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**THE " ENABLING STATE"? FROM PUBLIC TO PRIVATE RESPONSIBILITY FOR SOCIAL
PROTECTION: PATHWAYS AND PITFALLS**

BACKGROUND NOTE

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THE “ENABLING STATE”? FROM PUBLIC TO PRIVATE RESPONSIBILITY FOR SOCIAL PROTECTION: PATHWAYS AND PITFALLS

EXECUTIVE SUMMARY

1. Over the past decade OECD countries have come under increasing fiscal pressures to introduce market-oriented measures aimed at improving efficiency and lowering the costs of social protection. In response to these pressures there is growing interest in ways to enlarge the private contribution to the mix of public and private responsibility for social protection – in hopes of reducing public costs and increasing quality.
2. There are five basic policy pathways to achieving this goal:
 - encourage voluntary private financing through tax incentives
 - require private financing via charging partial fees for subsidized services
 - mandate private financing through regulatory legislation
 - indirectly promote private production and delivery of social provisions through providing public benefits in the form of cash or vouchers
 - measures that directly advance private production and delivery of social provisions through purchase-of-service arrangements.
3. These pathways are presumed to offer certain advantages over public provision by reducing costs through competition and innovation, heightening quality of services, promoting consumer choice, and cultivating civil society. These advantages, however, bear critical examination as some outcomes of privatization are not as beneficial as claimed.
4. For example, tax incentives may subsidise upper income groups, while reducing government revenues that might have provided transfers to low-income recipients. The benefits of tax incentives are not entirely transparent, which might lead to hidden welfare for the well-off. Fee-for service charges can be costly to administer; high co-payment rates may reduce costs, but deter consumption of needed services by low-income groups. Private financing through regulatory legislation can impose costs on the private sector with the danger that some employers could be forced out of business or reduce voluntary employee benefits they previously provided. Vouchers are vulnerable to substitution effects, whereby recipients use benefits to replace household resources already being spent on the designated goods and services. Private agencies in certain areas may be so scarce that they cannot generate enough private producers to create a competitive market. Promoting private delivery of social provisions through purchase-of-service arrangements may not generate the consumer signals that regulate cost and quality in competitive markets – since the third-party service producer stands in the profitable position of dealing with a first-party buyer (government) who rarely sees what is purchased and the second-party consumer who never bears the expense of the goods and services received. Purchase-of-service arrangements require considerable skill in formulating contracts that specify the quality components and unit costs of services – a technically complex and challenging task.

5. As policy makers explore the pathways to increasing private responsibility, they must come to grips with questions about how alternative approaches impact on access to services, quality, cost, redistribution, public oversight, social objectives, and consumer choice. There is no exacting social compass that points in the best direction. In treading the pathways toward partial privatization of social protection, the challenge is not to find the shortest and quickest route, but to recognize the trade-offs and risks – avoiding the pitfalls along the way.

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Neil Gilbert

6. Over the past decade OECD countries have come under rising fiscal pressures to introduce market-oriented measures that would heighten efficiency and lower costs of social protection. This development was spurred in part by the demographic imperatives of aging populations, and in part by the need for greater labour force adaptability and productivity as national markets are absorbed into the competitive sphere of the global economy.¹ As a result of these fiscal pressures, the long-standing debate about the proper blend of public and private provisions of social protection has favoured enlarging the private contribution to the mix – in the hopes of reducing public costs and increasing quality. Some see this as part of a minor adjustment being made by modern Welfare States. Others, including myself, interpret it as part of a fundamental movement away from the conventional Welfare State toward the Enabling State, whose role is to provide social protection through public support for private responsibility.

7. The shifting responsibility for social protection - more market and less state - is commonly referred to as privatization. This movement is guided by policies that aim to limit the direct role of the state and to increase private activity in the financing and delivery of social benefits.² Although the public sector still finances most social benefits, since 1980 there has been an increase in private spending as a proportion of gross social expenditures in many OECD countries.³ Whereas the private financing of social protection is increasing slowly, the private sector's involvement in the delivery of publicly funded social services has advanced rapidly in many fields. This paper first describes the five main pathways taken by governments pursuing the “privatization agenda”, and then discusses the justifications put forward for these policies and the pitfalls associated with them.

FIVE POLICY PATHWAYS

8. Policies designed to advance the march toward private financing and delivery follow five main pathways. Some of these approaches to privatization are more direct and transparent than others. All of them may be pursued simultaneously.⁴ Three approaches concentrate on increasing private financing and the other two on increasing the production and delivery of goods and services by the private sector.

1. For a more detailed analysis of these forces and their implications see, N. Gilbert, *Transformation of the Welfare State: The Silent Surrender of Public Responsibility* (New York: Oxford University Press, 2002).

2. The division between finance and provision (or delivery) of social benefits is a basic distinction drawn in analyses of social policies. See, for example, N. Gilbert and P. Terrell, *Dimensions of Social Welfare Policy* (Boston: Allyn and Bacon, 2005).

3. See W. Adema and M. Einerhand, “The Growing Role of Private Social Benefits,” *Labour Market and Social Policy Occasional Papers No. 32*, OECD, Paris 1998; W. Adema, “Net Social Expenditure,” *Labour Market and Social Policy Occasional Papers No. 39*, OECD, Paris, 1999.

4. See D. Besharov, “Creating a Marketplace for Social Welfare Services: Using Vouchers and Other Forms of Bottom-Up Decision Making to Give Clients Choice and Improve Services,” Washington D.C.: American Enterprise Institute, December 12, 2003. Another conceptualization is offered by T. Burchardt,

Private Financing

Encouragement through tax incentives

9. From a public-sector viewpoint, one of the best ways to offset the heavy costs of financing social welfare is to increase voluntary financing by tapping the charitable impulses of individuals and communities. In the United States, philanthropic contributions provided \$241 billion dollars for social purposes in 2002, three-quarters of which came from ordinary citizens, followed by corporate and foundation donations.⁵ But private voluntary financing is not always entirely a private matter – nor is it as philanthropic as it appears on first glance. This is because the private benefactions are often gently prodded by the invisible hand of the state, which returns a portion of the contributions through tax deductions to the donors. Thus, part of the total contributions attributed to private altruism is subsidized by public policy. Tax deductions provide a public incentive for private generosity, which stimulates individuals to support nonprofit services of their choice. In addition to tax deductions to encourage private charitable contributions, other tax-related incentives are widely used to promote private spending on provisions such as child care, health insurance and old-age pensions. In 2004, for example, France introduced a tax credit for employers who contribute to the payment of childcare costs.

Requirements through fees for service

10. Mandatory consumer charges (or so-called “user charges”) have been around for a long time. Over thirty years ago, fees and charges paid for almost 15% of the total expenditures for personal social services in England and Wales.⁶ Fee-charging schemes appeal to many policy makers not only because the up-front private contributions reduce public costs, but also because of the assumption that fee-charging makes consumers cost-conscious and restrains over-utilization of social services.

Mandating through legislation

11. Government can shift the responsibility and costs of public programs to both individuals and corporations in the private sector by legislative mandate. Although this has not been a widely traveled route to privatization, it is a viable option which some countries have used in recent years. In the Netherlands, for example, the sickness insurance scheme was privatized in 1994, when reforms were introduced that required employers to assume the responsibility of paying at least 70 percent of their workers’ salaries for six weeks of sick leave; in 1996, the period of private coverage was extended to 52 weeks after which workers could qualify for public disability benefits.⁷ And it is through legislative mandates that some OECD governments have introduced reforms which shift some portion of contributions from public pensions into privately managed retirement accounts.

12. This approach is evident in countries such as Australia, the Netherlands, Norway, Poland, Denmark, Sweden, and the United Kingdom, where private pensions are mandated either by legislation or collective agreement and partially incorporated into public schemes. A more circuitous and less apparent

“Boundaries between Public and Private Welfare: A typology and map of services”, London: Center for Analysis of Social Exclusion, London School of Economics, 1997.

5. American Association of Fund-Raising Counsel, Giving USA 2003 (New York: AAFRC).

6. K. Judge, Rationing Social Services, (London: Heinemann, 1978).

7. See R. van Wirdum, “The Context of Change: Social Security Reform in the Netherlands,” International Social Security Review 51:4 (October-December, 1998), pp.93-103 and S. Geurts, M. Kompier and R. Grundemann, “Curing the Dutch Disease? Sickness Absence and Work Disability in the Netherlands,” International Social Security Review, 53:4, (October-December 2000), pp.79-103.

shift toward privatization occurs when reforms that erode public pension benefits are joined by policies that support the expansion of voluntary private alternatives.⁸ In the absence of an explicit design, these incremental measures produce a steady decline in the percent of retirement income derived from public pension schemes relative to the percent of retirement income derived from employer-provided pensions and individual plans.

Private Delivery

Providing public benefits in the form of cash or vouchers

13. The production and delivery of social goods and services through the private sector is advanced when government substitutes benefits in the form of cash or vouchers (such as housing benefits, educational vouchers, vouchers for day-care services, and rent supplements) for publicly provided goods and services. For example, in Sweden, a system of educational vouchers was introduced in 1992, under which parents who chose to send their children to private schools were entitled to receive a voucher equivalent to a large percentage (currently 75 percent) of the cost of a public education. Cash benefits have also been substituted for public day-care services. Norway initiated a policy to pay cash benefits to all families with children up to three years old as long as the child was not enrolled in a state-subsidized day-care center. Finland employs a similar policy. In these instances the cash can be used to purchase care from private agencies, to pay relatives for care, and to subsidize private in-home care by parents.

Purchase-of-service arrangements

14. One of the most rapidly expanding avenues to privatization involves the use of public funds to contract with voluntary and for-profit organizations for the production and delivery of social services. The United States probably leads the field in contracting out all sorts of public services (even the management of prisons). More than 50% of the funding for services provided by voluntary non-profit social welfare agencies in the United States comes through government purchase of service arrangements. In addition to contracting with voluntary non-profit service providers, there has been a tremendous expansion in purchase-of-service arrangements with profit-making organizations. By the mid-1990s proprietary agencies in the United States were prominently represented as service providers in the fields of nursing home care (about 80% for-profit), homemaker aides, day care, child welfare, health care, and housing.⁹ Since the 1996 U.S. welfare reform, there has been an avalanche of multi-million-dollar contracting for welfare case management, training, job-search and placements services between human services agencies and private companies.

15. Many OECD countries have increased efforts to transform the role of government - less rowing and more steering is the metaphor that comes to mind - through purchase of services with private vendors. Tracing the changing mix in public and private provisions for child care and the elderly in Denmark, France, Germany, United Kingdom, and Sweden, researchers find that although the public sector and private households are still the main providers, state-organized services have been reduced as the role of voluntary organizations expands.¹⁰ For-profit providers have also increased their market share of social

8. N. Gilbert and B. Gilbert., *The Enabling State: Modern Welfare Capitalism in America* (New York, Oxford: Oxford University Press, 1989).

9. N. Gilbert and Kwong Leung Tang, "The United States," in N. Johnson, ed. *Private Markets in Health and Welfare* (Oxford: Berg Publishers, 1995).

10. A-L. Almqvist and T. Boje, "Who cares, who pays, and how is care for children provided?" Comparing family life and work in different European welfare systems," in *Comparing Social Welfare Systems in Nordic Europe and France*. Text collected by D. Bouget and B. Palier (Paris: DREES/MiRe, 1999), pp.265-292; J. Lehto, "Universal right to public social and health care services?" in *Comparing Social Welfare*

services through public outsourcing. In Sweden, for example, up until the mid-1980s for-profit providers were almost absent among residential treatment homes for alcoholics - by 1997 they came to dominate this field of services.¹¹

EXPECTED BENEFITS AND POTENTIAL PITFALLS

16. Various justifications are offered for shifting responsibilities for social protection from the public to the private sector – among which reducing costs through competition and innovation probably ranks highest. Increasing privatization is also seen as advantageous because it is supposed to heighten quality of services, promote consumer choice and in some cases cultivate civil society. All of which boils down to the assumption that, where social protection is concerned, the private sector can do it cheaper and better. This assumption bears critical examination. The advantages and consequences of privatization are not always as entirely beneficial as claimed. Policy makers deciding which paths to take should be cognizant of several pitfalls along the way.

17. There are several trade-offs to consider in designing **measures that encourage private financing through tax incentives**. Tax deductions for personal charitable contributions inspire citizens to voluntarily support philanthropic causes and agencies of their choosing, which certainly reduces some of the burden on public expenditures. These private subsidies are usually directed to local organizations – community chests, faith-based agencies – that may serve particular groups and address specific issues. Thus, voluntary private contributions tend to advance services and benefits that are not as inclusive as government programs in assisting people. And although these tax incentives stimulate private financing, they still impose heavy costs on the public coffers. Special credits and deductions for social purposes can erode the tax base, significantly reducing government revenues.

18. Beyond incentives for charitable contributions, there are various tax benefits for desirable social purposes such as child-care credits, housing mortgage deductions, private health insurance and pensions, which stimulate and partially subsidize private expenditures. These measures, however, often wind up providing the highest subsidy to middle and upper middle-income groups -- those with the fewest needs. Regarding both the amount of public subsidy and those who benefit to varying degrees, tax expenditures are much less transparent than direct government expenditures and may disguise welfare for the rich.

19. Economic, behavioral and psychological benefits are presumed to be associated with **measures that require private financing via charging partial fees for subsidized services**: the fees collected from users reduce the overall public costs of services; they foster responsible consumption; and they grant recipients the personal sense of dignity that comes with paying one's way (even if the way is partially subsidized). However, evidence in support of these assumptions is limited and in some cases contradictory.

20. As for the psychological advantages, there are well-accepted programs whose beneficiaries pay no user fees - for example, public education, unemployment, veteran's services and day care - yet feel no loss of personal dignity. Regarding the behavioral consequences, it is not clear whether user fees serve to restrain overutilization or act as a barrier to needed services for those too poor to pay (or even in some cases increase unnecessary demands). In the U.S. there is some evidence that co-payments act as a barrier to low-income workers' participation in employer-sponsored insurance schemes and inhibit office visits for

Systems in Nordic Europe and France. Text collected by D. Bouget and B. Palier (Paris: DREES/Mire, 1999), p. 650.

11. A. Bergmark, M. Thorslund and E. Lindberg, "Beyond Benevolence – Solidarity and Welfare State Transition in Sweden," *International Journal of Social Welfare*. 9:4 (October 2000), pp. 238-249.

primary care services.¹² In contrast, for upper income groups it is possible that rather than discouraging excessive use of services, charges may encourage trivial demands for more elaborate provisions from consumers who feel entitled to “get their money’s worth.”¹³

21. One way to reduce the potential barrier to service involves calculating user fees on a sliding scale that takes into consideration the consumer’s ability to pay – so that no one is turned away because of low income. Many social services charge user fees on a sliding scale. But sliding scales require income/means tests, which increase administrative costs.¹⁴ The problem here is that in charging very low user fees, the amounts collected may not cover the administrative expenses – defeating the revenue-raising objective. Even when high fees are charged, the apparent public savings may be illusory. Thus, as already noted, early research on consumer fees found that these charges covered about 15% of expenditures for social services in England and Wales. However, on close inspection much of this did not represent public savings, since client out-of-pocket contributions often came from cash they received via welfare benefits, which in the end amounted to intergovernmental transfers. Transfers of this sort take from Peter to pay Paul, with no real savings to public expenditure.

22. Although measures **that mandate private financing through regulatory legislation** may have slight impact on public expenditure, these social benefits are not without costs — the private sector pays through higher insurance rates or consumer prices (or in some cases through lower profits). In the U.S., for example, several states require private businesses to provide medical insurance to all their employees; others require that employer insurance be extended not only to employees, but to family dependents. Other examples of this approach to social protection can be found in the fields of pensions, child support and rent protection. The risk in this approach is that in some cases that costs imposed on the private sector are so high that small employers are forced out of business or that they reduce social benefits which they voluntarily provided prior to the mandate. The regulatory approach can be used not only with private businesses, but also to reinforce individual responsibility as, for example, in the case of regulations that ensure fair child-support payments from absent parents.

23. Although someone eventually winds up paying for regulatory measures – be it employers, employees, or separated parents – this approach broadens the avenues through which government can advance private responsibilities for social protection. Of course, regulatory measures are not entirely without public costs, since, once they are imposed, government oversight is necessary to insure private compliance. In an era of fiscal constraint, regulatory measures designed to increase private responsibility for social welfare are likely to increase as a substitute for public programs based on taxing and spending.

24. Competition and consumer choice are advanced by measures that promote private delivery of social protection via the substitution of cash benefits or vouchers for public goods and services. The argument for benefits in the form of cash and vouchers assumes that they maximize consumer choice, which stimulates competition among private providers, and in turn generates innovations that reduce cost and raise quality. Thus, according to theory everyone gains -- government benefits with lower expenditures, consumers with higher quality and the private sector profits from the increased business. But as the saying goes, the devil lies in the details. In maximizing consumer choice, the risk with cash benefits

12. S. Long, *Hardship among the Uninsured: Choosing Among Food, Housing and Health Insurance*, (Washington D.C.: The Urban Institute, 2003); D. Cherkin, “The Effects of Office Visit Co-Payments on Utilization in a Health Maintenance Organizations, *Medical Care*, July 1989.

13. This counter-intuitive point is suggested by E. Burns, *Social Security and Public Policy* (New York: McGraw Hill, 1966).

14. For a detailed analysis of alternative fee schedule designs and their implications for equity and administrative efficiency see N. Gilbert, *Capitalism and the Welfare State: Dilemmas of Social Benevolence* (New Haven: Yale University Press, 1983).

is that the money might not be used to advance the social purpose for which it was granted. Cash grants that government allocates to families for education or child care could be spent by recipients for other, less salutary purposes.

25. As an alternative to cash, benefits in the form of vouchers preserve a high degree of consumer choice, but restrict consumption to a publicly defined purpose be it food, housing, education, health care or some other vital service. Vouchers do not normally create the same degree of cost-consciousness among recipients as cash grants, from which cost-savings of lower priced purchases can be pocketed. Cost-consciousness can be increased by designing refundable vouchers, which allow recipients to keep the difference between the cost of the service purchased and the full dollar value of the voucher. This, however, reintroduces the problem of tempting low-income recipients to choose low-cost, low-quality services – violating the intended public purpose of the benefit. Although vouchers can influence what recipients consume, in many cases they are vulnerable to the “substitution effect.” This occurs when the recipient’s use of vouchers does not increase household consumption of designated goods and services, but simply replaces household resources that are already being spent on these commodities.¹⁵ Finally, just as recipients may not always use vouchers to choose goods and services as they are intended, the market may not always respond as expected in generating choices. For example, in sparsely populated rural communities, there may not be enough private producers of goods and services to create a competitive market.

26. Measures that directly advance the private production and delivery of welfare provisions through purchase-of-service arrangements constitute what are perhaps the most frequently used pathways for market-oriented reforms of social services. This contracting-out of services from the public to the private sector is part of a larger trend in the devolution of responsibility for social welfare from central to local units of government and from local government to community-based private agencies.¹⁶ The trend toward contracting is fueled by theories that local private providers are more responsive and efficient than public bureaucracies and more likely to promote civil society.

27. Contracting often reduces service costs not necessarily due to the market discipline imposed by competition, but because local community agencies tend to offer employees lower salaries and benefits than the civil service unions of public bureaucracies. The competition, such as it is, that operates under purchase-of-service arrangements is usually among voluntary and for-profit contractors vying for public funds to deliver social services. In the course of choosing among private providers, public officials must exercise considerable skill to formulate contracts that deliver the best deal – a task for which few have received adequate professional preparation. Purchase-of-service contracts demand a precise specification of what it is that the public agency is buying – the units of social service – and how much each of these units cost. The answers are often complicated because of the variable nature of social services.

28. Some social services, of course, involve uniform procedures as, for example, a drug abuse treatment program that periodically dispenses a prescribed dosage of methadone to clients. The unit of

15. For example, research on food stamps in the U.S. shows that they affect a modest increase in household food consumption – for every dollar spent in food stamps the recipients’ consumption of food increases by only thirty cents.

16. For an analysis of governments’ expanding use of voluntary non-profit organizations in Italy, the Netherlands, the United Kingdom, and Norway see, R. Kramer, H. Lorentzen, W. Melief and S. Pasquinelli, *Privatization in Four European Countries: Comparative Studies in Government-Third Sector Relationships* (New York: M.E. Sharpe, 1993). In the U.S. community-based organizations are starting to have difficulty competing for service contracts as several national for-profit organizations that rank among the nation’s top corporations are entering the field of social services. See, C. Morales, “How CBOs can compete in devolved contracting; field getting crowded,” *Welfare to Work* 14:4 (February 28, 2005), p.31.

service is discrete and the cost can easily be calculated. However, many services are individually tailored and multifaceted, involving a package of social care that is holistic in nature. The central challenge to purchase-of-service contracting involves computing the unit cost for complex and holistic forms of provision such as day-care for children, group home care for the emotionally disturbed, and community care for the elderly. The arithmetic is rudimentary – divide the total annual costs for a service component by the units of interest. However, the denominator in this equation is often baffling. There are at least three ways to define units of interest in service contracts: the consumers served, the type and quality of provisions delivered, and the level of performance in achieving results.

29. Although dividing the total cost by the number of consumers served is the easiest way to calculate the unit price of a service, such as group home care, it is the least effective method since it ignores the questions of exactly what is being delivered in the way of care and what outcomes are being achieved. Performance contracting is an alternative and more demanding approach, which ties the level of funding directly to what the purchaser hopes to achieve – linking service costs to results. Results are relatively simple to assess for fixed services that are highly standardized, such as administering inoculations, but difficult to set and measure in dealing with complex multi-faceted services. What is the desired outcome of group home care for emotionally disturbed children? Not only does pay-for-performance contracting involve measures that are costly, uncertain and difficult to administer for comprehensive types of social care, but a payment structure based on particular results may encourage the process commonly referred to as “creaming,” through which service providers avoid the risk of failure by selecting clients at the top of the pool, those who are most likely to succeed rather than those who are most impaired.

30. Given the limitations of pegging contract costs to the number of consumers receiving care and the difficulties and risks of the pay-for-performance approach, purchase-of-service arrangements are most often designed to pay contractors the actual costs of specific services delivered. In practice, some contract arrangements are highly complicated because of substantial variations in the level of services that clients require, which neither the purchaser nor the provider can know in advance. The managed care model in child welfare, for example, often provides a fixed amount of payment per client (the “capitation” fee) based on an estimate of the average costs of services to the enrolled population. Contracting agencies able to deliver adequate services for less than the capitation amount, can pocket the difference. And those who end up serving clients that cost more than the monthly payment are liable for the difference.

31. The decisive task in designing contracts that reimburse actual costs per service is defining all the relevant units of service and the level of quality expected in each area. The drive for efficiency can lead to the undervaluation of the qualitative components of care. One might ask, does all this really matter that much? Why not have public administrators just prepare contracts that enumerate the basic components (ratio of staff to children, number of meals) of the service being purchased and leave the rest to the professional judgement and good intentions of the private service provider? The answer, in part, is illustrated by the experiences of welfare offices in the United State in contracting out employment services under the Temporary Assistance to Needy Families (TANF) program. A study of four urban areas reports considerable variation within and between the sites in the amounts paid to private providers who were delivering similar types of service that involved job search, placement assistance and case management. For components of service that sounded very much alike, the average per person reimbursement across the four urban areas differed by as much as 130%, and very large differences, up to 400%, were also found on the price of services within each of the areas. The largest variations in cost appeared among the sites in which the public program administrators tended to accept the price set by service providers. These findings are hardly unexpected. In the ethos of market exchanges, the admonition that “customer is always right” is countermanded by the advice of “caveat emptor,” a warning especially pertinent to third-party purchases in which service providers stand between the buyer and the consumer.

Conclusions

32. The five pathways to increasing private responsibility open fresh avenues of thought and action concerning ways to finance and deliver social protection. As policy makers seek to find the appropriate balance between public and private responsibility, they must come to grips with questions about how alternative measures impact on access to services, quality, cost, redistribution, public oversight, social objectives and consumer choice. Measures that maximize consumer choice have a broad advantage in sending market signals that stimulate competition and innovation (and drive down costs), unless there are not enough providers for a true market to develop. But consumers may not always choose the goods and services that maximize social objectives. Fee-for-service measures may restrain consumption, with the greatest impact on poor people. Government purchase-of-service measures may breathe new life into local voluntary organizations, but deplete the infrastructure for public provisions.

33. There is no exacting social compass for deciding which ways to go among the various alternatives – trade-offs and risks await at every turn. Some social goods and services may be more amenable to public or private provision than others. And traditional relations among government, business, and labour in different societies will certainly influence the preferred paths toward increased private responsibility. In treading the pathways toward privatization, the challenge is not to find the shortest quickest route, but to avoid the pitfalls along the way.