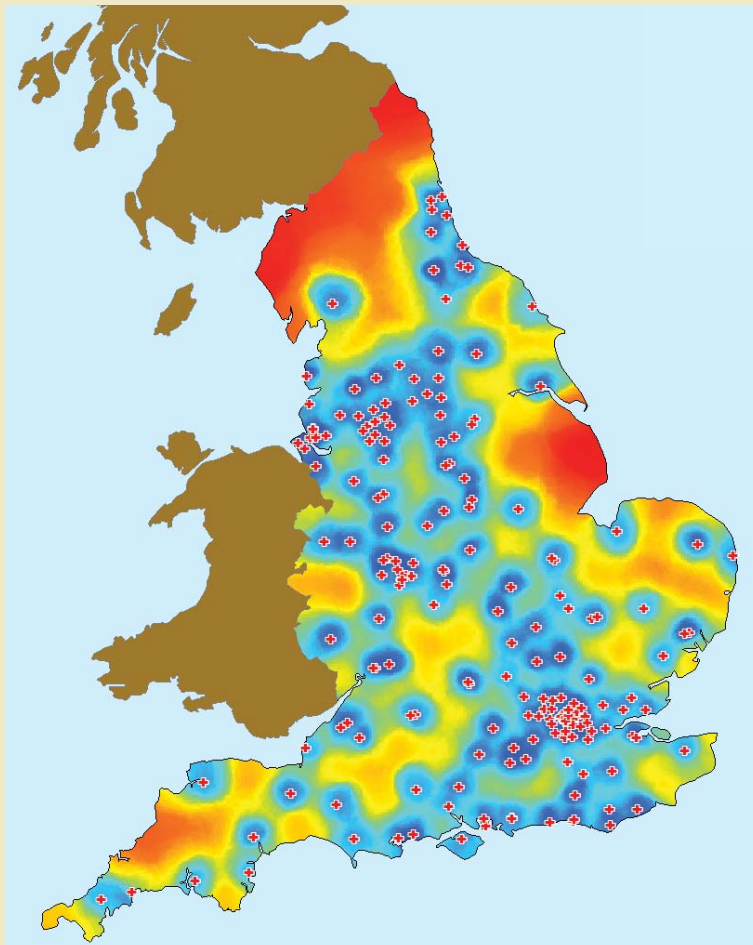


# Research in PUBLIC POLICY

Bulletin of the Centre for Market and Public Organisation



## Hospitals and choice

**How far from home will NHS  
patients have to travel to exercise  
meaningful choice of hospital?**

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Autumn 2005

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# Buying a Pension:

## How to calculate the cost

**How much money will you need in your pension fund to have an adequate income in retirement? Edmund Cannon has worked out a handy formula.**

Planning for a pension is one of the biggest financial decisions that we have to make. Yet there is widespread misunderstanding about even what decisions are required, let alone how to make the 'best' decision.

In the era of final salary pension schemes, this did not matter too much because employers made most of the decisions, providing a pension as part of their employees' total remuneration package. In some cases, the value of the pension was quite large relative to the salary or wage that employees received. But for a variety of reasons, final salary schemes are gradually disappearing and increasingly, people are having to plan for their own pension provision.

One interesting question is how much a pension will cost. In this context, a 'pension' means a guaranteed income lasting until death. You can buy this on the open market by purchasing a life annuity from an insurance company.

**The pension fund formula: start with 37, subtract one third of your age, subtract one seventh of your expected retirement age and then multiply by your current salary**

Consider a single man earning £30,000 a year just before retirement. For him, a pension of £21,000 would probably be a good target since the cost of living is generally lower in retirement (he does not need to commute to work, for example). To buy an annuity generating that income would cost about £300,000, since the annuity rate for men aged 65 is just over 7%.

An annuity rate of 7% can be compared with the rate of return on government bonds of about 4.5%. The reason that an annuity pays a higher rate than a government bond is that it pays an income only until the man dies. By buying an annuity, the man avoids the possibility of running out of money if he lives a very long time, since that risk is borne by the insurance company.

For someone about to retire, the cost of buying a pension is straightforward to calculate, since it is just the desired pension divided by the annuity rate. The Financial Services Authority sends information on annuity rates to people who are reaching this point in their lives.

But what about someone who is going to retire in the future and

needs to know roughly how much money they should attempt to save in their pension fund? Making such a calculation requires assumptions about wage growth: if a 25-year-old is earning £20,000 now, they are likely to be promoted and earn much more by the time they retire.

As with any predictions about the future, one can argue about what assumptions to make. Supposing wage growth of 2% per year, then the appropriate amount of money to save for someone aged  $T$  now who will retire at age  $R$  is:

$$\text{PENSION FUND NEEDED} = \text{CURRENT INCOME} \times 0.7 \times \frac{e^{0.02 \times (R-T)}}{a(R)}$$

where  $a(R)$  is the annuity rate. This is not particularly helpful for someone who doesn't have any mathematical training and most people do not understand annuity rates. Even most economics graduates know little about annuities, since they are rarely on the syllabus of standard undergraduate or master's degrees.

Perhaps surprisingly, one can substitute formulae like the one above with much simpler equations such as this:

$$\text{PENSION FUND NEEDED} = \text{CURRENT INCOME} \times \left( 37 - \frac{\text{CURRENT AGE}}{3} - \frac{\text{RETIREMENT AGE}}{7} \right)$$

In other words, to calculate how much money you will need in your pension fund at retirement, start with the number 37, subtract one third of your current age, subtract one seventh of your expected retirement age and then multiply by your current salary. The resulting figure turns out to be a surprisingly good approximation for men of most ages.

Clearly there are a variety of reasons why people find pensions off-putting: the subject has lots of technical jargon and it is easy for young people to think that they can put off making any pension provision until they are older. The need to make difficult numerical calculations involving compound interest does not make things easier. But I have found that formulae like the one above provide simpler ways of calculating pensions. I am now exploring whether this helps decision-making in practice.

**Dr Edmund Cannon is senior lecturer in economics at the University of Bristol.**

# Close to Home:

## Mapping choice in the NHS

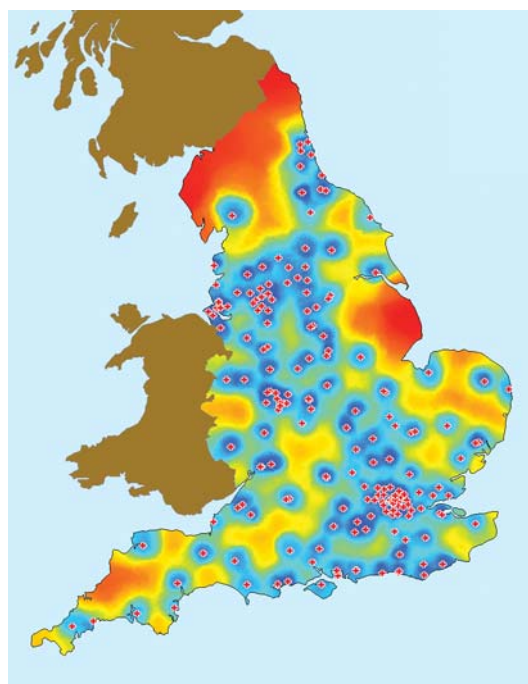
**How far from home will NHS patients have to travel to exercise meaningful choice of hospital? Research by Mike Damiani, Jennifer Dixon and Carol Propper maps access to hospital care in England - and identifies those parts of the country where there are likely to be most constraints on choice for patients waiting for elective care.**

A central aim of government policy on health is to introduce more choice for NHS users. The supply of providers - public and private - in secondary care (particularly elective care) and primary care is being boosted. Around 20 new diagnostic and treatment centres are now open and more are planned. Foundation hospitals are to compete with each other to provide care commissioned by primary care purchasers. And all of this is underpinned by a new system of financial flows - essentially fixed prices per type of case - designed to make buying health care more transparent to buyer and sellers.

Increasing patient choice of provider is central to this clutch of policies. Two pilot projects - one for all patients waiting over six months for cardiac surgery; and another for all those in London waiting over six months for treatment in selected specialties - offered a choice of provider offering quicker treatment. This proved very popular and choice continues to be rolled out. By the end of 2005, patients requiring hospital treatment will be able to choose between four or five providers.

**Most of the population has a choice of hospitals close to home - the question is how high is demand for beds relative to local supply**

But expanding provider choice for patients is a challenge for the NHS where supply is limited. There are already waiting lists for many kinds of elective care. To exercise choice, people will have to travel. Will there be differences in the time those seeking care will have to travel? If so, where will people have to travel furthest to exercise this choice? Will increased use of existing private facilities, in addition to those in the NHS, change the amount of time people will have to travel?



**Map 1: Travel time to nearest acute NHS Trust, England 2001**

Research by Mike Damiani, Jennifer Dixon and Carol Propper addresses these issues. Using routine administrative data for the NHS and the private sector, they examine how far patients would have to travel from their homes to access hospital facilities. Given this pattern of available supply, they then look at the number of patients already waiting for routine elective care at these facilities. The greater the number of people waiting already, the greater the existing demand for these facilities.

The researchers then put the supply and demand sides together to show the pattern of existing supply relative to demand. In areas of the country where supply is high relative to demand, people will not have to travel far to exercise choice of hospital. In contrast, in areas where existing demand is high relative to supply, people will have to travel further to exercise meaningful choice.

The results indicate that for most of the population of England there is already a significant potential choice of hospital. Map 1 shows the travel time to the nearest acute NHS hospital in 2001.

The areas shaded in red show where there are fewest facilities; the blue areas where there are most.

The map shows that for most areas of the country, an acute NHS hospital is accessible within 100 minutes of travel, and for large parts of the country, a hospital is accessible within 30 minutes (shaded as either blue or green on the map). While 50% of the population have no hospital within 15 minutes by car, 25% can access one hospital and the remaining 25% can access at least two. 98% of the population can access at least one hospital within an hour's journey, and over 90% can access two or more.

Map 2 shows the number of available and unoccupied beds within a given travel time - in this case 60 minutes - from the home location of patients. The areas shaded in red show where there are fewest facilities; the blue areas where there are most.

**People in the South East outside London, East Anglia and parts of the South West are likely to have to travel furthest to exercise meaningful choice**

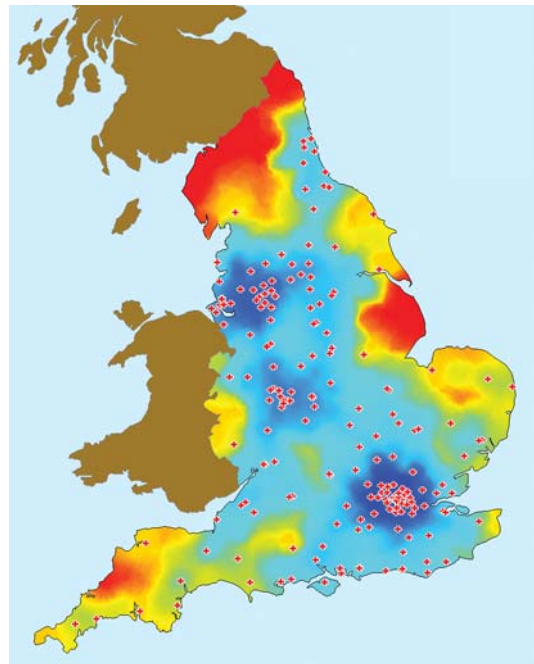
The map indicates that the number of beds in the NHS within a 60-minute journey time from a patient's home is lowest in the Scottish borders, north Yorkshire and parts of East Anglia, Lincolnshire, Devon and Cornwall. This is not surprising: these areas have the lowest population density and hospital location to some extent reflects population density. So to have a choice of hospital, people in rural areas will have to travel further.

Map 2 does not take account of private facilities, but the researchers find that adding them in does not really alter the pattern. This is partly because private facilities are located in areas where there are more NHS facilities, and partly because the private sector is small in comparison to the NHS.

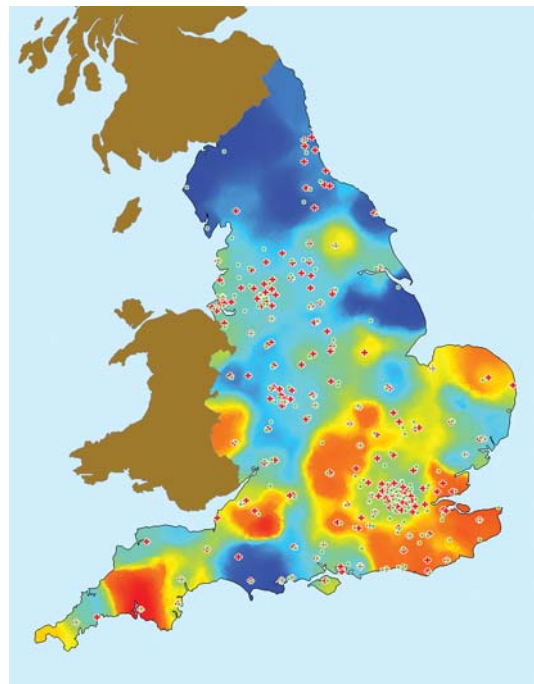
But putting together demand - the number already waiting for a bed - with supply changes the picture considerably. Map 3 shows the number of people waiting over six months *per available bed* within 60 minutes travel time. The areas shaded in red show where pressure per bed is highest; the blue areas where pressure per bed is lowest.

The map shows that despite the large number of facilities located in the South East, the amount of people waiting per available bed is high in the South East outside London. It is also high in parts of the South West - notably Cornwall and around Bristol - in East Anglia and along the Welsh border (though this area could also be served by hospitals in Wales, which are not included in the analysis). In other words, in these areas - which include the Tory heartlands of the South East - those wanting to exercise choice of hospital will have to travel further.

Obviously travel time is only one aspect of choice. People will also be interested in the quality of care. So choices will not be made on travel time alone. But what this research shows is that,



**Map 2: Number of NHS Trusts within 60 minutes, England 2001**



**Map 3: Number of patients waiting over six months for elective inpatient care per available and unoccupied NHS and private bed within 60 minutes travel time, England 2001**

for given quality, those who live where existing demand is high relative to existing supply - be it in the public or private sector - will need to travel further to exercise choice.

**This article summarises, 'Mapping Choice in the NHS: Analysis of Routine Data' by Mike Damiani, Jennifer Dixon and Carol Propper, *British Medical Journal*, 2 February.**

**For a discussion of choice policies in both education and health care, see *Will More Choice Improve Outcomes in Education and Health Care? The Evidence from Economic Research* (CMPO, 2005).**



# Paying Teachers by Results



**The introduction of performance-related pay for teachers was met by considerable hostility from many in the profession. But in the first evaluation of the effects of the scheme on educational outcomes, CMPO researchers find that teachers have responded to the financial incentives and the effects have been good for pupils' results.**

Public debate about improving educational outcomes has traditionally been around the level of investment in schools - issues like class sizes, computers and other resources, and school starting and finishing ages. More recently, the focus has been on reforms to the structure of education provision, including how teachers are paid. In 1999/2000, the government introduced a performance-related pay scheme for teachers, based in part on the progress made by their pupils.

At the time, there was deep and widespread scepticism about the likely impact of the scheme. But our results show that the introduction of performance-related pay has improved pupils' progress at GCSE. The gains are not trivial, averaging about half a grade per pupil per subject.

In our study, we tracked a number of teachers over five years and compared the average progress of their pupils between Key Stage 3 tests at age 14 and GCSEs at age 16, both before and after the reform. Comparing pupils with the same scores at Key Stage 3, those taught by teachers who were eligible for performance-related pay achieved on average half a GCSE point more than equivalent pupils taught by the same teachers before the scheme was introduced. Like workers in many other professions, the evidence is that teachers *do* respond to direct financial incentives tied to their performance.

We also looked at the distribution of test score gains and find evidence of larger gains for pupils who did less well in Key Stage 3 tests than for higher scoring pupils. This may arise from

teachers believing that there are easier 'value-added' gains to be made there than for already high-performing pupils. This distributional impact seems to be a welcome additional result of the scheme.

The government's consultative paper of 1998 signalled a range of reforms to education, including the introduction of a performance-related pay system - the 'performance threshold' and the 'upper pay scale'. The Green Paper argued that teachers' motivation was adversely affected by a culture that did not recognise and reward outstanding performance. The scheme was introduced in the academic year 1999/2000, with the first applications submitted by teachers in July 2000.

### **Like workers in many other professions, teachers do respond to direct financial incentives tied to their performance**

Prior to the introduction of the scheme, all teachers were paid on a unified basic salary scale, which had nine full points, ranging from £14,658 to £23,193 per annum (2000 prices). Since the reforms, teachers at pay point 9 have been able to apply to pass the performance threshold. Passing the threshold has two effects. First, it gives teachers an annual bonus of £2,000, payable without revision until the end of their career and included in calculations of pensionable salary. It is therefore of significant lifetime value. Second, teachers move onto a new upper pay scale, which comprises additional increments, each of which are also related to performance.

To pass the threshold, teachers have to demonstrate that they have reached acceptable standards in five areas including pupil progress. This reform had two goals: to provide rewards for performance among existing teachers; and to raise recruitment and retention rates in teaching. Our study focuses only on the first of these, but both are potentially important.

There has been debate about whether the performance threshold really constitutes a performance-related pay scheme. Doubts arose because the great majority of teachers who applied were successful, suggesting that the performance test was weak or purely cosmetic. But what matters is what teachers thought at the time, rather than how the process turned out later. And a survey of teacher opinion just before the introduction of the threshold suggested that a majority expected it to be 'real' and only to reward a few high-performing teachers.

What's more, passing the threshold is only the first stage of the overall scheme: progress on the upper pay scale is clearly

performance-related. These two points suggest that it is appropriate to treat the performance threshold as performance-related pay.

Our finding that teachers respond to financial incentives tied to their performance should not perhaps be a surprise. But it is controversial in the context of the original debate on performance pay for teachers. It was argued then that teachers - and perhaps public sector workers in general - have other motivations and do not respond, or may even respond negatively, to monetary incentives.

But the evidence from our data suggests that teachers who were eligible for the scheme improved the average value-added of their pupils between the two teaching cycles by more than teachers not eligible for the scheme. Focusing on value-added takes account of differences in the initial ability of the pupils assigned to the different teachers. Comparing the same teachers before and after the reform means that we also take account of differences in ability between teachers.

Of course, the scheme was very expensive, and this needs to be weighed against the educational gains when considering different educational policy options. But our study did not include a full cost-benefit analysis since the impact on teacher motivation is only part of the story. The effect on teacher recruitment is also important and requires a different study to evaluate.

### **The introduction of performance-related pay improved pupils' GCSE results by roughly half a grade per pupil per subject**

One other interesting issue that our data does not allow us to address is whether the improvements in pupils' achievement derive from greater overall effort by their teachers or from effort diverted from other professional activities. This issue requires a much broader data collection exercise than is currently feasible.

But while there remain a number of unanswered questions, our results suggest that teacher-based performance pay is a policy tool that education authorities should consider as part of their drive to raise educational performance.

**This article summarises 'Evaluating the Impact of Performance-related Pay for Teachers in England' by Adele Atkinson, Simon Burgess, Bronwyn Croxson, Paul Gregg, Carol Propper, Helen Slater and Deborah Wilson, CMPO Working Paper No. 04/113. For the full paper, see: <http://www.bris.ac.uk/Depts/CMPO/workingpapers/wp113.pdf>**

# Poor Children's Lives: The impact of Labour's welfare reforms

**Since 1997, the Labour government has targeted billions of pounds at low-income families with children with the avowed aim of 'ending child poverty within a generation'. New research by Paul Gregg and colleagues examines whether it is children who have actually benefited from these income changes.**

Welfare reforms like tax credits and child benefit were intended to improve the living conditions and future life chances of children in low-income families. But it is possible that low-income parents used the extra income generated by the reforms in ways that benefited themselves rather than their children - an outcome that would pose a serious challenge for policy-makers.

Our research compares the spending patterns of low-income families with children in the 'pre-reform period' with spending patterns in the years immediately following the most intensive period of welfare reform. Our conclusions are encouraging: spending on goods such as children's clothing, toys and books rose over the period at rates that narrowed the gap between poor children and their better-off counterparts.

At the same time, spending on the purely adult goods of alcohol and tobacco by those targeted by the reforms actually fell as incomes increased. Other changes - notably the improved access to employment and leisure opportunities generated by wider car and telephone ownership - should broaden the horizons of all members of low-income households.

Our study begins by comparing the spending patterns of low-income parents before (1995-98) and after (2000-03) the reforms. We then compare these changes with those among higher-income families to see whether spending on a range of different goods caught up - in relative or absolute terms - following the reforms.

One problem in making these estimates is assessing to what extent changes in spending resulted from the reforms themselves and to what extent they were driven by other factors, such as changes in the relative prices of different goods, changes in the macro-economic climate or changes in individuals' tastes and priorities.

In order to illuminate the role of policy, we make use of the fact that the terms of the reforms benefited families with children aged 10 and under to a far greater degree than they did families

with older children. This means we can test whether the catch-up in spending of the 'more-affected' group - families with a youngest child under 11 - was greater than for the 'less-affected' group - families with a youngest child between 11 and 15.

Figure 1 shows how levels of spending on a range of different items by households with a child under 11 differed according to income level in the pre-reform period. Spending here is 'equivalised' to take account of differences in the size and composition of families and adjusted for inflation. A family is defined as 'low-income' if its equivalised after-tax income falls in the bottom third of that of all families with children.

## **Low-income families' spending on children's clothing, toys and books has risen significantly since the welfare reforms**

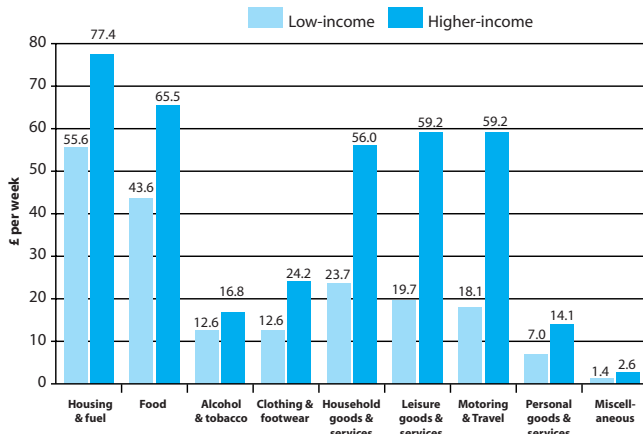
Panel A of Figure 1 shows how, on average, total expenditure was divided between eight broad types of good. It is clear that in the pre-reform period, low-income families lagged behind higher-income ones across the board, although it is noticeable that the gaps in spending on items like housing, food and alcohol and tobacco were much smaller than the gaps in household and leisure goods and services and motoring and travel. It seems that in these latter areas, children in poor families were experiencing really very different living conditions than their better-off counterparts.

Panel B of Figure 1 focuses on seven types of more specific expenditure that are of particular interest, either because they can be assigned to different members of the household (as with clothing) or because they may play a role in children's health and development (as with books and toys). Again, the picture is one of substantial gaps between rich and poor across the board.

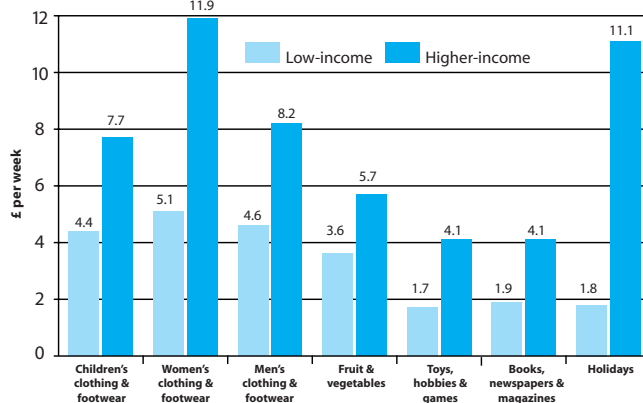
It is interesting to note that among poor families, spending on clothing was split pretty evenly between men, women and children while in more affluent families, women's spending was



**Fig 1A. Equivalised expenditures per week:**  
Households with a youngest child age 0-10, 1995-1998 (Sept 2003 prices)



**Fig 1B. Equivalised expenditures per week:**  
Households with a youngest child age 0-10, 1995-1998 (Sept 2003 prices)



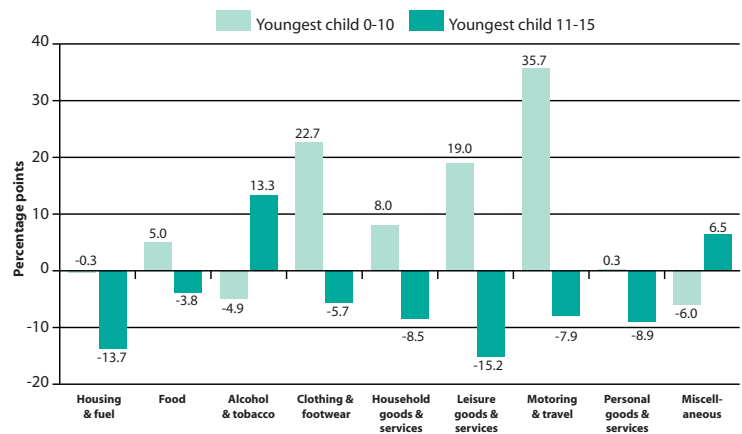
quite a lot higher. This raises the possibility that mothers in low-income households were holding back on their own clothing expenditure, perhaps in favour of spending on their children. Note also the extremely large gap in spending on holidays, another area in which poor children experience very different conditions from the better off.

By the post-reform period, overall spending by low-income families with a child under 11 had increased by 17% in real terms. Significant increases in spending by this group were recorded for all the items in Panel B of Figure 1 plus the broader groupings of food, clothing, household and leisure goods and motoring and travel. The largest increases, both in terms of pounds spent per week and percentage changes, occurred in the categories of leisure goods and services, motoring and travel, women's clothing, toys, games and hobbies, and holidays.

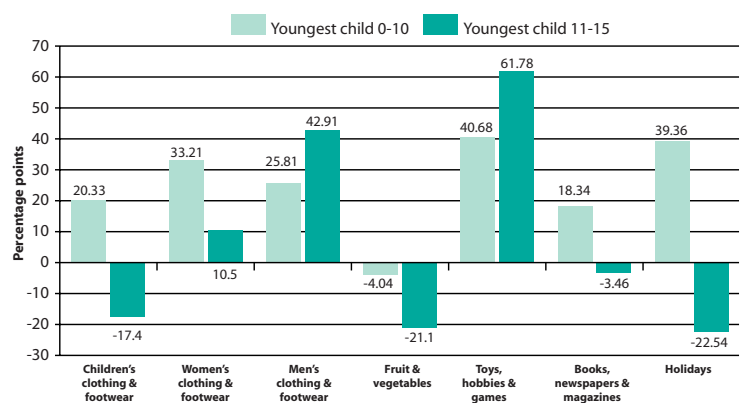
### Low-income parents' spending on the purely adult goods of alcohol and tobacco has fallen as incomes have risen

It is interesting to note that the areas in which spending grew the fastest for low-income families were precisely those where they had been lagging the furthest behind in the pre-reform period. This suggests that low-income families have the same types of spending priorities as more affluent families when they gain access to greater resources.

**Fig 2A. Rates of catch-up in expenditures of low-income families with higher-income families, 1995-1998 to 2000-03**



**Fig 2B. Rates of catch-up in expenditures of low-income families with higher-income families, 1995-98 to 2000-03**



While these increases are encouraging in their own right, whether or not poorer children were closing the gaps with the better off depends on what was happening further up the income distribution. Fast growth in the earnings of the better off over the period may have dwarfed the gains made by those lower down the scale.

To explore this, we calculate the percentage change in average expenditures of each type for both low-income and higher-income families and take the difference between the two as a measure of catch-up - how much the growth in average spending by the poor exceeded the growth in average spending by the rich. Figure 2 shows these results, contrasting the catch-up of a group that received large income increases following Labour's reforms - families with a child under 11 - with the catch-up of a group that received far less - families with a youngest child aged 11 to 15.

Looking first at those with younger children, we see that growth was faster among low-income families in the areas of food, clothing, household and leisure goods and particularly motoring and travel. It is also notable that spending on the purely adult goods of alcohol and tobacco *fell* among low-income families even as incomes rose, and it fell faster than such spending by higher-income households. Spending increases on all the specific items were also larger for the less well off, with the exception of spending on fruit and vegetables.

To assess the contribution of the welfare reforms to this pattern of convergence in spending, we can contrast the rates of catch-up for those with younger children with the rates for those with older children. As is clear from Figure 2, low-income families with older children fell behind their higher-income counterparts in many areas of spending. This implies that a similar divergence in living standards may have occurred for those with younger children were it not for the additional income generated by the reforms, which focused extra resources on families with younger children.

Our research also explores a slightly different dimension of living standards, relating to the ownership of a range of consumer durables, such as cars, telephones, washing machines and computers. These items are purchased infrequently and are therefore less likely to show up in weekly expenditure data.

We find that ownership of all nine items examined rose substantially among low-income families over the period, although in part this may be due to falling prices. But rates of car and telephone ownership converged significantly between the low-income and higher-income groups and more strongly for families with children under 11.

### **Given extra resources, the spending patterns of parents at the bottom of the income distribution converge on those of the better-off**

One area of potential concern is computer ownership, where large increases by higher-income households led to a widening gap between rich and poor. With computers becoming more widely used in schools, this highlights an area in which poorer children may be disadvantaged in terms of their learning opportunities.

On the basis of this research, it appears that the income targeted towards poorer families by Labour's welfare reforms has led to improved living standards along a variety of dimensions. There is a strong case that children will benefit from much of this spending, for example, on children's clothing, toys and books but also on access to a wider range of leisure opportunities.

At the same time, there is no evidence whatsoever that the benefit increases have been 'wasted' on greater consumption by parents of alcohol and tobacco. In fact, the spending patterns of those at the bottom of the income distribution seem to converge on those of better-off parents when they are given the resources to do so.

**This article summarises 'Expenditure Reforms Post-welfare Reform in the UK: Are Low-income Families Starting to Catch up?' by Paul Gregg, Jane Waldfogel and Elizabeth Washbrook, CMPO Working Paper No. 05/119. For the full paper, see: <http://www.bris.ac.uk/Depts/CMPO/workingpapers/wp119.pdf>**

# Children's

## **In June, CMPO hosted a meeting on children's health in developing countries organised by Sonia Bhalotra and funded by the Department for International Development.**

**Paul Schultz** (Yale University) presented a paper on the long-run impact of a family planning programme in Bangladesh on maternal and child wellbeing. The programme was initiated in 1977 in Matlab thana, a poor and isolated region that had about 180,000 inhabitants at that time in 149 villages. The programme operated in half of the villages, the other half being available as a fairly effective control group. Field workers visited women of reproductive age in the 'treated' villages every two weeks, with contraceptive supplies and services. Over the years, further maternal and child health services were added on.

The analysis relies on a survey undertaken in this region in 1996. The authors find that fertility had been falling in the programme-affected areas since 1978, and that it remained below that in the control villages. The decrease in fertility appears to be associated with improvements in women's health and also with their control over economic resources. Education and health indicators for children have also improved. Overall, the programme seems to have had significantly positive effects over a long period, and these effects illustrate that maternal and child health and wellbeing are closely related.

Not all policy interventions are successful in meeting their objectives. **Ina Santos** (Universidade Federal de Pelotas) presented an evaluation of the effect of a milk supply programme in northeast Brazil on the growth of 6-18 month-old children. The study finds no significant impact of the supplement on beneficiary children relative to other children of the same age, sex and nutritional status at entry. It concludes that this was due to irregular delivery of the supplement, intra-household redistribution of milk and low levels of maternal compliance with the specific feeding recommendations made.

**Alan Emond** (University of Bristol) also focused on northeast Brazil in a study of the long-range effects of low birth weight. As many as 90% of low birth weight babies are born at term in developing countries, in contrast with richer countries, where low birth weight is usually associated with premature birth. This paper analyses cohort data on 164 babies born in 1993. The sample includes low birth weight (less than 2.5 kg) and appropriate birth weight (3-3.5 kg) children and compares their development at age 8 using a set of clinical and psychological tests.

# health in developing countries

The main findings are that low birth weight children have poorer dynamic balance and eye-hand coordination, but better selective attention and a lower likelihood of peer problems. There are no IQ differences once social background controls are introduced. The study also finds that head circumference predicts IQ scores.

A further study of the effects of an actual policy intervention was presented by **Rozana Himaz** (University of Cambridge). She does not have experimental data but uses conventional econometric methods to try to identify the impact on child nutritional status of a means-tested cash transfer made by the Sri Lankan government since 1995. She finds a positive effect of the scheme, which contradicts anecdotal evidence of its failure.

Using panel data from Tanzania, **Kathleen Beegle** (World Bank) presented the initial results of an analysis of the impact of orphanhood on children and how their welfare (measured by a number of indicators) compares with that of other children. Tanzania is severely affected by HIV/AIDS, as a result of which huge numbers of children are losing their parents.

There were a number of studies of human development in India. **Anil Deolalikar** (University of California, Riverside) presented an overview of human development in India, motivated by the question of whether India would be able to achieve the Millennium Development Goals relating to child health. **Vani Borooah** (University of Ulster) presented a complementary analysis of regional development in India, suggesting a method for ranking districts by human development.

**Sabu Padmadass** (University of Southampton) presented a micro-data analysis of the impact of health services on child health in India. And **Sarmistha Pal** (Brunel University) described her investigation of the impact of sibling competition for resources on individual death risks, using Indian data.

**Wiji Arulampalam** (University of Warwick) and **Sonia Bhalotra** (CMPO) also presented a paper on childhood mortality in India. Mortality risks are known to be concentrated by, for example, region and socio-economic status. Less known is the fact that across developing countries, they are also concentrated by household. This unequal distribution of death risk has been

regarded as the result of differences in genetic frailty or environmental and other characteristics of households.

Arulampalam and Bhalotra investigated if, further, there is a causal effect of a child death on the risk of death of a younger sibling. They find evidence of such an effect in 14 of the 15 major Indian states. This is an important finding because it implies a 'social multiplier effect' or a larger return to policies that reduce mortality risk.

**Arthur van Soest** (Tilburg University) presented joint work with Bhalotra on religion and mortality risk. It is well-known that Muslims in India have higher fertility than Hindus, and this is a politically sensitive matter. In developing countries, there tends to be a positive association of fertility and childhood mortality. So, in India, we might have expected Muslims to exhibit higher child mortality. But the reverse is the case. This is puzzling because Muslims are a minority group and tend to be less educated than Hindus.

This paper investigates the religion differential in mortality. It finds that only about half of the difference is explained by observed differences in characteristics. Although higher parental education and longer birth intervals among Hindus act to narrow the gap, the Hindu average is brought down by its inclusion of low castes. Muslims have a further advantage because they live in relatively well-off states and are more likely to live in urban than in rural areas.

Interestingly, part of the Muslim advantage is that higher fertility implies their children are born a little bit later on average, and therefore able to avail themselves of general improvements in health technology. Another part of their advantage arises simply from persistence effects of the sort described by Arulampalam and Bhalotra: Muslim children today are less likely to die because, yesterday, their siblings were less likely to die, and the death risks of siblings are correlated via, for example, birth spacing.

**The programme and papers from the meeting (and a related workshop held in March in Delhi on *Human Development in India: Microdata Perspectives*) are available here:**  
<http://www.ecn.bris.ac.uk/www/ecsrb/bhalotra.htm>. For further information, contact Sonia Bhalotra: [s.bhalotra@bristol.ac.uk](mailto:s.bhalotra@bristol.ac.uk)

# The Sale of Manchester United:

## A lesson in expropriation

**Malcolm Glazer's purchase of one of the world's most famous football clubs represents a massive expropriation of money and time donated by supporters over decades. So says economics professor and CMPO associate *Patrick Francois*.**

Malcolm Glazer bought Manchester United Football Club because he calculated that the club's assets could be organised and run in a way that would raise their value. This is what asset trade is all about. So why should we be concerned?

Fans of the club are clearly concerned: note the disputes, the boycotts, the calls for league intervention and the attempts to repurchase. The fans are worried that the club will be run in a way that maximises value but does not maximise the team's winning potential. They also fear that their access to games may be limited.

In terms of access, the fans are consumers of a product and it seems clear that the product will be priced higher in future and perhaps out of some supporters' reach. Ticket prices rose by about 25% the year before the takeover as the board tried to raise the value of the firm in order to deter a takeover. Glazer's business plan sees price rises continuing and there are plans to increase corporate sales. With finite capacity, that means fewer spaces for those without corporate privileges.

Fans worry that the level of playing excellence that maximises asset value does not coincide with maximising winning. This is harder to assess given that we can't properly estimate the value of maintaining a winning team. How 'elastic' is demand? How will merchandising be affected by performance? How will corporate sales, new membership, new overseas fans, etc. be affected by the club being, instead of the most successful club in the premiership, a decent but not overpowering presence?

Without knowing for sure, the best bet as to the owners' intentions is the business plan. Glazer projects revenues based on the club averaging third place in the premiership and the second round of European competition. To a supporter used to considerably more success, this is not great news. According to the plan, they can expect the average season to be one that most of them would call a disappointment.

So preliminary evidence seems to favour the supporters' concerns. It does appear that running a club to make a profit might imply an operating strategy that is less oriented to football success than they have been used to.

But this in itself is not cause for wider concern. Some people are always made worse off when businesses are shut down, taken over or change their products or business plans. Groups of consumers may prefer the product, the company or the service to remain the way it has always been, but if that's not in the interests of the company, no one objects to the company changing things.

In 1972, Austin-Healey stopped making cars. This saddened many of the car's enthusiasts. But the company owners, British Leyland, decided production was no longer viable. Some consumers may have been upset but no one called for the closure to be blocked by a regulator. No one thought this reflected badly on the regulation of the motor industry. No consumer group was party to negotiations on the continued production strategy of the company. Nor does anyone think they should have been.

**Manchester United's longstanding implicit agreement with its fans will be violated when the club is run in a way that maximises the financial interests of its owner**

There are laws to limit the actions of company boards and to protect individuals when ownership changes hands. But these laws are primarily concerned with other shareholders or the company's employees or debtors and not, generally, the company's consumers. If Glazer were to decide that he could make more money by selling off the ground, trading the players and franchising the label, then Manchester United Football Club would no longer field a team. This seems highly unlikely, but the point is that if he chose to wind it up, just like Austin-Healey or any other business being wound up, we would not usually worry about the consumers. Why should we here?

In short, the answer is that Manchester United had an implicit agreement with its fans, which led to mutually beneficial reciprocal efforts on the part of both club and supporters over a number of years. This agreement will be violated when the club is run in a way that maximises the financial interests of its owner. This is very different from the agreement between Austin-Healey and its consumers, which largely terminated once the car had

been purchased (subject to servicing and warranty). The agreement there was: 'We build you a beautiful sports car, you pay us for it and then you drive it.'

The agreement between Manchester United and their core fans was much longer term. It went something like this: 'Support us as best you can, come to our games, help the club (volunteer perhaps), become a member and (more recently) buy one of our many products or the products our club endorses and we'll be as successful a football team as we can. Give us your money or your time and you too will benefit because the thing you care about - the success of the team - will be enhanced.'

Though the club had long been privately owned, the owners respected this implicit agreement. But what form did the fans' donations actually take? Surely many of the transactions were similar to standard consumer purchases. Buying a ticket to a game allowed an afternoon's entertainment, buying a Manchester United shirt meant having one to wear. What exactly were the donated transfers that fans made to the club?

The first are supporters' clubs with thousands of members, all organised by volunteers. Apart from the fabled direct efforts of these volunteers - the post-war clearing of rubble at the site of the original Old Trafford, for example - these individuals gave to the club in countless ways. When football was a much less professional sport and volunteer efforts played an important part in fielding a team, they provided the manpower necessary to make the organisation run.

But such efforts have not played an important role for a long time; the club is professional and employees are paid good salaries. Where are the 'donated' contributions to be found now? More importantly, where is the evidence that the club is benefiting from, and asking for, such donations?

Manchester United's product advertising gives some clues as to what the club's marketers at least think is going on. Consider the following lines quoted (with my emphasis) from the club's official credit card advertisement on its website:

'Support Manchester United? Then apply for the Manchester United credit card today. Show the world you're a United supporter. New designs, new benefits and a new reward scheme - *and every penny we earn goes to benefit the Club and the Academy*. What more could you ask for?'

Or Britannia Building Society's advertisement for Manchester United savings accounts:

'An account that *benefits both you and your Club*.'  
'Our Manchester United Savings Account offers you all the benefits of a great savings account *and helps you support your Club* at the same time.'

Or the spiel on Manchester United's insurance website:

'Another way to support your club.'  
'Remember when you take a MU Finance insurance policy, *a percentage of your premium goes straight to Manchester United for investment in the team, the Academy and the general development of the club*, at no additional cost to you... you can't get that from any other car or home insurer!'

The marketing for Manchester United products appeals to the implicit agreement with fans in a crystal clear way: 'Buy good x, not because it's the cheapest or the best (it may not be), but that doesn't matter because any profits that we make from it will go towards advancing something you really care about - the on-field success of Manchester United Football Club.'

Just what these appeals to the greater good mean now is not so clear when the club is owned by an individual with no interest in soccer, who has purchased it to make money. What could 'every penny we earn goes to benefit the club' mean in the present context?

### **With the implicit agreement broken, the marketing of Manchester United products may be unable to appeal to the greater good of the club**

It's interesting to note that the website of the Tampa Bay Buccaneer (an American football team, which is also owned by Glazer) makes no such appeals to the greater good in its product sales. There, the penny has already dropped. The idea of giving anything to the Buccaneers in return for improved performance is ludicrous. That would be like writing a cheque to Malcolm Glazer and telling him to spend it how he sees fit. It will be interesting to see whether, now that the implicit agreement with Manchester United fans has been violated, such appeals will also disappear.

So the bottom line is this: Manchester United was a good purchase for Malcolm Glazer because it had been run in a way that honoured a previous and longstanding implicit agreement with its supporters. The supporters gave it resources and in return the club was geared around maximising winning, not the value of the assets built from those resources.

The club's assets reflected those years of donations and were ripe for the picking. By buying the club at a value that reflects it being run as a success-maximising institution, and selling it later (which no doubt will happen) at a value that reflects it being run as a value-maximising institution, there is a large profit to be made. This represents a massive expropriation of money and time donated by supporters over decades.

**Dr Patrick Francois is associate professor at the university of British Columbia in Canada and Tilburg University in the Netherlands.**



# Public Service Performance:

## The rocky road from soft theory to hard evidence

**How can the quality, performance and efficiency of public services be improved? As Christopher Hood argues, there are plenty of remedies on offer. What has been in short supply until fairly recently is the kind of systematic and dispassionate evidence that can only come from serious social science research.**



An old civil service joke goes that any policy that does not produce the exact opposite of its intended goal can be counted as a success. Even by that apparently undemanding standard, public services fail all too often. Prisons still often function as academies of crime, as Jeremy Bentham called them 200 years ago. Hospitals can act as hotspots for the transmission of serious disease, as they did in China during the SARS crisis of 2003.

When pyromaniacs join fire services (as often happens with bush fire brigades), those services turn into the problem rather than the solution. And the same goes for policies intended to improve public services. Transparency laws intended to foster a new culture of openness in public organisations can - and usually do - lead to tighter central management of information. Bounty systems intended to reduce pests or crime can have the opposite effect if the bounty-hunters encourage the propagation of the stock from which their income is drawn. The old joke has a point.

**Many evaluators of public services and public policies are politically *parti pris* in a more or less overt way**

But we want public services and the policies that govern them to do far better than just avoid making things worse. The demand today is for efficiency, enhanced effectiveness, 'world-class' quality and performance. And indeed if stirring speeches and dramatically announced initiatives were all that it took to achieve such things, the UK would already be at the Olympic gold level of public service performance.

As it is, when put up against a dozen or more comparable OECD countries on some of the conventional rankings of school attainment, crime rates and health service performance, the UK and its component nations tend all too often to be ranked in the bottom third and there are no Olympic golds.

Are international rankings of this kind irremediably problematic on reliability or validity, or both? Are they stacked against the UK in some way? Maybe - but such arguments tend to be dismissed by central government as special pleading when they come from



local authorities, universities or hospitals questioning their place in national rankings.

Or could it be that the UK's performance on those rankings represent the best that could ever be expected of a country that is perpetually trying to attain Swedish-style public services with American-style tax policies? Again, maybe - but there is plenty of evidence that funding levels alone do not determine public service performance, and not much sign yet of the UK's international ranking levels changing as a result of recent increases in spending on public services.

So if there is a real problem revealed by such rankings, how can public service quality, performance and efficiency be improved? There is no shortage of remedies on offer from the policy shops and the seminar circuit.

Some see the answer as enhanced competition in some form or another - for instance, making public servants compete against one another for a fixed quotient of performance pay, more national or international market-testing, voucher systems of one kind or another.

Others see the remedy as more community participation, teamwork, long-term high-trust partnerships. Still others put the emphasis on determined leadership from the top, in setting strategic targets, bearing down determinedly on the weaker performers and redeploying resources as needs arise, as the New York mayor's office does with police resources in the light of weekly crime indices.

All of these remedies have their passionate advocates - and, in most cases, equally passionate critics. But most of these debates rarely go beyond exchanges of first principles or assertion of plausible but contradictory maxims. What tends to be lacking is systematic and dispassionate evidence.

There are several reasons for the scarcity of such evidence. Government departments and public organisations understandably tend to support the kind of research that

support the policy positions or ideological stances of their leaders. The data needed to do proper evaluation are frequently in the hands of different organisations, sometimes classified, often and increasingly claimed to be commercially confidential. Access to the information needed increasingly lies through ever-more arduous research ethics clearance procedures that can give an effective veto to the organisations concerned.

Many evaluators of public services and public policies are politically *parti pris* in a more or less overt way. And just as trade used to follow the flag, the research community itself tends to be stovepiped around the jurisdictional and policy boundaries of sectoral bureaucracies, which can work against studies cutting across policy domains and different parts of the UK.

For conventional academic research, the pace of progress from initial idea to final publication tends to be tortoise-like because of the built-in institutional delays in peer-reviewing for funding and publication, obtaining ethics clearance and increasingly onerous procedures for making appointments. And research capacity is limited in some parts of the UK, particularly for some of the less orthodox methodologies. None of those conditions are going to change any time soon. Some of them are likely to get worse.

Against that backdrop, CMPO stands out as a research centre that is making a serious effort to fill the evidence gap through rigorous and balanced research on public services and public organisation. The Economic and Social Research Council's new research programme *Public Services: Quality, Performance and Delivery* is committed to a similar approach.

### **Social scientists must make a serious effort to fill the evidence gap through rigorous and balanced research on public services and public organisation**

The programme launched in January with an international workshop on transparency sponsored jointly with the British Academy, and it now supports 16 research projects on public service performance, using a range of methods from data mining to direct observation and drawing on researchers from across the social sciences.

The programme has many points of common interest with CMPO, and the two ESRC investments will join together in December to sponsor a one-day conference in London on 'Where Does Britain Rank? International Rankings of Public Service Performance.' We hope it will be the first of many collaborations between CMPO and the programme.

**Christopher Hood is Gladstone Professor of Government and Fellow of All Souls College, Oxford. He is the director of ESRC's research programme on *Public Services: Quality, Performance and Delivery* ([www.publicservices.ac.uk](http://www.publicservices.ac.uk)).**

# Tax Compliance:

## How social norms and the threat of audit influence taxpayers' behaviour

An important decision for the tax authority is how to allocate investigation resources among different groups of taxpayers. For this, it is crucial for the tax authority to have a good understanding of the impact of audits on taxpayers' behaviour and how it may differ across different groups of people.

Recent empirical studies have tried to estimate the impact of audits on tax compliance. These studies, mostly based on US data, analyse the effects of audits on reported income and tax liabilities and distinguish between the direct and indirect effects of investigations.

The direct effect lies in the additional revenues in the form of unpaid taxes and fines collected by the tax authority through investigations. The indirect effect relates to the behavioural response of taxpayers to a change in audit policy and measures the increase in tax compliance induced among all taxpayers (not just those being investigated) triggered by a greater perceived threat of being audited.

The indirect effect is calculated as the predicted value of total reported tax for a given change in the audit rate: it varies across the studies depending on the time period of the data and the audit rate. The direct effect is derived as the difference between the predicted value of total assessed liabilities and the predicted value of total reported tax for the same change in the audit rate.

Although the estimates in these studies are quite different, a common result is that the indirect effects of investigations tend to outweigh the direct effects. This has non-trivial implications for the optimal allocation of investigation resources.

An important issue is whether the ratio between the indirect and direct effects varies across different groups of taxpayers. If the ratio were equal across different groups of taxpayers, then its magnitude would not matter as far as the allocation of compliance resources across groups of taxpayers was concerned, though it would affect the balance between compliance and non-compliance activities.

The methodology used in the empirical studies to calculate the indirect and direct effects of audits does not make it possible to distinguish the determinants of these effects and the issue of whether and how the ratio varies across taxpayers remains unclear.

Our research analyses the optimal allocation of investigation resources across different categories of taxpayers when the enforcement agency has a fixed budget to carry out investigations. We assume that the enforcement agency seeks to minimise the tax gap - the amount of tax evasion taking place minus the amount recovered through investigations - and derive the direct and indirect effects from the expression characterising the optimal allocation of investigation resources.

We show that the ratio between direct and indirect effect depends firstly on the 'elasticity' of evasion of a given group of taxpayers - how much less they will evade taxes in response to an increased threat of audit. The ratio also depends on how intensively the group is investigated, and the operational effectiveness of investigations.

### **The balance between direct and indirect effects of tax audits has important implications for the optimal allocation of investigation resources**

The intensity and the operational effectiveness of investigations do vary across fiscal areas and across different groups of taxpayers within the same fiscal area. Hence there is no reason to expect the ratio between the indirect and direct effects to be constant across different groups of taxpayers or different fiscal areas. It then becomes important to estimate the different components of the ratio to get an insight into how the impact of audits differs across different groups of taxpayers.

Estimation of the elasticity of evasion is particularly problematic. One important question is whether we should assume it to be constant across different groups of taxpayers. But this question can only be addressed empirically.

**Tax inspections can increase government revenues both directly through collecting unpaid taxes and fines and indirectly - via the threat of audit - by encouraging taxpayers to pay what they're supposed to in the first place. Theoretical work by *Marisa Ratto* and colleagues explores the additional impact of social norms on tax compliance.**

We, however, are interested in understanding how the behavioural response to an increase in the audit rate may differ if considered at an individual level or at the level of a group of taxpayers. This is important for choosing the level of data aggregation for calculating the elasticity of evasion.

**If tax compliance is a social norm within a group of taxpayers, their behavioural response to an increase in the audit rate will be stronger**

The behavioural response to investigations is obviously linked to taxpayers' compliance perceptions and propensities. There are many different factors affecting taxpayers' willingness to evade: attitudes towards tax compliance are influenced by opportunities to evade and personal circumstances that may affect the cost of compliance, by people's perceptions of how they are treated by the tax authority and their perceptions of the enforcement system, and also by interactions with other taxpayers.

Including all these aspects in theoretical analysis would not be feasible. We focus on the role of social interactions among taxpayers in determining the behavioural response to an increase in the audit rate. The underlying idea is that individual behaviour might not only be affected by purely individualistic calculus but might also reflect some sort of group norms. In other words, the compliance decision of an individual may depend on the proportion of taxpayers within their reference group who are honest.

Our results suggest that if tax compliance is a social norm in the relevant community, this has important implications for the impact of an increase in the audit rate on voluntary compliance. At the aggregate level of the community of taxpayers, we can expect a higher response to a change in the allocation of audit resources than in the absence of a social norm.

Essentially, social norms introduce a multiplier effect: generating greater compliance through a deterrent effect causes even more people to become compliant through the social norm. The

magnitude of the impact of audits on aggregate behaviour will therefore be higher the greater the importance attached to the social norm.

There are two important implications of these results:

- The choice of the data aggregation to calculate the elasticity of evasion should not neglect possible social norm arguments emerging from taxpayers' interactions.
- Specific targeting should be applied to different groups of taxpayers, as the importance attached to the social norm is likely to vary across groups of taxpayers and also for different types of tax compliance. For example, attitudes towards one's peers' behaviour may be very different for late filing, false benefit claims, income underreporting or VAT evasion.

**This article summarises 'Tax Compliance as a Social Norm and the Deterrent Effect of Investigations' by Marisa Ratto, Richard Thomas and David Ulph, CMPO Working Paper No. 05/127. The paper reports research undertaken for HM Revenue and Customs. For the full paper, see: <http://www.bris.ac.uk/Depts/CMPO/workingpapers/wp127.pdf>**

# School Choice Reform in England:

## The research evidence

**The latest education White Paper promises more choice for parents and pupils. Simon Burgess and CMPO colleagues lay out the key facts on school choice.**

Advance comment on the school choice White Paper included complaints that the plan would involve 'bussing' poor children to schools in wealthy areas. The use of this term implied a link to the highly emotive events around busing in the civil rights era in the United States, a situation far removed from the present day school system in England.

But the key point is that 'bussing' already goes on. The difference is that this bussing occurs in people carriers, not big yellow buses, and is not available to all. Affluent families whose nearest secondary school is of poor quality are much more likely to 'bus' their children out to schools further away than poorer families. They have the resources either to live near better schools or to transport them to better schools if not.

Poorer families follow this strategy too and go to other schools if the local one is weak. But they achieve this outcome to a much lesser extent. Policy should be aimed at redressing this imbalance.

Of course, the school choice agenda is broader than this, the central idea being that competitive pressures applied to schools that are vulnerable to losing more mobile pupils will raise standards everywhere. But the aim of increasing practical choice for poorer pupils seems a reasonable place to start.

The two important practical issues in the reform of school choice are transport and access. The average secondary school commute is 1.6 kilometres, though naturally lower in urban areas and higher in rural areas. A quarter of pupils travel over 3 kilometres, and 10% travel over 6.5 kilometres.

Only a half of all secondary school pupils in England attend their nearest school. One in two pupils are not going to their 'default' school - so we are already in a world with a lot of 'choice'.

But it is important to see that not all of this movement away from the local school is 'choice' in the sense of consumer choice with a desired outcome. The school system has been more-or-less a closed system: roughly speaking, there are as many school

places as children and each school can neither expand nor contract very rapidly (though there are excess places in some areas and schools can change size).

A useful analogy for the system is a modified game of musical chairs: there are enough chairs for everyone, but some are more desirable than others. The point is that one person's choice of chair has implications for the places available to others. Unlike in most situations of consumer choice, choice by one person has 'spillover' effects on others. The issue for policies around transport and access is how things look when the game finishes - which pupils are going to which schools.

**If the local school is poor, affluent families respond by transporting their children to other schools to a much greater extent than poor families do**

The facts show that the present system does not work well for pupils from poor families. CMPO research has analysed data on which pupils go to their nearest school, looking in particular at the quality of that local school, and whether the pupil comes from a poor family or not. Quality is measured by the previous league table score of the school in terms of the percentage of its pupils awarded at least 5 A\* to C grades at GCSE. A pupil's family background is measured in two ways: eligibility for free school meals; and whether they live in a poor or affluent neighbourhood.

The findings show that as the quality of the local school gets lower, children from affluent families are less likely to go there. Focusing on schools in the bottom quarter of the national league table, a pupil eligible for free school meals is 30% more likely to attend their low-scoring local school than an otherwise-identical pupil from a better-off family.

Focusing on pupils from poor streets and from affluent streets, the difference is very clear: if their local school is poor, affluent families respond by transporting their child out to another school to a much greater extent than poor families do.



The present system, which can be characterised as a mixture of neighbourhood schooling (where pupils simply attend their local school) and choice-based schooling, leads to the 'sorting' of pupils. Pupils are not evenly spread across a group of schools in terms of their Key Stage test scores, their eligibility for free school meals or their ethnicity.

This sorting is higher where there is more choice. The interplay of the decisions of schools, parents and local education authorities (LEAs) produces an outcome in which there is clustering together of pupils scoring well in the Key Stage tests, and a clustering together of pupils from poorer backgrounds. This is unlikely to be to the advantage of the latter pupils.

It is important to point out, however, that this sorting is much lower in comprehensive LEAs, even those with high choice, than it is in the few LEAs retaining elements of selection by ability.

Choice is feasible for most secondary school pupils in England, in the straightforward sense that they have more than one school near to where they live. In fact, 36% have at least three schools within 2 kilometres of their home, and over 80% have at least three schools within 5 kilometres.

Obviously, this varies over the country. In rural areas, the numbers are lower (only 42% have at least three schools within 5 kilometres) and in London, almost all pupils have at least three schools within 5 kilometres. Put another way, three quarters of secondary school pupils have at least three schools within 4 kilometres from their home.

The policies have to make a reality of this choice in principle. Components of the policy include continuing the programme of creating more schools close to where poorer families live; supporting the decision-making of poorer families by providing information; and subsidising the transport costs of poorer families.

The school choice reforms face a number of difficulties in achieving their aims. Responses of schools and parents will be important. Will the target schools - the schools that newly empowered parents want to choose - be willing and able to expand?

There are practical difficulties in increasing the number of places, but there may also be questions about the desire to do so. To the extent that a school's position in the league tables depends on the attainment of its intake, schools may be unwilling to increase and potentially to dilute the quality of their student body.

At the root of this is the question 'what makes a good school good'? If it is mostly attributes that can be readily extended (such as leadership and ethos), then increasing entry should not be a major problem; if it is attributes inherent in the intake (such as the ability of peer groups) then this policy is more problematic.

The response of parents too will be important. What are parents really looking for in a school? If it is educational quality, the changes will leave them unaffected. If it is an exclusive peer group for their child, then they may reconsider their choice of school.

Wouldn't it be better if all pupils simply attended their local school? This seems a more straightforward system, and also has benefits in terms of traffic pollution and congestion. But it is likely to be the most exclusionary system, with access to good schools highly dependent on income.

### **The average secondary school commute is 1.6 kilometres - but only a half of all secondary school pupils in England attend their nearest school**

A strict rule that all children attend their local school would increase the demand for residences near good schools, raising house prices and so excluding poor families. An egalitarian policy aim of trying to loosen the link between a family's parental income and the quality of the school their child attends would not be well served by neighbourhood-based schooling.

This argument is part of a broader insight: the rules by which children are assigned to schools affect the nature of neighbourhoods. Strict neighbourhood schooling is likely to produce communities strongly segregated by income. Other features of areas are likely to be less important than the need to be within so many kilometres of the good school.

On the other hand, if the school assignment system is choice-based, neighbourhoods will be more heterogeneous. The residence decision is detached from the school decision, and can be made on other grounds - such as being near parks or transport links or cultural centres - over which there is likely to be more diversity of tastes and consequently less steep house price gradients.

A policy shift towards a stronger choice element in school assignment will bring some interesting transitional problems. Neighbourhood schooling implies that part of the value of some residences is the entry ticket they provide to desired schools. If policy changes to reduce the importance of simple geographical proximity in admissions, these entry tickets will be lost, and consequently the prices of such houses will fall.

**This article draws on research evidence summarised in *Will More Choice Improve Outcomes in Education and Health Care: The Evidence from Economic Research* by Simon Burgess, Carol Propper and Deborah Wilson (<http://www.bris.ac.uk/Depts/CMPO/choice.pdf>); and *School Choice in England: Some Facts* by Simon Burgess, Adam Briggs, Brendon McConnell and Helen Slater.**

# Dishonesty and Legal Services:

## Is outside ownership really a problem?

The title of October's White Paper from the Department of Constitutional Affairs - *The Future of Legal Services: Putting the Customer First* - gives some indication of the government's view of the existing system. There are two main types of reform proposed: one in the regulatory structure of the profession; and one in who is entitled to own and manage law firms.

At present, the law profession is mainly self-regulated through institutions like the Law Society and the Bar Council. The White Paper proposes the introduction of a new Legal Services Board with statutory powers to regulate the profession though the intention is to devolve some of these powers to the current frontline regulators. Only time will tell how much effective change materialises, but the Law Society and the Bar Council will be obliged to separate their regulatory and representative functions. This will be a big improvement both in practice and perception.

The second major change the government favours is the introduction of new ownership structures allowing non-lawyers to own and manage firms. The new firms may choose to offer legal services only - what are known as legal disciplinary practices (LDPs) - or they may involve lawyers in firms providing a 'one-stop shop' for professional services - so-called multi-disciplinary practices (MDPs).

### **Dishonest practices are far more prevalent in small law firms than large ones**

The phrase 'Tesco Law' has been used to represent what the new structures might look like. Indeed, many household names have indicated an interest in setting up LDPs and MDPs, with the RAC leading the way. Many people in the legal profession have been particularly concerned about 'outside ownership', by which they mean non-lawyers.

As part of the reform process, I was asked to report on the potential downsides of new ownership structures and to suggest regulatory remedies. Among a number of aspects of the issue, I looked at the relationship between dishonesty and firm size and whether it matters if a lawyer or non-lawyer owns a large LDP or MDP.

The relationship between firm size and professional quality is particularly important given concerns that the reforms may lead to small law practices being driven out by well-funded, outside-owned firms. The problem I quickly found is that there are very few data on professional quality and what exists is not quite what is wanted.

### **It is difficult to believe that lawyers have a stronger 'social conscience' than other professions**

It would be an obvious point to suggest that there is no big surprise in finding that a self-regulated industry has limited evidence to get to the bottom of what causes dishonest practices. And from my dealings with the Law Society, I feel that this would be an unfair inference to draw. But this does not alter the fact that it is very hard from existing data to understand how much dishonesty there is and where and why it occurs.

Nevertheless, what evidence I have been able to find indicates quite strongly that dishonest practices are far more prevalent in small firms than large ones. This is true even before taking account of the fact that a large firm is likely to have at least 20 times more partners than a small one.

Trying to correct for size is difficult. But my analysis shows that if we correct for firm size by partner numbers, then a lawyer in a practice with 2-4 partners is almost 60 times more likely to engage in dishonest practices than a lawyer in a firm with 21 or

**The legal profession is concerned that government proposals for new ownership structures for law firms could breed dishonest practices. Research by *Paul Grout* suggests that lawyers may do better worrying about dishonesty closer to home.**

more partners. If we correct for size by fees, then the picture is even more dramatic.

The really interesting issue - and here we know even less - is why. Clearly, the type of business may differ. It may also be that it is harder to 'take on' a big firm, and more cases may get settled at an early stage. While there are many potential explanations, anecdotal evidence indicates that a major reason is that it is more common to have formal procedures in place in large firms. This is likely to restrict lawyers' ability to be negligent or dishonest, and helps to create a positive culture.

So under the proposed new regime, are lawyers running large firms more likely to be enticed into dishonest practices if there is a non-lawyer owner than when they own the LDP themselves? The professional wisdom is yes - and that this calls for 'ring-fencing' of legal teams within new ownership structures. My view is that the opposite is at least as likely to be the case.

It is difficult to believe that lawyers have a stronger 'social conscience' than other professions. For example, research evidence shows clearly that the medical profession's treatment of patients changes as financial incentives change. There is little reason to suppose that lawyers are likely to be less responsive to financial incentives.

### **Tighter financial regulation seems appropriate whether firms are lawyer-owned or not**

The new regulatory regime will be in a position to strip dishonest lawyers of their professional livelihood. So non-owning lawyer-managers will be placing a great deal of their livelihood at risk if they acquiesce to pressure from an outside owner to bend the rules, no matter how much of the LDP's value is at stake.

In contrast, if the LDP's ownership is concentrated in the lawyer-managers' hands, then the bulk of the lawyers' value at risk is the value of the LDP. If there is a large financial benefit to bending the rules for a major client, this is more likely to prove attractive to lawyer-managers when they are owners than when there is outside ownership.

Indeed, one of my primary regulatory concerns relates to the disproportionate attention given to outside ownership relative to the comparatively lax view of practices where ownership is highly concentrated in lawyers' own hands. Tighter financial regulation seems appropriate whether firms are lawyer-owned or not.

Large LDPs and MDPs may or may not bring big benefits, but it is not obvious that the profession should be so concerned about outside owners. Indeed, if there is genuine concern about dishonesty in large, concentrated LDPs, the profession may do better worrying about problems closer to home than focusing on outside owners.

**Paul Grout's July 2005 report to the Department of Constitutional Affairs - 'The Clementi Report: Potential Risks of External Ownership and Regulatory Responses' - is available here: <http://www.dca.gov.uk/legalsys/grout.pdf>**

# Law, economic incentives and public service culture

**A CMPO meeting in May discussed five papers that examine how external law and administrative norms, indicators and values operate to govern the delivery of public services. A central theme was that law takes place and is implemented in a competitive environment; law is matched with other administrative norms and values, some competing some complementing. The papers sought to bring new understandings to the operation of these relationships, and new insights into the tensions created with existing concepts of a public service culture.**

**Pat O'Malley** (Carleton University) examined the reshaping of public police management into a corporate executive in Canada and Australia. This 'corporatisation' has resulted not simply in an expansion of the domain of private police and a merging of public and private policing; somewhat ironically, it has also resulted in the revitalisation of police unions. Police management in both the public and private sectors demonstrates a return to traditional industrial relations. O'Malley concluded by suggesting that it is this 'industrial' distinction that may be the key to understanding the limitations to the transfer of business principles to public policing.

**Colin Scott** (LSE) discussed 'spontaneous accountability', calling for a recognition that traditional, hierarchical forms of accountability have limited applicability in emerging governance structures in public services. Scott argued for a reconceptualising of accountability, recognising that it operates through hybrid mechanisms involving elements of hierarchy, competition and community.

**Morag McDermont** (University of Bristol) focused on governance at the micro level, looking at the role played by the voluntary boards of housing associations, particularly tenant board members. Arguing that expertise, especially financial expertise, plays a vital role in the complex power relations within boards, means that if we are to understand how tenants can influence change, then we must focus on the ways in which tenants can see themselves, and be perceived by others, as 'experts'.

**Peter Vincent-Jones** (University of Leeds) considered the question of the 'public interest' in health services regulation

against the background of recent organisational reforms. He argued that proper account must be taken of the shifting organisational foundations of health services, and of the way in which the drift to privatisation is being encouraged by the introduction of new forms of consumer choice and individual exit from traditional state provision.

**Mike Feintuck** (University of Hull) also focused on the role that the public interest could play in protecting non-commodity values, seeking to take the debate on public service culture beyond an economic framework. He argued for a concept of public interest based on fundamental democratic values, explicitly oriented towards expectations of equality of citizenship.

Despite the wide-ranging subject matter of the papers, a number of themes recurred in the discussions, notably the apparent rediscovery of the 'hybridisation' of the state, linked perhaps to the breakdown of the 'welfare consensus'. In the context of the UK, devolution has begun to play a critical role in the splintering of public service delivery mechanisms, with the constituent nations taking very different directions.

As a consequence of hybridisation, we are seeing the increasing corporatisation and 'consumerisation' of public services. So while we can see evidence of tensions arising between public sector culture and private sector values, there is also an element of 'reading across' sectors, borrowing models such as spontaneous accountability. There is, however, another question: whether this increasing convergence of the public and private is at the expense of robbing each sector of its merits.

# Performance Measurement in the Public Sector:

## The impact on staff recruitment and retention

**New research by *Gian Luigi Albano* and *Clare Leaver* finds that performance measurement affects the cost of recruiting and retaining the best people.**

Performance measurement is becoming an inescapable part of life in the public sector. Government departments report annually on progress towards 'public service agreement' targets, while report card data are published for schools and even individual clinicians. But since political enthusiasm is not always a perfect predictor of economic efficiency, it is important to ask whether public sector performance measurement systems are being designed correctly.

Previous studies focusing on incentives have shown that performance measurement systems can elicit 'gaming' behaviour as well as productive effort. Our research shows that the collection and publication of performance data in the public sector can also have unexpected consequences for recruitment and retention.

In our analysis, a public sector organisation must design a performance measurement system, aware that it will then compete for employees with private sector organisations characterised by greater pay flexibility and publicly observable performance.

The main finding is that performance measurement systems affect the cost of recruiting and retaining public sector employees:

- A transparent system minimises the cost of recruitment because of what we call the 'option-value effect': private sector jobs have an option value when the public sector organisation fails to publish performance.
- An opaque system minimises the cost of retention because of an 'outside-offer effect': good performers receive lower outside offers when the public sector organisation fails to publish performance.

The upshot is that the public sector organisation faces a trade-off between recruitment and retention: it can be transparent, recruit cheaply but see its best employees leave; or it can be opaque, recruit at a higher cost and see its best employees stay.

In our benchmark case, where incentive considerations are absent, we show that this trade-off should be resolved in favour of retention. The advantage of a transparent system is that it minimises the transfer of rent to workers stemming from pay inflexibility. But the advantage of an opaque system is that it maximises retention and, in turn, the extraction of rent from workers that arises with public service motivation.

Crucially, whenever the public sector organisation is willing to recruit, and hence transfer some rent to poor performers, public service motivation must be high enough to make it optimal to retain *all* performers.

**A transparent system of performance management may mean that a public sector organisation can recruit cheaply but will see its best employees leave**

We conclude by pointing to two caveats. First, in the case of 'craft' organisations where employees have a good sense of their performance even in the absence of formal performance measurement systems, private sector employers cannot be prevented from inferring that it is good performers who quit the public sector. Since this removes the outside-offer effect, recruitment and retention considerations are best served by a policy of transparency.

Second, the recruitment-retention trade-off does not have to exist in any organisation. If public sector pay increases with tenure at a sufficiently high rate, the organisation can recruit and retain at the same (minimum) cost under any performance measurement system. Together with ports of entry, tenure-based pay can therefore be rationalised as an optimal response to rigidities in public sector pay.

**This article summarises 'Transparency, Recruitment and Retention in the Public Sector' by Gian Luigi Albano and Clare Leaver, CMPO Working Paper No. 05/132.**

**For the full paper, see:**

**<http://www.bris.ac.uk/Depts/CMPO/workingpapers/wp132.pdf>**



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## **The Centre for Market and Public Organisation**

Department of Economics  
Mary Paley Building  
12 Priory Road  
Bristol  
BS8 1TN

**Telephone:** 0117 954 6943

**Fax:** 0117 954 6997

**Email:** [cmpo-office@bristol.ac.uk](mailto:cmpo-office@bristol.ac.uk)

**Website:** <http://www.bris.ac.uk/Depts/CMPO/>



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