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Re-visiting the conceptual framework for public/private boundaries in welfare

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Background

This is one of a series of short papers which explain conceptual or methodological approaches underpinning analysis undertaken in CASE's research programme *Social Policy in a Cold Climate* (SPCC). SPCC is designed to examine the effects of the major economic and political changes in the UK since 2007, particularly their impact on the distribution of wealth, poverty, inequality and social mobility. It also examines geographical variations in policy, spending, outputs and outcomes, with a particular focus on London. The analysis includes policies and spending decisions from the last period of the Labour government (2007-2010), including the beginning of the financial crisis, as well as those made by the Coalition government since May 2010.The programme will conclude in 2015, with publication of a final volume. Interim reports will be published in 2013/14, and made available online at http://sticerd.lse.ac.uk/case.

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Introduction

Under the Conservative administration 1979-1997, there was considerable debate about the boundaries of the welfare state: what should be provided by the state, what could or should be provided through the market, what mix of tax finance and private insurance or out-of-pocket payments was desirable, what aspects of welfare should be the responsibility of the individual and what of the state?. The prevailing ideology was to reduce taxation and minimise state intervention; to 'roll back the frontiers of the state', especially the welfare state.

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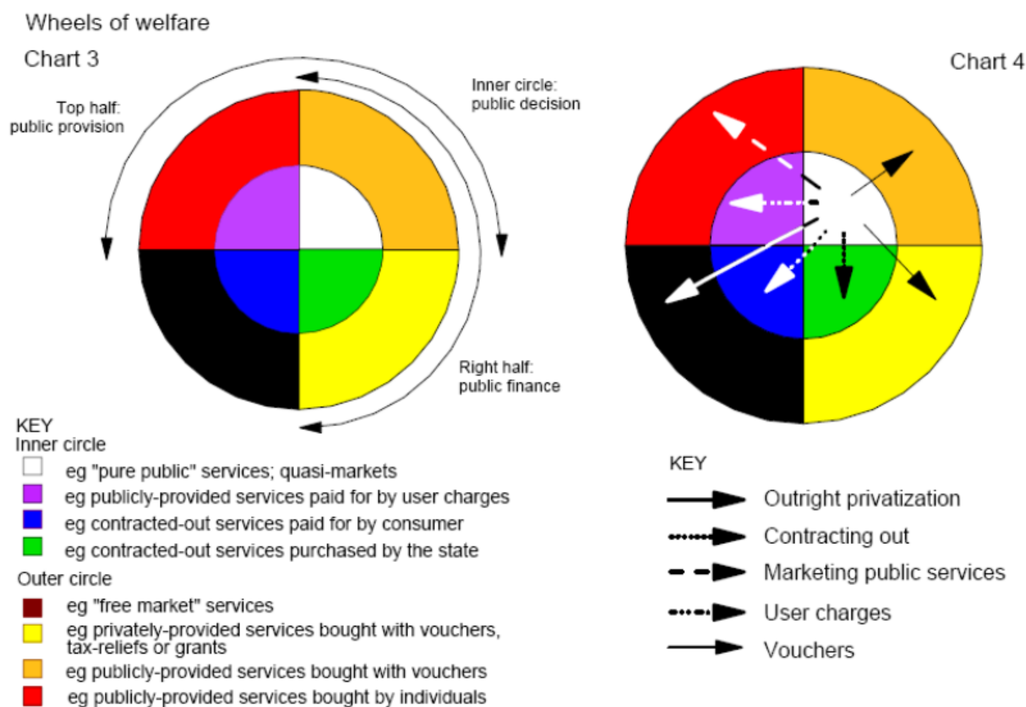
This produced initiatives such as 'contracting out' services like hospital cleaning, the Right to Buy council housing, and the opportunity for schools to opt out of local authority control - each of which was fiercely resisted in some quarters.

The political and public debate was intense, but some of the reforms were relatively small in volume and expenditure terms. In order to quantify the scale of the changes, the Welfare State Programme at LSE developed a framework for analysing public/private boundaries in welfare, based on three dimensions: finance, provision and decision, which could be public or private in any combination (Figure 1) (Burchardt, 1997; Burchardt, Hills and Propper, 1999). Earlier analyses had relied on the two dimensions of purchase and provision (Peacock, Glennerster and Lavers, 1968; Glennerster, 1992), but increasingly it seemed that 'purchase' had two components: the funding of the service and the decision about which provider or how much of the service to buy. For example, nursery vouchers were tax-financed but the decision as to whether, where and how much to spend (up to the maximum) lay with private individuals (parents in this case).

Figure 1.



The three-dimensional framework developed by the Welfare State Programme has subsequently been applied to track changes in the patterns of public and private welfare across education, health, social care, housing and social security, including pensions (Smithies, 2005; Hills, 2011; Edmiston, 2011). The most recent analysis suggests that by 2007/8, the 'pure public' category (ie tax-financed, publicly provided services under public decision-making) accounted for just under half (48%) of expenditure, which was only slightly smaller than the corresponding proportion in 1979/80 (52%). At the other end of the spectrum, the 'pure private' (free-market) category had grown from 24% of the total to 31%. In-between, there were significant increases in contracting out

(private provision, public finance and decision: rising from 6 to 10% of the total over the period), and slight falls in voucher-type schemes (public finance, private decision and either public or private provision: declining from 4.6 to 1.9% of the total in the case of public provision, and from 9.7 to 7.1% in the case of private provision). Overall, the picture is one of considerably greater stability than one might have expected given the rate of reforms in public services and plethora of initiatives in welfare under successive administrations. Nevertheless, because the scale of public and private welfare expenditure is so large (£620.3 billion in 2007/8), even marginal changes in the distribution of spending across different forms of public/private activity can have a significant impact.

The final years of the Labour administration and the first years of the Coalition government have witnessed yet further changes in the welfare landscape, and for this reason it may be timely to revisit the conceptual framework to assess its continued relevance for analysing welfare activity today. For example, where should the (short-lived) Child Trust Funds be classified? The providers were all in the non-public sector, but the largest providers were mutuals, so classifying them as 'private' providers could be misleading. The initial voucher was state-financed, but parents could make top-ups (private finance) which were themselves tax-free (public finance). The decision about which provider to use was the parents' (private decision), but if parents failed to make a choice, the state allocated the voucher to a particular provider on their behalf (public decision). Finally, the decision about *how* to use the fund was the child's (private decision), but *when* to use it was fixed in legislation (not sooner than the child's 18th birthday – public decision).

In addition to innovations of this kind, the debate about 'privatisation' of welfare has also moved on. The question of the division of responsibility for welfare between individuals and the state has been vigorously renewed through cuts to social security for people of working age and has been given a new twist by the 'Big Society' agenda, introducing an idea of collective but voluntary provision.

Other concerns centre on shifts towards greater use of private, especially for-profit, providers in spheres previously seen as the preserve of the public sector, such as NHS hospital care. Are 'knaves' replacing 'knights' and to what extent does the motivation of the provider matter to the service delivered? To what extent can the setting of minimum standards, regulation and inspection substitute for direct control over provision? Can a service remain genuinely universal when access, admission or eligibility criteria are applied by individual providers, albeit under central guidance? Does the division of a service into the hands of multiple, potentially competing, providers, together with the downgrading of central supervisory bodies (such as Local Education Authorities) threaten fragmentation and lack of coordination?

Finally, enthusiasm for behavioural economics and the idea of 'nudge' has led to innovations in the 'decision' dimension, such as auto-enrolment in workplace pensions. While the decision itself may remain with the individual, the framing of that decision is public policy and is explicitly designed to influence the likely outcome.

Thus there may be ways in which each of the three dimensions of the original framework needs some redefinition, or, possibly new dimensions may be required to reflect the complexity of present-day welfare activity and debate.

Overarching issues

Before considering each dimension in turn, there are three general issues to be considered. Firstly, in order to analyse welfare activity overall, we need a common metric across services. Services themselves come in all sorts of shapes and sizes, and are commonly made up of composite parts, so categorising 'services' as public or private on the three dimensions is not feasible. Instead, we use the metric of spending (public and private) and allocate it across the various segments of Figure 1. So where, as is common, a service is partly tax-financed and partly financed by individuals (NHS dentistry with user charges, for example), each part can be allocated to the corresponding category in Figure 1. Similarly, if a service is supplied by a mix of public and private providers (for example, welfare to work programmes), in principle the spending can be allocated proportionately to those categories.

Secondly, for the purposes of an overall analysis of welfare, keeping a tight limit on the number of dimensions and categories (3 dimensions and 2 categories – public/private - in the original framework) is desirable. However there may also be interest in looking in more detail within a particular area of welfare, such as education or health, in which case it may be possible to reflect finer distinctions, such as degrees of 'publicness' in the provision or decision dimensions. Or there may be interest in understanding one segment of the Figure in greater detail – for example, the privately provided, publicly financed segment - across welfare activity. Here again, there may be scope for introducing sub-divisions which would be unduly cumbersome in an overall analysis of welfare activity.

Thirdly, in allocating spending on services across the Figure there is the question of how to treat capital investment, debt and current expenditure. The objective is to consider current expenditure but to incorporate debt repayments and an annualised flow of benefit from capital investment; for example, housing should be assessed in terms of current rental value, whether it is actually rented or owner-occupied. Of course this is easier in principle than in practice.

Finance

The original framework classified spending financed by national or local taxation, or National Insurance Contributions, as public finance. Its key characteristics are its compulsory and collectivised nature: you must pay, whether you use a particular service or not, and the relationship between what you pay in and the benefit or service you receive is indirect. This was contrasted with private finance, where only those who use the service pay, and whether or not you use the service is usually voluntary.

Potentially difficult cases discussed in the original framework included:

- tax reliefs and allowances: considered to be tax expenditures and hence public;
- Private Finance Initiative: although the initial funds are private (raised by for-profit companies), the long-run commitment is to repay the loans through taxation and they are therefore considered public finance;
- user charges for publicly-provided services: considered to be private finance (the 'public' element is provision not finance);
- benefits paid by employers (such as corporate medical insurance): considered to be in lieu of wages and hence classified as private;
- benefits paid by trusts and charities (for example educational scholarships): considered to originate in private donations (albeit with tax relief) and hence classified as mainly private.

The most hybrid case identified in the original framework was payments through the Child Support Agency. These are compulsory payments, enforced by the state. Their main effect is to reduce the (tax-funded) social security expenditure on lone parents, although a small part of the payment may be retained by the parent-with-care on top of her benefits. All this makes them appear to be public finance, but on the other hand, they do not appear as public spending in the national accounts and they are not collectivised – there is no cross-subsidy between families.

More recently, there have been a number of new examples of co-funding, where services are partly publicly and partly privately financed. For example, the childcare element of Working Tax Credit, under which 70% of the cost of childcare (up to a maximum) could be reclaimed from the state, or school Academies, where in principle a private (or non-profit) sponsor supplies part of the initial capital and may continue to provide benefits-in-kind on an on-going basis, or higher education fees, which are levied on students and paid through student loans (private finance), but a proportion of which may not be repaid and hence fall to the Treasury (public finance). It is often challenging empirically to separate these elements, but conceptually there is no problem: the publicly-funded pounds should be counted under public finance and the privately funded pounds should be counted under private finance.

Perhaps one of the most complex areas in recent times as far as the 'finance' dimension is concerned is social housing. Since the late 1980s, we have witnessed large-scale stock transfers from local authorities to housing associations and other Registered Social Landlords (now called Registered Providers). Whether Registered Providers other than local authorities are themselves public or private bodies is contested (see 'Provision' below), but in addition, the sources of finance for social housing are very varied. In terms of current expenditure, rents (private finance) and Housing Benefit (public finance) remain the key sources (NAO, 2012). But the level at which rents are set is determined in part by the value of the stock and the Registered Provider's debt - each of which represents a combination of previous public and private capital investment. Rents are also affected by the Registered Provider's ability to borrow, which is in turn based not only on the value of its stock but also the expected future revenue stream, which is affected by the current and anticipated housing (especially Housing Benefit) policy regime. Moreover, Registered Providers may build housing for sale in the open market and use the proceeds to cross-subsidise spending

on social housing, a sort of private finance (the purchasers of the owner-occupied housing) for private not-for-profit provision, but where the purchasers are not the same as the beneficiaries (the subsidised tenants in the Registered Provider's social housing).

However, if we stick with the principle of categorising current rather than capital spending, on the basis that capital spending is reflected in revenue/expenditure flows eventually, and analysing the spending closest to the final welfare outputs, the situation becomes a little clearer. In addition to Housing Benefit, social tenants benefit from below-market rents. The majority of the subsidy is the result of public finance through one route or another; a minority is cross-subsidy from private finance generated by other activities of Registered Providers.

Provision

The question of whether a provider is public or private was considered in the original framework to depend on the degree to which the organisation was owned and controlled independently of Government. The original framework used the National Accounts scheme to classify organisations as public or non-public sector, with the latter including not-for-profit organisations as well as commercial organisations and private individuals. This meant that both "non-profit-making bodies serving persons" (including Housing Associations and universities), and "unincorporated businesses" (including GPs and dentists) were assigned to the non-public sector, as well as charities, mutuals and friendly societies. The one deviation from the National Accounts scheme was Grant Maintained schools, classified by National Accounts as non-public, but treated in the original public/private boundaries framework as public sector, on the grounds that their assets were owned by the state and their self-governing status could be removed by direct intervention of the Secretary of State if the school was held to be performing badly.

HM Treasury (2010) describes the current classification of public and non-public sector bodies for the purposes of National Accounts, and ONS (2012) provides an index. The classification is governed by the European System of Accounts 1995 (ESA95) and the key consideration is whether the body is *controlled by* central or local government, or by a public corporation. Control is the ability to determine general corporate policy, through ownership, specific legislation, or regulation. This may include the power to:

- appoint of the majority of directors
- replace directors in instances of poor performance
- take control in instances of poor performance.

Control may also be exercised through grant funding, where this makes up a large majority of the organisation's total funding and is tied to government approval of a business or strategic plan. Whether or not an organisation is deemed to be in the public sector is assessed on the balance of these criteria. The government retaining special powers to prevent changes in ownership or prevent sale of assets is not normally sufficient in itself for a body to be classified as public sector. Similarly, being subject to regulation is not, in itself, sufficient to be counted as public sector. All

commercial activities are regulated to some extent (through the legal system), and some – for example, the operation of utility companies – are regulated to a greater extent than others. But the utility companies are nevertheless firmly in the private sector.

Interestingly, there is overlap in the National Accounts criteria for classification of providers as public or non-public with both the finance and decision dimensions of our own framework. However, the provider classification remains distinct in so far as considerations of finance are in relation to the degree of control tied to the financing (eg approval of a business plan), and considerations of decision are at a strategic and organisational level, rather than at the level of the individual consumer.

All state schools (i.e. those where no fees are charged), including City Technology Colleges (CTCs), Academies and Free Schools, are classified as public sector. According to ONS, the distinction between Foundation and Community schools on one hand, and CTCs, Academies and Free Schools on the other, is whether the control is operated by local or central government. There are, however, differences between these school types in the aspects of school functioning over which they are autonomous: Academies and Free Schools need not follow the National Curriculum, and Free Schools can in addition employ non-qualified teachers and can change the hours of the school day. However, all state (ie non-fee-paying) schools are subject to significant inspection, control, and in the last analysis, take-over, by either the local authority or the Department for Education and for this reason are classified as public providers.

Further Education Colleges and Sixth Form Colleges were until recently classified as non-public sector but ONS recently decided this was mistaken and they have now been reclassified as public sector. Universities have always been classified as non-public, in the light of the greater autonomy they enjoy and the fact that a considerable share of their funding comes from non-state sources.

Housing associations are classified as non-public sector for the purposes of national accounts, despite a significant degree of government regulation of their activities, including rent regimes. The status of housing associations has however been subject to legal challenge, and in one case the High Court ruled that a particular housing association was a ‘public authority’ under the Human Rights Act (Pinsent Masons, 2008). The current state of play seems to be that housing associations (and other Registered Providers except local authorities) are non-public sector for accounting purposes, but may have public duties under Human Rights and other legislation.

Using the system of national accounts to classify welfare providers into public and non-public sector has the advantage of clarity and a definitive list. However, in a number of areas, the involvement of not-for-profit providers has grown considerably since the late 1990s. It would therefore be of interest to split the non-public sector into for-profit and not-for-profit. Many of the major new or growing actors in welfare provision are private not-for-profit: for example, voluntary sector providers in Early Years care, mutuals in health care, Academies and Free Schools in education, and housing associations benefitting from large scale voluntary stock transfers. Furthermore, a number of the controversial developments in welfare policy have concerned the use of private for-profit providers: A4E and Atos in social security and welfare to work

assessments, Circle taking over Hinchingbrooke hospital, the crisis in social care brought about by the collapse of Southern Cross, and the mis-selling of Mortgage Protection Insurance by high street banks. Being able to isolate the extent to which this part of the private provision has grown would be a useful function for a future version of the public/private welfare framework.

In addition, schooling is one area of welfare in which even a public / voluntary sector / for-profit distinction seems too crude to capture some of the interesting shifts in the nature of providers, and the degree of regulation to which they are subject, which have occurred in the recent years. A sub-analysis focusing specifically on schooling could usefully take into account ‘degrees of publicness’ among providers, depending both on the origins of the provider (eg LEA, charity or business) and on the regulatory regime, which depends on the type of school (eg Academy or Free School).

Decision

The original framework proposed two criteria for the ‘decision’ dimension: – the degree to which the individual consumer or user has agency, and degree to which s/he has the power of exit (terms borrowed from Hirschmann’s 1970 classic, *Exit, Voice and Loyalty*). Agency consists in how directly the individual consumer/user chooses the provider of the service, and how directly s/he chooses the amount of service. Exit consists in the availability of viable alternatives, ie alternatives reasonably similar from the consumer/user’s point of view in terms of accessibility (including geographic and price) and quality.

A ‘private’ decision is therefore one where there is a range of suitable services available to the consumer/user, and the choice of service is made directly by him or her. A ‘public’ decision is one where either there are agents acting on behalf of consumers/users, or decisions on level of service and identity of provider are made by a public body rather than individuals. These are not clear-cut distinctions and there being two criteria (or three, if decision about level of service and identity of provider are treated as distinct considerations) means that there is room for ambiguity over a classification. The ‘decision’ dimension is much more a matter of degree than the ‘finance’ or ‘provision’ dimensions.

The original framework also emphasised that influence could also be exercised by consumers/users through ‘voice’ (the third component of Hirschmann’s typology), and that in some circumstances this could be as effective as ‘exit’, if not more so, in giving end users decision-making power within a service. So a ‘public’ decision is not necessarily one immune from consumer/user influence.

Recently, we have also seen ways in which ‘private’ decisions are not immune from public influence, as in the case of auto-enrolment in workplace pensions. While the individual ultimately can choose to opt-out, the default is to be opted-in, so the ‘private’ decision is framed by a public policy with the explicit objective of influencing private decisions.

Table 1 analyses a number of areas of welfare activity according to the three criteria of who chooses the provider, who chooses the amount of service received, and whether there are viable alternatives. The classification is broad-brush because the areas considered are not described in detail; a more detailed analysis of expenditure in each area would allow for finer distinctions to be made. Nevertheless the table illustrates some interesting contrasts.

Decisions in education vary by the stage of education under consideration. In early years, parents are generally able to choose both the identity of the provider and the amount of service they wish to access (up to a maximum in the case of publicly-funded care for 2 to 4 year olds). Whilst the availability of affordable childcare is limited in places, there is nevertheless a range of providers from which to choose in most areas. Early years provision has been increasingly regulated, which effectively means that some decisions have been taken out of parents hands (by removing the worst providers and introducing greater conformity in the sector), but on the other hand new information has been provided which could in principle assist parental decision-making.

In primary and secondary schooling, the range of types of schools has expanded considerably, and 'parental choice' has been the mantra since the 1980s. However by definition, schooling at this age is compulsory, so there is no parental (or child!) decision about whether and how much schooling to use (aside from the option of home schooling), and in practice the choice of schools for many parents is limited by geography. Whether on balance this adds up to a public or private decision is controversial.

In social care, there is a contrast in the 'decision' dimension between clients who use direct payments – for whom there is a greater degree of autonomy – and those who continue to receive a package determined by social services.

Decision-making in healthcare has undergone repeated reforms since the 1980s but in the majority of cases, decisions continue to be made by intermediaries (GP consortia, Primary Care Trusts, GP fundholders) rather than by patients themselves. Patients may be given some choice over provider in the case of elective hospital treatment but this is from a significantly constrained set of providers. As with education, the classification of public/private decision is controversial, but on balance and at this high level of generality, it would seem to fall on the 'mostly public' side of the boundary.

In housing, social rents have been significantly de-regulated, and there has become a progressively closer relationship between the private rented sector and social renting. Interestingly, the level at which Housing Benefit is paid now refers to local market rent: so the level of public finance is dependent in part on decisions in the 'pure private' sector (private finance, provision and decision).

One recent development in the area of pensions is auto-enrolment for most employees not already in an occupational pension in a workplace pension, as mentioned above. This is an interesting blurring of the boundary between public and private decisions (along the lines of 'nudge' theory), but strictly speaking, the decision as to whether to enrol and the amount to contribute (within

limits) remains with the employee. They do not have a choice of provider, but they can opt out and choose instead to contribute to a private pension, or not at all.

Table 1: Areas of welfare activity by whether public or private decision

	End user chooses provider?	**End user chooses amount?**	**Viable alternatives?**	**Public/ private decision**
Early years	Y	Y	Y	Private
Compulsory education	Y	N	Y/N	Mostly public
Further & higher education	Y	Y	Y	Private
Social care – direct payments	Y	N	Y	Mostly private
Social care – social services	N	N	N	Public
Social care – privately funded	Y	Y	Y	Private
Primary care	Y	Y	Y	Private
Emergency hospital treatment	N	N	N	Public
Elective hospital treatment	Y	N	Y/N	Mostly public
Social housing	N	N	N	Public
Private renting with Housing Benefit	Y	N	Y/N	Mostly public
State pension	N	N	N	Public
Workplace pension	N	Y	Y	Mostly private
Private pension	Y	Y	Y	Private
Welfare to work	N	N	N	Public

Finally, in welfare to work, publicly-funded, private (for profit and not-for-profit) providers have increasingly taken on responsibility for administration of schemes and, in effect, decisions about eligibility for a range of benefits. However, while an important and controversial shift, from the end-user's perspective, it does not alter the fact that they have no choice over the identity of the provider or how much of their service to use, and nor do they have an 'exit' option, without forfeiting their benefits altogether.

Missing dimensions?

The three dimensions of the original framework, finance, provision and decision, seem to capture much of the variation in combinations of public and private welfare activity that we are interested in. But there is one other aspect of welfare activity which is a candidate for a fourth dimension,

namely, the degree to which the activity is regulated. This is of particular relevance in the context of increasing involvement of non-public sector providers in publicly-funded welfare, since one of the ways in which policymakers may seek to safeguard the public purse, and allay fears of malpractice especially in the for-profit sector, is to impose tight regulation on new providers. Since all regulation is public (although in an intriguing twist, the enforcement of regulation is now in some cases carried out by private bodies: OFSTED has contracted-out its inspections), a new 'regulation' dimension of the welfare activity analysis framework would be measured as more and less, rather than as public and private.

Would an additional dimension of this kind be helpful? Consideration of the degree of regulation already arises in the classification of public/private providers: it is one of the factors that determines whether an organisations is considered to be under the control of central/local government or independent on it. However, as ONS make clear, regulation by itself is not sufficient to switch the classification of an organisation from private to public. Regulation is also relevant to the 'decision' dimension, in so far as it affects whether there are viable alternatives for the individual to choose between.

All public sector providers are heavily regulated, so there would only be variation in a 'regulation' dimension amongst non-public provision. Similarly, all publicly-decided welfare activity is heavily regulated, so there would only be variation in the 'regulation' dimension amongst private decision. However, both privately and publicly financed activity may be more or less tightly regulated (for example, private pensions, GP services). It seems then that rather than adding a new dimension to the framework altogether, it would be interesting to look at the degree of regulation to which the privately-provided, privately-decided subsector is subject and how this has changed over time.

Conclusion

Despite considerable change in the welfare landscape over the last two decades, the discussion in this paper suggests that the three dimensions of the original public/private boundaries of welfare framework remain useful and relevant. Some refinements have been proposed:

Finance – capital investment and debt should wherever possible be included as annualised flows of benefit / repayments, and allocated as public or private spending as appropriate

Provision – the latest ONS national accounts public sector classification should be used. In addition, the non-public sector should be sub-divided into for-profit and not-for-profit organisations. For analysis of specific areas of welfare (especially schooling), as opposed to analysis of welfare activity overall, it may be desirable to consider 'degrees of publicness', based on the identity of the provider and the extent of regulation to which they are subject.

Decision – three tests should be applied: (i) does the end user choose the provider, (ii) does she/he choose the amount of service, and (iii) to what extent are there viable alternatives. The public/private classification is based on the balance of responses to these questions. The decision dimension is more often a matter of degree than either the finance or provision dimension, so

where the purpose of the analysis is specifically concerned with this dimension, or with an area of welfare in which there have been important shifts in 'decision', a 'mixed' category could be usefully employed in addition to 'public' and 'private'.

Finally, analysis of the degree of regulation to which the privately-provided and privately-decided sub-sector of welfare activity is subject (whether publicly or privately funded) would provide an interesting addition to the framework.

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