

# **Fair Shares for All?**

## **The development of needs based government funding in education, health and housing**

**Ross Hendry**

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## **Abstract**

Furthering equity as an achievable public policy objective is based on the ability to assess needs accurately, and distribute resources accordingly. The purpose of this paper is to plot the development of the formulae governing resource allocation in education, health and social housing and to chart their course as a tool with which governments attempted to achieve various objectives.

The paper begins by suggesting that allocation systems can be explained through a form of public choice theory. Having made this proposal it then charts the development of needs based resource allocation from its origin in the nineteenth century, when Sidney Webb set guiding principles, through the pre and post Second World war period, and into the major flowering of needs based formulae since 1970.

As a result there is an assessment of the rationale used in needs based formulae during a period when resources are constrained and attempts are made to push allocation even further down and apply the formulae to smaller units.

The conclusion focuses on equity as the single objective that remains consistent throughout the development of over a century of funding formulae. Yet, in a dynamic environment many forces affect the final design of allocation formulae. Intellectual, political and technical reasons interact with concepts of fairness and equity, assessments of priorities and need, the aspiration of budgetary restraint and efficiency, and the control of provision in order to explain former and current allocation systems.

## Introduction

Contemporary education, health and housing policy seem almost inevitably to be governed by finance. Fiscal constraints, real or imagined, determine what governments can spend on social policy while the way in which these budgets are spent determine how, where and on whom the benefits are bestowed. Crude expenditure levels or even efficiency never have been the sole measures of successful provision. Access by different social groups and equity issues have always been an important part of social policy debate. This study is concerned with one strand of that debate – area based equity or ‘territorial justice’ as one leading authority called it (Davies 1968).

The following historical account will concentrate on the education, health and housing sectors. The focus will be on explaining the development of contemporary funding formulae. In any historical study that is used as a precursor to the analysis of current systems it is important not to extrapolate backwards contemporary values into periods and schemes that were formed in very different conditions to that which exist today. Nevertheless one of the central questions is whether there is any common thread to the evolution these allocation mechanisms and what has driven it. In the most recent past there have developed a series of quite complicated mathematically based funding formulae that underpin the allocation of funds to health services, housing, education and local government more generally. They are all based on some concept of need. This is a fundamentally non-market, not to say socialistic concept (Doyal and Gough 1991). How did it come to prominence during a long period of Conservative, profoundly anti market, rule? Why should a mathematical formulation, beyond most electors understanding, gain such sway?

In this study we concentrate on education, health and housing as exemplars of service funding issues. Why? All three are in kind services administered by local agencies. Rights to benefit are not based on individual claims to a nationally set entitlement, as is the case with social security. Area based claims of some kind have to be judged. More recently each service has been the subject of quasi-market reform and the devolution of budgets to lower levels of service delivery (Le Grand, Glennerster and Maynard 1991; Hills 1990). This poses new problems of micro resource allocation. One of the themes that will emerge is that many of the same issues, problems and solutions periodically re-occur. Though each service system has distinctive relationships with the central

state all three also show similarities in the changing approaches governments have adopted over time. Why should this be?

We begin by postulating a theory that might answer some of these questions and explain the evolution of formula funding mechanisms.

## **A crude stage theory for the development of funding formulae**

In all the three services we are considering the state only came to be a major *provider* during the course of this century and a prime actor only after the Second World War. Housing is still predominantly provided by the private sector though government has been a prime mover in the tax and regulation of the private market. It turns out that the early history of service funding tells us a great deal about the forms we have today (Glennister 1996).

The reason why the state and, in the UK especially, the central state, came to evolve into such a major source of funding for these services has been the subject of much debate that we shall not re-run here (see for example Foster, Jackman and Perlman 1980). However, given that development major questions arise about how the central government should perform its rationing role. Should it provide matching grants to reward local initiative, base its allocations on some equity rule or reward the government's political friends? All would be, *a priori*, rational strategies. The Foster *et al* (*op cit*) account relies primarily on agency theory to explain developments. The UK is a unitary state. Central government may therefore be expected to act as the headquarters of a firm might do, using its subordinate levels of administration to carry out its will effectively – minimising transaction costs and maximising control. Funding mechanisms should be designed to achieve this and to maximise incentives for agents of central government to act in an efficient manner. Yet this perspective does not convincingly explain the dramatic changes funding systems have gone through in the past 100 years and especially in the last twenty. We postulate and then consider an approach that owes more to a modified form of public choice theory (Mueller 1989; Dunleavy 1991). This alternative stage theory is outlined in figure 1 below. If we take as our starting point that services and their funding mechanisms respond to the varied self interests of voters, politicians and public bureaucrats a crude stage theory of funding mechanisms can be put together.

Given the extended franchise in the late nineteenth century, a range of voters with a new set of interests became part of the electoral game. They and public bureaucrats had an interest in extending the boundaries of the state services we are concerned with here (see, for example, West 1975). We do not suggest this is the whole story but, in so far as politicians and central bureaucrats see it is in their interests to expand local services, we would expect the grant mechanisms they devise to be largely devoted to extending the scope and access to these services. It may, however, be that Civil Servants are less opportunistic and motivated by self interest than this model would suggest, and that many work within a moral framework in which they view well managed public services as integral to creating a better society. In either case the aim will be to expand service activity into previously virgin territory. This is not inconsistent with national politicians and the electorate having some notion of a basic national minimum standard of provision. We find this view articulated in the socio-political writings of individuals like Sidney Webb, who, as we intend to highlight, expressed many of the principles upon which future reform was to take place. This context may be called stage one.

State funding does not entail state provision. Service provision may begin with state support of the existing private agencies, go on to fund state and private providers equally then, as public provision expands it may be given preferential support.

Once state services have been firmly established in a comprehensive, if not uniform, fashion political concern will change to mechanisms that will achieve the maximum share of the incremental budget for local interests. This may be called stage two. In a political system characterised by a strong legislature and locally based politicians this process will come to be dominated by “log rolling” (or backscratching), lobbying and temporary coalitions (Wildavsky 1975). However, in a political system characterised by a strong national party system, a powerful executive and a unitary state the outcome will be different. It will be in the interests of the national parties to minimise public conflict about territorial budget disputes. Such open divisions will bring the national party into disrepute and weaken party discipline. Party politicians will be expected to search for rules of the game that internalise and formalise disputes about area allocations. They will not wish to rule out local political influence but minimise its capacity to produce external dispute. External validation and agreement on the rules of the game will be helpful.

For bureaucrats the problems are different but the solution may be the same. For budget allocations to be determined politically by log rolling or local deals with central politicians deprives them of power and influence. The more technical the solution the more power they wield and the more work they have to do.

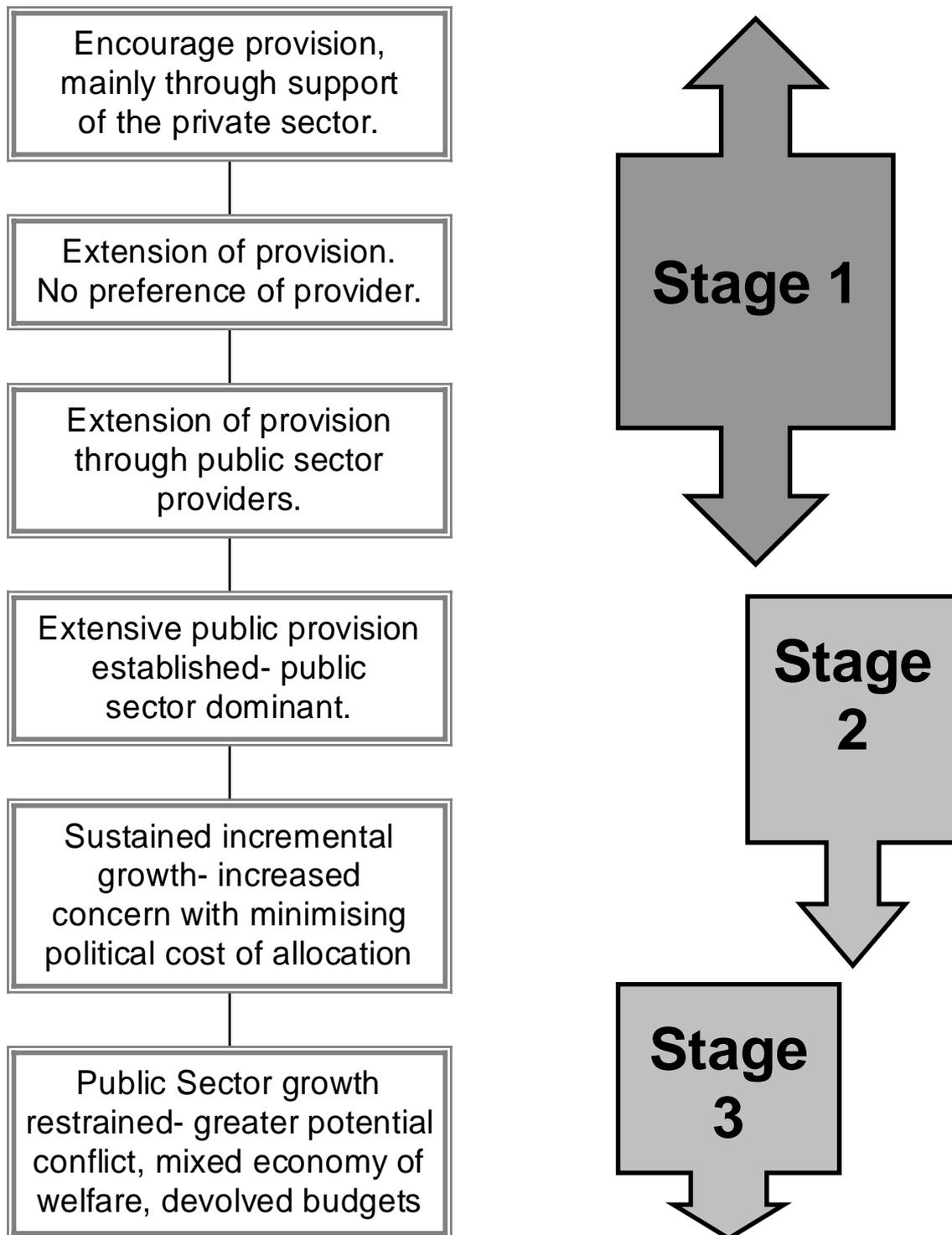
During stage one (see figure 1), when service provision was only partial, debate on priorities will tend to centre on which new groups or areas should be brought into the system. This will reflect area based interests, and judgements about the existing service base will tend to be a largely subjective or political judgement. This stage can be characterised by incremental legislation extending the scope of the service. Basic legislation in stage two is more stable and increments become the focus of interest.

Once budgets become very tight as voter resistance to high taxes grows, regular budget increments cease, so the scale and costs of disputes will tend to rise. Instead of basking in the glory of additional funds central politicians will be responsible for allocating cuts or resisting significant additions. This has been the basis of allocations in health since 1976. In figure 1 below, this is stage three. Two strategies may minimise these political costs – first, more technical solutions to the allocation process and second, devolved responsibility for budgets to smaller non- political units – schools, GPs, housing associations.

All of this will be much more acceptable if it is done within a normative framework that is widely accepted – geographical ‘equity’, fairness or ‘need’. These are all widely accepted in the abstract but have ambiguous meanings (Doyal and Gough 1991).

Another incentive will be for politicians to try to get more services from any given pound of tax. Thus formulae may come to be used to encourage efficiency and prevent manipulation and perverse outcomes. The tasks these formulae will be asked to perform thus become more complex. They must minimise the conflict that derives from a tight budget and rising expectations. They must be capable of devolution to much smaller units where ordinary people or front line professionals will come in direct contact with them. They must encourage efficiency. They may be being asked to do too much.

In what follows we examine the history of formula funding through each of these supposed stages to see how far this framework of explanation and sequence can be sustained.



**Figure 1: Stage theory structure of an historical analysis of education, health and housing funding formulae**

## **Stage 1: The genesis of funding formulae: allocating limited resource to enable provision.**

### ***The extension of provision...***

In the stage theory outlined above stage one represented the extension of service provision up to the point where public resources are mainly spent on state provision. Studies on welfare state finance have suggested, broadly speaking, that the pace and means of this development can be controlled in one of three ways (Glennerster 1996). These are regulation by (1) legislation, (2) hierarchical/management control, or, (3) financial arrangements. Legislation covers the statutory powers granted to ensure provision. Statutes define what providers at every level (e.g. Ministers of state, local authorities, and street level providers) are allowed to do. Legal action can then be taken if any one in the chain of provision exceeds their authority, or does not adequately fulfil their obligations. Hierarchical powers cover the bureaucratic means by which central government can influence provision. This category would include inspection, audit, and ministerial guidance. The third central government lever is finance. This chiefly includes the funding mechanisms that govern the allocation of resources. These may be unit grants, grants linked to performance, percentage or matching grants, general revenue enhancement or needs based grants. Each of these three levers is used in tandem, and the development of funding formulae has often been a response to legislative and hierarchical developments. This was particularly the case in stage one.

### ***...through private provision.***

Early government intervention in education was both small and governed by a belief that the provision should take place through private institutions. On this basis the first state grant to education was made in 1833. £20,000 was given to two national voluntary bodies – the National Society (Church of England) and the British and Foreign Schools Society (Nonconformist church body) – to build new schools, but was only designed to cover only fifty percent of the projects' costs. Although the allocation of this grant was at the discretion of the Privy Council it did favour projects which intended to provide at least 400 places (Godson 1966). Those receiving state finance would also be required to open up their schools to Her Majesty's Inspectors (HMIs),

who were first appointed in 1835, and who were directly accountable to the Privy Council.

Expenditure by, and the influence of, central government grew steadily throughout the 1830s, 40s and 50s. In 1843, for example, the central government supported expenditure on homes for teachers, their salary and pension costs, as well as school equipment and furniture. After 1846 grants from central government also covered teacher-training costs, which were awarded directly to teachers. Capitation payments were used for the first time in the education sector in 1853. Officials believed that flat-rate per-pupil funding promoted efficiency and economy, whereas its strong relationship to local need can only be a *post hoc* rationalisation. Qualification for this money continued to depend on the recommendation of government inspectors who then influenced the form and content of teaching, which meant that 'the central government had acquired a degree of control over the internal workings of the schools, which was never to be equalled again, despite the fact that they were private institutions' (Glennister 1977).

Despite a modest role for capitation based allocation the majority of resources were still allocated through a proliferation of specific percentage grants by the time the *Report on the State of Popular Education* was published in 1861. Complexity was becoming a major issue, and the priority was to find a simpler system of funding. The solution proposed by the Report formed the basis of the Government's *Revised Code of Regulations* in 1862, which established a funding formula based on a capitation grant that combined payment-by-results with an attendance feature. In time it was thought that this would replace the need for Her Majesty's Inspectors. Distributing revenue spending in this way survived more or less unchanged until 1895. Though the state Boards of Education became additional state suppliers of elementary education from 1870. The result was a rapid extension in the coverage of Elementary education so that it could become compulsory in the 1890s.

Hospitals and health care had existed in England since Medieval times, and great strides had been made in establishing medicine as a reputable and regulated profession during the course of the nineteenth century (Abel-Smith 1964). During the same period state financed health care was strictly limited to the provision of destitute paupers through the Poor Law. However, the rapid growth of voluntary hospitals and private practices occurred without state financial or legislative support. Within this system the state workhouse system became the providers of last resort for the very poor or terminally ill, and the voluntary societies

had little need for state assistance in their finances before the 1920s (Abel-Smith 1964).

The health sector that developed within the framework outlined above had very little to do with equity of access. Indeed an inverse relationship between need and provision arose. Doctors and hospitals were located in the prosperous areas that could maintain and pay for their services, whereas areas of social deprivation where ill health was prevalent simply could not afford to pay for such an infrastructure or service. This was the case for both voluntary hospitals and for General Practitioners, but given that GPs were the gatekeepers to specialists working in hospitals, limited access to a GP was a double concern.

These issues, raised by the contemporary profession, the trade unions, and other sectional interests such as the insurance companies, led to the introduction in 1911 of the National Insurance Bill. The details included an insurance scheme under which contributions were to be made by the individual, the employer and the government. At its inception in 1913 the scheme was compulsory for all manual and other workers who earned less than £160 per annum, and ensured cash benefits paid during periods of sickness, full and free GP care, and limited pharmaceutical benefits. The BMA originally objected to many of the financial and administrative provisions in the Act, but was careful not to push their case too far (BMA 1970). Lloyd George played on the fears of voluntary hospitals that Government grants would lead to government control, and that for GPs, that National Insurance was a means of preserving not eroding their independence (Abel-Smith 1964). 1911, therefore, was an Act that brought most general practitioners into a relationship of dependence upon state finance, whilst leaving the hospital system much as it was before. Although the provision of secondary care was to change radically within forty years, the 1911 National Insurance Act defined the form of GP finance that essentially lasted the remainder of the century. These independent agents were set a basic per capita sum to look after individuals accepted onto their 'list'. Even in the most recent studies primary care is still defined, quite correctly as provided by private/independent practitioners, funded through public resources (Burchardt 1997), though the 1997 Primary Care Act did, for the first time, introduce a category of salaried GPs as an alternative means of provision.

By 1938 forty-three per cent of the population were covered by the scheme and ninety per cent of all GPs had accepted a panel (list) of national insurance patients (Webster 1988). More than a third of their income came from the Insurance Fund, although it was stated that two-

thirds of their time was spent dealing with insured patients (Stevens 1966). However, NI still did not cover many of those groups excluded from the 'clubs', which were the forerunners of NI, or cover treatment by specialists in voluntary hospitals. This gap was closed with the foundation of the National Health Service in 1948. Yet it is important to remember that despite the universal coverage now guaranteed by legislation, and the use of general taxation to fund part of the service, GPs remained independent. Their basic relationship with the state did not change with the foundation of the NHS, even though financially they may have become more dependent on the public resources. Unlike the secondary sector, which is directly accountable to and controlled by the Minister of State, GPs largely remain contracted parties – not direct employees.

Statutory responsibility within the 1946 National Health Act for determining the number of practices in an area was handed to the Medical Practices Committee (MPC). This was a form of self-government for the service, with legislation (Section 34(2), 1946) requiring the Committee to 'secure that the number of medical practitioners undertaking to provide general medical services in the area of different Executive Councils or in different parts of those areas are adequate' (MPC 1949). In 1949 the Committee responded to the calls for a more equal dispersal of new doctors by classifying each district in England and Wales as 'needy', 'open', 'doubtful', or 'closed'. The classification appears to be based on the average list sizes within districts, with qualification for needy areas being average list sizes of 3,000 or more. In 1952, following the publication of GMSC concerns questioning whether this level was too high the MPC lowered its limit to 2,500, where it has remained more or less unchanged ever since (Butler 1980).

Despite the introduction of incentive payments such as the Initial Practice Allowance, which gave financial incentives for new doctors to locate in 'needy' areas, their power remains one of negative direction. Essentially, over the past 100 years the GMSC has aimed to limit or abolish competition between GPs, and to achieve, what is in essence, local cartelisation. In practice this has meant that the MPC can close off areas to new doctors, but cannot force them to locate in any other region, or to insist that doctors within an under-doctored area encourage colleagues to join them. In addition much of the negotiations with GPs concerns pay disputes. This issue exemplifies the different objectives between primary and secondary sectors. The GP contract determines a practitioner's income (an average). The negotiations are based on

securing an average income for most GPs whereas the HCHS formula is about distributing fair shares of the budget. The whole idea of the latter is that you expect unequal shares based on equity. So both elements are pulling in different ways.

By its own standards of crude list sizes the MPC has had a great deal of success in equalising the distribution of GPs. However, the MPC's use raw and unweighted population data and average list sizes to calculate an area's need seems particularly crude and arcane in comparison with other health measurements and formulae we shall discuss. However, the fact remains that the core NHS service- the GP primary practice- remains in the hands of private providers. The form of funding reflects these origins.

***...no preference of provider.***

The Education Act of 1870 was more immediately significant in the development of provision than in the funding of education, but its long-term implications were profound. Financially it repealed Government support for school building, and the exclusive support of private education institutions. Instead, where the voluntary and private sector had failed to provide enough places for elementary education 'Board schools' were allowed to fill the gap. These were to be built out of the local rate fund. Current costs of both Board and voluntary schools would remain funded by the government, whose annual capitation grant would now be supplemented in areas with large school populations relative to their rateable value. This final provision showed a clear understanding that there was some negative relationship in deprived areas between need and the ability to pay for provision. Much controversy surrounded the State's move into the provision of schooling. West (1975) has argued that central bureaucrats eager to extend their role exaggerated the need for the state to step in. Sutherland (1971) has shown that politicians were the prime movers in extending the role of the Boards of Education areas with poor children and accepting the logic that compulsory education entailed State funding. External pressure from highly organised nonconformist groups within the Liberal Party played a crucial part.

In 1895 the exam based funding formula for primary education was abolished. Instead separate grants covering a percentage of expenditure was seen as a more flexible means of funding, as it enabled funding to be tailored to the unique 'needs' of each individual school. Rather than create a system of homogenous schools producing uniform young people, the myriad of specific percentage grants enabled a variety

of specialisations. The 1902 Education Act attempted to unify many of these grants but ultimately failed to do so, and by 1918 the funding system had returned to an array of specific grants 'which stimulated and promoted expenditure in the particular ways thought desirable, rather than in other ways' (Webb 1920).

The Education Act of 1902 did establish Local Education Authorities (LEAs), which were to run parallel to the new local government authorities. The Act also placed an obligation on authorities to supply, or aid the provision of education other than elementary. There was no obligation to provide secondary education, simply to fund a proportion of it, and those voluntary sector secondary schools that could attract sufficient pupils from the elementary sector received a per capita grant. These schools were to form the basis of the direct grant list, which survived until 1976. A new 'unified' grant would now be paid to the LEA who assumed responsibility for sub-regional distribution. This grant was assessed according to an area's poverty, using rateable values as a proxy, its population, and school attendance.

Despite the early moves to amalgamate the various specific grants awarded to the elementary sector, much of the secondary, further and higher systems grew out of a variety of awards made by the Science and Arts Department, which sponsored separate classes and institutions for their areas of specialisation. Following the 1870 Act many Boards established secondary level courses, which were funded partly through the use of elementary grants, and partly by Science and Arts Department awards. However this use of elementary education money was deemed illegal by the high courts in 1899. Technical education, however, had been funded differently for some years before this judgement. The Technical Instruction Act of 1889 gave local authorities the power to raise a 1d education tax, specifically designed to fund technical education. The following year a system of assigned revenues was established along the lines of the 1888 Local Government reforms, that saw excise duties earmarked for education spending. Although the contents of the 1889 Act were largely repealed by the 1902 Education Act the assigned revenue from the 'whisky money' remained, and was redistributed to areas according to their relative share in the collection process.

### ***...public sector providers.***

The 1918 Education Act can be seen as a landmark piece of legislation for two reasons. First, it signalled the end of a common Capitation Grant for both private and public sectors. The bias in the 1902 Act towards

public provision was now firmly established. By 1926 voluntary schools had to choose whether to receive funding from the LEA or directly from central government. Once again there was another attempt to simplify the structure of the grants, whose number and complexity had once again multiplied. The new formula finally agreed upon was a fifty-percent grant for secondary education, and a block grant for elementary schooling based on a formula which took account of spending, pupil numbers and the area's rateable value. However, this formula exemplified the problem of achieving equity by approximating authorities' different spending. A Capitation allowance was set, which was the equivalent of 36s per pupil with average attendance levels, together with additional allowances that would cover sixty percent of teacher salaries, and twenty percent of all other costs. However, the desire to achieve an equitable formula complicated matters. So as not to over pay rich areas the grant was reduced by an equivalent of a 7d rate, and expenditure criteria were built in that stated central government spending on education could not amount to more than seventy-five percent but no less than fifty percent of an LEA's expenditure.

Increased provision and standards were the goal of the 1918 Act, but Government policy in the face of worsening economic conditions soon dampened the desire to increase public spending. In 1921 the Committee on National Expenditure was appointed, and in the subsequent report the percentage grant system was highly criticised for encouraging spending at the expense of economy and efficiency. It also criticised the open ended commitment central government had made to spending, and highlighted how local authorities could dictate the Board of Education's budget. Following these attacks the Board of Education issued a circular in 1925 proposing a switch from a percentage grant to a block grant which would be fixed three years in advance. This faced hostility from every sector of the education lobby, and was not, as intended, incorporated into the new local government block grant introduced in 1929. Once again, in 1931, education spending faced cuts, yet the percentage system remained intact, and proved remarkably resistant to periods of economic downturn (Vaizey and Sheehan 1968).

Although the Education Act of 1944 and the Local Government finance reforms of 1948 were extremely important pieces of legislation, they did very little to alter the way in which education was funded. The former piece of legislation was concerned primarily with provision, and the debate over religious instruction excluded practically all other issues. What little changes did occur simply reinforced the existing structure, so that education funding between 1946 and 1958 was calculated according

to a basic sum per child, plus sixty percent net expenditure, minus the income from a specified local rate. Special provisions were added to cover teacher training, school meals and free milk. The latter legislation simply brought local government finance into line with the predominantly percentage system already being used for education.

The structure of secondary health care before the creation of the NHS has been described above, and consisted of both voluntary hospitals run independently of the public sector and municipal institutions administered by local authorities. With most active authorities this role steadily expanded throughout the inter-war period. These authorities had inherited the old Poor Law infirmaries, and after legislation passed in 1890 were able to build new general purpose institutions. Although the voluntary hospitals were the more prestigious they were also more likely to be expensive, more selective regarding whom they treated, and concentrated in the more affluent locations. By the turn of the century voluntary hospitals also found themselves awkwardly placed to deal with the rapidly rising demand for and expense of medical care, whilst, at the same time, local authorities began building more general hospitals, and their stigma of treating paupers began to diminish.

By 1938 this had led to the paradoxical situation whereby the most prestigious institutions – the voluntary hospitals – supplied the least amount of beds and faced the greatest financial difficulties seen in the medical sector. Their dependence upon public resources intensified under Emergency Medical Service, created to cope with a war time situation. Between 1938 and 1947 donations fell from 33 per cent of hospitals' revenue to 16 per cent, while fees paid by public authorities rose from 8 per cent to 45 per cent. Yet even the best endowed group of voluntary hospitals at the top of the pyramid – London teaching hospitals – had a revenue deficit of £2 millions by the time they were nationalised (Forsyth 1966). Municipal hospitals on the other hand were mainly financed through local rates supplemented by the Exchequer block grants to local government. Within this framework responsible authorities were assumed to charge patients according to their means. This was assumed to be the method adopted by voluntary hospitals, though two exceptions are worth noting. The first concerns refusal to treat patients. Often an inability to pay coupled with long-term or particularly costly illnesses meant patients were turned away under the assumption that they could then turn to municipal provision. Second, treatment was often permitted under membership of ad hoc hospital contribution schemes. These payments were not in any sense proper

prepayment insurance plans, yet membership had still, by the outbreak of war, reached 7 million people, and accounted for around half the revenue of the voluntary sector.

### ***Stage 1 so far***

Education most closely fits the first stage of the theory outlined at the beginning of the paper. Private provision is subsidised to a growing degree, public provision is introduced first in cases where the voluntary sectors fail to provide (and where local nonconformists press hard to avoid a monopoly in Church of England provision). Once established the public sector with its great taxing powers gradually expands at the expense of the private and not-for-profit sectors, notably after free provision was introduced. Payments to private secondary schools for pupils transferring from the State sector remains a major and important avenue of provision up to and after the 1944 Education Act. Yet public provision has steadily extended its scope responding to funding mechanisms devised by central politicians and civil servants.

Health care followed a rather less steady incremental progress through each of the postulated stages, but the end result was similar. GPs remained private agents but were to be largely public funded as the scope of National Insurance brought in successive extensions of covered groups during the 1920s and 1930s. Voluntary hospitals' private funding had declined steadily over the same period, but the War brought a sudden infusion of public money. Local Medical officers working in combination with active politicians in authorities like the LCC, Middlesex County Council and Labour authorities in the north of England and Wales extended the scope of public hospitals

### ***The cyclical nature of resource allocation in social housing***

Social housing can be placed within the model outlined above, but the story is a little different. Firstly, the chronological development of social housing formulae is less linear than that followed by education and health. For example, central government did attempt to encourage provision through subsidies to the private sector, but only after a similar offer to local authorities. Similarly, there is a recurrent cycle in policy up until 1972, where redundant subsidies are revisited after being abandoned years before. Holding the model constant for housing, therefore, would only lead to a muddled chronology. Secondly, given that social housing never became a universal service in a similar way to education and health, there is no period that adequately corresponds to stage 2. Yet even if the sequence of policy implementation is different

there is a shared objective of using public subsidies as incentives to expand provision. Nevertheless, discussion of the social housing is best separated from that of education and health.

### *Up to 1921*

Nineteenth century state intervention in, and provision of, housing was at the same time similar and different to that taking place in the education and health sectors. The similarities concern the level and direction of public resources. Shelter was only funded for the destitute pauper within workhouses under the provisions of the 1834 Poor Law. Legislation was enabling, and committed no resources from central government for the construction of houses, which would then be let at lower rents. For most this was morally wrong, and opposed for all the reasons the old Poor Law system had been reformed.

However, there were suggestions before the First World War that financial assistance should be given to local authorities in order to build working class homes. The first such Bill was introduced to Parliament in 1912, but together with similar proposals in 1913 and 1914 failed to gain any significant section of support. During the same period the Royal Commission on Housing in Scotland (est. 1912, reported in 1917) was investigating the pre-war accommodation shortages. The Royal Commission's Minority Report advocated a subsidy,

payable to men with three children or more, equal to the difference between the average rent of a two-roomed-dwelling and "the higher rent of which would be requisite for the proper housing of the family on the higher standard to be enforced in the near future" (Holmans 1987).

Rather than allocate resources to local authorities to build homes this proposal suggested paying a specific cash benefit to the family whom could choose their preferred tenure and landlord. In principle such a system would work in a similar way to Housing Benefit (HB), although it took another fifty-five years before the rent rebate, precursor of the HB, was implemented. It has been suggested that this proposal was unacceptable to the political classes of Edwardian England because

Labouring men were not trusted to maximise their satisfaction in a sober and sanitary manner acceptable to the middle classes. Tory paternalism and nonconformist compassion could be alike the enemies of choice (McKie 1971; quoted in Holmans 1987).

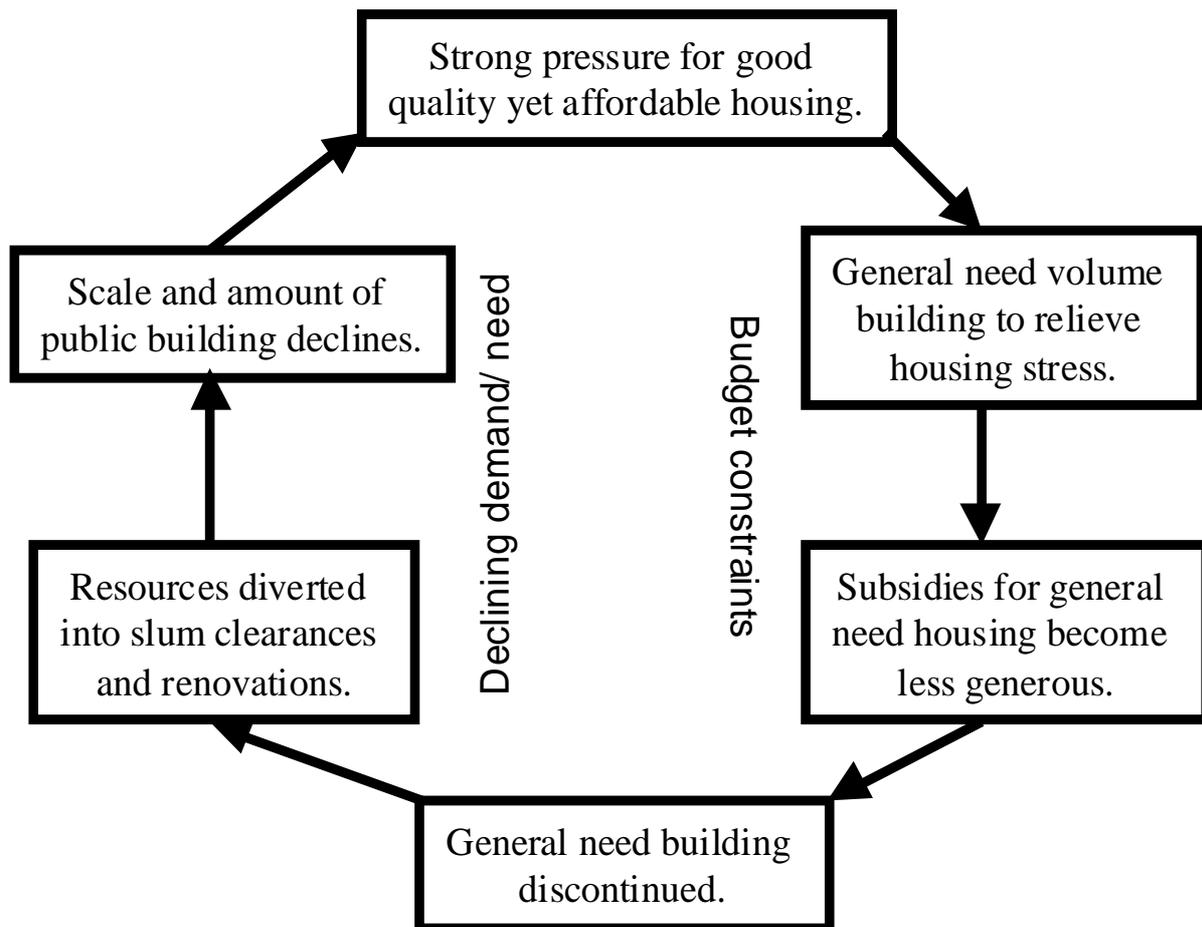
Therefore, government intervention before 1919 was limited to granting local authorities the power to build new homes and to control rents. The first government housing subsidy introduced in 1919 was therefore significant for its positive nature of encouraging building through financial incentives. Subsidies were deemed necessary to build the 500,000 new homes needed by the returning troops. The Government believed this number could be built within three years given the generous nature of the subsidy system offered to local authorities under the terms of the 1919 Housing Act. But in order to get local public bodies to even consider undertaking the scale of construction needed the Government had to guarantee that local authority liability would be limited to a penny rate. The Exchequer would then fund the difference between the income from a rent level set by a government officer and the cost of the project. There were two unforeseen consequences of this legislation. The first was short term, and concerned the rising costs of construction. The construction cost of the average working class house in 1914 was £250. However, the combination of inflation, scarce resources and higher standards meant that tender prices for subsidised housing in 1920 had risen to £930 per unit, whilst the cost of completion in 1921 was £1200 (Malpass and Murie 1987). It was left to the government to meet this increase, given that there was no incentive for local authorities to economise.

In the longer term the subsidy set an important precedent for future housing policy. Once bitten, the Exchequer would, forever more be shy of any system with an open ended liability. Nevertheless, although the estimated construction numbers and their cost were inaccurate, the Addison Act proved that government subsidies encouraged the construction of social housing. Thirdly the Act allowed authority discretion in determining housing needs. The assumption was that, if an area had need of additional housing and the subsidy was set at a fair amount, then a responsible authority would build the necessary amount. In practice some authorities were far more willing to build than others were.

### *1923–1972*

There have been three identifiable periods of local authority construction for general housing needs, all of which begin with a generous central government subsidy. These periods were 1919 to 1930, 1946 to 1956, and 1961 until 1972. The beginning of each period was marked by a desire to build high quality homes exemplified through the publication of reports by the Tudor Walters Committee (LGB 1918, Cmnd 9191), the Dudley

Committee (CHAC 1944), and Parker Morris (CHAC 1961). But high standards meant slower more costly construction, and within several years of their publication the standards initially advocated were diluted under the pressure to build more units quicker and cheaper (Merret 1979; Malpass and Murie 1987). These periods concluded with subsidies for general need housing being discontinued. Instead resources were targeted very narrowly into slum clearances and renovations. Generally this pattern was repeated three times up to 1972 and forms the social housing resource allocation cycle outlined below (figure 2).



**Figure 2: The local authority housing subsidy cycle, 1919-1972**

1923 saw the return of recurrent subsidies. The difference between the Chamberlain subsidy and its 1919 predecessor concerned the main recipients of resources. Addison's Act had seen local government as the only viable sector able to build the amount of homes needed in the timescale set down. 'Normal conditions would return by 1927' following

the construction of 500,000 subsidised homes. The subsidy could then be phased out and rents de-controlled; but with a strain on resources local authorities proved unable to meet these ambitious targets. Chamberlain's subsidy was different because it broadened the access to Government subsidies to include public and private builders alike. There was no mandatory rate fund contribution, and the Treasury commitment was set at £6 a year for twenty years. The system was simple to understand and, and became the blueprint for the classic British housing formula of £x for y years (Holmans 1987). The Act was specifically designed to stimulate the private sector, with no control on the rent of the new houses. Local authorities could only apply for the subsidy having proved local need. Although this was not difficult given the chronic housing shortages it did have the effect of weeding out all but the most enthusiastic local authority construction. During the six years in which the subsidy operated 75,900 homes were built by local authorities, whilst 362,000 were built by private landlords.

However, this was not to suggest a marginal role for local authorities in the long term. In 1924 an additional subsidy system was introduced by the minority Labour Government. The new subsidy was only available to local authorities and other 'public utility societies'. It held the structure of the classic formula constant but increased the annual award by fifty per cent, and doubled the duration of payment. 'Appropriate normal rents' were set at average working class levels in 1914, and mandatory rate fund contributions, up to 4s 10d, were to ensure this. If costs were to make this rent/income equation unworkable rents could be increased to offset the loss. Therefore, in practice, rents did rise significantly above the Governments desired level. Over half a million local authority homes were built with the assistance of the Wheatley Act before 1933 and together with the Chamberlain Act established the pattern for subsidies up until 1967. Post war general need subsidies took much the same structure, simply altering the values of x and y to keep pace with construction costs.

Towards the end of the 1920s there was a growing concern that general need housing only benefited the more affluent working class. New houses were doing little to displace the worst homes, whose rents remained the cheapest alternative for the very poor. The economic crash of 1929 heightened this concern for wasted resources. Therefore, as the perceived demand for general need housing lessened resources began to be redirected into slum clearance policies. The period between 1930 and 1933 saw two Acts which targeted resources on the worst areas, the repeal of the one remaining general need subsidy, and the publication of

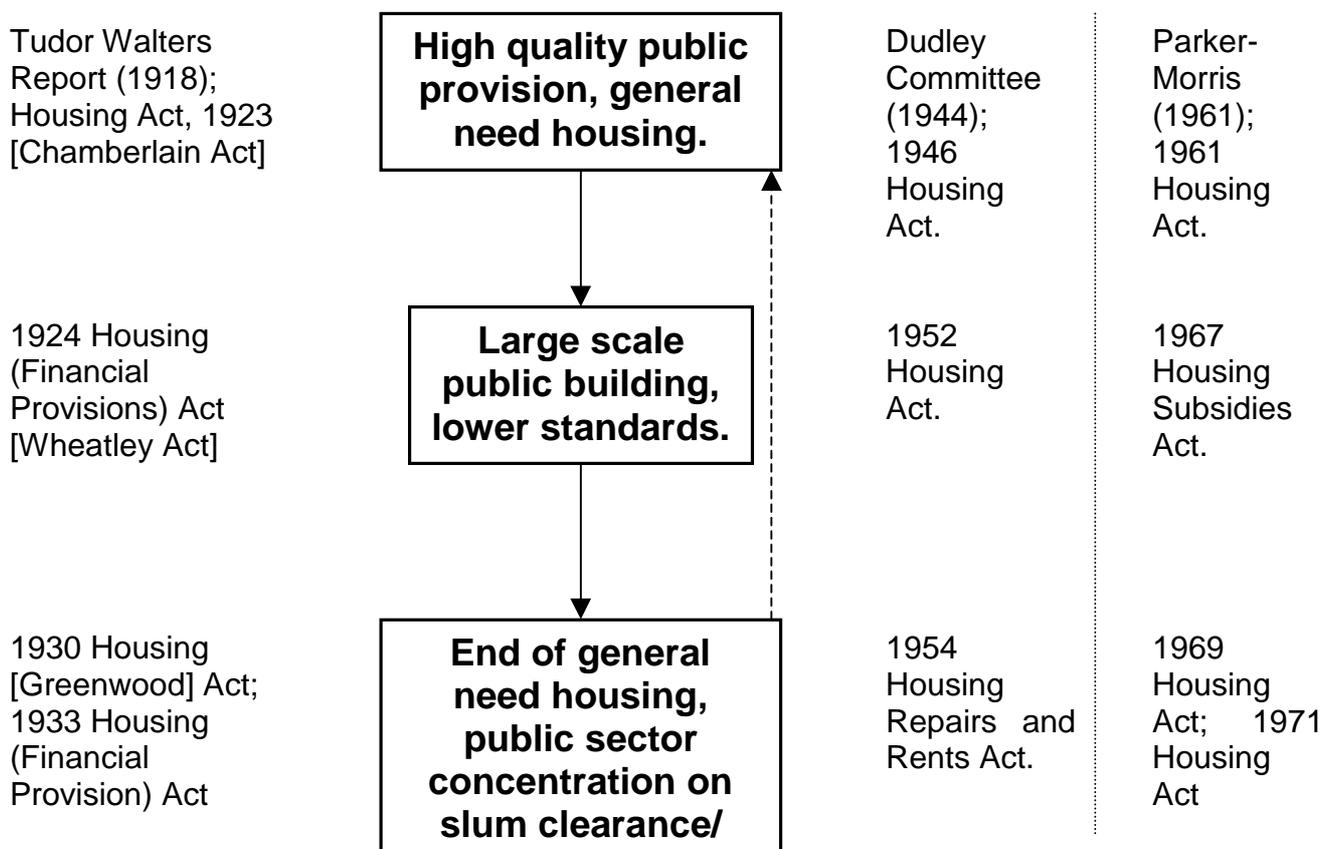
a report on Public Expenditure. The latter again criticised the waste of general need subsidies in building homes that the most needy still could not afford. It also noted the reluctance of authorities to operate rebates and house the poorest people in their districts.

Following the War, during which domestic construction had been sacrificed for the war effort, the desire to build high quality general needs housing returned. This brought policy full circle. Once again quality, standards and unit cost were substituted for an increase in absolute numbers, but after annual construction targets were met the numbers game began to lose its appeal. The benefit no longer justified the cost, and the Government announced its intention to terminate general need subsidies in 1955. In its place rose subsidies designed to stimulate local authorities slum clearances, and for the private sector to undertake renovations and new general need construction. However, by 1961 general need subsidies had returned, and the third policy cycle began. The remarkable feature of each period is how similar each was to its predecessor (see figure 3).

Despite these similarities the third cycle did show signs that the recurrent cycle which had been set in motion after the First World War. In 1964 the Housing Corporation was formed, with the clear intention of providing an alternative means of construction and tenure within the public sector. Up until the 1960s local authority building had been encouraged through the 'classic British housing subsidy, but high inflation and interest rates quickly undermined the value of these awards. The 1967 Housing Subsidies Act was the first attempt to overcome this problem. New subsidies would be calculated on the difference between loan charges at 4 per cent interest and the real market rate. However, although the system offset variations in interest rates local authority construction continued to decline up until 1973, and by 1969 the government had returned to a modernised form of slum clearance policy, introducing special subsidies for new 'general improvement areas'.

## Inter-war subsidies

## Post-war subsidies



**Figure 3: The cyclical nature of state housing policy; legislation 1919-72**

By the 1970s several forces were at work undermining the cycle of housing subsidies. One was the decline in crude housing shortages. The large-scale construction of the previous three decades had, by the mid-1970s led to a glut in the supply homes, and many council properties remained empty. Another reason for this was that as the quality of local authority housing declined it became less desirable (Power 1987). There was also a growing concern that the subsidy system failed to reflect the different needs and financial burden of various authorities. The new subsidy system in 1967 was the first break with all that had gone before, and foresaw the more radical changes that were to take place over the next two decades.

Yet the cyclical nature of housing subsidies does not end with the decline of new council housing during the 1970s. A current manifestation can be identified with reform of the Housing Association sector over the last decade. As described below, the Housing Association

Grant that matured after the 1974 Housing Act was designed to encourage the growth of alternative providers of social housing than existing local authorities. Perhaps because of this overtly political goal of extending the diversity of landlord capital grants were generous. By the late eighties, there were occasions when these grants could be worth more than the total development costs of a project. Essential in the calculation of subsidy were the desired rent levels and design and construction standards. The purpose of these grants was to ensure these requirements, in much the same way as stage one in the housing cycles outlined above.

This system of capital grants was reformed in 1989 and replaced with a system that placed far greater emphasis on value for money and increasing the scale of new housing association development (DoE, 1987). Again there is a close resemblance between the objectives that the Conservative government transposed onto the Housing Association grant system between 1990 and 1997, and administrations that used housing subsidies to play the 'numbers game' during the 1950s and 1960s. This system lasted until 1996/7 when the effect on rents of open competition for grants was deemed not to be a price worth paying. Results from the recent Comprehensive Spending Review have suggested that the relative importance of renovation should be increased. This is a clear echo of the final stage in the housing cycle outlined above- when general need subsidies are substituted with improvement grants. Although the current policy is to maintain the general level of new development funded through the Housing Corporation's Approved Development Programme there is no doubt that a desire to alter the emphasis of policy towards using existing stock in a more effective manner.

There are notable differences in the nature and detail between this latter cycle and previous subsidies. Yet the similarities are also striking. Conservative Party solutions to social housing questions may have presented radical alternatives for provision, and the promotion of Housing Associations at the expense of local authorities was a break with earlier policy tenets. However, the objective of government grants has been less radical, and continuity with previous cycles is clear.

### ***Stage 1 and housing***

We have seen that housing finance does not fit the developmental pattern we outlined at the beginning. Housing never moves from stage 1 to stage 2 – mass universal provision. Indeed it is characterised by a cyclical pattern that depends on the overall pattern of demand and

supply of housing, taking a residual role throughout. While housing skips stage 2 it does, as we shall see, converge with other services on stage 3.

### *Local authority grants before 1948*

Whilst education, health and housing were developing their own funding formulae a significant part of the debate surrounding resource allocation concerned local government finance. Any history of funding formulae must, therefore also take account of developments in local government finance as a whole.

Between 1835 and 1888 a number of specific percentage grants were established to cover local authority spending on the Poor Law, policing, and other law and order costs (Drummond 1962). However, as noted earlier, there were two main problems with percentage grants. First, 'percentage grants probably worked against the interest of high need authorities, because authorities with bigger expenditure needs often found it difficult to maintain high levels of spending because of the poverty of their local tax base' (Hale and Travers 1993). Second, these grants often created an overall picture, which grew increasingly complex as more services were financed, transferring power to central government (Metson 1933; Clarke 1939).

So discussion begun in 1887 on replacing the percentage system with assigned revenues from new customs and excise duties. The controversy surrounding the Bill centred on the three different methods that were proposed for determining allocation. The first two were allocation according to rateable values and total population. Both were dismissed as inaccurate measurements of need. The third- the number of paupers in workhouses- was believed to be a far better indicator of need. Yet even this drew criticism for overlooking the outdoor relief provided by some authorities. In the end the Goschen-sponsored Local Government Act of 1888 distributed resources partly on the basis of an authorities spending during the preceding year, and partly on the basis of the relative yields of the earmarked taxes (Foster, Jackman and Perlman 1980; Hale and Travers 1993). The compromise simply prolonged the inequitable distribution that existed before 1888, with the addition of the inadequacy allocation according to historic spending patterns.

By 1929 this system had been eroded by a number of percentage grants that had sprung up to finance new local government services. Both the 1888 system and more especially percentage grants were widely condemned by the number of Government Committees and

Commissions set up to investigate local government finance, as having no relation to need, committing central authorities to open ended spending commitments. The alternative that was finally introduced to Parliament was Chamberlain's block grant. Although this block grant covered less than a fifth of the total amount paid to local government it was the first time a formula incorporating some measurement or proxy of expenditure needs and the local ability to pay had been used to distribute a government grant. In trying to calculate need from the centre it was a radical departure from its predecessors. As this system was refined over the remainder of the century it was to become increasingly complicated. Nevertheless it still managed to confuse many politicians, amongst whom Lady Astor probably showed the most candour when she stated that 'I do not understand one quarter of it, but neither does anyone else. I do not understand electricity, but derive benefit from it'. Her lack of understanding and trust in the bureaucracy that administer such formulae were not unique in the history of funding formulae.

## **Stage 2: Extensive Provision Established through the Public Sector**

In education and health the beginning of stage two is clearly marked by two pieces of legislation- the 1944 Education Act, and the 1946 National Health Act. Both services were nationalised, with access becoming universal. Although pre-war public provision in education and health may have been extensive, and in many ways larger than its private counterpart, these Acts greatly extended the scope of the services at the expense of private provision. Private institutions were marginalised, with public institutions remaining the dominant means provision for the remainder of the century (Burchardt 1997). Public and social housing has never gained such a status, and therefore remains outside the focus of this section. Stage two is a summary of how funding formulae reacted to this 'New Jerusalem'.

Following the 1944 Education and 1946 National Health Service Acts grants slowly developed to incorporate the very different nature of universal provision. Both education and health formulae showed similar post-war patterns of development. Initially funding was allocated according to historic spending patterns with annual incremental increases. Gradually these systems evolved into block grants, which then

became more specific in their targeting and objectives and refined in defining, need.

The entitlement to education was radically altered by the 1944 education Act. Provision, access and quality were nevertheless restrained by the locational infrastructure of school buildings. Almost the entire debate surrounding the Act centred on the issue of religious instruction and Church schools. Getting the churches on board was central to the success of any such Bill. Nevertheless the dark cloud did have a silver lining. To ensure the support of churches Butler conceded a generous percentage grant for new building schemes. A similar agreement was made with local authorities. Comparable percentage grants were used to finance revenue expenditure, which remained independent of the local government block grant up until 1958. Thus from 1944 to 1958 the grant expectation of primary and secondary education was to meet the child population growth and to establish a full pattern of secondary education in England and Wales driven by generous allocation of funds provided out of general taxation.

When, in 1958, education funding was finally incorporated into the grant to local government the fear was that spending on schools would be squeezed by the demands of other services. The anxiety proved ill-founded for three reasons. Firstly, the Department of Education and Science 'had evolved a system of administrative control which enabled it to influence local authority programmes quite apart from any incentives which might be derived from the specific form of education grant' (Rhodes 1976). Secondly, a large amount of current expenditure in education was and is fixed into teachers salaries, whose salary and location was unaffected by the behaviour of individual authorities (Byrne 1974; Lawrence 1972). Between 1956 and 1972 a teacher's quota system was enforced. It sought to limit recruitment in popular areas, and encourage teachers to seek jobs elsewhere in much the same way as the practice administered on behalf of GPs by the MPC. Finally, it has been argued that during periods when the child population is increasing the system of allocating revenue resources is of secondary importance compared to capital allocations (Griffiths 1966). The control exerted by the Ministry over the form and location of capital spending has remained tight throughout the post-war period.

The sum of these processes was that education funding increased rapidly even after its incorporation into the local government grant. The 'general' grant introduced in 1958 was in itself a major step forward in needs equalisation compared to its predecessor. Since 1948 government support for local services had been through a series of specific

percentage grants, supplemented in poor areas with an 'Exchequer equalisation grant', whose aim was to raise the local rate base up to the average level (Hale and Travers 1993). Its 1958 replacement incorporated most of the individual specific grants into one block grant whose formula was broken down into the three components, which were the 'basic share', the 'supplementary share', and a 'rate product deduction'. The basic share was a set amount per person, with a small addition for under-15s. Additional payments were made under the second heading for schoolchildren, under 5s, old people, areas of high density or sparsity, declining population and areas within London. This was an acknowledgement of the greater need that was associated with these groups, though the discussion preceding the Act only went as far as mentioning fairness. In addition the weightings given to each component were the subjective outcome of these talks (Travers 1986; Hale and Travers 1993). The final element of the 1958 grant was a resource equalisation payment called the rate deficiency grant. This was simply a reformed version of Exchequer equalisation grant described above.

In 1967-8 the grant was updated again. The general grant became the Needs Element, and the rate deficiency grant the Resources Element of the new Rate Support Grant, which also included an additional component designed to ensure domestic rates were kept below those of businesses. The Needs Element contained almost the same list of characteristics as the old general grant, with the addition of 'education units'. This was the heading for a sub-formula based on education-related factors that were designed to be more sensitive to needs. Although this added complexity to its calculation, and was the forerunner of the modern grant formulae which amalgamate many service sub-formulae, the RSG was the 'last in the age of (relative) innocence for needs grants, needs equalisation and needs assessment' (Hale and Travers 1993).

Funding for the health service between 1948 and 1962 was based on incremental increases set by the Hospital Management Committees. If a formula did exist it was based on 'what you got last year, plus an allowance for growth, plus an allowance for scandals' (Maynard and Ludbrook 1988). Negligible amounts were spent on capital projects, and allocation was allocated to the noisiest rather than the neediest (Mays and Bevan 1987). By the late 1950s the system was accentuating regional inequalities, and was further criticised for not sustaining adequate levels of funding (Guillebeud 1956).

In response the Government committed themselves to major capital investments as a partial solution to regional inequalities. The investment was to be guided by the 1962 Hospital Plan for England and Wales, which envisaged equalisation through capital planning. In time the more equitable distribution of hospitals would work itself through to current spending through the Revenue Consequence of Capital Schemes (RCCS). Areas with new hospitals would therefore gain more revenue to staff and run them. Following the publication of the Plan capital spending did rise, though from a very low base. Yet the result was not an equitable distribution of resources, due to capital expenditure being used to renovate existing buildings (Klein 1995). A reform to the plan in 1966 did little to alter this situation, and regional inequalities remained the prevalent feature of hospital resources before the 1970s.

### ***Stage 2 reviewed***

Stage two is marked can be defined by attitudes towards legislation. During the early post war years it was believed that abolishing fee payments and creating universal institutions was sufficient to meet the needs of the population. But as the welfare state matured the realisation grew that geographical differences created different levels of need or potential demand for services. Differential availability of service itself posed a second kind of problem – enough doctors, beds, teachers or desks. Once universal primary and secondary education had been achieved, and once access to free universal health care had been (virtually) achieved in the 1950s and 1960s, so political pressure and academic critical interest began to turn to the question of distribution – income distribution in cash benefits and area distribution in services in-kind (Townsend and Bosanquet 1972; Cooper and Culyer 1970; Davies 1968).

These issues began to emerge for debate before the era of austerity began in the mid-1970s but serious attention devoted to geographical allocations rises sharply after the economic crises of that time. Stage 3 begins.

### **Stage 3: Universal Coverage brings a Strain on Resources – funding formulae used to make the hard choices.**

Up to the 1970s the primarily concern of the education sector was the acquisition of enough resources to meet the needs of a rising school population. The comparison with health shows how more resources

made this task far easier than it could have been. When the demographic pressure began to ease during the late 1960s central Government became increasingly preoccupied with standards and restraining spending increases. In order to achieve the latter the government promoted efficiency and encouraged local authorities to make the best use of their stock (school buildings and teachers). Safeguarding standards during a period of resource standstill required the Government to develop an interest in how it could control how money was spent. This objective had distinct results.

Firstly, capital spending was cut. Loan sanctions for building schemes had become one of the main ways in which the Government could control local authority resource allocation after 1957 (Griffith 1966). Local authority bids for capital expenditure had, not only to conform to Government building standards and cost limits, but also to be submitted under one of the Ministry's specific headings of major (school building) work, minor works, special education, teacher training and further education. LEAs had to submit annual proposals, ranking each project according to priority, and establish their need according to pupil numbers and projected figures. In 1974 the DES produced modifications to this system which gave a lump sum allocation under one of three headings (primary and secondary; nursery; special and further education), with the minor works programme abolished. There were three stages before the final loan sanction was made. Once the final sanction had been made the LEA was free to choose which projects it wished to go ahead with. This system gave less freedom than local authorities initially thought, with restricted budgets effectively restraining freedom of choice (Morris 1983; Regan 1977). In 1980 the Local Government Planning and Land Act changed the system once again and replaced loan sanctions with overall expenditure controls. This gave local authorities greater discretion over which areas received resources within their budgets, but placed tight restrictions on how and when LEAs could spend their allocation.

Secondly, the amount of specific grants increased dramatically during the 1970s. This form of resource allocation had declined throughout the 1960s, with such awards as the Schools and Meals Grant being incorporated into the main Rate Support Grant in 1967/8. Although they remained a small proportion of overall spending it did show an intention to direct spending very precisely. Another interesting point about such grants is that they were often allocated by Departments other than the DES, and were used to promote policy objectives with a

broad cross over into other Ministerial areas such as employment or industry (Morris 1983).

Despite the rise of specific grants the majority of education funding remained an integral feature of the local government block grant throughout this period, and allowed a great deal of local authority autonomy over sub-regional allocation. Between 1970 and the mid-1980s the distribution formula for local government changed three times, often resulting in greater central control over how and where resources were used. Annual budget allocations during the 1970s were a process of negotiation between the Local Authority Association and central government. The negotiations were one of the ways in which central authorities could express how much and where they wished resources to be spent. To this end an Education Steering group was formed in 1970 to provide the basis for negotiations by assessing future expenditure. The second way in which central government affected allocation was with the use of the distribution formulae. Under the RSG system more children meant greater education *need* and consequently more resources. Funding according to this need element continued until the introduction of GREs in 1981, which was based on the provision of a common standard of service. This system calculated the national average cost of educating a child, and multiplied this figure with the number of 'clients' within the LEA boundary.

Throughout the 1960s it was becoming increasingly obvious that the distribution of resources within the National Health Service bore little resemblance to the principles which Bevan had proclaimed three decades earlier. Equity of access was not consistent on a nationwide basis, and the allocation of resources was still dependent upon the historic distribution of hospitals. The inverse care law that the NHS was meant to dispel still existed. The limited amounts of capital investment associated with the two Hospital Plans during the 1960s meant little was done to solve these problems. A growing number of academics studied the related issues and a new subject area called health economics became an effective lobby for reform. Recent studies highlight their influence in the development of the formulae during the 1970s (Hurst 1997). Work done by economists at Exeter and later York University was to direct attention to the continuing if not growing inequalities in resource allocation between different regions (Cooper and Culyer 1970). Civil Servants began to take note of these criticisms. Interviews with civil servants who remember this period were clearly strongly influenced by these findings and convinced by the logic. They had internalised the idea that the NHS was about equal access and the facts suggested this

goal was not being achieved. Work began within the Department of Health and Social Security to consider what to do about it. When the Labour party was returned to government in 1974 this problem was readdressed. Brian Abel-Smith, Crossman's influential political advisor became Barbara Castle's adviser. He urged the issue to be taken up again by the new Secretary of State, David Owen, himself a doctor who was deeply committed to doing something about the allocation problem.

There was also growing political concern amidst some government officials and politicians regarding the inequitable distribution of resources. It was believed regions in which Labour had a strong representation were losing out to more affluent areas. Before Labour's election defeat in 1970 Richard Crossman had introduced a formula (used for the first time in 1971) that attempted to redirect resources to those who needed it most. In many respects this formula was a compromise between the Hospital Plans of the 1960s and the allocation formulas of the future. There were stark drawbacks to the Crossman formula. 50% of revenue expenditure was based on population, and 50% on the number beds and cases treated within a Regional Health Board. This meant that although half the formula included some crude but objective measure of need, the other half remained wedded to historic spending.

Finding an appropriate solution to the inverse care problem was finally given to a new Resource Allocation Working Party, whose initial report was published and adopted in 1975. Its conclusion was to create a new formula that assessed health needs according to measurements of population and mortality ratios. Before the details of this formula could be worked out an interim system was implemented based simply on population and caseload calculated at a ratio of 3:1. The full report, published in 1976 based funding on weighted populations that envisaged an equitable allocation of revenue and capital resources between and within regions. Resources were to be based primarily on the calculation of a Standard Mortality Ratio (SMR) which was used a measurement of morbidity, and a proxy for need. A region's need, and therefore allocation, would be calculated on the difference between national and regional SMRs for various areas of healthcare. The system was not without its critics (for summary see Maynard and Ludbrook 1980; Mays and Bevan 1987; Carr-Hill *et al.* 1994), but RAWP was the most significant step undertaken by the health sector towards an equitable distribution of resources based on some measure of need. Over the following decade RAWP did lessen regional differences, and

achieved remarkable regional equality in the distribution of resources in comparison with many other nations.

RAWP has remained central to health allocation formulae with its plain objective that equity should be at the heart of the process setting the standard by which future formulae were to be judged. Equity was interpreted as 'equal opportunity of access to healthcare for people at equal risk' (DoH 1976). It allocated funds on the basis of population, adjusted for variations in the age structure weighted for health needs and costs (Peacock and Smith 1995). Although the content and calculation of these factors has changed over time with the introduction of new formulae, this fundamental method has remained at the core of all subsequent systems. The objective of the formula was to ensure that sufficient sums of money were made available to purchase equal access given the assumption that all RHAs and districts spent their money with equal efficiency. Obviously there were managerial and administrative efficiency issues that affected the effectiveness of this objective, but these are separate problems which the formula dealt with only indirectly.

RAWP was the first time that geographical equity had been firmly implanted as a core objective of the NHS, although it was viewed as being totally consistent with the statements made in 1946 that stressed the removal of barriers to access. Nevertheless, the new formula was a major departure from all the funding systems that had gone before, and was an acknowledgement of the failure of previous systems to achieve similar objectives. The formula proposed by RAWP made no allowance for historic spending patterns and potentially meant significant shifts away from over-resourced areas like London and the southeast. Given this it is surprising how little opposition the report and the Government faced from regional offices. There may be several reasons for this. Equity, and the notion of a national service consists of deeply held public values when it comes to the NHS, moreover officials administering the bureaucracy do what they are told. Unlike local authorities, local health authorities are not political bodies regional offices may be sufficiently removed from those that the formula adversely affected. In addition, for central bureaucrats this was a new and interesting technical job to do. This implies that trouble would come from the districts or even individual hospitals, a theory partly borne out in the example of London. The capital could see the potential drain of resources away from the city in favour of other regions and lobbied heavily for some compensating allowance. In response the Labour government commissioned the Advisory Group on Resource Allocation (AGRA) to investigate the issue during 1979, and the main

recommendations of the report, published the following year, were adopted by the new Conservatives administration (DHSS 1980). Its main recommendation was to introduce a Market Forces Factor (MFF) element into the formula in acknowledgement of the higher costs faced by authorities in London and the southeast. Despite justified arguments and reliable reasoning both beneficiaries and others complained. To the London-lobby it was not enough, whilst for others it was too much.

Another reason for the lack of fundamental opposition is that the formula has always been applied with due regard to the ability of the NHS to deal with change. In other words it has been applied very gradually. Reading the RAWP report the impression was that the move towards an equitable distribution of resources would be achieved very quickly as targets for change were set. In practice the formula was implemented gradually and movement towards a target allocation was achieved through differing 'growth rates'. Those 'below target' gained resources, whilst those above target stood still. Health service budgets have always been seen as a very political issue, and cutting regional budgets would not be desirable. The extent to which the formula has been applied has been judged very carefully with due regard to its effects on individual RHA or HA budgets. The pace of change, therefore, has enabled successive Ministers to take political decisions whose results, in hindsight, may seem very strange. Unlike the position faced by colleagues in other departments the discussion regarding the HCHS formula is not about next year's allocation, but rather a target that is desirable for some time in the future.

Although the share of local authority housing as a proportion of the entire housing stock did not reach its peak until 1978 (Hills 1991), the sea change in attitudes and policy had occurred some years before. By the mid-1980s the proportion of homes owned by local authorities had declined sharply, and their role as the primary developers of social housing was being eroded by housing associations. Both the cause and effect of this shift were changes to the way in which social housing was financed.

In terms of capital expenditure a number of ad hoc controls were introduced between 1974 and 1976 governing local authority improvement work, mortgage lending, local authority house building, and private sector improvement. The Housing Act 1974 replaced the individual scrutiny of each local authority improvement scheme with an overall capital allocation (DOE 160/74). These 'section 105' allocations were determined in a two stage process. First, a study group on programmes of social ownership and renovation of council dwellings

was set up to determine the criteria of distribution to the regions, then, secondly the DoE's regional offices made the final allocations to individual authorities. Within this process priority was to be given to areas of housing stress (DOE 33/76). Mortgage lending became subject to similar controls midway through 1975/6, and the following year authorities were given a quota of 85% of their 1974/5 spending (DOE 80/76). Another major step was taken in July 1976 when it was decided to put a limit on the number of tenders that could be accepted by local authorities after the 23<sup>rd</sup> of the same month (Harrison and Webber 1977). Areas of housing stress would have first priority in determining the levels of house building, and in 1976/7 these areas managed to maintain their levels of activity, whilst the activity of non- stress areas was cut by a third (DOE 80/76; Harrison and Webber 1977).

These changes had been largely inspired by a desire to exercise a closer control over capital expenditure for macro-economic purposes. They did not aid local authority planning and priority setting in housing and the authorities pressed for a more comprehensive approach to housing problems. The Labour Government's review of housing policy recognised the need to develop this aspect, and in 1976 introduced the Housing Investment Programme (HIP). Within this scheme local authorities were to develop housing strategies taking into account both the public and the private sectors. The basis of the strategy would be a four-year capital expenditure plan approved by the DOE. The HIP procedure would thus give

greater co-ordination and sensitivity in the assessment and allocation of capital funds to be used for housing purposes so that both central and local government can respond more effectively in the determination of priorities and in directing resources where need is greatest (DOE 63/77).

Again, although the stated aims were needs related and equity driven, the implementation of the system gave the impression that HIPs was more a means of controlling and cutting expenditure than of sensitivity to needs. There is some truth and some falsehood in such a claim.

The HIP submission is a bid for a fixed pot of resources determined in the PESC process, which is then distributed to the regions following a consultation process with local authorities in which they are required to present their strategy statement, a numerical housing appraisal and a formal request for capital. Resources are then allocated to DOE regional offices and then from these bodies down to the local authorities according to three sets of criteria. The first was the

'Concentration of Needs' element. This was a portion of resources earmarked for use in the inner city partnership and programme authorities. Secondly, resources were distributed according to a 'General Needs Index'. This is by far the most important element of the three, and is based on a weighted index of nine measures of housing need. Thirdly, some resources were distributed on a discretionary basis. However, relatively few resources within the pot are left for officials to make such allocations, although there are examples of Regional Offices gaining resources by withholding sums that a pure GNI allocation would assume (Houlihan 1984).

One objective of the HIP was to encourage greater flexibility in planning housing expenditures between the many areas of local authority activity. In making their original bids for expenditure authorities were required to outline their proposals in each of seven categories. Over the course of the following four years after its implementation these seven categories were merged together into one block allocation. However, before this was achieved, the Government could exercise some influence over what form of capital expenditure it wanted local authorities to undertake. Another of the possible intentions behind HIPs that was never realised is forward planning. The desire to create a rolling four-year capital programme has never been achieved due to Treasury opposition. Allocations have been kept to an annual process, in which authorities have seen the overall amount of resources made available drop significantly. The Local Government Planning and Land Act 1980 extended capital expenditure controls in place of borrowing limits on all capital projects. HIPs had been the forerunner of this reform, but now allocations made to one service could be used for another, whilst capital allocation in general could be supplemented by the receipts from the sale of local authority capital stock. Finally, in setting capital allocations for each financial year, restrictions were placed in HIPs on the expenditure that could be carried over from one year to the next. Local authorities were placed under greater pressure to consider the timing of their projects.

Over the same period the housing subsidy system also underwent major reforms. Central to this was the Housing Finance Act 1972, whose central policy was establishing the 'fair rents' in the public sector (DOE 1971). Inequity was perceived within the housing sector given that council tenants enjoyed degrees of subsidisation far above that given to any other sector of the market. Under the legislation council house rents would be raised over a number of years until they achieved comparable rates to the private sector. The poorest council tenants were to be

protected by a national rent rebate scheme, which replaced the previous local ad hoc schemes. In addition a set rate fund contribution (RFC) was made mandatory, and subsidy was only paid on the Housing Revenue Account's (HRA) deficit not met by RFCs and rents. HRAs were also allowed to make a surplus, though if this were to exceed £30 per dwelling the difference was to be transferred to the Secretary of State.

The intention of the Act was to reduce the government's financial commitment to council housing through this subsidy. Indeed in 1972/3 there were savings of £20M in reduced subsidies to HRAs. However, in the short life of the Act's operation the Exchequer's contribution to housing grew. This can largely be attributed to inflation, and the persistence of local authorities to continue to build, repair and renovate their stock. The 50p per week increase in rents were never enough to compensate for the rising costs associated with these activities, and must have been the major contributory factor behind the development of HIPs after 1974. This failure gave added justification to the repeal of the 1972 Act in 1975, to be replaced by the Housing and Rents Subsidies Act of the same year.

This Act restored local authority autonomy over rent levels and contributions from the general rate fund. Amongst the five new subsidies contained within the provisions of the Act it was the 'capital costs' element which was to be the most important new award. Under this subsidy the Government undertook to pay 66% of all loan charges on all approved expenditure. Together with the other four subsidy components (high cost, transitional, cushioning and changeover subsidies) the 1975 Act represented a return to a system, which encouraged construction, and awarded subsidy according to the level of local authority activity. However, this activity incentive was soon counterbalanced by disincentives and control exerted by the capital finance system outlined above, which was introduced in the face of macro-economic constraints. In the light of such developments the 1975 subsidy system seems particularly incongruous. It seems less so however, if it is seen simply as a stop gap whilst the Housing Policy Review was carried out. The final report of this review in 1977 advocated a new subsidy system that was incorporated into a new Housing Bill, whose main provisions were taken up by the Conservatives in 1979, and adopted as 'new' reforms in 1980.

### ***Public sector growth restrained- mixed economy of welfare***

By the 1970s local authority housing accounted for nearly a third of the housing stock, and the proportion continued to rise throughout the

decade. However, the rate of increase had slowed nearly to a stop before a real decline set in during the 1980s. Although this can partly be explained away by the fall in demand for new housing, there were, nonetheless continued state support for new public housing. The difference now was that housing associations were beginning to assume the construction role previously held by local government.

Housing Associations (HA) have a long history which extends back beyond that of local authorities to the charitable trusts of the nineteenth century (Power 1987). Before the First World War they had been the main source of social housing, but the generous subsidies offered to Local Authorities during the inter-war years rarely extended to the Trusts, which meant that they were soon eclipsed as providers of social rented housing. Their growth stagnated until the Housing Act 1961 provided for the financing pilot 'cost rent' and 'co-ownership societies' (Holmans 1987). Although these experiments did not last the test of time the provisions of the 1964 Housing Act proved far more enduring. It established the Housing Corporation, which was awarded a £100 millions loan from the Exchequer that would be awarded to Associations as part of the financial package they needed to build new homes. However, high interest rates and inflation sabotaged most of the provisions contained within these two Acts, and the model housing society envisaged during the 1960s never materialised.

The only way to encourage Associations to build was to devise a subsidy system that negated the influence of interest rates and inflation through the sheer weight of resources offered. The 1972 Housing Association Grant (HAG) was such a system. HAG was a large capital grant awarded to approved schemes upon their completion. The idea was that this initial grant would lower the amount of capital borrowed, avoiding the front loading problem of housing finance, and allowing associations to charge 'fair rents' as set by a Rent Officer (Hills 1991). Indeed rents played a key role in the process, as they were the initial component that determined the size of grant awarded. In simple terms HAG was capital costs minus a residual loan, where the residual loan is calculated so that servicing the debt equalled the income from fair rents minus the amount spent on management and maintenance (M&M) allowances. The grant was designed so that, given these rent levels, standard M&M allowances, and servicing a residual loan, an Association would break even in the first year of a new project's life. Attempts were made to control costs through the Total Indicative Costs (TIC) system that represented average land and building costs for particular types of development. These values varied across the country, mainly in relation

to land prices. As the system attempted to become more sensitive to local variations and project type an increasingly complex matrix of values which were meant to act as a guide to the Grant levels awarded.

One of the potential advantages to Associations was that given the erosion of the real value of their debt in comparison with inflationary price and cost rises significant surpluses could be accumulated. The Labour Government recognised this and moved towards a policy of claiming these surpluses for themselves. However they were unable to legislate before their 1979 election defeat and found instead the Conservative administration implementing the same policy. The result was the Grant Redemption Fund (GRF) introduced in 1980. Although payments under this system never amounted to a significant proportion of total costs or expenditure, it was projected to rise steeply during the 1990s were there to have been no policy change (Hills 1991). Whilst surpluses on new stock were skimmed off, additional assistance was given to debt incurred on pre-1974 stock through the Revenue Deficit Grant.

The HAG system became all the more important in establishing a mixed economy in the social housing sector given the 1980 reform of the local authority housing system. Together with greater controls on capital spending discussed above a new subsidy system was introduced for the Housing Revenue Account. Although the new subsidy was, in essence very simple, it was also very different to that which it replaced (Hills 1987). The idea of using a deficit subsidy was first attempted in 1972, but was not fully implemented until the 1980 Housing Act. The idea was to construct a notional HRA for each authority, based on “reckonable” HRA expenditure, and income. The notional deficit was then deemed to be the subsidy payable on the actual account. Reckonable expenditure included the government subsidising 100 per cent of loan charges on capital spending before 1981, 75 per cent of loan charges on capital spending after 1981, a deduction of 65 per cent of notional loan charges relating to sales, and a reckonable amount spent on M&M. Management and maintenance was calculated from annual incremental increases on the average amount spent per dwelling in each authority during 1980-81. An element of reckonable expenditure therefore remained tied to historic spending patterns. In addition to capital charges and M&M there were also a number of less important items included in the notional accounts. Reckonable income was similarly taken as mostly being notional increases to rent levels across an authority’s housing stock. For most, but not all authorities, there was an initial deficit between notional income and reckonable expenditure, an amount that

became their HRA subsidy. Therefore, the calculation of this new Housing Subsidy consisted of a 'base amount' (equal to the total subsidy paid in the previous year) plus a 'housing cost differential' (representing the increase in total reckonable housing costs the previous year) less the 'local contribution differential' (the amount Government expects local authorities to pay towards housing through raising rent levels or rate fund contributions).

In addition to the HRA subsidy there was also a rent rebate subsidy paid to authorities through the Department of Social Security, and contributions from the general rate fund, which was eligible for subsidy from the local government Block Grant. Both these systems can be seen as an advance in terms of the equitable distribution of resource, yet it was the HRA subsidy that remained the focus of government policy. The advantage of this system to the Government was that calculating subsidy based on a notional HRA allowed it to exert a great deal of control whilst maintaining the impression of local autonomy. In principle subsidies were reduced on the assumption of rising rent levels, and authorities could either mirror these increases, substitute the income with rate fund contributions, or lower spending. In reality cutting the Housing Subsidy from £1,667M to £464M between 1979/80 and 1987/88 was far too large a decrease to be met solely from rate fund contributions, and therefore limited the ability of individual council's to oppose government policies directed through the subsidy system. Even if an authority had wanted to take this course of action contributions from the general fund had become increasingly expensive through penalties associated to their Block Grant, although the Government seemed reluctant to use the powers under the 1980 Housing Act to reduce an authority's Rate Support Grant. However the systems of incentives to increase rents or lower M&M spending was dependent upon authorities receiving a subsidy for doing so. By 1988 the notional HRAs of less than 90 authorities were eligible for subsidy. The HRA subsidy was, as an incentive system, becoming redundant.

Local Government behaviour was largely determined by the Block Grant, whose calculation and allocation formula was reformed in 1980 under the Local Government Act of the same year. The formula that it replaced had been in operation since 1974 and was based on multiple regression analysis. The formula was an attempt to move away from using subjective proxies and weightings for spending needs, and establish a more sophisticated and accurate means of measuring need. Cheap computing made this possible for the first time, and although complicated, regression analysis was believed to be the best way of

relating past expenditure patterns to social and demographic patterns. The Government claimed that it was beyond the means of individual authorities to influence the spending figures used in the formula and, therefore, alters their future allocation. This did not stop small, lower spending authorities from levying such accusations. Subsequent reports on local government finance from the study Team on Expenditure Needs Assessment (STENA) and the Layfield Committee suggested that there was some substance to these claims. Regression analysis used on past expenditure did, beyond the short term, encourage high spending authorities to spend more.

Labour therefore committed themselves to reforming the system, but following the 1979 election result the policy was repackaged and presented as the 'new' Conservative Local Government, Planning and Land Act in 1980. The striking feature of this formula was how closely it resembled an outline advocated by Lord Balfour in a Royal Commission Minority Report written in 1903 (Hale and Travers 1993).

The Act reformed the RSG by combining both need and resource equalisation elements into a single block grant, just as the 1977 Green paper had proposed. The apparent primary objective of this system was to restrain local authority spending. This was achieved by comparing an authority's actual spending with a centrally assessed figure for spending-needs (Grant-Related Expenditure Assessment). Control was exerted by fully compensating for expenditure at or below GREA, and the threat of penalties if spending rose above these levels (Loughlin 1994). Although councils could initially supplement their income and raise spending above their GREA additional legislation in 1982 severely restricted their future ability to raise rates and additional finance independent of central government (Bennet 1982).

Although some of the key aims of the new system were to make needs indicators more directly related to services, more intelligible, and based on common-sense judgement the use of over sixty components simply made the system more complex. Strong justifications could be given for each constituent part, but to local authorities the system in its entirety looked like a sophisticated smoke screen behind which political manoeuvres could take place.

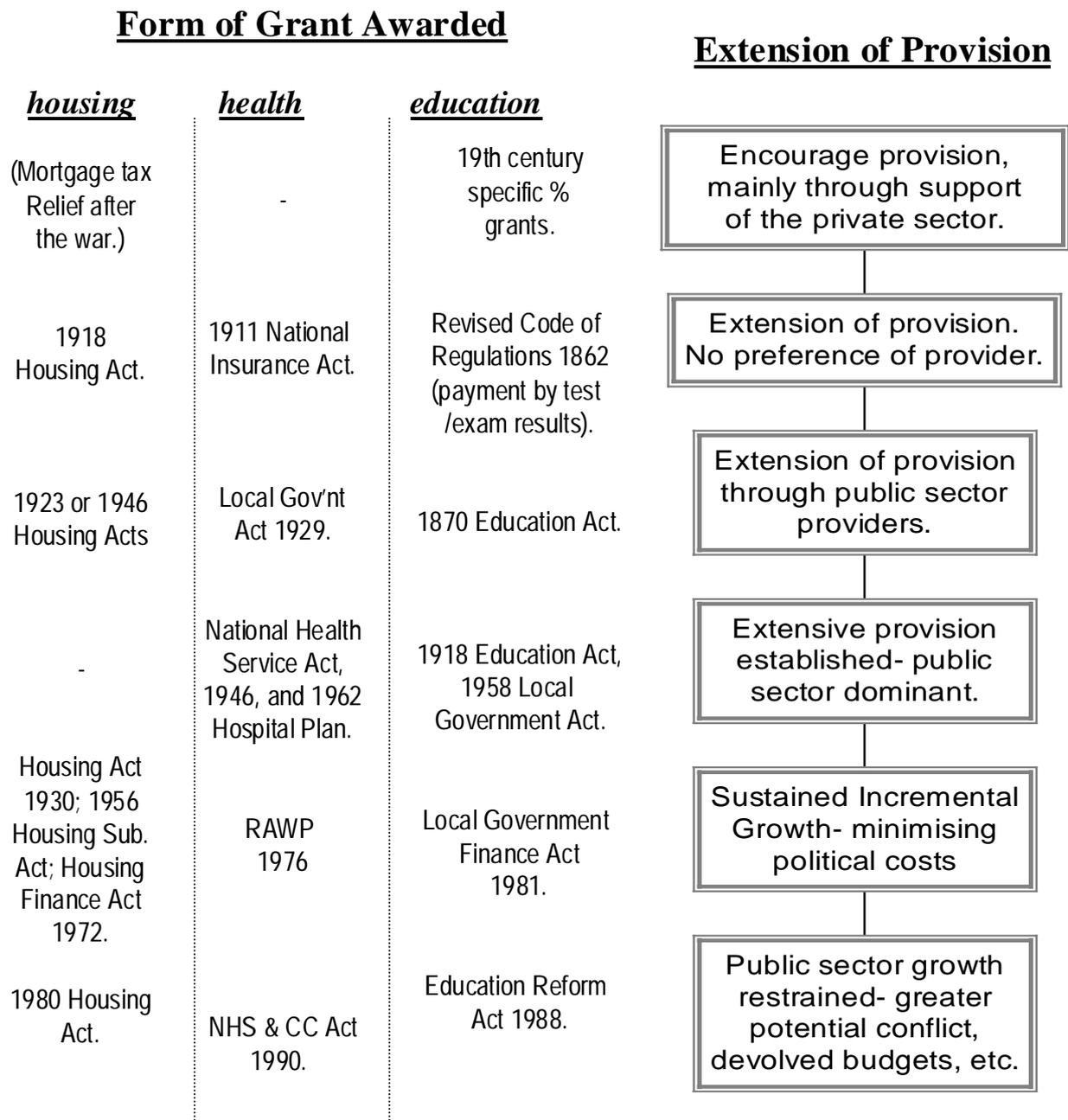
During this period, when a new government was elected and local government and housing finance was radically reformed, relatively little was done to the health system. Major organisational changes had taken place in 1974, and the RAWP formula was implemented two years later. The new resource allocation formula presented such a fundamental shift from its predecessor that many years were to pass before it was felt that

its course had been run. The movement of resources away from areas that were considered over resourced would be gradual and achieved through varied rates in resource growth. Within the formula based on Standard Mortality Ratios only peripheral or supplementary alterations were made. The most important of these was the introduction of the Market Forces Factor in 1980.

***Summary so far – medium term conflict minimisation***

Figure 4 below draws together most major changes to funding formulae in education, health and housing described above and places them within boundaries set by the stage theory postulated at the beginning. Although some reforms fit this model better than others it is still a useful explanatory tool. Broadly speaking the more linear the development path a service has followed the better it fits our stage theory. This is explained more clearly in a pictorial representation below (figure 6a-c).

The stage theory is based upon a model that draws upon public choice theory, and explains behaviour largely in terms of maximising self-interest in the medium term. Reforms may bring short and long-term benefits that extend beyond the pure self-interest of various groups connected with the formulae, yet the hypothesis proposed at the outset suggested that it should be the overriding or even only explanatory factor. Having seen that none of our three case study sectors fit the model perfectly this must suggest that there are other influences on the course of reform; some of the more influential of which are outlined below.



**Figure 4: A summary of funding formulae history**

### **The intellectual genesis driving formulae reform**

A revised public choice model similar to the one proposed earlier would suggest that opportunism and reaction governs the process of developing needs-based formulae. The narrative outlined above seemingly confirms this thesis. However, it simultaneously ignores the

intellectual and moral framework within which politicians, bureaucrats, academics and public devised policy. In short it explains medium term political expediency but fails to understand why individuals were predisposed to choose a certain course of development. Therefore, in order to appreciate the direction in which funding formulae developed we are required to understand the intellectual root and moral traditions from which reform springs.

Following this line of argument establishing equity as the underline principle for allocation systems was not only politically advantageous, but also a moral and intellectual necessity. The framework within which interested parties debated various reforms was defined by criteria that were first clearly defined around the turn of the century, but that had existed in an undefined state for far longer. Broadly speaking this framework consisted of a general perception of 'fairness/equity and efficiency'. Formulae were justified and tested according to these criteria. Few, if any, allocation methods have denied the importance of this framework, and most have warranted their introduction by claiming that these principles were enhanced by further reform. It is a notable feature that just as allocation formulae have developed over time, so too the perception and definition of fairness and efficiency is dynamic. What follows is a brief outline of how academics have sought to establish and tie down what these principles mean, and their subsequent impact on the development of funding formulae.

Predominant amongst those who attempted to define and place on the political and public agenda the need for equity, as a driving force for reform was Sidney Webb. Writing an article in 1897 Webb drew up a theory which he later called, in 1901 'a Policy of National Efficiency', and later the 'National Minimum'. All these writings advocated the moral and economic advantages of ensuring that those with the greatest need for State services should be the ones to benefit most from public expenditure. In 1911 the practical outcome of such an ethical, economic and political stance would mean that,

in the complications of a modern industrial civilisation...a formation and rigid enforcement in all spheres of social activity, of a National Minimum below which the individual, whether he likes it or not, cannot in the interests of the well-being of the whole, ever be allowed to fall. It is this policy of a National Minimum which, in my judgement is going to inspire and guide and explain the statesmanship and politics of the twentieth century (Webb 1911).

In the terminology of the Third Way (as defined in Giddens 1998) this fulfils many of the criteria that symbolise the classic state of 'social democracy'. Nevertheless, many of the implicit assumptions also equate to notions of neoliberalism. For example it is not at all clear whether Webb is advocating a cradle-to-grave or safety net welfare state. Indeed many of his own policy recommendations suggest that he favoured a cradle-to-grave safety net. In much of his work the preoccupation with childhood experiences suggest that his definition of equality is similar to that of opportunity advocated by proponents of the Third Way, rather than the equality outcome proposed by later left wing intellectuals. Indeed other themes that have been associated with this alleged new theory (Giddens 1998: 66) are all common themes in Webb's work, e.g. protection of the vulnerable, rights and responsibilities, etc.

Therefore, whereas some politicians and academics hail these concepts as a new dawn, history suggests that this unique combination of principles prove to be remarkably similar to the tradition of nineteenth century Christian Socialism from which the Webbs gleaned much of their framework (Bryant 1996). If such a concept as the Third Way does indeed exist perhaps we should attribute much more those who truly advanced its core values within British Politics. Work by Owen (Garnett 1972; Owen 1822), Kingsley, and Webb all call out to be revisited.

The elements Webb combined to form his argument, therefore, were neither original nor radical. Concerns regarding the efficiency of 'welfare' provision, State intervention and the individual productive capacity had been voiced by Conservative and Tory reformers during the previous hundred years, and were used to justify measures such as the Poor Law (e.g. Bentham, Senior, etc.). Similarly writing on equality, individual rights and needs had also developed into a sophisticated debate by the end of the nineteenth century (Freedman 1990). What Webb could claim however was a theory which appealed to a broader cross section than that of many other writers. Although future articles were to propose firm policy objectives the principle itself could mean all things to all men. To the newly enfranchised working class it offered the hope of radical reform and State intervention on their behalf; to the middle classes a means of providing the poor with the basic needs deemed, by consensus, to be necessary, whilst doing so in the most effective and efficient means possible; whereas to opponents of State intervention the theory advocated a minimum rather than maximum level of action.

It is easy to underestimate the significance of Webb's writing, especially on those who would seem, superficially, at odds with his

politics. Yet Webb's principles could seem equally at ease in the Party that has ruled for the majority of the century; a Conservative Party which believed in 'top down' rule, and (sometimes very) gradual reform. Balfour, for example, would certainly have been aware of Webb's wide appeal and influence having worked with other Fabians to produce the 1903 Minority Report on Financing Local Government. Other Balfour sponsored reforms like the 1902 Education Act also fit neatly into the Webb theory, despite their undoubted political differences. It would be foolish to attribute too much influence to Webb's work on Balfour, given that the latter had attained his own intellectual maturity before the former views gained pre-eminence. However, together with an eye for political expediency and a tradition of Tory paternalism Balfour would certainly have echoed the Fabian calls for efficiency.

Despite very different opinions on the appropriate scale State activity, Webb's concern with maintaining national efficiency at both corporate and individual level was a guiding force driving many Conservative reformers. Both Baldwin and Macmillan can be viewed in such terms. Macmillan in particular was the first in a new breed of Conservative leaders who accepted, if somewhat grudgingly, the permanency of universal state provision in health and education, as well as a significant commitment in social housing. Little could one imagine many previous party leaders who could state in an election pledge that his aim would be 'to redress the grave and social anomalies that are created by the imbalance between the 'rich' south and 'poor' north' (Macmillan 1962).

It was under his administrations that probably the two most influential modern Conservative intellectual politicians emerged. Iain Macleod and Enoch Powell's work was devoted to moulding the Welfare State into an image more in tune with their Conservative ideology. However the body of work they produced from the Conservative Research Department, Policy Study Group and others was never as radical as proposals from the Institute of Economic Affairs, or individuals like John Jewkes on health reform. In office, even the more right wing Powell introduced a more needs sensitive increase in capital spending on hospitals (*A Hospital Plan for England and Wales* 1962). Part of his inability to implement a more radically right wing series of real term cuts was the popularity of the Health service with the public, and the growing staff costs and pharmaceuticals bill. It was also the same administration that initiated a rapid increase in education as well as vast expenditure on new social housing (Raison 1990).

Nevertheless, Powell still justified his proposals by stressing that given inevitable expenditure the Government should undertake its commitment in the most efficient means possible. From this mutual position, on which both Macleod and Powell could stand, there was divergent Conservative opinions. Whereas Macleod increasingly came to accept the scale and scope of State action Powell never dropped his theoretical opposition. As a result we could suggest that Macleod remained embedded in the consensus politics of which the future Heath Government was a part, whereas Powell provided one of the strands from which the 'conviction politics' of the Thatcher administrations derive (Jones 1994). Equally important to both strands however are the development of needs based formulae that can improve the targeting of public spending.

Prior to the late 1980s most of the century's periods of radical reform have been influenced by Labour politics, in which it is far easier to identify Webb's influence. What many British socialist thinkers gleaned from Webb were egalitarian principles, and a belief that every individual had a right to expect certain needs to be met by themselves, a community network or by the State. Webb's theory was viewed by other socialists as 'an embryo of the welfare state' which

comprised a universal minimum standard of life embracing pensions, unemployment and sickness benefit, the legal regulation of hours of work, and the public provision of health, education, and housing, which would afford protection against sickness and squalor (Shaw 1996).

On an intellectual basis it was the concept of egalit $\ddot{u}$  that these proposals logically assumed which captured the imagination of future left wing academics. The first of these gained prominence within Labour policy circles before the end of Webb's career, and as an influence on Labour's principles R. H. Tawney is without parallel (Shaw 1996). By the 1930s he had already drafted one of Labour's main policy documents, *Labour and the Nation*, and founded the strand of intellectualism within the Party recently referred to as qualitative socialism (Ellison 1994). In his most influential work, *Equality*, Tawney sets out ideology and policy, which draws a great deal from the ethical socialism, which had also influenced Webb. Tawney devoted a whole section of this work to arguing that 'equality of provision is not identity of provision', and to adequately meet people's needs it was important to devote 'equal care to ensuring that they [needs] are met in different ways most appropriate to them' (Tawney 1964; quoted in Ellison 1994).

As well as directly influencing politicians from MacDonald to Gaitskell, Tawney was also defining the debate for the next generation of left wing academics. Leading this generation was Titmuss, who, in adopting the justification for universal services was also concerned with positive discrimination in allocating resources to those most in need. Titmuss' first major work, *Problems of Social Policy* (1950), argued that resources were misdirected to benefit the already secure middle classes, rather than the worst off sections of society who depended upon the State for many of their needs. Many have continued this theme (see Le Grand 1982), but it was Titmuss who first provided this theme as a credible argument in favour of more sensitive, non-historic allocation formulae.

Surrounding Titmuss in the LSE were others who were to take his work further. Amongst these were Brian Abel-Smith and Bleddyn Davies. Both have made considerable contributions to developing needs based allocation systems, with Davies in particular providing one of the defining works in this history. Although referring mainly to social services in *Social Needs and Resources in Local Services* Davies constructed a critique of contemporary resource allocation and set objectives to which reform over the next two decades aspired.

Perhaps Titmuss' most influential student was Peter Townsend. Townsend held a largely Marxist view of policy based on his idea of a 'social plan' that was 'designed to integrate provision across the full range of social services with the intention of making welfare provision the overriding priority of economic policy'. In *Social Services for All?* – much like Titmuss nearly two decades earlier – he called for positive discrimination to combat the historic inequalities within some services, and in order to meet the greater needs of certain sections of society. Townsend's work went on to influence many Labour politicians who, despite their different ideological stance, were persuaded by the need for radical change in the way resources were distributed. In implementing the RAWP proposals in particular recent evidence suggests that David Owen's political conviction was particularly important (Hurst 1997).

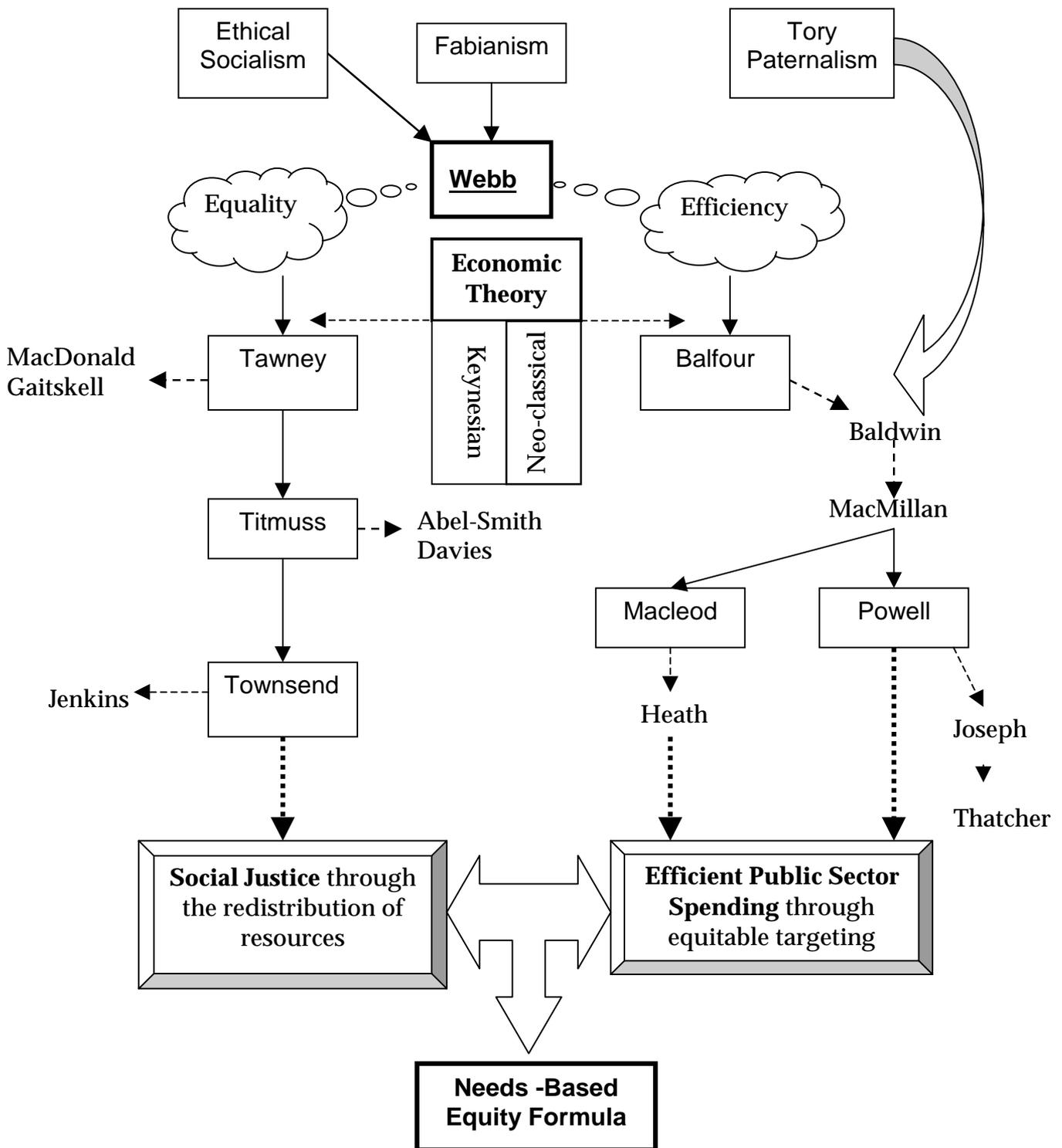
Although figures from Tawney through to Townsend all advocated very different policy proposals all were concerned with issues that could alleviate poverty and create a more equitable, egalitarian society. More importantly all the left wing figures noted above were concerned with how the distribution of public resources perpetuated inequalities that had, despite the creation of universal services free or subsidised at the point of delivery, continued to exist. During the late

1960's publications by Townsend and Abel-Smith (*The Poor and the Poorest*, 1966), and evidence by pressure groups like the Child Poverty Action Group suggested the divide between rich and poor was becoming even more entrenched.

Figure 5 attempts to present a schematic outline of the divergent paths both right and left wing academics and politicians have taken from Webb's original theory of a 'national minimum'. There is no suggestion that Webb's work was original, and many of his proposals echo the ethical and Fabian heritage from which his work drew. Likewise Balfour's contribution to the development of allocation formulae draws on a similar background with the addition of his Tory ideology. With various influences it is easy to see how Webb's writings could begin to mean all things to all men, and how it could provide the genesis for two very different political/ideological schools of thought. Both these groups were sustained by different economic theory that is also represented in the diagram. Whereas Keynesian theory implies greater intervention by the State, classical economics advocates minimal intervention. Of course redistribution of resources becomes far easier to achieve in the former, whilst efficient spending becomes a concern within the framework of the latter.

Those names placed within boxes are the key figures whose work has been outlined above, whilst those outside boxes were politicians influenced by various bodies of work. Little common ground would seem to cover these individuals, yet most can also be found to have supported various funding formulae using equity arguments. How politicians, often standing poles apart could use similar terminology or ideas to advocate their policies is explained in the lower section of figure 5.

Well before the end of any post-war consensus regarding the welfare state the problem of creating a fairer distribution of resources was no longer one of extending provision, but had returned again to the realm of funding formulae. Within academic circles whose sphere of influence included leading politicians there was increasing confidence that current spending often did not correspond to current or future needs. Furthermore needs could be identified and measured so that a fairer method of allocating resources could be found. During a period of resource constraint many on the right also saw this as a better option than systems which seemed to be spreading resources indiscriminately, hoping some would hit the most needy. Identifying and allocating according to need was a means of controlling and making better use of public resources. To both political wings therefore, the academic



**Figure 5: Intellectual influences on funding formulae**

promises of what funding formulae could deliver seemed increasingly attractive. Its appeal was exactly that which had made Webb's theory successful decades earlier. A needs based equity formula could seemingly achieve social justice through the redistribution of resources

and efficient public spending through targeting the most needy. From a common root back in 1898 divergent political stands had, once again found a consensus in funding formulae, though for very different reasons.

This brief history of how academics and politicians have defined equity is of limited value in itself. Although academic work can have direct impact (e.g. health formulae since the 1970s) developments outlined above are of greater importance in representing a wider context within which politicians, bureaucrats, pressure groups and public support or oppose allocation systems. Work during the twentieth century has centred both on designing policy that can be viewed as becoming more equitable, and on explaining more clearly what equity means to various groups at different points in time. Perceptions of what efficiency or equality may mean evolve over time, and equity therefore becomes a dynamic objective. Nevertheless the need to test and defend systems on the basis of equity remains. The public's idea of 'fairness' may change over time; nonetheless they will always demand that funding formulae allocate 'fairly'. Often these definitions and defence have succeeded significant pieces of academic work such as those described above.

## **Themes and trends**

One consistent objective running throughout the development of British funding formulae is the Government's desire to control the behaviour of the institutions that receive resources. This can be realised in one of two ways: formal restrictions or incentives.

Incentives that alter or encourage certain responses are intrinsic to any funding formula. As well as controlling expenditure through formal restrictions formulae have often set more flexible ceilings by encouraging frugality. Examples of this would include the 'classic British housing formula' or capitation payments in education. Both paid a fixed amount per unit, which becomes an incentive for the provider to perform the service as cheaply as possible. On the other hand percentage grants, the Addison housing subsidy, or the local government system introduced in 1974 all encouraged providers to spend as much as possible in order to increase the size of their award.

Spending is not the Government's only concern. Funding formulae have also been used to improve standards and quality of service or to influence the means and form of provision. In education this meant pre-war concern over the content of school curricula, quality of teaching

staff, and exam results. There was real optimism during the nineteenth century that the education funding formula could replace the need for inspectors and maintain good standards and results. Health formulae have proved less ambitious, with politicians feeling less inclined to define their expected outcomes. In contrast housing systems have been built upon the belief that the construction cost and quality of a house can be controlled. Therefore, the Government could allocate subsidies and capital spending approvals on the basis of plans submitted by contractors. Similarly formulae have been used as incentives to build certain types of building, by certain category of builder. The history of housing finance is a story of the discrimination between private and public sector landlords who have been willing to respond to payments or other forms of construction such as the notorious post-war “pre-fabs”. During the same period health funding encouraged the construction of large super hospitals rather than small community institutions.

Historically it is apparent that funding formulae have provided a series of restrictions and incentives that have enabled the Government to exert a degree of control over the behaviour of lower level institutions and individuals. These grant structures are used as classic agency tools in the way Foster *et al* expects. Response to these controls is distilled during periods of budget restraint, as institutions’ senses become keen to the prospect of additional resources. This partly explains the periods of intense reform to funding formulae, especially during the 1970s. Most of the exposition for these reforms must remain the desire to achieve an equitable system, for although control is a highly desirable goal in itself for central agencies it is far too pessimistic a view to hold alone. The overt question behind every investigation or reform of the various systems has been to ask ‘is it fair?’ It must be justified to a wider public on grounds other than efficiency if it is to carry political persuasion. To answer the question of whether the new formula is more equitable than its predecessor goes some way to providing a justification for change. The more tight the allocation the more convincing the criteria of fairness must be.

What the term equity has meant in various sectors and professions at different points in time is not always the same as the definition we hold today. Even contemporary literature does not hold the term constant across or within the services. Most current definitions accept that equity generally means equal access to services to those in equal need. In housing this has generally meant decent affordable housing. In health it has been taken to mean that those with equal need of care (equally ill) should have equal opportunity and access to the same

standard of care. Education has for the past forty years been part of the local government sector where equity is defined as a situation in which a person paying an average amount of council tax should expect a minimum standard of services. All these policy outcomes clearly echo Webb's thesis.

The different sector terminology is a symptom of the distinct evolution of funding formulae within each service. Figure 5a-c is an attempt to summarise these developments in each of the three sectors. The vertical axis represents the relationship between the allocation of resources and need. The higher the value the greater the degree of equity involved in the allocation procedure; alternatively, as the value decreases allocation becomes more random, incremental (i.e. rational conflict minimising but not needs based) and inequitable. Of course there can be no objective quantifiable measure, or an upper limit to this axis, given that equity is itself a subjective concept.

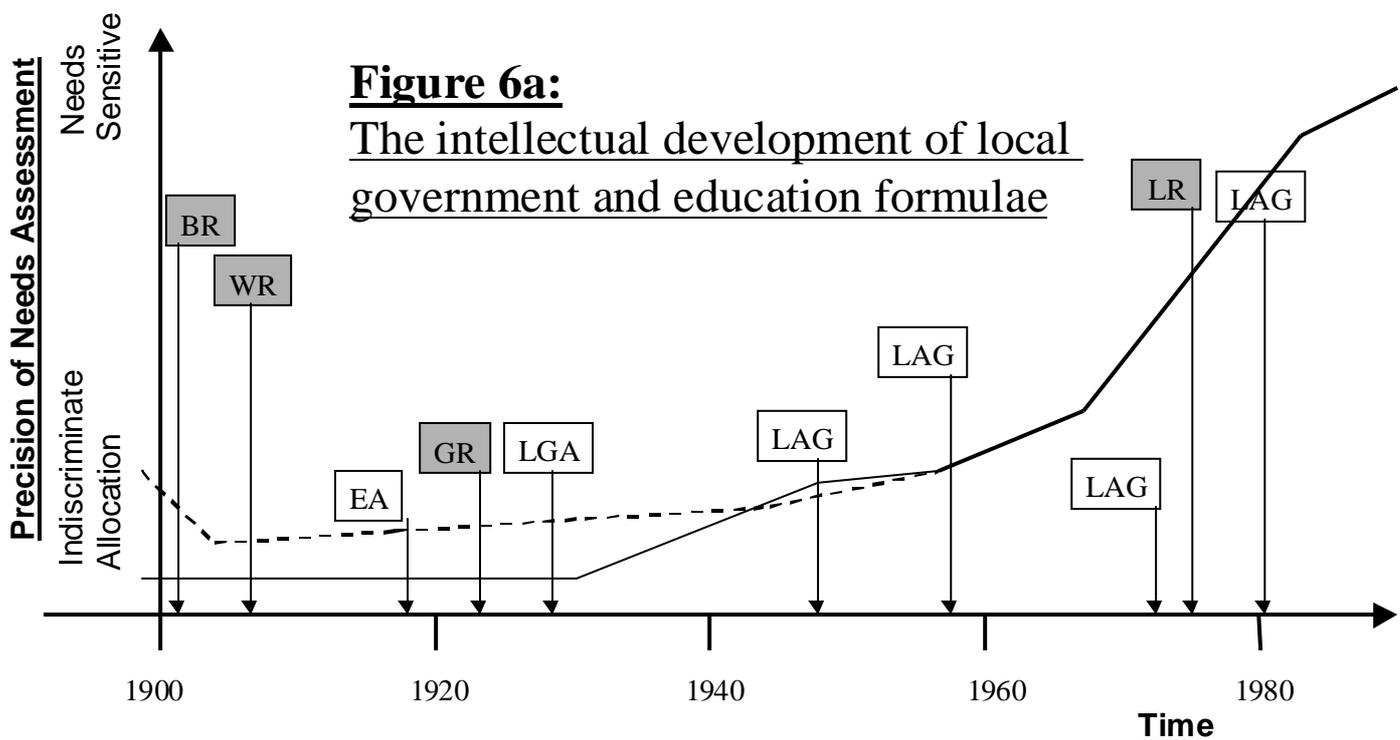
Equity is judged according to its sensitivity in meeting two criteria. The first of these is 'institutional needs'. One of the questions early formula failed to ask was to what extent does the formula take account of geographical differences in costs? Most modern funding formulae acknowledge that costs may be greater in one area than another, and compensates for the different purchasing power of resources. Another aspect of equity for local government, housing and pre-war health is the different ability of various communities to supplement central government resources. Central Government may assume that local institutions can supplement their income from contributions made by the surrounding communities. Given the uneven distribution of wealth some areas find this easier than others, a factor that the formulae must account for. These spending and cost needs represent the needs of the institutions and providers.

The second criteria by which equity is measured can be defined separately as the 'individual's needs'. It seems straightforward to state that there are some people and areas that have greater educational, health or housing needs than others and consequently they require more resources than do those living in a better environment or with better health. It has proven very difficult to find objective variables that can be accurately measured as an indicator or proxy for individual need. Even when suitable variables are found they may soon become outdated in the eyes of an evolving society. It is only when both criteria are fully fulfilled that an equity of allocation is achieved. What is perfectly equitable allocation of resources is an impossible question to answer; though we have noted the features that make some systems more

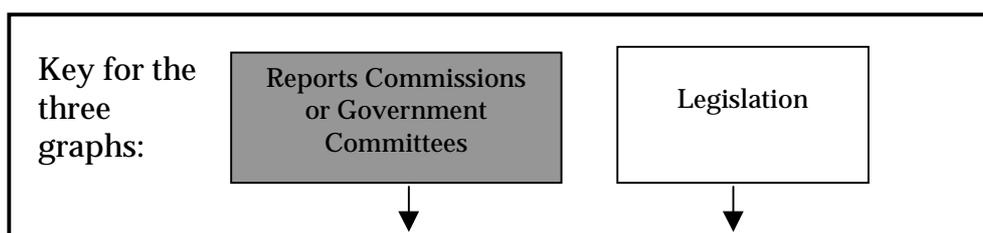
equitable than others. The intention of this exercise, therefore, is to show how certain formulae were more sensitive to need based criteria (both individual and institutional) than others, and how some proposals were well in advance of their contemporaries.

Therefore, the higher the value along the vertical axis the more equitable the distribution of resources. The lines denote the systems in operation across time, with their equity judged according to the criteria outlined above. The position of each piece of legislation or report (marked by the boxes) provides a useful comparison with the actual or preceding systems. By comparing the horizontal and vertical values of each we can subjectively claim that some proposals were well before their time, or that some pieces of legislation enabled a far more equitable distribution of resources than anything that had gone before.

Due to the historical connection between education and local government both formulae (merged into one in 1957) have been included in figure 6a. One of the most striking features of this graph is the foresight of several reports during the first quarter of the century. The Balfour Report (BR) and the Webb Report (WR) were both minority conclusions drawn from Royal Commissions. Although the main reports



**Figure 6a:**  
The intellectual development of local government and education formulae



from both Commissions were far from controversial the both the authors of the alternatives advocated systems that were similar to policies implemented years afterwards. Lord Balfour's proposals in particular resembled the post 1980 methods of allocating resources to local government, by calculating a notional standard expenditure level, and adjusting the grant according to an authorities ability to meet this target (Travers and Hale 1993). Webb's proposals were less advanced than that of Balfour, yet still looked ahead to 1944. Two other reports are noted. Perceived at the time to be a justification behind cutting expenditure the Geddes report did highlight many of the fundamental flaws in the percentage grant system, and advocated a form of grant that was not fully extended to education until the late 1950s. The final non-legislative event recorded was the Layfield Commission, which investigated local government finance during the 1970s. Again this has been included for many of its valid criticisms of the contemporary system rather than implementation of its proposals.

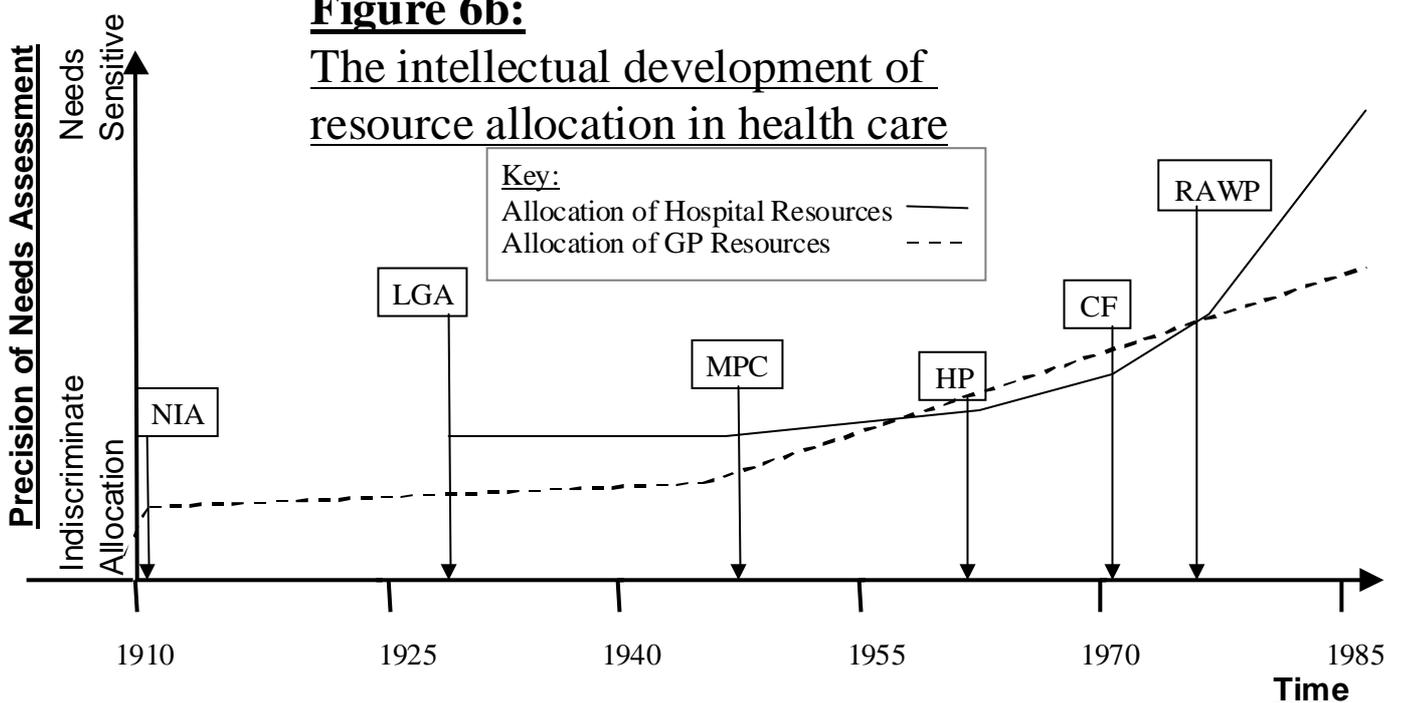
Most of the formulae introduced by Education Acts (EA) or Local Government Acts (LGA) were small advances in the cause of equity on their predecessors. However there are exceptions. The first was the 1929 Local Government Act that saw the introduction of the first block grant. Although only allocating only a small proportion of expenditure its significance in reforming the percentage grant system was a highly significant influence over the development of future systems. Similarly the 1957 formulae was another major advance on its predecessor. It saw the merger of education funding into an improved local government formula. Finally the 1974 formulae is notable, as it is the only recorded piece of local government legislation that remains below the general trend line. The reason is that the system of multiple regression did reward long term high spending through larger grants. Many local authorities realised this and a perverse incentive to increase spending arose due to the assumption within the system that spending patterns identified need. Although the use of multiple regression increased the technical sophistication of the formula little improvement was achieved in terms of distinguishing need.

Health funding has been less susceptible to reform than either education or housing. Prior to 1990 there has only been two pieces of legislation that have radically affected the allocation of resources to General Practitioners – the National Insurance Act of 1911 (NI) and the National Health Service Act of 1946, which established the MPC as guardians of GP distribution. Since then different pay disputes may have altered the method and scale of GP remuneration, but has not

fundamentally altered the distribution of GPs themselves. The first formal based funding system for secondary health was the 1929 Local Government Act, which provided resources to local authority institutions, and former Poor Law infirmaries. Although this system did not extend across the sector it was a far better in determining need than the simple incremental increases adopted after 1946, which simply reinforced historic inequities. The Hospital Plans (HP) of the 1960s were a small improvement on this, as was the Crossman formula (CF) that followed. The real development in the allocation of health resources was the RAWP formula of 1976. In explicitly stating equity as its central objective it was, in method and theory light years ahead of its predecessors.

The significant feature for many years in the allocation of housing subsidies has been the cyclical nature of policy. Local government (LGS) continued to receive the same form of general need subsidy for over fifty years. This was an indiscriminate allocation to almost any authority that wanted to build homes. Slum clearance policies did go some way to redirecting resources to the most needy, though again their success was still linked to an authorities propensity and ability to undertake such schemes. It was not until the late 1960s and early 1970s that government subsidies attempted to negate the effect of historic debt, interest rates and inflation, and the position of the rent rebate system and Housing Association Grant signals the advance in equity these policies represented. Housing subsidies have always had to consider issues of landlord and tenant equity, and although these policies confronted the

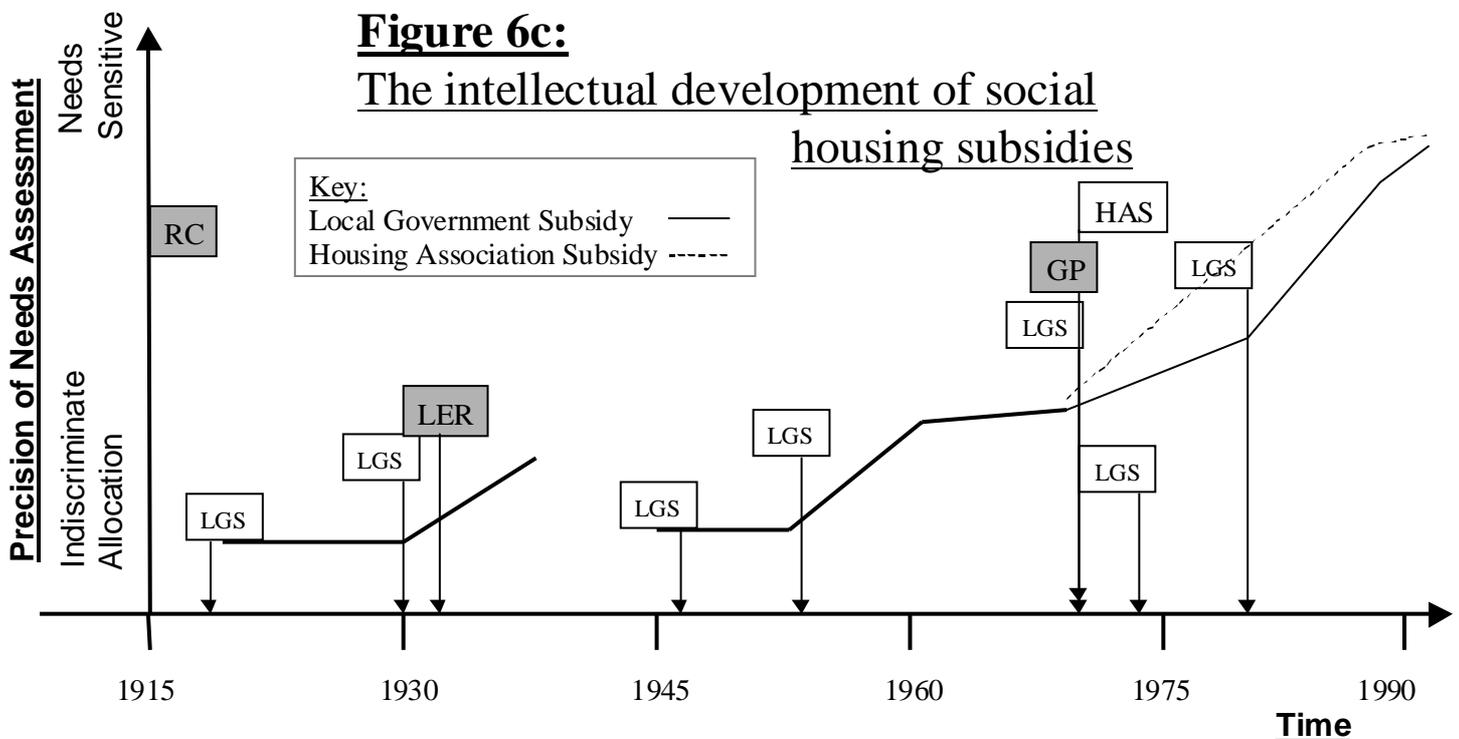
**Figure 6b:**  
The intellectual development of  
resource allocation in health care



latter much still remained to be achieved in the allocation between social landlords.

Although the measurements of equity are, in each case, relative values it is one of the most notable trends from both the historical narrative and figures 6a-c that the discussion regarding equity became far more intense in the years either side of 1970. The gradient of each trend line rises sharply, well beyond that seen previously. The only corresponding period of activity was following the economic slumps of the early and late 1920s. It seems almost paradoxical however to suggest that the 1970s, which saw two Conservative governments, and the rise of the new right should contribute so much to the equity agenda of welfare institutions.

**Figure 6c:**  
The intellectual development of social housing subsidies



### **The development of more equity based allocation formulae during the 1970s and 1980s**

It is clear from the narrative above that during the 1970s far greater pressures were put on resources than ever before. A lid was placed on spending that was kept down through a combination of economic and ideological developments (Glennerster and Hills 1998; Timmins 1995). The effect was an unprecedented drive towards more explicit rationing

through the funding formulae. If rationing was to be fiercer it had to be based on some kind of preferably 'scientific' or at least agreed criteria. This was not a trend unique or new to the 1970s, but a continuation and acceleration of processes that had been at work for decades. Nevertheless it seems paradoxical that the election of successive right wing governments during the 1980's, dedicated to reigning-in spending on the social wage, implemented and administered formulae that were unprecedented in their equity driven redistribution of resources. This question of why Conservative governments should make equity the guiding principle to resource allocation has not been fully answered in previous studies. Why should a government that advocates self-sufficiency, and whose power base remains in the Southeast implement formulaic changes that could see resources being directed towards groups and areas that had weak voices and little political advantage to offer? There are, however, five processes at work during these years that could in combination explain this paradox.

First, was the simple ability to devise, work and administer formulae that were more sensitive to need. This was largely due to the advent of cheap and powerful computing, but also drew on the growing academic interest in funding mechanisms and equitable allocations that derived from the work on poverty in the late 1960s.

The second is the timing of the financial crises, the high point of which occurred under a Labour government. Ideologically and politically Labour had far more invested in supporting socially deprived groups and areas than the post-1979 Conservative governments. According to measurements of need it was the North and the poor who were losing out through formulae based partly or wholly on historic spending. These also happened to be Labour's power-bases. It was in the party's interest, therefore, to advocate more equitable systems of resource allocation. Such alterations then take time to be formulated and then implemented, so that although it was a Labour government who instituted the committees and reports that proposed the relevant changes the consequences of reform were not fully worked out until the accession of the Conservatives to power. To a lesser extent this had also happened under the 1970 to 1974 Conservative government and Peter Walkers' local government reforms which did not work themselves through into resource allocation until the following Labour administration. The first factor behind the paradox of new right and equity, therefore, is procedural and legislative inertia.

A justifiable criticism to this viewpoint would argue that the areas that gained from formulae introduced during the 1970s were not

necessarily poor or Labour. Population was the main driving force in the health formulae, for example. This meant that many Labour inner city areas lost out to the growing Conservative suburbs. Additions were made for high cost areas in the Southeast, and rural areas could also claim that their costs and needs were higher. Thus 'need' turned out to be a politically adaptable concept capable of appealing to Conservatives and Labour voters. The inherent political conflicts between members of the same party, between central and local government, between government and the professions was very effectively side tracked or defaced into technical debates about the weightings derived from various coefficient calculations. These were debates that could be left to committees of experts.

The third factor is a basic shared belief by politicians across the political spectrum that the most needy in society must always be protected. This claim was used to justify reduced but targeted social security benefits in the 1980s (Evans 1998). So, too, could it be used to support tight education, health and housing budgets since the mid-1970s. Politicians were defending their policies by saying "yes budgets are tight, but we are concentrating them on the most needy".

Nor does one have to be entirely cynical about this claim as it proves a perfectly genuine belief in the virtues of equity. Despite the relative and absolute cuts in expenditure this simplistic sense that had permeated throughout British society stated that the poorest sections should not lose out equally to those better off. Rather cuts should be distributed so that the most needy suffer least.

Principles such as this penetrated the bureaucracy who administered and implemented the formulae. The Civil Service was central in the successful implementation of any new method of resource allocation, and their role can be interpreted in one of three ways. Politicians would like to believe that the members of the Service are neutral servants, who are directed by their masters. More likely, they are, at the very least, individuals who hold and are influenced by the societal values around them, whilst at the other extreme they are a self-interested group whose agenda is dominated by the desire to increase their own power. Formulae of increasing complexity were seemingly becoming better at allocating resources according to need, but were also becoming unintelligible to all but those directly involved in creating the systems. Thus "good-guy", and "bad-guy" theories of bureaucratic behaviour, and especially the bureau or regime slapping theories of Dunleavy (1991) are quite consistent with the development of formula funding in a period of fiscal restraint.

The final element, which was at work during this period, was the existence of a relatively small number of large and powerful local authorities. Their voice was too powerful and too loud to ignore, and their historic role in service provision, which extended back to the nineteenth century, had enabled them to build up historic spending levels which the Government found hard to cut without facing a severe battle. The evidence for their success has been illustrated in studies, which have shown inter-regional differences in the UK to be far smaller than that apparent in most, if not all of her developed neighbours and industrial competitors (Bramley 1992). Similarly we could also note the power and influence of the medical profession as a powerful interest group representing the whole country.

### ***Summary***

Figures 6a to 6c are not meant to represent the final distribution of resources in each sector, or more importantly to characterise outcomes in the three services. Rather, it indicates how sensitive to need each system has become; the precision of needs assessment; the ability of each formulae to achieve equalisation of need and resources. The progress charted is relative, both historically within a sector, and between sectors. Despite recent studies that show the formulae do achieve a redistribution of resources towards the poor few of the formulae studied make this an implicit aim. Measurements of deprivation are used as proxies for education, health or housing need, not as objectives in themselves.

In addition the equitable distribution that many of these formulae claim strive can be compromised by a number of further factors. Most obviously many of those systems studied above are 'damped'. This means that a redistribution of resources is weakened by the political necessity to ensure that no area or region suffers an absolute loss. Similarly the use of specific grants within each sector can alter the final allocation picture, just as local elements of local discretion in spending allocated resources may not equate to the patterns envisaged by the formulae. Finally, and most importantly there is no judgement made with regards to a sufficient level of funding. Allocation formulae are only designed to determine relative need and an equitable distribution of a fixed pot. Arguments over whether local services receive a 'fair' amount of funding often become confused with a universal demand for more resources. All three of the services studied are to some degree bottomless pits for additional resources, yet these are totally separate arguments from most of that which concerns the discussion above.

Given these qualifications, and further definition of the measurement of needs assessment it was clear that a great surge of development took place during the 1970s. Together with economic constraints that required a greater efficiency and effectiveness in public expenditure much of this advance can be explained in terms of increasing technical ability. The ability to devise and administer complex formulae was a necessity for the developments that took place, and together with the economic/political influences and the intellectual work that created the framework for this process technical progress was essential in the design of these formulae. It was noted that many of the principles and models for recent formulae had in fact been proposed years earlier, but it had simply been technically impossible to implement. Funding formulae have almost without fail managed to remain beyond the comprehension and understanding of most non-specialists, the clearest example of which are the formulae implemented over the last two decades. Quantitative research, analysis and explanations derived from the advent of cheap computing have accelerated the evolution of systems that have historically pushed the practical implementation of relevant theory and technology as far as possible. Whether this confirms the public choice model of empire building civil servants is ambiguous, and suggests that it should be considered as an explanatory variable on its own.

## **Conclusion**

In short the historic evidence reveals a more complex picture than the simple public choice based model we ventured at the beginning, but it does hold in its essence. During the 1970s a greater academic awareness of the problems, more research and data, as well as an ability to process this data following the advent of cheap powerful computing allowed formulae to become far more refined, sensitive, and complex. More complex need based formula both appealed to some basic normative values that become attached to social service provision, and helped reduce political conflict in a period of resource constraint, and increased the power of the central bureaucracy.

Yet we must also remember that reforms during the 1970s and 1980s drew upon an intellectual heritage that extends back over a century of political and ethical thought. This history has proposed changes that were only practical years later following technical advances

that introduced better data and calculating power. Clearly there are short, medium, and long term influences on the formulae (figure 7).

Furthermore these influences are dynamic over time and can be represented as concentric squares growing or contracting over the period of our study (figure 8). Academic work on equity and needs has largely defined the principled framework in which change takes place. Formulae outside these boundaries would be very unlikely given the lack of moral or academic justification.

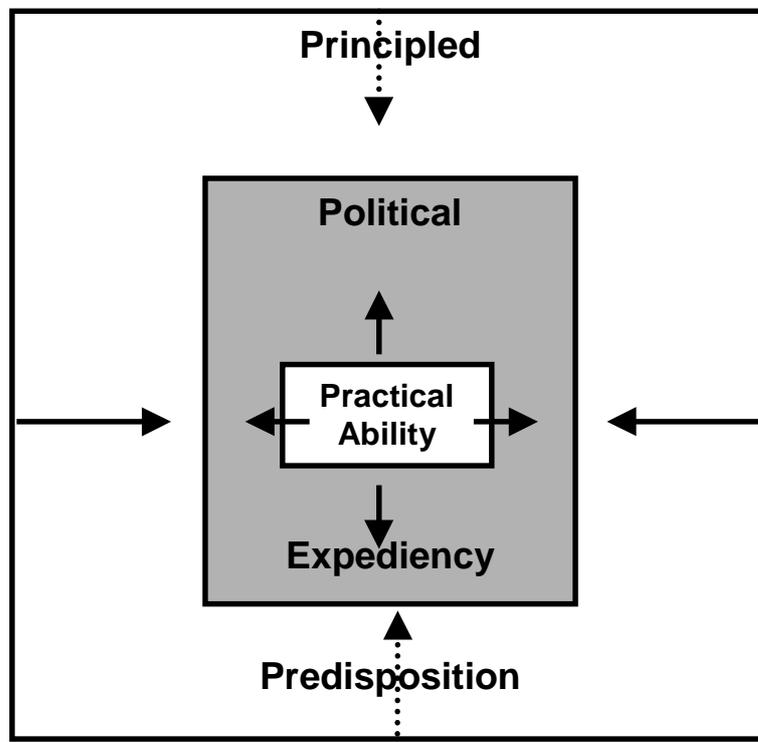
<b>TIME SCALE</b>	<b>EXPLANATORY THEORY</b>	<b>OUTCOME</b>
Long-term	Principled/ moral predisposition	A general societal belief in fairness; generally defined as those in equal need receiving equal resources.
Medium-term	Political expediency explained through public choice theory.	Devolved formulae the objectives of which everybody agrees upon. Minimisation of political conflict.
Short-term	Practical ability	The simple ability to collect enough data and process it in such a way as to make it useful as a tool for assessing measuring and allocating resources according to need.

**Figure 7: Factors that influence the development of funding formulae**

Figure 8 suggests that this area may have contracted over the period of our study as the definition of equity is refined and information regarding need grows. Equity in health resource allocation, for example, was unambiguously defined in the 1976 RAWP report, and subsequent formulae are tested against its standards. Previously the lack of such a definition led to a lack of clarity regarding the meaning of equity, and, more importantly for formulae, how this could be achieved. Although definitions and ideals are less clear in the other two sectors additional research and often greater public awareness that follows place constraints on what various groups accept as a fair allocative formula. This implicitly assumes that more restrictions are placed on new

proposals. Formulae have to prove themselves more equitable and academically more rigorous than their predecessors.

The inner area represents technical ability. This certainly increased over the last hundred years. Only through more information, more research and better computing could the complex formulae of the 1970s and 1980s become practical to administer. As the ability to implement and administer more complex formulae becomes a reality the inner area increases. The historical study suggests that for most of the century progress in this field has been consistent and gradual. Technical developments for example often act as pull factors on allocation systems. New information and knowledge can pull reform along by highlighting the weaknesses of existing formulae or illuminating the possibilities of new methods.



**Figure 8: The dynamics of long, medium and short term influences on funding formulae**

Exceptions to this gradual process have been noted in both the narrative and figure 6, when reforms are accelerated. These periods tend to follow or mirror times of economic crises- most strikingly during the late 1920s and 1970s. The implementation of more complex formulae during these periods certainly had political influences as well, that can be explained through a revised form of public choice theory. This

remains the core explanatory proposition, even though intellectual studies defined the principled disposition of policy makers and public, and technical developments restricted complexity and scope. Devising, implementing and justifying formulae is an intensely political process, and it is a force that runs through this entire history.

Electors, bureaucrats and politicians are all self-interested groups. Agreement on equity as an agenda for resource allocation systems may have appealed to such individuals. Yet many of these players also have motivations or constraints outside their own self interest, and to suggest that all is a political compromise may be an over pessimistic world view, just as an argument proposing equity as the sole objective of funding formulae is too optimistic. Yet the strength of a diluted public choice theory, and the consistency of equity as a theme within the development of allocative systems is undeniable.

Realistic policy choices, therefore, lie along the area where short, medium and long-term factors overlap (as defined in figure 7). Formulae that are described above are always an agreement between various claims and take account of public perception or technical constraints. Systems that have not often run into early difficulty and rarely survive for long. Studying the history of funding formulae these examples are notable by their absence, and the agreement and continuity between formulae within each sector is striking. This would seemingly support the claim of this paper that a model that accounts for and explains historic choices can explain the development of resource allocation systems.

Funding formulae have travelled a long journey over the last century. Different systems have all been steered by clear principles of equity, though additional goals of efficiency, economy and control may also have been introduced over time. The fuel for this development has been provided by research, understanding and greater technical ability, but driving the whole system was the engine of politics. Funding formulae have been used to produce equitable allocations of resources, and yet they have achieved far more. Different sectional interests have often been appeased by reforms to formulae. Conflict between groups both inside and outside the central process is minimised by using the latest statistical techniques and knowledge to create more sensitive needs-related formulae that appear equitable, politically acceptable and academically rigorous. Now, what more could one ask of a formula?

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