

January 2011

# Privatization as a Strategy in the United Kingdom, United States, and Beyond,”

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## Recommended Citation

Glenn, Brian J., "Privatization as a Strategy in the United Kingdom, United States, and Beyond,” (2011). *Division II Faculty Publications*. Paper 72.

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# Domestic Policy Discourse in the US and the UK in the 'New World Order'



Domestic Policy Discourse in the US  
and the UK in the 'New World Order'

Edited by

Lori Maguire

**CAMBRIDGE**  
**SCHOLARS**  

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**P U B L I S H I N G**

Domestic Policy Discourse in the US and the UK in the 'New World Order',  
Edited by Lori Maguire

This book first published 2010

Cambridge Scholars Publishing

12 Back Chapman Street, Newcastle upon Tyne, NE6 2XX, UK

British Library Cataloguing in Publication Data  
A catalogue record for this book is available from the British Library

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ISBN (10): 1-4438-2429-1, ISBN (13): 978-1-4438-2429-3

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## CHAPTER SEVEN

# PRIVATISATION AS A STRATEGY IN THE UNITED KINGDOM, THE UNITED STATES AND BEYOND

BRIAN J. GLENN

Conservatives in the United Kingdom and America have adopted a remarkably similar set of strategies towards developing new constituencies in the last two decades, and this is not a coincidence. What follows in this chapter is an intellectual history, not simply of a common policy *goal*, but also of a *strategy*, and one whose movement we will follow from the University of Chicago, to Chile, to Britain, and finally back to America. With the British election of 2010 and the return of the Conservatives to power, this strategy will be as important as it has ever been in Britain, just as American conservatives continue to follow it in America as well.

Free market conservatives believe in small government and low taxes, with decisions being made locally—if government must be involved at all—and thus seek to privatise government services and inject market forces into the creation of policy.<sup>1</sup> In short, privatisation is the foremost *goal* of free market conservatives. Yet many of the programmes most hated by free market conservatives are extremely popular with large portions of society, and conservatives in Britain and America have traditionally found it difficult to see their goals turned into lasting reforms, or reforms at all, for that matter. The long-term solution has been to design policies that make the concept of private provision of services more attractive than public provision for the beneficiaries. In short, conservative intellectuals have had to design methods of making privatisation attractive enough to elicit popular support, and this has resulted in new and important thinking about policy design.

## The Chicago School

The *laissez-faire*, free market ideas that have come to be identified with the “Chicago School of Economics” arrived in the 1930s with the influence of the first wave of scholars such as Frank Knight, Lloyd Mints, Henry Simons, and Jacob Viner. Although they approached the subject from a variety of angles, these individuals were linked by the idea of the free market bringing goods to society that monopolies (especially state monopolies) simply could not offer—along with, of course, the fundamental good of personal freedom of choice.

To understand what has come to be known as the Chicago School of thinking about economics, we can begin with the definition provided by Milton Friedman:

In discussion of economic policy, Chicago stands for belief in the efficacy of the free market as a means of organising resources, for skepticism about government intervention into economic affairs, and for emphasis on the quantity of money as a key factor in producing inflation. In discussions of economic science, “Chicago” stands for an approach that takes seriously the use of economic theory as a tool for analyzing a startlingly wide range of concrete problems, rather than as an abstract mathematical structure of great beauty but little power, for an approach that insists on empirical testing of theoretical generalizations and rejects alike facts without theory and theory without facts.<sup>2</sup>

Friedman’s description is a bit too vague for our purposes, and certainly understates the intensity with which many of these beliefs are held. H. Laurence Miller has placed the same concepts into a more specific framework in describing an acolyte of the Chicago School:

1. A polar position as advocate of an individualistic market economy;
2. The emphasis he puts on the “usefulness and relevance of neo-classical economic theory”;
3. The way in which he equates the actual and the ideal market;
4. The way in which he sees and applies economics in and to every nook and cranny of life;
5. The emphasis that he puts on hypothesis testing as a neglected element in the development of positive economics.<sup>3</sup>

As component number four above makes clear, the market becomes the driving force behind the Chicago School of Economics. The market is something that for proponents can be applied everywhere, in all elements of life—and here is the key point, not simply because the market works

(not all members of the first generation agreed that it did, especially Knight), but rather because the market guaranteed maximum freedom. As Milton Friedman explained,

It prevents one person from interfering with another in respect of most of its activities. The consumer is protected from coercion by the seller because of the presence of other sellers with whom he can deal. The seller is protected from coercion by the consumer because of other consumers to whom he can sell. The employee is protected from coercion by the employer because of other employers for whom he can work, and so on. And the market does this impersonally and without centralized authority.<sup>4</sup>

We should also note the combination of component numbers one and five from Miller's list above. For adherents, being an advocate of market theory was central, and their work was not meant to be purely theoretical, but rather appropriate for application to the real world, and this meant seeing their theories shaped into policy and deployed. Friedman, for example, began to develop policy proposals regarding a wide range of issues such as the "negative income tax, substitution of publicly subsidised private schools for public schools, making participation in social security voluntary, abolishing licensure for doctors, [a] volunteer army in lieu of the draft," and he advocated their enactment.<sup>5</sup> Yet the academics sitting in Chicago found that America's leaders in the 1940s and 1950s were simply not yet receptive enough to their ideas to work them into domestic policy—while at the same time they greatly feared the spread of communism both overseas and in Central and Latin America and were willing to do something about it in terms of domestic policy abroad. Thus began a fascinating experiment to plant the seeds of the Chicago School abroad in Chile.

### **The Chicago School and the Chicago Boys**

In 1939 Franklin Delano Roosevelt's administration reacted to the spreading appeal of communism abroad in part by trying to improve America's relationship with various Latin American countries through the creation of the Institute for Inter-American Affairs (IIAA), which would fund programmes that were mutually beneficial to the U.S. and the recipient country.. In 1953 the International Cooperation Administration created a programme in which American universities would directly train other countries' administrators, and within two years, seventy-eight American universities had entered into relationships with foreign countries.<sup>6</sup> One country in particular that attracted attention was Chile,

which was perceived as having the potential to open its markets and serve as a bulwark against communism if properly supported. This perception led the U.S. government (with additional help from the Ford Foundation) to fund scholarships for Chilean students to study economics at the University of Chicago, with the goal of these individuals returning to their home country to spread the Chicago School of thinking both as professors, business leaders, and policy experts.

Between 1957 and 1970, the University of Chicago welcomed about one hundred carefully selected Chilean students into its graduate programmes in Economics. In the words of Juan Gabriel Valdés, this “deliberate endeavor aimed, quite explicitly, to influence economic views and, potentially, to influence government decisions on the course of the economy.” The department created a special workshop on developmental economics where the students could see how the kinds of theory being taught at Chicago could be applied back at home.<sup>7</sup> Ford Foundation reports repeatedly noted that students were highly limited in the kinds of theory being taught such that the “Chicago approach to development” .... “differs from the typical approach to development programs at other universities and one often encounters rather sanguine reactions about Chicago economics around Latin America.” Another author described the education of the students in terms of “an excellent reputation plus a controversial ideological aroma in Latin America.”<sup>8</sup>

The “Chicago Boys” (as the Chilean students came to be called in non-derogatory terms) quickly assumed authoritative positions in Chile’s business community and in academe. Importantly, they maintained communication networks and were broadly seen as having a distinctive free market approach that was very attractive to many in industry and banking—especially in the late 1960s and early 1970s when the country socialised many of those same firms under the direction of President Salvador Allende.

In 1973, General Augusto Pinochet took power after a successful coup against Allende. In preparation for the coup, the navy requested that a research group create an economic plan for the new government. The plan was written under the direction of the Chicago Boys, who:

introduced into Chilean society ideas that were completely new, concepts entirely absent from the “ideas market” prior to the military coup, equivalent to the exact sciences—as the motor behind the organization of society. The Chicago Boys immediately converted a set of economic objectives into the sole determinant of all that was socially desirable. Economic analysis was subsequently extended to other areas of social activity, including a proposed ideal “modern individual”: competitive and

acquisitive, he was supposed to spawn a culture in tune with his own reproduction and the creation of a “nation of owners.” The Chicago Boys introduced the concept of a minimal state, concerned solely with public order: in other words, a state limited to repressive duties and dealing with extreme poverty. Above all, they introduced into the “public debate” (which during the years of dictatorship became a mere monologue) a self-sustaining economic discourse, whose variables formed part of a theoretical framework that excluded ethical, cultural, political, or social considerations. Indeed, it did not even acknowledge the presence of such considerations.<sup>9</sup>

Price controls (excepts for wages) were almost immediately eliminated, regulation was reduced in many areas to virtually nothing, and public corporations and other entities such as universities and television stations had to finance themselves without governmental support. Perhaps most dramatically, the government reduced its economic role as producer, owner, and employer and focused instead on facilitating growth in the private sector. In 1975, the State Corporation for the Promotion of Production (*Corporación do Formento do la Producción*) sold off 86 percent of its bank stock to private citizens, along with control of over one hundred and ten firms. In the following three years, from 1975 to 1978, the country sold off more than four hundred additional firms. In 1978 alone, the sale of just forty-four firms (which included four large banks) represented a transfer of over \$730 million (US), which is the rough equivalent of about two-thirds of all investment for that year. By the end of the first quarter of 1979, roughly a third of all the land appropriated by the government under Allende had been returned, and an additional 35 percent was distributed to the nation’s peasants by the end of the decade. In 1973, the government had been a major stockholder in nineteen banks. By 1981 it held interest in just two.<sup>10</sup>

More than anything else, perhaps, the privatisation of the country’s social security system has stood out as a shining beacon for how the state can be detached from a policy. Chile had the hemisphere’s oldest social security system, which it had established in 1924. By the late 1970s, the system’s deficit was running equal to 25 percent of the nation’s GDP, and it was clear that a major change to the system was needed. The solution provided by the Chicago Boys was to privatise it, with one analyst seeing their intent being to “switch the burden of retirement to the individual, lessen the government’s financial responsibilities, stimulate the economy, and encourage employment.”<sup>11</sup> The old system had over thirty different categories of retirement funds, each with different benefits, although over 90 percent of citizens were in the three largest, which allowed up to 100

percent of final earnings for salaried government employees and 70 percent for wage earners in the private sector. Employers paid a payroll tax for each worker ranging from 11 to 16 percent of wages. Under the new system, workers had to pay in at least 10 percent of their wages, which were tax deferred, and had the option of making additional payments after income taxes were paid. These contributions would be invested in a range of mutual funds that were privately operated but carefully overseen by regulators. Each worker was also given a bond equal to the value of his or her existing contributions, indexed to inflation. Finally, the government would no longer provide for disability or survivor's benefits, rather, each worker had to purchase insurance to cover these potential costs, equalling about three percent of wages. An additional 7 percent of wages went to covering health care.

"Public opinion at the time was more in favor of standardizing and centralizing the system while maintaining the pay-as-you-go arrangement ....than in changing the system itself," and while the government could simply have implemented the changes, it still felt the need to create a financial arrangement that was initially cost-neutral to both workers and employers.<sup>12</sup> The government also mandated that the employers of any worker who switched to the new system had to grant that worker an 18 percent wage increase, while at the same time the employer's social security contributions would be reduced to zero. It was estimated that this would be cost-neutral to the employers, and actually give a raise to each worker.

The privatisation efforts of the Pinochet government were not fully supported by the citizens, as polls revealed once the government left power, but they remained in a softened form by succeeding governments. The ability of parliamentary governments to privatise or nationalise industries is not in question, rather, the concern for privatisers was how to protect their efforts once the opposition entered office. This was the concern of British privatisers, and their answer was to employ a strategy that would focus on the demand-side.

### **Privatisation Efforts in the United Kingdom**

The British government under Labour Prime Minister Clement Attlee (1945-51) nationalised a significant portion of Britain's heavy industry and utilities, and also created the National Health System. Despite the desires of successive Conservative prime ministers, privatisation proposals could not muster enough support among the population to merit efforts that could simply be overturned by later Labour governments. Starting in

the 1970s, a new generation of conservative intellectuals began asking how a government could design policies in order to make lasting changes, and the conclusion they eventually reached was to make working-class citizens *owners*, so that claims that privatisation served only the needs of the wealthy would ring hollow. Driven by the need to create lasting mass support, many of the privatisation efforts specifically targeted working-class elements of the population.

While British Petroleum was partially sold off in 1974, the big wave of privatisation took place only after Margaret Thatcher's government entered office following the 1979 election. Even in cases where the government did not sell off its holding completely, it always sold off enough to be nothing more than a minority holder, allowing (in theory at least) market forces to drive the company's decisions. In 1979, the process began with ICL (computers), followed by Fairey (aerospace) and Ferranti (electronics) in 1980. 1981 saw British Aerospace, British Sugar Corporation, National Freight Corporation, and Cable and Wireless sold off, with Amersham (chemicals), Britoil, and British Rail Hotels in 1982. British Airways and British Petroleum were privatised in 1983, with British Gas Corporation (oil assets only), Enterprise Oil, Sealink, Immos (microchips), Jaguar, and British Telecom in 1984. These sales totalled around £7.2 billion.<sup>13</sup>

In order to generate support for privatisation among wage-earners, the Conservative government at times adopted the strategy of selling small numbers of shares to low-income households at discount rates and giving extra shares to those who held their shares for a certain number of years. We see this in the sale of Britoil, a company that explored for oil in the North Sea. Preference was given to those seeking to purchase small amounts of shares, and those who held them for at least three years received additional ones at no cost. When the sale was finally tendered, 99 percent of applications came from small investors, with 92 percent of the company's employees seeking to buy in as well.<sup>14</sup>

One problem the Conservative government encountered was that many of the companies it sought to privatise were not making profits and hence were unattractive to potential investors. In order to create consumer demand, the government went to the one set of stakeholders who could turn the companies around—the employees themselves. As we just saw, more than nine out of ten Britoil employees sought to buy into their employer when given the opportunity, and this was the case for National Freight as well. National Freight had suffered from long-standing labour disputes and had been in the red for a number of years prior to the offering, and yet when employees were given the chance, they purchased

82 percent of the company's stock. The company quickly turned a profit, and two years later the value of the stock quadrupled.<sup>15</sup>

For our purposes, the most interesting case is the sale of council housing. In 1979, when Thatcher came into office, approximately 30 percent of all Britons lived in public housing, owned by the local city councils. Council houses were initially rented at cost, but over the decades rent failed to increase with costs, and thus grew heavily subsidised, much to the benefit of those who lived there. Moreover, families only had to meet income eligibility requirements at time of entry into their first residence, with the result that far from being safety nets for the poor, council housing were often enclaves that differed little in income from the larger demographic, and because residents received quality subsidised housing, Conservative politicians who sought to privatise them found a large and vehemently opposed constituency. The solution was to buy out the stakeholders.

In 1979, Britain had approximately seven million public housing units. The Thatcher government wanted all of them sold off, and in councils controlled by Conservatives, many did immediately go on sale. But in councils controlled by Labour, opponents put up a number of roadblocks, leading Parliament to pass a "Right to Buy" law, which not only mandated units be put up for sale to current residents, but also subsidised the purchase price. The plan worked like this: Each tenant or family in a unit was eligible to purchase that unit if they had been residing in it as their principal residence for at least two years. If the purchaser had lived in the unit for at least three years, the sale price would be 67 percent of the assessed value, and the price was dropped by an additional one percent for every additional year the purchasers had been living in council housing—regardless of whether it was in that unit or not—up to a discount of sixty percent off the valued price for someone who had been residing in council housing for thirty years. For those who still could not afford their units, the law allowed them to purchase as low as 50 percent of the unit's equity. They could subsequently purchase additional 12.5 percent increments in following years, while still paying rent to the council for the remaining portions. Finally, the law allowed the poorest a rebate in taxes that higher earners received for mortgage interest rate deductions. Thanks to the support provided by the programme, low-income earners purchased their housing at significantly higher percentages than the national average.<sup>16</sup>

In the first five years of the programme, tenants purchased 500,000 out of the 7 million units, and in 1983, there was evidence that many of the new owners flipped their votes from Labour to Conservative as well. A study in June of 1983 revealed that 49 percent of "working-class" voters

living in council housing voted for Labour in that year's election, while the percentage dropped to 26 percent for those in the same income brackets who owned their homes.<sup>17</sup>

The efforts of the Chicago Boys and of the Conservative governments in Britain were carefully watched by conservative intellectuals in America, especially by Stuart M. Butler, an Englishman who had been on the staff of the Adam Smith Institute before being recruited by the Heritage Foundation in 1979. Butler asked two important questions. First, "Why do government programs in America seem always to grow and never shrink?" Second, "What are the implications for those seeking to downsize government?" His answer appeared in a brilliant, slender book entitled, *Privatizing Federal Spending*.<sup>18</sup>

### **Stuart M. Butler on Privatising Federal Spending**

Butler built his analysis on one simple insight that has long been known but rarely discussed by those seeking to shrink government: policies generate interest groups to support them.<sup>19</sup> Butler called these groups "public spending coalitions," and noted that these coalitions alter the dynamics of politics in ways that facilitate programmatic growth and increased spending.<sup>20</sup> The most obvious reason such coalitions exist is because the benefits their members receive are greater than the expenses the recipients themselves pay out. Since the costs are diffuse and the benefits are specific, there is a great incentive for recipients to work for increased spending, along with perceived rewards for the lawmakers who vote for the increases, while the average taxpayer barely notices the marginal uptick in taxes, and would have a difficult time attributing a decrease (or more likely, a lack of increase) in their taxes to the efforts made to rein in a specific programme.<sup>21</sup>

Butler noted that most attempts to rein in spending focused on denouncing the costs of a given programme, decrying it as being wasteful and inefficient. Attempts to cut spending by appealing to outraged taxpayers are referred to as "supply side" approaches, and are almost always doomed to fail because those who receive the benefits have large incentives to mobilise in order to protect them, rewarding supportive legislators with votes and donations while demonising those seeking cuts as mean spirited. On the other end, the average taxpayer will barely notice a cut in the programme, and hence will not bother to mobilise. To overcome this incentive structure, Butler suggested that those who seek to control spending or even shrink programmes should focus on the "demand side," by which he meant convincing beneficiaries to want their benefits to

be supplied privately instead of from the government. Butler offered a series of strategies to make privatisation a more appealing option. The challenge was to present privatisation of government programmes in a manner that appealed to beneficiaries by offering more services and more choice while making the costs of public provision apparent to those who pay for them. Butler focused on four elements.

First, establish the government as the facilitator, but not as the provider, of goods and services. In the early twenty-first century, of course, we take this for granted, but when he was writing in the mid-1980s, garbage collection was still performed by public employees in most locales on both sides of the Atlantic and the concept of subcontracting out services had yet to be fully discovered.

Second, divert demand into the private sector. This, Butler argued, was the heart and soul of privatisation, since it aligned the interests of stakeholders with those seeking to shrink government. For recipients, it offered the potential of choice of services, while for politicians, it presented the ability to offer more, not less. Third, detach elements of the spending coalitions by applying user fees when possible, “buying out” key elements, and fighting a public relations battle to redefine the issue (which, he noted, might entail subsidising conservative think tanks that could counter the research conducted by service providers). Fourth, create “mirror image” private spending coalitions, for example, by offering contracts to private sector providers who could operate schools, prisons, collect the trash, staff the cafeterias and indeed even the mess tents for military stationed abroad. Finally, Butler suggests starting out small and working incrementally so as to prevent the opposition from frightening key populations with stories about how the whole system will be brought down.<sup>22</sup>

Importantly, Butler noted that not all services can be detached from the government in the same way, and the form of privatisation had to fit the type of programme involved. The purest form of privatisation involves *load shedding*, “where the government transfers the tasks of funding and providing the service into the private sector.” The second method entails *contracting out*, where the government still retains responsibility for setting the standards of service and remains in charge of paying for them, but the services themselves are provided by private sector firms. Finally, there are *vouchers*, “where the government provides consumers with the funds they need to purchase the service in the open market.”<sup>23</sup>

Throughout *Privatizing Federal Spending*, Butler reminded the reader that the key to designing any successful policy is to *align the interests of the stakeholders with those of the policy goals*. Where recipients get more

while paying less, it will be difficult to shrink that policy. By creating user fees and offering carefully designed tax incentives, for example, the same recipients could potentially find private sector alternatives more financially attractive. Likewise, coalitions built up around a public sector policy could be counteracted by coalitions of potential private sector service providers coupled with potential new recipients—or with existing recipients who could be convinced they would be treated better if given the opportunity to choose their providers. Policies, in short, could create constituents.

## **Privatisation as a Strategy in America**

### **Education**

Privatisation emerged as a formal strategy for American conservatives in two domestic policy fields. The first was federal K-12 education policy, the second was Social Security. In both cases, conservatives appear to have come to Butler's "demand-side" strategies reluctantly and indeed perhaps inadvertently after their initial attempts to privatise the system through "supply-side" means failed.

American conservatives have had a troubled relationship with federal education policy for the simple reason that if one believes the federal government has no role to play whatsoever, any policy beyond that will cause one difficulties, leaving either the choice of trying to reduce the policy's reach or standing on the sidelines while others make decisions. Despite President Reagan's campaign promise to eliminate the Department of Education, its budget grew above inflation across his term in office. This left conservatives in the lurch, since if Reagan himself could not stop growth of federal spending on what they considered a local issue, who could? The logical conclusion was that if they could not shrink the government's role as a facilitator in education, they could at least reduce its role as a provider, and the mechanism for doing so was to privatise the system through education vouchers, in which parents could take a portion of the funds allocated by a local school district per child, and use that money to send the child to another school, be it in a suburb where the schools were better, a private school, or even a religious school. Opponents feared vouchers for a number of reasons. They were untested and held the potential to wreak havoc with local school systems if widely adopted, since administrators might not know until quite late what their staffing needs and budgets would look like for the next school year, especially if high percentages of students used vouchers to move out of the

district. In a period where bussing was still widely used and controversial, vouchers kindled fears of racial and economic resegregation if white children fled mixed school systems, and of course the fear of vouchers being used to fund students attending religious schools raised many constitutional concerns. Proponents simply found it too difficult to overcome these fears, and as an assault on government involvement in education, vouchers were a non-starter.

The opening came instead in the form of magnet schools, in which a school focused on a particular subject, such as the performing arts, or computer skills, and opened its doors to students from a range of neighbouring districts. This had the appeal of “choice,” and was linked to attempts to integrate students voluntarily. Moreover, magnet schools avoided concerns about sending students to private religious schools, while at the same time allowing attacks on a public sector “monopoly” of unresponsive neighbourhood schools. Magnet schools hardly constituted an opportunity for broad educational change, but they did facilitate the state of Minnesota moving to allow “charter schools” in which public funds could be used at private (and often non-union) schools. In Minnesota, these schools were seen by both parties as an opportunity to integrate communities while lifting the debate out of the “political and ideological morass” that vouchers threatened. Yet to certain conservative intellectuals, these schools also presented the very opening they needed to push for vouchers.<sup>24</sup>

By the late 1980s, conservatives began to institutionalise efforts at promoting vouchers, not merely by linking them to charter schools, but also through creating think tanks that could provide proponents with the needed information and communication networks. The State Policy Network, for example, was created to arm local proponents with the resources they needed to push for vouchers, and was funded by the Bradley, Castle Rock, Richard and Helen DeVos, and Olin foundations. The bigger move happened in 1993 with the founding of the Center for Educational Reform (CER), also funded with help from the Bradley, Olin, and Scaife foundations. Headed by one of Stuart Butler’s former Heritage Foundation colleagues, Jeanne Allen, CER systematically monitored charter schools across the country and attempted to use that knowledge to help supporters focus their efforts effectively. Foundations also funded a number of others working to promote vouchers and school choice, such as Chester Finn, a well-known pro-voucher advocate (who was granted over a million dollars between 1988 and 2002 by the Olin Foundation), the Institute for Justice, which litigated on behalf of voucher proponents in a number of jurisdictions, and the Program on Education Policy and

Governance at Harvard University, headed by Prof. Paul Peterson, a pro-voucher advocate and researcher.<sup>25</sup>

The first true attempt at vouchers was the Milwaukee Parental Choice Program (MPCP), which began in Milwaukee, Wisconsin in 1990, allowing those who won a lottery for a voucher to use the money to send their child to a school other than the one to which he or she was assigned. What makes the programme so interesting is that it garnered support from a wide range of proponents across the ideological spectrum, from Gov. Tommy Thompson, a privatising governor, to Howard Fuller, a community activist who several years prior proposed dividing Milwaukee into segregated school districts so as to be able to focus on the specific needs of black students, to Annette “Polly” Williams, an African-American Democratic state representative who had twice chaired Jesse Jackson’s presidential campaign in the state.<sup>26</sup> Thompson was a true free marketer who believed that all services that could be privatised should be. Fuller and Williams supported the endeavour out of their frustration with the inability of the school district to raise its students’ academic performance.

The Milwaukee experiment with vouchers was tiny, even by Milwaukee’s standards, with less than one percent of the students having an opportunity to move schools, yet this programme took on a national scope in the attention it garnered. For proponents of school choice, this experiment had the potential to break them if it failed. Thus, the Lynde and Harry Bradley Foundation began funding supplemental vouchers for Milwaukee’s students in order to generate increased participation for a few years until vouchers became accepted. The programme took the name Partners Advancing Values in Education (PAVE), and the grants given were not called “vouchers” but rather “scholarships” so that they were not seen in a provocative light, all the while generating (it was hoped), more support for vouchers among the families that received them. PAVE “was intended as a stopgap measure, offering educational options to low-income families, stabilising enrolment at Milwaukee’s secular schools, and cultivating a political constituency for the voucher programme, while proponents sought to expand the MPCP to include religious schools.” Bradley spent over \$2.7 million on the project between 1986 and 1995.<sup>27</sup>

As mentioned above, one powerful argument against vouchers was that opponents feared they were an attempt to allow middle-class whites to flee mixed schools in favour of ones with students similar to themselves. If vouchers were really a means of resegregating schools both along race and socioeconomic position, arguing in their favour would be difficult indeed. The Milwaukee experiment, therefore, needed to dispel this fear by targeting poor and racial minorities and framing vouchers and PAVE’s

“scholarships” as civil rights measures aimed at helping the city’s neediest students find their way out of failing schools—and this was pretty much what happened. Since both Howard Fuller and Polly Williams came from the very segment of the population vouchers were allegedly intended to help, and also claimed to speak on behalf of that constituency, their support for vouchers blunted opponents’ claims about vouchers being intended to serve middle-class whites.. The framing of vouchers as a civil rights issue was a brilliant tactical move, and indeed, the very first issue of the *Journal of School Choice* presented vouchers as the intellectual offspring of the civil rights movement that has started with *Brown v. Board of Education* just over fifty years earlier.<sup>28</sup>

As Jeff Henig notes, one of the great early contributions of the Milwaukee experiment was simply to make citizens comfortable with vouchers.<sup>29</sup> The Milwaukee experiment allowed school choice proponents elsewhere to employ vouchers as a wedge policy, opening the door to further experimentation, while at the same time attracting new constituencies into their “mirror image” coalitions. Still, the ultimate goal was of course to grow the voucher movement, and this remained stifled if only private schools were available, since they remained expensive—usually far above the price a voucher could purchase. What was needed was the ability to use vouchers to send children to less expensive religious schools.

The test came in 1995 when Republicans took control of both houses of the Wisconsin legislature and the governor’s seat, and passed a law allowing vouchers to be used in religious schools. This truly pushed school choice onto dangerous ground, and when the state’s Supreme Court ruled the law constitutional, this sent ripples across the educational establishment. The law was accompanied by an increase in funding for vouchers, and while the year before the court’s ruling saw just 1,501 Milwaukee students using vouchers, the following year saw the number shoot up to 5,740. After the U.S. Supreme Court allowed public funds to be used in parochial schools in the 2002 case of *Zelman v. Simmons-Harris* (536 U.S. 639), vouchers finally became a nationwide educational plank for Republicans. Cleveland had over 5,500 students using vouchers in the fall of 2004, the same year that Congress passed a voucher programme for Washington, DC. While over a million students have at this point been through either a charter or magnet school and some 39,000 have employed a voucher in Cleveland, Florida, Milwaukee and Washington, DC, vouchers have certainly not yet exploded in the manner proponents had hoped they would, but at this point has all the elements

allowing them to do so.<sup>30</sup> We will return to school choice after examining Social Security privatisation efforts, allowing us to contrast the two.

## **Social Security**

Conservative politicians mostly opposed passage of the Social Security Act of 1935, and many have not fully reconciled themselves to the programme even up to the present day. This is so for a variety of reasons, but for our purposes free marketeers argue the programme falsely presents itself as an insurance programme and is financially untenable without large cuts in benefits or increases in taxes. Moreover, the programme taxes workers at a rate higher than many conservatives are willing to countenance and places staggering amounts of money in the hands of government bureaucrats for investment.

Prior to Ronald Reagan's ascension to the presidency, the basic strategy of congressional conservatives opposed to expanding Social Security was to attempt to tie any increases in benefits directly to increases in the programme's contributions, so that Democrats could not increase the size of the state without making workers feel it through higher taxes.<sup>31</sup> For reasons relating to the increase in the number of workers relative to retirees, and the growing economy for the better part of the 1960s and 1970s, this strategy backfired, since the programme was able to increase benefits for existing retirees based on nothing more than the nation's economic growth, allowing congressional Democrats to paint Republicans as being mean spirited towards the elderly.<sup>32</sup>

Upon assuming office, Reagan's administration attempted to shrink Social Security directly by cutting benefits almost immediately for workers about to retire. Social Security is structured so that each worker will receive a given percentage of his or her calculated earnings upon retiring at the full retirement age of 65, or they could retire early at age 62 and receive 80 percent of benefits, which, when Reagan took office, a significant 60 percent of workers did. David Stockman, the administrations' director of the Office of Management and Budget, was tasked to find economies in the programme, and he settled on cuts to the disability programme, combined with lowering the benefits of early retirement from 80 percent of benefits to 55 percent. This plan was approved by the President in spring of 1981, and had it gone into effect, which would have happened almost immediately, effective January 1, 1982, "a worker retiring at age 62 on that date and expecting to get \$247.60 a month would instead get \$163.90."<sup>33</sup>

Needless to say, this idea did not sit well with members of Congress. The Senate unanimously rejected the bill, and the whole episode led to Social Security coming to be known as the “third rail” of politics, after the electrified third rail on subway lines that is so highly charged that it kills anyone attempting to touch it. Shortly thereafter, Butler published *Privatizing Federal Spending*, and a number of conservatives based in the newly-emerging Washington, DC think tanks came to believe that Social Security was indeed open to change for the simple reason that it was destined to implode down the line if changes were not made either to benefits or funding. What was needed was an effective long-term strategy that would serve to raise doubts among stakeholders that Social Security would be there for them in the future, while at the same time presenting privatised accounts as a more preferable alternative. The solution settled upon, at least by the staff at the Heritage Foundation, was to promote Individual Retirement Accounts (IRAs), as the first step towards a larger privatisation effort.

In 1974, Congress created IRAs as part of the Employee Retirement Protection Act. IRAs were for workers who did not have retirement plans where they worked, and allowed workers to invest up to \$1,500 a year into an investment account and receive tax deferred treatment on them. In 1981, Congress allowed all workers to create IRAs, and contribute up to \$2,000 a year into them. Thus, every worker could also be an investor, earning returns on their contributions in ways similar (at least in theory) to the ways the U.S. “invested” their Social Security contributions. As Butler’s sometime co-author Peter Germanis noted in 1983, if workers got used to making and controlling their own investments in IRAs, it would be easier for them to conceptualise doing the same with their Social Security funds.<sup>34</sup>

### **George W. Bush and the Privatisation of Social Security**

The election of George W. Bush to the White House led to the finest opportunity for privatising Social Security that proponents had seen in decades. Bush had long and sincerely been a supporter of privatising Social Security. Indeed, it had been in his platform when he ran for Congress in 1978.<sup>35</sup> Moreover, this was not merely an issue he paid lip service to, rather; it was one he studied at some level of depth in his time as Governor of Texas.<sup>36</sup> Accepting the nomination for president from the Republican Party, Bush stated:

Social Security has been called the third rail of American politics, the one you’re not supposed to touch because it might shock you. But if you don’t

touch it, you cannot fix it. And I intend to fix it. To the seniors in this country, you earned your benefits, you made your plans, and President George W. Bush will keep the promise of Social Security, no changes, no reductions, no way. Our opponents will say otherwise. This is their last parting ploy, and don't believe a word of it. Now is the time—now is the time for Republicans and Democrats to end the politics of fear and save Social Security together. For younger workers, we will give you the option, your choice, to put part of your payroll taxes into sound, responsible investments. This will mean a higher return on your money in over 30 or 40 years, a nest egg to help your retirement or to pass on to your children. When this money is in your name, in your account, it's just not a program, it's your property.<sup>37</sup>

The idea as presented was that those who so desired could transfer some of their previous Social Security contributions into private accounts in the form of a government bond, very similar to what happened in Chile, and afterward their future contributions would go into an account similar to an IRA. The problem for Social Security is that the very first generations of recipients received more in benefits than they paid in, and every generation since has been making up for this continuing “legacy debt,” with the complication that if every worker immediately left the system and placed all of their contributions in their own accounts, the system would not be able to afford to pay existing retirees.<sup>38</sup> The incoming Bush administration was handed a beautiful opportunity to overcome the legacy problem thanks to the budget surplus it initially inherited, yet the president-elect opted to put the money towards tax cuts instead, and once the economy went into recession, this left little room for privatisation efforts to succeed.

By the time President Bush made an effort to see private accounts enacted at the start of this second term in 2004, the momentum was gone, the framing had been almost entirely controlled by its opponents, and the idea was widely mocked in late night talk shows (which were, in all likelihood, the primary source of information about the plan for most Americans). As Sen. Phil Graham noted in a *Wall Street Journal* interview, the president “jumped out with a very big idea that he ran on, but he didn't lay the political groundwork in the Senate or the House. He ran on it. We didn't. He's not up for election again. We are.”<sup>39</sup>

## Butler Applied

If we look back to Butler's strategy as outlined above, we can recall that he suggested five steps. First, establish the government as the

guarantor of services, but not the direct provider. Second, divert demand into the private sector by offering recipients more rather than less, and choice rather than command. Third, detach key elements of the spending coalition, possibly through side payments. Fourth, create a “mirror coalition” that would fight for private provision to offset those who were fighting for public. Finally, move incrementally, in part to learn from early mistakes or to avoid making huge ones, and also so as not to frighten the population, which almost always finds any change worrisome. As we shall see, school choice proponents met these criteria far more successfully than the Social Security privatisation proponents did.

Establishing the government as the guarantor of services was in many ways easier for education than it was for Social Security, since by default the latter was not going to be guaranteed at all. Contributions invested in mutual funds could rise, but they could also fall. The libertarian Cato Institute purchased the website *www.socialsecurity.org* for example, and at the time of President Bush’s proposals had a “Social Security Calculator” where citizens could enter the amount taken from their pay in FICA taxes and could find out how much more they could earn if the stock market continued its stellar upward climb. Of course, markets go down too, helping to explain why the calculator was taken off the website once the market dropped (it has not yet returned). The simple reality is that Social Security has always been there for today’s generations, and Americans are very comfortable with the security it provides. Promises of greater returns, it turns out, were unable to offset the fears many held about market downturns.

In contrast, public education had already set standards. Those who thought their districts met them really were not all that concerned about vouchers, since they would not be needing them for their own children. For those who thought their schools were failing to start with, vouchers offered the very chance for better performance they were looking for. The key fear for those concerned with vouchers was not that they would lower standards but rather that they would lead to further racial or socioeconomic segregation of schools, which is why the strategy of presenting vouchers as a “redistributive program targeted to liberate low-income minorities from stifling and bureaucratic public systems” was so brilliant.<sup>40</sup> Whether the conservative foundations that funded support for vouchers were truly concerned about the wellbeing of poor minorities is irrelevant, as activists like Polly Williams and Howard Fuller quickly realised, as long as the programmes achieved their goals.

Pertaining to Butler’s second element of diverting demand into the private sector, education vouchers hold the potential to offer parents who

want to make use of them the opportunity to send their children to better schools than the one offered by their own district, and also the choice of what kind of education their child could receive. The so-called “education blob” comprised of the dreaded National Educators Association, teachers colleges, and supportive politicians, it was claimed, constantly spoke of change and improvement, but those reforms never seemed to appear, particularly before the No Child Left Behind Act (NCLB) of 2001. Lifetime tenure, complacent school boards that were seen as pandering to unions, and low standards plagued failing public schools because they did not face competition that would draw away students and funding. Magnet schools and charter schools, of course, were seen as a step in the right direction (especially if they were non-union), but vouchers, particularly in conjunction with NCLB, offered beleaguered parents a powerful attractive option: choice. Since vouchers gave parents *more* funds for their child to go to a private or religious school than they themselves paid in taxes, these schools in particular (since they could also send their child to another public school) suddenly turned into financially attractive alternatives.

Vouchers also served nicely in detaching the poor from the pro-spending coalition. The nation’s public schools have been portrayed as one of the great levelling elements in American society, and the strategy of portraying vouchers as a civil rights issue was critical, since it not only blunted concerns about attempts at re-segregation, but allowed for libertarian conservatives and black civil rights activists to work hand-in-hand—a strategy, it should be noted, that has been deployed by the conservative legal movement to great effect in other areas as well.<sup>41</sup> In all fairness, the numbers to-date have been modest. Somewhere around forty thousand voucher recipients nationwide constitutes a miniscule percentage, yet as Jeff Henig has noted, this still has the makings for a powerful future movement.<sup>42</sup> Firstly, the fact that vouchers have been intensely concentrated in Milwaukee and Cleveland has allowed them to become firmly established components of those district’s school systems, while in Washington, DC and Dayton, Ohio, a startling one child in five now attends a charter school. School choice, in other words, has become a settled part of public education, admittedly in less than a handful of cities, but enough for it to serve as a beachhead for those who want to expand it elsewhere, and the potential for this to happen is enormous.<sup>43</sup>

Vouchers also hold the potential, finally, to dislodge the connection many taxpayers feel about supporting their local schools financially. Even families without children often feel a need for strong schools, and there is empirical evidence that an economic payoff exists, but this “depends upon the relatively tight geographical nexus between the taxation and the

investment. School choice programs attenuate and potentially sever that connection,” by literally moving a locale’s children beyond the district.<sup>44</sup>

Social Security also had a strong suit in private accounts. If the legacy debt was somehow overcome (and there is reason to believe it could have been had President Bush opted to place the surplus into it), there is a strong argument to be made that carefully regulated private accounts could generate larger returns for them over a worker’s lifetime than the existing Social Security system could. There are however, a lot of assumptions in this. Firstly, as mentioned above, markets can go down as well as up, and as many retirees discovered during the recession at the start of the new millennium, expected funds may be far lower than hoped for when it comes time for retirement. The Cato Institute’s calculator’s disappearance is telling, and those familiar with the pioneering work of Kahneman and Tversky know that most individuals, most of the time, experience the pain of loss more intensely than they do the joy of gain, which in plain English means that many Americans, if given the choice, will be more than happy to keep the Social Security system as it is rather than risk investing those same contributions on their own.<sup>45</sup> The fact that Social Security simply cannot remain as it is, of course, looms positively for those seeking to privatise in the future.

Butler’s fourth criteria was to create what he called a “mirror image” spending coalition that would compete to move a policy further towards the privatised end of the spectrum to offset the public spending coalition. As it relates to education vouchers, the connection between parents who employ vouchers for their children is obvious—yet the targeted populations of poor minorities are often among the least engaged citizens in America. More powerful would be the civil rights organisations that claim to speak on their behalf, much as Fuller and Williams did in Milwaukee. Obviously, the most powerful groups of all are business actors that would profit from increased enrolments in private or religious schools. There are now a wide range of Educational Management Organizations (EMOs) that offer professional school administration and (more frequently) support services to smaller schools that have difficulties achieving economies of scale. This industry is tiny and still trying to find its footing, but there is great reason to believe demand will grow.<sup>46</sup> Moreover, research has indicated that not only are EMOs active in lobbying for increased school choice, but moreover, school choice proponents have worked to support EMOs politically in order to further their agenda.<sup>47</sup> The fact that there are now multiple think tanks focusing on vouchers is also crucial.

The mirror image spending coalition for Social Security may at first glance appear to be even more powerful, especially if investment firms had gotten behind the idea—which they did not. As Steve Teles and Martha Derthick explain:

Business support for Social Security was nowhere near what it was for many of the administration's other priorities, especially tax cuts. First, most employers' key interest in Social Security is preventing an increase in the payroll tax, but especially after the surpluses dried up, it became clear that private accounts would make the job of eliminating the program's long-term funding shortfall *more* difficult without tax increases. Second, businesses that might have had a profit motive for supporting privatization, such as the financial services industry, are in fact faced with a complex political calculus. If private accounts are structured like 401ks and IRAs, with broad access to existing mutual funds, the possibilities for a substantial regulatory burden are significant, and the amounts of money, especially for low earners, may be unprofitable. But fairly early in the process of developing Bush's proposals (and in the thinking of many of the privatization network's members) it was decided that preventing moral hazard and having to create some form of minimum benefit required that the accounts be indexed, like the Federal Employee Retirement System (FERS). This had the effect of taking almost all the profit out privatization and with it much of the benefit for financial providers to compensate for their regulatory risk.<sup>48</sup>

Despite being depicted as small and anaemic in power, America's labour unions still have staggering amounts of retirement funds under their control. In 1999, an umbrella organisation representing unions sent a letter to hundreds of investment companies explaining that if the firm supported President Bush's privatisation efforts, the unions would pull all of their investments out from its management. Speaking in a 2006 interview, David John of the Heritage Foundation complained that the union letter "scared away many potential supporters, and remains so to this day."<sup>49</sup>

Finally, Butler recommended that efforts to detach service provision from the state be done incrementally, so as not to frighten off key stakeholders. As we saw above, the school choice movement proceeded in just such a manner. In fairness, it was less because that was their early strategy than because they literally had no other choice in the matter, since vouchers were initially a non-starter. Conservatives came to support charter schools because that was the only option they saw open to them, and given the bipartisan support for them, the move was neither controversial nor radical, and this incremental move opened the door for

the next logical step in the “choice” paradigm by allowing parents to move their children out of failing public schools without their children having to pass often competitive exams to get into charters.

As it pertained to Social Security, the lesson taught by E.E. Schattschneider remains as powerful today as it did when he wrote the *Semisovereign People* in 1960, namely, that controlling the perceptions of the policy are often as important as the policy itself.<sup>50</sup> Whether the privatisation steps were incremental or not became irrelevant since they were quickly and effectively branded as broad and dangerous. Proponents of Social Security privatisation completely lost control of how the issue was defined, which is no surprise given they went head-to-head against the American Association of Retired Persons (now known simply as AARP). Immediately after President Bush was elected to his second term in 2004, *Modern Maturity*, AARP’s magazine came out powerfully against any attempts to privatise the programme.<sup>51</sup> Given the magazine was sent out to 35 million seniors, almost all of whom vote, the message was extremely difficult for proponents to counter. In combination with the \$5 million media campaign, opponents of privatisation came completely to dominate how the issue was depicted.

Privatisation has also been the central strategy of British conservatives since the 1990s as well, and here again, we can see how Butler’s approach has been effective. As we saw discussed above in the section on the Thatcher era, the challenge was to build support for efforts among wage-earners, and the government employed a number of strategies to do so. Most centred around incentive structures to turn wage-earners into owners, often by heavily subsidizing their purchases. Council housing residents were able to purchase units at literally one-third the assessed valuations, under some circumstances, while nine out of ten workers in some companies opted to purchase stock in their newly privatised firms thanks to subsidies. We have devoted far more attention to the American case than the British one, largely because of the complexity of the American federal system, but intellectually, British conservatives have been forced to follow similar strategies in order to avoid re-nationalisation once they lose power.

The privatisation of the railroads is a perfect example. Completed under the leadership of John Major, the selling off of the rail system had all the potential to be a highly popular policy. Privatisation could have resulted in a more consumer driven system that offered trains when needed at more competitive prices. Yet to this day the act has remained controversial and highly unpopular, for the simple reason that it has not been able to generate a supportive constituency. Consumers have not felt

as though service has improved, and while the Labour government opted not to re-nationalise it, it is not obvious they would face that much opposition from the broad electorate if they did. As noted above, it is often hard for citizens to appreciate privatisation merely as a cost-cutting endeavour for the simple reason that they more likely than not will not feel the savings directly through lower taxes, while cuts in service may be immediately obvious.

The story of privatisation in Britain picks up again in 2010 with the election of a coalition led by the Conservatives. Again, as with Chile, parliamentary governments lack the considerable roadblocks to change faced by Americans, but this is a double-edged sword, since the concern moves to designing policies in a manner that makes reversing them by succeeding leftist governments difficult.

Prior to the election, Conservatives had promised dramatic cuts in government. Shadow culture secretary Jeremy Hunt promised a “golden age” of tax breaks with incentives for philanthropy, coupled with cuts in arts spending.<sup>52</sup> After the election, the massive cuts in spending were depicted as necessitated by a fiscal emergency, but what does that mean once the fiscal emergency is dealt with down the line?

This strategic question has surfaced with the question of privatising the Post Office. Actually first considered under the Labour government of Gordon Brown in late 2009, the subject remained too challenging despite the obvious need to deal with massive budgetary problems. The feasibility of selling off a minority stake to an established carrier proved not to be the issue. Rather, the challenge was to move the current employees (and retirees) into the supporting “mirror” coalition. Privatising companies by subsidising the sales during times of healthy finances is one thing, doing so under a recession is another. Whether the government can successfully build support without a privatisation strategy similar to the ones employed under Thatcher may prove to be the difference down the line between the Post Office’s sale being seen as successful (as with British Telecom) or a questionable failure (as with the railroads).

Policy entrepreneurs really can learn from past mistakes. The intellectual journey of privatisation efforts began in the halls of the University of Chicago’s Economics Department and travelled from there to Chile. From that point on, conservatives had a role model, but one that needed to be modified to succeed under democratic conditions. The lessons learned from the Thatcher government’s successful efforts were adapted for the American system. How they will be employed on both

sides of the Atlantic from this point on may prove critical, if conservatives seek to find lasting change.

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## Notes

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