Supply Side Futures for Public Services

Paul Grout and Pete Alcock

2020 Public Services Trust
at the RSA

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About the 2020 Public Services Trust

The 2020 Public Services Trust is a registered charity (no. 1124095), based at the RSA. It is not aligned with any political party and operates with independence and impartiality. The Trust exists to stimulate deeper understanding of the challenges facing public services in the medium term. Through research, inquiry and discourse, it aims to develop rigorous and practical solutions, capable of sustaining support across all political parties.

In December 2008, the Trust launched a major new **Commission on 2020 Public Services**, chaired by Sir Andrew Foster, to recommend the characteristics of a new public services settlement appropriate for the future needs and aspirations of citizens, and the best practical arrangements for its implementation.

For more information on the Trust and its Commission, please visit www.2020pst.org.

The views expressed in this report are those of the authors and do not represent the opinion of the Trust or the Commission.

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About the ESRC

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Professor Grout was the Specialist Advisor to the House of Lords Economic Affairs Committee in its recent report on private finance projects and off balance sheet finance. He has considerable experience in advising government departments and companies on public services and regulation. Recent examples include Ofgem, BERR, Ministry of Justice, Competition Commission, Office of Fair Trading, European Bank for Reconstruction and Development, European Investment Bank, BBC, and Swedish Competition Authority.

Professor Alcock has been teaching and researching in social policy for over twenty-five years. Since September 2008 he has been Director of the Third Sector Research Centre (TSRC) based at Birmingham. The TSRC is a collaborative enterprise with the University of Southampton and is funded from five years initially by the Economic and Social Research Council (ESRC), the Office of the Third Sector (OTS) and the Barrow Cadbury Trust. From 2003-2008 he was Head of the School of Social Sciences at Birmingham. He is also past Chair of the Social Policy Association and of the Editorial Board of the Journal of Social Policy, and was a member of the Subpanel for Social Work and Social Policy and Administration for 2008 HEFCE Research Assessment Exercise.

Professor Alcock is author and editor of a number of leading books on social policy including *Social Policy in Britain 3e* (2008), *Understanding Poverty 3e* (2006); *International Social Policy 2e* (2009) (all Palgrave), and *The Student's Companion to Social Policy 3e* (2008) and *The Blackwell Dictionary of Social Policy* (2002) (Blackwell), and *Welfare and Wellbeing* (2001) (The Policy Press). His research has covered the fields of poverty and anti-poverty policy, social security, and the role of the voluntary and community sector and he has written widely on these and related topics.

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Introduction to this series

The Commission on 2020 Public Services is a major inquiry into how public services should respond to the significant societal challenges of the next decade. The Commission is developing a practical but compelling vision of the priorities for public action to address the emergent challenges facing society in 2020. The Commission has three aims:

1 To broaden the terms of the debate about the future of public services in the UK.
2 To articulate a positive and long-term vision for public services.
3 To build a coalition for change.

This series of essays represents a working partnership between the 2020 Commission and the Economic and Social Research Council (ESRC). As part of our commitment to rigorous, evidence-based research, we jointly commissioned a series of experts to examine the key issues in public services. Two broad themes emerged: one considering future relationships between citizens, state and society; the other exploring the future delivery of public services.

Generous support from the ESRC has allowed the Commission to dig deep into a complex set of issues, and ensure its inquiry represents the best contemporary thinking on public services and society, with a strong evidence base.

Each paper can be read separately, and will also be available as a collected volume in the future. We believe that the research and analysis emerging from this partnership is a rich and significant contribution both to the ongoing national debate on public services and to the Commission's vision for the future. We hope that you enjoy the series, and we invite you to share your own reflections and analysis at www.2020pst.org.

Foreword

The UK's new coalition government is undertaking a fundamental review of public services. A long period of economic growth and public investment is over, and the country is being invited to join in a new type of debate: about what to prioritise and what to cut. At the same time, policymakers are worrying about how to sustain and improve the productivity of public services. Doing 'more with less' is the mantra.

Public services face a tough period ahead against this backdrop. But the question is not only about how to squeeze our existing system and resources. Citizens' needs are diversifying, and we know that demographic change, behavioural challenges and a changing climate pose new problems for a system designed in the 1940s. Such dynamics will require creative ways of designing and delivering public services that can both meet the demands of the people who need them, and be more productive within this constrained environment.

This creativity will come in part from a diverse supply-side market. Public services are already being delivered by a range of different organisational forms, and recent political enthusiasm for social enterprise, co-operative and voluntary sector models of delivery may well increase this diversity in future. At the 2020 Public Services Trust, our own approach for 2020 would be to call for 'markets not monopolies' - encouraging diversity and innovation, but warning against any simple transfer of monopoly provision from public to the private or third sectors.

Citizens themselves appear to favour a 'blended' approach to the provision and funding of public services. As Professor Grout and Professor Alcock both allude to, there is some disagreement about the appropriate extent and role of the private and third sectors, but this is underpinned by a desire to see good quality services whatever the funding or delivery mechanism. For instance, only 11% of citizens polled by Ipsos MORI thought that the private sector should be prevented from providing public services under any circumstances. Meanwhile 81% accepted the treatment of patients in private facilities if that meant quicker treatment.

The Commission on 2020 Public Services has put considerable thought into the question of what a 'blended' approach might look like, and what it might imply for the role of central and local government. We have critiqued a system that is at times passive, narrow and static - and called for a state that is leaner, more flexible and decentralised, but able to invest strategically in early intervention and integrated, citizen-centric services. This would be a state that encouraged diverse local supply side markets, in which central and local government would act as effective regulator and quality controller. Supporting citizens - through providing education, advice and information - would be essential to hold this to account from the bottom up. In our interim report 'Beyond Beveridge' we argue that three systemic shifts are needed to make this happen:

1 A shift in culture - from social security to social productivity
2 A shift in power - from the centre to citizens
3 A shift in finance - reconnecting finance with purpose

The papers in this publication are in agreement that if our aim is to see public services that can better meet the changing needs of citizens, then we should be open to the innovation and stimulus that a diverse supply side can provide. As Professor Alcock states, 'the mixed economy of welfare is both given and desired'. And as the means of funding and delivering public services is being debated, we should think also about the ends. What do we want public services to achieve? What kind of society will they support and reinforce? The papers presented here offer both a stimulus for answering these questions, and a way into better understanding the means we might employ to get there.

Dr Henry Kippin
2020 Public Services Trust

1 Fostering Supply Side Markets For Public Services[1]

Professor Paul A. Grout

1. Introduction

The private sector's involvement in the delivery of public services has grown enormously in the last thirty years. The recent BERR Public Services Industry Review (2008) estimated that the turnover of the industry in the UK was £79bn in 2007/8. Globally it is estimated that 18% of the global stock market value and 39% of the non-US total value (Megginson, 2005) consist of assets that have been transferred from the public sector to the private sector in the preceding 20 years, a significant proportion of which consists of public services. Within developed economies, privatised companies account for a significant fraction of the stock markets: more than 13% in Germany and nearly 12% in Australia (Megginson and Netter, 2001), most of which are public services. Over 1,000 'public-private partnership' (PPP) projects – again mostly public services – had reached financial closure in the European Union alone by 2007, with a total capital investment of around €200 billion (Blanc-Brude et al, 2007).

Clearly the supply side has delivered sufficient providers from the private sector to make this possible and in the immediate future spending restrictions are such that constraints in the private markets are unlikely to appear. However, this does not mean that over a longer period private suppliers will either maintain their position or be available if growth of private involvement in the delivery of public services continues.

1 This first half of this paper draws heavily from my keynote address at the European Commission's Eurosocial Taxation Conference, Mexico, 24th – 28th November 2008.

The first half of the paper (Sections 2 through to 7) identifies separate of models of private delivery, and addresses the benefits that the private sector suppliers bring, with a view to indicating where long-term growth in the market may arise. A crude but useful taxonomy is given which boxes non-public provision of public services into three main categories: (i) full privatisation (essentially an arms-length relationship between provider and government), (ii) public private partnerships (separated again into outsourcing partnerships and private finance initiative arrangements), and not-for-profit. The comparative merits of these three are explored through the answers to a series of questions: when are private incentives likely to be beneficial, how does pro-social motivation impact on whether we should be fostering for-profit or not-for-profit, and should we be fostering more long-term partnerships or arms-length relationships? The general theme that emerges is that, on average, privatisation and outsourcing partnerships have been successful. Private finance initiative partnerships have brought benefits but it is difficult to be really sure. In contrast, the view that not-for-profit is a superior to for-profit delivery is unproven.

This picture suggests that the private sector has a significant and growing role to play in the delivery of public services. But things are not this straightforward. The reason is that the empirical evidence runs totally counter to public opinion. Surveys and focus groups show that private delivery is greeted with scepticism by the public. There appear to be two problems (although these are really the same thing viewed from two different angles). The public seem to think that private provision lacks the public service ethos that is deemed to be essential and that the profit motive is unacceptable in public services. In contrast not-for-profit delivery is growing rapidly and is perceived in a positive light. This conflict between what private delivery has to offer and what the public think of it and want from it is probably the biggest constraint on the growth of private delivery mechanisms.

The second half of the paper (Sections 8 to 10) considers some of the political economy issues that both restrict the private sector's ability to maintain its position in the public services market and reduce the attraction of the market to the suppliers. I also make some suggestions to improve the situation. I focus on three issues.

One problem is that private suppliers are damaged by a dearth of information. For example, public private partnerships often involve 25 or 30 years contracts with the private sector where a private consortium builds and runs an activity. The cost to the government will be the whole-life cost of the private project, which is a mix of up-front build costs, operating costs, maintenance, etc. To know if this is a cheaper method we need to compare the whole-life cost of the private option with the whole-life cost of the public alternative. The problem is that no-one ever keeps a record of the whole-life cost of public activities. The whole budgeting structure in the public sector does not lend itself to this way of doing things. So no-one can really answer the fundamental question of which is cheaper. Several things follow from this. One is that the debate often takes place at the level of assertion. Another is that careful studies are usually case studies. The history of large public projects makes for sorry reading and there have been well publicised problems with some PPPs. So case studies may be enlightening as to what problems can arise but they are not so helpful in identifying the broader picture. Finally, because PPPs and regulation increase transparency of costs, private provision is a soft target if one wants to argue that private provision is costly. The private cost is on display whereas the whole-life public equivalent is usually buried in a morass of project costs. So improving the quality of information would help enormously.

Another problem is the need to legitimise profit. If the public do not perceive that profit in public services is legitimately earned then there will always be pressure for governments and regulators to reduce it and public pressure to retain public provision will remain. Crudely put, a company will never be able to keep earning profits unless it is legitimised. But many of the fixed price or RPI-X type incentive structures simply exacerbate the problem. There should be much more use of upside quality triggers so that higher profit is correlated with measurable improved service quality rather than simply cutting costs in a fixed price contract. The perception may then slowly be changed in a way that makes profit in public services more acceptable. Such triggers may not be necessary to incentivise cost reduction (we know fixed price contracts do that quite well) but economists have for too long ignored the political economy of public services and have focused too much on designing simple incentive schemes which work well for the companies but do not confront the problem of public perception.

Finally, the way that private services are compared to public provision understates the private value add. For example, PPPs have proved very attractive because the costs could be kept off balance sheet. Essentially, governments can use partnerships to provide investment today without having to pay upfront or counting the cost of the project as government debt. It is extremely common to hear criticism of this reason for opting for PPPs. The criticisms typically assume (often implicitly rather than explicitly) that this justification for private sector delivery is bad because the public sector could borrow and do the project. But this is not the relevant test. What matters is the realistic alternative not a hypothetical alternative. It is not whether the public sector could have taken the project on but whether the public sector would have undertaken the project instead of the private sector. Politicians are not commonly thought of as angels so it does not make much sense to assume that they are in this context. They are usually deemed to be too short-term and are reluctant to commit expenditure and increase debt for something that does not bring immediate benefits to voters. So a mechanism that allows politicians to improve the infrastructure of the country while not raising debt, yet still passing on the cost to future generations, seems a plausible way of correcting the distortion. It may not be perfect but this is not a perfect world. So we should be comparing private provision with the 'true counterfactual' not a hypothetical public equivalent. How one does this formally is far from clear. Currently the problem is fudged.

2. The public sector, public services and public services industry

To map out the sphere of private involvement in public services, it is important to distinguish between the 'public sector', 'public services' and the 'public services industry' (though it is difficult to provide watertight definitions of these things).

The public sector comprises the economic activities controlled by the government. A legitimate concern is that the public sector is not subject to the discipline of the competitive market and may lack incentives to control costs, provide good quality service and respond to customers' needs. Hence, what is the appropriate sphere of the public sector and which sector should deliver which public services is a critical question. As a working definition, this paper takes public services to be the set of services provided for large numbers of citizens in which there are potentially significant market failures (broadly interpreted to include equity as well as efficiency) that justify government involvement, whether in production, finance or regulation (Grout and Stevens (2003)). The public services industry has been defined by the Public Services Industry Review (2008) as 'all private and third sector enterprises that provide services to the public on behalf of Government or to the Government itself'.

What's in and what's out of these three definitions is a little blurred at the edges, but the definition of public services clearly includes utilities, transport infrastructure, most education and health services, street cleaning and rubbish collection, and national defence.

The terms ‘public sector’, ‘public services’ and public services industry’ are not aligned. Not everything that the public sector does is a public service – for example, helping to promote the efficiency and exports of private sector industry is not a public service in the sense used here. It may well be a public sector activity and if provided by private companies to the relevant government department it would be part of the private services industry. Similarly, many services supplied in some countries by the private sector are unambiguously public services – for example, water supply and electricity distribution.

3. A crude taxonomy

Although the role of the private sector is diverse and there are numerous delivery ‘mechanisms’, most non-public delivery can be loosely categorised into one of three (overlapping) models: full privatisation, partnerships between the private and public sectors, and heavily restricted legal forms of organisation, which in practice mostly boil down to non-profit organisations.

Full privatisation

The defining characteristic of full privatisation is that the government’s role is ‘arms-length’. Ownership is fully transferred to the private sector. The newly created private company recovers most if not all of its revenues from the general public and private sector customers. And the government’s involvement is, at least in theory, thereafter limited to setting up regulatory agencies and keeping a watching brief on the objectives to which the regulator is to be held accountable. This model has been very common around the world for big utilities such as telecoms and energy and, to a lesser extent, water and transport. Of course, in many cases, the transfer of ownership is more apparent than real, since companies often operate under a licence from a regulator. Although a company may legally have full ownership of its assets, the assets are of limited use if the company does not have a licence to sell the service.

So the full privatisation model still allows scope for political pressure and corruption, which in many countries causes problems for investment and growth. It is not surprising therefore that the independence of the regulator and the general level of corruption in an economy have turned out to be important elements in determining the success of the approach. Furthermore, because of the scale of the infrastructure involved, these companies tend to be placed on stock markets or put out to the world's capital markets. So the full privatisation model has become forever intertwined with political sensitivities about stock markets, global capital markets and, particularly in developing countries, the development of their own financial markets (see, for example, Grout (1987, 1994).

Public-Private Partnerships

For other services governments have chosen to maintain a more direct relationship with the private sector or to continue to provide many public services themselves. There are many reasons why they might do this. The nature of the services may make the full privatisation model impractical – for example, an integrated urban road network, poverty may make it impossible to charge economic tariffs, sometimes the only purchaser is the government itself – for example, defence or, in many economies, healthcare and primary education services, the government may face anti-privatisation political pressures from workers or the electorate.

In any of these circumstances, the government may end up having a far more intimate, complex, continuing and subtle relationship with private providers. These partnerships tend to be either *outsourcing-type partnerships*– where services are provided on short- or medium-term contracts – or longer-run *private finance project partnerships*. PPPs are not partnerships in the way that lawyers, professional service providers or private companies understand the term. All exchanges take place under a clear contractual relationship and there is clear ownership of all assets.

There is an element of truth in the idea that the global public was sold privatisation by governments as if it was a panacea for all public sector sins, and the public have since found that this could never be the case. As a result, the word privatisation is now met with more scepticism. For politicians and non-governmental organisations, it carries a tarnished feel that the word partnership nimbly sidesteps since it suggests more of a closely balanced relationship than is really present.

The evidence on outsourcing partnerships is well documented. In contrast, there is far less evidence on PFI partnerships and they remain highly controversial. Nevertheless, there has been a large global shift towards their use. The International Monetary Fund (IMF) has described PPPs as 'a wave that is sweeping the world' (IMF, 2004). This may be slightly overly enthusiastic but indicates the scale of what is happening.

Not-for-profit

While the profit motive and its consequences are generally considered a central plank of what the private sector has to offer, they are not essential. Private legal forms can be set up with all sorts of restrictions on what they can and cannot do. Setting up an organisation in a way that prevents the distribution of profit to shareholders is relatively common. It is then a moot point whether a not-for-profit organisation is really part of the private sector or a sector in its own right (often referred to as the third sector). There is a vast theoretical literature on the potential benefits of such structures though it is yet not matched by empirical research. Not-for-profit organisations play a major role in delivery of public services in the United States, and despite the mixed evidence there is a clear sense that governments are likely to increasingly turn to this model, in part because of popularity of the sector with the public.

4. When are private incentives likely to be beneficial?

Here I focus on two messages. These arise from the answer to an obvious question –why should it matter which sector delivers services? Or to put it another way, why can't the public sector replicate the most beneficial aspects of the private sector and vice versa?

One view, which we can think of as the direct effect, is that the primary reason stems from incomplete contracts. Contracts tend to be incomplete for all sorts of reasons. For example, some activities may be important but too nebulous to specify in a contract. Even though the parties involved may be able to identify accurately what is happening it may not be possible for a third party (e.g., a judge) accurately to observe or for other reasons it may be too difficult to define in a watertight legal way. Another obvious reason is that the potential outcomes may be too numerous and vague to categorise or at least too numerous to write into a contract without incurring onerous transaction costs.

If contracts are incomplete, then it will not be possible to describe fully what actions agents and the owner of an asset should make in every possible situation. So the owner of an asset is likely to have some flexibility over outcomes when the other party would prefer this not to be the case and even when assets are not significant contractual silence on issues conveys power to different parties according to the nature of the service. This will be a more significant issue the harder it is to cover critical issues within a legal contract. Incompleteness of contracts may be a particular problem with public services since the service is often difficult to define completely. For example, it is difficult to define the quality of care that should be administered in particular situations and hard to prove legally that someone is not doing enough in different situations.

Where contractual incompleteness is a significant issue and cost reduction reduces quality, then how much cost reduction there will be may depend on the sector that is doing the delivery – that is, which sector owns the assets and the 'production' process. If a profit-maximising private company owns the assets, then the company may choose to reduce costs regardless of the consequences for (non-contractible) quality reductions. In contrast, the public sector will care about quality as well as cost, taking account of any effect of quality reduction when reducing costs – so quality should be higher and cost reductions lower. But the public agent is harder to motivate to reduce costs even when it has limited effect on quality.

The net effect is that the private sector is more likely to provide lower costs but lower quality. This simple reasoning provides a clear implication: where the social cost of reductions in non-contractible quality reduction is large relative to potential cost savings – for example, brain surgery – then public provision has benefits. Where the social cost of non-contractible quality reduction relative to potential cost savings is less of a problem – for example, emptying dustbins – then private provision is likely to bring benefits (e.g., Hart et al, 1997, Shleifer, 1998).

The other view I wish to emphasise suggests that the prime value of involving the private sector stems from the difficulty of introducing competition in the public sector. The argument is that limited competition makes the public sector expensive and hence the private sector has a role to play as the enabler of competition.

There is considerable evidence that competition has a cost-reducing effect, but there are limitations to the services to which it can be applied. For competition to be real, there has to be a genuine fear of termination of contract for the incumbent. Indeed, the big advantage of using private suppliers is that it is practically and politically easier to remove underperforming agencies. But the process is only suitable where changing supplier is practical. If there are significant costs of transfer, then the incumbent is in a strong position and the competitive framework can unravel. If a government threatens to replace a supplier but the costs of replacement are high, then, when it comes to it, the government may not follow through their threat – the threat of replacement is said to be 'time inconsistent'.

Competition may have a big impact on some services, such as refuse collection, since if things go wrong during transfer, then bins may be emptied haphazardly for a short while but this is an inconvenience not a major problem. But this is not true for many public services. For example, with gas or electricity transmission or railways, there may be real dangers with transfer of contracts.

Generally, the evidence on the impact of outsourcing on costs is very clear. For example, Domberger et al (1986) look at refuse collection in 305 local authorities and find that where the service was put up for tender and given to a private operator, there were average cost savings of 22% (after allowing for differences in service factors that would have affected cost). It is possible that this could have been due to sample selection effects – notably that the authorities that put their waste collection up for tender were those that thought they were paying too much for the services. Szymanski and Wilkins (1993) show this is not the case: they find savings of approximately 20% after the introduction of compulsory competitive tendering in local government. Using data from 3,000 hospitals in the UK, Domberger et al (1987) find savings of 34% from competitive tendering for hospital domestic services.

So the private sector effect is present but is this effect direct or indirect? Several studies address the question of whether the price falls are greater if a private sector company wins a bid compared with the situation where the public sector incumbent wins. Most studies find no direct sector effect –for example, Domberger et al (1986, 1987), Dijkgraaf and Gradus (2003) and Milne and McGee (1992). But Szymanski (1996) reports that if a local authority awards the tender to their in-house team, then costs are reduced by about 10% compared with a 20% cost reduction with private contractors. Using Italian procurement cases, Bandiera et al (2008) also find a sector effect. Other studies using different approaches also suggest that competition is a key driver. Coviello and Mariniello (2008) look at Italian procurement and the effect of publicity laws. Using evidence from over 40,000 procurement auctions, they show that increasing publicity from local to regional increases bidders by 50% and reduces the price paid by 5%. Increasing publicity to the European level has no effect on the number of bidders but reduces the price paid by an additional 10%.

Bel and Costas (2006) suggest that the benefits of contracting out may decline over time, and Ohlsson (2003) finds that public production is only 6% cheaper than private production. There are insufficient recent studies to know if there is a time effect but it is not implausible. As outsourcing develops, then more public sector suppliers realise that they may become exposed to these competitive forces. The probability that this will happen will itself be sensitive to the performance of the public supplier since the worse it is, the more probable a government will turn to outsourcing. So it would not be surprising to find public delivery improving over time even for services where outsourcing is not formally present. Of course, this does not mean that the benefits from having outsourcing, relative to a situation where outsourcing could never arise, are reduced. It is simply that the growing threat of outsourcing is enough to bring about some of the benefit through better public delivery. So when the sector actually is changed, the net effect is less since part of the gain is already in the public cost figures.[2]

But it appears that much of this effect operates through competition rather than there being something unique about the private sector that makes it inherently cheaper. There is some evidence that the sector effect is present but it is not the biggest part of the story.

5. Pro-social motivation: Should we foster for-profit or non-profits?

Individuals may care about the activities in which they are involved beyond the financial rewards that they receive. In the context of public services, this is sometimes called public service motivation – the desire to work in public services to contribute to output and quality. More generally, this can be thought of as pro-social motivation (Francois and Vlassopoulos, 2007). Pro-social motivation can lead to pro-social behaviour such as 'donated labour' – labour donated beyond what is explicitly or implicitly contractually required – but this may depend on the type of organisation that employs the motivated individual.

The idea that not-for-profits may be better at encouraging employees and management to display pro-social behaviour than for-profit organisation stems from the work of Arrow (1963), Hansmann (1980), Easley and O'Hara (1983) and Rose-Ackerman (1996). In this literature, not-for-profits generate a trust signal – that is, not-for-profit suppliers will not reduce quality even though they are not contractually bound to a specific standard. The idea that not-for-profit organisations elicit pro-social behaviour has been formalised in a series of papers by Francois (2000, 2001, 2003 and 2007). The analysis rests on the inability to contract fully over all outcomes.

2 There is little evidence showing that quality falls if the private sector takes over an activity. E.g., Domberger et al (1995) undertake a careful analysis of 61 cleaning contracts and find that cleaning performance was either maintained or improved.

Consider a hospital where all employees have pro-social motivation and, by way of example, decide that they will never leave a shift if there is no-one else at hand to take over. The commitment of the staff to stay if needed protects a for-profit employer from bad outcomes, including potential legal redress, if there is a staff shortage, and so a for-profit company will find it hard to pre-commit not to take advantage of this by hiring fewer employees than before. Of course, the employees will realise this and so will not 'go the extra mile' because their donated labour does not improve the quality of patient care. So the for-profit form is unable to deliver the preferred outcome – it cannot prevent itself from diverting donated labour if it arose and so any desire to offer any is diluted or destroyed completely. In contrast, in a non-profit organisation, the non-distribution constraint prevents this expropriation and so the donated labour does indeed improve the outcome of the business. Employees who are motivated therefore have an incentive to donate labour. This literature suggests that donated labour will be positively associated with not-for-profit and government organisations, and absent or limited in for-profit organisations.

An alternative 'mission-matching' approach (most clearly formalised by Besley and Ghatak, 2005) also identifies when the profit motive may be inappropriate. In this model, individuals have particular missions, which motivate them to engage in pro-social behaviour. The mission – and the associated behaviour – is a fixed individual characteristic, but people will be attracted to like-minded organisations, so that mission-oriented organisations that favour high quality public service provision will attract employees whose personal mission matches this. The core distinction is between mission-oriented and profit-oriented organisations, and the approach suggests that, in some circumstances, profit-oriented organisations may perform less well than mission-oriented ones because they will not attract mission-oriented individuals. So the profit motive may be less effective where individuals have strong pro-social missions and this raises a question as to whether we wish to promote non-profit organisations rather than for profit.

There is a significant literature looking at the comparative performance of not-for-profit and for-profit firms, much of which looks at US not-for-profits since these are well established, notably in health. Despite the appeal of arguments suggesting that not-for-profits should have clear advantages, it is hard to see this effect in the evidence, which tends to be mixed. Of course, in terms of global reach, the evidence is drawn from a limited pool so further analysis is certainly needed. Research finding that not-for-profits are more efficient than for-profits includes Cutler and Horwitz (2000), Ferrier and Valdmanis (1996) and Wilson and Jadlow (1982) on hospitals, and Nyman and Bricker (1989) on nursing homes. Research finding the opposite includes studies undertaken by Woolhandler and Himmelstein (1997), Becker and Sloan (1985) on hospitals, and Blau and Mocan (2002) and Mocan (1997) on day care centres. In response to these inconclusive results, Eggleston et al (2006) use a quantitative meta-analysis approach to review the literature on US hospital performance systematically. They find that many of the results were driven by differences in the way that studies accounted for market variation and regional differences. Yu et al (2006) find only tentative evidence for higher patient care costs and profits at for-profit hospitals.

A well-established argument for the not-for-profit form is that it provides a trust signal – essentially a third sector supplier will not cut quality in the way that a for-profit supplier may. There is some evidence of self-selection of less well-informed consumers into non-profit institutions (e.g., Holtmann and Ullmann, 1991) although the proxies for less well-informed are difficult to capture well. Where competition is low, not-for-profits provide a higher level of access – for example, Mas (2008).

Analysing contracts of the UK's Department for International Development, Huysentruyt (2006) finds that not-for-profit firms compete most where there are important non-contractible quality innovations and that ex-post transaction costs are higher with for-profits than not-for-profits. But not-for-profit firms are less likely to adhere to procurer's terms of reference. So not-for-profit employees and organisations may go the extra mile but it may be in the 'wrong direction' from the perspective of the procurer. This is a bigger issue in some areas than others. For example, it is thought to be a problem with evangelical religious groups in the developing countries. The groups will potentially give more 'bangs for the buck' in terms of commitment and effort but along with this goes the particular religious pressure that is difficult for the procurer to control. This may be another reason for the lack of positive evidence on productivity.

Simple cross section evidence shows that there is more unpaid overtime in non-profit (public and not-for-profit) than private in 'caring industries', such as health and education. At first glance such evidence would appear to prove the theoretical arguments against the for-profit organisational form when there is pro-social motivation. But Gregg et al (2008) use data from the British Household Panel Survey (BHPS) to show that this need not be the case. The research confirms that there is a positive and significant correlation between sector and donated labour. After including a robust set of individual and job-specific controls, individuals in the non-profit sector are more than 40% more likely to do unpaid overtime than individuals in the for-profit sector. But, by exploiting the panel nature of the data, the authors find no evidence that individuals change their donated labour when they switch sector. Thus this data throws doubt on the validity of the theoretical arguments for not-for-profit outlined above. Indeed, the study has a negative message for analysis of not-for-profits. Although not-for-profits are clearly able to attract employees who donate labour and hence may be more efficient as a result, these employees are sucked away from other employees who may lose as a result. So any aggregate efficiency gains that might arise from extending the not-for-profit sector would have to come from the improved efficiency that could arise from having a better match of employees and firm. The employees do not appear to engage in more pro-social behaviour as a result of changing sector.

So overall, the idea that not-for-profit firms deliver something that for-profit firms cannot is not confirmed by the evidence in existing studies. Indeed, although not-for-profit firms may attract individuals that offer more donated labour, there is as yet no evidence that these individuals only provide this when they work in a not-for-profit environment. Of course, there is an enormous amount of analysis needed before these questions can be answered. But currently the limited evidence does not point to a clear not-for-profit effect and so it is not clear that economic efficiency arguments point to fostering not-for-profits at the expense of for-profit.

However, it is easy to see how not-for-profit delivery appeals to politicians who wish to appease voters who, at least globally, are sceptical of more and more privatisation. But the evidence suggests that the efficiency justification of not-for-profit as a method of delivery is yet to be proved.

6. Should we be fostering more long-term partnerships?

A common criticism of public delivery of public services is that services are delivered late (particularly if there is a significant build or renovation element involved), costs overrun and risk is not well managed. The blame is frequently put at the door of the traditional procurement process which separates initial investments (build, renovation and general sunk costs) from ongoing maintenance and delivery. Typically with traditional procurement there are different contracts for each component. The effect is that there is limited incentive to sink upfront costs which reduce future maintenance and delivery costs. In contrast, long-term partnerships bundle contracts and have some hope of sidestepping these problems and bringing about better decisions.

The extreme examples of long-term partnerships are PFI-type public private partnerships. Here the government signs a long-term contract with a private supplier and pays for the delivery of the public service throughout the life of the contract. Thus the government pays for the service as it gets it rather than paying upfront, which is the traditional procurement model. The private contractor typically owns the physical 'asset' and makes money from the payments for the service that it generates. Essentially, the building of an asset and the delivery of services over a long period are bundled together.

A road contract is good example. The traditional public provision arrangement involves the government signing an agreement with a contractor to build a road: the government pays the contractor for the road when it is built, after which the government owns the road, maintains it and makes it freely available to the public. With a PPP, a private contractor builds and owns the road: the government pays the contractor a fixed fee for every vehicle that uses the road over, say, a 25-year contract period. Upfront expenditure by the private sector followed by long-term payments by the public sector for the service is the key theme of many PPP partnerships.

The economic argument for bundling in this way can be seen in the following example. In the traditional public provision model, builders are paid for the building and they then move on to build another. If the building turns out to be rather poor quality after many years, then the government faces a complex legal battle to prove that poor building rather than poor specification or incorrect maintenance is at fault. In contrast, in the PPP model, the government pays for the service it gets. If a road is poor quality and needs expensive repairs, then the builder pays this and also suffers loss of income if cars use other routes while the road is repaired. So if the private contractor fails to deliver the service, then it receives no payment. The idea is that the contractor has a strong incentive to deliver on time (to start the money flowing) and to ensure good quality design and build to avoid costly repairs and failures later on.

There are, however, some obvious costs to entering long-term partnerships. If a long-term contract is signed and the public sector department wants to change something then the private sector supplier has the department 'over a barrel' and changes are very expensive. Also it is not obvious that the difference in funding costs between public and private sector simply reflects the true measurement of risk. If there is a monopoly return in the cost of finance then the private project has to be sufficiently better to justify the approach.

The contract structure of PPPs is designed to provide incentives to deliver on time to start the money flowing and the evidence suggests that this happens. For example, the National Audit Office (NAO, 2003a) surveyed the PFI construction projects up to 2002 and found they compared favourably with traditionally procured hospitals (75% of which were delivered late). Mott MacDonald (2002) found similar results. There are comparable results outside the UK. A European Investment Bank (EIB) study (Thomson, 2005) found fewer time delays.

Being on time is not the same as being better value. A detailed study of 200 roads funded by the EIB (Blanc-Brude et al, 2006) finds that PPP projects are 24% higher than the traditionally procured roads at contract signing. There is a sample selection issue that makes it hard to interpret the results. For example, projects that are thought to be particularly expensive might be more likely to be put out as PPPs to try to use competition to control costs. This would make PPPs look abnormally expensive. But apart from such issues, the results are statistically significant. There appears to be a large additional cost to increase the delivery on time, but the authors point out that the value of cost overruns in traditional projects is between 20% and 28%, suggesting that at the build stage, these PPPs are neither more expensive nor cheaper than traditional public projects. Of course, theory suggests that the building costs of PPPs should be higher than traditional public projects since the PPP contractual structure should create incentives to ensure better quality delivery over time. So as well as obtaining better delivery at no greater cost, this research suggests PPPs may be better value than expected.

But currently, as I discuss later, there is insufficient data to know whether this is true. There is evidence that financial risk is passed on to contractors, though investigations are limited to specific markets. Using a large sample of debt payments, Blanc-Brude and Strong (2007) find that spreads do indeed reflect the systematic risk that PPPs face (notably traffic risk).

The discussion here has side-stepped the off balance sheet issue. I return to this in section 9.

7. Or do we want to foster arms-length arrangements?

As indicated in Section 2 an alternative way of using the private sector to deliver private services is for the public sector to step back and to use regulated private companies to operate under licence, essentially full privatisation. There has obviously been a global shift in favour of this model from the 1980s onwards. The rationale for the privatisation wave was part economic and part political. On the economic side, the ambition was to reduce costs and improve efficiency by replacing 'soft' public budget constraints with hard market constraints while simultaneously bolstering government coffers. On the political side, reducing the size of the state and its workforce offered the prospect of making voters more conservative and rapidly ushering in market mechanisms, particularly in transition economies, rendering a return to the old ways less probable.

Much of the evidence suggests that the privatisation programme globally achieved many of its economic and political objectives. Privatisation is generally, although not universally, associated with improved efficiency indicators. It is also positively associated with higher sovereign debt (Bortolotti et al, 2004). The situation with public services was and remains more complex. But the general drive to raise funds and move activities rapidly to the private sector meant that those public services with good market value that could be shifted fully into the private sector were first up. This basically meant big utilities and among these the services with strong demand and market power. Telecoms were the prime target everywhere, and the vast majority of telecoms networks in the world now sit in the private sector. Energy networks followed and, in some countries, including the UK, water and rail networks were also privatised.

Megginson and Netter (2001) provide the most comprehensive international survey of studies of privatisation. They conclude, 'we know that privatisation "works", in the sense that divested firms always become more efficient, more profitable, and financially healthier, and increase their capital investment spending'. In the UK, Martin and Parker (1997) find that in the 1990s, telecoms firm BT achieved annual labour productivity growth of 15% and British Gas achieved 6%. Parker (1999a,b) documents a long list of improvements in service measures in UK telecoms, gas and electricity and water since privatisation. Indeed, Pollitt and Smith (2002) show that there were major efficiencies achieved in the early years after privatisation even in the rail industry in the UK, which is generally regarded as a difficult case. Newbery and Pollitt (1997) document significant welfare gains following privatisation in electricity in the UK – mainly caused by greater investment, lower prices and improved productivity. These effects are also apparent in other developed economies, for example, Galal et al (1994).

Privatisation is also generally beneficial in developing countries though the picture here is more mixed. Davies et al (2005) identify productivity gains in most developing countries and document far more positive than negative effects for consumers, governments and investors. Campos et al (2003) show gains of 2% per year in productivity in Argentina's water industry from privatisation, and Estache and Kouassi (2002) find clear benefits from having private operators in Africa. But Estache and Rossi (2002) find no clear difference between public and privatised provision in Asia.

A clear message from many studies is that privatisation alone does not deliver anything like the same benefits if it is not accompanied by liberalisation (that is, increased competition) or independent regulation. Newbery (1997) argues that liberalisation is critical in obtaining the full benefits of privatisation: 'privatisation is necessary but not sufficient'. Zhang et al (2002) (in 24 developing countries) and Alesina et al (2005) (looking at several sectors of many OECD countries) find similar results. Bortolotti et al (2001) conclude that the financial and operating performance of telecoms companies improves significantly after privatisation, but that a sizable fraction of the observed improvement results from regulatory changes – alone or in combination with ownership changes rather than from privatisation alone.

But an obvious question is how far the privatisation model can be pushed in the delivery of public services. The privatisation of the UK railways is informative here, having culminated in the first bankruptcy in the UK of a privatised utility. To some extent, the blurred incentives and responsibilities (on the side of both the regulator and the companies) were the result of the original privatisation structure and have been much improved subsequently. But the problem is deeper since it was the government that decided the future of the business and the returns to shareholders, not the independent regulatory body, and the government decided that it would no longer contribute enough to keep the company afloat. If companies cannot cover all their costs from customers, then the model suffers from being too close to government and the benefits of having an independent regulator are hard to achieve.

Furthermore, keeping government at arm's length is clearly beneficial but is a common concern. This is notable in developing countries, where corrupt administrations can seek to dictate the behaviour of privatised companies. But even in the UK, government actions have had a significant impact on privatised companies even in the presence of independent regulators (see Grout and Zalewska, 2006).

8. A major constraint on growth of private delivery mechanisms

The general theme that emerges from the previous sections is that, on average, privatisation and outsourcing partnerships have been successful. Private finance initiative partnerships have brought benefits but it is difficult to be really sure. In contrast, the view that not-for-profit is a superior to for-profit delivery is unproven. This picture suggests that the private sector has a significant and growing role to play in the delivery of public services. But things are not this straightforward.

The reason is that the empirical evidence runs totally counter to public opinion. Surveys and focus groups show that private delivery is not popular. For example, in depth research by Ipsos MORI for the 2020 Public Services Trust showed that:

> 'The idea of private provision of public services tends to be greeted with suspicion. In general, alternative service provision by the private sector is rejected by many, both because the remit of private provision is perceived to lack a public sector ethos and because the profit motive is usually considered unacceptable in public services.'

And in similar vein:

> 'Alternative service provision is unpopular with many participants because it is too often considered to be synonymous with private provision, which is felt by some to compromise the kind of 'rective security' which the public hold so dear in public service arrangements'.[3]

In contrast not-for-profit delivery is growing rapidly and is perceived in a positive light. Since 2000 the voluntary sector's statutory income has grown much faster than public spending (although expenditure on the voluntary sector is still only around 2% of government spend).[4] In contrast to attitudes to the private sector,

3 Both quotes from Section 7, Citizen engagement: testing policy ideas for public sector reform, Ipsos MORI for the 2020 Public Services Trust.
4 The UK Civil Society Almanac 2010 (ncvo).

Ipsos MORI found that many people felt strongly the voluntary sector should have more of a role in achieving social outcomes (although the public has little knowledge of the sector).

This conflict between what private delivery has to offer and what the public think of it and want from it is probably the biggest constraint on growth of private delivery mechanisms. In the following sections I consider some of the political economy issues that both restrict the private sector's ability to maintain its position in the public services market and reduce the attraction of the market to the suppliers. I also provide some suggestions to help foster private delivery.

9. Private suppliers are 'damaged' by the dearth of information

The previous sections have presented empirical evidence around private input into the delivery of public services. What one would like to do is move from there to a clear recommendation of where and how one would like to foster these suppliers. Although there are very careful studies of bits of the story the problem is that we are really at a loss to do a true comparison of private versus public. The root cause is the way that the public sector procures activities. Section 5 focused on the economic consequences of unbundled procurement methods but a critical consequence of unbundling is that information comes in discreet boxes and, even with a will to do so, is costly and hard to put together. For things like cleaning contracts this is not an important issue. However, for many activities, and particularly most of the big ticket activities, the true cost of an activity, the whole-life quality and the dynamic relationship between these is rarely, if ever, followed through for public sector projects. Without this data we are left in a position where we can compare a few bits of the story very well but are thrashing when it comes to making the main comparisons.

The National Audit Office have made this point of late: "We have yet to come across truly robust and systematic evaluation of the use of private finance built into PPPs at either a project or programme level. The systems are not in place to collect comparable data from similar projects using different procurement routes." They point out that the main reason that we have not seen such costs comparison is because departments do not collect data on whole-life costs of projects in a systematic way. The NAO claim that (i) central Government rarely collects data from Local Government funded projects or devolved funding, (ii) the costs of ongoing services for conventionally procured buildings are rarely monitored, making whole-life costs very difficult to compare, and (iii) different procurement routes collect data on different bases (see NAO (2009)).

The absence of this data has three interrelated effects. One is that much of the debate takes place at the level of assertion building from specific bits of the story.

Second, because of the data problems much of the analysis takes place at the individual case study level. But this is a problem for many of the activities and particularly acute for the big ticket items. For example, a series of studies by Flyvberg and colleagues of the financial performance of major public infrastructure projects throughout the twentieth century is informative (Flyvbjerg, Bruzelius and Rothengatter, 2003, and Flyvbjerg, Holm and Buhl, 2002, 2003, 2004, 2005). These studies show that nine out of ten transport infrastructure projects fell victim to cost escalation. For rail, the average cost escalation was 45%; for fixed links (bridges and tunnels), the average cost escalation was 34%; and for roads, the average cost escalation was 20%. There are examples of cost escalation across five continents, and so the researchers conclude that it appears to be a global phenomenon, and they also claim that cost escalation has not decreased over the past 70 years, suggesting that lessons are not being learned. Finally, these studies find that the average cost escalation for private fixed link roads is 34% compared with 110% for public, providing weak evidence that private may be cheaper. But almost all of the projects in the studies are public sector projects so this comparison needs to be treated with caution.[5]

This kind of evidence helps to explain the attitudes to public procurement and public delivery that influenced the proponents of privatisation. It makes for sorry reading but some important points follow. Given the evidence, it makes little sense to expect that any change in delivery mechanism would be able to move from such poor performance to first class delivery. The evidence suggests things are going to be a long way from perfect whichever sector delivers. So while small scale case studies can help elucidate problems and help learn from the past, they are unlikely to be much use in informing which mechanism is best since everything is likely to look poor relative to some textbook ideal. Furthermore, if the history is bad enough and the projects large enough, then even minor improvements may bring huge benefits. So, for example, an apparently really poor private or public project might still represent good value for money.

5 Other studies confirm this gloomy picture. For example, in the UK, the National Audit Office (NAO, 1988) finds average cost overruns of around 28% on a sample of 42 road construction projects.

A third point is that, because PPPs and regulatory mechanisms increase transparency, private provision is a soft target if one's prior is that public provision is likely to be better.

So a primary recommendation that would help answer the question where, and by how much, we should foster private provision is for the government to collect the relevant data or at least to undertake some major studies of public procurement.

10. The need to 'legitimise' profit from public services

A 'political' problem with fostering private sector players to deliver more public services is that the general public seem to have a different attitude to private sector profitability in public services than in other industries. There are various reasons for this. Some are justified some are not but it operates as a constraint on developing the private sector in this area. This appears to be a global problem and the difference in public opinion towards privatisation is markedly different after the millennium than before.

As indicated earlier the full privatisation model has become forever intertwined with political sensitivities about stock markets. Particularly in the UK, the mechanism of floatation was designed to meet other objectives, notably wider share ownership. This was 'bought' through the promise of short-term gains for individual investors. This, combined with the inability of the stock market to understand initially how much fat there was to be cut and how well the companies would be able to play the 'regulation game' in the short run, created a backdrop of distrust and belief that regulated companies were making soft profits in public services compared to life outside in more competitive environments. Although the regulation utility experience is extreme, similar perceptions seem to be associated with delivery of other public services.

Economists have not helped the perception problem by the simple incentive structures that have been put in place. The price cap RPI – X model basically incentivises firms to cut costs and this is the main way that higher profit can be made from public services. Similar issues arise in PPP and fixed price contracts for other service delivery. This is good economics since if price does not respond quickly to declines in cost then firms have good incentives to reduce costs. The problem is that this is true whether the decline in costs comes from genuine improved efficiency or just not doing what the company said was needed to do the job (and hence built into the contract price). Given the lack of information there is a natural scepticism by the public that profits do not arise just from the former.

So there is a stability problem and constraint on long run profits. If the public do not perceive that profit is legitimately earned then there will be pressure for governments and regulators to reduce it and public pressure to retain public provision. Crudely a company will never be able to keep earning profits unless it is legitimised. The problem with the simple fixed price/RPI – X incentive structures is that they create good incentives but are very poor at legitimising earnings. When high profits are announced then a government official or regulator has no 'machinery' to justify the profits that does not fall foul of the problem that it may not have been legitimately earned.

One way to solve the problem is to introduce significant upside quality triggers in addition to penalties for downside quality (the latter are typically present in public contracts). Then earnings are at least in part contingent on meeting quality targets. Then if a company earns significant profits a regulator can justifiably say that this would not have been possible had they not increased quality and met quality targets. Thus good news is directly linked to what the public perceives as bad news (i.e., making too much profit out of public services). Upside quality triggers ought to be included as a matter of course in contracts.

There is, however, one potential problem with introducing such triggers. When consumers are canvassed on willingness to pay they attach very little value to improvements in tangible quality measures, such as further reductions in electricity supply failures or brown outs. It is not clear which bit is to blame here but there is a genuine problem that one may have to provide delivery incentives that over compensate companies for the social value of further quality improvements. I personally have no problem with this but it does mean that the incentive structures are stepping outside of conventional measures of efficiency to resolve 'political' problems with private provision.

11. Private suppliers' value added may be understated

A difficulty that arises in trying to develop private provision is that the private/public test is often inappropriate because it has implicitly built into it a false view of the public alternative. The off balance sheet issue is a good example.

The UK National Accounts are produced according to international statistical guidance laid out in the European System of Accounts (ESA95) which itself is based on the international System of National Accounts (SNA93). Until April 2009, UK GAAP (Generally Accepted Accounting Practice) rules were used by economists to determine how PPP projects were treated in the accounts of public bodies. These accounting procedures only include liabilities if the balance of risk and reward is with the public sector, and excluded them if the balance of risk is with the private sector. This resulted in most PPP deals being off balance sheet both for departments and national accounts, and hence not counted. Around 78% of operational PPPs in England by capital value are not recorded on the balance sheet of public sector financial accounts and thus excluded from the Public Sector Net Debt statistics part of the National Accounts. Changes in place will result in PPPs being on department accounts in the future but the situation with regard to Public Sector Net Debt will not change since ESA 95 remains the legal obligation on the UK.[6]

Partnerships have proved very attractive because of this off balance sheet issue, both in the UK and elsewhere. Essentially, governments can use partnerships to provide investment today without having to pay upfront. A new hospital or school agreement signed today will only start to cost the government money once it is up and running, and the cost is spread over the next 25, sometimes 40, years. PPPs provide a mechanism for governments to modernise infrastructure without having to find or borrow money today to meet the cost. Of course, in terms of commitment, a legal duty to pay in the future may not be different from borrowing today. This depends on the risk that the private sector is bearing. If the government only pays for the service it gets, then this is clearly different from entering a commitment to pay a fixed debt repayment every year regardless of the outcome. Signing a PPP may also be different from borrowing if the final destination of borrowed funds is more obscure and fungible than signing a PPP. So again borrowing and investing may not be viewed as identical by a government or the population.

It is extremely common to hear criticism of these justifications for PPPs. The criticisms typically assume (often implicitly rather than explicitly) that this justification for private sector delivery is bad because the public sector could borrow and do the project. But this is not the relevant test. What matters is the realistic alternative not a hypothetical alternative. Politicians are not commonly thought of as angels so it does not make much sense to assume that they are in this context. Politicians are usually deemed to be too short-term and this affects their choices.

6 From April 2009 departments are required to issue accounts using IFRS (International Financial Reporting Standards). Under IFRS those assets which are controlled by the public sector – which include most PPP projects – will be brought on to the departments' balance sheets. Thus the department accounts and National Accounts will conflict. To resolve this conflict the Treasury has decided that departments will also produce a second set of accounts in line with the old UK GAAP basis which will be consistent with the National Accounts.

The poor state of public sector infrastructure (hospitals, schools, etc.) in many countries (including the UK) is well documented and it is caused in no small part by reluctance to commit expenditure and increase debt for something that does not bring immediate benefits to voters.

So a mechanism that allows politicians to improve the infrastructure of the country while not raising debt yet still passing on the cost to future generations seems a plausible way of correcting the distortion. It may not be perfect but this is not a perfect world. But this implies that the value for money test (based on the Treasury's Green Book) is not comparing like for like and is not a sensible choice mechanism. In practice the problem gets fudged by the use of optimism bias to increase the estimate of the public sector alternative and PFI credits which have the effect of making PFI 'the only game in town'.

12. Conclusions

The first half of the paper (Sections 2 through to 7) identifies separate of models of private delivery, and addresses the benefits that the private sector suppliers bring, with a view to indicating where long-term growth in the market may arise. A crude but useful taxonomy is given which boxes non-public provision of public services into three main categories: (i) full privatisation (essentially an arms-length relationship between provider and government), (ii) public private partnerships (separated again into outsourcing partnerships and private finance initiative arrangements), and not-for-profit. The comparative merits of these are then explored and the general theme that emerges is that, on average, privatisation and outsourcing partnerships have been successful, private finance initiative partnerships have brought benefits but it is difficult to be really sure and, in contrast, the view that not-for-profit is superior to for-profit delivery is unproven.

This picture should suggest that the private sector has a significant and growing role to play in the delivery of public services. But things are not this straightforward. The reason is that the empirical evidence runs totally counter to public opinion. Surveys and focus groups show that private delivery is greeted with scepticism by the public. There appear to be two problems (although these are really the same thing viewed from two different angles). The public seem to think that private provision lacks the public service ethos that is deemed to be essential and that the profit motive is unacceptable in public services. In contrast not-for-profit delivery is growing rapidly and is perceived in a positive light. This conflict between what private delivery has to offer and what the public think of it and want from it is probably the biggest constraint on growth of private delivery mechanisms.

The second half of the paper considers some of the political economy issues that both restrict the private sector's ability to maintain its position in the public services market and reduces the attraction of the market to the suppliers. I suggest that improving the information on public sector costs would prove beneficial. It is also essential to put in place procedures that legitimise profit in public services. Finally, the way that private services are compared to public provision understates the private value add, although it is not clear how this problem can be resolved.

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2
What are our Future Sources of Welfare: a New Role for the Third Sector?

Professor Pete Alcock

Introduction

Many protagonists looking to new models for the delivery of welfare services over the coming decade see third sector organisations as a potentially radical new alternative to both state welfare producers and commercial market enterprises. Third sector organisations are not-the-state and they are not-the-market. They could provide both values and capacities that these, supposedly more traditional providers, have not been able to deliver therefore. This paper explores the potential for third sector organisations to play a new role in the delivery of welfare services. It explores both the opportunities for this within these organisations, and the challenges that such a developing role may produce both for organisations and for those seeking to plan policy around them. There are opportunities here; but not all organisations will be able, or willing, to respond to them.

A Mixed Economy of Welfare

Those who are planning for the future delivery of welfare services in the UK recognise that these will come from a mixed economy of service providers. This is the view held by most academic analysts and policy practitioners concerned with the future of policy planning; and it is underpinned by a strong normative commitment to a welfare pluralism based upon combining the strengths of both the state and the market. There is also recognition that this is a more or less given social context as different providers currently dominate welfare delivery and this diversity is unlikely to decline. All major political parties also now embrace welfare pluralism. The new Labour governments had championed a 'third way' between (or within) the state and the market, most recently referred to as 'building a stronger civic society' (HM Treasury, 2009); and the new Conservatives have talked of a 're-imagination of the state' (Cameron, 2009) to operate alongside other welfare providers. The mixed economy of welfare is both given and desired.

Whilst this welfare pluralism embraces both the state and the market, it also includes within the mixed economy third sector providers of welfare. Indeed the identification of, and celebration of, the third sector has been a key element of third way politics and policy planning. That a third sector of providers exist alongside the state and the market contributes to the pluralism that is at the centre of twenty-first century welfare politics, and provides evidence that organisational structures exist that operate between the state and the market. The third sector is a concept that has currency internationally, for instance, in the major international research network the International Society for Third Sector Research (ISTR). But within the UK it is a term that had been largely created and promoted by the recent Labour governments. It is thus one that is not without its challenges and contradictions, as we shall discuss shortly - not the least the cry from some in the sector that 'relegating' it to third place is to deny its history and its broader social importance. The new coalition government have dropped the term from early policy discourse, seeming to prefer the term 'civil society'.

Despite this, however, there can be no doubt that the third sector is now a core feature of the planning and delivery of welfare policy, and that an examination of the future sources of welfare must pay particular attention to it. Indeed for some protagonists in the futures debates, it is to the third sector that we must look for new organisational forms for service delivery to take up the opportunities flowing from state and market failure. For instance, Blond's (2009) *Ownership State*, sees 'civic associations' replacing public bodies in a transfer of ownership of welfare services to an extended third sector, and argues that it is role of policy makers to facilitate and support this re-mixing of welfare provision. In the work of the Office of the Third Sector, and now the Office for Civil Society, we can see significant government commitment to promoting and supporting third sector forms of service delivery. This is discussed below.

However, there is a danger in seeing within the current and future political embracement of the third sector something that is new and different to past welfare forms, and able because of this to rise above their limitations. A longer term critical perspective tells us that neither welfare pluralism nor third sector service delivery are new, and that concerns and contradictions that have challenged and constrained them in the past will continue to pose challenges to their place in future policy planning.

For a start, history tells us that the mixed economy of welfare is not just a late twentieth century phenomenon. Whilst the establishment of the 'welfare state' in the middle of the last century was a major achievement in the provision of comprehensive public services for all citizens, it never entirely displaced either market or voluntary provision of services; and, as analysts have revealed, welfare pluralism has always been at the centre of social policy planning (Powell, 2007). Certainly third sector welfare delivery has a long history which can be traced back to the nineteenth century before the development of much public welfare support. Organisations like the National Society for the Prevention of Cruelty to Children (NSPCC) and Barnardo's were active then in developing new forms of social service; and they remain important today despite the existence of state social service provision. In fact the history of relations between the third sector and the state is a long and complex one (see Lewis, 1999; Harris, 2010), with boundaries shifting and roles changing over time. Current and future manifestations must be seen within this broader context, and from that perspective look much more like particular kinds of adaptation and accommodation than revolutionary departure or innovation. However, from them flow some difficult questions about what is meant by the third sector and how policy making might best engage with it.

The Third Sector

The concept of a third sector implies of course that it exists in relationship to another two (or more) sectors. These are the state and the market, although which of these comes first is perhaps debateable. The third sector is thus not the state or the market; and other conceptualisations of the sector have similarly distinguished it relatively. It is also referred to as the non-profit sector (especially in the United States), or the non-statutory sector (more common in Europe), or the non-government sector (often used for international agencies). These are all of course negative definitions. They tell us what the sector is not, but not what it is.

More sophisticated academic approaches to definition have sought to explore this relational approach and to locate the sector in terms of its relations with the state and the market, suggesting that in practice third sector activity exists in between these sectors (and in some an informal sector too), and yet in places overlapping with them, where organisational forms are hybrids between the different sectors (see Evers and Laville, 2004). These definitional boundaries are explored in more detail in Alcock (2010a), where these exogenous approaches to definition are contrasted with attempts to identify core features of third sector organisation. The conclusion of this, however, is that, even when viewed internally, the third sector can only ever be a strategic unity between different organisational forms and activities.

In other words the third sector is not a single, still less a simple, entity; but rather an aggregation of diverse forms and different fields and subsectors, who may or may not act collaboratively in the delivery of services or other areas of social and economic activity. This was recognised by the government department created in 2006 to provide policy co-ordination and support for the sector, the Office of the Third Sector (OTS). Their website explained that:

> "The third sector is a diverse, active and passionate sector. Organisations in the sector share common characteristics: non-governmental , value-driven, principally reinvest any financial surpluses to further social, environmental or cultural objectives. The term encompasses voluntary and community organisations, charities, social enterprises, cooperatives and mutuals both large and small."

In practice there are different subsectors (charities or social enterprises), operating in different fields (housing or health and social care), and pursuing different goals (service delivery or community advocacy). The new government have sought to capture this diversity by reference to these as elements within civil society. This is in part a terminological, rather than a conceptual change, as the breadth and depth of differences are still included within this new policy frame. However, it raises some broader questions within academic debate where civil society is often seen as a site for social relations (outside the state and the market), rather than an organisational sector (see, Evers and Laville, 2004, Ch. 1).

Nevertheless, both concepts embrace diversity, and this is not a problem for the sector in itself – indeed arguably it is its greatest strength. But it is a challenge to policy makers who see in the third sector or civil society an alternative to state and market failure in the delivery of welfare services, and may wish to promote the sector as a unified policy space for this. What is more, as argued above, this is not new. Policy makers must recognise this, and policy planning for alternative future sources of welfare must pay attention to the lessons that flow from it.

The Policy Environment

The identification and recognition of the third sector in the most recent manifestations of state and sector relations has resulted in a much higher profile for the sector, and its constituent parts, at the beginning of the new century than was the case for much of the latter half of the last one. In a review of recent changes in this policy environment Kendall (2009) describes the current phase as one of 'hyperactive mainstreaming'. By this he means that there are a greater range of policy initiatives directed at the sector, with a general aim of bringing it into the centre of policy planning. This can be seen most clearly in the creation of the OTS, with its Cabinet Office location in 2006. OTS replaced previous smaller units focused on the voluntary and community sector (in the Home Office) and social enterprise (in the then Department of Trade and Industry); but its brief is wider and its resource base more extensive, and this seems likely to be retained in the new Office for Civil Society (OCS). It has also been responsible for a wide range of new forms of support for sector organisations, including Futurebuilders (now the Social Investment Business) and ChangeUp (delivered by Capacitybuilders). Kendall (2003) referred to these as *horizontal* support for organisations across the sector, contrasted with the *vertical* support provided to those operating in particular fields such as health and social care. The latter are longer standing but still important, and indeed have also been expanded - for instance in the Department of Health Social Enterprise Investment Fund.

The overall picture is thus one of greater political interest in the third sector, backed up by greater policy support and public resource, all geared to consolidating the role of sector organisations within policy planning (see HM Treasury and Cabinet Office, 2007). Central to this role is the involvement of third sector organisations in the development and delivery of public welfare services. An expanded role for the sector in the mixed economy of welfare is already at the centre of policy planning therefore. This is likely to expand further if, as suggested below, policy planning moves further towards a concern with service outcomes rather than provider forms. What is more, this is a role which is embraced by some leading voices within the sector itself, not the least the Association of Chief Executives of Voluntary Organisations (ACEVO) which with an ever louder voice has for a number of years been championing the sector as an innovative and efficient alternative to state and market welfare (ACEVO, 2004; 2008).

Those concerned to achieve service outcomes should be expected to be agnostic about provider forms, and new models of commissioning are likely to challenge any assumptions about the desirability of publicly provided welfare. In 2010 ACEVO challenged what had been the Labour government's plans to install NHS agencies as preferred providers of commissioned health care services. Much of the motivation for this was driven by a desire to protect employment in public health services, but, as ACEVO pointed out, it ran counter to the principles of independent commissioning based on quality of service. The government were forced to back track and alter procurement guidance to make it clear that commissioners should not favour or discriminate against providers from any one sector.

So those championing the third sector as an integral part of new future sources of welfare are pushing at a door that is already open, and indeed is already opening more widely. It is the balance of welfare provision by the sector that may change in the next decade; but not the principles behind it, nor the policy support for it. And if this balance is to change then it is the existing strengths of the sector that are likely to be the key drivers of this, and the existing problems and limitations that are likely to be the key challenges to it.

Before going on to consider these opportunities and challenges however, it is worth reflecting briefly on another feature of the policy environment that has developed significantly in the last decade and is likely to become more important in the next. This is the devolution of politics and policy making to the separate administrations in Scotland, Wales and Northern Ireland. Since devolution was established in 2000 the UK has ostensibly become a less united nation, with significant areas of welfare policy devolved to the new administrations in Scotland, Wales and Northern Ireland, including third sector policy. There are now separate agencies delivering independent policies for the sector across these three nations.

This is in itself a major policy change and has led to new challenges for sector organisations to engage with their new policy agents; but it has also led to potentially divergent policy goals and priorities. In practice, however, policy development has not thus far been significantly divergent across the new devolved administrations within the UK (Alcock, 2010b). This may in part be a product of the fact that until recently political control within all had been dominated by Labour. This political hegemony was fractured in Scotland with the advent of the SNP administration, and is less secure in Wales and Northern Ireland for different reasons in each. And now there is a new Conservative and Liberal Democrat coalition government in power in the

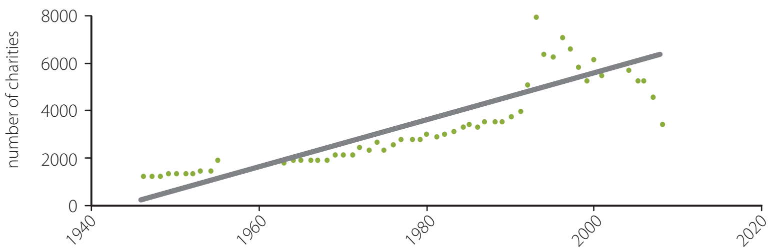
UK. Political change in the future will be likely to fragment politics further across the four nations that now make up the UK therefore; and this will be likely to lead too to further policy divergence, with support for public welfare likely to remain stronger in all of the devolved administrations than may be the case in England. We should be wary therefore of assuming that the prospects for a new mixed economy of welfare in England will be shared in the same way by our relatively independent neighbour nations.

Third Sector Opportunities

Third sector organisations have been involved in the delivery of welfare services for over a century because the users of these services value them and because both volunteers and funders are committed to providing them. If the availability of comprehensive public welfare services was to displace third sector activity here, then this would have resulted in the decline or demise of these organisations in particular during the post war welfare state era. But this did not happen. Public welfare has not displaced voluntary, community and mutual action. Some organisations such as the voluntary hospitals and friendly societies were incorporated into public provision; but others developed to provide supplements to new state services (such as hospices) or even to campaign to improve or challenge them (such as Citizen's Advice Bureaux).

Across the developed world there is no evidence that public welfare has crowded-out voluntary action, and there is no evidence of a decline in the numbers of voluntary organisations in the UK after 1945. Indeed analysis from the Third Sector Research Centre suggests a more or less continual process of growth over the latter half of the twentieth century, albeit that changes in registration criteria complicate the picture after 1990 – See Figure 1.

Figure 1 – Growth in Charity Registrations from 1945-2005



This must be because the third sector is offering something distinctive and valuable.

There is of course much debate about the core features and values of third sector service delivery, and the extent to which they are indeed distinctive. However most protagonists agree on various combinations of core elements which are shared by most organisations. Most important of all perhaps is *independence*. Third sector organisations are not part of the public sector and are not therefore part of the state. They are not bound by statutory and regulatory frameworks, nor are they directly accountable to civil servants and politicians. They are thus free to act as they think fit in the interests of their members and their users. This independence can have negative as well as positive consequences, as we shall return to discuss below. It is also rather more relative than some might think as regulation and accountability extend to some extent to all those delivering public services, as we shall see. But it is undoubtedly a core attraction for those who see in many public services monopoly providers and unresponsive bureaucracies.

Third sector organisations also enjoy independence from the market. Because they are not required to deliver dividends to shareholders, they are not under pressure to follow only profitable activities and can make decisions about priorities for development for other reasons. Independence from the market is also relative, however. Third sector organisations may not be driven by the profit motive, but they must remain financially viable, and will need to plan, and perhaps, adjust their business to ensure this – or collapse, as inevitably some do.

Most of the distinctive features of the third sector are in practice relative rather than absolute opportunities for alternative welfare provision. For instance, the need to survive in competitive markets and the growing importance of public funding for third sector organisations mean that fortunes of much of the sector are closely aligned to developments in the state and the market. In 2008 just under £13 billion, around 36 per cent, of total income for charities in England and Wales came from statutory sources (Clark et al, 2010, p.43); and trends in government funding are now recognised to be of critical importance for sector planning by the National Council for Voluntary Organisations (NCVO, see Clark et al, 2009).

What is more, though flexibility may be a feature of third sector activity - as organisations are free to adapt and change both their mission and their practice without recourse to public regulation or account - members, donors and users will all expect some consistency too in organisational structure and action. Organisations can be conservative as well as innovative. Linked to this is the mission focus of voluntary, community and mutual action. Third sector organisations have generally been set up for a purpose, and it is that purpose which drives organisational development and action. This is a key strength: it is critical in underpinning the voluntary ethos and added value of third sector action; but it can also be a constraint on flexibility and innovation more generally when missions are no longer relevant, or organisational forms no longer the most appropriate means of meeting them.

Mission focus does draw volunteers into third sector action. The altruism that underpins volunteering is generally guided by the desire to achieve some particular social improvement through social action; and the same is largely true of the indirect support provided through philanthropy and giving. It is because we care about the missions of third sector organisations that we are willing to support them. And as a consequence of this these organisations are able to deliver added value to their users.

Third sector organisations can add value through the provision of services by those motivated to further the mission of the organisation. To some extent therefore third sector action can overcome the classic principal/agent dilemma: volunteers are motivated to deliver the aims of the organisation and so do not need to be managed or incentivised to meet organisational goals. It is argued that this applies to those working in the sector too, who may have taken a deliberate decision to seek employment within third sector organisations with defined missions. That said, robust evidence on the extent to which employment patterns and practices within the sector do reflect such distinctions is hard to find.

There may be debates about the motivations of volunteers and donors; but voluntary activity and charitable donations do provide added value to the fees users pay for third sector services or the funds contractors provide, as a result of the additional resources that flow from these. Again there is no robust evidence quantifying the extent of this additional contribution; but the measures which some third sector organisations use to evaluate their contribution to service provision (such as social return on investment (SROI)) do offer some mechanisms for doing this at the organisational level (Cabinet Office, 2009; and see Nicholls, 2009). For the most part these do demonstrate the wider value provided (see Then and Kehl, 2009).

In sum, third sector organisations can offer independence, flexibility, mission focus and added value to the delivery of public services. What is more they have been doing this for over a century. The model of voluntary, community and mutual action is not a new one. It is tried and trusted. And the trust that users, and citizens more generally, place in third sector organisations because of their independence from the state and the market is an essential, if unquantifiable, feature of the sector. This could be central to the future delivery of welfare services.

Third Sector Challenges

The values that third sector organisations bring to the delivery of public services are not necessarily exclusive ones. People may trust the mission focus of third sector; but they also trust the service orientation and professionalism of public services like the NHS, even if this has been challenged by recent managerial reforms (Taylor Gooby and Wallace, 2009). As suggested above, most of the supposedly core values of third sector policy delivery are neither absolute nor exclusive. Avoidance of public regulation and financial accountability can only partially be achieved where organisations are delivering services paid for by taxpayers or users and defined and regulated by public agencies. Flexibility, mission focus and motivated workers can be found within public and private sector provision too.

More generally, ascribing values and even characteristics to third sector organisations collectively is problematic. We may regard the sector as an entity, and indeed through public support develop policies to support and promote it. But in practice the third sector is really little more than an aggregation of widely diverse organisations, who themselves are more likely to associate with subsectors - such as advice agencies, medical charities or housing associations - than any over-arching, generic and homogeneous entity. Within this diversity there are many, indeed probably most, organisations who have no involvement in the delivery of welfare services, and probably no interest in developing this. Some third sector organisations are excluded from service delivery by the requirements imposed by procurement and commissioning. Others have no intention of entering such a competitive market, and may have mission commitments to challenge service providers rather than joining them. From sports and leisure clubs to campaigning and advocacy groups there is diversity in mission, scale and structure.

One of the challenges facing those, such as OTS/OCS, with a policy brief for the third sector is the difficulty inherent in developing and delivering support and guidance for such a diverse community. In practice it is just about impossible for policy makers to meet the needs of all. Within diversity there is competition and conflict, and inevitably policies that benefit some are likely to be criticised by others who feel excluded or ignored.

One important conclusion that flows from this is the need for caution and sensitivity in any expectation that there may be a sector of would-be providers just waiting to play an enhanced role in the future delivery of UK welfare services. There may be organisations that could willingly expand their service provision, and would be happy to do that in partnership with state and market providers in a new mixed economy of welfare. But in practice many such organisations are already engaged in just such partnership action, and foreseeable change may look rather like more of the same than something completely different. The prospects for extending welfare provision across the wider and diverse third sector that might appear in some statistical measures of its scale will flounder because of the diversity of mission and form that these disguise.

There are other challenges to an expanded role for third sector organisations in public service delivery. The diversity, independence and mission focus of the sector are weaknesses as well as strengths. Third sector organisations can provide excellent, even unparalleled, examples of service provision; but their unique features are just that; and there is no guarantee that these can be found in other organisations or at all times and places where these services might be needed. Third sector activity is not universal, comprehensive or in any sense formally accountable; yet in many cases welfare services have traditionally needed to be all of these things.

In practice this means that that there may be problems with the distribution, accessibility and inclusiveness of third sector welfare services. There may be excellent organisations in some service fields or local areas, but in others this may not be case. The services that particular organisations provide may be highly valued and widely understood by those who use them; but there is no guarantee that all potential users will be able to find them, or find information about them - in particular where potential users might be on the margins of the organisational mission. Third sector organisations may have a mission to meet the needs of particular communities, and may even target services exclusively upon these. But for those outside of these groups, such targeting could amount to exclusion, a particular problem perhaps from some marginal groups such as refugees or asylum seekers.

Underlying these problems of accessibility and exclusion is the lack of a public mandate for third sector welfare provision. There is no formal public requirement on third sector organisations to provide, and no requirement on government to ensure that they do. This is no doubt as it should be for an independent sector of provision; but it cannot be the basis for comprehensive welfare planning. Indeed, it was in part because of the uneven nature of voluntary and mutual provision that comprehensive state welfare services were introduced in the middle of the last century. The planning and delivery of these state welfare services may now be more critically questioned; but the public mandate that underpins them must not be forgotten or eroded.

One of the most important policy questions that flows from this, is the extent to which public policy planning and intervention can overcome some of the challenges to third sector service delivery by introducing regulation and accountability into the delivery of services by the sector, and ensuring, through partnership with public agencies, that comprehensive service provision can be guaranteed. As we shall see this is perhaps the central challenge for those looking to develop third sector provision as an alternative source of welfare in the future. Current policy already addresses some of the implications of this; and is already as a result posing other challenges to third sector action.

The Implications of Policy Planning

Public policy planning for third sector welfare action requires intervention to support, direct, control and monitor service provision. Such intervention inevitably undermines the independence of the sector, in particular where this means that public management measures of target setting and evaluation are imposed on organisations through contracts for public service delivery. The regulatory frameworks that accompany management and accountability may also stifle the innovation, flexibility and mission focus of third sector action. Indeed there is the ever present danger that, when those who thought they were working or volunteering in mission focused independent organisations encounter regulatory control, their commitment and motivation may wane – leading to a return of the principal/agent dilemma.

There are serious contradictions at the heart of the principle of public control of third sector action. But there are major practical problems too. Contracting to deliver public services means that third sector organisations must undergo elaborate procedures for procurement and commissioning, and must satisfy the accompanying legal requirements. These can impose significant burdens on the organisations involved, requiring the capacity and the skills to deal with these technical processes. Once awarded, public service contracts generally also come with procedural requirements for the monitoring and evaluation of service delivery. Public resources must be accounted for and the effectiveness of services assured.

There are significant 'transactional costs' here for third sector organisations engaging with the policy environment of public service delivery – although it should not be forgotten that these are also imposed on those public agencies contracting with them too. Organisations now require managers, accountants and lawyers to pick their way through the regulatory frameworks within which they operate; and they require the skills and capacity to engage with these. This is already recognised by policy makers and a range of measures have been introduced by government to provide support for institutional capacity building to equip organisations for public service delivery. One example is the Futurebuilders programme, now delivered by the Social Investment Business (HM Treasury, 2003).

Not only do these add to the burdens of third sector activity, they may also change the very nature of third sector organisations themselves. In contracting with and working within these frameworks, third sector organisations run the risk of becoming more and more like the public agencies they may have sought to displace, but with whom they now need to engage. Third sector commentators talk about these as the problems of *incorporation* and *isomorphism* – third sector organisations being in danger of take-over by public agencies, or becoming indistinguishable from them.

The practical problems, and the costs, of engagement with the public regulation of service delivery are now recognised as significant issues within the sector. They are challenges to be faced by third sector agencies; but they are challenges that can, and should, be met directly. They are also not unique to the UK. And as those arguing for a positive approach to learning and development in third sector service delivery such as the Association of Chief Executives of Voluntary Organisations point out, much can be learnt from the ways in which these challenges are identified and met in a range of analogous policy regimes (ACEVO, 2008). They are not the only challenges that flow from a growing role for third sector service delivery within a mixed economy of welfare.

The commissioning of services from third sector organisations also places these organisations within a competitive contractual environment. Organisations must compete with private sector providers and, in some cases at least, with alternative public sector providers too. They must also compete with one another. Competition for service contracts is likely to be governed by efficiency and effectiveness of delivery, as well as mission focus. Just being committed to a particular service or user group may not be enough to secure contract funding. Competition may not be welcomed by some third sector organisations. It may exclude some organisations from service delivery, and may be reason why some will want to remain outside of this altogether.

For those who rise to meet the competitive challenge, however, it may also have organisational consequences. There may be pressures towards take-overs and mergers. In 2010 *Age Concern* and *Help the Aged* merged to form *AgeUK*, to equip them better to compete for and secure public service contracts. Alternatively organisations may seek partnerships with other providers - the *Third Sector Consortium (3SC)* now provides the leadership for a wide range of third sector and private sector operating in partnership to deliver employment services. Competition and regulation are therefore already re-shaping the third sector through its engagement with welfare service delivery.

Towards a New Policy Landscape

That engagement with welfare service delivery is re-shaping third sector organisations should not be a surprising development. Nor indeed is it a recent phenomenon, as historical analysis of the sector's role here tells us (Lewis, 1999; Harris, 2010). The challenges it creates for third sector organisations are not insurmountable; and, even where they shift the character and structure of third sector action, they can still leave unique and innovative organisations delivering excellent services. The real question for policy makers here is to ensure that the best of third sector delivery is maintained and nurtured, whilst the broader planning for welfare services continues to evolve.

The broader planning framework is evolving. Much has changed in the first decade of the new century; and more will follow in the second. The shift to consensus over a mixed economy of providers is now established. What is driving future change is a shift in the nature of the relationships between providers and users. This can be seen most clearly in the moves, albeit relatively tentative ones, towards the *personalisation* of service commissioning – the transfer of the public resources for service delivery to the users of those services, through direct payments or personal budgets, so that individual packages of provision can be purchased directly from providers. Much discussion of this user shift has focused on health and social care services (see Glasby and Littlechild, 2009), but it has the potential to transform service commissioning in other areas too such as education or employment.

Those with personal budgets to spend may well choose to purchase from alternative welfare providers in the third sector, although equally they may not. What will be likely to drive purchasing behaviour will be the quality and accessibility of services provided, rather than the location or character of the provider. This is perhaps as it should be: users determining the value of the services they need. But, leaving aside the practical difficulties that many users may face in operationalising these new choices, the consequences for service providers will be significant as the certainty of public service contracts is replaced with the more open environment of a competitive market. Third sector organisations may welcome this competition and the abandonment of public monopolies implicit in it. It may lead to a wide range of forms of provision and providers – perhaps much smaller entities operating in niche markets. Third sector organisations may have much to offer here; but there is no guarantee that all will be able to respond effectively to it.

Even where personalised budgeting is not directly implemented, future service policy planning is likely to see a shift towards a more 'outcome focused' commissioning process, perhaps with a more localised focus on delivery, as exemplified in the recent *Total Place* developments. Where users are not themselves specifying the terms of policy provision, public planners can do this by gearing funding and contracting towards expected service outcomes rather than specific provider inputs. This could take procurement and commissioning out of Departmental and service silos and encourage new provider forms. There are opportunities in this too for third sector organisations to expand their input to welfare services by operating across service boundaries and exploiting their knowledge of local niche markets. But here too success will be based on what they can offer rather than what they are.

Another developing feature of the welfare policy landscape is the encouragement of the co-production of services by providers and users. To some extend co-production is a new term for an old concept: the notion that in the delivery of all services the experience of provision is shaped by what both users and providers bring to the relationship of provision – observation of no-smoking rules in public buildings being an obvious, and successful, example. Where it is likely to provide new dimensions to the delivery of welfare services is in the expectations that policy makers, and funders, will have of those delivering services that these be developed and delivered through direct engagement between frontline providers and individual users. Even where personal budgets and outcome focused commissioning are not operating directly, service providers are likely in the future to have to be more open in prioritising and planning their engagement with the users of their services.

Future welfare service provision is therefore likely to see a shift towards greater user focus and user engagement in policy planning. Co-production and personalisation may replace public management accountability and contractual procurement; and they have been championed both by official government statements (HM Treasury, 2009) and independent policy campaigners (Blond, 2009). Both the former Labour government and the new coalition also see in these shifts enhanced opportunities for third sector providers, with talk of encouraging public sector providers to move out of the state and create instead John Lewis style co-operatives and independent civil associations of welfare providers.

As discussed, however, the involvement of third sector organisations in the delivery of welfare services is not a new phenomenon. They have always offered an alternative to both state and market providers, and have always occupied an important position within the mixed economy of welfare provision. Third sector providers will continue to offer significant opportunities for future provision, though these are not all unique to this sector, whose independence will remain only a relative advantage. However, third sector public provision also creates major challenges for organisations and for policy planners. Many third sector organisations will continue to play no part in welfare service provision, and most of those that do will need to adapt significantly to meet its changing requirements.

It will be those organisations who can adapt to the changing priorities of policy and practice that are most likely to play a significant role as major providers of future welfare services. The independence and distinction of third sector providers have already been challenged by the regulation and competition of the current policy environment, with those who have adapted to this best emerging most strongly. The shift towards greater user and outcome focus will require further adaptation. There is no guarantee that all third sector providers will able to accommodate such new challenges; but past evidence suggests that many will and that the sector will continue to play a major role within the new welfare mix. There will be a continuing role for the third sector as future source of welfare; but its scale and scope will depend upon the ability of those involved to continue adapting their organisational structures and practices to an evolving policy environment, rather than any unique or distinctive features within the sector itself.

Conclusion

The next decade or so is likely to see significant reform to public services, driven both by public sector reform and private market restructuring. Given the limitations of both public services and private markets that have been exposed over the last few years, there are some who see in this coming future a 'golden age' for third sector delivery of public services. Such rhetoric needs to be treated with some caution, however. For a start there is nothing new about voluntary action or social enterprise providing public services; these organisations have been a key element in the mixed economy of welfare that has in practice been operating in the UK across three centuries now. And over this time third sector organisations have adapted to earlier major shifts in the policy environment, not the least the reforms of the 'post war welfare state'. They will do so in the future too.

Third sector organisations will adapt and respond to the coming changes, and will continue to provide an alternative (and a partner) to public and commercial welfare providers. Some organisations will be well placed to offer distinctive and attractive service packages to user purchasers or outcome focused planners. Some organisations will need support to build capacity and acquire new skills to respond to these changing pressures. Some organisations will neither seize these opportunities nor welcome them, for their mission does not include service provision and there is no incentive for them to move into this field. And where third sector organisations do succeed in providing new and distinctive service forms, it will be because of what they do, not who they are. Policy planners must therefore understand the continuing diversity of the sector and work to support this appropriately. This will require engagement where appropriate, and respect for independence where needed. Policy makers cannot just stand back and assume that the third sector is ready and waiting to step into all the places where others may in the future fear to tread.

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