VOLUME 4

THE COLLECTED WORKS OF ARTHUR SELDON

Introducing Market Forces into "Public" Services

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ARTHUR SELDON

Edited and with a New Introduction by Colin Robinson

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INTRODUCTION

Volume 4 of the Collected Works of Arthur Seldon brings together six of Seldon's publications that discuss ways of paying for "public" services other than through general taxation.

One of the features of this volume is that it shows Seldon's prescience, starting in his early days as a professional economist, in foreseeing the dangers of "universalist" provision of services by the state. At a time when most British intellectuals were wholehearted supporters of centralized collectivism, Seldon identified and analyzed the underlying problems of state provision, financed by general taxation rather than specific charges. The problems he foresaw have undermined welfare states almost everywhere.

Throughout the volume, Seldon's main and recurring argument is that nonmarket provision, financed by taxpayers, leads to a fatal disconnection between suppliers and consumers. Suppliers do not depend directly on consumers for payment and therefore have no reason to discover what consumers want, to provide for existing demands, or to innovate to meet the demands of the future. Furthermore, because suppliers do not face any competition, efficiency standards set by rivals do not exist. Consumers see a price of zero at the point of service delivery, and so their demands inevitably expand far beyond what they would have been had they been charged the full cost of the service. In the absence of any price mechanism, the mismatch between supply and demand is not automatically corrected, and thus the state must resort to rationing by a bureaucracy insulated from the market, which, over time, develops a high-handed attitude toward those it is supposed to serve, regarding them as supplicants rather than as valuable customers.

In Britain, the country with which Seldon was most concerned, the reforms that he advocated are, almost forty years after he originally suggested them, tentatively being introduced by the Labour government first elected in 1997. Several years of office appear to have convinced the government that it can no longer simply pour more and more money into "public" services in the hope that they will improve. Grudgingly, Labour has accepted that market forces must play a bigger role and it is very gradually embarking on the necessary reforms, though evidently it has yet to understand and accept the full implications of the Seldon analysis of the benefits of charging.

In the earliest publication in this volume—"Which Way to Welfare?" from *Lloyds Bank Review,* October 1966—Seldon sets out some of the problems of providing "welfare" centrally through the state. He writes of the

> inadequacies, indignities and injustices in all the welfare services, which exhibit increasing demand and flagging supply (p. 3).

The public sector has been inflated and politicians have been diverted from the tasks they should have been performing. The solution, he says, is to create

> the legal and institutional framework within which, where practicable, personal welfare services can be supplied through the market to consumers armed with purchasing power, original or supplemented, sufficient for at least essential purchases (p. 3).

He goes on to explain various ways of creating such markets (for example, by tax rebates, subsidies, cash grants to consumers, or vouchers). These methods are, however, second best: a better way of establishing a market would be through a general reduction in taxation to allow people to pay charges or insurance contributions at market levels. The eventual aim should be that

> It must become more proper and moral for a man to work for himself and his family than to expect others to work for him, unless he cannot help himself (p. 17).

In 1967, the year after "Which Way to Welfare?," the Institute of Economic Affairs published a paper by Seldon entitled *Taxation and Welfare* (Research Monograph 14). It is the second paper in this volume. *Taxation and Welfare* is based on an April 1967 opinion survey carried out jointly by the IEA and the company Mass-Observation. Among the questions asked in the survey were the following: How much tax does the government take from your earnings? How much tax should it take? Should "welfare" spending concentrate on the most needy? and Should the existing welfare system be replaced by one using cash payments or vouchers? The April 1967 survey followed up a number of earlier surveys, starting in 1963, in which the IEA and Mass-

Observation pioneered studies of public attitudes toward state and private welfare provision.

One of the principal findings of the survey was that, contrary to mainstream intellectual opinion at the time, there was no consensus in favor of universal benefits paid by the state and financed through general taxation. Seldon described this result as "unexpected and perhaps . . . remarkable" (p. 56). Almost twice as many of the respondents (65 percent) supported selective benefits, concentrated on the needy, as favored universal benefits (35 percent). Nor was there evidence to support another generally held view of the time—that support for universalism would be strongest among lower-income people.

State welfare through the provision of services in kind, concludes Seldon, has been a "tragic error" (p. 76) and has been "tried and found wanting" (p. 77). High-quality health, education, housing, and similar services will not be provided through taxation; rather, informed purchasers in a market are required. State services in kind should be replaced by

> social benefits in cash, or coupon, for all except the small minority of people . . . incapable of learning choice (p. 77).

In the 1970s, Seldon returned to the argument that a large part of government expenditure is not directed at genuinely "public" goods or services and that markets in the relevant goods and services be established so that consumers can decide for themselves how much they wish to spend on those goods and services. *Catch '76 . . . ?* is an IEA Occasional Paper (number 47), published in 1976, in which Seldon assembled a collection of essays on Britain's then-precarious economic position.

Seldon's own essay in *Catch '76,* "Remove the Financing Flaw in 'Public' Services," reproduced as the third work in this volume of the Collected Works, is notable for a table (p. 86) that lists items of government expenditure and, for each one, shows first the extent to which charges were levied for the goods and services provided by the government, and second a subjective estimate of the extent of private benefit from the government expenditure. For most items the charges are very small. Indeed, they are tiny in relation to the considerable private benefits that Seldon estimates: for the main education services, for example, Seldon puts the private benefit element at 80 to 100 percent, whereas the element of private benefit implied by the proportion of fees and charges to total expenditure is in most cases well under 10 percent. Of course, one can argue about the precise size of the private benefits, but Seldon's purpose in producing the table was to emphasize his point that, though much government expenditure is justified by politicians on the grounds that the goods and services are "public," in most cases the benefits of spending could perfectly well be appropriated privately. Charging for these services is therefore not only possible but also desirable to promote economic efficiency.

Charge, the fourth work in this volume, published in 1977, is a much longer and more detailed analysis of the issues addressed in "Remove the Financing Flaw in 'Public' Services." Seldon was invited to write the book by the publisher Maurice Temple Smith following a letter that Seldon had written to the *Times. Charge* sold well, being reprinted in 1978, the year after first publication.

Early in the book, Seldon quotes approvingly Keynes's remark that governments should concentrate on doing "those things which are not done at all" rather than "things which individuals are doing already" (p. 110). That remark provides the theme for the book, which sets out to demonstrate that a large part of the goods and services provided by British governments are not "public" at all and that charges should be applied to them. The goods and services supplied by government

> do not all have to be organised by government and financed by taxes. Some could be financed by prices. They are not all necessarily in the public interest. Some could be organised outside government. This possibility opens up new vistas of wider choices (p. 131).

Seldon begins by analyzing in some detail, though in simple language, the functions of price—which, as he says, should be considered as a neutral and informative link between buyer and seller rather than as a barrier to purchases. Without price, he points out, the prime means of determining preferences is absent, and so allocation of scarce resources takes place by politicians and bureaucrats who act in a state of ignorance about what consumers want. The machinery of representative democracy is "avoidable and inefficient" where there are private benefits, and it

> unnecessarily but irremediably prejudices lower-income people with little or no social connections, political influence or economic muscle (p. 287).

Seldon separates the main elements of government expenditure into those that are public goods in the economist's sense (of which defense is the main item), those in which some of the benefits are private (for example, roads and public lighting), and those in which most of the benefits are private (such as education, health, and housing) (table B, pp. 136–37). In total, he estimates only about a third of British government expenditure is on goods and services that necessarily have to be financed by taxes (p. 286). Thus, he claims, most state services "yield separable private services that could be more efficiently financed by charges" (p. 286).

Much of the book (part 2) is taken up with detailed analyses of education, medical care, housing, roads, local authority services, public corporations, and other principal items of government expenditure. In these chapters, Seldon shows how government has taken over functions that used to be exercised by the private sector even though, in most cases, there is no "public good" case for it to do so. He explains how charging for such services could be introduced and how consumers and taxpayers would benefit.

In part 3, Seldon confronts the arguments of those who favor state provision and financing. For Seldon, poverty is not an acceptable argument: it is better treated by a reverse income tax. People's supposed "irresponsibility" in making choices is also an invalid argument: they would become more responsible if they were placed in a market. The costs of provision are usually not lower but higher when the state is the supplier. Externality arguments for state provision are generally unsubstantiated. Moreover, Seldon argues that there is no basis for the belief that government control is required to avoid private monopoly: on the contrary, government control perpetuates monopoly and encourages lobbying.

Not long after the publication of *Charge,* in April 1979, the IEA held a seminar to discuss ways of keeping government in check. The seminar was opened by Lord (Lionel) Robbins and addressed by a number of distinguished speakers who analyzed the growth of government and suggested ways of curbing its powers: the proceedings were published by the IEA in 1979 as *The Taming of Government,* Readings 21.

Seldon's contribution to the seminar, "Micro-economic Controls—Disciplining the State by Pricing," is the fifth paper in this volume. In the paper, Seldon begins from the proposition that macroeconomic controls on government are not enough to keep government down to an appropriate size because they will be devised and implemented by politicians and bureaucrats. Following *Charge* and his earlier works on the subject, he puts forward powerful arguments for subjecting state spending to the more objective test of the market: it should price its services and try to sell them in competition with private suppliers. Seldon uses a table similar to that in *Charge* to demonstrate that only around one-third of government spending can reasonably be classified as on "public" goods. Wherever possible, therefore, charges should be imposed on services provided by government. Taxes should be reduced and a negative income tax introduced to help the poor. Seldon summarizes his case for charging as follows:

> The mechanism is quite clear and simple: if you pay directly for something in the market you buy ("demand") less than if you pay indirectly to government through taxes, because you then think its price is nil—that it is "free" (p. 310).

He acknowledges that there are sometimes difficulties in charging (for example, administration costs and lack of information about the right charge). Nevertheless, the drawbacks of not charging are more damaging.

The final paper in this volume is *The Riddle of the Voucher* (IEA Hobart Paperback 21), published in 1986. Its purpose, in Seldon's words, is to study

> the reasons why the education voucher, despite impressive intellectual lineage and distinguished academic advocacy, has so far failed to be applied in British public policy (p. 330).

It reviews the "obstacles, in faulty ideas and vested interests, that obstructed" introduction of the voucher (p. 333).

As earlier papers in this volume make clear, Seldon himself had long advocated charging or vouchers for government services, including education, and British academic economists had since the 1960s also supported education vouchers.[1] Still earlier advocacy of the voucher had come from Milton Friedman.[2]

In the early 1980s, the time seemed ripe for introduction of the voucher in Britain. A reforming government sympathetic to market ideas was in office, led by Margaret (later Lady) Thatcher. Ministers in the Department of Education and Science, especially Sir Keith (later Lord) Joseph, the senior minister who was a well-known advocate of the use of market forces, were known to have been impressed by the intellectual case for vouchers. They had made approving comments about vouchers in political speeches and had been considering in some detail how to introduce vouchers into the education system.

The ministers had gone so far as to invite two education lobbies to comment on ways of overcoming the difficulties envisaged by department of-

1. Notably, A. T. Peacock and J. Wiseman, *Education for Democrats,* IEA Hobart Paper 25, 1964; and E. G. West, *Education and the State,* IEA, 1965, 2d ed. (1970), 3rd ed. (revised and extended), Liberty Fund, 1994.

2. Milton Friedman, "The Role of Government in Education," in *Economics and the Public Interest,* ed. Robert Solo, Rutgers University Press, 1955.

ficials in introducing the voucher. One of these organizations, FEVER (Friends of the Education Voucher Experiment in Representative Regions), in turn invited a number of academics to respond: eleven did so through FEVER, and another three commented separately. Seldon summarizes these academic responses and includes his own in a list of "refutations" in part II of *The Riddle of the Voucher.* Yet, as Seldon explains in 1983, without any specific response from officials to the points made by the academics, the secretary of state for education pronounced the education voucher "dead." Furthermore, even though soon afterward ministers again began to make favorable comments about the voucher, no action followed. The book sets out to solve this "riddle," using three main sources of evidence: documents that passed between the Department of Education and named academics in 1981–82 or that were written in 1983–84, confidential conversations between Seldon and unnamed "knowledgeable individuals in the political process" (p. 333), and records kept by FEVER.

As Seldon points out, the attitude of the Department of Education and Science toward the voucher was essentially defensive, and its objections were completely rejected by the academics, who were "somewhat surprised at the indifferent quality of the argument" (p. 356). He goes on to discuss, with the aid of some academic commentators, the underlying reasons why the voucher was rejected, principally because of its political unacceptability rather than because it was administratively impracticable.

To understand these underlying reasons, says Seldon, the key is public choice theory and, in particular, its emphasis on the power of organized interest groups. Economists should recognize from the episode of the voucher that a good idea will not come to pass "simply because a Government of sympathetic politicians is furnished with the intellectual argument" (p. 391). Powerful interest groups opposed the voucher and overwhelmed the initial instinct of politicians that this was an opportunity to garner a "harvest" of votes from grateful parents.[3]

> The voucher was a challenge to the formidable fortress of paternalism, professional corporatism, monopoly and political authority that had long

3. An insight into the strength of the opposition is provided by a previously unpublished letter from Sir Keith Joseph to Sir Alan Peacock in 1992. Sir Alan, one of the originators of the idea of an education voucher, had been asked by Sir Keith to help counter the opposition of his officials to the introduction of a voucher. Joseph's letter, reproduced in Alan Peacock, "Victory for Vouchers," *Economic Affairs* (autumn 1995), identifies the sources of opposition and says any experiment with vouchers would probably have been deliberately wrecked by some unions and the educational establishment.

> ruled British education. That the ramparts did not fall to the first intellectual assault was almost predictable (p. 389).

Among the interest groups, the civil servants in the Department of Education were in a key position because they would have been in charge of the voucher's introduction. They most likely viewed it as dangerous because it would have transferred influence and control of education away from them and to parents. Ministers, even in a reforming government, were unwilling to antagonize their civil servants: they will often tolerate bureaucratic obstruction of reform proposals because disaffected bureaucrats can undermine ministerial authority. Many teachers also opposed the voucher—those who are "security minded" would have felt threatened by the idea of becoming accountable to parents. So, as frequently happens, it was "producer" interests that combined to seal the fate of the voucher proposal, even though its introduction would have been very much to the advantage of pupils and parents.

There are, says Seldon, important lessons to be learned from the voucher affair that go

> to the roots of British democracy. The politicisation of education has transferred power from *demos* to public "demos" in which the dispersed parent cannot match the marching, banner-carrying teacher (p. 416).

Thus, for Seldon, the ultimate objective must be to depoliticize education, through choice and competition, for the benefit of consumers. One step he advocates to bypass the organized pressure groups is to replace the Department of Education's role as provider of tax-financed schools with a new agency that would distribute vouchers.

The last paper in this volume conveys essentially the same message as the first. The consistency of the message throughout this volume is because, for many years and often as a lone voice, Seldon has maintained that tax-financed government provision of welfare inflates demand, restricts supply, and produces services of inferior quality. Purchasing power should, he says, be restored to people by reductions in taxes and, where necessary, by specific measures such as vouchers. People will then act as consumers, behaving as they do in other markets, and a variety of suppliers will compete to meet their demands. Efficiency in the provision of these services will improve, and, above all, people will regain the incentive to provide for themselves instead of relying on the state.

WHICH WAY TO WELFARE?

Which Way to Welfare?

For more than a century, since before the Forster Education Act of 1870, the philosophy underlying the welfare services—education, health, housing, pensions, libraries and the arts—has been that, where personal income is low or mis-spent, they must be provided by public authority at less than market costs and prices. Professor Walter Hagenbuch's penetrating analysis in this *Review* in 1953[1] showed that the early aim of relieving primary or secondary poverty had developed into an all-embracing universalist philosophy of equal, growing, free benefits for everyone for all time.

The indictment against this philosophy is formidable. It appears to put equality before humanity. It has denied pensioners, large families, neglected children, the mentally sick and others in need. Yet even its equality is spurious, since equal treatment of people in unequal circumstances is inequality. It lies at the root of the inadequacies, indignities and injustices in all the welfare services, which exhibit increasing demand and flagging supply. It has unnecessarily inflated the public sector of the economy, diverted politicians from the essential tasks of government, not least the protection of persons and property, strained our representative institutions.

Attempts by all parties to create humane, effective welfare services without a mechanism for measuring preferences and costs have failed. This article argues that the lasting solution is to create the legal and institutional framework within which, where practicable, personal welfare services can be supplied through the market to consumers armed with purchasing power, original or supplemented, sufficient for at least essential purchases. The small residue, perhaps 1 or 2 per cent, requiring personal care or assistance in kind could then be given the resources they have long been denied.

Professor Hagenbuch's review appeared at about the same time that Mr. Colin Clark's articles (later published under the title *Welfare and Taxation*)

1. "The Rationale of the Social Services," *Lloyds Bank Review*, July, 1953.

pioneered a strategy for transferring welfare from the State to voluntary and private agencies. Together they initiated or crystallized a continuing reconsideration of the universalist welfare policy and philosophy. Yet, in spite of mounting evidence of failure, it persists in the writings of sociologists. One or two, notably Professor Brian Abel-Smith, have indeed recently shown disquiet at the absence of choice by the citizen and at the arrogant power of the public official:

> You wait your turn and are told what you will have. And when shortages of staff generate rudeness from public servants, the customer is seldom in a position to take his custom elsewhere. . . . We have got to get rid of the autocratic frame of mind of some civil servants, local government officers and councillors—even Labour councillors.[2]

Professor Abel-Smith's use of "customer" is rare in sociological writing, which does not normally see that the citizen is not a customer unless he pays for a choice between suppliers competing for his custom. In sociological folklore and political wishful thinking he remains a dependent "beneficiary" beholden to benefactors. To enfranchize the citizen and make him sovereign will require more than "a change in the attitude of all those working in the social services."[3] He must be empowered to reject what does not satisfy. And that he can do only in a market that offers choice.

The Fallacies of Free Welfare

A century of increasing welfare services provided by public authority with no close link, or no link at all, at the point of service, between payment and cost has demonstrated three basic errors: first, its assumptions on the nature of man and his motives; second, the *non sequitur* in the logic of proceeding from the premiss of poverty to public provision; third, the error of supposing that price was no more than a "barrier" to be disguised, distorted or "abolished" by fiat or decree.

The history of free, or partly free, State welfare has substantially vindicated the major precepts and premisses of classical political economy. It has postulated a degree of disinterested benevolence in the givers and of self-less abnegation in the recipients that has never existed anywhere in history except in short periods of emergency, military or civil.

2. *Freedom in the Welfare State,* Fabian Tract 353, 1964.
3. Ibid.

The assumptions, explicit or implicit, on human nature derive from a mystical wishful hoping for a "common purpose," "general good" or "public interest" that misleads its proponents to over-generalize from emergency into normalcy. "The public interest" has no vivid, recognizable, *generally* acceptable meaning in everyday life: human conduct is motivated by the requirements, desires and hopes of the people whom individuals know around them: their families, friends, associates. The error has been to condemn the service of visible, comprehensible purposes as hedonistic self-interest rather than to gear it to mutual satisfaction, which it creates no less effectively because it is indirect and unintentional. Instead, conflicts that individuals cannot resolve have been created—in price and incomes policies, business practice and trade union activity as well as in welfare—between private purposes, which are understood and clear, and social objectives, which are ambiguous and obscure. A man will work harder for "the common good" if his children want food or his wife a new coat, or for a time if Hitler is shelling Dover, than if politicians, who may be culpable, tell him that sterling is under pressure or the gold reserves have lost £37 millions.

Little wonder that politicians down the centuries have conjured crises and emergencies to secure more ready acquiescence in the surrender of private purposes to government discretion. The classical thinkers were wiser. The notion of a universal sharing of goods and services among self-less men received short shrift from Jeremy Bentham:

> The prospects of benevolence and concord, which have seduced so many ardent minds, are . . . chimeras of the imagination. Whence should arise, in the division of labour, the determining motive to choose the most painful? How many frauds would be attempted to throw that burden upon another, from which a man would wish to exempt himself? . . . What an apparatus of penal laws would be required, to replace the gentle liberty of choice and the critical reward of the cares which each one takes for himself. . . .

The doctrine of the primacy of uncomprehended social purpose fastens a guilt complex on the man who serves the people he knows and the purposes he understands. It thus destroys the prime mover of productive effort.

In our day, the philosophers of universal disinterest proliferate among the *literati* as well as among sociologists. Only a few writers with the most penetrating understanding of human nature see through it. Mr. E. M. Forster, whose *A Passage to India* ranks as one of the most perceptive studies of human hope and motive, has punctured its pretences:

> Love is a great force in private life; it is indeed the greatest of all things: but love in public affairs does not work. It has been tried and tried again: by the Christian civilizations of the Middle Ages, and by the French Revolution, a secular movement which reasserted the Brotherhood of Man. And it has always failed. The idea that nations should love one another, or that business concerns or marketing boards should love one another, or that a man in Portugal should love a man in Peru of whom he has never heard—it is absurd, unreal, dangerous. It leads us into perilous and vague sentimentalism. "Love is what is needed" we chant, and then sit back and the world goes on as before . . . we can only love what we know personally. And we cannot know much.

The insight of this passage—the similarity with Bentham is significant—is perhaps not unexpected in a great-grandson of Henry Thornton, author of the essay *Paper Credit of Great Britain* (1802).

Poverty and free welfare

The *non sequitur* is clear. Public provision of welfare has been justified by an appeal to poverty. The incomes of some, or most, people, it is said, are too low to enable them to pay for education or health services or homes or pensions (or books, or music, or art . . .); therefore the State must provide them free or at low prices. Or incomes are enough but many people will not buy them because of ignorance or neglect. These reasons—primary and secondary poverty—were used a hundred years ago to justify State education; they are still deployed today. They are fallacies.

If some incomes are low it does not follow that the State must supply the required purchases for everyone free or at a price below cost. Shortage of private money can be a case for providing State aid in cash so that market prices can be paid: education grants, sickness, unemployment, maternity benefits, family allowances, pensions, national assistance; and even then only if voluntary, flexible organizations cannot supply the missing money better, or if families cannot be encouraged to redistribute income between their members. But it is not a case for supplying universal State education or hospitals or homes free or below cost. Yet a large part—some £3,400 millions out of £6,500 millions of tax and social insurance revenue allocated to State welfare—represents expenditure on goods, services and capital formation.

Nor does secondary poverty necessarily require free or subsidized State welfare in kind. If parents will not pay for the desirable minimum of education, or sick people for medical treatment, or families for homes, or earners for rights to retirement income, logic points in the first place to methods of impelling them to do so by State requirements or standards ensured by inspection. It requires not necessarily State schools but receipt of tuition that satisfies State requirements, not necessarily council housing but housing to council standards. There may be emergency conditions in which State provision—particularly in unpredictable illness or accident—is administratively convenient because there is no time for the market process to work, although, as seen in the NHS casualty services, the State machine is often too cumbersome to respond to emergency. But the welfare services are not designed for a society in permanent crisis, an implication of much sociological writing and political advocacy.

The price barrier

The confusion over the price "barrier" makes easy victims of politicians. The reasoning is *simpliste:* if a price stands between a man and his pension, or a child and school, or a woman and medical treatment, remove the barrier. So is humanity reconciled with political popularity.

But instead of solving the problem, the politician has dispersed or distorted its symptom. Prices have two central—and, as the communist countries are discovering, indispensable—economic functions. They are not only a form of payment by a buyer (and income to a seller): they also ration scarce quantities. If prices are removed or reduced, something or someone else must ration in their place, and these substitutes set in motion a chain of reactions that can reverberate increasingly throughout the economy for decades long after the circumstances that called them into being have disappeared. In education they have lingered at least since 1870, in health services since 1911, in housing since 1915, in pensions since 1925.

Nil or depressed prices swell demand and choke off supply. Demand has to be rationed by officials, often well-intentioned but necessarily less impartial than impersonal prices. Supply has to be provided by public authority out of compulsory levies, which are usually inadequate, so supply is "short." Income deficiencies are alleviated, but in the end those who should benefit most may suffer most, by degeneration into supplicants asking favours. The province of the official and his political employer is enlarged. It will be difficult to reduce except by mounting pressure, perhaps from the children of