Corporate Governance and Financial Accountability: Recent Reforms in the UK Public Sector

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During the last decade, several financial initiatives aimed at "reforming" the public sector in the UK have been introduced by the Government. These initiatives seek to supplant established modes of governance within many public sector organizations. Historically, the governance of these organizations has been based on hierarchical, bureaucratic mechanisms, underpinned and infused by a public service ethic. A key element of this ethic has been the understanding that work in these organizations is dedicated to the provision of "social goods" that are provided for collective, public value rather than produced for private gain. Since the 1960s, this ethic has been in decline. Or, at the very least, its importance has been increasingly challenged and marginalized by other values – such as those more directly associated with individualism and consumerism. It is the latter values that have legitimized and facilitated the recent, and more radical, shift in the reforms of public sector organizations where market principles are now taking precedence over established bureaucratic/public service modes of organization.

This shift towards governance by the market principles has been demanded and justified by those who espouse the idea, legitimized through institutional economics, that, in principle, "market"-based transactions provide a more rational, more efficient basis for economic organization than those regulated by other, e.g. "hierarchical" and "clan" (to be discussed below) forms of governance (Ouchi, 1980; Williamson, 1975, 1985). These ideas are drawn from the theory of institutional economics and have come to be referred to specifically as the "markets and hierarchies" (M&H) framework. In the UK, such reforms have been motivated by anxieties about national economic performance, together with a (monetarist) diagnosis of consistent "underperformance" as the result of a "dependency culture" supported by "inefficient", undisciplined expenditure on public sector organizations[1].

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It is worth noting that M&H has been extremely influential in the field of industrial economics (e.g. Armour and Teece, 1978; Steer and Cable, 1978; Thompson and Wright, 1988). Within the accounting field, the last decade has witnessed several attempts by academics to inform their research through the use of the M&H framework. For example, Johnson (1983) examined the role of M&H in the historical emergence of management accounting systems. Also, Spicer and Ballew (1983), Tiessen and Waterhouse (1983) and Ezzamel (1985) examined the relevance of the M&H framework to management accounting research and developed a number of propositions for empirical testing. Further, Swieringa and Waterhouse (1982) and Spicer (1988) used M&H to analyse transfer pricing scenarios in divisionalized organizations. These examples provide an illustration of the growing importance of M&H in the accounting field, even though some researchers have expressed their surprise "that it has yet to have a major impact on the direction of management accounting research" (Spicer, 1992, p. 8).

It is easy to see why the M&H framework holds sway with many of the researchers interested in examining the contractual forms and the internal organization of firms, including their management accounting systems. For these researchers, M&H "provides an appropriate theoretical tool to analyse, interpret and understand these changing contractual relationships and the need for measurement to monitor key aspects of these relationships for management purposes" (Spicer, 1992, p.9). M&H is also seen as providing a powerful analytical framework which builds on the interplay between historical conditions and economic processes to generate apparently unambiguous but, as we wish to argue later, problematical, statements concerning the most economically efficient means of organizing transactions (Ezzamel, 1992).

Yet, a number of academics have been critical of the M&H framework, both from outside accounting (e.g. Boisot and Child, 1988; Perrow, 1988; Robins, 1987) and from within accounting (Flamholtz, 1983; Neimark and Tinker, 1986; Tinker, 1988). The purpose of this article is to elaborate and extend the critique of M&H by focusing more specifically on its role in governing public sector organizations. We argue later that the special attributes of public goods render the use of M&H to govern public sector organizations even more problematical than would be the case in private organizations. The M&H framework provides a means of interpreting and *legitimizing* current reform in the governance of public sector organizations (see also Bartlett, 1991). Central to our critique of institutional economics is its abstraction of the analysis of alternative modes of governing economic relations from the class and institutional *politics* of regulation. In particular, institutional economists' appreciation of the social and organizational dimensions of contractual relationships is constrained by a failure to understand how "market" relations are routinely predicated on a hierarchical structure of domination.

We begin by sketching the nature and context of recent public sector reform, drawing attention to the relevance of the M&H framework for interpreting these developments. This leads us to a closer examination of the assumptions and claims of institutional economics. We then review some recent developments in the governance of public sector organizations in the UK, making special reference to the areas of health and community care, where we focus on the implications of these developments for managerial/professional practices and the delivery of service. This is followed by a discussion of the wider implications of using a combination of market and hierarchical arrangements, legitimized by the institutional economics framework, to govern public sector organizations. Finally, we summarize and draw out the implications of our arguments.

However, before moving on, it is perhaps worth stressing that our attentiveness to institutional economics should not be taken as an endorsement of the coherence or value of the M&H framework. To the contrary, and as will become increasingly obvious, we use M&H as a point of departure: we explore reforms in the public sector as a means of highlighting some of its deficiencies. In this, we are in agreement with Robins (1987, p. 80) who notes that "although transaction-cost theory cannot, in itself, provide an account of the relationship between the individual and organization or the organization and society, it can help to explore those relationships once they are defined". Our basic objection to institutional economics concerns its assumption that the minimization of transactions cost is the principal purpose of the emergence and reproduction of alternative means of mediating contractual relations. Instead of assuming this purpose, we contend that the discourse and practices of economic rationalism are not "given" or "natural" but arise within, and serve to secure and legitimize, particular (historical) power/knowledge relations. It is only by developing more substantially democratic forms of governance that there is any prospect of removing the irrational consequences attributed to markets and hierarchies.

The Nature and Context of Public Sector Reform

One of the underlying intentions and implications of promoting a greater reliance on market modes of governance is to strengthen constraints on both the size and scope of the public sector provision of goods and services. In general, programmes of reform within the UK public sector have been underpinned by the belief that the "best value for money" can be secured by mediating transactions directly through the private sector or, at least, through the construction of quasi-markets within and between public sector organizations. In this context, calls for the increased use of seemingly neutral financial controls and accounting systems in the public sector are frequently rooted in a neoliberal *political* philosophy. As Hopwood (1984, p. 171) has pointed out:

> Economic calculations are now being seen as a way not only of reforming the management of the State but also of influencing the priorities which are given in policy determination and decision making. Accounting is quite explicitly becoming implicated in the construction of different views of the problematic, the desirable and the possible.

In the name of formal rationality – preferably secured through the market or, until this is achieved or perfected, through some pseudo-market arrangements (e.g. internal markets) engineered and legitimized by the use of accounting technologies – emphasis is placed on minimizing the cost of providing services. Such emphasis can easily result in the loss of provision for many members of the population. Diluted, if not denied, is any commitment to extend the provision of public goods. Instead, the emphasis switches to limiting the cost of providing these goods by focusing attention on the unit cost of their production.

It is worth recalling that the substantive unacceptability of a reliance on markets to provide desperately needed goods and services (e.g. energy and education) led to the post-war political settlement followed by the decades of "consensus politics" in which many goods – most notably, health care – were decommodified. The value of public sector provision, inspired and supported by a public service ethic, is now being forcefully challenged and displaced by a preoccupation with attacking the "inefficiencies" of public sector organizations with the espoused aim of lowering the unit cost of (improved) service provision. For example, in the National Health Service (NHS) an emphasis on perfecting the means of controlling cost has been pursued to the neglect of extending and improving the availability and quality of health care. This tendency has been compounded by subjecting health care staff to the pressures and routines of factory work – pressures that are further compounded by patient expectations that have been raised by the populist ideology of the Patient's Charter. These developments have been to the detriment of the less quantifiable dimensions of health care which are nonetheless substantively valued by both patients and staff[2].

Before exploring a number of reforms in public sector provision in more detail, we present an overview and critique of transaction cost analysis as a means of differentiating and interpreting the (co)existence of alternative governance structures.

Institutional Economics: An Overview and Critique

Building on the earlier insights of Coase (1937), Williamson (1975) has argued that economic transactions are organized within different forms of governance structure, principally "markets" or "hierarchies", depending on which mode of governance achieves the greatest economies in cost. From within the M&H framework, governance structures: (1) regulate relationships between multiple agents; (2) specify the extent of adjustments to be effective on negotiated terms; and (3) promote co-operative behaviour by parties interested in transactions (see Spicer and Ballew, 1983). In Williamson's (1985, p. 387) account for the presence of diverse governance structures, the variety of organizational forms for governing transactions "arise primarily in the service of transaction cost economizing".

In principle, the *market* form of governance structure is deemed to be the most functional because it carries little or no administrative overhead. However, in practice, a variety of factors – uncertainty, small numbers of transacting agents, information impactedness, opportunism, etc. – are said to limit the disciplinary power of the market in minimizing transactions costs. As a consequence, and despite its own limitations (e.g. greater overhead), the presence of such factors can, in such circumstances, conspire to make *hierarchy* a more efficient form of governance structure. When this occurs, the operation of markets is complemented by the existence of hierarchies in which transactions are mediated by rules and procedures rather than by prices and the laws of supply and demand.

From this brief sketch of transaction cost theory, it is evident that a *dynamic* relationship is postulated between market and hierarchical modes of governance. For example, with changes in the normative and/or technological ordering of economic life, the cost of market-based transactions may be reduced (or increased) relative to the governance of these transactions within hierarchies. Williamson attributes such changes to the *impersonal operation of economizing forces*: a shift from hierarchy to market (or vice versa) is deemed to occur because it reduces transaction costs. However, as Boisot and Child (1988, p. 511) have argued:

> Williamson's reliance on economic efficiency for explaining the choice of transaction mode not only *depends on the assumption of the universal motivational primacy of economic considerations*; it also overlooks the extent to which a country's social relations, as the behavioural and structural expressions of its culture and development, support or detract from the efficient operation of different transaction modes (emphasis added).

Indeed, we would go further. For we would argue that *the very identification of economic efficiency*, as well as associated shifts in the form of governance structure, is mediated by cultural and political discourses and practices. The development of markets, for example, is conditional on the creation of a normative structure that sanctions impersonal modes of exchange and more fundamentally on the emergence of an elite (i.e. government officials) that has the power to establish and institutionalize their existence.

Instead of understanding hierarchies as something that arises from market failures, it is more plausible to view hierarchy as a significant condition of market-based transactions. The very development and institutionalization of markets is based on hierarchical relations of exchange. Only in an abstract, idealised sense do those engaged in market exchanges routinely experience symmetry of information and power. In practice, markets favour those who are equipped with the material and symbolic resources necessary to organize markets as well as participate freely and successfully within them. It has been suggested that modern labour markets, for example, were developed as a necessary condition for the effective mobilization and rationalistic socialization of labour by (proto-capitalist) employers (Perrow, 1988).

Moreover, when markets "fail" and are replaced by overtly hierarchical forms of governance, their appearance is generally more strongly associated with an effort to increase control over markets – for example, by expanding a network of relationships with suppliers, customers or even competitors (Johanson and Mattsson, 1987). The reduction of transactions cost may be an element in a strategy to increase control but it is rarely the single or motivating force for change.

Institutional economics simply fails to recognize "hierarchy" as an instrument for securing market and employee control (Flamholtz, 1983). Instead, hierarchy is represented as the saviour of economic practices that are let down by the, as yet imperfect, operation of the market principle. Subsequently, a fundamentalist faith in the basic virtue of the market principle is reaffirmed by asserting that sources of failure endemic to hierarchies (e.g. lack of incentives) can be corrected by the application of market disciplines. For example, the use of subcontracting in "community care" services is heralded as a more cost-effective method of delivering high quality provision. Seemingly, the best of all possible worlds, as viewed from the myopic perspective of institutional economics, is attainable by combining their respective strengths to combat their corresponding weaknesses. However, unless the subcontracting of services is underpinned by draconian processes of hierarchical control, the marketization of care services scores more highly on the political rhetoric of choice and access than it does on the delivery of a comprehensive and reliable range of services.

What the rationalist myth of transaction cost reduction dissembles or disregards is the historical, particularistic motives and social forces that produce and institutionalize the development of markets (Appleby, 1978; Polanyi, 1957). For it lacks a real grasp of how the emergence and institutionalization of forms of governance – such as markets or the shift to hierarchies – is conditional on the rise and reproduction of groups who are able to secure and advance their position, through the development or reform of institutional structures of *domination* (Francis *et al.*, 1983). Insofar as the arguments of institutional economics are perceived to be coherent, persuasive or useful, it is not because they have accurately discerned the "natural" motives of human behaviour or because they have identified the universally rational alternatives for governing economic relations. Rather it is because they "capture" – or, better, distil and legitimize – a historically specific form of commonsense thinking and practice that dominates conventional economies. To put this argument more forcefully, the plausibility of institutional economics rests on its contribution to sustaining a social world in which its analysis is (more or less) plausible and meaningful.

There is nothing natural or predestined about any form of social institution. In order to understand the presence and pervasiveness of particular institutions, it is therefore necessary to appreciate their historical formation, including the development of modes of governance, as an inherently *political* process. Markets and hierarchies emerge through a process of political struggle, and are deployed as instruments of these struggles. As Perrow (1988, p. 443) has pointed out, the development of hierarchical organizations in capitalist economies has been underpinned by the desire to reduce the risks and uncertainties associated with the operation of markets:

> Market control means greater profits. But more is at stake. It also means the power to reproduce the system... Control over labor...stabilizes the system, making dissent more difficult and socialization into support values easier.

Here Perrow interprets markets and hierarchies exclusively as instruments of the ruling, employing class. We would qualify this interpretation by noting how employees can support the development of hierarchies (and even markets) as a means of "stabilizing the system" in ways that are deemed to be productive of an increased sense of security. For example, there has been, and continues to be, widespread public support for the development of non-market mechanisms for governing the provision of health care. Nonetheless, the development of market or quasi-market forms of governance may also attract considerable public support when, adopting the logic of institutional economics, a hierarchical mode of governance is discredited by attributing problems of provision to its alleged inefficiencies, and markets are presented and promoted as a more responsive and efficient means of allocating scarce resources.

The practical danger of an uncritical acceptance and adoption of the assumptions and logic of transactions cost analysis is that it encourages a submerging of a *substantive* interest in developing structures that are ethically defensible as well as practically effective by a technical interest in designing and refining *formally* more efficient structures of control. We now illustrate elements of our critique of institutional economics by turning to consider recent reforms in the governance structures of public sector organizations.

The Shift towards Market-based Control in the UK Public Sector

The Changing Mode of Governance in the Public Sector

During the past decade or so, a number of public sector organizations have been the target of reviews and reports that favour a shift towards market disciplines of resource allocation. Frequently, a precondition of this shift has been the strengthening of hierarchical forms of control that have eroded "collegial" or "clan" modes of regulation – such as those associated with a public service ethic.

In addition to the area of health and community care, which we examine in more detail below, parallel initiatives have occurred in many other fields, including schools, the army, higher education and the civil service. For example, the Education Reform Act (HMSO, 1988) has "empowered" schools, as of 1 April 1990, to assume responsibility for the management and control of their financial expenditures. Through the Board of Governors, each school must now evolve and implement its own budgets and financial management systems. Coinciding with the abolition of the Schools Inspectorate, the prospect is for market discipline, in the form of competition for pupils based on centrally determined and administered measures of examination performance, to determine the flow of resources into (and out of) schools.

In the army, a New Management Strategy requires the implementation of financial performance measures and rationalization processes. Impressions gained from informal talks with several officers indicate that even the army is expected to assume the mantle of a "profit-making" organization. Closer to home, the Steering Committee of Vice-Chancellors and Principals (CVCP) has adopted many of the recommendations of the Jarratt Report (1985) as it seeks "to bring planning, resource allocation and accountability together into one corporate process linking academic, financial and physical aspects" in the form of a rolling academic and institutional plan, to identify more clearly levels of accountability, and to "develop reliable and consistent performance indicators, greater awareness of costs, and more full cost charging". In the civil service, recurrent calls for creating tighter financial controls were made throughout the 1970s. These came to fruition in 1982 in the form of the Financial Management Initiative (FMI). The FMI requires government departments to clarify their objectives and measure performance through the use of devolved budgets geared to outputs rather than inputs (Tomkins and Colville, 1992). Subsequently, a loss of momentum of the FMI initiative was corrected by the development of a much grander vision, in the form of the Next Steps initiative, which is modelled in the image of a divisionalized company. Once again, this initiative operates through devolved budgets with virement across expenditure heads, with an emphasis on outputs delivered given the cash budget awarded. But it incorporates a much stronger and more sustained emphasis on the development of internal markets and the tendering of its business to the private sector. For example, in the Inland Revenue, it is planned that virtually all aspects of the service will become subject to such tendering. Already, work is being transferred to the private sector, with existing employees either made redundant or being offered their jobs back at a much reduced wage with inferior terms and conditions of employment.

The express purpose of all these developments is to achieve greater economies in the mediation of public sector activities by promoting highly calculative and rationalistic regimes of competitiveness and financial accountability. Of course, this spirit is not entirely foreign to the public sector. However, current reforms signal a major shift in emphasis, from a reliance on hierarchy to facilitate the bureaucratic and meritocratic development of organizational cultures imbued (to a greater or lesser extent) with a public service ethic towards a greater tendency to rely more heavily on market disciplines – disciplines that subvert and undermine an ethic of public service. We focus below on some of these developments in the areas of health and community care which are encapsulated in two White Papers issued in 1989 by the UK Government: *Working for Patients* and *Caring for People* (DoH, 1989a, b).

Recent Developments in the Governance of Health Care

The White Paper, *Working for Patients,* contains a wide-ranging set of budgetary proposals which are apparently aimed at increasing efficiency and value for money of health care delivery by creating a competitive market for the suppliers of health care; these relate to District Health Authorities (DHAs), Hospitals and General Practitioners (GPs).

DHAs: The White Paper proposes that DHAs should receive funds on a new capitation-based formula which is similar to the Resource Allocation Working Party (RAWP) formula, and should be responsible for *providing or acquiring* health care services to meet the needs of its population. The precise combination of provision/acquisition of health care services can range at one extreme from full provision to the other extreme of full contracting of public/private sector hospitals (providers), with or without competitive tendering, for all services needed[3].

Hospitals: Working for Patients also proposes the creation of new types of hospitals designated as NHS Hospital Trusts. These will be self-governing hospitals and will enjoy considerable freedom compared with other NHS hospitals[4]. Other directly managed NHS hospitals are also to be accorded greater autonomy by being managed on an arm's length basis. Both types of hospital are to be funded only to the extent that they successfully compete in the market for contracts offered by purchasers of health services.

GPs: The White Paper proposes that GPs with at least 9,000 patients on their lists will be allowed to apply for cash budgets. GPs are to have substantial autonomy as budget holders, being able to shop around for hospital in-patient services, out-patient services and diagnostic tests for their own patients. They will also be allowed to keep their budget savings and put them into use in whichever parts of their practices they desire.

Recent Developments in the Governance of Community Care

Caring for People advocates a budgeting system which is "determinedly devolutionary", based on delegation of responsibility for resource management to local levels. Local authorities are to distinguish between the *purchasing* and *providing* functions, stimulating not-for-profit agencies while at the same time making maximum use possible of private service providers to achieve the best value for money and to stimulate the growth of new domiciliary and day-care services in the private sector. The intention is for local authorities to operate as "enabling authorities", by acting not only as direct providers but also by developing their purchasing and contracting roles, monitoring the quantity, quality, and cost effectiveness of service, and assessing the clients' abilities to contribute to the full cost of service.

The Paradox of Consequences

In common with initiatives in other public sector organizations (e.g. the Inland Revenue), the budgetary devolution system and the framework of accountability described above are deemed to have several enabling attributes. Ostensibly, they promote increased power and responsibility of operating units (e.g. hospitals, schools, etc.) by ensuring that operating decisions are taken locally. They are also likely to increase cost awareness among budget holders. For the advocates of institutional economics, M&H will be seen to provide the underpinnings of these reforms. Thus, in both health care and community care the separation of purchasing services from the provision of services is a means of promoting market-based contracting which is perceived to minimize the cost of mediating transactions. Similarly, the creation of trust hospitals and the introduction of devolved budgets among GPs and local authorities can be seen to be aimed at increasing the interface between care agents and the market in the belief that the competitive forces of the market will drive down transaction costs. By stimulating and strengthening the private sector for care it is assumed that market forces will drive out wasteful and inefficient practices which the reformers perceive are prevalent in the public sector for care. Given this M&H rationalization, only those activities which are both cost-effective and offer the best value for money will survive. Hence, under the M&H framework budgetary devolution and accountability are the very manifestation of what the market dictates.

However, there are several potential limitations inherent in such arrangements, limitations that are likely to compromise significantly the delivery of service, and thereby undermine the declared objectives of "reforming" the public sector. To avoid needless repetition, and to highlight the commonality of the basic features of these initiatives, we focus our discussion on some of the potential dysfunctional consequences of the last of our examples: the case of community care[5]. In a later section, we consider reforms in the provision of health care.

First, in terms of scope and quality, the delivery of care could be undermined by the lack of a grant specifically designated for community care. The Government rejected the proposal made by Griffiths for a specific grant earmarked for community care on the grounds that: (1) this could curtail flexibility in responding to availability and growth of community-based alternatives to care in long-stay institutions; and (2) its preferred scheme will ensure maximum local accountability and value for money service by enabling local authorities to make their own decisions about community care. While this seems to be consistent with the spirit of accountability embedded in the White Paper, there is a potential for local authorities to shift funds away from community care towards other uses. A tendency towards such behaviour is likely to be intensified owing to the increased pressure on local authorities to secure good value-for-money services, and the ability of each local authority to switch funds around, given the devolved budgetary system to be employed. This could lead to considerable variations in the scope and quality of community care across local authorities where the audience (residents) are captive, in the sense of having little mobility to shop around for better services.

Second, there is a potential for an increase in means-testing, given the power local authorities wield in determining the contribution to be paid by each resident. Indeed, local authorities are able, *but not required*, to charge for day and domiciliary care. This creates a potential for overcharging, or charging for services that are expected, at least by residents, to be free of charge. There are genuine fears that residents will be charged for services which are now being provided free of charge (Prowse, 1990). The incentives to do so are obvious since local authorities will have a vested interest in maximizing their revenues, and this is likely to be made easier by virtue of the lack of mobility of residents.

Third, potential conflict is likely to arise between health authorities and local authorities as to allocating people between hospital patients and health care residents, given existing technology of knowledge, where there is no clear point at which "health" treatment ends and "social" support begins. For example, in Bromley Social Services Department, the interdependence between the roles of the Home Helps and Auxiliary Nurses (of the health authority) was so high that they had to be amalgamated (HMSO, 1990). Those proposing the new scheme are caught in a vicious circle which is likely to defeat the best efforts of those who seek to implement it: in trying to supplant the tightly coupled system of joint planning by a loosely coupled system of planning agreements, they are finding that they have to introduce co-ordinating mechanisms between local and health authorities which, if they were to work effectively, will lead to tightly coupled structures. In recognition of this problem, the White Paper proposes that health and local authorities will have to decide locally how they share objectives, responsibilities and funding of different services, but this is likely to be problematical given that the distinction between "health" and "community" care is arbitrary and always blurred.

Fourth, emphasis on value for money service may jeopardize the delivery of community care, since local authorities may shy away from securing those services for which it is difficult to demonstrate that they are "good" value for money. This is likely to be so, given that the emphasis in the White Paper is on shifting objective setting and monitoring towards *outcomes* and away from *practice* and *process*. This change of emphasis is wholly consistent with the increased reliance on the market mechanism. But this does not ensure a satisfactory delivery of care since, at least for some services, the attainment of actual, substantive care requires a move away from outcome monitoring of quantities and towards process monitoring which is directly concerned with the quality of care delivery.

A bald listing of these unintended consequences of the projected reform of community care provision may of course be interpreted as a vindication of the view that there are always costs as well as benefits associated with any governance structure. Without denying this truism, it is important to reflect critically on the nature of the costs and benefits incurred by different forms of governance. The costs we are seeking to emphasize here differ fundamentally from those directly associated with the implementation of any particular mode of governance, for instance the salaries of accountants and other bureaucrats which in themselves represent a significant burden on the public purse but are typically legitimized by the belief, or myth, that they secure even more significant economic savings. Rather, as the preceding discussion illustrates, we are more concerned with the costs, both visible and hidden, that are inflicted on those who are assumed to be the recipients of market/hierarchic regulated services. As we have seen, the potentially visible costs of the reliance on markets and hierarchies for the regulation of the delivery of community care are reflected in the compromise of the quantity, range and delivery of care. These visible costs demonstrate the failure of governance modes rooted in economic rationality, such as M&H, to promote both the development and delivery of high quality public service.

In the next section, we consider the largely hidden costs associated with the heavier reliance on the markets and hierarchies forms of control. More specifically, we highlight the erosion of what Ouchi (1980) has termed the "clan" mode of governance where there is an extensive reliance on "symbolic means to promote an attitude of egalitarianism and of mutual trust… by encouraging a holistic relation between employees" (Ouchi, 1981, p. 70). Without wishing to exaggerate the presence or influence of what may loosely be termed a "public service ethic" within the public sector, we argue that it is a valuable resource, socially as well as economically, even though its presence and significance is largely ignored or negatively assessed within the established framework of institutional economics.

Discussion

Clan Control and the Public Service Ethic

When seeking to interpret recent efforts to reform public sector organizations in the UK (and in other advanced societies), two forms of explanation and/or justification are widely canvassed. Either the reforms are represented as a product of efforts to improve efficiency by gaining more output from a similar amount of input – often by introducing market disciplines into "bureaucratic" organizations; or the reforms are interpreted as the outcome of an ideological campaign (or act of faith) directed at the reduction of the "burden" of the public sector, almost regardless of whether market disciplines actually yield better "value for money". What tends to be lost in these accounts of reform are the conditions that render different forms of economic organization both possible and problematical.

What is distinctive about the public sector? Of course, there are diverse answers to this question. However, we are not persuaded that a convincing answer can be formulated in terms of the type of goods or services that they produce, nor even the contrasting strength of market discipline within them[6]. Rather, for present purposes, we will argue that public sector organizations have been marked by a sense of purpose and *service* that is more difficult to generate and sustain in for-profit organizations[7] – an ethic that has been reflected and reinforced by the comparative job security of much public sector employment. Major industrial disputes notwithstanding(!), a public service ethic of "common purpose" as much as the principles of "hierarchy" or "market" has been a significant, though not necessarily the dominant, organizing principle. This is now changing as an ethic of public service is being eroded by the rise of divisive, marketing principles that are especially hostile to its claims. But the appeal of contributing to the production of "public" goods and services has not yet been wholly erased.

To a rather limited extent, Ouchi's (1980) concept of "clan control", as an alternative to "market" and "hierarchy", appreciates the presence and significance of the "common purpose" principle of corporate governance that colours organizational practice within the public sector. This, of course, is somewhat paradoxical because Ouchi at once identifies and urges its promotion within the private sector. Anticipating the growth of interest in the strengthening of corporate cultures that has been a dominant flavour in management theory during the 1980s, Ouchi and Price (1978) have celebrated the functional value of clan control – control that: "functions by socializing each member completely so that each merges individual goals with the organizational ones, thus providing them with the motivation to serve the organization" (p. 36).

To repeat, clan control is advocated by management gurus consulting within the private sector. It is commended because it promises to improve the co-ordination and responsiveness of organizations and increase the motivation of individual employees who become identified with corporate goals. In principle, clan control is distinguished by members' high levels of trust in each other and maintains a high level of ambiguity in relation to both output measurement and knowledge of the transformation process (Child and Fulk, 1982; Scott, 1966). It is, of course, perverse that the qualities of clan control, on which such a high value is placed by private sector consultants, are currently denigrated by public sector reforms which seek to emulate private sector practice.

Programmes of reform currently being pursued within many UK public sector organizations resonate with the assumptions and logic of a narrowly conceived understanding of institutional economics. As we argued earlier, a basic deficiency of institutional economics is its very limited capacity to appreciate the interdependence of politics and economics – an interdependence that is perhaps most clearly evident in the economic value of an ethic of common purpose that has little or no worth within the M&H framework. As Wilkins and Ouchi (1983, p. 479) articulate this argument, "the loyalty produced by assumptions about goal congruence provides tremendous energy and willingness to adapt". It should hardly be necessary to add that this energy and willingness lies at the very heart of the productive power of human beings.

However, within the confines of institutional economics, human beings are the objects, not the subjects, of governance structures. That is to say, governance structures are produced in response to the logic of impersonal economic forces, and not as a consequence of political struggles to establish or abolish different kinds of governance structure. Those who continue to work within the tradition of institutional economics – such as Ouchi and his collaborators – assume that the recognition of (common) human purpose can be accommodated within the M&H framework simply by identifying a third principle of governance: the clan. Against this tactic, we argue that the forces implicitly acknowledged in the principle of the clan pose a direct challenge to the basic (depoliticised) assumptions and logic of the M&H framework. For this reason, we find the discussion of clan control particularly relevant but also ultimately unsatisfactory since its effect is to "save" the M&H framework rather than "discredit" it.

In particular, we find a connection being made between clan control and resistance to change of relevance to our analysis. For example, Wilkins and Ouchi (1983, p. 479) argue that resistance to change arises "when organizational conditions are so radically altered that clan members must clearly violate their basic assumptions". For here a direct link is made, but not further developed or explored, between the (collective) assumptions of individual actors and the securing or shifting of particular modes of governance. This argument can be illuminated by considering the way many public sector organizations have relied on the "clan control" developed by professionals who, in response to breaches in their assumptions, have sought, more or less successfully, to resist reform and/or to achieve the maximum of control of the new arrangements.

Professional Workers and Accounting Systems

Various labels, including "enucleated bureaucracies" (Becker and Gordon, 1966) and the "autonomous form" (Scott, 1982), have been used to describe public sector organizations in which "professionals" rather than "administrators" or "managers" make key decisions. The behaviour of professionals – such as clinicians in hospitals – is understood to be patterned by common values and beliefs which are irreducible to a set of rules and regulations, let alone a calculus of market prices. Historically, a distinctive feature of such organizations is the comparative absence of accounting information and associated hierarchical methods of management control. Work in these organizations is shaped and sustained by practices and traditions that are rooted in rationality that privileges "professional" or "clan" over "bureaucratic" or "managerial" modes of governance. As Daniels (1975, p. 313) has observed:

> Professionals strive to avoid clearly demarcated levels of supervision whenever practicable, arguing that this evasion is necessary to the production of good service. While total independence is clearly not possible, the notion of professional autonomy and its connection to ideal standards of service can be retained to some extent if only colleagues judge one another.

By subscribing to an ethic of public service, and by asserting their monopoly of knowledge of the resources necessary to deliver the services/goods, professionals have represented financial and accounting systems principally as a passive, bureaucratic means of recording the financial consequences of their professional judgement. Such systems are deemed by these professionals to be of little importance within these organizations. Why? Because, in principle, their own commitment and integrity is understood to ensure that all available resources are already well directed. Any suggestion that accounting systems could play more than a subsidiary house-keeping role aimed primarily at balancing the books is represented as a slur on their integrity. For it implies the unthinkable (or at least unspeakable) possibility of professional "license". Attempts by (internal) administrators to introduce mechanisms of financial control *into* decision-making processes are strongly resisted on the grounds that they inhibit or distort the exercise of impartial, professional judgement.

During the decades following the post-war settlement, the professionals or mandarins who control major public sector organizations were able to establish and strengthen their clan control. It was accepted that their expertise equipped them to organize the service for which they were accountable. In essence, they were trusted, as "gentlemen" (rarely women) to "do a good job". In turn, they encouraged, and appealed to, the development of a public service ethic among their subordinates as a means of securing "discipline", in the form of energy and willingness to provide public goods and services.

For example, prior to the reform initiatives of the last decade, clinicians ruled hospitals through the mythology of "clinical freedom" (Bourn and Ezzamel, 1986, 1987) just as academics ruled universities through the parallel mythology of "academic freedom" (Ezzamel and Bourn, 1990). Until comparatively recently the "professionals" in each case were successful in persuading politicians and civil servants that their respective organizations should be funded and regulated at a level and in a manner determined by their specialized, technical knowledge of what was required to provide a satisfactory level of service. According to Dawson (1971) "clinicians cannot, and do not, endure complex regulations and regimentation...A good clinician does not need, and should not have, impertinent supervision by meddlers of the citizen-fixit type".

However, during the past decade or so, a rising tide of individualism and privatism, promoted by a consumer society fed by increased personal and social mobility, has depleted the potency of appeals to a public service ethic. In the face of a growing fiscal crisis during the 1970s, the appeal to an ethic of public service was insufficient to counter employee resistance, in the form of widespread industrial disputes, to a sustained squeeze on the public sector. As the (apparent) bankruptcy of this ethic was exposed, a view was articulated, particularly by the Conservative politicians (e.g. Parsons, 1988) that an alternative form of discipline would have to introduced if repeated industrial action was to be averted. Following the logic of the M&H framework, it was believed that the discipline of the market would remove the "excesses" and "inefficiencies" associated with the hierarchical mode of organization.

As market disciplines have been introduced into the public sector, established forms of clan control have been subverted by the disciplines of financial accountability. Either the organization and control of public sector institutions has been taken over by managers conversant with these disciplines or, not infrequently, professionals themselves have willingly or reluctantly undertaken to learn and operate these disciplines. In many cases, these reforms have been facilitated by the increased surveillance provided by centralized, computerized forms of hierarchical control that enable the adoption of market principles of resource allocation, e.g. internal markets. Put at its simplest, the governance structures of many public service organizations are being transformed, in espoused rhetoric but also in practice, from one dominated by hierarchy supported (and to an important degree dissembled) by a clan ethic of public service towards one of hierarchy constrained (and also dissembled) by the discipline of markets.

The Case of the NHS

In a cultural and political climate that champions entrepreneurialism and market values, the value of reciprocity is simultaneously assumed and routinely violated. Assumed because market relations are dependent on it; and violated because, as institutional economists acknowledge, market relations promote opportunistic behaviour. Such a climate is not supportive of what is readily viewed as professionals' self-interested and even cavalier attitudes to formal mechanisms of public accountability. In turn, this has weakened the credibility of opposition to the managerial view that the disciplines of bureaucracy and the market ensure better value for money and quality of service. As Salmon (1985, p. 173) has noted of the established methods of running the National Health Service, "the NHS has come under increasing attack as an unmanageable and costly system of acute hospital care. An ideological crusade has been launched to limit the budget and force hospital closures and service cutbacks".

This onslaught on state funding of the NHS has been sustained in recent years despite the statistics indicating that health expenditures in the UK account for only 5.5 per cent of economic output, one of the lowest percentages among advanced capitalist nations.

Unconcerted efforts to trim and rationalize the NHS were gathering pace well before the 1989 White Paper; several were made during the 1970s (Doyal, 1979, p. 209; Perrin, 1989). In a number of important ways, these rather half-hearted proposals prepared the ground for a more sustained offensive during the 1980s. In particular, the Griffiths Report (the NHS Management Inquiry, 1983) and resource management (DHSS, 1986) have been influential in seeking to rationalize management control in the NHS through devolved financial accountability. Notably, the Griffiths report called for the development of a business ethos within the NHS, including the appointment of managers in regions, districts and units of management, the development of clinical budgets and procedures for the monitoring of performance, and the evolution of rules determining expenditure authorization limits.

In our view, such initiatives have posed a direct challenge to established governance structures in public sector organizations. The challenge occurs because, to take the example of the NHS, the recommendations are founded on the assumption that an integral feature of its governance structure – what we have characterized, rather loosely, as their "clan"-like characteristics – renders them inefficient. This claim, we have argued, resonates directly with the basic tenets of institutional economists, that (1) economizing on the costs of transactions is the single most important criterion for evaluating the merits of alternative governance structures: and (2) the presence of forms of management control developed within the market-disciplined context of the private sector provide the most reliable evidence of an efficiently run service. Where such controls are absent, there is the immediate suspicion of the pursuit of narrow self-interest rather than the wider "public interest" of delivering "value for money" (Tullock, 1976). For, if public service ethic is either disregarded or viewed with contempt, why else would there be resistance to what are self-evidently necessary controls on self-interested, opportunistic behaviour?

For an M&H perspective, the exclusive focus is on the efficiency costs ascribed to the absence of market disciplines – such as increased risk aversion, over-manning and non-optimal pricing and investment, with slack being built into departmental budgets (Buchanan, 1978; Downs, 1967). Without the disciplinary "whip" of the market, clan-based methods of monitoring expenditures are deemed to be ineffective in exposing and correcting inefficiency (Kristensen, 1980). Seeking to fill a perceived vacuum of control, the emphasis is placed on making people accountable through the competitiveness of markets – markets that frequently rely on a complex process of hierarchical observation and assessment[8].

Little – and often – no account is taken of the costs – economic and otherwise – of introducing such disciplines in terms of the quality of working life or even the quality of service provided to "customers".

In a climate where market values are in the ascendant, and all other modes of governance are viewed with suspicion and disdain, those who seek to defend "clan" control face severe difficulties. This is because any defence of the established governance structure is readily interpreted as an expression of self-interest and special pleading. In other words, it tends to fuel the suspicion that resistance to market disciplines has more to do with defending the privileges of self-regulation than with any genuine concern to safeguard the quality of service or give value for money[9]. The task is made doubly difficult because the relative autonomy enjoyed by professionals is as much connected with their monopoly control of scarce skills as with the intrinsic qualities of their work – qualities which, the defenders of clan values argue, can only be preserved by resisting market forms of discipline.

As a consequence, the efforts by clinicians to neutralize the impact of reforms can be crude and counterproductive. An example of this is Devlin's (1984) characterization of the recommendations of the Griffiths report as being of mere "recreational interest for local worthies". With regard to the universities, similar gut reactions have been expressed by academics in response to the operation of selectivity exercises, and the like, that have been characterized as "arcane accounting practices" that corrupt and damage the universally beneficial value of "academic freedom" (Ezzamel and Bourn, 1990). Precisely because any challenge to proposed reforms appears to be motivated by a self-interested desire to evade accountability, public sector professionals have generally had limited success in resisting and circumventing the recent imposition of market-based modes of governance. In part, this is because the imposition of these controls has exposed and deepened divisions among them: for example, between those who are unwilling to countenance any kind of market control, those who believe that the best method of defence is to manage the appearance of compliance with its demands and, finally, those who see reform as an opportunity to be rewarded as leaders in the brave new world of market-driven modes of resource allocation. For example, some of the findings of field research suggest that when administrators succeeded in motivating clinicians to absorb the benefits of autonomy in decision making into their culture financial delegation was implemented with enthusiasm (Russell and Sherer, 1991, p. 14).

The preceding discussion suggests that there are two possible consequences of the recent changes in the governance of health care. On the one hand, it seems possible, and even likely, that new disciplines – such as those involved in financial delegation – will be adopted by professionals. In which case, elements of "hierarchy" and "market" are combined with residues of "clan" organization in a way that proponents of the new public sector believe will increase efficiency and effectiveness as it curbs the excesses and unintended consequences associated with heavy reliance on established governance structures. On the other hand, it would be naïve to ignore the longer-term prospect of professionals acting as the unwitting destroyers of their clan culture as they become surrogate managers and administrators, dominated by accounting procedures and calculations; or, conversely, that financial disciplines will be appropriated as a means of expanding their autonomy and resisting accountability for the allocation of resources.

Summary and Conclusion

A deepening sense of crisis within many public sector organizations in the UK, and elsewhere, provides an important opportunity for reflecting critically on the purpose and value of different forms of corporate governance. In this article, we have deployed the framework of institutional economics to reflect on the nature and significance of the current wave of reform that is engulfing public sector organizations in the UK. In broad outline, we have argued that these reforms are intended to shift the mode of governance in the public sector away from hierarchy infused by a public service ethic towards markets regulated by strengthened bureaucratic control.

Despite the difficulty, and perhaps the absurdity, or deriving meaningful prices for goods and services in situations of high task interdependence – a common characteristic of public sector organizations – the primacy of market forms of governance is being rapidly established. Providers of services are being required to calculate guide prices; pressures are intensified to contract out services; special incentives are given to encourage initiative and flexibility; decentralization of decision making coupled to close monitoring of performance is being used to promote responsiveness.

In this new public sector, reforms are being shaped and directed by accounting and financial controls that are increasingly market-oriented and market-driven. The logical requirement of these controls is the production and normalization of data on market prices; the overseeing of market-based contracts; the assessment of market opportunities and threats; and the development of decision models based on market prices. Information derived from professional values or interpreted according to bureaucratic rules loses its relevance and authority as market prices become the main information item perceived to be relevant for the co-ordination of transactions.

Our examination of shifts in the governance of UK public sector organizations suggests that institutional economics can be heuristically useful. Although developed as an instrument for analysing and promoting the technical rationalization of transactions costs, it can also be adapted to interpret and advance critique of current changes in the corporate governance of the UK public sector. To this end our analysis has exposed the limitations of a theory that represents forms of governance as the outcome of an impersonal, disembodied logic of transactions costs reduction rather than as the product of political struggles to establish more effective modes of social domination. It is for this reason that the distinction between "markets" and "hierarchies" was found to be useful heuristically but ultimately superficial and problematical. Not only is its appreciation of political struggles weak, if not entirely absent, but the effort to remedy this deficiency by incorporating the idea of clan control simply obscures this basic problem.

In conclusion, the basic deficiency of institutional economics can be related to a distinction drawn by Weber between formal and substantive rationality. On the one hand, there is formal idealized rationality, associated with the *technically* perfect operation of markets or the smooth functioning of hierarchies. As Brubaker (1984, p. 38, quoting Weber, 1978, p. 108) has observed, formal rationality, as exemplified in the calculations and attributions of institutional economics,

> "is indifferent not only to the substantive demand for adequate provision, but to all substantive postulates, an indifference which is absolute if the market is perfectly free". This perfect indifference to substantive considerations underlies what Weber describes as "the ultimate limitation, inherent in its very structure, of the rationality of monetary economic calculation".

On the other hand, there is *substantive, messy rationality (or rationalities)* that gives rise to imperfect and often internally contradictory kinds of *political* organization. Fortunately, the logic of formal rationality – whether of markets, hierarchies or clans – is destined to fail, or be subverted, because it concentrates exclusively on the rationalizing of means in a way that disregards the practical operation of (competing forms of) substantive rationality. It is therefore most unlikely that striving to perfect a way of calculating and implementing what is deemed, formally, to be the most economically efficient combination of markets, hierarchies and clans will result in a quality or quantity of delivery that satisfies the substantive needs of either the provider or the consumer of public goods and services.

Arguably, the only way to reduce the gap between formal and substantive rationality is to recognize that modes of governance are media of political struggle, and to move towards a mode of resource allocation and application that approximates more closely to a more participatory (i.e. democratic) form of accountability. Such a mode of resource allocation would begin by opening up channels of communication between those who pay for, those who receive and those who provide public services. It would acknowledge rather than sweep away the tensions between formally rational systems and substantively irrational provision. It would involve the recipients of care in the redesign and refinement of more substantively effective methods of providing these services. It would encourage the providers of public services to incorporate within their "professional" duties a responsibility for opening and developing lines of communication and demonstrating their responsiveness to criticisms and suggestions that are made. It would involve and support a progressive shift from centralized to more decentralized and locally accountable modes of governance of public sector institutions. In sum, it would be dedicated to translating the idea of "partnership" between the providers and recipients of care from glossy, doublethink rhetoric that simultaneously repudiates the claims that it makes (Orwell, 1949/1990, p. 39) into a working reality that is committed to the development of practices that facilitate a continuous, substantive improvement in public services.

To conclude, if the substantive value of different modes of governance is to be adequately recognized and developed, it will be necessary to move outside of institutional economics, and not just to extend its domain[10]. For all its efforts to make economics "institutional", institutional economics trivializes the political and cultural discourses and practices through which the value or acceptability of different forms of governance come to be identified. When theoretical and practical effort is concentrated principally, if not exclusively, on the formal rationality of means, the wider question of how natural resources and human labour power might be organized in ways that may continuously improve the substantive quality of life of the producers/consumers of commodities is marginalized, if not entirely ignored. The key to improvements in the provision of public sector services is not the imposed substitution of one abstract principle of corporate governance by another but the opening and development of processes of communication, accountability and mutual adjustment between those who pay for, receive and provide public services.

Notes

1. When associating cost-cutting reforms in public sector organizations with an overloading of fiscal commitments (Offe, 1984), it is also relevant to note that cuts in social and health expenditure have been routinely accompanied by increases in expenditures on defence and law and order (Navarro, 1985).
2. A parallel series of developments has occurred in universities where the accumulation of resources and the earning of "brownie points" by delivering what is measurable has been accompanied by a deterioration in staff-student ratios and relationships. Quality of care provided to patients/students which is of substantive, yet immeasurable, value to both is simply unrecognized within formally rational calculations concerned with loads.
3. It is relevant to note that the budgetary discretion of the DHAs is constrained by some major enforcement rules. First, they have to meet the costs of emergency services and immediate admission for every patient of their population who needs these services irrespective of whether or not the patient is resident in a District which has a contract with the hospital. Second, DHAs should hold a contingency reserve to allow for referrals by

GPs to hospitals with whom no contracts have been placed. Some additional restrictions are planned, the aim of which is to achieve the "happy" compromise of curbing GPs potential excessive extracontractual referrals while at the same time allowing them to exercise judgement on referrals in cases of genuine emergency and to ensure having access to the contingency fund. However, while aiming to ensure that patients should have access to needed health services without being unduly impeded by DHAs' self-interest, these, and similar situations, create the possibility of health care providers who are not constrained by a contractual relationship with the relevant DHA to "oversupply" services given their right for reimbursement for these services from the DHA (see Mullen, 1990).

4. *Inter alia*, NHS Hospital Trusts are entitled to: earn revenues from selling services to DHAs, GPs, private hospitals, etc.; settle the pay and conditions of their own staff; borrow money from Government or private sector; retain surpluses.
5. In case it should be thought that paradoxical consequences are limited to, or most conspicuous in the delivery of community care, it is relevant to touch briefly on the case of hospitals. In the case of block contracts seeking to provide services for a defined population, hospitals providing services have an incentive to treat fewer patients and provide the minimum level and quality of service possible. If block contracts specify the number of patients to be treated, hospitals providing services have an incentive to select the cheaper cases and to minimize the level of services per patient. In the case of fee-for-service contracts, hospitals have an incentive to maximize the number of patients treated and to minimize the cost per patient. As a consequence, the incentive will always be to shift treatment costs onto other services outside the contract – for example, from providing hospitals to community care (see Mullen, 1990).
6. In most advanced societies, one can find examples of the "private" provision of all types of goods and services, the most obvious exception being the emergency services and the central organs of force: the judiciary, army and police. But, even here, there are national variations, with the fire service, for example, being operated by private companies in many countries. As we noted earlier, the First Steps initiative means that few public services will be spared from the possibility of being put out to private tender.
7. Without going into a lengthy analysis of why this is the case, it is evident that, historically, public sector organizations have been established to provide a level or quality of goods and services for which there was (deemed to be) a public demand but which had not been satisfied by the market mechanism. Put at its simplest, working to provide these goods and services has been understood to serve a public need in a way that was not directly geared to the accumulation of private wealth.
8. In the field of higher education, the use of assessment exercises to monitor and evaluate the performance of University departments and allocate resources accordingly is an example of how a complex and costly system of hierarchical observation is applied to create a quasi-market in which departments compete for access to scarce resources (Willmott, 1993).
9. For example, studies of doctors reviewed by some researchers suggested that overt forms of collegial control are exceptional: "Colleagues are supposed to evaluate each other's work, but the real collegial ethic is to live and let live" (quoted in Alvesson and Lindkvist, 1991).
10. For example, when interpreting current public sector reforms, there is a tendency to accept, or even celebrate, the arrival of market discipline as it brings with it many career opportunities; or alternatively, to bemoan the erosion of established, clan values – such as clinical or academic freedom – and to fight a rearguard action in defence of the status quo. Interestingly, both responses tend to be framed within a discourse that assumes the "inefficiency" of clan values. Most plainly, critics of clan control (e.g. professional autonomy) highlight the neglect of financial measures and market disciplines; and its proponents reject the application of any kind of efficiency measures on the grounds that

they are incompatible with the exercise of professional judgement. Marginalized within such debates is a recognition of the actual or potential contribution of a democratized form of clan-type governance for increasing the quality and availability of public goods and services, as well as supporting a better quality of working life for their providers.

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