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Competition, Contracting and the New Public Management

Kieron Walsh

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KIERON WALSH

Introduction

Throughout the world there is a search for a new approach to public sector management, for the 'reinvention' of government (Osborne and Gaebler, 1992). In the United States the management of the federal government and of health and education is central to the political success of the presidency. In the previously communist regimes of Eastern Europe and the Soviet Union the organisation of basic services, health, housing and water, along with the privatisation of public enterprises, presents huge problems. In less-developed countries economic difficulties and external pressure are leading to a re-examination of the role of the state in the economy. In Australia and New Zealand there has been a programme of micro-economic reform, which is intended to change the basis upon which public services operate. European countries, to varying degrees, are introducing new approaches to the management of the public sector. In Britain, perhaps most of all, there is a revolution in progress in the way that government manages itself.

A major feature of the 'new public management' (Hood, 1991) is the introduction of market mechanisms to the running of public service organisations: the marketisation of the public service. The earliest form of marketisation was the introduction of competitive tendering for public service (Ascher, 1987). Since the late 1980s there has been a rapid expansion of the use of competitive tendering but other approaches, such as internal markets, have also been developed. The focus of this book is the emerging process of marketisation.

The most radical change in the management of public services has involved outright privatisation, particularly in the United Kingdom and Japan, and increasingly in Eastern Europe and the Soviet Union (Clarke and Pitelis, 1993). Other countries have pursued a less ideological line, and the extent of privatisation has, in most cases, been limited. Even where it has been extensive, privatisation should be seen as a change of the nature of government involvement, rather than its total withdrawal, with regulation replacing direct ownership and control. As Foster (1992) says:

While some privatized enterprises can be let loose upon a free market to be subject to its disciplines, the old public utilities, when privatized, need be no more under market disciplines as private monopolies than they were as public monopolies. To remedy this in Britain, ministerial control has been replaced by regulation (p. 3).

More generally governments' regulatory role in relation to the private sector has been expanding, as has that of supranational bodies such as the European Union.

As outright privatisation runs up against the immediate limits of practicality and public acceptability, reform within the public service is becoming the more important issue. Arguments can be made for radical privatisation of services and functions that have come to be seen as quintessentially public. Saunders (1993), for example, argues that the wholesale privatisation of the consumption of public services such as education and health, by moving 'away from provision in kind and towards income support and subsidy' (p. 65), would enhance citizenship.

The privatized society which is slowly emerging out of the ruins of the collectivist welfare system holds out the prospect not of social and moral disintegration, but of new and active forms of citizenship based on individual competence and the development of genuinely collective forms of association and sociability springing up from below (p. 88).

The Adam Smith Institute in the UK has made a similar case, while from the left there are arguments for provision of welfare through associations (Hirst, 1993) or for similar forms of privatisation, as proposed by Roger Douglas, the former New Zealand Finance Minister (*The Observer*, 13.3.94).

So far this radical agenda has made little headway; what governments have been willing to do has been to engage in transformation of the way that they are managed. This has generally involved two main strands: the introduction of managerial techniques from the private sector, and the development of market mechanisms within the public services.

The new public management

The first strand of the new public management is managerialism, defined by Pollitt (1990, pp. 2–3) as involving:

- continuous increases in efficiency
- the use of ‘ever-more-sophisticated’ technologies
- a labour force disciplined to productivity
- clear implementation of the professional management role
- managers being given the right to manage

This approach to the management of the public services has a long history, and has been the subject of continual debate. F. W. Taylor, the pioneer of scientific management, had, it might be remembered, an influence on government services in the United States before the First World War (Nesbitt, 1976, p. 284). Throughout its history the public sector has intermittently rediscovered the need for a focus on productivity, performance and control. In the 1980s we witnessed no more than the continuation and enhancement of a managerialist process that had long existed. Indeed, in the British civil service in particular, many of the developments of the 1980s can be seen as little more than the implementation of approaches that had been proposed in the 1960s and before, for example by the Fulton Commission. In that sense the ‘new managerialism’ is no more than another wave of a tide that had long been flowing, however slowly.

The increasing acceptance of the Taylorist agenda has been described as Fordist, to be compared with a post-Fordist phase of development in public service management that became increasingly strong from the late 1980s (Stoker, 1989). The post-Fordist approach is:

... to fragment the organization and leave each constituent part or unit to deal with the detailed problems of resource allocation, methods of work, organisation charts and so on ... At the centre, top management would be left with strategic tasks only ... (Harrison *et al.*, 1992, p. 15).

The aim of managerialism is to gain more effective control of work practices.

The second strand of the new management is based upon indirect control rather than direct authority. The strategic centre attains its objectives through creating processes of management that involve appropriate incentives and value commitments. The emphasis is not so much upon managers' right to manage, as the need for managers to be appropriately motivated and believe the right things. The reduction of trade union power in the 1990s has made the cry for managerial control less affecting. The characteristics of the second strand of the new management are:

- continual improvements in quality
- emphasis upon devolution and delegation
- appropriate information systems
- emphasis upon contracts and markets
- measuring performance
- increased emphasis on audit and inspection

The two strands of the new public service management are quite distinct. The first, Taylorist, strand, is based on the adoption of industrial production engineering techniques within the public sector. It is not a rejection of bureaucracy but its fulfilment. The second is based on the primacy of market-based coordination. This approach to management involves the creation of a core-periphery model of organisation, intended to enhance flexibility. At the core are the central strategists, while at the periphery are those who deliver services, frequently with a less permanently established position than they had in the traditional bureaucracy. This model is being pursued by a range of mechanisms from 'outsourcing' to the creation of internal markets.

Meyer and Rowan (1977) have argued that the process of institutionalisation in the public sector partly depends upon the need to adopt what is seen as best practice in the private sector. The difficulty of demonstrating the performance levels of intangible public services leads to the adoption of ideas in good currency in order to gain legitimacy. There is a process of mimesis (Di Maggio and Powell, 1983) that is particularly strong in the public service, since one organisation cannot afford to be left behind in the chase for legitimacy, which often brings funding with it. Pollert (1988) argues that:

... the public sector is now turning to the 'flexible firm' framework as legitimation for restructuring on commercial lines, precisely because the model is seen as the 'leading edge' practice in the private sector ... (p. 308).

The language of 'enabling' (Ridley, 1988) has now become established within the public sector, so that, even if one wishes to argue against the new orthodoxy, one must start from its ideological presuppositions. The failure of traditional approaches is taken as axiomatic, even if on limited evidence.

The user of public services has an explicit place within the new management as customer or consumer. The Citizen's Charter in the UK conceives the citizen as an amalgam of separate consumer positions giving rise to a Parent's Charter, a Patient's Charter, a Passenger's Charter, a Victim's Charter and so forth. Individual citizens have rights, and must be allowed the maximum choice in the services that they use, and that choice, bolstered by systems of complaint and redress, will act as the spur to maintaining and improving public service quality and efficiency. The need for collective choice at the political level is then significantly reduced, and politicians play a strategic role. The management of public services is the central issue in public sector reform.

The development of the new market-oriented public service management allows ministers to argue that democracy is essentially concerned with providing efficient service. The exercise of choice in the marketplace for public service is seen as more effective than the use of the vote. William Waldegrave (1993), the minister responsible for the implementation of the Citizen's Charter, argues that:

... there is no guarantee – indeed there may not even be a sporting chance – that by periodically expressing his or her democratic decision at the ballot box the citizen (by the use of that sovereign power) will necessarily obtain on a continuous basis efficient, properly accountable, responsive public services. You don't have to go far back in history to see that.

The key point in this argument is not whether those who run our public services are elected, but whether they are producer-responsive or consumer responsive. Services are not necessarily made responsive to the public simply by giving citizens a demo-

cratic voice, and a distant one at that, in their make-up. They *can* be made responsive by giving the public choices, or by instituting mechanisms which build in publicly approved standards and redress when they are not attained (p. 13).

In this system, accountability operates at two levels – the strategic level for which politicians are responsible, and the operational one which is the sphere of the managers. The test of the legitimacy of the public service is the acceptability of the services it produces for the citizen.

The development of the welfare state involved the integration of the political and the managerial level of public services, particularly through the role played by professionalism; the new public management involves their radical separation. The ability of people to participate in the control of their own lives is seen as resulting from the return, as far as possible, of public services to the private sphere. Citizenship relates less to participation in the public realm than to consumption in the private realm. The radical privatisation of the public service through individual choice is more possible in Britain than many other countries because of the limited explicit development of the concept of citizenship in this country, and because of the fragmented structure of public institutions. This privatisation of citizenship can be contrasted with a view of citizenship as participation in the public realm.

Some would see the equation of citizenship with consumption as limiting. Hansen (1993), discussing the work of Hannah Arendt, says:

To deprive humans of the possibility of acting and speaking together in a common world is to imprison them in the subjectivity of their singular experience, which does not cease to be singular if the same experience is multiplied innumerable times.

By contrast Harrison (1991, p. 12) argues that:

It might be feasible, for instance, to argue that privatised forms of social provision (and access to 'choices' in markets) amount to an alternative form of 'modern citizenship' which has been expanding and securing certain types of household welfare in Britain recently.

This is a fundamental debate, which affects the very basis of liberal democracy. It has commonly been argued that the creation of the welfare state was necessary to the full development of citizenship. The critics on the New Right argue that, on the contrary, the welfare state has prevented the development of effective citizenship:

The paradox of social cohesion, then, is that the more governments try to sustain it through the extension of 'citizenship rights' (broadly defined) the weaker it becomes (Saunders, 1993, p. 85).

The way that the citizenship can be created, on this view, is to make citizens into consumers/customers with choice, rather than subjects of the public bureaucracy. Introducing market processes within public service organisations is a central part of this process.

From state to market

A variety of market mechanisms have been proposed and adopted for the reform of state bureaucracy, apart from outright privatisation. The first is the introduction of pricing and charging for public services, in order to create market pressures on politicians and officials. More services are charged for, and charges have been brought closer to those that might apply in a free market. There have been attempts to give the users of public services the ability to act as customers with choices through the use of vouchers. There has been extensive development of pricing and charging within public service organisations, involving a move from 'hierarchies' to 'hierarchies with markets'. There is a process of internal privatisation.

The second and most fundamental mechanism for changing public service management, is the development of contract. The simplest form of the use of contract is the buying in of services from private providers. The public organisation may be allowed to compete with potential private providers in a market-testing programme or work may simply be externalised. Contract has become, along with the concept of customer, a fundamental metaphor for the changes that are being made in the public

service. It is as likely to be used to characterise relationships within the organisation as those with private providers. Authority relations are being redefined as contracts.

Contract is allied with performance measurement to produce an individual focus on the public sector worker, making the employment contract more like that for purchase on the market. The public service is becoming a 'nexus of contracts', rather than a bureaucratic hierarchy.

The use of prices and contracts is being extended in the UK through the development of internal markets, most explicitly in the National Health Service, but, increasingly, in other public services. Purchaser and provider are separated, and relate to each other through quasi-contracts, with prices and charges operating to ensure the match of supply and demand. Internal purchasers are increasingly free to buy where they want, a development encouraged by the Audit Commission (1994), which puts downward pressure on service costs and creates incentives to increase productivity and efficiency. Purchasers, acting as surrogates for ultimate users, are forced to be more explicit about the rationing decisions that they make.

Large public service organisations, organised along bureaucratic lines, are being broken down into smaller independent units, with autonomy to operate relatively freely. Schools, colleges and hospitals have been allowed independence from overseeing authorities. Autonomy has been increased within organisations through the creation of internal agencies operating at 'arm's length'. These independent, or internally autonomous agencies operate according to quasi-market principles, relating to each other through contracting and the purchase of services. They are monitored and controlled through performance measurement and targets. The public service is becoming a more or less integrated network of organisations that relate through contract and price rather than authority.

The market that is developing for public services is managed. There is close regulation of the way that it operates, and control of the pattern of change. In the British National Health Service, for example, the government has been unwilling to allow the unbridled operation of the market to lead to wholesale hospital closure. What is emerging is a new form of organisation that is neither market nor hierarchy, but which lies rather uncomfortably between the two.

Efficiency and organisation

The argument for the introduction of market processes is that it increases both efficiency and accountability. Efficiency is argued to follow from the clearer statement of what is to be provided, and the pressure that results from consumer choice. The argument for the greater efficiency of the market compared to traditional bureaucracy is often simply asserted, with little attempt at justification. In practice the evidence for the greater efficiency of the new pattern of public service management is limited. The evidence on effectiveness and the quality of service is even more debatable. The lack of clear evidence is no more than might be expected, given the complex nature of public services, and the early stage of development, but it makes the introduction of the market a matter of faith as much as technique.

The 'new public management' has a considerable impact on patterns of organisation within the public service. Organisations are becoming more differentiated, through the separation of purchaser and provider and the creation of more operational autonomy for those delivering services, such as schools and hospitals. Existing patterns of management involving traditional Weberian approaches to organisation are giving way to decentralised forms. New patterns of integration, appropriate to a more differentiated structure, are needed to replace authority and planning. Networks are developing in contrast to unified, authority-based organisation. Planning is giving way to more general strategic management and coordination through market processes and adjustment. Power is shifting from professionals to managers. The basic assumptions that have guided the organisation of the welfare state are being challenged.

The basis of organisation is changing from hierarchical authority to contracts and markets. To some extent this change parallels developments in the industrial sector, where there is a growing use of contracts and alliances alongside competition (Lorange and Roos, 1992; Sako, 1993). Internalisation is giving way to complex links between organisations, taking a variety of forms from franchises to joint ventures, and from contracting to co-production. These changes are not easily established and depend upon the development of an appropriate underlying culture and set of values. Much emphasis is laid upon trust, which is not easily or quickly developed.

Markets for public services are at an early stage of development, and are characterised by high levels of monopoly and monopsony. In most cases they are, at best, quasi-markets (Le Grand and Bartlett, 1993), operating within organisations and with surrogates, such as health authorities or social services departments, acting for final recipients of services. There are clear examples of highly developed markets, for example in some parts of the British National Health Service (Appleby *et al.*, 1994), or in simple services such as building cleaning and refuse collection. There is a highly developed market for residential care for elderly people. Elsewhere, for example in education, markets can only be claimed to exist in a very limited sense. It might be possible to establish more effective markets in some cases by the use of vouchers, and in others by reducing regulation, but both of these approaches have been little developed. The development of markets in which the ultimate 'customer' chooses, and from which they can exit, is slow and faltering.

A central feature of the new management of the public service is the separation of politics and management. Politicians, it is argued, should play a strategic role, deciding broad policies and setting targets for managers, rather than being involved in day-to-day operational issues (Audit Commission, 1990b). This approach is maintained to be the route to overcoming the public choice problems identified by Niskanen and others, whereby both politicians and managers have an incentive to pad budgets and there is little to prevent them from doing so. A combination of internal markets, performance measures and inspection is seen as overcoming the incentives of self-interest. The voice of the 'customer' will be heard through complaints processes.

It is over issues of accountability that the new public management raises the most basic questions. Market-based approaches are seen as overcoming the dominance of the producer that has, it is argued, characterised the development of the welfare state. Producers will be put under market pressures and will be unable to put their own interests ahead of the public. As John Major has argued, the Citizen's Charter, the manifesto for the new management:

. . . sees public services through the eyes of those who use them. For too long the provider has dominated: now it is the turn of the user . . . The principles of the Citizen's Charter, simple but tough,

are increasingly accepted. They give the citizen published standards and results; competition as a spur to quality improvement; responsiveness; and value for money to get the best possible service within the resources that the nation can afford. They give more power to the citizen and more freedom to choose. And where choice is limited in some of the key public services like schools, social services, probation and the police, the Charter is bringing in independent inspection with a strong lay element to ensure that the citizen's voice is heard (Prime Minister and Chancellor of the Duchy of Lancaster, 1992).

The move is from professional and political to market-based accountability.

Outline of the book

The purpose of this book is to analyse the nature and implications of the use of market mechanisms in the management of the public service. The central focus is upon the key market-like changes that have been introduced: charging, contracting, internal markets and the creation of autonomous units. Other elements, quality systems, performance measurement, inspection and others, will be examined but only to a limited degree. They are seen as secondary to the main development of a market-based management system for the public service. It is the success or failure of market principles that will decide the effectiveness of the new public service.

The book is in three parts. The first part examines the background to the development of a market-based approach to public service management. In chapter 1, I examine the basic argument for state action as a corrective to market failure. This traditional justification of public, collective, action has recently been criticised by liberal theorists, putting forward a parallel theory of government failure. The second part of chapter 1 considers this argument. In chapter 2, I analyse the theoretical issues that are involved in the development of market-based institutions for public service management. The chapter will draw upon recent developments in economics, law and organisation. In economics, I shall examine the implications of theoretical developments based upon transaction

costs, principal-agent, and property rights theory. In law I shall examine developments in the theory of relational contracts. In organisation theory I shall discuss network-based management. This chapter will draw out key issues involved in the analysis of public service markets, such as information availability, trust, quality and risk.

In the third chapter I seek to develop an explanation of the pattern of development in public service management. It cannot simply be asserted that the new public management is the result of the New Right gaining political power. In many cases the introduction of the new public management has been undertaken by regimes of the Left, for example in Australia and New Zealand. I shall argue that change depends upon a variety of factors, and the way that they interact in different countries. The United Kingdom is important as an exemplar, in that it has developed the new market-based management further than most other countries.

The second part of the book is taken up by an examination of the components of the new market-based management. Chapter 4 presents evidence about charging and the use of prices in the public service. I also examine the slowly developing movement for introduction of vouchers. Contracts and competition are examined in chapter 5, and the use of internal markets in chapter 7. Finally I consider the devolution of control within public organisations, for example through the creation of trusts in the British National Health Service.

The final section of the book examines the implications of the new public markets. First I consider financial impacts, the effect on quality of service and the impact on users. These aspects of the new management are much debated, but the evidence is partial: large claims are being made with limited foundation. The final substantive chapter is concerned with the organisational and accountability effects of markets. This debate is fundamental to the issue of the effectiveness of markets. It is central to the question of whether or not we need a public realm of any size or not, which is considered in the final, concluding, chapter.

The core chapters of the book concentrate on the experience of the United Kingdom. This reflects the fact that the British government has taken the marketisation of the public service further than any other country. The case of the United Kingdom is placed in international context throughout the book, with particular attention

paid to countries like New Zealand which has pursued even more radical policies in certain areas, and a broader comparative account is provided in the more general chapters.