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Key Parameters in Policy Design: The Case of Intrinsic Motivation

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Abstract

An important consideration when designing social policy is the expected response of individuals to new taxes and expenditures. Response is predictable when individuals are assumed to optimise instrumentally. However, the extent to which instrumental behaviour can be deemed 'representative' has been questioned. Behavioural experiments reveal that individuals rely more heavily on low-cost signals and heuristics than on an optimising calculus. When costs and benefits are not easy to discern the consequences of action are difficult to estimate and perceptions of the intrinsic value of action assume greater relevance. Such considerations are particularly apposite when social policy affects altruism. In this paper the proposition is that policy signals impact on motivation systematically. Policy can have a greater (or lesser) impact than anticipated by instrumental response to the sum of its parts. Two examples prove illustrative. The first considers institutional reform and the supply of 'merit wants'. The second focuses on recent proposals to nurture the voluntary charitable sector. In both cases, policy expectations based only on instrumental response prove misleading; the impact of policy signals on perceptions of the intrinsic value of action cannot be ignored.

1. Introduction

Rational choice theory facilitates prediction; with preferences taken as 'given' (that is, determined exogenously and constant), predictions can be based on individuals' optimum response to changes in income, price and/or tax (Stigler and Becker, 1977). Yet, while responses can be determined rigorously, empirical studies have increasingly reported behaviour at variance with predictions (for example, Thaler, 1994); the extent to which it is possible to rely only on instrumental rationality has been questioned (for example, Abelson, 1995). Taylor (1996: 225) argues that instrumental behaviour is only strictly relevant 'where the courses of action available to the actor are limited; the costs and benefits attached to the alternative courses of action are . . . well defined . . . [and] . . . much, for the agent, turns on his or her choice'. When such conditions do not apply there is evidence that behaviour is more likely to depend on perceptions of the intrinsic

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value of action, that is on intrinsic motivation. Policy analysts have relied heavily on predicted instrumental responses, even though it has long been recognised that performing an act may be as important as attaining an outcome.[1]

One explanation for this pre-occupation is concern that intrinsic motivation is no more than tautology (that is, no more than stating that individuals choose to act because they enjoy the act). Barry (1970: 33) warned that such discussion leads commentators 'to explain everything merely by re-describing it' (1970: 33). In this context, results from recent behavioural experiments prove very important. Not only do they confirm that behaviour differs from that predicted of 'rational' instrumental individuals, they also reveal that behavioural differences are systematic, not random. They reveal, for example, that individuals are more likely to rely on signals when information costs are significant and when non-market conditions prevail (De Meza and Dickinson, 1984). They indicate that individuals respond to signals that are capable of enhancing, or damaging, perceptions of the inherent value of action (Deci, 1971; Deci and Ryan, 1980, 1985; Frey, 1997a). Information signals acknowledge, or demean, perceptions of intrinsic value and systematic responses are relevant when designing social policy.

The central proposition in this paper is that policy analysis must incorporate consideration of both instrumental and intrinsic motivation. Attention focuses on the relevance of intrinsic motivation when explaining behaviour and when predicting policy impact. Two examples shed insight that has widespread application. The first, considers the motivation of those who supply services in the public sector; the discussion builds on Le Grand's (1997) observation that policy is capable of turning 'knaves' into 'knights' (and vice versa). The second considers recurrent policy proposals to induce voluntary charitable activity by reducing welfare state expenditure. In both cases rational choice theory yields predictions even when individuals are altruists (Frank, 1996); 'rational' altruists maximise their own utility by equating the increase in utility per pound given to 'good causes' with an increase in utility per pound spent on goods and services. However, in both cases there is cause for concern if policy analysis is premised only on instrumental rationality.

While some would argue that preference formation and motivation in the social sciences are the remit of psychology (Olson, 1967), the proposition here is that there is sufficient behavioural evidence to require that this analysis be integral to the design of social policy.

2. Merit wants and motivation

It is difficult to divorce perceptions of policy reform from the political charisma of proponents. When introducing the National Health Service to the UK, Aneurin Bevan asserted: 'No society can legitimately call itself civilised if a sick person is denied medical aid because of a lack of means.' He insisted that: 'Society

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becomes more wholesome, more serene, and spiritually healthier, if it knows that its citizens have at the back of their consciousness the knowledge that not only themselves, but all their fellows have access, when ill, to the best that medical skill can provide' (Foot, 1975: 103). Such rhetoric highlights 'collective responsibility' and 'duty of care'; for some, these attributes appear embedded in welfare state institutions. Robinson (1995: 33) referred to a tradition in the UK, based on 'equality, community and rights of citizenship'; he argued: 'currently the NHS is probably *the* most important embodiment of this tradition' (author's emphasis). It is difficult to imagine that those who supply welfare state services are unaffected by such signals. For example, focussing on the launch of the NHS, specific responsibility was assumed by medical staff; Klein (1995: 248) noted: 'it was the doctor's judgement which would determine who should get what . . . It was the experts who determined the need for health care.'

These considerations inform discussion of the rationale for government intervention. Social policy and public finance analysis readily acknowledges that intervention might take the form of supplying 'merit wants' (Musgrave, 1957). Merit wants are provided when individuals are unable to 'rationally' accumulate and assimilate information. Stiglitz (2000: 86) notes, for example, that: 'Individuals continue to smoke even though it is bad for them, and even though they know it is bad for them. Individuals fail to wear seat belts, even though wearing seat belts increases the chances of survival from an accident, and even though individuals know the benefits of seat belts.' The response is not 'rational'. A merit want case for government intervention is distinct from intervention based on market failure, for example, if government intervention were a response to the externality created by smoking, corrective action might require no more than a tax on cigarettes to make smokers aware of the full costs of their action. Jones and Cullis (2000) distinguish between intervention to correct market failure and intervention to correct individual failure; individual failure occurring when individuals fail to assess services in the same way as would rational *homo economicus*.

A literature review suggests that demand for paternal intervention arises when there is: 'impulsiveness of behaviour'; 'weakness of will'; 'individual response to a lack of full information'; 'preference endogeneity' (Head, 1990). Merit want provision implies altruistic concern and in-kind provision of services (Barr, 1998). Referring to medical care, Bruce (2001: 280) argues that the observation that 'many people believe that health care is a merit good' is 'more compelling' than public good and externality arguments.

In-kind provision has been justified when merit is associated with increased consumption of the service; prohibition has been prescribed when demerit is associated with the activity (for example, the illegal status of marijuana, prohibition of alcohol in the USA in the 1930s). In the case of merit want provision, individual preferences are no longer relevant; the government makes

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decisions paternalistically. Mooney (1979) refers to voters' willingness to delegate responsibility for decisions to those who are assumed to have 'expert' knowledge.

Yet, for all that a rich literature deals with demand, no attention has been paid to supply of merit wants. The expectation is that such wants are supplied in exactly the same manner as other services, for example, in the same way as goods supplied in markets. It is important to note that merit wants are often labour-intensive services (Billis and Glennerster, 1998)[2] and that labour is sentient. Is it really the case that labour is indifferent to the perceived status of goods and services supplied?

Evidence suggests the reverse. Wage differentials depend on perceptions of social responsibility. Frank (1996) reports the results of a questionnaire survey in which occupations were ranked on a social responsibility scale. Of 141 job titles, stock-broker was ranked lowest and teacher ranked highest. Caring professions scored well (for example, emergency medical technician ranked just below teacher and medical-related occupations, such as nurses assistant, were well above average). Frank concluded that, *ceteris paribus*, estimates of compensating wage differentials for social responsibility were particularly high, that is much lower wages were required if a task was deemed to have a high social responsibility rating.[3]

After analysing wage differentials of a cohort of graduates from Cornell University (adjusted for academic profile), Frank also reported that 'a person employed by a private for-profit firm earns a salary more than 13 percent larger than she would if she was employed by government'. This observation is consistent with another literature, in public administration, which similarly presents evidence of 'public sector motivation' (see, for example, Brewer, 1998; Crewson, 1997; Perry, 1996; Dilulio, 1994; Perry and Wise, 1990; Wamsley and Wolf, 1990; Staats, 1988; Kelman, 1987; Fredrickson and Hart, 1985; Rainey, 1982). Such motivation is often explained in terms of the service supplied; Kuttner (1989: 24) notes: 'The logic of service and the logic of profit are largely at odds.'[4]

If perceived status of service is relevant to those who supply labour, how are such perceptions informed? When will individuals attach greater intrinsic value to the supply of merit wants? An individual is said to be 'intrinsically motivated to perform an activity when one receives no apparent reward except the activity itself' (Deci, 1971: 105). Such intrinsic motivation is based on 'internal' moral and ethical considerations (Deci and Ryan, 1980, 1985). However, experiments reveal that perceptions of intrinsic value are also sensitive to 'external' signals. Perceptions of intrinsic motivation depend on the extent to which intrinsic motivation is *acknowledged* (Deci and Ryan, 1980, 1985). Frey (1997a) examined employees' behaviour in labour markets that was at odds with predicted instrumental behaviour; the *form* of remuneration (that is, as a gift, or as payment) itself emitted a signal that either acknowledged or demeaned intrinsic motivation.

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Such studies are relevant when designing social policy; mechanisms by which signals are transmitted can be identified. In the first instance, evidence reveals that 'ethical posturing' emits signals capable of acknowledging intrinsic motivation. Survey evidence indicates that the ethical stance adopted by management is important when explaining workers' sense of job satisfaction. After surveying employees in management information systems, Vitell and Davis (1990) measured the extent to which respondents agreed with the statement 'managers in my company often engage in behaviour that I consider unethical'. The study revealed a negative correlation (significant at the 0.05 level) between responses to this statement and responses to an index of job satisfaction. Ethical posturing was capable of enhancing job satisfaction.

A second mechanism by which signals are transmitted relies on perceptions of institutional structure. Supply of in-kind transfers (with no charge at the point of delivery) emits a different signal to that associated with market provision. Titmuss (1970) questioned economists who advocated a market mechanism to increase supply in blood transfer programmes. Evidence supported Titmuss' proposition that market structures might diminish willingness to donate blood (for example, Ireland and Koch, 1973). More generally, Ware (1990: 191) identified attributes of market structures which heighten instrumental response (as compared with intrinsic motivation); he commented that 'habits, conventions and principles which support aid for others are weakened when cost/benefit calculations of self-interest are even contemplated'. Such observations are by no means unusual (see, for example, Michelman, 1967 and Hirsch, 1976). It follows that changes in 'knightly' motivation are likely to be related to institutional reform (Le Grand, 1997).

But if merit-want-motivation matters, this should be evident in lower costs and/or greater output? International comparisons of medical care provision invariably identify low costs per unit of output achieved by the UK National Health Service. Maynard's (1978) study and subsequent research (for example, Le Grand and Vizard, 1998) provide evidence that, by international comparison, UK expenditure on medical care (as a share of GNP) is lower per unit of output (measured by various health indices). Reviewing such studies, Powell (1997: 183) concluded that the NHS 'is one of the bargain buys of international health care systems'. One explanation (based on pure self-interest) is that lower costs reflect the monopsony position of the NHS (for example, Maynard, 1978). However, if monopsony were the answer, low costs would only be possible at lower output (and lower demand for inputs) than expected in competitive markets. By contrast, merit-want-motivation explains why low costs per unit are experienced even though output exceeds that of a competitive market (Jones and Cullis, 2002).

It is impossible to resist a growing consensus that perceived status of services affects motivation. This is consistent with behavioural experiments that identify the way in which wages and prices are perceived to be 'fair' (Kahneman *et al.*,

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1986). Policy analysis proves inaccurate when such evidence is neglected. However, before turning to a narrower evaluation of policy predictions, it is necessary to demonstrate that issues discussed in this section have broader resonance.[5]

3. 'Rolling back' the welfare state: a stimulus to altruism?

Before focussing on policy design, it is important to emphasise that intrinsic motivation is not specific to the supply of merit wants. It proves relevant when altruism takes other forms. To illustrate, a similar analysis can be presented when altruism takes a different form. In this section, the difficulties of explaining behaviour in terms of instrumental rationality and the importance of policy signals are again obvious; this time when altruism takes the form of private charitable giving. Hard-pressed welfare states face ever-increasing demands; it is little surprise that politicians are attracted to policies offering additional, non-tax, sources of finance. Foster *et al.* (2001) report that British charities provide services valued at £22 billion at a cost of no more than £16 billion (*The Economist*, 30 May 1998). With value-added of 40 per cent, the question is how can this sector be best nurtured. William Hague (when leader of the Conservative Party) launched a 'moral crusade' against high levels of taxation, arguing that lower taxes would enable individuals to act more philanthropically (*The Economist*, 22 July 2000: 36). Similarly, in the USA, George Bush's first presidential address to Congress was on the evils of high taxation, emphasising the way in which taxation repressed civic duty and 'crowded out' charitable voluntary giving (*Independent*, 28 February 2001: 17). There is widespread support for the proposition that reduced welfare state spending, coupled with tax incentives, generates both reason and resource for private charitable donation.

Focussing only on instrumental rationality, individual A is described as an altruist if A derives utility from an increase in the welfare of others (Collard, 1978). Individual A's utility is greater when individual B (a potential beneficiary) is better off (individual B's utility is an argument in A's utility function). If the only consideration is 'outcome', altruism is said to exude 'public good' characteristics (Collard, 1978).[6] Rational (instrumental) altruists are better off if others bear the costs of acting altruistically; in large groups such altruists have the incentive to free ride (Olson, 1965).

The prediction of under-provision of voluntary charitable giving provides a *prima facie* case for welfare state spending. However, the same analysis identifies inherent problems; for, if welfare state spending is increased, voluntary giving will decrease (potential donors will free ride) (for example, Warr, 1982). This does not imply that private giving must be completely eradicated; a rationale for voluntary sector provision still remains, as this sector enjoys a unique comparative advantage (Billis and Glennerster, 1998). Also, other motives (premised on self interest) explain private giving (for example, individuals may give to acquire personal prestige) and such giving is not reduced by increased welfare state

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spending.[7] Moreover, welfare state spending depends on the consent of a majority of voters and altruism by the majority may fall short of that preferred by those who are more 'saintly' (Weisbrod, 1988).

Yet, for all that a voluntary charitable sector survives, crowd-out is unwelcome. Instrumental ('public good') analysis of altruism identifies both a rationale for intervention and a reason to intervene with caution. In this context, it is interesting to note that estimates of crowd-out are not one-for-one, as implied by theoretical, instrumental, 'public good', analysis; crowd-out parameters are far lower (usually 0.1, very rarely as high as 0.6) (Schiff, 1989; Jones and Posnett, 1993 survey empirical work). Self-interested motives for giving (see footnote 7) might explain this evidence, as state provision is not a perfect substitute for private giving. However, it is impossible to dismiss the relevance of intrinsic motivation; behavioural experiments report that individuals give because they derive a 'warm glow' from the *act* of giving (for example, Andreoni, 1988).

If the importance of intrinsic motivation appears a matter of balance, the balance tilts in favour of intrinsic motivation when evidence is more closely considered. Empirical studies sometimes identify crowding-in (not crowding-out) as welfare state spending increases. If increased welfare state spending emits signals that enhance perceptions of the intrinsic value of altruism (as discussed when considering merit-want motivation), the same signals acknowledge the intrinsic value of giving to charity. Intrinsic motivation can explain why crowding-out is less than expected but when it is particularly relevant, it also explains crowding-in.[8]

Khanna *et al.* (1995) examined data for 159 of 178 'top flight' UK charities for the period 1983–90.[9] They reported that at 'the aggregate and disaggregate level we find no evidence of crowding-out' (Khanna *et al.*, 1995: 271) but increased government grants to charities *increased* private giving (that is, crowded-in private altruism). Weisbrod (1988: 105) noted that 'governmental activity and charitable giving could be either substitutes or complements in the sense that an increase in one would cause a decrease (the substitute case) or an increase (the complementarity case) in the other'. Rose-Ackerman (1981) argued that government grants to nonprofits increased private donations; Andreoni (2001: 14) commented: 'citizens who are unsure about the quality of a charity could see a grant as a "stamp of approval"'. Recently, Khanna and Sandler (2000) report further analysis of donations to UK charities throughout 1983–90 to indicate that such approval is an important signal when explaining crowding-in. It follows that citizens may also take their cue from such signals when forming perceptions of the intrinsic worth of charitable activity.

As in Section 2 of this paper, it is not easy to dismiss the relevance of intrinsic motivation (and to explain evidence of charitable giving purely in instrumental terms). Once again, it is necessary to assess the importance of policy signals. Evidence is consistent with the proposition that there is a 'demonstration effect'

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(Jones and Cullis, 2000). Goodin's (1993) review of empirical studies suggested more, that is, via a model of moral 'character building', welfare-state provision might induce altruistic activity.

In the 1980s, the New Right argued that 'rolling back' welfare state spending would stimulate personal giving (Bosanquet, 1983). Attempts to cut welfare spending in the UK were associated with signals that exhorted Victorian values and individual responsibility (Kavanagh, 1990). Such signals highlighted the role of the individual (to some, social responsibility seemed passé). During this period there is evidence that such perceptions informed private giving (Jones *et al.*, 1998). In the same way, psychologists present evidence that perceptions of the role of individual responsibility matter. Empathy depends on the perception that assistance is 'deserved'; that individuals are not feckless (for example, Eisenberg, 1986). Wax (2000) claimed that popularity for Clinton's 1996 welfare reform in the USA depended on these considerations. When taxpayers are persuaded that the poor are poor for reasons beyond individual control (that is, not because they do not want work), the poor are more likely to be deemed 'deserving'.[10] Intrinsic motivation is sensitive to the perception that action is 'deserved'.[11]

Policy signals that affect the intrinsic value of action may sometimes outweigh instrumental rationality. Roy (1998) carried out an econometric study of giving to overseas charity. In line with theories of instrumental rationality (that is, that underpins 'public good' analysis), he expected that private giving would fall the more individuals were aware of official international aid (and aid provided by non-government organisations). The evidence was the opposite; individuals were more likely to give to overseas aid the more they were aware of such activity. He concluded: 'Actors in a theoretical world of complete information may attempt to predict one another's behaviour and exploit it through such responses as free riding. In our uncertain world, the actions of others seem to serve as cues to guide behaviour rather than be regarded as strategies to be counteracted . . . In the absence of perfect information, a standard rational choice account of individual behaviour that ignores social construction of individuals cognitive environment is at best incomplete' (page 412).

4. Implications for policy design

The reviews in Sections 2 and 3 paint a similar picture. Behaviour cannot be explained easily by instrumental rationality alone; policy signals are relevant. Analysts who rely only on predicted instrumental response to tax and expenditure changes are aware that individuals seldom, if ever, possess such full information. Questionnaire surveys describe a dearth of knowledge of different taxes and tax rates (Lewis, 1979 reviews empirical work); responses are to low-cost signals, not well-informed calculus. Indeed, the irony is that instrumental analysis, itself, predicts that individuals will be 'rationally ignorant' of policy detail (Downs, 1957). Individuals are conscious of the costs of information (Stigler, 1961). For

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example, McCaffery (2000) reports that individuals' views of tax changes depend more heavily on newspaper headlines than on close assessment of the impact on personal finances. If instrumental response is gauged by reference to low-cost signals (rather than by finely judged reaction to full information), why ignore the systematic effect of signals on motivation? The objective in this section is to illustrate how both instrumental response and intrinsic motivation can be incorporated in policy analysis. Three case studies are considered; predictions based only on instrumental rationality are compared with those premised on both instrumental and intrinsic motivation.

1. *Quasi-markets*: In the 1980s both proponents and critics of the introduction of quasi-markets focused on instrumental response. Proponents of quasi-markets expected improved resource allocation; market discipline would enhance efficiency (Enthoven, 1985). The same behavioural responses were expected of those who supplied merit wants as might be expected of those supplying goods for market.

In the NHS a purchaser–provider framework was established in which Area Health Authorities and fundholding general practitioners (as providers) demanded services from hospitals competing (as independent trusts) for patients. The purpose of quasi-markets was to deliver greater output for a given NHS budget (Le Grand, 1991; Jones and Cullis, 1996). This might increase transactions costs (for example, writing and monitoring contracts) but proponents expected net cost savings from improved resource allocation.

Empirical appraisal of this policy reform revealed that, while incentives were put in place, for 'markets to work effectively individuals need to be motivated by the furtherance of their own self interests' (Le Grand *et al.*, 1998: 132). Analysis of behaviour in quasi-markets indicated that those who supplied services continued to see themselves as engaged in the provision of public services (Broadbent and Laughlin, 1997; Flynn *et al.*, 1996). Propper and Bartlett (1997) showed that managers responded more acutely to financial incentives than clinicians but, in general, the response to an internal market failed to match expectations based on a market ethos.

Such reforms in the National Health Service were one example of a 'new managerialism' in the 1980s and 1990s (Exworthy and Halford, 1999; Pollit *et al.*, 1998; Clarke *et al.*, 2000). The presumption was that reform would require application in the public sector of managerial skills that were extolled in the private sector. However, as Cutler (1999: 764) noted, these 'major changes in structure and roles' were accompanied by 'a limited realisation of the . . . persistence of professional values and a skin-deep commitment to performance management'.

Assessing the impact of the quasi-market experiment in the National Health Service, Le Grand *et al.* (1998: 129) reported that 'the *most striking conclusion* to arise from this survey of the evidence is *how little overall measurable change*

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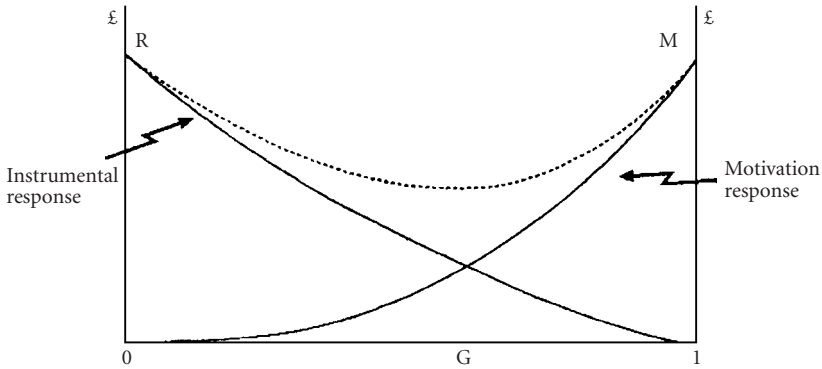


Figure 1. Instrumental and motivation response.

there seems to have been' (our emphasis). Motivation responses might have been slow, but, as will be illustrated, they were not likely to prove consistent with policy expectations. While New Labour's modernisation places greater emphasis on mobilising support from medical and nursing professionals, there is still 'a commitment to extending particular aspects of the New Right's managerialist policies' (Clarke *et al.*, 2000: 18); the impact of such reforms on intrinsic motivation remains relevant.

How realistic were policy predictions regarding the quasi-market experiment likely to be? On the horizontal axis of Figure 1 an index of 'state-market mix' describes institutional status (via a ratio of market activity to total activity within the institution). At point 0 the index is zero and the institution is strictly non-market; at point 1 the index is 1 and the institution is no different to any other market institution (that is, no different to other firms that compete in markets). A rightward movement (towards 1) increases institutional reliance on market incentives (for example, within the NHS, hospitals now compete for patients and/or contract-out services). The introduction of a quasi-market in the NHS implied a rightward shift; but not a shift as far as point 1 (medical care would remain 'free' at the point of delivery). Inefficiency costs (arising from the absence of market incentives) are shown as R1; they diminish as market incentives are introduced (and would be zero if point 1 were reached). Following Enthoven (1985), the introduction of quasi-markets in the NHS (a rightward shift) was expected to reduce inefficiency costs.

Such analysis ignores merit-want-motivation. Reporting on quasi-markets, Keaney and Lorimer (1999: 117) emphasise: ' The downside of these developments has been the effects on staff morale . . . caused by . . . an emergent managerialism.' Morale of nurses was monitored via perceptions of job dissatisfaction; Shields and Ward (2001: 678) commented: 'Nurses have reported widespread demoralisation . . . since the introduction of the "internal market" in the health reforms of 1991.'[12] Concern was expressed that quality of service might be reduced

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if suppliers were preoccupied with monitored targets, for example, Mullen (1993) complained that staff would have no incentive to admit patients to see hospital consultants once they had fulfilled contracts because they would not meet waiting list targets. It was reported that 'the NHS reforms increase the potential for the use of economic studies' (Drummond *et al.*, 1997: 583) and there was implied concern that quality of treatment (which was difficult to monitor) might be ignored. Clarke and Newman (1997: 158) refer to anxiety regarding 'the perceived dominance of the 'business culture' and its effects on the availability of health care through cost calculations dominating 'clinical judgement' in highly publicised cases'. With reference to Section two of the paper, a rightward shift along the horizontal axis in Figure 1 would increase costs, either directly (in terms of wage increases to compensate for increased job dissatisfaction) or indirectly (in terms of intrinsic quality of service supplied at a given wage). These 'motivation costs' (increasing as 'market' rewards assumed greater prominence) are as shown by oM in Figure 1.

When both motivation and instrumental responses are considered it is no surprise that there was 'so little measurable change' (Le Grand *et al.*, 1998). Focussing on a movement from point o towards point G, cost savings are estimated by reference to the slope of the (shallow) dashed curve RM (that is, R1 + oM), not by reference to the (steeper) slope of R1. The reduction in cost is less apparent when both instrumental and motivation responses are considered. (To the right of point G costs increase if market reforms are continually introduced but more will be said of point G later.[13])

The first conclusion at this stage is that quasi-markets will have less impact on costs if merit-want-motivation is relevant. Cost changes are far less than expected when analysis only incorporates instrumental rationality (that is, when only R1 applies). While policy intervention changes the form (or composition) of costs, it has little impact on the magnitude of costs.

2. *Crowding-out*: The proposition is that the analytical format (illustrated by Figure 1) has broad resonance. Consider its application when appraising policy to increase welfare state spending; will this always crowd out voluntary charitable giving?

Once again, in Figure 1 a movement to the right implies greater reliance on 'markets'. At the origin on the right of Figure 1 (that is, point 1) services are financed only by the voluntary charitable sector (that is, there is complete reliance on a 'charity market').[14] A shift to the left, that is, toward point o, records an increase in state spending. As state spending increases, 'rational' altruists reduce donations to voluntary charities, substituting state spending for private giving (that is, free riding). In Figure 1, R1 shows the *loss* of private instrumental giving associated with increased state spending. The rate at which this loss increases (that is, the slope of R1) measures 'crowd out'.

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The objective is again to compare policy expectations when intrinsic motivation also responds to policy design. Empirically based behavioural assumptions, derived from the literature review in Section 3 of the paper, permit predictions. Perceptions of the intrinsic value of altruism rely on signals that intrinsic value is acknowledged and (as in the case of merit-want-motivation) increased reliance on welfare state spending can act as such a signal. Consider the *loss* of private intrinsically motivated giving when state spending is reduced from the left origin in Figure 1 (that is, point 0). The loss of intrinsically motivated giving associated with a reduction of state spending (a movement to the right) is shown as 0M.[15]

It follows that total costs (measured as 'loss to the voluntary charity sector') associated with any level of state spending are shown by the dashed curve RM (= R1 + 0M). At a level of state spending shown by point G this loss to the voluntary sector is at a minimum (i.e. at the lowest point on RM). If state spending were to increase (moving leftwards from point G towards 0): (i) the loss of private instrumentally motivated charitable spending increases as shown by R1; (ii) the loss of private intrinsically motivated giving decreases as shown by 0M. Crowd-out in this analysis is estimated by reference to the slope of RM. However, the slope of RM is lower than that of R1; crowd-out is less than anticipated by analysis of only instrumental response (a result consistent with empirical evidence). Now consider a leftward movement from point 1 towards G, the loss of private voluntary giving *falls* as state spending increases (as shown by the negative slope of RM between 1 and G). This richer analytical framework identifies crowd-in, not crowd-out (an observation that has been reported in empirical studies).

If both instrumental response and intrinsic motivation are relevant there is a need for caution when evaluating policy to 'roll back' welfare state spending as a stimulus to voluntary giving (that is, a rightward movement in Figure 1). If only instrumental analysis were relevant this would be the *only* policy expectation (as shown by R1). However, if altruists are also motivated by perceptions of the intrinsic value of action this is not always so. In the first instance, any expected crowd-in (consequent on cuts in welfare state spending) is likely to be lower than anticipated; second, successive cuts in welfare spending need not always increase voluntary charitable giving.[16]

3. *Anti–tax-evasion policy*: A final example illustrates the resonance of the analytical format (illustrated by Figure 1). Instrumental analysis of 'rational' tax evasion is based on Allingham and Sandmo (1972) where the decision to evade depends on net expected gain. The net expected gain from increased evasion is the difference between anticipated tax savings and the prospect of punishment (where the prospect of punishment is the probability of detection multiplied by the fine if detected). Instrumental analysis may favour increased

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audit because if this increases the probability of detection it is expected to deter evasion.

In this policy application the horizontal axis in Figure 1 measures the probability of detection (between 0 and 1). When more auditors are employed (more queries raised) there is a rightward shift along the horizontal axis. The loss of revenue from evasion is reduced, as shown by R1. However, can instrumental analysis prove sufficient? If Allingham and Sandmo's (1972) model encompassed all considerations, tax evasion would be far greater than reported estimates (Cullis and Jones, 1998).[17] Compliance also reflects individuals' perceptions of the intrinsic value of acting as 'good citizens'; that is, of acting honestly. More than this, empirical studies report that policy signals of increased compulsion (for example, as reflected in increased audit and authority) are capable of demeaning perceptions of the intrinsic value of 'good citizenship' (Frey, 1997a, 1997b). Indeed, such compulsion itself signals 'that others do not, or are not willing to contribute their fair share' (Frey, 1997b: 1049).[18]

If increased compulsion atrophies intrinsic motivation then there is loss of tax revenue (decreased compliance) as a consequence of a rightward shift in Figure 1. In Figure 1 the loss of revenue associated with a 'high handed' audit (that erodes perceptions of the intrinsic value of honesty) is shown as 0M.[19] Once again, the dashed line shows full costs (this time measured as loss of tax revenue). An increase in compulsion, that is, a rightward shift between 0 and G, will not increase revenue by as much as expected in an instrumental analysis; the slope of RM is less than that of R1. It is not surprising also that empirical analyses reveal that, *ceteris paribus*, increased compulsion can *reduce* tax compliance (for example, Frey, 1997b). Individuals reciprocate to trust; in this Journal, Bergman (2002: 301) concludes that 'perceptions of institutional performance are among the most consistent variables that explain commitment to comply'.

Summing up, there is a common theme. Both instrumental response and intrinsic motivation are relevant when designing social policy; empirical evidence informs testable theoretical predictions; policy expectations based only on instrumental analysis prove misleading. The specific examples deal with policy concerned with altruism but the insight applies generally when individuals attach intrinsic value to acting as 'good citizens'. As noted, there is no presumption that perceptions of intrinsic value are apolitical; there is no presumption that they must be identical between cultures or within cultures over time (a social science literature relates social norms and practices to culture, for example, Heath (1976) and Weeden (2002) review this literature). As Blau (1964: 94) states 'social consensus . . . legitimates . . . feelings and reinforces them' and as Grossberg (1997: 255) adds, 'a practice . . . does not exist apart from the forces of the context that constitute it as what it is'. With reference to social policy analysis, dynamics are important (Chamberlayne *et al*., 1999), for 'the view of culture as being constructed, changeable, contradictory and contested . . . gives

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a particular — and important — inflection to what the "social" in social policy means' (Clarke, 1999: 86). While response to policy signals can only be considered in context, the proposition here is that a growing contemporary empirical literature is capable of informing policy analysis. Systematic response to policy signals (based on intrinsic motivation) is as relevant as predicted instrumental response (to policy imposed changes in tax — public expenditure — regulatory constraints).

5. Conclusions

This paper has two main conclusions and, while they are related, each is important in its own right. The first is that, if policy reform impacts on the supply of welfare state services, appraisal will require more than the instrumental analysis usually applied when goods and services are supplied in markets. Attention must be paid to merit-want-motivation and to predicted responses to policy signals. Modern social policy texts recognise demand for merit wants as a rationale for government intervention; merit-want-motivation must be taken into account when analysing supply. Increasingly, behavioural experiments identify systematic response to signals capable of acknowledging the intrinsic value of action. A substantial body of evidence indicates that perceptions of the service supplied and institutional structure in which they are supplied explain compensated wage differentials. There has been increasing recognition of the importance of institutions (for example, Révauger, 2002); Mackintosh (2000a, 2000b) demonstrates that, when quasi-markets were introduced, the form that 'economic' interaction took depended on social construction within institutions. The focus here has been on the impact of policy signals on motivation, that is, on the proposition that appraisal of policy reform requires assessment of the impact of signals on merit-want-motivation.

The second main conclusion is that policy analysis, generally, must be formulated with explicit consideration of both instrumental and intrinsic motivation. The 'economics of social policy' is usually premised on a presumption that analysis of instrumental response is sufficient; analysts discount changes in tastes and preferences (Stigler and Becker, 1977: 78 claim that to include such '*ad hoc* arguments' would merely be to 'disguise analytical failures'). With the growth of an empirical behavioural literature (for example, Thaler, 1994) this situation has changed; it is now possible to formulate testable hypotheses for both instrumental and motivation response. Individuals base decisions on bounded rationality (less than full information) rather than on a fully informed calculus; preferences based on the intrinsic value of action respond systematically to signals. It is predictable that perceptions of the intrinsic value of action assume greater importance in non-market scenarios when the consequences of individual action are less clear (Abelson, 1995).[20] It is predictable that individuals' perception of the intrinsic value of action will respond systematically to signals that intrinsic value has been

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acknowledged (inclusion of merit-want-motivation in analysis of institutional reform is but one example).

Of course, such conclusions raise further issues that have yet to be addressed. Case studies have proved illustrative but similar analysis has yet to be explicitly applied in other policy fields (for example, education).[21] Normative questions are also begged, for example, is there a difference when designing policy to manipulate altruistic preferences than when attempting to nurture altruism by changed tax incentives? Is ethical posturing by politicians so fundamentally different to private company advertisements for marketed goods which 'play' on emotions? Such questions await further deliberation.[22]

The analysis in this paper is commensurate with an emerging orthodoxy that 'deviations from self-interest have a fundamental impact' (Fehr and Fischbaher, 2002: 1) and that altruism cannot be ignored. However, it differs in that it focuses on the distinction between instrumental and intrinsic motivation. The conclusion is not simply that altruism can be relevant, it is that the relevance of altruism relies as much on perceptions of the intrinsic value of action as on instrumental perceptions of an altruistic outcome. The impact of policy signals on perceptions of the intrinsic value of action means that the design of social policy may be greater (or lesser) than the sum of predicted instrumental response.

Notes

1 In 1789 Jeremy Bentham argued that individuals derive satisfaction, not just from goods and services, but also from self-esteem experienced by acting in a specific manner. Reflecting on Bentham's conception of utility, Lowenstein (1999: 315) argues that 'the evolution of the utility concept during our century has been characterised by a progressive stripping away of psychology'.

2 The National Health Service, for example, is the biggest UK employer; two-thirds of its budget is spent on wages and salaries.

3 His results were confirmed in similar questionnaires (for example, Jacobson, 1998). Moreover, they are consistent with evidence of wage differentials elsewhere. For example, lawyers employed by public interest groups (for example, the American Civil Liberties Union) receive far less than lawyers employed by for-profit firms, even though public interest lawyers 'could have had their pick from among the choice entry level jobs in the legal profession' (Frank, 1996; see also Goddeeris, 1988).

4 For an alternative interpretation see Francois (2000).

5 The proposition that individuals' willingness to supply labour differs in different contexts is also familiar in observations made by politicians. For example, Tony Blair acknowledged that people employed in the health service could be earning far more in the private sector (*Financial Times*, 27 January, 1999). Indeed, remuneration adjustment in the NHS has long been premised on the need to 'catch-up' up with that paid in the private sector (Glasser, 1970).

6 A public good is defined as a good that is non-rival in consumption and non-excludable (Buchanan, 1968). It is non-rival in consumption when the availability of the good to one individual is not reduced by consumption of the good by another individual. It is non-excludable when making the good available to one individual means that it cannot be denied to others in the group.

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7 Self-interest inducements to donate (which would explain the continuation of private action) include:

(i) Charitable giving as a *response to fund raising*; donors' objective being to obtain invitations to gala occasions, ownership of lottery tickets, etc. (Olson, 1965).
(ii) Giving to enhance *reputation*; politicians adopt altruistic postures to increase electoral support and prestige.
(iii) Voluntary work effort to acquire 'on-the-job' training experience and/or valuable personal contacts (Knapp *et al.*, 1994 refer to *personal investment* gains).
(iv) Donations by workers to ease social pressure (*coercion*) from employers and supervisors to contribute to philanthropic schemes (Keating, 1981 and Keating *et al.*, 1981).

8 Rational altruists 'regard the government's spending as equivalent to an increase in their total private budget.' (Feldstein, 1980: 106) and if the marginal propensity to give is positive then it is unlikely that there will be full crowding-out. However, the marginal propensity to give would have to be greater than one to explain crowding-in as an instrumental response (see Cullis and Jones, 1983).

9 An empirical analysis based on predictions that emerge from an earlier study by Cullis *et al.* (1984).

10 Bowles and Gintis (1999) describe results of survey work that also support this claim.

11 When examining intrinsic motivation Frey (1997b) noted that individuals care less for others the more they believe that others act cynically; as Elster (1989: 180) notes: 'if people feel that they are taken advantage of, why should they not rip off the system in return?'.

12 Heavy workloads always characterised nursing but more dissatisfaction was now expressed (Seccombe *et al.*, 1994).

13 At this point it is worth noting that point G (the minimum point of RM) depends on the intercepts and slopes of R1 and 0M. In Figure 1 each cost function has been afforded equal importance *a priori*. In practice, this may not be the case and the minimum point of RM (point G) is not necessarily at the intersection of R1 and 0M.

14 See Johnson (1973) for an example of how analysts deal with this sector as a 'market'.

15 The distinction between these losses for any individual donor can also be identified by reference to the economist's familiar 'indifference curve-budget line' analysis (Jones *et al.*, 1998).

16 The first observation arises from a comparison of the slopes of RM and R1 when there is a *rightward* shift from 0 towards G; the second when the rightward shift continues from G towards 1 (and loss of voluntary charitable giving *increases* along RM).

17 Alm *et al.* (1992: 22) state that 'A purely economic analysis of the evasion gamble implies that most individuals would evade if they are rational because it is unlikely that cheaters will be caught and penalised.'

18 Empirical evidence reveals that the perception of avoidance by other persons is important (Klasko, 1992). In experiments, co-operation declines if individuals believe that cooperation by others is lower than they anticipated (for example, Brubaker, 1975; Taylor, 1987).

19 For example, Feld and Frey (2001) compare tax collection in different Swiss cantons. Cantons which place heavier reliance on 'direct democracy' (that is, on referenda) 'show less distrust towards taxpayers that commit mistakes in their declaration of taxable income' (p. 9); taxpayers who do not submit a declaration are treated more respectfully and are not punished as heavily for minor misdemeanours. Frey (1997b) shows that, *ceteris paribus*, the proportion of income declared is higher in 'direct democracy' cantons.

20 See Brennan and Lomasky (1993) for analysis of such behaviour in other non-market scenarios, that is, when explaining participation in political processes.

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21 Reviewing incentive mechanisms for teachers in the USA, Odden and Kelly (1996: 63) note that 'emphasis on professional development . . . is intrinsically motivating'. Kelly (1999) reported that most teachers placed a higher value on intrinsic rewards (see also Kelly and Protsik, 1997).

22 Bowles and Gintis (1999: 10) argue that both experimental and historical evidence sheds enough evidence to enable policy design to 'tap powerful reciprocity motives'. They offer insight into the way in which broader (instrumental and motivation) analysis might be applied to policy to subsidise employment.

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