated, 170,000 extra day cases, and 1.3 million extra out-patients. This is clearly not the chaos and confusion of an unravelling health service predicted by the Labour Party and the professionals' lobby. What it does indicate is that a system which can respond to the signals of those involved can be more efficient than a command system which sends down orders from a remote height.

Reports from the individual Trusts add up to an impressive picture of initiatives being taken, of sloppy procedures tightened, of staff working as a team to bring better care to patients, both in terms of the availability of treatment and of its quality. These are some of the developments related in the report:

Southend Health Care NHS Trust had treated 2,500 more patients by November than in the corresponding period in the previous year. This was an increase of 6 percent. It renovated its accident and emergency department. Trust consultants now provide out-patient clinics at GP surgeries, while GPs can use Trust facilities for evening and weekend clinics.

United Bristol Healthcare NHS Trust treated 5 percent more patients than last year between April in September. Inpatients can now visit an anaesthetic room and talk to staff in advance of surgery. The Trust now runs a free bus between the city hospitals, the car parks and the bus station. They have hired a new

ophthalmology surgeon to treat those who have been waiting a long time for treatment. There are now Saturday sessions to treat 300 day cases for general surgery and urology.

The Freeman Group of Hospitals (Newcastle) NHS Trust installed the new CAT scanner which the regional budget had denied them for 7 years. By introducing lithotripsy for kidney stones they ended waiting lists for surgery in the Northern Region.

Broadgreen Hospital (Liverpool) NHS Trust opened a new £4.5 million psychiatric unit, moving care from far away and into the local community. It now runs a free car service to take frail elderly people home.

West Dorset Community Health NHS Trust now runs 24 hour community nursing. It opened a day hospital for the elderly in Sherborne, and a day hospital for the chronic young disabled in Blandford.

The Royal Free Hospital NHS Trust reduced the number waiting over a year for surgery from 560 to 13. For non-urgent orthopaedic surgery the numbers are down from 440 to 200. Waiting time for non-urgent orthopaedic appointments is down from 25 weeks to 15. It opened a new 100 bed hospital for the elderly, paid for by efficiency savings.

These case histories from the NHS Management Executive Report fill out the individual details that breathe life into the overall statistics, improved as they are. The individual cases show how enterprise and initiative was already working, only months after the reforms came into effect, to respond to local needs and to improve patient care.

The speed with which the Trust hospital idea has spread, and the regularity with which improved performance is reported, indicate that, as with the schools, there was a wealth of talent suppressed by the old system that was waiting only for the space to express itself by seizing opportunities. That talent now finds its outlet in improving the overall quality of the health service in ways in which the top down command system could never achieve. The Trust Hospitals, only just given their independence within the NHS, must already be rated a success.

Under the General Practitioner fund-holding scheme, practices with over 7,000 patients, or smaller practices which joint together to reach that number, can apply to manage their own budgets, and undertake to provide their patients with an agreed range of services. Basically the practice takes over the role normally exercised by the District Health Authority, assessing the needs of patients and ensuring they are met out of the global budget for the practice. From April 1993, the limit has been lowered to practices handling over 7,000 patients.

The first wave of practices took fund-holding status in April 1991. It consisted of 306 practices, representing 1,720 GPs, and covering 3.5 million patients, or about 7.5 percent of the population. The second wave brought the total to 540 practices, representing over 3,000 doctors, covering 6.7 million people, or 14

percent of the population. The third wave brought the total approved to 580, with many more GPs expressing an interest in fund-holding, allowing the Department of Health to predict that one third of the population would be in fund-holding practices by the end of 1993.

The actual money received by each practice is based on its previous patterns of prescribing and hospital referral, with estimated future needs included as well. The fund has to pay for the cost of staff, prescribing, and of nominated hospital services which do not include emergency treatment. The GPs reach contracts with local hospitals and their personnel to cover anticipated patient needs. In effect, fund-holding GPs operate their practices like miniature Health Maintenance Organizations (HMOs), taking care of patient needs within a global budget supplied by the government.

What fund-holding allows the GPs to do is to make decisions. They can switch funds between different aspects of patient care, seek savings from efficient management and waste cutting, and use those savings to improve patient care and services. Although the scheme is, like the hospital Trusts, in its infancy, it has also produced some impressive early gains in the volume and the quality of treatment.

The independent report *A Foothold for Fund-holding*, published by the King's Fund Institute in February 1992 and written by Professor Howard Glennerster and LSE researchers, shows that fundholders have already been able to obtain a better service for their patients. It concludes, furthermore, that all patients can be expected to gain as a result of the fundholders' initiatives.

Prof. Glennerster reported that although he himself started the project as a skeptic about fund-holding, his team's research led him to adopt a far more positive position. This coincides with the Dr David Owen's comment in the *BMA Monthly News* (Jan 1992): "Some of the strongest advocates are those who were initially most skeptical."

What the fund-holding practices have been able to achieve is the ability to do things differently, and in ways preferred by their patients. Instead of following rules emanating from a remote central authority, the GP fundholders can innovate in ways which correspond to local conditions and which meet local needs.

Many of them report progress in cutting waiting lists for their patients. Even in their first six months of operation, between April and September 1991, *GP Magazine* reported that an independent poll showed 40 percent of fundholders had already reduced hospital waiting times for their patients. Significantly, 68 percent of fundholders thought that they now had better quality control over hospital work, and 63 percent reported that fund-holding had increased their range of referral options.

The point about quality is important, not least because one of the arguments against fund-holding was that GPs would put their budgets first, and economize

by cutting quality to their patients. In practice the fund-holding GPs can control quality much more by specifications in contracts reached with local hospitals. One, for example, now requires information packs about hospitals to be sent to prospective patients.

In fact the new role of GP fundholders as purchasers has made hospital consultants much more receptive to their views. Since consultants and their hospitals now have to sell their services to fundholders among others, there is good reason for them to heed what GPs want for their patients. The new avenues of communication mean that the views of patients are taken more account of.

Not least among the achievements of fund-holding has been the local availability of services. GPs are cutting the need for their patients to travel by arranging for consultants to come in to their surgeries to perform simple procedures on the spot. This means that more patients can be treated, and waiting lists cut further. Many fundholders arrange for physiotherapists to visit the practice and provide physio therapy in the surgery. As predicted, some GPs are arranging for a range of procedures which used to involve referral, waiting and travel, to be performed within the practice.

*The Economist* reported after budget-holding started that GPs had routinely referred patients with rheumatoid arthritis to hospital-based rheumatologists. This involved a wait of about six weeks, and a cost to the NHS of £150 for each booking. Now budget-holding GPs were finding it quicker and far cheaper to do the work themselves. The patients benefited from quicker treatment and the elimination of the need to travel.

The NHS Management Executive Report published in January 1992 contains several examples of GP fundholder initiatives which succeeded in improving patient services within the first six months of fund-holding status:

GP fundholders pressed the John Radcliffe Hospital (Oxford) to include a "Patient's Charter" in their contracts for out-patient services. Amongst its features are a requirement for patients to be seen within 30 minutes of their appointment time. It now features in contracts for all purchasers, and thus brings its benefits to all out patients.

A fundholder in Lancashire wanted better response times from local pathology laboratories. The negotiations resulted in an improved transport system at the laboratory, which benefits all practices in the area.

A fundholder in South East Thames has moved referrals from the local provider unit to a neighbouring unit. In place of the previous two year waiting time for orthopaedic work, his patients now have only a three month wait.

A fundholder in Oxford region reached agreement with the ophthalmology department to do extra cases, with the money put toward new equipment to



increase patient throughput. This has already started to lower waiting lists for all patients

A fundholder in Berkshire has paid the local hospital £25,000 to treat an extra 25 orthopaedic patients. The money is being used to build a day bed unit to help all patients in the area.

A fundholder in Oxford noted duplication in X-rays between the CP and the hospital; 7 percent in cases of back pain, 18 percent in physiotherapy. This duplication has been eliminated.

There are more cases like these, in which the initiatives of fundholders have brought improvements to the care of their own patients, and by doing so have improved care for all patients in the area. This is an important point, because once again it refutes in practice one of the objections raised in theory.

It was claimed by Labour Party opponents and others that the fundholders would create a two tier system, in which their own patients would benefit at the expense of patients of other doctors. These were the same fundholders, presumably, whose patients were going to suffer as they put their budgets first and their patients second.

The record has shown quite convincingly that the initiatives of the fund-holding GPs bring general improvements in quality standards, improvements which are quick to spread to all patients. Far from suffering at the expense of the fundholders' patients, other patients have already gained substantial benefits.

In fact none of the objections raised to the fund-holding scheme have been validated by experience. Doctors continue, not surprisingly, to put the interests of their patients first. They continue, again without surprise, to make available to their own patients the benefits and improvements which they have read of elsewhere. Practical modifications to the facilities and procedures of hospitals and consultants have been employed to the benefit of all patients, and not simply to those of the fundholders who initiated them.

Thus even though the health reforms have only been in place a short time, their record is overwhelmingly one of success and achievement. The misgivings and deliberate scare campaigns have already been shown to be unfounded. The reforms have worked and are working. As they are extended, so that more hospitals and more GPs take advantage of their provisions, so their benefits will be even more widespread.

The health reforms, like the education reforms, represent a partial reform; they go only part of the way toward creating a system directed from the bottom by consumers. The education reforms, even when they are extended to cover all schools, will still leave a gap which can only be filled by procedures to facilitate the starting of new schools.

Similarly, even when most hospitals have achieved Trust status and most GPs are in budget-holding practices, there will be a gap in the effectiveness of the internal market. That gap is caused by the comparatively few choices which are accessible to the consumers, the patients themselves.

There are choices for hospitals to decide whether to apply for Trust status. There are choices for GPs to become budget-holders. There are choices for DHA managers as they shop around for the most effective way in which to exercise their role as purchasers. These choices have already improved the health service, and will continue to improve it even more. But they are essentially choices by professionals. The internal market, efficient though it is proving, is one in which managers and doctors bargain and deal with each other. It is done on behalf of patients, but it is not done by patients.

The next stage of NHS reforms, after the current changes have settled in and are seen to be functioning as intended, must be the extension of choice to patients themselves. Patients have the choice of GP, of course, and can choose to move to a budget-holding practice, or even away from one. This is made easier under the reforms. Patients cannot choose a health authority, however, and cannot themselves shop between hospitals and consultants in the public sector, as many private patients do.

Just as parents, by choosing the school for their child, now direct the public resources which drive the system, so should there be opportunities for patients to decide, by their choices, how public funds are to flow through the health service. Of course they will take professional advice. Parents do so in educational matters; and it is even more necessary where health is concerned. But having taken advice, there should be the opportunity for their preferences to be expressed by their decisions.

One of the attractive consequences of the NHS reforms is that patients are being consulted much more. Some areas have launched comprehensive surveys; others have set up "health shops" to give advice and to listen to the concerns which are expressed. While this is a great improvement on not taking notice of patient needs, it is not the same as empowering patients with the right to make decisions and choices for themselves.

It would not require major changes to the fund-holding system to build in the incentives for practices to compete for patients, to try to attract patients to their rolls by offering an attractive range of services and care. Similarly the DHAs could be given an incentive structure which made it worth their while to attract patients. Patients currently come under a DHA simply by living in its area. It should be possible to make this a positive decision by the patient to enrol, given several competing alternatives.

When patients themselves can choose which organization they wish to enrol with to handle their health needs, and by that decision pull down the government's resource allocation on their behalf, the internal market in health will be functioning fully.

Meanwhile, the start made is an impressive one. Already it has replaced the top-down command structure of the NHS with a market in which decisions made by participants ultimately determine where the resources are to be spent. The faults of the tax-funded state producer have been redressed by well-targeted reforms which critically alter the incentives within the system.

Given the level of opposition which it encountered from entrenched lobbies, the government is to be commended for the resolution which it showed in going ahead. It should also be commended for the skill which it showed in constructing reforms which ultimately succeeded because large numbers of those selfsame lobbies perceived advantages in them for themselves and for their patients.

## 9. Origins of the Charter

Privatization is a very effective means of bringing state industries and utilities into a position where they have to take notice of their customers. Similarly, internal markets can provide the basis of reforms which restructure the human services such as education and health in ways which allow their customers to influence the output. Both of these have proved very effective in Britain, and to be politically achievable in ways which other proposed reforms were not.

They raise the question, however, of what can be done with public services which are not yet ready for either of these two types of approach, or where the decision has been taken neither to privatize nor to introduce internal markets. These other public services often show the characteristics typical of state industries and services. They tend to be producer dominated and insensitive to the wishes and needs of consumers. They tend to be inefficient, to produce a relatively poor service at high cost, and are typically out of date in their equipment and attitudes.

Those industries and utilities which are turned over to the private sector are exposed to commercial pressures, and some degree of competitive pressures. They treat customers with consideration because it is in their interest to do so. Either they need to attract customers directly, or they value for commercial reasons the reputation which attaches to good customer relations.

The human services which are converted to internal markets make themselves attractive to customers because this is now the way to pull down state resources. Although still tax-funded, their ability to attract tax funds now depends upon the free choices of customers who have other options. Whether those choices are made by parents selecting a school for their children, or District Health managers and fund-holding doctors deciding where to buy treatment for their patients, the principle is the same. The service now has to be consumer directed in order to attract resources.

The problem with the remaining public services is to make them consumer directed in the absence of a private market in which customers pay with their own cash, or an internal market in which customers pay with state monies. The answer in Britain has been the Citizen's Charter. It represents the attempt to make the public services required by statute to do what the private sector does for commercial reasons.

Behind the charter lies the simple principle that the public have paid for their public services in taxation, and are therefore entitled to expect something for their money. It is accompanied by the equally simple principle that if the public do not receive the appropriate services they have paid for, then something should happen to make sure that they do.

High street stores give refunds for defective or unwanted articles. Airlines give compensation for cancelled bookings, or hotel vouchers when their lateness makes passengers miss connections. This behaviour is routine in the private sector and is motivated not by altruism, but by a desire to keep customers satisfied so they will return, and to keep a reputation for fair dealing which will attract other customers. Any who fail to pursue such policies will probably lose trade to firms which do follow them.

It is because public services receive their money in taxation, and because their customers do not have the option to take it elsewhere, that they are not required to be responsive to consumer inputs. Instead they respond to the needs of producers, who do have the ability to affect their well-being.

The Citizen's Charter represents the third wave of the initiatives to transform a top-down command society into one which receives and responds to signals from its participants. The Charter uses legislation to induce the consumer responsive behaviour which is characteristic of the private sector, and which is replicated in the operation of internal markets.

The Charter starts with the assumption that the public services represent a contract with the public. In return for their taxes they are to receive services. This contract, if present at all in state-run public services, is implicit. It contains no enforceable clauses, and sets no standards by which performance is to be punished for not keeping his or her side of that contract by paying taxes, but the state service is under no compulsion to deliver anything in return, and cannot be punished for failing to do so.

The Charter makes that contract explicit. It starts by asking of each public service just what it is supposed to be doing, and what the public is entitled to expect of it. It then introduces procedures under which that level of service will be delivered, and sets up redress mechanisms to which the public shall have access in the event of default.

In other words, the Charter spells out what the citizen is entitled to under that previously implicit contract, and proceeds to make it enforceable. An understanding is replaced with a specification. A weak moral obligation is replaced by a strong legal one. The Charter revolutionizes the relationship between the citizen and the state by turning it into one of explicit and enforceable contract.

The social contract once beloved of political philosophers had at least two major weaknesses. It was unspecific, and it was single. It was unspecific in that it did not set out in detail what the citizen was entitled to receive in return for

allegiance and discharge of obligations. Being unwritten, it did not contain enforceable promises. It gave the citizen no basis for action in the event of non-performance by the state, save perhaps the dubious advantage of feeling that resistance was morally justified, albeit ineffective. Citizens who tried to secure performance from the state soon discovered that unwritten contracts are not worth the paper they are not written on.

A second weakness was its singularity. It was one contract, and therefore represented a take-it-or-leave-it package in which everything came together. Indeed, the option of not taking it was hardly a viable one, given the state's monopoly of power. It is as if we had to buy all of our goods together in one package from one store. We would hardly have much control over any individual item. Fortunately we buy different things in different places, and reach different agreements with each seller. We pick and choose, and can be satisfied with most items and yet pursue disagreements with the suppliers we feel have failed us.

The Citizen's Charter replaces the one vague and indefinable social contract with a series of specific and enforceable contracts, one for each public service. It spells out the state's obligations in detail, area by area, and sets up mechanisms under which citizens can exercise rights in the event of non-delivery. It thus represents a revolutionary redefinition of the relationship between citizen and state. It gives the citizen the means to secure compliance which the state has always enjoyed. In doing so it redresses the balance between the two in favour of the citizen.

In practice this means a complete reappraisal of public services, area by area. Each one has had to examine what its purpose was, and set out what it aimed to achieve. For many of them this was the first time they had ever thought about what their end product should be. Each one has had to institute an independent monitoring procedure to measure its performance objectively. There would be little point in having public services give their own evaluation of how they performed. The measurement has had to be such as can command public confidence.

Finally, each service has had to introduce some system of redress when it falls short of the standards it has committed itself to achieve. In some cases this involves compensation being paid to members of the public. In some cases it means opening access by the public to alternative services. In some cases it means that remedial procedures kick in automatically in the event of a specified shortfall.

The principle is that the public services publish the performance targets to which the public is deemed to be entitled. There is procedure for these targets themselves to improve as the charter programme develops. A system of independent measurement is agreed, and a set of procedures is established which come into play when the service output falls below the published targets to a specified degree.

The three points, of targets, monitoring and redress, have in turn entailed others. For example, the public services in setting their performance targets, have had to consult with members of the public to discover what would be expected of them and what would be thought reasonable. In many cases this has been the first time that it even occurred to the services to find out what their customers thought. The market research, which comes routinely to the private sector's pursuit of satisfied customers, never entered the awareness of the public services.

The public services have also had to put in place management systems to enable them to exercise sufficient control over their output. They have had to establish information systems which would continually tell them what was being achieved, in order that performance could be modified to secure the required output. Again, these are routine in private firms. In Britain's public services they are a revolutionary innovation.

These changes, made in detail throughout the public sector, represent a massive effort. Every single area of the state's activity has been required to issue its performance targets, and to specify the mechanisms by which it intended to achieve them. It has had to set in place a process by which its achievement could be fairly assessed, and to indicate in detail the procedures which would be followed whenever it failed to reach its announced goals.

Each service has had to show what steps it has taken to consult with its customers to determine their needs and preferences. It has been required to say how it intended to motivate its own personnel toward the achievement of performance targets and customer satisfaction.

The entire public sector of the economy has been converted into a series of specific and enforceable contracts to which the public services are bound. The whole culture of the public sector is thus in the process of change. It is being transformed from being an arm of government, from obeying its directives and doing its work, into a customer service operation which picks up signals from its customers and responds to them.

For all of the weaknesses which the system of state production imposes, the personnel are for the most part dedicated public servants who know how to respond to a strong lead. The emphasis has now shifted over to one of consumer satisfaction and, given that clear directive, the public services have been responding in some innovative and imaginative ways. Many of them have responded by studying what it is that the private sector does to satisfy its customers, and introducing equivalent versions into the public sector.

Of course, the private sector does this to augment profits. It seeks satisfied customers so there will be more customers, more revenue and more profits. It keeps costs low and efficiency high so it will not go bankrupt by losing trade. The public sector knows no such motivations; if it is to achieve similar results, then equivalent incentives must be put in place to encourage its personnel to aim for similar achievements.

Performance related pay is one such mechanism, and one which featured prominently in the government's White Paper which introduced the Citizen's Charter. If the public services are to have an incentive to hit their performance targets, one way is to have the pay of those involved directly related to their ability to hit those targets.

This is light years away from the traditional "merit bonuses" which have characterized the public sector. The latter have little to do with merit and quickly become institutionalized as entitlement. Performance related pay, on the other hand, is to be related not to the inputs by which the public services have always measured themselves, but to the outputs which alone are of interest to customers. The Charter is in the process of changing the complete orientation of the public sector away from the producer and toward the consumer.

Opposition to the Charter has generally taken the form of skepticism. It is, after all, difficult to oppose such worthy aims as giving improved services and value for money. Among the general public there has been a good deal of reserve. They do not believe that the public services, after treating them with indifference or contempt for decades, are suddenly going to become courteous and attentive. Yet they overwhelmingly approve of the attempt, and wish it well.

This type of criticism can only be answered in practice. Suspicion of the public services is inevitable, given their record of behaviour. Only when members of the public see clear evidence of a changed attitude and of better services will they believe that the switch to explicit contracts can bring the promised benefits. As the various charters take effect, the public begin to see the benefits at first hand. They support fixed appointment times with public servants; they like a maximum 30 minutes of waiting time; they approve of information being made public; they favour the new attentiveness to their concerns. This is an argument which will be won or lost in practice, not in theory.

A more philosophical criticism is based on the notion that only privatization can solve public sector problems. The argument is that private firms are responsive to customers only because they have to attract cash, and because they fear bankruptcy. Public services which are funded from taxation, whether or not there are internal markets, will never behave like private firms because they will never need to. Since the cash is assured and they can never go broke, the incentives are simply not there.

This criticism largely misses the point of internal markets and the Citizen's Charter, which is to supply alternative incentives that replicate to a degree the conditions of the private market. While it will never be quite like a private market, it might be sufficiently similar to induce a similar behavioural response.

The resources might come from taxation, but if it is consumer choices which cause them to flow, then there will be an incentive to satisfy consumers. The service might not make profits from its consumers, but if the pay of producers depends upon consumer satisfaction, then they might treat consumers with no less consideration.



In any event, the Charter does not pretend to be a substitute for privatization and competition. These are among the mechanisms which help it to function. The White Paper promised more of both of them, as well as greater use of private firms under contract to perform public work. Part of its programme calls for choices to be introduced for public service customers wherever possible, and for competition in production to be brought in.

If more privatization is the aim, it will certainly be easier to implement if the public services are already behaving like private firms. Competition and choice are part of that similarity. A system of finance which couples the resource allocation to consumer preferences is another. Once services have to bid for public custom in a competitive situation, and gain resources according to their success in doing so, they have moved a long way toward the conditions which prevail in the private sector.

The Charter also attempts to tap into the pride which public servants want to take in their work. Most people in public services are motivated; they want to do a good job and serve the public well. They have for a long time been the prisoners of a system which neither encourages nor permits the easy exercise of those desire. Now the Charter is changing the situation, making excellent service the goal, and rewarding it financially.

Private firms often seek internal motivation by schemes which reward effort and achievement with recognition as well as with cash benefits. They run "employee of the month" awards, and honour the branch which topped the league table. The Charter has adopted the same ethos. Its coveted "Chartermark" will only be awarded to services which have achieved excellence in public service.

Only 50 Chartermark awards will be made, given on the basis of evidence that the service consulted its customers, provided clear information about standards, gave courteous and efficient service, and attained its targets. Independent validation is required for these achievements, and the awards will only be made for exceptional service.

The idea behind the Chartermark is to foster an esprit de corps within public services, such as private firms try to encourage, so that pride and a sense of achievement motivate people to give better service to their customers. The huge difference which the Charter has made is that the public services now know just what it is they are trying to do. It is spelled out in the contract they have with the public.

It is a small feature of the Charter that name badges are required wherever possible within the state services. The psychology is very straightforward. When people dealt with officialdom, they felt they were up against a large, faceless and impersonal organization. It was one which kept its procedures opaque and complex. It was not user-friendly.

The use of name badges, and the practice of giving names over the telephone, allows members of the public to deal with an individual. The person concerned behaves differently when their performance will be assigned to their own name, rather than attributed to the machine whose nameless cog they are. Name badges go with the new culture of accessibility. The public services publish information about themselves and their standards. They give customers the benefit of easy-to-use complaints procedures with maximum response times. The fact that they also identify their staff is part of this culture change. Customers now have the right to know who they are dealing with.

## 10. The individual charters

Most of the charters for individual public services were published between the Autumn of 1991 and the Summer of 1992. The services covered are as diverse as the Benefits Agency, HM Customs, and the various public services pertaining to Scotland, Wales and Northern Ireland. The charters varied quite widely in quality, and in the degree of customer-consciousness which permeated their thinking.

This might be expected with a new enterprise in which each department was preparing its charter without much knowledge of what others were doing. As the charters are renewed and amended each year, they are expected to show more coherence and uniformity as they learn from each other, and begin to emulate the best ideas and build upon successes gained in other fields.

The government's chosen method of co-ordination was to establish a civil service Citizen's Charter Unit in the Cabinet Office, and a Citizen's Charter Panel of people from outside government to advise them. These two bodies were later incorporated into the new Department of Public Services and Science. Draft charters, initiated from within the departments responsible for each public service, were submitted to the Unit and the Panel, and were amended after a two-way process of discussion and suggestion.

The Charter Unit and its advisory Panel oversaw all of the individual charters, and were therefore in a position to pass on useful suggestions and innovations. Such homogeneity as did emerge owed a lot to this co-ordination process. It is significant, for example, by how much the proposed charters were improved between the first drafts which were submitted and the final versions which were published.

The decision was taken early on that each charter should be "owned" by the public service concerned. That is, instead of having outsiders attempt to impose on them some idea of what they ought to be doing, the service itself should be putting forward the ideas for improvement and accountability. In this way each service would have a commitment to implement the ideas which it had volunteered itself.

It also meant that the standards which eventually came forward were based on a knowledge of the operations of the service concerned, and in awareness of its limitations. Those responsible for drawing up the proposals for individual charters found a series of questions began to emerge which were common to all of them.

Had they, for example, taken any steps to consult their customers as to what the standards ought to be? Market research takes time to initiate, so some departments established as best they could in the short time they had available what the public expected and required of them, and took steps to incorporate detailed public consultation into the setting of future standards.

Were there in place the management systems which would give them the information which their charter would need, and would enable them to control their output through a chain of command? If what was delivered were to correspond with what was promised, there needed to be the management controls to achieve this.

Was there a satisfactory mechanism to measure what they actually delivered, and was it one the public would trust? Was there easy access to information by the general public, and was it written in plain language which was easy to understand? Were there easy-to access complaints procedures available to members of the public? Were there clear commitments on how members of the public would be dealt with, including maximum response times to letters and telephone calls?

These questions were asked not only because the answers mattered, but because they conveyed a sense of culture change which was required. Services now had to rethink their entire operations, and they had to start from the point of view of the customer. It would have done little good to have each service setting forth what it wanted to produce.

The Prime Minister, John Major, whose own experiences as a young man dependent upon public services had provided much of the impetus behind the Charter, called a special Cabinet seminar on the subject. The Secretaries of State, the Civil Service heads of department, and the Charter Panel and Unit met in January 1992 to review progress on the Charter and to plan ahead. The format required each Cabinet Minister to speak for five minutes on his or her own departmental charters, to answer questions, and to announce what new progress was planned.

The format required performance. Having to perform in front of their colleagues meant that each minister wanted their department to have something to say. The question period enabled shortcomings to be highlighted for future attention. And the requirement for new progress made it clear that the Charter was to be progressive; each year was to represent an improvement upon the last.

To emphasize the performance requirement even more, the seminar was made a six monthly event. Within each department, therefore, the seminar became a

fixed diary event, something to be prepared for. It provided an incentive to get things done, and to make progress which could be announced at the next seminar. Each department now had a team working on making their public services sufficiently accountable and customer oriented to merit not only a respectable charter, but a respectable showing at the next seminar.

While more than 30 individual charters were to emerge from this process, many were of such limited scope and interest that they would not have a major impact upon the public. While justice policy for Scotland is important, it cannot claim to affect the daily lives of large numbers in quite the way as do the railways, the health service or the schools.

There was a perception in government that the general public's faith in the principle of the Charter might well hinge upon its performance in the big areas which most citizens make use of during the year, and in which there had been widespread concerns expressed in recent years. If the Charter could bring visible improvements in these areas, then it would have proved its worth to the general populace, as well as to government.

Three main areas were identified in particular. They involved the "three Ps," passengers, patients and parents. If railway users, health service patients and parents of school children could see their respective services begin to be transformed by the Charter, then it would have established its value. If these three services could become consumer oriented, then the ability of the Charter to change the culture of public services would be confirmed.

Two of the three, namely the NHS and the school system, had been recently transformed by reforms which began to restructure them with internal markets. In the case of education these reforms themselves promised to make the schools direct their output according to what consumers wanted. In the case of health they promised to use resources more efficiently by making them follow choices made by the participants.

What the Charter was required to do was to make each service conscious of its customers, to appreciate that public funding was part of a two way contract, and to have it recognize and fulfil its own side of the obligation. In short, they had to start putting customers first.

The third of these "three Ps," the railways, was already set for privatization, in a manner to be unveiled in a forthcoming White Paper. The combination finally chosen was that of a separate track authority, the award of franchises to private competitors, and the sale or lease of most stations. This would take time to implement, and in no way removed the need for a charter

The precedent was thus established that the Charter was not an alternative to privatization: it might in some cases be a precursor to it. It was certainly clear that a British Rail which took its customers into consideration and which laid down its own performance standards, would be easier to privatize than one

which did not. As already pointed out, private firms behave in this way for solid commercial reasons.

It was always known that the rail charter would be among the most difficult. The railways had been under-capitalized for many years. Making huge losses which consumed subsidies, the railways were practically unique in not subsidizing commuters into the capital city. Passengers were required to pay full cost fares, unlike those of comparable countries. More even than other public services, British Rail had to make do with antiquated equipment and rolling stock on some of its routes. The modern Intercity service with its 225 kph electric trains contrasted with some of the Network Southeast lines which were still using 1930s rolling stock.

Heading the list of complaints about BR services were those concerning late trains and cancelled trains. Again, some lines were affected more than others; the infamous London Tilbury and Southend service was known as the "misery line," and some of its long suffering passengers had even attempted legal action against British Rail. It could be added that lack of information, combined with staff attitudes which seemed to regard passengers as an unfortunate inconvenience, gave the classic impression of a producer dominated service.

The Passenger's Charter took longer to produce than most, and was one of the last to appear. For the first time it published performance targets on punctuality and reliability. For its Intercity services, punctuality meant 90 percent of trains arriving within 10 minutes of the scheduled time. Reliability meant that 99 percent of advertised services would run.

For the Regional Railways, the same standards applied with the additional one that 90 percent of short distance trains were to arrive within 5 minutes of the scheduled time. For the third business, Network Southeast, there were separate standards for each of the 15 service groups. Wisely, BR set low but achievable standards for the notorious London Tilbury and Southend line, aiming at 80 percent of trains arriving within 5 minutes of schedule, and 97 percent of advertised trains to run. This was the lowest of all service levels, but still represented a considerable improvement for passengers if it could be achieved.

British Rail backed up their promises with redress for passengers if they failed. If during the year punctuality was 3 percent or more below target, or reliability was more than 1 percent below, then a 5 percent discount would be offered to season ticket holders. If both were off target, the discount would be 10 percent.

For individual journeys, BR offered vouchers equivalent to a 20 percent discount if any leg of the journey were delayed more than an hour. An immediate refund would be available if the train were delayed or cancelled and the passenger decided not to travel.

BR also announced maximum waiting times at ticket offices of 5 minutes at busy times, and 3 minutes at off-peak hours. Staff would wear name badges, and all managerial pay would be related to performance. They made specific pledges to

consult their customers, to ascertain their opinions and their requirements, and to keep them fully informed of what was happening. This point alone would do much to relieve passenger disquiet and frustration if it can be delivered.

BR made additional pledges concerning the availability of seating and about the booking of seats and sleeper compartments. They also instituted procedures to make complaints easy and straightforward to make, with forms at stations and notices on trains. Significantly, those who now travel on trains hear BR announcers referring to them as "customers" rather than "passengers."

The Passenger's Charter illustrates an important point about the whole charter process. It is not about high sounding promises which are empty of substance. It is about specific targets which are within reach, and about redress mechanisms when they are not achieved. The British Rail performance targets might sound limited, but they are attainable, and are backed up by compensation procedures. Far better, it was thought, to have limited targets which can be achieved than impressive sounding ones which cannot. British Rail customers are certainly getting more than they ever had before, and BR is learning about its customers ahead of its own future privatization.

The second of the big three charters is the Patient's Charter for the National Health Service. This had a somewhat easier job to do, in that public opinion of the NHS remains high, and the government has spent heavily putting extra cash into the NHS and introducing the internal market reforms to spread improvement in their wake.

Nonetheless, there were specific grievances which market research identified. People thought the waiting lists were too long. They felt they were well treated, but kept in the dark about what was going on. There was almost a cult of expertism, which assumed that treatment was not really the concern of patients. And there was disquiet at the attitude of some consultants, who would typically arrange for a dozen or more patients to have identical appointment times, then simply keep them waiting.

The Patient's Charter confirmed and spelled out the existing rights which patients have under the NHS. These include the right to be treated regardless of financial circumstances, the right to a GP, to emergency care, to be referred to a consultant, to have access to information and records, and a choice of whether to participate in research and training.

Three new rights were added. One is the right to information on local health services, including quality levels and waiting times. A very important new right is the guarantee of treatment within a maximum of two years. Two years sounds a lot, but most patients are in fact treated within six months, and the overwhelming majority within a year. There were, however, some who waited with much longer delays, and for the first time the NHS committed itself to a specific deadline. The third new right was to have any complaint investigated and to receive a full and prompt written reply from the chief executive or general manager.

Within a few months of issuing its new charter, the NHS began to improve it. The two year maximum wait was reduced to 18 months for specific conditions, with the announced intention to reduce it to that level for all conditions within a further year, and with the intention to reduce it to one year for all conditions within the life of the current parliament. This is the progressive nature of the improvement the Charter is supposed to bring.

In addition to the rights, old and new, which the Patient's Charter spelled out, it set out National Charter Standards which, although not yet legal rights, are the standards which the government expects the NHS to achieve as circumstances and resources allow. There were also Local Charter Standards left to individual health authorities to publish.

Among the National Standards including respect for the dignity and privacy of patients and supplying information to friends and relatives are some specific pledges. These include the arrival of emergency ambulances within 14 minutes of being summoned in an urban area, 19 minutes in the country. They include being seen immediately for treatment assessment in accident and emergency departments, and being given a specific appointment time as an out-patient, and being seen within 30 minutes of that time. There are other pledges relating to non-cancellation of operations, and the assignment of a named qualified nurse, midwife or health visitor for each patient.

The Patient's Charter also pledges that patients will be consulted for their opinions, and will have access to the widest possible information about health services. The Local Standards specify name badges for staff, and waiting times after treatment has been assessed, and before being taken home.

All in all the Patient's Charter was seen to offer significantly better treatment to patients, and to show evidence of a significant change in attitude on the part of NHS personnel. What is particularly good about it is the way in which the NHS have already started to improve it. In other words, they correctly took the view that the Charter was only their opening bid. The services which it specifies will be upgraded in quality in subsequent charters. Patients can only benefit.

The third of the three Ps is the Parent's Charter. It is unlike any of the other charters in that most of the new rights it gives are rights to information. With choices already given in the 1988 Act to establish an internal market in education, the Charter concentrates its measures largely on helping to make those choices effective ones. It is also unusual in that most of its important provisions required changes in the law before they could be implemented. The Charter itself therefore included a list of what the new rights would be if the law were to be successfully changed.

Under the Parent's Charter all parents are entitled to a written report annually about their child. It must include the child's performance in the national curriculum core subjects, and the results of the national tests taken at 7,11 and 14. Other exam and test scores must be featured, as must the child's progress in



other subjects taught. There must be an attendance record, and a comparison of how the child is doing compared to other children of the same age.

The Charter also pledges more regular inspection of schools by new independent bodies. The inspections will not only include at least one non-specialist, but will feature an open meeting at which parents can talk about the school. These reports will be published, and parents sent summaries which spell out the school's strengths and weaknesses. The school will be obliged to act on the report, and to tell parents how it intends to do so. Prospective applicants for school places will be able to receive these reports, and summaries of them must be included in the school's prospectus.

League tables have been published, giving comparable information about all schools in the area, and details about how to obtain information from each school. This includes examination results and truancy rates, and the numbers going on to university or college or into employment. Schools are required to supply certain classes of information to parents of pupils and prospective applicants.

The charter confirms the existing rights, including choice of school, the right to become a governor, and the right to initiate and to participate in a vote to opt out of Local Education Authority control. It spells out the procedures which can be used in the event of complaint or dissatisfaction, and specifies the rights which parents shall enjoy in the event of disputes with the school or with the LEA.

Many people, looking at the rights to information enshrined in the new charter might express some astonishment that those rights were not already enjoyed. They might wonder how any parent could take a meaningful interest in their child's education, or make any sensible choices, without such information. This is the point. Parents were not expected to do either of these activities. The education system was so producer dominated that it deliberately withheld this kind of information precisely because it did not want parents to act upon it.

The Parent's Charter, like the internal market reforms which preceded it, is an instrument of change. Its purpose is, like that of all of the charters, to transform a producer directed service into a consumer directed one. The education charter is unique, in that while the mechanisms had already been introduced, they were wanting the access to information which could make them work. In supplying that access, the Charter tips the balance in favour of the consumers.

Thus on all three of the big charters, those affecting passengers, patients and parents, there is an important shift in power away from producers and toward the consumers. All three make an important start in reorienting their public services to serve their customers and respond to their needs. It is important to stress that this is only a start. The Citizen's Charter is progressive; each of the individual charters will improve year by year, tightening the ratchet on consumer rights and redress until a quality of service is provided which is generally agreed to be the best possible.

The Charter therefore takes its place alongside the two other initiatives: privatization and internal markets. The three policies, pursued systematically, all have something to contribute to the process of reorganizing society so that it is directed from below. Each has a role to play in replacing the centrally-directed order with a spontaneous order. Each is a part of the process of ensuring that the shape of society and its services shall be determined not by the decisions of those in authority, but by the interaction of the citizens as they express their preferences by the choices they make.

## 11. Reshaping the bureaucracy

One of the most dramatic and far-reaching reforms is also one of the least visible. It represents the most fundamental overhaul of the Civil Service seen this century. Whereas privatization, internal markets and the Citizen's Charter all have a direct impact upon the public at large, the restructuring of the bureaucracy has its most immediate effects upon the machinery of government itself. The general public only see its impact indirectly, in terms of improved and more efficient services, and of smaller claims made upon the public purse.

The British Civil Service is widely admired internationally. It is regarded, correctly, as incorruptible. Its members cannot be bought, and pursue public service as their tradition sees it in a dedicated manner. For comparatively small financial rewards they carry out the policies of state. Except for a very few high flyers, the majority settle for the satisfaction of the job itself, and for the occasional honours which a grateful monarch bestows through the patronage system.

Its reputation overseas has been coloured by the comedy series *Yes, Minister* and *Yes, Prime Minister*. They show another side to the Civil Service, that which seeks to preserve their hold on policy, and to thwart the attempts of politicians to introduce changes of their own. The popularity of the series in Britain with both legislators and bureaucrats owes much to the kernel of truth, albeit highly exaggerated, which the series contains.

In reality the criticisms of the bureaucracy have been more mundane. It lacked the management structure and incentives of private business. There was little incentive to spend effectively. The attempt was usually to protect the budget and to ensure it was spent within the financial year. There was no concept of capital values, or any notion of return on capital.

The hierarchical structure descending from the permanent secretaries at the top was such that managers at a lower level had no scope to assume independent responsibility, or to take innovative decisions. Everything had to be referred up, and the ultimate subservience to political control meant that the tendency was always to play safe. The desired results were the ones which did not cause trouble or arouse controversy.

Pay and promotion depended heavily on seniority rather than on any evident ability. Importance and salary were related to the size of the department, and the number of employees under an officer's control, rather than to their value to the organization. There was thus a tendency to both "empire building" and time serving. It was also characteristic of the bureaucracy that it was driven by rules. The safest option for underlings was to follow the rule book.

None of these criticisms related to the quality of the staff. On the contrary, recruitment policy ensured a constant supply of highly capable people. The problems were with the system which produced these effects. That system was also cumbersome. Civil Servants were employed as such, and with appropriate rank and remuneration, regardless of the amazingly diverse range of tasks which were included within their ambit.

At the upper levels, Civil Servants advised on policy. At lower levels they might be trying to detect illegal immigrants at airports, testing vehicles and issuing licences, or paying out social security benefits. They even ran conference centres and pathology laboratories. The finance for most of this came from budgetary allocation. Those who took the decisions on the ground did so without reference to the budgetary effect, except insofar as there was a general desire to stay within the budget. The budgets tended to increase each year, since each started with reference to the previous one.

In 1982, after three years of the first Thatcher administration, an initial step toward reform was taken with the Financial Management Initiative. This basically tried to give management the financial responsibility for their actions. The ability to take decisions was to be matched by the ability to commit resources. It was a step towards implementing a recommendation of the 1968 Fulton Report, which had advocated setting up management units to cover activities which could be grouped together.

The major reforms had their origins in the high level study of the Civil Service begun late in 1986 by Sir Robin Ibbs and a small Efficiency Unit set up for the purpose, and including people from business and industry, as well as from the Civil Service itself.

By then the Thatcher government's drive to reduce the burdens of bureaucracy had cut Civil Service numbers by nearly one fifth, and had saved more than £1 billion of public money. But the Efficiency Unit concluded that the only way to achieve major cost savings and efficiencies was to break up the bureaucracy's unified management structure. What they proposed was delegating the functions of the Civil Service into discrete units. These units would have independent management with full delegation of responsibility. They would have clearly delineated boundaries, and would be responsible for carrying out the functions which they encompassed. They would be rather like separate private corporations, but would remain part of the public sector for the time being at least. They were to be called Agencies.

The first and most radical proposal was to concentrate on what government did, rather than on what it was. The agencies were to be based on functions judged by output. That is, they would be created to perform specific services for the public. They would be geared, not to the convenience of government and its bureaucracy, but to the needs of their customers.

The second was that they would have to be autonomous to a large degree. Only in this way would they take direct responsibility for the service they provided, and earn praise or blame depending on their performance. The old habit of passing responsibility up the line was to cease. The clear boundaries of each agency would make it clear where responsibility lay, and who carried the can. The personnel would be encouraged to take a pride in what they did, firstly because they and they alone were clearly responsible for it, and secondly because their rewards and promotions would depend upon how well they did.

In practice this would mean having a chief executive in charge of each agency, just like in a private corporation. He or she would have power of independent management, including the ability to determine rewards and promotions. They were to be the visible embodiment of independent responsibility. They were to be directly responsible to the Minister.

The changes proposed by the Efficiency Unit were indeed revolutionary. The Civil Service was to become a core surrounded by independent agencies, each performing work according to policies guidelines set by the Minister, and with the resources allocated to them. They were to be free to spend those resources in whatever way they thought most appropriate to the efficient delivery of each designated service. Each chief executive would have the power of independent management.

A clearer idea of what was proposed can be gained if one thinks of the Civil Service being broken up into independent agencies, each of which operated under contract to do the work allocated to it, and within the global budget specified for each of them. They would be quite similar to private firms performing government work under contract. The price would be set, the work agreed, and then it would be up to each to decide how the work could best be done, and what management structures were appropriate to the efficient discharge of the contract.

The comparison was made closer by the specification of the Efficiency Unit that top executives for the new agencies were to be recruited from the commercial and business world, as well as from the Civil Service. The proposal would indeed herald a revolution in the bureaucracy. When the report was put forward in 1987, its title *Improving Management in Government: the Next Steps* gave a new name to the initiative. Henceforth it was to be called *The Next Steps*.

Following that report, the decision was taken to begin with those Civil Service functions which were already separated off to some extent from the main body of the bureaucracy. There were already distinct activities calling for specialized skills, such as, for example, the Vehicle Inspectorate, which tested road vehicles

to ensure that they met safety standards. During 1987 an initial list was compiled of the activities which would become the first candidates for agency status.

The first question to be asked was "should the activity be done at all?" There were some Civil Service activities which had been carried out simply because they had always been carried out. Now the value was called into question, and in some cases it was determined that the activity was unnecessary and should cease.

The second question was "assuming the activity should be done, should government be doing it?" This covered quite a wide group of activities which could be performed perfectly well in the private sector as commercial undertakings. In some cases the government activity was in competition with the private market, and could itself be turned into a private company. In others it was an activity which, although traditionally performed by government, could easily be transferred to a private market. Where the second question was answered in the negative, the decision to privatize was taken.

Agency status was not assumed to be an automatic bridge to the private sector. In some cases it would be, and in others the new agency was expected to remain in the public sector. Where privatization was indicated, it was thought advisable to say so at the outset, even while organizing the move to agency status. In other cases the future status was left unchanged and undetermined.

The key problem to solve was how to combine the maximum flexibility and independence for the managers of the new agencies, while keeping tight Treasury control over public expenditure. The Treasury and Civil Service Select Committee of Parliament recommended that the new chief executives should be designated Accounting Officers for their agency, and should be answerable for financial as well as managerial policy. The principle of accountability could be preserved, in the committee's view, by making chief executives not only answerable to their minister, but also required to give evidence in person when required to do so by Parliamentary select committees.

Twelve initial candidates were selected for agency status, and a project manager, Sir Peter Kemp was put in charge. Significantly, Sir Peter had joined the Civil Service from outside in mid career, and so brought with him the ideas of both worlds. The first list was a varied one, illustrating the range and type of government activities which could be turned over to agencies.

The smallest was the Queen Elizabeth II conference centre in Westminster, with a staff of 65. The largest was the Employment Service, providing services and job placement for the unemployed. It had a staff of 35,000. The list also included the aforementioned Vehicle Inspectorate. The full list consisted of the following:

Candidate	Employees
Employment Service	35,000
Non-nuclear Research Establishments	15,000
Driver and Vehicle Licensing	5,400
Her Majesty's Stationery Office	3,245
Meteorological Office	2,600
Vehicle Inspectorate	1,600
Companies House	1,100
Passport Office	1,000
Resettlement Units	600
Royal Parks	600
Historic Royal Palaces	300
Queen Elizabeth II Conference Centre	65

The Prime Minister announced the proposal in February 1988, and The Next Steps became part of the vocabulary of the Civil Service. When the project Manager, Sir Peter Kemp, testified before the Treasury and Civil Service Select Committee of Parliament three months later, he indicated a desire to have three-quarters of the entire Civil Service moved over to agencies within a decade. By any standards this counted as a major change in the status of the bureaucracy.

The initial twelve were regarded as trail blazers, but they were only the first of what would be a series of lists. As more and more candidates were identified, the process would be set in motion for each of them. It was also envisaged that each one would continue to develop and change after it had achieved agency status. Its new found freedom would allow it to do so, and to assume the most efficient shape for the discharge of its duties.

It was further assumed that each agency would be different. Since each would be performing a unique function, no two would be the same. Just as privatization policy was tailor made for each industry sold, so would the form of each agency be adapted to the individual case. As with privatization, there was no set pattern. The common strand in each policy was a determination to solve the problems and to achieve a viable result.

In practice much of the impetus came from below. Not only were departments instrumental in suggesting candidates for agency status, but Civil Servants themselves began to take the initiative and volunteer their own departments, suggesting ways in which it might be turned into an agency. At every stage there was close liaison between the Efficiency Unit, the Departments, and the individual candidates. The would-be agencies would be more likely to succeed if they had the support and enthusiasm of their staff.

The "contract" was called a "framework document," and evolved after a process of consultation and bargaining. The aim was to satisfy several aims simultaneously: to allow maximum freedom for independent management, while preserving accountability and tight control of overall finances. The

management had its own ideas about the freedoms they were seeking, while the Minister was concerned to ensure that visible improvements would take place.

The outcome was that while the initial document specifies the improved performance targets among the conditions agreed between the chief executive and the Minister, the documents are reviewed at three year intervals to take account of changes. Particular attention was paid to making sure that management control systems would be in place to actually deliver what was planned and specified.

Chief Executives could be recruited from outside, as stated. In fact open competition soon became the normal method of recruitment. Outsiders were appointed in roughly half the cases decided by this method. Interchange of staffs between central Civil Service and agency personnel was deliberately fostered to give each some experience of the other. The aim was to make good the shortfall of management expertise in the upper ranks of the Civil Service, a shortfall accentuated by the higher status accorded hitherto to policy formulation as opposed to management and delivery.

All chief executives are appointed for a fixed term, many on terms and conditions quite different from those which prevail in the core Civil Service. While higher rewards than are prevalent occasionally have to be offered, the aim has been to avoid this practice bidding up wages of senior Civil Servants. In fact the senior staff of agencies are still paid markedly below what they could be expected to earn in the private sector. This no doubt serves as one more incentive which might lead to full privatization of more of the agencies in due course.

Financial control is achieved by annual budgets agreed between the chief executive, the Minister and the Treasury. Where outside revenues are generated by user charges, the aim is to allow these to be deployed internally in the expansion of services, instead of simply coming of the budget allocation.

Although agencies can negotiate to vary the pay and conditions of their staff, few have chosen to do so significantly. Departments are reluctant to lose staff forever, which would probably happen if substantially better pay were awarded by the agencies. Agencies themselves have had their energies taken up in the early stages with getting the new financial regimes to function.

Performance related pay has been introduced spasmodically, but government has still felt obliged to launch a major drive to spread the concept. Despite much effort, the Civil Service appears reluctant to embrace the idea that reward should be determined in part by results. It has to be said that the notion has made only a little headway outside the agencies, and not by any means a convincing hold within the agencies. It goes against the pay-by-seniority system which has governed the bureaucracy for so long. Persuading them to embrace merit rewards instead of security will be an uphill climb, along which path the agencies represent a significant step, but only a single one.



The best that can be said at the moment is that the agencies are now in a position where it is very much in their interest to offer rewards based on merit and performance, and to hire such people as they see fit, and at terms they deem appropriate. It is also in their interest to dispense with the services of any staff who are not up to the task. The real test will come when they are prepared to hire and fire on the basis of need, as the private sector does. It is a reasonable assumption, given the three-yearly contract reviews, that more will choose to exercise this kind of freedom because of the huge advantages it will bring. The practice will spread gradually. Given that it will overturn more than a century of tradition, this is understandable.

The momentum toward agencies was maintained. The early success of some of the first candidates prompted others to examine their status with the same end in view. Even before the first twelve had completed the transition, a further 25 candidates were announced, with additional ones in Northern Ireland. This represented a total of 185,000 staff, nearly one third of the total Civil Service. It was this announcement in May 1989 which persuaded the press that major changes were indeed afoot, though it has to be said that the transformation of the Civil Service is not something which fires the imagination of the general public in Britain.

The process was helped to achieve acceptance by the improved performance targets required of and agreed by the candidates. The Vehicle Inspectorate, for example, was set a target of improving cost efficiency by 3.7 percent in its main activities over two years. Companies House was set a 12 percent productivity improvement over two years. Her Majesty's Stationery Office was required to break even in historic cost terms, and to achieve a 5 percent return on average net assets in current cost terms. These were real and substantial gains, and did much to secure ministerial and parliamentary acceptance.

By the time of the 1991 review, the Queen Elizabeth II Conference Centre had lost its place as the smallest agency to Wilton Park, also a conference centre, but with a staff of only 29. Similarly, the Employment Service had lost its place as the largest agency to the Social Security Benefits Agency with a staff of 65,600. The report to Parliament listed 56 agencies (plus HM Customs and Excise executive units) with a total Civil Service staff of 217,870, nearly 40 percent of the entire Civil Service. Open competition had been used to recruit two thirds of the chief executives, with people outside the Civil Service winning roughly half of them, and thus comprising one third of the total number of chief executives.

The Minister of State at the Privy Council Office, Timothy Renton, reported that of 26 financial performance targets, 20 had been met or bettered. Of 38 efficiency targets, 28 had been met or bettered; and of 53 quality of service targets, 37 had been met or bettered. Clearly more effort was needed on the quality side, but the Citizen's Charter was being launched at about the same time to provide impetus and help in this direction.

Mr Renton referred to The Next Steps as "a quiet revolution," and predicted that before long half the Civil Service would be working within agencies. He was

right. By June 1993 there were 90 agencies, representing 262,945 staff, some 46 percent of total Civil Service numbers. Adding the Inland Revenue and Customs & Excise (which are not strictly agencies, but which work along Next Steps lines), brings the number to 567,849 staff, or nearly 62 percent of the total. Sir Peter Kemp's prediction of two-thirds within the decade now looks easily attainable.

No-one should suppose that this is the end of the road. The Efficiency Unit made it quite clear that this is only a start. The agencies are expected to evolve and change under the impact of their new freedoms. The three-yearly reviews of each framework document allow for change and development. Agency status has placed over half of the Civil Service into a curious limbo between public and private sectors. Still part of the government bureaucracy, they nonetheless operate to a large extent as if they were private firms under contract. They take actions similar to those of private firms, such as controlling costs and expanding in response to demand.

Their management takes decisions like those of the private sector. The Passport Office soon cleared the infamous summer delays with their attendant street queues in London by doing what any private company would have done. They took on extra part time staff and worked weekends to clear the backlog. The result is that the street queues have gone, and the average wait for a passport is down to five days. This is very much better than the target figure of ten days.

While the rest of the Next Steps programme unfolds, eyes are already turning to look at what might lie beyond it. Undoubtedly some of the agencies will opt for full privatization. A government agency performing work under a framework document at an agreed budget does not differ substantially from a private corporation performing work under contract. The transition would be an easy one to make. Fully private status would bring not only much greater freedom of action, it would also bring comparability with private sector rates of pay and conditions. Some talented agency managers will chafe at the bit for that kind of status, and will opt to take their agencies private.

An intermediate stage will be reached when agencies can expand the amount of paid work they do for non-government clients. Some already do a large measure of this type of activity. Conference centres, for example, cater for private paying clients as well as government bodies, and raise outside income by doing so. As agencies bid for more outside work, so the boundary which separates them from the private sector will become blurred.

Indeed, if some agencies find the government becomes a minority client, accounting for a diminishing proportion of their total budget, it might well be in their interest to go private and put the relationship with government on a straight commercial basis.

A key element in this is the government's determination to spread what it calls "market testing," by which it means inviting the private sector to bid for performing core government services. The private sector was admitted over the 1980s into bidding for peripheral services such as cleaning and catering. Now it

is to be admitted systematically into the core functions of government. Sometimes the in-house Civil Service team will win, sometimes the private sector bid will be unbeatable. The government has made this the object of a major drive, and lent its full weight to the effort.

Inevitably there will be consequences for the agencies. Instead of being given their contracts automatically, an increasing number of them will have to bid against private firms for the work. This will make them more competitive, and will sharpen their efforts to improve quality and hone down costs. It will also make them virtually indistinguishable from the private sector firms they are bidding against.

Some agencies, of course, will find that there are no private firms which can perform the work that they do, and therefore bid against them. Even here, the temptation to go private will be great. Without effective competitors they have nothing to lose in the private sector, and a great deal to gain in terms of flexibility and expansion of their markets.

This is not to say that there is a hidden agenda to transform the Civil Service into a series of private firms performing government work under contract. There is not. But the changes already made as agency status is extended create pressures, some of which lead in that direction. The new Civil Service of independent agencies revolving around a central core will be far less distinct from the private sector than the Civil Service it is replacing.

Its managers and key personnel will find themselves in a world which increasingly requires them to act as if they were running a private corporation, and to make the kind of decisions which they would take if they were. Inevitably there will be several among them who will examine the diminishing difference between their agency and its private counterparts, and who will calculate that the advantage lies in taking that difference toward vanishing point.

Thus, while the move toward agencies has been successful in itself, and has made bureaucracy more efficient, it has also created a situation which will lead to even more changes in the future. Cost effectiveness, efficient management, and the flexibility to respond to needs as they arise, are all somewhat alien transplants into a Civil Service esteemed internationally for quite different virtues. They are changing it into something much more like the private sector, and therefore much closer to it.

The time may well come when agencies can no longer be distinguished from their private counterparts, and when the transition from one to the other can occur effortlessly and at their own instigation.

## 12. Conclusion

The four policies of privatization, internal markets, the Citizen's Charter and the executive agencies initiative, have all been put into place. The primary legislation has been passed, and the reorganization implicit in them has begun to have its effects felt. The first of these, privatization, has had such overwhelmingly positive results that it is now generally expected in Britain that the few remaining state industries will eventually be privatized. Not only this, but across the world in more than 100 countries privatization is assumed to be a valid and effective cure for the failings induced by state control of industries.

Regarding the second policy, internal markets have been introduced on a voluntary basis so far, in the expectation that the success achieved by the pioneers will motivate others to follow. Before long the policy of self managed units attracting public funds by their ability to attract customers will be the norm. Indeed, it is quite likely that government will feel impelled to legislate to make it the norm if the early successes are repeated.

The assumption is that the pioneers who have opted for self managed status, be it for schools which leave their Local Education Authority, or for Trust hospitals, or for fund-holding practices, are blazing a trail down which the majority of their profession will follow. The positive results of their experiment will make it uncontroversial when others follow. Indeed, it is quite possible that the benefits will be so pronounced that government would be seen as irresponsible if it did not act to extend them more widely. This happened with competitive tendering for local authority services.

The third of these policy initiatives, the Citizen's Charter, has only just been put into place. While the early signs are those of the culture change it was designed to bring about, it will be the practical, measured achievements which determine the verdict. If the measured output of the public services does indeed improve in quality and in responsiveness to its consumers, then the exercise will be seen as worthwhile.

The fourth strategy, the Next Steps initiative to improve the management of public services by setting up free-standing executive agencies, has achieved in only five years what was expected to take ten. Nearly 62 percent of the UK's civil servants now work in agencies or on agency lines. Their focus is clearer, their pay structures provide more incentive, they are more customer-centred, and more flexible. Some are even hoping to be privatized.

Good though the early results on the last three of these policies have been, they still need to undergo the kind of development through which privatization went. That policy was adapted by experience, extended, developed and modified as part of a learning experience. By the end of the 1980s privatization was a more sophisticated and varied undertaking than the relatively crude approach which it had been at the start of the decade.

Similarly the policy of internal markets must respond to experience and adapt accordingly. There is a need for mechanisms under which new schools can be started and for one under which bad schools can be improved. There need to be choices for patients introduced into the NHS to supplement those which can now be made by doctors and health managers.

In the Citizen's Charter the services with a poor record need to learn from those which have been successful. The best points of the good charters, and the best service innovations, need to be copied by those services whose charters have been at best indifferent. Fortunately the structure of the Charter enterprise is such that this learning and cross-fertilization will take place. The system has been designed in such a way that the good will inspire and shame the bad.

The new executive agencies too need greater management autonomy if they are to show what they can really achieve. This may well happen as politicians become more confident about the new system. As more and more agencies take on non-government work and think about future privatization, their traditional relationship with the government as their sole customer will need to be rethought, and new contractual systems will have to be put in place.

The impact of all these policies is to effect a change in the culture of the public sector; but a corollary is that there will be a change in the culture of their consumers. The old British habit of accepting bad service without complaint has been eroding. Indeed, it says a lot that it is no longer considered as it once was to be a virtue. The decade of the 1980s was one of rising expectations.

Part of this can be attributed to rising standards in the private sector. As service levels and courtesy improved in private services, people were much less ready to accept low standards in the public sector. Part of it might derive from the 1979 strikes which brought the public sector to a virtual standstill. The notion that these industries operated in the public interest was scarcely tenable after so naked a display of self interest by their workforces.

Part of it might derive from the visible improvements which occurred in the privatized industries. If privatization could make so big an impact on service levels and simple politeness, perhaps the bad habits of the public sector no longer deserved to be tolerated, if indeed they ever did.

There has been a feedback process in which the policies fed upon these changes in public attitudes and reinforced them in turn. Because people were less tolerant of poor services it was easier to put these policies into effect. And because the

policies began to improve standards, people became even more intolerant of low ones.

The crucial change is that people have begun to see themselves as consumers of public services. Instead of regarding the state industries as part of government, privatization has encouraged them to see them instead as an alternative means of supply, and an inferior one at that. Once they were ready to regard the state sector as a producer, the visible contrast between the quality of its output and that of private producers was enough to spur the impetus for reform.

It was argued at the onset of these policies that the public simply did not have the expertise to be informed consumers of education or health services, for example, and that only the articulate and informed minority would be able to use the system to gain better service. It was certainly true that under the system of public sector supply it was the articulate middle classes who knew how to use the system to advantage. There was effectively a two tier system in which the less articulate, less educated and less self confident received the worst service.

The criticism in any case seriously misunderstands the way in which the private market works. Only a minority are informed and articulate in many product areas; it is they who improve the products for everyone else. The discriminating shoppers might constitute only a few percent of the total, but they are the ones whose choices spur manufacturers to improve, and they are the ones who write columns in specialist publications which tell the rest which brands to buy. The general public as they shop for video recorders are to a large extent free riders on those who are sufficiently expert to pick out the superior products.

The same is true for public services. Now that parents can choose schools, it is the well informed who give schools their reputation; they improve the quality for other parents by causing schools to strive for their custom. The discriminating few improve the services for the rest who follow their lead. Even if the criticism were a valid one, which it may not be, it would still not prevent the few from improving service quality for the many.

Once people regard themselves as consumers of state services, they begin to behave as consumers do, demanding value for money, and reserving the right if they are not satisfied to have their money back to shop elsewhere. In the state services the reforms have so far fallen short of this ultimate sanction, but there may well be a case for eventually introducing it. Few influences are more powerful in the private sector than the ability of potential customers to spend their money in another shop or on another product.

The four policies have begun to achieve the revolution they were designed to bring about. It is in part a revolution in attitudes, in part a revolution in the role of government. All over the world democratic values are on the ascendant as the alternative has withered and collapsed once shorn of the military power and the state repression which sustained it. People expect more from their governments. They expect them to heed their concerns. They expect them to treat their populations with respect.

The old relationship in which a helpless and powerless individual faced an omnipotent and uncaring state is being replaced by a more equal one. People now expect things of their governments, and are not averse to contracts which translate those expectations into specific performance targets. They are by no means averse to the ability to pick and choose between what government offers. It is choice which empowers consumers most of all, particularly when those choices have consequences which impact upon producers.

People are now much more ready than they were not only to expect better things of government, but to require them. The state, like the citizen, should be obligated to fulfil its side of any contracts. This steady change in attitudes has been caused to some extent by these policies. The move to the private sector has heightened the contrast between private and public services. As people have received more they have been prepared to demand more, and to acquiesce in the revolution which was designed to bring it about.

The four policies of privatization, internal markets, the Citizen's Charter and executive agencies are part of a seamless whole. They represent a logical progression through the instruments which might make the state serve its citizens. The aim behind all of them has been to alter the structure of society in ways which allow decisions made by ordinary citizens to determine the shape of what emerges. These decisions, made for different reasons as people act in pursuit of independent goals and according to different values, interact to produce an overall order which is more favourable to all than can any design which is planned and executed from the centre.

The policies which have served to bring this about all start from a viewpoint which sees state power as a potential enemy of free choice. In reducing the power of the state they have enhanced that of the individual. In making the state industries respond to the wants and needs of their customers they have elevated those wants and needs into the determinants of production, as they are in the private sector.

The policies of privatization, internal markets, the Citizen's Charter and the Next Steps agencies have made huge strides in transforming the public sector from one which directs from the top, sending signals downward from its planners through layers of bureaucracy, into one where authority flows from the bottom, and in which the choices and decisions of its customers send signals upward to alter what is done at the top.

They have more to do, but the pattern by which they will attain it has already emerged. They are gradually being studied and adopted in other countries, and will perhaps transform their public sectors as thoroughly as they have been transforming the public sector in Britain. They constitute a programme and an agenda, the instruments which can be applied systematically to the task. They constitute, in fact, a blueprint for revolution.