Social enterprise

A different way of doing business

David Smith, economics editor, The Sunday Times

SOCIAL ENTERPRISE IS the Cinderella sector of the British economy, about which relatively little is written. For something that comprises what is conservatively estimated at 55,000 enterprises, with an annual turnover of at least £27 billion, that is perhaps strange. But social enterprise is being noticed more widely, partly as a result of the efforts of the Centre for Business Relationships, Accountability, Sustainability and Society (BRASS), based at Cardiff University.

What is social enterprise? A social enterprise, according to the Government’s definition, is “a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners”. The Social Enterprise Coalition, the sector’s national representative body, says social enterprises are “dynamic businesses with a social purpose working all around the UK and internationally to deliver lasting social and environmental change”.

Examples include household names such as Cafedirect, The Big Issue, The Co-operative Group, Welsh Water (Glas Cymru), The Eden Project and Jamie Oliver’s Fifteen. Most people will know the names but be unaware that they are social enterprises rather than conventional firms. And as the coalition points out, there are many other social

The Big Issue is a social enterprise fighting homelessness.
Social enterprises working in a wide range of activities from farmers’ markets and recycling companies through to transport providers and childcare.

Professor Ken Peattie, Director of BRASS, admits that the centre came across social enterprises as a by-product of other work it was engaged in. “I suppose we backed into it”, he says. “One of the key areas we were working on was waste. As we got into waste, we realised there were a lot of social enterprises in that sector.”

They included a local social enterprise, Newport Wastesavers, which started life in 1985 as a small voluntary organisation intended to raise awareness about reuse and recycling and is now one of the largest community projects in Wales, employing 50 people, with a turnover of over £1 million. It recycles waste from homes and businesses in South East Wales, including, in 2007, 12,000 tonnes of Newport’s waste.

Professor Peattie sees the rise of social enterprise as part of a more fundamental change. “What we have seen over the second half of the 1990s and into the new millennium is an effort to bring companies closer to consumers and communities”, he says. “Social enterprise has been a key element of that. It is part of going back to a more integrated economy.”

Social enterprise also meshes neatly with Government policy in a number of respects, as he points out. “Governments want to empower people and social enterprise fits very much into that. It also allows you to handle difficult problems without necessarily a big cost to the public purse. Social enterprise is a very attractive alternative for other reasons. Should you make a profit, for example, out of caring for the elderly?”

The discovery of social enterprises in the waste and sustainability area was not the only motivation for BRASS’s interest. “It is to do with alternative business models, different ways of organising”, says Professor Peattie. “And it is about the nature of social enterprises; whether they can combine good

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➤ Social enterprises are dynamic businesses with a social purpose working all around the UK and internationally to deliver lasting social and environmental change.
intentions with professionalism. There is a huge diversity of size and motivations within the social enterprise sector. Some look like multinational organisations while others look like the community scout group.

A great example of a social enterprise, which BRASS uses as a case study, is One – www.onewater.org.uk – which took as its starting point the fact that one billion people in the world do not have access to clean water and two million die each year as a result of water-related diseases. Combine that with the fast-growing market for bottled water in Britain and you have One’s idea. If the profits from selling such water under the One brand could be recycled into providing clean water in poor countries, you have a wonderfully symmetrical business model that also does a lot of good.

In the summer of 2005, One broke into the tough bottled water market thanks to Total, which sells it in service stations as part of the company’s corporate social responsibility strategy, and the Co-op, which launched the product simultaneously in all its stores, the first brand it had done this for.

The profits, meanwhile, are used to build PlayPumps – pumping systems that provide clean water as the children play alongside. As Duncan Goose, One’s founder, puts it: “We can’t change the world overnight, but we can improve the lives of one person, one day at a time.”

Despite its growing importance, social enterprise is still under-researched compared with conventional firms. It does not feature in the traditional business school research agenda, despite the fact that many social enterprises are highly innovative. Part of the aim of BRASS’s work on social enterprise is to help managers, funders and supporters understand the sector better. Many of the needs of social enterprises are no different from those of conventional firms. They include help with finding and renting premises, refurbishment, accounts, tax, personnel administration, and health and safety.

Some of the needs, however, are unique to social enterprise. For those supporting, advising and funding them, it is important to understand that social entrepreneurs differ in their motives and objectives from conventional entrepreneurs. These differences spread, often subtly, throughout an organisation. The way staff are trained, for example, should reflect the fact that the motivations of those who work for social enterprises often differ from those of people employed in firms where profit is the primary objective.

What can research do to help? Social enterprises are under some pressure to be more professional in their approach. The fact that more funding is available for social enterprise often requires that they offer greater transparency and more concrete proof of the social and other benefits they bring. In short, they need a way of capturing their social and commercial contribution, as Professor Peattie puts it, ‘holistically’.

So BRASS has developed a series of sustainability indicators for social enterprises, designed to give a full and fair picture of the enterprise, both internally for managers and staff, and externally for funders, partners and customers. It is just one way in which researchers are engaging with this exciting and fast expanding sector.
ECONOMY

A fresh look at Britain’s tax system

THE AGENDA OF THE MIRRLEES REVIEW

Reforms have been approached ad hoc, without regard to their effects on the evolution of the tax system as a whole. Conflicting objectives are pursued at random; and particular objectives in contradictory ways.

That was how Dick Taverne, former Treasury minister and then director of the Institute for Fiscal Studies (IFS), saw the evolution of taxes in Britain in the late 1970s. In response, he asked the Nobel laureate James Meade to chair an independent review of the tax system. It was published in 1978 and has influenced thinking on the subject ever since.

Almost 30 years on, many observers believe that Lord Taverne’s critique still holds true. Thousands of pages of tax legislation have been added to the statute book, contributing to a system seen by many as complicated to comply with and costly to administer. So, with support from the ESRC and the Nuffield Foundation, the IFS has commissioned a new review, chaired by another Nobel laureate, Sir James Mirrlees.

Why retrace our steps? Well, much has changed in the last 30 years to justify a fresh look at how and what we tax. For example, new constraints on policymakers. To name just three: globalisation has made footloose profits harder to tax; fraud and e-commerce have made value added tax (VAT) harder to operate; and international bodies like the European Court of Justice are doing more to limit national autonomy in tax design. What politicians hope to achieve with the tax system has also changed, for example with environmental concerns moving up the policy agenda.

The key to successful tax design is to take a coherent view of the appropriate roles for taxes on earnings, saving and spending.

As policy goals and the external environment have changed, so too has our understanding of how individuals might respond to tax changes. We have more detailed data on individuals’ decisions to work, spend and save – and better methods with which to analyse them. Much of this draws on research carried out over recent years at the Centre for the Microeconomic Analysis of Public Policy at IFS. So-called ‘behavioural’ economics has also given us a richer understanding of people’s motivations and how they might respond to the signals that tax changes send.

Although the Mirrlees review is designed to look beyond the short-term political debate, it is a happy coincidence that all the main parties are currently taking a lively interest in tax reform. Conservative proposals at their annual party conference to finance inheritance tax cuts by making a charge for ‘non-domiciled’ tax status struck a chord with voters – and were swiftly followed by action in both areas in Alastair Darling’s debut Pre-Budget Report. The new Chancellor also announced a welcome simplification of capital gains tax, only to be greeted with howls of protest from business lobby groups. The Liberal Democrats have meanwhile had the dubious satisfaction of seeing a number of their tax plans hijacked by the other parties, so they may need to refresh their proposals.

What sort of issues is the Mirrlees review likely to tackle? In some areas, the sensible direction of reform looks obvious at first glance. For example, abolishing stamp duties, which make the property and securities markets less efficient; integrating income tax and national insurance contributions, now that the ‘contributory principle’ in the welfare system has been all but abandoned; removing zero and reduced rates of VAT, which are an inefficient way to help the less well-off; auctioning emissions trading permits, which are currently given free to existing polluters; aligning the rates of corporation tax for small and large companies; and stopping the double taxation of annuities bought outside pension funds.

Of course, if all these really are as desirable as they first appear, the review will need to ask why they have not been done already. Are the barriers economic, administrative or political? And how might these barriers be lowered?

The review will also have to tackle some questions where the answer appears less obvious. These include: the treatment of housing and the future of council tax; the relative treatment of debt-financed and equity-financed investment; the treatment of the family and of inheritance; cross-country taxation in a world of increasing globalisation; and the impact of a sensible system of environmental taxes on the scope to cut taxes elsewhere.

In addressing these issues, the Mirrlees review team is increasingly drawn back to the Meade committee’s insight that the key to successful tax design is to take a coherent view of the appropriate roles for taxes on earning, saving and spending.

Where saving and borrowing merely reflect decisions over when in someone’s lifetime they wish to spend what they have earned, this seems to be a choice that the Government should not distort by taxing saving. But some cases are not so clear-cut, for example: where people on low incomes cannot borrow and save freely; where investments in housing or particular companies earn exceptionally high returns; or where the passing on of accumulated wealth creates inequalities in the next generation.

In some respects, the central questions for tax design look remarkably similar to those asked 30 years ago. But when the world has changed so much, the answers may look very different. □

http://www.ifs.org.uk
ALTHOUGH COMMENTATORS have for years been claiming that economic activity no longer respects international frontiers, economists have been sceptical. Although cheap communication, falling shipping costs and the internet make things easier, face-to-face interaction remains as important as ever, even in high-tech sectors like software and biotechnology – just think of Silicon Valley or Bangalore. And looking at trade patterns shows that international boundaries matter a lot (home bias).

Research from the Centre for Economic Performance and the Institute for Fiscal Studies finds the first evidence that distance really is dying – at least in the world of ideas. The study by Professor Rachel Griffith, Dr Sokbae Lee and Professor John Van Reenen shows that national barriers are crumbling when it comes to the flow of innovations, as measured by the relative speed of patent citations over time. The researchers have looked at over two million patent citations over a quarter of a century and broken these down by the country of the inventors (covering just about every nation in the world). They find that there was a great deal of ‘home bias’ over the whole period. For example, before 1990, German inventors cited other Germans 14 per cent faster than American inventors cited German patents.

But the really interesting thing is how these citations have changed over time. Since 1990, the Americans have been only five per cent slower at citing Germans than the Germans themselves. And the French are now only one per cent slower.

The chart shows that this is true for just about every major region. The higher the bar, the more the home bias. The degree of home bias is almost always lower in more recent years than it used to be. So even though information spreads faster within countries than before, it has started to flow more quickly between countries.

One implication for policy is that it makes less sense to subsidise corporate R&D if the ideas generated benefit other countries quickly. Similarly, firms may worry more that their innovations may earn them profits for less time than in the past, as foreign firms learn to imitate and leapfrog them.

http://cep.lse.ac.uk/pubs/download/dp0818.pdf

IS DISTANCE DYING AT LAST?
The time it takes for ideas to spread across nations has fallen

AT A GLANCE
Innovations are flowing more quickly between countries, as measured by the relative speed of patent citations over time. So it may make less sense to subsidise corporate R&D.

RELATIVE TIME TO FIRST CITATION FOR GERMAN AND UNITED STATES CITED PATENTS

This graph shows the relative time, in mean number of days, from the date that a patent was granted until the first citation of that patent. For example, the first bar shows that it used to take 4% longer for a French inventor to have a patent cited in Germany than it would have done had the inventor been German.
PRIVATE EQUITY, PUBLIC GAIN

Private equity firms are better managed than other manufacturing firms

PRIVATE EQUITY owned firms are the best managed on average, according to a new survey of management practices covering thousands of firms in Europe, the United States, China, India and Japan. The study by the Centre for Economic Performance, in partnership with McKinsey & Company, also finds that better management is associated with higher productivity, faster growth, lower bankruptcy rates and higher pay and improved ‘work-life balance’ for employees.

The researchers use a new survey method to measure management systematically across more than 4,000 manufacturing firms. Their interview-based evaluation tool defines and scores – from 1 (worst practice) to 5 (best practice) – 18 of the key management practices based on McKinsey’s expertise in working with thousands of companies across several decades. Combining these data with firm accounts and industrial statistics makes it possible to explore the relationship between management practices, the economic environment and company performance.

The 18 practices fall into four broad areas: shopfloor operations (have companies adopted both the letter and the spirit of lean manufacturing?); performance monitoring (how well do companies track what goes on inside their firms?); target setting (do companies set the right targets, track the right outcomes and take appropriate action if the two don’t tally?); and incentive setting (are companies hiring, developing and keeping the right people and providing them with incentives to succeed?)

The survey reveals significant differences in management performance across countries. The United States is at the top of the management league table, while Greece, India and China are the worst performers. Germany, Sweden and Japan are (not surprisingly) strong performers given the manufacturing focus of the survey, while France, Italy and the UK are all solidly mid-table.

The United States supremacy in management practices appears to be driven by simple ingredients: free markets, low regulation and merit-based promotion. But performance differences between companies in the same country are far larger than any cross-country variation. And as the chart illustrates, firm ownership seems to be a powerful driver of the quality of management practices.

Family ownership and the traditional practice of primogeniture – handing down the CEO position to the eldest son – are associated with particularly bad management practices. This is an issue for the UK, where around ten per cent of the manufacturing firms are family-owned with a CEO chosen in this way; the equivalent proportion for the US is just two per cent. As one of the research team notes: “Imagine if we picked the England team as the
The combination of rising house prices, financial deregulation and competitive mortgage offers has tempted increasing numbers of homeowners to borrow on their mortgage equity for other expenses. But ‘banking on housing’ is not without stress, according to a study by Professor Susan Smith of Durham University.

Housing investors who use their homes to maximise assets report lower levels of wellbeing than both general investors and homeowners who are less conscious of the financial potential of their homes. Depending on a single investment both for consumption and as a future insurance adds risks to the ‘traditional’ one of defaulting on the mortgage.

One in three borrowers are challenged by the variety of products in the mortgage market, but overall, people acquire financial skills as they negotiate the market. The research suggests that lay people’s knowledge and experience with housing finance is a resource that could be actively used by policymakers. Although spending mortgage equity boosts the financial market through increased consumption, the ‘leakage’ of equity drains the housing sector, leaving less investment for the quality and condition of the housing stock. From a policy point of view, balancing wealth effects and equity leakage could be essential for neighbourhood regeneration and sustainable home ownership.

While the housing boom has created wealth for home owners, many others have been left out of the property market altogether. The study shows that house buyers are positive about replacing the philosophy of home ownership with other, more sustainable and socially just models of house occupancy – a form of ‘home stewardship’ preserving the value of housing stock and transcending tenure divides.

http://www.dur.ac.uk/geography/research/researchprojects/?mode=project&id=44

Eldest sons of the 1966 World Cup winners – I doubt we’d ever win a match.”

In contrast, private equity firms are some of the best managed. One possible explanation is that they only buy well-managed firms so that their high management scores simply reflect their ability to cherry-pick the firms that they buy. But the usual story of private equity buy-outs is the reverse: they buy badly managed firms with the aim of turning them around. This suggests that their management scores are more likely to be biased downwards by having recently purchased badly run firms.

To investigate this, the researchers re-plot the management scores for only those firms that have had the same ownership for at least the last three years. Doing this increases the lead of private equity firms over all other firms: they are not only far better managed than government and family-owned firms but also significantly better managed than firms with dispersed shareholders.

There is currently a distortion in the UK inheritance tax system that promotes the continued ownership of privately held manufacturing firms in family hands, keeping them out of private equity ownership. The current research suggests that by appointing managers on the basis of primogeniture rather than competitively on the basis of merit, we are possibly promoting bad management. What’s more, private equity firms may play a role in preserving UK manufacturing when they buy out traditional family firms.

http://cep.lse.ac.uk/pubs/download/cp233.pdf
ECONOMY NEWS

BRITAIN IN 2008

SINCE LABOUR CAME to power in 1997, hundreds of thousands of people have been lifted out of poverty, but most measures of inequality have remained stubbornly high. Although Gordon Brown was a Robin Hood chancellor, giving generously to the poor, he has not taken enough from the richest to keep them from racing ahead.

Changes in the distribution of income have become much more complicated under Labour than they were in the previous two decades. Under the Conservatives, the pattern was straightforward: the higher a household’s income was to begin with, the more rapidly it was likely to increase. As a result, relative poverty and inequality both rose sharply, as those at the bottom fell further below the middle, and those in the middle fell further below the top. This reflected both trends in the economy and changes to taxes and social security benefits.

We can see this in the chart on the next page, which divides the population into 100 equal-sized groups, ranked from those with the lowest incomes on the left to those with the highest on the right. The red line shows the average rate at which incomes grew in each of these percentiles between 1979 and 1996/97, after inflation. The line slopes up from left to right, showing incomes growing more quickly as you move from poor to rich. In accordance with the Biblical injunction: to them that already have, more appears to have been given.

The pattern under Labour – shown in the chart by the bars – looks very different. Over most of the income distribution – from around the 15th richest percentile to the 90th richest percentile – we can see the opposite pattern to that under the Conservatives: the higher a household’s income is, the less rapidly it increases.

If this were the whole story, inequality as well as poverty would have fallen since 1997. And indeed, on some measures – such as the ratio of incomes at the 90th percentile to those at the 10th percentile – inequality has fallen. But most measures also take account of what has happened at the very top and bottom, where this trend is reversed.

As the chart demonstrates, income growth accelerates significantly as you move up through the richest ten per cent of the population. The incomes of the top percentile have grown at an average real rate of 3.1 per cent a year under Labour to date, much more quickly than those of any other percentile and significantly above the 2.3 per cent average growth rate across all percentiles. Meanwhile, income growth gets weaker and weaker as you move down through the poorest 15 per cent of the population.

INEQUALITY TRENDS

How the rich and poor have fared under the current Labour government

DIGITAL TV

DIGITAL BROADCASTING HAS transformed the TV market, supplementing mass appeal programmes with more specialised niche channels and pay TV. So how does this trend affect the way commercial and public service broadcasters compete?

Research by Dr Helen Weeds of the University of Essex confirms what most of us suspect: that having more channels doesn’t mean we get higher quality programmes. The audience is divided between an increasing number of channels, leading to reduced quality investment in each channel and a trade-off between diversity and quality.

Viewers differ in how much they are prepared to pay for higher quality programmes, which could explain the difference in quality between different channels. This makes it possible for competing free-to-air and pay TV broadcasters to co-exist: while the former deliver low-cost and low-quality programmes for a low (or no) price, the latter deliver quality productions for an audience more willing to pay higher fees.

If a public service broadcaster competes with a commercial broadcaster, the study finds little justification for public intervention in pay TV. The audience would benefit more if the public broadcaster competed by raising the quality of its own programmes, reducing the price for pay TV or increasing advertising (on advertising-funded TV). The commercial broadcaster could reduce its price or advertising – but this would lead to poorer programme quality.

The research also finds that the digital TV market has changed the buying and selling of premium programme content, such as popular sports broadcasts. Previously, a broadcaster might have chosen to re-sell premium content to competitors for distribution revenues. But in a digital market, a broadcaster might prefer to keep exclusive rights so as to acquire more viewers and a bigger market share.

http://privatewww.essex.ac.uk/~hfweeds

IN A GLANCE

Having more channels to watch doesn’t mean that we are getting higher quality programming, but the digital TV revolution has changed the way premium programme content is bought and sold.

http://privatewww.essex.ac.uk/~hfweeds
income distribution as a motivation for their recent redistributive tax proposals. So what is going on?

Using data from income tax records, Sir Tony Atkinson has found that the share of total income received by the richest one per cent of individuals fell from 13 per cent before the Second World War to about five per cent by 1979. This had doubled to ten per cent by 2000, the highest level since before the war. He found similar trends for the richest ten per cent and 0.1 per cent of individuals.

We can use the same data to analyse the incomes of the richest ten per cent of individuals each year (about 4.8 million adults in 2004/05) since Labour came to power. This group experienced strong income growth between 1996/97 and 2000/01, with the richest one per cent enjoying average annual income growth of about seven per cent after inflation. But since 2000/01, the richest ten per cent have actually experienced quite weak income growth, generally below one per cent per year.

Why might this have happened? These people receive a higher than average proportion of their income from investments, which makes them disproportionately dependent on interest rates and the performance of the stock market for their total income. They are also disproportionately likely to work in the financial sector, so the fortunes of the markets will also affect their employment income.

This makes the stock market declines in 2000 and 2001 – and subsequent cuts in interest rates around the world – a plausible explanation for slow growth in incomes at the very top over the same period. The investment income received by the top one per cent of individuals dropped by a fifth in real terms in 2000. And their employment income dropped by 16 per cent between 2000 and 2003.

So what of the future? At a time when public spending is being squeezed to reduce government borrowing, Mr Brown’s successors at the Treasury may have less money to give to the less well-off than he did. Meanwhile, notwithstanding the enthusiasm of the Liberal Democrats, it seems unlikely that Labour will increase taxes significantly at the top.

Whether the richest race away again may well depend more on the health of financial markets and the financial sector than on any action that the Government might take.

Robert Chote and Luke Sibieta, Institute for Fiscal Studies
http://www.ifs.org.uk

Some words of warning: survey evidence at the very top and bottom is likely to be less reliable than that in the middle, as the people at each extreme of the income distribution lead more complicated lives than those in the middle. It is also worth bearing in mind that when we talk about the top ten per cent, we are not talking about exactly the same households over the whole span of a government. In part we will be adding together the experiences of different temporarily rich households.

That said, the growing inequality of incomes towards the very top and the very bottom has offset the trend to greater equality in the middle. So most popular measures of income inequality show little change overall, with a small increase in inequality in Labour’s early years followed by a small reduction in inequality, thanks to more generous benefit and tax credit payments.

The most commonly used measure of poverty has continued to fall, in part because the poorest ten per cent of the population lie below the poverty line. So the weakening of income growth as you move down through the bottom ten per cent does not push households under the poverty line – it pushes some already below the poverty line further below it.

The strong growth at the top of the income distribution has been a topic of heated debate over the past few years. The Liberal Democrats cite public disquiet over the strong growth at the very top of the
Growing inequality
DO PEOPLE KNOW WHAT IS GOING ON?

PRIVATE EQUITY PLAYER and prime ministerial confidant Sir Ronald Cohen said recently that the gap between the ‘haves’ and the ‘have-nots’ could lead to street riots if nothing is done to reduce it. But do ordinary people care? And if not, why not?

Apparent quiescence in the face of growing inequality has been a longstanding conundrum for social scientists. Over 250 years ago David Hume suggested: “It is not a great disproportion between ourselves and others which produces envy, but on the contrary, a proximity. A common soldier bears no envy for the general compared to what he will feel for his sergeant or corporal.”

In the 1960s, the sociologist WG Runciman formulated the idea in terms of relative deprivation: people were concerned more with how well they were doing in relation to those socially closer to them than with the full range of inequality in society.

But arguably, modern mass media have led to changes in popular understanding, as stories about celebrity lifestyles and ‘fat cat’ salaries are widespread. If people take an avid interest in the daily lives of the rich and famous, do they become ‘virtual neighbours’? And unlike Hume’s ‘common soldier’, ordinary people now have the democratic power to change things – if they are minded to do so.

This implies a feasible alternative way of arranging things. But even if people are aware of gross inequalities, they may be unsure about an effective response. There is no clearly articulated radical critique providing the language to oppose growing inequality (although the unions are at least helping to focus on foreign billionaires who live in Britain but pay no taxes) and managerial politics is dominating the centre. The ‘big tent’ approach may wittingly or unwittingly encourage political apathy by co-opting dissent or dismissing it as being impractical or ill-informed.

In response to such arguments, the Institute for Social and Economic Research has undertaken a pilot study, using in-depth interviews and focus groups with carefully selected informants. We find that people have much higher material expectations nowadays: what was aspirational in the 1960s is considered a basic necessity today. Couples want – indeed need – a dual income to afford their desired lifestyle.

This affluence seems to have produced a relative contentment. Some are content because they see their standard of living rising over time. And some are not particularly discontented as they always have others less fortunate (or less deserving?) to look down on.

Our study confirms that people may have some sense of there being a large disparity between top earners and people ‘at the bottom’, but they are not necessarily well-informed about particular occupational incomes. Nor are they typically aware of incomes among their siblings, friends and neighbours.

With dual earner households, it seems even more unlikely that people know with any accuracy how much money others have. Generally, as long as others have worked hard for their success and do not become arrogant or disdainful of their old friends, it is a case of ‘good luck to them’.

When asked about comparisons with people outside their immediate social contexts, the respondents refer both up and down the social scale: to the super-rich and to those at ‘the bottom’, whom they strongly resent – people on benefits, shirkers, refugees and asylum-seekers. While they actively distance themselves from the latter, respondents see celebrities’ lifestyles as so far removed from everyday life that there is no point making a comparison.

When people do make social comparisons, they explicitly refer to differences in terms of lifestyle – to the visible trappings of consumerism, the house and area in which people live, the car they drive and the clothes they wear. Of these, houses and neighbourhoods are seen as the strongest indicators of how well people are doing.

We find little evidence of sentiments of solidarity. Instead our informants speak overwhelmingly in terms of individual career trajectories, individual lifestyle and consumption choices and an individual assessment of their social position in relation to other individuals.

This focus on the individual may be in part a product of a subtle shift in political rhetoric, particularly in the Labour Party, in which Britain has been rebranded as a ‘market’ rather than as a ‘capitalist’ society. Here individual consumers are encouraged to make choices between both public and private goods and services, even when such ‘choice’ is in practice illusory.

As ‘clients’ of doctors or lawyers, they may sometimes feel intimidated by their superior knowledge, expertise or manner. But this does not generally prevent them from accepting without resentment the evidently higher economic rewards of certain occupations.

Indeed, in exploring social comparisons, we find little evidence of serious resentment. We tend to agree with JK Galbraith that The Affluent Society has led to The Culture of Contentment, as his book titles put it.

Such a conclusion may be reassuring to politicians anxious to co-opt the ‘middle mass’ into managerialist policies. But it might be unwise to be too complacent. People in the middle mass may consume individually and have similar lifestyle aspirations, but they are collectively and seriously in debt. Capitalism could return to bite. ■

http://www.iser.essex.ac.uk
What problem does mechanism design address?
It is obvious that in any organisation, decisions should be made by whoever happens to have the necessary expertise. The people at the top will almost never have the local knowledge needed to make good decisions at the coalface. So an efficient organisation will decentralise authority to the most appropriate level. The problem is that people lower down the pecking order are unlikely to have the same motives as their bosses.

There are two traditional ways of dealing with this. The first is to rely on market incentives to generate efficient outcomes: Margaret Thatcher was dimly aiming at this when she introduced ‘internal markets’ into the NHS. The second, used in the early NHS, is to run an organisation as a command economy: central planners make up rules intended to deal with every contingency, and hammer anyone who cheats.

How does mechanism design solve this?
It provides a third way, combining the carrot of a market economy with the stick of a command economy. The government or central planner – called the ‘principal’ – has various ‘agents’ whom she wishes to act jointly in the public interest. Where she can monitor behaviour, she can set rules like an old-time central planner and apply the stick to deviants. But when she can’t observe behaviour or can’t tell if what agents are doing is good or bad, she must apply the carrot by offering incentives based on what she can observe. For example, the manager of a factory may offer a bonus if output reaches a high enough level.

The fatal error that governments invariably make is to assume that people won’t change their behaviour in response to new rules and incentives. NHS targets are a good example. Some aspect of the service is thought inadequate, and so a target is set without taking account of the fact that a manager will thereby have an incentive to move resources from other services in an effort to meet the target.

The inventors of mechanism design coped with such problems by recognising that the system of rules and incentives created by the principal’s attempts at reform create a deadly serious game for agents to play. Their main achievement was to show how the best outcome can sometimes be found by designing the ‘rules of the game’ – the ‘mechanism’.

How can mechanism design improve our lives?
In 2000, the use of an innovative procedure to prevent collusion in the auction of 3G telecoms licences in Britain made £22.5bn for the taxpayer. After auctions, the most promising area is the regulation of imperfectly competitive industries.

What about the NHS?
The same basic principles apply. If you are going to base incentives on targets, do some research on how managers are likely to respond. It will involve writing a new model for each institution you try to regulate, because one lesson of mechanism design is that ‘one size fits all’ is a bad philosophy.

Such models need thought. Data needs to be gathered and analysed. All this will be expensive, but in the NHS, quick fixes cost lives. So does politically motivated micromanagement from Whitehall. We need to delegate responsibility to the appropriate professionals. As with the Bank of England or the BBC, there is a strong case for making the day-to-day management of the NHS independent of government.

http://www.prospect-magazine.co.uk/article_details.php?id=9880